The University of Hull

Changing Dimensions of Single European Market: Implications for the Non-member Countries – A Case Study on India's Textile and Clothing Exports

being a Thesis submitted for the Degree of

Doctor of Philosophy

in the University of Hull

by

S. Gnanasekara Pandian

B.Sc (MKU, India), M.A (MKU, India), M.Phil (JNU, India)

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S.G.Pandian

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Glossary

ATC	Agreement on Textiles and Clothing
CAD	Computer Aided Design
CAM	Computer Aided Manufacturing
CET	Common External Tariff
CN	Combined Nomenclature
COMEXT	Community External Trade
Crore	Indian unit for 10 million
ECU	European Currency Unit
EIB	European Investment Bank
ERDF	European Regional Development Fund
ESF	European Structural Fund
EU	European Union
EURATEX	European Textile Association
FGI	Federation of German Industry
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
GSP	Generalised System of Preferences
IDA	Irish Development Authority
ISEPC	Indian Silk Export Promotion Council
Lakh	Indian unit for 100,000
MFA	Multi-Fibre Agreement
MFN	Most Favoured Nation
MoU	Memorandum of Understanding
OECD	Organisation for Economic Cooperation and Development
OPT	Outward Processing Trade
PES	Plant Economies of Scale
PSES	Product Specific Economies of Scale
Rupees (Rs.)	Indian currency
SME	Small and Medium Enterprises
VAT	Value-Added Tax
VER	Voluntary Export Restraint
WTO	World Trade Organisation

INTRODUCTION

Introduction

One of the most significant economic developments of the twentieth century is the creation of regional trade blocs. The formation of regional trade blocs has come a long way since the successful creation and subsequent development of the Benelux Customs Union (1948). It culminated in the creation of the European Common Market. Ever since the successful creation of the Single European Market (1987) studies on the economic implications of the creation of regional trade blocs have become a focus for contention among researchers. There have been growing theoretical and empirical studies on the creation of the regional trade blocs aimed at studying the effects of the regional trade blocs on the member and non-member countries. The direct effects of the regional trade blocs seemed to vary depending upon their nature and objectives, apart from the nature of the economies entering into an agreement to form the regional trade bloc. However, there has been unanimity among the experts as regards the effects of the regional trade blocs on the participating countries. It is, however, the impact on the non-member countries that has become the point of contention.

The regional trade blocs are by no means similar in their nature and objective. The dissimilar nature of these blocs makes it difficult to generalise the impact of regional trade blocs on the member and non-member countries. This is mainly because the levels of economic integration achieved between the participating countries vary widely. Also the features of the regional trade blocs cannot be generalised as the participating countries have differing characteristics. The varying nature of the regional trading agreements, which differ from one another both in scope and the extent of liberalisation, make it possible only to study the localised effects of the creation of the regional trade blocs on both the member and the non-member countries.

The creation of the regional trade blocs is a cause of concern for the non-participating countries as regards trade and investment diversion along with its impact on the trade patterns on the non-member countries. Jacob Viner's seminal work on Customs Union theory and the post-Vinerian literatures arrives at two important conflicting conclusions. One is that the formation of the Customs Union, through the removal of trade barriers, enhances the flow of trade across the countries benefiting both the member and the non-member countries. The second is that the formation of the regional trading blocs undermines the liberal objectives of the world trading system. It is argued that the creation of the regional trade blocs stimulates the intra-regional trade by restricting the imports from the non-member countries. It goes on to argue that the exports of the non-participating countries would be diverted by unfair trade practices.

Unlike other regional trade blocs, which display contradictory trade patterns, the creation of the EU exhibits clear policy objectives. The increased openness to imports from the non-member countries with a gradual dismantling of tariffs, along with continuous widening and deepening, has made the EU a unique regional trade bloc. Even this uniqueness has not made it possible to generalise the effects of the creation of the EU for both the member and the non-member countries. In the EU there seems to be a conflict between the real agenda and the member countries' policy objectives. The rationale for economic integration is in direct conflict with the policy objectives of the member countries. While the public agenda is to create a less protectionist EU, which is more open to the extra-EU imports, the economic policies often seem to be scuttling that effort. The real objective seems to be achieving the unexploited scale economies in the enlarged market rather than achieving the welfare gains of the creation of the Single Market by improving the industrial efficiency and international competitiveness of European firms.

The creation of the European Common Market has become a milestone in European economic history. The evolution of the European Common Market into the Single Market, with continuous structural change, has silenced the critics of European economic integration who viewed it as a pessimistic exercise. Now the Single Market is the core of the fifteen member European Union (EU). Its success in stimulating production, increasing competition, reducing prices and increasing demand has encouraged other countries to seek membership of the EU.

The decisions of the EU are carefully monitored by the non-member countries. This is particularly true for the developing countries for most of whom the EU is the single largest market. Whatever effects are witnessed in the EU these would also have their impact on the exports of the developing countries. This is especially true in the case of the labour-intensive traditional industries in which the developing countries have a comparative advantage. The developing countries follow an established pattern of moving from the primary to the secondary sector while restructuring their economies. In this regard it would be most appropriate to capitalise on the sectors in which they have comparative advantage. The abundance of labour encourages them to concentrate and specialise in these industries. This is in direct conflict with the EU's labour-intensive industries. Though the EU has successfully transformed its economy to the service based industries, the labour-intensive industries still occupy a predominant position as they account for a considerable manufacturing output and employment. The low-cost imports from the developing countries seriously threaten employment levels involved in these industries.

Many arguments have linked international trade, wage levels and employment, suggesting that the developed countries' trade with the developing countries results in a

considerable loss of manufacturing employment in the former. It is also argued that the trade with developing countries reduces the relative demand for unskilled labour in the developed countries. In the EU, this argument is heard many times in the labour-intensive industries. This is particularly true in the case of the textile and clothing industries where the low-cost imports have caused serious damage to the domestic industries. There has been serious erosion in the level of employment in this industry during the last few decades. This caused the EU to impose restrictive trade practices such as the Multi Fibre Agreement (MFA) and tariffs. Though the quotas have proved to be more of a deterrent than the tariffs in preventing the influx of imports they have not been able to arrest the decline in the performance of these industries. Apart from the quotas and tariffs, there have also been Voluntary Export Restraint measures (VER's) aimed at limiting the imports that cause damage to the domestic industries. The intense competition from the low-cost imports has driven many of the European textile and clothing firms out of business. The European manufacturers' efforts to preserve their market share have proved to be futile in the face of increased import penetration.

In this thesis the labour-intensive textile and clothing industries have been chosen to explore the effects of the Single Market on the member and non-member countries. The comparative advantage in textile and clothing trade has gradually been shifting towards the developing countries. Since the developing countries have a comparative advantage in the labour-intensive industries, they have been chosen to study the effects on the formation of the Single Market. The peculiar nature of these industries in the developed and the developing countries makes this study important. The textile and clothing industries are as important in the developed countries as they are in the developing countries. These industries have consistently played a prominent role in the process of economic development both in the developed and the developing countries. They are also major economic sectors in these countries. While these industries played a prominent part in the industrialisation of many of the developed countries, they have equally been playing an import role in the economic development of the developing countries. For the developing countries the export revenues from the textile and clothing industries form a sizeable foreign exchange earnings.

The textile and clothing industries have always been a vital part of the manufacturing industry. This is particularly true in the case of the EU. Despite falling contribution of the EU's textile and clothing industries in the total GDP, they still remain one of the important and sensitive sectors in terms of manufacturing employment. The international trade in textile and clothing industries has always been intensive and disputatious. The trade disputes concerning the textile and clothing trade have intensified many folds particularly after the formation of the Single Market in the textile and clothing industries. Two important developments witnessed in the Single Market have contributed to this protectionist tendency. Firstly, the formation of the

Single Market has created a level playing field for the developing countries thereby increasing the rate of export penetration of the non-member countries. Secondly, the enhanced export penetration has forced the member countries to undertake a process of restructuring to remain competitive in the Single Market. The removal of both tariff and non-tariff barriers has prompted many member countries to restructure their textile and clothing industries. However, this has been proven to be expensive as the process of restructuring has inevitably resulted in high unemployment. This has made the EU's textile and clothing industries susceptible to external competition. Therefore many member countries seek protectionist measures against the low-cost imports. Hence the EU's trade in textile and clothing industries has become more contentious. Protection against the textile and clothing imports is a recurring phenomenon in economic history. However, in the present scenario, they have been less successful in preventing the continued increase in import penetration. Despite the presence of the MFA for more than 25 years, the textile and clothing producers in the EU complain of the inadequacy of the protection resulting from various MFA regimes. They often argue that the protection provided is inadequate to let them restructure their ailing industry thereby making it more vulnerable to external competition. In the EU the increased import penetration of the textile and clothing imports has been caused by rather slow industrial restructuring.

The moderate levels of specialisation and industry concentration make this industry highly vulnerable to the effects of the Single Market. The theoretical arguments on the formation of the Customs Union make it clear that only the efficient firms survive in the Single Market. In the EU, the textile and clothing sector is considered to be a sector with moderate specialisation whose export-specialisation ratio is less than 1.2. The industry concentration is also very diverse with the industry being dominated by a large number of small and medium-sized firms. For many of the member countries it is in their national economic interest to protect the industries vulnerable to external competition. The member countries, which continued to maintain the role of global leadership in international textile and clothing trade, are facing a series of threats from various quarters. In recent times, the survival of the European textile and clothing industries has been seriously doubted in the face sluggish demand associated with falling consumption in domestic markets, falling production, rising labour costs, decreased industrial efficiency and falling international competitiveness. Two simultaneous events - a change in the single market mechanism and the changes in the international trading environment - have affected the member countries' market dominance in the Single Market. Studies of the market mechanism and the market policies confirm the continued asymmetric structure of the member countries. Though the member countries participating in the formation of the Single Market cannot be expected to have identical market structures, they could at least be expected to show a movement towards structural convergence. A single market of analogous economies would have more welfare effects on the member countries than one with dissimilar economic

structures. The analogous market structure would exert a pressure on the inefficient firms, which continue to exist in the Single Market under state protection, to go out of the business. The resources that were hitherto allocated to the inefficient firms would now be reallocated among the efficient firms thereby enlarging the scope of realisation of the benefits of the Single Market. Hence the success of the Single Market is conditional upon the fact that there would be more goods traded in the Single Market than before.

The consequence of structural convergence in the Single Market would be greater realisation of the economic effects arising out of increased intra-industry trade. Though there have been movements towards more competitive intra-industry trade in other industries, this movement is rather slow in the textile and clothing industries. The policies of many of the member countries in encouraging the continued existence of these industries, despite the higher cost involved in it, have affected the realisation of the benefits of the Single Market. As a result, we witness a trend, in which the developed member countries continue to specialise in the comparatively disadvantageous textile and clothing industries, though the economic arguments would suggest that the welfare gains arising out of these industries would be greater if they were concentrated in the low-cost member countries. The subsequent effect of this trend would be the misallocation of resources and the unexploited economies of scale in the EU. As far as the changes in the international trading environment are concerned, the high penetration of the exports from the non-member countries and the gradual elimination of trade barriers in the member countries have contributed to the decline of the member countries' dominance in the Single Market. The opening up of the Single Market and an increased competition from the newly industrialised and developing countries of the South and South East Asia have affected the performance of the European textile and clothing industries. The rising competition from the non-member countries has also affected the member countries' market share in other markets of the developed countries. The abolition of various safeguard measures and regimes, such as MFA, also highlight the unfavourable condition these industries are facing in the post-abolition period.

The formation of the Single Market in the textile and clothing industries is expected to result in large-scale welfare gains. However, the welfare gains of the Single Market are not only limited to the member countries. The exports of the non-member countries are also expected to gain considerably from the formation of the Single Market. It is believed that there would be an increase of exports from the non-member countries to the EU. The Customs Union theory has been used to study the effects of the creation of the Single Market in the EU's textile and clothing industries on both the member and non-member countries. The Customs Union theory argues that the removal of barriers to trade would result in an increased competition in the Single Market. The increased competition, in turn, is expected to result in an efficient

reallocation of resources and subsequent cost reduction effect. The cost reduction effect results in higher consumer demand and concomitant supply side effects. The supply side effects increase the export opportunities for the exports of the non-member countries. Though the theoretical arguments believe that there would be enormous welfare gains created in the Single Market, it has not been clear whether these benefits are going to be shared equally among the non-member countries. Nevertheless it has been believed that the export gains would be larger for the leading exporting countries. Though the Customs Union theory believed that there would be an intense economic activity in the Single Market with the welfare gains outweighing the welfare losses, the outcome proves to be inconclusive. This is particularly true in the case of the textile and clothing industries where the formation of the Single Market has resulted in the mixed effect. Though there has been an increased level of textile and clothing trade in the Single Market, there has not been any associated increase in the level of activities in the European textile and clothing industries. Using the Customs Union theory the present work analyses the effects of the formation of the Single Market in the textile and clothing industries and their impact on the exports of the non-member countries. The research has been analysed with in the two broad parameters of the market mechanism and the economic policies of the member countries that inadvertently affect the welfare objectives of the creation of the Single Market.

Though the Single Market offers increased opportunities for the non-member countries, there exist high regulations in the EU. These regulations are aimed at protecting the textile and clothing industries. The European textile and clothing industries face increased competition from the low-cost imports resulting in sizeable employment losses in the member countries. The European Commission, with the objective of safeguarding the interests of the domestic textile and clothing industries, has imposed higher tariffs on external imports, as the domestic industries are highly vulnerable to external competition. As a result, the textile and clothing imports, compared to other imports, are facing higher tariff barriers in the Single Market. According to the EU's tariff classification, the textile and clothing products are considered to be very sensitive and hence call for higher tariffs against external imports. There are also quota restrictions on the exports of the non-member countries to the EU. Apart from this, the member countries have also entered into various export restraint arrangements with the non-member countries as a way of limiting the external imports into the Single Market.

The external imports of textile and clothing into the EU are highly regulated through various tariff arrangements within and without the ambit of the General Agreement on Tariffs and Trade (GATT). Though the arrangements covered under the GATT are binding on the EU, it would not apply for the non-binding arrangements covered outside the scope of the GATT. Some of these non-binding tariff arrangements are the Most Favoured Nation (MFN) agreement and Generalised System of Preferences (GSP). These two agreements cover almost 55 per cent

of total imports into the EU. The remaining 45 per cent of the EU imports fall under a variety of categories. Notwithstanding the domestic regulations there also exists biased import policies in the member countries, which favour the geographically adjacent non-member countries. The member countries have preferential trading arrangements with the countries of the Mediterranean, Central and East Europe and the former countries of the Soviet Union. The EU's preferential trading arrangements with the geographically adjacent countries (Hungary, Poland, Bulgaria, the Czech Republic, Romania, the Slovak Republic, Latvia, Lithuania, Estonia, Cyprus, Malta and Turkey) have given them undue advantage over the developing non-member countries, which do not have any preferential access to the Single Market. This is mainly because the imports from these countries are subjected to zero tariff apart from unlimited quota limits on their exports to the EU. Although the European firms are competitive at the upper end of the textile and clothing market, they are taking advantage of the lower manufacturing costs in geographically adjacent non-member countries in order to be competitive in the face of imports from the low-cost traditional exporters. As a result, 80 per cent of the EU's trade, including the outward processing trade, is within this region. Of the remaining 20 per cent, 10 per cent is with the Americas and another 10 per cent with Asia.

It is true that the textile and clothing markets in many of the member countries are highly protected. This is mainly because the textile and clothing industries occupy an important place in the EU. Though this industry accounts for less than 5 per cent of manufacturing industries' value-added, its importance is highlighted as a large-scale provider of manufacturing employment in many of the member countries. The textile and clothing sector is one of the largest employment providers in the EU accounting for 20.02 per cent during 1985-95. The nature of this employment is largely labour-intensive engaged in mainly less- and un-skilled activities. The skilled activity in this industry accounts for a negligible proportion of total employment. Another factor that highlights the problems of this industry, particularly in garment manufacturing, is its low level of technology content. This is an industry, in which the level of automation is limited as it involves many complex activities. Though there have been some improvements in the directions of R&D into the technological challenges faced by this industry in its traditional production line, there are still considerable obstacles in progressing even towards partial automation. The main commercial drive towards the clothing industry R&D is the perceived need in the high-cost countries to protect their industries from the low-cost countries by increasing their labour productivity and reducing their overall manufacturing costs.

The effects of the formation of the Single Market are studied within the framework of the Customs Union theory. By studying the effects of the Single Market on the member countries, the effects on the exports of the non-member countries have also been studied. The

effects of the Single Market on the European textile and clothing industries have therefore been studied in detail together with the effects on the non-member countries. And as a case study the effects of the Single Market on India's exports of textile and clothing have also been investigated in this work.

The Single Market is an important market for India's exports. Much of India's exports are directed towards the Single Market. Many of the member countries are the traditional export markets for Indian exports. More than 30 per cent of India's total foreign trade is with the EU. The Indo-EU bilateral trade continues to grow larger with India becoming one of the important trading partners for the EU. India's ranking among Europe's trade partners moved up to 19 by 1994 from 25 in 1990. India's market share in Europe also increased from 0.98 per cent in 1990 to 1.3 per cent in 2000. India's bilateral trade with the EU has reached $20 billion annually. India's exports to the EU have been growing up substantially in value terms from $3.4 billion in 1988-89 to $8.7 billion in 1995-96 registering an increase of 155 per cent. Similarly the imports grew by 71 per cent from $6.01 billion to $10.2 billion during the same period. The Indian exports to the EU have a higher thrust rate than their imports. The growth rate of India's exports to the EU has also been consistently higher than India's overall growth rate. This highlights the importance of the EU for India's exports. However, the imports from the EU have been broadly in line with India's overall import growth rate. While the EU accounted for 28 per cent of India's exports, only 26 per cent of India's imports were from the EU. Though India's exports exceeded its imports from the EU, it could not be translated into a trade surplus in India's favour. While India's exports to the EU largely consist of low-value added items, the imports from the EU are largely high-value added items. The main items of exports to the EU include textile, yarn, fabrics, garments, leather and leather goods, gems and jewellery, carpets, engineering goods, besides agricultural and marine products. Major imports by India from the region are manufactured goods, machinery, transport equipment and other capital goods. Hence India's continued trade surplus with the EU could not be translated into higher foreign exchange (in value terms). There is a mismatch between India's export structure and the EU's import structure. There is therefore a structural incompatibility between India's exports and the EU's imports. The product items that are of high significance for Indian exporters are of less significance for the EU. For example, the textile and clothing, which account for nearly a third of India's exports, account for only a 7 per cent of the EU's imports. Nevertheless the trade in textile and clothing is still an area of contention for both the member countries and India as it is sensitive for both of them. For the member countries, it is sensitive in so far as their manufacturing employment is concerned.

India has signed many co-operation agreements with the EU with the latest being '

India's textile and clothing exports to the EU are subjected to tariff barriers. India signed the 'Agreement on Textiles and Clothing' with the EU on 31 December 1994, which took effect from 1 January 1995. Under the agreement, the MFA would be gradually phased out during the next ten years (by 2005) for Indian textile and clothing exports. The gains to Indian exports are the quota enhancement on certain categories and removal of the quota barriers on handloom and cottage industry products. Indian exports of textile and clothing to Europe are subject to 19 quotas until December 2001, when 18 per cent in volume of the 1990 imports into the EU, would disappear as agreed according to the Agreement on Textiles and Clothing. Indian textile and clothing exporters are also benefiting under the GSP programme, which have gradually been withdrawn. Under these benefits, the Indian textile and clothing exporters face 85 per cent of the MFN tariff or the normal tariff applicable to the members of the WTO. Indian exports are subjected to non-tariff barriers such as social, environmental and health-related issues, aimed at protecting the domestic industry. There is a growing feeling among the Indian textile and clothing exporters that the removal of the MFA quotas might be replaced by the growing anti-dumping measures. It has also been feared that there are efforts on the part of the European industries seeking protection in the face of WTO-regulated moves to lower the trade barriers. There seems to be some truth in it. Since 1996 there have been increasing instances of anti-dumping charges being slapped against Indian textile and clothing exporters. In 1996 alone there were more than 10 investigations against India, two of which have ended with the imposition of anti-dumping duties on oxalic acid, polyester blended yarn and polyester staple fibre. In September 1996, the Commission imposed the anti-dumping duty on plastic woven sacks. This was followed by the investigation into the alleged dumping of unbleached cotton imports from India. As a result, the anti-dumping duty was imposed on unbleached cotton imports from India in November 1996. The case against Indian cotton fabrics was not closed even after the initial probe concluded that there was no case of dumping. The case had been reopened in July 1998, with the initiation of investigation against India. However, it was again withdrawn at the instance of European unbleached cotton importers. There were also anti-subsidy investigations and slapping of anti-dumping duties against India's exports of cotton bed linen and polyester texturised filament yarn (PTFY).

For India, the textile and clothing exports remain a top foreign exchange earner out performing all other sectors. This sector continues to grow unabated. The textile and clothing exports have achieved a dominant place by accounting for over 30 per cent of India's total exports as against 20 per cent in 1991. This is also a sector with moderate growth performance of 11 per cent during recent years. Indian textile and clothing exports during 1996-97 was to the tune of $10.25 billion, of which readymade garments alone accounted for $4.76 billion. India, at present, accounts for 2.3 per cent of global textile trade and 2.4 per cent of the world's trade in clothing. The garment sector displayed an impressive growth performance during the 1980's

with exports rising seven times in value and four times in volume terms. During the past decade, the garment exports had consistently exceeded the target except in 1991-92, when the achievement fell short by 1.5 per cent. Garment exports yielded an average annual growth rate of 26 per cent from 1990 to 1995.

The EU is the leading market for India's textile and clothing exports in many product categories. India is one of the largest exporters of textile and clothing to the EU. The EU is the most important market for Indian textile and clothing exports as it offers opportunities in a number of product lines mainly due to differentiated domestic market conditions prevailing across the member countries. The EU, as a whole, forms the single largest destination accounting for a third of India's total textile and clothing exports. India's trade with the EU in textile and clothing industries has largely been inter-industry in nature. The exports of textile and clothing to the Single Market continue to grow from one fourth of the total exports in 1976 to a third of it now. The exports of Indian textile to the EU increased by more than 150 per cent between 1980 and 1994, while the clothing exports rose dramatically by almost ten times during the same period. The categorisation of Indian exports to the EU lists the textile and clothing exports under the dominant class. In value terms, India is the third largest supplier of textile and the fourth largest supplier of clothing to the EU. However, in volume terms, India is the largest exporter of textile and clothing to the EU. Indian exporters are well placed in some of the export categories such as jute (jute yarn and jute fabrics) and carpets (knitted and woven carpets). India enjoys a market share of as high as 63 per cent (jute fabrics) and 45 per cent (woven carpets) in certain product categories.

Notwithstanding the disputes over the market access and tariff reductions, the Indian textile and clothing exporters are also concerned about the long-term external effects of the structural changes of the Single Market on their exports. The structural changes that are being witnessed in the European textile and clothing industries are the cause of concern for many of the Indian exporters. The Indian exporters are mainly anxious about the strategic effects of the Single Market. The strategic effects depend on factors such as the efficient reallocation of resources and the economies of scale. The Indian exporters are also concerned about strategic external trade diversion, in which the expensive domestic production in the EU is being replaced by the imports from geographically adjacent non-member countries of the Mediterranean, Central and Eastern Europe thereby diverting Indian exports. This is more likely to challenge the existing trade pattern based on comparative advantage. For example, countries with relative advantage in textile and clothing industries, such as Turkey, would have better access to the Single Market over other countries such as India, which has absolute advantage in many of the sectors.

The EU's trade with India in textile and clothing has largely been negative. This is a cause of concern for many member countries. Though the EU had an overall trade balance with India during 1991-99, its textile and clothing trade witnessed an opposite effect. The EU's overall trade with India witnessed a positive trade balance during 1991-99, except 1994 and 1998, when India witnessed a trade surplus. The EU's trade surplus in overall trade increased despite a decrease of 19 per cent (in value terms) in its trade balance during 1991-99. Though the EU's trade surplus in overall trade increased during 1991-99, the trade in textile and clothing continues to witness a trade deficit. The trade deficit, in textile and clothing trade, increased by more than 82 per cent during this period. However, it is the trade in textile, which account for a large proportion of this deficit. The EU's trade deficit in textile trade with India increased by around 90 per cent during 1991-99. This is against the increase in trade deficit of 72 per cent in its clothing trade with India.

It is against this backdrop that the effects of the formation of the Single Market on India's textile and clothing exports have been studied. Various effects of the creation of the Single Market - the trade creation, trade diversion, trade suppression, trade contraction and trade modification effects - have been studied using the Customs Union theory. Simple statistical methods have been used to study the effects of the creation of the Single Market for India's textile and clothing exports. Various factors have been taken into account while analysing the effects of the Single Market on India's exports of textile and clothing. A total of 22 products (16 textile and 6 clothing products) have been taken from the dominant category of India's export basket. However, two dominant product categories, Jute (jute yarn and jute woven fabrics) and Carpets (knitted and woven), have not been taken into account while analysing the effects of the Single Market on Indian exports. The overwhelming dominance of India's exports in the EU and the limited competition its exports face in these two particular product categories give India's exports unlimited access to the EU. Hence the study of the Single Market on India's exports in these product categories would have less significance.

The thesis is composed of seven chapters. In Chapter I, the theoretical framework of the Customs Union theory has been discussed. The formation of the Customs Union among the contiguous national economies and the associated structural changes has been studied in this chapter. Both the welfare gains and welfare losses of the formation of the Customs Union have been investigated. Also the four main effects arising out of the formation of the Customs Union have also been examined along with their production and consumption effects.

In Chapter II, the changing dimensions of the Single Market have been analysed in detail. It also tries to find out why the industrial efficiency, competitive effects and other large-scale benefits have not been realised in all the member countries. The member countries' intra-

regional trade patterns, regional disparities and their tendency to convergence towards more similar structures have been discussed in detail. I have also looked in detail at the member countries' efforts to reduce the regional disparities and various factors that hinder the convergence efforts have been studied. Finally the rather slow cross-border factor mobility with in the EU has also been studied in this chapter.

In Chapter III, the economic policies of the member countries have been studied. I have tried to find out why the Single Market lacks flexibility as well as looking at how the less market friendly and anti-competitive economic policies distort the resource allocation. The chapter also studies how these policies run counter to the objectives of the creation of the Single Market. The ill effects of these policies - slow growth and long-term unemployment - have also been scrutinised here. Factors such as labour market rigidity, welfare benefits and employment protection, that affect the industrial efficiency and industrial competitiveness of European industries have been analysed.

In Chapter IV, the nature of the European textile and clothing industries has been studied in detail. It describes in detail the impact of the Single Market on the European textile and clothing industries, takes into account the consumption and supply patterns in the member countries. It examines the employment and productivity patterns in the textile and clothing industries across the member countries. The problems faced by the European textile and clothing industries and the strategies adopted by the member countries have also been discussed in detail in this chapter. The effectiveness of these strategies and their implications on the exports of the non-member countries bring the chapter to a close.

In Chapter V, a survey of Indian textile and clothing industries has been undertaken and its evolution, nature, structure and importance to the domestic economy have been studied. Also the industrial efficiency and the competitiveness of Indian textile and clothing industries have been analysed. The cost competitiveness of both the textile and clothing industries has been compared with other leading textile and clothing exporters in order to throw light on the competitiveness of India's exports in the Single Market. This chapter helps to provide more understanding of the nature of the Indian textile and clothing industries and their competitiveness which is vital when analysing the effects of the Single Market on their exports to the EU in the next chapter.

Chapter VI provides a detailed study of the impact of the Single Market on India's textile and clothing exports and also investigates in detail the changes in the intra-EU trade, extra-EU trade and the levels of consumption changes in the Single Market. In addition the effect of the Single Market on the leading export markets and its subsequent implications for

India's exports have been examined and the implications of the European textile and clothing industries' strategic choices on India's exports have also been analysed in detail.

Chapter VII constitutes the conclusion of the thesis and summarises the effects of the creation of the Single European Market on India's textile and clothing exports. While assessing the welfare effects of the Single Market, the limitations of the usage of the Customs Union theory have also been explained. The nature of the textile and clothing industries and the limitations imposed by various factors explain why the welfare effects in the textile and clothing industries vary from other industries. Crucially it analyses why the formation of the Single Market in the textile and clothing industries has not followed the arguments of the Customs Union theory.

We will turn now to examine the Customs Union theory in Chapter I.

CHAPTER - I

A Theoretical Framework to Study the Implications of the Single European Market

A Theoretical Framework to Study the Implications of the Single European Market

The impact of the creation of the Single Market on non-member countries will be studied by analysing the market gains and losses created in the formation of the Single Market. The indirect effects of the formation of the Single Market on the non-member countries will also be studied by analysing the welfare effects (welfare gains and losses) of the creation of the Single Market on the member countries. With the EU accounting for more than a fifth of world trade, the implications of the Single Market would have serious implications on global trade. It is not only the welfare gains, but also the welfare losses of the Single Market have implications on the non-member countries.

The implications of the creation of the Single Market will be studied by using the framework of *Customs Union theory.*[1] This theory evolved with the writings of Jacob Viner in 1950 on the distinction between the trade creating and trade diverting effects. Though the development on Customs Union theory was preceded by the idea of the creation of the European Community (EC), analyses on the implications of a customs union go back to as early as 1920, when Augustis Cournot analysed the effects of the removal of tariff barriers on efficiency and equity. Wicksell gave explicit consideration to the study of Customs Unions.[2] The theoretical arguments about both the creation and implications of the Customs Union were built by many economists under varying assumptions on the framework provided by Jacob Viner. While Viner's traditional Customs Union theory largely focussed on the creation of the Common Market, the post-Vinerian developments merely substantiated the Vinerian arguments with statistical and mathematical evidences.

Customs Union theory has been used to study the static and dynamic effects of an enlarged market. The theoretical utility of Customs Union theory is strictly limited in analysing the effects of the creation of a Customs Union on both the member and non-member countries. It is not possible to use Customs Union theory in analysing the effects of other trading arrangements such as Free Trade Areas (FTA's) and Preferential Trading Arrangements (PTA's) as these trading arrangements could not be treated as a single entity except for its intra-regional trade. On the basis of Customs Union theory, it is possible, to arrive at a conclusion on a Customs Union's

[1] Jacob Viner, *The Customs Union Issue*, (Carnegie Endowment International Peace: New York), 1950.
[2] For more details on the origin of Customs Union theory see Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd: London), 1962.

impact on any particular industry in both the member- and non-member countries. It is mainly because Customs Union theory treats a Customs Union as a single entity (two-country model). In this regard, the theoretical utility of the Customs Union is limited to the analysis of only the Customs Union. Since there is only one Customs Union (which meets the parameters of Customs Union theory), the research works on Customs Union theory is limited to the EU. Moreover the predominance of the EC - later the EU - in the world trading system for the last 50 years did not necessitate the post-Vinerian economists to widen the horizons of Customs Union theory to be used in other trading systems. Nevertheless, it cannot be concluded that this theory is defective as it is EU-specific. This is mainly because the EU is a single largest trading bloc and a leading export destination for most of the countries of the world. In this regard, Customs Union theory could be used to study the trade relationship between the EU and any country in the world. No research has so far been carried out to generalise the use of Customs Union theory in other spheres of economic activity. As a result, the review of literature in this research did not include the possible literatures where Customs Union theory could have been used in wider context.

When the process towards the creation of the Single Market was being completed, there had been voices against its creation in both the member and non-member countries. While the member countries argued that the creation of the Single Market would increase the influx of low-cost imports thereby making the domestic industries increasingly vulnerable to the external imports, the non-member countries argued that it was an attempt to protect the domestic industries in the EU from external competition. There had also been arguments against further liberalisation in the Single Market as many of the non-member countries still pursued import-substituting trade policies for political reasons. This argument found its support from those who supported bi-directional approach in international trade. They argued that if some countries pursued uni-directional approach, in which they continued to protect their domestic industries for political reasons, they had no right in demanding further liberalisation in the export markets. However others argued that the uni-directional approach is morally justified as many of the non-member developing countries were latecomers to the process of industrialisation. This argument was countered by the sceptics as some of the member countries, such as Greece, Spain, Portugal and Ireland, were also latecomers in the process of industrialisation and this was more than enough to demand protection for these economies against the onslaught of low-cost imports and the Commission still proceeded with further liberalisation of its enlarged market.

With the trimming down of cohesion and structural funds, and with the closing down of many industries of national importance, one is forced to assume that the European Commission adopts a market approach as the Commission argues that the non-market arguments would only result in sub-optimal Single Market that goes against the objectives of the Treaty of Rome. This

is particularly true in the case of the EU's labour-intensive textile and clothing industries, which had been showing a declining trend since the 1960's. Despite the calls for a serious debate on the need for protection of an industry of national importance in many member countries, the Commission ignored the suggestions for protection of this industry. As a result the EU's textile and clothing industry was forced to restructure, the failure of which forced many less competitive firms to adopt strategic measures aimed at surviving in the Single Market. If the assumption for this research were to be that the EU adopts a political economy approach, this research would not have adopted Customs Union theory as such an approach would go against the very purpose of establishing the Single Market. The Commission's reluctance to extend the cohesion and structural funds, and subsidies to the accession countries only confirms that the EU is less willing to entertain the political thought in the process of market enlargement as it is considered to distort the competitive forces in the Single Market.

While many non-member countries traced the origin of their export retardation in the EU to the member countries' strategic trade policies, they continued to ignore the anomalies in their industrial policies. This continued to provide an excuse for many in the EU to demand protection for their vulnerable domestic industries against low-cost imports. However, with many developing non-member countries embarking on the process of globalisation - with the reduction of tariffs, dismantling of subsidies and the deregulation of national industries - this anomaly has been removed. As a result, many developing countries are in a position to demand market openness in the EU as they have also been pursuing the liberalisation policies to stay competitive in the global market.

Many countries have been pursuing neo-classical approach with outward-looking economic policies exemplified by economic restructuring. The import-substitution has become a thing of the past for many countries. This is particularly true in the case of India, which embarked on the liberalisation process in 1991. The opening up of the domestic market is accomplished with the reduction in the levels of tariffs and subsidies. Efforts have also been made to reduce state intervention to stimulate investment. Thrusts have been forced on export side with the concentration of traditional industries such as textiles and clothing and the promotion of knowledge-based industries such as information and bio-technology.

With both the exporting country and the export market adopting the neo-classical approach, it is only natural that neo-classical approach has been adopted in this research. The classical approach also gives little attention to macroeconomic issues such as business cycles. It also ignores the importance of effective allocation of resources in a competitive economy. This leads to a justification of misallocation of resources and subsequent distortions in the enlarged

market. The objective of international economic integration is to reap the microeconomic benefits of specialisation, rationalisation and increased competition. As microeconomic objectives could not be separated from macroeconomic issues, macroeconomic discussions are important in studying the competitive effects in a competitive economy. Any discussions ignoring the interface between market mechanism and market policies would only yield sub-optimal results. It is in this regard, the neo-classical 'Customs Union theory' has been used to study the effects of the Single Market on the exports of the non-member countries. Though simple statistical estimates could find the effects of the Customs Union on the member- and non-member countries, it would not able to interpret the results as it lacks theoretical interpretation. Customs Union theory is the only theory used by the economists and the political economists to study the static and dynamic effects of an enlarged market. Nevertheless the parameters used to study these static and dynamic effects vary.

The main arguments of Customs Union theory are centred on the effective reallocation of resources in an enlarged market. Customs Union theory argues that in the process of market enlargement, only the efficient industries retain their position in enlarged market as the effective reallocation of resources exerts its pressure on the inefficient industries to go out of the market. It is in this regard, the classical framework is discarded as it does not present credence to the existence of competitive forces in an enlarged market. Also the classical arguments justify the infant industry argument and the resulting resource misallocation, which goes against the objectives of the creation of Single Market. If there is a scope for resource misallocation in enlarged market, the member countries would not have preferred the formation of the Single Market as it would seriously undermine their competitiveness (For example, if Germany feels that the inclusion of the Czech Republic would seriously undermine the competitiveness of its textile and clothing industry through the Czech Republic's state intervention, it would not prefer to include it in the Union. Likewise, if the Czech Republic opines that its entry into the Union would not benefit its competitive textile and clothing industry as the Italian and French textile industries continue to enjoy state protection, it would not prefer to enter into the Union as its membership does not confer upon it real economic benefits).

The formation of a Single Market among contiguous national economies is accomplished with the removal of tariff barriers among the member countries but maintaining them against the non-member countries. This removes discrimination between the member countries but maintains it against the non-member countries. As a result, competition among domestic firms is expected to increase as they compete against each other to capture the opportunities created in an enlarged market. When firms are thrown into competition with a number of firms in other countries, the resultant efficient reallocation of resources may increase because technically more efficient

methods of production are forced on firms (forced efficiency) now facing fierce foreign competition (firms from the member countries). Increased competition among firms yields an efficient allocation of resources, which in turn results in the increased specialisation of firms.[3] The combined effects of the efficient reallocation of resources and increased specialisation of firms in the market result in significant economies of scale. The existence of economies of scale in an industry reflects diminishing average costs under increased efficient production structure and increased competitiveness. Hence the formation of the Single Market is expected to result in an increased efficiency and international competitiveness through the process of efficient allocation of resources, increased specialisation of firms and economies of scale.

The formation of a Customs Union with the removal of tariff barriers among the member countries, while maintaining it against non-member countries, is expected to result in structural changes. These structural changes alter the nature of the trading patterns of the member countries internally as well as externally. Before the creation of a Customs Union, the firms in the member countries witness wide levels of disparity in production costs. This is due to the misallocation of resources in hitherto protected national markets. However in a Customs Union, only the most efficient firms survive as a result of efficient reallocation of resources and increased competition. This forces structural changes in production and trading patterns among the firms operating in a Single Market. As a consequence, member countries' dearer domestic production is replaced by cheaper sources of supply from both the member and non-member countries. This is called the *trade creation effect.*[4] This can be divided into two components: (i) an *internal trade creation* and (ii) an *external trade creation.*[5] When the dearer domestic production in one member country is replaced by cheaper imports from other member countries, internal trade creation occurs, which implies that trade is created internally. When the dearer domestic production is replaced by imports from non-member countries, then the Single Market witnesses external trade creation, which means that trade is created externally. The relative strengths of these two effects, among other factors, determine the trade creating nature of the Customs Union. The greater the internal trade creation effect than the external trade creation effect, the more the gains for the member countries and the less the gains for the non-member countries. Conversely, the more the external trade creation and the less the internal trade creation, the more will be the gains for the non-member countries and the less will be the gains for the member countries. When the low-cost member country becomes the effective supplier in the Single Market, it witnesses economies of

[3] For a detailed study on the basics of the common market see J.F.Deniau, *The Common Market*, (Barrie and Rockliff, London), 1963.
[4] ibid., p.2
[5] For more details on internal and external trade creation effects, see Edwin M.Truman, *The European Economic Community: Trade Creation and Trade Diversion, Yale Economic Essays*, vol.34, 1969, pp.150-71.

scale, as the market expansion is associated with increased specialisation. As a result, a *cost-reduction effect* is also witnessed in the Single Market.[6]

In the formation of a Customs Union, national tariffs are replaced by the introduction of common uniform tariffs against the non-member countries in the form of *Common External Tariffs* (CET's). The level of CET's could be either higher or lower, depending upon the pre-Union tariffs. However these tariff rates operate at *made-to-measure levels* designed to make the tariff-inclusive import price just equal to average cost, including normal profits, hence avoiding any excess profits.[7] The objectives of the CET's operating at a made-to-measure level are two fold. First, it is aimed at reducing the monopoly of firms in the domestic market, which is most likely to arise in the formation of the Customs Union. Secondly, it is aimed at the imports of the non-member countries, thereby avoiding any excess profits to them in the process of external trade creation. This is also aimed at reducing the distortions created in the Customs Union by the imports from the non-member countries. In other words, we can say that the CET's operate at the import-preventing level, in so far as the main objective of the imposition of the CET's is to protect the domestic market from external competition.

As a result of the imposition of the CET's, low cost imports from the non-member countries are replaced either by imports from the member countries or by non-member countries or by domestic production. This is called the *trade diversion effect*.[8] When the low cost imports from the non-member countries are replaced by the high cost imports from the member countries, the Customs Union witnesses trade diversion. If the imports from the non-member countries are replaced by domestic production, the Customs Union witnesses a *trade suppression effect*.[9] It is akin to a trade diversion effect, since a dearer source of supply replaces a cheaper source, but this time the dearer source is newly established domestic production, not the member countries. The trade suppression effect affects both the member and non-member countries. It affects the member countries and non-member countries by preventing the realisation of internal and external trade creation effects respectively in the formation of the Customs Union.

The member countries also trade among themselves some goods that they do not import at all from non-member countries. The elimination of tariffs among the member countries on goods traded only within the union is likely to change the trade pattern of the member countries

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[6] W.M.Corden, *Economies of Scale and Customs Union Theory*, pp.33-43 in Alexis Jacquemin and Andre Sapir (eds.), *The European Internal Market: Trade and Competition-Selected Readings*, (Oxford University Press: Oxford), 1989.
[7] ibid., p.5.
[8] ibid., p.1.
[9] ibid., p.1.

with the non-member countries. This may prevent the non-member countries from extending their production structure to the products traded only among the member countries. This is called the *trade modification effect.*[10]

From the above analysis, it has been concluded that the creation of a Customs Union results in four main effects namely, trade creation effect (internal and external), trade diversion effect, trade modification effect and trade suppression effect. Each of these four effects has *production* and *consumption components.*[11] Both the production and consumption components relate to shifts in the demand for commodities produced by the member and non-member countries.[12] The production effect in the Customs Union can be defined as a shift in the pattern of production. This can be either positive or negative depending upon the direction of shifts in the production pattern. The positive production pattern can be defined as the savings in cost resulting from a shift of purchases from higher cost domestic sources to lower cost sources of both the member and non-member countries, whereas the negative production effect can be defined as the extra cost incurred in shifting the purchases from lower cost non-member countries to higher cost member countries. The production effect depends on the elasticity of supply in the home country. The higher the elasticity of supply in the home country the higher will be the reduction in the home production and thus a positive production effect. The lower the elasticity of supply in the home country, the higher will be the reduction in the production of the member and non-member countries and thus a negative production effect.

Likewise, the consumption effect can also be defined as a shift in the consumption pattern witnessed in the formation of the Customs Union. The consumption effect depends on the unit price differences of the traded commodities between the member countries. If they are greater the greater will be the substitution of home products by that of the member and non-member countries, and hence the positive consumption effect. If the unit cost price differences are lower in the Customs Union, the lower will be the substitution of commodities among the member countries and that between the member and non-member countries, and hence the negative consumption effect. The Customs Union will witness a positive consumption effect if the

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[10] Wilfred Ethier and Henrick Horn, A New Look at Economic Integration, pp.71-93 in Alexis Jacquemin and Andre Sapir (eds.), The European Internal Market: Trade and Competition-Selected Readings, (Oxford University Press: Oxford), 1989.

[11] Vinerian orthodox theory assumed that the commodities are consumed in fixed proportions independent of the structure of relative prices. Hence, it did not expect the changes in the consumption and the production pattern. This analysis rules out substitution of commodity. However this view was challenged by the introduction of consumption and production effects by Lipsey and Bhagwati respectively.

[12] For a detailed analysis on the production and consumption effects of the trade creation and trade diversion effects of the Customs Union, see Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd: London), 1962.

consumers shift their consumption pattern from high cost domestic sources to low cost sources from the member and non-member countries. The negative consumption effect will be witnessed if consumers replace the low cost imports from the non-member countries with the expensive products from other member countries. The degree of the negative consumption effect witnessed will be higher if the consumers replace the low cost imports from both the member and non-member countries with that of the domestic products (this is a result of the trade suppression effect).

When the trade creation effect takes place in the Customs Union, the whole benefit goes to the consumers in the market, as the consumers in the Customs Union benefit from a new low cost source of imports from the member and non-member countries instead of the more expensive domestic products. It also results in a *positive consumption effect*. The *positive consumption effects* are likely to dominate if the consumers in the Customs Union substitute imports from the member countries for domestic products rather than for the products of the non-member countries. In contrast to this the trade diversion effect incurs an extra cost to the consumers as they replace the low cost supply from the non-member countries with the more expensive member countries' supply. This is the *negative consumption effect* as it increases extra costs on the consumers. It also results in *negative production effects*. Similarly the trade suppression effect of the Customs Union - by replacing the low cost supply from the non-member countries with the domestic supply - results in *negative consumption and negative production effects*. The production and consumption effects of the Customs Union may be either positive or negative depending upon the complementarity and competitiveness of the participating economies and the height of tariff levels.

Trade creation is economically desirable, since it increases production levels in both the member and non-member countries by increasing the levels of consumption in the Single Market. If the increased consumption in an enlarged market increases the production levels of the member countries, internal trade creation would be witnessed. In contrast to this, external trade creation would be witnessed if the consumption increase in the market results in an increase in the production levels of the non-member countries.

The relative magnitude of these four main effects determines whether the formation of the Single Market is harmful or beneficial to both the member and non-member countries. However there are also other factors, which determine the levels of these four main effects in the Customs Union. The net effects of the creation of the Customs Union depend on the following factors: (a) the unit costs of the commodities traded between the member countries and that between the member and non-member countries; (b) the combined effects of the production and consumption

effects of trade creation and trade diversion; (c) the elasticity of supply in the member and non-member countries; (d) complementary and competitive economic structures of the member and non-member countries; (e) the size of the Customs Union; (f) the height and nature of the CET levels in the Customs Union.

Now we can analyse the different possibilities arising from the creation of the Single Market for both the member and non-member countries.

The formation of a Customs Union is more likely to result in welfare gains if the level of intra-regional trade among the member countries in the post-Union period is similar to that in the pre-Union period. This implies that the economies of the member countries are so integrated that welfare losses arising in the form of trade diversion would be less that could be outweighed by increased trade creation effects. In this case, the trade creation effect will be more than the trade diversion effects and results in welfare gains for both the member and non-member countries. Contrary to this, both welfare gains and losses would be witnessed, if intra-regional trade in the post-Union is much higher than the pre-Union trade. It refers to an increased trade diversion and trade creation. However, the net effects depend on the cumulative outcome of these two effects. If trade creation is higher than trade diversion, it would be beneficial to both the member and non-member countries. It would be harmful, to both the member and non-member countries, if trade diversion is higher than trade creation.

A Customs Union is more likely to increase the welfare of the member countries and that of the world, if the Union partner's volume of trade with the non-member countries is a small proportion of their domestic consumption.[13] It means that the losses arising out of the trade diversion effects would be minimal compared to enormous gains created by the trade creation effects. However there are also other factors, which determine the levels of these four main effects in the Customs Union. The net effects of the creation of the Customs Union depend on the following factors:

(a) *unit costs of the commodities traded between the member countries and that between the member and non-member countries:* - the cost ratios are an important determinant of the trade creation and trade diversion effects in the Customs Union.[14] The more dissimilar the cost ratios in the member countries the more will be the gains from the Customs Union. If the member countries have almost identical cost ratios, the gains from trade creation will be small in the

[13] Barry Bracewell-Mines, *Economic Integration in East and West*, (CroomHelm: London), 1976, p.70.
[14] For more details on the analysis of the cost ratios see H.Makower and G.Mortan, A Contribution to the Theory of Customs Unions, *Economic Journal*, vol. LXII, no.249, March 1953, pp.33-49.

Customs Union. If the unit cost differences are relatively greater for commodities in which trade has been created than for the goods in which trade has been diverted, then the creation of the Customs Union may have a beneficial effect on world welfare[15] in the form of net trade creation.

(b) *combined effects of the production and consumption effects of trade creation and trade diversion*:- the combined effects of the production and consumption effects of trade creation and trade diversion decide the outcome of the Customs Union. If the positive production and positive consumption effects of the trade creation effects are higher than the negative production and negative consumption effects of the trade diversion, then the net effect would be positive for both the member and non-member countries.

(c) *elasticity of supply in the member and non-member countries*:- the larger the elasticity of supply the greater will be the reduction in home production and thus the positive production effects. On the other hand, the greater the elasticity of supply in the member countries, the larger will be the reduction of imports from the non-member countries and thus negative production effects.

(d) *complementary and competitive economic structures*[16] *of the member and non-member countries*:- the less the degree of complementarity - or greater the degree of competitiveness - the greater would be the gains from the formation of the Customs Union. This is borne out of the cost effects. The formation of a Customs Union between complementary economies does not result in cost-reduction effects as the competition among them does not yield any substitution effect between commodities. A Customs Union comprising of competitive economies increases the competitive and productive efficiency of the member countries' economies thereby resulting in the substitution effect. As a result, increased competition and cost-reduction effects are witnessed in the Customs Union, which ultimately increases the gains for the member countries. It is also argued that the welfare gains from integration would increase, if the newly imported goods are complementary to domestic commodities and decreases if they are substitutes.[17] The increase in the cost-reduction effect increases the welfare gains of the Customs Union.[18]

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[15] For more details on this argument see Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd.: London), 1962.

[16] R.G.Lipsey defines the competitive economies to be the ones with similar cost ratios and the complementary to be ones with dissimilar cost ratios. For more details in this regard, see R.G.Lipsey, *The Theory of Customs Union: A General Survey*, pp.33-55 in Melvyn B.Krauss (ed.), *The Economics of Integration: A Book of Readings*, (George Allen and Unwin Ltd: London), 1973.

[17] F.V.Meyer, *Complementarity and the Lowering of Tariffs*, American Economic Review, vol.XLVI, no.3, June 1956, pp.323-35.

[18] It was believed that the Customs Union between the complementarity economies was advantageous and that between the competitive economies disadvantageous. Hence the Customs Union between the complementary economies had been supported by both the protectionists and free traders. However this view was challenged by Viner.

(e) *size of the Customs Union:-* the size of the Customs Union also plays an important role in deciding its outcome. The size of the Customs Union increases its bargaining power in international trade negotiations. If the Customs Union accounts for a considerable proportion of world trade with a large number of countries participating in it, then any decision taken unilaterally may result in a less beneficial Customs Union, as the non-member countries are unable to react against the creation of a discriminatory Customs Union. The larger the Customs Union, the larger the possibility that the most efficient producers of various goods will be inside the Customs Union and thus the smaller the trade diverting effects.[19] The larger the economic area of the Customs Union the greater the potential scope for the international division of labour.[20] The larger the area of the Customs Union, the greater will be the positive production effects.[21] This is based on the argument that an enlarged market increases the scope for internal division of labour, and the efficient allocation of resources thereby results in a trade creation effect. However a different view was expressed by P.J.Verdoorn in the 1950s.[22] He argued that there were reasons to assume that the smaller the area covered by the Union the greater would be the increase in intra-regional trade, for the influence of price differences would be dampened due to the geographical distance in the formation of the Customs Union itself. However this argument is brushed aside as the rapid development in science and technology has reduced the importance of transportation costs in international trade. It is also assumed that the increase in the size of the market is associated with the increase in the volume of production. The effectiveness of the market is further increased with low transportation costs for intra-regional trade and more diversified tastes among the consumers. The diversified consumption nature in the market increases the opportunities for more trade creation effects.

(f) *height and nature of the CET levels in the Customs Union:-* the height and nature of the CET's affect the economic desirability of a Customs Union. The lower the level of the CET's against the non-member countries, the greater will be the advantages of the Customs Union[23] as this increases the positive production effect and the associated trade creation effects. The higher the level of the CET's the higher will be the negative production effect and associated trade diversion effect. The nature of the CET's is two fold in a Customs Union, viz restrictive and

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[19] Jorgen Ulff-Moller Nielsen, Hans Heinrich and Jorgen Drud Hansen, *An Economic Analysis of the EC*, (McGraw Hill: London), 1992, p.25.

[20] Jacob Viner, *The Customs Union Issue*, p.51.

[21] For more details on this argument see Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd: London), 1962.

[22] For more details on this argument see P.J.Verdoorn, *Two Notes on Tariff Reductions*, Appendix II, pp.160-169 in *Social Aspects of European Economic Cooperation - Report by a Group of Experts*, (International Labour Office: Geneva), 1956.

[23] see Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd: London), 1962.

protective.[24] The protective and restrictive effects of the CET's on the non-member countries would be studied by analysing the nature of imports from them. The ultimate effect on the outside world may be adverse or beneficial according to the levels of the CET's.[25] If the CET's are low on a particular product with large imports of it from the non-member countries, then, this would result in a trade creation effect for the non-member countries. If the levels of the CET's in the Customs Union are less than the pre-Union tariffs of the member countries, it would result in an increased trade creation for the non-member countries (external trade creation), and increased trade diversion for the member countries. Otherwise, if the levels of the CET's in the Customs Union are greater than the pre-Union tariffs, an increased trade creation would be witnessed for the member countries (internal trade creation) with increased trade diversion for the non-member countries. At this stage, the *trade suppression effects* could also be witnessed, if some of the member countries are using this situation - where the CET's are more than the pre-Union tariffs of the member countries - to replace their imports from both the member and non-member countries with domestic production. This effect would witness a negative production effect and a negative consumption effect as the cheaper imports from both the member and non-member countries are being replaced by domestic production. The resultant effect would be increased trade diversion for the member and non-member countries.

If the CET's are higher than the pre-Union tariffs of the member countries and the export structure of the non-member countries are competitive rather than complementary, then the creation of Customs Union results in a harmful trade diversion effect. If, otherwise, the CET's are less than the pre-Union tariffs, with the non-member countries having competitive export structures, then trade creation would be witnessed for the non-member countries (external trade creation). If the export structures of the non-member countries are complementary with the member countries and the CET's are higher or lower than the pre-Union tariffs, then the creation of the Customs Union may result in either positive or negative effects depending upon the elasticity of demand for its products in the Customs Union. If the elasticity of demand for its exports in the Customs Union are more, then it would gain less from the formation of the Customs Union; otherwise, it would gain more from it. Though the trade diversion effect would be less in the case of the non-member countries having complementary export structures, it cannot be ruled out.

Hence it can be concluded that the creation of a Customs Union results in four main

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[24] the restrictive and prohibitive effects are clearly defined in Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd: London), 1962. The former refers to a reduction in the importation and the latter to an increase in the domestic production of a given commodity.

[25] ibid., p.78.

effects, namely, the trade creation effect (internal and external), trade diversion effect, trade modification effect and trade suppression effect. The relative magnitude of all these forces and their interaction decide whether or not the creation of the Customs Union is harmful or beneficiary. If the creation of the Customs Union results in net trade creation effects, then it is beneficial for both the member and non-member countries. Otherwise, the net trade diversion effect may result in undesirable effects for the member and non-member countries. The Customs Union will result in positive welfare gains to both the member and non-member countries, if the net welfare gains of the creation of the Customs Union exceed that of the net welfare losses.

REVIEW OF LITERATURE:

There have been numerous studies of the economic impact of the Single Market on the member and the non-member countries. Jacob Viner in his pioneering work on the impact of the Common Market developed a model to help analyse the effects of the enlarged market on both the member and non-member countries. He argued that the creation of the Common Market is largely welfare creating in which the welfare creations outweigh welfare losses. He also identified two effects: trade creation and trade diversion. When intensified competition in the enlarged market exerts competitive pressure upon the high-cost and inefficient industries and forces them out of business, an opportunity is created for the low-cost exporters. This is called *trade creation*. *Trade diversion* is witnessed when the imports of inefficient industries of the member countries replace the low-cost imports from the non-member countries. His pioneering work formed the basis for many works to study the effects of the Customs Union on the member and non-member countries.

Two reports on the dynamics of the Single Market expected substantial cost saving effects resulting from the abolition of non-tariff barriers, border control and customs clearance. These reports also expected performance enhancement in the Single Market induced by increased strong industrial performance and international competitiveness. A substantial increase in productivity was also expected.

Truman calculated, with the traditional Vinerian approach, the effects of the European integration on the production structure in the manufactured sector. (Edwin M. Truman, *The Effects of European Economic Integration on the Production and Trade of Manufactured Products* in Bela Balassa, Krenin, et. at (eds.,) *European Economic Integration*, North Holland Publishing Company, 1975). His estimates followed the lines of Customs Union theory in all ten sectors.

Balassa in his work estimated the levels of trade creaton and trade diversion in the Common Market. (Bela Balassa, *Trade Creation and Trade Diversion in the European Common Market: An Appraisal of the Evidence* in Bela Balassa, Krenin, et. at (eds.,) *European Economic Integration*, North Holland Publishing Company, 1975). His work concluded that trade creation has been substantial in absolute terms and has exceeded trade diversion several times. Balassa argued that the trade creation has resulted largely from intra-industry specialisation through the exploitation of economies of scale. He also predicted the scope for further gains through intensified competition in a wider market.

Balassa also studied the impact of structural policies on European competitiveness. In his work on *Structural Politics in the European Common Market*, (Bela Balassa, Krenin, et. al (eds.,) *European Economic Integration*, North Holland Publishing Company, 1975), he studied three main obstacles - legal, fiscal and financial barriers - that distort the Common Market's competitiveness by preventing the interpenetration of industries in the member countries. He also discussed how fiscal incentives, in bringing the backward regions into the fold, went against the spirit of the Treaty of Rome by compromising with the region's industrial performance and international competitiveness.

The correlation between the economies of scale and the cross-national differentiation of products has been used by Jacques Dreze (Jacques H Dreze, *The Standard Goods Hypothesis* in Alexis Jacquemin and Andre Sapir, (eds.,) *The European Internal Market: Trade and Competition - Select Readings*, Oxford University Press: New York, 1989). According to Dreze, the economies of scale need not necessarily be realistic in an enlarged market given differentiated consumer preferences and subsequent problems associated with product standardisation in the member countries. This argument is best suited in the EU's textile and clothing industries where the cultural and climatic differences across the member countries dilute the efforts to garner the effects of economies of scale in garment production. In other words, economies of scale are difficult to achieve in an industry characterised by product standardisation.

Corden in his work Economies of Scale and Customs Union Theory (W.M. Corden, *Economies of Scale and Customs Union Theory*, in Alexis Jacquemin and Andre Sapir, (eds.,) *The European Internal Market: Trade and Competition - Select Readings*, Oxford University Press: New York, 1989) has systematically incorporated the concept of the economies of scale in customs union theory, a clear deviation from orthodox customs union theory. His argument centred on the introduction of import protecting made-to-measure tariffs designed to protect the member countries' interests in the enlarged market. He analysed the consumption effects in the

member countries after the introduction of made-to-measure tariffs in the member countries and thus arrived at two new effects, cost-reduction and trade suppression, in addition to the existing trade creation and trade diversion.

The quantitative effects of economic integration on trade has been analysed by Mayes in his work *The Effects of Economic Integration on Trade* (David G Mayes, *The Effects of Economic Integration on Trade* in Alexis Jacquemin and Andre Sapir, (eds.,) *The European Internal Market: Trade and Competition - Select Readings*, Oxford University Press, New York, 1989). He measured the quantitative effects of economic integration on the member and EFTA countries in manufactured goods.

Jurgen Muller and Nicholas Owen in their work on *The Effect of Trade on Plant Size* (Jurgen Muller and Nicholas Owen, *The Effect of Trade on Plant Size*, Alexis Jacquemin and Andre Sapir, (eds.,) *The European Internal Market: Trade and Competition - Select Readings*, Oxford University Press, New York, 1989) introduced Minimum Efficient Technical Scale (METS) to argue that scale is not always a crucial factor in business as higher quality products could be produced in small plants at higher costs.

Bela Balassa and Luc Bauwens in their work on *Intra-European Trade in Manufactured Goods* (Bela Balassa and Luc Bauwens, *The Determinants of Intra-European Trade in Manufactured Goods* in Alexis Jacquemin and Andre Sapir, (eds.,) *The European Internal Market: Trade and Competition - Select Readings*, Oxford University Press, New York, 1989) have argued that trade between any two countries is positively correlated with their average per capita income and country size and negatively correlated with inter-country differences in these variables. This explains why trade between the developed member countries always tends to be intra-industry as opposed to inter-industry trade which is witnessed between developed and less-developed member countries.

The study of the impact of the Single Market on non-member countries will be studied within the framework of Customs Union theory. The framework to analyse the impact of the Single Market on both the member and non-member countries has been examined in this chapter. Since the impact of the Single Market on the exports of the non-member countries is studied from the perspective of the EU, the impact of the Single Market on the member countries has been studied in detail. By studying the welfare gains and losses of the Single Market on the member countries, the implications of the Single Market on the exports of the non-member countries can be examined. In this research, however, the framework of Customs Union theory is used with two

broad parameters of the European market mechanism and the economic and trade policies. Now the research will proceed to study the impact of the Single Market on member countries. It then analyses the impact on both the member and non-member countries.

CHAPTER - II

Structural Problems and Economic Benefits in the Single European Market

Structural Problems and Economic Benefits in the Single European Market

The failure of the Single European Market to deliver long-term effects has been ascribed to the absence of an enhanced competitive atmosphere in the EU. The economic objectives of the Single European Market were to increase the welfare of the member countries by increasing their industrial efficiency and international competitiveness. The theoretical models on the formation of the Customs Union assumed that a complete removal of intra-regional trade barriers among the member countries would result in intense competition, as the inefficient firms operating in protected national markets would be forced to go out of business. The increased competition, in turn, was expected to induce efficient reallocation of resources as the resources allocated to inefficient industries in protected national markets would be reallocated only among the efficient firms in the Single European Market. It is the resource reallocation, which is responsible for increasing the efficiency and competitiveness of firms in the Single European Market. It also results in economies of scale, a factor ultimately responsible for the welfare effects of the Single European Market. It has been estimated that approximately one third of the gains accrue as a result of scale economies and one quarter from increased competition.[1] These dynamic effects of the Single European Market were expected to stimulate growth to create more employment opportunities and sustain prosperity in the European economies. The failure of the Single European Market to realise the resource reallocation and economies of scale would distort the realisation of a competitive environment in it. However, a close look at the performance of the Single European Market reveals that the expected objectives and expectations of the Single European Market have not been fully realised as it has not delivered greater macroeconomic benefits. Though the creation of the Single European Market has resulted in intense trade flows, it has not increased the competitive atmosphere in it. Contrary to what was expected in the formation of the Single European Market, the two way trade flows - intra and extra-regional trade flows - have not influenced the competitive atmosphere in the Single European Market. It is found that only extra-regional trade flows exert a significant competitive effect.[2] Intra-regional trade does not seem to have had a greater competitive effect on the firms operating in the Single European Market. This evinces the reality that the formation of the Single European Market is not yet completed, as market segmentation persists even in the post-unification period. Market

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[1] Stephen James, *Economic Policy After 1992: Introduction,* p.12 in David Gowland and Stephen James (eds.), *Economic Policy After 1992,* (Dartmouth: Aldershot), 1991.

[2] Alexis Jacquemin and A.Sapir, *Competition and Imports in the European Market* in L.A.Winters and A.Venables, (eds.), *European Integration: Trade and Industry,* (Cambridge University Press: Cambridge), 1991.

segmentation is a phenomenon, which prevents the realisation of competitive effects of the Single European Market by preventing the reallocation of resources.

It is important to analyse the factors discouraging the competitive effects of the Single European Market as non-realisation of a competitive environment results in efficiency distorting protectionist policies. The complete realisation of competitive effects of the Single European Market has been complicated by the complex economic structures of the member countries forming it. The failure of the European Commission to redress these structural issues has resulted in the non-realisation of the objectives of the Single European Market. Brussels had admitted that the European Single European Market, a flagship of closer integration, has been a flop in terms of job creation and prosperity.[3] The Single European Market Commissioner, Mario Manti, advances that short-lived intense business activity in the Single European Market is responsible for its disappointing performance. It is important to investigate whether this explanation alone is responsible for the disappointing performance of the Single European Market. Could the Single European Market - in its present form – have delivered the long-term benefits? The answer is certainly no. There are other factors preventing the long-term benefits of the Single European Market, such as structural adjustment problems, convergence failure and immobility of factors. The structural problems of the European economies are largely censurable for the poor performance of the Single European Market. The realisation and the efforts to redress these problems would have resulted in long-term benefits in the Single European Market.

Different factors are preventing the realisation of a competitive environment in the Single European Market. The first and the foremost factor is the immobility of factors of production. Balassa argues that factor mobility is necessary for efficient resource allocation, since the prices of productive factors will not be equalised in the absence of factor movements.[4] However the EU's experience shows that the factor movements have been limited in the Single European Market. It is often argued that the removal of tariff and non-tariff barriers among the member countries forming the Single European Market would enhance the mobility of factors across the member countries, thereby resulting in factor price equalisation. However in the EU, this process has been rather slow for the structural incompatibility of the member countries. The complete realisation of the competitive effects of the Single European Market seems to be complicated by the adjustment problems associated with incompatible economies. Hence the success of the Single European Market becomes conditional on the success of the member countries reducing their structural problems to realise the competitive environment. It is important to address these

[3] *The European*, no.318, 13-19 June 1996.
[4] Bela Balassa, *The Theory of Economic Integration*, (George Allen & Unwin Ltd: London, 1962), p.92.

structural problems as they are preventing the realisation of dynamic effects, such as efficient resource reallocation, efficiency enhancement, increased competition and economies of scale.

2.1. STRUCTURAL PROBLEMS IN THE SINGLE EUROPEAN MARKET:

Two factors are primarily responsible for the disappointing performance of the Single European Market. They are the lack of structural uniformity among the economies forming the Single European Market and the failure of these diversified economies to converge in the post-unification period. It is important that the structural problems are to be elaborately discussed here.

2.1.1. IMPORTANCE OF UNIFORM MARKET STRUCTURE:

One of the preconditions for the success of the Single European Market is the realisation of competitive effects in the member countries. The formation of the Single European Market among homogeneous economies intensifies the level of competition among them. This is mainly because of competitive effects associated with homogeneous economies. The more competitive the production structures of the countries that form a Union, the better substitutes are the commodities of the member countries.[5] Hence the formation of the Single European Market among the competitive economies increases the scope for product substitution, as the trading pattern between the competitive economies is intra-industry trade.[6] The salient feature of intra-industry trade is product differentiation, which increases the scope for unit cost differences and product substitution. Balassa opines that the extent of intra-industry trade is positively correlated with product differentiation, besides other factors.[7] Nonetheless, the increase in product differentiation would increase the degree of competition, thereby resulting in economies of scale. Hence it could be argued that the economies of scale increase with the degree of competition among the member countries. The realisation of these dynamic effects results in a beneficial trade creation effect, whereby the high-cost domestic products are replaced by low-cost imports from other member countries.[8] The trade creation effect of the Single European Market results in welfare effects on all the concerned economies whereas the absence of uniformity among the economies in the Single European Market results in harmful trade diversion effect. The inter-industry trading pattern of the heterogeneous economies reduces the scope for unit cost differences and product substitution. Hence the success of the Single European Market primarily depends on

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[5] ibid., p.61.

[6] intra-industry trade corresponds to the two-way trade in identical products. The driving force causing this effect is product substitution, induced by price discrimination.

[7] see Bela Balassa, The Determinants of Intra-Industry Specialisation in the United States Trade, *Oxford Economic Papers*, 38, 1986, pp.220-33.

[8] Jacob Viner, *op. cit.*, *The Customs Union Issue.*

the nature of the economies forming the Single European Market and their trading patterns. If the member countries forming the Single European Market are competitive, it would increase the welfare of all participating economies. Otherwise the result would be complex, depending upon the nature of separate economies and the role played by them in the Single European Market.

A careful look at the nature of European economies reveals that a clear divide has been witnessed among the developed and less developed member countries in production and specialisation patterns. The Commission's report on the impact and effectiveness of the Single European Market reveals that the member countries have not witnessed a trend towards increased sectoral specialisation with the member states concentrating on the industries in which they have comparative advantage.[9] The developed member countries are highly industrialised with very efficient industrial structures and specialised production processes. They have comparable industrial structures, wages, productivity levels and capital-labour ratio. They are also relatively open economies with liberal trade regimes, which are manifested in their competitiveness. These economies display their strong position in capital and R&D intensive sectors, which are engaging skilled labour. The similarity in economic structure and semblance in production and specialisation patterns of these economies allows them to realise the competitive effects of the Single European Market through intra-industry trade. Whereas the less developed member countries are less industrialised with less efficient industrial structures and production processes. They have varying industrial structures with differing levels of productivity and wages along with low capital-labour ratios. These economies tend to concentrate and specialise in sectors with high labour and low-technology content. Therefore they have a strong position in traditional industries, which are labour-intensive in nature (e.g., textile, clothing, leather and footwear). The dissimilarity of these economies does not allow them to realise the competitive effects of the Single European Market, as they observe an inter-industry trading pattern. As a result of different sectoral specialisation, both intra and inter-industry trade are witnessed in the Single European Market. The trade between the northern and the southern member states still tends to be principally inter-industrial and the intra-industry trade is most developed between northern member states.[10] It is these structural impediments, which are limiting the incidence of competitive effects of the Single European Market. Thus the welfare effects of the Single European Market appear to be limited and they are realised only in the developed member countries. The less developed member countries do not seem to be benefiting from the competitive effects of the Single European Market because their trading pattern is not allowing them to realise

[9] see Commission of the European Communities, *The Impact and Effectiveness of the Single European Market*, Brussels, COM (96), 520 final, p.4.

[10] see P.Buigues, F.Ilzkovitz and J.F.Lebrun, *The Impact of the Internal Market by Industrial Sector - the Challenge for the Member States*, European Economy, Social Europe, Special Edition, 1990, p.43.

the competitive pressure on their industries. This argument often highlights the importance of having similar economies to realise the competitive effects in the Single European Market.

2.2. Implications of Heterogeneity in Market Structure:

The dissimilarity in the economic structure of the member countries affects them in such a way that it results in a disproportionate distribution of gains. The competitive effects among the homogeneous economies would be higher than that among the heterogeneous economies. As a result, the open and competitive economies are expected to gain more of the Single European Market as it mainly depends on the ability of their industries to become truly *European* in their trading pattern. Since the process of *Europeanisation* of industries in developed member countries is already advanced, they are more likely to gain in the Single European Market. The main economic gain for these economies would come in the form of consolidating their position in the home market and capturing the markets in other member countries by replacing their inefficient industries. Moreover the European dimension of their industries allows them to penetrate into the weaker markets with ease. However the scenario for the less developed member countries is entirely different. The less developed member countries have industries, which are truly national in their operational dimensions. These industries need more 'outward orientation' to perform well in the Single European Market. The *Europeanisation* of these industries would be a long way to go, as they were latecomers not only in the process of industrialisation, but also in the process of liberalisation. In the borderless and barrierless Single European Market, the less developed member countries are more likely to lose out in competition to strong developed member countries of the Single European Market. As a result of these structural dissimilarities, the member countries will gain disproportionately in the Single European Market. This necessitates the importance of having more similar structural and production patterns among the economies forming the Single European Market. The failure to redress the structural problems would not only result in unequal distribution of gains, but also increases the existing disparity levels among the member countries.

2.3. Importance of Convergence in the Single European Market:

It is possible to accomplish the competitive effects and associated welfare gains of the formation of the Single European Market in the event of the member countries exhibiting convergence tendencies to reduce existing structural disparities. It is important that the member countries forming the Single European Market redress any possible structural imbalances among them as they affect the competitive and welfare effects of the Single European Market. Any structural imbalances among the member countries would affect the proportionate distribution of

gains arising out of the Single European Market. The highly developed and relatively open economies are likely to gain more than the weaker and closed economies of the Single European Market. It is natural to expect that the unequal distribution of gains calls for some measures to protect the weaker economies, otherwise the weaker member countries would not have preferred the membership of the Single European Market along with stronger member countries. As a result member countries are following the dualistic strategy of implementing the measures to achieve competitive effects in the Single European Market on the one hand and protecting the weaker member countries against competitive pressures from both the member and non-member countries on the other hand. If competitive forces are allowed to operate freely in the Single European Market of weaker and stronger members, there is every prospect that the unequal distribution of gains will become a permanent feature in the Single European Market. Hence some measures would have to be taken in the Single European Market to protect the weaker economies, so that the economic gains of the Single European Market are distributed proportionately. These measures might take the form of preferential treatment of weaker and depressed regions, whose ultimate objective is to increase the economic performance of less developed member countries. The effectiveness of these measures depends on the success of the less developed regions to reduce their gap against the developed regions (convergence) and their ability to reach the levels of the developed regions in the Single European Market. The failure of these measures to bring convergence in the Single European Market would not only affect its overall economic performance and efficiency, but also the international competitiveness of their industries.

2.4. REGIONAL DISPARITY IN THE EU:

The structural analysis of the EU's Single European Market reveals widespread disparities among the highly developed and less developed member countries. Even after forty years of the formation of the Common Market, the structural disparity is still witnessed and it is still a dominant subject for deliberation among European economists. Though the EU consists of fifteen member countries, the debate on European economies is mainly focusing on the core developed member countries, as they are considered the engine of the EU's growth whereas the role of the less developed member countries in the EU has been minimised.

A careful look at the contribution of the member countries in the EU's total GDP reveals wider differences in structural and production patterns among the member countries of the EU. In 1993, the total GDP of the EU(15) amounted to ECU 5906.4 billion, equivalent to about a quarter of the GDP of the entire world economy. The four largest countries of the EU - Germany, France, Italy and the UK - accounted for more than 75 percent of total GDP of the Union. Four other member countries - Ireland, Luxembourg, Portugal and Finland - accounted for only 3.3

percent of the EU's total GDP. The comparison of average per capita GDP also confirms the wider disparity witnessed among the member countries. There are only eight countries with per capita GDP of more than the EU average. The lowest per capita GDP is witnessed in Portugal followed by Greece and Spain. These per capita GDP differences in the EU explain the reason for the increased level of intra-industry trade among the developed member countries and vice-versa for the less developed member countries.[11] A comparison of the contribution of the member countries in the EU's total industrial production also confirms wider differences witnessed in the level of industrialisation. The developed member countries are considered to be the engine of the EU. The four largest industrial countries of the EU - Germany, France, Italy and the UK - accounted for 79.6 percent of the EU's total industrial production in 1993, whereas the remaining eleven countries accounted for only 20.4 percent. Germany and France together accounted for more than 40 percent of the EU's total industrial output.

These facts confirm that wider disparities are witnessed among the member countries of the EU. It is, however, important to mention that disparity is witnessed both at micro and macro levels. At macro-level, the GDP of Portugal is 2.17 times lower than the EU average and 3.66 times lower than that of Luxembourg, the country with highest per capita GDP. At micro-level, the differences are considerably larger. The GDP per capita in the EU's richest region of Hamburg is six times that of Alantejo in Spain for the period averaged 1989-91.[12] An analysis of the per capita income also confirms this disparity. An average income per head on the Community's 25 richest regions is two and a half times greater than that in the 25 poorest.[13] The ten richest regions of the EU have an income roughly four and a half times greater than that of the ten poorest regions.[14] The regional disparities in the regions of southern member countries are more that in the northern member countries as they are less developed compared to any region in the northern member countries. The less developed regions are situated on the periphery of the EU in mountain areas, in areas with low levels of industrialisation and in areas where the old industries are in crisis.[15]

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[11] This corresponds to Helpman's argument that the level of intra-industry trade between two countries is negatively correlated to the difference in their GDP per head. For more details see, Helpman, E., International Trade in the presence of Product Differentiation, Economies of Scale and Monopolistic Competition: A Chamberlin-Heckscher-Ohlin Approach, *Journal of International Economics*, no.3, pp.305-40.

[12] Tony Dignan, Regional Disparities and Regional Policy in the European Union, *Oxford Review of Economic Policy*, vol.11, no.2, Summer 1995, p.67.

[13] Opening Up of the Internal Market, *Commission of the European Community*, June, 1991.

[14] *EuroBusiness*, June 1996.

[15] Europe in Figures, *Commission of the European Community*, Luxembourg, *1995*, p.355.

There are different reasons for persistent disparity witnessed among the member countries. The main reason is the predominance of depressed regions (*Objective1 regions*) in less developed member countries, whose productivity level is much less than the EU average.[16] These regions are economically less active, plagued by high unemployment, low endowment of physical and human capital and low capital-labour ratios. These are also the regions with unemployment averaging 16.7 percent against the EU average of 10.4 percent in 1994. The economic inactivity of *Objective1* regions is fostered by the absence of a strong industrial base coupled with a dominant agricultural sector, which accounts for twice as large a share of total unemployment compared to the EU as a whole. The unemployment rate in these regions would have been much higher, had it not been for the agriculture sector and relatively weak social security system. The Agricultural sector still accounts for much of the hidden unemployment in these regions. In Greece and Portugal, this sector absorbs a large fraction of working-age population.[17] It is these underdeveloped regions, which are complicating the process of structural adjustment in the Single European Market. The EU's drive to deepen the degree of integration between its constituent member states was considerably complicated by the presence of a bloc of relatively poor member states, comprising about one-fifth of the EU's population.

When the Community was formed in 1957 the original member countries had almost similar economic structures. With the exception of Mezzogiorho - in the south of Italy - the original six member states were sufficiently homogeneous in their structure that regional disparities did not feature as a major item on the policy deliberation of the Commission. The first enlargement with the accession of Ireland, the United Kingdom and Denmark resulted in the inclusion of relatively depressed regions associated with these countries. The successive enlargements further exaggerated the number of relatively underdeveloped regions represented within the Union. This exaggerated the existing disparity level between the developed and less developed member countries. The factors responsible for regional imbalances were resisting the competitive effects expected in the formation of the Single European Market. They were also challenging the gains due to arise in the formation of the Single European Market.

2.5. CONVERGENCE EFFORTS IN THE SINGLE EUROPEAN MARKET:

The Commission in its efforts to reduce the existing disparity and structural imbalances between the member countries have imposed measures to achieve regional convergence so that the competitive effects of the Single European Market would be realised across all the member

[16] The European Commission defines *Objective1* regions as the region with per capita GDP of less than 75 percent of the Community's average.
[17] Tony Dignan, *Regional Disparities and Regional Policy.*

countries. To promote cohesion between socially and economically underdeveloped regions with the developed regions, the Commission decided to support the underdeveloped regions through European Regional Development Funds (ERDF) and the European Structural Funds (ESF). The less developed regions are funded with the objective of improving their infrastructure, as they are weaker peripheral regions, which might lose out in competition to stronger central regions of the Union. It is in these areas 60 percent of the structural funds are to be met.[18] Three quarters of the structural funds are being invested in *Objective1* regions and very largely in the four poorest member countries of Greece, Portugal, Ireland and Spain, as these economies are dominated by *Objective1* regions. The proportion of the Union's budget allocated to structural operations has increased from just over 18 percent in 1987 to 31 percent in 1993 and is scheduled to rise to over one third by 1999.[19] It was envisaged that under the 1994-99 programme, spending on structural funds would rise from 31 percent to 36 percent of the Community budget.[20] The regional funds to these regions take the form of subsidies for firms willing to invest in these regions. However, serious reservations are expressed about the effectiveness of these regional funds in bringing convergence in the Union. Even in countries where there has been an active regional policy, it has had only a limited effect in reducing regional imbalances. The research on the effectiveness of regional funds in Spain unveils that the structural funds do not exert much macroeconomic effects on the performance of recipient economies.[21] It is interesting to note that it is unable to redress disparity existing even among the regions of the same country. This is due to the dominance of *backwash effects* over *favourable effects* in the integration process.[22] The dominant backwash effects reinforce or strengthen the core's competitive advantages and result in the movement of both capital and labour to the core regions from the periphery.[23] The Italian example confirms the dominance of backwash effects. In Italy the regional imbalances between the southern and northern regions, instead of reducing, have been widening, despite the government's efforts to attract investors through subsidies.[24] Italian economist Fiani believes that the flow of capital is

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[18] Commission of the European Communities, *The Impact and Effectiveness,* p.12.
[19] Tony Dignan, *Regional Disparities and Regional Policy*, p.87.
[20] Iain Begg, Graham Gudgin and Derek Morris, The Assessment: Regional Policy in the European Union, *Oxford Review of Economic Policy*, vol.11, no.2, 1995, p. 8.
[21] Angel de la Fuente and Xavier Vives, Infrastructure and Education as Instruments of Educational Policy: Evidence from Spain, *Economic Policy: A European Forum*, 20 April 1995, pp.13-51.
[22] in the integration process two types of linkages, favourable and unfavourable linkages, develop between the developed and less developed regions. The unfavourable linkages augment the core's competitiveness at the cost of peripheral regions by attracting capital and labour from core to the peripheral regions. This is also known as *Backwash effects.* The favourable effects take place at the time of congestion and high costs of productive factors. This encourages the capital and labour to move towards the peripheral regions. Kaldor argues that the backwash effects will prevail over favourable effects. For more details see N.Kaldor, The Case for Regional Policies, *Scottish Journal of Political Economy*, 17, 1970, pp.327-48.
[23] Tony Dignan, *Regional Disparities and Regional Policy*, p.77.
[24] *The European*, no.348, 9-15 January 1997.

moving in the opposite direction, contrary to what was expected.[25] In the period of slow growth, the southern regions are no longer able to attract investment solely because of its abundant labour as the northern capital finds attractive locations in the centre and north.[26] In the long run, the peripheral regions are losing out as the industry moves towards the core regions of France, Germany, Belgium and the Netherlands.

The dominance of backwash effects would further decelerate growth and weaken the investment pattern in depressed regions. Any further movement of productive factors away from the periphery would be compensated by the supporting measures for the peripheral regions. At this juncture the investment in these regions demand subsidies as in the case of southern Italy, Spain, Ireland, East Germany and other less developed regions. Now regional funds are used by the Commission and the member state authorities to attract investments into these regions so that convergence would occur among the regions. However this does not seem to have had positive effects on the depressed regions. It is believed that the failure of regional funds to achieve regional convergence may make these protectionist policies (subsidies) permanent even to maintain the existing position. The East German example confirms this dependency culture. Even after consuming a staggering $580 billion in government funds since 1990, the East German regions do not show any convergence pattern towards West Germany. German policy makers are starting to realise that the former East German states show the signs of becoming permanent welfare cases.[27] A study by the Federation of German Industry (FGI) estimated that it will take at least another 15 to 20 years for East Germany to reach West Germany's development level. To encourage investment in East Germany, it recommended that subsidies and special tax allowances be continued in East Germany.[28] This not only increases the dependency of the less developed regions, but also widens the present disparity level witnessed between the two regions. As a result most of the weaker member countries and depressed regions continue to rely on government support rather than on market forces for attracting investment.

It is believed that unequal factor prices are responsible for slow convergence in the Single European Market. It was expected that in the Single European Market the inequality in factor prices would result in factor movements across the countries, as the productive factors are moving in the directions in which they are treated well. As a result, capital would flow from capital-abundant developed member countries to capital-scarce less developed member countries

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[25] Ibid.

[26] see Bruno Jossa, Credit and Economic Development in Southern Italy, *Review of Economic Conditions in Italy*, no.2, July-December 1995, pp.179-204.

[27] *International Business Week*, 17 June 1996.

[28] *German Brief Update*, 11-17 September 1996, vol.8, no.38.

as the marginal return on the capital in the former regions would be lower than that in the latter. Similarly, labour would flow from labour-abundant less developed member countries to the labour-scarce developed member countries responding to increased wages in the developed member countries. However the EU's experience shows that the factor mobility in the Single European Market is limited by various factors. The differing productive capacity of the productive factors endowed in different member countries stifles the free flow of factors of mobility in the Single European Market. The capital flow from the capital-abundant member countries to the capital-scarce member countries is hindered by:

- the low marginal return on the capital in the less developed member countries;
- the low-skill levels associated with the labour force in the less developed member countries, which make productive capacity of capital less productive in presence of a low-skilled work force;
- the institutional policies, which make labour market less flexible.[29] The consequences of the less flexible labour market are higher costs and less competitive cost structure of the firms, which discourages investment in less flexible labour markets;
- the low level of technology in the production line which makes capital less productive in the less developed regions;
- the lack of infrastructural facility which constrains the supply responses of firms to changing demand conditions in the Single European Market;

Similarly, the labour flow from the labour-abundant less developed member countries to the labour-scarce developed member countries is complicated by:

- the prevailing unemployment conditions in the developed member countries, which dissuade them from moving northwards.
- the institutional policies, which are discouraging labour mobility towards high labour cost countries. Though the amount of social security given is less in less developed member countries, it is still discouraging the labour to move out of the domestic labour market[30];
- the discriminatory treatment meted out (different wage levels for the domestic and immigrant labour) to the immigrated labour discourages the future mobility of labour[31];
- the inflow of people from non-member countries (Turkey, former Yugoslavia and Central and East European countries) reduces the demand for people from the other member countries, as they demand low labour cost with more or less similar skill levels;
- the restricted health care benefits is often restricted for people from one member country residing in another member country[32];

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[29] it is argued that the less developed member countries have less stringent social security measures, which would attract investment into these regions. Nonetheless they also have less flexible labour markets, which make dismissals more expensive in the less developed member countries. This discourages the investments aimed at capitalising the low labour cost in the less developed member countries. *The European* dated 19-25 June 1997 published a report on the labour market flexibility undertaken by Lehman brothers and OECD Jobs Study of 1994. According to that report, the less developed member countries have the toughest dismissals in the EU.

[30] Iain Begg, The Assessment: Regional Policy, pp.96-112.

[31] for example, an average German builder gets Dm24 an hour compared to Dm7 paid to Portuguese construction worker. Apart from this they are not by health insurance and other privileges enjoyed by the German workers.

[32] Iain Begg, The Assessment: Regional Policy, p.101.

- it is not only the wage differentials that stimulate labour migration.[33] There are also cultural and linguistic barriers, which are preventing the willingness of labour to migrate to a foreign country.

These arguments confirm that cross border factor mobility in the Single European Market is limited. The absence of complete factor mobility deters the welfare effects of the regional development funds. The low endowment of physical and human capital makes these regions less attractive for private investment. As a result, the investment decisions of industries are concentrated in the developed member countries.[34] The theoretical models of Bertola suggest that a tendency in production concentration towards the north is expected, if growth is influenced by private investment decisions.[35] Since the private investors are operating with the sole purpose of profit, the less developed regions are less likely to attract private investments. This further increases the gap between the developed and less developed regions of the EU.

Due to the industrial backwardness of the less developed regions, mainly public investments are directed to these regions, as the private investors demand supportive measures to invest in the less developed regions. The Italian example confirms this, where the private investors are not prepared to invest in the less developed southern regions as they lack necessary infrastructure. State-owned Petrochemicals, steel making plants and car maker Fiat are surviving in the south only because of decades of government incentives to keep them in the south for employment reasons.[36] Many of the multinational companies are attracted to Spain and Ireland, only because of various subsidy programs, tax concessions and incentive funds provided by the Commission and the national Governments. Depending on various factors, incentive programs in Spain can cover up to 75 per cent of a project.[37] Ireland provides massive subsidy programmes and tax concessions for investors to attract investment. Incentives, in Ireland, are provided on the basis of the number of jobs created. Ireland's Industrial Development Authority (IDA) had agreed to pay Intel a grant aid of Ir£22,000 per job created to invest in Ireland.[38] They have also agreed to provide Ir£18,000 per job, well above the average for this sector, to attract IBM to invest in Ireland.[39]

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[33] see O.Stark, *The Migration of Labour*, (Blackwell: Oxford), 1991.
[34] The German electronics and electrical engineering group Siemens' investment pattern confirms this trend. Its investment in semiconductor industry in Britain amounted to $1.7 billion (*International Business Week*, 8 January 1996), whereas its investment in memory chip plant in Portugal is only $380 million (*The Financial Times*, 30 May 1996). Though the labour cost in Portugal is much lower than that in Britain, the skill level of its workforce makes their region less attractive.
[35] G.Bertola, Models of Economic Integration and Localised Growth, CEPR Discussion Paper no.651, London.
[36] *The European*, no.348, 9-15 January 1997.
[37] Investing in Spain, *Europe*, no.341, November 1994.
[38] *The European*, no.348, 9-15 January 1997.
[39] ibid.

It is important to mention that the investment-encouraging measures do not have any positive effect in increasing the efficiency of productive factors in the depressed regions. Though the incentives are provided with the final objective of reducing the regional imbalances, they do not seem to have any major impact on these regions. This is for two reasons. First, the incentives are directed to safeguard employment in depressed regions. For example, a French oil company was given Dm1.2 million in subsidies from the German government to set up its operations in eastern Germany, after it gave the assurance that it would provide employment for 500 workers.[40] Secondly the investors are selective in preferring their industrial locations and industries to invest. Though they are provided with the incentives to invest in the depressed regions, the private investors are specific in selecting their investments and locations. Much of the foreign investment directed to Ireland is in electronics industry concentrating in Dublin. Ireland's Industrial Development Authority (IDA) is unable to divert investment to other regions as it is the companies, which are deciding their investment pattern, not the government authorities. For many companies investing in Ireland, it is Dublin or some other country rather than Dublin or elsewhere in Ireland.[41] In the case of Spain and Portugal, the investments are mostly directed to the automobile industry. As a result, investment continues to concentrate in selective sectors and regions. Though the less developed regions have a comparative advantage in labour-intensive industries, investment is not heavily focused in those sectors. It is mainly the capital-intensive industries that attract investment into these regions. The failure of these incentives to attract investment to other depressed regions and areas of activity, would further distort the centre-periphery alignment. Since capital and labour are mobile within the country, they would move from the peripheral regions to the core developed regions. The case of southern Italy confirms this as the capital and labour, despite decade long supportive measures, flow from the southern regions to the developed regions of the north. The limited success of the regional funds in bringing convergence may make these measures permanent in the Single European Market.

The consequences of infrastructural deficiency and structural rigidities in the less developed member countries are inward investment by the less developed member countries in their own regions to protect their employment and the outward investment from capital-abundant developed countries destined for non-member countries. The investment pattern of the northern member countries confirms this trend. With high labour costs in the domestic labour market, they continue to invest in the Central and East European countries, rather than investing in the southern member countries. West German companies looking for new factory locations prefer neighbouring countries like Czech and Slovakian republic, where the wage costs are one-tenth of

[40] *German Brief Update*, 9 August 1996, vol.8, no.32.
[41] *The European*, no.348, 9-15 January 1997.

the German rate.[42] Though the labour costs in the southern member countries are much cheaper than that in the northern member countries they are not willing to invest in these regions, as the productive capacity of these regions are considered much lower than that of the Central and East European countries.[43] The region's changing structure is more likely to replace southern Europe, a region that attracted far more investments from northern and western European countries.[44]

It is the weak industrial base, infrastructural deficiency and limited capacity of productive factors that are responsible for the inability of depressed regions to attract private investment. The weak industrial base is due to the dominance of agricultural and agro-based sectors in these regions. The inability of these regions to develop a strong industrial base can also be traced to some of the institutional policies aimed at reducing the income disparity between the developed and the less developed regions. These policies designed to protect the income levels of the farm workers - by providing them price-supporting measures - deter the release of labour engaged in agricultural sector in these regions. The agricultural support policies provided to the less-profitable agricultural sector in the absence of a strong industrial base discourage the farm workers from being released from this sector. The Spanish experience shows that the government's efforts to narrow the wealth gap between the industrialised north and agricultural south has resulted in the implementation of a safety net aimed at providing subsidies to agricultural workers. According to their Agricultural Employment Agreement, an Andalusian or Extremaduran farm worker is entitled to claim a minimum unemployment benefit of Pts 49,000 a month ($377), if he can prove that he works at least 35 days per year. It is jocularly said that 'if you are unemployed, better live in sunny Andalusia than some of the darker, harsher climes of northern Europe'. It is these institutional policies, which are discouraging the release of agricultural workers involved in this less profitable, fragmented sector and a transition towards the industrialised sector. Since these regions are dominated by the farm sector, the skill content of the work force is also less impressive to attract investments in those regions. The lack of any new

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[42] *International Business Week,* 17 June 1996.

[43] The increase in foreign investment in some of the less developed member countries, particularly Spain and Ireland, could be related to the operational strategy of companies taking the advantages of their proximity to the main markets of the EU. Companies' response strategy to the demand changes could be considered as one of the reasons for the investment in these regions. According to a report published in *The Financial Times* of 21 October 1996, Korean electronic company Samsung is moving its production base to the EU as it takes 45 to 50 days to move products from Korea. The response of supply chain is critical to its success. Though the labour costs in its Korean plants ($10 an hour) and in Barcelona (between $13 and $14 an hour) are not much different, the plants in Barcelona enjoy proximity to the main EU markets. However it argues that the quality still lags behind in the EU with the yield rates of only 90 percent of Korean levels. Hence labour costs alone may not be a factor deciding the companies' investment decisions. The labour cost and the skill levels of the domestic labour market do not seem to be playing an important role in deciding the investment pattern of the non-member countries. Their investment (mainly Japanese and the US) into these countries are mainly concentrated in technology-intensive industries, such as car and consumer electronics industries. Since most of their production line is automated, they do not require skilled labour throughout their production and assembly line.

[44] *EuroBusiness*, March 1995.

investments in these regions and the less employable nature of the work force make it harder to further their skill levels. As a result the investment decisions of industries continue to concentrate in the developed member countries.

Failing in their efforts to reduce the regional imbalance between the developed and less developed regions, two possible scenarios were proposed to alter the structural pattern of the less developed member countries: (I) a scenario of inter-industry specialisation with growth in those sectors, where the less developed member countries currently enjoy comparative advantage; and (II) a scenario of intra-industry specialisation with the industrial structure of the less developed member countries becoming similar to that of the developed member countries.

2.5.1. SCENARIO OF INTER-INDUSTRY SPECIALISATION:

The first option of the less developed member countries specialising in those sectors in which they have comparative advantage is not viable for two reasons: (a) the industries operating in the less developed member countries are national actors and the continual specialisation and concentration on those industries would require market expansion and access for their finished products. This would be facilitated by the developed member countries giving up the activities in which the less developed member countries have a comparative advantage (labour-intensive sectors such as textile, clothing, leather, and footwear). Though the developed member countries have comparative disadvantage in labour-intensive industries, they would not give up the production of these activities as they are sensitive in terms of employment in these countries. Giving up these sectors would increase the level of unemployment in these countries, which would obviously increase the social costs of unemployment. At this juncture, the developed member countries would think that the economic costs of preserving this employment by continuously concentrating on the sector in which they are disadvantageous, would be cheaper than the social costs of unemployment resulting from the closing down of these industries.[45] This could be explained as one of the reasons for the developed member countries' continual concentration on industries in which they have comparative disadvantage. Moreover the inter-industry trading pattern of the less developed member countries would not influence the investment pattern of the developed member countries towards the low-wage less developed member countries. Though the developed member countries' outward investments are growing, it

[45] *The Financial Times* of 30/31 March 1996 stated that Frankfurt city with the population of 600,000 spends over DM 1 billion (£400 million) on unemployment benefits alone. This is definitely a huge amount for the Germany government. This might force them to think that the costs of preserving the inefficient industries would be cheaper than the social costs of unemployment. However, a IFO report on subsidies (cited in *German Business Update*, vol.8, no.11, 13 March 1996) mentions that the cost of protecting one job is DM11,800 in aerospace industry. Hence the amount of DM 1 billion could be used to create 8474 jobs in aerospace industry in Frankfurt alone. The cost benefit analysis reveals that the cost of protecting inefficient industries would be a better option than the social costs of unemployment.

is not directed towards the low-wage, less developed member countries. The reduction in the EU's tariff rates also plays an important role in diverting the investment of the developed member countries to the neighbouring non-member countries.[46] This has made the relocation across the borders an interesting strategy over the relocation within the regions of the Single European Market. As a result the high cost member countries are investing in the low cost regions of Mediterranean and Central and Eastern Europe; (b) this option could be plausible in the more open Single European Market, only if the less developed member countries have a comparative advantage in labour-intensive sectors over their long-term rivals, the low-cost developing countries. Failing to penetrate into the markets of the developed member countries, they would need to penetrate into the global markets to maintain their persistent specialisation pattern of labour-intensive sectors. However this strategy got the set back by the rise in growth of these sectors in many developing countries. Many fast growing developing economies, like China, India and Indonesia have started specialising in labour-intensive sectors in which they already have a comparative advantage. The diffusion of technology is also playing an important role in continuous product concentration and upgrading of the low-cost, labour-intensive products produced in those countries. The emergence of labour-intensive sectors in other parts of the world is challenging the competitive position of less developed member countries of the EU. As a result imports would seem to be more attractive and profitable than the domestic products. The result would be consumer preferences for imported products over domestic products. The source of these imports may be either the developed countries or the developing countries. Any effort to protect the domestic industry at this juncture, would increase the costs on consumers, as they are forced to go for domestic products in the presence of cheap supply from the member and non-member countries. Hence the option of concentrating on the traditional industries in which they have the competitive advantage does not seem to be viable, as their competitive position is not enough to outpace the competition from both the developed member and non-member countries.

2.5.2 SCENARIO OF INTRA-INDUSTRY SPECIALISATION:

The second option of moving towards intra-industry trade, where the technology composition is higher is the only alternative for the less developed member countries in the face of growing competition in labour-intensive sectors. However it should be mentioned that the nature of international specialisation is to some extent determined by historical accident.[47] Because the

[46] the present international tariff rates and the Community's associated agreements with the countries in the Mediterranean and Central and East European region make Outward Processing Trade (OPT) an interesting corporate strategy for European companies facing higher wages, higher corporate taxes in the domestic market.

[47] see P.J.Verdoorn, *Two Notes on Tariff Reductions*, Appendix III, in *Social Aspects of European Economic Co-operation: Report by a Group of Experts*, (International Labour Office: Geneva, 1956), pp.160-69.

internal and external economies of specialisation take time to reach full development, those firms and countries which first started the production of particular items tend to become more and more efficient and it becomes increasingly difficult for other firms or other countries to get a footing in the same field.[48] The take off of this scenario would take considerable time given the amount of technological backwardness of the less developed member countries. Hence the less developed member countries of the EU with comparative advantage in labour-intensive industries would not be expected to compete with the developed member countries that specialise in capital-intensive industries. Moreover, some of the capital-intensive industries (for e.g. automobile and electronics industry) in the EU are already saturated with increasing competition from both developed member countries and developed non-member countries. For example, the US and Japanese companies are dominating the EU market for advanced technology and high-value added products, such as computers and telecommunication equipments. To counter the competition from developed non-member countries, the member countries are resorting to various industrial strategies of downsizing and pruning the existing operations, plant relocation and assembling in low-cost, high skilled countries. At this juncture, the disadvantageous skill composition of the work force in the less developed member countries makes it less attractive and less profitable to move into those saturated sectors, which require skilled work force and high-technology composition. It is less likely that the second scenario of moving towards the capital-intensive sectors to avoid competition from the developing countries, would succeed as the market for capital-intensive goods is already facing intense competition from all the sides.

The abovementioned arguments confirm that the structural imbalances among the member countries cannot be removed easily in the presence of different productive levels of productive factors. It is mainly the structural imbalances, which distorts and prevents the intensified competition in the Single European Market. As a result, market segmentation still persists in the Single European Market. This affects the efficient allocation of resources and economies of scale in the Single European Market. However a research reveals that 47 out of 53 major industrial sectors in Europe still show unexploited scale economies.[49] The dominance of small and medium sized enterprises (SME's) is cited as another reason for the non-realisation of economies of scale in the Single European Market. Though its presence is witnessed invariably in all the EU countries, they are predominant in the less developed EU countries. The main handicap for the less developed countries of the EU is the failure to exploit the economies of scale, which is possible in countries with large firms. Though the SME's flexible supply structure is best suited to the

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[48] P.J.Verdoorn, *Social Aspects of European Economic Co-operation: Report by a Group of Experts*, (International Labour Office: Geneva, 1956), pp.13-14.

[49] *Frontier-free Europe*, Making the Single European Market Effective, (Commission of the European Communities: Luxembourg), January 1997.

heterogeneous demand nature in the Single European Market, they have not resulted in economies of scale. This also limits the benefits of the Single European Market.

The above analysis clearly shows that the benefits of the Single European Market are limited due to the non-realisation of the dynamic effects. The dynamic effects of the Single European Market are deterred by the structural imbalances among the member countries. The presence of a large bloc of less developed regions in the less developed member countries is complicating the process of resource reallocation in the Single European Market. The efforts of the Commission to redress these problems have not succeeded as the less developed member countries are unable to converge towards the developed member countries. Though the integration process has succeeded in intensifying the level of competition to the certain extent, it has not been uniform across the member countries. The competition has mostly been witnessed among the developed member countries, due to their structural similarity. It is witnessed mostly in capital-intensive sectors. The specialisation of labour-intensive sectors in the less developed member countries has been complicated by the attitude of the developed member countries to protect their less efficient labour-intensive industries for employment reasons. The transition towards capital-intensive sectors, for the less developed member countries, has been discouraged by the market saturation and intensive competition witnessed in those sectors among the developed countries. As a result the structural funds have resulted only in sub-optimal results. The EU's experience reveals that it is not an easy task to reduce the regional imbalances in the presence of various productive levels of productive factors. Though the efforts of the Commission and the member countries to provide incentives to attract investment into the depressed regions have yielded some positive effects, they have not resulted in improving the efficiency of productive factors. Although the structural funds have succeeded in sustaining the economic activity in the less developed member countries, it increases the dependency culture of these countries. The removal of these funds would mean that these regions would witness even greater unemployment as a result of the slow down in economic activity. As a result, we may assume that the incentive would have to be offered permanently to keep the investments in these regions, failing which they would move out of these regions. A steep increase in the regional funds offered by the Commission confirms this argument. This could be avoided by improving the productive capacity of productive factors. The physical and human capital needs to be improved in these regions. The EU's subsidy regimes aimed at reducing the regional imbalances rather discourage the transition towards sectors requiring skilled labour. If the less developed member countries continue to rely on the regional funds to reduce the disparity levels, it would take a long-time, as the past experience shows that regional funds alone are not able to reduce the regional differences in the Single European

Market. As a result the regional differences between the member countries are likely to persist for some time. This would continue to affect the competitive effects of the Single European Market.

The changing dimensions of the Single European market have been analysed in this chapter in detail. Though the arguments of the Customs Union theory expected large-scale welfare gains in the formation of the Single European market, it is confined mainly to the developed member countries. An attempt has been made to find out why the industrial efficiency, competitive effects and other large-scale benefits have been limited to the developed member countries. The member countries' intra-regional trade pattern, regional disparity and their ability to convergence towards more similar structure have been analysed in detail. It also analyses in detail the member countries' efforts to reduce the regional disparity and various factors that hinder that effort have been studied. The arguments of this chapter goes on to prove that the expectations of the Customs Union theory may not be realised until the member countries' markets function efficiently. Having studied the importance of effective market mechanism in the Single European market to realise optimal welfare gains, we proceed to study the importance of the economic policies in realising the welfare effects in the member countries. It is not only the market mechanism but also the economic policies that decide the impact of the Single European market on the member and non-member countries.

CHAPTER - III

Changing Economic Policies in the EU: Implications for the Member and Non-member Countries

Changing Economic Policies in the EU: Implications for the Member and Non-member Countries

The Customs Union theory argues that realisation of competition is the main force behind any beneficial effect in the Single European Market. In the absence of intensified competition, the amount of welfare effects realised would also be limited. However the analysis on the market mechanism of the Single European Market (Chapter II) suggests that the degree of competition is limited due to various reasons, the main reason being the structural incompatibility of the member countries. The high degree of structural mismatch between the developed and less developed member countries continues to stifle the free flow of productive factors, which are considered essential for enhancing the competitive atmosphere in the Single European Market. However it is important to mention that it is not only the market mechanism but also the market policies of the member countries, which are responsible for the non-realisation of the fuller potential of the Single European Market. The market policies play an equally important role in distorting the competitive effects of the integrated Single European Market by making the institutions of the Single European Market inferior to what they would have been without the imposition of these policies. It is these policies, which affect the flexibility of the institutions of the Single European Market. The trade policies implemented in the member countries result in welfare-distorting trade-diversion as they affect the industrial efficiency and international competitiveness of the European industries. These policies, which are often highly regulated, affect the productivity, employment and output of European economies.[1] The consequences of these policies on the member countries are slow growth rate, long-term unemployment, increasing income disparity between various strata of society and other side effects. As a result the European economies tend to become highly vulnerable to external competition, which induce them to impose protective trade policies thereby exaggerating the trade diverting effects. Since the developed member countries, given their high labour costs and increased external competition, find the concentration on the production and export of high-labour content products unprofitable, they switch over to high value-added and up-market products which cannot be imitated or rivalled by countries with low production costs

[1] for example labour productivity, output and employment in the European economies are less than that of the benchmark economy, Japan in automobile and the US in other manufacturing industries. An indicator of purchasing power parity reveals that Germany (West) produces 30 per cent fewer goods and services per capita than the benchmark economy. Their labour productivity is less than 20 per cent, whereas the employment utilisation is 15 per cent less than that in the benchmark economy. France is lagging behind these measures by 40 per cent, 20 per cent and 25 per cent respectively. For more details in this regard see Bernhard Brinker, et al., Germany and France: Confronting the Costs of Social Policies, *McKinsey Quarterly*, no.2, 1997.

and a low-technology base.[2] However the social costs of transition towards high-technology sectors (the social costs of unemployment created in the process of transition, either by excluding or downsizing the labour engaged in labour-intensive sectors) would make it important to have these sectors present in some form or with some alternatives. As a result the labour-intensive industries of the developed member countries resort to various industrial strategies such as relocating their production at low-cost neighbouring locations and screwdriver assembly. The consequences of this strategy are many folds. It would alter the internal trade equations by furthering the structural mismatch between the developed and less developed member countries. The less developed member countries which specialise in traditional labour-intensive industries, in which they have a comparative advantage, tend to suffer as the high-cost developed member countries instead of investing in the low-cost less developed member countries would shift their investments abroad - especially to the low-cost neighbouring locations - and deprive the less developed member countries of the opportunity to specialise in the industries in which they have comparative advantage over the developed member countries. As a result the less developed member countries face competition not only from the non-member countries but also from the developed member countries, which produce the labour-intensive products in the low-cost non-member countries. This would have serious impact on the performance of these economies, as their transition towards service sectors is rather slow due to intense competition prevailing in these sectors.[3] The trade diverting effects would have undesirable economic consequences on unequal trading partners, as they are not in a position to counter or retaliate against the measures imposed to protect their domestic industries against external competitors.

The institutions of the Single Market are less flexible due to less-market friendly and anti-competitive policies, which impose constraints on the European industries from preparing to face an increased external competition in the Single Market. Though the restrictions have been removed for intra-regional trade, competition is still limited, as the factor movements across the member countries have been stifled. The labour market arrangements and the policies implemented in the Single Market tend to limit factor movements across the member countries thereby narrowing down the possibilities of converging the economies of the member countries. As a consequence the resources are not reallocated efficiently. This results in an under-

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[2] This is similar to the Japanese experience, where rising labour costs, associated with labour shortages and rising yen, has encouraged the Japanese companies to relocate their industries producing high-labour content products at low-cost locations, while preserving high-technology sectors at home to maintain existing employment. However in the case of the EU's member countries this strategy might not be possible as their high-technology sectors did not account for considerable proportion in total manufacturing trade.

[3] In Germany manufacturing still accounts for 30 per cent of all jobs compared to 16 per cent in the U.S. Cited in Fortune, 9 June 1997).

performance of the Single Market with the loss of efficiency and competitiveness whose social effects further compel the governments to initiate political measures. The under-performance of the Single Market results in a slow growth with high and long-term unemployment that makes the domestic market highly vulnerable to external competition. This forces the member countries to act against external competition in the interest of the member countries.[4] This chapter would mainly focus on the factors causing trade diversion in the Single Market. This would also analyse various market policies and the industrial strategies adopted by the member countries and their impact on the member countries. By studying the impact of the market policies on the member countries, its impact on the non-member countries would also be studied.

Various factors are attributed to the under-performance of the Single Market. The nature of the European industries plays an important role in not realising the benefits of the Single Market offered through economies of scale. The structural analysis of the European economies reveals the predominance of the Small and Medium sized industries (SME's) in the member countries. Though the existence of a large number of the SME's could help the European industries in responding to an increase in the influx of imports by altering their production and marketing strategies in a short time, it prevents them from enjoying the benefits of economies of scale, which could be achieved by large production plants. As a result the amalgamation of national markets has not offered the national industries to exploit the potential economies of scale. Though its presence is witnessed in almost all the EU countries, the SME's are predominant in the less developed EU countries. Italy, Greece, Spain and Portugal have the highest density of SME's and contain 65 enterprises per 1000 people, compared with fewer than 40 in the rest of the EU.[5] In Italy firms employing less than 10 people account for over 20 per cent of the GDP.[6] Whereas large firms are predominant in Germany, the Netherlands and Denmark.[7] The main handicap for the less developed countries of the EU is the failure to exploit the economies of scale, which is possible in countries with large firms. However it has to be highlighted that the institutional policies affect the developed member countries from exploiting the benefits of the economies of scale. There are estimated to be about 15 million SME's in the Europe. They are considered as the backbone of the European economy and can contribute decisively to its growth.[8] Roughly 68 per cent of the 100 million people employed in the EU

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[4] This is based on the popular argument that the trade with the developing countries is responsible for the labour market woes of the developed countries. It is also argued that the fall in demand for the less skilled in the developed countries is mainly due to increased manufacturing imports from the developing countries. For more details regarding this argument see, Adrian Wood, How Trade Hurt Unskilled Workers, *Journal of Economic Perspectives*, vol.9, no.3, summer 1995, pp.57-80.

[5] *Eurobusiness*, June, 1994.

[6] ibid.

[7] ibid.

[8] *Eurobusiness*, November/December, 1995.

work for companies with less than 250 employees. According to Commission's European Observatory for SME's, small firms (employing up to 100 employees) provided all the new jobs in the EU from 1988 to 1993 by adding some 2.6 million net employment.[9] Any effort to restructure their industries would increase the level of unemployment and subsequent social costs in the member countries. The Commission has a programme of aid to SME's on which it spent ECU 25 million in 1993. The European Investment Bank's (EIB) job creation scheme awards SME's ECU 3000 for each new jobs they provide.[10] The SME's provide about 69 per cent of the EU's jobs, but a disproportionate number (about 60 per cent) fails in their first ten years.[11] It is the SME's in the EU, which are more likely to be affected by the inflow of goods from third-world countries.[12] The SME's are the first to be affected by growing external competition in the Single Market. Though they are capable of competing with external competitors with their inherent strengths, they do not have the financial strength to sustain their strength in the long run. The SME's are operating with limited budget, which imposes constraints in the form of not being able to prepare the employees to further their skills in the face of increasing competition from the low-cost countries.

The market policies and public finance management in the member countries result in a decline in industrial competitiveness of European industries as they affect the labour productivity and cost competitiveness of their European operations directly and indirectly.[13] The consequence is high and long-term unemployment in addition to other factors such as slow growth, inadequate aggregate demand, technological change, skill mismatches and growing international competition. An inflexible labour market is considered to be the primary cause of under-performance of the European industries. Other factors are also responsible for labour market rigidity in the member countries such as (i) high wage labour costs; (ii) minimum wage regulations; (iii) strict employment security legislation; (iv) high non-wage labour costs; (v) generous unemployment benefits and (vi) organised trade unionism.

It is necessary to study the policies responsible for the under-performance of the Single European Market. It has always been argued that when economic integration occurs the countries, which come together, will tend to acquire the characteristics of large country as the factor prices would be expected to contribute increasingly to adjustment.[14] This argument has been based on the principle of factor mobility across the member countries. However in the case

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[9] *Eurobusiness*, June, 1994.
[10] *Eurobusiness*, November/December, 1995.
[11] ibid.
[12] *Eurobusiness*, June, 1994.
[13] For example public spending in the EU is 50 per cent of GDP whereas it is 30 per cent in U.S. and 20 per cent in tigers economies.

of the EU, the integration among the contiguous national economies has not resulted in sufficient structural transformation of the member countries. This is mainly due to limited factor movements across the member countries. The Commission also confirms the limited factor mobility across the member countries. With limited factor mobility the member countries continue to struggle to restructure their economies. As a result the productive factors seem to be under-utilised in most of the member countries. This has also been reflected in the overall performance of the Single European Market. The analysis of the dynamics of the EU's market mechanism (Chapter II) suggests that the persisting differences in factor prices across the member countries are mainly responsible for inefficient performance of the Single European Market. The impending factor flows across the borders have not satisfied the popular perception that the factor flows across the countries would result in improved economic performance. However in the case of the EU this has been limited due to various socio-economic and political reasons. Though there have been factor movements across the member countries they do not always have backward linkages. In other words it could be argued that the factors continue to move in only one direction causing further mismatches among the member countries. In the case of labour the mobility is limited to skilled labour alone as the demand for semi-skilled and unskilled labour is dismal in most of the member countries. Even this mobility is from push regions towards the pull regions.[15] This is a cause of great concern among the less developed member countries as they might lose out permanently in competition with the core developed member countries. This is also true with capital as it is not attracted towards the regions where the return would be higher. Though interest rates are higher in the less developed member countries capital is not directed towards these regions. Apart from this the persisting economic conditions in the member countries also discourage the mobility of factors, especially the labour. As a result the productive factors continue to be under-utilised in most of the member countries. There are various reasons for this slow movement of factors across the member countries. The main reasons are the inflexible labour market and associated market policies. The labour market arrangements and the market policies implemented in the Single European Market tend to discourage any possible movements of productive factors thereby narrowing down the possibilities to converge the economies of the member countries. This tends to offset the positive outcome of the Single European Market as it restricts the level of competition between the member countries. It is also interesting to note that these factors display no trend to reduce the existing gap even in a competitive atmosphere in the Single European Market.

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[14] Iain Begg, op. cit., p.96.

[15] The developed member countries tend to attract more skilled workers than the less developed countries as the demand for them is higher in the latter. For example up to 30 per cent of newly qualified graduates from tertiary education in Ireland are obtaining employment outside Ireland.

3.1. LABOUR MARKET RIGIDITY:

One of the main factors responsible for increasing the competitiveness of any economy is its flexibility in labour markets, which has not been witnessed in the EU's labour market. A study of European business conducted by Oslo-based *Performance Group* traced the sluggish growth in European economies to persistent employment problems, high taxes, rigid labour forces and insupportable generous welfare schemes apart from other factors.[16]

According to conventional economic theories, wage levels are to be determined by the skill and productive levels of labour. As a result the wage levels of the skilled labour would always be higher than those of low-skilled labour. However in the case of the EU, the wage levels are determined not only by direct labour costs (determined according to skill content and productivity level of a labour) but also by other indirect non-labour costs such as welfare and social costs. In other words, the wage levels in the EU are determined by both the direct and indirect costs of labour.[17] These indirect labour costs are an important agent of market rigidity as they account for a considerable proportion of total labour costs. The employer funded non-wage labour costs such as holiday, pension, maternity and sickness benefits account for up to 30 per cent of pay roll costs.[18] In France, non-labour costs account for 65 per cent of a person's salary[19], whereas in Germany it accounts for 41 per cent.

The problem with the non-wage labour cost is that it is charged uniformly over all types of jobs, irrespective of regional productivity differences. As a result the productive capacity of productive factors does not seem to play an important role in deciding the labour costs in the EU. This results in a situation whereby the difference between the semi-skilled and the unskilled is hardly noted.[20] As a result companies are forced to adopt cost-cutting measures such as globalising the production by reducing the domestic production as a way of increasing their price competitiveness, which ultimately results in the loss of domestic employment. In the EU, unemployment is seen as a loss factor as it could be related to a loss in GDP. Higher labour costs in the EU affect the cost competitiveness of European industries. The rising labour costs of

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[16] Cited in Richard Evans, Why Cannot Europe Go for Growth?, *Fortune*, 14 April 1997.
[17] Direct costs include all payments made to employee whether in the form of direct wages or salaries, bonuses, payment for days not worked or benefits in kind. The indirect costs consist of social security contributions, but also include other expenses such as costs for vocational training.
[18] William K. Roche, Brian Fynes and Terri Morrissey, Working Time and Employment: A Review of International Evidence, *International Labour Review*, vol.135, no.2, 1996, pp.129-57.
[19] What's Behind France's Funk? *Fortune*, 31 March 1997, pp.24-24.
[20] According to World Development Report on the comparison of international wages for various strata of workers, the wages of the unskilled workers of the OECD countries are far more higher than even those of the skilled from other parts of the world. For more details see *World Development Report 1995* on Workers in an Integrating World.

European labour coupled with the industrialisation of the Third World countries also affect the demand for European produce. The European Commission's white paper on Growth, Competitiveness and Employment attributed the major share of the rise in unemployment rates to the fact that other countries are becoming industrialised and competing with them. Even in their own markets - at cost levels - they are losing their competitiveness. There are a number of studies that correlate the effect of trade with low-wage countries on the demand for un-skilled labour in the developed countries. Though there are different views about the impact of trade with Third World countries, most economists agree that the imports from the low-wage countries reduces the demand for the un-skilled labour in the developed countries, though they differ on the degree of impact on the labour markets of the developed countries. It is argued that the growth in the Third World increases the worldwide supply of goods, improves the terms of trade of advanced countries and lowers the prices of similar goods there.[21] This is expected to weaken the demand for un-skilled labour in developed economies. When this is aggravated by stringent labour-market regulations in the domestic market, which prevent wages from falling, the un-skilled becomes unemployed. The growth of low wage manufactured imports from the Third World has certainly some effects on unemployment in Europe.[22] The opponents of this view argue that there is no correlation between these two variables, as the imports from the third sources account for less than 2 per cent of the EU's GDP.[23] If there is a real problem with low cost imports it is that the exports require higher skills than the imports and this imbalance of required skills could aggravate a surplus of unskilled labour.[24] With highly rigid relative wages in the domestic labour market and growing skill imbalances between the domestically produced and imported goods, the unskilled labour faces an exit from the labour market. The analysis of the labour market arrangements and wage levels in the EU reveals a far more interesting picture. The over-regulated labour market of the EU is seen as less flexible with higher wages. Wages are also highly rigid and not seem to respond to high levels of unemployment. The reservation wages[25] are also high. Few Europeans believe in the notion of upward mobility, so they are reluctant to take-up entry-level jobs or temporary work, fearing they will never rise.[26]

Most of the member countries of the EU have minimum wage regulations, which prevent wages responding to the labour market situation. Apart from this, international trade has weakened the bargaining power of workforce on wages[27], as the capital becomes highly mobile

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[21] *Eurobusiness*, June 1995.
[22] See Paul Krugman, Growing World Trade: Causes and Consequences, *Brookings Papers on Economic Activity*, 1:1995, pp.327-62.
[23] *Eurobusiness*, June 1995.
[24] ibid.
[25] The reservation wages are defined as the wages below which a worker will refuse to take up a job.
[26] A Continent at the Breaking Point, *Business Week*, 27 February 1997.
[27] Paul Krugman, Growing World Trade, p.354.

across the countries. In this scenario, an unemployed person remains out of employment for a long time because the rigid labour market regulations force the companies to operate from outside the EU. Long-term unemployment is more likely to affect the skill levels of the unemployed. If unemployment has risen several times in the lifetime of a generation of workers and they become unemployed for a long time or frequently, they become hard to employ again.[28]

It is possible that disadvantages in direct labour costs could be off set by increasing the productivity of labour.[29] However this strategy does not seem to be working well as the member countries have imposed stringent regulations, which affect the flexibility and efficiency of the labour market. These regulations affect not only the productivity of their industries but also the employment prospects of European labour. In most European Union countries more than a third of all unemployed workers have been unemployed for at least a year (which was 46 per cent in 1993).[30] The spill over effects of long-term unemployment result in undesirable consequences like social unrest and high crime rates.[31] One report suggested that growing social unrest and rising crime rates in some of the European cities could be attributed to rising youth unemployment. It is natural to expect economies participating in a regional bloc to exhibit higher levels of unemployment in the process of structural adjustment as the economies take some time to adjust themselves to the changing environment. This would again be expected to come down in the adjusted markets. However what has been surprising in the EU is that the rise in unemployment continues to increase without any trend to show a downward movement. This suggests that the mechanisms through which the economy absorbs and adjusts to major shocks are much less effective in Europe (than the USA).[32] Various factors are attributed to the slow adjustment of unemployment in the EU.[33] They are: (i) slow adjustment of real wages to rising unemployment or real wage rigidity; (ii) weakness of employment response to changing wages; (iii) deterioration of human capital as unemployment gradually erodes the skills and motivation of the unemployed; (iv) membership effects and insider wage setting.

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[28] Eurobusiness, June 1995.

[29] Nevertheless the indirect labour costs cannot be addressed as most of the non-western countries do not have the generous welfare programmes. Faced with these challenges many European leaders argue that the rest of the world should change, not Europe. The US and France renewed calls for the WTO to study the link between labour standards and trade, despite strong opposition from developing countries. See *The Financial Times*, 12 June 1996.

[30] Freddy Heylen, Lucia Goubert and Eddy Omey, Unemployment in Europe: A Problem of Relative or Aggregate Demand for Labour?, *International Labour Review*, vol.135, no.1, 1996, p.32.

[31] An Economy Torn into Two, *International Business Week*, 26 January1998.

[32] Andrew Sentance, Europe's Economic Malaise: A Problem for Competitiveness?, *Business Strategy Review*, vol.7, no.2, 1996, p.40.

[33] Freddy Heylen, Unemployment in Europe, p.32.

Another factor responsible for high and long-term unemployment is minimum wage regulations, which exist in most of the member countries. The proponents of welfare democracy argue that the objective of the minimum wage in the EU was not only to reduce unemployment, but also to redistribute the earnings to low-paid workers.[34] Most of the workers in Western Europe are covered by either a statutory minimum wage or legally binding industry or sectoral agreements with a range of £1.50 per hour in Portugal to over £4 per hour in several northern European countries.[35] Minimum wages are considered as a barrier to job creation.[36] There was no minimum wage in the UK, where the unemployment rate was around 8 per cent, which was one of the Europe's lowest.[37] Successive British Conservative governments argued that signing the social chapter of Maastricht Treaty would cost them more than 500,000 jobs. Two options of the policy of minimum wage are viewed in the EU. At best, it will shift the earnings distribution in favour of the low-paid and buttress the bottom tier of the distribution from erosion.[38] At worst, it will reduce the share of earnings going to the low-paid by displacing many from employment.[39] The conventional view about the minimum wages is that it reduces the level of employment. Though it results in redistribution effects, it reduces the employment, as it does not increase the demand for labour. However in the EU the minimum wages result in high unemployment. This is particularly true for the labour-intensive economies of less developed member countries as they cannot compensate the rise in wages by increasing their productivity.

3.2. WELFARE BENEFITS:

Apart from rigid wage structures, the social security benefits are also high in the EU, which is another important factor responsible for high and persistent unemployment in the EU. Since the EU is dominated by countries, which followed the welfare tradition, it was forced

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[34] This argument seems to be reliable with the given statistics display a wider gap between the top and bottom docile of the society in both the Anglo-Saxon and other West European economies. While the gap is narrower with 2:1 in Germany it is wider in the Anglo-Saxon economies with 6:1. For more details see Jean Boissonnat, Combating Unemployment, Restructuring Work: Reflections on a French Study, *International Labour Review*, vol.135, no.1, 1996, pp.5-15. In the case of Britain, one in five people live on less than half the average income today compared with one in ten in 1979. For related arguments see Welfare Fails to Feel Benefit, *The European*, 30 March-5April, 1998, p.7.

[35] Mary Campell, What is Minimum Wage?, *Business Strategy Review*, vol.6, no.2, summer 1995, p.75.

[36] There had been no minimum wage in United Kingdom, until the middle of 1999, where the unemployment rate was around 8 per cent, which was one of Europe's lowest. The Conservative government argued that signing the social chapter of Maastricht Treaty would cost its economy more than 500,000 jobs. However the Labour Party, which assumed power in the last election, announced minimum wage regulations though it was only modest.

[37] *Business Week*, 14 August, 1995.

[38] See Richard Freeman, Minimum Wage as a Redistributive Tool, *The Economic Journal*, vol.106, no.436, may 1996, p.639-49.

[39] ibid.

to fulfil its socio-political obligations in the process of the completion of the Single European Market. European welfare expenditure seems to have grown enormously over the past two decades. In Belgium, Portugal and Sweden, it represents about 0.5 per cent of total GDP.[40] However in Germany and the Netherlands, it is 2 per cent whereas in Ireland and the UK, it is about 2.5 per cent.[41] The people are also used to increased social benefits, whereby they think that Europe's notion of a fair and prosperous society is far more important than its industrial performance. One French poll showed that 66 per cent of respondents prefer France's rich social benefits and high unemployment to America's low jobless rate and tattered safety net.[42] This attitude of the people forces the politicians to take a negative view on any pro-reform proposals to preserve welfare state intact. The overgenerous social security benefits of the EU is made possible either by introducing new taxes or by increasing the existing taxes on both the employers and employees. Lower profits and falling employment are producing yawning gaps between the taxes the governments are taking in and heavy state spending.[43] This, in turn, will have its impact on the consumers in the form of new tax burdens. The higher tax proposal would reduce the growth of the economy with less consumer spending. The tax increase many member countries prefer to choose in place of spending cuts have kept Europeans out of shops and showrooms.[44] Faced with these challenges many European leaders argue that the rest of the world should change, not Europe. The US and France renewed calls for the World Trade Organisation (WTO) to study the link between labour standards and trade, despite strong opposition from developing countries.[45]

Though the objectives of the EU's welfare programmes are necessary in the light of equitable distribution of the resources, it should also be highlighted that they are overgenerous in nature, which retards welfare by preventing the creation of new employment as it is the employer who contributes increasingly to the funding of the welfare programme. Employer funded non-labour wage costs such as holiday, pension, maternity and sickness benefits account for up to 30 per cent of payroll costs.[46] In West European economies, the social costs represent between 25 to 30 per cent of the total labour cost of employing labour.[47] For example, contribution rates for pensions alone make up roughly 20 per cent of total labour costs.[48] Apart

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[40] ILO, *Europe's Social Protection System Under Increasing Strain: Problems are Most Acute in the East*, ILO Press Release, ILO/95/23, 19 September 1995.
[41] ibid.
[42] A Continent at the Breaking Point, *Business Week*, 27 February 1997.
[43] *Business Week*, 6 November 1996.
[44] ibid.
[45] *The Financial Times*, 12 June 1996.
[46] William K.Roche, Working Time and Employment, pp.129-57.
[47] *World of Work*, no.14, December 1995.
[48] ibid.

from this, they also enjoy the non-wage benefits, such as holiday pay, employers pension contributions, profit sharing and profit related pay. For example, in France, over a third of household income does not derive directly from work.[49] The higher social costs in the EU makes its labour expensive compared to other countries. This is seen as affecting the cost competitiveness of the EU's industries. The high social costs affect the employment creation in the EU as the industries are going offshore to avoid higher labour costs, sales tax and corporate tax as in the case of textile and clothing and chemical industries.

3.3. EMPLOYMENT PROTECTION:

The inflexibility in the EU's labour market is caused by other factors as well such as higher levels of employment protection. It is argued that the long-term unemployment and the weak responsiveness of employment to changing real wages have been ascribed mainly to extensive employment protection legislation.[50] The EU's employment regulations are seen as a hurdle for job creation in the Single European Market. A survey by Unice, the Union of Industrial and Employer's Confederation, discovered that the widespread belief of the job creation in the Single European Market is stifled by an excessive number of complicated EU regulations.[51] The excessive employment protection is seen as increasing the direct and indirect labour costs in the EU. These provisions impose direct costs of dismissal through compensation payments as a function of length of service or further indirect costs through delaying or even excluding the possibility of dismissing excess personnel.[52] The unemployment compensation seems to be affecting the wage flexibility. The unemployment compensation persuades more people to be choosier over whether to work or what job to accept.[53] It is also due to over regulatory rigidities impeding job creation and to diminished economic incentives resulting from generous social welfare programs. An important factor responsible for long-term unemployment in most of the member countries is over-generous unemployment benefits provided by the state. Before reforms were introduced in Spain in 1992-94, unemployment benefits were non-taxable and were paid on a declining scale as a proportion of previous income; 80 per cent for the first six months; 70 per cent for the next six months; and 60 per cent for the second year of unemployment. It was argued that the workers receiving non-taxable unemployment benefits equivalent to 80 per cent of their former salaries could theoretically get a higher net income

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[49] Jean Boissonnat, Combating Unemployment, Restructuring Work: Reflections on a French Study, *International Labour Review*, vol.135, no.1, 1996, p.6.
[50] Freddy Heylen, *Unemployment in Europe*, p.33.
[51] *Eurobusiness*, September 1995.
[52] Michael Emerson and Andre Dramais, *What Model for Europe*, (The MIT Press, Cambridge: England), 1988, p.7.
[53] ibid.

(unemployment compensation) than working. What was even more surprising, according to OECD calculations, was that the unemployment benefits provided by the Spanish government were second only to Sweden's. In the case of Spain, over-generous welfare benefits had increased the number of unemployed workers receiving the benefits from 25 per cent in 1983 to nearly 70 per cent in 1993. Though the level of unemployment is less, the level of long-term unemployment witnessed is relatively higher in the United Kingdom (Table 3.1) as the gap between the working wage in the active labour market and the welfare income derived from various programmes was becoming narrower. This is confirmed by the statistics where the proportion of households with no one working has doubled to one in five in 1998 from one in ten in 1979.[54] This confirms the trend that higher unemployment benefits encourage the workers to stay out of the active labour market for longer periods.

Table 3.1

Unemployment and Long-term Unemployment in the EU

Countries	Total unemployment	Unemployed under one year	Unemployed Over one year	Long-term unemployed
Belgium	10.1	2.8	7.3	61.6
Denmark	8.3	5.8	2.5	31.2
Germany	5.8	3.2	2.6	45.5
Greece	7.9	4.4	3.5	N.A
Spain	19	8	11	51.1
France	9.6	5.4	4.2	37.2
Ireland	16.3	7	9.3	60.3
Italy	10.1	3.6	6.5	67.1
Netherlands	9.6	4.9	4.7	43
Portugal	6.3	4.1	2.2	38.3
UK	9.6	5.4	4.2	28.1
Sweden	3.8	3.5	0.3	20.6
Austria	3.5	3.1	0.4	34.5
United States	6.9	6.3	0.6	11.2
Japan	2.5	2.1	0.4	15.4

Source: Richard Layard, How to Cut Unemployment, *CentrePiece*, Issue 1, February 1996, pp.2-6 and Elaine Buckberg and Allan Thomas, *Wage Dispersion and Job Growth in the United States*, Finance & Development, June 1996, vol.32, no., pp.16-19.

An important reason for inflexibility in the labour market is the wage rigidity of the member countries. An analysis on the relationship between the level of unemployment and the wage response and between the wage and productivity level yields an interesting picture about the structure of the EU's labour market. In the EU, the high level of unemployment is caused by labour market inflexibility. There are two aspects to this inflexibility: employment inflexibility and the wage inflexibility. The former relates to the ability of an economy to generate new jobs to take up slack in the labour market, the latter emphasise the responsiveness of wages to

[54] Welfare Fails to Feel Benefit, *The European*, 30 March-5April, 1998, p.7.

unemployment.[55] A study of the relationship between the wage flexibility and employment level reveals that a one per cent decrease in real wage will lead, after several years of adjustment, to a one per cent higher level of employment.[56] Another study on the relationship between output and employment and the impact of unemployment on wages in the European labour market was conducted by Julian Morgan.[57] He argues that in an inflexible labour market, employment may not move in line with output, whilst wages would be little affected by high unemployment. His study of the Spanish labour market concludes that there is evidence to suggest that a persistently high level of unemployment has a low and diminishing effect on wage bargaining. This view was also reinforced by an OECD study, which found that the wage responsiveness to unemployment in Spain was amongst the lowest in the OECD.[58] The views about Spanish labour are noteworthy to mention here, as unemployment in Spain is the highest in the EU with youth unemployment alone accounting for 30 per cent of it.[59] The Commission also held the view that inflexibility of the labour market is responsible for a large part of Europe's unemployment.[60] A study of the relationship between wage levels and their impact on employment in the European labour market shows that a one per cent decrease in the real wage level will lead, after several years of adjustment process, to about one per cent higher level of employment.[61] Any inflexibility in wage level is likely to distort the levels of employment.

The working hour regulations implemented in the member countries, which are aimed at improving the working condition of the employees is one such statutory restriction that affects the industrial efficiency and international competitiveness of the European industries. Most of the member countries have maximum working hour regulations that limit European industrial productivity. The labour unions want reduced work hours in a week whereas the employers prefer a longer workweek. In France, working hours have been estimated to have been cut by half over the past 100 years.[62] Due to shorter working hours the factories are working well below their capacity with utilisation rates going down. As a consequence the actual outcome is well below the optimal outcome. In the EU the working hours have

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[55] For more details see Andrews Sentance, Europe's Economic Malaise: A Problem for Competitiveness?, *Business Strategy Review*, vol.7, no.2, 1996, pp.37-44.
[56] R. Layard, G.Basevi, O.Blanchard, W.Builter and R.Dornbusch, Europe: The Case for Unsustainable Growth, (*Centre for European Policy Studies*: Brussels), 1984.
[57] Julian Morgan, Structural Change in European Labour Markets, *National Institute Economic Review*, 1/96, no.155, February 1996, p.81-89.
[58] OECD, *Economic Survey: Spain*, OECD, 1994.
[59] *Eurobusiness*, June 1995.
[60] Commission's White Paper on Growth, Competitiveness and Employment, (*Commission of European Communities*, Luxembourg),1994.
[61] Layard, Europe: The Case for Unsustainable Growth.
[62] Jean Boissnnat, Combating Unemployment, Restructuring Work: Reflections on a French Study, *International Labour Review*, vol.135, no.1, 1996, pp.5-15.

diminished over the past decade to around 40 hours a week in 1992.[63] Peugeot's CEO Jacques Calvet opines that under European rules linking working hours, *Peugeot* and *Citroen* have a production capacity of only 1.9 million cars, which could be increased to 3 million cars, if the US rules of three shifts and six days a week were followed.[64] In 1994, Volkswagen reduced hours at its main German assembly from 36 to 28.5 hours. It argued that shorter working hours is the main reason for some of its least productive auto plants.[65] An average Volkswagen (VW) worker works only 33 hours a week, which are less than normal work hours. The Wolfsburg plant of Volkswagen, which used to produce 4400 cars a days in 1991 produced only 2850 cars a day in 1997 due to diminished working hours.[66] This makes the companies urging their employees to finish up the task by working over time. The German carmaker BMW argued that it was forced to look for overseas production sites as their targets were achieved only after doing over time and extra-Saturday shifts as it was stifled by a 35 hour work week.[67] Surprisingly this adds up additional cost on the employer due to the legislation concerning the overtime in the member countries. In Belgium, overtime is limited to only 10 hours per week and 130 hours per annum. A statutory requirement of 50 per cent premium is applied to overtime work.[68] In France, overtime is paid at the rate of 125 per cent for the first eight hours above 39 hours regular working hours.[69] Above this level, rates are 150 per cent up to a maximum of nine hours per week. In Germany, overtime is paid at the rate of 125 per cent. In Spain, overtime payments are 175 per cent of normal pay.[70] In Netherlands, overtime is paid at a premium rate beyond normal working hours. [71]

The profit margins of the European companies are also affected by other statutory payments such as sick pay. Before the cuts in sick pay were introduced, German companies paid 100 per cent of employee's wage towards their sick benefits. Daimler-Benz argued that it paid Dm 600 million ($400 million) on sick benefits a year.[72] General Motors Corp's Adam Opel unit reckoned that it routinely paid about 120 percent of base pay.[73] In addition to these over generous benefits workers were also allowed six weeks off with 100 per cent pay. Since compensation is based on the amount of pay, overtime and bonuses received before the sick leave, sick workers could earn more than they would on the job.

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[63] Eurostat, Europe in Figures, 1998.
[64] *Business Week*, 27 May 1996.
[65] *BusinessWeek*, 20 October 1997.
[66] Bringing Back the Beetle, *Forbes*, 7 April 1997.
[67] German Firms Look Abroad to Escape Cost Base, *Management Today*, June 1992.
[68] William, *Working Time and Employment*, p.141.
[69] ibid.
[70] ibid., p.142.
[71] *The World of Work*, no.19, March 1997, p.26.
[72] *The European*, no.334, 3-9 October 1996.
[73] Business Week, 23 September 1996.

Not only the above mentioned factors increase the concern about public expenditure, which add up to higher corporate taxes, but also other factors such as unfavourable demographic factors such as longer life expectancy, lower retirement ages, decreased fertility rates and ageing population with the fall of active working age population. Total pension outlays now amount to around 10.5 per cent of GDP and 25 per cent of total public spending in Western Europe. According to an OECD study, the problem of an ageing population is expected to increase the tax-to-GDP ratio to five percentage points in most of the countries.[74] It is also argued that such a tax increase would exert unfavourable pressure on the labour markets. Unfavourable demographic trends have increased the pressure on the member countries to increase public spending. While the ageing population in the United Kingdom is expected to increase government spending by 2.1 per cent of GDP on health and pension provisions, the estimates are even higher in countries such as Germany (5.8 per cent), France (5.6), Belgium (6.1 per cent) and the Netherlands (10.2 per cent).

Welfare spending has been increasing in all the member countries irrespective of their public finance management. French welfare spending accounts for one third of the country's GDP as against one fifth in the 1970s.[75] In the United Kingdom the social security budget alone accounts for a third of all government spending.[76] The liberal welfare provisions of the member countries increase the level of public expenditure. Due to increasing welfare costs the corporate tax is rising high in most of the member countries. France increased sales tax and corporate profit tax to fund job programmes. Over regulation, over taxation, excessive labours costs and over generous welfare schemes are the main concerns of European companies operating in the member countries as they affect their profit margin. The consequence is an increase in the outflow of investment from the member countries to the non-member countries. With profit margin already on record low due to under utilisation of capacity and over generous welfare costs, companies are forced to invest abroad to retrench their present costs at home. The German companies made $26 billion in direct investments outside the country in the first nine months of 1995, double the 1994 rate.[77] This investment is destined to East Europe, Asia and even to UK, whose manufacturing costs are 40 per cent lower than Germany's. The hourly wages in Hungary amount to about 20 per cent of German (West) levels.[78] The unit wage costs (which takes into account costs and productivity) are significantly lower in the UK and the US,

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[74] cited in Tax and Spend in the Euro-norm, *Management Today*, February 1997.
[75] All Over Europe Belts are Being Tightened and Benefits Reined, *Management Today*, October 1993, p.17.
[76] Welfare Fails to Feel Benefit, *The European*, 30 March-5April, 1998, p.7.
[77] Business Week, 8 January 96.
[78] *Eurobusiness*, April 1995.

where they are 74.3 per cent and 55.9 per cent respectively of German levels.[79] As a consequence many German companies are transferring jobs to low cost foreign countries. The international comparison of manufacturing costs by Stihl AG, a chain-saw manufacturer, reveals competitive disadvantages of producing in Germany. It compared its five production locations - Germany, Austria, Switzerland, the US and Brazil - and found tremendous differences in production costs across the regions. Out of the total number of 262 working days, Germany and the US have 11 national holidays followed by 10 in Austria and 8 in Brazil and Switzerland. Vacations, the next deductible, take 30 days in Germany, 25 days in Austria, 20 in Switzerland and just 12 in Brazil and the US. German workers are also the most prone to illness, averaging 15 sick days, compared to 6 in the US and 9 in Brazil. If shorter working hours are calculated, a domestic worker clocks 1322 hours a year against 1624 in Austria and 1784 in Brazil (Table 3.2). Taken together, a Brazilian employee costs just 17.3 per cent of a German and works 35 per cent longer.[80] This views has been reflected by most of the companies operating in the member countries.

Table 3.2

Comparative International Labour Costs

	Germany	US	Japan
Hours worked per week (no.)	36.4	40	40
Vacation holidays (no.)	30	12	18
Holidays (no.)	10	11	13
Hourly take home pay ($)	16.39	11.61	13.67
Benefit cost per hour ($)	13.36	4.85	9.52

Source: Business Week, 1 July 1996 (* Germany represents only West Germany)

The effects of institutional rigidity were reflected in slow growth and long-term unemployment. As a consequence, the member countries resort to various methods to restore the level of employment. France had announced shorter working hours, much against the wishes of the employers, to increase the level of employment along with the assurance to create more jobs in public sectors, which are already considered as an important source of inefficiency in the labour market. Sweden undervalued its currency and expanded its public sector to control high unemployment. Instead of forcing the government to act in favour of flexible working regulations and to lower the tax rates, the Swedish employers resorted to the dismissal of

[79] *Financial Times*, 8 February 1996.
[80] German Brief, vol.8, no.19, 10 May 1996.

employees to counter rising wages and costs only to find that they did not have any effect in increasing the efficiency and international competitiveness. However the Swedish model of dismissing the employees is considered to be an expensive option in most of the member countries.

Due to strict employment protection legislation, member countries are hesitant to recruit new staff in their operations as the procedure of dismissal is considered to be too expensive and time consuming in most of the member countries. Even the less developed member countries have difficulties with dismissals in the EU.[81] Under Germany's complicated labour regulations, employees of companies with more than ten workers are protected against dismissal. It is estimated that it takes more than a year to lay off workers in Germany due to the Companies' Work Councils and the labour courts. It is also argued that in 90 per cent of the cases the labour courts favour the employees.[82] The German law requires a minimum notice period of four and a half months. In Spain the average cost of laying off employees on permanent contracts is two years of full salary. As a result the employers have started focusing on temporary contracts with a third of all Spanish wage earners now on temporary contracts.[83] In the Netherlands, a law prohibits any discrimination between full and part-time workers. They cannot be laid off first because of shorter working hours. These regulations also result in the creation of a black economy in the member countries. This continues to employ undeclared workers in order to avoid taxes and other welfare benefits. A report adopted by the Commission estimated that undeclared work at between 7 and 16 per cent of the EU's GDP, corresponding to between 10 and 28 million jobs.[84] Despite the huge amount of undeclared jobs the EU witness high unemployment.

3.4. IMPLICATIONS FOR THE MEMBER AND NON-MEMBER COUNTRIES:

The policies implemented in the Single European Market also have wider implications on the performance of the member countries but they also affect the non-member countries' external trade as the European industries are forced to alter their strategies due to their market policies.

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[81] A report jointly undertaken by Lehman Brothers and OECD Jobs Study showed that Portugal has the most difficult dismissal followed by Spain and Italy in the EU. Three of the four poorest member countries of the EU, Portugal, Spain and Greece ranked among the top five dismissals in the EU. Cited in Flexibility Can Bend Job Rules, *The European*, no.371, 19-25 June 1997.
[82] The Cost of Over regulation, *German Brief*, 13 June 1997.
[83] Survey on Spain: Labour Reform, *The Financial Times*, 27 May 1997.
[84] Cited in *The Financial Times*, 8 April 1998.

The investment patterns of both the member and the non-member countries reveal that the member countries tend to focus their attention on very few locations in the EU. The consequence is both internal and external investment diversion. In this scenario the EU witness investment diversions on two counts. One is due to high labour and welfare costs and the other due to high corporate taxes on profits. The rise in labour costs and other welfare costs forces the member countries to alter their investment pattern across the world. The successive global trade negotiations, which has resulted in a sharp decline in international tariff rates, is facilitating the cross border manufacturing investments from high cost European countries. This is particularly true for countries such as Germany and France, where the labour costs are enormously high. The German companies are increasing their investments in Central and East European countries. Where this is not possible, in industries such as construction, the imported labour replaces the domestic labour. Many German and French companies divert their investments to the United Kingdom, Ireland and other non-member countries. Some member countries are internalising their production by resorting to screw-driver assembly, co-production. The German companies invested DM47 billion overseas while foreign companies invested only DM4.5 billion last year.[85] German automobile industries are moving to Britain and non-member countries to avoid high labour costs at home.

Due to the constraints in increasing the profit margin many European industries are forced to adopt various cost cutting measures such as restructuring, downsizing the domestic industry with the expansion of production at overseas locations, outsourcing, reengineering their factories, thinning down the labour intensive downstream processes. Companies such as ABB, Electrolux, Philips, Siemens, Olivetti, Daimler Benz are heavily reliant upon restructuring to compete with external competitors. The restructuring also increases the level of unemployment in most of the member countries. The Swiss-Swedish engineering group ABB announced that it is planned to shed thousands of jobs in Western Europe over the next five years in an effort to increase efficiency and cut costs.[86] They also announced that it would be offset by establishing their production bases around the world. The Swedish manufacturer of household appliances Electrolux announced that it was to shed 11 per cent of its workforce in the process of restructuring. The German chemical company BASF announced that it would cut its domestic production in order to expand its production in the South and Far Eastern economies as most of the labour intensive industries, such as textile and clothing industries, had been shifting their production and assembling to that region.[87] The German textile industry had doubled their

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[85] What Keeps Them Here?, *German Brief*, 20 March 1998.
[86] *The Financial Times*, 9 June 1997.
[87] *German Brief Update*, no.30, vol.8, 17-23 July 1996.

foreign investment to over DM 2 billion over during 1992-95.[88] The Tire maker Continental had announced its plans to increase its production from 25 per cent to 40 per cent at low cost locations such as the Czech Republic.[89] The high labour costs and the strong Deutsche Mark has compelled the mini-van manufacturing unit of Mercedes Benz to move its plant to China, where the labour cost is cheap. It is producing the same model *viano* in Spain from 1996. Siemens AG, the Munich based electrical engineering and electronics group announced that it will increase its workforce in Asia to 50,000 from the current 35,000 by the year 2000.[90]

Most of the European companies are looking for low cost overseas locations. German automobile manufacturers are looking for cheaper locations such as North America and Central and Eastern Europe. Volkswagen has poured money into its subsidiaries such as SEAT in Spain and Skoda in the Czech Republic. In 1996, 55 per cent its cars and trucks were made outside Germany.[91] The tire maker Continental closed its plant at low-tax and investor friendly Ireland in 1996 to announce its decision to shift their production to low cost locations such as Czech Republic.[92] Adidas closed down its high cost factories in Germany and Austria to expand its production at East Asian locations. According to a survey conducted by VDMA, the German Plant and Equipment Manufacturers Association, the German companies are more than three times keener to relocate production to the Czech Republic than to any other European country.[93] In the case of immobile industries such as the construction industry, high cost domestic workers have been replaced by the workers from non-member countries, though it is illegal to employ them in Germany.

Not only the labour costs but also high utility prices at home forces the industries to opt for outward investment. For example the mid - size companies in Germany argue that their competitiveness is being affected by high utility rates at home as they pay 25 per cent more on electricity then their counterparts in Britain.[94]The consequences of high domestic production costs are continual increase in outflow of investments from the member countries and other concomitant effects associated with outward investments. Though the rise in labour costs along with productivity increases have been considered as a common factor both in the developed and developing countries, the wage rise in the member countries is not incongruous with productivity increases. The changing investment patterns in the EU have created new growth

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[88] *German Brief Update*, vol.8, no.33, 6-13 August 1996.
[89] *Business Week*, 28 July 1997.
[90] *German Brief Update* 11 April 1996, vol.8, no.15.
[91] *Business Week*, 15 September 1997.
[92] *Business Week*, 28 July 1997.
[93] cited in The Financial Times, 4 July 1997.
[94] Energy: The Walls Come Tumbling Down, *Business Week*, 1 June 1998.

centres both in the Single European Market and in non-member countries whereby the traditional centres, which used to attract foreign investments are being replaced. The member countries' investment patterns in the Central and East European countries, such as the Czech Republic, Poland and Hungary, confirm this trend. Ireland is one such country, which benefits from increasing investment diversion from other member countries due to their low corporate taxes. Ireland's success is mainly attributed to their low corporate tax and other employer funded welfare benefits, which attract manufacturing and financial services away from other member countries.[95] Few member countries raise objections to unrestrained tax competition policy followed by the Irish government as it diverts the investment destined for their locations. For example Denmark raised objections when Boston Scientific decided to close down their Danish plants in order to expand their operations in Ireland.[96] French and German financial companies are aware of investment diversion from their financial sector to Ireland where the profit tax is 10 per cent tax against 30 per cent at their locations. It is not only Ireland but also other locations that are emerging in the non-member countries that tend to attract such investment.

The newly emerging centres of outward investment change the patterns of trade the non-member countries had with the member countries. According to the traditional pattern the non-member countries had been exporting the labour-intensive and intermediary products to the member countries as they had comparative cost advantage over the member countries. The new production strategies adopted by the European industries tend to focus less on the cost advantage as they have started producing in low cost locations of the Central and East European and Mediterranean countries, whereas the production costs adjusted to the labour productivity are comparably higher in relation to those of other developing countries around the world. The preferential treatment enjoyed by some of the geographically adjacent non-member countries of the Central and East European and Mediterranean region are depriving the traditional exporters of the opportunity to export to the member countries. For example the importing pattern of some of the member countries confirms the impression that the imports are diverted from the distant non-member countries. The imports from the non-member countries are being replaced either by: (a) their own produce produced at geographically adjacent non-member countries or (b) the imports from the non-member countries with which the member countries have agreement. This would affect the non-member countries whose products are oriented towards the Single European Market.

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[95] Irish government has pledged to further reduce their corporate tax from the present 36 per cent to 10 per cent by 2010.

[96] Irish Reined by Brussels, no.390, *The European*, 30 October - 5 November.

In this chapter the member countries' economic policies have been studied in detail. Various factors responsible for less flexible market structure have been identified. These factors, because of their anti-competitive and efficiency distorting nature, distort the resource reallocation, a process necessary for realising the economic benefits of the enlarged Market. With the absence of resource reallocation, the completion of the Single European Market would only result in sub-optimal results. The consequence of this sub-optimal result is more protected Single European Market in which the member countries demand protection against the more competitive exporting nations. These anti-competitive policies run counter to the objectives of the creation of the Single Market resulting in sub-optimal welfare gains in the Single European Market. These polices also discourage the exit of many inefficient firms which are preventing the efficient reallocation of resources in the Single European Market. This is particularly true in the case of the European textile and clothing industries, where the anti-competitive protectionist policies discourage the exit of many inefficient firms. However with the dismantling of various protectionist regimes the textile and clothing industries find it difficult to readjust themselves to the changing international environment in textile and clothing trade. The next chapter proceed to find out the nature, the strength, the efficiency and international competitiveness of European textile and clothing industries. Also the impact of the formation of the Single Market in the textile and clothing industries and their impact on the domestic firms would be studied in detail. The nature of competition prevailing in this sector and various strategies adopted by the domestic firms and their success would be studied in detail in the next chapter. The impact of these strategies on the exports of the non-member countries to the EU would also be analysed in next chapter.

Table 3.3

Basic statistics of the EU member countries

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxemb	Nether	Austria	Portugal	Finland	Sweden	UK	EU
Population	10084.7	5189.4	80594.4	10368.2	39082.6	57664.9	3563.3	57057	398.1	15290.3	7986	9876.1	5066.5	8718.6	58182	24608
Unemployment (%)	9.4	10.3	7.2	7.7	21.8	10.8	18.4	11.1	2.6	8.8	8.6	5.1	17.9	8.1	10.4	10
Employment in agriculture (%)	2.9	5.2	3.7	21.9	10.1	5.9	13.8	7.9	3.1	3.9	7.1	11.5	8.6	3.2	2.2	7
Employment in industry (%)	30.9	27.4	39.1	25.4	32.7	29.6	28.9	33.2	29.6	25.2	35.6	32.6	27.8	26.6	30.2	30
Employment in services (%)	66.2	67.4	57.2	52.8	57.2	64.5	57.1	59	67.3	70.9	57.4	56	63.5	70.1	67.5	62
Agriculture in GDP (%)	1.8	3.6	1.2	17	3.8	3.1	7.6	3.3	1.7	4	3.4	6.3	6.7	3.1	1.5	4
Industry in GDP (%)	31.4	27.2	39.4	27.3	34	30.9	38	33.5	35.8	30.9	43.9	39	38	40.4	34.5	34
Services in GDP (%)	66.7	69.2	59.3	55.6	62.2	66	54.4	63.2	62.5	65.1	52.7	54.7	55.3	56.5	64	60
Export/Import ratio (%)	93.6	116.4	105	41.3	70.8	96.5	129.9	94.5	N.A	95.3	82.7	60.6	113.2	116.9	84.4	864
Percapita GDP	17849	22254	20097	7406	10434	18640	11335	14586	26856	17286	19453	7324	14110	18256	13835	15944

CHAPTER - IV

Survey of European Textile and Clothing Industries

Survey of European Textile and Clothing Industries

An analysis of the European textile and clothing industries reveal the impact of the market mechanism and market policies on both the member and non-member countries. Though the impacts are considered to vary between industries depending upon their sectoral specialisation, the levels of development and the nature of competition they witness, these effects are particularly higher in labour-intensive industries. The changing pattern of international trade confirms that the developed countries can no longer be able to compensate their higher labour costs by increasing their per capita productivity. This is mainly because of the fact that the low labour-cost countries are also able to consistently increase their productivity, though not matched by their Western competitors, by increasing the investments in physical and human capital and by importing new technology and adapting to new production techniques. This is particularly true for textile and clothing industries, where the proportionate link, hitherto been witnessed between the labour costs, productivity and quality (such as high productivity compensating the high labour costs and higher product quality), has not been present any longer. Now it is possible to preserve the quality of the labour-intensive products produced at low-labour cost countries and still enjoy the competitive advantages over the products produced at high-labour cost countries as the skill differences between the labours of low and high-cost countries are narrowing down, at least for mass produced products. This is largely true for European textile and clothing industries, which are challenged both internally and externally. They are challenged internally by the changing market mechanism and the concomitant market policies. The challenges thrusted upon the EU render the production and concentration of textile and clothing industries in their high-cost locations cost disadvantageous. Externally they are challenged by the low-cost imports from the low-cost non-member countries. The implications of these challenges are as follows. The changing market mechanism would not alter the existing trading pattern among the member countries in their favour. Though the high-cost member countries are confronted with the cost disadvantageousness of domestic production in labour-intensive industries, they still prefer to invest either in their own locations or the low-cost locations of the non-member countries rather than investing in low-cost member countries (as presumed in the Customs Union theory). This strategy allows the developed member countries not only to capitalise on the low-cost production centres but also to preserve the domestic employment involved in associated industries.

While the developed member countries tend to diversify their labour-intensive processes to the low-cost neighbouring non-member countries, they continue to concentrate on the upstream and other high value-added production processes at home. This strategy would have more implications for the less developed member countries than they are for the non-member countries. This deprives the less developed member countries of any possible

investment-diversion from the developed member countries, which would have been witnessed in presence of the low cost factors. This would also deter the less developed member countries from specialising in areas (such as labour-intensive and mass produced sectors), in which they continue to enjoy comparative advantage over the developed member countries in the form possessing the traditional knowledge base apart from their low production costs.

4.1. TEXTILE AND CLOTHING INDUSTRIES - A HISTORICAL PERSPECTIVE:

The textile industries had been playing an important role in the period immediately following the industrial revolution in Europe.[1] They were also the earlier industries in which new production and processing methods were introduced aiming at increased productivity.[2] The textile and clothing industries, which had once been the preserve of the colonial powers during the periods of industrial revolution and afterwards, played an important role in the development of imperial economies during the colonial history. The colonial powers continued to enjoy the monopoly over their colonies as the colonies were continuously exploited as the producer of the raw materials for the industrial base of the colonisers. The colonies were discouraged from concentrating on the production of textile and clothing products as they were considered to be posing a threat to the survival of the textile and clothing industries in the Empires. Protection against textile and clothing imports is a recurring phenomenon in economic history.[3] British, French and German textile and clothing industries were heavily protected from external competition. With the end of colonial era, the newly liberated countries concentrated not only on the production of raw materials, but also on the development of garment and textile production. These industries, even now, are considered very important in many of the economies as they account for a considerable proportion of total manufacturing output. This is particularly true for countries with higher population as these industries account for a considerable proportion of total employment and cater the employment needs of the less- and unskilled workers. This is also true for countries, which were latecomers in the process of industrialisation as textile manufacturing provided many of these countries the first experience

[1] For example Britain's dramatic period of growth was evidently concerned with the textile industries (particularly the cotton industries). For more details see F.Stuart Jones, The Financial Needs of the Cotton Industry During the Industrial Revolution: A Survey of Recent Research, *Textile History*, 16(1), 1985, pp.45-67.

[2] It is interesting to note that new innovations, such as the introduction of power loom replacing handloom, aimed at enhancing the productivity during industrial revolution in Europe, were forced upon mainly due to the competition they were facing from the low-cost countries such as India.

[3] Giorgio Babra Navaretti, Riccardo Faini and Aubrey Silberston, Beyond the Multifibre Agreement: Third World Competition and Restructuring Europe's Textile Industry, *Development Centre Documents*, OECD, Paris, 1995, p.13.

of large-scale modern industry. Large-scale export earnings were necessary to finance the development of local textile industries since the main problem afflicting their textile industries continued to be acute shortage of capital in both local currency and foreign exchange. As a consequence, over a period of time, these industries were further encouraged by substantial amount of subsidies provided by their national governments as they contributed substantially to total manufacturing output, employment and foreign exchange earnings in several developing countries. The attention and focus on these industries best suited the interests of the labour markets in the less developed and developing economies as these industries were considered to be labour-intensive largely employing less and un-skilled workers. In many developing countries, it grew sequentially in a backward manner starting with clothing, then into the textile industry and finally into man-made fibres.[4] The biggest changes in the textile industry occurred in the 1960s when new production centres were established in many parts of Asia. Many of these centres were aimed to provide service facilitating the less capital-intensive clothing industry, and then used the export earnings from these products to set up their own textile production. As a result of new production centres, the share of textile from developing countries increased dramatically throughout the 1970s. The production of certain fibres by these countries increased by nearly 300 percent, to account for more than 21 percent of the world's supply by 1980.[5] During the past two decades, textile production in Asia has forged further ahead at an average increase of 3.6 percent per year. By comparison, industrialised countries have only increased production an average of 0.2 percent per year over the same period. Despite these recent developments, the industrialised countries still lead in the worldwide production of textile and clothing. The lead of the industrial countries is mainly due to the level of technology associated with the textile and clothing industries. The textile and clothing industries of the industrialised countries continued to modernise their plants and adopt new production process to maintain their global lead. However, in recent years, the lead in the international clothing trade has been overtaken by the newly industrialised countries of the East, Far East and South Asia, which occurred in three successive waves of production. At present, more than 60 percent of world's clothing exports are manufactured in developing countries. Asia is the major world supplier today, producing more than 32 percent of the world's clothing exports.[6] With the development and continued specialisation of these industries in the developing countries, they

[4] Saha Dhevan Meyanathan and Jaseem Ahmed, Managing Restructuring In the Textile and Garment Sub-sector: An Overview, p.1 in Saha Dhevan Meyanathan (ed.) Managing Restructuring In the Textile and Garment Sub-sector: Examples from Asia, *EDI Seminar Series*, The International Bank for Reconstruction and Development, The World Bank, Washington, 1994.

[5] Globalisation Changes the Face of Textile, Clothing and Footwear Industries, Press Release, (ILO/96/33), *International Labour Organisation*, Monday 28 October 1996.

[6] ibid.

also became the subject of contention between the developed and developing countries.[7] The geographical distribution of textile and clothing industries has changed dramatically in the past 25 years resulting in sizeable employment losses in Europe and North America with vital gains in Asia and other parts of the developing world. This is especially true for the member countries of the European Union, where textile and clothing industries are considered to be an important sector for the less-skilled and un-skilled labourers among all labour-intensive industries.

4.2. AN OVERVIEW OF EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

The European textile and clothing industries correspond to NACE codes 43 (natural and synthetic fibres), 453 (clothing) and 455 (other textile items and accessories). An overview of the European textile and clothing industries reveals a very close link between upstream (textile) and downstream (clothing) industries. The links between these two industries are close as the textile industry delivers almost half of its production to the clothing industry.[8] The textile industry is very heterogeneous with demand heavily dependent on other industries, particularly clothing and home furnishing, but also on other industrial sectors such as automobiles. The textile and clothing production involves three major stages: fibre production, clothing production and the production of final product. The textile and clothing industry covers all production processes needed for the manufacturing of garments, from natural (wool, cotton, silk, linen, flax, ramie, jute) and man-made (synthetic or cellulose) fibre production, spinning, weaving and knitting, cutting, assembly and finishing of clothing. The differences between textile and clothing production are reflected in investment levels per worker being almost three times higher in the former than in the latter.[9] There is also a significant difference with the textile sector more amenable to technical progress. As a result the productivity gains and employment reduction have been significantly larger in textile than the clothing. The clothing industry still remains largely labour-intensive, where the labour accounts for about four-fifths of the production costs of clothing. The clothing industry has one of the lowest ratios of capital to

[7] The trade regime for textile and clothing has become such an important and controversial issue for both industrialised countries and less developed countries. This is mainly because of the level of employment associated with these industries in both the industrialised and less developed countries. While they accounted for 10 per cent of manufacturing employment in industrialised countries they accounted for 26 per cent in less developed countries. Apart from this they have also become an important foreign exchange earner for most of the less developed countries representing some 14 per cent of their overall exports and 24 per cent of their manufactured exports. For more details see, Giorgio Babra Navaretti, Riccardo Faini and Aubrey Silberston, Beyond the Multifibre Agreement: Third World Competition and Restructuring Europe's Textile Industry, *Development Centre Documents*, OECD, Paris, 1995.

[8] For more details see, Panorama of European Industry 97, Volume I, Chapter 4, *European Commission*, Luxembourg, 1997.

[9] The European Community's Textile Trade, External Relations Series, 76/85, *Commission of European Community*, Brussels, 1985.

output or capital per worker of any manufacturing industry.[10] It also has a very low level of physical capital per worker.

A close analysis of the EU's textile and clothing industry reveals the importance of textile and clothing industry in many of member countries. With a turnover of ECU180 billion, the textile and clothing industry plays an important role in the socio-economic development of the EU. This is particularly true for regions, where the presence of textile and clothing industry is widespread and intense, such as in Lombardy and Veneto (Italy), Catalonia (Spain), Bavaria and North Westphalia (Germany), and Norte (Portugal), where they account for more than 100,000 direct jobs.[11] These industries also account for more than 10 per cent of industrial jobs in 43 European regions. As for employment, the textile and clothing industry employs nearly 2.5 million people in 120,000 firms. They account for 7.6 per cent of all industrial employment and 4.2 per cent of value-added. A large proportion of their workforces are female, part-time worker. Another feature of these industries is that they are a leading employment provider in certain regions of high unemployment.

Table 4.1. Output and Employment Growth in the EU's Textile and Clothing Sector

Sectors	Output Growth (in %)	Employees (in persons)	Employment Growth (in %)
Textile finishing	+1.4	100657	-13.6
Clothing Manufacturing	+1.2	714125	-16.4
Knitting	-0.2	252690	-26.8
Silk Industry	-0.3	72677	-23.9
Man-made Fibres	-0.9	40694	-38.8
Textile Machinery	-1.4	74818	-29.4
Wool Industry	-1.6	113283	-31.2
Cotton Industry	-2.1	189173	-36.9
Carpets, floor covering	+0.5	62737	-10.8

Source: Data compiled from Panorama of EU Industry – 1997, Volume – I, Office of the Official Publications of the European Communities, Luxembourg, 1997.

[10] Jose de la Torre, *Clothing Industry Adjustment in Developed Countries*, Trade Policy Research Centre, Macmillan: London, 1986, p.79.

[11] The Single Market Review: Impact on Manufacturing – Textile and Clothing, Sub series I, Volume 3, (*Office for Official Publications of the European Communities*: Luxembourg), 1998, p.9.

Table 4.2. Sectoral Breakdown of the EU's Exports and Imports

Sectors	Share in Total Manufacturing Exports (ratio)	Share in Total Manufacturing Imports (ratio)	Export Specialisation Ratio**
Textile	4.1	5.2	1.17
Footwear & Clothing	3.1	6.5	1.34
Man-Made Fibres*	14.2	10.1	1.11

Notes:

* also includes the chemicals industry;

** share of sector in total EU manufacturing exports divided by the same share calculated for the OECD.

Source: Data compiled from Panorama of EU Industry - 1997, Volume I, Office of the Official Publications of the European Communities, Luxembourg, 1997.

The textile and clothing sector is considered to be a sector with moderate specialisation with the export-specialisation ratio less than 1.2. The textile and clothing sector is one of the largest employment providers in the member countries accounting for 20.02 per cent during the years 1985-95. The employment levels in this sector in 1995, as a percentage of the 1985 employment level, is only 74.3 per cent.

Table 4.3 Importance of Textile and Clothing Industries in the Member Countries (in 1990)

Country	Share of GDP (in %)	Amount of Wage earners (%)	Country	Share of GDP (in %)	Amount of Wage earners (%)
Belgium	1.6	2.8	Italy	3.6	5.6
Denmark	0.8	1.4	Luxembourg	0.8	0.6
France	1.3	2.2	Netherlands	0.6	1.1
Germany	1.1	1.9	Portugal	6.1	8.4
Greece	N.A	7.4	Spain	2.0	3.9
Ireland	N.A	2.7	U.K.	1.2	2.1

Source: The Single Market Review: Impact on Manufacturing – Textile and Clothing, Sub series I, Volume 3, Office for Official Publications of the European Communities: Luxembourg, 1998, p.8.

The European textile and clothing industries, which continued to maintain the role of global leadership in international textile and clothing trade, are facing a series of threats from various quarters. The EU is the world's largest importer and the second largest exporter of textile and clothing products. In 1997, the value of imports amounted to over ECU55 billion and the exports over ECU34 billion. The world exports in textile amounted to $155.3 billion in 1997 out of which the EU accounted for $22.7 billion.[12] The EU's textile exports grew at the same rate of world textile exports during the period 1990-97. Among the top ten leading textile exporters, five of them are the member countries of the EU. However the trend in

[12] See The EU Textile and Clothing Sector 1999: A Factual Report, (*L'Observatoire Europeen du Textile et de L'habillement:* Brussels), April 1999.

clothing trade is not too impressive as it witnesses declining trend. In 1997, world exports of clothing totalled $176.6 billion of which EU alone represented 9 per cent.[13] Among the top ten leading exporters of clothing, only four of them are the member countries of the EU.

Table 4.4. Ten Leading Textile Exporters (in 1997)

Countries	Value (in billion US$)	Countries	Value (in billion US$)
China	26.8	France	7.2
South Korea	13.3	Bel/Lux	7.0
Germany	13.0	Japan	6.7
Italy	12.9	United Kingdom	5.6
Taiwan	12.7	World	155.3
United States	9.2		

Source: The EU textile and clothing Sector 1999; A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, April, 1999.

Table 4.5. Ten Leading Clothing Exporters (in 1997)

Countries	Value (in US$)	Countries	Value (in US$)
China*	45.6	France	5.3
Italy	14.8	United Kingdom	5.3
Hong Kong	9.3	India	4.2
United States	8.7	South Korea	4.2
Germany	7.3	World	176.6
Turkey	6.7		

Source: The EU textile and clothing Sector 1999; A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, April, 1999.

Nevertheless, in recent times, the survival of these industries has been seriously doubted by industrial experts in the face of various factors such as sluggish demand associated with falling consumption in domestic markets, falling production, raising labour costs, decreased industrial efficiency and falling international competitiveness. Two simultaneous events have affected the member countries' market dominance in the Single European Market. The high penetration ratios of the exports of the non-member countries and the gradual elimination of trade barriers have contributed to the decline in the member countries' dominance in the Single European Market.[14]

[13] ibid.

[14] Market penetration by products of extra-community origin has significantly increased. Between 1986 and 1994 it grew from 13.6 per cent to 25.6 per cent for textile, and from 15.6 per cent to 33.4 per cent for clothing in volume terms. For more details see The Single Market Review Series – Sub series I - Impact on Manufacturing: Textile and Clothing - Summary, *CEGOS*, March 1996.

The opening up of the Single European Market[15] and an increased competition from newly industrialised and developing countries of the South East and South Asia have affected the export performance of the European textile and clothing industries not only in the Single European Market but also in other developed countries. The abolition of various safeguard measures and regimes, which were used to protect the textile and clothing industries in the developed countries, such as Multi-Fibre Agreement (MFA)[16] also project the unfavourable condition for these industries.

The effect of the Single European Market would be felt differently upon different member countries. The Single European Market would have different implications for the textile and clothing industries of the developed member countries than for the less-developed member countries. For the former, they mainly involve the ability of firms to become truly European at all levels of management, research and development, production, marketing and distribution to meet intense competition from the developed countries of the region and from other parts of the world. For the less-developed member countries, they mainly involve restructuring and modernisation of these traditional industries in the face of growing competition from not only the developed countries but also the non-member developing countries. Though the effects of the Single European Market on the member countries are visible, they are particularly visible in the less-developed member countries such as Greece, Portugal, Spain, Ireland and Italy where these industries are protected by specific barriers (such as export grants in Greece and tariff barriers and quotas in Portugal). Though the less-developed member countries continued to enjoy sectoral specialisation in the concentration of textile and clothing industries, the lifting of tariff, non-tariff barriers and other protective mechanisms would eventually change the pattern of sectoral specialisation in these countries.

4.3. PRODUCTION IN THE EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

The textile industry covers the spinning, weaving and knitting of natural and man-made fibres and finishing the textile and the production of made-up textile such as household (bed, table linen, blankets, carpets and knitwear products) and technical textile. The textile industry is mainly concentrated in Italy, Germany, France and the UK. The clothing industry covers the manufacture of woven and knitted garments and clothing accessories. The production of clothing involves a number of different stages such as design (styling, prototyping), sourcing of

[15] The EU argues that their market for textile and clothing products is open with a market penetration ratio of almost 50 per cent.

[16] The MFA imports account for 80 per cent of textile and 99 per cent of clothing imports. They also account for 18 per cent and 21 per cent of apparent consumption in textile and clothing respectively. For more details see, The Single Market Review: Impact on Manufacturing - Textile and Clothing, Sub series I, Volume 3, *Office for Official Publications of the European Communities*: Luxembourg, 1998.

fabrics, planning of cutting, manufacturing (cutting, sewing, assembly, pressing, finishing) and packing. The clothing industry continues to remain relatively labour-intensive.

European textile production has been centred around the developed countries of the North while the developing countries concentrated on the production of clothing. Various factors are responsible for this existing sectoral specialisation. The nature of the textile industry, such as its capital-intensive and high technology content, necessitates the presence of textile industries in the developed north. Though the labour costs were higher and they continued to increase at an alarming rate in the developed member countries, the productivity adjusted for the labour costs still made it possible to maintain their global leadership in textile trade. This has been made possible as an average proportion of labour costs in total production costs in EU's textile industries is only 40 per cent, while it is about 60 per cent in the EU's clothing industries.[17] However this could not be made possible in European clothing industries as they continued to be labour-intensive in nature in their operational characteristics.

The development and arrival of new synthetic fibres had mixed effect on the performance of European textile and clothing industry.[18] While it helped the developed member countries to maintain their lead, it had inadvertent effect on the competitiveness of their clothing industries. The new fibres put undue pressure on material prices thereby emphasising the role of labour costs as the most important factor in preserving the competitiveness of the clothing industry. As a consequence, the European textile and clothing industry witnessed an internal restructuring with the shifts of production-centres. Within the Western Europe, there had been shifts to lower-cost centres of production in the South. This is evident from the fact that the Northern members of Belgium, Denmark, France, West Germany, the Netherlands and the United Kingdom lost 954,000 jobs between 1965 and 1977, while 285,000 new jobs were created in the Southern members of Greece, Italy, Portugal and Spain.[19] Most of the jobs lost in the developed member countries belonged to clothing industry while the jobs created in the less-developed member countries belonged to the clothing industry.

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[17] The EU Textile and Clothing Sector 1999 - A Factual Report, *L'Observatoire Europeen du Textile et de L'habillement*, Brussels, April 1999.

[18] the effort to replace the natural fibres had started in the 19th century. However the production of artificial silk and the development of synthetic fibres has begun in the period between the two world wars. However the synthetic textile were unable to fully replace the cotton textile. On the other hand the rise of oil prices - from which most of the raw materials are produced - had significant cost disadvantages on the production of man-made fibres. The fall in oil prices had given rise to the over production of these fibres. Since the European producers of man-made fibres wanted a stabilised demand they started showing interest in maintaining a viable European textile industry as they were not sure that the textile industries of developing countries would automatically become their customers and in case they drive the European textile industry off the market.

[19] Allan M.Williams, *The Western European Economy: A Geography of Postwar Development*, (Hutchinson: London, 1987).

The Community trade in textile and clothing is mainly intra-EU in nature. The textile and clothing sector has long been internationalised with intra-EU trade representing a significant proportion of its turnover. Intra-community trade represents about 60 percent of total textile trade and 50 per cent in total clothing trade. In 1996 intra-Community trade in textile and clothing accounted for ECU 53.4 billion, while exports to non-member countries accounted for ECU 30.3 billion.[20] This trade developed steadily throughout the 1970's and 1980's. This is particularly true in the post-1992 period, where the abolition of border controls has resulted in a decline of time taken for transport to an average of three days.[21] The EU's internal textile trade is witnessed mainly among the developed member countries while its external trade is with the developed non-member countries. The geographical origin of textile imports into the EU confirms this trend. The leading suppliers of textile to the EU are Japan and Switzerland. The EU's clothing trade is also mainly intra-regional with 83 per cent of clothing industry exports went to other European countries.[22] The Community's external clothing trade is mainly with low-cost non-member countries of South Asia and South East Asia.

Table 4.6. Effects of the Single European Market on Intra-EU and Extra-EU Trade in Textile and Clothing

Country	Intra-EU trade		Extra-EU trade	
	Exports	Imports	Exports	Imports
Belgium	+	+	+	+++
Denmark	0	++	-	++
Germany	++	+	+	+++
Spain	-	+++	0	+++
France	+	+	+	+++
Ireland	0	+	-	+++
Italy	0	+	0	+
Luxembourg	++	-	+	0
Netherlands	0	+	-	+++
Portugal	-	+	+	+
United Kingdom	-	+	0	++

Source: Employment, Trade and Labour Costs in Manufacturing, Aggregate and Regional Impact, The Single Market Review, Sub series VI, Volume 4, Office for the Official Publications of the European Communities, Luxembourg, 1997.

[20] Plan of Action to Increase the Competitiveness of European Textile and Clothing Industry, *Communication from the Commission to the Council*, The European Parliament, The Economic and Social Committee and the Committee of the Regions, European Commission, Brussels, 29 October 1997, COM (97), 454 final.

[21] The Single Market Review: Impact on Manufacturing – Textile and Clothing, Sub series I, Volume 3, Office for Official Publications of the European Communities: Luxembourg, 1998, p.28.

[22] The Garment Industry in the Restructuring Global Economy, in Edna Bonaich, Lucie Cheng, Norma Chinchilla, Nora Hamilton and Paul Ong (eds.), *Global Production - The Apparel Industry in the Pacific Rim*, (Temple University Press: Philadelphia), 1994, p. 4.

4.4. IMPACT OF THE SINGLE EUROPEAN MARKET ON THE EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

The removal of all barriers apart from the abolition of the formalities such as frontier delays, origin verification, restrictions in public tendering, technical and fiscal barriers have considerable beneficial effects on the member countries' textile and clothing trade. The abolition of frontiers has enabled to the textile and clothing industries to improve their service to customers in the Community:

1. by cutting back delivery times between orders to deliveries by 15 to 20 per cent.[23]
2. by reducing transports costs considerably. Since the transport costs form a considerable proportion of turnover – between 2 and 5 per cent – the abolition of frontiers is saving the European textile and clothing industries 10 per cent on transport costs, which is equivalent to 0.2 to 0.5 per cent of the turnover.[24]
3. by reducing the administrative costs of the firms between 0.08 and 0.06 per cent of the turnover.[25]

At the same time, the impact of the abolition of frontiers had made Article 115 inapplicable. The abolition of Article 115 especially affects the textile and clothing industry, which accounted for more than 50 per cent of the instances of recourse to this article.[26] Though this resulted in shorter delivery times, saving of transport and administrative costs, this also resulted in an easy and enormous circulation of articles of non-Community origin. The consequence is dwindling down of the share of the EU's products in the Community's external trade. Market penetration by products of extra-Community origin has significantly increased. Between 1986 and 1994, it grew from 13.6 to 25.6 per cent for textile and from 15.6 per cent to 33.4 per cent for clothing in volume terms.[27] Nevertheless an increased penetration rate has also resulted in an increase of higher productivity in European textile and clothing industries.

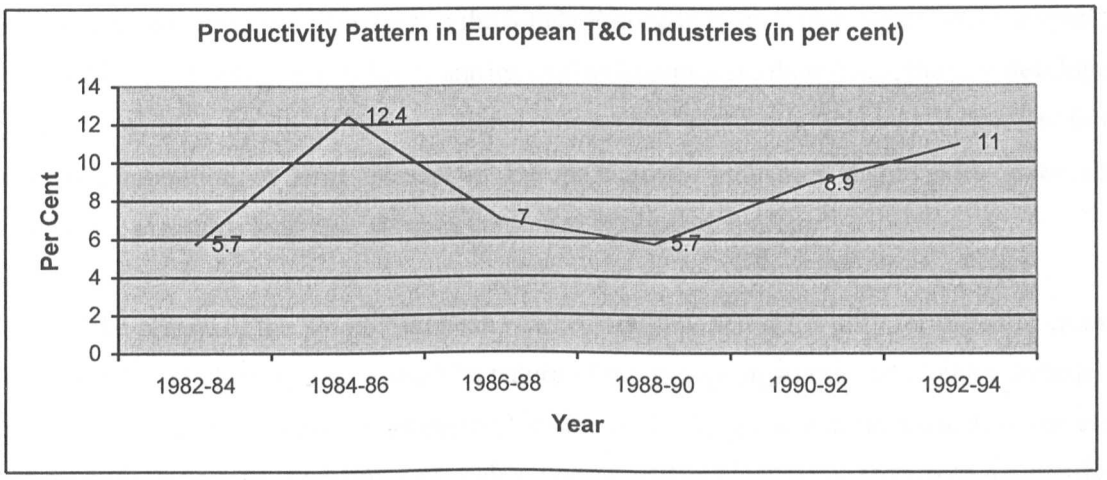
Table 4.7. Productivity Pattern in European Textile and Clothing Industries (between 1982-94)

1982-84	1984-86	1986-88	1988-90	1990-92	1992-94
5.7	12.4	7	5.7	8.9	11

Source: The Single Market Review: Impact on Manufacturing - textile and clothing, Sub series I, Volume 3, Office for Official Publications of the European Communities: Luxembourg, 1998, p.5.

[23] The Single Market Review: Impact on Manufacturing - Textile and Clothing, Sub series I, Volume 3, (*Office for Official Publications of the European Communities*: Luxembourg), 1998, p.2.
[24] ibid.
[25] ibid.
[26] The Single Market Review Series - Sub series I - Impact on Manufacturing - Textile and Clothing, March 1996.
[27] Ibid., p.5.

Graph 4.1. Productivity Pattern in the EU's Textile and Clothing Industries



The Cecchini Report on the post-1992 scenario for European textile and clothing industries found these industries to be already reaping the benefits from progress toward home market conditions in Europe.[28] This is mainly because of the fact that the European textile and clothing sector has long been internationalised resulting in an earlier exploitation of the benefits of the plant and technical economies of scale by restructuring themselves to face the challenges in the Single European Market even before its completion. Though the industrial restructuring had been taking place, there existed considerable non-tariff barriers for both intra- and extra-EU trade. A research carried out on the effect of the Single European Market on various industrial sectors found that sectors with moderate non-tariff barriers, such as textile and clothing, would not able to avail potential economies of scale as there continue to exist technical, administrative and fiscal barriers. The creation of harmonised standards, which is aimed at removing technical barriers, is making rather slow progress. The consequence is a fall in intra-Community trade with subsequent price dispersion across the member countries.[29] The economic gains of the removal of non-tariff barriers on sectoral specialisation across the member states were expected to be minimal as existing non-tariff barriers were inconsistent with their comparative advantages. In other words, it could be argued that the levels of non-tariff barriers did not correspond to the vulnerability of national textile and clothing industries. Even the sectors with comparative disadvantage face a fall in non-tariff barriers. Moreover the removal of technical and other non-tariff barriers would only have marginal effect as it would not result in the restructuring of these industries. Though the removal of these barriers would enhance the level of competitiveness in these industries, it would not be sufficient enough to outweigh cost factors such as high labour and material costs, which directly affect the industrial efficiency and

[28] P.Ceechini, et al., *1992: The European Challenge: The Benefits of a Single Market*, London, 1988.
[29] Fore more details on the impact of the internal market by industrial sector, see P. Buigues, F.Ilzkovitz and J.F.Lebrun, The Impact of the Internal Market by Industrial Sector: The Challenge for the Member States, Special Edition, 1990.

international competitiveness of European textile and clothing industries. Therefore the sectoral gains of the completion of the Single European Market depended on the determination of firms to Europeanise themselves. However in the Single European Market two contradictory scenarios exist. While the developed member countries tend to Europeanise their firms, the less-developed member countries try to promote national champions protecting national industries from external competition. A large number of Europe's textile industries should have given into competitive pressures long ago, yet they continued to obtain subsidies.[30]

The effects of the Single European Market would be felt differently for different sectors of the textile and clothing industries. The nature of the European textile and clothing industries also play an important part in realising the benefits of the Single European Market. In the case of the textile industries, economies of scale could be realised as they are technology-intensive, which increases the scope for potential economies of scale. Since intra-EU trade in textile is mostly intra-industry in nature, they are most advanced compared to any other manufacturing industries. The textile industry is also one of the earliest industries to restructure itself to face the changing scenario in the Single European Market. The intra-regional trade in textile has always been intense in the Single European Market, which has limited the scope for price differentials across the member countries thereby limiting the scope for market segmentation.[31] This has improved the scope for product standardisation, which further increases the Plant Economies of Scale (PES).[32] However, in the case of European clothing industries, the possibility of exploiting both the plant economies of scale and Product Specific Economies of Scale (PSES)[33] is limited by higher levels of market segmentation and low levels of product standardisation. In segmented markets, as in the case of the European clothing market, the product standardisation could not be achieved as cultural preferences and orientation tend to differ from one member country to another. The segmented markets characterised by different cultural and consumer preferences increased the need for flexible manufacturing production system. However the usage of flexible manufacturing system does not allow for the exploitation of the PSES, which gains importance as we move from upstream stages of differentiated production to downstream stages of mass production. The contrasting levels of dominance in both the textile and clothing segments could be explained by the levels of market segmentations prevailing in respective segments.

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[30] Oliver L.Landreth, *European Corporate Strategy: Heading for 2000*, (St.Martin's Press: New York), 1992, p.4.

[31] In 1996 intra-Community trade in textile accounted for ECU 53.4 billion, while exports to non-member countries accounted for ECU 30.3 billion.

[32] Plant Economies of Scale (PES), as opposed to Product Specific Economies of Scale (PSES) is an economies at plant level. PES is possible in markets characterised by low-market segmentation.

[33] Product Specific Economies of Scale (PSES) is an economies of scale at product level. PSES is needed in markets characterised by high-market segmentation.

The Customs Union theory would argue that given the scenario of free trade between the member countries, the low cost country in a unified market becomes an effective supplier for the whole of the unified market. This is based on the argument that enhanced competition among the member countries would result in a situation, whereby the inefficient industries would go out of the business. Another argument was the removal of non-tariff barriers would encourage factor movements across the member countries, which would result in factor price equalisation. This, in turn, was expected to have a considerable effect on the cost considerations of these industries. However the analysis on the performance of the EU's textile and clothing industries reveals an interesting scenario in which the competition between the firms was encouraged at the same time efforts were on to protect these industries in less-developed member countries. This conflicting attitude did not allow for the realisation of efficient resource allocation as the inefficient industries continued to make their presence felt in the Single European Market. This was also encouraged by the policies of various member countries aimed at protecting their domestic employment, which did not encourage the unemployed to leave the welfare state in search of better employment opportunities.[34] As a result, the Single European Market did not witness factor price equalisations in its textile and clothing industries. The free movement of individuals is still not a very important aspect in this industry, which has been losing more than 100,000 jobs every year since 1988.[35] Enhanced competition among the member countries, with no or less state interference, would have allowed the resources to be allocated efficiently as the inefficient industries, which had been operating under the protection would be forced to go out of the industry. This supposed demise of the inefficient industries would have resulted in a situation, where the resources, which had hitherto been used also by inefficient industries, would be reallocated only among the efficient industries. This is the scenario predicted in the Customs Union theory, where the efficient reallocation of resources would result in economies of scale and subsequent cost reduction effect.

An analysis on the implications of the creation of the Common Market during the period 1978-85 confirms higher levels of mutual inter-relationship between the member countries in textile than in clothing industries. While the textile industries continued to witness competition exclusively from other developed countries, the clothing sector faced increased competition from both developed and developing countries.[36] However the creation was believed to have benefited the countries, which already had a dominant role in their respective

[34] It has to be highlighted that the labour mobility for the less and un-skilled is normally far less than it is for the skilled labour. Given the unemployed benefits an unemployed receive, it is less likely that he or she would be prepared to leave the more than generous welfare system in search of potential employment somewhere else in the Single European Market.

[35] The Single Market Review: Impact on Manufacturing - Textile and Clothing, Sub series I, Volume 3, *Office for Official Publications of the European Communities*: Luxembourg, 1998, p.50.

[36] Michael Breitenacher, Sergio Paba, Gianpaolo Rossini in *The Cost of Non-Europe in Textile -Clothing Industry: Executive Summary*, December 1987, p.17.

sectors. The Italian textile and clothing industries are main beneficiaries of the trade creation effects to a large extent compared to their French and British compatriots.[37] With respect to the Community's intra-regional sectoral specialisation, the leading position was held by the German textile and Italian clothing industries.[38]

Table 4.8. EU's Textile and Clothing Production by Member Countries (in 1998)

Country	Textile (%)	Clothing (%)	Country	Textile (%)	Clothing (%)
Austria	3.0	1.3	Ireland	0.6	0.8
Bel/Lux	6.9	2.0	Italy	30.3	33.9
Denmark	1.0	1.1	Netherlands	2.4	0.9
Finland	0.7	0.9	Portugal	4.4	5.0
France	13.8	12.5	Spain	7.5	10.6
Germany	14.4	16.9	Sweden	0.8	0.4
Greece	1.4	1.5	UK	12.8	12.2

Source: The EU textile and clothing Sector 1999 : A Factual Report, L'Observatoire Europeen Du Textile et de L'Habillement, April 1999, Brussels.

The above table (Table.4.8) on the production pattern in the textile and clothing industries reveals the share of the member countries in EU's total production. The table also confirms the expected trend whereby the high-cost developed member countries continued to concentrate on the technology and capital-intensive textile industries to avoid competition from low cost non-member countries. This also confirms the declining importance of labour-intensive clothing industries in many of the member countries. The exorbitant production costs in the developed member countries and the continual rise in production costs of the less-developed member countries could be attributed to this declining trend. Interestingly, even in labour abundant and low cost countries, where they are considered to be the backbone of manufacturing activity, this trend has been witnessed. Italy is the largest producer of textile in the EU accounting for 30.3 per cent of the EU's total production. This is followed by Germany, France and United Kingdom with 14.4, 13.8 and 12.8 per cent respectively. This trend is more similar to clothing industries as well where the production shares are 33.9, 16.9, 12.5 and 12.2 per cent respectively. Though the less-developed member countries do not contribute a large share in EU's total production, the textile and clothing industries are most significant in these countries.

As for consumption in textile and clothing industry, the consumption has outstripped the production with the gap filled by extra-EU imports. An analysis on recent trends in EU's textile and clothing production between 1992-1996 (Table.4.9) confirms a declining trend in the production of both textile and clothing. The textile and clothing production has been

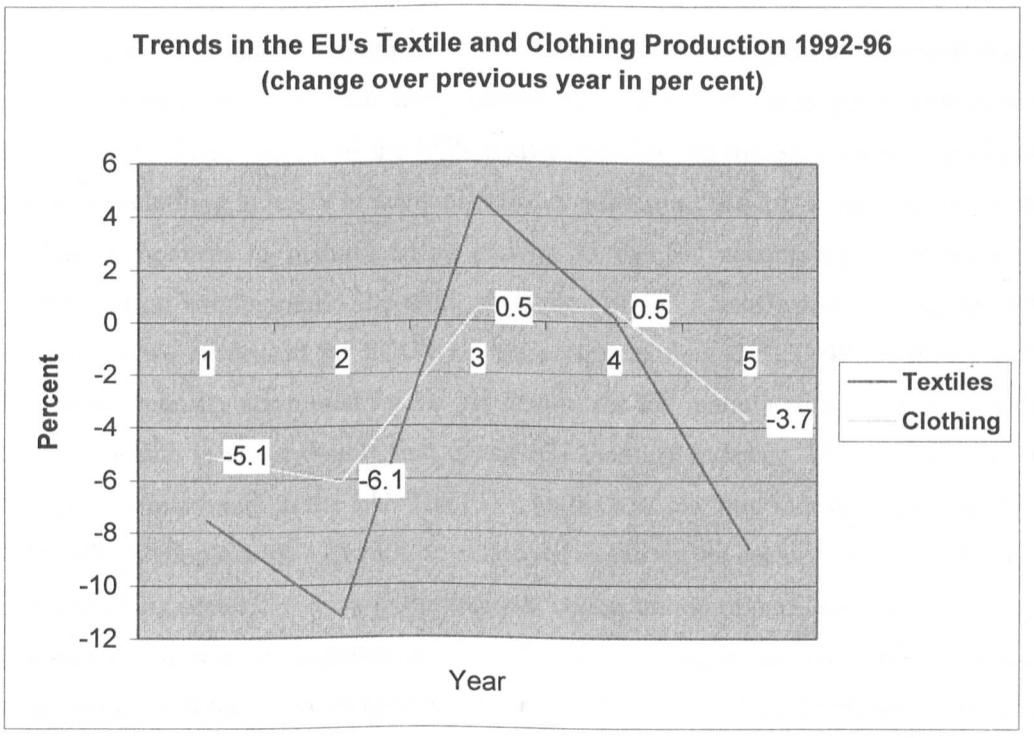
[37] ibid.
[38] ibid.

consistently witnessing a downward trend in production except for the year 1994 (and also 1995 for clothing), where they witnessed a recovery compared to previous years.

Table 4.9. Recent Trends in the EU's Textile and Clothing Production (changes during 1992-96 in per cent)

Year	1992	1993	1994	1995	1996
Textile	-2.4	-5.1	4.2	-0.3	-4.9
Clothing	-5.1	-6.1	0.5	0.5	-3.7

Graph 4.2. Recent Trends in the EU's Textile and Clothing Production (changes during 1992-96 in per cent)



4.5. EMPLOYMENT IN EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

The EU's employment in textile and clothing has experienced a continuous decline for a long time. During the eighties and the first half of the nineties, the EU's textile and clothing industries have lost 1.31 million jobs or about one third of its 1980's workforce.[39] Most of these job losses have occurred in the textile industry. This trend has been unique across all the member countries with significant job losses witnessed in high cost countries. Though high productivity in these industries could be argued as an important determinant of job losses, other

[39] for more details see chapter 4 titled, Employment in Long-term Scenarios for the EU Textile and Clothing Industry: Employment and Technology, (*L'Observatoire Europeen du Textile et de L'habillement:* Brussels), January, 1996.

factors such as a fall in average real income, falling consumption and demand could also be cited as important factors responsible for this.

The textile and clothing industries are characterised by complex income elasticity of demand with the latter displaying high elasticity of demand than the former. It is confirmed that, between 1973 and 1988, employment fell by 44 per cent in textile and 39 per cent in clothing. Production declined slowly than employment.[40] This confirms the trend that the increased imports from the non-member countries posed a serious challenge to the European textile and clothing employment. A fall in EU's average real income levels would also have a considerable impact on the levels of employment in textile and clothing industries.

The textile and clothing production in the EU assumes greater significance in presence of their share in total manufacturing output and amount of employment provided by these industries. A close analysis of the EU's textile and clothing industry reveals the importance of textile and clothing industry in many of member countries. The textile and clothing industry is a leading component of manufacturing activity in the EU accounting for 8 percent of total manufacturing employment. The total production of EU's textile and clothing in 1996, at the prices of 1997, accounted for ECU 87.6 billion for textile and ECU 49.7 billion for clothing.[41] The textile industry accounted for 3.2 per cent of the EU manufacturing industry's value-added in 1994, which is about double that of the EU clothing industry. They are also an important source of employment in the EU. The EU's textile and clothing industry employs an estimated 2.25 million people with 1.23 million employed in the textile sector and 1.02 million employed in the clothing sector.[42] A look at the regional concentration of textile and clothing employment (Table.4.10) shows the importance of textile and clothing industries in the southern member countries than in the northern member countries. Though the less-developed member countries have sectoral specialisation in textile and clothing industries, the developed member countries continue to enjoy comparative advantage in the production and exports of textile and clothing products.

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[40] Ricardo Faini, Demand and Supply Factors in Textile Trade in Giorgio Babra Navaretti, Riccardo Faini and Aubrey Silberston (eds.), Beyond the Multifibre Agreement: Third World Competition and Restructuring Europe's Textile Industry, *Development Centre Documents*, OECD, Paris, 1995, pp.45-60.

[41] This is against the background that the world trade in textile and garments accounted for $300 billion in 1995 (approximately 187 billion pounds).

[42] The EU Textile and Clothing Sector 1997 - A factual Report, (*L'Observatoire Europeen Du Textile et de L'Habillement:* Brussels) April 1997, p.23.

Table 4.10. EU's Textile and Clothing Employment (in 1996)

Country	Textile (%)	Clothing (%)	Country	Textile (%)	Clothing (%)
Austria	1.8	1.2	Ireland	0.8	0.8
Belgium	3.8	1.6	Italy	28.3	21.3
Denmark	1.0	0.7	Netherlands	1.2	0.8
Finland	0.6	0.8	Portugal	11.9	13.6
France	10.7	12.5	Spain	11.3	11.5
Germany	12.4	11.7	Sweden	1.0	0.3
Greece	3.5	2.6	UK	12.3	20.6

The challenges witnessed by the European textile and clothing industries have wider implications for their employment. The gradual elimination of trade barriers by the member countries has resulted in significant employment losses for the member countries. In other words, it could also be argued that the removal of protection offered to the European textile and clothing industries has resulted in a considerable influx of imports from the non-member countries, which resulted in a considerable employment losses. It is estimated that, even for relatively competitive Italian textile and clothing industry, a complete elimination of both tariff and non-tariff protection is a reduction of employment by 3 per cent in textile and 19 per cent in clothing.[43] Likewise the impact of this elimination could be estimated to be higher in less competitive textile and clothing industries of the member countries. Another factor responsible for the loss of European textile and clothing employment is a fall in the prices of less developed countries' exports to the member countries. A 10 per cent reduction in developing countries' export prices would, on average, increase the textile and clothing trade flows by 30 and 10 per cent respectively.[44] Any increase in import-penetration would have to be construed as a lost employment in the member countries. This is particularly true in the case of the exporting countries, whose exports are close substitutes of the Community products. The effects of the removal of the trade barriers on employment would have been considered to be higher in countries where the textile and clothing industries constitute a major proportion of total manufacturing output such as in the case of Portugal, Spain and Ireland.

The geographical distribution of production in the textile and clothing industries has changed dramatically in the last 25 years, resulting in sizeable employment losses in Europe and important gains in Asia and other parts of the developing world. While the textile industries are trying to reorganise themselves by introducing various strategies such as automating to boost their productivity, downsizing to reduce operational costs, re-engineering to improve flexibility, they inadvertently result in employment losses. However the case of the clothing industries is

[43] Fabrizio Guelda and Marco Ratti, Price-Cost Margins in Italian Textile and Clothing in Giorgio Babra Navaretti, Riccardo Faini and Aubrey Silberston (eds.), Beyond the Multifibre Agreement; Third World Competition and Restructuring Europe's Textile Industry, *Development Centre Documents*, OECD, Paris, 1995, pp.89-101.

[44] Ricardo Faini, Demand and Supply Factors, pp.45-60.

entirely different as the reorganisation of these industries would be extremely difficult given the high labour content associated in the production process. Hence any rise in the labour cost would obviously result in high production costs, which would hurt the industrial efficiency and international competitiveness of European textile and clothing industries. In many of the member countries, the clothing industries - while facing intense competition from low-cost non-member countries - are left with no option but to re-deploy a part of their manufacturing operations to offset the effects of higher domestic labour cost. It is not necessarily the labour cost, but also other costs such as the costs of raw materials - chemicals and synthetic fibres - that would affect the cost competitiveness of this industry. As a result the impact of employment losses would be considered more in clothing than in textile industry given the nature and level of labour employed in the production process.

4.6. CONSUMPTION IN EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

The EU's textile and clothing industries are facing a difficult time characterised by deteriorating consumption and demand. The decline in demand for the textile and clothing industries in the EU is mainly because of the fact that the demand for textile and clothing products is derived mainly from two sources: (i) domestic demand within the member countries[45]; (ii) demand in the non-member countries. Every change that has been witnessed in the economies of the member countries is reflected in the way the demand for their textile and clothing products are effected. The domestic demand is an important component of final demand in EU's textile and clothing industries. The textile and clothing industries are so integrated in the EU's national economies that whatever changes witnessed in the domestic economic environment would affect their performance. The performance of the EU's textile and clothing industries is reflected by the general economic performance of respective national economies. The strong performance of the economy as a whole would raise consumer confidence and encourage them to spend more and save less. The assumption that the economy would perform better in the long-run would encourage the consumers to spend more on items, which are considered as being more discretionary than necessary thereby influence consumers' preference towards the consumable items. Whereas uncertain future induced by an adverse economic climate and slow growth rate would shift consumer confidence away from consumption-oriented values towards post-materialist values, characterised by greater concern for personal well being, security and social concerns for issues such environment.

[45] Domestic demand represents a largest source of demand for EU's textile and clothing. As measured by apparent consumption in value terms, domestic demand accounted for 83 percent of EU textile production and 79 percent of EU clothing production in 1996. In this household consumption of textile and clothing alone accounted for 80 percent of EU's final demand of ECU 154 billion in 1996 against the remaining 20 percent represented by manufacturing (11 percent) and service sector (9 percent) consumption. For more details see, The EU Textile and Clothing Sector 1997 - A factual Report, (*L'Observatoire Europeen Du Textile et de L'Habillement:* Brussels), April 1997.

The deterioration in the level of clothing consumption in the member countries is associated with the state of the economy and the changing attitude and values of the consumers given the present state of economy. A decline in the textile and clothing consumption has been witnessed in most of the member countries, despite the fact that prices have fallen in relation to other consumer goods. A decline in disposable income associated with rising tax levels in the member countries forces the consumers to spend less on clothing thereby making the spending on clothing less fashionable. This trend is evident in most of the member countries including the countries where upmarket clothing continues to dominate such as France and Italy.

An analysis of apparent consumption in the EU confirms an overall declining trend. Apparent consumption of textile fell, in value terms at 1997 prices, by 4 per cent between 1995 and 1996, whereas the same for clothing rose by 0.4 per cent for the same period.[46] Over the period from 1990 to 1996, apparent consumption of textile fell by 10 per cent in value terms compared to an increase of 8 per cent for clothing.[47] It is also important to look at the structure of the final demand for textile and clothing, which would confirm the relationship between the two dependent factors, the level of disposable income associated and the performance of the domestic economy and the final demand for textile and clothing in the EU. As for the textile sector, measured in producer prices - which exclude VAT and retail margins, it is estimated that households' consumption of clothing accounted for 69 per cent of total final demand of 154 billion in the EU in 1996 followed by home textile with 11.1 per cent, manufacturing industry consumption with 10.9 per cent and service industry consumption with 9.3 per cent.[48] This statistics confirm the importance of household consumption in determining the total demand for EU's textile and clothing industries. In terms of final products consumed by households, clothing accounts for the largest proportion with 86 per cent followed by home textile with 11 per cent and floor coverings with 3 per cent.[49] Among the consumption by manufacturing and service industries, clothing accounts for 30 per cent followed by specific textile used for special industrial purposes such as geo-textiles used in construction and civil engineering, agro-textiles and textile products used in the manufacture of vehicles and medical and pharmaceutical applications. Home textile are also important representing 27 per cent of manufacturing and service industry consumption.[50] A large part of this takes the form of furnishing fabric used in furniture manufacturing and table and toilet lined consumed in hotel and catering sector. Textile flow coverings represent 13 per cent of manufacturing and service industry consumption in the form of carpeting for office buildings, hotels and restaurants.[51]

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[46] The EU Textile and Clothing Sector 1997 - A factual Report, (*L'Observatoire Europeen Du Textile et de L'Habillement:* Brussels), April 1997, p.9.
[47] ibid., pp. 9-10.
[48] ibid., p.10.
[49] ibid., p. 11.
[50] Ibid., p. 11.
[51] Ibid., p. 11.

Table 4.11. EU's Textile and Clothing Consumption (breakdown by product category in per cent in 1996)

Product Group	Household Clothing	Household Home Textile	Manufacturing Industry	Service Industry
Per cent	68.7	11.1	10.9	9.3

Table 4.12. EU's Household Consumption (breakdown by product category in per cent in 1996)

Product Group	Clothing	Home Textile	Textile Floor Coverings
Per cent	86	11	3

Table 4.13. EU's Manufacturing and Service Industry Consumption (breakdown by product category in per cent in 1996)

Product Group	Clothing	Home Textile	Textile Floor Coverings	Specialised Textile
Per cent	30	27	13	30

A further analysis of the household clothing consumption, a largest proportion in total textile and clothing consumption, reveals the consumption by product categories. The largest single category of clothing is casual wear with 33 per cent closely followed by formal wear with 32 per cent. There are also other categories such as underwear with 14 per cent, sports wear 11 per cent and children's wear with 10 per cent.

Table. 4.14. EU's Household Textile and Clothing Consumption (breakdown by product category in per cent in 1996)

Product Group	Casual wear	Formal wear	Underwear	Sports wear	Children's wear
Per cent	33	32	14	11	10

A look at the textile and clothing consumption in the member countries highlights the correlation between the consumer's affluence and their attitude towards spending on textile and clothing. In 1996, among the total textile and clothing consumption, Germany accounted for a largest proportion with 26.8 per cent followed by Italy with 16.4 per cent, France with 15.5 per cent and the UK with 13.8 per cent. Whereas the three less developed member countries, Ireland, Portugal and Greece, accounted for only 0.7 per cent, 2.1 per cent and 1.8 per cent respectively. While the four developed member countries accounted for more than 72 per cent

of the total EU's textile and clothing consumption, the three less developed member countries, Ireland, Portugal and Greece, accounted for only 4.6 per cent of total EU consumption. The per head spending on textile and clothing in the member countries, which often corresponds to the per capita income, shows the disparity in the consumption pattern between the consumers in the developed and developing member countries. Among the countries with high consumer spending on textile and clothing, Austria leads the table with ECU 914 per head followed by Belgium with ECU 861, Germany with ECU 812 and Italy with ECU 772.[52] Whereas the spending in the less developed member countries remains low compared to those in the high spending member countries. For example the per head spending in Greece is ECU 452 followed by Ireland with ECU 454, Spain with ECU 481 and Portugal with ECU 537. This is against the background where the average per head spending in the EU remains at ECU 658. The per head spending in the developed member countries are more than two times those in the less developed member countries. This clearly shows the demand for the final products of the textile and clothing industries are mainly derived from high consumption countries with high spending consumers, such as Germany, Italy, France and the United Kingdom.

[52] It is important to highlight the fact that the member countries consumption always do not correlate with per head consumer spending as the disparities reflect the differences in the population in the member countries. Though the per head consumer spending in Austria is the highest, Germany still retails the position as a leading consumer of textile and clothing products as it has the higher population than Austria.

Table 4.15. Textile and Clothing Consumption by Member Countries – 1996 (in per cent)

Countries	Austria	Belgium	Denmark	Finland	France	Germany	Greece	Italy	Ireland	Nether.	Portugal	Spain	Sweden	U.K
Per cent	2.8	3.8	1.4	1.2	15.5	26.8	1.8	16.4	0.7	4.4	2.1	7.0	2.1	13.8

Source: various issues of The EU Textile and Clothing Sector - A factual Report, *L'Observatoire Europeen Du Textile et de L'Habillement:* Brussels.

Table 4.16. Per Head Consumer Spending by Member Countries – 1996 (in ECU)

Countries	Austria	Belgium	Denmark	EU (avg.)	Finland	France	Germany	Greece	Italy	Ireland	Luxem.	Netherlands	Portugal	Spain	Sweden	U.K
ECU	914	861	640	658	424	601	812	452	772	454	854	669	537	481	540	545

Source: various issues of The EU Textile and Clothing Sector - A factual Report, *L'Observatoire Europeen Du Textile et de L'Habillement:* Brussels.

Table 4.17. Consumer Spending on Textile and Clothing as a Proportion of Total Consumer Spending in 1996 (in percent)

Countries	Austria	Belgium	Denmark	EU (avg.)	Finland	France	Germany	Greece	Italy	Ireland	Luxem.	Netherlands	Portugal	Spain	Sweden	U.K
Per cent	7.0	6.9	4.6	6.1	4.3	4.6	6.5	6.7	7.6	5.5	5.6	5.7	10.4	6.4	4.8	5.7

Source: various issues of The EU Textile and Clothing Sector - A factual Report, *L'Observatoire Europeen Du Textile et de L'Habillement:* Brussels.

The rise in cotton, fibre and yarn prices would affect the intermediate demand for textile sector which would further affect the final demand by households and other manufacturing and service sectors which rely heavily on finished textile and products for using in their products (for example automobile industry, hotel industry). On the other hand the rise in domestic labour, energy and other related costs affect the foreign demand for the EU's textile and clothing products in the non-member countries thereby imposing further constraints on the concentration on this sector. The consequence is that these industries not only demand specialised treatment in the domestic market in preference to other sectors but also demand protection against external competition.

An analysis of the European textile and clothing industries reveals the changing nature of the European textile and clothing industries and serious economical and social problems they face, mainly due to phenomena such as relocation, internationalisation, outsourcing and intensive automation.

4.7. Foreign Trade in European Textile and Clothing Industries:

The EU continues to be a single largest trading unit in international textile and clothing trade. Imports and exports continue to grow at a faster rate in textile than it is in clothing. However in clothing imports grow at a faster rate than exports. In 1998, the EU exported 3.3 million tonnes of textile worth Euro 21.7 billion and imported 3.9 million tonnes valued at Euro 17 billion. The leading export destinations for European textile are the USA, Poland, Tunisia, Switzerland and Morocco which together account for nearly 37 per cent total EU exports in value terms. Most of the exports (33 per cent) destined to Tunisia, Morocco, Romania, Hungary, the Czech Republic and Poland were meant for Outward Processing Trade (OPT). The leading exporters of Community textile (including intra- and extra- exports) are Germany (21.4 per cent), Italy (20.7 per cent), Belgium and France (12 per cent each) and the United Kingdom (9 per cent). The leading importers are Germany (20 per cent), the United Kingdom (15 per cent), France (14 per cent) and Italy (13 per cent).

The performance scenario of European clothing industry is not impressive that it continues to shows a declining trend. The EU's clothing exports, in 1998, accounted for Euro 13.1 billion. The leading export destinations are the USA, Switzerland and Japan, which together account for nearly 42 per cent of EU's total clothing exports. The clothing imports accounted for Euro 38 billion. The leading clothing suppliers to the EU are China, Turkey, Hong Kong, India and three OPT partners Tunisia, Morocco and Romania which together account for about 49 per cent of total EU clothing imports.

The trade balance in EU's textile and clothing trade continues to deteriorate due to disproportionate increase in its clothing trade deficit. The trade balance remained negative with a deficit of nearly 2.5 million tonnes worth Euro 20.2 billion.

4.8. PROBLEMS AND STRATEGIES OF EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

For EU's textile and clothing firms, success in the fast changing markets of the 1990s is very information intensive. Trade liberalisation and the emergence of many low-cost countries as producers of textile and clothing have forced the industry in all parts of Europe to engage in a far-reaching process of restructuring. They can no longer rely on their competitive advantage in the mass production of standardised goods for price-sensitive markets. Instead they are forced to compete more on the basis of design, quality, and responsiveness to market trends.

The European textile and clothing industries are coming under increasing competition from both the developed and developing non-member countries. In the case of textile industries, the competition is witnessed between the countries of similar economic strength. This is mainly because of the level of technology associated with the textile industries. While the member countries compete against other non-member developed countries, the developing countries compete amongst themselves. In the case of clothing industries the competition is not limited to any particular region as the cost factors mainly determine the level of competition in this industry.

The textile and clothing industry is by no means a homogeneous sector with sub-sectors have different problems and had to experience different adjustment strategies to cope with economic integration.[53] As already mentioned above, it is important to realise Plant Economies of Scale (PES) and Product Specific Economies of Scale (PSES) in the European textile and clothing industry with the latter gaining more importance as the production process moves from downstream stages to upstream stages. It is possible that the European textile and clothing industries, which has long been internationalised could have witnessed both PES and PSES. However the existing literatures confirm that the Plant Economies of Scale play a limited role in textile and clothing industry.[54] Few factors could be considered responsible for the non-realisation of PES and PSES. Firstly, the effective reallocation of resources, which, according to Customs Union theory, is to be witnessed in any unified Single European Market, had not been witnessed in the Single European Market. Though higher levels of competition were witnessed

[53] see Michael Breitenacher, Sergio Paba, Gianpaolo Rossini, *The Cost of Non-Europe in Textile-Clothing Industry: Executive Summary*, December 1987.
[54] ibid., p.11.

in the Single European Market, it did not result in the exit of many inefficient firms from the market. The existence of these firms are very important for most of the member countries as they provided a considerable manufacturing employment aimed at semi-skilled and unskilled labourers. Moreover employment was the real issue behind the public interest in the industry during the period of difficulties. Many of the inefficient firms had to be preserved, as it was in the case of France, Italy by providing state subsidies. As a result cross border resource allocation had not been witnessed. Factor-Price equalisation theory argues that in presence of unhindered competition, factor prices tend to become equal. However in the case of the Single European Market, it is not only the resources, which did not cross the borders, but also the labour that did not respond to higher wages in the developed member countries. Various factors responsible were explained for this non-movement in the previous chapters. Instead cross border investment had been witnessed. Secondly the nature and size of these firms did not allow them to realise the PES. Most of the firms operating in these sectors are comprised of SME's, which did not have either the operational and financial characteristics to attain the PES. Thirdly the possibility of exploiting PES and PSES is seriously limited in sectors characterised by product standardisation. There is a clear trade-off between product variety and PES and the choice depends on the market target of the firms.[55] Since the European textile and clothing market is very volatile with fast changing consumer preferences, these industries could not, to a large extent, exploit the benefits offered by the economies of scale in the Single European Market.

The main problem facing the European textile and clothing industries is their inability to compete against the low-cost non-member countries. Inflexible labour market and rigid market policies make it difficult for these industries to face cost competition in their own market. Excessive labour and production costs, excessive taxes and social expenses and increased competition from low-cost non-member countries have increased the significance of cost-management in the member countries. The direct relationship between the wages and productivity makes it imperative for the European textile industries to compensate their wage rise in higher productivity to remain cost competitive against the low-cost imports from other developed countries. Faced with the challenges of increasing costs, falling consumption, falling employment, falling market share, many of the industries are forced to adopt the measures aimed at increasing their industrial efficiency and international competitiveness. As a result various strategies were adopted to increase the efficiency and competitiveness of these industries in the EU. Compared to clothing industry, textile industry has performed better by enhancing its competitiveness through investment and modernisation. The European textile industries are able to maintain their efficiency and competitiveness by adopting various strategic measures aimed at increasing the productivity level. Since the nature of the European textile industry is capital- and technology- intensive, higher investments and intensive use of

[55] ibid., p.12.

technology have been used to consolidate the market position in the Single European Market. Technology has been widely used in all lines of production to facilitate flexibility, product upgrading, shorter production times and reduction of wastage. Lately they are also intensively used in spinning, weaving and finishing. The high level of automation has not only helped the industry to increase its productivity level and reduce the unit production costs but also helped in protecting from low-cost competition by increasing their reliance on product differentiation, design and quality, the areas that are harder to compete for the low-cost non-member countries. The introduction of new technology has been so successful that the European textile industries are resorting to increased automation in their production lines rather than relocating their industries to low-wage countries as it is in the case of many clothing industries. The automation of production erodes developing countries' major factor advantage of cheap labour.[56] Nevertheless relocation has also been taking place in European textile industries. However it is interesting to note that it is the introduction of modern production techniques rather than the static and dynamic effects associated with the completion of the Single European Market that resulted in cost-reduction effects in the Single European Market. Technological innovation has caused a strong increase in productivity with significant cost reduction as in the case of German and Italian textile industry.[57]

The clothing industries are characterised as low-skilled, labour-intensive sector operating with limited capital availability. In clothing industries, labour alone accounts for more than 65 per cent of total production costs. Hence the meaning of cost competition has gained significant importance in clothing industries. However in the case of European clothing industries, the relationship between wages and productivity is less than proportional, though it is not averse. In many member countries, the wages have risen at a faster rate than productivity making the gap between the wages and productivity even wider than it was before. The consequence is a fall in cost competitiveness, which has forced the member countries to adjust themselves to the changing scenario. This has limited the choices available to European clothing producers.

Various strategic choices are available to European clothing producers. Two important options are market oriented and production oriented strategies. Market oriented strategies aim at improving the market condition of the firms by entering market segments with a relatively rigid consumer demand by introducing new patterns of consumption through the creation of brand names and advertising or by increasing the efficiency of distribution through direct distributive

[56] Georg Kell and Jurgen Richtering, Technology and Competitiveness in the Textile Industry, UNCTAD Discussion Paper no.42, October 1991, p.1.
[57] Michael Breitenacher, *The Cost of Non-Europe*, p.15.

networks. Production oriented strategies aim at re-deploying the existing production lines to the low-cost countries and introduce new patterns of production through technical innovation. The following four strategies are considered to be important to preserve the market share of European clothing producers in the Single European Market.

(i) rationalising and re-engineering the existing mass production lines through: (a) downsizing; (b) optimally utilising the work force and (c) implementing automation;

(ii) introducing product sophistication and moving to upmarket quality production thereby avoiding competition in the low-profit margin and high-competitive downstream mass produced products;

(iii) sub-contracting the part of the production process;

(iv) relocating the production to low-cost neighbouring countries;

4.9. RATIONALISING THE EXISTING PRODUCTION LINES:

4.9.1. DOWNSIZING:

The rationalisation in clothing industry could be achieved by re-engineering the existing production lines. Industrial restructuring through downsizing and by introducing automation would have considerable impact on total production costs in the industry where labour costs alone account for more than two thirds of total production costs. Increasing the flexibility in production lines and optimally utilising the work force could help in reducing the labour costs and revitalise the competitiveness of the European clothing industries. However the critics of this strategy argue against the ill effects of this strategy on an already shrinking industry. The restructuring of clothing industries has caused heavy employment losses in many member countries of the North.[58] It is intended to reduce to the greatest possible extent the volume of salary costs in production costs and to shift production towards sectors less exposed to low-wage countries competition. Moreover this strategy did not seem to have considerable effect in reducing the total labour costs. This is because the clothing industry is mostly dominated by female labour that is mostly unskilled and paid lower than their male counterparts in this industry. The share of women in total labour force is much higher in clothing sector than

[58] Belgium, the Netherlands, Ireland, the United Kingdom, Germany and Denmark have witnessed heavy employment losses in their clothing industry. This is not the same for the less developed member countries as they have not only less expensive labour force but also an extensive flexible underground work force.

that for textile sector.[59] The average female salary is below the average male salary.[60] Most of the work force in this industry is temporary and part timers and their entry and exit rates are often high in this industry. Moreover the clothing industry in Europe is highly unorganised with substantial work force being represented under various unorganised forms such as independent employment, part-time, temporary and homework employment.

4.9.2. OPTIMAL UTILISATION OF THE WORK FORCE:

The optimal utilisation of the work force would require an increase in investment levels. The clothing industry has one of the lowest ratios of capital to output or capital per worker of any manufacturing industry. It also has low level of human capital per worker, with the average worker has a low standard of education compared to other industrial sectors. As a result it is argued that the feasible way of redressing the survival capability of this industry is to increase the level of investment in plant and equipment. Any investment in human capital to increase their skills could only be achieved in the longer run with substantial costs, with often unnoticeable effects on this industry. Rather interestingly the need to be more capital-intensive in this sector has also been questioned. A French research centre working on the problems specific to this industry estimated that 90 per cent of any productivity gains would be the result of improved methods with only 10 per cent attributable to investments in plant.[61]

4.9.3. AUTOMATION:

The effects of the reorganisation of existing production lines towards greater flexibility could be felt differently among various member countries. While the clothing industries of the southern member countries - due to their limited enterprise size and scattered structure - could witness flexible production, the same could not be witnessed by the developed member countries as their production has always been mass-oriented. The main problem facing these un-fragmented, mass-produced units is their failure to respond to greater diversity of products and

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[59] In Belgium, women accounted for 63.3 per cent of labour force. In Denmark, three-fourths of jobs at lower tier are held by women. In Spain, women represent more than with 67 per cent in clothing sectors with as much as 90 per cent of work force in spinning and fabric sub-sectors. In Ireland, Portugal, Greece women are highly represented in less skilled jobs with 77, 91 and 60 per cent respectively. Even in countries with well developed clothing industries women are highly represented in most of the semi-skilled or less-skilled jobs. In Italy, women account for 77 per cent of the work force. In Germany (84 per cent), United Kingdom (64 per cent), the Netherlands (82 per cent) women have substantial role than men in the lower stratum of skill levels. For more details see, The Impact of the Single Market on Women's Employment in the Textile and Clothing Industry, Social Europe, Supplement 2/91, *Commission of the European Communities*, 1991.

[60] The Impact of the Single Market on Women's Employment in the Textile and Clothing Industry, Social Europe, Supplement 2/91, *Commission of the European Communities*, 1991, p.52.

[61] cited in Jose de la Torre, Clothing Industry Adjustment in Developed Countries, *Trade Policy Research Centre*, (Macmillan: London), 1986, p.82.

to respond rapidly to changing demand conditions. It is also argued that the need for flexibility in the clothing industry could have a detrimental effect on the quality of work force, which would further erode the efficiency and competitiveness of European clothing industry. Automation is another important strategy that could be implemented in the European clothing industries that are facing cost competition from the low-cost non-member countries. This is expected to erode the developing countries' major factor advantage of cheap labour. Though the technical innovations are slower in clothing industry compared to textile industry, rare technical innovations have not allowed these industries to resort to greater automation in their production lines. Nevertheless the use of computers and their techniques such as Computer Aided Design (CAD) and Computer Aided Manufacturing (CAM) could be mostly used in pre-assembly stages of design, grading and cutting[62]. Significant developments have taken place in computerised marking and grading, and in automated cutting. The aim of the pre-assembly computerisation is to reduce material wastage, cut the labour used and training times, reduce lead times and increase the flexibility, improve quality and reduce costs. It has also been argued that the use of computer aided techniques could allow the clothing industry in reducing the defects and rejection rates, in shortening the production lines and increasing the flexibility without the need for more skilled labour. However the use and the impact of the microelectronic technology on the performance of the clothing industry has often been contested. The total cost of investing in automated machines is relatively high for average clothing manufacturer. Since it is very expensive to introduce CAD, which costs between £25,000 and £200,000 depending on the range of functions and the computerised cutter costs around £60,000 per cutter, not many firms, which are often small sized enterprises, could introduce these facilities in their production lines.[63] The laser-cutters that are used in precision cutting are also very expensive to be used by many small-sized enterprises.[64] The judiciousness of spending a large sum of money by small enterprises in high skilled areas, which normally account for less than 4 per cent of the work force has often been debated.[65,66] It has also been widely believed that the use of computers allows the clothing industry shorter production runs and flexibility without the need

[62] The other processes in clothing industry are assembly, sewing the finished garments and pressing.

[63] Cited in Caroline Lloyd, Microelectronics in the Clothing Industry: Firm Strategy and the Skills Debate, *New Technology, Work and Employment*, vol.12, no.1, March 1997, p.39. For more related arguments see, Chris Byrne, The Industrial and Social Impact of New Technology in the Clothing Industry into the 2000s, Paper produced for the *International Labour Office* in Geneva.

[64] Cited in Italy: High-tech sparks latest Renaissance, *The Financial Times*, 18 April 1998.

[65] This statistics is based on the clothing manufacturing activity in the United Kingdom. Though this statistics could not be taken on its face value, it could still be argued that the share of skilled work force is considerably smaller in total workforce across the Europe.

[66] a study carried out by Kurt Salmon Associates for the for Commission of the European Community analysed the impact of the introduction of new technologies on the performance of the manufacturers. Their study concluded that the optimal investment level would have to be increased to the order of ten to twelve times the current levels to achieve the reduction in the labour content to 25 per cent, 50 per cent and 70 per cent in medium, high and super-technology sub-sectors. For more details see *The 1980s: The Decade for Technology: Report Prepared for the Commission of the European Community*, (Kurt Salmon Associates: Washington), 1979.

for more skilled labour. However it has to be highlighted that the use of computers in the production line has its own limitations. Though the main objective of the computerisation is to reduce the production costs, it does not seem to serve the purpose. The introduction of computers in pre-assembly production has not reduced the employment level to a considerable extent as they pre-assembly workers account for only a small proportion of total work force. The high skilled jobs such as designers, mechanics and pattern cutters, where the modern automated techniques are often used, represent a negligible proportion.[67] Reducing costs through improved fabric utilisation are also not seen as the outcome of the computerisation.[68] It is claimed that though CAD improved consistency and the computerised cutting is felt to have increased accuracy and quality, some of these techniques are considered to have deficiencies compared to their manual operations such as the computer cutting of fabrics such as lycras and elastics which do not normally lie flat in the process of cutting. However it is suggested that the developments in CAD and CAM in clothing industry are not due to rationalisation.[69] Furthermore the automation of production lines has not given the developed member countries any greater competitive advantage over the low-cost developing member countries as the recent trends in technology diffusion make most of the new technologies immediately available to the producers in the developing countries (as in the case of Hong Kong and South Korea).

COMPUTERISATION AND AUTOMATION IN TEXTILE AND CLOTHING INDUSTRIES

Computerisation In	**Automation In**
the Cutting Room	Fabric Preparation
the Design Process (CAD)	Cutting
the Computer Added Manufacturing (CAM)	Materials Handling
	Fusing
	Sewing
	Pressing
	Garment Dyeing

Nevertheless the use of computerisation and microelectronics in the production lines has:

1. increased the spinning process in individual spinning machines where different materials and blends are used;
2. increased the scope for automatic fabric fault detection;

[67] In the case of United Kingdom, the semi-skilled and the highly skilled account for 55 per cent and 4 per cent respectively of all employees. For more details see Caroline Lloyd, Microelectronics in the Clothing Industry: Firm Strategy and the Skills Debate, *New Technology, Work and Employment*, vol.12, no.1, March 1997, pp.36-47.

[68] Caroline Lloyd, Microelectronics in the Clothing Industry; Firm Strategy and the Skills Debate, *New Technology, Work and Employment*, vol.12, no.1, March 1997, p44.

[69] ibid., p.45.

3. increased product quality as computer pre-assembly ensures quality in terms of more design input, more expensive materials or a generally better-made garment;
4. have increased the flexibility in their production so that they could respond to the rapidly changing needs of the consumers. One questionnaire showed the computerisation has reduced the laying up to half an hour from half a day that was used to make with the use of manual techniques.[70] Even the most complicated lays are thought to take twenty minutes compared to a few days it used to take previously. It is also widely believed that it has increased the output to a considerable level;[71]
5. increased productivity and competitive advantages, particularly in the areas of rapid response, 'just in time' techniques, quality, creativity, know-how and innovation.[72] The European industry is still the world's leading exporter of textile products and the third largest exporter of clothing products.

4.10. MOVEMENT TO UP-MARKET PRODUCTION:

Introducing product sophistication and moving to upmarket production are considered to be important factor in countering the competition from the low-wage countries. The 1970s witnessed the emergence of a global consumer demand for clothes with a high fashion content. By the end of the decade, a few large multinational companies were deriving considerable profit from privileged market position they had obtained in most of the developed countries. Design, style and colour as well as exclusive distribution were the hallmarks of these firms. They aimed their market strategies of product value and differentiation at a new segment of the market for clothing, the relatively affluent consumer, who is willing to pay for intangible qualities of a limited degree of exclusivity and excellence in design. An interesting factor about this segment is that it has been expanding rapidly while increasing the prospect for the survival and prosperity of any firms based in developed countries as customers could always be found for this segment across the world.

One of the most successful strategies adopted by some of the member countries is to introduce product sophistication and move to up-market production process from their traditional mass production which limit the scope for cost competition against the low-cost non-member countries. Since the level of competition is intense for mass produced clothing products in the Single European Market, some of the member countries resort to upmarket movement, where the sense of vulnerability from low-cost countries is limited as it requires high-investment for them to imitate this strategy. The broadening of immaterial-investment factors, such as design, advertising and distribution could be exploited to counter the competition from the low-cost countries. The argument behind such a move is that there is only

[70] ibid., pp.36-47.
[71] ibid., p.44.
[72] *Communication from the Commission to the Council*, The European Parliament, The Economic and Social Committee and the Committee of the Regions, Brussels, 29 October 1997, COM (97), 454 final.

a little, the clothing manufacturer in the developed countries could do to meet the challenges posed by the low-cost competition from the developing countries.[73] Given the huge wage differentials, no amount of investment and automation could close the gap in the short- to medium-term. Moreover the nature of demand for textile and clothing products across the Single European Market, which is often heterogeneous, hinders any possible attempt by the European textile and clothing producers to rationalise and standardise their production to adopt mass production strategy.[74] Hence the move to shift towards non-price factors such as style, product differentiation, design (knitwear, print and weaving designs) and quality is considered to give the producers of the developed countries a comparative advantage. The most popular strategy used in this aspect is to develop and actively promote a brand name to consumers and retailers. Large clothing brands in Europe are internationalising rapidly.[75] The growth of brands such as Armani, Hugo Boss and Benetton is being led by retail expansion into new markets. Throughout the Western Europe, many companies used the same concepts of brand image and careful segmentation.[76] Many of the Italian companies, unlike their German counterparts who tend to concentrate more on Outward Processing Trade as a strategy to counter the increasing production costs, are focussing on market oriented strategies such as increasing the product quality, advertising, differentiating products, developing new brand names and distributive network.[77] A number of Belgian, French and Italian companies have invested heavily in market brands aimed at promoting exclusive product design and quality to emerge as a leader in the high-value-added, high-profit margin sector.[78] The growth of branded clothing has, in recent times, shaped the clothing industry's structure by significantly increasing the price-inelastic consumer demand for these products. Hence style, product differentiation, design, quality have become the hallmarks of European clothing industries.

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[73] A look at the sustainability of different factors of competitive advantage and the competitor's reaction time to it would reveal the importance of the factors of immaterial-investment in any industry. While the reaction time of the competitors to the lower-price is two months, it is two years for the new product. The other reaction times are one year for publicity campaign, three years for the new production process, four years for the distribution network and seven years for the investment in human resources.

[74] the structure of demand for textile and clothing in the EU varies greatly from one country to another and in some cases from one region to another. Hence the economies of scale could not successfully be achieved in this sector as the mass production strategy depends to a large extent the manufacturing of standardised products.

[75] Alison Ashton and David Rigby, Branding in the Textile and Clothing Supply Chain, *Paper Submitted at Textile Institute World Conference*, Tampere, Finland, May 1996.

[76] Jose de la Torre, Clothing Industry Adjustment in Developed Countries, Trade Policy Research Centre, (Macmillan: London), 1986, p.91.

[77] for more related arguments see, Giorgio Barba Navaretti, Trade Policy and Foreign Investments: An Analytical Framework in Giorgio Babra Navaretti, Riccardo Faini and Aubrey Silberston (eds.), Beyond the Multifibre Agreement: Third World Competition and Restructuring Europe's Textile Industry, *Development Centre Documents*, OECD, Paris, 1995, pp.120-44.

[78] Italian fashion trade is estimated to be around $50 billion (cited in Italy: High-tech sparks latest Renaissance, *The Financial Times*, 18 April 1998). Though it is expensive to make clothes in Belgium, luxury clothes are still made in Belgium (cited in Fashion Upstarts Storm the Gates of Paris, *International Business Week*, 17 February 1997).

The flexible manufacturing system introduced through the computerisation and the use of micro-technology would help the clothing firms in developing quick responses (Just-in-Time), which is considered very important in an industry where the designs change very often. The table below shows the various characteristics of mass and up-market production.

TABLE 4.18. VARIOUS CHARACTERISTICS OF MASS AND UP-MARKET PRODUCTION

Characteristics	Mass Production	Up-market Production
Competitive Advantage	Based principally on cost advantage	Based on responsiveness to market trends
Future	Lie with large, vertically integrated firms	smaller, highly versatile units, either SME's or loosely attached to parent firms
Competition	Mainly from developing countries	Between developed countries
Dependence	On a limited number of retail Customers; few exports	On large number of niche customers in an international market
Nature of the Product	Low design content; design initiated by the retailer	High design content; design innovation led by the manufacturer
Production Runs and Change of Styles	Long production runs and infrequent style changes	Short runs and frequent style changes
Skill Levels	Operatives de-skilled and opportunities for discretion minimised.	Multi-skilled operatives provide competitive edge through problem solving and innovative abilities
Training Levels	Minimal training and opportunities for progression limited	Continual vocational education and training for all Employees

4.11. INTERNAL SUB-CONTRACTING IN EUROPEAN TEXTILE AND CLOTHING INDUSTRIES:

The efficiency and flexibility of the European textile and clothing could also be increased by subcontracting either the production of initial process or the manufacturing of final products in low-cost units. Subcontracting involves all areas of production in textile and clothing industry, but is particularly widespread in labour-intensive processes such as finishing and the made-up articles. The costs, response and flexibility are considered be an overriding rationale for approximately two-third of subcontracting in Europe.[79] The attempt to subcontract a part of the production process to a greater number of small firms, which provides necessary flexibility and efficiency in production, has been considered an important strategy by European textile and clothing industries. Italy is a leading proponent of this strategy. Italian textile and

[79] The Competitiveness of Sub-contracting in the Textile and Clothing Industry in the European Union, *Commission of the European Communities*, COM (96), 210, p.6.

clothing sector provides a large part of their production process to large number of small and often efficient production units.

Small sub-contracting firms working for local or distant manufacturers make up a large proportion of the textile and clothing industry in the EU, varying from 10 per cent to 60 per cent depending on the member country.[80] The subcontracting activities often take the form of cottage industries, which play a leading source of employment and income in many regions.[81] However this strategy does not go without its inherent limits. This is because subcontracting is highly labour-intensive and these firms are operating with less capital formation. These subcontracting firms suffer from certain structural weakness such as in failing to cope with far-reaching changes and the adjustment strategies adopted by their customers (manufacturers and distributors). They are also victims of sluggish European demand, frequent changes in consumer preferences. Even in subcontracting firms, labour costs remain high because of seasonal, irregular work load, which requires more flexible use of working time.[82] Still the gap between wages of subcontracting European labour and low-cost countries' labour is still considered too high to rely on subcontracting alone exclusively. As a result they are vulnerable to external competition, which results in internationalisation of European textile and clothing production to low-cost locations.

4.12. INTERNATIONALISATION OF PRODUCTION:

One of the earliest responses to low cost foreign competition is internationalisation. Relocation of production is one of the most popular strategy adopted in this regard. The internationalisation of production was in sequel to the rise in domestic labour costs and their inability to restructure the domestic industry to challenge the competition from low-cost non-member countries. This strategy has mainly been implemented for most labour-intensive production process in high cost countries. As a result we tend to see many overseas centres of production for clothing industries. Though it is more prevalent in clothing industries we could also see this strategy also being evolved in textile production.

Redeployment of a part of manufacturing operations - which has also been known as Outward Processing Trade[83] - has been in operation for a long time. The Dutch and West

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[80] ibid.

[81] It is suggested that subcontracting accounts for a considerable proportion of total textile and clothing employment with 650,000 people. See The Competitiveness of Sub-contracting in the Textile and Clothing Industry in the European Union, *Commission of the European Communities*, COM (96), 210.

[82] The Competitiveness of Sub-contracting, p.5.

[83] In this strategy the Clothing manufacturers export their fabric to nearby countries for making up into clothing. This clothing is re-imported into the EU as Outward Processed product. Such an import form a considerable part of EU's external import.

German foreign investment were witnessed in Belgian and Italian clothing industry long before the recession of 1970's. The high-cost countries discouraged by unfavourable domestic labour market conditions diverted their investments to Belgium and Italy in response to regional incentives and low-cost manufacturing locations. However this process was stimulated by the world recession of 1973, which induced the European producers to expand their production bases rapidly to low-cost locations. This process witnessed two stages: (a) delocalisation and (b) foreign production, subcontracting and sourcing. In the first stage the high cost member countries diverted their investment to low cost locations in other member countries. In the 1960s, the Belgian, Dutch and West German clothing producers, attracted by low labour costs, invested southwards. The German clothing manufacturers targeted low cost countries within Europe. Even the Italian clothing industries shifted their investments to southern Italy. And in the second stage as the labour cost started rising in the low-cost member countries in the late 1970s, they moved their investment to less developed countries and Newly Industrialised Economies (NIE's). The disproportionate rise in the labour cost against the productivity level has made the production in the low-cost locations of the south less profitable. This has given rise to the outward investment in locations outside the regions of the European Union. Germany successfully implemented this strategy with substantial cost reductions while preserving the quality of these subcontracted products.[84] Italian manufacturers were less than eager to internationalise as they were successful in domestic subcontracting. There had been, until recently, much less involvement by firms in Italy and the United Kingdom, but Italian companies are now expanding their foreign investment and clothing operations due to the steady growth of Italian wages and consumer buying habits. Because of its strong retailer and manufacturer relationship, the United Kingdom's indulgence in outward processing has been minimal, but is growing.

One of the most popular forms of internationalisation is "Outward Processing Trade" (OPT) in which goods are re-imported into the Community after the processing of fabrics supplied by the member countries. There are two forms of OPT. One is Fiscal OPT used in customs regulation aimed at covering the differential exemption of duties on materials already brought into free circulation in the Community. Duties are paid only on the value-added of re-imported goods. Another is Economic OPT, which is specific for clothing imports under which goods are re-imported into the Community after processing a number of products originating from the non-member countries. According to the Community's recent agreements with certain countries of Mediterranean, Central and Eastern Europe, re-imports into the Community of clothing goods originating in these countries are granted preferential duties (0 per cent) irrespective of the origin of the fabrics and other goods used in the manufacturing of these goods.

[84] Michael Breitenacher, *The Cost of Non-Europe,* p.14.

At present OPT accounts for a considerable amount of EU's textile and clothing exports and imports. The leading export destinations for the OPT operations are Poland, Tunisia, Morocco, Romania, Hungary and the Czech Republic. Five of the top ten leading export markets are largely employed in OPT operations on behalf of the EU's textile and clothing industry. The OPT accounts for 33 per cent of EU's textile exports.[85] More than 24 per cent of Germany's textile exports are accounted for by OPT purposes.[86] Morocco, Tunisia and Eastern Europe traditionally have been the focus of manufacturing garments for EU companies. The share of outward processing exports from Central and East European countries, in clothing sector, went up from 23 per cent in 1988 to 56 per cent in 1992. Morocco and Tunisia are among the EU's leading 10 clothing suppliers. Moroccan textile companies are quick to react to intense competition, notably from Asia. With 1800 firms regularly employing 200,000 people, the textile industry attained a level of production valued at $2.3 billion, of which 65 per cent is exported.[87] In the case of Tunisia, this sector is the largest employer and also a source of export revenue with 45 per cent of its export receipts maintained from this industry. These exports enjoy free access to the EU apart from the quota preference on its trousers and T-shirts. There are estimated to be about 222,000 workers working in its small and medium sized industries. EU investors are investing in Tunisia's textile and clothing industries. Their minimum wage is $130 per month, which is equal to that of Portugal and twice that of Morocco and 6 times that of Egypt. This may threaten their competitiveness in this sector. Average textile workers' cost per hour is $2.82 compared with $1.28 in Morocco and between 96 cents and $1.25 in East European countries. They face high transportation costs and also the unavailability of certain materials and inadequate quality for export markets. Hence they rely on raw material imports. This reduces the profit margins of these industries in their OPT preparation.

4.13. CUSTOMS UNION THEORY IN PERSPECTIVE:

An analysis of European industries within the framework of the Customs Union theory confirm the belief that the welfare effects of the creation of the Single European Market would be felt disproportionately across various industries according to their efficiency and international competitiveness. The welfare effects of the creation of the Single European Market in one industry need not necessarily be equated with those in other industries. The effects are considered to differ to a large extent from labour-intensive to capital-intensive industries. They differ even among the labour-intensive industries depending upon various factors such as the reallocation of resources, the realisation of economies of scale, the levels of intra-industry trade and import-penetration ratios of the non-member countries.

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[85] The EU Textile and Clothing Sector 1999: A Factual Report, (*L'Observatoire Europeen du Textile et de L'habillement:* Brussels), April 1999, p.55.
[86] ibid., p.55.
[87] *International Business Week*, 27 November 1996.

The basic argument of the Customs Union theory is that the removal of the discriminatory trade barriers between the member countries would result in the free mobility of factors of production. This, in turn, was expected to enhance the efficiency and competitiveness of the industries in the Single European Market. However, in reality, this argument cannot be substantiated by the events of the Single European Market. In the Single European Market, only one factor of production - capital, is highly mobile across the member countries. Other factors, such as labour and resources, are immobile for various reasons as clearly discussed in previous chapters. The removal of internal barriers to trade did not result in the exit of many inefficient firms, which were using the resources ineffectively as analysed in the Customs Union theory. Many inefficient firms continued to subsist in the period following the completion of the Single European Market. Even the high-cost countries continue to concentrate on the production and specialisation of the labour-intensive sectors, in which they have comparative disadvantage (Table.4.19). As a result the completion of the Single European Market has not resulted in the sectoral specialisation of the sectors in which the member countries have their comparative advantage.

Table 4.19. Sectoral specialisation of the member countries in the textile industry

Country	Major strength			Major weakness		
	Price-quality range					
	Down	Medium	High	Down	Medium	High
France	✖	✖	✖	✓	✖	✖
Bel/Lux	✖	✓	✖	✖	✖	✖
Netherl.	✖	✖	✖	✖	✓	✖
Germany	✖	✖	✖	✓	✓	✓
Italy	✖	✓	✓	✖	✖	✖
U.K.	✖	✖	✖	✓	✓	✖
Denmark	✖	✖	✓	✖	✖	✖
Ireland	✖	✖	✖	✖	✖	✓
Greece	✓	✓	✓	✖	✖	✖
Portugal	✓	✓	✖	✖	✖	✖
Spain	✓	✓	✖	✖	✖	✓

Source: Trade Patterns Inside the Single Market - Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 2, Office for the Official Publications of the European Communities, Luxembourg, 1997.

The reasons for the misallocation of resources are the failure of the member countries to converge their economic structure. While the northern member countries show a comparative advantage in the up-market products, the southern member countries show a continued specialisation in the medium- and down-market products.[88] As a result, two trade types,

[88] For example, one-way trade accounts for a considerable proportion of total trade in the less-developed member countries compared to the two-way trade (in both similar and vertically differentiated products). The one-way trade in Greece and Portugal accounts or 86 per cent and 69 per cent of their total trade respectively. There were seven countries, according to the statistics of 1994 (EC-12), whose inter-industry specialisation is higher than the EC-12 average. They are Greece, Portugal, Denmark, Ireland, Italy, Spain and the Netherlands.

intra-industry and inter-industry, have been witnessed among the member countries in the Single European Market, though it is certain that the share of inter-industry trade continues to decline since 1980.

Another important characteristic of the Customs Union theory is the realisation of economies of scale. The existence of economies of scale naturally interacts with the phenomenon of product differentiation. The demand for product differentiation increases as the size of the market increases. Product differentiation limits the scope for the realisation of economies of scale. This is particularly true in the case of products, where efforts to standardise are rather difficult to obtain as a result of differentiated consumer preferences. Even in sectors such as textile, where there is increased scope for product standardisation, the level of economies of scale realised has been limited. This is mainly because of the presence of inefficient or expensive industries in many of the member countries. The creation of the Single European Market for the EU's textile and clothing industries had not completely resulted in the inefficient and expensive firms going out of the market. Though they are in the process of being absorbed by the larger firms, they still exist in less-developed member countries as they contributed to a considerable proportion of manufacturing employment. The textile production in countries such as Portugal, Greece and Spain is much more important in terms of employment than it is in other member countries.[89] Hence the cost considerations have not driven these member countries from discouraging the production and concentration of high-cost textile production from their locations.

Market enlargement has not resulted in an enlarged trade in the EU's textile and clothing industries. Though the member countries specialise in different product lines, they could not increase their intra-EU trade by exploiting the benefits of the economies of scale. The efficient firms of the member countries could not replace the inefficient firms in other member countries as they were considered to be significant employment provider in some of the member countries. Though the German textile and the Italian clothing firms were more efficient than those in Greece, Spain and Portugal, the textile and clothing firms in the latter continued to operate in their own markets rather than preferring to go out of the markets thus declining an opportunity for the relatively efficient producers to exploit the economies of scale. In reverse the textile and clothing firms in these countries could not able to enjoy the benefits of the enlarged market as they were based on low productivity, unskilled labour, high-labour costs, low investment and product quality. Thus in the Single European Market we see a process of

[89] Textile and clothing accounts for more than a third of Portugal's employment (30 per cent) and manufacturing production (18 per cent). Fore more details see, Cristina Corado and Joao Ferreira Gomes, Adjusting To Trade Liberalisation: The Case of Portugal in Giorgio Babra Navaretti, Riccardo Faini and Aubrey Silberston (eds.), Beyond the Multifibre Agreement: Third World Competition and Restructuring Europe's Textile Industry, *Development Centre Documents*, (OECD: Paris), 1995, pp.61-76.

parallel trade between two blocs of countries. As a result of misallocation of resources, subsequent effects such as economies of scale and concomitant cost-reduction effects are also not being witnessed in the Single European Market.

The analysis of the European textile and clothing industry confirms the wide ranging government intervention in various member countries. Widespread subsidies, tariff and non-tariff barriers and import and export quotas contributed to the maintenance of un-competitive industries. The protection of European textile and clothing industry has resulted in welfare losses in the form of decreased industrial efficiency and international competitiveness. Many of the policies of the member governments were actually decreasing the competitiveness of this industry. They not only affected the efficiency of these industries through misallocation of resources but also increased the costs on the consumers. For example, the imposition of quotas in the United Kingdom increased the prices of clothing by 5 per cent, which amounted to a cost of £29000 per jobs saved or three or four times the average earnings in the textile and clothing industry.[90] The costs could be assumed to be similar in other member countries as well.

Another factor that hinders the realisation of economies of scale in the member countries is the structure of the textile and clothing industries. Domestic market size has an important effect on plant sizes.[91] The larger the market size the larger will be the plant size and larger will be the scale effects in the market. However the existence of differentiated consumer preferences creates virtual segregation in the market though the market has been physically enlarged. Interestingly in this case the market enlargement need not result in increased trade as the virtual segregation in the unified Single European Market does not still allow the firms to exploit the potential economies of scale. However in the case of products where the scope for product standardisation is higher such as in textile industry, the European industries are able to exploit limited scale economies. This is particularly true in the case of German textile industries where market enlargement resulted in an increased trade for German textile trade.

Market enlargement has not resulted in an enlarged trade in the EU's textile and clothing industries. Though the member countries specialise in different product lines, they could not increase their intra-EU trade by exploiting the benefits of the economies of scale. The efficient firms of the member countries could not replace the inefficient firms in other member countries as they were considered to be significant employment provider in many of the member countries. Though the German textile and the Italian clothing firms were more efficient than those in Greece, Spain and Portugal, the textile and clothing firms in the latter continued to

[90] Ian Barbed and Pamela Barnes, *The Enlarged European Union*, (Longman: London), 1995, p.363.
[91] This explains why the American plants are larger than European plants. For similar arguments see Jürgen Müller and Nicholas Owen, The Effect of Trade on Plant Size, pp.173-184, in Alexis Jacquemin and Andre Sapir, *The European Internal Market*, (Oxford University Press: New York), 1989.

operate in their own markets rather than preferring to go out of the competitive market thus declining an opportunity for the relatively efficient producers to exploit the economies of scale. The continual presence of the inefficient firms facilitated by state intervention and their inability to exit the market stifles the realisation of economies of scale. In reverse, the textile and clothing firms in these countries could not able enjoy the benefits of the enlarged market as they were based on low productivity, unskilled labour, low labour costs, low investment and low product quality. Thus, in the Single European Market, we see a process of parallel trade between two blocs of countries. The misallocation of resources continues to exist in the member countries thereby affecting the industrial efficiency and international competitiveness of European textile and clothing industries. As a result of misallocation of resources, subsequent effects such as economies of scale and concomitant cost-reduction effects are also not being witnessed in the Single European Market. As a result, the effects of the Single European Market on the textile and clothing industries are rather limited.

It has generally been agreed that the creation of Single European Market has resulted in both trade creation and trade diversion. A research on the direct effects of economic integration for both the member and the non-member countries reveal the realisation of expected effects of the formation of the Single European Market on the lines of the Customs Union theory. Table 4.20 reveals the direct effects of the economic integration for both the member and the non-member countries. It suggests the following effects on both the member and the non-member countries.

(i) high-cost domestic production has been replaced by the imports from other member countries characterising the presence of the 'trade creation effect';

(ii) the expensive domestic production has been replaced by the imports from the non-member countries confirming the presence of ' external trade creation effect';

(iii) the 'trade diversion effect' has also been witnessed in the Single European Market with the imports from the non-member countries being replaced by those from other member countries;

(iv) trade suppression has also been witnessed with the low-cost imports from the non-member countries being replaced by the high-cost domestic production.

Table 4.20. Direct Effects of Economic Integration

Description	Home	Imports - member countries	Imports – Non-member countries
Trade Creation	+	+	No change
Trade Diversion	No change	+	–
External Trade Creation	–	No change	+
External Trade Diversion	No change	–	+
Trade Suppression	+	No change	–

Source: *Trade Creation and Trade Diversion*, Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 3, Office for the Official Publications of the European Communities, Luxembourg, 1997.

Though it has been agreed that the creation of the Single European Market has resulted in a net positive effect, with the trade creation effect outweighing the effects of trade diversion, the effects would be dissimilar across various sectors of the member countries. In other words, the effects of the Single European Market are sector specific. The cumulative effect of the Single European Market on an industry corresponds to its competitive position. The stronger the industry, the larger would be the cumulative effects of the formation of the Single European Market. However, in the case of the European textile and clothing industry, the net effect depends on the following factors (Table 4.21 and Table 4.22): (i) the share of textile and clothing industry in the member countries' total output; (ii) the level of concentration; (iii) the level of of raw materials and the share of capital, manual and non-manual labour in total value-added; (iv) the level of returns to scale; (v) the level of intra- and extra-EU trade; (vi) the level of import penetration; (vii) the level of export intensity; (viii) the wage levels; (ix) the unit labour cost; (x) the capital intensity; (xi) the R&D intensity; and (xii) the level of non-tariff barriers against the non-member countries.

Table 4.21. Descriptive Sectoral Statistics of the EU's Textile and Clothing Industries

Country	Output share	Intra-EU	Extra-EU	Import penetration	Export penetration	Wage rate	Unit labour costs	Capital intensity	R&D intensity
Bel.	8.54	0.03	-0.01	1.10	1.11	0.72	1.17	0.65	0.08
Den.	4.79	-0.31	-0.12	1.52	1.34	0.73	1.15	2.25	0.11
Ger.	4.39	-0.24	-0.32	2.16	1.51	0.65	0.99	0.70	0.09
Greece.	8.18	0.03	0.27	1.88	4.53	0.98	NA	NA	NA
Spain	8.18	-0.27	-0.26	1.05	0.98	0.65	1.09	0.31	0.01
France	6.11	-0.18	-0.15	1.37	1.18	0.75	1.15	0.67	0.06
Ire.	3.74	-0.18	-0.39	1.59	1.55	0.55	1.56	0.79	0.04
Italy	14.57	0.46	0.34	0.70	1.21	0.65	0.94	0.77	0.01
Lux.	3.00	0.01	-0.02	0.98	1.19	0.81	0.71	1.40	0.12
Nether	3.18	-0.44	-0.62	1.56	1.77	0.68	1.08	0.00	0.13
Portugal	23.66	0.35	0.54	0.98	1.62	0.81	1.15	1.09	0.01
UK	5.10	-0.35	-0.39	1.57	1.18	0.64	1.17	0.54	0.04

Notes:

1. Share of output is the ratio of gross output of a sector to the total manufacturing gross output;
2. Import-penetration ratio is the ratio of the imports of an industry to the domestic demand for that industry;
3. Export-penetration ratio is the ratio of the exports of an industry to the gross output of that industry;
4. Wage rate is the ratio of the real labour costs for an industry to the overall industry;
5. Unit labour cost is the ratio of nominal labour costs for an industry to the nominal value-added for that industry;
6. Capital-intensity ratio is the ratio of an investment in an industry to the amount of value-added in that industry;
7. R&D intensity is the ratio of R&D expenditure in an industry to the value-added in that industry.

Source: Employment, Trade and Labour Costs in Manufacturing, Aggregate and Regional Impact, The Single Market Review, Sub series VI, Volume 4, Office for the Official Publications of the European Communities, Luxembourg, 1997.

Table 4.22. The Characteristics of the EU's Textile and Clothing Industries

NACE	Industry	Con*	V.A **	Share in Value-added			Return to Scale
				Capital	Non-manual labour	Manual Labour	
436	Knitting Industry	0.01	0.37	0.28	0.41	0.32	1.03
438	Manufacturing of Carpets	0.05	0.33	0.34	0.40	0.26	1.10
439	Textile Industry (miscell.)	0.05	0.41	0.34	0.40	0.26	1.03
453	Ready-made Clothing	0.00	0.34	0.25	0.43	0.32	1.03

Notes: * Concentration: Average degree of concentration. Higher the value, the higher will be the level of concentration (highest value 1; lowest value 0); ** Value-added: The share of value-added in each sector.

Source: *Trade Creation and Trade Diversion*, Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 3, Office for the Official Publications of the European Communities, Luxembourg, 1997.

Table 4.23. Estimated Direct Impact of the Single European Market Programme by Sector

	Change in market share (in %)			Change of total import share (in %)	
	Home	MC	NMC	Intra-EU	Non-member countries' Imports
Clothing	- 2.9	- 2.5	+ 5.4	- 0.86	1.86
Weighted avg. for 15 sensitive sectors	-5.4	3.0	2.5	0.55	0.46
Rest of manufacturing	-0.4	-0.9	1.3	-1.60	2.60
Agg. Manufacturing	- 2.2	+ 0.5	+ 1.7	0.23	0.77

Note: The above calculation has been made using the average estimates for Germany, France, Italy and the United Kingdom

Source: *Trade Creation and Trade Diversion*, Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 3, Office for the Official Publications of the European Communities, Luxembourg, 1997.

An analysis on the direct impact of the Single European Market on the European textile and clothing industries reveals that the net positive gains would be minimal as many of the member countries are comparatively disadvantaged in the production and exports of textile and clothing products. Table 4.23 compares the direct impact of the Single European Market on the clothing sector with that on aggregate manufacturing. While the market share of both the domestic clothing industries and those of the member countries has reduced, the share of the non-member countries has increased. A decline in the domestic production is clearly attributed to an increase in imports from the non-member countries. However it is important to highlight that a considerable proportion of the imports into the Single European Market are the produce

of the member countries, which makes use of the off shore production as discussed previously.[92]

A close look at the price-competition effect of the Single European Market on the price-cost margins reveals the modest impact on the textile and clothing industries (Table 4.24).

Table 4.24. Price-Competition Impact of the Single European Market on Price-cost Margins

Sector	Change (in %)
Clothing	-1.8
Weighted Avg. for 15 sensitive sectors	-3.9
Rest of manufacturing	-3.4
Agg. Manufacturing	-3.6

Source: *Trade Creation and Trade Diversion*, Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 3, Office for the Official Publications of the European Communities, Luxembourg, 1997.

The price-cost margin in the clothing sector has reduced by 1.8 per cent, while it has reduced by 3.4 per cent for the rest of the manufacturing. This is against the change of 3.4 per cent for weighted average for 15 sensitive sectors and 3.6 per cent for the rest of manufacturing sector. Various factors could be attributed to this marginal price-cost margins effect compared to other manufacturing sector. This marginal effect clearly highlights the fact that the level of competition witnessed in the post-Single European Market period is limited. The misallocation of resources continues to exist in the member countries affecting the industrial efficiency and international competitiveness of European textile and clothing industries. The continual presence of the inefficient firms and their inability to exit the market facilitated by state intervention stifles the realisation of economies of scale by other efficient firms in the Single European Market. As a result the benefits arising out of the Single European Market's price-cost margin in clothing sector is less than it is for other manufacturing sectors.

The overall impact of the Single European Market on the textile and clothing industries (Table 4.25 and Table 4.26) shows a decline in the demand for both the home production and the imports from member countries. However this has increased the demand for the imports from the non-member countries.

[92] However it is important to highlight that a considerable proportion of the imports into the Single European Market are the produce of the member countries, which makes use of the off shore production (Outward Processing Trade) as discussed previously. In 1998, the OPT imports of clothing (not inclusive of textile, which accounts for 6 per cent) accounted for 11.7 per cent of total clothing imports into the Single European Market.

Table 4.25. Overall Impact of the Single European Market by Sector

	Change in Market Shares (in %)								
	Direct Demand			Price Competition			Overall Impact		
	Home	EU	NMC	Home	EU	NMC	Home	EU	NMC
Clothing	-2.9	-2.5	5.4	0.7	-0.5	-0.2	-2.1	-3.1	5.2
Weighted avg. sensitive sectors	-5.4	3.0	2.5	1.2	-0.8	-0.4	-4.2	2.1	2.0
Rest of manufacturing	-0.4	-0.9	1.3	-0.8	0.4	0.4	-1.2	-0.4	1.7
Manufacturing (Aggregate)	-2.2	0.5	1.7	-0.1	0	0.1	-2.3	0.5	1.8

Source: *Trade Creation and Trade Diversion*, Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 3, Office for the Official Publications of the European Communities, Luxembourg, 1997.

Table 4.26. Comparison of the Estimated Effect of the Single European Market with Actual Changes Between 1991-94

	Change in Market Share (in %)					
	Estimated Impact			Actual Change		
	Home	EU	NMC	Home	EU	NMC
Clothing	-2.1	-3.1	5.2	-4.9	-1.6	6.5
Weighted Avg. sensitive for sectors	-4.2	2.1	2.0	-2.3	-0.1	2.4
Rest of manufacturing	-1.2	-0.4	1.7	-2.3	-0.1	2.4
Manufacturing (Aggregate)	-2.3	0.5	1.8	-2.8	0.3	2.5

Source: *Trade Creation and Trade Diversion*, Impact on Trade and Investment, The Single Market Review, Sub series IV, Volume 3, Office for the Official Publications of the European Communities, Luxembourg, 1997.

From the discussions above, we could conclude that all the expected effects of the Single European Market are witnessed in the member countries, though in varying degrees. However the impact of the Single European Market on the member countries' textile and clothing industries is largely adverse in that it has increased the imports from the non-member countries. This is mainly because of the market policies of the member countries, which affect the industrial efficiency, and international competitiveness of European textile and clothing industries. Many factors such as high labour cost - both labour and non-labour cost, high taxes, high costs of utilities contribute to this decline in the textile and clothing industries' competitiveness. As a result, the survival of this industry becomes paramount for many of the member countries as it still contributes to large scale manufacturing employment. The effects of the Single European Market on the European textile and clothing industry could be summarised as follows:

1. the effect of the Single European Market on the European textile and clothing industry is limited. Many of the effects expected in the post-Single European Market, such as efficient reallocation of resources, economies of scale, have not been witnessed in the member countries. This is mainly because of the limited cross-border factor mobility. Factor mobility tends to be unidirectional in it the capital moves across the member countries. The labour has less incentive to cross the borders as discussed in the previous chapters.

2. the *trade creation effect* (*internal and external*) has been witnessed in the Single European Market. However the external trade creation is more than internal trade creation. *Internal trade creation* has been witnessed in some sub-sectors where there is a direct competition among the member countries. Strategic e*xternal trade creation* has been witnessed in which the expensive domestic production is being replaced by those from geographically adjacent non-member countries of the Mediterranean, Central and Eastern Europe. Though the imports from other non-member countries of the South, East and Far East Asia could be imported at more cheaper costs, the member countries continue to strategically choose their exporters to the Single European Market;

3. though not widespread, some form of *trade diversion effect* has still been witnessed in the EU's textile and clothing industry. In this case the cheaper imports from both the member and non-member countries are being replaced by expensive domestic production. Though the French, British, Belgian textile and clothing firms could benefit from low-cost imports from the member countries, they continue to concentrate on domestic production.

4. *Trade suppression effect* has been witnessed indirectly in EU's textile and clothing industry. In this process more expensive indirect domestic production replaces cheaper imports from the non-member countries. Many member countries involved in relatively expensive off shore production centres in geographically adjacent non-member countries of the Mediterranean, Central and Eastern Europe replaces the cheaper imports from other non-member countries by the imports of their offshore production centres.

5. though the creation of the Single European Market has resulted in a net positive effects, with the external trade creation effect outweighing the effects of the trade diversion, the effects would not be similar on all non-member countries. The effects on the distant non-member countries would be certainly different from those of the geographically adjacent non-member countries. This is mainly because of the changing trade patterns of the EU's textile and clothing industry, which have given rise the distinction between these regions. Strategies such as OPT has made the production and concentration in the geographically adjacent non-member countries much more important than it would be in the distant non-member countries. The distance of the non-member countries to the Single European Market plays an equally important role in deciding the potential benefits of the external trade creation effect. Hence it is believed that the effects of the external trade creation

would be felt differently across the non-member countries with the geographically adjacent non-member countries feeling more than the distant non-member countries. This is particularly true in industries such as clothing, where the importance of the distance to the main market decides the non-member countries' success in responding to fast changing consumer preferences.

The analysis of the European textile and clothing industries within the framework of the Customs Union theory reveals that the formation of the Single European Market in the textile and clothing industries have resulted in welfare gains for both the member and the non-member countries. However these welfare gains are not entirely the resultant of the formation of the Single European Market. Some of the important effects of integration, such as reallocation of resources and the economies of scale, have not been witnessed in the European textile and clothing industries. This is mainly due to the limitations of the internal competitive pressure in the Single European Market. Nevertheless the European textile and clothing industries have been undergoing the process of restructuring resulting from increased external competition. The enhanced competition associated with the dismantling of the protective trade regime, has, at present, forced many to alter their production strategies such as moving towards high-cost, upmarket production, while producing the low-cost products at the geographically adjacent non-member countries facilitated by the OPT strategy. Nevertheless the Single European Market has resulted in enormous trade creation effect for the exports of the non-member countries. The EU's net trade creation effect is likely to benefit the exports of the many leading non-member countries. Various factors decide the levels of the trade creation effect the non-member countries could accrue in the formation of the Single European Market. In this regard, the effect of the Single European Market on India's exports of textile and clothing would be analysed in detail. Before proceeding to study the impact of the formation of the Single European Market on India's exports of textile and clothing, a detailed survey of Indian textile and clothing industries would be undertaken. In the next chapter, the nature, the strength, the efficiency and competitiveness of Indian textile and clothing industries would be examined.

CHAPTER - V

Survey of Indian Textile and Clothing Industries

Survey of Indian Textile and Clothing Industries

The textile industry in India, one of the oldest and most established industries, occupies a unique role in Indian economy for its contribution to industrial production, employment and export earnings. The textile industry, which is India's largest industry, accounts for 8 per cent of GDP. It contributes 20 per cent to the total industrial output. This industry accounts for over 60 million jobs[1] with one in four non-agricultural workers being employed in this industry. It also provides direct employment to as many as 11.5 million workers in organised sector alone, accounting for about one-fifth of the total factory employment in India. The textile industry is India's single largest foreign exchange earner accounting for over 33 per cent of total foreign exchange revenue. Hence the development and growth of this industry has always been paramount to Indian economy.

Notwithstanding its contribution to the Indian economy, this industry suffers from various problems pertaining to obsolete technology, falling productivity, rising costs and growing sickness. The consequence of this problem is witnessed both in the production and receiving ends. With obsolete technology, labour is not able to produce sufficiently to earn adequately while consumers receive goods that are produced inefficiently and therefore prove costly and inferior. Although the textile industry is one of the earliest industries to be established, it is also one of the slowest growing industries in India. It is also clear that the Indian textile system appears to be a very high cost, high price, low production, low productivity system and consequently low per capita production of cloth.[2] The consequences of these problems are closure of many industrial units and high labour displacement.

5.1. Evolution of Indian Textile and clothing Industries:

The Indian textile industry is one of the highly regulated industries with high state controls and interventions aimed at protecting the national interest. The evolution of textile trade in the post-independence period co-existed with Government regulations aimed at providing the cloth of acceptable quality at acceptable prices for the clothing needs of a growing population. The Industrial Policy Resolution of 1948 identified textile industries as one of the eighteen industries to be protected to ensure adequate clothing production and distribution. Thus state intervention was sought at every stage of textile production from the installation of textile

[1] NTC Revival Cost Up By Rs.1500 Cr., Business Line, 3 July 96.
[2] S.S.Mehta and Vinod Shanbhag, Indian Textile: An Intersectoral Perspective, (Oxford & IBH Publishing Co. Pvt Ltd: New Delhi), 1990, p.8.

machinery to the pricing of yarn and cloth. Hence the evolution of the Indian textile industry witnessed varying proposals facilitating state intervention in this industry.

The initial years following Indian independence in 1947 saw government planning and policies being influenced by strong nationalist perceptions. The Industrial Policy Resolution of 1948 was marked for its preference for achieving the long-term socio-economic developmental tasks. This was also the period, in which the propagation of the Gandhian notion of self-sufficiency through self-reliance was strongly advocated. The consequence of this notion was inward looking and export pessimistic policies even in sectors, which showed strong export tendencies. Though the textile industries, except textile machinery industries, were poised to compete on their own in the international market, the new import-substitution policy practised by the Indian Government did not make any exception to India's competitive textile industry.

The era of the Indian textile industry began with the development of the decentralised Handloom (*Khadi*) sector. The handloom sector, deploying over four million looms, is engaged in the production of natural fabrics such as cotton, silk and wool. This sector has also been at the centre of discussion among the economists for its importance in the Indian economy. The importance of the handloom sector to the economy can hardly be over-emphasised, as it accounts for about 22 per cent of the total cloth produced. It is also providing employment to 12 million people. It also plays the role of the exporter as 15 per cent of handloom cloth and products are exported to more than 135 countries. The export earnings of the sector are in the region of Rs.1500-2000 crores per annum. As a result, the traditional handloom sector, which in the nineteenth century witnessed a gradual erosion by imported British mill cloth, was promoted to achieve the twin objectives of generating mass employment and mass production of clothing at an affordable price to the growing needs of the people.

However the growth of the handloom sector did not go unhindered. The rise and growth of other sectors had considerable impact on the growth of the handloom sector. This was particularly true in the case of the powerloom sector, whose impact on the handloom sector was considered to be enormous. The high-powered committee of the Planning Commission (1974), headed by Mr.Sivaraman, had pointed out that for every powerloom set up, six handlooms were rendered dormant. That is, for every job created in the powerloom sector, 14 handloom weavers were displaced (it had been calculated that the per weaver productivity in the powerloom sector was 14 times that in the handloom sector).[3] Hence this sector needed to be protected from competition as a way of protecting the domestic employment. This also resulted in restricting the

[3] ibid.

growth of other sectors, such as mill and powerloom sectors, whose production was artificially made expensive by the Government interventionist policies. Additional duties were also levied on cloths made from the mill sector to subsidise the handloom sector. Government regulations also resulted in certain products not being produced at mill sector as they were perceived to be damaging the survival of the handloom sector.

The inability of the handloom sector in satisfying the needs of the growing population had given rise to the belief that the handloom sector alone could not fulfil the Government's desire of providing cheap clothing. It was widely believed that the economics of handloom clothing production was disadvantageous as the handloom sector could not produce better quality products at lower prices compared to those in the mill and powerloom sectors.[4] Hence it was recommended that the handlooms be converted gradually into powerlooms over a period of fifteen to twenty years so that its impact on the domestic employment would be minimal.[5] However these views were strongly opposed by the Karve Committee, which, in its report on small and village industries, recommended the freezing of the mill and powerloom output at the existing level, so that the entire incremental demand for cotton cloth could be met with the handloom industry.[6] This Committee, which clearly revealed the mind set of the Indian Government's attitude against modernisation of small industries at the cost of mass employment as envisaged in Mahalanobis Model, came out strongly in support of the small and cottage industries against the modern powerloom industry.[7] However the recommendations of this Committee, which were considered to be affecting the performance and output of the mill sector, went against the very interest of the handloom industry as they entirely relied on the mill sector for the supply of the raw materials. Since the Kanungo and Karve Committees recommended two conflicting views on the state of Indian textile industries, the Government had to take a view in common with both the Committees, which was to restrain the productive capacity of the mill sector in order to protect other sectors. As a result the weaving capacity in the mill sector had to be frozen at the existing level. Excise and tax relief were offered to powerloom sectors, which made the powerloom clothes cheaper than the mill-made cloths, resulting in an exponential growth of powerlooms in

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[4] The handloom sector is made expensive by its labour-intensive nature. The labour cost component is about 55 per cent and more in this industry. Cited in How Does the Khadi Sell?, The Hindu, 3 November 1997.

[5] Kanungo Committee Report on Indian Textile Industry, Ministry of Industry, Government of India, September 1954.

[6] Karve Committee Report on the Village and Small Scale Industries, Planning Commission, Government of India, October 1955.

[7] The Mahalanobis Model, which was the basis of the Second Five Year Plan, was based on the Feldman's Model of Soviet Growth published in Russia in 1928. The twin objectives of Mahalanobis Model were the promotion of heavy industries for the growth of the economy and the concentration on small industries for the protection of domestic employment. The architect of Mahalanobis model was Professor Mahalanobis, a former Physicist and a Professor of Statistics at the Indian Institute of Management, Calcutta. He was critically involved in the formation of the Second Five Year Plan.

the country. As a result concerned voices were raised about the survival of the handloom sector in its competition against the powerloom and restrained mill sectors. These views were further reinforced by the recommendations of the Ashoka Mehta Committee report, which resurrected the views recommended in the Kanungo Committee. Raising the questions about the viability of the handloom sector in the country, the Committee recommended the expansion of the powerloom sector in Indian textile industry.[8] The Government, concerned about the growth of the powerloom sector and its impact on the handloom sector, set up a Committee headed by Mr. Sivaraman. The Committee report, which was submitted in 1974, pointed out inadequacies in protecting the handloom sector and recommended wide-ranging fiscal measures to narrow down the cost advantages the powerloom sector had commanded over the handloom sector. The Government, which successfully restrained the physical output of the mill sector in order to protect the powerloom and handloom sectors, now stepped in to protect the handloom sector by freezing the capacity of the powerloom sector. This was clearly evinced by the Textile Policy of 1978, which proposed legislation to prevent the growth of the powerlooms. However this legislation was never enacted.

Despite the policy preferences for the handloom sector, the powerloom sector continued to grow unabated.[9] In due course of time, this sector also emerged as the exclusive producer of man-made cloth. The cloth output in the mill sector has declined to seven per cent of total production compared to 72 per cent in the powerloom sector and 21 per cent in the handloom sector.[10] As a result, the mill sector's contribution had gradually declined from 79 per cent of the country's total clothing production in 1950-51 to 13 per cent in the early nineties.[11,12] However, the expansion of the mill sector could be curbed only with serious consequences for the availability of such cloth, for which consumers had demonstrated a marked preference.[13] Also the observed Government regulations, over a period of time, resulted in significant dysfunction. The Government realised that the administrative curbs could not help restrain other sectors while

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[8] Ashoka Mehta Committee report on the Powerlooms Enquiry, Ministry of Industry, Government of India, May 1964.

[9] The decentralised powerloom sector plays a pivotal role in meeting the clothing needs of the country as it accounts for over 55 per cent of total clothing production. The production continues to increase steadily from 1400 million square metres in 1994-95 to 17200 million square metres in 1995-96 and further to 19300 million square metres in 1996-97.

[10] Liberalised Textile Policy Advocated, Business Line, 20 November 1995.

[11] Focus on Indian Textile Industry: Textile Units – Good Foreign Exchange Earners, Monthly Commentary on Indian Economic Condition, June 1993.

[12] At present mill industry is the single largest organised industry in the country employing nearly one million workers. It has 1581 mills, 1306 spinning and 275 composite mills with spindlage capacity of 32 million spindles. Production of the mill-made textile has been estimated at 1957 million square metres with cotton accounting for over 50 per cent of the production, followed by cotton fabrics and 100 per cent non-cotton fabrics. Exports of mill-made cotton fabrics and made-ups during 1996-97 amounted to $1838.40 million registering a constant growth of 10 per cent over the previous year.

[13] Sanjay Misra, India's Textile Sector: A Policy Analysis, (Sage Publications: New Delhi), 1993, p.28.

trying to protect the handloom sector. Despite the importance given to the handloom sector, its share in the total production of cloth had come down to almost half over the last decade, from around 40 per cent to just about 22 per cent.[14] Consequently, it can no longer fit into the role of the provider of mass clothing and it would become increasingly difficult to justify the huge subsidies provided to the sector on grounds of employment alone. The logic of economic liberalisation suggested that the subsidy regime for handlooms was not likely to continue for long notwithstanding its social justification. As a result, the Government decoupled its preference for the handloom sector from the growth of other sectors of the textile industry. This was largely reflected in the Textile Policy of 1985, which made a major deviation from the traditional past by removing the hitherto existing ban on the mill sector capacity. This policy had also aimed at ending the needless sectoral war among the organised mills, powerloom and handloom sectors. The national and international economic scenario, technological developments, and the sectoral composition of textile production have undergone a radical transformation since the adoption of the Textile Policy Statement of 1985. Large capacities have developed in response to this policy initiative and India has not only become self sufficient, but has also become a leading international player in this sector.

5.2. TEXTILE MANUFACTURING IN INDIA:

The textile manufacturing in India is highly labour-intensive, operating with limited capital availability and low technology content. It is covering varying natural and man-made fibres.[15] The major fibres used in Indian textile industry are cotton, rayon and synthetics. They account for over 95 per cent of fibre consumption in the Indian textile industry. Other fibres used are wool, silk and jute. However the Indian textile industry is predominantly cotton based with cotton fibre accounting for a considerable proportion of the raw materials consumed by the spinning mills. Cotton yarn accounts for about three quarters of the yarn produced in India. Of the total fibre consumption of 2.72 million tonne, cotton accounts for 2.18 million tonnes.[16] The same pattern obtains in the production of yarn with cotton spun yarn accounting for 1788 million kg out of a total consumption of 2378 million kg.[17] Blended yarn accounts for 395 million kg and 100 per cent non-cotton account for another 195 million kg.[18] Cotton forms more than 85 per cent

[14] Handloom needs innovation, Business Line, 21 December 1996.
[15] All types of natural and man-made fibres are used in Indian textile industry. They are (I) Cellulosic (Viscose): viscose filament yarn, viscose tyre yarn, viscose staple fibre (regular), modal fibre and (II) Synthetic: (a) Nylon - Nylon Filament Yarn and Nylon Tyre Yarn; (b) Polyester - polyester filament yarn, and polyester staple fibre; (c) Polypropylene - polypropylene filament yarn and polypropylene staple fibre; (d) Acrylic Staple Fibre and (e) Spandex Fibre.
[16] At the Crossroads, The Financial Times, 4 January 1997.
[17] ibid.
[18] ibid.

of fibre consumption within the country in spite of a spectacular development of man-made fibres and inroads in the field of natural fibres throughout the world.[19] In the last four decades, cotton enjoyed the status of dominant textile fibre and substitute fibres were disfavoured through high taxes. Cotton and cotton blended with other man-made fibres comprise the major portion of raw materials consumed by the textile industry.

5.2.1. COTTON INDUSTRY:

Cotton is one of the most important commercial corps in India. It has a special significance as India is one of the major producers of cotton in the world. The cultivation of hybrid cotton has helped India attain self-sufficiency in cotton production. This has been shown by the quantum jump in production from 4.9 million bales in 1966-67 to 13.3 million bales in 1989-90 with an impressive annual growth rate of 3.5 per cent. Despite having the largest area under cultivation for cotton crops, India has only one-tenth share in world's cotton production. Though the cotton cultivation occupies five per cent of total cultivated area in India - about 7.5 million hectares - it caters about 85 per cent of the raw material need for the textile industry. As for cotton, the country has become not only self-sufficient but also a regular exporter. The raw cotton, which constitutes the backbone of the Indian textile industry, has now made a transition from a low level of output and shortages to an era of self-sufficiency, including a strong capability to gain a foot hold in overseas markets. In India, the production of cotton ranges from virtually un-spinnable to super fine variety. India also produces the cotton of various staple lengths – coarse, medium, long and superior long.

The textile economy is often referred to as the cotton economy as cotton provides direct and indirect employment to millions of people in the country who are engaged in its cultivation, ginning, processing, trade and manufacturing. At present nearly four million handlooms are engaged in weaving fabrics of nearly 23 varieties of cotton. Though India has the largest area under cotton cultivation[20], the production is disappointing as the per hectare productivity of cotton in India is much less than the world standards. While India's per hectare yield is only 300 kg, the world average yield remains at 560 kg.[21] As a result, the Indian cotton production comes next only to China and the US. Although India is the third largest producer of cotton and having a largest area under cultivation, its share in international cotton export is negligible.

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[19] The State of Indian Textile Industry, Link, 18 October 1992, p.12.
[20] When Those Cotton Balls Get Rotten, The Economic Times, 19 April 1999.
[21] Liberalised Textile Policy Advocated, Business Line, 20 November 1995.

Table 5.1 Productivity Level in Leading Cotton Producing Countries (Kg per hectare)

Country	Productivity (Kg per hectare)	Country	Productivity (Kg per hectare)
Australia	1482	Pakistan	563
China	910	United States	686
India	300	World (average)	560
Israel	1814		

Source: The Economic Times, 19 April 1999.

Given the importance of the cotton economy to the Indian textile industry, India's successive textile policies insisted on the predominant use of cotton in textile manufacturing thereby restraining the competition posed by man-made fibres and synthetic yarns. Fiscal and administrative measures were imposed on the man-made fibre industry to limit the competition to cotton manufacturers. These measures also prevented the mills from manufacturing and using fibres, yarns and fibre and yarn based non-cotton clothes. Even the manufacturing of blends prepared with cotton beyond a certain proportion was discouraged. Also the composite mills were discouraged, by the imposition of high levies on the use of man-made fibres to limit their consumption. This obviously increased the production costs of these fibres and yarns, so that the synthetic and blended cloth became three to four times more expensive than cotton cloth.

However, cotton has been facing an increasing competition from man-made fibres during the last few years. The man-made fibres, at present, account for about 50 per cent of all textile fibre consumption in highly industrialised countries, which do not grow cotton. As a result, these countries have reduced their dependence on imported cotton as a raw material for their textile industries. To make the Indian fibre consumption synonymous with international fibre consumption the Government has been encouraging the manufacturing of polyester-cotton and polyester-viscose blends, for which there has been an increasing demand in the domestic market. It is expected that the usage of cotton to non-cotton ratio in India would come down to 75:25 from the existing 88:12. This is against the backdrop of the world average of 49:51.[22]

5.2.2. MAN-MADE FIBRE INDUSTRY:

Notwithstanding the policy-bias against man-made fibres, indigenous production of man-made fibre was started to supplement the cotton fibres and yarns. India developed a sizeable man-made fibre industry with the production of viscose filament yarn in 1950. Subsequently the textile industry had to diversify its fibre base as consumers had started to prefer non-cotton and blended cloths despite higher prices as the durability and longevity of these clothes proved successful compared to cotton-made clothes. Hence the production of synthetic fibre was started in 1957. In

[22] At the Crossroads, The Financial Times, 4 January 1997.

the following years, nylon filament yarns (1962), viscose filament fibres (1965), polyester stable fibres (1965) and polyester filament yarns (1967) were also produced. The Indian textile industry at present, is capable of producing all man-made fibres and yarns. The textile policies of 1978 and 1981, motivated by the need for utilising the available stocks of aromatic gas and naphtha in the country, recommended increased production of synthetic fibres and filament yarns. However with the rise in production of the man-made fibres, the textile industry has reduced its reliance on the imports.

5.2.3. WOOL INDUSTRY:

Although Indian textile industry is dominated by the production of cotton yarns and fabrics, a small wool industry has been emerging to show rapid development. They are also aided by the growing silk and jute industries. They also export a considerable proportion of their production. The wool industry includes firms both in organised and decentralised sectors. The organised wool sector comprises the worsted sector, which consumes most of the imported merino-type wool for the production of tops, yarns and fabric mainly for woven clothing. The woollen sector, which consumes most of the domestic wool and a considerable quantity of imported New Zealand wool, concentrates mostly on the production of machine made carpets and blankets. The demand for wool is increasing continuously that in some areas the woollen fibres are being replaced by Acrylic fibres as the latter is not only a close substitute for the former but it costs only half as much as wool and therefore offers a significant cost advantage.

5.2.4. SILK INDUSTRY:

India also has an important silk industry, which is second only to China in the volume of silk produced, representing around 14 per cent of total world production.[23] The production of silk has increased from 9498 tonnes in 1987-88 to 14093 tonnes in 1996-97. However India's share in international silk trade is a meagre 4-5 per cent.[24] This is mainly because of the huge amount of domestic consumption in the domestic market. The export scenario for Indian silk and silk products is a cause of concern for the Indian Government. According to the Indian Silk Export Promotion Council (ISEPC), exports in 1995-96 declined by Rs.818 million ($23.37 million) from the previous year to Rs.8.45 billion ($241.4 million).[25] This sector plays an important role as a rural employment provider. The work force in this sector is estimated to be around 5-6 million and largely centred in poorer rural and sub-urban areas. A significant proportion is also being employed in the handloom weaving of silk fabrics.

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[23] Doing Business With India, Presentation of Guy Arnold, EURATEX Bulletin 98/5.
[24] Project to Boost Silk Exports, Business Line, 25 July 1997.
[25] Silk Garment Exports in a Quandary, The Economic Times, 13 August 1997.

5.2.5. JUTE INDUSTRY:

Indian textile and clothing industries also have considerable size of Jute industries. There are 73 jute mills in India with an installed base of about 43034 looms. Though the production of jute is spread over fourteen states, a majority of them are located in the Eastern part of India. Most of the sacking produced is consumed by the domestic industries while most of the hessian is exported. The carpet-backing-cloth, which was introduced in 1950, has received a good reception in the international markets. India is a major jute producing country and it produces more than 40 per cent of the entire world's production. Jute and jute products are gaining immense popularity around the globe because of bio-degradable character. The jute industry, of late, has been suffering from the growing use of man-made fibres in the production of sacks, carpet-backing, despite the Government measures mandating the use of jute fibres in cement and fertiliser sacks.

5.3. STRUCTURE OF TEXTILE MANUFACTURING IN INDIA:

Like most developing economies, the Indian textile industries are characterised by dualistic structure, that is the existence of relatively modern, capital-intensive sectors along with traditional, low-technology and labour-intensive sectors. According to the division of labour, a distinction is made between the two sectors, the *organised* and *decentralised* (*unorganised)* sector. While the organised sector represents the mill sector, the decentralised sector represents the powerloom and handloom sectors. Though they concentrate on the production of clothing and compete with each other, there existed an intimate linkage between the organised and decentralised sectors, in which the latter is entirely dependent on the former for the supply of basic raw materials such as yarn at an affordable price. Also a part of the processing of cloth produced in the decentralised sector is finished in organised sector. In India, the organised mill sector has always been dominated by decentralised powerloom sector. This is evident from the fact that the share of the organised mill sector in the total production of cloth has come down to just around 6.75 per cent while that of the powerloom sector has zoomed to 54 per cent.

The manufacturing of textile is generally divided into three broad stages such as (i) Spinning; (ii) Weaving and (iii) Processing. In cotton based textile industries, an additional stage of ginning and pressing is also added to the existing stages. Fig 5.1 and Fig 5.2 explains various stages of Indian textile industries. In spinning, the fibres - natural and man-made - are cleaned, straightened and aligned. This would result in the production of yarn. In Weaving, yarn is stretched into the making of woven cloth. Under processing, chemicals and other substances for fabric conditioning are added. Also the wovened clothes are bleached, dyed and printed. Finally the wovened clothes are mercerised and made into finished cloth.

FIG 5.1 STRUCTURE OF INDIAN TEXTILE MANUFACTURING

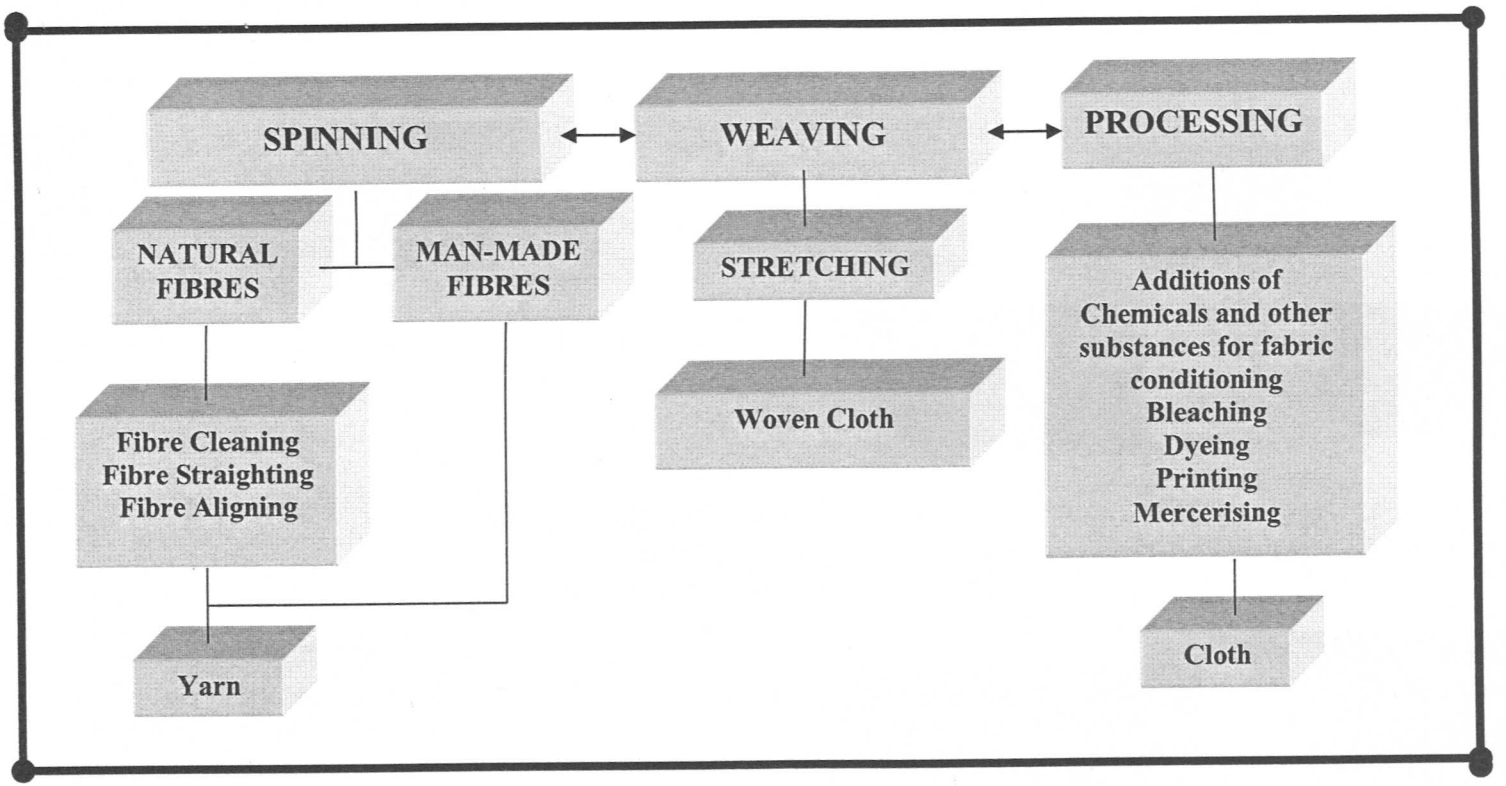
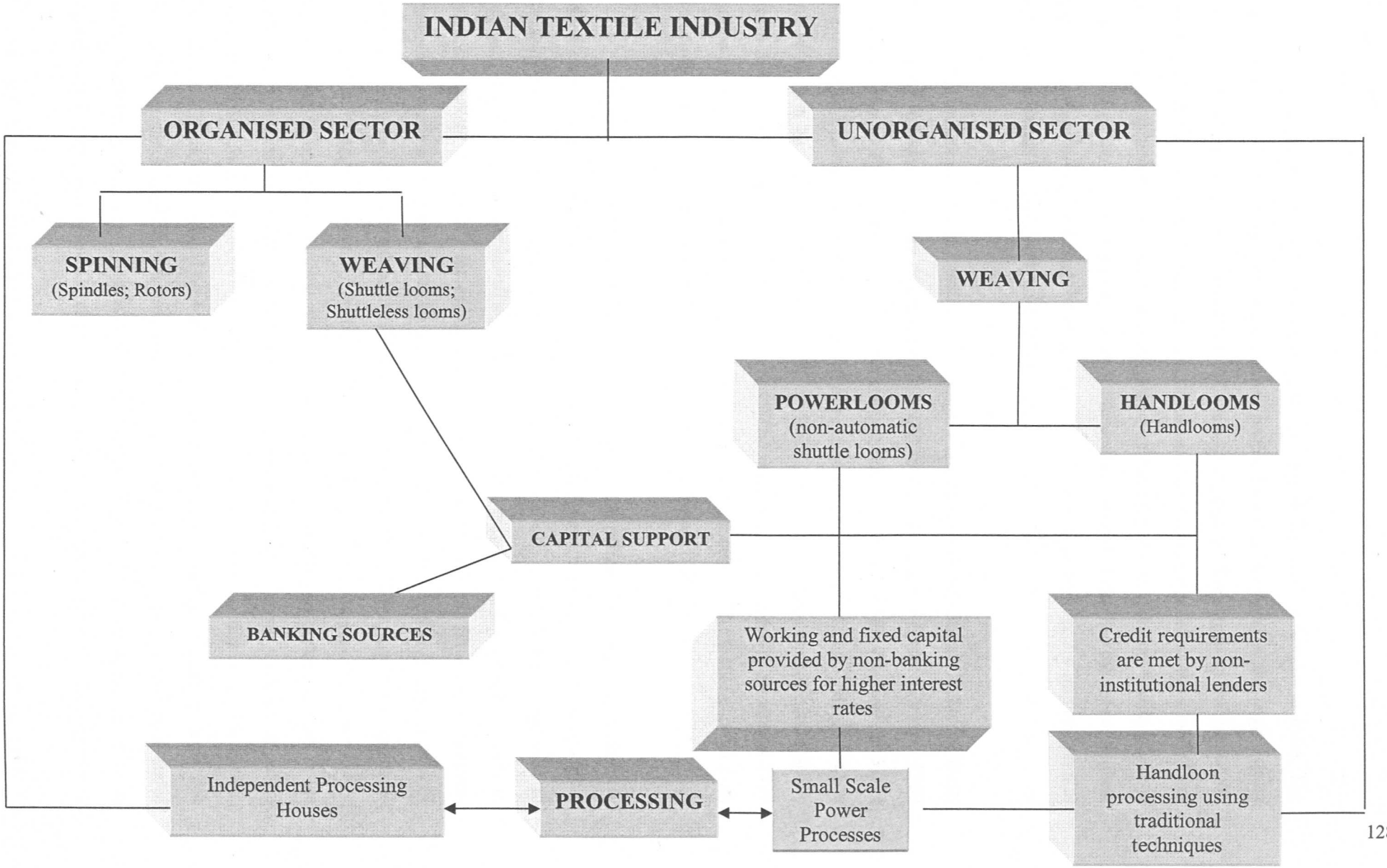


FIG 5.2 STRUCTURE OF INDIAN TEXTILE INDUSTRIES



5.3.1. SPINNING:

The spinning, the process of making yarns, is one of the oldest industries in India. The spinning, along with weaving, was known to the people living in Harrappa at the beginning of Indian Civilization. Before the introduction of mechanised means of spinning in the early 19th century, all Indian cottons and silks were hand spun and hand woven (known as the khadi). Over the years, the spinning sector has come to acquire a dominant position in Indian textile industry. India has one of the largest spinning sectors in the world. Currently India has the second highest spindlage in the world after China. Forty percent, i.e. 1.2 million of the over 3.4 million spindles installed worldwide in 1994, were installed in India.

The spinning sector in Indian textile industry has its own peculiarities. Unlike the West, the spinning in India is mainly done in the organised sector. It is estimated that there are 1500 spinning mills in the organised sector. India has a vast installed spindle capacity of 32.21 millions, with 1.6 million looms operating in the decentralised powerloom sector.[26] Besides, there are 38 million handlooms. Over 70 per cent of India's loomage is non-automatic against the world average of 80 per cent automatic looms. The domestic textile industry produced 2420 million kg of yarn and 30,000 million square metres of fabrics annually. The textile exports from the country have crossed $11.75 billions (Rs.41826 crores) during 1996-97.

The policies pursued by successive governments in the period of economic liberalisation, which started in 1991, have had considerable impact on the performance of the spinning sector. As a result the number of spinning mills, the spindles and the spindlage have continued to increase. The increase in the installed capacity of the mills was undertaken largely to cater to overseas markets. The rapidly increasing number of cotton and man-made fibre textile mills has made the expansion of spinning plausible in India. Between 1990-91 and 1997-98, the number of spinning mills, including small units, grew three-fold from 777 to 2290, while the spindlage increased by 30 per cent, from 27 million to 35 million. During the same period, the number of rotors - used in open-end spinning units, which adopt a more efficient technique than in the traditional spindles, but which are more suited to the production of coarser varieties of yarn - grew almost five fold, from 67000 to 3.17 lakh (.31 million). During the last three-year period, the number of spindles increased by 4.33 million and rotors by 1.32 lakh (.13 million). In the last five years, spindlage capacity has risen from around 27 million to 32 million, while open-ended rotors used for coarse have doubled from 113,000 to 229,000. Now the spinning sector is considered to be building up excess capacity as a result of increase in spindlage. The recessions

[26] Technology Upgradation Fund – Textile Machinery Sector Hopes Up, Business Line, 29 July 1997.

in the domestic and to a limited extent in overseas markets have magnified the problem of excess capacity.

Between 1990-91 and 1997-98, yarn production in India increased by 63 per cent. Yarn exports increased from 90 million kg to 485 million kg during this period. In value terms, exports increased from $500 million to $1.6 billion between 1993-94 and 1997-98. During this period, the annual average increase in the value of yarn exports in dollar terms was 45 per cent. The magnitude of the collapse in demand in overseas markets can be gauged from the fact that yarn exports increased by only 6 per cent in 1997-98. Moreover, the volume of yarn exports fell by 20 per cent between January and July 1998. The crisis was accentuated by the fact that over the years the spinning industry became increasingly dependent on export markets. In 1990-91, only 6 per cent of the cotton yarn produced in India was exported; by 1997-98, exports rose to 22 per cent. In addition, yarn supplies to powerlooms that catered principally to export markets also increased. In short, yarn supplies for export markets - whether directly as yarn or yarn going into textile products - became a crucial factor in the market dynamics in the 1990s. This proved beneficial so long as exports were booming, but a slump in the overseas markets pushed down yarn prices and put huge levels of capacities at risk - as was the case following the outbreak of the crisis in South East Asia.

5.3.2. WEAVING AND KNITTING:

As in the case of spinning sector, India has one of the largest installed weaving and knitting capacities in the world. While the spinning sector is modern the same is not the case with weaving and knitting. In weaving, about 60 per cent of cloth production is in the decentralised powerloom sector, where the majority of looms are not even semi-automatic. The organised mill sector, in weaving, accounts for only 7 per cent. This is the pattern with cotton, silk and synthetic cloth weaving. Where the weaving is complicated, as in woollens, it is dominated by the organised sector.

Despite its huge size, the weaving sector is suffering on the production side. This sector is suffering from some technological and structural problems inherent to it. Though the technology obsolescence is very striking in the weaving sector, government policies are also to be blamed for the poor performance of this sector. The Government's policies instead of facilitating the operational performance proved to be obstacle for the development of the industry. In the eighties, when Korea, Taiwan and China were concentrating on building up a strong export base, the Indian Government put a freeze on expansion of the mill sector during 1980-1985. This is against the fact that the average unit value realisation for powerloom fabrics is Rs.6 per square

metre as against Rs.28 per square metre for mill-made fabrics.[27] Consequently, the industry lost out to the powerloom and handloom sectors. Again the foreign exchange crisis of 1990-93 did not allow the import of machinery for modernisation. No doubt, Indian machines are available, but the industry has always preferred to invest in imported machines. Such a stifling scenario led to the mills' weaving capacity coming down from 2.1 lakh looms in 1985 to 1.5 lakh looms in 1994. Capacity utilisation too has come down from 62 per cent in 1986 to 54 per cent in 1994. As a result, the capacity utilisation in the weaving sector was only 50 per cent as against 86 per cent in the spinning sector.[28] If the rate of technological upgradation in the weaving sector remains sluggish, the country would be left behind in the world textile market, especially when the focus of international textile trade is rapidly shifting towards clothing.

The continued Government intervention, up until the announcement of liberalisation policies, not only scuttled the expansion, but also increased the cost of weaving, making the weaving sector unprofitable to concentrate. Investment in the sophisticated weaving and processing is very expensive because of high interest rate and unequal competition from the decentralised sector of processing factories.

India has a very well developed knitting industry as well. It is estimated that there are around 6000 knitting enterprises employing 200000 people and operating around 50000 machines. However the knitting industry has not kept pace with the development of other sectors of Indian textile industry or with the growth of this industry in other developing economies. A reason suggested for this rather slow development is the limited domestic demand for knitwear items such as socks, stockings, sweaters and even underwear, which is considered a luxury item by most of the population. The general preference is given for woven clothing. Another reason is the fear of successive Governments that warp knitting posed a threat to handloom weaving, which mainly prevented the expansion of an efficient and modern knitting industry in India. However, in recent years the knitting industry has been gaining momentum. Foreign buyers have tended to regard India as a source of low-priced volume merchandise and consequently there has been little pressure to improve product quality. This has further been encouraged by reduced import duties on knitting machinery, which helped the industry replace outdated, inefficient machines that caused concern regarding low productivity.

[27] Textile Panel for Steps to Boost Cotton Output, The Financial Times, 13 February 1997.
[28] Weaving Industry Needs to be Modernised, Business Line, 9 September 1997.

Table 5.2 Trends in Capacity and Production in Indian Textile Industry (1988-94)

Category/Year	1988	1989	1990	1991	1992	1993	1994
Man-made fibres							
Synthetic fibres (1000 tonnes)	399.6	607.2	785.0	922.0	664.1	850.3	782.0
Cellulose (1000 tonnes)	199.6	215.0	215.0	248.7	305.4	367.5	282.0
Spinning							
Short staple spindles (1000s)	26411	26549	26647	27410	28130	28320	..
Long staple spindles (1000s)	580	681	700	745	790	..	..
Open-ended rotors (1000s)	40	47.7	66.9	69.9	115	129.9	..
Weaving							
Cotton-type looms (1000s)							
Shuttle	195.5	185.3	174.6	174.4	160.5	154.2	..
Shuttleless	2.2	2.9	3.6	3.9	4.1	4.7	..
Filament weaving looms (1000s)	330	330	330	330	330	..	..
Wool weaving looms (1000s)	7.0	7.1	7.1	7.1	7.1	..	..

Source: India - Textile and clothing, Quarterly Bulletin on Textile and clothing Volume, vol.1/1996, March 1996, OETH.

Table 5.3 Textile and Clothing Production in Indian Textile Industry (1988-93)

Category/Year	1988	1989	1990	1991	1992	1993
Man-made fibres (1000 tonnes)						
Synthetic fibres	321.6	367	436.6	439.6	537.9	603.7
Filament	200.1	217.5	259.3	263.1	321.2	..
Staple	121.5	149.5	177.3	176.5	216.7	..
Cellulosic	174.1	198.7	216.7	215.4	219.9	238.9
Wool-type yarn (1000 tonnes)	73.1	65.4	65.9	68.4	70.6	..
Woolen	39.3	40.0	41.1	44.0	440	..
Worsted	33.8	25.4	24.8	24.4	26.6	..
Woven fabrics (m^3 million)	..	18722	20354	20035	..	..
Knitted fabrics (m^3 million)	2149	2379	2696	2827	3207	..
Ready-made garments (pcs. million)	735	778	1010	1515	..	..

Source: India - Textile and clothing, Quarterly Bulletin on Textile and clothing, vol.1/1996, March 1996, OETH.

5.4. Structure of Clothing Manufacturing in India:

The clothing industry in India, has emerged as a major sector in terms of production, employment and foreign exchange earning. It is estimated that there are now around 80,000 enterprises concentrating on garment manufacturing with an installed sewing machines totalling over one million in 1990, of which two-thirds are operated by fabricators working as sub-contractors, mainly for export and a remaining third are catering to the needs of domestic market.[29] Annual level of production of garment industry is more than 2000 million pieces. It is

[29] India - Textile and clothing, Quarterly Bulletin on Textile and clothing, vol.1/1996, March 1996, OETH, p.76.

also estimated that the garment manufacturing units are employing around three million people. It is also one of the India's largest foreign exchange earners, accounting for nearly 16 per cent of the country's total exports. In 1996, the Indian textile exports approximately amounted to Rs.35000 crores of which apparel occupied over Rs.14000 crores.

The clothing industry started with the manufacture of traditional Indian garments for domestic consumption. It is a decentralised sector comprising a large number of small to medium-sized enterprises. India's supply base is medium quality, relatively high-fashioned, but small volume business. The garment sector has centred around an extensive sub-contracting system, which made use of powerloom fabrics and second-hand machinery.[30] It is estimated that the Indian clothing industry, which is dominated by sub-contractors, consists mainly of small units of 50 to 60 machines.

The performance of India's clothing sector explains how an efficiently managed labour-intensive sector could be transformed into a leading foreign exchange earner. The performance of Indian clothing industry is concurrent with the performance of its textile industry. It is supported by strong raw material base, particularly cotton. Since 1980's, the Indian clothing industry has witnessed an unprecedented growth. However it is interesting to note that this growth has been witnessed with very little change in textile imports into the country. Most of the inputs used in the clothing industry are the products of the textile industry. In spite of this advantage, the apparel industry has not been able to raise its share in the world trade, because more than 60 per cent of the textile mills are sick and the garment industry is not able to easily get the quality fabrics required. Moreover, the structure of the garment industry is based mostly on sub-contracting to small establishments. While this type of household-industrial structure has its advantages such as catering to the needs of varying customer tastes in small lots, it cannot help in achieving a quantum jump in exports.

A structural change is necessary, if India has to increase significantly its share of the world garment trade. While retaining the production base to cater to the existing market segment, the industry would have to set up bigger and modern factories for mass production of jackets, suits, trousers, industrial garments and formal wear. A closer co-ordination between composite mills and the garment industry can go a long way in achieving this objective. Now, the garment industry is reserved for the small sector and large units are allowed only with 75 per cent export obligation. This policy needs to be liberalised to enable big units to enter the sector. This is all the more necessary to prepare the country for the impending phasing out of quotas and tariff barriers

for imports. Also, while India will continue to enjoy a natural advantage in cotton garments, there is an imperative to increase the share of synthetic garments in volume terms from the present 15 per cent to at least 25 per cent. This will also help in relieving the growing pressure on cotton, apart from diversifying the product mix of exports. Indian clothing industries need to change their raw material usage. In India, despite 50 years of efforts, synthetics have failed to replace cotton as the core fibre for consumer textile. The country's competitiveness in textile exports still remains largely cotton-based. The over reliance on cotton increases the costs of Indian garments at the times of fluctuations in international cotton prices as Indian cotton producers are tempted to export their cotton to international market. It is believed that domestic prices immediately react to a spurt in global prices thereby increase the end production cost of value-added products such as garments. The high cotton price in international market worries garments exporters, as they tend to lose their price-competitive edge due to the increasing input cost.

5.5. COMPETITIVENESS OF INDIAN TEXTILE AND CLOTHING INDUSTRIES:

Although India was the first among the developing countries to establish a full-fledged textile industry, it rapidly lost out in international competition to other developing countries, where this industry was started much later. From a peak share of 58 per cent of all developing countries' textile exports in 1953, India's shares fell to a meagre 8 per cent by 1969.[31] By 1993, this fell to 4 per cent. At present India's textile exports, as a whole, stand at 3.2 per cent of the world textile exports. This was far below the growth rate shown by its main competitors like Taiwan and Indonesia.

The competitiveness of the Indian textile industry was seriously impaired by the industry's inward-looking and export-pessimistic attitude. The blame for this lies on the government policies, which instead of being a facilitator have proved to be obstacle. In the eighties, when Korea, Taiwan and China were concentrating on building up a strong export base, the Indian Government put a freeze on expansion of the mill sector during 1980-1985.[32] Consequently, the mill sector lost out to the powerloom and handloom sectors. As a result the cloth output in the mill sector has declined to seven per cent of total production compared to 72 per cent in the powerloom sector and 21 per cent in the handloom sector.[33] The years following India's independence witnessed the handloom sector being given the prominence at the cost of other sectors, which scuttled the growth of sectors such as mill sectors. Though the powerloom

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[30] Somnath Chatterjee and Rakesh Mohan India's Garment Exports, Economic and Political Weekly, 28 August 1993.
[31] Sanjay, India's Textile, p.16.
[32] At the Crossroads, The Financial Times, 4 January 1997.
[33] Liberalised Textile Policy Advocated, Business Line, 20 November 1995.

sector was the largest contributor of Indian textile exports accounting for 90 per cent of it, the handloom industry continued to get preferential treatment from the successive Governments with the sole purpose of protecting the rural economy and rural employment. The Government legislations such as Handloom Reservation Act of 1985, which reserved 22 varieties of clothing for handloom sector that were prohibited from production in other sectors, only acted as a deterrent of the competitiveness of Indian textile industry

The textile policies formulated for the domestic industry were aimed at limiting the level of competition in the domestic market. Even the export promotion was considered to be affecting the interest of the domestic consumers as the Government priority was to provide cheaper clothes for all using the raw materials available in the local market. Since India has been one of the largest producers of cotton in the world, most of the Indian products tended to be cotton-based. India's unique fibre composition defies world-wide norms in fibre usage. According to recent studies, cotton accounts for 75.5 per cent of India's textile production and non-cotton 24.5 per cent.[34] In contrast, 49 per cent of the world's output of textile is cotton-based and a larger proportion – 51 per cent – is from non-cotton materials.[35]

Though the annual exports of textile, yarn and garments amounted to about $9 billion, a breakup of this export shows an overwhelming bias of cotton. At present, the world trade in textile is largely synthetics-based. While, three quarters of global trade is in synthetics, with synthetic-cotton blends accounting for another big component, 80 per cent of Indian exports are cotton-based. This really affects Indian textile exports in value terms. Had the cotton and cotton made-ups accounted for not more than half the total, as a 1998 study shows, Indian textile and garment exports would have been 75 per cent higher in value terms.[36]

In India, textile trade is highly regulated with continuous Government intervention aimed at protecting the weaker sectors such as handloom, which might otherwise lose out in competition to more efficient sectors. This intervention was also aimed at increasing the maximum usage of cotton, a primary crop that is mainly used in Indian textile industries. The healthy development of the industry was further impaired by the regulations on the import and export of cotton. The cotton fibre market is highly regulated with very strict export controls. Indian cotton is around 20 per cent cheaper than global prices and the Indian authorities would argue that India's entry into the international market would dip the price level and would also increase the domestic price

[34] Textile Industry at the Crossroads: Major Changes Poised Soon, Monthly Commentary on Indian Economic Condition, January 1996, p.11.
[35] ibid.
[36] For a Proactive Textile Policy, The Economic Times, 25 March 1999.

level. The export regulations of cotton are mainly aimed at protecting the cost competitiveness of Indian garment industry. To facilitate the Government's cotton-bias policy, man-made fibres have always been subjected to higher rates of indirect taxation vis-à-vis similar cotton-based products. This increases the costs of manufacturing the synthetic fibres and polyester filament yarn, thereby discouraging the production of man-made fibres. Further, the punitive controls on export of cotton and cotton yarn would mean lower relative domestic prices and hence an implicit subsidy for downstream sectors. Also the import duties on synthetics and intermediates remain high.

Though many Indian textile exports are cotton-based, India is yet to gain absolute cost-advantage in cotton exports. Many factors are set to determine the cost competitiveness of cotton exports. In the case of cotton fibres, cleanliness is one of the most important aspects that determines the characteristics of the cotton, as it is very relevant in the ginning and the textile industry. High level of trash content in Indian cotton has led to production of yarns with a high level of irregularity, imperfection and objectionable faults. The newer spinning technologies, in comparison to the older technologies, are more susceptible to the type and levels of trash content in the cotton. And they also affect the high speeds of working on these machines, thus leading to increased end breaks and loss in efficiency in addition to spoiling the working components of the machine.

Over the years, the performance of the textile industry has not been satisfactory. Technical and organisational shortcomings resulted in high prices for textile. As a result of structural and operational rigidity, the textile industry has experienced fluctuations in its activities. The cost of textile has been rising. Various factors complicate the process of development in this industry. Indian textile industry faces problems from both the supply and demand-side. Failure to modernise and upgrade the technology increases the problems on the supply-side. Modernisation demanded the replacement of old machines with the newer ones, which would increase the optimal outcome of this industry. This would also reduce the costs as the operational costs of old machines remain high. The foreign exchange crises often witnessed by India discouraged the importation of machines to modernise this industry. Even the importation of the second-hand machinery was discouraged as the Government wanted to protect the domestic

textile machinery industry.[37] When India's competitors such as China, Taiwan and Indonesia relied heavily on technology upgrading to regain competitive edge over other countries, Indian textile industry continued to operate with outmoded machines, which affected their operational performance. This industry has also been witnessing a growing incidence of sickness due to the failure to modernise the firms. Almost 50 per cent of the organised textile sector remains saddled with outdated technology.[38] The result is a fall in the rate of capacity utilisation in most of the industries, such as mill sector, which heavily relied on the machines for increasing their output. Though the foreign exchange crisis stabilised after the introduction of the new liberalisation policy in 1991, other factors continued to affect the development in this industry. Another problem, which often discourages the technology upgrading in this industry, is the non-availability of funds to undertake modernisation. Even in cases where they are available, the interest rates work out to be higher for the industry struggling to survive in the biased market. The high interest rates charged by the financial institutions works out to be Rs.1.50 to Rs.2 per metre of cloth, which further affects the competitiveness of this industry.[39]

The impact of the failure to modernise the production process is more evident in the case of Indian silk industry. Despite being the world's second largest silk producer, India has a minuscule share of four to five per cent in global silk trade, which is shrinking further. Infrastructural deficiencies and the inability to cope with buyers' demands are said to be the main reasons for the decline in foreign sales. India is lagging far behind other Asian countries in upgrading the technology and the failure to modernise the industry has been affecting India's share in global silk trade. In India there are only three factories, which have installed computer-aided cutting systems.[40] Many overseas buyers now insist that the exporters should have their own manufacturing facilities and a good track record. Buyers also insist that the factories to be clean, modern, have better needles, pressing and finishing equipment. Not only the supply-side, but also the demand-side that greatly decides the health of the Indian textile industry. On the

[37] Evidently the textile mills prefer to import new or second-hand machinery rather than buying them indigenously. Before liberalisation also, the mills were reluctant to buy the indigenous machinery, their contention being that the so-called new equipment offered by the domestic producers was new hardware with vintage technology. Considering that India's textile industry is one of the oldest and the second largest in the world and the textile machinery industry of 40 years' standing, the growing dependence on imports is not desirable. In fact, on the contrary, the country should have emerged as a major exporter of textile machinery. At present there are over 100 major manufacturers producing complete machinery and over 400 small units making components, parts and accessories. The liberalisation wave is threatening to take a toll of these units unless they keep pace with the technological advances abroad with a sense of urgency. For more details in this regard see Modernise Machinery, Business Line, 29 November, 1996 and Import of Second-hand Textile Machinery To Be Banned, Business Line, 24 November, 1996.

[38] Weaving A New Policy, Business Line, 5 November 1996.

[39] At the Crossroads, The Financial Times, 4 January 1997.

[40] Silk Garment Exports in a Quandary, The Economic Times, 13 August 1997.

demand-side, the general demand is mostly influenced by the state of Indian economy, which is often in recession. Factors such as sluggish demand could be attributed to the slower growth of the Indian economy in general. Because of low incomes, the expansion of production is limited by inadequate purchasing power. The per capita consumption of cloth has been falling. The per capita availability of cloth has remained at a low level and productivity is declining.[41] Though clothing is the most important item of family expenditure in India, next only to food, it is accounting only for about 10 per cent of private final consumption expenditure.[42]

5.6. PERFORMANCE IN THE POST-LIBERALISATION PERIOD:

The production and exports scenarios in Indian textile industries have been changing in the last few years. The textile policies announced in the last few years have encouraged the Indian textile industries resulting in substantial additions to capacity. Since liberalisation the powerloom and mill sectors have continued to expand with a sharp decline in the production of handloom sector. Handloom fabric production has declined sharply during the last two decades with handloom exports falling from 30 per cent of textile exports in 1981-82 to 10 per cent by 1994-95 although handloom made-ups increased to 40 per cent of total production by 1994-95. With the continued expansion of spinning and weaving capacities, the textile industry has been witnessing an enormous supply of filament yarn. Between 1990-91 and 1997-98, the number of spinning mills, including small units, grew three-fold from 777 to 2290.[43] During the three-year period, the number of spindles increased by 4.33 million and rotors by 1.32 lakh.[44] During the same period, the production of spun yarn increased by 774 million kilograms and filament yarn by 347 million kilograms.[45] The share of filament yarn in the total yarn production went up from 17 per cent in 1995-96 to 20 per cent in 1997-98. The production of fabrics surged by 8000 million square metres that is by 28 per cent.[46] The spindlage increased by 30 per cent, from 27 million to 35 million.[47] During the same period the number of rotors - used in open-end spinning units, which adopt a more efficient technique than in the traditional spindles, but are more suited to the production of coarser varieties of yarn - grew almost five-fold, from 67000 to 3.17 lakh.[48] The sharp increase in spindlage, a consequence of the policy of economic liberalisation pursued by successive Governments since 1991, is now being blamed for the build-up of excess capacity in the industry.

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[41] S.S.Mehta, Indian Textile, p.23.
[42] ibid., p.22.
[43] Front Line, Volume 16, no.5, February 27 – 12 March 1999.
[44] cited in Mills Still Split on Seconds Import, The Economic Times, 4 February 1999.
[45] ibid.
[46] ibid.
[47] Front Line, Volume 16, no.5, February 27 – 12 March 1999.
[48] ibid.

Over the years the spinning industry became increasingly dependent on export markets. In 1990-91, only 6 per cent of the cotton yarn produced in India was exported; by 1997-98, exports rose to 22 per cent. In addition, yarn supplies to powerlooms that catered principally to export markets also increased. Between 1990-91 and 1997-98, yarn production in India increased by 63 per cent. Yarn exports increased from 90 million kg to 485 million kg during this period. In value terms, exports increased from $500 million to $1.6 billion between 1993-94 and 1997-98. During this period, the annual average increase in the value of yarn exports in dollar terms was 45 per cent.

5.7. Cost Competitiveness of Indian Textile and clothing Industries:

Indian textile and clothing industries, despite factors that affect the efficiency and competitiveness, have relative cost advantage over their main competitors. Every segment of textile and clothing industries - spinning, weaving and processing - enjoy cost advantage. India has an abundant and skilled workforce, therefore the wages in the textile industry are considerably lower. The experience of Indian textile and clothing industries confirms that the wages, unlike in other countries such as South Korea, Taiwan and Malaysia are unlikely to go higher as the primary agriculture sector continues to release people engaged in it. In both the textile and garment sectors, India's strengths lie basically in natural resources and factor endowments - namely cheap labour and raw cotton. Also, the garment industry is based on a system of decentralized production, i.e. subcontracting, which is a low-risk and low-capital strategy. Easy availability of raw materials, abundant labour force and low factor prices such as electricity and transport costs make the production costs in Indian textile and clothing industries cheaper. Hence Indian products are cost competitive over their main rivals in other parts of the world. A look at the comparative costs of textile production of various countries (Table 5.4) reveal the enormous cost advantages of Indian textile and clothing industries in fabric and yarn production against leading textile producing countries.

Table 5.4 Comparative Costs of Textile Production

Countries / Cost Elements	Spun Yarns		Woven Fabrics		Knitted Fabrics	
	Ring spun ($/Kg)	OE spun ($/Kg)	Ring spun ($/Kg)	OE spun ($/Kg)	Ring spun ($/Kg)	OE spun ($/Kg)
Brazil	3.30	3.05	0.98	0.94	1.08	1.01
India	2.79	2.67	0.91	0.89	0.93	0.90
Italy	4.11	3.32	1.36	1.49	1.44	1.20
Japan	4.19	3.66	1.38	1.21	1.45	1.29
South Korea	3.10	2.97	0.90	0.89	1.03	0.98
Thailand	3.21	3.09	0.91	0.89	1.06	1.03
U.S.A	3.61	3.14	1.12	0.96	1.24	1.09

Source: India - Textile and clothing, Quarterly Bulletin on Textile and clothing, vol.1/1996, March 1996, OETH.

Though Indian textile industries could capitalise on their very low labour costs against their main competitors, it is made difficult by factors such as the high cost of borrowing and the cost of depreciation. The cost of depreciation associated with outdated machines increases the cost of production in Indian textile industry. Investigations carried out by industry research associations indicate that labour costs in Indian mills are 25 per cent higher, compared to international mills using a similar technology.[49] If Indian textile industries were to have an easy access to capital borrowing, it would again decrease their cost of production and further enhance their cost competitiveness. Nevertheless the cost of production in Indian textile industries still continues to be minimal.

A close look at the cost structure of the Indian cotton textile industry (Table 5.5) reveals the cost of various elements in the production process. The labour costs, in the production of yarns and fabrics, continue to account for negligible proportion in the total production costs. This is similar in all sub-sectors. The cost of depreciation and interest continues to be high in the total production cost. This highlights the continual usage of outmoded machines in Indian textile industry. This also reveals the high cost of capital borrowing in Indian capital market. The cost of the raw materials also continues to account for a considerable proportion of total production cost. This is mainly because of Indian textile industry's high reliance on natural fibres, which are highly susceptible to variations in rainfall.

Table 5.5 Cost Structure of Indian Cotton Industry

Cost Elements	Spun Yarns		Woven Fabrics		Knitted Fabrics	
	Ring spun ($/Kg %)	OE spun ($/Kg %)	Ring spun ($/Kg %)	OE spun ($/Kg %)	Ring spun ($/Kg %)	OE spun ($/Kg %)
Waste	6	4	4	3	6	4
Labour	2	1	4	3	2	2
Power	8	9	9	9	4	9
Aux. Materials	3	4	6	7	8	5
Deprec. & Interest	48	47	58	58	50	49
Raw Materials	32	35	19	20	30	31
Total Production cost ($)	2.79	2.67	0.91	0.89	0.93	0.90

Source: India - Textile and clothing, Quarterly Bulletin on Textile and clothing, vol.1/1996, March 1996, OETH.

Indian textile industries are enjoying sector-specific cost advantages in textile production. A comparison on the cost of production in spinning, knitting and weaving reveal the costs of various elements involved in textile production (Table.5.6). In all three sub-sectors of textile

[49] At the Crossroads, The Financial Times, 4 January 1997.

production - spinning, knitting and weaving - the Indian textile industries are enjoying cost advantage over the leading textile producing countries.

Table 5.6 International comparison on the Costs of Spinning 1993-95

Countries	Brazil		India		Italy		Japan		S.Korea		USA	
Year	93	95	93	95	93	95	93	95	93	95	93	95
Waste (%)	23	13	**9**	**17**	11	15	12	14	20	21	13	15
Labour (%)	5	8	**3**	**2**	38	30	29	29	7	8	24	19
Power (%)	7	8	**12**	**15**	9	8	16	17	10	9	7	6
Aux.material (%)	6	5	**5**	**5**	4	4	5	5	6	6	4	5
Depreciation (%)	35	29	**34**	**30**	19	25	27	26	36	33	39	38
Interest (%)	24	37	**37**	**31**	19	18	11	9	21	23	14	17
Total manufacturing cost (%)	100	100	**100**	**100**	100	100	100	100	100	100	100	100
Total manufacturing cost ($/kg of yarn)	1.74	2.75	**1.87**	**2.25**	2.80	3.00	2.80	3.40	1.71	2.25	2.35	2.81
Raw material	1.56	2.01	**0.92**	**2.04**	1.31	2.27	1.39	2.32	1.39	2.30	1.26	2.15
Total yarn costs	3.30	4.76	**2.79**	**4.29**	4.11	5.27	4.19	5.72	3.10	4.55	3.61	4.96

Source: The EU textile and clothing Sector: A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, various years.

Table 5.7 International Comparison on the Costs of Weaving 1993-95

Countries	Brazil		India		Italy		Japan		S.Korea		USA	
Year	93	95	93	95	93	95	93	95	93	95	93	95
Labour (%)	9	16	**6**	**7**	42	35	37	40	13	16	35	30
Power (%)	8	7	**11**	**12**	11	9	14	15	12	10	8	7
Aux.material (%)	11	12	**10**	**13**	7	8	10	10	19	17	11	9
Depreciation (%)	46	31	**39**	**38**	22	30	29	27	36	35	32	39
Interest (%)	27	34	**35**	**31**	18	18	10	8	20	23	14	15
Total manufacturing cost (%)	100	100	100	100	100	100	100	100	100	100	100	100
Total manufacturing cost ($/yard fabric)	0.32	0.47	**0.34**	**0.39**	0.52	0.59	0.49	0.65	0.28	0.39	0.38	0.48
Raw material	0.9	0.83	**0.83**	**0.75**	1.24	0.92	1.25	1.00	0.82	0.79	1.01	0.87
Total fabric costs ($/yard fabric)	1.22	1.30	**1.17**	**1.14**	1.76	1.51	1.74	1.65	1.10	1.18	1.40	1.35

Source: The EU textile and clothing Sector: A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, various years.

Table 5.8 International comparison on the costs of Knitting 1993-95

Countries	Brazil		India		Italy		Japan		S.Korea		USA	
Year	93	95	93	95	93	95	93	95	93	95	93	95
Labour (%)	11	16	**6**	**4**	60	53	52	53	16	20	45	40
Power (%)	10	9	**16**	**20**	8	7	16	15	13	11	7	6
Aux.material (%)	14	9	**12**	**12**	6	6	6	7	14	11	7	9
Depreciation (%)	39	30	**31**	**31**	13	20	19	19	37	35	30	32
Interest (%)	26	36	**35**	**33**	13	14	7	6	20	23	11	13
Total manufacturing cost (%)	100	100	100	100	100	100	100	100	100	100	100	100
Total manufacturing cost ($/yard fabric)	0.07	0.13	**0.07**	**0.08**	0.17	0.18	0.16	0.12	0.07	0.10	0.12	0.15
Raw material	0.43	1.32	**0.25**	**1.20**	0.36	1.47	0.38	1.68	0.38	1.27	0.35	1.38
Total fabric costs ($/yard fabric)	0.50	1.45	**0.33**	**1.28**	0.53	1.65	0.54	1.80	0.46	1.37	0.47	1.53

Source: The EU textile and clothing Sector: A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, various years.

5.8. COST COMPETITIVENESS OF CLOTHING INDUSTRY:

Not only in textile but also in clothing production, India has competitive edge over the leading producers. The labour cost is an important element of competitiveness in clothing industry as it accounts for a considerable proportion of total production cost.[50] In this regard, the cheap labour cost in India has given the garment producers an edge over their main competitors. This could be realised from low unit value realisation felt in Indian clothing industry (Table 5.9).

The salient feature of the Indian garment industry is a system of decentralised production. Hence, there exists a flexible production and low labour cost. The level of sub-contracting is high in Indian clothing industries compared to their main competitors. Apparel firms in India subcontracted 74 percent of their output, compared with only 11 percent for Hong

[50] Garments are manufactured in three stages. They are the *fabric to patterns*, usually done by power-operated cutting machines; *making* or *sewing* the garment on sewing machines, either foot-operated or power-operated; and *finishing* the garment by trimming, checking for dimensions, washing, ironing and packing. The most labor-intensive part of the process is the sewing operation. Most firms in India outsource at least the sewing operation, which, together with cutting, constitutes 21.5 percent of overall costs. Materials contributed 54.5 percent of costs, while finishing and overheads contributed 9 and 15 percent respectively. Cited in Sanjay Kathuria and Anjali Bhardwaj, Export Quotas and Policy Constraints in the Indian Textile and Garment Industries, SASPR, World Bank, New Delhi, 8 October 1998.

Kong, 18 percent for China, 20 percent for Thailand, 28 percent for South Korea and 36 percent for Taiwan.[51] The high level of sub-contracting is translated into low labour cost.

Table 5.9 – Average Unit Value Realisation

Year	Quantity (in Million Pieces)	Value (in Million US$)	Value realised Per piece (in US$)
1987	384.2	1388.30	3.61
1988	396.7	1432.20	3.61
1989	494.1	1834.00	3.71
1990	602.7	2494.50	4.14
1991	664.8	2407.50	3.61
1992	758.5	2883.10	3.80
1993	905.2	3466.60	3.83
1994	996.0	4421.90	4.44
1995	1060.2	4473.50	4.22
1996	1184.7	4292.10	3.62
1997	1301.5	4863.6	3.74

Source: Apparel Export Promotion Council, Ministry of Industry, Government of India.

The high level of flexibility achieved by Indian apparel firms, mainly because sub-contracting, helps them maintain not only low cost, but also to meet small orders with variable output. It would not be unfair to say that Indian garment exports have been niche-based, focusing on low-volume and high variety of outputs, within the broad area of fashion clothing and especially ladies outerwear. The flexibility in the Indian production system is eminently suited to meet this demand.

The subcontracting is a low-risk, low-capital strategy. The high cost of capital borrowing in India indirectly encourages the garment industry to make use of decentralised production. With subcontracting, the bulk of the labour force is outsourced resulting in a major decline in fixed costs. Investments in equipment and factory space are also minimized. This is clearly reflected in the low cost of investment levels in Indian apparel firms. An analysis on the levels of investment in various Asian countries, which are India's main competitors in international market, reveals the low levels of investment in Indian apparel firms.[52] The average investment in Indian machines was $29760 as compared with an investment of $2.45 million in Hong Kong and $943000 million in China. It could be argued that the smaller amount reflects the small size of Indian firms, which are operating with an average of 119 machines per firm as against 698 in Hong Kong and 605 in

[51] cited in Sanjay Kathuria and Anjali Bhardwaj, Export Quotas and Policy Constraints in the Indian Textile and Garment Industries, SASPR, World Bank, New Delhi, 8 October 1998.

[52] Khanna's comparisons are the based on his research, which is based on individual field surveys of 177 firms in India and 149 apparel manufacturers in five countries of South East Asia. The research covered the period till 1991/92 except India where it was done in 1987.

China. The size of the Indian firms is smaller than their main competitors as Indian apparel firms heavily rely on sub-contracting. This table also reflects the lower levels of investment per machine, with investment in India being only $250 per machine against $3510 in Hong Kong and $1500 in China. Though it is mainly attributed to the high proportion of manual machines as against power machines, it also reveals the less sophistication of power machines.

Table 5.10 Machinery and Investment Levels by Apparel Exporting Firms (in nos.)

	Total machines /firm	Manual machines	Power machines	Total Investment ($1000)	Investment/ machine ($1000)
S. Korea	258.08	6.14	240.33	722.19	2.79
Taiwan	264.62	0.15	264.46	579.21	2.18
Hong Kong	698.12	4.35	688.76	2456.64	3.51
China	605.15	1.5	603.65	943.86	1.5
Thailand	572.32	0	572.32	722.25	1.26
India	119.28	37.26	75.39	29.76	0.25

Source: Khanna, S.R., The Challenge of Global Competition in the 1990s: An Agenda for Enhancing the Competitive Position of the Indian Textile and clothing Industry: Mimeo, ICRIER, New Delhi, 1993.

Table 5.11 Comparison of Garment Factories in Asian Countries
Productivity Levels of Apparel Firms (no. of pieces per machine per day)

Country	Ladies Blouses	Gents Shirts	Ladies Dresses	Ladies Skirts	Trousers
S. Korea	14.6	17.4	8.8	17.5	15.6
Taiwan	18.9	18.2	12.4	16.6	16.1
Hong Kong	20.6	20.9	20.2	19.3	19.3
China	10.9	14.0	7.8	13.0	6.7
Thailand	17.0	19.8	12.2	20.5	13.1
India	10.2	9.1	6.3	9.6	6.8

Source: Cited in Sanjay Kathuria and Anjali Bhardwaj, Export Quotas and Policy Constraints in the Indian Textile and Garment Industries, SASPR, World Bank, New Delhi, 8 October, 1998. However the original study was undertaken for all countries over 1991/92 except India where it was done in 1987.

As for the labour costs in the Indian textile and clothing industries as a whole, Indian industries are enjoying enormous cost advantage over their main competitors. According to the latest Werner study on the labour costs in textile and clothing industries in various countries, India's labour cost is many times cheaper than many of its competitors, except China. India's labour cost is just equivalent to that of China. India's labour cost is many times cheaper than many of the leading textile and clothing producers of the EU and the Mediterranean region. In the textile industry, India's labour cost is 35 and 26 times cheaper than it is in Germany and Italy. Even the low labour cost countries of the EU, such as Greece, Spain and Portugal, have wages many times higher than that of Indian wages. Indian labour cost is 14, 13 and 7.5 times lower than that in Spain, Greece and Portugal respectively. Even when compared to the countries of the

Mediterranean region, they are comparatively lower in Indian textile industry. Indian labour cost is 4 and 3.5 times cheaper than their main competitors in Czech Republic and in Turkey respectively. However it is in the clothing industry, Indian clothing firms are enjoying absolute competitive edge over their main competitors. While the labour cost is 46 and 35 times cheaper in Indian clothing industry compared to Germany and Italy respectively, it is also many times cheaper than that in Spain, Greece and Portugal. It is also many times cheaper than that in the Czech Republic and in Turkey.

Table 5.12 Labour Costs in Textile and Clothing Industries in Selected Countries (in 1990-98 $/hour)

Country	Textile Industry			Clothing Industry		
	1990	1996	1998	1990	1996	1998
European Union						
Belgium	17.85	25.00	21.70	12.92	20.92	16.49
Denmark	18.35	25.65	23.10	15.93	21.38	18.71
Germany	16.46	21.94	21.48	07.23	20.35	18.04
Greece	05.85	08.92	07.99	04.33	07.19	06.55
Spain	07.69	9.21	08.49	07.08	07.78	06.79
France	12.74	16.45	14.16	12.52	16.33	13.03
Ireland	09.15	11.83	10.76	07.50	10.00	08.72
Italy	16.13	16.65	15.81	12.50	13.68	13.60
Netherlands	17.84	23.02	19.88	14.71	18.93	14.71
Austria	15.70	20.61	18.13	09.96	18.22	14.32
Portugal	02.75	4.77	04.51	02.30	03.85	03.70
Finland	14.44	16.48	15.69	14.16	14.71	13.96
Sweden	18.70	20.94	19.41	17.78	15.93	16.30
United Kingdom	10.20	11.71	13.58	08.02	09.28	10.86
USA	10.02	12.26	12.97	06.56	09.62	10.12
Japan	13.96	24.31	20.70	06.34	20.95	13.55
Switzerland	19.23	27.30	24.08	14.19	22.42	17.58
Central & E.Europe						
Poland	..	02.39	03.15	00.50	01.42	02.77
Hungary	01.24	03.18	02.98	00.92	01.68	02.12
Czech republic	..	02.21	02.05	02.79	01.55	01.85
Romania	..	..	..	01.73	01.08	01.04
Turkey	01.82	02.02	02.48	01.35	01.52	01.84
Morocco	01.28	01.92	01.89	00.92	01.22	01.36
Tunisia	..	01.89	01.76	01.46	01.76	..
Egypt	00.45	00.84	00.91	00.34	00.51	00.68
Israel	06.59	07.34	06.98	05.17	05.61	05.37
China	00.37	00.58	00.62	00.26	00.25	00.43
India	00.72	00.56	00.60	00.33	00.29	00.39
Indonesia	00.25	00.52	00.24	00.16	00.33	00.16
South Korea	03.22	05.65	03.63	02.46	03.29	02.69
Pakistan	00.39	00.43	00.40	00.24	0.29	00.24
Taiwan	04.56	06.38	05.85	03.41	05.18	04.68
Vietnam	..	..	..	..	00.29	00.22

Source: The EU textile and clothing Sector: A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, various years.

5.9. INDIA'S TEXTILE AND CLOTHING EXPORTS:

The Textile and clothing exports remain one of the India's top foreign exchange earners outperforming country's overall exports. While the textile exports increased by 150 per cent between 1980 and 1994, the clothing exports increased by almost ten times during the same period. As a result, starting from a share of 20 per cent in 1991, textile exports have achieved a dominant place by accounting for over 30 per cent of India's total exports. The growth rate in exports of Indian textile and clothing during 1996-97 was 11 per cent. Indian textile and clothing exports during 1996-97 was to the tune of $10253.60 million, of which readymade garments alone accounted for $4762.10 million. India's textile exports are targeted to reach US $20 billion by 2002. India, at present, accounts for 2.3 per cent of global textile trade and 2.4 per cent of the world's trade in clothing.

The garment sector displayed an impressive growth performance during the eighties with the exports rising seven times in value and four times in volume. During the past decade, the garment exports had consistently exceeded the target except in 1991-92, when the achievement fell short by about 1.5 per cent. Garment exports yielded an average annual growth rate of 26 per cent from 1990 to 1995. Indian garments are exported to over 100 countries out of which 75 per cent is exported to Europe, USA and Canada. Notwithstanding the impressive growth performance of Indian textile and clothing industries, most of the exports are still cotton based. Despite 50 years of trying, synthetics have failed to replace cotton as the core fibre for consumer textile. While India's leading competitors concentrate on the production and export of synthetic based products, Indian exports are still dominated by cotton base. It is disadvantageous for Indian textile and clothing producers to have a system dominant on a single product. Since cotton is a seasonal crop and is susceptible to variations in monsoon changes, the industry is highly vulnerable. Also the availability of man-made fibres would relieve the pressure away from domestic spinning industries. The Government's long-term cotton export policy, which is aimed at maintaining a minimum level of cotton export every year irrespective of the size of the crop or the demand for cotton from the users, has also come in for criticism. The Government claims that the policy is aimed at ensuring that India is seen as a regular and reliable exporter of cotton. The spinning industry says that short supply of cotton, its basic raw material, has made prices unstable. In this regard, it would have been better, if Indian textile and clothing industries changed their export structure away from cotton and cotton oriented products to synthetic base.[53]

[53] It would be interesting to highlight the case of Chinese textile and clothing industries as they had comparative production and export structure to that of India's. Since the mid-seventies, the Chinese textile and clothing industries have successfully diversified their export structure from cotton-based to synthetic-based products. In China, which is set to become the world's largest polyester producer, the use of synthetics has leapt from 18 percent in 1978 to 45 percent in 1995.

The Table 5.13 and 5.14 below shows the export composition of Indian textile and clothing industries. The readymade garments are the single largest product accounting for almost half of total Indian textile and clothing export. It is followed by cotton fabrics and made-ups. Cotton yarn also continues to be a leading export product.

Table 5.13 Export Composition of Textile and Clothing from India (1996-97)

Items		Share in total value (in per cent)
Cotton fabrics and made-ups	Mill-made/ powerloom	18.18
	Handloom	4.90
Cotton Yarn		14.85
Readymade Garments		47.10
Woollen Textile		2.93
Silk Textile		2.46
Man-made Fibre Textile		8.98
Coir		0.57
Total		100

Source: Apparel Export Promotion Council, Ministry of Industry, Government of India.

Table 5.14 Trends in India's Exports of Textile and Garments (US $ Million)

	1996-97	1995-96	1994-95	1993-94
Total Indian exports	33768.0	32311.0	26855.0	22683.0
Export of yarn, textile and garments of which	7990.4	7468.7	6352.0	4739.0
Cotton yarn, fabrics and made-ups	3113.5	2576.8	2234.0	1537.0
Readymade garments of which	4762.2	4502.3	4458.7	3653.4
Cotton garments	3418.4	3150.2	3127.7	2744.4
In per cent	(71.78)	(69.97)	(70.15)	(75.12)
Synthetic garments	1176.9	1179.8	1160.7	794.7
in per cent	(24.71)	(26.20)	(26.03)	(21.75)
Readymade garments of which				
Exports to the USA	1352.7	1200.0	1257.9	930.2
in per cent	(28.40)	(26.65)	(28.21)	(25.46)
Export to the EU	1900.3	1969.7	2042.4	1522.9
in per cent	(39.90)	(43.75)	(45.81)	(41.68)

Source: Cited in Sanjay Kathuria and Anjali Bhardwaj, Export Quotas and Policy Constraints in the Indian Textile and Garment Industries, SASPR, World Bank, New Delhi, 8 October, 1998. However the original study was undertaken for all countries over 1991/92 except India where it was done in 1987.

The salient feature of Indian textile and clothing exports is that it is less dependent on imports for its finished products. This confirms that the exporters are highly reliant on the domestic raw materials. A look at the export-import ratios of leading textile and clothing producing nations (Table 5.15) reveal that the export-import ratios were always in favour of India.

Table 5.15 Export/Import ratios of leading textile producing Countries (1990-97 in million $)

Countries	1990		E/I ratio (%)	1997		E/I ratio (%)
	Exports	Imports		Exports	Imports	
China	13261	5292	2.5	26796	12267	2.2
EU	15123	14237	1.1	22700	18268	1.2
South Korea	6076	1946	3.1	13346	3563	3.7
Germany	14033	11868	1.2	13053	10388	1.3
Italy	9492	6133	1.5	12901	6412	2.0
Taiwan	6128	1013	6.0	12048	1776	6.8
United States	5039	6730	0.7	9193	12463	0.7
France	6058	7595	0.8	7214	6972	1.0
Belgium/Luxembourg	6375	3579	1.8	7010	3992	1.8
Japan	5859	4106	1.4	6750	5807	1.2
United Kingdom	4379	7018	0.6	5618	8456	0.7
India	2180	240	9.1	4358	345	12.6
Pakistan	2663	126	21.1	4919	111	44.3
Turkey	1440	567	2.5	3352	2324	1.4
Netherlands	2911	3615	0.8	3010	3801	0.8
Spain	1497	2050	0.7	2784	2923	1.0
Indonesia	1241	785	1.6	2255	1152	2.0
Austria	2084	1971	1.1	1911	1804	1.1
Switzerland	2557	1849	1.4	1795	1522	1.2
Hong Kong	2171	4140	0.5	1635	3238	0.5
Portugal	1328	245	5.4	1629	2405	0.7

Source: The EU textile and clothing Sector: A Factual Report, L'Observatoire Europeen du Textile et de L'habillement, Brussels, various years.

The leading markets for Indian textile and clothing exports are the USA followed by the EU. These two largest markets for Indian textile and garments accounted for 73 percent of total textile and clothing exports in 1995/96. The member countries of the EU as a whole form the single largest destination for Indian textile and clothing exports accounting for a third of India's total textile and clothing exports (Table 5.16). The Single European Market is the most important market for Indian textile and clothing exports as it offers opportunities in a number of product lines mainly due to differentiated domestic market conditions prevailing across the member countries. Hence whatever changes occur in the Single European Market will have a corresponding effect on the Indian textile and clothing industries.

Table 5.16 Leading Export Markets for Indian Garment (in 1996)

Rank	Country	Share value (in per cent)	Rank	Country	Share value (in per cent)
1	U.S.A.	26.13	8	Denmark	1.26
2	Germany	12.39	9	Austria	1.10
3	U.K.	9.94	10	Finland	0.38
4	France	7.65	11	Ireland	0.21
5	Benelux	5.34	12	Greece	0.13
6	Italy	3.47	13	Portugal	0.08
7	Spain	1.31		Total EU	43.26

Source: Apparel Export Promotion Council, Ministry of Industry, Government of India.

Though the Single European Market offers increased opportunities for Indian textile and clothing exporters, there exist high regulations in the Single European Market as the textile and clothing industries face increased external competition from the low cost imports. The European Commission, with the objective of safeguarding the interests of the domestic textile and clothing industries, imposed higher tariffs on external imports as the domestic industries are highly vulnerable to external competition thereby resulting in sizeable employment losses. As a result, the textile and clothing imports, compared to other imports, are facing high tariff barriers in the Single European Market. According to the EU's tariff classification, the textile and clothing products are considered to be very sensitive and hence calls for higher tariffs against external imports. Apart from this the member countries have also entered into various export restraint arrangements with the non-member exporting countries as a way of limiting the external imports into the Single European Market.

The external imports of textile and clothing into the EU are highly regulated through various tariff arrangements within and without the ambit of the General Agreement on Tariffs and Trade (GATT). Though the arrangements covered under the GATT are binding on the EU, it would not apply for the non-binding arrangements covered outside the ambit of the GATT. Some of these non-binding tariff arrangements are the Most Favoured Nation (MFN) agreement and Generalised System of Preferences (GSP). These two agreements cover almost 55 per cent of total imports into the EU. The remaining 45 per cent of the EU imports fall under a variety of categories such as co-operation agreements entered into by the EU.

Notwithstanding the domestic regulations there also exists restrictive import policy in the member countries, which favour the geographically adjacent countries of the EU. The member countries have preferential trading arrangements with the countries of the Mediterranean, Central and East Europe and the former countries of the Soviet Union. The Commission's associated agreements (Hungary, Poland, Bulgaria, the Czech Republic, Romania, the Slovak Republic, Latvia, Lithuania, Estonia, Cyprus, Malta and Turkey) with these countries give them undue advantage over the countries that do not have any preferential access to the Single European Market. This is mainly because the imports from these countries are subjected to zero tariff.

Indian textile and clothing exports to the EU are subjected to both tariff and non-tariff barriers (anti-dumping and other measures aimed at safeguarding the environment). At the same time they were also subjected to GSP treatment, which ceased to exist with the successful completion of the Agreement on Textile and clothing. However, in the long run, the prospects for free trade in textile and clothing should improve in the Single European Market as they are

gradually integrated into the products subjected to complete tariff reduction under the Agreement on Textile and clothing agreed upon by the developed and the developing countries at the Uruguay Round GATT negotiations. Accordingly by January 2005, the trade in Textile and clothing would face no tariff barriers in the Single European Market. This is more likely to enhance the prospects of the Indian Textile and Clothing exports, which compete mainly on the mass consumed items.

However the market mechanism and the effects of the policies in the member countries will decide the direction of investment in textile and clothing industries. The strategies adopted by the member countries, such as Outward Processing Trade and investment diversion will also decide the effect of the internal changes on India's exports to the member countries. The effects of internal changes on Indian textile and clothing exports to the Single European Market will therefore studied in detail in the next chapter.

CHAPTER - VI

Impact of the Single European Market on India's Textile and Clothing Exports

Impact of the Single European Market on India's Textile and Clothing Exports

The Single European Market is an important market for India's exports. Much of India's total exports are directed towards the Single European Market. Many of the member countries are the traditional markets for Indian exports. More than 30 per cent of India's total foreign trade is with the member countries of the Single European Market. The Indo-EU bilateral trade, which is at present $22 billion, continues to grow larger with India becoming one of the important trading partners for the EU in some sectors. Apart from this the EU is also the biggest source of foreign direct investment and a major contributor to development assistance. It is also India's major partner in technical collaboration. India's ranking among Europe's trade partners moved up to 19 by end of 1994 from 25 in 1990. India's market share in Europe also increased from 0.98 per cent in 1990 to 1.28 per cent in 1994.[1] India's exports to the EU have been growing up substantially in value terms from $3.4 billion in 1988-89 to $8.7 billion in 1995-96, registering a 155 per cent increase. Similarly, imports grew by 71 per cent from $6.01 billion to $10.2 billion in the same period. The growth rate of India's exports to the EU has been consistently higher than India's overall growth rate. This highlights the importance of the EU for India's exports. However the imports from the EU has been broadly in line with India's overall import growth rate. While the EU accounted for 28 per cent of India's exports in 1994-95, only 26 per cent of India's imports were from the EU. Though India's exports exceeded its imports from the EU, it could not be translated into trade surplus in India's favour. While India's exports to the EU largely consist of the low-value added items, the imports from the EU are largely high-value added items. The main items of exports from India to the EU include textile, yarn fabrics, garments, leather and leather goods, gems and jewellery, carpets, engineering goods, besides agricultural and marine products. Major imports by India from the region are manufactured goods, machinery, transport equipment and other capital goods. Hence India's continued trade surplus with the EU could not be translated into higher foreign exchange (value terms). There is a mismatch between India's export structure and the EU's import structure. There is structural incompatibility between the India's exports and the EU's imports. The product items, which are of high significance for Indian exporters are of less significance for the EU. For example, the textile and clothing, which account for nearly a third of India's exports, account for only a 7 per cent of the EU's imports. Nevertheless the trade in textile and clothing is still an area of contention for both the member countries and India, as it is sensitive for both of them. For the member countries, it is sensitive in so far as their manufacturing employment is concerned. For India, it is a leading foreign exchange earner.

[1] EU to Strengthen Ties With India, Business Line, 7 March 96.

India has signed many co-operation agreements with the EU. The latest among them is the 'India-EC Cooperation Agreement for Partnership and Development' signed on 20 December 1993, which came into effect on 1 August 1994. Despite these agreements, the trade between India and the EU has always been contentious for various reasons. The Indian exporters feel the EU could demonstrate a higher flexibility in extending better market access to Indian products and services by laying down more transparent and predictable standards and requirements. There are also problems of repeated anti-dumping and anti-subsidy action against Indian exporters. Though Indian exports accounted for less than 1.3 per cent of the Extra-EU imports, the action against Indian imports was disproportionately high. In terms of cumulative cases since 1994, India accounted for 13 per cent of the total number of cases in which the Commission had taken action.[2] The Indian industry strongly feels that the EU's action regarding anti-dumping and anti-subsidy investigations are neither rational nor fair. The Indian exporters also voice their concern about the countervailing duties imposed on their exports to the EU.

There have been many irritants in the Indo-EU bilateral relations, which are yet to be resolved. This is particularly true in the case of labour-intensive industries such as textile and clothing. The role played by these industries in the respective economies makes trade in these industries more contentious. Many of the Indian textile and clothing exports to the EU are facing high tariff barriers. There are also non-tariff barriers against the Indian exports. The Indian exporters are facing many anti-dumping investigations by the Commission. Notwithstanding the domestic regulations, there also exists biased import policy in the member countries, which favour the geographically adjacent countries of the EU. Indian textile and clothing exporters have always accused the EU of being protectionistic for their exports. They also accuse the EU for repeatedly violating the Memorandum of Understanding (MoU) signed in Brussels on 31 December 1994 on arrangements in the area of market access for textile and clothing products. Under this agreement, India was supposed to get up to 8000 tones of additional quota annually as 'exceptional flexibility'. Since Indian exporters always utilise their quota limits in certain segments, this would enable them to switch quotas, so that they could use unutilised quota in certain segments, where the quota has been fully used.[3] Thus, though the flexibility does not increase the overall quantity of Indian textile exports to the EU, it allows exporters to focus on their core strengths. This would also allow the Indian exporters to increase the unit value realisation of their exports by utilising the quotas granted under the 'exceptional flexibility' for their higher value-added items. Though the EU announced this flexibility in

[2] E.U. Measures Thwarting India's Market Access says Maran, The Hindu, 8 March 2000.

[3] As of the week ended November 6, 1999, Indian exports in women's dresses - cotton, wool or man-made fibre - had already reached 17.46 million pieces, utilising the 100 per cent quota allocated for the category. In another category, men's shorts, breeches and trousers of cotton and man-made fibres, the quota utilisation stood at 97 per cent and for women's shorts and trousers at 93 per cent on November 4. This means that no Indian exporter could not despatch any more women's dresses and that in the two other categories too the quota is expected to be fully utilised soon. for more details see *India and EU on collision course over export dole*, The Economic Times, 8 November 1999.

1996, it was facing strong opposition from some members so it could release only a third of the actual quota during 1997. As opposition from a few EU members led by France and Portugal mounted the European Commission did not grant the flexibilities during 1998.[4] In 1998, 3000 tones of Indian textile imports were blocked in various ports due to the same problem. During the last two years India has not received any quota under this clause. As a result estimated 1.5 million pieces of garments were not being allowed to enter the EU markets.[5]

The eagerly awaited implementation of the agreement on flexible imports ended in a deadlock and could not be implemented until May 2000 over disputes on tariff reduction and market access for European textile products in Indian markets. After hectic discussions on both the sides, India, much to the disappointment of its exporters, obtained an extra quota of 3500 tones of textile products to the EU as against the quota of 8000 tones agreed upon in the EU-India agreement of 1994 on textile trade.[6] There was a suggestion from the Commission that if India complied with its commitments on the tariff reduction for European products in Indian market, the full flexibility volume of 8000 tones would be made operational in due course. However, the full agreement was not implemented even though India fulfilled its obligation of ratifying the tariff rates for EU's exports to India.

It is true that the textile and clothing markets in many of the member countries are highly protected. This is mainly because the textile and clothing industries occupy an important place in the EU. Though this industry accounts for less than 5 per cent of manufacturing industries' value-added, its importance is highlighted as a large-scale provider of manufacturing employment in many of the member countries. The textile and clothing sector is one of the largest employment providers in the member countries accounting for 20.02 per cent during the years 1985-95. The nature of this employment is largely labour-intensive engaged in mainly less-skilled and un-skilled activities. The skilled activity in this industry accounts for a negligible proportion of total employment. Another factor that highlights the problems of this industry, particularly in garment manufacturing, is its low level of technology content. This is an industry, in which the level of automation is limited as it involves many complex activities. Though there have been some improvements in the directions of R&D into the technological

[4] A similar MoU signed by the EU with Indonesia was challenged by Portugal as it questioned the Commission's locus standi in giving assurances on member-countries' behalf. Portugal also challenged the granting of flexible export quotas to Indian exporters.

[5] In December 1999 the Commission had slapped an embargo on nearly five lakh pieces of T-shirts, 1.6 lakh pieces of trousers and over seven lakh pieces of dresses, totaling worth Rs 30 crore due to which these goods were held up in various European ports. The shipments were held up on the grounds that India had over-utilised the import quota in the EU for these garments last year under various categories. See *India and EC Bury the Hatchet on Textile Trade*, Business Today, 27 September, 1999. For related details see *Before embarking on fresh pacts-Fulfill existing commitments first, India tells EU*, The Hindu 7 April 1999.

[6] EU allows India to increase textile exports, *The Hindu*, 13 May 2000

challenges faced by this industry in its traditional production line, there are still considerable obstacles in progressing even towards partial automation. The main commercial drive towards the clothing industry R&D is the perceived need in the developed countries to protect their industries from the low-cost countries by increasing their labour productivity and reducing their overall manufacturing costs.

The low-levels of moderate specialisation and industry concentration make this industry highly vulnerable to the effects of the Single European Market. In the EU, the textile and clothing sector is considered to be a sector with moderate specialisation with the export-specialisation ratio less than 1.2. The industry concentration is also very diverse with the industry being dominated by large number of small and medium-sized firms. Hence, for many of the member countries, it is in their national economic interest to protect this industry, as this industry is highly vulnerable to external competition. The member countries, which continued to maintain the role of global leadership in international textile and clothing trade, are facing a series of threats from various quarters. In recent times, the survival of the European textile and clothing industries has been seriously doubted in the face of factors such as sluggish demand associated with falling consumption in domestic markets, falling production, raising labour costs, decreased industrial efficiency and falling international competitiveness. Two simultaneous events - a change in the single European Market mechanism and the changes in international trading environment - have affected the member countries' market dominance in the Single European Market. The study on the market mechanism (Chapter II) and the market policies (Chapter III) confirms the continued asymmetric structure of the member countries. Though the member countries participating in the formation of the Single European Market cannot be expected to have uniform market structure, they could at least be expected to show a movement towards structural convergence. A single European Market of more analogous contiguous economies was expected to have more positive welfare effects on the member countries than the one with dissimilar economic structure. The analogous market structure was expected to exert an increased pressure on the inefficient firms, which continue to exist in the Single European Market under the state protection, to go out of the industries. The resources that were inefficiently allocated to these firms would now be reallocated among the efficient firms thereby enlarging the scope of realisation of the benefits of the Single European Market. Hence the success of the Single European Market was conditional upon the fact that there would be more goods traded in the post-market amalgamation than it was before. The positive impact of the structural convergence in the Single European Market would be greater realisation of the economic effects of increased intra-industry trade. Though there have been movements towards more competitive intra-industry trade in other industries, this movement is rather slow in the textile and clothing industries. The policies of many of the member countries in encouraging the continued existence of these industries, despite their higher cost, have further affected the realisation of the benefits of the Single European Market. As a result, we witness a trend, in

which the developed member countries continue to specialise in the comparatively disadvantageous textile and clothing industries, though the economic arguments would have suggested their traditional specialisation in the low-cost member countries. The subsequent effect of this trend would be the misallocation of resources and the reduced effects of economies of scale in the EU. As for the changes in international trading environment is concerned, the high penetration ratio of the exports of the non-member countries and the gradual elimination of trade barriers in the member countries have contributed to the decline of the member countries' dominance in the Single European Market.[7] The opening up of the Single European Market[8] and an increased competition from the newly industrialised and developing countries of the South and South East Asia have affected the export performance of the European textile and clothing industries. The rising competition from the non-member countries has also affected the member countries' market share in other markets of the developed countries. The abolition of various safeguard measures and regimes, such as Multi-Fibre Agreement (MFA)[9], which were used to protect the textile and clothing industries in the developed countries, also project the unfavourable condition for these industries.

For India, the textile and clothing exports remain a top foreign exchange earner out performing all other industries. This sector continues to grow unabated.[10] The textile and clothing exports have achieved a dominant place by accounting for over 30 per cent of India's total exports as against 20 per cent in 1991. This is also a sector with moderate growth performance of 11 per cent during 1996-97. Indian textile and clothing exports during 1996-97 was to the tune of $10253.60 million, of which readymade garments alone accounted for $4762.10 million. India, at present, accounts for 2.3 per cent of global textile trade and 2.4 per cent of the world's trade in clothing. The garment sector displayed an impressive growth performance during the eighties with the exports rising seven times in value and four times in volume. During the past decade, the garment exports had consistently exceeded the target except in 1991-92, when the achievement fell short by about 1.5 per cent. Garment exports yielded an average annual growth rate of 26 per cent from 1990 to 1995.

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[7] Market penetration by products of extra-community origin has significantly increased in recent years. Between 1986 and 1994 it grew from 13.6 per cent to 25.6 per cent for textile, and from 15.6 per cent to 33.4 per cent for clothing in volume terms. For more details see, 'The Single European Market Review Series - Subseries I - Impact on Manufacturing: Textiles and Clothing - Summary', *CEGOS*, March 1996.

[8] The EU argues that their market for T&C products is open with a market penetration ratio of almost 50 per cent.

[9] The MFA imports account for 80 per cent of textile and 99 per cent of clothing imports. They also account for 18 per cent and 21 per cent of apparent consumption in textile and clothing respectively. For more details see, 'The Single European Market Review: Impact on Manufacturing- Textiles and Clothing', Subseries I, Volume 3, *Office for Official Publications of the European Communities*: Luxembourg, 1998.

[10] The Indian government is very ambitious about its textile and clothing exports. The Government's recent planning on the textile sector expected to achieve an export target of $50 billion by 2010.

The leading markets for India's textile and clothing exports are the USA and the EU. These two largest markets accounted for 73 percent of total textile and clothing exports in 1995-96. The Single European Market is the most important market for Indian textile and clothing exports as it offers opportunities in a number of product lines mainly due to differentiated domestic market conditions prevailing across the member countries. The member countries, as a whole, form the single largest destination accounting for a third of India's total textile and clothing exports. India's trade with the EU in textile and clothing industry has largely been inter-industry in nature.

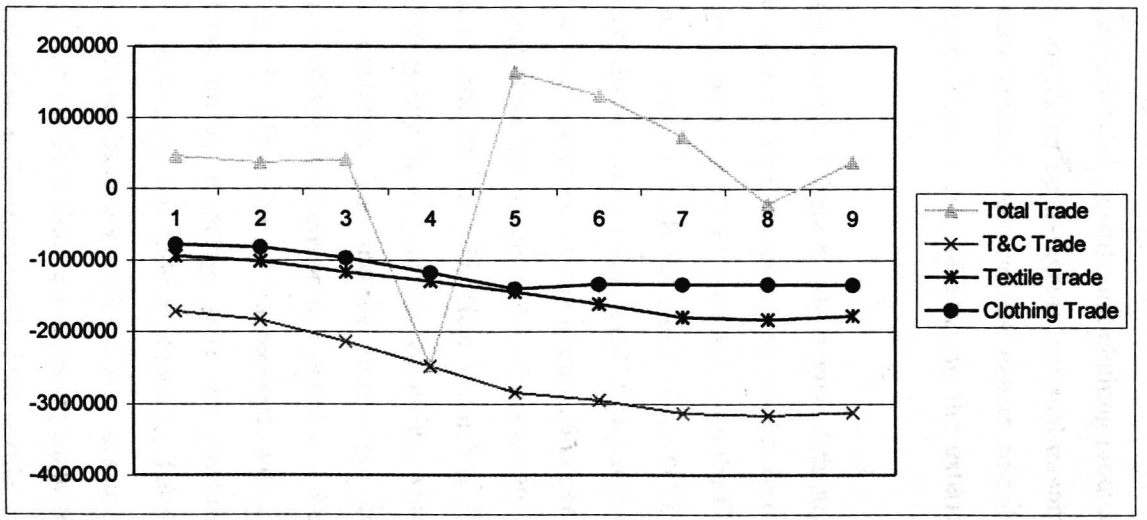
India is one of the largest exporters of textile and clothing to the EU. The exports of textile and clothing to the Single European Market continue to grow from one fourth of the total exports in 1976 to a third of it now. The exports of Indian textile to the EU increased by more than 150 per cent between 1980 and 1994, while the clothing exports rose dramatically by almost ten times during the same period. The categorisation of Indian exports to the EU lists the textile and clothing exports under the dominant class. In value terms, India was the third largest single supplier of textile and fourth largest supplier of clothing to the EU in 1994 accounting for 6.8 per cent each in extra-EU textile and clothing imports into the EU. However in volume terms India is the largest exporter of textile and clothing to the EU. Indian exporters are well placed in some of the export categories such as jute (jute yarn and jute fabrics) and carpets (knitted and woven carpets). India enjoys a market share as high as 63 per cent (jute fabrics) and 45 per cent (woven carpets) in certain product category.

The EU's trade with India in textile and clothing has largely been negative (Table 6.1 and Graph 6.1). The EU's trade with India, in textile and clothing, is a cause of concern for many of the member countries. Though the EU had an overall trade balance with India during 1991-99, its textile and clothing trade witnessed an opposite effect. The EU's over all trade with India witnessed positive trade balance during 1991-99, except 1994 and 1998, when India witnessed trade surplus. The EU's trade surplus in overall trade increased despite a decrease of 19 per cent (in value terms) in its trade balance during 1991-99. Though the EU's trade surplus in overall trade increased during 1991-99, the trade in textile and clothing continues to witness a trade deficit. The trade deficit, in textile and clothing, trade increased by more than 82 per cent during this period. However, it is the trade in textile, which account for a large proportion of this deficit. The EU's trade deficit in textile trade with India increased by around 90 per cent during 1991-99. This is against the increase in trade deficit of 72 per cent in its clothing trade with India.

Table 6.1 The EU's Textile and Clothing trade balance with India 1991-99 (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (99/91)
Total Trade	461318	366292	412446	-2472446	1629676	1312330	737701	-218638	373283	-19.08
T&C Trade	-1717259	-1828149	-2136199	-2472446	-2842055	-2947043	-3132205	-3163062	-3125516	82.01
Textile Trade	-937584	-1015469	-1166742	-1294847	-1443053	-1614844	-1795103	-1825185	-1780223	89.87
Clothing Trade	-779675	-812680	-969457	-1177599	-1399002	-1332199	-1337102	-1337877	-1345293	72.55

Graph 6.1 The EU's Textile and Clothing trade balance with India 1991-99 (in million ECU)



Though the Single European Market offers increased opportunities for Indian textile and clothing exporters, there exist high regulations in the Single European Market. These regulations are aimed at protecting the European textile and clothing industry as they face an increased competition from the low cost imports resulting in sizeable employment losses in the member countries. The European Commission, with the objective of safeguarding the interests of the domestic textile and clothing industries, imposed higher tariffs on external imports, as the domestic industries are highly vulnerable to external competition. As a result, the textile and clothing imports, compared to other imports, are facing high tariff barriers in the Single European Market. According to the EU's tariff classification, the textile and clothing products are considered to be very sensitive and hence calls for higher tariffs against external imports. Apart from this, the member countries have also entered into various export restraint arrangements with the non-member exporting countries as a way of limiting the external imports into the Single European Market.

The external imports of textile and clothing into the EU are highly regulated through various tariff arrangements within and without the ambit of the General Agreement on Tariffs and Trade (GATT). Though the arrangements covered under the GATT are binding on the EU, it would not apply for the non-binding arrangements covered outside the ambit of the GATT. Some of these non-binding tariff arrangements are the Most Favoured Nation (MFN) agreement and Generalised System of Preferences (GSP). These two agreements cover almost 55 per cent of total imports into the EU. The remaining 45 per cent of the EU imports fall under a variety of categories such as co-operation agreements entered into by the EU. Notwithstanding the domestic regulations there also exists biased import policy in the member countries, which favour the geographically adjacent non-member countries. The member countries have preferential trading arrangements with the countries of the Mediterranean, Central and East Europe and the former countries of the Soviet Union. The EU's associated agreements with the geographically adjacent countries have given them undue advantage over the countries (Hungary, Poland, Bulgaria, the Czech Republic, Romania, the Slovak Republic, Latvia, Lithuania, Estonia, Cyprus, Malta and Turkey), which do not have any preferential access to the Single European Market. This is mainly because the imports from these countries are subjected to zero tariff. Although the EU companies are competitive at the upper end of the textile and clothing market, they are taking advantage of the lower manufacturing costs in North African and East European countries in order to be competitive in the face of imports from the low cost traditional exporters. As a result, some 80 per cent of the EU's trade, including outward processing trade, is within this region. Of the remaining 20 per cent, some 10 per cent is with the Americas and another 10 per cent with Asia.

India's textile and clothing exports to the EU are subjected to tariff barriers. India signed 'Agreement on Textiles and Clothing' with the EU, on 31 December 1994, which took

effect from 1 January 1995. The gains to Indian exports are the quota enhancement on certain categories and removal of the quota barrier on handloom and cottage industry products. Indian exports of textile and clothing to Europe are subject to 19 quotas until December 2001, when 18 per cent in volume of the 1990 imports into the EU would disappear as agreed according to the Agreement on Textiles and Clothing. Indian textile and clothing exporters are also gaining benefits under the GSP programme, which are gradually being withdrawn. Under these benefits, the Indian textile and clothing exporters face 85 per cent of the MFN tariff or the normal tariff applicable to the members of the WTO. Indian exports are also subjected to non-tariff barriers such as social, environmental and health-related issues, aimed at protecting the domestic industry from external competition. There is a growing feeling among the Indian textile and clothing exporters there the removal of MFA quotas might be replaced by the growing anti-dumping measures. It has been feared that there are efforts on the part of the European industry trying to protect itself in the face of WTO-regulated moves to lower trade barriers. There seems to be some truth in it. Since 1996, there has been an increasing instance of anti-dumping charges being slapped against India's exports of textile and clothing. In 1996 alone there were more than 10 investigations against India, two of which have ended with the imposition of anti dumping duties on oxalic acid, polyester blended yarn and polyester staple fibre. In September 1996, the Commission imposed the anti-dumping duty on plastic woven sacks. This was followed by the investigation into the alleged dumping of unbleached cotton imports from India. As a result, the anti-dumping duty was imposed on unbleached cotton imports from India in November 1996. The case against Indian cotton fabrics was not closed even after the initial probe concluded that there was no case of dumping. The case has been reopened in July 1998, with the initiation of investigation against Indonesia, China, Egypt, Pakistan and Turkey along with India. However it was again withdrawn at the instances of European unbleached cotton importers. There were also anti-subsidy investigations and slapping of anti-dumping duties against India's exports of cotton bed linen and polyester texturised filament yarn (PTFY). However this had to be with drawn in May 1999. Though these cases were withdrawn at some stages, the investigation still causes an array of hindrances on the exporters concerned since the cost of fighting such cases is enormous, especially for small and medium firms. It is understood that exporters of woven sacks had to spend about Rs.22 lakhs in the initial stages alone to fight the investigation launched against them.[11]

Notwithstanding the disputes over the market access and tariff reductions, the Indian textile and clothing exporters are more concerned about the long-term external effects of the structural changes of the Single European Market on their exports. The structural changes that are being witnessed in the European textile and clothing industries are the cause of concern for many of the Indian exporters. This is mainly because the Single European Market has failed to

[11] Anti-Dumping Probes Dog Indo-EU Trade, Business Line, 8 March 1996.

exert a large-scale pressure on the European textile and clothing industries. As discussed in the previous chapter, many of the expected effects of the Single European Market, such as the efficient reallocation of resources, the economies of scale, have not been realised in the Single European Market. Many of the inefficient industries continue to exist in many of the member countries. This stifles the large-scale realisation of the benefits of the Single European Market. Though trade creation effect (internal and external) has been witnessed in the Single European Market, it is largely external trade creation. The Indian exporters are mainly worried about strategic external trade diversion, in which the expensive domestic production in the EU is being replaced by the imports from geographically adjacent non-member countries of the Mediterranean, Central and Eastern Europe. As a result, the effects of trade creation in the textile and clothing industries are more likely to result in a situation, in which the comparative advantages of the non-member countries are least likely to play a role in distributing the benefits of the trade creation effect. The trade creation effects would be felt differently upon different non-member countries because of the discriminatory nature of quantitative restrictions in the Single European Market. The discriminatory nature of the quantitative restrictions allow certain countries to have a better access to the Single European Market, while discriminating against the imports from other countries. For example, countries with relative advantage in textile and clothing industries, such as Turkey, would have better access to the Single European Market over other countries such as India, which has absolute advantage in many of the sectors in this industry.

It is at this juncture the Indian textile and clothing exports to the Single European Market gain enormous attention. The market mechanism and the effects of the policies in the member countries would decide the direction of the investment in textile and clothing industries. Also the strategies adopted by the member countries, such as Outward Processing Trade (OPT) and investment diversion would decide the effect of the internal changes on India's exports to the member countries. The effects of internal changes of the Single European Market, such as trade creation, trade diversion, trade suppression, on Indian textile and clothing exports to the EU would be studied in this chapter.

6.1. Methodology:

Various factors have been taken into account while analysing the effects of the Single European Market on Indian exports of textile and clothing. A total of 22 products (16 textile and 6 clothing products) have been taken from the dominant category of India's export basket. However two of India's major dominant product category, Jute (jute yarn and jute woven fabrics) and Carpets (knitted and woven), have not been taken into account, while analysing the effects of the Single European Market on Indian exports. This is mainly due to two reasons. The overwhelming dominance of India's exports in the EU and the limited competition its exports

face in this product category gives India's exports unlimited access to the EU. For example, the trade in Jute yarn (5307) is limited in the EU with two leading exporting countries, Bangladesh and India accounting for more than 96 per cent of the extra-EU imports. The same is the case for trade in Jute woven fabrics (5310), in which the same two countries account for more than 98 per cent of extra-EU import share. Hence the study of the Single European Market on India's exports in this product category gains less significance.

The leading textile and clothing exports from India and their market share in extra-EU imports have been shown below. Since textile products represent a dominant category in India's exports to the EU, compared to the clothing products, more textile products have been taken to analyse the effects of the Single European Market on their exports to the EU. India's exports of textile and clothing are broadly classified into five broad categories according to their export share in extra-EU imports in 1999. They are:

- Category I - the exports account for more than 40 per cent of extra-EU imports (5007; 5307; 5310; 5702 and 6304),
- Category II - the exports account for more than 21 per cent of extra-EU imports (5510 and 5514),
- Category III - the exports account for more than 16 per cent and less than 21 per cent of extra-EU imports (5205; 5509 and 5701),
- Category IV - the exports account for more than 10 per cent and less than 15 per cent of extra-EU imports (5107; 5208; 5209; 6302 and 6305) and
- Category V - the exports account for less than 10 per cent of extra-EU imports (5112; 5513; 6104; 6108; 6109; 6110; 6204; 6205 and 6206).

The products from various categories have been chosen to study the competition distorting effects of the Single European Market. Moreover these are also the products, in which many of the developing and emerging economies are competing. Apart from this, the Indo-EU trade in these products has always contentious because of the unabated trade deficit the EU has been witnessing in its trade with India.

The statistical data used in this analysis is based on the *Combined Nomenclature* (CN) system. The electronic data have been obtained from various COMEXT CD ROM's, published by the Office of the Statistical Division, the Commission of the European Communities, Brussels. The data have been collected to cover the periods 1991-99. The starting period for the collection of the data is 1991. This year is important for the textile and clothing industries in both the EU and India. For the EU, these industries started witnessing a great deterioration in growth, production and employment since 1991. As for India, the textile and clothing industries have started competing in the international market during the early nineties as the Textile Policy of 1985 encouraged the textile and clothing industries to be more export oriented, a major deviation from the traditional import-substitution strategy. Also the liberalisation policy announced by the Government of India in 1991 made these industries free from government controls and intervention.

Table 6.2 India's leading Textile and Clothing exports and their share in extra-EU imports in 1996 (in per cent)

No.	CN	Product Description	Extra-EU Import share
Textile (silk; cotton; vegetable fibres; man-made filaments and staple fibres; wadding, felt and laminated fabrics; carpets; knitted, crocheted fabrics and articles)			
1	5007	Woven fabrics of silk, schappe or bourette	43.51
2	5107	Worsted yarn of wool (excluding that put up for retail sale)	14.95
3	5112	Woven fabrics of combed wool or of combed fine animal hair	5.53
4	5205	Cotton yarn other than sewing thread	16.40
5	5208	Woven fabrics of cotton (weighing not more than 200 gms per) m^2)	14.67
6	5209	Woven fabrics of cotton (weighing more than 200 gms per m^2)	12.69
7	5307	Yarn of jute or of other textile	45.41
8	5310	Woven fabrics of jute or of other textile	63.78
9	5509	Yarn of synthetic staple fibres (excluding sewing thread)	19.94
10	5510	Yarn of artificial staple fibres (excluding sewing thread)	22.82
11	5513	Synthetic staple fibres (weighing not more than 170 gms per m^2)	8.24
12	5514	Synthetic staple fibres (weighing more than 170 gms per m^2)	22.42
13	5701	Carpets of textile materials (knotted)	20.68
14	5702	Carpets and other textile floor coverings (woven, not tufted or flocked)	45.53
15	6104	Women's or girls' suits, ensembles, jackets, dresses, skirts, etc.,	3.12
16	6108	Women's or girls' slips, petticoats, briefs, panties, nightdresses, etc.,	8.96
17	6109	T-shirts, singlets and other vests, knitted or crocheted	4.90
18	6110	Jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted (excluding wadded waistcoats)	2.60
Apparel and clothing and other made-up articles			
19	6204	Women's and Girls suits (excluding knitted or crocheted)	4.45
20	6205	Men's or boys' shirts (excluding knitted or crocheted, nightshirts, singlets and other vests)	8.42
21	6206	Women's or girls' blouses, shirts and shirt-blouses (excluding knitted or crocheted and vests)	8.53
22	6302	Linen: bed, table, toilet and kitchen	12.69
23	6304	Furnishing articles excluding 9404	42.86
24	6305	Paking sacks and bags	11.37

* Jute and other textile fibres, raw or processed, but not spun; tow and waste of such fibres, including Yarn waste and garnetted stock (excluding flax, hemp and ramie)

The data collected are in Euro currency terms (ECU), not in volume terms. Both intra-EU and extra-EU trade data have been collected. Intra-EU import data have been collected to study the effects of the extra-EU imports on intra-regional trade. This has been used to study the trade deflecting effects of extra-EU imports.

As for intra-EU trade, the intra-EU import data have been used to cover the periods 1991-97. However the data could not be obtained for the periods 1998-99. The EU's consumption of any particular product is calculated by adding the intra-EU imports with the extra-EU imports. Since the intra-EU imports could not be obtained for the periods 1998-99, the consumption levels for those periods could not be calculated. Where the analysis is concerned about the intra-EU imports and the EU's consumption, it is limited for the periods 1991-97. Also the data could not be obtained for the period 1997 for the lack of the electronic data for that year. In many cases, for the sake of graphical analysis, the average of the years 1996 and 1998 has been taken as a value for 1997, so that a linear curve would be obtained for graphical illustration. However this has been used purely for graphical representation, and not for real analysis. Apart from intra- and extra-EU imports, the extra-EU trade has also been calculated. This has been obtained by calculating the extra-EU imports and exports. Also the EU's trade balance with the non-member countries have been calculated. In all these cases, the changes (in percentage terms) in the trade pattern over the periods 1991-99 have been observed.

Many of the non-member countries' exporting patterns to the EU have been observed during 1991-99. The export pattern of 32 countries, irrespective of their export volume and share in extra-EU imports, have been covered during this period. Their export shares in extra-EU imports have also been calculated. While studying the effects of the Single European Market on the exports of the non-member countries to the EU, the changes in the export pattern, both in real value and in extra-EU share, have been studied. These changes have been studied in accordance with the changes such as the changes in (i) consumption; (ii) intra-EU imports; (iii) extra-EU exports; (iv) extra-EU trade and (v) EU's trade balance.

The changes in India's export pattern, both in value (Table 6.3) and in percentage terms (Table 6.4) have been observed for the periods 1991-99. These changes have been studied in accordance with the over all changes witnessed in the EU, such as the increase in extra-EU imports, the increase in intra-EU imports and the changes in the levels of consumption.

Table 6.3 India's Exports of Textile and Clothing to the EU (in million ECU)

Product	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
5007	47615	50142	45114	53618	45265	42763	54745	55977	17.56
5107	2193	4942	8884	18635	23344	26515	31437	26284	1098.54
5112	1752	2957	3660	4558	4690	3563	3871	4786	173
5205	94569	90760	99464	112137	138695	144099	160701	135070	43
5208	116290	91837	85794	101196	123325	151963	125602	130942	12.60
5209	38698	40550	46979	54659	56955	77983	60640	58226	50.46
5307	12161	14628	21993	32605	29869	30346	34559	30802	153.29
5310	14613	17917	22859	28057	26859	35379	25631	20897	43.00
5509	22582	31878	35193	56330	70396	80241	77614	79374	251
5510	13059	18127	19264	28728	35478	27912	25083	19843	51.95
5513	22528	31654	33331	37047	26336	34847	24132	22256	-1
5514	14854	13696	20382	27153	36602	30484	42346	33858	128
5701	186599	178059	216816	188825	175242	178473	176934	154919	-17
5702	42735	51050	66708	73537	94302	106975	113848	117384	175
6104	32814	40723	42054	43282	38040	34726	38556	42613	29.86
6108	17279	26864	41723	52766	60857	72372	92478	117381	579.33
6109	64410	90454	96242	81302	127356	149601	149962	153305	138.01
6110	43735	60889	74234	70650	72306	78504	105950	138031	215.61
6204	171518	162465	208403	268596	367529	315007	289463	277390	61.73
6205	167769	171926	193068	200235	275813	267740	201954	182528	8.80
6206	174265	183904	191074	216432	225243	198472	163339	146503	-15.93
6302	81748	92817	120874	151353	186255	210146	225624	228904	180.01
6304	28099	32958	38229	47123	54061	58858	103897	113550	304.11
6305	11084	19684	21651	19314	19798	26589	25371	27221	146

Table 6.4 India's share in extra-EU imports (in per cent)

Product	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
5007	17.29	19.47	21.22	25.47	25.71	25.10	32.80	43.51	26.22
5107	2.20	4.49	7.50	13.45	15.02	16.03	15.67	14.95	12.75
5112	1.75	2.96	4.31	5.38	5.71	5.03	4.56	5.53	3.77
5205	10.67	12.50	15.92	12.88	17.23	18.37	15.06	16.40	5.73
5208	10.66	9.82	9.54	10.21	12.80	15.03	13.74	14.67	4.01
5209	8.25	9.72	10.52	10.07	10.93	13.63	10.44	12.69	4.44
5307	16.96	20.46	28.09	33.29	36.45	34.88	45.66	45.41	28.45
5310	39.67	48.29	54.71	57.38	59.06	66.24	59.69	63.78	24.11
5509	7.71	9.31	12.45	14.55	19.63	22.04	19.13	19.94	12.23
5510	8.00	10.88	12.78	14.22	30.42	26.68	23.23	22.82	14.82
5513	6.93	11.12	12.16	12.50	9.16	9.89	9.80	8.24	1.31
5514	23.11	23.45	26.67	29.68	32.88	26.54	26.43	22.42	-0.68
5701	18.76	18.52	20.38	17.99	18.35	19.69	21.58	20.68	1.93
5702	26.35	32.00	39.77	39.34	45.76	46.62	50.84	45.53	19.17
6104	3.37	3.10	3.50	4.15	3.66	3.23	2.94	3.12	-0.25
6108	2.38	3.63	4.86	5.89	6.62	7.12	7.50	8.96	6.58
6109	5.03	6.31	5.90	5.14	7.17	7.08	5.44	4.90	-0.12
6110	1.83	2.15	2.42	2.31	2.41	2.25	2.29	2.60	0.77
6204	5.24	5.35	6.20	7.20	8.61	6.78	4.95	4.45	-0.79
6205	8.78	9.07	9.24	9.52	12.27	12.50	8.84	8.42	-0.35
6206	13.05	13.50	11.65	12.02	12.48	11.68	8.73	8.53	-4.52
6302	8.32	9.41	10.87	12.85	14.45	15.36	13.36	12.69	4.37
6304	26.48	26.81	28.56	33.45	34.08	36.00	43.77	42.86	16.38
6305	7.20	12.41	14.91	11.90	10.85	13.81	10.90	11.37	4.17

6.2. ANALYSIS:

6.2.1. ANALYSIS FOR TRADE IN WOVEN FABRICS OF SILK, SCHAPPE OR BOURETTE - 5007

Table 5007.1
EU's Trade in Woven fabrics of silk, schappe or bourette (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	271068	256368	196883	207020	205161	194360	199405	-	-	-26.44
Extra-EU Import	275463	257578	212553	210506	176081	170397	-	166882	128664	-53.29
Total Consumption	546531	513946	409436	417526	381242	364757	-	-	-	-33.26
Extra-EU Export	327924	298435	304905	335295	292530	287699	-	271187	187560	-42.80
Extra-EU Trade	603387	556013	517458	545801	468611	458096	-	438069	316224	-47.59
Balance	52461	40857	92352	124789	116449	117302	-	104305	58896	12.27

Graph 5007.1
EU's Trade in Woven fabrics of silk, schappe or bourette (in million ECU)

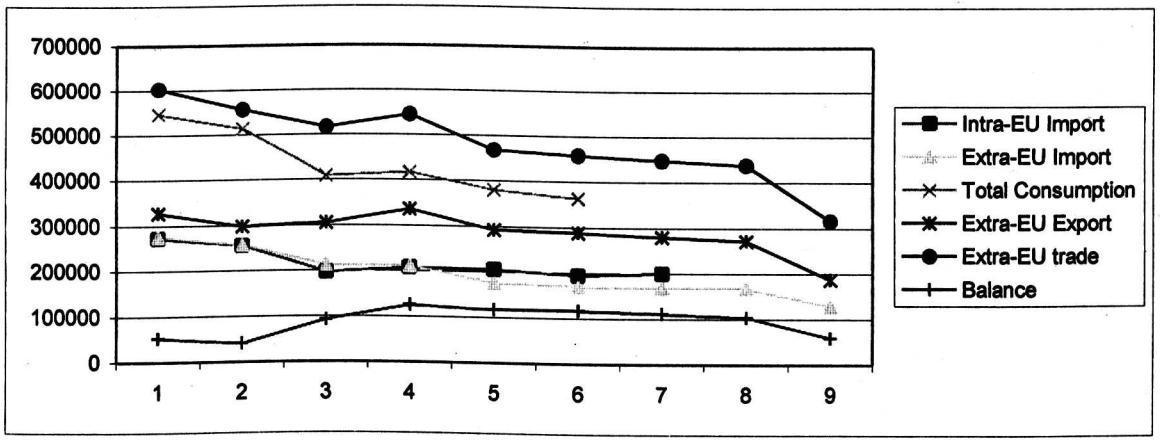


Table 5007.2
EU's Imports of Woven fabrics of silk, schappe or bourette from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
India	47615	50142	45114	53618	45265	42763	54745	55977	17
China	121534	115315	104712	106301	93313	97661	87473	49655	-59
South Korea	36261	26720	16565	11083	10533	7314	6450	5026	-86
Thailand	3918	4406	3725	3357	2678	2990	3642	3820	-2
Hong Kong	35299	34143	23085	21242	11782	7021	2696	1577	-95
Turkey	6	186	9	19	303	428	317	898	14866
Philippines	1	21		9			29	195	19400
Bulgaria	280	491	104	287	8	26	90	65	-76
Slovenia		6	10	77	40	13	180	60	900
Extra-EU	275463	257578	212553	210506	176081	170397	166882	128664	-53

The EU's trade in woven fabrics of silk, schappe or bourette was largely welfare distorting during 1991-99. This is mainly because of the trade contraction effect witnessed during this period. The trade in this product had reduced considerably during 1991-99. This is mainly because of the decline in EU's consumption, which had reduced by a third during 1991-97. This could largely be attributed to the EU's OPT. The domestic consumption reduced largely because of the relocation of domestic industries or the closure of many domestic textile industries responding to competition from the low cost imports from the non-member countries. The reduction in the number of industries in the EU, which accounted for a larger proportion of domestic consumption, had a considerable effect on the trade in this product. All aspects of the EU's trade witnessed gradual decline in this industry. The fall in EU's import, both intra- and extra-EU trade, confirms the trade contraction effect of the Single European Market in this product category. The intra-EU import declined by more than a quarter during 1991-97. There had also been a fall in the EU's extra-EU import, which declined by more than half during 1991-99. Also the EU's extra-EU export declined by 42 per cent during the same period. The fall in extra-EU imports and extra-EU exports resulted in the extra-EU trade having been reduced by more than 47 per cent during 1991-99.

There had been no trade creation effect for trade in this product category for the member countries. All the member countries, except the United Kingdom, had witnessed a fall in their exports to other member countries.

The Single European Market had mixed effect on the non-member countries for trade in this product category. However many non-member countries had witnessed a fall in their export to the Single European Market. This is in line with the fall in the level of EU's consumption. Many leading exporting non-member countries had witnessed a decline in their exports to the EU, both in value and in percentage terms. However India's exports witnessed an increase in their exports to the EU even in the period of trade contraction in the EU. There had been a trade creation effect for India's exports in this product category during 1991-99. The increase in India's exports to the EU's was at the cost of the exports of other non-member countries' exports, particularly India and China. This is confirmed by the increase in India's trade share in extra-EU imports. India's exports increased from 17 per cent in 1991 to 43 per cent in 1999, an increase of 26 percentage point during 1991-99. Among the leading non-member countries, only India's exports increased during this period. This is in contrast to the sharp decrease in the imports from China and South Korea. While China's exports fell from 44 per cent in 1991 to 38 per cent in 1999 (a decrease of more than 5 percentage point), the exports of South Korea declined sharply from 13 per cent in 1991 to 3.9 per cent in 1999, a fall of more than 9 percentage point. India's exports had shown a strong performance despite the fall in the EU's consumption and subsequent fall in extra-EU imports. Hence it could be argued that India's exports had even replaced the domestic production to a considerable extent. The EU's trade in this product category largely had a trade creation effect on India's export.

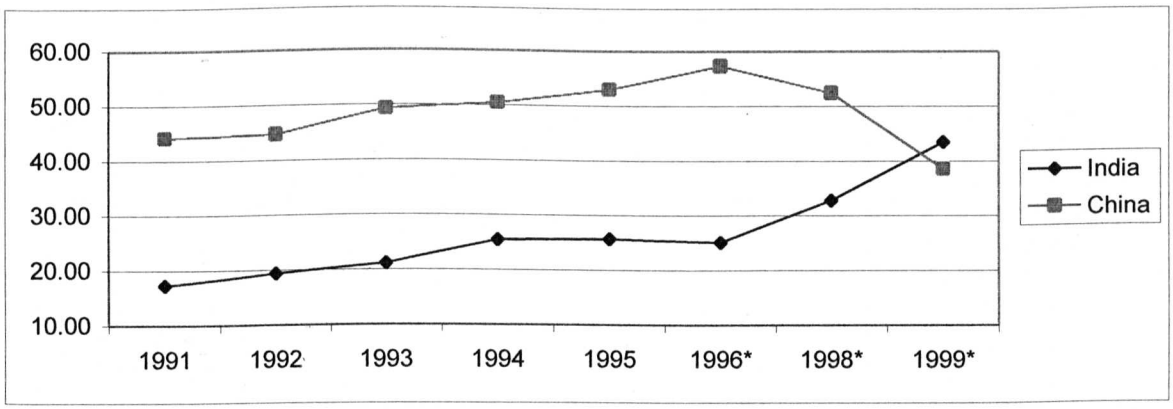
The leading markets for India's exports in this product category, in 1997, are the United Kingdom (36 per cent), Germany (17 per cent), France (15 per cent) and Italy (11 per cent). The increase in India's exports to the EU had associated with the fall in their export share in intra-EU trade. The fall in the share of these member countries had resulted in an increase in India's exports to the EU.

India's exports to the EU an impressive growth during 1991-97. This is mainly stimulated by the increased demand created for India's exports in the leading exporting markets such as the United Kingdom (7 per cent) and France (225 per cent). Though India's exports to Germany and Italy had fallen by 30 and 10 per cent respectively during 1991-97, the demand created for their exports in the United Kingdom and France was sufficient enough to witness an overall export growth.

Table 5007.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

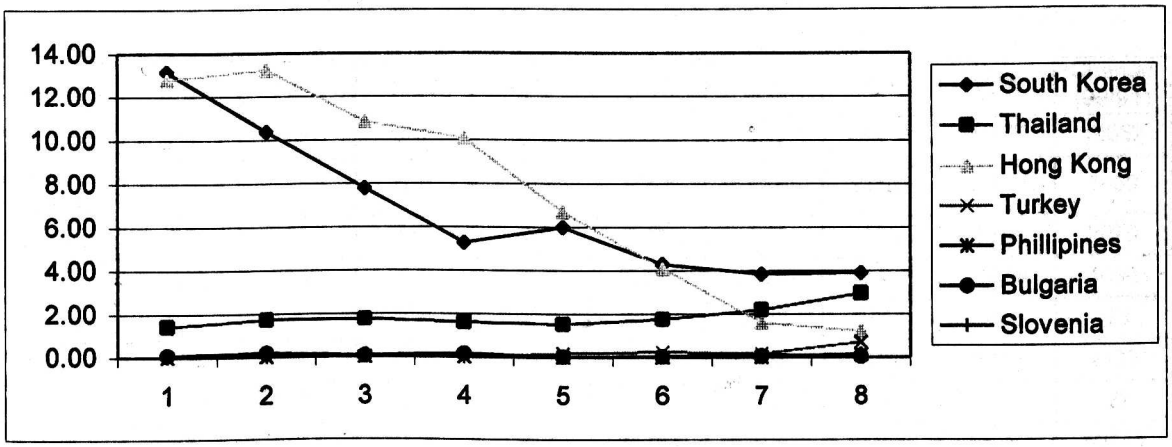
Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
India	17.29	19.47	21.22	25.47	25.71	25.10	32.80	43.51	26.22
China	44.12	44.77	49.26	50.50	52.99	57.31	52.42	38.59	-5.53
South Korea	13.16	10.37	7.79	5.26	5.98	4.29	3.87	3.91	-9.26
Thailand	1.42	1.71	1.75	1.59	1.52	1.75	2.18	2.97	1.55
Hong Kong	12.81	13.26	10.86	10.09	6.69	4.12	1.62	1.23	-11.59
Turkey		0.07		0.01	0.17	0.25	0.19	0.70	0.70
Philippines		0.01					0.02	0.15	0.15
Bulgaria	0.10	0.19	0.05	0.14		0.02	0.05	0.05	-0.05
Slovenia				0.04	0.02	0.01	0.11	0.05	0.05

Graph 5007.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5007.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.2. ANALYSIS FOR TRADE IN WORSTED YARN OF WOOL - 5107

Table 5107.1

EU's Trade in Worsted yarn of wool (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	344564	384252	315267	388879	404865	426150	455448	-	-	32.18
Extra EU-Import	99597	110167	118418	138522	155410	165374	-	200565	175807	76.52
Total Consumption	444161	494419	433685	527401	560275	591524	-	-	-	33.18
Extra-EU Export	145769	161298	187381	222440	222757	261627	-	294196	255877	75.54
Extra-EU Trade	245366	271465	305799	360962	378167	427001	-	494761	431684	75.93
Balance	46172	51131	68963	83918	67347	96253	-	93631	80070	73.42

Graph 5107.1

EU's Trade in Worsted yarn of wool (in million ECU)

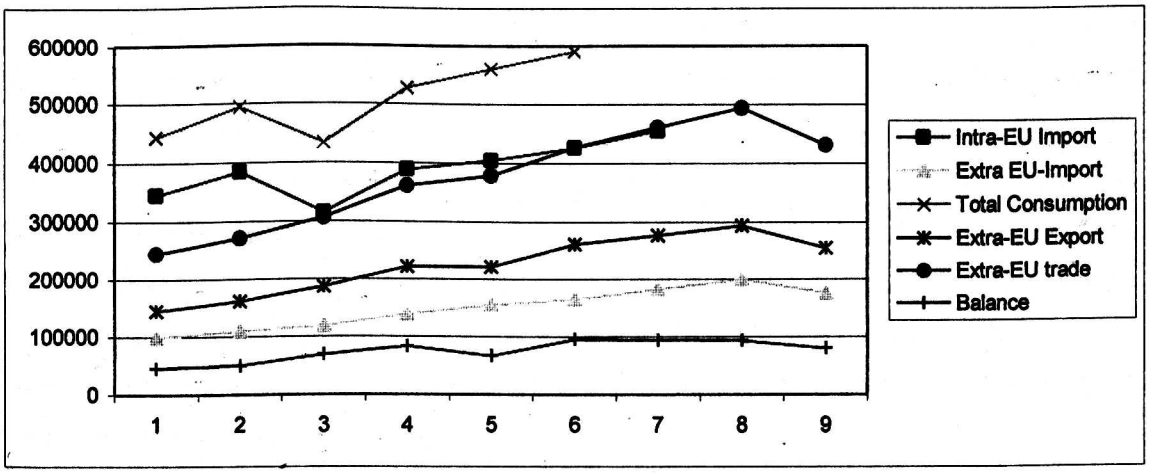


Table 5107.2

EU's Imports of Worsted yarn of wool from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
China	157	426	237	1802	2576	15951	44930	31012	19652
Czech Republic			938	3712	8660	13378	11167	16517	1660
Hungary	50	51	411	165	380	457	965	1085	2070
India	2193	4942	8884	18635	23344	26515	31437	26284	1098
Indonesia					5579	6633	3684	1488	-73
Lithuania			81	12	243	110	444	1814	2139
Malaysia	2380	3815	9370	6677	8581	4219	3188	1734	-27
Poland	88	3513	12989	18379	25393	22160	51085	44215	50144
Slovenia		764	1339	2248	3081	2029	1896	3063	300
Thailand		4	7		1125	14573	19521	18146	453550
Turkey	934	1084	925	1369	1369	964	707	6216	565
Extra-EU	99597	110167	118418	138522	155410	165374	200565	175807	76

The EU's trade in worsted yarn of wool is largely intra-regional during 1991-97. The trade in this product category was welfare creating in that it created trade creation effects for both the member and non-member countries. There had been an increase in the EU's consumption of worsted yarn of wool during 1991-97. This resulted in an overall increase of EU's trade. The EU's intra- and extra-EU trade increased during 1991-99 with the extra-EU trade increasing at faster than the intra-EU trade. There had been a similar increase, in per cent terms, in both extra-EU imports and extra-EU exports. Though the extra-EU exports and extra-EU imports increased at similar level during 1991-99, the base value of the imports was lower than the exports. For example, the value of extra-EU imports, of this product category, was only 68 per cent of the extra-EU exports. This resulted in an increase of the EU's trade balance in its favour, which increased similar to its extra-EU trade.

There had been a trade creation effect for member countries in this product category during 1991-99. Some of the leading producers, such as Germany, Italy, United Kingdom and Portugal increased their export value considerably in the intra-EU trade. Among them only United Kingdom and Portugal increased their exports both in value and percentage terms. The other two countries, Germany and Italy, could increase their export value, though they suffered a fall in their share in intra-EU imports. This implies that an increase in the exports from United Kingdom and Portugal would have replaced the imports from Germany and Italy. Other leading producers (France, Belgium/Luxembourg) worsted yarn of wool witnessed a fall in their export value, both in value and in percentage terms.

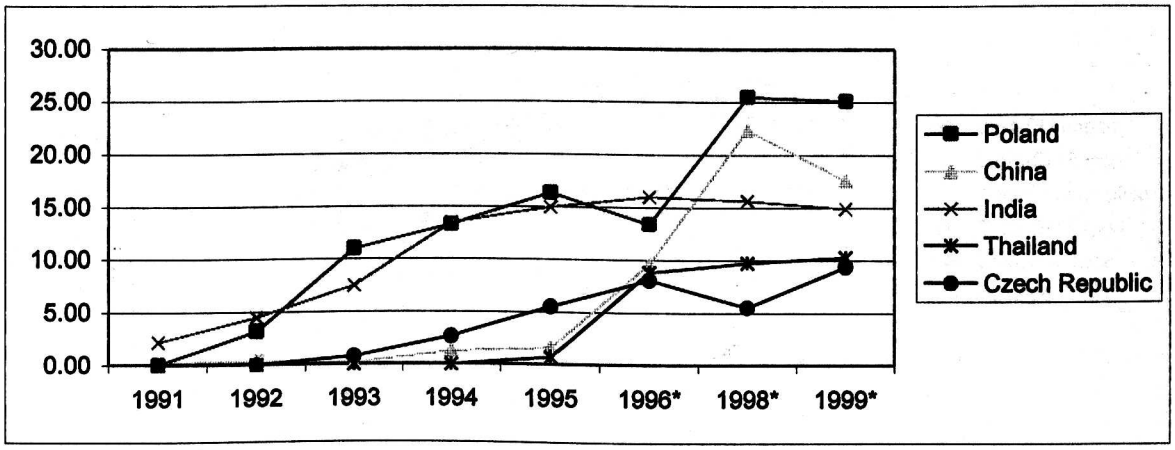
The leading exporting markets for India's exports in this product category are United Kingdom (75 per cent) and Italy (19 per cent) in 1997. India's exports to these countries increased by more than 1417 and per cent and 1232 (for 1992-97) respectively. Though the United Kingdom and Italy had increased their intra-EU trade considerably, it did not have any trade diverting effect on India's exports to either their locations or to the EU.

The leading exporters in this product category from the non-member countries are both the distant and geographically adjacent non-member countries. All the leading exporters witnessed an increase in their exports to the EU. They had all increased their exports both in value and in percentage terms. The leading beneficiaries of the EU's external trade creation effect in this product category are Poland, China, India and Thailand, who had increased their exports exponentially. These countries had also increased their share in extra-EU imports. In the case of Poland, the exports increased from a mere 0.09 percent to more than 25 per cent of extra-EU imports during 1991-99. The exports from China also increased considerably from 0.16 per cent in 1991 to 17.64 in 1999. However India's exports have also increased from 2.2 per cent in 1991 to 14.9 per cent in 1999, an increase of 12.7 percentage point. Though there is no evidence to suggest that the exports from Poland and Czech Republic had diverted India's exports, there is strong reason to believe that their exports had retarded the growth of India's exports to the EU.

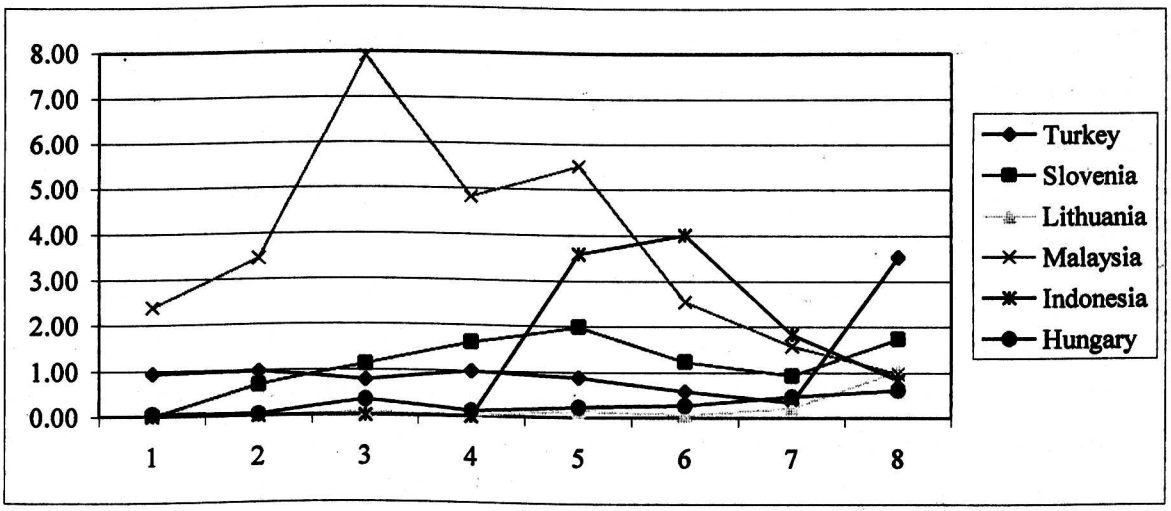
Table 5107.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Poland	0.09	3.19	10.97	13.27	16.34	13.40	25.47	25.15	25.06
China	0.16	0.39	0.20	1.30	1.66	9.65	22.40	17.64	17.48
India	2.20	4.49	7.50	13.45	15.02	16.03	15.67	14.95	12.75
Thailand			0.01		0.72	8.81	9.73	10.32	10.32
Czech Republic			0.79	2.68	5.57	8.09	5.57	9.39	9.39
Turkey	0.94	0.98	0.78	0.99	0.88	0.58	0.35	3.54	2.60
Slovenia		0.69	1.13	1.62	1.98	1.23	0.95	1.74	1.74
Lithuania			0.07	0.01	0.16	0.07	0.22	1.03	1.03
Malaysia	2.39	3.46	7.91	4.82	5.52	2.55	1.59	0.99	-1.40
Indonesia					3.59	4.01	1.84	0.85	0.85
Hungary	0.05	0.05	0.35	0.12	0.24	0.28	0.48	0.62	0.57

Graph 5107.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5107.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



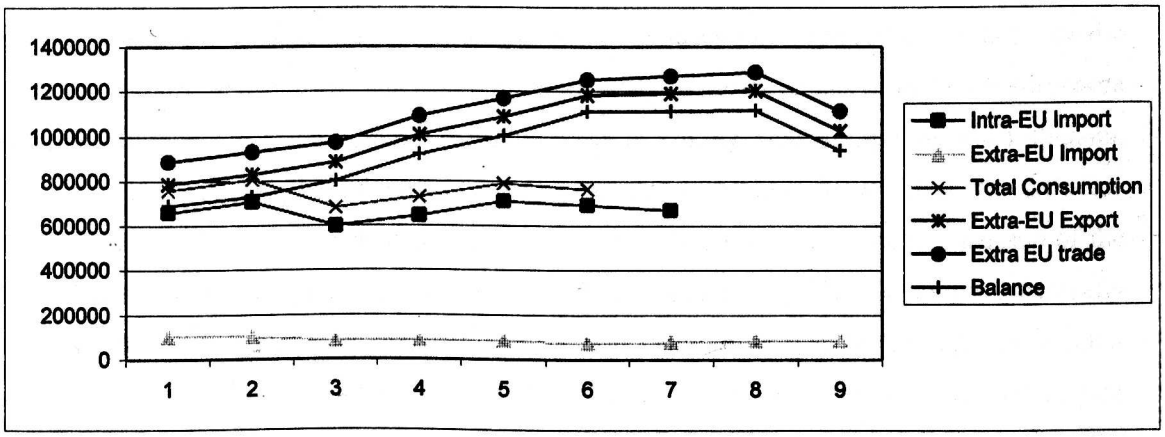
6.2.3. ANALYSIS FOR TRADE IN WOVEN FABRICS OF COMBED WOOL - 5112

Table 5112.1
EU's Trade in woven fabrics of combed wool (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	660743	709408	598073	645919	711219	693989	671198	-	-	1.58
Extra-EU Import	99991	99973	84946	84714	82144	70850	-	84893	86620	-13.37
Total Consumption	760734	809381	683019	730633	793363	764839	-	-	-	0.54
Extra-EU Export	790163	831987	887709	1007631	1087719	1183283	-	1202943	1027165	29.99
Extra EU Trade	890154	931960	972655	1092345	1169863	1254133	-	1287836	1113785	25.12
Balance	690172	732014	802763	922917	1005575	1112433	-	1118050	940545	36.28

Graph 5112.1

EU's Trade in woven fabrics of combed wool (in million ECU)



The EU's trade in Woven fabrics of combed wool is largely intra-EU in nature. The member countries trade heavily in this product category. The extra-EU imports accounted for only 10 per cent of intra-EU imports in 1996. Though there had been an intensive extra-EU trade in this product category, much of was extra-EU export in nature. The extra-EU import as a component of extra-EU trade is marginal. The extra-EU imports constitute only 7.77 per cent of extra-EU trade. More than 92 per cent of the extra-EU trade was extra-EU export in nature. There had been a marginal increase in the EU's trade in this product category during 1991-97. The intra-EU imports increased by a mere 1.5 per cent. This is mainly because of the marginal increase in the consumption in the member countries, which increased only by half a percent. There had been a fall in extra-EU imports during this period. The extra-EU imports declined by more than 13 per cent during this period confirming that the external imports were being replaced by the domestic production. This is a typical trade diversion effect in the Single European Market for trade in this product category. Among the member countries, Italy, United Kingdom, Portugal and Spain increased their export value. Other member countries, Germany, Netherlands, Belgium/Luxembourg and France, witnessed a decline in their exports to other member countries.

The leading exporting markets for India's exports in this product category are United Kingdom (47 per cent), France (16 per cent), Portugal (12 per cent) and Germany (7 per cent) in 1997. India's exports to the leading market had increased enormously during 1991-97. While the exports to the United Kingdom increased by more than 3300 per cent, it increased by 1000 per cent for Portugal. The overall increase in India's exports to the EU had been mainly created by the increase in its exports to these two leading export markets.

The trade creation effect in the EU for trade in this product category created a space for the exports of the non-member countries. The leading non-member countries had increased their exports to the Single European Market despite the over all decrease in the extra-EU imports. In another words, the leading exporting non-member countries had replaced the exports of the peripheral exporting countries. The leading non-member countries of this product category were geographically adjacent non-member countries such as Turkey, Czech Republic and Lithuania. They were also the main beneficiaries of the EU's external trade creation effect. Nevertheless the exports of India also increased during the period 1991-99. However the comparison of the non-member countries' export growth in this product category reveals that the geographically adjacent non-member countries increased their export value faster than the distant non-member countries. Some of these countries had witnessed a great leap in their exports by increasing their exports with the low value base. Though the exports from these countries did not affect the growth of India's exports directly, they seemed to have retarded its export share. This could have been made possible by the increase in the exports of geographically adjacent non-member countries. Turkey increased its trade share in extra-EU imports from a mere 3.69 per cent in 1991 to more than 30 per cent in 1999, an increase of 26 percentage point. Also the exports of Lithuania increased by 6.62 percentage point during 1991-99. Though India increased its share in extra-EU imports by 3.7 percentage point during 1991-99, it was still not an impressive performance. The slow growth in India's export share in extra-EU was attributed to low growth of its exports in real value terms.

Table 5112.2
EU's Imports of woven fabrics of combed wool from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	3693	7474	7288	7651	10265	10342	19182	26447	616
Czech Republic			5206	5992	6218	5379	9566	6924	33
Lithuania		117	461	1394	1083	886	6204	5837	4889
India	1752	2957	3660	4558	4690	3563	3871	4786	173
Slovenia		3207	2975	2300	3011	4340	3815	3710	16
Morocco	67	59	180	280	158	1097	1904	2124	3070
Bulgaria	547	972	966	768	1385	1520	1005	1143	109
Slovakia			325	207	1307	905	868	1024	215
Romania	19	263	528	880	1314	671	754	964	4974
Hungary	359	388	290	139	401	405	530	739	106
Extra-EU	99991	99973	84946	84714	82144	70850	84893	86620	-13

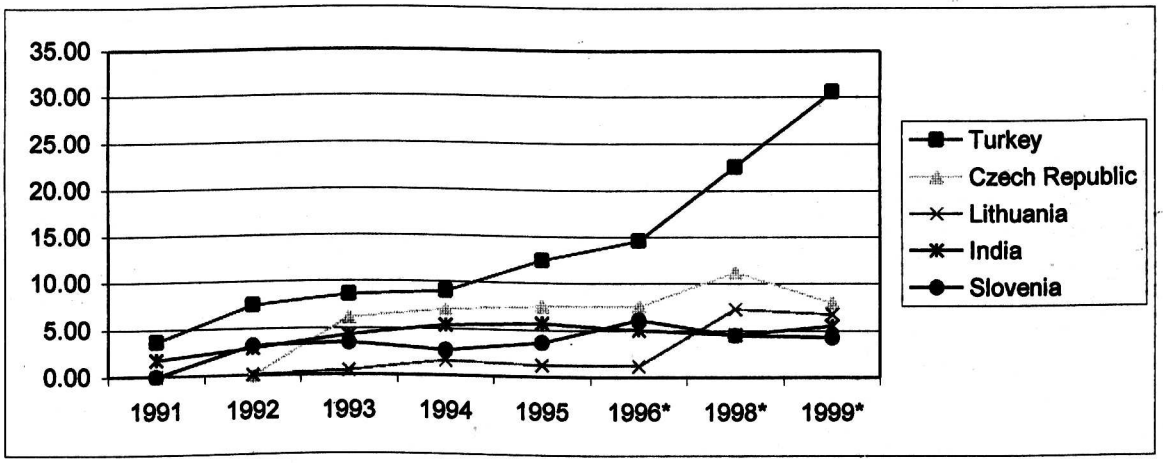
Table 5112.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	3.69	7.48	8.58	9.03	12.50	14.60	22.59	30.53	26.84
Czech Republic			6.13	7.07	7.57	7.59	11.27	7.99	1.86
Lithuania		0.12	0.54	1.65	1.32	1.25	7.31	6.74	6.62
India	1.75	2.96	4.31	5.38	5.71	5.03	4.56	5.53	3.77
Slovenia		3.21	3.50	2.72	3.67	6.13	4.49	4.28	1.07
Morocco	0.07	0.06	0.21	0.33	0.19	1.55	2.24	2.45	2.39
Bulgaria	0.55	0.97	1.14	0.91	1.69	2.15	1.18	1.32	0.77
Slovakia			0.38	0.24	1.59	1.28	1.02	1.18	0.80
Romania	0.02	0.26	0.62	1.04	1.60	0.95	0.89	1.11	1.09
Hungary	0.36	0.39	0.34	0.16	0.49	0.57	0.62	0.85	0.49

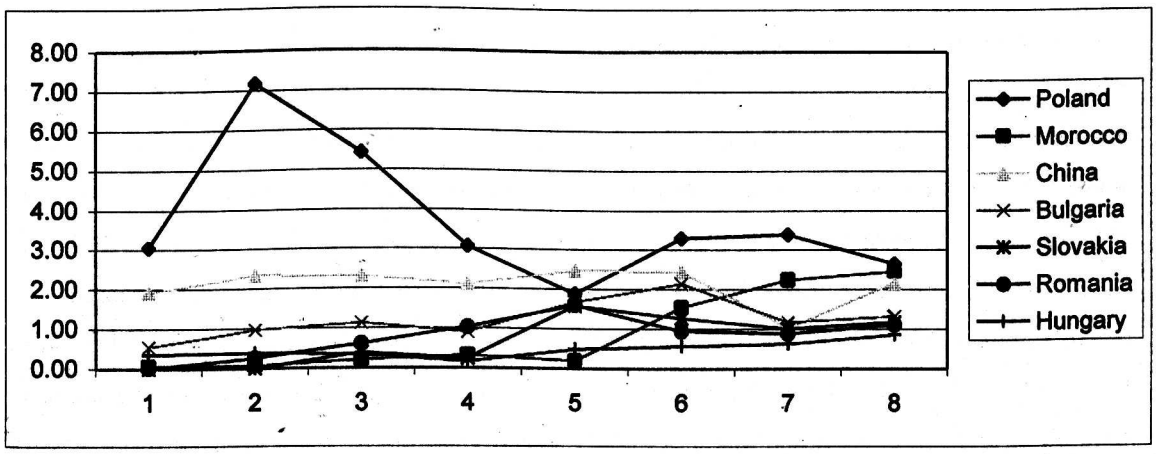
Graph 5112.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5112.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

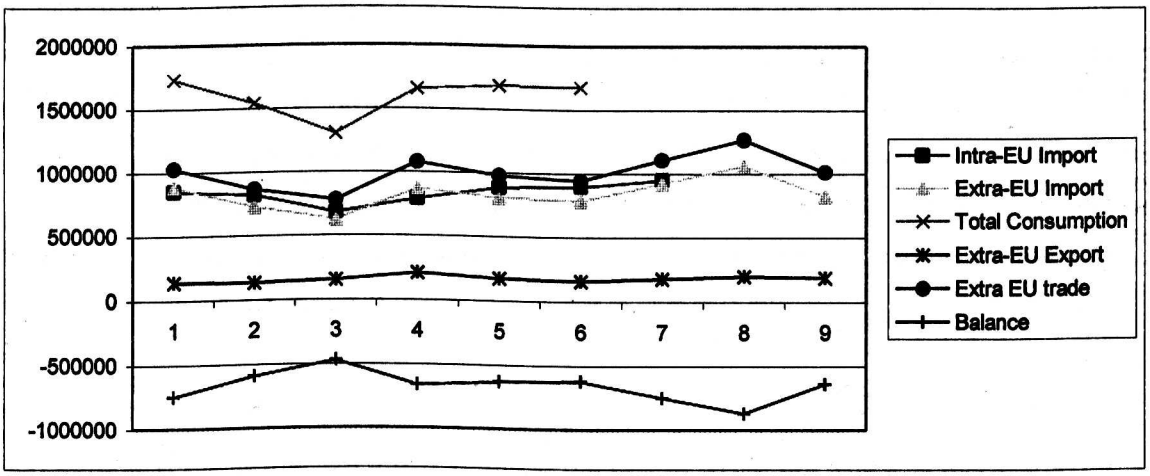


6.2.4. ANALYSIS FOR TRADE IN COTTON YARN (other than sewing thread) - 5205

Table 5205.1
EU's Trade in cotton yarn (other than sewing thread) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	848141	820943	678193	788722	885703	894037	949388	-	-	11.94
Extra-EU Import	886432	726343	624936	870915	805195	784460	-	1066935	823523	-7.10
Total Consumption	1734573	1547286	1303129	1659637	1690898	1678497	-	-	-	-3.23
Extra-EU Export	141155	137458	157138	210869	172748	162416	-	202177	190873	35.22
Extra EU Trade	1027587	863801	782074	1081784	977943	946876	-	1269112	1014396	-1.28
Balance	-745277	-588885	-467798	-660046	-632447	-622044	-	-864758	-632650	-15.11

Graph 5205.1
EU's Trade in cotton yarn (other than sewing thread) (in million ECU)



The EU's trade in cotton yarn (other than sewing thread) is largely intra- and extra-EU in nature during 1991-99. The consumption of cotton yarn (other than sewing thread) was enormous given the quantity of intra-EU trade. A large part of the consumption was met by the extra-EU imports during 1991-99. The consumption level during this period declined marginally (by 3 per cent). The fall in consumption was reflected in the fall in extra-EU imports. However this fall did not affect the intra-EU imports in any way. The fall in consumption resulted in the EU's excess produce of cotton yarn (other than sewing thread) being exported. This has been confirmed by 35 per cent increase in the extra-EU export during 1991-99. The increase in the extra-EU exports associated with fall in extra-EU imports resulted in the EU's trade deficit being reduced by more than 15 per cent during 1991-99. There had been considerable internal

trade creation effect in the EU. There had also been trade diversion effect. Though this was mainly caused by the fall in the EU's consumption, there had also been signs of the intra-EU imports replacing extra-EU imports.

The leading exporting markets for India's exports in this product category are Italy (40 per cent), Belgium/Luxembourg (17.5 per cent) and the United Kingdom (14 per cent) in 1997. The increase in India's exports to the EU has largely been stimulated by the increase in exports to the leading markets. India's exports to these markets increased by more than 100 per cent, except in the case of the United Kingdom, where it increased by 23 per cent during 1991-97.

The leading exporting countries in this product category are the distant non-member countries. Turkey and India, the two leading exporting countries, who together accounted for more than 40 per cent of extra-EU import share, continued to increase their exports despite the fall in the extra-EU imports. Not with standing the fall in the EU's consumption of cotton yarn (other than sewing thread) and the fall in extra-EU imports, these two leading non-member countries continued to increase their exports, both in value and in percentage terms, during 1991-99. This is typical trade creation effect, in it the effect was not caused by the replacement of the produce of the member countries, but that of the non-member countries. While Turkey increased its exports by 37 per cent, India increased its exports by 43 per cent. Some other leading exporting countries suffered a fall in their exports to the EU as in the case of Egypt and Pakistan, whose exports declined by 42 and 32 per cent respectively. The leading exporting countries increased their trade share at the cost of the other non-member countries' exports to the EU. Many of the non-member countries had witnessed a fall in their exports both in value and in percentage terms during 1991-99.

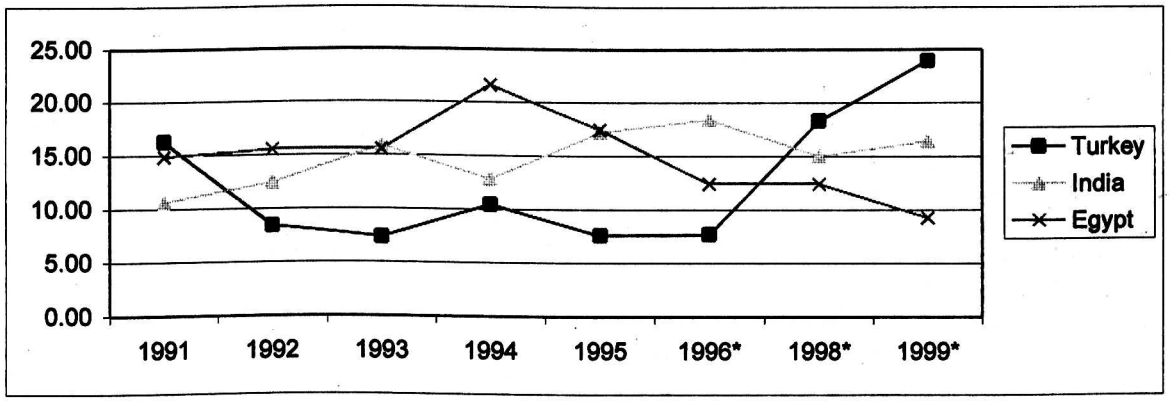
Table 5205.2
EU's Imports of cotton yarn (other than sewing thread) from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	143997	61248	46067	91059	60884	60332	194814	197123	37
India	94569	90760	99464	112137	138695	144099	160701	135070	43
Indonesia	17877	45862	32129	38420	39347	38945	53760	21013	18
Czech Republic			467	1811	3102	9521	16315	17189	3581
Slovenia		1178	4267	8841	7461	8521	11085	8263	601
Tunisia	292	1764	2994	10227	8733	7577	6782	6143	2004
Russia		1990	1742	5002	4042	3724	3296	4239	113
Lithuania		33		494	624	1455	5162	3121	9358
Extra-EU	886432	726343	624936	870915	805195	784460	1066935	823523	-7

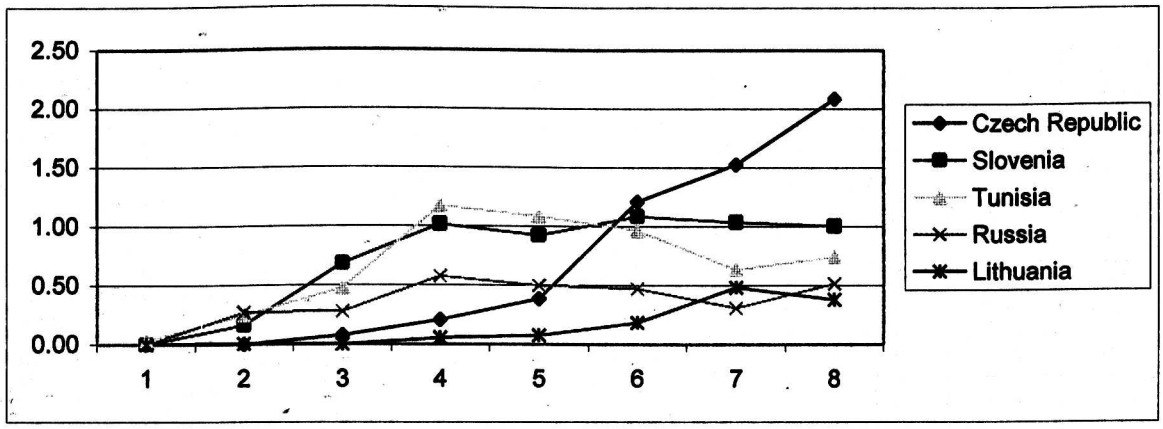
Table 5205.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	16.24	8.43	7.37	10.46	7.56	7.69	18.26	23.94	7.69
India	10.67	12.50	15.92	12.88	17.23	18.37	15.06	16.40	5.73
Indonesia	2.02	6.31	5.14	4.41	4.89	4.96	5.04	2.55	0.53
Czech Republic			0.07	0.21	0.39	1.21	1.53	2.09	2.09
Slovenia		0.16	0.68	1.02	0.93	1.09	1.04	1.00	1.00
Tunisia	0.03	0.24	0.48	1.17	1.08	0.97	0.64	0.75	0.71
Russia		0.27	0.28	0.57	0.50	0.47	0.31	0.51	0.51
Lithuania				0.06	0.08	0.19	0.48	0.38	0.38

Graph 5205.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5205.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.5. ANALYSIS FOR TRADE IN WOVEN FABRICS OF COTTON (weighing less than 200 gms/ m^2) - 5208

Table 5208.1
EU's Trade in Woven fabrics of cotton (weighing less than 200 gms/m^2) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	1249536	1147204	924474	1024504	1192521	1247570	1213173	-	-	-2.91
Extra-EU Import	1090904	935420	899737	990674	963843	1011066	-	914192	892494	-18.19
Total Consumption	2340440	2082624	1824211	2015178	2156364	2258636	-	-	-	-3.50
Extra-EU Export	899482	927022	937895	942838	960835	1019592	-	1128238	1080886	20.17
Extra-EU Trade	1990386	1862442	1837632	1933512	1924678	2030658	-	2042430	1973380	-0.85
Balance	-191422	-8398	38158	-47836	-3008	8526	-	214046	188392	-198.42

Graph 5208.1
EU's Trade in Woven fabrics of cotton (weighing less than 200 gms/m^2) (in million ECU)

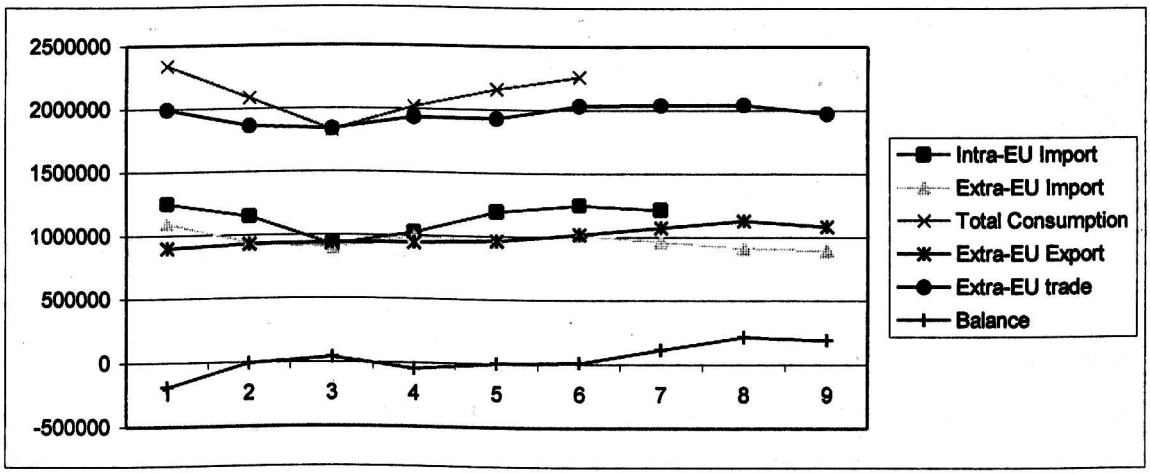


Table 5208.2
EU's Imports of Woven fabrics of cotton (weighing less than 200 gms/m^2) from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
India	116290	91837	85794	101196	123325	151963	125602	130942	12
Czech Republic			38933	51953	75180	67304	80414	72698	86
Russia		8228	18454	24129	17407	19652	29446	36810	347
Slovenia		3047	7373	10382	11997	11556	8021	6462	112
Latvia		45		631	3673	6727	7618	5113	11262
Romania	3411	1286	2500	5030	7689	7100	8789	5020	47
Tunisia	2524	2942	2260	1567	2600	3719	1045	4152	64
Extra-EU	1090904	935420	899737	990674	963843	1011066	914192	892494	-18

The EU's trade in woven fabrics of cotton (weighing less than 200 gms/m^2) had witnessed mixed effect during 1991-99. The intra- and extra-EU imports Changed similarly during this period. The intra-EU import induced by a fall in the consumption declined. The fall in intra-EU import was more in line with the fall in the EU's consumption of this product. As a result of the fall in the EU's consumption there had also been a fall in the extra-EU import. However the extra-EU import declined more than the intra-EU import. Nevertheless there had been an increase in the EU's extra-EU export during this period. Hence the EU's trade balance increased by around 200 per cent in its favour during 1991-99.

The fall in the level of consumption prevented the creation of any possible trade creation effects in the EU. The increase or the maintenance of the existing production combined with the fall in the domestic consumption resulted in a situation in which the excess produce were exported to the non-member countries.

The leading markets for India's exports in this product category are the United Kingdom (27 per cent), Belgium/Luxembourg (20 per cent), Germany (13 per cent) and Italy (11 per cent). India's exports to the leading destinations changed very widely during 1991-97. While the exports to Belgium/Luxembourg increased by around 500 per cent, it decreased in other markets. It exports to the United Kingdom (17 per cent), Germany (25 per cent), Italy (7 per cent) and France (46 per cent) decreased during 1991-97. However the increase in exports to Belgium/Luxembourg was sufficient enough to gain overall market share in the EU.

The fall in the EU's consumption did not affect the export pattern of the leading non-member countries. Many non-member countries had increased their exports considerably during 1991-99. there had been external trade creation effect for the exports of the leading non-member exporting countries. These countries had increased their exports both in value and in percentage terms. The Indian exports also benefited from the EU's external trade creation effect for trade in this product category during 1991-99. Indian exports increased by 12 per cent during this time period as against 86 and 347 per cent for Czech Republic and Russia respectively. These countries had also increased their market share in the extra-EU imports considerably. While India's market share increased by 4 percentage point, the Czech Republic and Russia increased their share by 8 and 4 percentage point respectively. Though the increase in the exports from these countries did not affect the India's exports during 1991-99 (by diverting India's exports), they are more like to challenge their exports in the coming years.

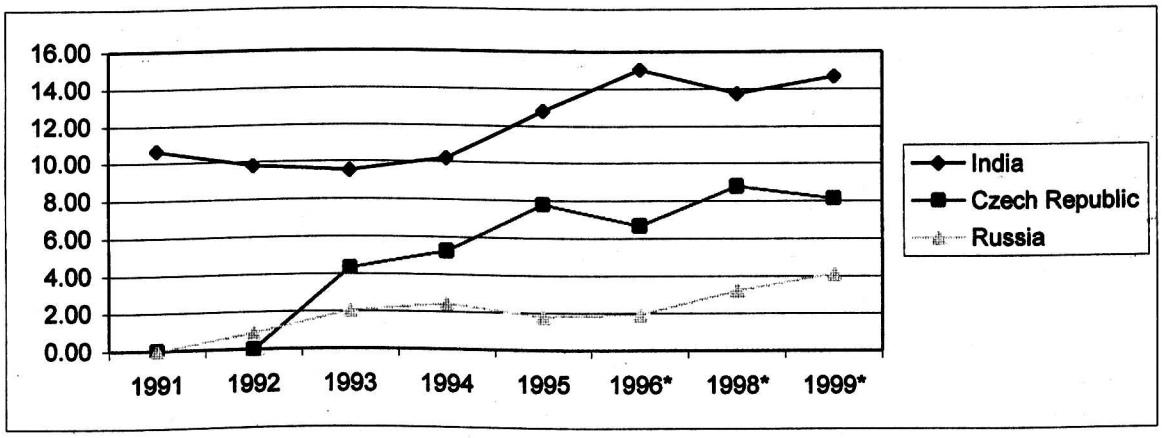
Table 5208.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
India	10.66	9.82	9.54	10.21	12.80	15.03	13.74	14.67	4.01
Czech Republic			4.33	5.24	7.80	6.66	8.80	8.15	8.15
Russia		0.88	2.05	2.44	1.81	1.94	3.22	4.12	4.12
Slovenia		0.33	0.82	1.05	1.24	1.14	0.88	0.72	0.72
Latvia				0.06	0.38	0.67	0.83	0.57	0.57
Romania	0.31	0.14	0.28	0.51	0.80	0.70	0.96	0.56	0.25
Tunisia	0.23	0.31	0.25	0.16	0.27	0.37	0.11	0.47	0.23

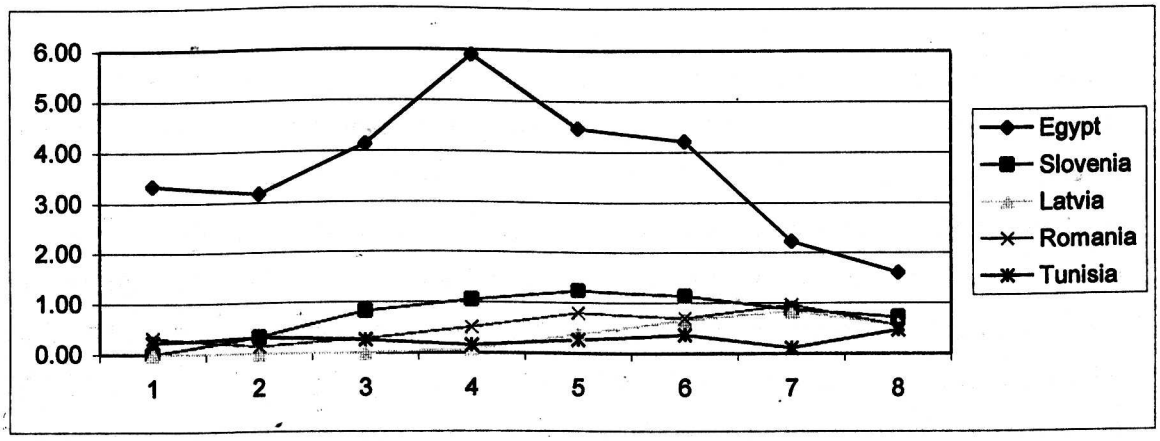
Graph 5208.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5208.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

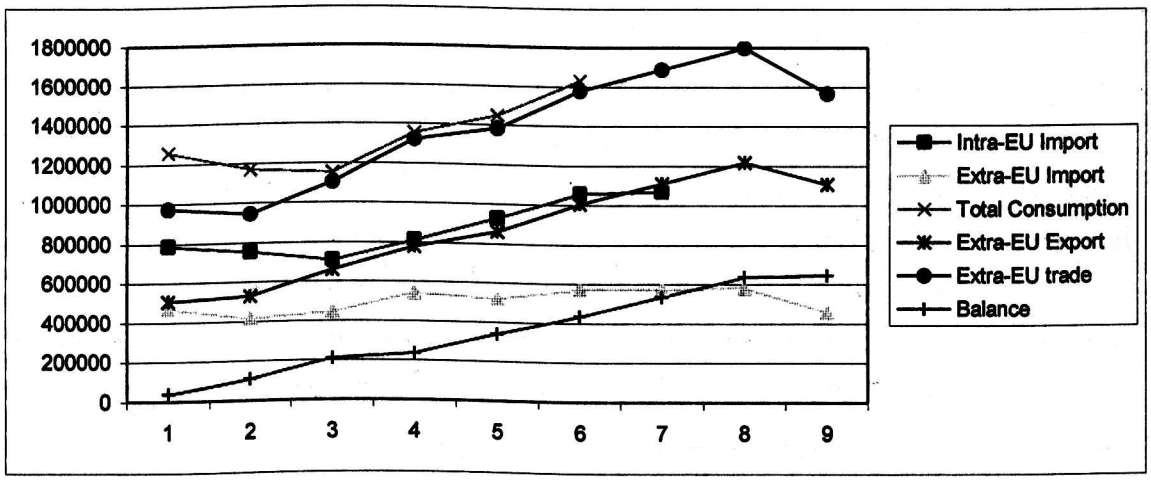


6.2.6. ANALYSIS FOR TRADE IN WOVEN FABRICS OF COTTON (weighing more than 200 gms/m^2) - 5209

Table 5209.1
EU's Trade in Woven fabrics of cotton (weighing more than 200 gms/m^2) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	787380	752196	707494	810853	928787	1059639	1068798	-	-	35.74
Extra-EU Import	468797	417018	446694	542596	520945	571964	-	580713	458741	-2.15
Total Consumption	1256177	1169214	1154188	1353449	1449732	1631603	-	-	-	29.89
Extra-EU Export	506537	528241	659385	781295	862392	1005900	-	1218377	1106886	118.52
Extra-EU Trade	975334	945259	1106079	1323891	1383337	1577864	-	1799090	1565627	60.52
Balance	37740	111223	212691	238699	341447	433936	-	637664	648145	1617.40

Graph 5209.1
EU's Trade in Woven fabrics of cotton (weighing more than 200 gms/m^2) (in million ECU)



The EU's trade in woven fabrics of cotton (weighing more than 200 gms/m^2) is largely intra-EU in nature with the intra-EU imports higher than the extra-EU trade by 100 per cent. The trade in this product category witnessed a large scale increase in the EU stimulated by the huge increase in the EU's consumption increase. While the consumption increased by around 30 per cent, the intra-EU imports increased by 35 per cent. At the same time the imports from the non-member countries reduced marginally. The extra-EU imports declined by 2 per cent during 1991-99. at the same time the extra-EU imports increased by more than 118 per cent resulting in an overall increase in the extra-EU trade. The extra-EU trade increased by 60 per cent during

1991-99. As a result of continual increase of the extra-EU exports combined with decreasing extra-EU imports, the EU's trade balance continued to increase unabatedly. The trade balance, during 1991-99, increased by more than 1600 per cent, largely favouring the member countries.

The leading markets for India's exports in this product category are the United Kingdom (68 per cent) and Germany (13 per cent) in 1997. India's exports centred on these two markets during 1991-97. India's overall increase in growth in this product category was due to its increase in exports to these two markets. The exports to the United Kingdom and Germany increased by 61.5 per cent and 137 per cent respectively during 1991-97. The increase in India's exports to these markets was accompanied by the decrease in the export share of these countries in their intra-EU trade during 1991-97.

Though the extra-EU imports declined during 1991-99, it did not have any diversionary effect on the exports of the leading non-member exporting countries. The increase in the EU's consumption of woven fabrics of cotton (weighing more than 200 gms/m^2) increased the opportunities for the leading exporting countries in the EU. The leading non-member exporting countries, such as Turkey, India, increased their exports to the EU irrespective of the changes that had taken place in the levels of extra-EU imports. Turkey, the leading exporter in this product category, had increased its exports by 44 per cent during 1991-99, thereby increased its market share from 10.67 in 1991 to 15.79 per cent in 1999, an increase of 5.13 percentage point. At the same time, India also increased its exports by 50 per cent, and increased its market share from 8.25 per cent in 1991 to 12.69 in 1999, an increase of 4.44 percentage point. The increase in the EU's consumption of woven fabrics of cotton (weighing more than 200 gms/m^2) also increased the space for many of the geographically adjacent non-member countries. These countries, many of them were late comers to international trade in this product category, had increased their exports to the EU many folds. They had also considerably increased their share in extra-EU imports by replacing the imports from other non-member countries. For example, Bulgaria and Slovenia, the two countries, who accounted for a negligible share in extra-EU imports increased their exports considerably. Slovenia, which accounted for a mere 0.21 per cent in 1992 increased its share to 2.34 per cent in 1999. Bulgaria also increased its trade share from 0.11 per cent to 2.11 per cent during the same period. However the increase in exports from the geographically adjacent non-member countries did not affect the India's exports to the EU.

Table 5209.2

EU's Imports of woven fabrics of cotton (weighing more than 200 gms/m^2) from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	50006	50381	51039	82758	92361	101861	87067	72447	44
India	38698	40550	46979	54659	56955	77983	60640	58226	50
Czech Republic			5334	8344	13192	11835	20540	16148	202
Slovenia		877	1893	4616	9452	13038	14967	10729	1123
Bulgaria	519	1104	1661	4014	6296	6541	13932	9681	1765
Estonia		11	306	1376	2855	5993	11873	6151	55818
Srilanka	71	78	1208	3798	3372	4340	13136	4657	6459
Hungary	364	175	689	3030	2107	1006	2504	3534	870
Slovakia			212	515	849	935	4382	3395	1501
Extra-EU	468797	417018	446694	542596	520945	571964	580713	458741	-2

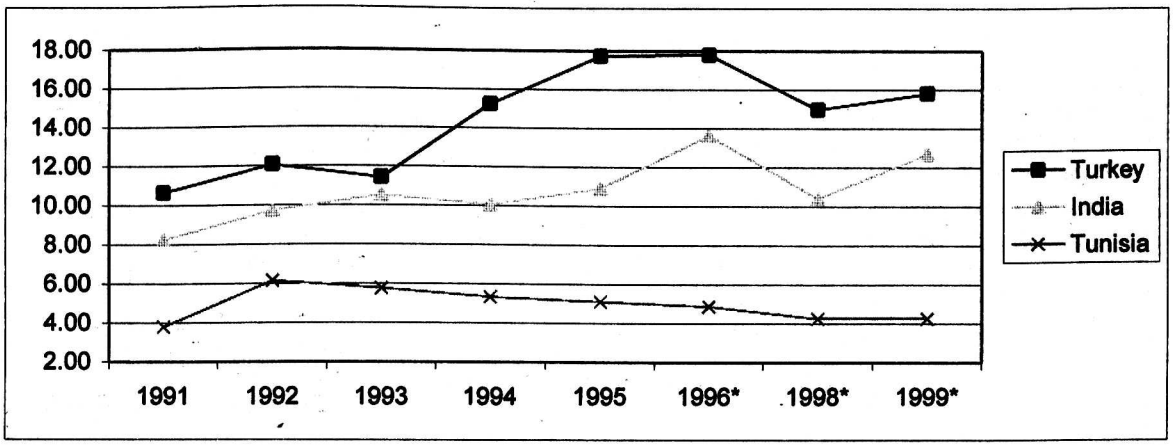
Table 5209.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

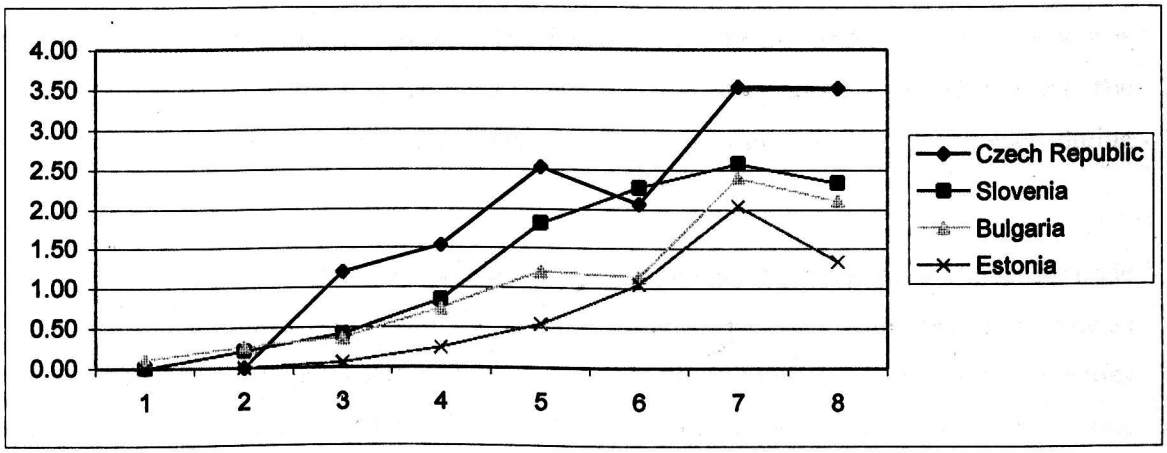
Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	10.67	12.08	11.43	15.25	17.73	17.81	14.99	15.79	5.13
India	8.25	9.72	10.52	10.07	10.93	13.63	10.44	12.69	4.44
Czech Republic			1.19	1.54	2.53	2.07	3.54	3.52	2.33
Slovenia		0.21	0.42	0.85	1.81	2.28	2.58	2.34	2.13
Bulgaria	0.11	0.26	0.37	0.74	1.21	1.14	2.40	2.11	2.00
Estonia			0.07	0.25	0.55	1.05	2.04	1.34	1.27
Srilanka	0.02	0.02	0.27	0.70	0.65	0.76	2.26	1.02	1.00
China	0.61	0.48	1.10	0.52	0.51	0.49	0.35	0.85	0.24
Hungary	0.08	0.04	0.15	0.56	0.40	0.18	0.43	0.77	0.69
Slovakia			0.05	0.09	0.16	0.16	0.75	0.74	0.69

Graph 5209.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5209.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

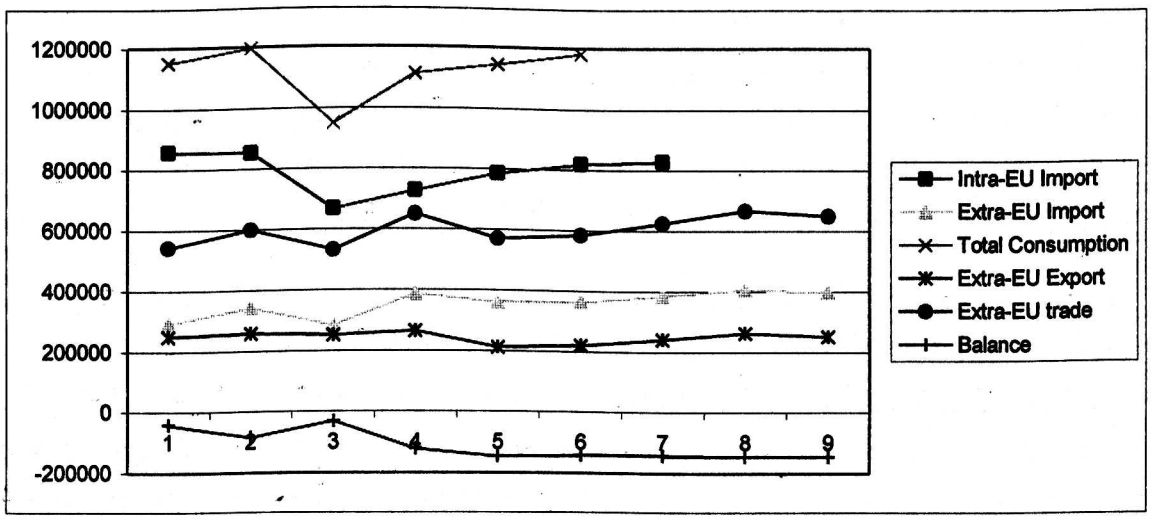


6.2.7. ANALYSIS FOR TRADE IN SYNTHETIC STAPLE FIBRES YARN - 5509

Table 5509.1
EU's Trade in synthetic staple fibres yarn (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	857692	856442	667401	726332	786247	819628	828807	-	-	-3.37
Extra-EU Import	292957	342338	282568	387116	358602	364112	-	405660	398046	35.87
Total Consumption	1150649	1198780	949969	1113448	1144849	1183740	-	-	-	2.88
Extra-EU Export	250829	258431	251140	264463	211570	220940	-	261552	252653	0.73
Extra-EU Trade	543786	600769	533708	651579	570172	585052	-	667212	650699	19.66
Balance	-42128	-83907	-31428	-122653	-147032	-143172	-	-144108	-145393	245.12

Graph 5509.1
EU's Trade in synthetic staple fibres yarn (in million ECU)



The EU's trade in synthetic staple fibres yarn is largely intra-EU trade. Nevertheless the trade with the non-member countries had also been growing during the years 1991-99. Much of this increase was accounted for by the increase in the extra-EU imports. There had been a marginal increase in extra-EU exports. The increase in intra-EU trade, in value terms, was mainly caused by an increase in the level of consumption of synthetic staple fibres yarn. The EU's consumption of synthetic staple fibres yarn had grown marginally (2.8 per cent) during 1991-99.

There has been no internal trade creation effect in the Single European Market for trade in synthetic staple fibres yarn during the years 1991-97. In fact they witnessed their products being replaced by the imports coming from the non-member countries. Many member countries had witnessed the trade diversion effect. All the member countries, except Italy, Spain and Ireland, had witnessed the trade diversion effect. Among these three countries, Italy, which had a leading market share in intra-EU imports, had witnessed a marginal increase of 1.12 percentage point in their share of intra-EU imports. Other countries such as Spain and Ireland, which had the market shares of 6 and 10.8 per cent respectively in intra-EU imports, had witnessed their combined share increasing from 9.8 per cent in 1991 to 16.2 per cent in 1999. Germany, Belgium/Luxembourg, and France, the other leading countries in this product category, had in fact witnessed their share replaced by extra-EU imports during the years 1991-99. Among all the member countries, only Italy managed to retain or increase its market share in intra-EU imports during 1991-99.

There had been an external trade creation effect in the Single European Market for trade in synthetic staple fibres yarn during the years 1991-99. In fact, the intra-EU imports in synthetic staple fibres yarn had reduced during this period. This is mainly caused by the increase in extra-EU imports. It is important to highlight that the increase in extra-EU imports was caused not merely by the increase in the EU's consumption of synthetic staple fibres yarn, though the increase was negligible during 1991-97. These extra-EU imports seemed to have competed with the member countries in the Single European Market and hence had diverted the intra-EU imports to a large extent. There was intense competition between the member and non-member countries in this product category. This was mainly witnessed from the influx of extra-EU imports during the years 1991-99. This was also witnessed with the EU's adverse trade balance with the non-member countries, which increased by 245 per cent during 1991-99.

The leading markets for India's exports in this product category in 1997 are Spain (23 per cent), Belgium/Luxembourg (19 per cent), Italy (17 per cent) and United Kingdom (14 per cent). During 1991-97, India's exports to these markets witnessed a huge increase. While India's exports to Spain increased by more than 1300 per cent, its exports to Belgium/Luxembourg increased by 515 per cent during this period. However the exports to Italy

and the United Kingdom increased by 82 and 48 per cent respectively. Though India's exports to these markets had increased during 1991-97, it did not have any trade diverting effect on the intra-EU trade.

The leading non-member exporting countries had increased their market share, both in value and percentage terms, in the Single European Market during 1991-99. The main beneficiaries of the external trade creation effect are the leading exporters of this product category. The four largest exporting non-member countries, India, Indonesia, Turkey and Pakistan, which accounted for a mere 30 per cent of extra-EU imports in 1991, increased their share to 71 per cent in 1999, an increase of 137 per cent during this period. Among them India was the single largest beneficiary with the exports increasing both in value and percentage terms. Indian exports increased by more than 250 per cent during the period 1991-99. They also increased their market share in extra-EU imports from 7.7 per cent in 1991 to 20 per cent in 1999, an increase of 12 percentage points. This was a large- scale benefit for Indian exports in the Single European Market. There had not been any trade diversion effect in the Single European Market. Though many of the non-member countries had increased their exports share in the extra-EU imports, they did not divert Indian exports. The increase in India's exports in the extra-EU imports was independent of the increase of other member countries' exports to the Single European Market. Though India's exports were believed to have diverted exports from other non-member countries, such as Turkey, there was no evidence to suggest that the increase in other member countries' exports to the EU had distorted India's exports to the EU.

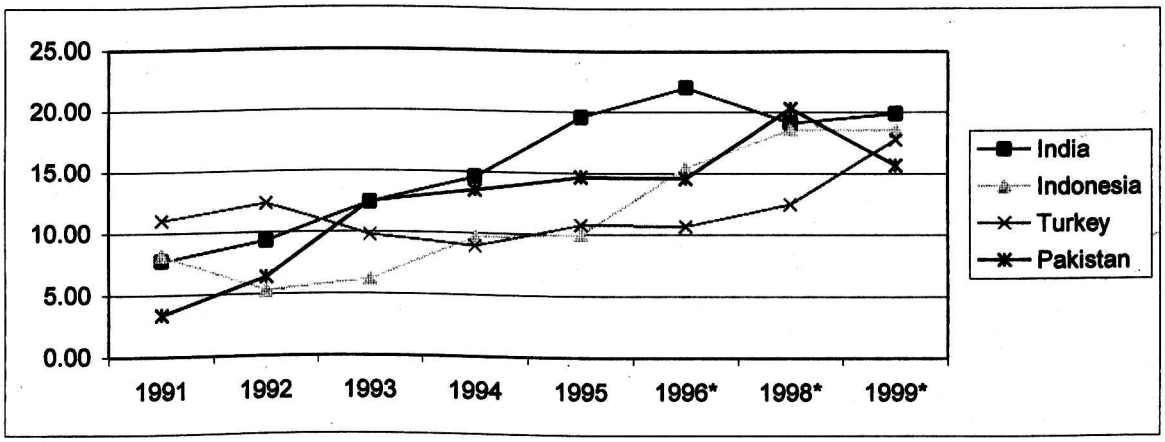
Table 5509.2
EU's Imports of synthetic staple fibres yarn from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
India	22582	31878	35193	56330	70396	80241	77614	79374	251
Indonesia	23966	18147	17420	37569	35943	56371	75602	73862	208
Turkey	32424	42518	27681	34823	38762	38981	50801	70775	118
Pakistan	9882	21838	35276	52421	52580	53081	82400	62427	532
Czech Republic			2896	5816	6881	11299	12949	12550	333
Slovenia		5010	11894	13895	10671	9107	8265	7669	53
Poland	752	4392	1729	479	1632	747	8123	7039	836
Lithuania			23	54	485	658	4697	6634	28743
Extra-EU	292957	342338	282568	387116	358602	364112	405660	398046	36

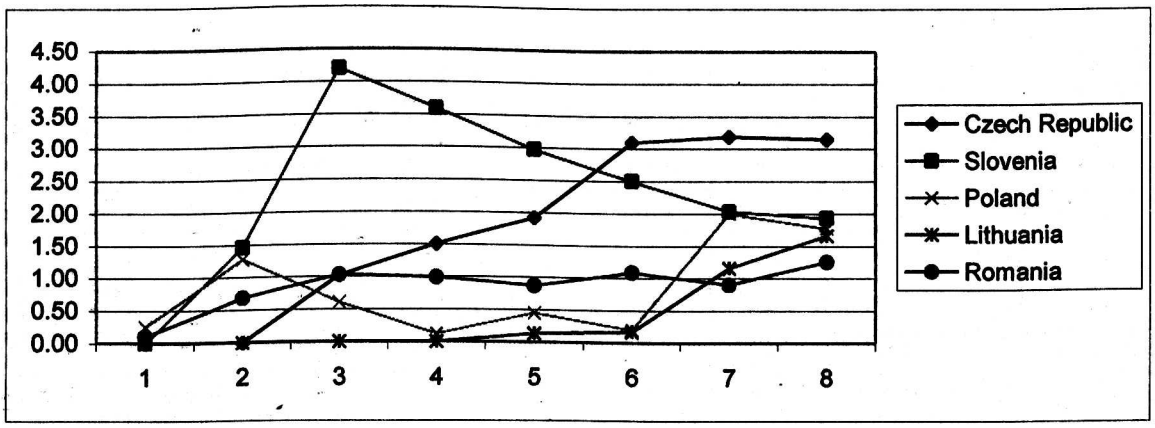
Table 5509.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
India	7.71	9.31	12.45	14.55	19.63	22.04	19.13	19.94	12.23
Indonesia	8.18	5.30	6.16	9.70	10.02	15.48	18.64	18.56	10.38
Turkey	11.07	12.42	9.80	9.00	10.81	10.71	12.52	17.78	6.71
Pakistan	3.37	6.38	12.48	13.54	14.66	14.58	20.31	15.68	12.31
Czech Republic			1.02	1.50	1.92	3.10	3.19	3.15	3.15
Slovenia		1.46	4.21	3.59	2.98	2.50	2.04	1.93	1.93
Poland	0.26	1.28	0.61	0.12	0.46	0.21	2.00	1.77	1.51
Lithuania			0.01	0.01	0.14	0.18	1.16	1.67	1.67

Graph 5509.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5509.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.8. ANALYSIS FOR TRADE IN ARTIFICIAL STAPLE FIBRES YARN - 5510

Table 5510.1
EU's Trade in artificial staple fibres yarn (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	122475	122199	94739	127208	205580	181106	187148	-	-	52.81
Extra-EU Import	163291	166588	150711	201956	116645	104626	-	107962	86969	-46.74
Total Consumption	285766	288787	245450	329164	322225	285732	-	-	-	-0.01
Extra-EU Export	34084	33020	39414	55729	68139	74787	-	70173	74972	119.96
Extra-EU Trade	197375	199608	190125	257685	184784	179413	-	178135	161941	-17.95
Balance	-129207	-133568	-111297	-146227	-48506	-29839	-	-37789	-11997	-90.71

Graph 5510.1
EU's Trade in artificial staple fibres yarn (in million ECU)

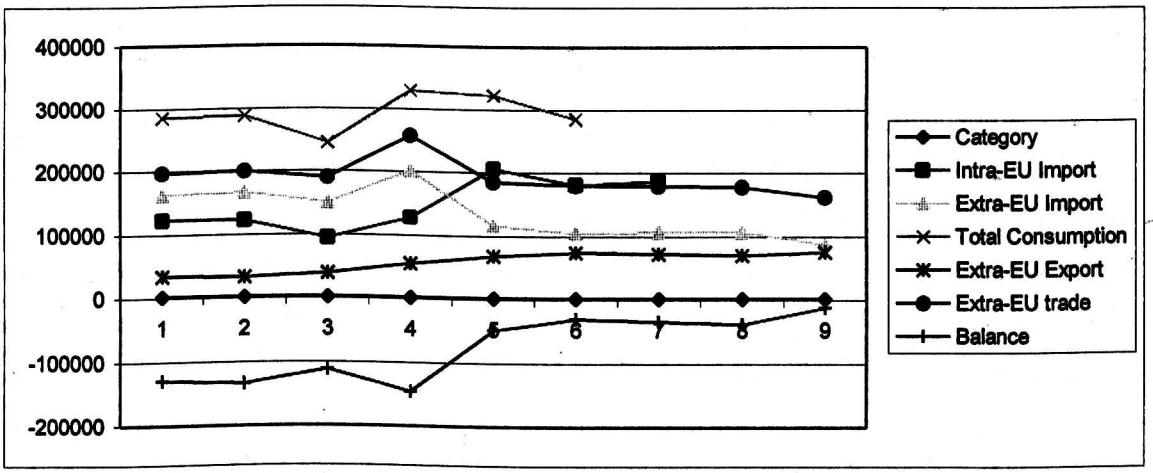


Table 5510.2
EU's Imports of artificial staple fibres yarn from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Indonesia	15580	16931	23877	38124	39003	41982	42854	38406	146
India	13059	18127	19264	28728	35478	27912	25083	19843	51
Thailand	9167	7211	6652	11448	9909	10675	16431	11667	27
Czech Republic			1486	3963	6015	3844	2796	2812	89
Slovenia		427	1907	4049	1658	954	1510	1831	328
Turkey	100	70	281	2587	718	581	1446	1545	1445
Extra-EU	163291	166588	150711	201956	116645	104626	107962	86969	-46

The analyses of EU's trade in artificial staple fibres yarn during 1991-99 reveal the complex effects of the Single European Market on the trade. There had been no increase in EU's consumption of artificial staple fibres yarn in the EU during this period. However there had been an increase of intra-EU imports in the EU against the fall in extra-EU imports. The increase in intra-EU import was much higher than the extra-EU imports. Since there was no increase in the consumption of artificial staple fibres yarn in the EU during 1991-97, much of it was exported to the non-member countries. This was reflected in the extra-EU exports, which increased by 119 per cent during 1991-97. As a result of increased intra-EU imports coupled with the decline in extra-EU imports and raising extra-EU, the EU's trade deficit with the non-member countries declined sharply. During the years 1991-99, the trade deficit, with the non-member countries, reduced by 90 per cent. The huge increase in extra-EU exports was notable during the period 1991-99. This has to be analysed with in the context of the EU's clothing trade with the geographically adjacent non-member countries. A large part of this increase in extra-EU exports was caused by the member countries' exports of artificial staple fibres yarn, which were meant for the OPT. Likewise a large part of the imports from the geographically adjacent non-member countries account for a sizeable portion of extra-EU imports imported through OPT.

There had been a remarkable increase in internal trade creation effect in the EU for trade in artificial staple fibres yarn during 1991-99. The intra-EU imports had increased by 52 per cent, creating opportunities for many of the member countries to export to the non-member countries. However only a limited number of countries benefited from the internal trade creation in the EU at the cost of other member countries. Among the leading producers of artificial staple fibres yarn, only France and Italy benefited in increasing the value of their exports. They increased their exports by 27 per cent and 8 per cent respectively. Other leading producers such as Germany and Belgium/Luxembourg witnessed a sharp fall in their export value. The exports from these two countries declined by 15 and 14 per cent respectively during 1991-97. The leading producer of this product category in the EU, Austria, witnessed a decline of about 1.9 per cent during the same period.

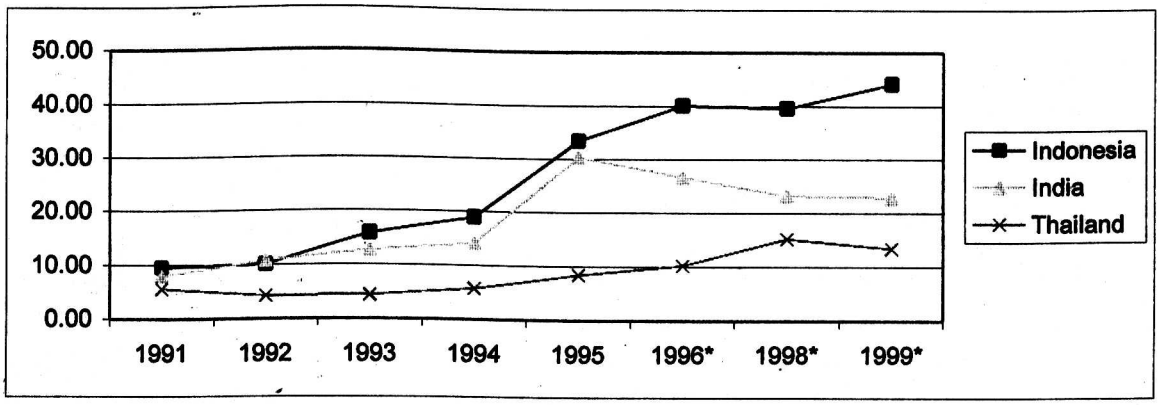
The leading markets for India's exports in this product category in 1997 are Italy (40 per cent), Belgium/Luxembourg (34 per cent) and Spain (14 per cent). These three markets alone accounted for 90 per cent of India's export market in this product category. These exports to these markets consistently increased during 1991-97. While the exports to Spain increased by 1500 per cent, it increased by 115 and 103 per cent to Italy and Belgium/Luxembourg respectively during the same period. India's exports did not have any trade diverting effect on the intra-EU trade of Italy and Spain. However India's exports to Belgium/Luxembourg is seemed to have diverted its intra-EU trade during 1991-97.

The effects of the Single European Market on the extra-EU trade are mixed in which certain member countries benefited at the cost of exports from non-member countries. The leading non-member exporting countries had greatly benefited by increasing both the value of their exports and also their share in extra-EU imports. The four leading non-member countries had benefited by increasing their exports to the Single European Market. While Indonesia increased, a leader in this product category among the non-member countries, its exports by 146 per cent, India and Thailand increased their exports by 51 and 27 per cent respectively during 1991-99. Many of the geographically adjacent non-member countries had also benefited by increasing their exports with very low base value. As for India's exports to the EU were concerned there were no trade diverting effect on them. Though there were trade diverting effects on extra-EU imports, it did not divert the exports of the leading non-member countries. This was confirmed by the increase in India's share in extra-EU imports. India also increased its share in extra-EU imports by 14.8 percentage point during 1991-99. Nor were there any trade suppression effect in the EU against India's exports in the form of India's exports being replaced by the domestic production.

Table 5510.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

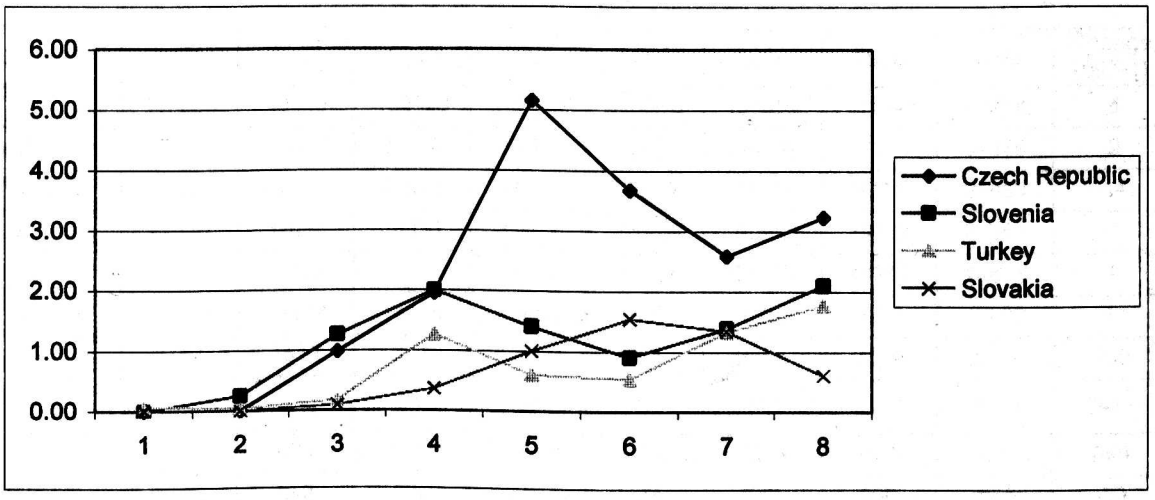
Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (%)
Indonesia	9.54	10.16	15.84	18.88	33.44	40.13	39.69	44.16	34.62
India	8.00	10.88	12.78	14.22	30.42	26.68	23.23	22.82	14.82
Thailand	5.61	4.33	4.41	5.67	8.50	10.20	15.22	13.42	7.80
Czech Republic			0.99	1.96	5.16	3.67	2.59	3.23	3.23
Slovenia		0.26	1.27	2.00	1.42	0.91	1.40	2.11	2.11
Turkey	0.06	0.04	0.19	1.28	0.62	0.56	1.34	1.78	1.72

Graph 5510.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5510.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.9. ANALYSIS FOR TRADE IN SYNTHETIC STAPLE FIBRES YARN (woven - weighing less than 170 gms) - 5513

Table 5513.1

EU's Trade in synthetic staple fibres (woven - weighing less than 170 gms) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	320115	295568	214932	211850	226250	232972	235621	-	-	-26.39
Extra-EU Import	325015	284692	274121	296427	287509	352496	365626	246126	270061	-16.91
Total Consumption	645130	580260	489053	508277	513759	585468	-	-	-	-9.25
Extra-EU Export	121961	133175	122521	136455	140768	138294	147095	131921	140174	14.93
Extra-EU Trade	446976	417867	396642	432882	428277	490790	512721	378047	410235	-8.22
Balance	-203054	-151517	-151600	-159972	-146741	-214202	-218531	-114205	-129887	-36.03

Graph 5513.1

EU's Trade in synthetic staple fibres ((woven - weighing less than 170 gms) (in million ECU)

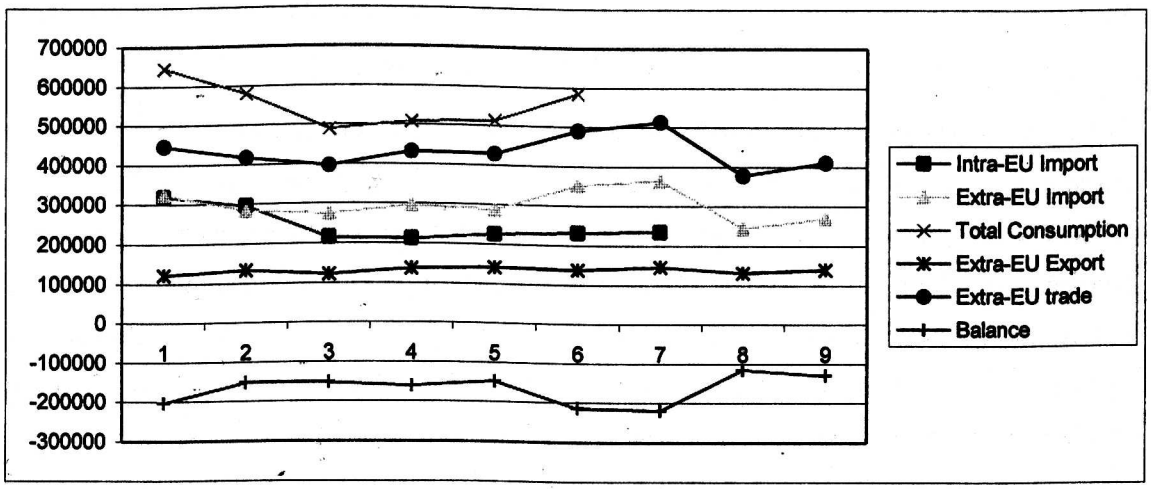


Table 5513.2

EU's Imports of synthetic staple fibres (woven - weighing less than 170 gms) from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Pakistan	119885	99825	102323	120431	104908	153599	131348	115609	-4
Indonesia	38109	36306	33588	30706	32895	34416	27974	37379	-2
Thailand	29100	27390	23653	27073	30789	32327	6381	24953	-14
India	22528	31654	33331	37047	26336	34847	24132	22256	-1
Malaysia	14435	10632	12395	15139	16282	17770	13215	14613	1
China	16446	12517	13345	12603	18485	18283	9320	13632	-17
Turkey	1757	1613	341	651	474	2523	3679	4551	159
Czech Republic			91	679	751	433	2178	2340	2471
Bulgaria	165	895	1273	2129	2978	1893	1953	1551	840
Poland	1708	642	626	592	444	792	286	522	-69
Extra-EU	325015	284692	274121	296427	287509	352496	246126	270061	-17

The EU's trade in synthetic staple fibres (woven-weighing less than 170 gms) did not witness any positive effects during 1991-99. Both intra- and extra-EU trade witnessed trade compression, in which the trade decreased during the period 1991-99. This was a period of welfare loss for both the member and non-member countries. Both the intra- and extra-EU trade witnessed contraction. All components of the EU's trade, such as intra- and extra-EU imports, witnessed contraction. Not with standing the decline in EU's extra-EU trade, the EU's trade deficit witness a sharp decline during the years 1991-99. The EU's trade deficit decline by 36 per cent during 1991-99. This was made possible because of the fall in extra-EU imports along with a rise in extra-EU (of 14.9 per cent) during the same period.

There had been trade contraction effect in the EU with the overall fall in the level of trade. There was neither trade creation nor trade diversion effect in the EU for the member countries in this product category. There had been mixed effect on the member countries. While some member countries had increased their export value, others had their export value fallen during 1991-99. A sizeable increase in the EU's extra-EU exports would suggest that the level of OPT using synthetic staple fibres (woven-weighing less than 170 gms) had been increasing.

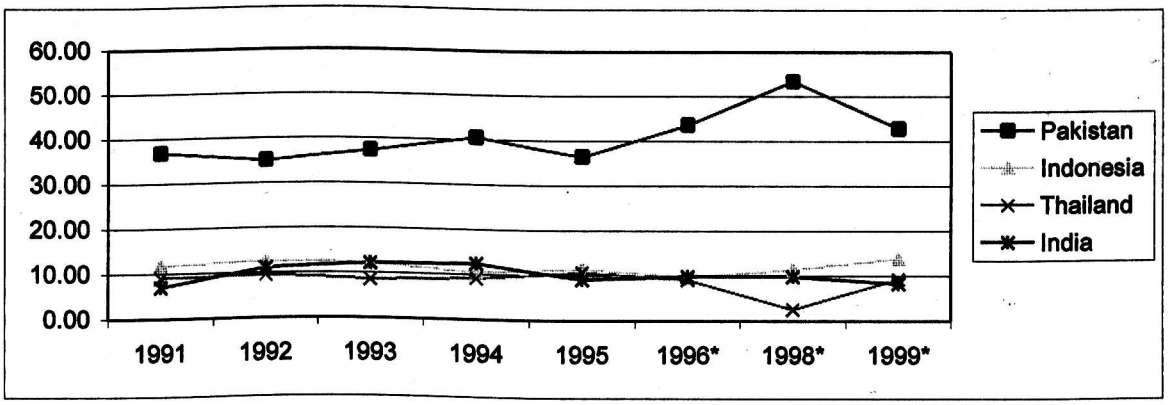
The effect of the Single European Market on non-member countries' trade in this product category is generally adverse. The leading exporting countries, Pakistan, Indonesia, Thailand and India, had witnessed a fall in their exports to the EU. This is mainly because of the overall trade contraction witnessed in the Single European Market. At the same time there had been an increase in the exports of the geographically adjacent non-member countries. For example countries such as Turkey, Czech Republic, Bulgaria and Tunisia, witnessed a large scale increase in their exports to the EU. The increase in exports in these countries was associated with a fall in the exports of the leading exporting countries. Though these countries,

as individual exporting countries, did not pose a threat to the exports of the leading exporting countries, their combined exports posed a serious challenge to the exports of the leading exporting countries. Hence it could be considered to be a trade diversion effect, in value terms, for the India's exports to the EU.

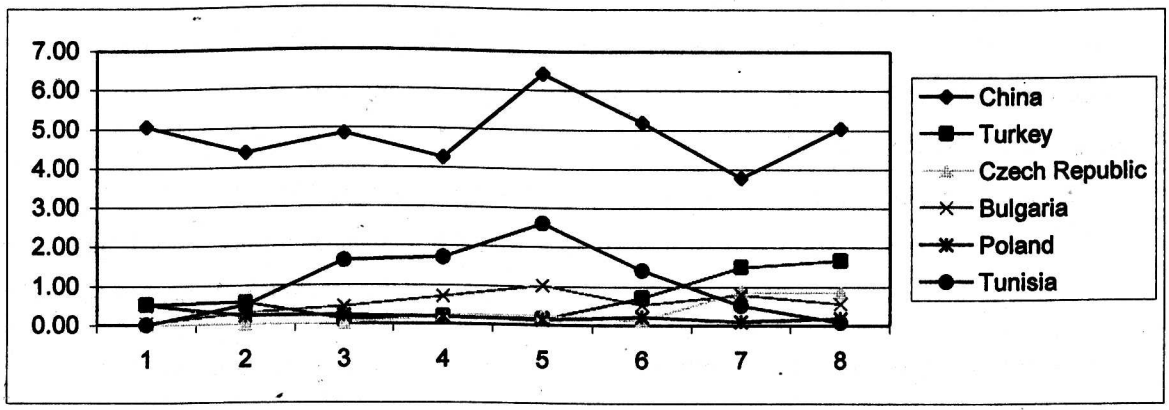
Table 5513.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Pakistan	36.89	35.06	37.33	40.63	36.49	43.57	53.37	42.81	5.92
Indonesia	11.73	12.75	12.25	10.36	11.44	9.76	11.37	13.84	2.12
Thailand	8.95	9.62	8.63	9.13	10.71	9.17	2.59	9.24	0.29
India	6.93	11.12	12.16	12.50	9.16	9.89	9.80	8.24	1.31
Malaysia	4.44	3.73	4.52	5.11	5.66	5.04	5.37	5.41	0.97
China	5.06	4.40	4.87	4.25	6.43	5.19	3.79	5.05	-0.01
Turkey	0.54	0.57	0.12	0.22	0.16	0.72	1.49	1.69	1.14
Czech Republic			0.03	0.23	0.26	0.12	0.88	0.87	0.87
Bulgaria	0.05	0.31	0.46	0.72	1.04	0.54	0.79	0.57	0.52
Poland	0.53	0.23	0.23	0.20	0.15	0.22	0.12	0.19	-0.33

Graph 5513.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5513.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.10. ANALYSIS FOR TRADE IN SYNTHETIC STAPLE FIBRES (woven-weighing more than 170 gms) - 5514

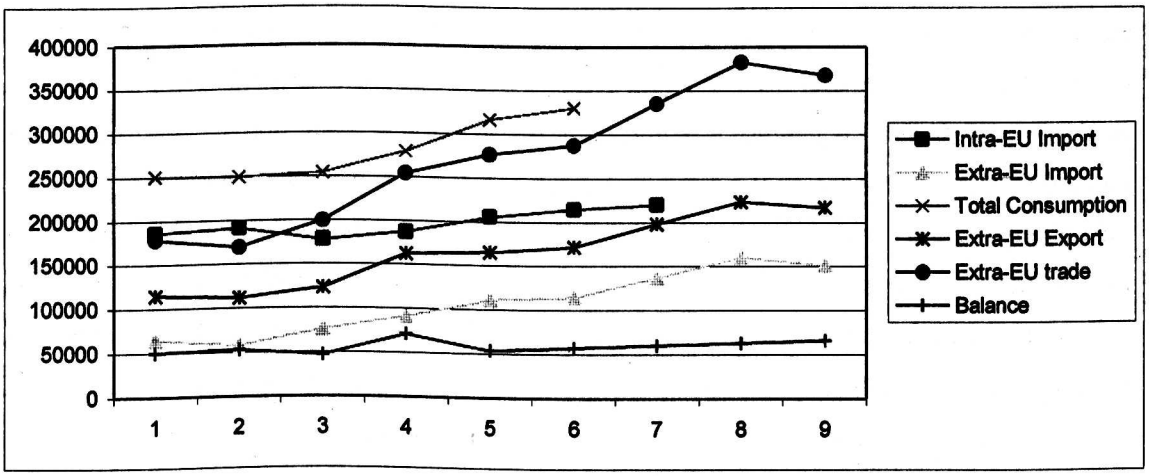
Table 5514.1

EU's Trade in synthetic staple fibres (woven-weighing more than 170 gms) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	186065	191094	177626	187251	205304	215153	219817	-	-	18.14
Extra-EU Import	64289	58396	764118	91492	111308	114873	-	160209	151005	134.88
Total Consumption	250354	249490	254044	278743	316612	330026	-	-	-	31.82
Extra-EU Export	114442	111514	123531	162866	165270	172403	-	223322	217037	89.65
Extra-EU Trade	178731	169910	199949	254358	276578	287276	-	383531	368042	105.92
Balance	50153	53118	47113	71374	53962	57530	-	63113	66032	31.66

Graph 5514.1

EU's Trade in synthetic staple fibres (woven-weighing more than 170 gms) (in million ECU)



The EU's trade in synthetic staple fibres (woven-weighing less than 170 gms) during 1991-99 was largely extra-regional. Both intra- and extra-EU trade witnessed an increase. There had been a large scale increase in extra-EU trade. Both extra-EU imports and exports increased in the EU for this product category. There had been a slight increase in intra-EU imports during 1991-97. At the same time the extra-EU imports increased by 134 per cent. The EU's consumption of synthetic staple fibres (woven-weighing less than 170 gms) increased by 31 per cent. Though the extra-EU imports increased by 134 per cent, the EU still had trade balance in its favour. This is mainly because of the base value of extra-EU exports, which was much higher than the base value of the extra-EU imports.

Though there had been an increase in intra-EU imports, this did not have any specific effect on the member countries. Though some member countries had benefited from this

increase, many other member countries had witnessed a fall in their export value. Hence the increase in intra-EU imports alone could not considered to be the internal trade creation effect in the EU.

The leading markets for India's exports in this product category are Italy (44 per cent) and United Kingdom (41). These two countries alone had more than 85 per cent of India's exports to the EU in 1997. The exports to these countries increased exponentially during this period. However the exponential increase in India's exports to these countries did not affect these countries' intra-EU trade.

The EU's trade in synthetic staple fibres (woven-weighing more than 170 gms) had a considerable benefit for the leading exporting countries of this product to the EU. These countries, such as India, Pakistan, Malaysia and Indonesia, had increased the value of their exports considerably. While India's exports increased by 128 per cent, Pakistan increased its exports by 279 per cent, followed by Malaysia and Indonesia, who increased their exports by 58 and 771 per cents respectively during 1991-99. Not only the leading exporting non-member countries, but also the marginal exporters benefited by increasing their export value to the EU. This is particularly true in the case of the geographically adjacent non-member countries, which continued to increase their export value despite their very low base values in 1991. For example countries of low export base, such as Lithuania, Bulgaria, Hungary, Poland, Slovenia and Romania, witnessed their exports increasing many fold during 1991-99. This increase could be solely attributed to EU's preferential treatment for imports coming from the geographically adjacent non-member countries. However it has to be noted that the increase of exports from these countries did not pose a direct challenge to the exports of the leading exporters to the EU. This is particularly true in the case of India's exports to the EU. The fall in India's share in extra-EU imports could not be directly attributed to the increase in the exports of the geographically adjacent non-member countries to the EU.

Table 5514.2
EU's Imports of synthetic staple fibres (woven-weighing more than 170 gms) from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
India	14854	13696	20382	27153	36602	30484	42346	33858	128
Pakistan	7192	7472	11776	14959	20139	22860	31827	27290	279
Malaysia	12776	12529	14495	16522	19224	20241	21121	20233	58
Indonesia	1409	1539	1161	1801	4201	7763	15566	12278	771
Turkey	3525	1780	2069	1112	1010	696	2921	10580	200
Thailand	1462	1875	4415	4189	6923	8760	10181	10471	616
Tunisia	483	277	129	272	177	1059	5018	5149	966
Czech Republic			2632	2642	4045	1072	1116	2775	5
Extra-EU	64289	58396	76418	91492	111308	114873	160209	151005	135

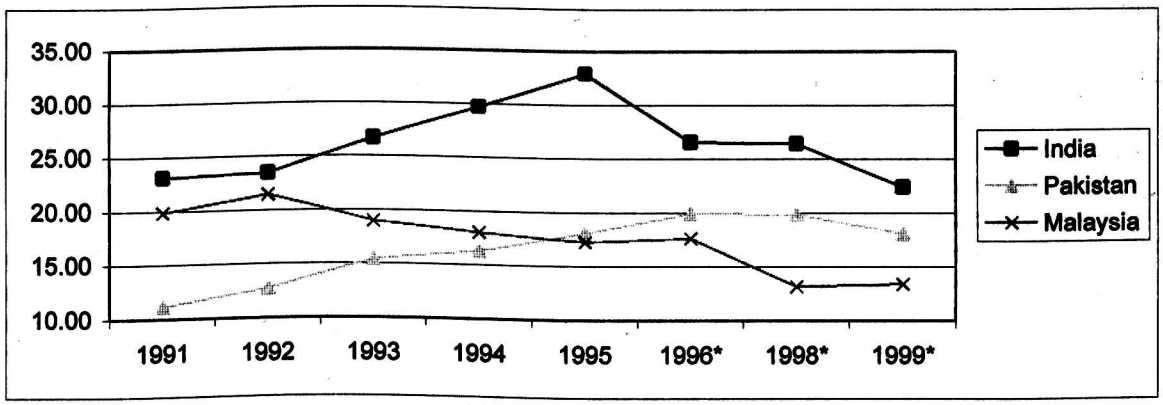
Table 5514.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
India	23.11	23.45	26.67	29.68	32.88	26.54	26.43	22.42	-0.68
Pakistan	11.19	12.80	15.41	16.35	18.09	19.90	19.87	18.07	6.89
Malaysia	19.87	21.46	18.97	18.06	17.27	17.62	13.18	13.40	-6.47
Indonesia	2.19	2.64	1.52	1.97	3.77	6.76	9.72	8.13	5.94
Turkey	5.48	3.05	2.71	1.22	0.91	0.61	1.82	7.01	1.52
Thailand	2.27	3.21	5.78	4.58	6.22	7.63	6.35	6.93	4.66
Tunisia	0.75	0.47	0.17	0.30	0.16	0.92	3.13	3.41	2.66
Czech Republic			3.44	2.89	3.63	0.93	0.70	1.84	1.84

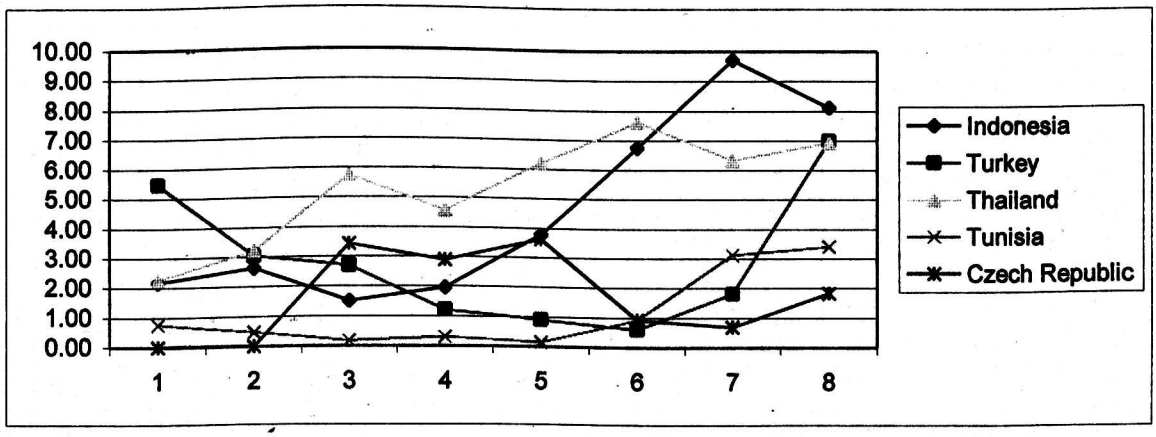
Graph 5514.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 5514.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.11 ANALYSIS FOR TRADE IN WOMEN'S AND GIRLS' SUITS, ENSEMBLES, JACKETS, ETC., (knitted or crocheted) - 6104

Table 6104.1
EU's Trade in Women's and Girl's (knitted/crocheted) Suits (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	822513	911104	770867	750407	940427	1066012	1060836	-	-	28.97
Extra-EU Import	975028	1314635	1199905	1043515	1039642	1075314	-	1311092	1367733	40.28
Total Consumption	1797541	2225739	1970772	1793922	1980069	2141326	-	-	-	19.13
Extra-EU Export	406616	453648	392923	415271	368148	392325	-	434452	392649	-3.43
Extra-EU Trade	1381644	1768283	1592828	1458786	1407790	1467639	-	1745544	1760382	27.41
Balance	-568412	-860987	-806982	-628244	-671494	-682989	-	-876640	-975084	71.55

Graph 6104.1
EU's Trade in Women's and Girl's (knitted/crocheted) Suits (in million ECU)

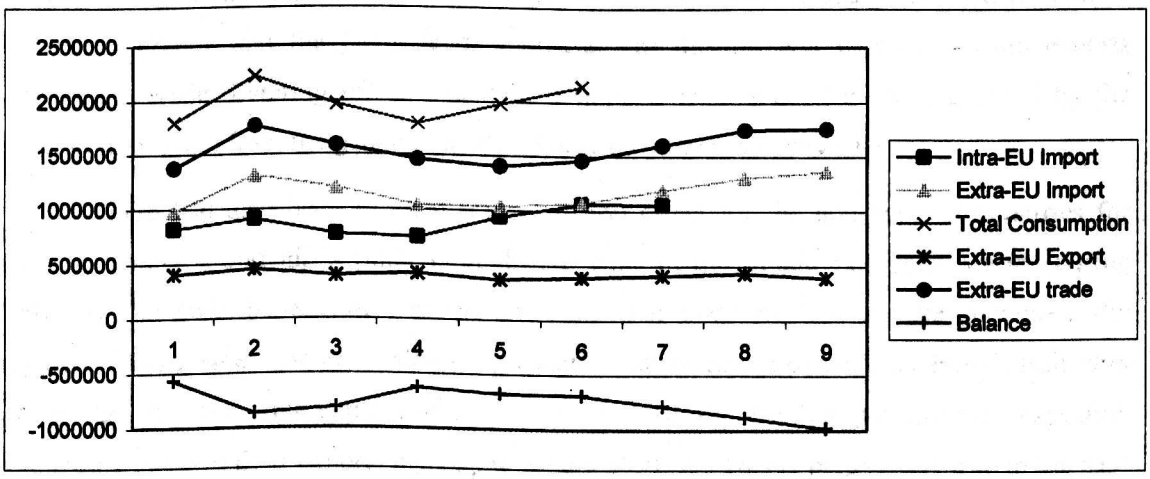


Table 6104.2
EU's Imports of Women's and Girl's (knitted/crocheted) Suits (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	257093	429239	354029	271291	310042	266885	323942	337056	31
China	88889	141156	143583	132403	116109	148709	242309	273914	208
Poland	19310	27313	28744	34570	49673	53752	55625	57901	199
Tunisia	30078	37936	40315	38019	34506	29018	46022	48876	62
Morocco	60598	59233	59328	55765	56237	56856	53652	46613	-23
India	32814	40723	42054	43282	38040	34726	38556	42613	29
Indonesia	31856	46153	51863	38804	31140	40190	55695	42127	32
Malaysia	40226	53772	59118	54261	39387	39927	38581	30342	-24
Romania	5418	7187	6254	6663	12653	15070	23008	25350	367
Hungary	16092	19334	17089	15531	22002	23555	27315	24205	50
Extra-EU	975028	1314635	1199905	1043515	1039642	1075314	1311092	1367733	40

The EU's trade in women's and girl's (knitted/crocheted) suits increased considerably during 1991-99. The EU's consumption of women's and girl's (knitted/crocheted) suits increased by 19 per cent along with an increase in intra-EU imports, which increased by 28 per cent. The extra-EU exports decreased by 3 per cent with an increase in extra-EU imports of 40 per cent resulting in an increase in trade deficit of 71 per cent during 1991-99. There has been a considerable trade creation effect in the Single European Market for both intra- and extra-EU imports. All the member countries, except Finland, increased their exports in value terms in intra-EU imports. Many member countries benefited from the EU's internal trade creation effect of 28 per cent. Belgium/Luxembourg (18 per cent), France (17 per cent) and Spain (17 per cent), Germany (16 per cent) and the United Kingdom (16 per cent) gained considerably at the cost of Greece and Portugal, who saw their market share dwindling during 1991-99.

The leading markets for India's exports in this product category are the United Kingdom (21 per cent), France (19 per cent), Germany (19 per cent) and the Netherlands (10 per cent). India's exports to these countries had mixed effect during 1991-97. In the case of exports to two leading markets, the United Kingdom and Germany, it decreased. On the other hand its exports to France and the Netherlands increased. In this product category Indian exports witnessed a trade diverting effect. The fall in imports from India had been effected by the increase in imports from the geographically adjacent non-member countries.

There had also been external trade creation effect for the non-member countries for trade in women's and girl's (knitted/crocheted) suits in the Single European Market during 1991-99. The main beneficiaries of the EU's external trade creation are the geographically adjacent non-member countries along with certain other countries such as Bangladesh with whom the EU has preferential trading agreement. All the leading non-member exporting countries witnessed their exports increasing during 1991-99. This is particularly true in the case of Central and East European Countries. All of the Central and East European Countries, except Slovenia, have benefited from the EU's external trade creation effect. They have benefited both in value terms and also in percentage terms. Some countries, such as India, Pakistan and Malaysia, lost their market share in the extra-regional imports because of increasing imports from the Central and East European Countries. The increases in imports from these countries are at the cost of replacing imports from distant non-member countries. Though India increased its exports value during 1991-99, it found its market share in extra-EU imports declining because of growing imports from other geographically adjacent non-member countries such as Poland, Romania and Tunisia. These countries increased their market share by 2.25, 1.3 and 0.45 percentage points respectively during 1991-99.

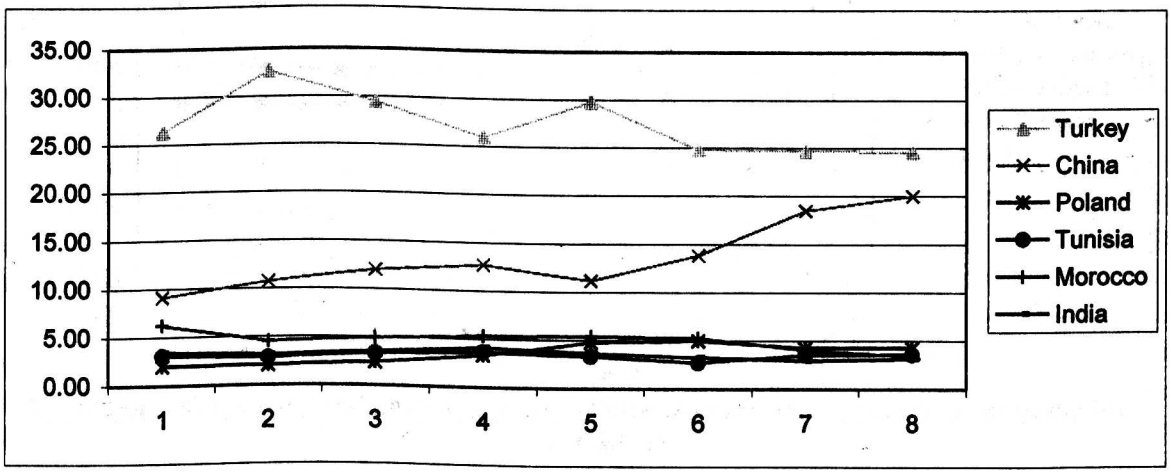
The main reason attributed to the growing imports from the geographically adjacent non-member countries is an increased in the OPT. Many of the member countries, because of growing competition from the distant non-member countries, have resorted to OPT trade as a

way of preserving the employment engaged in the domestic clothing industries. Since the trade in clothing products are consumer sensitive, with the designs often changed to the needs and preferences of the consumers in short-interval and short-run, the member countries found the OPT an easy way of countering the competition from the imports of distant non-member countries.

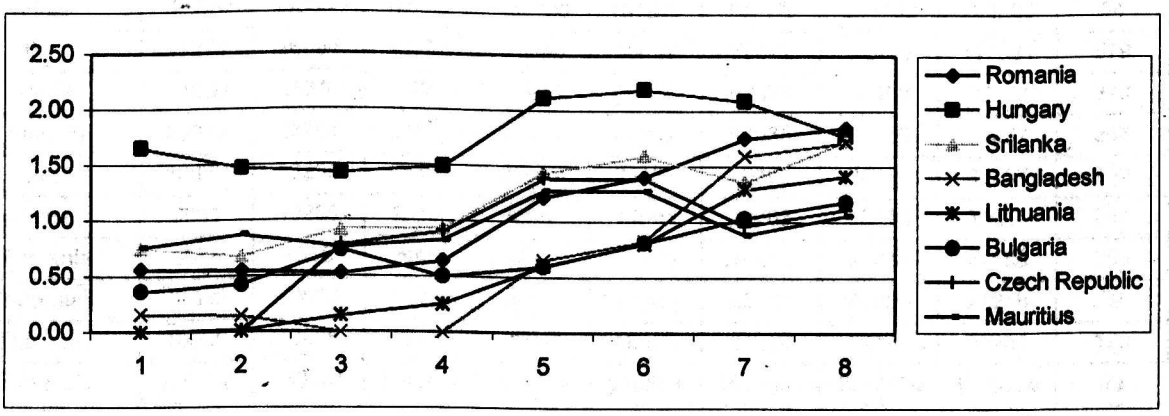
Table 6104.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	26.37	32.65	29.50	26.00	29.82	24.82	24.71	24.64	-1.72
China	9.12	10.74	11.97	12.69	11.17	13.83	18.48	20.03	10.91
Poland	1.98	2.08	2.40	3.31	4.78	5.00	4.24	4.23	2.25
Tunisia	3.08	2.89	3.36	3.64	3.32	2.70	3.51	3.57	0.49
Morocco	6.22	4.51	4.94	5.34	5.41	5.29	4.09	3.41	-2.81
India	3.37	3.10	3.50	4.15	3.66	3.23	2.94	3.12	-0.25
Romania	0.56	0.55	0.52	0.64	1.22	1.40	1.75	1.85	1.30
Hungary	1.65	1.47	1.42	1.49	2.12	2.19	2.08	1.77	0.12

Graph 6104.2
EU's Imports of Women's and Girl's (knitted/crocheted) Suits (in million ECU)



Graph 6104.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.12 Analysis for trade in women's and girls' slips, etc. (knitted or crocheted) - 6108

Table 6108.1
EU's Trade in women's and girl's slips (knitted/crocheted) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	542356	525710	447789	464007	646723	694363	691524	-	-	27.50
Extra-EU Import	725052	739841	858278	896091	918598	1016559	-	1232610	1310138	80.70
Total Consumption	1267408	1265551	1306067	1360098	1565321	1710922	-	-	-	34.99
Extra-EU Export	237953	228776	217794	247564	246794	295926	-	341654	317678	33.50
Extra-EU Trade	963005	968617	1076072	1143655	1165392	1312485	-	1574264	1627816	69.04
Balance	-487099	-511065	-640484	-648527	-671804	-720633	-	-890956	-992460	103.75

Graph 6108.1
EU's Trade in women's and girl's slips (knitted/crocheted) (in million ECU)

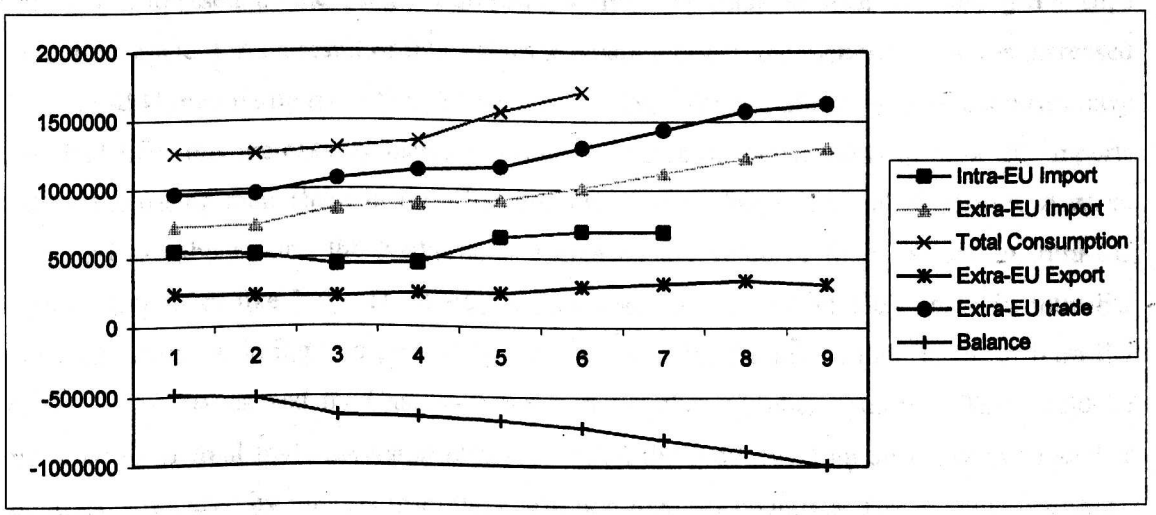


Table 6108.2
EU's Imports of women's and girl's slips (knitted/crocheted) from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
China	125950	127138	138728	163821	210001	241128	262502	328749	161
Turkey	129557	143358	169980	156729	181879	181070	204702	200286	54
India	17279	26864	41723	52766	60857	72372	92478	117381	579
Tunisia	21600	25270	32980	41873	60154	67974	82488	80573	273
Hungary	22813	28761	34480	37313	47842	51635	89189	79077	246
Poland	10977	13235	15584	21267	25368	29393	34738	38737	252
Morocco	9681	13265	13340	12952	14595	20763	33448	33647	247
Romania	6076	7356	8021	8417	12779	16268	21239	27558	353
Indonesia	17832	19898	24380	26470	27085	26161	30906	27248	52
Thailand	10055	10388	12230	13847	16905	17250	19190	22205	120
Extra-EU	725052	739841	858278	896091	918598	1016559	1232610	1310138	80

The EU's trade in women's and girl's slips (knitted/crocheted) had an overwhelming growth during the period 1991-99. Both intra- and extra-EU trade increased during this period. There had been an increase of 34 per cent in the consumption of women's and girl's slips (knitted/crocheted) in the EU. Large part of this consumption was accounted for by the imports from the non-member countries. Though intra-EU trade increased by 27 per cent during 1991-99, the extra-EU had increased by an unprecedented increased of 80 per cent. There had also been an increase in extra-EU exports. As a result of an increase in extra-EU imports and extra-EU exports, the extra-EU trade increased by about 70 per cent during 1991-99. The disproportionate increase in intra-EU imports (80 per cent) and intra-EU exports (33 per cent) had also resulted in a situation, whereby the EU's trade deficit with the non-member countries increased by more than 100 per cent during 1991-99.

In the EU, there had been considerable trade creation effect for trade in women's and girl's slips (knitted/crocheted) during 1991-99. both internal and external trade creation effects had been witnessed in the Single European Market for trade in women's and girl's slips (knitted/crocheted). As a result of internal trade creation effect, the member countries increased their intra-EU imports by more than 27 per cent during 1991-97. Many member countries have benefited from this increase by increasing both the value of their exports in intra-EU imports and by increasing their share in intra-EU imports. France, Spain, Ireland, Germany, Austria, Belgium/Luxembourg and the Netherlands increased the value of their exports in intra-EU imports. Countries like Italy, Denmark, Greece and Portugal found their share in intra-EU imports decreasing during this period. In the case of Italy, the fall in their share in intra-EU imports is mainly caused by Changes witnessed in other member countries. This could be attributed to internal trade diversion effect in which the products from an expensive member countries is replaced by imports from the cheap non-member countries. The member countries, which had been importing their products from Italy, had either Changed their sellers or starting going for their own OPT. In the case of Greece and Portugal, the competition from the influx of imports of low-cost non-member countries had adversely affect their share in intra-EU imports during 1991-99. This could have been attributed to the replacement effect of the production centres of many of the member countries, which had been trying to exploit the benefits of low production cost associated with moderate labour and resource costs.

The leading markets for India's exports in this product category are the developed member countries. They are France (24 per cent), Italy (15 per cent), Belgium/Luxembourg (14 per cent), the United Kingdom (14 per cent), the Netherlands (13 per cent) and Germany (10 per cent). India's exports to these countries during 1991-97 in this product category witnessed an unprecedented growth. India's exports to these countries increased both in value and percentage terms. It increased by more than 1300 per cent in the case of exports to Italy and Belgium/Luxembourg. The exports to France increased by 450 per cent. The exports to the

United Kingdom and the Netherlands increased by 390 and 245 per cent respectively during 1991-97. The unprecedented growth in India's exports to these countries did not affect the levels of their intra-EU trade.

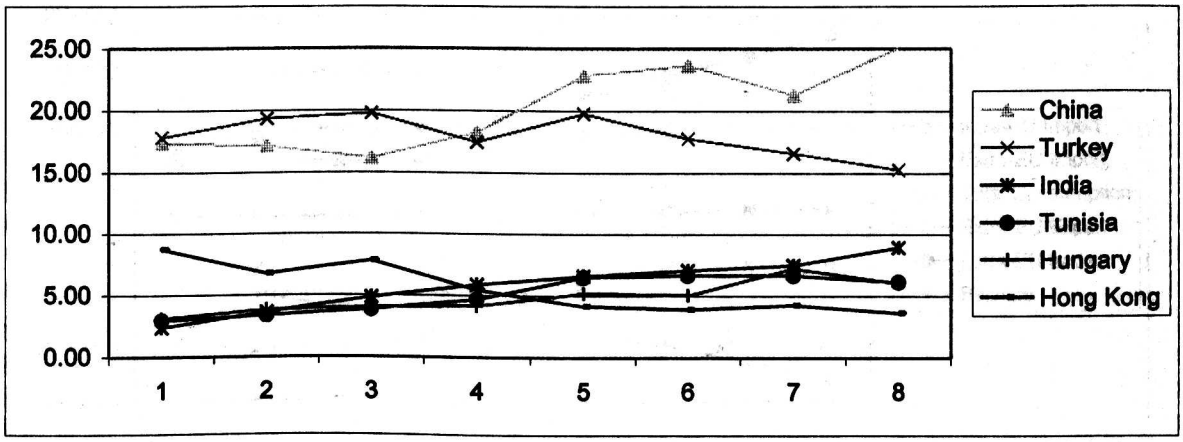
The EU's external trade creation effect created enormous opportunities for the exports of the non-member countries. Many of the leading exporters had considerably increased their exports both in value and in percentage terms. This is particularly true in the case of Indian exports, which increased, in value terms, 579 per cent during 1991-99. Other leading exporters who benefited to a great extent from the EU's internal trade creation effect are China (161 per cent) and Turkey (54 per cent). Other geographically adjacent non-member countries, such as Tunisia, Hungary, Poland, Morocco and Romanic had also increased their exports in value terms. Much of the exports from the geographically adjacent non-member countries were caused by the EU's OPT in this product. Also the countries of the Central and East European Countries had benefited from this external trade creation effect. The non-member countries had also increased their share in extra-EU imports considerably. The leading non-member, such as China and India, had gained larger in this process. While China increase its share by 7.7 percentage point, India increased its exports by 6.5 percentage point. However the exports from Turkey witnessed a fall in their market share. This could have caused by the increase in the EU's OPT or the imports from other geographically adjacent non-member countries.

Table 6108.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
China	17.37	17.18	16.16	18.28	22.86	23.72	21.30	25.09	7.72
Turkey	17.87	19.38	19.80	17.49	19.80	17.81	16.61	15.29	-2.58
India	2.38	3.63	4.86	5.89	6.62	7.12	7.50	8.96	6.58
Tunisia	2.98	3.42	3.84	4.67	6.55	6.69	6.69	6.15	3.17
Hungary	3.15	3.89	4.02	4.16	5.21	5.08	7.24	6.04	2.89
Poland	1.51	1.79	1.82	2.37	2.76	2.89	2.82	2.96	1.44
Morocco	1.34	1.79	1.55	1.45	1.59	2.04	2.71	2.57	1.23
Romania	0.84	0.99	0.93	0.94	1.39	1.60	1.72	2.10	1.27
Indonesia	2.46	2.69	2.84	2.95	2.95	2.57	2.51	2.08	-0.38
Thailand	1.39	1.40	1.42	1.55	1.84	1.70	1.56	1.69	0.31

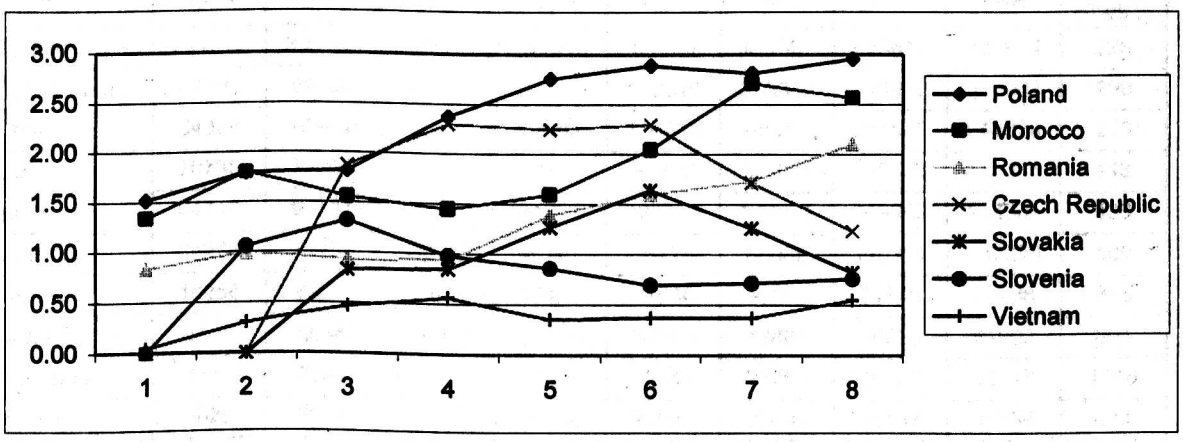
Graph 6108.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6108.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.13 ANALYSIS FOR TRADE IN T-SHIRTS, SINGLETS AND OTHER VESTS (knitted or crocheted) - 6109

Table 6109.1

EU's Trade in T-shirts, singlets and other vests (knitted or crocheted) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	1291459	1469639	1361171	1339204	1643636	1883665	1890714	-	-	46.40
Extra-EU Import	1281242	1433220	1631021	1583197	1776404	2114255	-	2758846	3126523	144.02
Total Consumption	2572701	2902859	2992192	2922401	3420040	3997920	-	-	-	55.40
Extra-EU Export	344839	376474	359833	400538	358608	415776	-	513665	506731	46.95
Extra-EU Trade	1626081	1809694	1990854	1983735	2135012	2530031	-	3272511	3633254	123.44
Balance	-936403	-1056746	-1271188	-1182659	-1417796	-1698479	-	-2245181	-2619792	179.77

Graph 6109.1

EU's Trade in T-shirts, singlets and other vests (knitted or crocheted) (in million ECU)

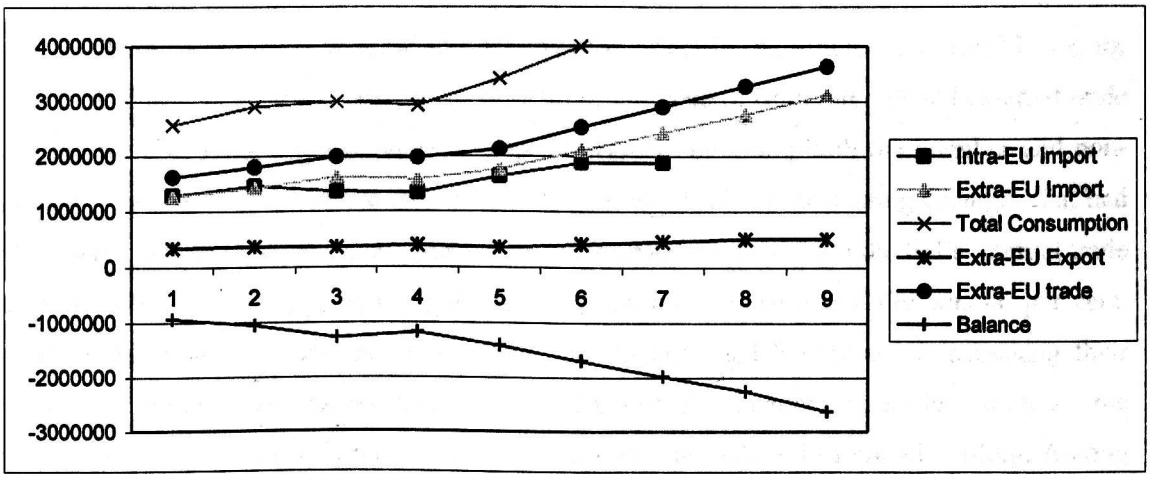


Table 6109.2

EU's Imports of T-shirts, singlets and other vests (knitted or crocheted) (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	241512	304607	310615	304611	373867	441867	696643	787524	226
Bangladesh	97205	89396			188310	276915	316036	387003	298
China	64386	65946	75182	94803	110918	145254	221543	241826	275
Mauritius	70735	77694	86256	79630	95292	105068	146633	172345	143
India	64410	90454	96242	81302	127356	149601	149962	153305	138
Morocco	34279	41264	43594	47161	56175	66035	110311	137230	300
Tunisia	18256	20671	28309	40023	52646	59290	81706	77788	326
Hungary	6802	12090	16655	21535	34853	42484	66220	61602	805
Romania	4311	2561	6147	8783	18449	25264	40905	53720	1146
Poland	9029	8673	13459	16564	24086	26601	45167	48484	436
Extra-EU	1281242	1433220	1631021	1583197	1776404	2114255	2758846	3126523	144

The EU's trade in T-shirts, singlets and other vests (knitted or crocheted) had an unprecedented growth during 1991-99 with both intra- and extra-EU trade witnessing an enormous growth. The major factor that had given rise to an enormous increase of growth in trade in T-shirts, singlets and other vests (knitted or crocheted) is the increase in the level of consumption. The EU's consumption of T-shirts, singlets and other vests (knitted or crocheted) increased by 55 per cent during 1991-97. The intra-EU imports increased during 1991-97 by 46 per cent. Major Change was witnessed in the extra-EU imports, which increased by 144 per cent during 1991-99. There had also been an increase in extra-EU exports. The EU's trade in T-shirts, singlets and other vests (knitted or crocheted) is largely extra-EU with the extra-EU trade increasing by 123 per cent during 1991-99. The extra-EU exports as a component of extra-EU trade is small. The main component of extra-EU trade is extra-EU imports, which increased by continued to increase causing a great concern. This, subsequently, increased the EU's trade deficit in its trade with the non-member countries. The EU's trade deficit increased by 179 per

cent during 1991-99. This is against the background that the extra-EU exports only by 46 per cent during the same period.

There had been an increase in trade creation effect in the Single European Market for trade in T-shirts, singlets and other vests (knitted or crocheted). Both internal and external trade creation were witnessed in the Single European Market benefiting both the member and non-member countries. A look at the intra-EU trade pattern reveals an interesting Changes that had taken place during 1991-99. Many member countries had benefited from the EU's internal trade creation effect. The Change in internal trade creation effect during 1991-99 was 46 per cent. Most of the member countries, except Italy and Ireland, had benefited by increasing their exports in value terms during this period. Some of the member countries, such as the Netherlands, Italy, Ireland, Greece and Portugal, found their share in intra-EU falling. Among these countries, Greece and Portugal witnessed a steep fall in their share in intra-EU imports. These two countries, which accounted for 40 per cent of intra-EU imports of trade in T-shirts, singlets and other vests (knitted or crocheted) in 1991, found their share declining to 32 per cent in 1999, a fall of about 23 per cent during 1991-99. The decline in share in these countries is attributed to the increase in the member countries' OPT trade. As a result of this increase in OPT trade, the T-shirts, singlets and other vests (knitted or crocheted), which had hitherto been imported from these less developed member countries, are being replaced by the imports from the non-member countries. For these countries, it is a typical trade diversion effect.

The leading markets for India's exports in this product category are again the developed member countries. They are Germany (29 per cent), France (17 per cent), the United Kingdom (16 per cent) and the Netherlands (10 per cent). India's exports to these countries during 1991-97 in this product witnessed an impressive growth with exports increasing by 78 per cent to Germany. It increased by more than 100 per cent to France, and 166 per cent to the Netherlands. The exports to the United Kingdom also witnessed an increase in the growth of exports by more than 90 per cent during 1991-97. However the increase in India's exports to the EU did not affect the member countries' intra-EU trade.

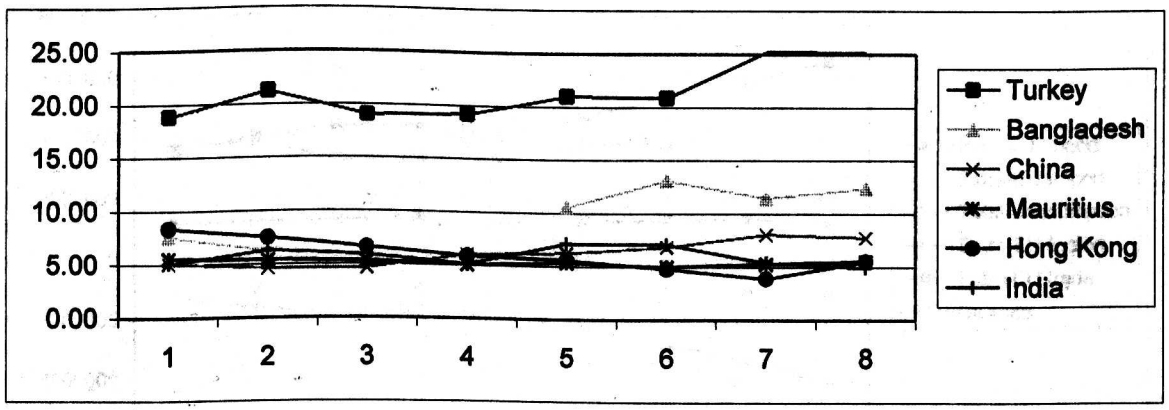
Many of the non-member countries witnessed their exports to the EU increasing by many fold during 1991-99 due to the external trade creation effect created in the Single European Market for trade in T-shirts, singlets and other vests (knitted or crocheted). All the leading exporters increased their exports, in value terms, during 1991-99. The leading beneficiaries of the EU's external trade creation are the geographically adjacent non-member countries who had been benefiting from the member countries' offshore production (OPT) trade. Such countries are Turkey, Mauritius, Morocco and Tunisia. The countries of Central and East European Countries are also main beneficiaries of the external trade creation effect. Even the countries with very low export base, such as Lithuania, Latvia and Estonia, had benefited

largely from the effects of the Single European Market on their exports to the member countries. The effects of the leading distant non-member countries are different from the one on the geographically adjacent non-member countries. The effects of the external trade creation are complex. Though Indian exports had increased in value terms, their share in extra-EU imports had decreased marginally. During 1991-99, the share of Indian exports in extra-EU imports had reduced by 0.12 per cent. However this is not the same case with other leading exporting countries from the geographically adjacent non-member countries. The fall in the share of India's exports in the extra-EU could be attributed to the increase in imports from the geographically adjacent non-member countries. This is typical trade diversion effect on Indian exports.

Table 6109.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

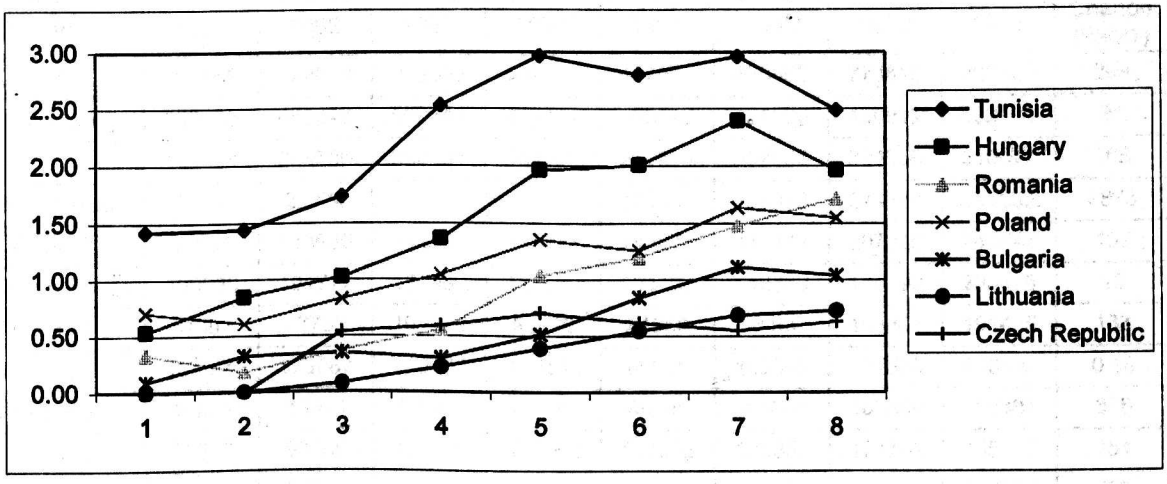
Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	18.85	21.25	19.04	19.24	21.05	20.90	25.25	25.19	6.34
Bangladesh	7.59	6.24			10.60	13.10	11.46	12.38	4.79
China	5.03	4.60	4.61	5.99	6.24	6.87	8.03	7.73	2.71
Mauritius	5.52	5.42	5.29	5.03	5.36	4.97	5.32	5.51	-0.01
Hong Kong	8.33	7.48	6.62	5.89	5.59	4.80	3.91	5.51	-2.82
India	5.03	6.31	5.90	5.14	7.17	7.08	5.44	4.90	-0.12
Morocco	2.68	2.88	2.67	2.98	3.16	3.12	4.00	4.39	1.71
Tunisia	1.42	1.44	1.74	2.53	2.96	2.80	2.96	2.49	1.06
Hungary	0.53	0.84	1.02	1.36	1.96	2.01	2.40	1.97	1.44
Romania	0.34	0.18	0.38	0.55	1.04	1.19	1.48	1.72	1.38
Poland	0.70	0.61	0.83	1.05	1.36	1.26	1.64	1.55	0.85

Graph 6109.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6109.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.14 ANALYSIS FOR TRADE IN JERSEYS, PULLOVERS, ETC. (KNITTED OR CROCHETED) - 6110

Table 6110.1

EU's Trade in Jerseys, Pullovers, etc (knitted/crocheted) (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	3570441	3902789	3197470	3179420	3295639	3780011	3886427	-	-	8.85
Extra-EU Import	2392334	2829790	3071372	3054977	2995107	3494431	-	4616848	5309734	121.95
Total Consumption	5962775	6732579	6268842	6234397	6290746	7274442	-	-	-	22.00
Extra-EU Export	1156401	1200866	1229195	1342825	1105766	1233473	-	1313008	1208668	4.52
Extra-EU Trade	3548735	4030656	4300567	4397802	4100873	4727904	-	5929856	6518402	83.68
Balance	-1235933	-1628924	-1842177	-1712152	-1889341	-2260958	-	-3303840	-4101066	231.82

Graph 6110.1

EU's Trade in Jerseys, Pullovers, etc (knitted/crocheted) (in million ECU)

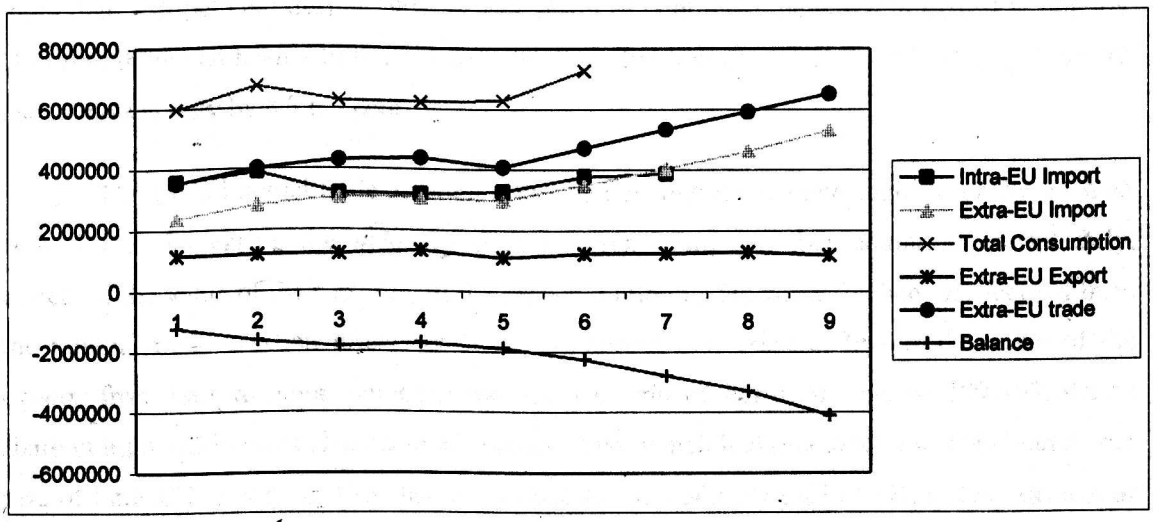


Table 6110.2
EU's Imports of Jerseys, Pullovers, etc (knitted/crocheted) (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	259755	322058	333929	407879	477950	638853	773616	805039	209
Hong Kong	439035	483047	500443	492702	496543	481338	496919	532198	21
China	192744	283500	394681	364928	252665	297632	394366	516877	168
Bangladesh	9905	22974			101193	138323	274180	294535	2873
Indonesia	93854	113986	132453	130013	140876	174141	207335	243547	159
South Korea	199930	191777	171999	133610	104162	112379	174592	238375	19
Thailand	81851	87753	101771	91172	84558	98496	153804	191495	133
Taiwan	187500	173087	110431	105305	88055	102849	151579	188402	0.48
Romania	19243	33974	50241	60825	68498	90734	163206	188381	878
Morocco	72909	93706	101605	108382	114023	135852	177709	185770	154
Tunisia	17743	28261	35457	53177	62613	77256	135300	148654	737
Mauritius	144953	164521	168044	140829	140543	142253	151037	139821	-3
India	43735	60889	74234	70650	72306	78504	105950	138031	215
Poland	25873	37301	56255	63166	73191	84551	96510	105940	309
Srilanka	9348	21204	32610	41312	31690	42461	75762	101361	984
Hungary	14190	26538	29908	33670	46537	50686	71089	81101	471
Extra-EU	2392334	2829790	3071372	3054977	2995107	3494431	4616848	5309734	121

The EU's trade in Jerseys, Pullovers, etc (knitted/crocheted) is mainly extra-regional with the extra-EU imports and extra-EU exports increasing consistently during 1991-99. There had been an increase in the EU's consumption of this product during 1991-99. The consumption in this product category increased by 22 per cent. The EU's extra-EU trade had increased by more than 83 per cent during 1991-99 with the extra-EU imports outweighing the extra-EU exports. While the extra-EU imports had increased by 121 per cent, the extra-EU exports increased only by a marginal 4.5 per cent resulting in high trade deficit for the member countries against their trade with the non-member countries. The EU's trade deficit increased by more than 230 per cent during 1991-99 as a result of continued increased in extra-EU imports. However there had been a little Change in the intra-EU imports. The intra-EU, during 1991-97, had increased only by 8.8 per cent.

The EU's internal trade creation effect had created many opportunities for the member countries in increasing the value of their exports. Many member countries, except Italy, increased the value of their exports in the intra-EU imports. However the benefits accrued from the internal trade creation effect for Italy was almost non-existent. In fact the value of the exports from Italy to other member countries had reduced during the period 1991-99. Italy's share in intra-EU imports also declined sharply. Italy, which had accounted for more than 51 per cent of intra-EU imports in 1991 had accounted for only 36 per cent in 1991, a sharp decline of 30 per cent. This could be attributed to the changing trade practices in many of the member

countries. Many of the member countries, who had been importing the Jerseys, Pullovers, etc (knitted/crocheted) had either shifted their supply base to the low production locations (trade suppression, in which the imports are replaced by their own production) or opted to go for OPT, which work out to be cost effective compared to imports from other member countries. However the same had not been witnessed for Greece and Portugal, the countries who would normally be the victim in the case of the trade diversion effect.

The leading markets for India's exports in this product category are Germany (28 per cent), France (30 per cent), the United Kingdom (18 per cent) and the Netherlands (10 per cent). The exports to these countries witnessed a consistent growth during 1991-97. The exports to the two leading markets of Germany and France increased by 138 and 291 per cent respectively. The exports to the Netherlands increased by 140 per cent during this period. However there had been an increase in these member countries' intra-EU trade, which proves that India's exports did not have any trade diverting effect.

Many of the leading non-member countries exporting to the EU in this product had witnessed a massive increase in their exports. The leading exporting nations were, except Turkey, distant non-member countries. While Turkey experienced a growth, in the value of its exports, by more than 200 per cent, other countries such as China, Bangladesh and Indonesia also witnessed an enormous growth in their exports to the EU. These countries had also managed to increase their share in extra-EU imports into the EU. However India's exports in this product category witnessed a mixed effect. As for its exports to the EU are concerned, they increased in their value during 1991-99 by 215 per cent. However this increase is not enough to increase their existing share in the EU's extra-EU imports. The India's exports, as a percentage of extra-EU imports, had increased marginally during 1991-99. It increased by 0.77 percentage point during this period. Since India is not a leading exporter in this product category, they were not able to increase their market share. Moreover the trade in this category is such that it encourages the OPT as the costs of production in offshore production centres outweighed the costs of producing domestically. As a result even the high cost member countries had moved their production base to the geographically adjacent non-member countries to exploit the benefits offered by these low cost countries

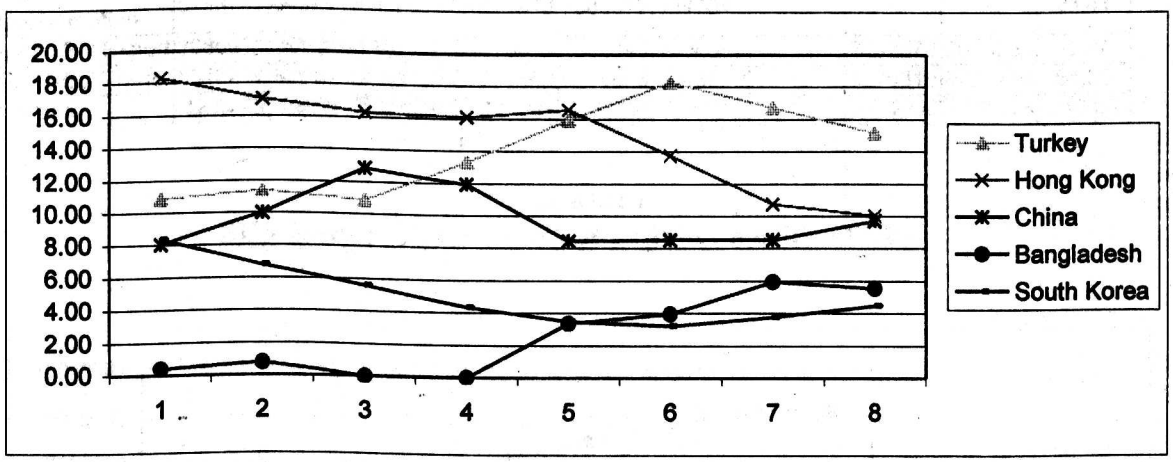
Table 6110.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	10.86	11.38	10.87	13.35	15.96	18.28	16.76	15.16	4.30
Hong Kong	18.35	17.07	16.29	16.13	16.58	13.77	10.76	10.02	-8.33
China	8.06	10.02	12.85	11.95	8.44	8.52	8.54	9.73	1.68
Bangladesh	0.41	0.81			3.38	3.96	5.94	5.55	5.13
Indonesia	3.92	4.03	4.31	4.26	4.70	4.98	4.49	4.59	0.66
South Korea	8.36	6.78	5.60	4.37	3.48	3.22	3.78	4.49	-3.87
Thailand	3.42	3.10	3.31	2.98	2.82	2.82	3.33	3.61	0.19
Taiwan	7.84	6.12	3.60	3.45	2.94	2.94	3.28	3.55	-4.29
Romania	0.80	1.20	1.64	1.99	2.29	2.60	3.54	3.55	2.74
Morocco	3.05	3.31	3.31	3.55	3.81	3.89	3.85	3.50	0.45
Tunisia	0.74	1.00	1.15	1.74	2.09	2.21	2.93	2.80	2.06
Mauritius	6.06	5.81	5.47	4.61	4.69	4.07	3.27	2.63	-3.43
India	1.83	2.15	2.42	2.31	2.41	2.25	2.29	2.60	0.77
Poland	1.08	1.32	1.83	2.07	2.44	2.42	2.09	2.00	0.91
Srilanka	0.39	0.75	1.06	1.35	1.06	1.22	1.64	1.91	1.52
Hungary	0.59	0.94	0.97	1.10	1.55	1.45	1.54	1.53	0.93

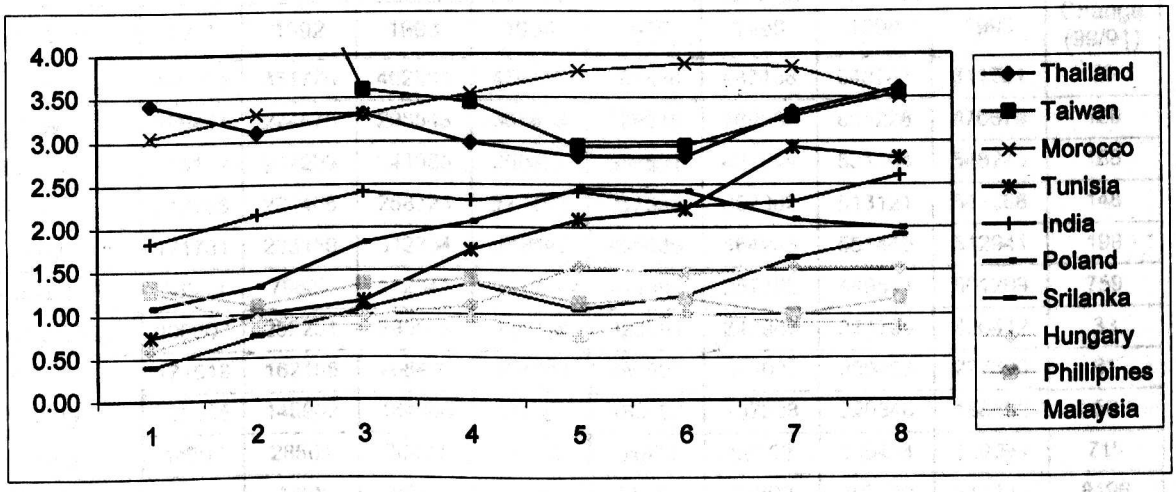
Graph 6110.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6110.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.15 ANALYSIS FOR TRADE IN WOMEN'S AND GIRLS' SUITS, ENSEMBLES, JACKETS, DRESSES, SKIRTS, ETC. - 6204

Table 6204.1

EU's Trade in Women's and Girl's Suits (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	3490472	3419286	2646652	2685432	3320467	3700905	3614425	-	-	3.55
Extra-EU Import	3273260	3039027	3358845	3732377	4266210	4646436	-	5844238	6227192	90.24
Total Consumption	6763732	6458313	6005497	6417809	7586677	8347341	-	-	-	23.41
Extra-EU Export	2066958	2016480	1972386	2214983	1980443	2296653	-	2432072	2026264	-1.97
Extra-EU Trade	5340218	5055507	5331231	5947360	6246653	6943089	-	8276310	8253456	54.55
Balance	-1206302	-1022547	-1386459	-1517394	-2285767	-2349783	-	-3412166	-4200928	248.25

Graph 6204.1

EU's Trade in Women's and Girl's Suits (in million ECU)

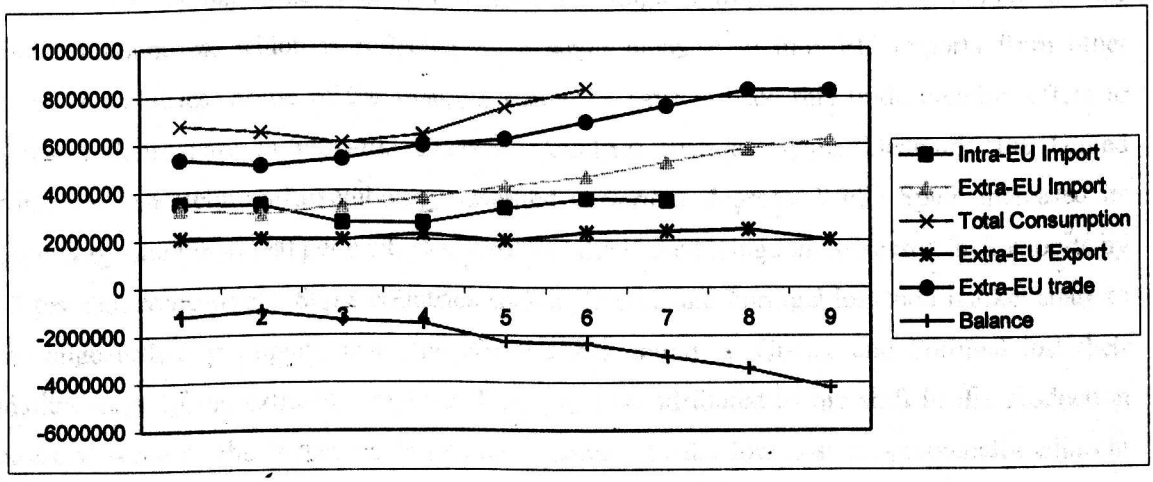


Table 6204.2
EU's Imports of Women's and Girl's Suits from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
China	460226	351776	402991	454115	391686	487488	648263	811781	76
Turkey	296411	274675	298543	307648	429618	469934	604228	670679	126
Tunisia	204109	247299	241985	269353	362601	421949	531104	548279	168
Morocco	218768	234406	258723	274453	337533	352362	513121	543266	148
Poland	171781	233159	312734	372992	455036	464243	551449	512941	198
Romania	58330	79837	112341	161347	211967	257182	449541	501209	759
Hong Kong	300803	252251	290015	288796	323981	343907	364705	400412	33
India	171518	162465	208403	268596	367529	315007	289463	277390	61
Hungary	125535	146902	164848	180685	186802	187238	220340	188692	50
Bulgaria	14595	28561	30447	38622	54874	59059	105484	119091	715
Lithuania		1388	8567	15933	34476	52392	100589	115159	8196
Extra-EU	3273260	3039027	3358845	3732377	4266210	4646436	5844238	6227192	90.24

The EU's trade in women's and girl's suits is largely extra-regional in it, the intra-EU trade is much less compared to the extra-EU trade. The consumption of women's and girl's suits increased during the period 1991-99 by 23 per cent. While the intra-EU imports increased by 3.5 per cent, the extra-EU imports increased by 90 per cent confirming the large scale benefits arisen from the EU's external trade creation effect for the non-member countries. The industry concentration continued to decline in this sector with the extra-EU exports increasing less than 2 per cent during 1991-99. Though the EU's extra-EU trade increased by more than 50 per cent during 1991-99, much of it was accounted for by increased imports from the non-member countries. Because if falling extra-EU exports associated with disproportionate increase of extra-EU imports, the trade deficit continued to increase against the non-member countries. During the period 1991-99, the EU's trade deficit in this product increased by about 250 per cent.

The internal trade creation effect in the Single European Market is limited for the member countries, which is reflected by a small increase in intra-EU imports from other member countries. Some of the member countries have utilised this trade creation effect to enhance their share in intra-EU imports. Countries such as Spain, Denmark, the United Kingdom and Belgium/Luxembourg benefited at various degrees. While Spain increased its exports by more than 280 per cent, Denmark and the United Kingdom increased their exports by 43 per cent respectively. Some countries such as Greece and Portugal lost their market share to the huge influx of imports from the non-member countries. Greece and Portugal lost their market share to the extra-EU imports. This could be attributed to the shift in the production bases of some of the industries from their locations to the low cost geographically adjacent locations.

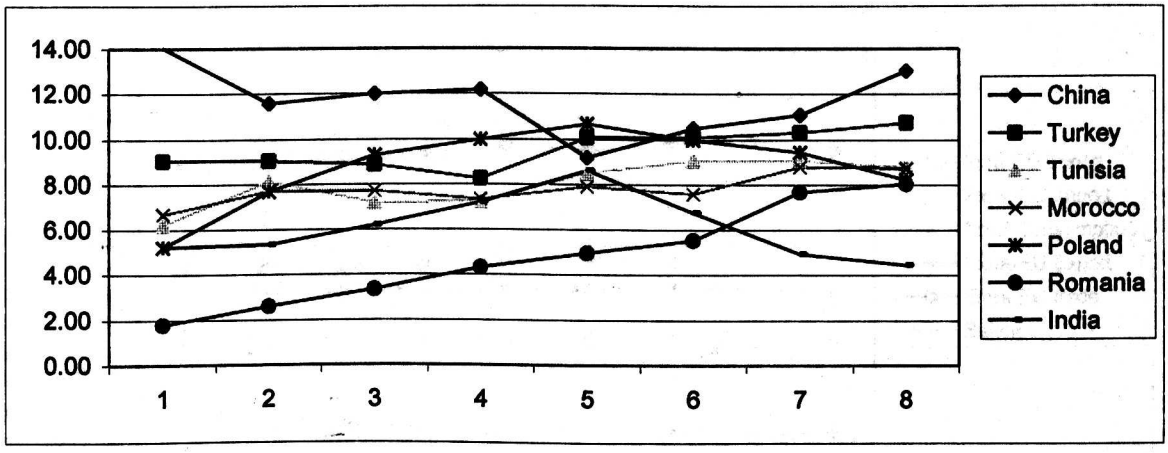
The leading export markets for India's exports in this product category are the United Kingdom (31 per cent), France (21 per cent) and Germany (15 per cent) in 1997. India's exports to two of these leading markets increased considerably, while it reduced to the third. India's exports to the United Kingdom increased by 66 per cent as against the 69 per cent for France. However the exports to Germany decreased in value terms by 11 per cent during 1991-97. The fall in exports to Germany could be interpreted as the trade diverting effect resulting out of its OPT on trade. The increase in Germany's OPT resulted in the fall in imports from India.

There has been large-scale trade creation effect in the Single European Market for the non-member countries. The extra-EU imports increased by 90 per cent during 1991-99 benefiting the non-member countries considerably. However this has not greatly influenced the distant non-member countries in increasing their share in extra-EU imports. The main beneficiaries of this large increase in external trade creation effect are the geographically adjacent non-member countries. This is mainly because of the member countries' OPT in this product. Many of the member countries continue to go for OPT with countries such as Turkey, Tunisia, Morocco, Poland and Romania, the preferred locations for OPT trade in clothing products. This is confirmed by the increase in the trade share of these countries' in extra-EU imports. The EU's OPT trade has greatly affected traditional exporters such as China, Hong Kong and India. All these countries have lost their market share to the geographically adjacent non-member countries. While China lost their market share by one percentage point, Hong Kong and India lost by 2.76 and 0.79 percentage points respectively. Though India and Poland had similar market share of 5.2 per cent in extra-EU imports in 1991, the exports from Poland increased to 8.24 per cent during 1991-99. While Indian exports to the EU decreased to 4.45 per cent, a fall of 0.79 percentage points during the same period. This is a perfect case of trade diversion effect of OPT on India's exports to the EU. Almost all of the geographically adjacent non-member countries, except Hungary and Czech Republic, have increased their share in extra-EU imports during 1991-99.

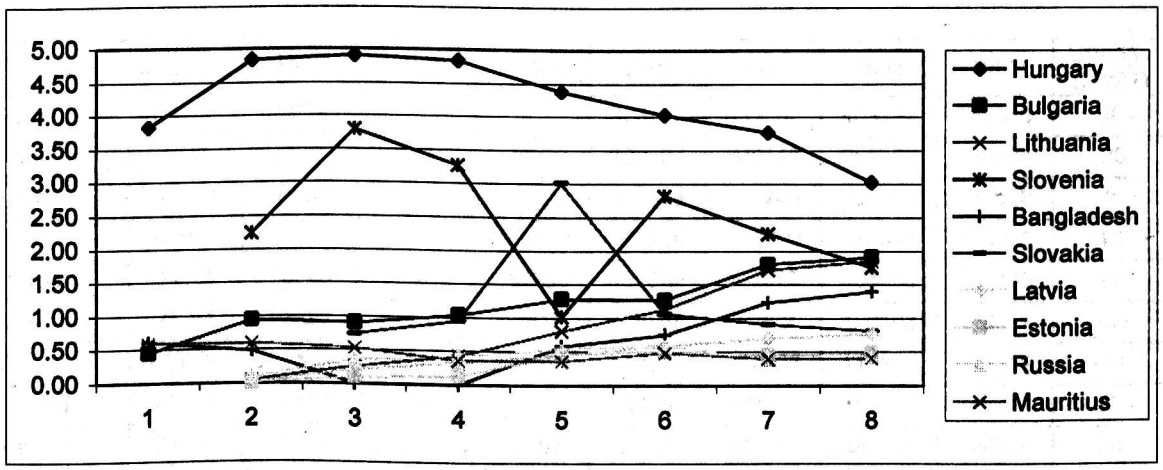
Table 6204.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
China	14.06	11.58	12.00	12.17	9.18	10.49	11.09	13.04	-1.02
Turkey	9.06	9.04	8.89	8.24	10.07	10.11	10.34	10.77	1.71
Tunisia	6.24	8.14	7.20	7.22	8.50	9.08	9.09	8.80	2.57
Morocco	6.68	7.71	7.70	7.35	7.91	7.58	8.78	8.72	2.04
Poland	5.25	7.67	9.31	9.99	10.67	9.99	9.44	8.24	2.99
Romania	1.78	2.63	3.34	4.32	4.97	5.54	7.69	8.05	6.27
Hong Kong	9.19	8.30	8.63	7.74	7.59	7.40	6.24	6.43	-2.76
India	5.24	5.35	6.20	7.20	8.61	6.78	4.95	4.45	-0.79
Hungary	3.84	4.83	4.91	4.84	4.38	4.03	3.77	3.03	-0.81
Bulgaria	0.45	0.94	0.91	1.03	1.29	1.27	1.80	1.91	1.47
Lithuania		0.05	0.26	0.43	0.81	1.13	1.72	1.85	1.80

Graph 6204.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6204.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.16 ANALYSIS FOR TRADE IN MEN'S AND BOYS' SHIRTS (excluding knitted or crocheted, nightshirts, singlets and other vests) - 6205

Table 6205.1
EU's Trade in Men's and Boys Shirts (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	629490	701430	649039	667687	781854	828526	765217	-	-	21.56
Extra-EU Import	1911891	1896262	2090206	2103464	2248140	2141523	-	2284227	2166519	13.32
Total Consumption	2541381	2597692	2739245	2771151	3029994	2970049	-	-	-	16.87
Extra-EU Export	266737	282971	287122	314176	288676	326105	-	355110	299672	12.35
Extra-EU Trade	2178628	2179233	2377328	2417640	2536816	2467628	-	2639337	2466191	13.20
Balance	1645154	1613291	1803084	1789288	1959464	1815418	-	1929117	1866847	13.48

Graph 6205.1

EU's Trade in Men's and Boys Shirts (in million ECU)

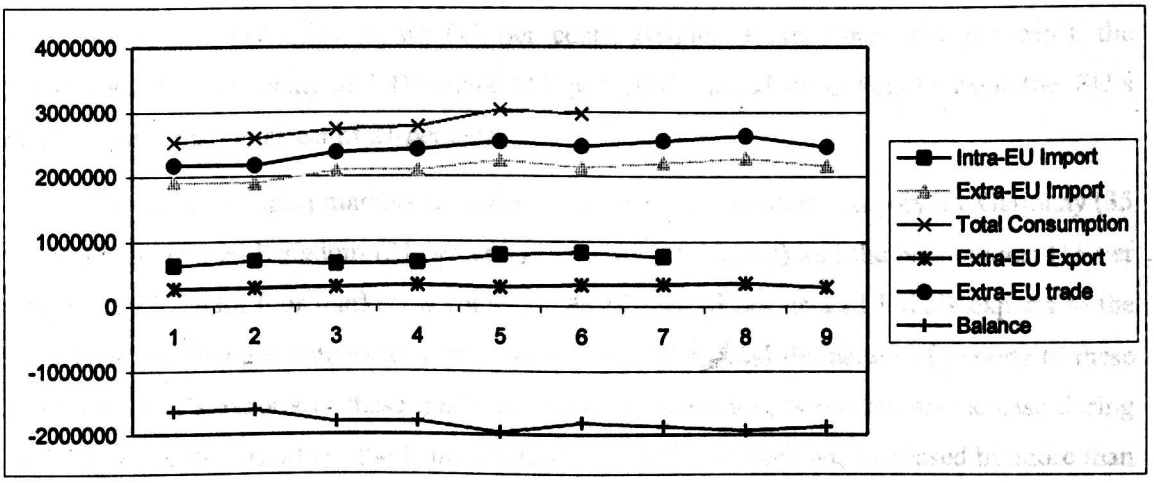


Table 6205.2

EU's Imports of Men's and Boys Shirts from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Bangladesh	194423	208732			373320	343062	403382	385830	98
Hong Kong	317430	292376	336552	310232	298407	288112	251450	228094	-28
India	167769	171926	193068	200235	275813	267740	201954	182528	8
Turkey	102317	116339	143148	135047	170256	136762	133427	119235	16
Morocco	93308	110075	125217	131330	137332	120826	131665	118159	26
Romania	25211	31987	49787	55512	72080	71872	120503	113517	350
China	248334	220056	218458	164510	117567	118467	117101	111911	-54
Poland	61301	71351	86962	104380	108451	91074	110533	99507	62
Tunisia	78852	80919	77372	87397	94799	87422	95357	95232	20
Indonesia	29620	31362	40963	42749	44972	47490	88834	89907	203
Vietnam	4979	6139	13258	34530	40060	42159	62383	63850	1182
Mauritius	44961	45852	45218	45467	45085	53561	55642	60324	34
Bulgaria	10932	16422	20319	21976	26698	26636	43163	41315	277
Extra-EU	1911891	1896262	2090206	2103464	2248140	2141523	2284227	2166519	13.32

The EU's trade in men's and boy's shirts increased marginally during 1991-99 with the intra- and extra-EU imports increasing simultaneously. This is in line with the EU's trade in this product. The consumption also increased in accordance with the general pattern in this trade as also the EU's trade balance. The intra-EU imports increased higher than the extra-EU imports with the total consumption increasing by 16 per cent during 1991-97. Also the EU's trade balance at the same level as the extra-EU imports of this products into the EU.

The trade in this product, during 1999-91 has resulted in trade creation effect for both the member and non-member countries. Many member countries have benefited, mainly in value terms, from the EU's internal trade creation effect for trade in this product. The countries such as Italy (22 per cent), Spain (13 per cent), Belgium/Luxembourg (11 per cent), the Netherlands (11 per cent) and Denmark (11 per cent) gained considerably from the EU's internal trade creation effect of 21 per cent.

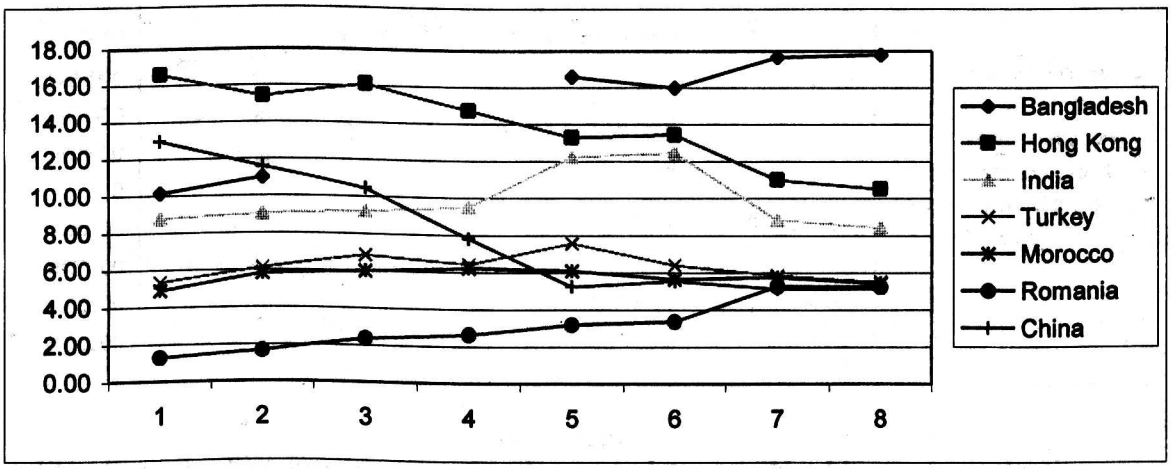
The leading export markets for India's exports in this product category are Germany (35 per cent), the United Kingdom (21 per cent), France (12 per cent) and the Netherlands (11 per cent) in 1997. These four markets account for more than 80 per cent of India's exports to the EU. Hence the changes witnessed in this market largely decided the nature of exports to these countries. India's exports to these markets, except for Germany, witnessed an increase during 1991-97. while the exports to the United Kingdom and the Netherlands increased by more than 70 per cent, it increased by 142 per cent to France. However the exports to Germany, the largest market in this product category, witnessed a fall in their exports by 10 per cent during this period. This is again attributed to the trade diverting effect of Germany's OPT in this product category.

The EU's trade creation effect benefited many non-member countries. The main beneficiaries are Bangladesh, Turkey, Morocco, Romania, Poland and Vietnam. These countries have increased their exports both in value and in percentage terms during 1991-99. Vietnam increased its exports by more than 1000 per cent, followed by Romania (350 per cent), Bangladesh (98 per cent), Poland (62 per cent), Tunisia (20 per cent) and Turkey (16 per cent). However Indian exports to the EU increased, in value terms, by 8 per cent during this period. As for their share in extra-EU imports are considered, Bangladesh increased its share by 7.62 percentage points followed by Romania and Vietnam which increased their share by about 3.92 and 2.69 percentage points respectively. Though Indian exports to the EU increased in value terms, they have not increased their share in extra-EU imports. Rather India's exports in extra-EU imports reduced by 0.35 percentage points. Though Indian exports have not been affected adversely, the present trend confirms the emergence of the trade diversion effect on Indian exports to the Single European Market. The increase in other countries' exports, particularly the Central and East European countries, is in accordance with the fall in India's exports of these products to the EU. This could be attributed to the growing OPT trade in garment products between the member countries and the countries of Central and East European region along with countries such as Bangladesh and Vietnam, who have preferential access to the Single European Market.

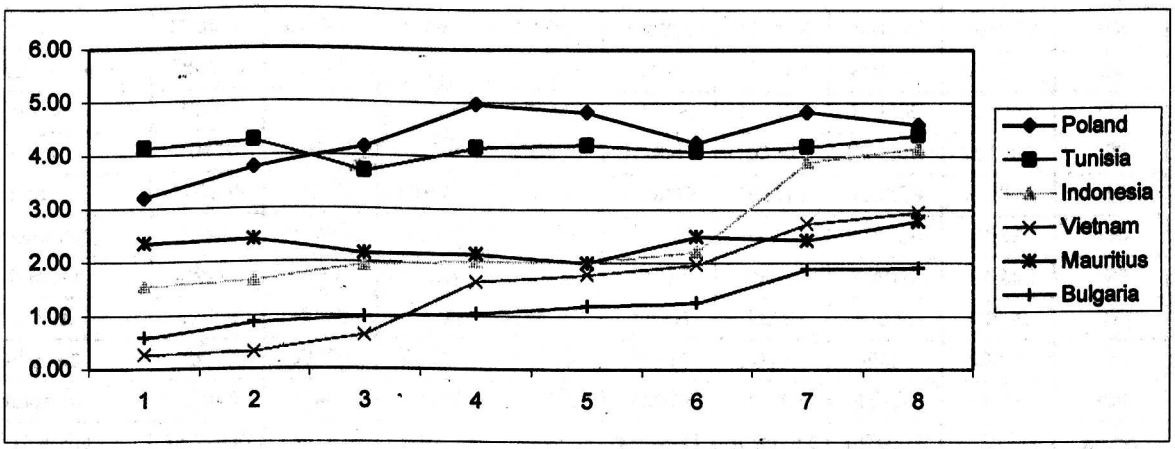
Table 6205.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Bangladesh	10.17	11.01			16.61	16.02	17.66	17.81	7.64
Hong Kong	16.60	15.42	16.10	14.75	13.27	13.45	11.01	10.53	-6.07
India	8.78	9.07	9.24	9.52	12.27	12.50	8.84	8.42	-0.35
Turkey	5.35	6.14	6.85	6.42	7.57	6.39	5.84	5.50	0.15
Morocco	4.88	5.80	5.99	6.24	6.11	5.64	5.76	5.45	0.57
Romania	1.32	1.69	2.38	2.64	3.21	3.36	5.28	5.24	3.92
China	12.99	11.60	10.45	7.82	5.23	5.53	5.13	5.17	-7.82
Poland	3.21	3.76	4.16	4.96	4.82	4.25	4.84	4.59	1.39
Tunisia	4.12	4.27	3.70	4.15	4.22	4.08	4.17	4.40	0.27
Indonesia	1.55	1.65	1.96	2.03	2.00	2.22	3.89	4.15	2.60
Vietnam	0.26	0.32	0.63	1.64	1.78	1.97	2.73	2.95	2.69
Mauritius	2.35	2.42	2.16	2.16	2.01	2.50	2.44	2.78	0.43
Bulgaria	0.57	0.87	0.97	1.04	1.19	1.24	1.89	1.91	1.34

Graph 6205.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6205.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.17 ANALYSIS FOR TRADE IN WOMEN'S AND GIRLS' BLOUSES, SHIRTS AND SHIRT-BLOUSES (excluding knitted or crocheted and vests) - 6206

Table 6206.1

EU's Trade in Women's and Girl's Blouses, Shirts and Shirt-blouses (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	920442	952925	805381	809874	871810	880556	864550	-	-	-6.07
Extra-EU Import	1335200	1362614	1640733	1799979	1804991	1699132	-	1870328	1716814	28.58
Total Consumption	2255642	2315539	2446114	2609853	2676801	2579688	-	-	-	14.37
Extra-EU Export	362903	356858	365151	394643	309480	311436	-	334834	283936	-21.76
Extra-EU Trade	1698103	1719472	2005884	2194622	2114471	2010568	-	2205162	2000750	17.82
Balance	-972297	-1005756	-1275582	-1405336	-1495511	-1387696	-	-1535494	-1432878	47.37

Graph 6206.1

EU's Trade in Women's and Girl's Blouses, Shirts and Shirt-blouses (in million ECU)

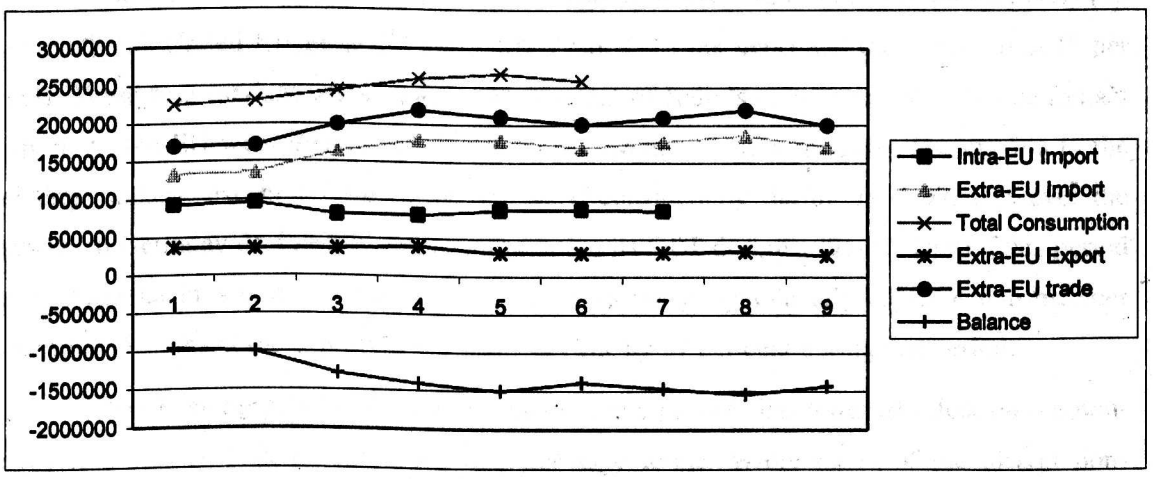


Table 6206.2

EU's Imports of Women's and Girl's Blouses, Shirts and Shirt-blouses from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
China	223006	227905	297347	290022	196869	212192	199305	195072	-12
Hong Kong	268573	231438	276858	280657	281363	230687	219458	188052	-29
Poland	76761	104059	156095	179272	205659	181353	199436	164083	113
Turkey	70410	89232	103739	120936	156641	163382	200166	161163	128
India	174265	183904	191074	216432	225243	198472	163339	146503	-15
Romania	14387	18549	32429	50505	62635	61327	115706	135376	840
Morocco	56514	64083	72309	80083	95727	95385	124017	126446	123
Tunisia	39850	45535	55531	64317	73664	68243	81511	70690	77
Srilanka	25977	33352	44397	55959	59714	59140	69451	53219	104
Bulgaria	12845	16987	21073	22356	24449	22856	43154	42450	230
Extra-EU	1335200	1362614	1640733	1799979	1804991	1699132	1870328	1716814	28.58

The EU's trade in women's and girl's blouses, shirts and shirt-blouses witnessed a sharp decline in industry concentration. The fall in industry concentration resulted in a fall in both intra-EU imports and extra-EU exports. Also this resulted in an influx of imports into the Single European Market from the non-member countries. This increased the EU's trade deficit for trade in this product by 47 per cent during 1991-99. The consumption level also grew less notably during 1991-97. It grew only by 14 per cent during 1991-99. This resulted in a fall in intra-EU imports. The intra-EU imports witnessed a decline in growth by more than 6 per cent confirming the trade diversion effect on the domestic products. This confirms the trade diversion effect for trade in blouses, shirts and shirt-blouses in the Single European Market. The trade in this product is marked by large scale Outward Processing Trade with many of the domestic industries shifting their production bases abroad. This is confirmed by an increase in extra-EU imports, which increased by 28 per cent during 1991-99. At the same time the extra-EU imports increased by 28 per cent confirming the external trade creation effect in the Single European Market for the non-member countries.

The leading export markets for India's exports in this product category are Germany (33 per cent), the United Kingdom (23 per cent), France (13 per cent) and the Netherlands (8 per cent). These four markets accounted for 80 per cent of India's exports in 1997. Hence India's exports to the EU were greatly influenced by the events of these markets. The exports to the leading markets, except for Germany, increased considerably during 1991-97. However the exports to Germany declined, the main cause being its OPT during 1991-97. During this period many German importers diverted their attention to the geographically adjacent non-member countries. As a result the exports to Germany decline by 27 per cent during this period.

The changing pattern of the EU's trade in this product has a mixed effect on the non-member countries both in value and in percentage terms. While many of the distant non-member countries witnessed a fall in their exports to the Single European Market, the geographically adjacent non-member countries witnessed a growth in their exports. While the leading exports of this product such as China, Hong Kong and India witnessed a fall in their exports both in value terms and percentage terms, other countries such as Poland, Turkey, Romania, Morocco, Tunisia and Bulgaria increase their exports considerably. The Indian exports, during 1991-99, witnessed a sharp decline of 15 per cent in value terms, along with the exports from China (12) and Hong Kong (29 per cent). This is in sharp contrast against an increase of imports from Poland (113 per cent), Turkey (128 per cent), Romania (840 per cent), Morocco (123 per cent) and Bulgaria (230 per cent). Every single country of the Central and East European region, except Slovenia, benefited largely at the expense of India's exports to the Single European Market. Though there has been a considerable trade creation effect for trade in this product in the Single European Market, it has not benefited all the non-member countries. It has benefited the geographically adjacent non-member countries to a large extent. This is mainly because of the EU's OPT, which allows the imports from these countries to enter the

Single European Market duty free so long as these imports products consist of a large part of the raw materials from the member countries. The fall in imports from India is mainly due to the increase in imports from the geographically adjacent non-member countries, a typical case for trade diversion effect. The main beneficiaries of the EU's trade creation effect for trade in this product are largely the geographically adjacent non-member countries.

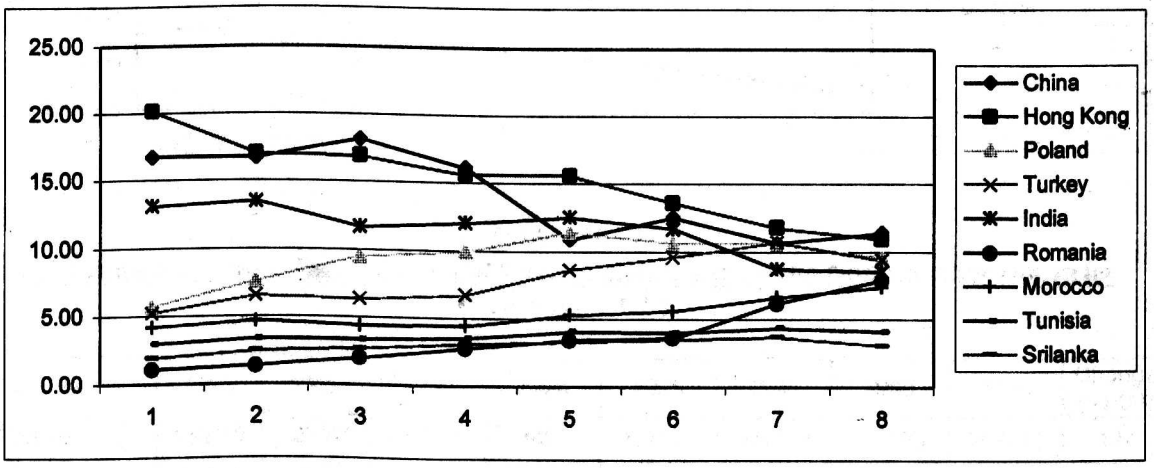
Table 6206.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
China	16.70	16.73	18.12	16.11	10.91	12.49	10.66	11.36	-5.34
Hong Kong	20.11	16.98	16.87	15.59	15.59	13.58	11.73	10.95	-9.16
Poland	5.75	7.64	9.51	9.96	11.39	10.67	10.66	9.56	3.81
Turkey	5.27	6.55	6.32	6.72	8.68	9.62	10.70	9.39	4.11
India	13.05	13.50	11.65	12.02	12.48	11.68	8.73	8.53	-4.52
Romania	1.08	1.36	1.98	2.81	3.47	3.61	6.19	7.89	6.81
Morocco	4.23	4.70	4.41	4.45	5.30	5.61	6.63	7.37	3.13
Tunisia	2.98	3.34	3.38	3.57	4.08	4.02	4.36	4.12	1.13
Srilanka	1.95	2.45	2.71	3.11	3.31	3.48	3.71	3.10	1.15
Bulgaria	0.96	1.25	1.28	1.24	1.35	1.35	2.31	2.47	1.51

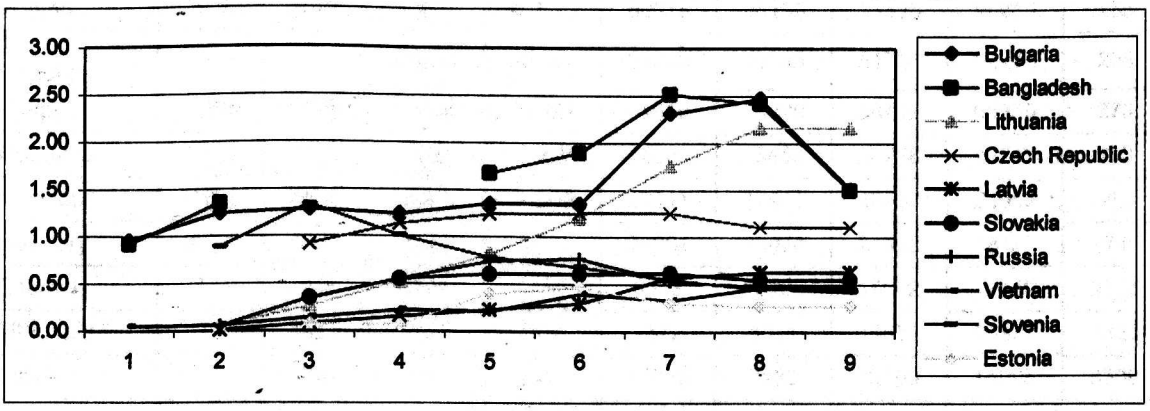
Graph 6206.2

Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6206.3

Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.18 ANALYSIS FOR TRADE IN LINEN - BED, TABLE, TOILET AND KITCHEN CLOTHING- 6302

Table 6302.1

EU's Trade in Linen - Bed, table, toilet and kitchen clothing (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	1000949	972413	752102	778197	907887	1000908	1001390	-	-	0.04
Extra-EU Import	982534	986008	1112112	1177916	1289252	1368031	-	1689130	1804425	83.65
Total Consumption	1983483	1958421	1864214	1956113	2197139	2368939	-	-	-	19.43
Extra-EU Export	342007	342935	361499	432419	413863	459749	-	545691	544232	59.13
Extra-EU Trade	1324541	1328943	1473611	1610335	1703115	1827780	-	2234821	2348657	77.32
Balance	-640527	-643073	-750613	-745497	-875389	-908282	-	-1143439	-1260193	96.74

Graph 6302.1

EU's Trade in Linen - Bed, table, toilet and kitchen clothing (in million ECU)

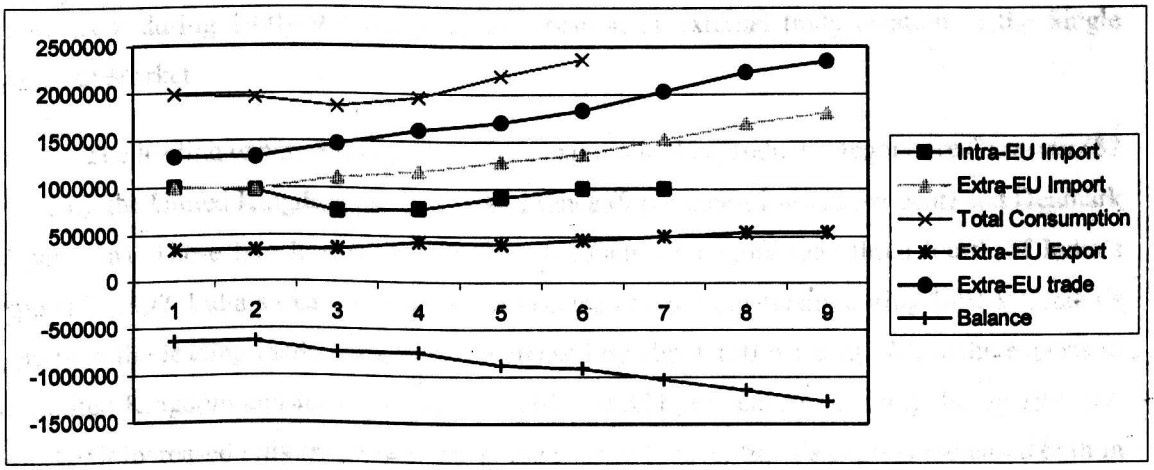


Table 6302.2

EU's Imports of Bed, Table, toilet and kitchen clothing from the Non-member countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (91/99)
Turkey	133539	139083	128989	136812	177926	217402	363399	397452	197
India	81748	92817	120874	151353	186255	210146	225624	228904	180
China	162736	147096	164168	166918	144487	135392	157700	179235	10
Poland	23403	22042	30440	41635	60618	68130	93530	90257	285
Czech Republic	-	-	20971	28824	36788	40246	61756	64730	208
Egypt	16979	16161	21426	32321	44610	49829	56747	63359	273
Romania	6546	4918	3544	9401	14623	15453	30758	29717	353
Indonesia	24810	26771	41829	26360	20111	17941	18103	21952	-11
Hungary	10400	8517	7747	6350	24864	26974	21940	18157	74
Estonia	-	176	2386	4169	9583	10496	18982	17412	9793
Lithuania	-	1010	1397	2636	7872	8841	11831	15377	1422
Latvia	-	396	1896	5933	10835	9486	12499	14295	3509
Extra-EU	982534	986008	1112112	1177916	1289252	1368031	1689130	1804425	83.65

The EU's trade in bed, table, toilet and kitchen clothes grew less significantly than other products. The intra-EU imports grew negligibly during 1991-97. It witnessed an increase of only 0.04 per cent. The level of consumption increased only by 19 per cent during 1991-96. This increase was made possible by an increase in extra-EU imports, which increased by 83 per cent during 1991-99. The extra-EU exports grew less markedly by 59 per cent during 1991-99. As a result of an increase in extra-EU imports associated with a limited growth on extra-EU exports the trade deficit increased by 96 per cent during this period.

The internal trade creation effect in the Single European Market was negligible due to the negligible growth of intra-EU imports. However there has been an overwhelming external trade creation effect in the Single European Market for trade in bed, table, toilet and kitchen clothes. This has been confirmed by the continual increase in the external imports from non-member countries. The EU's external imports, in real value terms, in this product increased by 83 per cent during 1991-99 confirming the creation of external trade creation in the Single European Market.

The leading export markets for India's exports in this product category are Germany (32 per cent), the United Kingdom (20 per cent), France (9 per cent), Italy (8 per cent) and Denmark (7 per cent). These five leading destinations accounted for more than three fourth of India's exports in 1997. India's exports to these markets increased dramatically during 1991-97. India's exports to the leading market, Germany, increased by about 150 per cent. While the exports to the United Kingdom and Italy increased by 266 and 354 per cent respectively during 1991-97. however it increased only by 67 per cent in the case of France. India's exports increased both in value and in percentage terms. This resulted in an overall increase in India's exports to the EU.

The EU's external trade in bed, table, toilet and kitchen clothes expanded rapidly during the period 1991-99 with the external imports continued to increase at higher rate than the external exports. As a result the EU witnessed their trade balance with the non-member countries increasing by more than 96 per cent during this period. There has been an overwhelming external trade creation effect in the Single European Market for trade in bed, table, toilet and kitchen clothes. This has been confirmed by the continual increase in the external imports from non-member countries. The EU's external imports, in real value terms, in this product increased by 83 per cent during 1991-99 confirming the creation of external trade creation in the Single European Market. This has benefited the non-member countries considerably in increasing their exports share in the EU's external imports. Some non-member countries such as Turkey, India, Poland and Czech Republic benefited largely because of this external trade creation effect. While Turkey's exports to the EU in this product, in real value terms, increased by about 200 per cent, India increased its exports to the EU by 180 per cent. Other countries, such as Poland and Czech Republic have also increased their exports by 285 and 208 per cent respectively during this period. However a look at the Change in trade pattern

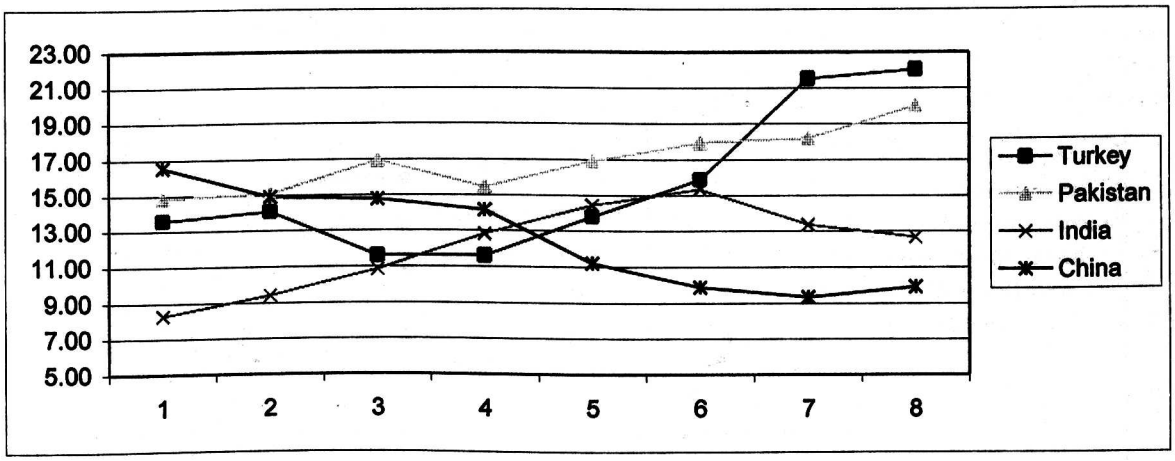
of the non-member countries in the EU's external imports give a different picture. Though Turkey and India increased their share in the EU's external imports in this product during 1991-99, Turkey increased its share from around 14 per cent to 22 per cent, an increase of more than 8 percentage point. However in the case of India, this increase is only 4.3 percentage point from 8.32 per cent in 1991 to 12.69 per cent in 1999. The Indian exports have not increased at the same pace as their main competitor, Turkey during this period.

The slow growth rate of Indian exports in this product category could have been made possible by an increase in the trade share of other geographically adjacent non-member countries such as Poland and Czech Republic. However this argument does not confirm the strong presence of trade diversion effect for Indian exports (unlike the case for Chinese exports, which witnessed strong decline in their exports share in extra-EU imports) in this product category. This is mainly because other geographically adjacent non-member exporting countries such as Romania and Hungary have not shown any impressive growth performance in the exports of this product category.

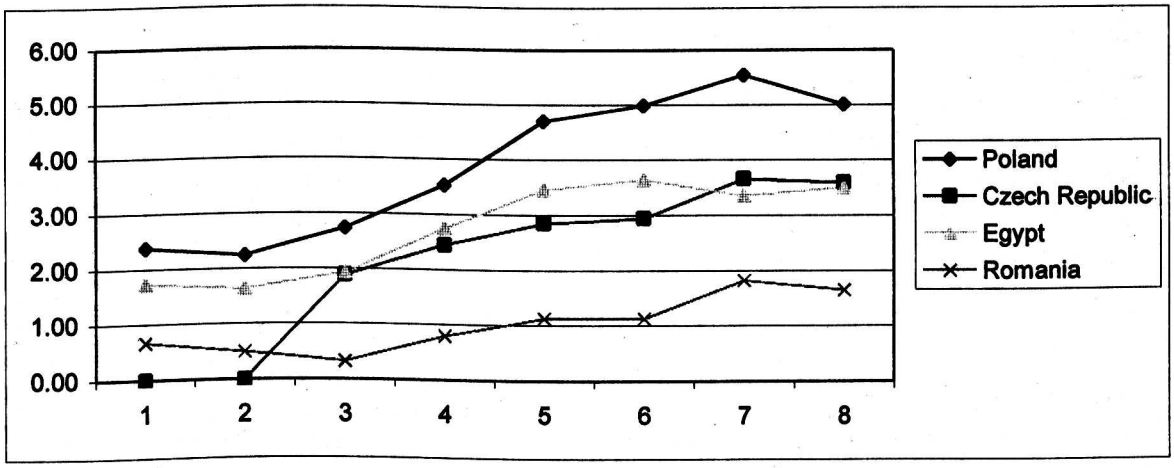
Table 6302.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	13.59	14.11	11.60	11.61	13.80	15.89	21.51	22.03	8.44
India	8.32	9.41	10.87	12.85	14.45	15.36	13.36	12.69	4.37
China	16.56	14.92	14.76	14.17	11.21	9.90	9.34	9.93	-6.63
Poland	2.38	2.24	2.74	3.53	4.70	4.98	5.54	5.00	2.62
Czech Republic	-	-	1.89	2.45	2.85	2.94	3.66	3.59	1.70
Egypt	1.73	1.64	1.93	2.74	3.46	3.64	3.36	3.51	1.78
Romania	0.67	0.50	0.32	0.80	1.13	1.13	1.82	1.65	0.98
Indonesia	2.53	2.72	3.76	2.24	1.56	1.31	1.07	1.22	-1.31
Hungary	1.06	0.86	0.70	0.54	1.93	1.97	1.30	1.01	-0.05
Estonia	-	0.02	0.21	0.35	0.74	0.77	1.12	0.96	0.95
Lithuania	-	0.10	0.13	0.22	0.61	0.65	0.70	0.85	0.75
Latvia	-	0.04	0.17	0.50	0.84	0.69	0.74	0.79	0.75

Graph 6302.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6302.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.2.19 FURNISHING ARTICLES (excluding 9404) - 6304

Table 6304.1
EU's Trade in Furnishing Articles (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	86850	86519	117735	125521	148397	146732	148788	-	-	71.32
Extra-EU Import	106095	122933	133856	140859	158650	163510	-	237365	264920	149.70
Total Consumption	192945	209452	251591	266380	307047	310242	-	-	-	60.79
Extra-EU Export	42704	43154	62639	59295	62700	72186	-	96349	84213	97.20
Extra-EU Trade	148799	166087	196495	200154	221350	235696	-	333714	349133	134.63
Balance	-63391	-79779	-71217	-81564	-95950	-91324	-	-141016	-180707	185.07

Graph 6304.1

EU's Trade in Furnishing Articles (in million ECU)

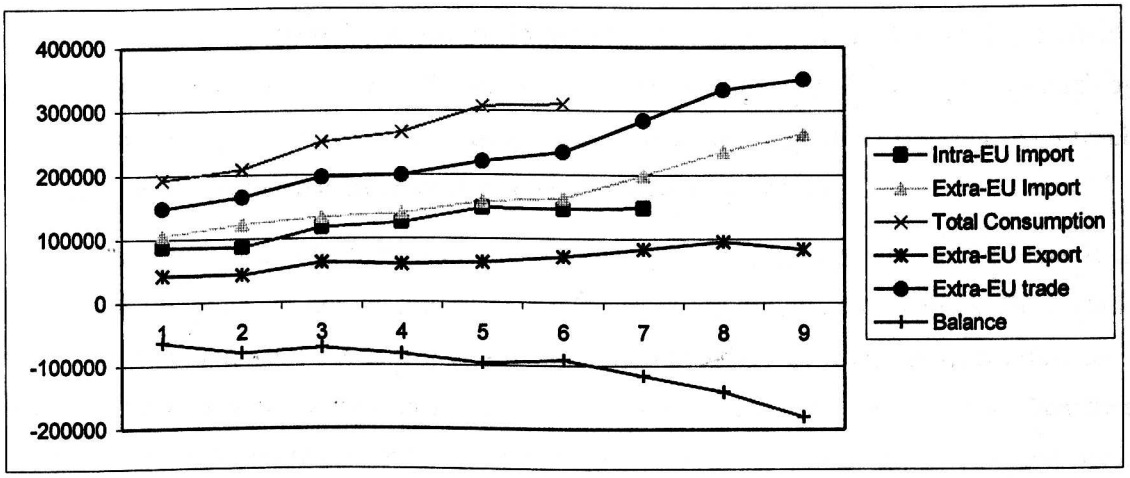


Table 6304.2

EU's Imports of Furnishing Articles from the Non-member Countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
India	28099	32958	38229	47123	54061	58858	103897	113550	304
China	35743	35954	41132	42905	44541	42457	46754	47313	32
Turkey	7451	7899	5772	5579	10152	9492	18995	23632	217
Poland	4398	4102	9654	9775	11339	9971	20326	16976	285
Pakistan	6714	10058	8513	6102	6130	3888	7874	11333	68
Czech Republic	0	0	683	1520	1836	2552	4247	7921	1059
Tunisia	1651	3817	327	653	2632	9523	7036	7250	339
Slovenia	0	187	511	266	1509	1359	2146	3834	1950
Extra-EU	106095	122933	133856	140859	158650	163510	237365	264920	149

Table 6304.3

Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
India	26.48	26.81	28.56	33.45	34.08	36.00	43.77	42.86	16.38
China	33.69	29.25	30.73	30.46	28.08	25.97	19.70	17.86	-15.83
Turkey	7.02	6.43	4.31	3.96	6.40	5.81	8.00	8.92	1.90
Poland	4.15	3.34	7.21	6.94	7.15	6.10	8.56	6.41	2.26
Czech Republic			0.51	1.08	1.16	1.56	1.79	2.99	2.48
Tunisia	1.56	3.10	0.24	0.46	1.66	5.82	2.96	2.74	1.18
Slovenia		0.15	0.38	0.19	0.95	0.83	0.90	1.45	1.30

The EU's trade in furnishing articles continued to grow during 1991-99. the consumption increased during 1991-97 by 60 per cent resulting in an increase in both intra- and extra-EU imports. The intra-EU imports increased at higher speed than the extra-EU imports. While the intra-EU imports increased by 68 per cent during the period 1991-97, the extra-EU regional imports increased only by 54 per cent. For the year, the extra-EU imports increased by 149 per cent as against the extra-EU exports, which increased only by 97 per cent. As a result the trade deficit continued to increase (by 185 per cent) during 1991-99.

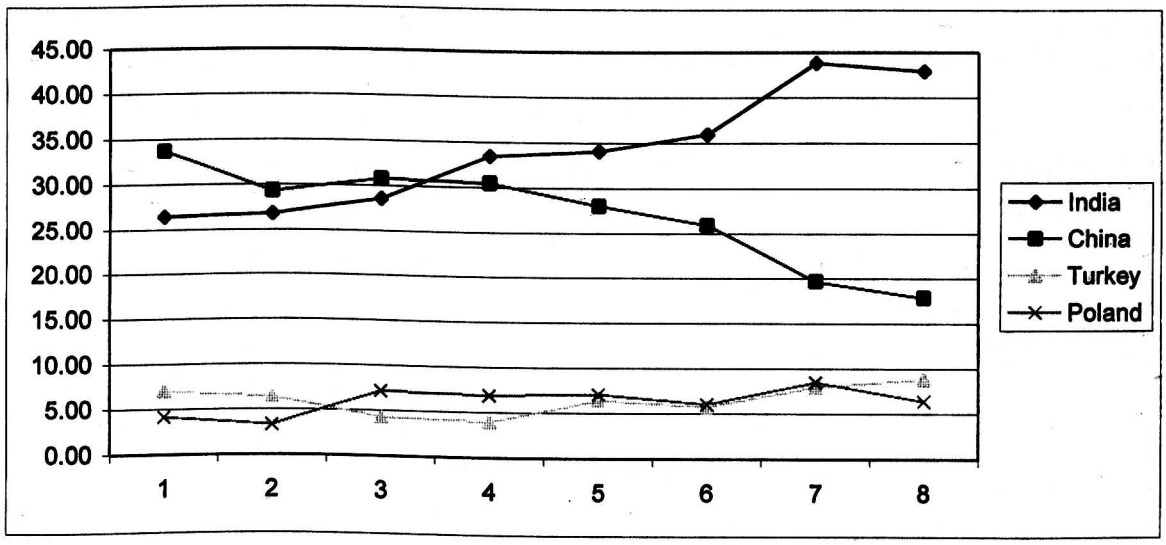
However there is no trade suppression effect for trade in this product as the increase in the intra-EU imports has not decreased the flow of extra-EU imports into the EU. The trade in this product during 1991-99 confirms the large-scale presence of trade creation effect as it resulted in an increase in both intra- and extra-EU trade. Many member countries benefited from the EU's internal trade creation effect. Countries such as Germany, Portugal and Spain witnessed their trade share in intra-EU imports increasing considerably. These countries increase their share by 96 per cent, 15 per cent and 17 per cent respectively. Since the intra-EU imports increased by more than 70 per cent, many countries benefited largely from this increase. Countries such as Portugal (26 per cent), Germany (25 per cent), Spain (10 per cent), Italy (9 per cent) and the United Kingdom (8 per cent) benefited from the increase in intra-EU imports.

The leading export markets for India's exports in this product category are the United Kingdom (29 per cent), Germany (21 per cent), France (11 per cent) and the Netherlands (9 per cent). The Indian exports in this product category had witnessed a big leap in their export to these countries. The exports to the largest market, the United Kingdom increased by more than 900 per cent during 1991-97. The exports increased by more than 340 per cent to France and Belgium/Luxembourg. However the exports to the second largest market, Germany, increased by only 40 per cent. Though exports to Germany were not diverted by Germany's imports from geographically adjacent non-member countries, it certainly prevented the increase in the growth of exports.

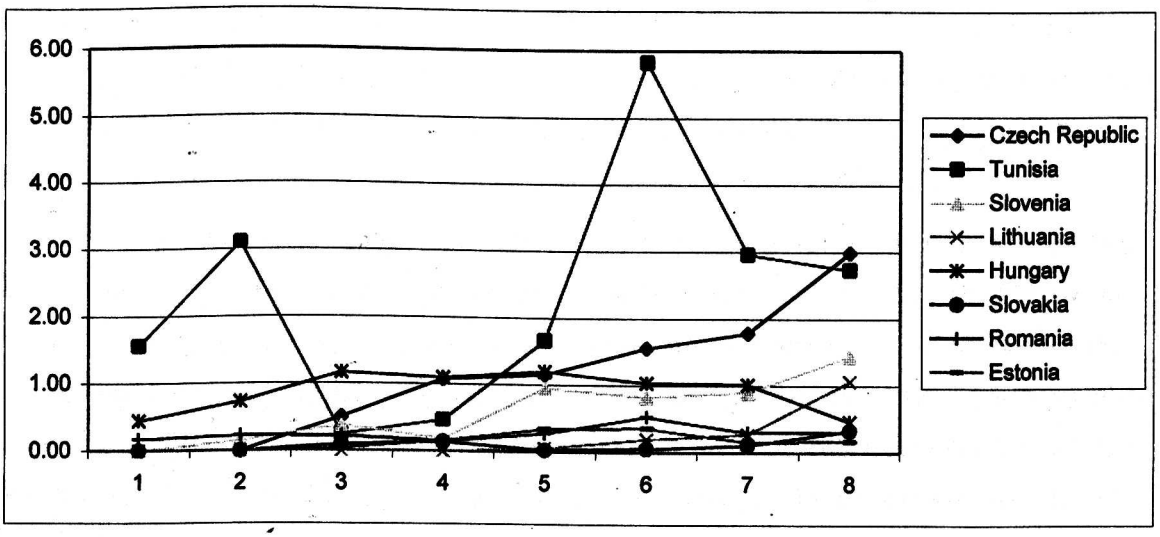
The main beneficiaries of the EU's external trade creation effect are the leading exporters of this product to the Single European Market. However the associated member countries have also increased their trade share in extra-EU imports considerably. The huge external trade creation effect created in the Single European Market has largely benefited Indian exporters. Indian exports have continued to increase since 1991 both in value and percentage terms. Indian exporters have increased their trade share from 26 per cent in 1991 to more than 42 per cent in 1999, an increase of more than 16 percentage point. The increase in India's market share has come at the expense of exports from China, whose exports suffered considerably. The Chinese exports declined by more than 15 percentage point during this period. Though many of the associated member countries have increased their trade share in extra-EU imports, they are marginal compared to India's exports growth rate. The leading

associated member countries have increased their combined trade share from 13 per cent in 1991 to more than 24 per cent in 1999, an increase of more than 10 percentage point. However the increase in their exports has not diverted Indian exports to the EU. Between 1991 and 1999, no trade diversion effect has been witnessed on India's exports of furnishing articles. The continual increase in the non-member countries' exports to the Single European Market is unlikely to divert India's exports to the Single European Market resulting in trade diversion effect. This is mainly because the Indian exporters have already established their dominance in this product category. However the continual increase in the non-member countries' exports to the EU is unlikely to challenge India's dominance in this product category as the Indian exporters have already established a strong hold in this product category.

Graph 6304.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6304.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

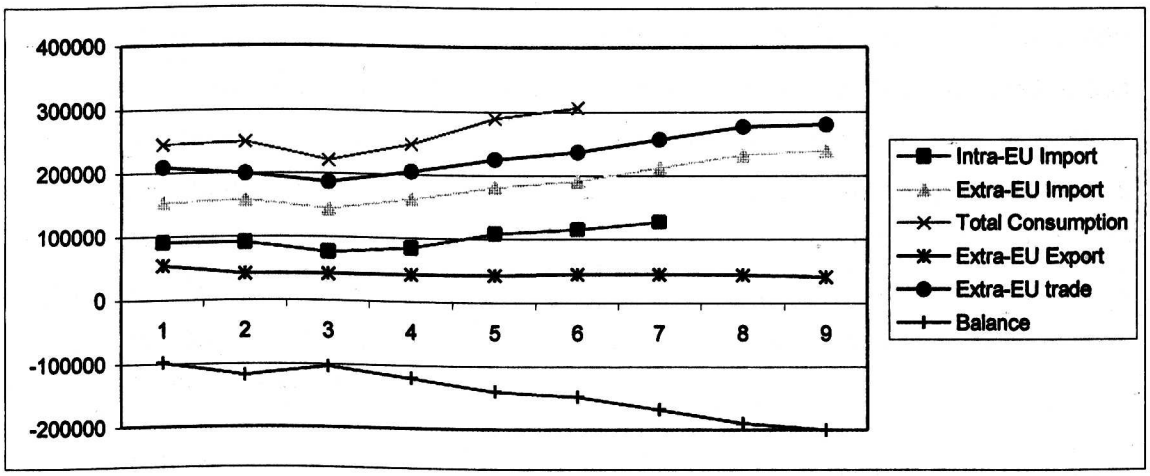


6.2.20 ANALYSIS FOR TRADE IN PACKING SACKS AND BAGS - 6305

Table 6305.1
EU's Trade in Packing Sacks and Bags (in million ECU)

Category	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change (%)
Intra-EU Import	91437	90907	75678	85481	107712	114650	127088	-	-	38.99
Extra-EU Import	153919	158671	145181	162354	182464	192481	-	232837	239464	55.58
Total Consumption	245356	249578	220859	247835	290176	307131	-	-	-	25.18
Extra-EU Export	55498	41687	41917	42854	42964	44878	-	44141	40522	-26.98
Extra-EU Trade	209417	200358	187098	205208	225428	237359	-	276978	279986	33.70
Balance	-98421	-116984	-103264	-119500	-139500	-147603	-	-188696	-198942	102.13

Graph 6305.1
EU's Trade in Packing Sacks and Bags (in million ECU)



The EU's consumption of packing sacks and bags continued to grow during the period 1991-99. The EU's imports, both intra- and extra-EU imports, of this product increased confirming the increase in the EU's overall consumption. The overall consumption of this product increased during this period by more than 25 per cent. There has been a trade creation effect, both internal and external, in the Single European Market for trade in this product. The intra-regional imports in this product increased by 38 per cent, while the extra-regional imports increased by more than 55 per cent confirming the presence of trade creation effect.

Though both the member and non-member countries have benefited from the EU's trade creation effect, it is largely the non-member countries that benefited most. The EU's extra-regional imports grew faster than both intra-regional imports and extra-EU exports of this product resulting in continued trade imbalance against the member countries. This is mainly because of the fall in extra-EU exports in this product, which has fallen by more than 25 per cent during 1991-99 resulting in unfavourable trade balance against the non-member countries. The EU's adverse trade balance increased by more than 100 per cent during this period.

Four member countries, Belgium/Luxembourg, the United Kingdom, Spain and Sweden, have benefited from the EU's internal trade creation effect. Two main beneficiaries of this effect are Spain and the United Kingdom, who increased their share both in value and percentage terms. While Spain increased their share in intra-regional imports by more than 85 per cent (from 5.43 per cent to 10.15 per cent), the United Kingdom increased their trade share marginally by 14 per cent (from 12.56 per cent to 14.40 per cent). However all other countries have witnessed their share declining in intra-EU imports confirming the presence of trade diversion effect. The main beneficiaries of the 38 per cent of increase in intra-EU trade are Spain (22 per cent), the United Kingdom (19 per cent), Germany (13 per cent) and Belgium/Luxembourg (13 per cent).

The leading export markets for India's exports in this product category are the United Kingdom (35 per cent), Germany (13 per cent), Italy (12 per cent), Belgium/Luxembourg (11 per cent), Spain (8 per cent) and France (7 per cent). These five leading markets accounted for more than 86 per cent of India's exports in 1997. India's exports to the leading markets, except for Belgium/Luxembourg, increased in value terms. While the exports to Italy increased by 835 per cent, it increased by 260 per cent to the United Kingdom. The exports to Spain and France increased by more than 50 per cent during this period. This is against the background in which the exports to Germany increased only marginally. However the exports to Belgium/Luxembourg witnessed a fall of 24 per cent during 1991-97. The huge increase in exports to the largest market resulted in a situation whereby India could increase its market share considerably during 1991-97.

Not all the non-member countries benefited from the EU's external trade creation in packing sacks and bags. While some countries benefited, others witnessed their market share replaced by imports from other non-member countries. Many of the non-member countries found their exports to the Single European Market expanding many times higher than the increase in EU's external imports. Countries like Turkey (446 per cent), India (146 per cent), Czech Republic (289 per cent), Poland (241 Per cent), Estonia and Romania realised their exports to the EU increasing in real value terms. However the Change of the non-member countries' exports share in the EU's total imports is very notable, in which it clearly shows the difference in Change of imports from the distant and associated non-member countries. Though Indian exports of packing sacks and bags to the EU increased in both the real value and percentage terms, it is less notable in the latter. Though Indian exports benefited from the EU's external trade creation effect in this product, it is less obvious in percentage terms. While the Indian exports to the EU, as a share of EU's total external imports, increased by 4.17 percentage point, it increased at higher rate for countries such as Turkey (28.41 percentage point), Czech Republic (5.42 percentage point). Since Indian exports in this product continue to increase in both real value and percentage point terms, it is difficult to arrive at a conclusion about any

possible trade diversion effect. However the fall, in percentage points, during 1993-94, 1994-95 and 1996-98 cannot be entirely accounted for by the EU's trade diversion effect as the Changes in domestic market in India would have adversely affected Indian exporters of this product. Since the Indian exporters does not account for a dominant share in the EU's market in this product, it is highly unlikely that they would continue to gain from the EU's external trade creation effect. This is mainly because of the growing imports of these products into the EU market from the associated member countries. The imports from these countries into the EU of this product are remarkable.

Table 6305.2
EU's Imports of Packing Sacks and Bags from the Non-member Countries (in million ECU)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	Change (99/91)
Turkey	17414	19914	21276	33924	47052	55002	90895	95116	446
India	11084	19684	21651	19314	19798	26589	25371	27221	146
Czech Republic			5791	8303	12229	12232	18858	22542	289
China	51043	41689	25198	25420	26202	23006	20888	16335	-68
Poland	4666	6311	6337	6777	9658	10426	11440	15905	241
Bangladesh	18556	10869			10525	15136	11727	11553	-38
Indonesia	5244	14404	15806	17462	18750	10834	7196	6476	23
Thailand	10277	8312	7701	8822	10909	10577	5630	5569	-46
Vietnam	101	93	-	1	518	1713	5347	4678	4532
Philippines	1496	1371	1321	1565	3047	4685	4091	4161	178
Hungary	5374	5477	4034	4163	4175	3916	4707	3604	-33
Estonia			23	153	334	1614	2762	3309	14287
Romania	103	249	227	866	1308	1030	2826	3213	3019
Extra-EU	153919	158671	145181	162354	182464	192481	232837	239464	56

Table 6305.3
Share of Non-member Countries in Extra-EU Imports (in per cent)

Countries	1991	1992	1993	1994	1995	1996	1998	1999	% Change
Turkey	11.31	12.55	14.65	20.90	25.79	28.58	39.04	39.72	28.41
India	7.20	12.41	14.91	11.90	10.85	13.81	10.90	11.37	4.17
Czech Republic			3.99	5.11	6.70	6.35	8.10	9.41	5.42
Poland	3.03	3.98	4.36	4.17	5.29	5.42	4.91	6.64	3.61
Vietnam	0.07	0.06			0.28	0.89	2.30	1.95	1.89
Philippines	0.97	0.86	0.91	0.96	1.67	2.43	1.76	1.74	0.77
Estonia			0.02	0.09	0.18	0.84	1.19	1.38	1.37
Romania	0.07	0.16	0.16	0.53	0.72	0.54	1.21	1.34	1.27

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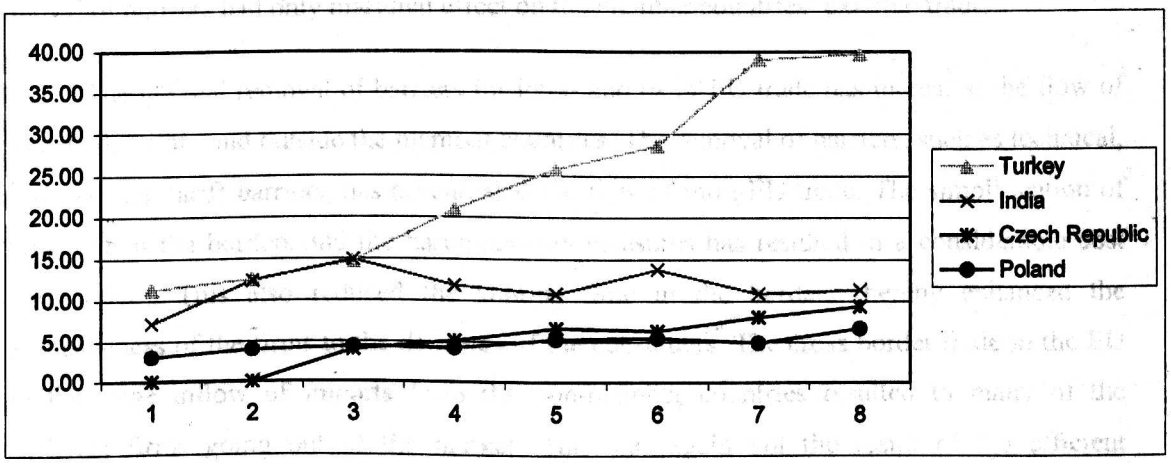
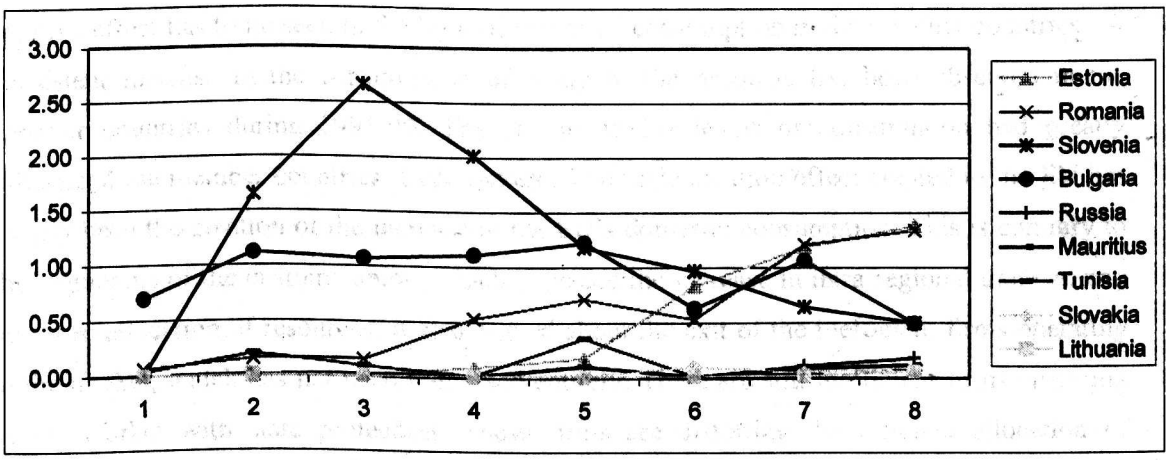
Graph 6305.2
Share of Non-member Countries in Extra-EU Imports (in per cent)



Graph 6305.3
Share of Non-member Countries in Extra-EU Imports (in per cent)



6.3. SUMMARY OF THE EFFECTS OF THE SINGLE EUROPEAN MARKET ON INDIA'S EXPORTS:

The Single European Market is the most important market for Indian textile and clothing exports as it offers opportunities in a number of product lines mainly due to differentiated domestic market conditions prevailing across the member countries. The trade in textile and clothing in the EU witnessed an intense competition during 1991-99. However the competition is not a new phenomenon to be witnessed in this industry after the completion of the Single European Market. The competition is a resultant of the creation of the Common

Market. This industry is exposed to increased external competition since the 1970's. Since these industries were exposed to early competition, they had already witnessed a process of restructuring in the member countries. With this industry already being internationalised, the removal of barriers had only marginal effect on the member countries' external trade.

The gradual removal of barriers for intra- and extra-EU trade has increased the flow of goods both within and outside the member countries. The removal of barriers, such as technical, fiscal and non-tariff barriers, has accentuated the flow of intra-EU trade. The simplification of formalities at the borders and the harmonisation measures has resulted in a considerable cost saving effect. This also reduced the waiting time in the borders thereby enhanced the responsiveness of the firms to the demands of the consumers. The cross border trade in the EU and the huge inflow of imports from the non-member countries resulted in many of the inefficient firms going out of the market. This was again not the result of the efficient reallocation of resources. It was merely the effect of the cost competitiveness of the external imports. Though the completion of the Single European Market in textile and clothing trade resulted in the cost-reduction effect, this was not sufficient enough to outweigh the cheap imports coming from the non-member countries. The effects of the economies of the scale are also limited for reasons of the size of the European textile and clothing firms. As a result, any positive effect has to be seen in the light of increased consumption in the member countries. A consistent increase in the consumption of many of the products has been observed in the member countries during 1991-99. The change in the levels of consumption had greatly influenced the member countries' trade pattern. The trade creation effect created in the EU has largely been the creation of the increase in the EU's domestic consumption. This is contrary to the arguments of the customs union, which expected the increase in intra-regional trade arising out of re-allocation of resources. It also argued about the exit of the inefficient firms operating in the market, which has not been witnessed entirely. There are still inefficient firms operating in the market with state protection. These firms are distorting the efficient allocation of resources and thereby prevent the realisation of economies of scale.

The changes in the levels of domestic consumption have largely decided the direction of the EU's textile and clothing trade during 1991-99. A relationship has been witnessed between the changes in the levels of domestic consumption and the internal trade creation effect for the member countries. Whenever there is an increase in the domestic consumption, there has also been an increase in the trade creation effect. Similarly the fall in the consumption has adversely affected the levels of intra-EU trade. This is applicable to all the products chosen for this research, except women's and girl's blouses, shirts, shirts and shirt-blouses, in which the increase in the domestic consumption resulted in trade diversion for intra-EU trade.

Table 6.5 Impact of the Single European Market on India's exports of Textile and Clothing to the EU

Products	Change in consumption (in per cent)	Change in Intra-EU Imports		Change in Extra-EU				Trade Contraction	Trade Creation for Indian Exports		Trade Diversion for Indian Exports	
		Internal Trade		Trade	Imports	Exports	Balance		%	value	%	value
		Creation	Diversion									
5007	-33.26	-	-	-47.59	-53.29	-42.8	12.27	✓	26.22	17	-	-
5107	33.18	32.18	-	75.93	76.52	75.54	73.42	-	12.75	1098	-	-
5112	0.54	1.58	-	25.12	-13.37	29.99	36.28	-	3.77	173	-	-
5205	11.94	11.94	-	-1.28	-7.1	35.22	-15.11	-	5.73	43	-	-
5208	-3.5	-	-2.91	-0.85	-18.19	20.17	-198.42	-	4.01	12	-	-
5209	29.89	35.74	-	60.52	-2.15	118.52	1617.4	-	4.44	50	-	-
5509	2.88	3.37	-	19.66	35.87	0.73	245.12	-	12.23	251	-	-
5510	-0.01	52.81	-	-17.95	-46.74	119.96	-90.71	-	14.82	51	-	-
5513	-9.25	-	26.39	-8.22	-16.91	14.93	-36.03	-	1.31	-	-	1
5514	31.82	18.14	-	105.92	134.88	89.65	31.66	-	-	128	0.68	-
6104	19.13	28.97	-	27.41	40.28	-3.43	71.55	-	-	29	0.25	-
6108	34.99	27.5	-	69.04	80.7	33.5	103.75	-	6.58	579	-	-
6109	55.4	46.4	-	123.44	144.02	46.95	179.77	-		138	0.12	-
6110	22	8.85	-	83.68	121.95	4.52	231.82	-	0.77	215	-	-
6204	23.41	3.55	-	54.55	90.24	-1.97	248.25	-	-	61	0.79	-
6205	16.87	21.56	-	13.2	13.32	12.35	13.48	-	-	8	0.35	-
6206	14.37	-	6.07	17.82	25.58	-21.76	47.37	-	-	-	4.52	15
6302	19.43	0.04	-	77.32	83.65	59.13	96.74	-	4.37	180	-	-
6304	60.79	71.32	-	134.63	149.7	97.2	185.07	-	16.38	304	-	-
6305	25.18	38.99	-	33.7	55.58	-26.98	102.13	-	4.17	146	-	-

Table 6.6 The leading market for India's Textile and Clothing exports in 1997 (in per cent)

Products	France	Bel/Lux	Neth	Germany	Italy	UK	Ire	Den	Greece	Port	Spain	Sweden	Fin	Austria
5007	15.38	1.74	4.96	17.95	11.43	36.31	0.16	1.13	1.00	3.50	3.65	1.54	0.42	0.83
5107	0.19	1.14	0.00	1.16	19.18	75.56	0.00	0.00	1.45	1.24	0.10	0.00	0.00	0.00
5112	16.32	1.83	1.86	7.75	2.19	47.10	0.00	10.04	0.00	12.23	0.27	0.24	0.18	0.00
5205	1.41	17.52	2.33	8.76	39.75	14.21	0.48	0.35	2.21	5.32	5.24	1.06	0.32	1.04
5208	8.57	19.66	3.03	13.15	10.82	26.99	0.07	2.15	1.39	1.95	5.33	2.60	0.39	3.90
5209	3.06	4.87	3.23	13.30	3.76	66.72	0.00	0.45	0.42	0.33	0.99	2.27	0.54	0.04
5509	2.16	19.41	0.73	6.76	17.24	14.60	0.00	0.19	4.67	10.36	22.63	1.20	0.00	0.05
5510	0.01	34.16	0.00	3.81	40.23	2.11	0.00	0.00	3.55	2.11	13.87	0.15	0.00	0.00
5514	0.47	3.04	5.94	0.61	44.13	41.49	0.00	0.00	0.09	0.00	4.23	0.00	0.00	0.00
6104	18.95	5.40	10.42	18.75	7.66	20.67	0.68	3.76	0.09	0.10	2.28	6.13	2.82	2.26
6108	23.91	13.97	13.34	10.32	15.34	13.94	1.22	1.32	0.20	0.11	1.89	1.74	1.39	1.32
6109	17.20	4.11	10.58	29.03	5.45	16.06	1.50	2.99	0.03	0.08	3.15	5.41	1.43	2.99
6110	24.97	3.60	10.75	27.88	3.30	18.04	0.61	2.42	0.02	0.08	2.61	1.94	1.55	2.23
6204	21.30	3.36	5.01	15.39	7.17	30.87	0.25	4.09	0.40	0.23	5.72	3.65	1.26	1.29
6205	12.24	2.20	10.89	35.26	4.85	21.15	1.55	2.45	0.43	0.08	1.61	3.68	1.48	2.13
6206	13.60	2.56	8.69	33.36	4.18	23.94	1.12	1.89	0.28	0.11	2.69	4.83	0.91	1.86
6302	9.27	5.03	5.85	31.80	7.72	19.79	0.92	7.44	0.57	0.26	1.19	7.04	1.74	1.39
6304	11.18	8.06	9.16	20.61	4.27	28.94	0.58	2.48	1.50	0.97	3.67	6.46	1.30	0.84
6305	7.10	10.68	4.47	13.28	12.19	34.91	2.31	1.71	3.38	0.61	8.31	0.83	0.08	0.11

The creation of the Single European Market had large-scale positive effects on India's exports of textile and clothing during 1991-99. As shown in Table 6.5 both textile and clothing exports benefited from the external trade creation effect created in the Single European Market during 1991-99. However it was the textile exports, which gained a strong place in the Single European Market both in value and percentage terms. Every single textile product taken for this research had witnessed a positive growth in their exports to the EU. They increased both in value and in percentage terms. Though Indian textile exports gained enormously by the EU's trade creation effect, its growth was independent of the EU's consumption growth. Even in cases where the EU's consumption had fallen (as in woven fabrics of silk, Cotton yarn, woven fabrics of cotton, artificial staple fibres and synthetic staple fibres), India's exports continued to grow. Hence it could be concluded that India's export growth in textile products does not depend on the growth in the EU's consumption. Irrespective of the levels of the EU's consumption growth, India's exports witnessed a continual growth. However in the case of synthetic staple fibres, the exports increased only in value but not in percentage terms. India's exports of clothing products witnessed a slow growth compared to the textile exports. This is mainly because of the nature of competition prevailing in this industry. It is also in this industry the peripheral countries continued to gain at the cost of the leading non-member countries. These peripheral countries belong to the geographically adjacent non-member countries. They are Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The textile and clothing industries are an important component of the manufacturing employment in these countries. These countries together have employed more than 1.3 million people in these industries. In many of these countries, the textile and clothing exports are one of the three leading sectors. The EU's has removed all tariff and quantitative restrictions on the exports coming from these countries, thereby allowing their imports duty and quota free in the EU. Hence the imports from these countries are given the advantage of entering into the EU's market duty free as against the imports from India, which face both tariff and quota restrictions. Though these countries, as individual countries, do not pose any direct threat to India's export to the EU, they, as a group of countries, challenge India's exports to the EU. In many of the clothing exports, there are strong reasons to believe that they have diverted India's exports to the EU. Many of India's clothing exports have witnessed a fall in their export share during 1991-97. This is accompanied by the increase in the imports from these countries. The leading textile and clothing competitors for India's exports of textile and clothing are Poland, Hungary, Romania and Czech Republic. More than 63 per cent of EU's knitted products and knitwear are originating from Poland, Hungary, Romania and Czech Republic. More than two thirds of EU's imports of clothing other than knitwear are originating from Poland, Romania and Hungary. The Mediterranean countries such as Tunisia and Morocco are also leading textile and clothing exporting countries to the EU. The trade diversion effects are likely to widen in the coming years as these countries create a free trade zone with the EU within

twelve years (by 2007). Morocco and Tunisia have already signed up for associated member status. Morocco is separated from the EU by a distance of less than 15 kilometres. The shortened distance also means reduced shipping costs. It also acts as a platform for those wishing to penetrate the European market (American businessman are partnering with Moroccan companies to export their production into the Europe). Its textile companies are quick to react to intense competition, notably from Asia. And the products from Tunisia enjoy free access to the EU apart from the quota preference on its trousers and T-shirts.

India's exports to the EU are unidirectional because much of the exports are directed towards the developed countries (Table 6.5). The leading export markets for India's exports in textile and clothing are the developed member countries. The United Kingdom is the single largest market for India's textile exports and Germany accounted for a considerable share of Indian clothing exports. The United Kingdom, Italy, Germany, Belgium/Luxembourg, France and the Netherlands account for a sizeable proportion of India's textile and clothing exports to the EU. These markets, except in the case of yarn of synthetic staple fibres, account for more than 80 per cent of India's exports to the EU. However in the case of yarn of synthetic staple fibres, these markets accounted for only 61 per cent as against the less-developed member countries' share of 88 per cent. Since Indian exports are uni-directional they are highly influenced by the changes in these markets and hence become highly susceptible to the changes in domestic market condition in these countries.

The United Kingdom continued to play a host for many Indian products followed by Italy and Germany. India's exports to the United Kingdom consist of wool yarn, cotton fabric, synthetic staple fibres, women's and girl's suits and packing sacks and bags. India's exports to Italy mainly consist of cotton yarn and synthetic stable fibres (yarn and woven). The clothing products dominate India's exports to Germany. This is mainly due to their strong textile industry. Indian exports largely consist of men's and boys' shirts, women's and girls' blouses, linen, T-shirts, singlets and other vests, jerseys, pullovers, cardigans, furnishing articles and women's and girls' suits. India's clothing exports to Germany, of late, have been affected by the non-tariff barriers. The main non-tariff barriers for Indian clothing exports to Germany are the ban on azo-dyes, the requirement of eco-labels and the so-called regulations on the usage of child labour. India exports largely textile products to Belgium/Luxembourg. The leading exports are yarn of synthetic staple fibres, woven fabrics of cotton, cotton yarn, women's and girls' slips and packing sacks and bags. India's export to France consisted of both textile and clothing products. The main exports are jerseys, pullovers, cardigans, women's and girls' slips, women's and girls suits, women's and girls' suits, woven fabrics of combed wool, woven fabrics of silk and furnishing articles. India's exports to the Netherlands consisted of knitted textile and clothing products. The main exports are women's and girls' slips, T-shirts, singlets and other vests, jerseys, pullovers, cardigans, women's and girls' suits and men's or boys' shirts

The less-developed member countries accounted for less of India's exports to the EU. In many product categories, they accounted for less than 10 per cent. However the trade in yarn of synthetic staple fibres witnessed the less-developed member countries being the leading export markets for India's exports. In this product category, they accounted for 38 per cent of India's exports to the EU. There are also other product categories, such as woven fabrics of combed wool, cotton yarn, yarn of artificial staple fibres, packing sacks and bags, in which less-developed member countries' markets accounted for between 10 and 20 per cent of India's total exports to the EU.

India's trade with the EU in the selected product category is complementary rather than competitive. Though there have been structural similarities between the India and the less-developed member countries in their sectoral specialisation - with high level of concentration on labour-intensive industries such as textile and clothing industries - the nature of India's trade with these countries are still less competitive. These countries, because of increasing labour costs, have lost their traditional competitive edge over the developed member countries. The less-developed member countries' sectoral specialisation had changed over the time from their traditional labour-intensive industrial base. This is against the traditional customs union theory, where the costs were expected to play an important role in deciding the member countries' sectoral specialisation. The rising labour cost in the member countries' did not server the purpose for the less-developed member countries in preserving their competitive edge in the textile and clothing industries.

Since India's exports are concentrated on the markets of the developed member countries, much of the effects of the Single European Market are related to the changes witnessed in their exporting markets. Whatever effect realised in the EU for India's exports – trade creation and trade diversion effect – are created in the EU for India's exports of textile and clothing are created in the leading export markets. Though the developed member countries accounted for a large proportion of the trade creation effect created for India's exports, much of it has been created in the United Kingdom. This is mainly because of the nature of the United Kingdom's trade in this industry. The textile industries of the United Kingdom are neither developed like the German textile industries nor are their clothing industries similar to those in Italy. The cost factors in the United Kingdom make the production there still a viable alternative compared to the OPT chosen by other high cost member countries. The avoidance of the OPT benefits the traditional exporters such as India, which continued to remain a large-scale exporter of textile and clothing to the United Kingdom.

India's exports of textile and clothing to the EU witness an intense competition. Though Indian exports to the EU do not pose any direct competition to the developed member countries, the less-developed member countries bitterly complain about the increase in India's exports to

the EU. The less-developed member countries, particularly Portugal, believe the increase in India's exports to the EU would be at the cost of their exports to other member countries. However there is no strong evidence to suggest that the increase in India's exports to the EU would be at the cost of the less-developed member countries' exports to other member countries.

The leading clothing exports from India had witnessed a mixed effect in the EU. Though they increased their export share in the EU, their export value had reduced. India's clothing exports to the EU, unlike the textile exports, faced stringent regulations in the EU. There has also been a challenge to India's existing market share in many of the member countries. Three factors could be attributed to the falling share of Indian exports in the EU. They are (i) the stringent regulations of the EU; (ii) the low unit-value realisationation of Indian exports and (iii) the increase in the EU's OPT. India's clothing exports were highly regulated by the export quotas in the EU. However these quotas are not very flexible to the need of Indian exporters. In many product categories, Indian exporters have fully utilised their export quotas in the individual member countries. There had also been a limited increase in export quotas offered to Indian exporters in the member countries. Hence Indian exports, though increased in value terms, did not increase in percentage terms in many product categories. India's clothing trade was mainly in low-value added products. Though India was the largest exporter of clothing to the EU among the non-member countries, it is ranked only fourth in value terms. This is mainly because of the low value realisation of India's clothing exports to the EU. The importance of preserving the domestic textile employment played an important role in many of the member countries shifting their clothing production base to the geographically adjacent non-member countries.[12] The low production cost in their locations associated with the traditional knowledge base of these industries make them the leading choice for many of the member countries' OPT. Since 1998, the EU was able to import clothing, through its OPT, processed from the EU fabric. However the usage of fabrics of the third countries would result in their imports facing tariff and quantitative restrictions in the EU. Many of the imports entering into the EU are produce of either the member countries' or geographically adjacent non-member countries' (of Central and East European origin) raw materials. Hence they enjoy the duty free access on their exports, which has not been granted to the exports of the distant non-member countries. The challenges are expected to be much harder for India's exports to the EU in the coming years as many member countries', to counter high labour costs in their own markets, prefer OPT over low cost

[12] A model developed by David Rigby of David Rigby Associates calculated that, assuming half the West European garment imports currently sourced from the Far East were switched to Eastern Europe, and 50 per cent of the woven garments and 30 per cent of the knitted garments were manufactured from Western European materials under OPT rules, as many as 1.36 million jobs could be created in Greater Europe (including secondary effects). For more details, see Filling the Textiles and Clothing Vacuum in Eastern Europe, David Rigby Associates, A paper given at the International Textile Manufacturers Federation (ITMF) Conference, Prague, October 1995.

imports from the distant non-member countries. The compulsions involved in maintaining the textile industries at their own locations further increase the possibility of these countries opting for OPT. The EU's OPT facilitates safeguarding the domestic textile industry and the associated employment. In 1996, the OPT accounted for more than 20 per cent of EU's extra-EU imports in value term and it is continued to increase over the years. In this regard, the market strategies adopted by many of the European clothing firms, such as OPT, are resulting in 'trade diversion effect' on India's exports. The imports, which were imported from India, are now being imported from the geographically adjacent non-member countries, many of which have associated membership with the EU. The EU's increased OPT act as a deterrent on India's clothing exports to the EU.

A considerable amount of trade creation effect has been witnessed in the Single European Market for India's exports of textile and clothing. However much of it was created by the positive consumption effect rather than by the efficiency related effects. The consumption effect in the EU was caused by two sources. The intense competition among the member countries on one side and the competition between the member and non-member countries on the other side have given rise to the EU's consumption effect. The positive consumption effect has been witnessed in the EU for many of the Indian textile products. The Single European Market has varying effects on the textile and clothing exports. While it has more beneficial effects for trade in textile products, it has mixed effect on its clothing exports. This is mainly because of India's specialisation in textile products compared to its clothing products. India has typically been an exporter of textile products. Also the international trading in textile products is confined to limited countries with India being one of them. However the international trade in clothing products followed a different pattern with many countries specialising in clothing products. Also the member countries' labour costs in textile and clothing industries play an important role in deciding the export configuration of Indian exports. India's competitiveness with the developed member countries in textile trade is direct with the Indian exports competing with the member countries for a share in the EU. European textile industries sufficiently mechanised with high levels of automation trying to avoid the adverse high labour costs in their textile industries. But the competition between India and the member countries in clothing products is indirect in the Single European Market, in which the Indian exports compete with the products manufactured in the low cost locations processed from the raw materials sent from the European locations (OPT). In this indirect competition Indian exports are adversely affected, as rules of the games do not follow any established pattern. This is particularly true in the case of high labour cost countries such as Germany. India's clothing exports to Germany, the leading market for the clothing exports, has witnessed a sharp fall over the periods. Certain products such as women's and girls' blouses, men's or boys' shirts, women's and girls suits and women's and girls' suits, witnessed a sharp fall in their exports to Germany. However this fall has been associated with the increase in the exports of the same from the geographically adjacent non-

member countries. Germany's OPT with the geographically adjacent non-member countries has been playing an important role in diverting India's export to the EU. This has not been the case for India's exports to other leading destinations such as the United Kingdom and Italy. These two countries at present, unlike Germany, do not resort to OPT as a component to counter the high domestic labour cost in the clothing industries. These two countries have flexible labour market, which does not force them to resort to OPT as a tool to counter cost competitiveness. However other high cost countries such as Austria, Denmark, Finland and Sweden continue to witness an increase in their OPT trade.

1. The trade creation effect has been witnessed for many of India's textile and clothing exports to the EU. It is the consumption effects, rather than the efficiency related effects, that stimulated the trade creation effect for India's exports to the EU. The benefits of the trade creation for Indian textile exports is absolute as India continued to maintain its role as a leading textile exporting nation to the EU. Since India did not witness any intense competition from the geographically adjacent non-member countries, and also the distant non-member countries, the Indian textile exporters continued to reap the benefits of the trade creation effect in the Single European Market. Even the leading distant non-member countries, which are traditional exporters like China, did not pose greater competition to India's textile exports to the EU.

2. There has been trade diversion effect in selected product categories. This is particularly true in the case of garment exports. The arrival of the imports from Central and East European countries, and also the former republics of the Soviet Union, posed direct competition to India's exports to the EU. There has also been an intense competition among the garment exporting countries. This is particularly true in the case of the geographically adjacent non-member countries. These countries exploit the maximum benefits offered to them by the EU's OPT with these countries. This also permit the member countries, which opts for the OPT trade, to maintain their textile industries at home.

3. There has not been any trade suppression effect witnessed in EU for India's textile and clothing exports. Though the traditional arguments of the Customs Union theory expected the trade suppression effect to be witnessed in the enlarged market, this has not been witnessed in the European textile and clothing industry. Two reasons could explain the lack of trade suppression effect in the EU. The member countries' success in the OPT, which encourages the sustenance of the textile industries in their locations, dissuade them from resorting to domestic production of the same goods, which could be successfully produced and imported from the geographically adjacent non-member countries. Though there have been the protectionist tendencies in many of the member

countries to protect their textile and clothing industries against the low cost imports, they have not resulted in the trade suppression effect in the EU. Even though the member countries witness a decline in their textile and clothing industries consistently, there has not been any effort to replace the low cost imports by the domestic production. This is mainly because of the liberal trade regime, imposed on the developed member countries under the multilateral trade negotiations.

4. However there has been the trade contraction effect witnessed in one particular product category. The trade in silk woven fabrics witnessed an overall fall in its trade both inside and outside the EU. However this could not be attributed to the formation of the Single European Market. The developed member countries' changing fabric preference from silk towards artificial fabric could be attributed to the fall in the EU's overall trade in this product category. Nevertheless the EU's trade contraction effect did not have any adverse effect on India's exports because India is one of the leading exporters, apart from China, in this product category (accounting for about 46 per cent of extra-EU imports in 1999).

CHAPTER - VII

Conclusion

Conclusion

The analysis of European textile and clothing industries within the framework of Customs Union theory confirms that the formation of the Single European Market in the textile and clothing industries has not supported the arguments of Customs Union theory in many ways, though it has validated certain arguments. It also confirms that the welfare effects of the creation of the Single European Market will be felt disproportionately across various industries depending on their nature, efficiency and international competitiveness. The creation of welfare effects of the Single European Market need not necessarily be similar across all industries. The effects differ from labour-intensive to capital-intensive industries. They vary even among the labour-intensive industries depending on factors such as the reallocation of resources, the exploitation of economies of scale, the levels of intra-industry trade and import-penetration ratios of the non-member countries.

Customs Union theory rightly anticipated the cost saving effect resulting from the abolition of trade barriers and customs formalities. In the case of the European textile and clothing industries, the abolition of frontiers, origin verification, restrictions on public tendering and technical and fiscal barriers, has benefited the member countries. The delivery times have been cut back along with reduced transport and administrative costs in the Single European Market. While the delivery times have shortened by 15 to 20 per cent, the transport costs have been reduced by 10 per cent. The administrative costs have also been reduced between 0.08 and 0.06 per cent respectively. This is however the cost of abolishing the trade barriers and the formalities in the Single European Market and they cannot be confused with the efficiency related effects expected in the formation of the Single European Market.

Customs Union theory anticipated the efficiency related effects resulting from enhanced competitive pressure exerted upon firms operating in the Single European Market. The formation of the Single European Market, according to Customs Union theory, will result in increased competition and associated resource reallocation. It, therefore, expected high levels of factor mobility across the member countries. However factor mobility, a factor considered important for enhancing efficiency and competitiveness, has been rather slow in the EU's textile and clothing industries. In the Single European Market, only one factor of production – capital – is highly mobile across the member countries. Other factors, such as labour and resources, are immobile for various reasons. Though labour cost is highest in the developed member countries, labour in the less-developed member countries is not encouraged to move towards the high-wage countries. Though labour force surveys show a slow but steady increase in EU nationals working in other member countries, migration is confined to specific occupations such as managers, professionals and specialised technicians. Likewise capital movement towards the

less-developed member countries is selective in that they are directed towards more profitable locations. The removal of the trade barriers, which was aimed to facilitate factor mobility across boundaries, has not resulted in the exit of many inefficient firms. Many inefficient firms continued to subsist in the period following the completion of the Single European Market. Even the high-cost member countries continue to concentrate on the production and specialisation of labour-intensive industries though they have a comparative disadvantage in these industries. As a result the completion of the Single European Market has not resulted in the sectoral specialisation of the industries in which the member countries have their comparative advantage.

The efficient reallocation of resources, on which Customs Union theory has been built, has been hindered by persistent structural disparity between the member countries. The member countries are unable to reduce their structural disparity to exploit the benefits of the scale economies. The structural disparity of the member countries, to a large extent, prevents the realisation of competitive pressure on the European textile and clothing industries. An enhanced intra-industry trade is necessary to realise the competitive effects of the enlarged market. Market segmentation still persists across the member countries with a clear divide between the developed and less-developed member countries. The textile and clothing industries of the developed member countries, completely Europeanised with high levels of sophistication and modernity, are prepared for intense competition from low-cost imports. However, in contrast the textile and clothing industries of the less-developed member countries like Greece and Portugal are less competitive and geared mostly to the needs of the domestic market. These industries are also less modernised and less equipped to face low-cost competition. Apart from this they are also ill equipped to face the challenges of the sudden influx of low-cost imports. Given the persisting structural disparity between the two blocs of countries and the inability of the less-developed member countries to restructure themselves towards the structural pattern of the developed member countries (towards more intra-industry trade from the inter-industry trade), the influx of low-cost imports adversely affects the less-developed member countries' textile and clothing industries. Since the clothing industries in the less-developed member countries are concentrating on the low-cost, mass-consumed items, they are also more vulnerable to low-cost imports. The leading non-member countries, exporting textile and clothing products to the Single European Market, are also specialising in the same product categories upon which the less-developed member countries have traditionally been concentrating. Hence the less-developed member countries are more susceptible to external competition than their counterparts in the developed member countries. The limited availability of capital to firms operating in the less-developed member countries makes it very difficult for them to move towards capital- and technology-intensive, up-market production.

The failure of the member countries in moving towards a more uniform market structure has affected the distribution of the gains of the Single European Market. In the European textile and clothing industries the benefits of the Single European Market are disproportionately shared between the developed and less-developed member countries. The developed member countries, with their more competitive economic structure, have largely been benefiting by replacing the less competitive firms in the less-developed member countries. As expected the developed member countries have benefited by consolidating their position in the home market and capturing the markets in other member countries by replacing their inefficient firms. Since the less-developed member countries do not display higher levels of competition in the textile and clothing industries, the firms in the developed member countries find it a relatively easy task to replace these less competitive firms.

Customs Union theory argued that, given the scenario of free trade between the member countries, the low-cost country in a unified market becomes an effective supplier for the whole of the unified market. This is based on the argument that enhanced competition in the Single European Market would result in a situation in which the inefficient firms would be forced to go out of business. As a result, the resources, which had hitherto been allocated to the inefficient firms, would now be reallocated only among the efficient firms. However, in reality, the process of resource reallocation has not entirely been witnessed in the European textile and clothing industries. Many inefficient firms continue to operate in the Single European Market under state protection and they do not feel the competitive pressures in the Single European Market. These firms distort the efficient reallocation of resources in the Single European Market. The analysis of the performance of the EU's textile and clothing industries reveals an interesting scenario in which the competition between firms is encouraged at the same time as efforts are being made to protect inefficient firms in the less-developed member countries. The large-scale employment involved in these firms has forced many member countries to protect them against low-cost imports. This conflicting attitude did not affect the efficient resource reallocation as the inefficient firms continued to make their presence felt in the Single European Market. These firms, though inefficient in the face of all out competition in the Single European Market, are also encouraged to sustain their operations by the policies of various member countries aimed at protecting the domestic employment dependent upon these firms. These market unfriendly policies have resulted in a less flexible market because of generous welfare state benefits. These policies have also made entry and exit in the labour market very difficult as the cost of hiring and firing is extremely prohibitive in the Single European Market. The sub-optimal policies did not encourage the unemployed to leave the welfare state in search of other employment opportunities. As a consequence there has only been a limited competition in the European textile and clothing industries, contrary to what was expected in Customs Union theory. Though the formation of the Single European Market has resulted in some cost-reduction effects, it is

yet to witness full-fledged cost-reduction effects resulting from an increased competition in the textile and clothing industries.

The competitive market is the basis of Customs Union theory with which the efficiency and competitive effects of the Single European Market are realised. Much of the welfare gains of the Single European Market depend on the increased competition and the potential benefits arising out of the economies of scale. Since the European textile and clothing industries are already internationalised, with continual structural changes taking place, the removal of internal barriers has only a marginal effect in realising the benefits of the plant and technical economies of scale.

The existence of economies of scale interacts with the phenomenon of product differentiation. The demand for product differentiation increases as the size of the market increases. However in the EU there are many problems associated with market enlargement. The market enlargement in the EU is not merely a geographical enlargement. Differences in demand - consumer preferences, tastes, and habits - between the member countries result in market segmentation. The market segmentation increases the scope for product differentiation in the Single European Market thereby limiting the scope for the realisation of the economies of scale. This is particularly true in the case of products, where standardisation is rather difficult to obtain as a result of differentiated consumer preference. The possibility of product standardisation in the European textile sector has improved the scope for Plant Economies of Scale. Also the technology-intensive textile industries increase the scope for economies of scale in the Single European Market. However in the clothing sector, where there is less scope for product standardisation, the realisation of the economies of scale has been limited. The need for product differentiation prevented the clothing firms from obtaining the European dimension, as they could not harmonise their production process to the needs of all European consumers. In segmented markets, as in the case of the European clothing markets, product standardisation could not be achieved, as cultural preferences and orientation tend to differ from one member country to another. The segmented markets characterised by different cultural and consumer preferences called for the need for a flexible manufacturing system. However the usage of a flexible manufacturing system does not allow for the exploitation of Product Specific Economies of Scale, which gains importance as we move from upstream stages of differentiated production to downstream stages of mass production.

The creation of the Single European Market for the EU's textile and clothing industries has not resulted in the inefficient and expensive firms going out of the market due to high competitive pressures. Though they are in the process of being absorbed by larger and more efficient firms, they still exist in less-developed member countries as they contribute to a

considerable proportion of manufacturing employment. Textile production in countries such as Portugal, Greece and Spain is much more important in terms of employment than it is in other member countries. Hence the unprofitable cost considerations have not driven these member countries from discouraging the production and concentration of high-cost textile production from their locations.

Though the Single European Market has resulted in increased trade flows across the member countries, it has not exerted competitive pressure on the European textile and clothing industries. Since the member countries specialise in different product lines, they could not increase their intra-EU trade by exploiting the benefits of the economies of scale. The efficient firms have not completely replaced the inefficient firms in the Single European Market as they are considered to be a significant employment provider in some of the member countries. Though the German textile and the Italian clothing firms were more efficient than those in Greece, Spain and Portugal, the textile and clothing firms in the latter continued to operate rather than preferring to go out of the markets thus reducing an opportunity for the relatively efficient producers to exploit the economies of scale. In reverse the textile and clothing industries firms in the less-developed member countries could not take advantage of the benefits offered by the enlarged market as they are based on low productivity, unskilled labour, low investment and low product levels. Hence it is the extra-EU trade, rather than the intra-EU trade, which has influenced the competitive pressure on the European textile and clothing industries. The intra-EU trade has not exerted greater competitive pressures on the European textile and clothing firms. Though the EU's trade in textile and clothing industries is intra-EU in nature, the intra-EU trade in textile and clothing represents about 60 and 50 per cent respectively, they have not exerted greater pressure on the domestic industries.

The competitiveness of the European textile and clothing industries has seriously eroded in the face of intense competition from the low-cost imports from the non-member countries. The labour cost is an import component in deciding the cost competitiveness of the textile and clothing industries. Though the Single European Market expected a decline in the production costs resulting from the efficient reallocation of resources and the removal of internal barriers, it did not take into account the possibility of a wide disparity in labour cost structures between the member countries of the EU and non-member countries. The labour costs in European textile industries are the highest in the world. This is particularly true in the case of the developed member countries. The high labour costs in the developed member countries, to a certain extent, are compensated by increased productivity levels in their textile industries. This is made possible by the extensive use of sophisticated machineries (such as robots and microprocessors) and an intensive use of the equipment to gain the maximum from these machines. The less-developed member countries, however, are not able to adapt to this strategy

because of the limitations imposed on their textile industries. As for the competitiveness of the clothing industries, the comparative advantage in the clothing trade has shifted from high-wage to low-wage countries. This is mainly because of the high proportion of labour cost in the overall production costs. The developed member countries, in their efforts to concentrate on the clothing industries, follow two main strategies in this respect. The developed member countries diversify their labour intensive processes to the neighbouring low-cost locations (OPT), while continuing to concentrate on the upstream and high-value-added products at home. This strategy has more implications for the less-developed member countries than for the non-member countries. Firstly the developed member countries, by adopting this strategy, prevent any possible investment diversion being witnessed in this industry from their high-cost locations to the low-cost locations of the less-developed member countries. Secondly this deters the less-developed member countries from specialising in areas in which they continued to enjoy a comparative advantage over the developed member countries in the form of possessing a traditional knowledge base apart from their low labour costs.

The inability of the European textile and clothing industries to compete against the low-cost non-member countries is attributed to many factors. Inflexible labour market and rigid market policies make it difficult for these industries to face cost competition in their own market. High labour and production costs, high taxes and high social costs have all increased the significance of cost-management in the member countries. The direct relationship between wages and productivity makes it imperative for the European textile industries to compensate their wage rise by higher productivity to remain cost competitive against the low-cost imports. Faced with the challenges of increasing production costs, falling employment, falling market share, many of the member countries are forced to adopt measures aimed at increasing the industrial efficiency and international competitiveness of their textile and clothing industries. Various strategies have been adopted to increase the efficiency and competitiveness of these industries in the EU.

The European textile industry, compared to the clothing industry, has enhanced its cost competitiveness though investment and modernisation. There are significant differences between the textile and clothing industries with the former amenable to technical progress. Also the productivity and employment gains are significantly larger in the textile industries. The textile industries are able to maintain their efficiency and competitiveness by adopting various strategic measures aimed at increasing productivity. Since the nature of the European textile industry is capital- and technology- intensive, higher investments and intensive use of technology have been used to consolidate market position in the Single European Market. Technology has been widely used in all lines of production to facilitate flexibility, product up-grading, shorten production times and reduce wastage. Lately they are also intensively used in

spinning, finishing and weaving. The high level of automation has not only helped the industry to increase its productivity level and reduce the unit production costs but it has also helped in protecting them from low-cost competition by increasing their reliance on product differentiation, design and quality, the areas that are harder to compete in for the low-cost non-member countries. The introduction of new technology has been so successful that the European textile industries are resorting to increased automation in their production lines rather than relocating their industries to low-wage countries as in the case of many clothing industries. The automation of production erodes developing countries' major factor advantage of cheap labour. Nevertheless limited relocation has been taking place in European textile industries. Technological innovation has caused a strong increase in productivity with significant cost reduction as in the case of high wage countries such as Germany and Italy.

The clothing industries, characterised as a low-skilled and labour-intensive sector, are operating with limited capital availability. The cost competition has gained significant importance in clothing industries as labour costs account for more than 65 per cent of total production cost. Unlike many industries, the relationship between wages and productivity is less than proportional in the European clothing industries. In many member countries, wages have risen faster than productivity thereby widening the gap between wages and productivity. The consequence is a fall in cost competitiveness, which has forced the member countries to adjust themselves to the changing scenario. This has limited the choices available to European clothing producers and they had to adopt market and production oriented strategies. These strategies, though they have yielded some results, have not helped the clothing industries to regain their lost competitiveness. These strategies, such as downsizing, optimal utilisation of work force, automation and computerisation of the production and assembly processes, do not seem to have had a significant effect in reducing total labour costs. As a result many of the member countries are resorting to sub-contracting and internationalisation of production. This, to a large extent, has helped the member countries in arresting the rate of decline of the clothing industries. Another strategy adopted by the European clothing firms in the high-cost member countries is the movement towards up-market products. Moving towards the up-market quality products has not only allowed the clothing firms to realise high-profit margins, but also to sustain their textile industries in their own locations. The developed member countries, to a large extent, have been successful in protecting their industries by moving towards high quality, up-market products, whose product design and quality is difficult to imitate by the low-cost non-member countries. The less developed member countries have also not been very successful in this regard. Rising labour costs in the domestic clothing industries have adversely affected the competitiveness of industries that have traditionally been based on cheap labour. As a result the clothing firms of the less-developed member countries often become the victims of the low-cost imports from the

non-member countries resulting in huge employment loss. The liberalisation of the MFA regime has seriously affected the less developed member countries.

The failure of the member countries to realise cost competitiveness in the European textile and clothing industries has helped the non-member countries in boosting their exports to the member countries. The inability of the member countries to have flexible market policies has caused great damage to their industrial efficiency and cost competitiveness. Though higher productivity could outweigh the adverse effects of higher costs, the production costs adjusted to productivity in the European textile and clothing industries is still higher and makes these industries less profitable, without state protection, in many of the member countries. There have also been limitations in compensating the higher labour costs with higher productivity in industries involving intensive usage of labour. This is particularly true in the case of the clothing industries as many of its production processes involve intensive labour usage. In this scenario, many of the non-member countries are able to translate their low-labour cost into their advantage while exporting to the Single European Market. Since the direct labour cost accounts for more than two thirds of the total production cost in the clothing industries, many of the developing countries are able to capitalise on their low labour cost in the Single European Market. Moreover labour cost in these countries does not include any indirect labour costs, such as welfare benefits.

Though the formation of the Single European Market in the textile and clothing industries has not followed many of the arguments of Customs Union theory, it has still resulted in welfare benefits for both the member and the non-member countries. The creation of the Single European Market has resulted in: (i) high-cost domestic production being replaced by the imports from other countries characterising the trade creation effect; (ii) expensive domestic production being replaced by the imports from the non-member countries confirming the presence of the external trade creation effect; (iii) the trade diversion effect in the Single European Market with the imports from the non-member countries being replaced by those from other member countries; and (iv) the trade suppression effect with the low-cost imports from the non-member countries being replaced by high-cost domestic production.

The gradual removal of barriers for intra- and extra-EU trade has increased the flow of goods both within and without the member countries. The removal of barriers, such as technical, fiscal and non-tariff barriers, has accentuated the flow of intra-EU trade. The simplification of formalities at the borders and also the harmonisation measures has also resulted in a considerable cost saving effect. This also reduced the waiting time at the borders thereby enhancing the responsiveness of the firms to the demands of the consumers. The cross border trade in the EU and the huge inflow of imports from the non-member countries resulted in many

of the inefficient firms going out of the market. This was again not the result of the efficient reallocation of resources. It was merely the effect of the cost competitiveness of the external imports. The import demand is a function of total domestic consumption in the importing country, the price of domestically produced goods, as well as the prices of the exporting countries. Hence any price competition in the member countries is expected to increase the levels of consumption in the member countries. Though the completion of the Single European Market in the textile and clothing trade resulted in the cost-reduction effect, this was not sufficient to outweigh the cheap imports coming from the non-member countries. The effects of the economies of scale are also limited for reasons of the size of the textile and clothing firms. As a result, any positive effect has to be seen in the light of increased consumption levels in the member countries. A consistent increase in the consumption of many of the products has been observed in the member countries during 1991-99. The increase in apparent consumption could be attributed to the gradual abolition of MFA regimes. The MFA regimes restrict the supply of textile and clothing products from the developing countries, thereby inducing a shortage of such goods and an increase in their price. Hence the gradual abolition of MFA regimes results in the price competition and associated increase in consumption. The change in the levels of consumption had greatly influenced the member countries' trade pattern. The trade creation effect created in the EU has largely been the creation of the increase in the EU's domestic consumption. This is contrary to the arguments of Customs Union theory, which expected an increase in intra-regional trade arising out of reallocation of resources. It also anticipated the exit of the inefficient firms operating in the market, which has not been witnessed entirely in the Single European Market. There are still inefficient firms operating in the market with state protection. Maintaining the protectionist measures against the non-member countries to defend output and employment in the EU has resulted in adverse effects. The protected firms could not exploit protection to restructure production techniques and processes in order to meet higher competition. Protection also created artificial profits, thereby encouraging the entry of new firms, and the entrant firms constitute an inefficient cluster of sub-optimal plants. They also act as an impediment to the exit of the inefficient firms, which have been operating in the protected market with state assistance. These firms are distorting the efficient reallocation of resources. Protectionist measures, though protecting output and employment in the short run, have not sustained the investment and employment in the long run. With the rise in labour costs and the fall in productivity growth, investment would be less than forthcoming for the ailing European textile and clothing industries.

Though it has been agreed that the creation of the Single European Market has resulted in net positive effects, with the trade creation effect outweighing the effects of trade diversion, the effects are felt disproportionately among the non-member countries. Many of the leading exporters of textile and clothing products are anxious about the effects of the Single European

Market on their exports. This is particularly true in the case of Indian textile and clothing exporters, whose exports are market and product specific. Their exports are market specific in the sense that much of their exports are directed towards the Single European Market. The Single European Market is the most important market for India's textile and clothing exports as it offers opportunities in a number of product lines mainly due to differentiated domestic market conditions prevailing across the member countries. The trade in textile and clothing in the EU witnessed an intense competition during 1991-99. However competition is not a new phenomenon to be witnessed in this industry after the completion of the Single European Market. This industry was exposed to increased external competition since the 1970's. Since these industries were exposed to early competition, they had already witnessed a process of restructuring in many of the member countries. With the European textile and clothing industries already being internationalised, the removal of barriers had only a marginal effect on the member countries' external trade. In this regard, India's exports to the EU had witnessed a mixed effect in textile and clothing sub-sectors.

Due to the cost reduction effect associated with trade creation effect, as discussed in the theoretical framework, the prices of imports from external sources (both intra- and extra-EU imports) witnessed a sharp decline. This has led consumers to expand their consumption pattern of the textile and clothing products at the expense of less desirable substitutes thereby resulting in favourable consumption effect. Because of the EU's consistent growth in the 1990's, the EU imports - including the intra-EU and extra-EU imports - increased at a considerable rate. There has been a shift in the consumption pattern of the EU's textile and clothing products from the domestic to external sources instigated by the unit cost differences. With the high labour and non-labour costs in the EU, the unit cost differences always tend to be higher between the domestic products and external sources. Since the unit cost differences between the domestically produced and the imported products are greater in the Single Market, the product substitution effect has been witnessed in the EU. As a result, the EU has witnessed a positive consumption effect and thus an increased consumption of textile and clothing products.

As discussed already, the benefits of trade creation effect in the Customs Union goes to the consumers as they benefit from new low-cost imports from the member and non-member countries instead of the more expensive domestic products. A tendency has been witnessed in the EU whereby the consumers substitute domestic products with products from other member and non-member countries. This is confirmed by an increase in both intra- and extra-EU imports. A sharp increase in intra-EU imports has been witnessed in sixteen product categories out of the twenty products taken for this research. In thirteen product categories, the extra-EU imports witnessed a sharp increase (as much as 140 per cent in certain product categories). This

is a result of trade creation effect associated with the product substitution effect in the Single Market.

The changes in the levels of domestic consumption have largely decided the direction of the EU's textile and clothing trade. A relationship has been witnessed between the changes in the levels of domestic consumption and the trade creation effect. Whenever there is an increase in domestic consumption, there has also been an increase in the trade creation effect. The consumption effect in the EU was caused by the two sources. Intense competition among the member countries on one side and the competition between the member and the non-member countries on the other side have given rise to an increase in the EU's consumption effect. The creation of the Single European Market has had a positive effect on India's exports of textile and clothing. A considerable trade creation effect has been witnessed for India's exports of textile and clothing. The growth rate of India's textile and clothing exports has been stimulated by the EU's positive consumption effect. Though India's textile and clothing exports have been largely stimulated by the EU's trade creation effect, their growth was independent of the EU's consumption growth. Even in cases where the EU's consumption had fallen, India's exports have grown considerably. Hence it could be concluded that India's exports had a relatively large share in the Single European Market which was unaffected by the changes in the EU's consumption pattern. Irrespective of the levels of the EU's consumption growth, India's exports witnessed a continual growth.

India's exports to the EU are unidirectional because much of the exports are directed towards the developed countries. The less-developed member countries accounted for less of India's exports to the EU. In many product categories, they accounted for less than 10 per cent. Since India's exports are concentrated on the markets of the developed member countries, much of the effects of the Single European Market are related to the changes witnessed in these markets. The beneficial effects of the Single Market on India's textile and clothing exports are created in the leading export markets. India's exports of textile and clothing to the EU witnessed an intense competition. Though Indian exports to the EU do not pose any direct competition to the developed member countries, the less-developed member countries bitterly complain about the increase in India's exports to the EU. The less-developed member countries, and particularly Portugal, believe the increase in India's exports to the EU would be at the cost of their exports to other member countries. Less developed member countries seem to believe that Indian exports have a trade diverting effect on their intra-EU exports. However, there is no strong evidence to suggest that the increase in India's exports to the EU would be at the cost of the less-developed member countries' exports to other member countries.

India's trade in textile and clothing products with the member countries is complementary rather than competitive. India exports the much-needed raw materials such as fibres and yarns to the member countries. India's clothing exports consist of low-value added mass consumed items. Though there have been structural similarities between India and the less-developed member countries in their sectoral specialisation - with a high level of concentration on labour-intensive industries such as textile and clothing industries - the nature of India's trade with these countries is less competitive. These countries, because of increasing labour costs, have lost their competitive edge in the traditional labour-intensive industries. The less-developed member countries' sectoral specialisation has changed over time from their traditional labour-intensive industrial base. This is against the notion of Customs Union theory, where costs are expected to play an important role in deciding the member countries' sectoral specialisation. The rising labour cost in the member countries' did not serve the purpose for the less-developed member countries in preserving their competitive edge in the textile and clothing industries.

The Single European Market has varying effects on India's textile and clothing exports. While it has a more beneficial effect for trade in textile products, it has a mixed effect on its clothing exports. However it is in the textile exports that Indian exports have made a strong presence in the Single European Market. Every single textile product taken for this research has witnessed a growth in their exports. This is mainly because of India's specialisation in textile products compared to its clothing products. India has always been a leading exporter of textile products. Apart from this the international trade in textile products is confined to countries with an established textile industrial base, with India being one of them, whereas the global clothing trade follows a different pattern with many countries specialising in clothing products. Also the specialisation patterns of the member countries have played an important role in deciding the export configuration of Indian exports. India's textile exports to the EU compete directly with the developed member countries for a market share in the EU. However, the competition between India and the member countries in clothing products is indirect because the Indian exports compete with the EU products manufactured in the low-cost adjacent locations facilitated by the OPT. The indirect competition adversely affects Indian exports, as they have a trade-diverting tendency against India's clothing exports to the EU.

The leading clothing exports from India had witnessed a dismal performance in the Single European Market. Though they increased their export share in the EU, their export value had declined. This is mainly because of the nature of competition prevailing in this industry. It is in this industry that the peripheral countries have continued to gain market share at the cost of the leading non-member countries. These peripheral countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. The EU has

removed all tariff and quantitative restrictions on exports coming from these countries, thereby allowing their imports duty and quota free in the EU. Hence the imports from these countries are given the advantage of entering into the EU's market duty free as against the imports from India, which face both tariff, non-tariff and quota restrictions. Though these countries, as individual countries, do not pose any direct threat to India's exports to the EU, they, as a group of countries, collectively challenge India's exports to the EU. In many of the clothing exports, there are strong reasons to believe that they have diverted India's clothing exports to the EU. Many of India's clothing exports have witnessed a fall in their export share during 1991-97. This is accompanied by an increase in the exports from these countries.

There have been serious challenges to India's existing market share in many of the member countries. The falling Indian share in the EU could be attributed to four main factors. They are: (i) the stringent regulations of the EU; (ii) the growing imports from the geographically adjacent non-member countries; (iii) the increase in the EU's OPT; and (iv) the low unit-value realisation of Indian exports. India's clothing exports were highly regulated by export quotas in the EU. However these quotas are not very flexible to the need of Indian exporters. In many product categories, the export quota limit restrains India's clothing exports. Indian exporters have fully utilised their export quotas in the individual member countries. There had also been a limited increase in export quotas offered to Indian exporters in the member countries. Hence Indian exports, though having increased in value terms, did not increase in percentage terms in many product categories. India's clothing trade was mainly in low-value added products. Though India was the largest exporter of clothing to the EU among the non-member countries, it is ranked only fourth in value terms. This is mainly because of the low-value realisation of India's clothing exports to the EU. The importance of preserving the domestic textile employment played an important role in many of the member countries shifting their clothing production base to the geographically adjacent non-member countries. The challenges are expected to be much harder for India's exports in the coming years as many member countries prefer OPT over low-cost imports from distant non-member countries. The EU's OPT regulation creates a strong incentive to concentrate production in neighbouring countries because the European firms can use OPT quotas only if they use European fabrics. Also the transport costs are much lower, if the production process is carried out in the neighbouring countries. In this regard, the strategies adopted by many of the European clothing firms, such as OPT, are resulting in a trade diversion effect on India's exports. The imports from India are being replaced by adjacent non-member countries, many of which have associate membership with the EU. The EU's increased OPT acts as a deterrent on India's clothing exports to the EU.

Indian exports to the EU lack market proximity that has been enjoyed by the geographically adjacent non-member countries. Among the geographically adjacent non-member countries, some of them, such as the countries of the Mediterranean region do not pose a serious threat to Indian exports. Though Indian exports have a comparative advantage in many of the textile and clothing productions, the geographically adjacent non-member countries, due to their proximity to the Single European Market, are able to enjoy more benefits arising out of the Single European Market's welfare objectives. Though these countries continue to increase their exports to the EU, mainly in garment products, they are not expected to replace India's exports, through a trade diversion effect, in the short-run. However the structural and export specialisation of the Central and East European textile and clothing industries are characterised by not only their relatively lower labour cost, but also by the high skill levels of their work force. Apart from this, they have geographical proximity to their main market of the EU. These countries are expected to pose a direct challenge to Indian garment exports to the EU in the long-run. These countries as *individual* exporting countries are not likely to replace India's exports to the EU, but as a *group* of countries they are expected to replace them eventually.

The implications of the Single European Market on India's exports of textile and clothing industries to the EU can therefore be summarised in the following four statements that bring the thesis to a close:

1. The trade creation effect has been witnessed for many of India's textile and clothing exports. It is the consumption effects, rather than the efficiency related effects, that stimulated the trade creation effect for India's exports to the EU. The benefits of the trade creation for India's textile exports are absolute as India continued to maintain its role as a leading textile exporting nation to the EU. Since India's textile exporters did not witness any intense competition from the geographically adjacent non-member countries, or from the distant non-member countries, the Indian textile exporters continued to reap the benefits of the trade creation effect in the Single European Market. Even the leading distant non-member countries, which are traditional exporters like China, did not pose greater competition to India's textile exports to the EU.

2. There has been a trade diversion effect in selected product categories. This is particularly true in the case of garment exports. The arrival of the imports from Central and East European countries constituted direct competition to India's exports to the EU. There has also been an intense competition among the garment exporting countries. This is particularly true in the case of the geographically adjacent non-member countries. These countries exploit the maximum benefits offered to them by the EU's OPT with these countries. This is facilitated by the member countries' preference to keep their textile industries at home.

3. There has not been any trade suppression effect witnessed in the EU for India's textile and clothing exports. Though the traditional arguments of Customs Union theory expected the trade suppression effect to be witnessed in the enlarged market, this has not been witnessed in the European textile and clothing industries. Two reasons could explain the lack of trade suppression effect in the EU. The member countries' success in the OPT dissuade them from resorting to the domestic production of the same goods, which could be successfully produced and imported from the geographically adjacent non-member countries. Though there have been protectionist tendencies in many of the member countries to insulate their textile and clothing industries against low-cost imports, they have not resulted in the trade suppression effect in the EU. Even though the member countries witness a decline in their textile and clothing industries consistently, there has not been any effort to replace low-cost imports by domestic production. This is mainly because of the liberal trade regime, imposed on the developed member countries under the multilateral trade negotiations, which make trade in this industry more competitive.

4. However there has been the trade contraction effect witnessed in one particular product category. The trade in silk woven fabrics witnessed an overall fall in its trade both within and without the EU. But this could not be attributed to the formation of the Single European Market. The developed member countries' changing fabric preference from silk towards artificial fabric could be attributed to the fall in the EU's overall trade in this product category. Nevertheless the EU's trade contraction effect did not have any adverse effect on India's exports because India is the leading exporter in this product category (accounting for about 46 per cent of extra-EU imports in 1999).

The traditional Customs Union theory evaluated the trade creating and trade diverting effects using the typical parameters of static and dynamic effects. However in the present work the economic policies in the EU are taken into account while analysing the effects of Customs Union theory on both the member and non-member countries. In other words, the effects of the Single European Market on the non-member countries are studied largely by analysing the effects witnessed in the European textile and clothing industries. The traditional analysis of Customs Union theory assumes that resource reallocation forces the inefficient industries to go out of business in the Single European Market. However this research could not analyse what would be the resultant effect if the State actors were to intervene to protect the inefficient industries thereby distorting the effects of resource reallocation in the Single European Market. Consequently, Customs Union theory could not highlight the industrial efficiency and international competitiveness of the European textile and clothing industries. However the present work addressed this problem by taking into account State intervention in the EU's textile and clothing industries. For example, this work highlights the fact that the textile and clothing industries of the less developed member countries, such as Greece, Portugal and Spain

account for a disproportionate amount of trade diversion witnessed in the EU as State intervention in these countries is correspondingly higher than that in other developed member countries.

India's trade relations with the EU remain largely unhindered by the turbulent political relationship. The Indo-EU trade relationship, ever since India's independence, was largely dormant in that attention had not been paid to mutual co-operation between India and the EC. India did not enjoy preferential access, other than the GSP, to the EC. Even the entry of the United Kingdom into the EC did not grant any preferential access to India. The direction of the Indo-EU was largely decided by the competitive forces rather than the political affinity between India and the EU. This has been confirmed by India's declining market share in the EU's extra-regional trade over the years. India remained in the periphery of the EC's external trade accounting for less than 1.5 per cent of its overall external trade. Also the Indian economy was content with the domestic market, which was large enough to foster the domestic industries. Apart from former Soviet Union, India did not seriously engage itself in promoting its economic interests in non-Soviet markets. The *Mahalanobis* model, which India adopted on the basis of Feldman's Model of Soviet Growth, did not help India in increasing its share in global market. Rather it had insulated India from being an active player in international trade. There was realism among Indian policy makers to explore alternative markets for Indian exports in the aftermath of the disintegration of Soviet Union. With the collapse of the Soviet market, the Indian exports were forced to alter their direction towards the EU and US. India's balance of payment crisis of 1991 forced it to liberalise its economy. With the opening up of the Indian market, there has been a strong feeling in the developed countries to exploit the opportunities offered in huge Indian market. The EU remains, next to the US, one of the largest investors in India. Both the EU and India realise the importance of co-operating with each other in addressing global issues. Nevertheless there are issues where they differ with each other. This is particularly true in the case of Indian nuclear ambition, which goes against the EU's non-proliferation objectives. During India's nuclear testing of 1998, the EU expressed serious objections but it did not impose sanctions.

Though the completion of the Single Market has offered enormous opportunities for India's labour-intensive industries, in which India has competitive advantage, they are far from realised. This is mainly because of the EU's changing structure and corporate strategy. The EU's corporate strategy is aimed at exploiting the opportunities offered in the neighbouring non-member countries in the short-run. There are efforts in India to restructure its economy towards knowledge-based industries such as the information and bi-technology industries. There are the industries in which the profit margin is larger. Also the concentration on these industries would increase the scope for enhanced co-operation and further understanding between India

and the EU. In this regard, it is strongly believed that India would reap the benefits of the Single Market in the long-run.

The conclusion of this work cannot be generalised to the EU's external trade as a whole. The impact of the EU's internal market mechanism is country specific in which the EU's external trade policy needs to be taken into account. The impact of the EU's market mechanism and trade policies on India's exports of textile and clothing industries need not necessarily be the same for countries that enjoy preferential market access to the EU. Nevertheless it would be fair to say that the internal market dimensions and the trade policies in the member countries largely decide the nature of the trade creating and trade diverting effects.

Also the finding of this work is unlikely to be justified in the long-term for two reasons. Firstly, the gradual rise in labour in costs in the Mediterranean, Central and East European countries is unlikely to justify the present European corporate strategy of investing in these countries to reap the benefits of low-labour costs. This effect is already being witnessed in Hungary, where the rise in labour costs is forcing many EU companies to search for an alternative location for their production plants. Secondly, their membership in the EU would make the external trade diverting effects on distant non-member countries transitory. This is similar to what happened in Spain, Greece and Portugal in the 1960's and 1970's, when there was a rush to exploit the opportunities offered in their locations such as low-labour costs and low-corporate taxes. Though their membership of the EU immediately offered them the opportunity to attract investment from high-cost member countries, they could not sustain this strategy as the rise in labour-costs in these locations did not justify the European corporate investments. The low-productivity associated with rising labour costs forced many high-cost countries to look for emerging low-cost countries in the region such as Hungary, Poland and the Czech Republic. In this regard, it could be argued that the trade diverting effects of the Mediterranean, Central and East European countries would only be transitory for the non-distant member countries like India. Though the emergence of these countries as a leading destination for European investment would damage Indian exports into the EU in the medium-term, they would not be able to divert India's long-term exports to the EU in traditional product categories. India's export share in the EU would continue to rise in the post-MFA period when the quota regime would cease to exist.

Although it is possible to identify the impact of the Single European Market on India's textile and clothing exports to the member countries, it is rather difficult to generalise the impact on all the non-member countries. This is mainly because the operational characteristics of the non-member countries differ profoundly from one another. For example, India, China and Turkey have dominant textile and clothing industries, which contribute substantially to their

foreign exchange earnings. However the impact of the Single European Market on India's textile and clothing exports is different from those of Chinese and Turkish exports. While Turkish exports benefit from preferential trading access to the EU, Chinese exports reap the benefits of their aggressive export policies. However in India's case, the textile export policies are the remnants of its socialist model which badly reflect on its export competitiveness in competitive markets.

The present Textile Policy framed by the Indian government is designed to address the anomalies in the Indian textile export policy. It is also a move forward from its previous policy where the State's interest - rather than the domestic handloom industries' interests - predominantly decided the nature of the export policies. The Indian government's present Textile Policy, which witnessed a drastic change from its traditional policy formulation aimed to address the domestic market, would be a pointer in the right direction. This policy change would bolster the growth of often neglected power loom industries that would help the Indian textile and clothing exporters take a dominant share in the EU. The present study did not address the domestic policy formulation in Indian textile industry for the reasons of Customs Union theory being made obsolete. Future studies could take into account the domestic policy anomalies and subsequent industrial performance and international competitiveness in the Customs Union framework before proceeding to address the issues of 'fortress Europe'.

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