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# Strategies for Survival

## The Example of the Clothing Industry

by Uwe Schwarting, Bonn \*

**In the debate about relocation to the developing countries of "structurally weak" industries the clothing industry has attracted the special interest of academic and political economists in the Federal Republic of Germany. The following article constitutes a summary of the most important findings of a study of the conditions under which this industry will be able to ensure its continuing existence in the Federal Republic in the future<sup>1</sup>.**

New measures are needed in changed situations. This truism applies in an especially great measure to the clothing industry of the Federal Republic of Germany which has had to submit to an exceptionally extensive process of adjustment in the last few years. As a result of the change to flexible exchange rates this labour-intensive industry has been exposed to competition by imports from a large number of foreign suppliers who are deriving marked advantages from their relatively low producing costs. The ascendancy of the foreign competitors was at first contained by intensified rationalization and through removal of manufacturing activities to the peripheral and structurally weak areas of the Federal Republic, but measures of this kind were only temporarily successful because the remuneration for the production factor labour in the Federal Republic of Germany is — apart from a few exceptions — far above the international level.

It has to be pointed out that the Table — which relates to 1974 because more recent figures are not available for all the countries concerned — is of limited value as evidence because

□ The wages have been converted into Deutschmark and therefore do not fully reflect the internal developments in other countries;

□ The incidental labour costs — which vary widely from country to country — have not been taken into account;

□ There is no indication of labour productivity rates which affect the comparison in practice as many a hoped-for labour cost advantage is counterbalanced by low productivity.

Even so many of the competing supplier countries are enjoying price advantages which are attributable to their low wage levels. The locational handicap of the German clothing manufacturers has become greater rather than smaller as time passed. This is probably part of the explanation for the wide range of protection given to the German clothing industry by quantitative import restrictions and self-restraint agreements in addition to higher import tariffs. The importation of certain textiles originating from a number of third countries for instance is at present subject to common licensing requirements as well as a limit on maximum imports under the agreement

**Table**

### The Competitive Position of the German Clothing Industry (in regard to Labour Costs) compared with Other Countries, 1974

(German Gross Hourly Wages = 100 %)

5<10%	10<30%	30<50%	50<70%	70<100%	100<140%
South Korea	Singapore	Argentina	France	Belgium	Denmark
Colombia	Syria	Spain	Italy	Netherlands	USA
	Ecuador		United Kingdom	Sweden	
	Hungary		Austria		
	Yugoslavia				
	Bulgaria				
	Greece				
	Hongkong				
	Cyprus				

Sources: Bundeskammer der Gewerblichen Wirtschaft: Sektion Industrie, Vienna. Census & Statistics Department, Labour Department, Annual Report, Hongkong. International Labour Office: Year Book of Labour Statistics, Geneva. Statistical Office of the European Communities: Social Statistics — Labour Costs in Industry, Luxembourg. Statistisches Bundesamt, Fachserie M, Reihe 12: Verdienste und Löhne im Ausland, I. Arbeitnehmerverdienste und Arbeitszeiten, Streiks und Aussperrungen (Earnings and wages abroad. I. Employed persons' earning and working-times, strikes and lockouts), Wiesbaden.

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<sup>1</sup> Uwe Schwarting, Direktinvestitionen, passive Lohnveredlung und Zukäufe als Unternehmensstrategien der deutschen Bekleidungsindustrie — Eine unternehmensgrößenspezifische Untersuchung (Direct investments, passive job processing and buying-in of goods as business strategies of the German clothing industry — An investigation into specific enterprise sizes), Beiträge zur Mittelstandsforschung, No. 42, Göttingen 1978.

on the international trade in textiles and bilateral arrangements with the third countries concerned. Compliance with the fixed export ceilings under the mentioned agreements is ensured by a jointly agreed bilateral control system.

Following demands for dismantlement of these protectionist measures it has been recommended in a number of studies that the clothing industry should be relocated from the highly industrialized countries into the developing countries<sup>2</sup>. These suggestions are based above all on the comparative labour cost advantages of the developing countries in conjunction with the low capital requirements for equipment and training in the clothing industry.

These proposals build on the "factor proportions theorem" which however is not accepted by all economists as a theoretically valid model, even in its modified form which allows for the human skill content of the production factor labour. The cost relations and factor proportions deducible from the available statistics are in the view of critics<sup>3</sup> inadequate for an even approximately satisfactory qualitative characterization of the variety of articles actually existing in a product range, for there is a great deal of evidence to suggest that the consumption of upper-garments will be less price-elastic in the future but all the more income-elastic. In consequence the clothing industry will become increasingly market- and product-orientated which is likely to impair the substitution "chances" of the more distant suppliers.

Critical views have also been heard from political quarters. In the context of the debate on the relocation of locationally disadvantaged industries the German trade union for the textile and clothing industry has pointed to the example of Sweden which has forfeited its textile and clothing industry almost entirely by pursuing a foreign trade policy of this kind. Once the Swedish industry had ceased to be a competitor in its local market, foreign suppliers were able to exploit their pricing monopoly at the consumer's ex-

pense. At the present time the Swedish Government is trying to re-establish an indigenous textile and clothing industry with state support.

What has been said indicates a need to diverge from the thesis that the clothing industry, being a disadvantaged industry, should be relocated and to choose a more differentiative approach. The clothing industry will certainly undergo further adjustment processes but it will nevertheless retain its legitimate place in the highly industrialized countries in the coming years. This assumption is borne out by the findings of an analytical study undertaken by the Ifo-Institut für Wirtschaftsforschung (Munich) conjointly with the Rheinisch-Westfälisches Institut für Wirtschaftsforschung (Essen) on behalf of the Federal Ministry of Economic Affairs.

It was found that the German clothing industry is conducting 62% of its foreign trade with countries whose exports to the Federal Republic bear an "exceptionably close" resemblance to their imports from the Federal Republic. Its high exchange-intensity with highly developed industrialized countries shows that the German clothing industry is well able to play a role in the international goods exchanges — on a relatively low level — where differentiated end-consumer wishes have to be met. The developing countries are clearly at a disadvantage in this field even though the conditions on the supply side favour them compared with industrialized countries<sup>4</sup>.

### Alternatives for Survival

It follows that the clothing industry should find one alternative for survival in deliberate withdrawal from the down-market, where prices are no longer profitable, and concentration on high-grade product groups. Such a strategy may be described as "sophistication in marketing": the manufacturers produce and sell "cleverly" devised products for the market opened up by the steady growth of freely disposable incomes. In doing so, the manufacturers can make good use of their very detailed knowledge of the latest materials, consumer habits, the trade structure and of their personal contacts. Attention to and emphasis on the quality image of the German product is one particular variant of this "sophistication" approach. However, even if this alternative offers an escape route from a difficult economic situation to creative and flexible firms capable of supplying the market with the fashions which it wants, it must be realized that

<sup>2</sup> Cf. Hugo Dicke et al., Beschäftigungswirkungen einer verstärkten Arbeitsteilung zwischen der Bundesrepublik Deutschland und den Entwicklungsländern (Employment effects of increased division of labour between the Federal Republic of Germany and the developing countries), Kieler Studien No. 136, Tübingen 1976; Gerhard Feis, Spezialisierungsmuster in der Arbeitsteilung zwischen Industrie- und Entwicklungsländern (Patterns of specialization in the division of labour between industrialized and developing countries), in: Die Weltwirtschaft, 1971, No. 1, p. 19ff.; Eva-Maria Scharrer, Die Chancen der Textil- und Bekleidungsindustrie in hochentwickelten Ländern — ein empirischer Beitrag zu kontroversen Fragen der Standortwahl beider Industriezweige (The chances of the textile and clothing industries in highly developed countries — an empirical contribution to the discussion on controversial issues concerning the choice of plant locations in both these industries), Kieler Diskussionsbeiträge No. 26, Kiel 1972.

<sup>3</sup> Cf., e.g., Jens Jessen, Die Bedeutung der Importkonkurrenz für ausgewählte Erzeugnisse der Textil- und Bekleidungsindustrie (The importance of import competition for selected products of the textile and clothing industry), Forschungsberichte des Landes Nordrhein-Westfalen, No. 2730, Opladen 1973, p. 4.

<sup>4</sup> Hans Baumann et al., Außenhandel, Direktinvestitionen und Industriestruktur der deutschen Wirtschaft. Eine Untersuchung ihrer Entwicklung unter Berücksichtigung der Wechselkursveränderungen (Foreign trade, direct investments and industrial structure of the German economy. An investigation of their development with special consideration of the exchange rate movements), Volkswirtschaftliche Schriften, No. 226, Berlin 1977, p. 122.

□ the need for continual innovation to keep abreast of the fashion makes rationalization more difficult and

□ there is a risk of an eventual production switch by the majority of firms to a volatile high-fashion field which will in consequence suffer strong price competition and dwindling profit margins.

A *second* alternative for survival has therefore to be considered – usually in conjunction with the first alternative – namely, cooperation with a manufacturer in a low-wage country. This cooperation variant has become especially important in the fashion trade where it has given a new lease of life to quite a few old-established firms. This “supplementary” alternative for the survival of an enterprise takes the form of what is known as “passive job processing”: fabrics and unfinished clothes are sent abroad, finished – i.e. in the main, made up – there for the account of the German principal and then re-imported into the Federal Republic. A *third* alternative to be mentioned is the establishment of a foreign production unit by the German manufacturer (direct investment). Here again it is not a question of “either/or” but of filling out the firm's basic strategy. The fourth alternative, finally, consists of buying-in garments which have been made abroad; the “production” element of the German clothing manufacturer takes here second place.

An opinion poll about these various alternative strategies with a foreign element in the summer of 1977 elicited results which shall be summarized here briefly:

### The Direct Investment Strategy

□ From the German clothing manufacturer's point of view direct investment is to be classified as definitely supply-orientated; the advantages of low production costs combined with the possibilities of re-importation were given the highest preference rating (48% of all mentions). Besides, mention was made of: market development (22.6%), spreading the risk (22.6%) and fiscal and financial incentives (6.5%). Direct investments by clothing manufacturers are thus motivated “one-sidedly” by the criterion of low wages. This contrasts with the main motives of other industrialists who, as shown by a number of studies, put sales considerations above cost and profit motives<sup>5</sup>.

□ Against the background of this vote for low-cost production abroad the actual extent of the direct investment in developing countries by the

German clothing industry – compared with the average of other industries – must be regarded as small. In 1977 developing countries accounted for about 15% of the direct investment undertaken by the clothing industry while the corresponding rate for all industries was about 30%. These figures suggest that the very low wage costs in the developing countries have not proved as great an incentive as had been expected, which is most surprising seeing how great the possible savings were in fact. Costing of the manufacture of shirts in Nigeria produced the following comparative figures:

□ A multistage production unit operated at a cost advantage of DM 29.60 per kilogram compared with a similar one in the Federal Republic of Germany when working *the same number* of shifts.

□ The cost advantage rose to DM 40.60 per kilogram when the Nigerian unit worked an *extra* shift.

In spite of governmental efforts to make direct investment in developing countries more attractive (investment promotion treaties, development countries taxation law, etc.) it is to be noted that the incentives for capital investments in developing countries have in the past proved insufficient to bring about an increase of the investments in the clothing industry. The fact that the industrialized countries enjoy greater favour reflects the higher rating by German direct investors in the clothing industry of the advantages of market proximity and well-developed infrastructure in the industrial countries of Europe which for the most part also offer labour cost advantages. Besides, the provisions of the International Textile Agreement carry some weight in the choice of location as this creates a hazard for possibly intended re-imports. It is thus seen that clothing manufacturers choosing a site for their operations do not confine their calculations to a purely monetary computation of relative labour costs; these by themselves work out clearly in favour of siting manufacturing activities in developing countries.

□ It is generally assumed that big enterprises find it relatively easier to plan and carry out direct investments – at least in the preparatory phase of scrutinizing and plotting a project – than do medium-sized and small firms which have no staff sections of their own and therefore depend upon the assistance and intermediation of outsiders. This is true as far as the clothing industry is concerned. The “threshold level” for manufacturing operations abroad was found to be in the group of firms with 100–199 employees; most direct investments however were concentrated in the hands of the (few) large-scale operators.

<sup>5</sup> Cf., e.g., Heinrich Jüttner, Förderung und Schutz deutscher Direktinvestitionen in Entwicklungsländern (Promotion and protection of German direct investments in developing countries), Aachener Studien zur internationalen technisch-wirtschaftlichen Zusammenarbeit No. 15, Baden-Baden 1978, p. 99.

□ No reliable data have so far been available about the quantities of clothing re-imported from the — primarily supply-orientated — foreign factories, but a consideration of the difference between the sales total and domestic production of the German clothing industry — of which only part can be attributed to markups — or of the difference between the imports of the textile retail trade and the corresponding imports shown by the foreign trade statistics can only lead to the conclusion that a high percentage of the clothing imports consists of "intra-company imports" by the clothing industry itself.

The evaluation of the answers showed that the questioned firms tend to import 50% of their foreign production or more. Estimates led to the conclusion that such intra-company imports from foreign factories accounted in 1970 for about 16% of all clothing imports. This figure underlines the importance of direct investment for the clothing industry. The products from the foreign factories can make a decisive contribution to the survival of an enterprise through overhead cost spreading and filling-out of product ranges. It is to be assumed however that the concentration process, which is taking place in the clothing industry as elsewhere, stems largely from the cost advantages accruing to the firms in question from the lower cost of their foreign production. Bearing in mind that according to the inquiry nearly half the firms with foreign factories belong to the group of large-scale operators, it must be anticipated that the — as yet dominating — medium-sized and small firms will suffer further setbacks if they do not adopt different business strategies. This being so, the reluctance of the medium-sized firms in the clothing industry to engage in direct investment must cause misgivings.

This reluctance suggests management shortcomings among intermediate clothing manufacturers as — according to another inquiry<sup>6</sup> — problems of finance are not the main obstacle to direct investment in the clothing industry.

### The Strategy of Passive Job Processing

Passive job processing which involves making-up or repair of garments — i.e. a processing operation — in a foreign factory has attracted especially great interest in the Federal Republic of Germany. This form of extraterritorial engagement extends all the way from ordinary outwork through cooperation including the use of German know-how and machinery to the setting-up of

foreign companies. These different degrees of participation have however one thing in common within the scope of passive job processing: unmade-up merchandise is exported, processed and then re-imported.

Countries with an active job processing business with the Federal Republic have a contingency quota in addition to their ordinary German import quota. A weighting system is used for sharing out the quotas among applicants so as to ensure that their individual quotas correspond to the market position and prevent a monopoly or oligopoly of big importers who possess better sources of information or react more quickly. The allocation procedure devised to avoid such an — on structural grounds undesirable — development is as follows: The entire quota is divided into three equal parts so that newcomers can get an appropriate share of the market for themselves. One-third of the quota (known as the basic or per-capita quota) is shared out among all applicants, another third part is divided in proportion to the sales turnover of the applicants, and the imports in the preceding years are referred to for the allotment of the remaining third part of the quota. This method of quota allocation suits a middle-class industry like the clothing trade. Job-processed garments are, moreover, partially exempted from import duty insofar as the amount of duty charged is reduced by the (notional) dutiable value of imported unprocessed goods of the same kind (differential charging).

A criticism which has to be made is that passive job processing is governed by a narrow framework of regulations which do not always facilitate the execution of this kind of transaction. The regulations governing the foreign trade, tariffs and payments are very diverse; in some countries customs clearance is hampered by petty-mindedness; clothing manufacturers may not be sufficiently flexible, knowledgeable or venturesome. It is probably in some measure due to all these factors that medium-sized clothing firms have not made as good use of job processing arrangements as was feasible. The following figures give an idea of the actual extent and importance of passive job processing:

□ About 90% of the clothing imports into the Federal Republic from Yugoslavia result from this kind of processing business.

□ 17% of all clothing imports into the Federal Republic fall under the heading of passive job processing.

These figures indicate the scope for this "survival strategy" even though access to the European Community market has lately been denied to many job-processed products by protectionist

<sup>6</sup> Institut für Mittelstandsforschung, Forschungsgruppe Köln (Authors: Ralf-Peter Thürbach, Josef Geiser), Exportprobleme mittelständischer Betriebe. — Eine empirische Analyse in ausgewählten Industriebereichen (Export problems of middle class enterprises — An empirical analysis in selected industrial areas), Beiträge zur Mittelstandsforschung, No. 23, Göttingen 1977, Table 25, p. 109.

measures against merchandise originating in certain third countries.

### Strategy of Complemental Buying-in

The examined types of intra-company imports focused — to varying degrees — on the “production element”. In the kind of intra-company imports still to be investigated — the buying-in of ready-made garments from outside sources by clothing manufacturers intent on complementing their assortment it is the „merchant“ element which provides the sole motive. Without production there is no production risk — what risk there is concerns mainly the sales side and can be countered by correct demand analysis. The “industrial character” of the clothing *manufacturer* recedes into the background. Complemental buying-in of ready-made garments offers advantages in that

- ☐ The entrepreneurial risk is smaller than in the other two kinds of intra-company imports;
- ☐ The bought-in garments made at lower cost in a foreign country benefit from the brand image of the German manufacturer;

☐ Orders can in principle be placed more quickly; and

☐ Overhead cost spreading enables the principal to offer better value and a more comprehensive assortment.

If the sample is representative, complemental buying-in by clothing manufacturers accounts for another 5% (by volume) of all garments imports.

The importance and dimensions of the *three* business strategies show clearly in the fact that at least 40 vol. % of all clothing imports are attributable to the activities of German clothing manufacturers. To give an example, the total value of their purchases in 1976 was of the order of DM 2.8 bn. It may thus be noted as a fact that even today firms in industries reputed to be structurally weak can still safeguard their survival by setting different priorities. In highly industrialized countries well-managed clothing firms taking heed of all these strategies in their business calculations have still a better “survival chance” than badly-managed enterprises in so-called growth industries.

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## TRADE REGIMES

# Devaluation and Its Consequences in Developing Countries

by Anne O. Krueger, Minneapolis \*

**To analyze the role of the trade and payments regime in economic development the National Bureau of Economic Research undertook a major research project on this issue. In this article a brief report on some of the findings pertaining to the effect of exchange rates, i.e. devaluation under exchange control is provided.**

**E**ver since conscious efforts to increase growth rates in developing countries began in the early 1950's, a major source of controversy has been the role of exchange-rate policy in affecting the rate of economic growth. Numerous issues are related to this central question. Many developing countries' exchange rates were maintained by use of fairly severe quantitative restrictions which restricted purchases from foreigners well below desired levels. This, in turn, led to relatively weak incentives for exports, and a marked divergence in domestic prices of import-compet-

ing goods from their international prices even inclusive of tariff charges. Some “export pessimists” believed that this did not matter because they regarded import substitution as the only feasible means of rapid growth. Others saw the bias against exports as a major impediment to rapid development. In addition to these issues, “stabilization programs” which included currency devaluation and efforts to curtail the government deficit and the growth of the money supply were highly controversial. Critics alleged that devaluation resulted in more rapid inflation and recession, with little or no improvement in the balance of payments, while defenders asserted that over-

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