

## ***Judit Hamar: From crisis to crisis? Past, present and future, textile and clothing industries in Hungary***

### Abstract

Policies and studies on competitiveness of the Hungarian economy, its growth prospects, on employment and social problems, rarely mention problems and challenges in the TC industry, while the world conditions for this sector are under dramatic changes. Geographical location has been restructured radically, essential transformation has reached in each segment of the production line in the sector. All of these certainly do affect Hungarian actors in the sector; the new challenges force them to adjust more, than ever before. What is happening meanwhile in Hungary?

The background study dealt with analyses of measurable (foreign, indigenous, mezzo and micro) factors and non-measurable links (among competencies in business functions, factors of competitiveness, and magnitude of changes in the firms) to draw a picture about the role of the TC sector in the Hungarian economy and its prospects. What are the possible answers to the international challenges, and what is the role of policies to help this adjustment? Based on the relative small share of the sector in the economy, previous expectations estimated relatively few detrimental impacts – of the EU-accession and that of the WTO liberalization process – on the Hungarian TC sector. Contrary to this, our analytical results proved a strong declining trend of this sector. TC sector (especially clothing industry) was the first being able to succeed after the transitional crisis, and was a leading export-oriented industry during the 90s. Since 2000, however, it seems to be “out of breath” as a result of its ways of adjustment to the new emerging situation. Our main conclusion to macro and industrial policies is that the similarly serious problems to the agriculture can be eased and competitiveness of the sector can be improved only by introducing and applying the already existing measures invented, decided and already used by the EU and by some EU member states. This would, however, require a “new way of thinking” of policy-makers at macro and even at local level.

### Introduction

Development in the textile and clothing industries is “breath-taking”:<sup>1</sup> “A traditional industry steps into a new period, it has become of strategic importance”. Based on results of numerous studies’ estimations on the EU-enlargement and freeing of all trade barriers on the TC world trade after 2005, several actions have been planned and even started in the EU and at national levels to help the sector to adjust to the changes happening inside the firm and on the world market. The concept of industrial policy<sup>2</sup> has also changed, as terms of knowledge and innovation developed.<sup>3</sup> Horizontal policy tools based on deep knowledge on special features of sectors aim to improve competitiveness of the sector and to diminish the negative effects of restructuring.

What is happening meantime in Hungary? The economic policy seems to accept the shrinkage of the sector (or even its disappearance?). Emphasizing FDI-attractiveness and economic growth by focusing only on high-tech industries (such as car, electronic, biotechnology, health- and amusement industries), “knowledge-based” economy, “innovation”, and “technological development” are the frequently used “miracle” words. An industry with about

<sup>1</sup> Hamar (2005): Present and prospects for the Hungarian TC industry (KOPINT-DATORG zLtd, manuscript).

<sup>2</sup> Lutz Walter: European Technology Platform for the future of textiles and clothing. <http://www.euratex.org/>

<sup>3</sup> Luis Navarro: Recent theoretical developments and implications for EU policy (Enterprise Papers, No 12)

<sup>4</sup> Szalavetz (2004); and Discussion on Innovation (organized by NFH-KOPINT-DATORG, January of 2005).

100 thousand employees at the turning point of the century (without trade and services) has experienced recently an accelerating and continual shrinkage. This raises the question whether the feature of Hungarian labour market, the time-intensity of transformation in education system and the space of restructuring could result reemployment of those who left labour-intensive sectors, such as the TC industry? In a time when unemployment rate is already high (7%) and fast increasing, especially in some regions.

Role of the TC sector in Hungarian economy, and the main factors of its declining competitiveness

Sector development during 90s demonstrated, that clothing industry came out first from the transitional crisis. It had a leading role in export reorientation, and in restructuring, and first attracted the FDI. It started to decline at the second part of the decade, and speeded up after 2000. Our analysis proved that – similarly to agriculture – recession, accession to the EU and recent world trade liberalization of TC products affected the sector at the same measure (or even more), than the transition.

**Table 1. Textile and clothing industry in the transitional crisis**

At current prices, billion HUF, and percentage, manufacturing = 100

	<i>Production, at current prices</i>			<i>Employees, head</i>		
	Shares, %		Rate of growth, %	Shares, %		Rate of growth, %
	1988	1992	1992/1988	1988	1992	1992/1988
Textile industry	5,0	3,4	72,4	8,0	6,0	47,8
Clothing industry	1,7	2,1	127,4	5,1	6,7	84,5
Manufacturing	100	100	105,9	100	100	63,8

Source: Central Statistical Office (CSO), own calculation (*Hitchens et al*<sup>5</sup>)

**Table 2. Role of T/C sector in manufacturing**

2000-2004, at current prices, billion HUF, and percentage, manufacturing = 100

	<i>Production, at current prices</i>			<i>Employees, head</i>		
	Shares, %		Rate of growth, %	Shares, %		Rate of growth, %
	2000	2004	2004/2000	2000	2004	2004/2000
Textile industry (17)	1,5	0,9	79,7	4,4	3,8	80,7
Clothing industry (18)	1,8	1,4	103,2	9,1	6,5	67,6
Textile and Clothing industries DB (17+18)	3,3	2,3	92,2	13,5	10,2	71,9
Manufacturing D	100	100	131,4	100	100	94,9

Note: firms with more than 5 employees, in 2004 > 4 persons

In 2005, the share of the sector's production in the manufacturing industry decreased further to only 1,9%, 92% of the value of the previous year and 85% of the value in 2000. The number of employees in 2005 (including leather and shoe industries) was only 70 thousand, less than 84% of the labour force in the previous year (employees in manufacturing industry also declined to 97% from 2004) (CSO).

Source: Central Statistical Office (CSO), own calculation

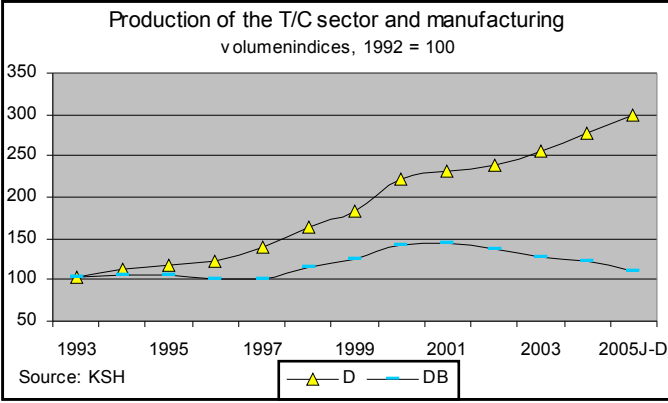
Decline of the sector in production and in exports at the second part of 90s was relative, rather statistical than real, mainly due to the emerging and fast developing new export-oriented industries (such as car industry and electronics).

After 2000, recession at main export-markets, accession to the EU and import-liberalization caused an absolute decrease, much greater and stronger decline of the TC sector output than earlier or than previously expected: TC production (at constant prices of 1992) first stagnated and later, since 2002, has declined.

Relative decline of the TC sector in manufacturing production and exports was continuous, but had hardly changed in employment by 2002. Recently, however, the sector became the

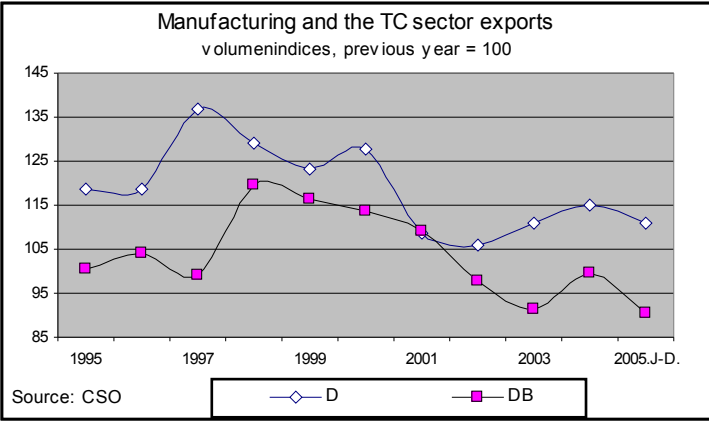
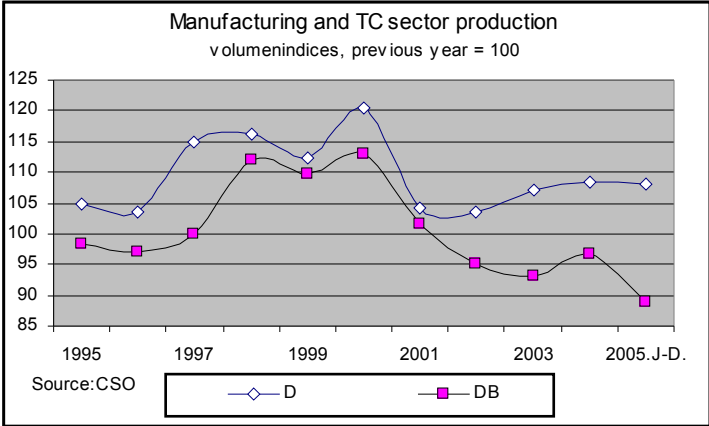
<sup>5</sup> Hitchens et al: Competitiveness of Industry in the Czech Republic and Hungary (Avebury, 1995)

main factor for losing work places in manufacturing, due mainly to the firm closures and lay-offs in the clothing industry.



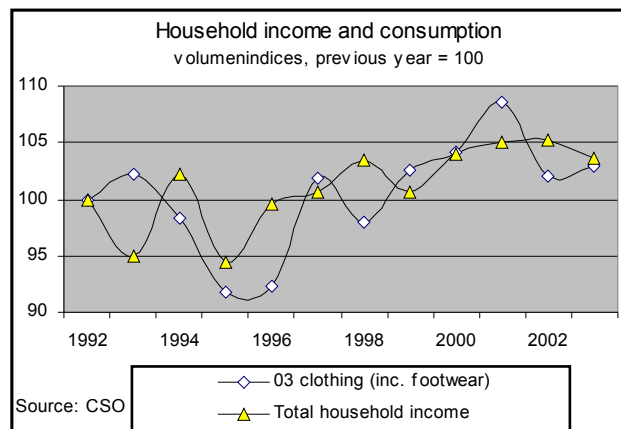
- Between 2000-2004, the number of employees in the sector decreased by 28,5 thousand people, and out of this more than 22 thousand disappeared from the clothing industry. In 2003, in one year, the number of lay-off (8291 people) was larger than in two previous years altogether (7962) and in 2004 further 5841 employees lost their jobs (data considers firms larger than 4 employees). (In manufacturing, in four years 38,5 thousand, and in 2004, “only” 7233 people were dismissed).

Sector development had strong correlation with export-performance (See the next two charts)



The sector started to lose its competitive advantages already in the second part of 90s, contrary to the fact that production and exports still increased that time at a dynamic space. The rate of growth in exports has started to diminish since 1998, and in production since 2000. Fall in space has become an absolute decline since 2002. The main factor for output decline was the shrinkage in domestic household spending after the introduction of economic

stabilization package in 1995, while the opposite trend in 1998 and especially in 2001, postponed the output decline up to 2002. (See next chart).



In 2002, the fall in domestic expenditure on clothing together with decreasing volume of exports again set back TC production. In 2003, exports decreased by near to 10%. After a small recovery in 2004, next year the sector also experienced a large decline both in exports and in the production (at real term by 10%).

#### *Exports, Outward processing trade (OPT)*

In the second part of 90s, in spite of the still dynamic increase of TC export products (by 275%), their share in exports decreased from 13% to 6%. This fall was mainly due to growing exports of the new export-oriented industries (such as electric and transport equipment) (Total exports at current prices, in HUF increased by five times at the same period).

- EUROSTAT data placed clothing products (HS62) in 1995 at third in exports to the EU<sup>6</sup> with 6,7% share. By 1997 – the expansion of transport equipment exports (HS87) – pushed it to the fourth place with 5% share, by 2000 the proportion of clothing products fell below 3% and in 2002 they disappeared from the first five product groups.

Contrary to the earlier trend, the recent further fall in the sector's export-share (from 6% to 4%) is mainly due to the radical decrease of clothing items (SITC84) (at current prices, in HUF by 13%, their export-share felt from 4,5% to 2,7%). (CSO)

Demand on OPT has had an important role in the fall of rate of growth in TC exports. Eliminating quotas since 1998 toward the accession countries ended up custom advantages on OPT compared to ready-made-products imports, and gave incentives to production relocation to Romania, Bulgaria, Turkey and the Mediterranean countries. Due to global geographical reallocation and fast restructuring, traditional partners for OPT (especially in Germany) turned rather to more prosperous industries (such as engineering, electronics), or those producers who newly entered into globalisation, such as Italian and Greek firms, went rather to Romania, or Bulgaria to make production.<sup>7</sup>

As a result of these changes in conditions of the Hungarian exporters, clothing export under the OPT had decreased even in absolute value terms (in USD), especially since 1998, and the income on the OPT exports had diminished at all markets by 2000.<sup>8</sup>

<sup>6</sup> The first two groups of goods were HS84 (Boiler, machine, mechanical equipment), and HS85 (Electronic equipments) EUROSTAT (OECD ITCS), calculated by Ákos Z. Kovács in „EU-accession and the adjustment ability of the Hungarian economy” research under OTKA (T 035132 KGJ).

<sup>7</sup> Andreff M., F. Boudier-Bensebaa: La sous-traitance de façonnage entre l'Union européenne és les pays est-européens (2000) (Tampere, VI. ICCEES World Congress)

<sup>8</sup> Hamar: Paradigma-váltás? (Külgazdaság, 2002)

Due to decreasing share of OPT in exports and especially the fall of income rate on OPT-exports, the TC sector contributed less and less to the gross value-added (GVA) of manufacturing output.

- The sector's contribution to manufacturing GVA was still 7,3% in 1995, and by 2000 it had decreased to 5,5% mainly due to the textile industry. Since 2000 the whole manufacturing has lost its share of GVA production, which temporarily (in 2001) let the GVA share of TC sector increase. In 2002, however, GVA shares of both the textile and clothing industries decreased by one percent point (altogether to 4,8%).

Decline now is in absolute value, and due to a complex combination of factors. The first factor was the impact of economic slowdown in the EU, and at its major export markets. Second, the evolution of the US-dollar and Euro exchange rate has continued to have a negative impact on price competitiveness of several types of product both in industrial textile and clothing production. Finally, the development of the Euro-Med Zone and preparation for the new economic realities post 2005 in the wake of quota elimination, has led to further relocation of production within and outside the EU-25. Each sector from spinning through weaving to clothing was affected by one or the other factors.

Since the great openness and extreme level of export share in the Hungarian TC production and the already high level of integration to the EU markets by the end of 90s, these changes obviously strongly affected the Hungarian producers. Development of the exchange rate had also much stronger economic effects on the Hungarian exporters, as the appreciation of Euro exchange rate was aggravated by the appreciation in HUF/Euro. This impact was especially strong in 2001, when exchange rate regime was changed suddenly, and unexpectedly. In the following years the high volatility of exchange rate caused rather the problems to the firms.<sup>9</sup>

In spite of the main market developments, the losing trend in OPT markets, and the exchange rate development, all having large negative impact on the export-income, the export-orientation of the sector increased more than manufacturing average between 2000-2004.

- Export shares in clothing production significantly decreased between 2000-2002. After then, by reacting to the recovery of external markets, it increased again, especially in 2004-ben, when the share of exports in production grew by almost 3 percent points.

**Table 3. Export-orientation in manufacturing industry and in the T/C sector, 2000-2004**

<i>Exports in production, % (at current prices, based on HUF data)</i>	2000	2002	2003	2004
Manufacturing industry (D)	58,4	59,7	61,2	62,8
TC sector (17+18)	64,9	70,3	69,2	71,2
Out off it: Textile industry (17)	54,5	67,1	62,4	64,2
Clothing industry (18)	74,0	72,4	73,3	76,0

Source: CSO, own calculation

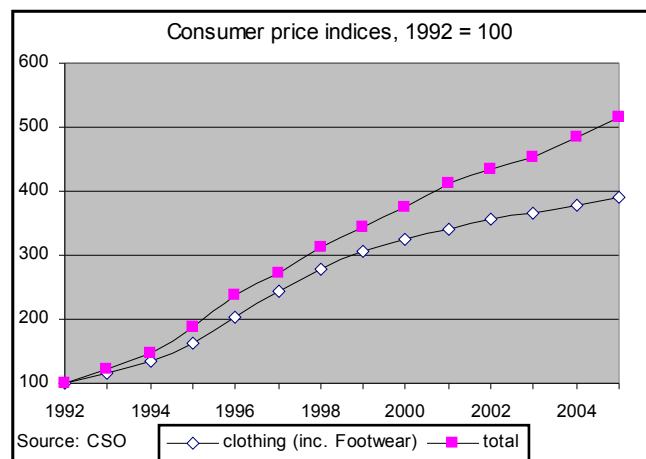
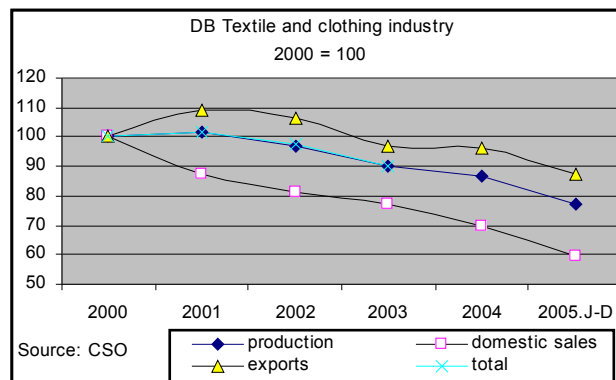
- Contrary to clothing, the textile-producers – despite the deteriorating export-possibilities, and because of the worst domestic market potential – had increased their export share in production by 2002. After then, a significant fall was registered again and in spite of a two percent point increase in export shares in 2004, this still was much lower than in 2002.

#### *Domestic market changes*

TC sector output development – in spite of the high export-orientation level – depends also on home market developments. The fall in household expenditures on clothing and a relative decline in consumer prices signalled the increasing problems of firms to sell their products at home markets. Next chart well illustrates these increasing problems. In 2004, domestic sales

<sup>9</sup> GKI-KD-PKI: Direct and indirect impacts of the Forint's exchange rate on the economy, 2001, 2003.

(at current prices) fell by 9% compared to the previous year, and in 2005, a further decline of 13% caused that the value of domestic sales was only 60% of the level of 2000.



The level of domestic demand is characterized by the fact, that per capita household spending on clothing in 2004 was only 3,7% of the total (with footwear 5,1%). (Ten years earlier households still spent 7,2%, and even in 1998, this proportion was still 6,1%. To compare this to the German level, where a continuous fall in clothing expenditure raises complains, household' expenditure on clothing is still 6% of their income.)

Deteriorating trend of domestic sale-prospects of Hungarian producers certainly is aggravated by the dynamic increase of cheap Chinese imports, however, without detailed data, we can rely only on information coming from the firms.

- Foreign trade data showed a dynamic increase of imports of textile and clothing products even during the second part of 90s, which surpassed the rate of growth of exports: (except textile fibre, HS65), all items had higher increase in imports than in exports. In the largest export-product group (clothing, HS84), imports increased three times from 1995 to 2000, but its share still decreased in the total imports (from 8,8% to 5,3%).
- After 2000, the imports of TC products increased relatively at a modest space (in four years, only by 3,8%!, compared to the total import-growth of 35%). This trend can be explained by the fall of imports of textile fibre (HS26, and HS65), which is due to the fall of OPT-exports. Imports of clothing (HS84) increased at a dynamic rate (by 25%, while that of the travel accessories (HS83) grew by 44%!) from 2000 to 2004.
- Trade deficit in the sector increased from 10 billion to 37 billion HUF between 2000-2004, mainly as a consequence of declining export-surplus (from 201 billions to 120 billion HUF) in clothing foreign trade.

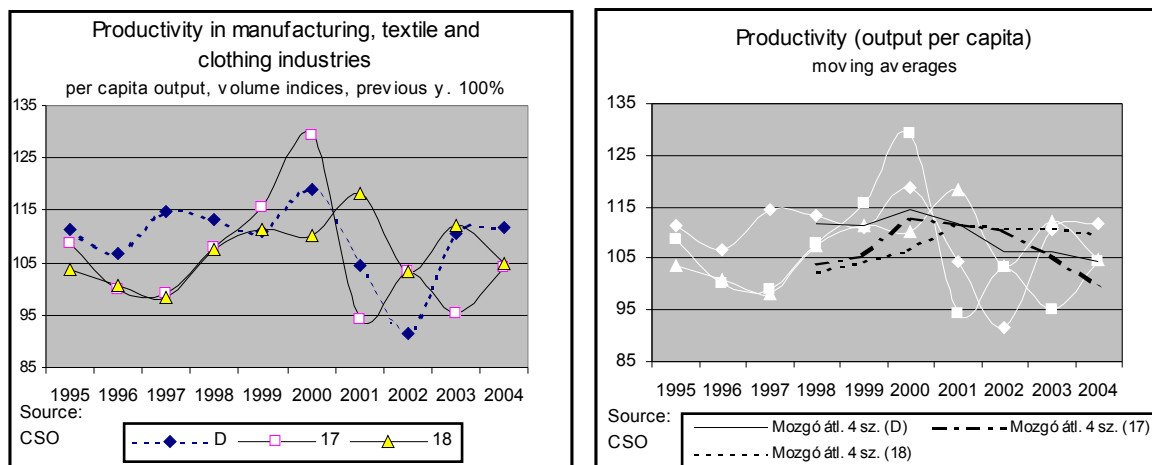
Summarizing the present for the Hungarian TC sector, it can be characterised as a highly integrated (and dependent) industry on foreign markets, much more than in the EU average, while the import-penetration at the manufactured clothing product markets (presumably) is still clearly much lower, but fast growing. Assumption of the European Commission was 20% for import-penetration in textile and clothing apparent consumption, in 2002 (28% in textile and 15% in clothing). The same proportions in the EU-15 were 30, 18, and 41%, respectively, and in the new member states: 17, 18 and 16%.<sup>10</sup> It is well known, also, that Hungarian firms outsource production abroad, but there are no correct data on the size of this activity.

In the sector, clothing industry further increased its share at the expenses of textile industry after 2000. There are new phenomena, however, that textile industry could expand its role at the home market after 2002, and increased its share in production and exports in 2004. That is, the shrinkage of clothing industry has speeded up just after the end of global recession.

As a conclusion, we can assume (in the absence of correct detailed data), that the free market after the EU-enlargement and the impact of fast increasing Chinese imports after the quota (temporary) elimination raised competition more than earlier for the Hungarian producers mainly at the home markets of clothing goods.

#### *Adjustment ability and productivity*

While the sector's economic role decreased, productivity growth proved its significant ability to adjust. Between 1995-2000, a considerable adjustment happened both in textile and clothing industries, however its dimension differed in timing and in magnitude: from 1995 to 1997 productivity in both sub-sectors slowly declined, while from 1997 to 2000 a strong catch-up trend could be registered. (See next chart at left side). After 2000 a large volatility in productivity featured the sector.



Note: Comparing indicators in TC sector to the manufacturing needs to take account the high share of OPT in the previous, especially in clothing industry, which distorts downturn the indicators of the sector.

The moving average indicators (*right chart*) show that contrary to the decreasing trend of productivity in manufacturing, clothing industry improved the per capita output indices annually by more than ten percents between 2000-2004, while productivity in textile industry has steeply decreased since 2002, more than the manufacturing average.

*In spite of the significant adjustment in the sector, productivity level is still much lower than manufacturing average:* the indices of gross value added per employees in 2000 were only

<sup>10</sup> The fact, that foreign trade data include raw material and spare parts imported to the exports under OPT, while industrial data of firms include only items the firms paid for, makes it difficult (or impossible) to calculate a more valuable rate of import-penetration in consumption.

third to half of those in manufacturing. Inside the sector it is clearly visible that textile industry has higher value-added productive ability, while clothing industry getting higher and higher share in the sector still has the lowest GVA indicator. By 2002, GVA productivity had grown everywhere, but the gap had increased mainly due to the relative drop of productivity in textile industry. Productivity in clothing industry increased the most, but its level hardly surpassed the 38% of the level of manufacturing average.

**Table 4. Productivity level in the TC sector**

Gross Value-Added (million HUF) per number of employees (head), manufacturing average = 100, percent

		GVA/head		Manufacturing = 100	
		2000 Million HUF/head	2002	2000 Percent	2002
D	Manufacturing	3,7	4,3	100	100
DB	Textile, and textile products	1,5	1,7	41,1	40,3
	Out off: 17 textile industry	1,8	1,9	50,1	44,7
	18 Clothing industry	1,3	1,6	36,8	38,2

Source: CSO, author' calculation

*Role of foreign direct investment and indigenous firms abroad*

FDI had a similarly important role in the sector development as in manufacturing. Dynamic growth and export-orientation were speeded up by the FDI during the 90s. However, as in production and in exports, clothing industry lost its leading position even in attracting the FDI. The lower rate of foreign equity share in clothing industry is a special character of the sector and relates to the high frequency of OPT links, where the foreign partner can keep in hand all important business functions without investing directly. Indigenous firms, also, have much higher export-intensity under OPT than in other industries.

**Table 5. Foreign and indigenous firms' export-orientation, 1996-2000**

Export-orientation	Exports/output			
	Foreign firms	Indigenous firms	Foreign firms	Indigenous firms
		1996		2000
DB Textile and textile products	58,2	37,2	72,0	37,5
D Manufacturing	42,5	20,6	59,9	21,8

Source: Double-entry accounting firms, tax reports (APEH-KOPINT-DATORG data-base) author's calculations

The fact that the export share in total sales of the indigenous firms had hardly grown by 2000 was a signal of their losing competitiveness, while foreign firms could increase further their export-orientation.

Foreign firms had the smallest proportion in clothing industry (except in exports), smaller than manufacturing average (except the number of firms).

**Table 6. Shares of firms with FDI in the TC sector, 2000**

Proportion, percents, total companies in the sector = 100%

	FC/IC proportion	No of firms	FDI/SC*	II. ASSETS	Exports in Net sales	Total sales	Number of employees
D Manufacturing		17,3	61,0	75,7	88,6	73,8	49,4
17 Textile industry		24,5	58,0	63,7	71,9	59,1	43,1
18 Clothing industry		17,4	53,4	57,0	76,1	60,9	37,3

Source: Double-entry accounting firms, tax reports (APEH-KOPINT-DATORG data-base) author's calculations

Foreign firms dominated, however, – in assets, output, exports, and even in employees – the most the clothing industry: they had three or four times higher average indicators per firm, than the indigenous firms. In textile industry the gap was smaller but still significant.

**Table 7. Foreign firm's indicators compared to the indigenous firms in the TC sector, 2000**

Averages, percent, indicators of all firms in the industries = 100

	Indicators: FC/IC	II. Assets	Exports in Net Sales	Total Net Sales	Number of employees
17	Textile industry	259,5	293,0	240,8	175,7
18	Clothing industry	327,2	437,2	349,7	214,4

Note: FC= foreign company, IC= indigenous company; \*SC=statuary capital

Source: the same as at the previous table

After 2000, a global decline and significant slow-down of FDI in Hungary also contributed to loosing attractiveness of clothing industry for FDI.

Data on foreign investments of Hungarian (resident) firms do not reveal significant equity positions abroad. Except a considerable investment abroad in 2000, they participate at a modest rate in this trend: the value of FDI abroad radically decreased in 2001, and since than there has been a constant trend to disinvest abroad. There are no correct data about outsourcing the clothing production abroad without equity relationship.

**Table 8. Resident foreign direct investment abroad, stock, million euros**

EUROSTAT	NACE	1998	1999	2000	2001	2002	2003
3995	D	50	125	172	201	320	801
1805	DB	1	1,6	13,6	0,9	0,4	0,1

Source: Hungarian National Bank (HNB): Direct investment statistics, Hungary, 1995-2003 (21/03/2005)

Trend-changes (?) and prospects

Almost all indicators, so far, indicate an accelerating decline of the TC sector in the Hungarian economy after 2000, in production, in exports and even in employment, too. The question is, whether these changes are temporary mainly due to the recession and the slowdown of domestic demand, or signals for a permanent trend-change? Productivity raised the most in clothing industry, but the gap, also, is still here the largest.

Recession, outsourcing, growing competition of neighbouring countries, fast emerging Far East competition, high sensitivity of the Hungarian exports (especially the OPT) on external demand, and the better adjustment ability of the clothing industry over the textile production are not new phenomena. Declining FDI attractiveness of the sector is also not a new symptom. The *magnitude of changes is novel*: radical fall in FDI role (disinvestments, closure of firms), and the fact, that – despite of recovery at external markets –, clothing producers in particular face with deteriorating domestic market prospects and struggle with new dimension of problems.

It is new that clothing industry has ceased to be an employment-absorbing industry. Magnitude of lay-off is extraordinary and the fact that it is further going on even after the end of recession, signals a changing trend. As a consequence of the recession, decrease in the number of employees accelerated in both sectors after 2000, but its dimension now is so great, that the sector became the most important factor of unemployment growth in manufacturing. In 2004, textile industry seemed to recover somewhat, at least employment started to increase by 641 persons, while in the clothing industry the lay-off and the closure of factors continued (81% of total lay-off in manufacturing happened here).<sup>11</sup>

<sup>11</sup> According to the database of FigyelőNet, out off 641 textile and clothing firms more than one quarter are under closure (100) or end up process (63).

*The sudden and radical minimum wage level increase* was another new phenomenon, which obviously affected the most those industries where wage level was the lowest in manufacturing, such as footwear and clothing industry. However, or just therefore, average gross monthly wages increased first at the same way as in manufacturing, but since 2002 and mainly in 2004, wage-increase in clothing industry were the most modest.

The *very low salary level* featured the white colour workers, too. The gross average salary for them was hardly the half of manufacturing average, which is not too encouraging for future prospects of the sector.

Despite lower wage level, the *wage- and social security* contributions in the sector meant two- or three times higher *burden* (1/5 of total costs) than in manufacturing. This is partially the main reason for the relatively high and increasing rate of part-time work in the sector: in 2000, near to 1/10-th of employees worked in part time, it increased to 16% in 2003 (in textile industry this rate was 17%).

*Firm size* in the sector is dominated by the SMEs in Hungary, too. Due to the high share of OPT, and the labour intensive character, however, one or two large firms can determine employment-level and even tax income in some regions. Productivity gap to manufacturing is also the largest in the case of large firms.

Decreasing trend in *investment*, mainly in 2003, is also not too encouraging for future prospect of adjustment ability in the sector. In 2004 investment in the sector further decreased (to 95% of the previous year value) and it was only 1,2% of the manufacturing average.

Present state of *R+D* (based on measurable but very incomplete data) also makes it difficult to expect a fast and successful catching up process in the sector. In 2004 there were only 11 researchers (CSO data, calculated for full-time equivalent) working in R+D in the sector, this meant 0,25% of all researchers in all enterprises. The expenditure on R+D also fell radically. (In 2004, the sector R+D expenditure was only 0,1% of that of all enterprises.) By patents, fashion, or brand names it is also difficult to identify any Hungarian firm.

Under negative effects of recession, slow-down in external demand, exchange rate changes, wage-increase, and fast growing import-competition, *the main tool of strategy to adjust, the most frequent and feasible way seemed to be the lay-off, and keeping low the wage-level (by part time work and by avoiding wage-contribution, such as social security), and that of the investment. For longer run, however* (which could be very short due to fast and radical changes on international markets), *it is questionable, whether this kind of strategy could preserve the present level of competitiveness.*

Competitiveness based on micro data, by sub-sectors and ownership pattern

By analysing financial data of double book-keeping companies in 2000-2003, it turned out, that the most important changes in the textile and clothing industries were, that the attractiveness of the sector now not only deteriorated but the role of FDI fell radically.

In *textile industry* a clear new trend appeared after 2000: that is the decreasing role of foreign firms in all respects, even in exports. In 2003, their performance indicators deteriorated, too. Performance indicators for foreign firms still marked an improving trend in 2001, but in 2002 the operating surplus fell to 45% of the value of previous year and in 2003 even the balance sheet produced negative results. *Foreign firms produced only the 34% of operating surplus of the sector, 13% of the own results, and only 10% of profit before taxation compared to the total of the sector. The foreign firm group produced only 7%(!) of results after taxation, while they paid 86% of total dividend accumulated in the sector in 2003.*

**Table 9. Market shares of foreign firms and trends in the foreign and in the indigenous firms**

Group average

Textile industry	The share of foreign firms in the sub-sectors				Foreign firms	Indigenous firms	All firms
	2000	2001	2002	2003	Dynamics, 2003, 2000=100%		
01 Net income on sales at home	46,5	38,1	40,7	26,0	44,3	109,5	79,2
02 Net income on Exports	71,9	71,0	72,1	65,9	71,2	94,1	77,7
Total net income on sales	59,1	55,3	56,8	45,6	60,5	104,3	78,4

Source: Double entry bookkeeping firm's financial declarations to the Tax Office (Tax Office and KOPINT-DATORG data-base), own calculations

Despite of the relatively better (at least less worst) performance of the indigenous textile firms, the narrowing gap between the two groups still remained important even in 2003, at favour to the foreign group. Each performance indicator of the foreign firms in 2003 – except the profit to the NIS, or the ROI – was two or three times higher than the indigenous firm group average. The smallest gap (of 20%) emerged in per capita wage costs.

**Table 10. Economic indicators**

Textile industry	Foreign firms				Indigenous firms				All firms			
	2000	2001	2002	2003	2000	2001	2002	2003	2000	2001	2002	2003
	Indicators to the Net income on sales (NIS), percent (NIS=100)											
Profit (operating surplus to the NIS)	4,6	5,6	2,7	2,5	4,7	2,9	2,2	4,1	4,7	4,4	2,5	3,3
Exports to the NIS	60,3	67,2	65,2	71,0	34,1	34,0	33,2	30,7	49,6	52,4	51,4	49,1
	Indicators to the employees (million HUF/ head)											
Number of employees per firm (person/piece)	88	91	78	81	38	31	27	26	50	43	38	36
Net income on sales per head	7,4	6,6	7,3	6,1	3,9	4,2	4,3	5,0	5,4	5,2	5,6	5,4
Exports per head	4,4	4,5	4,8	4,3	1,3	1,4	1,4	1,5	2,7	2,7	2,9	2,7
Capital intensity (own capital per head)	2,5	2,4	2,8	2,8	1,3	1,3	1,7	1,8	1,8	1,8	2,2	2,2
Wage costs per head	0,8	0,9	1,1	1,0	0,6	0,7	0,8	0,8	0,7	0,8	0,9	0,9
	ROI and investment (%)											
Profits (own activity) to statutory capital	13,9	15,7	6,9	5,3	13,8	8,8	5,6	11,5	13,8	12,8	6,4	8,3
Profits (own activity) to assets	18,8	21,3	9,1	6,3	24,7	14,5	10,9	25,5	20,8	18,7	9,7	12,6
Investment to the statutory capital	11,5	10,6	9,9	6,0	6,3	3,6	4,2	4,2	9,3	7,6	7,4	5,2
Investment to the assets	15,6	14,3	13,0	7,1	11,2	6,0	8,1	9,4	14,1	11,2	11,3	7,9
Investment to FDI	17,5	16,2	14,4	7,8	0	0	0	0	24,2	20,2	19,0	12,8
Profit after taxation to profit before taxation	74,1	73,1	75,2	27,1	80,9	71,5	57,3	79,0	77,4	72,5	71,2	69,4
Long run liabilities to statutory capital	41,0	42,0	30,2	31,2	29,8	14,1	11,5	12,4	36,3	30,3	22,1	22,2
Short run liabilities to statutory capital	87,8	88,6	87,4	111,2	87,3	89,6	83,5	78,9	87,6	89,0	85,7	95,9

Source: the same as at the previous table

Specific trend characterized the development of the ROI, too: good performance in 2000 in both groups, turned to be deteriorating first in the indigenous group in 2001, but next, especially in 2003, deterioration was so large in the case of foreign firms, that the indigenous firms' indicators surpassed those of the foreign groups. The debt-level (at short run) also increased at an extreme way in the foreign group.

In the *clothing industry* similar tendencies could be registered: withdraw of capital, radical investment fall, decreasing share of foreign firms featured this industry, too, with an important difference, that here, performance indicators deteriorated radically in the indigenous firm group. While the fewer number of foreign firms with decreasing number of employees increased their share in exports, and according to the most performance indicators, their positions became extraordinary in the sector. Even the ROI improved in this group.

The market share of foreign firms decreased in the clothing industry, too. At domestic markets this trend was continuous and radical: in 2003 their share in domestic sales was only 68% of that of 2000. Their exports, however, increased further – contrary to the textile industry –, while the indigenous firm group faced an opposite tendency. The foreign firms, having only a rate of 1/10 by number of firm, and 1/4 of employees, produced the 82% of the sector’s export-income in 2003.

**Table 11. Market shares of foreign firms and trend in the foreign and in the indigenous firms**

Group average

Clothing industry	The share of foreign firms in the sector				Foreign firms	Indigenous firms	All firms
	2000	2001	2002	2003	Dynamics, 2003, 2000=100%		
01 Net income on sales at home	27,7	21,9	18,0	15,8	67,5	138,0	118,5
O2 Net income on Exports	76,1	77,5	79,1	81,5	117,7	85,0	109,9
I. Total net income on sales	60,9	59,9	56,8	59,8	110,5	115,8	112,6

Source: the same as at the previous table

Investment in the clothing industry also fell radically (to the 37% from the level of 2000), mainly due to the decrease in investment of foreign firms to one/fifth of the value in 2000. The indigenous firms had decreased their investment “only” by 30% by 2003.

While subcontracting activities decreased much in both groups, purchase of material type services (outsourcing) increased two times in the indigenous group, and four times in the foreign group in three years. A significant increase in the value of immaterial goods (intangible assets) in both company groups may signal a quality adjustment.

Contrary to the changing trends in textile industry, *performance indicators in clothing industry significantly improved* (after the negative results in balance sheets of 2001). This was *due exclusively to the foreign firms. Indigenous clothing firms experienced a continuous deteriorating trend*: in 2002 and in 2003, according to the balance sheets, their results were negative, and “improvement” meant only decreasing losses. The main sources of losses were financial market activities (in both groups in 2000, and in 2003, but in 2001 and in 2002, only the indigenous firms got negative results). Operating surplus of the indigenous group also significantly deteriorated.

*Foreign firms* in the sector (hardly more than 1/4 of firms) with 1/4 of the employees produced the 92% of the operating surplus and that of the profit before taxation, while after taxation their share reached 95%. Even in 2003, each performance indicator signalled an important improvement (except the ROI). There was a continuous increase in the already high level of export-orientation: exports took 91% of their total output in 2003. Parallel with decreasing average firm size, the wage level per head increased, however, its level of 940 thousand HUF still in 2003 was very low. The capital/labour ration increased by 0,9 percent points in one year, and the ROI also grew at a spectacle rate.

The *indigenous firms* – contrary to the foreign group – experienced radical deteriorating conditions especially after 2001. In 2003, a little improvement could be registered, but in spite of this, the profit to the NIS fell to the half, the export-share to output from 42% to 31%, and the ROI also decreased nearly to the half of 2000. Capital intensity did not change, and the wage level – in spite of an important increase between 2000-2002 – suffered a significant fall in 2003. By this way it resulted an annual level of 550 thousand HUF per capita, which was hardly more than the half of that in the foreign firm group. So far, the gap between performance indicators of the two firm groups further increased, especially in 2003.

**Table 12. Economic indicators in the clothing industry**

Clothing industry	Foreign firms				Indigenous firms				All firms			
	2000	2001	2002	2003	2000	2001	2002	2003	2000	2001	2002	2003
	Indicators to the Net income on sales (NIS), percent (NIS=100)											
Profit (operating surplus to the NIS)	6,0	5,9	6,4	10,0	2,7	1,4	0,7	1,3	4,7	4,1	3,9	6,5
Exports to the NIS	85,7	88,4	88,4	91,3	41,8	38,2	30,7	30,7	68,5	68,3	63,5	66,9
	Indicators to the employees (million HUF/ head)											
Number of employees per firm (person/piece)	106	96	79	76	38	30	27	29	49	40	33	34
Net income on sales per head	5,0	5,9	6,7	8,7	1,9	2,2	2,3	2,1	3,0	3,5	3,6	3,8
Exports per head	4,3	5,2	5,9	7,9	0,8	0,8	0,7	0,6	2,1	2,4	2,3	2,5
Wage costs per head	0,76	0,81	0,88	0,94	0,47	0,57	0,65	0,55	0,58	0,65	0,72	0,65
	Rate of return on investment (%)											
Profits (own activity) to statutory capital	29,0	35,3	27,3	34,9	10,0	5,9	2,7	4,9	20,3	20,8	16,3	23,4
Capital intensity (million HUF/head)	1,0	1,0	1,6	2,5	0,5	0,5	0,6	0,5	0,7	0,7	0,9	1,1
Profits (own activity) to assets	45,3	51,8	57,0	110,5	19,8	11,8	5,6	10,7	35,1	35,1	33,8	62,9
Investment to the statutory capital	14,0	6,7	2,4	3,7	10,1	7,5	7,2	6,8	12,4	7,0	4,6	5,2
Profits (own activity) to assets	15,6	14,3	13,0	7,1	11,2	6,0	8,1	9,4	14,1	11,2	11,3	7,9
Investment to FDI	16,9	7,6	2,7	4,1	0	0	0	0	25,0	13,7	9,5	11,1
Profit after taxation to the profit before taxation	91,1	91,8	95,5	95,2	67,1	39,0	-46,9	57,7	86,7	86,5	90,1	92,1
Long run liabilities to statutory capital	20,1	27,1	11,7	14,5	21,0	21,4	20,3	24,0	20,5	24,3	15,6	18,2
Short run liabilities to statutory capital	172,9	186,6	94,7	94,2	95,3	113,6	117,0	120,8	137,4	150,6	104,7	104,4

Source: the same as at the previous table

More detailed analyses of firm data (*standard deviations and variances*) proved the already well-known fact that heterogeneity inside a company group is larger than between two groups. This was valid for both industries.

*Correlation calculations* revealed strong and significant links between foreign investment, export-orientation, firm size, and cash flow, both in textile and clothing industries. Performance indicators did not relate to the FDI. The ROI (dividend to the assets) opposite to the textile industry produced a positive, significant correlation to most indicators, the strongest to the operating surplus.

*Regional distribution of textile firms* did not show a geographical concentration (but the dominance of Budapest). *Clothing industry* – according to its traditional development and results of earlier delocalisation of production to the cheaper countryside – less concentrated to the capital. But, in both cases, one or two large firms could determine employment (and income) level of a county. Even in area, where the scope of the sector is small, foreign firms have a determinant role, so a closure could affect sensitively the county development. The role of clothing firms in employment was also important in areas, where unemployment level was already very high, such as at Szabolcs-Szatmár county, where beside employment problems, tax income would be affected seriously if a foreign firm leaves the area.

#### Non-measurable factors of firm competitiveness

An international empirical survey in five new member states<sup>2</sup> aimed to analyse the fact, how much the subsidiaries of multinational firms depend on parent firms, how much they can decide and what business functions? Are there any links between the competence of firm

<sup>12</sup> To analyse the factors of competitiveness and productivity gap a survey was made in Estonia, Hungary, Poland, Slovakia, and in Slovenia, among 438 subsidiaries of multinational firms in manufacturing, during 2001-2002. Here we rely on results only on the TC firms. (*EU Integration and the Prospects for Catch-Up Development in CEECs – The Determinants of the Productivity Gap* – (Contract no. HPSE-CT-2001-00065) ([www.iwh-halle.de/projects/productivity-gap.htm](http://www.iwh-halle.de/projects/productivity-gap.htm)))

management on decision process and firm development, and if there are, how much the competitive position of the firm depends on where and who made the decisions?

In the whole sample we did not find any significant correlations among the degree of autonomy (vs. integration) in decision-making and industries grouping by technology intensity (according to the OECD categories). While for textile and clothing firms (and for the Hungarians, too) the results were clear and significant: the level of integration (degree of parent firm's competence in business functions) linked strongly to the firm's market structure.

The Hungarian TC firms were featured by a relatively high autonomy – with a large variation of answers – in most business function. Even in process engineering Hungarian management had an exceptional high independence which might mean, that foreign partner acknowledged the Hungarian experiences in this field, or that foreign investors left the firm alone, or they might produce matured goods, when there is no need further development in process.

Product development, strategic planning, marketing, generally all market related business functions (setting prices, advertisement, marketing) belonged more to parent's competence.

Most firms have experienced important development since the appearance of foreign investor, the largest at the *level of technology*, and the least in the *export-orientation* (due to its high starting level). The magnitude of changes in sales correlated strongly to quality improvement, while the lack of links in other functions was the result of the large variance of answers.

Quality improvement related strongly to investment finance where a negative sign refers the fact that the more independent the firm the more development happened in quality level.

Analysing links among the importance of sources of competitiveness and the magnitude of changes in firm's development revealed that only the exports correlated with the importance of management, and there was a strong and significant correlation between the exports and the importance of the quality control in the case of the Hungarian textile and clothing firms.

**Table 13. Source of competitiveness and the magnitude of changes of the main factors**

In the Hungarian textile and clothing sample

Correlation (Spearman-Rho)	Sales	Exports	Level of Productivity	Level of technology	Quality level
CO_QUAL	0,322	0,802*	0,283	0,322	0,495
CO_PATEN	0,198	0,063	0,532	-,171	0,471
CO_PEOPPL	0,478	0,379	0,459	0,375	0,500
CO_MANAG	0,190	0,929**	0,395	0,463	0,342
N	8	8	8	8	8

CO\_QUAL = quality control; CO\_PATENT = patent, licences, R+D; CO\_PEOPLE = development in human resources; CO\_MANAGEMENT = level of management

Source: PROD-GAP database, own calculation

Strong and significant correlations featured the links between different financial sources and the degree of autonomy, especially, if the parent firm decided on strategic issues. In respect to past development, however, only reinvested earning had important (and significant) role in productivity improvement.

Answers on the question, who initiates changes in profile or organic functions, undertaking new functions or changing markets, revealed that Hungarian subsidiaries had extreme high autonomy (especially in functional upgrading, such as changes in organization and business functions). Despite of this, Hungarian managers had pessimistic view for future expectations:

- Only 25% of them expected an increase in sales or exports, the 38% forecasted stagnation, while 25% expected a significant fall in market prospects. Considering the functional

upgrading the picture was worst, only 25% planned any changes in business functions to improve value-added, and also only 25% of them wanted to reach VA improvement by product-differentiation. The remaining firms did not plan any changes.

Small sample size and large deviation in answers do not let generalize the survey results on the TC firms. The picture, however, which came out from the analyses of the non-measurable-factors of competitiveness, on autonomy/integration level of the Hungarian subsidiaries of multinational firms, and about the factors determining past development, is not too encouraging for the future.

Relative autonomy in business functions (especially in operating functions, operational management and even in process engineering, some role in strategic decision-making) placed Hungarian TC firms to a better position on the “learning curve”, but this was below average of all Hungarian firms, despite of their long life of a decade in most cases. Market functions (even accounting in some cases) belonged rather to the competence of the parent firm. The outstanding importance of the quality control, and the fact, that R+D was considered as less or not important, the lack of any links to other indigenous institutions, such as Universities, or research institute, all give the intention that these firms are rather production units than real companies, and their isolated positions raise barrier to technology transfer through spill-over effects, too. Their dependency on the foreign partner is extraordinary even in those cases when the parent firm does not interfere directly the business decisions, parent firm has determining role through market links, human-development and investment, and generally through financial issues. Even the very few home-market oriented firms depend also on the parent firm, at least by the fact, that in a deteriorating market conditions the parent firm could withdraw its capital, or finally close up the firm. Despite of the significant development at the most factors of competitiveness and the relative autonomy we can conclude that the future of these firms is almost exclusively in the hand of the foreign partner.

#### Scope and competitiveness of the Hungarian TC sector in international comparison

Previous studies<sup>13</sup> estimated, that the Hungarian economy would be affected the least among the new member and candidate countries by the drastic changes following the EU-enlargement, quota-elimination, and the Chinese export-invasion. The different effects of these changes cannot be separated, but our results of the international comparison oppose this forecast.

The recession affected the most (after Slovenia) the Hungarian textile and clothing industries.

**Table 14. Textile and clothing production in the CEEC countries**

Volume indices, 2000-2003 (I.-IV.), percentage, previous year = 100

	<i>Bulgaria</i>	<i>Czech Rep.</i>	<i>Estonia</i>	<i>Hungary</i>	<i>Latvia</i>	<i>Lithuania</i>	<i>Poland</i>	<i>Romania</i>	<i>Slovenia</i>	<i>Slovakia</i>
2000	112,8	111,9	118,6	113,1	110,4	107,1	99,8	112,6	104,3	105,0
2001	118,5	102,1	113,5	101,6	103,9	110,3	97,0	111,8	92,0	109,6
2002	123,5	98,6	107,1	95,2	100,2	99,5	99,8	107,8	87,5	103,9
2003. I-IV	133,0	97,2	103,7	92,6	96,4	102,9	101,7	98,5	88,6	98,5

Source: CANSTAT, 2004

It is true, that the Hungarian TC sector had relatively the smallest role in the economy at the time of getting full membership in the EU, as a result of a recent radical adjustment, in 2004.

<sup>13</sup> EU Commission: Economic and Competitiveness analysis of the European textile and Clothing Sector in support of the Communication „The future of the textiles and clothing sector in the enlarged Europe” Brussels, 21.11.2003. EU: Competitiveness Report, 2004, EU Commission: „The Future of Textile and Clothing After 2005”.

**Table 15. Structure of manufacturing in CEEC countries, percent, 2004**

	<i>Bulgaria</i> <i>a</i>	<i>Croatia</i> <i>a</i>	<i>Czech Rep.</i>	<i>Estonia</i> <i>a</i>	<i>Hungary</i> <i>y</i>	<i>Latvia</i> <i>a</i>	<i>Lithuania</i> <i>a</i>	<i>Poland</i> <i>d</i>	<i>Romania</i> <i>a</i>	<i>Slovakia</i> <i>a</i>	<i>Slovenia</i> <i>a</i>
DB	10,0	3,3	3,5	10,7	2,3	6,9	12,5	3,7	8,0	2,3	4,1
D	100	100	100	100	100	100	100	100	100	100	100

Notes: Czech and Slovakian data include firms > 20 employees, the Hungarian data are for firms > 4.

Source: WIIW database.

The Hungarian economy depended the least to the export-performance of the TC sector, as the export-share was already the smallest (similar to the Czech structure). The export-concentration on the EU markets (79%), however, was higher only in Poland and in Lithuania, and at the US markets (3,6%) only in Estonia (4,7%). Structural similarities with the Chinese export-structure, also, endanger also the most the Hungarian exports!

**Table 16. Export-structure to the EU15 in the new member states (C10)**

1995-2002

	<i>Czech Rep.</i>	<i>Estonia</i>	<i>Hungary</i>	<i>Latvia</i>	<i>Lithuania</i>	<i>Poland</i>	<i>Slovakia</i>	<i>Slovenia</i>	<i>C10</i>
				Knitted wear and crocheted fabrics (HS61)					
1995	..	2,3	2,9	5,1	4,5	2,0	2,1	2,6	2,2
2002	..	1,5	1,4	6,8	5,8	1,4	1,9	1,0	1,4
				Clothing product, non-knitted (HS62)					
1995	3,3	9,7	6,8	2,1	11,4	11,1	7,2	7,7	7,7
2002	1,5	4,8	2,3	3,5	14,9	4,6	3,8	2,9	3,5

Note: based on the first 15 product-groups in exports

Source: EUROSTAT (COMEXT)

The Hungarian domestic market conditions deteriorated more, than in most countries. Household's spending on clothing was relatively the lowest (after Bulgaria and Poland), and its fall was also high (similar to the Slovakian, Estonian and the Czech tendencies).

**Table 17. Households' expenditure on clothing (and footwear)**

2000-2003 (I-IV.), percentage, total household's expenditures = 100

	<i>Bulgaria</i>	<i>Czech Rep.</i>	<i>Estonia</i>	<i>Hungary</i> <i>y</i>	<i>Latvia</i>	<i>Lithuania</i> <i>a</i>	<i>Poland</i>	<i>Romania</i>	<i>Slovenia</i>	<i>Slovakia</i>
2000	5,4	6,7	7,3	6,3	7,0	7,5	5,5	8,2	8,9	8,0
2001	4,6	6,7	6,9	6,0	.	7,1	5,3	7,7	9,9	7,8
2002	4,7	6,5	6,6	5,7	7,3	8,7	5,2	7,8	..	7,7
2003. I-IV	4,5	6,1	6,2	5,7	..	9,3	..	..	..	6,6

Source: CANSTAT, 2004

The Hungarian consumer prices of clothing increased (after Romania) the most – but at a decreasing rate –, while in the other countries (mainly in Czech Republic and Lithuania) a significant decrease characterized consumer prices of clothing items. In the second part of 2004, the price increase started to slow down also in Hungary, and in 2005 supposedly due to the Chinese imports, Hungarian prices even fell in one and another months.

**Table 18. Consumer prices on clothing (including footwear)**

2000-2003 (I-IV.), percentage, previous year = 100

	<i>Bulgaria</i>	<i>Czech Rep.</i>	<i>Estonia</i> <i>a</i>	<i>Hungary</i> <i>y</i>	<i>Latvia</i>	<i>Lithuania</i>	<i>Poland</i>	<i>Romania</i>	<i>Slovenia</i>	<i>Slovakia</i>
2000	96,0	98,1	103,4	106,1	101,2	99,2	105,5	129,8	106,9	103,1
2001	100,3	98,3	103,8	105,6	100,9	95,8	101,5	128,0	101,3	102,4
2002	99,8	97,4	104,1	104,2	99,2	96,5	99,2	115,6	103,3	103,1
2003. I-IV	97,8	95,0	101,3	103,2	103,7	97,2	97,5	111,8	106,3	102,6

Source: CANSTAT, 2004

European wages increased continuously almost everywhere. Among the new member states, wages in the textile and clothing industry increased in the Czech Republic by 25%, in Hungary by 17%, in Slovakia by 9%, while Polish wages stagnated. Despite the significant increase, the Hungarian (and the Polish) wage level was only 15% compared to the German level (in the case of Slovakia, this rate was 12%). The Hungarian wage level was not at all the highest among the new member states, but productivity level – however with a large gap to manufacturing – was the highest in Hungary (after Slovenia), mainly in the clothing industry.

**Table 19. Average monthly gross wages and salaries in CEEC countries**

In euros, 2004

	<i>Bulgari a</i>	<i>Croati a</i>	<i>Czech Rep. a</i>	<i>Estoni a</i>	<i>Hungar y</i>	<i>Latvi a</i>	<i>Lithuani a</i>	<i>Polan d</i>	<i>Romani a</i>	<i>Slovaki a</i>	<i>Sloveni a</i>
DB	100	410	375	302	301	230	220	298	124	230	650

Notes: Czech and Slovakian data for firms > 20 employees, Hungarian data include firms larger than 5 employees, \* data for 2003, \*\* data for 2001.

Source: WIIW database

**Table 20. Productivity level in textile and clothing industries in NMS**

Gross Value Added per employees (GVA/head), thousand €/head

	<i>Estonia*</i>	<i>Poland</i>	<i>Czech Republic*</i>	<i>Slovakia</i>	<i>Hungary</i>	<i>Slovenia</i>
			GVA /head, 1000 € /person			
17+18	9,1	11,0	12,1	7,0	13,2	14,9
17	14,8	15,6			15,3	
18	5,8	9,0			12,2	

Notes: Gross Value Added in euros (PPP), data for 2000, except \* 1999

Source: WIIW and PROD-GAP database, own calculation

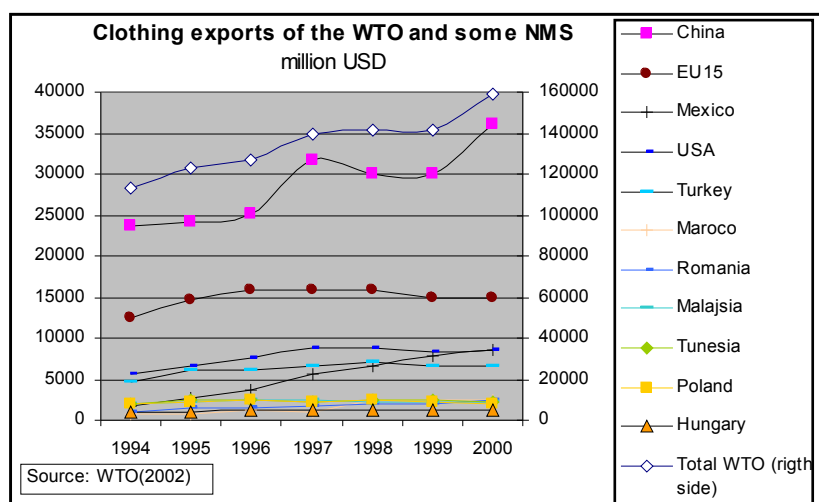
The role of the FDI became very similar by the end of last decade (according to the rate of employment) in these countries: the smallest was in the Czech and the greatest in the Romanian TC sector.

#### Global market shares and competitiveness

Hungarian clothing exports were losing market position even in the period of relative dynamic growth (between 1994-2000), but in a modest rate (from 0.9% to 0.8% compared to the total clothing exports of the WTO countries). The Chinese clothing exports – without any trade advantages – jumped even that time and became a determining factor of world trade. The Polish clothing exports started to decrease even in absolute terms since 1998, and the Hungarian decline (in US dollar term) happened in 2000.

The trend of Hungarian clothing exports practically followed the export-trend of the EU-15: Hungarian exporters could reach a significant improvement of their positions on the EU markets only in the first part of the 90s, following this period, they could increase their market shares only by 0,3 percentage points to 2,6% in 2000, when the EU15 exports stagnated and later decreased.

Hungary had only the 16<sup>th</sup> position in the extra TC exports of the EU15 in 2002, with less than 2% market share. China, Turkey, India, and Romania became the most important suppliers of the EU in textile and clothing trade. Hungary had a more important role as buyer than seller even that time, before the enlargement.



The revealed comparative advantage (RCA) indicators<sup>14</sup> on the Hungarian textile exports to the EU signalled comparative disadvantages for all items, but with decreasing trend from 1995 to 2000. Hungarian clothing exporters had comparative advantages for all items, which improved between 1995-1998, but after it by 2000 had reduced.

The Grubel-Lloyd indices revealed a fast increase and relatively high share of intra-industry trade in clothing exports (HS62), mainly in the first part of decade to 34%, but after 2000 it decreased similar to the total trade. GL index for knitted wears (HS61) became extraordinary high by 1996 (65%), but later on continuously fell, but still the largest after the furniture trade). The high share of intra-industry trade is important in the context of adjustment costs, which is supposedly lower in the case of intra-industry trade than in inter-industry trade, since in the same industry it is easier to change profile, and humane resources and needs less resource allocation. (Venable).

## Conclusions

All in all, the impacts of full EU membership, geographical reorientation of global markets, quotas elimination (according to recent not complete data) have been much more detrimental on the Hungarian textile and clothing industry than even the worst expectations. A survey<sup>15</sup> on the impacts of Chinese imports also proved large market losses and competitive disadvantages of Hungarian clothing producers. The actors of the sector – despite of their heterogeneity and dispersed structure – tried to make commune steps and turned for help to Ministries and even to the Parliament to get help to solve (or at least to lessen) the problems they had foreseen. They have got only some promises and advices how and what they themselves should do. While in the EU, and even in much more developed countries such as Great Britain, or the Netherlands, governments have done and do serious efforts to improve competitiveness of the sector, and to ease negative effects of restructuring. Our main conclusion considering policy measures is that besides to make these tools known and available in Hungary, too, and to help SME-s to join to these programmes, the way of thinking must be changed.

Today, it is still valid – as results of an international study revealed ten years ago<sup>16</sup> – that the main factor for productivity gap – besides the technological lag and the under capitalisation of

<sup>14</sup> EU-enlargement and the adjustment ability of the Hungarian economy, partially financed by OTKA (T35132)

<sup>15</sup> Made by HAME, the Hungarian Association of Clothing Producers

<sup>16</sup> Hitchens et al: Competitiveness of Industry in the Czech Republic and Hungary (Avebury, 1995)

firms – is the lack of proper management and market knowledge. Foreign investment and/or OPT links could surmount these deficiencies but at a price of high dependency.

Based on our empirical research results on the non-measurable factors of competitiveness, one of the most important conclusions for economic policy is, that it is high time to realise, that policy makers could and must improve the general investment worthiness of the country. But they have to give up illusions that they can determine or influence behaviour of multinational subsidiaries, select suppliers, or profile or wage-level by offering large tax- or other advantages. Education and incentives for improving management ability, market knowledge, human-resource development, institutional background for R+D, or conditions for networking would certainly increase the ability of these firms to attract investment even in this sector and group of firms. However, the effective improvement could be expected only from a new kind of economic policy which uses tools for helping the largest part of the sector, that is the indigenous SMEs (which make the 80-90% of the firms in the sector) to form clusters (at least virtual ones), to improve their market abilities, to establish with commune efforts independent chain-stores, R+D, fashion centres and brand names, and to form intensive links with professional educational institutions.

The lack of regional concentration outside Budapest makes it difficult to use those tools (such as geographical clusters, which helped much the Italian exporters to keep competitiveness on global markets) or do not let apply concentrated aid for regions where restructuring caused by the decline of TC sector. Therefore the local decision makers at small regional level should pay special attention on future social and economic impacts of changes in the sector and form strategy based on deep knowledge of concerning actors to lessen the emerging problems.

It is still valid that it is not possible to upgrade on the value chain with badly paid workers. It is quiet certain that Hungarian producers cannot keep competition at the wage level of China, or Bangladesh, but even with Romanian, Turkish or Bulgarian levels. (This was already known in the 60s). Keeping wage level low by lay-offs, subcontracting or part-time works has already proved to be insufficient strategy to keep competitive positions. To fill international challenges it is possible only with well-educated, well-paid, creative employees able to understand even nano-, or biotechnology, to use IT.

The only way is to transform product-structure and production processes for upgrading on the value chain. Producing quality products at affordable prices demanded by middle class, with brand names, special fashion, or other creative ideas could give some special characters to the Hungarian products, which could not be imitate easily. Where the necessary changes for upgrading on the value chain cannot be done, helping institutions for retraining labour force and to create new jobs need to be supported.

*For all of these, the way of thinking must be changed in industrial policy.* Industrial policy has to avoid focusing only on some high-tech industries. Special needs of sectors and industries must be carefully followed and understood. By knowing that the spectacle technological development has happened just in the so-called low-tech industries, such as in food industry, agriculture or in the TC sector. These industries became important consumers of new innovations and technologies developed in other sectors (such as in chemistry, nano- or biotechnology, IT and telecommunication). They even generated those innovations, created new markets and new area of use, and by this way, increased value added and produced competitive advantages.