

**OVERCOMING THE TIDES OF CHANGE:
A LOOK AT GLOBALIZATION AND THE ITALIAN TEXTILE INDUSTRY**

by

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A thesis submitted to the Faculty of the University of Delaware in partial fulfillment of the requirements for the degree of Honors Bachelor of Arts in International Relations with Distinction.

Spring 2009

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ACKNOWLEDGMENTS

First, and foremost, I would like to thank my thesis committee: Kenneth J. Campbell, David Black and Barbara H. Settles. All three advisors have provided ample support, guidance, and above all, patience, throughout this process. By asking provoking questions they guided and spurred my curiosity and determination to uncover the important information which rounds out this complete story.

Second, I would like to thank Susan Senior Nello, Luca Verzichelli and Nicolò Conti from the Economics and Political Science Departments at the Università di Siena for their hospitality during Winter Session 2008, and for their assistance in utilizing the libraries and maximizing my time while conducting research abroad. Their interesting fields of study, and their passion for analyzing and improving the Italian political system and economy, further fuel my desire to do the same.

Third, and most notably, I would like to thank my technical and moral support group from home. Thank you, Aunt Cin, for your awing computer skills and for late nights of helping me to prepare presentation after presentation. Thank you, Michelle, for your brilliant feedback and editing. Lastly, thank you, Mom, for your nimble fingers, discerning eyes, and never ending moral support.

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ABSTRACT

Globalization is an unstoppable trend which leads to a freer global market. The Italian textile and clothing industries are now facing greater competition from developing countries that have a comparative advantage in unskilled labor-intensive manufacturing, namely China. This study focuses on the impacts that globalization has had on the Italian textile and clothing industry and discusses recent trends in business operations, structures, and strategies and WTO trade regulations surrounding this industry. The findings of this study indicate that globalization has had a negative impact on those Italian textile and clothing manufacturers catering to the mid-market while those which utilize greater skill-intensive labor, and cater to high-end consumers, continue to survive. This study concludes that, in order to remain competitive in the global market, Italian textile, clothing, and fashion industries must shift their target consumer base to high-end consumers, for which Italians have a clear competitive advantage.

Chapter 1

INTRODUCTION

Globalization is a trend of increasing collaboration and interdependence between states. Countries are opening their borders to trade and expanding their businesses into foreign markets. The developed economies are exploring emerging markets as means to outsource production and capitalize on cheap foreign labor. Conversely, developing countries are grabbing on to this life raft, western business manufacturing opportunities, to pull themselves out of poverty. Many argue that globalization has allowed the developed and the developing world to meet on common ground: the global marketplace. Furthermore, globalization, through increases in technology, has made rapid exchange of information and ideas possible.

Although far from homogenization, globalization has facilitated the spread of ideas, business practices, and economic interdependence, to virtually every corner of the globe. Thomas Friedman, author of *The World Is Flat* believes that the world is being increasingly leveled by these globalizing forces. He offers some sage advice to countries whose economic power is threatened by globalization trends: “With China and the other nine flatteners coming on so strong, no country today can afford to be anything less than brutally honest with itself” (313). This globalization process and the emergence of new key players in the world market forces those countries losing market share to reassess and restructure their outdated business strategies.

Italy is one such country that is in great need of self-examination. The textile and clothing industries that had previously bolstered Italy’s economy are

greatly losing business to those in China and other developing countries. Italy's reputation for producing high quality, unparalleled garments has also been eroded by the "need to compete" with cheaper manufacturers. Although quotas have been levied for the past two decades on textile and clothing exports originating from China, these quotas have been gradually lifted and, as of December 2008, no longer exist. This paper examines the detrimental effects that globalization trends have had on the Italian textile and clothing industries and argues for a restructuring of these industries in order to capitalize on the prestige that Italian manufacturing previously enjoyed.

Chapter 2

OVERVIEW

2.1 Overview of the Italian Economy

The Italian economy is founded upon innovation and artistic design. Ivor Thomas asserts that “[t]he foundations of a powerful modern economy are coal, petroleum and iron ore. Italy has small reserves of coal and iron ore and no petroleum” (11). With a dismal supply of valued natural resources, Italy has relied on the skill and craftsmanship of its artisans to bolster its GDP. Italy is renowned for its production of wine, olive oil, cars and fashion. The passion, artisanship and detailing put into each product have attracted consumers from around the world.

However, technological change, globalization and the emergence of new players in the global market have created hardship for the Italian economy. An article entitled “Addio, Dolce Vita” cites a startling statistic by the World Economic Forum ranking Italy’s competitiveness for the year 2005 as 47th, which puts Italy just in front of Botswana. In the World Economic Forum’s Global Competitiveness Report for 2008 Italy ranked 49th (“Global”). These rankings are a clear departure from the glory days of Italian production, prior to the globalizing trends of the present. That the same report in 2001 put Italy in the 26th position indicates that Italy’s downward spiral has been significant in recent years (“Global”). The article “Addio, Dolce Vita” goes on to state that Italy’s competitiveness is rapidly declining and that “its shares of world exports and foreign direct investment are very low” (1).

The Italian economy has always lumbered under the burden of its rigid labor markets and generous social welfare system, both of which are clearly and directly linked to its fragmented and volatile politics. Because of the rapid turnover of political parties, politicians strive to pacify the Italian citizens' immediate needs and refuse to implement unpopular reforms. The *Economist* article "Reform or Die" describes the perilous position of Italy's economy:

As in the rest of the euro zone, only more so, the country desperately needs structural reforms to liberalise markets, inject greater competition and shake up a bloated, inefficient and sometimes corrupt public sector. Currency devaluation to offset deteriorating competitiveness is no longer an option, and the vulnerability of small manufacturing firms to cheaper imports from Asia, especially China, has become painfully clear. (1)

Although Italy's labor market is highly regulated, the Berlusconi government realizes the need to loosen the rigidities and bureaucracies that strangle Italian business. As a business tycoon himself, Prime Minister Silvio Berlusconi wants Italian business to fare well and has begun some unpopular reforms to that end:

In two areas, pensions and the labour market, it has been quite bold, although it has built on changes set in train by previous governments. Given its demographic outlook, Italy still needs to do more to reduce its formidable pensions burden; and the government has timidly put off the start of some of its more painful reforms until 2008. But by raising the retirement age, cutting pension values and encouraging private pension funds, it has done more than some other EU countries to tackle this looming problem. ("Structurally" 3)

Although the Italian government has begun the process of deregulating Italian business, many believe that these reforms are not enough to create a competitive business environment for Italy. The individual firms will need to do much more if they are to survive the tides of globalization and the onslaught of cheap labor abroad.

2.2 Overview of Globalization

Globalization, defined as an integrating world market for products, services, ideas, and cultures, spurred by new technology and economic growth, is the central discussion of this paper. Colin Hay and Ben Rosamond detail the various economic repercussions and responses necessitated by recent globalization trends:

It [discourse of globalization as an external economic constraint] associates globalization with the near perfect mobility of capital... and with a variety of attendant economic imperatives for state actors. It implies and assumes a world of rigorous tax competition lubricated by flows of capital, of an intense struggle for locational competitiveness secured principally on the basis of cost reductions, welfare retrenchment, labour market flexibilization and the removal of supply-side rigidities – in short, market-conforming deregulation. (152)

Globalization breeds greater international competitiveness as new and growing markets emerge. Many developing countries are experiencing the growing pains of industrialization while some of the more rigidly established markets, such as Italy, are being outpaced. This increased competition has provoked varied responses from Italian industries. According to Maurizio Ferrera and Elizabetta Gualmini, “The winds of internationalization have blown upon all regional and sectoral realities of the country in a differential and often subtle way, sometimes stimulating, sometimes disturbing or reshuffling the existing configuration of actors and resources” (75). The Italian textile, clothing and fashion industries have each been separately challenged to maintain their pre-eminence, prestige and market share within the global marketplace.

2.3 Overview of the Italian Textile, Clothing and Fashion Industries

Globalization has been detrimental to one of Italy’s most prominent sectors: the Italian textile and clothing industry, and by extension, the Italian fashion industry. International trade in clothing is historically one of the oldest trades and one

which all humans consume (“Looming” 2). While it is clear that the European textile and clothing industry has been suffering from the effects of greater competition, the European Union is still considered the “world’s leading exporter of textiles and the second largest exporter of clothing” (“Great” 2). In 2006 there were nearly 600,000 jobs in the Italian textile and clothing industries. This number amounts to one-third of the sector for the old fifteen-member EU and one-quarter of the EU-25 (“Material” 1). According to the *Economist* article “Material Fitness,” “The sector has been a major exporter and the generator of a large positive contribution to Italy’s trading account. Both employment and that financial contribution are now declining” (1). The domestic rigidities of the Italian market as well as heightened competition abroad have put the Italian textile and clothing industries in great peril. Maurizio Ferrera and Elizabetta Gualmini describe the impact of both catalysts,

... focused on the textile and clothing sector, the steady growth of imports due to the growing liberalization of markets contributed modestly to the decline of the domestic demand of labour, since there were at least three other endogenous and institutional factors pushing in that direction: the rigidity of the Italian labour market, technological change and the particular mode of organization of production. (76)

While the Italian textile and clothing industry has been at the forefront of quality garment making for centuries, its position is now being challenged by the effects of globalization. In the article “The Sorry State of Fashion Today” the author describes the situation at present, “Europe’s fashionistas are asking how long high fashion can survive. With a dwindling client base and copies rapidly available from clothes chains with quick production cycles, it has become almost impossible to make money out of custom-made garments” (1). With competition from cheap imports from developing countries, luxury garment makers are having a difficult time maintaining a

strong client base in the world. If this trend continues price-sensitive fashionistas will have a more elastic demand for custom garments and will settle for cheaper imitations of the latest runway trends to satisfy their need for style.

However, some members of the fashion community remain optimistic about the Italian market. They argue that although some fashion connoisseurs must tighten their financial belts and abstain from high-priced clothing at times, there will always be the excessively wealthy, for whom money is no object, and who have a price inelastic demand for luxury goods. It is these consumers to whom Italian industry must cater.

There are many reasons to believe that, despite competition in textile and clothing production, Italian industry has the chance to survive by utilizing its strengths. Vittorio Giulini, chairman of Moda Industria, which is the Italian clothing industry's association, feels optimistic about the unique vertically integrated structure and demand operating within Italy itself. According to the article "The Changing Fabric of Italian Fashion," Vittorio asserts that "the technological complexity of the industrial system that connects the spinner to the catwalk and the historical memory it embodies, are two of the four pillars holding up Italian fashion" (1). He goes on to claim that there exists a

... natural link that Italians make between fashion and other parts of their artistic culture. Italians live amidst ancient beauty, and this immersion produces both designers with flair and the discriminating consumers who are to be seen promenading past the glamorous shop fronts of Milan's Via Montenapoleone ... [Also, there is] Italy's profusion of small independent retailers. They ensure that every small-town dandy can flaunt the finest threads. ("Changing" 1)

Many businessmen within the Italian textile and clothing industry are cautious and determined about the future of their industry. Many, such as Michele Tronconi, who

is deputy chairman of a local trade association and Euratex, the sector's lobbying body located in Brussels, heed the lessons of the past. In the 1980s and 1990s Britain's textile industry plummeted into despair. Determined not to allow Italy's industry to follow suit, Michele Tronconi proclaims, "But we are still struggling, still fighting" ("Steps" 3).

Globalization is driven by increases in technology, which facilitate trade and competition with the invention of new, cutting edge products. This too can prove harmful to the Italian textile, clothing and fashion industries, which rely heavily on their ancient craft. Italian textile makers must incorporate new fabrics into their textiles and fashion icons must experiment with these new textures and sheen in order to remain on the "cutting edge." "The Changing Fabric of Italian Fashion" explains, "The major chink in Italy's armour [lies...] in developing the highest-tech materials" (2). The article goes on to discuss the successes of synthetic materials made in Delaware by Du Pont and Gore & Associates, which are being debuted in avant-garde designs. One expects these futuristic fabrics to permeate the catwalks and trickle down to mainstream design. (2).

Chapter 3

LOCATION, LOCATION, LOCATION

3.1. The Way it Was

The Italian textile, clothing and fashion industries are situated in Northern and Central Italy. These areas have been praised over the years for their efficiency and renowned artisanship. Towns such as Biella are recognized for their specialty textile production. They are often considered advanced in their artisanship as they “research and develop new woollen yarns and fabrics continually, spinning fibres even thinner and gaining even more precise control over their cloth” (“Changing” 2). One author asserts, “No one can rival their [Biella’s] mastery of the properties of wool” (“Changing” 2). Other areas of this sector are “already almost monopolized by Italian know-how.” The region of Castl Goffredo is famous both for its superior production of women’s stockings as well as thirty-percent of the world’s luxury men’s clothing fabrics produced here at the men’s fashion firm Ermenegildo Zegna’s mill (“Changing” 2). Figure 1 below depicts the primary Italian fashion districts in Italy (“Sistema”).

WHERE MADE IN ITALY FASHION IS BORN

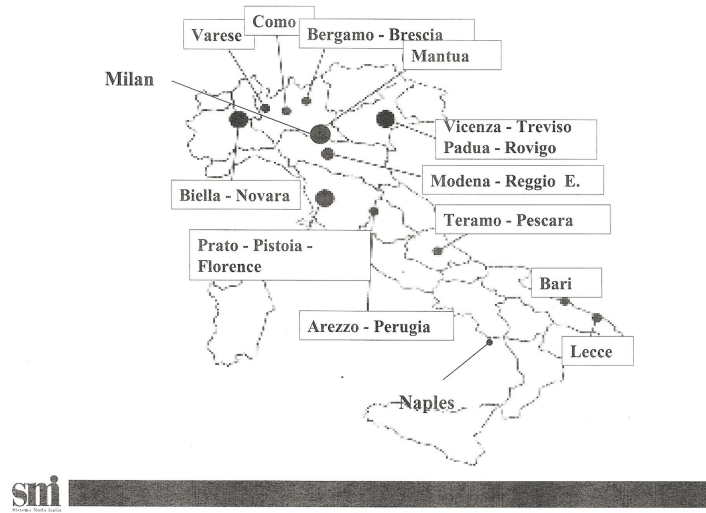


Figure 1 Map of Italian Fashion Districts

The success of the Italian textile, clothing and fashion industries is uniquely attributed to the organizational composition of these industrial towns. The author of “The Changing Fabric of Italian Fashion,” describes the strengths of this organizational structure: “Two hundred years of spinning, dyeing, weaving, cutting and stitching have peppered Biella, Como, the Veneto, and other pockets of the Italian landscape with mills and workshops operated by families and linked in tight networks. More management gurus see this, rather than Silicon Valley, as the future of business organization” (1). Italian textile and clothing firms organize themselves into local groups so as to make the industries as efficient as possible via rapid communication and vertical integration.

One of the most notable Italian textile towns is Prato, in the Tuscan region in central Italy. In Prato the art of textile production is a time-honored tradition dating

back to the Middle Ages (Fioretti 2). In the 1950s, a period of enormous Italian economic growth, some Pratese firms utilized family members during times of high textile demand. Fioretti explains, “In this way, woolen mills could meet demand peaks with a productive capacity tailored to demand throughs” (2). By the 1970s, Prato was comprised of more than 10,000 firms linked to the textile sector (Fioretti 2). Prato continues to be an important location for the production of textiles and clothing.

For centuries these major textile towns have played an integral part in supporting their local economies (Italy was not unified until 1861). Maurizio Ferrera and Elizabetta Gualmini describe the unique structure that has provided Italian firms with a competitive advantage in the past. They explain, “In the north companies are mainly large and specialized in manufacturing and services. The third Italy (Emilia-Romagna, Tuscany, Umbria, Marche and Abruzzo) is mainly based on family-led small firms and on industrial districts specialized in those products which are at the edge of Italy’s competitiveness: textiles, and apparel, footwear, ceramics, precision mechanics.” (77, 78). As will be discussed in the subsequent paragraph the strategic clustering within these industries provided ample benefits to producers. Figure 2 depicts another view of the prominence of various regions within Italy that are significant to the textile and fashion industry (“Sistema”). This diagram highlights the importance of Lombardy, Tuscany and Veneto to these industries.

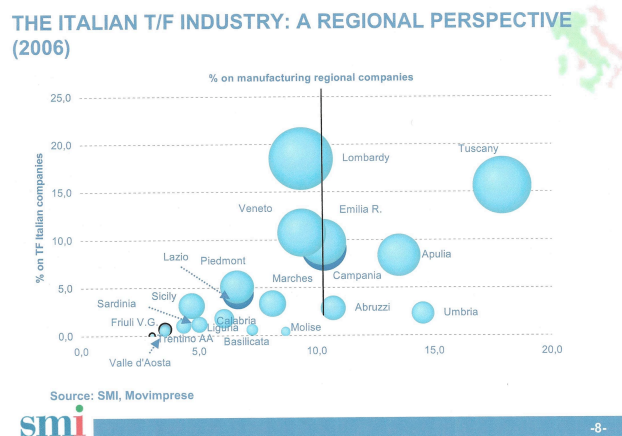


Figure 2 Regions Pertaining to the Italian Textile and Fashion Industries

The appropriate term for the organizational structure of an Italian textile town is “industrial district.” Guido Fioretti provides a concise definition that describes the composition of an industrial district. He elaborates, “Industrial districts...are geographical clusters of a large number of small firms that show little or no tendency to increase their size” (2). Fioretti praises this model for the success of Italian firms, which “counterbalance[s] the economies of scale that larger firms would enjoy” (2).

The family proved essential to the workings of the textile, clothing and fashion industries prior to the globalization phenomenon. The author of “The Sorry State of Fashion Today” describes the Italian textile and clothing firms as being “small, often family-run firms employing an average of ten people...[and] nearly two-thirds of their production is exported” (2). The *Economist* article, “Structurally Unsound” describes the acclaim this business strategy had once enjoyed:

Yet for many years after the Second World War, the family was considered an asset, not a liability, in Italian business. This can be seen most clearly in the proliferation of (often family-owned) small firms

across northern Italy, many of them grouped in clusters: woollen goods in Biella, cotton textiles in Varese, shoes in Ascoli Piceno, knitwear in Capri, women's clothing around Treviso (home of Benetton among others), and so on. At one time these clusters figured into business-school studies as a key source of Italy's economic strength, especially in the north, now one of Europe's richest regions. (1)

The mode of clustered, family-oriented operations is the classic Italian business model, which will be discussed later in this paper.

3.2. The Tides of Change

While many textiles, clothing and fashion firms have chosen to operate within Italy and within prominent districts of Italy there are those who in recent years have realized the economic benefits of cutting costs through the use of cheap labor abroad. One ideal case study of the outsourcing phenomenon is the company Benetton. Originally, Benetton had set up shop in an important industrial district within Italy. According to one source, "The heart of the industry lies in places like Castrette in northern Italy, where robots work 24 hours a day in Benetton's cavernous warehouses shunting garments to and fro" ("Changing" 1). However, Benetton has now abandoned the classic Italian business model. The article goes on to explain that Benetton is "Famous for dangerous advertising and safe clothes" but is grounded in "manufacturing industry, not fashion" (as stated by Bruno Zuccaro, Benetton's director of information systems) ("Changing" 1). Although Benetton started out producing its output at home, recent relocations made by the company are clearly indicative of globalization, and the effects cheap labor has had on the textile, clothing and fashion industries.

Many Italian textile and clothing manufacturers have suffered in recent years from the onslaught of abundant cheap labor readily available across the ocean. By outsourcing production to countries where their products can be assembled more cheaply, fashion firms are able to increase their profit margins. This creates serious problems for Italian textile and clothing manufacturers. According to the article “The Sorry State of Fashion Today,” “Many of these [textile and clothing] firms have already felt the pinch. Fratelli Piacenza, a cashmere company in Biella, is moving production to lower-wage countries. Other firms have reduced production and cut workers.” (2). In 2005 Mario Boselli, head of Italy’s fashion association, Camera Nazionale della Moda was quoted lamenting, “Italy is now going through the crisis that happened in France about eight years ago” (“Sorry” 2). In the important silk province of Como, the number of silk firms operating in recent years has halved (“Material” 2). The author of the *Economist* article “Material Fitness” describes one casualty of the “crisis” facing Italian textile and clothing manufacturers:

Across the Po Valley in the north-eastern Italy, the gates of Lanerossi’s huge wool mill in Schio shut for the last time at the end of August 2005, ending almost two centuries of activity; 30 years ago the firm employed 7,000 workers. Times are hard, and getting harder, in every part of Italy where yarn is spun, textiles woven and clothing made. (2)

The author of “In the Steps of Adidas” paints a broader picture of the dismal situation in northeastern Italy:

Places such as Busto Arsizio and Gallarate, north of Milan, are turning into ghost towns as firm after firm goes under, leaving empty factories boarded up. Some 30 miles to the west, in the foothills of the Alps, the same thing is happening to the cluster of woollen mills around Biella. Window grilles are rusting on the Manifattura di Valduggia, where woollen undergarments were made until the early 1990s. The Grignasco group is still turning out knitting wools, but its output halved

to 2,500 tonnes in the decade to 2004 and its workforce has fallen steeply. (3)

Busto Arsizio and Gallarate are the major textile and clothing districts of the Varese province, which was once considered the “Manchester of Italy.” However, during the years 1981-2001, the number of textile and clothing workers in the Varese province decreased by half to a mere 27,300 workers. The number of firms in this region dropped from 4,900 to 2,900; and, even more startling, 440 firms have disbanded since 2001 (“Material” 2). These numbers indicate that the effects of globalization have severely damaged the Italian textile and clothing industries.

The statistics and stories above make clear the devastating effects of globalization, in particular the lure of cheap labor from developing countries, on the Italian textile and clothing market. Many experts who follow the textile, clothing and fashion industries worry that Italy is in the most vulnerable position to receive the brunt of a cheap labor assault to the market. One *Economist* writer explains, “Home to more than half of Europe’s textile companies, Italy stands to suffer most from China’s new [trade] freedom” (“Sorry” 2).

Though, as the above quote indicates, China has been a hotspot for outsourcing the production of Italian fashion products, some companies have chosen to outsource production to Eastern Europe, in order to ensure rapid communication and turnover. The article “Material Fitness” describes one such popular destination:

Romania has been a magnet for Italian businessmen, particularly those based in the north-east. Thanks to geography, and monthly unit labour costs of around 250 euros (\$298) against a minimum of 2,000 euros at home, Italians own about 1,500 textiles and clothing factories and 1,000 footwear factories in Romania and employ around 200,000 people there. As pressure from China increases in the coming years, even these operations are likely to find it an ever harder struggle to survive. (3)

Romania has become a prime location for Italian outsourcing because it is still within close proximity to Italy and has a significantly cheaper workforce. Wages in Romania are only one-tenth of those in Italy. Because cheap labor, found outside the country, leads to lesser input costs of manufacturing textiles and clothing businesses have incentives to move production to these places (“In the Steps” 3). According to the article “In the Steps of Adidas,” “Italians own some 1,500 textile and clothing firms there. Italy’s trade minister called it ‘an Italian industrial province’” (3).

While many textile towns have dried up, Prato continues to thrive due to its restructuring in recent years. Giorgio Fioretti cites several reasons for the strategic survival of Prato:

To some extent, Prato recovered because it was able to exploit a cheaper labour force than the one that is generally available in Tuscany today. On the one hand, Pratese firms either learned to purchase intermediate products abroad, or they moved abroad the early stages of their production chain. On the other hand, massive illegal immigration from low-income countries provided cheap and unregulated labour. (3)

Rather than ship production abroad, Pratese firms have shipped workers into the town. In addition to minimizing input costs through utilizing cheap, illegal workers from abroad, Pratese companies have also managed to misleadingly maintain their marketing label, “Made in Italy.” The emphasis of a globalized era of textile production clearly lies in a country’s abundance of cheap labor, as textile manufacturing is highly labor-intensive.

However, as Prato finds it increasingly difficult to compete on price, it has shifted its strategy towards specialized production and rapid turnover. According to Fioretti, “Today, Prato is successful because it has been able to switch from price flexibility to features flexibility. Its traditional structure of a large number of family

firms is still there, but these firms now compete on taste and variety, rather than price” (4). He goes on to elaborate, “Prato is basing its competitive advantage on its ability to provide anything a buyer may request, in a reasonable time, and in lots of any size...they are highly appreciated for their creativity and taste” (4). Prato’s example seems to say that if cheap labor can be utilized at home there are no incentives for outsourcing production.

Although Italy is still recognized as a leader in the textile, clothing and fashion industries, its dominance and strength are greatly diminished as firms increase their profits by utilizing cheap labor abroad.

Chapter 4

THE THREAT: DEVELOPING NATIONS AND CHINA

4.1 The Menacing Threat: China

While some Italian firms remain loyal to the marketing label, “Made in Italy,” many find the lure of cheap input costs, such as Asian labor, to be all too attractive. The outsourcing of production to China by many Italian labels creates tension between the Italian fashion industry and the clothing and textile industries within Italy. The *Economist* article “Material Fitness” describes this tension: “Competition from China has also revealed a stark difference between the interests of Italian brand owners, who see a market opportunity for buying and selling, and many manufacturers, who feel threatened as their mainly domestic customers abandon them” (2).

China is at the forefront of cheap labor and mass production capability. The author of “The Sorry State of Fashion Today” attributes the fashion industry’s difficulties to the emerging Chinese economy: “The main cause of the mass market’s troubles is competition from China. Producers cannot match its low labour costs: the effect can be devastating” (1). The allure and incentives for outsourcing to China arise from the fact that it “offers buyers a more attractive and cheaper option” (“Looming” 3). One striking statistic, illustrative of China’s comparative and absolute advantage in clothing making, states that China can produce an item of clothing for as little as 45 US cents (“Looming” 3). Although many question, and even criticize, the means by

which Chinese producers drive costs so low, it is evident that China's cheap labor provides ample advantage to Chinese unskilled labor-intensive manufacturing.

In recent years the Chinese economy has been growing at a rapid pace. The *Economist* article "Global Agenda: China and Europe" states that "China's economy is growing so fast that it now dwarfs those of many individual EU member states" (1). Moreover, China's trade with the European Union has also accelerated in recent years. In 2006, bilateral trade between China and the European Union grew by 21%, totaling more than 250 billion Euros ("Global" 1). World-renowned journalist, Thomas Friedman explains China's development best: "...if Americans and Europeans want to benefit from the flattening of the world and the interconnecting of all the markets and knowledge centers, they will have to run at least as fast as the fastest lion – and I suspect that lion will be China, and I suspect that will be pretty darn fast" (127).

Throughout the past decade trade in textiles and clothing has become more open as various quota systems have been removed from Chinese exports, as will be discussed later in this paper. The liberalization of the textile and clothing industries clears the path for China's dominance in this very important European industry. The 2007 article "In the Steps of Adidas" explains the imminent threat that China poses to this sector:

Foreign direct investment poured into China to build up production capacity for both fabrics and clothes once the country was free to export at will. Italy, which had been Europe's leading textile and clothing producer for about 25 years, felt the effect almost immediately. EU imports from China increased by nearly half in 2004 alone. In some products imports have grown sixfold and prices have fallen by a third. An emergency deal in 2005 on trade restraint between the EU and China will offer only temporary relief. (2)

Recently, protectionist measures have been gradually lifted from Chinese textiles and clothing exports, although the United States and many European countries, including Italy, are fighting tirelessly to stem the flood of Chinese textile and clothing goods in the market. The *Economist* article “The Great Stitch-Up” describes the situation in 2005 as well as the disdain for China’s growing economic power:

The added pressure on profits may spur consolidation in what is still a fragmented sector with a large number of single-workshop manufacturers. So it could result before long in a more competitive industry with greater economies of scale. Meanwhile, most of the bigger firms are protected by two factors. The first is geographical diversification – the distortions of the old quota system forced Chinese-owned textile companies to finish clothes in other Asian countries to avoid the “Made in China” tag. Luen Thai, for example, has factories in four foreign countries, accounting for three-quarters of its production. (2)

Over time, as quotas are lifted from the textile and clothing industries, China will surely swamp the market with more products.

China has a clear advantage in resources due to its “huge domestic fibre and fabric production” (“Great” 3). Figures 5 and 6 in the Appendix show China’s emerging prominence in the textile and clothing industries over the years 1995- 2003 (“Sistema”). These diagrams also show Italy’s prominence, although in decline through these years. One author suggests, “Chinese textile factories have tended to specialize in one process and finish goods overseas to avoid quotas” (“Great” 3). He goes on to predict that China will soon take over the market after quotas cease to constrain the market: “Without quotas, it could build vertically integrated firms, lowering costs, raising quality and cutting time to market – great for western customers. That will surely happen, sooner or later. China’s emergence as the ultimate one-stop textiles shop can be delayed – but not stopped” (“Great” 3). China

is the main competitor with which Italy must compete. While China focuses on cheap, mass-produced products, Italy must stay the course of high-fashion, quality and artisanship, thus appealing to a different consumer base that is willing to pay for quality and skill.

4.2 India

India, with its abundant cheap labor and cotton resources, is another country that is well-suited for the textile industry. One expert describes India's position in this sector: "[India] is an English-speaking democracy. It is, after China and America, the world's third-largest cotton producer. Reliance, an Indian firm, is the world's largest polyester maker. With 34m spindles, India is, next to China, the world's biggest yarn-spinner...the wealth of the Mughal empire...was founded on carpets and textiles" ("Looming" 4).

India has had trouble organizing its textile industry in recent years and the Indian textile industry argues that the quotas lobbied against it by the United States were much more severe and detrimental than those imposed on China. In "The Looming Revolution" D.K. Nair, of the Indian Cotton Mills Federation (ICMF), explains the unjust inequity between the two quota systems. He argues that...

American quotas turned China's textile industries into a Frankenstein's monster. As many Indians see it, China's quotas were set generously in the 1980s for political reasons. This explains the Chinese industry's hectic expansion. By contrast, India's growth was artificially stunted. The entire Sri Lankan and Bangladeshi garment industries were, he argues, 'an offshoot of our quota problems.' (3)

India has suffered as a result of the type of industry-regulation that many Western countries continue to impose on China's burgeoning manufacturing sector.

Although Indian textile and clothing manufacturers feel that they were slighted out of their competitive edge in the industry, India has gained much from the textiles and clothing sector. “The Looming Revolution” describes how Orient Craft, India’s largest exporter of clothing, employs around 18,000 workers. Sudhir Dhingra, head of Orient Craft, says “that each machine he buys creates four jobs in his factories and four outside” (2).

Both the Chinese and Indian textile and clothing sectors have proven very successful because of the abundance of cheap, unskilled labor in each country. One article states that in an Indian apparel factory about “four-fifths of the workers will have started life as poor villagers. Few will have had more than an elementary education” (“Looming” 2). In countries with massive populations and widespread poverty, workers will offer their services for very cheap. Moreover, they are willing to work more hours and even more days per week than labor laws in the developed world allow.

4.3 Other Developing Asian Competitors

Other developing Asian countries have also emerged on the scene of the textile and clothing sector. Many of these industries have developed as a result of trade quotas on Chinese and Indian products, which have had the effect of trade distortion. These other developing Asian countries step in to fill in the gap in world supply in order to meet the high consumer demand for these mass-produced products. According to *The Economist* article “The Great Stitch-Up,” quotas on Chinese textile and clothing exports have a positive effect on neighboring economies: “At most, the restrictions will slow Chinese export growth to the West. But any slack is likely to be

taken up by other poor countries” (2, 3). However, these newly bolstered industries may not be able to exist if quotas end.

There is great concern that the vitality of these growing industries within developing countries will be seriously threatened as China expands its textile and clothing production, following the eventual cessation of export quotas. One article explains the mounting concerns of these industries as follows: “In South Asia, Bangladesh, Nepal and Sri Lanka are all vulnerable. In Bangladesh, for example, the industry has grown from 400,000 people and 800 factories in 1990 to nearly 2m people and 4,000 factories now....Zaidi Satar, an economist at the World Bank in Dhaka, estimates that 10m-12m people depend on the industry” (“Looming” 4). Although this paper will primarily focus on how quotas and Chinese production impact the Italian textile clothing industries, it is important to note the world implications of these past and present trade distorting quotas. While the cessation of quotas will help to further develop China’s burgeoning economy, it will prove detrimental to other developing nations.

Chapter 5

THE LINES ARE BEGINNING TO BLUR

5.1 The Stigma of “Made in China”

In recent years China has been an up-and-rising contender in the global marketplace. Nevertheless, as people have become increasingly aware of China’s dominance in the mass production of textiles and clothing, the manufacturing tag “Made in China” has come to be synonymous with cheap labor and mass production. In order to avoid this label, companies have become more cosmopolitan with their manufacturing processes. The author of “The Looming Revolution” explains that a consumer may have bought a clothing item “in America and the label said it was ‘Made in Sri Lanka.’ It may well have been made from Chinese fabric, woven from Chinese yarn, spun from Chinese cotton or man-made fibre” (1). To avoid the “Made in China” stigma many companies will use China for cheap intermediary processes while shipping their products elsewhere for final assembly.

While some manufacturers use the “cosmopolitan” assembling process to mask the source of Chinese production, others are even more devious in their attempts to conceal the truth. Dana Thomas exposes more of the tricks that some companies employ, “Some hide the ‘Made in China’ label in the bottom of an inside pocket or stamped black on black on the back side of a tiny logo flap...Or some simply replace the original label with one stating it was made in Western Europe” (2).

As a consumer, it is now impossible to really know the origins of the clothing you buy. The country name stamped on the tag of a blouse or a pair of blue jeans may be the place where the garment was finally assembled or it may be the place in which a majority of the production took place. Because producers realize that a “Made in China” tag might detract consumers from a product, they obscure a garment’s true country of origin through creative labeling.

5.2 The Prestige of “Made in Italy”

The “Made in Italy” tag is recognized throughout the world as a marker of high quality and craftsmanship. The fashion observers of the world desire to sport clothing associated with one of the world’s fashion capitals. If a garment is made in Italy two things are assumed: 1) the item is fashionable and 2) passion and skill were two ingredients in the creation of this product. If only it were that simple to distinguish high quality and Italian artisanship from the rest.

While there are attempts to mask the “Made in China” reality, there are just as many attempts to forge or falsify the “Made in Italy” claim. Again, manufacturers utilize the multinational production processes of clothing and textiles in order to extract the profits from low cost labor abroad while finishing products at home. Dana Thomas exposes this phenomenon: “Some bypass the ‘provenance’ laws requiring labels that tell where goods are produced by having 90 percent of the bag, sweater, suit or shoes made in China and then attaching the final bits – the handle, the buttons, the lifts – in Italy, thus earning a ‘Made in Italy’ label” (2).

Another way in which companies are masking the use of Chinese workers is even more disturbing. Instead of sending products abroad to be manufactured by

Chinese workers, the companies are bringing in Chinese workers to manufacture the goods on Italian soil. The *New York Times* article “Made in China on the Sly” explains how this is being accomplished:

To please customers looking for the “Made in Italy” label, several luxury companies now have their goods made in Italy by illegal Chinese laborers. Today, the Tuscan town of Prato, just outside of Florence and long the center for leather-goods production for brands like Gucci and Prada, has the second-largest population of Chinese in Europe, after Paris. More than half of the 4,200 factories in Prato are owned by Chinese entrepreneurs, some of whom pay their Chinese workers as little as two Euros (\$3) an hour. (Thomas 2)

It is my opinion that those consumers desiring the “Made in Italy” label would not value the label as highly if they knew that the meaning of such a label has been so severely weakened. It is not just enough to say that a product is made in Italy; fashion consumers want it to be “made by skilled Italians.”

An additional problem with the blurred significance of the “Made in Italy” label is that Italian cheap labor is also being exploited in order to keep production within Italy. In Roberto Saviano’s brave masterpiece, he attempts to explain how the Naples Mafia, La Camorra, runs everything in the South and exploits Neapolitans in order to satisfy their cut-throat business greed. Saviano describes the mafia-funded Italian black market for clothing production as it exists today:

‘Made in Italy’ is made here. Caivano, Sant’Antimo, Arzano, and all across Las Vegas, Campania. ‘The face of Italy in the world’ wears fabric draped over the bare head of the Naples suburbs. The brand names don’t dare risk sending everything East, contracting out to Asia. Factories here are crowded into stairwells, on the ground floors of row houses, in sheds on the outskirts of these outlying towns...they’re skilled workers, born staring at a sewing machine. Officially these don’t exist, and neither do the employees. If the same work were done legally, prices would go up and there’d be no more market – which means the work would disappear from Italy. (25)

These anecdotes are evidence that the discussion of skilled labor and production quality associated with Italy and China is not as clear cut as it seems.

Chapter 6

THE ITALIAN BUSINESS MODEL

6.1 The Advantages of the Italian Business Model

For many years the Italian textile, clothing and fashion industries have garnered great success and recognition for both their superb artistry and business know-how. The past business success of the Italian textile and clothing sectors can be attributed to their organizational structures, innovation and utilization of skilled workers. The authors of *Rescued by Europe?* provide a concise description of the “peculiar model of Italian specialization”:

The model is primarily based on labour-intensive productions in traditional sectors and in some specialised suppliers industries, potentially very vulnerable to the competition of labor abundant, low wage economies...Italy is mainly specialized in the top end of the vertically differentiated spectrum of products. Many of these products are characterized by a relatively high level of skill intensity and by a price elasticity which is not high and is decreasing over time.” (Ferrara ibidem: 106).

Many economists praise the structure of the Italian firms for their effectiveness and efficiency in the past. One author describes the success and acclaim of the Italian firms: “Italy as a whole became a case study in ‘small is beautiful.’ About two-thirds of manufacturing workers are in firms with fewer than 100 employees, compared with 37% in America and 31% in Germany. Italy has more small and medium-sized enterprises than any other country in Europe; some 4.5m, or

roughly one-quarter of the total in the EU 15” (“Structurally” 1). Figure 3 shows the number of small and medium sized businesses within five different European countries (“Structurally” 2). By far, Italy exceeds the others in small businesses.

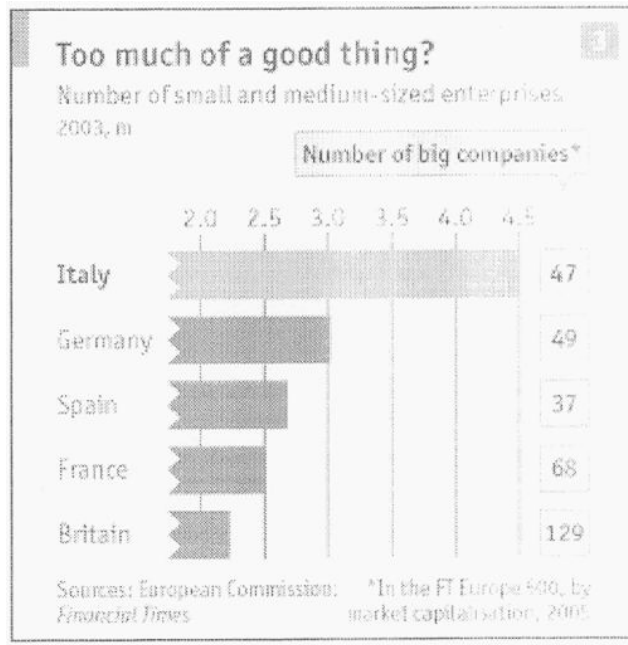


Figure 3 Small and Medium-Sized Italian Enterprises in 2003

Another author also links the particular Italian firm structure to the success of the Italian fashion industry:

They [Italian textile and clothing manufacturers] supplied not just the high-end fashion labels and designers, but also used the ‘Made in Italy’ tag as a powerful marketing tool. Their success led to attention from economists such as Michael Porter, who noted the role of clusters and promoted them elsewhere as a way to jump start stalled or fledgling economies. (“Material” 1)

Many believe that small, family owned, localized Italian firms have been successful because of their intimate, ancient knowledge of their specific industry. However, globalization decreases the value of these attributes. One article notes that while Italy enjoys an abundance of small firms there is a “dearth of big ones. For a member of the G7, Italy has remarkable few big companies: for many years the list barely ran beyond Fiat, which at one time accounted for almost 5% of Italy’s GDP” (“Structurally” 1). Rather than these structural attributes serving as an asset to Italian industry, as they have in the past, they might very well be precisely what threatens Italy’s dominance in the textile and clothing sector in our modern, globalized era.

6.2 The Disadvantages of the Italian Business Model

Globalization has forced many companies throughout the world to re-examine both their manufacturing strategies and their strategies in approaching the global marketplace. This challenge both threatens and inspires companies. The author of “Material Fitness” explains the situation of the Italian textile, clothing, and fashion industries: “Nowhere is that threat [globalization] more potent than in Italy. For generations its economy has relied on dense networks of firms, most of them small and middling family concerns, that clustered together and created wealth by mid-level manufacturing of goods such as clothing and shoes” (1). Another author states that the “Italian companies, especially the small, family-owned firms that have been the backbone of the economy, are under ever-increasing pressure” (“Addio” 1). Because the Italian business model is ill-suited to adapt easily to the current global markets, the effects of globalization appear quite dismal for Italian companies and

many firms are finding it difficult to keep their heads afloat with the onslaught of increased competition from abroad.

Those who cannot keep up with the pace of globalization will surely go under, while those who will survive must adapt to the changes of the world market and re-invent themselves. One *Economist* article describes the effects that globalization has had on this important sector of the Italian economy:

Further down the fashion chain things are equally dire. Mass-market producers cannot afford sustained losses. Medium-sized and small companies in France, Italy and Spain are cutting production or moving it abroad. Some have merged or tried to cut costs by lowering the quality of their products. Dozens have already gone under; many more are fighting for survival. (“Sorry” 1)

The inability of many Italian firms to adapt to the changes brought about by globalization has cast doubt on the effectiveness of the Italian business model. While many credit the isolated, exclusive and intimate structure of the Italian industries with ensuring industry purity and fueling consistent success, these same structures are now considered by many to be rigid, inflexible, and ultimately detrimental because they make it difficult for the Italian market to reinvent itself and to compete with cheap labor abroad. The *Economist* article “Material Fitness” details the concerns of economists who have begun to re-think the Italian business model. The author writes:

The process is raising doubts about whether the Italian economic model, once seen as robust and effective, was in fact more vulnerable than it appeared. Far from being an advantage, it seems that it might actually be risky to be part of a cluster where survival depends in part on others to respond to threats in kind. And family firms, though in theory as flexible as any, are not necessarily nimble in practice. Generational conflicts that once mattered little can prove fatal when speed and decisiveness are needed. (2)

One example of an Italian firm that is struggling with the traditional Italian business model is the fashion house, Prada. While many fashion firms have chosen to accept public investment and outside input, there are those who have chosen to remain concentrated with complete family-autonomy. According to one article from 2000, “Prada is one of the few big Italian firms that seems intent on keeping family control, even as it adds brands to its stable” (“Families” 2). Although Prada can be admired for its determination to keep its stronghold and power consolidated under the family, there are those who feel this might be detrimental to the fashion house as designers find the family’s mentality increasingly difficult with which to work. The article states that “Mr. Bertelli’s [Prada’s CEO] interfering style of management has already caused Jil Sander [renowned German fashion designer]...to storm out, only months after Prada took a 75% stake in her company, [...] Critics say that Prada needs an outsider to offset Mr. Bertelli’s management style” (2).

Prada provides an example of how the close-knit family structure of an Italian fashion firm can affect its business relations and professionalism. The family, which is considered a strong entity in Italian life, might actually erode a company’s competitiveness in world markets that require greater agility and responsiveness in decision making situations. Prada’s example reveals one of the many weaknesses of the Italian business model in adapting to an increasingly globalized economy.

6.3 So, What Went Wrong?

There are many aspects of the Italian business model, once considered beneficial, that are now being scrutinized and re-assessed. One difficulty for Italian firms is their small size. Now that there is an integrated global market for these

products, Italian firms must have the production capacity to supply at a volume commensurate to that of global demand. According to the article “Structurally Unsound,” there are several reasons why the small Italian firms remain at a disadvantage in the globalized marketplace:

What is wrong with having lots of small firms? [...] One is that globalisation and competition from Asia (especially China) have put a bigger premium on size. In the 1960s and 1970s it was enough to supply the home market, or at most reach out to such near neighbours as France and Germany, and to rely on your local bank for finance. (2)

The *Economist* article “Material Fitness” also sheds some light on the shortcoming of the once renowned Italian business model. The article explains that “The family firm, apparently flexible, committed to investment and loyally carried forward by successive generations, has been widely reckoned a strength of Italian industry. But too many of them lack the scale they need to survive in tougher markets” (2). The same article goes on to describe the small scale of these Italian firms. It states that according to a 2001 census, textile companies in Varese employed an average of twelve workers and that clothing firms employed an average of six workers (“Material Fitness” 2). The small size of these companies makes economic expansion and production capacity growth nearly impossible.

Another article further describes the difficulty for small firms in the global market:

Globalisation is daunting for many smaller firms that lack the financial and human resources to follow their customers as they move offshore. At the same time many of them are feeling the effects of globalization in their domestic and export markets. Clusters of smaller firms in Italy and Germany that were once successful exporters have suffered as commoditised textiles, footwear and toys from China have swamped the market. They offer particularly instructive examples of how

European firms are adapting to the challenges of a globalized economy.
("Steps" 1)

The Italian business model has also come under much scrutiny in recent years because of its structure, which predominantly depends on industry clusters. The article "Material Fitness" describes the viewpoint of Franco Pantaleoni, a consultant for the Hong Kong sourcing company, Tangelo. Franco Pantaleoni is quoted saying, "They [clusters] have...encouraged shortsightedness, the black economy and consumption, while discouraging education and failing to prepare firms for change" (3). This dogmatic Italian business structure makes expansion and the adoption of new business practices difficult to achieve.

While many Italian textile and clothing firms are being decimated by the sweeping tides of globalization, others are keeping their heads afloat by re-strategizing and turning to new investors. The article "In the Steps of Adidas" explains that "export-minded small and medium-sized enterprises in Italy and Germany are also gradually transforming themselves, often with the help of new finance from private-equity investors..." (1). According to this author, "Germany and Italy both have strongly export-oriented manufacturing sectors with many small and medium-sized companies, often family-owned. Both are turning to private equity to help their firms deal with Chinese competition" (3). The article elaborates on the viewpoint of Mr. Tronconi who believes that private equity will be crucial in order to salvage these industries. It goes on to explain how "he is trying to put together a private-equity fund from among the surviving firms so that they can help each other consolidate at the top end of the market. But most mid-market clothing brands in Italy have already shifted production to lower-cost countries such as Romania, Bulgaria and Turkey" (3). While high-end Italian clothing companies can find ways to remain competitive, due to their

innovation and brand marketing, those companies offering mid-market products have much to fear.

Another source of the demise of the Italian textile and clothing manufacturing industries in recent years has to do with an important aspect of the Italian business model, the family. The family is the central structure around which many small Italian firms operate. However, this can lead to stale ideas and can make change more difficult. These firms must be revitalized through new ideas, technologies and fresh faces. According to *The Economist* article “Structurally Unsound,” the family unit is responsible for the difficulty Italian businesses face:

Over the past decade or two, the structural failings of the Italian economy have become brutally clear. What makes them especially hard to deal with is that for years many of them were seen not as weaknesses but as strengths. Asked to explain what went wrong with Italy, Francesca Bettio, an economist at Siena University, has an instant answer: the family. It is responsible for the fact that most Italian companies are small and privately owned; it has contributed to a low female participation rate in the workforce; and it is at least partly to blame for low social and labour mobility. (1)

6.4 Silver Lining on the Horizon...

Although the Italian textile and clothing industries have been greatly disturbed by the cheap manufacturing capability of developing countries, there are many experts who believe that the Italian firms are equipped with raw talent and originality which will pull surviving firms from the rubble and thrust them into the twenty-first century and the new globalized era. There are various ways in which Italian firms are beginning to seek to capitalize on this talent and originality.

Some experts suggest that Italian companies must focus on re-inventing themselves and their strategies. In their view, the Italian firms must specialize in those products in which they have a comparative advantage. In the textile, clothing and fashion industries, the Italians clearly have an edge on high-end, high-quality products. One article explains the evidence of a silver lining, which might actually appear as the clouds part:

More specifically, the textiles, clothing and footwear industries are dividing, as competition brings out the best in some companies and others fail to adapt. The best have ripped up their business models and ruthlessly shifted production to wherever it makes sense – some in eastern Europe, others in China itself - in order to concentrate on strengths such as design and marketing where the Chinese can be matched or beaten. (“Material” 2)

The article goes on to explain that Italy must focus on its strengths, craftsmanship and design, and cut ties with its weakness, cheap production. The *New Zealand Herald* also argues for strengthening Italy’s specialization in catering to the high-end fashion consumer: “Many companies which are still struggling to get by have tried to distinguish themselves from Chinese competitors through high-quality and original design, targeting the fashion-conscious wealthy who are willing to pay more for a ‘Made in Italy’ tag” (Russell 1).

Shifting resources away from manufacturing and specializing instead in innovation and marketing can also create jobs within Italy. This possible expansion of the high-end fashion sector might offset the increased unemployment within low-end textile and clothing production. In Thomas Friedman’s book, *The World Is Flat*, he refers to an essay from the *McKinsey Quarterly* which states, “In northern Italy’s textile and apparel industry...the majority of garment production has moved to lower-cost locations, but employment remains stable because companies have put more

resources into tasks such as designing clothes and coordinating global production networks” (235). The Italian journalist Roberto Saviano also believes that Italy’s specialization in high-end production will help it to weather the tides of globalization. He writes, “Not everyone has ended up in the quagmire of defeat. At least not yet. Some successful factories are still strong enough to compete with the Chinese because they work for big designer names. By delivering speed and quality – extremely high quality - they still hold the monopoly on beauty for top-level garments” (25). Figure 4 is a depiction of the attributes of the Italian business model, according to one of Italy’s most notable fashion associations, Sistema Moda Italia (“Sistema”). These are the areas in which Italian firms excel, and thus have a competitive advantage.

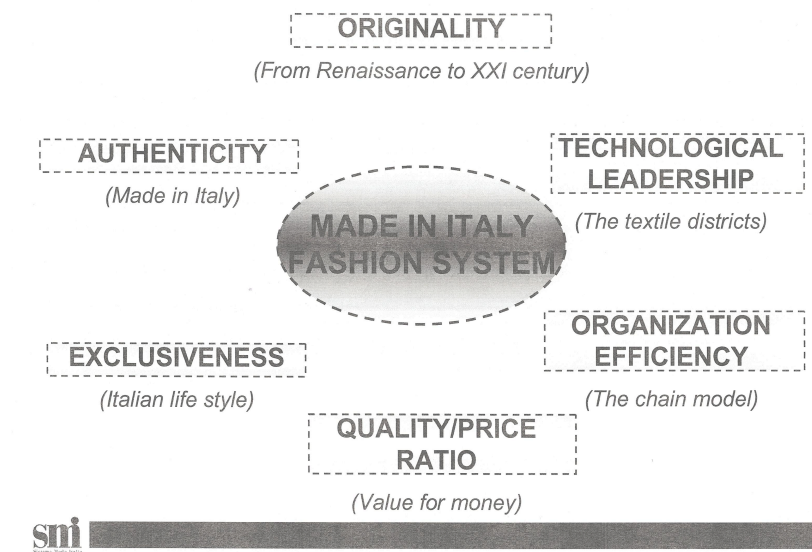


Figure 4 Facets of the Italian business model

It would be impossible for Italy to compete with China on cheap production when the Chinese can manufacture an article of clothing at the price of 45

US cents. However, Italian passion and creativity will ultimately save the industry in years to come. The article “Material Fitness” argues, “Yet there cannot be a niche for everyone and, niches apart, the survival of Italy’s footwear, textiles and clothing companies depends on them getting their strategies right across four main factors: brands, market positioning, exporting, and careful buying for price and quality” (3). The Italian textile and clothing industry has restructured itself significantly in recent years and has chosen to specialize in high-quality items. Angelo M. Cardani and Marzio Galeotti explain this Italian reaction to increased competition, “The behaviour of the Italian industries was more towards specialisation in market segments of high quality in Clothing, relative retreat from mass production in Textiles and more integration with the artificial fibres produced by the Chemical industry” (3). Although some would argue that China’s textile and clothing products are of good quality; I disagree. My use of the term “quality” correlates with the skill-intensity of the labor utilized in the manufacturing process as well as the thoroughness of assemblage. During my time as an employee for a reputable fashion company, the company had begun to outsource a majority of production to China. Immediately there was a noticeable divergence from the quality of past clothing lines. The seams were loose and became unwound at the slightest provocation and the store received many returns and complaints for buttons falling off and hemlines shredding. One of my co-workers explained to me that in order for cheap labor to maximize the amount of clothing assembled in the shortest amount of time, workers will tie less effective knots in the thread, single bind buttons instead of taking the time to make them more secure and utilize a host of other cost and time cutting techniques that ultimately decrease the lifespan, and therefore quality, of the product.

While Italy has been renowned for producing textiles and clothing of superior quality for decades, economies of scale and cheap labor have produced low quality, mass-produced garments in other countries. These prove desirable in today's cut-throat and bottom-line/bottom-dollar obsessed world economy. According to Salvo Testa from Università Bocconi, the Italian fashion firms have greatly compromised the quality of their garments by outsourcing production and must return to a reputation for quality in order to survive in the long-run:

The additional financial burden of such immaterial components [advertising, PR, events, celebrities, product placement, etc.] has ended up penalizing intrinsic quality: few have worried at the progressive cheapening of the product, accentuated by processes of outsourcing and offshoring in order to take advantage of cheaper labor, as long as the growth in the demand for branded goods guaranteed rising prices. This strategy, which bet on the low attention to substantial product value on the part of clients (both trade and end-user customers) proved the most rapid and effective way to achieve sales and profit growth... (1)

The Italians have always been considered creative, inventive, passionate and skilled artisans. They are the safe keepers of passion and craftsmanship. It will be difficult for another country to surpass the Italians on a creative front. In economic terms, it will be difficult for another country to gain a comparative advantage over the creativity bred in Italy. The author of "Reform of Die" shares a similar optimistic viewpoint of the enduring qualities and advantages found among Italian firms: "In the long run, Italians' natural flair, inventiveness and creativity should be enough to rescue what is still a rich country in every sense. After all, this is where much of European capitalism began, complete with modern banking and double-entry book-keeping" (1). The author goes on to assure readers that "The country's plethora of small firms and its lack of big companies may seem a weakness right now, but in

future it might prove an advantage again...”(1). Only time will tell which Italian firms will skillfully surf the tides of globalization and which will drown in the flood of change.

Chapter 7

FASHION HOUSES: THE HEAVY HITTERS OF THE INDUSTRY AND THE CHOICES THEY HAVE MADE

7.1 An Introduction to the Fashion Industry

The Italian fashion firms once produced very exclusive clothing for the rich and famous. Although these fashion houses continue to sell products for those willing to spend a pretty penny, they have begun to target the middle-class fashion devotee. *New York Times* journalist Dana Thomas explains this shift in consumer base:

For more than a century, the luxury fashion business was made up of small family companies that produced beautiful items of the finest materials. It was a niche business for a niche clientele. But in the late 1980s, business tycoons began to buy up these companies and turn them into billion-dollar global brands producing millions of logo-covered items for the middle market. The executives labeled this rollout the “democratization” of luxury. (1)

Italian fashion houses in the past have followed the Italian business model for the structuring of their firms. They are often small, private, family owned and family operated. According to the 2000 article “Families Out of Fashion,” the Italian firms have tried to resist loosening their grip on executive decisions, although the lure of outside investment has become increasingly tempting. The article states, “Many of Italy’s rags-to-riches stories are similar. Of its 53 fashion companies,... 30 remain private and independent...Of the four big quoted companies, Gucci, Bulgari, Ittierre

and Marzotto, only Gucci, listed in the Netherlands, is no longer family-controlled”

(1). The following excerpt from an Economist article in 2000 describes the prevalence of family owned fashion firms among the heavy hitters of Italian Fashion:

The late Gianni Versace learnt his craft sewing at his mother’s knee in Calabria. With his mother, brother and sister, he built a fashion empire that catapulted him to astonishing riches. Giorgio Armani, who is 65, still runs the fashion business that he has built over the past quarter-century. Prada, which is turning itself into a conglomerate of luxury brands, is micro-managed by Patrizio Bertelli, husband of Miuccia Prada, a grand-daughter of the founder. Krizia, a fashion house based in Bergamo, is run by a septuagenarian, Mariuccia Mandelli, and her husband, who have no heirs. (“Families” 1)

While the family structure has garnered much success in past decades, globalization is forcing companies to expand and compete at a level warranting outside investment. In order to survive in the global economy, fashion houses may have to be willing to relinquish some degree of family control.

7.2 Restructuring of the Italian Fashion Industry

With the tides of globalization all high-end fashion firms have been hurting. One 2005 article states that “Givenchy, Yves Saint Laurent, Versace and Valentino are all making losses – only Chanel is making money” (“Sorry” 1). A new era and the expanding global marketplace call for a revised global business strategy.

A crucial part of the new strategizing process is for the Italian firms to abide by the Heckscher-Ohlin theory of comparative advantage. In other words, the Italian firms must specialize in those products and those tasks in which they have an abundance of the required input resources. The author of the article “In the Steps of

Adidas” argues that Italy’s expertise lies in marketing, as evidenced by the symbol intensive marketing of its fashion industry. He writes:

Success stories such as Adidas and Puma are an inspiration to Europe’s smaller companies as the winds of globalisation sweep around them. Many realize that they will have to go global, transforming themselves from manufacturing to marketing companies and keeping only 10-15% of their total workforce in their country of origin. (2)

The fashion firms are beginning to realize that their success in the market can only come through concerted efforts. These companies are finding strength in numbers as they forego autonomy in order to bolster their investment and resources. The article “Families out of Fashion” explains that “the advantage lies with a new breed of multi-headed brand conglomerates, such as LVMH and Gucci, that have the clout to negotiate the best property and marketing deals and can offer manufacturing and distribution synergies across their brands.” The article goes on to note that “these monsters are mindful that their existing brands cannot be stretched too far. That is why they are on the prowl...Italy is their favourite hunting-ground.” (1). Small Italian companies are now caught between their renowned family structure and the more modern and less-intimate structure of falling into the hands of a conglomerate.

Many companies have begun the consolidation process. A 2000 article explains how Valentino was bought by the Italian investment company HdP in 1998 and that in the Spring of 1999 the French conglomerate LVMH made an attempt to buy out Gucci (“Families” 1). The article goes on to explain how many private Italian fashion houses have begun to play the game of making and accepting bids on their companies: “Gucci bought Sergio Rossi, an Italian shoe maker. Bulgari, Gucci, Prada

and LVMH all scrambled for Fendi...That fight was eventually won in October [1999] by LVMH and Prada, which jointly took a 51% stake” (1).

Joining a conglomerate is one way in which Italian firms are surviving in this highly competitive and demanding global marketplace. A 2005 article explains that “Europe’s rag trade has been in trouble now for more than five years. Luxury-goods groups reliant on glamorous names keep high fashion alive. Valentino, for example, is owned by Marzotto, Italy’s biggest clothing and textile group; Yves Saint Laurent belongs to Pinault-Printemps-Redoute, a French rival to LVMH” (“Sorry” 1). Another article provides a great description of the chaotic auctioning of various Italian fashion firms to major European fashion conglomerates:

Giorgio Armani, eager to add know-how in accessories to his skill in clothes, is said to have been talking to both LVMH and Gucci. Although LVMH would love to own some Italian ready-to-wear, Armani may prefer a joint venture with Gucci. This would let Mr. Armani retain control, on condition that Gucci buys him out when he retires. Versace too is considering its options. Gucci’s boss, Domenico de Sole, a fellow Calabrian, is thought to be friendly with the family, although Versace may prefer a flotation. Krizia, Cerruti and Gianfranco Ferre all need to expand and find new blood. (“Families” 2)

While many might fault the Italian fashion firms for abandoning their domestic textile and clothing industries, it is important to realize that high-end specialization requires a company to relinquish control of the entire vertically integrated business structure and to focus its financial resources and manpower on those aspects of production in which it excels: design and marketing. Thomas Friedman also defends a company’s strategic choice to outsource segments of production. He writes, “The best companies outsource to win, not to shrink. They outsource to innovate faster and more cheaply in order to grow larger, gain market share, and hire more and different specialists...”

(360). The Italians must stick to their strong suits while giving up low-end textile and clothing production.

7.3 Case Study #1: Marzotto

Italian textile firms are also realizing the benefits of conglomerate activity. They have come to understand the importance of vertical integration within the production process, so as to cut out the opportunity for Chinese intermediary production. The 1998 article “The Changing Fabric of Italian Fashion Today” describes this somewhat recent phenomenon:

Increasingly the industry is integrating vertically and firms are gaining control over the entire value chain. Marzotto, based in Valdagno, is a prime example. The company, whose looms by themselves consume 5% of Australia’s entire wool exports, has been steadily adding designers and fashion brands to its portfolio. In the process it has transformed itself from a low-margin textile-manufacturing business into one that derived two-thirds of its revenues in 1997 from garments.
(3)

Marzotto is an ideal example of the ingenuity of Italian companies to elevate their standards and production capacity in order to compete with the cheap production found in China and other developing nations. Many fashion labels and retail stores continue to seek Italian companies, such as Marzotto, in order to produce their high end products, while outsourcing their cheaper clothing to Asian countries. The article “The Changing Fabric of Italian Fashion” explains Italy’s niche in the textile and clothing markets:

Marzotto makes clothes for a wide variety of labels. Some are Italian, others are not. On the racks in its warehouse a row of Gianfranco Ferre suits hangs alongside a row of equally smart, albeit less flashy, blazers destined for Marks and Spencer, a middle-of-the-road British retailer.

Big American names such as Ralph Lauren and Calvin Klein manufacture their cheaper lines in countries with lower labour costs, but they invariably have their top range sewn in Italy. For as long as someone, somewhere is making smart clothes, Italy's manufacturers are unlikely to stand idle. (2)

Although the Italian textile, clothing and fashion industries have been greatly harmed by the comparative advantage found in China, many Italian companies have realized their comparative edge in skilled production and high-end products. Marzotto is a prime example of an Italian company that used vertical integration to corner the high-end market. With an emphasis in high-end production the Italian companies have been able to maintain their renowned "Made in Italy" high quality status.

Although textiles have been a major specialty within Italy and have enjoyed much acclaim throughout the world, Chinese fabric producers have seriously damaged this Italian industry, as noted previously in this paper. However, Italian textile companies, such as Mazotto have begun to realize the niche Italy has in the garment industry and has thus accumulated designers under its umbrella company in order to acquire the ability to market clothing, rather than stop at textile production. The 1998 article "The Changing Fabric of Italian Fashion" sheds light on the recent decisions made by Marzotto:

The company bought businesses such as Hugo Boss, originally a German menswear firm, and signed deals with blue-chip Italian designers, such as Gianfranco Ferre. The strategy, says Jean de Jaegher, an executive vice-president, was to enjoy the higher profit margins to be found in clothing. It seems to have worked. Overall, margins rose last year from 9% to 11.2%. (2)

The strategy of consolidating fashion houses under one conglomerate has proven successful in recent years by allowing firms to accumulate even more power and strength in world markets.

7.4 Case Study #2: Ermenegildo Zegna

Another Italian fashion firm, Ermenegildo Zegna, has also realized the importance of maintaining the prestige, quality and integrity of Italian design and production. A 2007 article describes the mentality of this die-hard Italian company: “Zegna considered taking its production to China a decade ago, but decided that the advantages of Italian skills and its closely integrated production system outweighed savings in wages” (“Steps” 3).

Ermenegildo Zegna is also noted for its reversed strategy to harness the advantages of developing countries and emerging markets. Instead of outsourcing its production to China, thus taking advantage of cheap labor, Zegna has decided to open stores in Asia in order to attract Asian consumers who have become wealthier and more fashion conscious in recent years. One article states that “another part of Italy’s strategy is to seek out niches in which to sell fashion items. One example is Ermenegildo Zegna, near Biella, whose brand stands for classy men’s suiting. Zegna has taken to selling rather than producing in China, opening its own shops in 24 cities” (“Steps” 3). The article “Material Fitness” also describes Ermenegildo Zegna’s success in the era of globalization:

Plenty of firms are clinging on, even prospering, by milking and developing already established brands. For example, Ermenegildo Zegna, based near Biella, shows little fear for its future. Known for its classy men’s suits, the firm has a strong brand. It was among the vanguard of global brands entering China, making its first downstream investments in 1991, says Ermenegildo Zegna, grandson of the firm’s founder and its joint head. [...] The group is vertically integrated and manufactures mainly in Italy, which it claims has not been a problem so far. (3)

Ermenegildo Zegna is a paradigm for the future, as consumers begin to realize the importance of quality and integrity within high-end, high-cost products. This Italian

firm offers their customers just that, and those who are dedicated to high fashion and Italian craftsmanship are grateful.

7.5 Case Study #3: Benetton

The Italian fashion group Benetton is an ideal example of a company that has chosen to outsource its production abroad. While Benetton relied on Italian manufacturing for the creation of its products in the past, it has realized the economic advantages of manufacturing its products in Asia, where labor costs are much cheaper. A majority of these outsourcing endeavors are directed towards China. According to the 2007 article “In the Steps of Adidas,” “The next destination is China. In the 1970s Benetton, based in Treviso in the hinterland of Venice, used to outsource garment-making to home workers near its base. In 1990 about 90% of its clothes were still produced in Italy. Now the proportion is 30%, and set to drop to 10% in a few years” (3). In order to remain close to its production so as to maintain the efficiency once found in clustered Italian cities, Benetton “has opened an office in Hong Kong to supervise its growing supply chain in mainland China” (“Steps” 3).

Benetton is often considered to be one of the most successful Italian companies to weather the tides of change, globalization. Rather than trying to fight the currents of change by clinging to dogmatic practices, Benetton has reinvented itself in the last couple decades, using cheap Asian labor to its advantage. According to one article:

The scale of Benetton’s machinery is remarkable, but its emphasis on industrial know-how is typical of Italy’s fashion business. Ten years ago Italians were worried that the country faced a difficult future thanks to its reliance on ‘mature’ industries such as apparel and footwear. But

the booming success of this decade [1990s], during which Italy's exports of textiles and clothing have grown over 70%, has proved that maturity can mean strength. ("Changing" 1)

Expansion and outsourcing are necessary for large companies, such as Benetton, that focus on middle-of-the-road clothing. One author claims that "now to be successful a company such as Benetton has had to grow to the point where it now supplies a world market and obtains its products far beyond Italy; it is quoted not only on Milan's stock market but New York's too" ("Structurally" 2).

Benetton is an ideal demonstration of what one company can achieve by cooperating with globalization trends. Outsourcing to China has been beneficial to this company, which still remains successful and world-renowned. The company has been able to maintain its client base due to its middle-of-the-road high-fashion replicas, which utilize rapid production abroad. Other fashion houses, such as Gucci, Prada and Zegna would find it difficult to maintain their client base if their quality waned, and the "Made in China" tag became associated with their production.

As demonstrated thus far in this paper, Italian firms have been re-evaluating their previous strategies in order to bring their products into the twenty-first century marketplace. Some have failed to reform their strategies and have boarded up their factories, leaving ghost towns where textile communities once thrived. The surge of globalization has been swift and overwhelming, a tidal force that requires immediate and drastic responses on behalf of all companies wishing to maintain their established prestige in the market. However, it has not been enough for companies to simply respond to the threat of Asia's cheap labor alone; intervention is needed.

7.6 The Implication of the Global Recession

As already discussed, globalization is clearly and inextricable linked to economic integration and often pegs economies to one another. In recent years people have made the following joke in regard to the economic hegemony of the United States: “When the United States sneezes the rest of the world catches a cold.” As countries open up their borders to free trade and pursue exportation themselves, their industries become subject to the supply and demand of a virtually global market. This subjectivity to world demand can have dire consequences for the Italian fashion industry. The *Economist* article “The Changing Fabric of Italian Fashion” asserts, “What can threaten this Italian dominance? [...] A wider falling off of fashion buying – whether because of an improbable bout of global asceticism or (more likely) the onset of widespread recession – would extend the pain quite widely” (2). The 2008 global recession has greatly impacted the world community and it will be interesting to see how detrimental this will be for the Italian textile industry as some of the wealthiest patrons of fashion are losing money in the stock market.

Università Bocconi has conducted research on the effects of globalization for the Italian fashion firms. According to Bocconi’s article “Made in Italy: The Shift Toward Responsible Luxury,” the recession has caused Italian firms to question whether or not they had put all their eggs in the correct basket, in terms of targeted consumer base and business strategy. That article asserts the following:

The global economic recession puts into question the growth strategies of Italian fashion and luxury brands. Over the recent years, these have grown enormously through mergers and acquisitions. The worsening economic situation makes ever more apparent the crisis of the model based on “speculative luxury,” which has prevailed over the last decade. At the basis of such a model, is the either conscious or subconscious decision to assign higher priority to new luxury

consumers: aspirational middle classes in advanced countries and business oligarchs in emerging economies. (1)

The article argues that in order to cater to the middle-class consumers, fashion firms have taken on increased financial burden in order to market their brand names. In addition, the firms attempted to cut costs by outsourcing production as a way to maximize profits. These new marketing and production approaches have decreased the quality of their fashion garments. This recent business strategy has created what the article calls a “luxury bubble, which is now deflating fast.” Bocconi researcher Salvo Testa elaborates, “The companies that have heavily pushed this business model are paying the highest price during the current crisis, while those which have kept betting on quality, customer service, high value/price ratio, and on the integrity of their brands, show that they can better weather the storm and possibly strengthen their competitive position” (1). If this proves to be the case, it would certainly support the argument that Italian firms must focus on high-end fashion in order to survive in today’s marketplace.

Chapter 8

THE TEMPORARY DAM: RESTRAINTS ON THE SURGE OF GLOBALIZATION

8.1 Italy Needs an Injection of Competition

In recent years the Italian government has realized that more needs to be done on its part to facilitate Italian business. There are many domestic barriers and bureaucratic red-tape measures currently in place in Italy that make it difficult for businesses to remain competitive against rivals abroad. The article “Structurally Unsound” describes the views of Mr. Siniscalco, Italy’s ex- finance minister. It says that Mr. Siniscalco “praises the government’s pension and labour-market reforms, but acknowledges that too little has been done to increase competition, to liberalize protected parts of the economy or to privatise” (4). The article goes on to state that the Organisation for Economic Co-operation and Development believes that “Italy suffers from the heaviest product-market regulation in Europe” (4). Maurizio Ferrera and Elizabetta Gualmini also write about the ailments of the Italian economy: “...this process of internationalization has not fully alleviated Italy’s historical problems. Exports have indeed increased, but the ‘specialized polarization’ of Italian industry has intensified maximum export in the traditional sectors (shoes, clothes, textiles,...) and relatively small in the other sectors” (74).

Many critics blame Italy’s dogmatic business practices and rigid industrial sectors for the country’s inability to maintain a competitive position in the world market. As noted above, those companies that have been successful in recent years

are those who have re-strategized. Companies that have been unwilling to adapt have simply gone under. One author describes how some such Italian firms have sought protectionist policies rather than trying to reinvent themselves:

The other problem with Italy's small firms is that too many of them are in the wrong industries, relying for too long on cheap labour for their competitive advantage. The textile firms in the north that have spent much of the past year bleating for protection are classic examples. They had ten years' warning of the demise of the World Trade Organisation Agreement on Textiles and Clothing that limited imports from developing countries. Yet when the agreement expired at the start of this year [2005], many firms rushed to Brussels to demand 'voluntary' restraints on Chinese exports....Very few seemed willing to accept any blame for failing to establish new niches based on good design, marketing or use of technology, rather than cheap labour. ("Structurally" 2).

Italian business people are known to "suffer from a pervasive anti-business, anti-customer culture. Italians may be entrepreneurial and creative, but they are by no means pro-market" ("Structurally" 5). The Italians will have to adjust their thinking if they are to survive in the years to come, when trade regulation of the textile and clothing industries becomes obsolete.

Italian politics has also contributed greatly to Italy's anti-competitive environment in recent decades. The incumbent Prime Minister of Italy Silvio Berlusconi appears to be a capitalist economic liberal; however, a closer look at his track record as a media tycoon suggests otherwise. Berlusconi entered the sphere of politics in 1994 when he formed the center-right political party "Forza Italia," (Go Italy) named after the famous soccer cheer often heard at A.C. Milan games (the soccer club that he owns). He does not come from the political world but from the business world, where he was a media proprietor and billionaire. He was recently re-

elected in 2008 and is the party leader of a new center-right movement, Popolo della Libertà (People of Freedom). Currently, Berlusconi is working with trade unions to protect Italian industry from harmful international competition. Michele Napolitano, an economist at the *Economist Intelligence Unit* offers the following observations:

The unusual alliance between a media mogul, who claims to represent economic liberalism, and trade unionists, might shed some light on the intricate world of Italian politics and economics... His [Berlusconi] mindset is simply not that of a liberal because the sectors in which he has been successful as a businessman are hardly competitive... Therefore, it should not come as a surprise that, as a politician, he has never shown any interest in reforming the Italian economy. It has been largely because of the lack of real competition that he has become rich and powerful. (1-3)

Italian politics has a history of corruption through its linkages to business, both legal and illegal.

In the early 1990s the Italian political parties went through a major restructuring as many high profile politicians were investigated and charged with links to mafia business. These investigations were known as “Mani Pulite” (Clean Hands) and the network of corrupt practices that were uncovered were coined, “Tangentopoli” (Bribesville). It was in the mist of this turmoil that Silvio Berlusconi won over the Italian people as a charismatic fresh face in politics. In his 2008 article, Michele Napolitano writes, “Mr. Berlusconi’s likely minister of finance, Giulio Tremonti, has underlined plans to lobby the EU for more tariff barriers on Asian imports...Mr. Tremonti is also advocating the idea of a stronger state against globalisation and has vaguely talked about a “Banca del Sud,” (Bank of the South)...” (2).

Although there is rapid turnover of politicians within the Italian government, the current Berlusconi administration seems to be in favor of greater protection of Italian industry contrary to Berlusconi’s political platform as an

economic liberal. Trade barriers are still discussed at the government level and little is done to further deregulate the bureaucratic business environment within Italy.

For many years the Italian textile and clothing industries have survived because of restrictions placed on Chinese exports through the use of quotas. This quota system should have expired in 2008, and, as numbers come in for present and future years, it will be interesting to see if the Italians are prepared for this change.

8.2 Review of the Effects of Protectionism

The ability for developing countries to mass-produce products using cheap labor presents a significant threat to existing unskilled labor-intensive industries in developed countries. The developed world has used protectionist measures such as tariffs and quotas to lessen, or at least delay, the impact that a surge of unskilled labor-intensive exports from the developing world would have on existing structures. The protectionism advocated by the textile lobbyists from developed countries is primarily the institution of quotas. The 2008 *Economist* article “Unquotable” explains the economic distortions set in motion by these barriers to trade:

Quotas are a particularly perverse kind of protectionism. Like tariffs, they distort markets and harm consumers: they restrict the supply of a good, thus raising the price consumers must pay. But unlike tariffs, which are collected by the government, quotas are of value to the exporter that fills them, not the state that imposes them. They give the exporters the opportunity to overcharge an undeserved market” (1).

Quotas then throw off the supply and demand relationship in such a way that producers benefit at the expense of consumers. These are just some of the reasons why quotas can be injurious to consumers in a marketplace.

Many proponents of free trade would cite the above trade distortions in order to argue for the removal of quotas in international trade. However, people who are in industries that are protected by these quotas suggest that quotas provide additional and necessary benefits to the protected firms. Angelo M. Cardani and Marzio Galeotti describe both the positive and negative effects of quotas for producers in the market:

The effect on productivity is less clear *a priori*: protected firms can either be content with widening their profit margin, or exploit the protection to re-structure production techniques and processes, gearing to higher competition. Also, the effect on productivity might pass through market imperfections: protection generates supranormal profits encouraging entry, and the entrant firms constitute an inefficient cluster of sub-optimal plants. (2)

The time and space provided by temporary quota restrictions allow for the developed countries to restructure and innovate. Time will tell whether firms have taken advantage of this time and space to find new competitive strategies and restructure or if they have twiddled their thumbs and basked in the false prosperity of protectionism.

8.3 The World Trade Organization and the General Agreement on Tariffs and Trade

Because the Italian textile and clothing industries rely heavily on the maintenance of protectionist policies, it is helpful to understand the governing body that seeks to reduce the presence of quotas. This organization is the World Trade Organization, (its predecessor was the General Agreement on Tariffs and Trade).

The General Agreement on Tariffs and Trade (GATT) was founded in 1948 after the Second World War. Its aim was to provide “a framework for international trade negotiations, and attempts to regulate world trade” (Senior

349,350). According to Susan Senior Nello's book, *The European Union: Economics, Policies and History*, there were three main functions of the GATT: "Setting out regulations governing the conduct of international trade...making provisions for the settlements of disputes and retaliatory actions...[and] providing the framework for multilateral negotiations to liberalize world trade" (349, 350).

The GATT came into effect with the specific purpose of promoting economic development through the reduction of tariffs following the Second World War. Although those countries volunteering to partake in GATT did so in order to further their own export agendas, there are some positive externalities generated through the liberalization of trade. As the second President of the Thunderbird School of Global Management Dr. William Lytle Schurz said, "Borders frequented by trade seldom need soldiers" (Cornuel 1). One idea behind international trade is to create interdependence amongst nations, making them each depend on one another for their own economic prosperity. With the establishment of trade alliances and partnerships two countries are much less likely to engage in armed conflict that would damage trade ties and lead to economic depression.

In 1986 at Punta del Este the GATT launched what is known as the Uruguay Round. This series of negotiations "was far more ambitious than earlier GATT trade negotiations, which had been almost exclusively concerned with tariff reductions" (Senior 351). Until the Uruguay round textiles had for the most part been exempt from GATT rules due to the protection provided by the Multifibre Agreement (MFA).

In the paper "International Trade of Textile and Clothing: The Euro-Mediterranean Area" Lory Barile cites articles 1.2 and 1.3 of the MFA that was

instituted in 1974. It describes the overall objective of this controversial agreement.

The articles explain some of the goals of the agreement:

To achieve the expansion of trade, the reduction of barriers to such trade and the progressive liberalization of the world trade in textile products, while at the same time ensuring the orderly and equitable development of this trade and avoidance of disruptive effects in individual markets and on individual lines of production in both importing and exporting countries [also] to further the economic and social development of developing countries and secure a substantial increase in their export earnings from textile products and to provide to a greater share for them in world trade in these products. (Barile 447).

Originally the MFA was intended to provide “base levels and quota growth as well as provisions for flexibility in quota use” (Faini 1). However, “further renewal of the MFA...contributed to a substantial tightening of import restrictions” (Faini 1). This created significant trade distortions. Faini explains that “[b]y limiting export growth in a set of goods where developing countries clearly hold a comparative advantage, the MFA is alleged to significantly retard growth in such countries” (1). Nonetheless, the MFA dam, which stemmed the flood of Asian textile and clothing exports, was eventually dismantled in 2004 (“New” 1).

The first time the textile industry came under serious scrutiny and jurisdiction was in 1995 with the creation of the World Trade Organization, which replaced the General Agreement on Tariffs and Trade, and the implementation of the Agreement on Textiles and Clothing. The 2004 Economist article, “The Looming Revolution,” describes this revolutionary agreement:

Along with food, [clothing] is also most subject to artificial distortions. The demise of the biggest such distortion, the quota regime, was agreed a decade ago. The Agreement on Textiles and Clothing (ATC) came into force, along with the WTO itself, in 1995. It covered the staged elimination of quotas in America, Canada and the EU [...] It was

intended as a bridge between the old Multi-Fibre Arrangement, which has covered textile trade since 1974, and the full integration of the trade into the multilateral system. (2)

By setting in place a definite end to the quota system, the Agreement on Textiles and Clothing marked the end of European dominance in the textile and clothing sector and sent European countries scrambling to compete and innovate. With the initiation of the Agreement on Textiles and Clothing, quotas were to be completely phased out by 2005. An article in the *Economist* in 2005 states, “Since January 1st world trade in textiles has been freed of all restrictions and members of the European Union are expecting a flood of Chinese imports” (“Sorry” 2). The article goes on to explain the European industry’s 2005 position: “At the moment the EU is the world’s leading exporter of textiles and the second-largest exporter of clothing. The industry employed 2.7m people in 2003 and has a turnover of more than 225 billion Euros (\$250 billion dollars)” (2). European dominance in the textile industry still existed in 2005 only because the quota system had protected the European textile industry from bearing the full brunt of China’s competitive advantage. However, we can already see that things have started to change. The liberalizing of markets and loosening of protectionist measures have provoked vehement responses from those negatively impacted by the change. These responses have primarily taken the form of calls for a return to protectionist measures. This in turn has provoked a reactionary response from China, which has cried “foul play.”

8.4 The Italian Response to the Deregulation of the Textile and Clothing Industries

The response of developed countries to the phasing out of textile and clothing quotas has been to lobby for the return of the protectionist measures on which

their firms depend. The author of “The Sorry State of Fashion Today” argues that “The EU’s imports of Chinese textiles and clothing almost doubled between 2001 and 2003, partly as a result of a phase out of the quotas that had begun ten years ago. The World Trade Organization (WTO) predicts that within two years China could control about 50% of the world’s textile market” (2). The probability of such a drastic surge of Chinese textile and clothing exports makes the future appear grim for Europe and has elicited calls for a return to regulated trade for the industry.

Many fashion houses, realizing the consequences of compromised production quality, a proliferation of designer imitations and increased market competition, have banded together to fight for a return to a quota regime that would safeguard their prominence in the industry. One author writes, “The French and Italian fashion associations have long been bitter rivals, but on January 17th Messrs Grumbach and Boselli agreed on a plan designed to soften the shock caused by the ending of textile quotas. They intend to co-operate in the battle against counterfeiting and to fight for further measures to stem the flow of low-quality textile imports” (“Sorry” 2). The author goes on to describe how Euratex, the Brussels based textile trade association, “has argued for ‘safeguards,’ controversial instruments used to justify stemming the flood of Chinese imports” (“Sorry” 2).

Regardless of any success on the part of European textile and clothing workers lobbying for the reinstatement of quotas on competitive Asian exports, any such “success” could only be temporary. The deluge of these cheap exports will surely come and makeshift measures designed to delay it will only wash away. According to the article “Material Fitness” “Only tariffs had kept it at bay before then, and threats of trade wars quickly led to some of them being renewed...But no one

should be fooled by such measures. It is only a matter of time before China's low labour costs and growing production skills crush competitors in western economies"

(1). Many predict a dismal future for Italian companies who face an impending Chinese flooding of the market.

Although the economists predict a doomsday scenario for the decline of Italian, and overall European, dominance of the textile and clothing industry in the future, the effects are presently tangible and already in progress. The article "The Great Stitch Up" describes the situation in 2005, when Chinese clothing exports were increasing their presence in the American market:

Predictably, exports from Asia, particularly China, have soared. In the first quarter of 2005, for example, the number of Chinese cotton trousers imported by America rose by 1,573%, cotton T-shirts and blouses were up by 1,277% and cotton underwear by 318%, according to America's Commerce Department. Total Chinese textile and clothing exports to America were over 60% higher in the first quarter of this year than in the same period in 2004. (1)

The article also explains the Chinese presence in Europe's clothing market: "In Europe, imports of Chinese pullovers more than quintupled, as did imports of men's trousers. Imports of T-shirts and blouses nearly doubled as prices fell by as much as one-quarter" (1). While China and other developing countries scramble to acquire access to the liberalized textile and clothing markets, developed countries like Italy are clearly losing ground. People in these developed countries have fiercely protested the liberalization of markets, even demanding a return to the quota system. One writer explains, "A big trade row seems inevitable. American manufacturers want their government to maintain 15 of the 91 quotas that expire at the end of the year [2004]" ("Looming" 1). The writer continues, "They also want to keep limits on imports of three products – bras, dressing gowns, and knitted fabrics – for which quotas were

lifted in 2002 and the ‘safeguards’ subsequently invoked” (“Looming” 1). This push and pull struggle for the zero-sum market has created great tension and wrathful counter-action by those countries, predominately China, who stood to gain from the removal of barriers to trade. The next section will discuss the debate and actions taken in recent years in the battle for market share.

8.5 The Battle for Market Share in the Textile and Clothing Industry

For the last two decades the global struggle for deregulation of the textile and clothing industry has been in great flux, as evidenced by the preceding account of GATT and WTO negotiation. Many countries, including Italy, have been resistant to the liberalization of a market that they have dominated for years. The author of “Material Fitness” describes Italy’s loss of market share: “The reason is that cheap, good quality imports, many from China, are taking market share. A research paper published last September [2005] shows that the slice of domestic [Italian] demand taken by imports of textiles and clothing into Italy has risen from less than 20% in 1991 to almost 50%” (2). Although the author of “Material Fitness” considers the imports to be of good quality, the term “quality” appears to be quite relative as discussed in section 6.4. This statistic clearly illustrates Italy’s declining market share.

The tensions produced by this increased competition have multiplied in recent years, leaving both sides dissatisfied and craving more support. The appropriately titled article “Europe’s Textile War with China – and Itself” describes these tensions:

When China became a member of the WTO in 2001, it did so under special terms that allowed importing countries to impose short-term ‘safeguards’ on Chinese goods until 2013 if they could show those

goods to be causing ‘material injury’ to domestic producers. And separate measures for textiles allow safeguards to be imposed whenever imports threaten ‘market disruption.’ The expiry of the previous quota system made it inevitable that countries with big textile industries – such as France, Spain, and Italy – would press for quotas to be imposed. (2)

The author of the 2005 *Economist* article “A Knotty Problem” describes the reaction of developed countries to the deregulation of the textile industry: “In recent weeks America has slapped ‘safeguard quotas,’ which limit the rise in imports to 7.5%, on seven categories of Chinese textiles, including trousers and shirts. The European Union plans similar restrictions on T-shirts and flax yarn” (1). Already we see that Western textile and clothing industries will not go down without a fight and will use their political clout and soft-power muscles to try and revert back to old crutches, the quota system.

From an economic standpoint many would argue that textile companies in Italy and other Western nations are outdated and out-competed by those in Asia. These economists would argue that from a comparative advantage standpoint, China’s abundance of cheap labor provides an unbeatable competitive edge in unskilled labor-intensive manufacturing. Furthermore, many lack sympathy for the outmoded westernized textile industries because, while they have had ample time to rethink their economic strategies, they wasted this time by clinging to the protections afforded them by the quota system. The author of “A New Knot in Textile Trade” laments the situation as follows: “Textile producers have had since 1994 to prepare for the end of quotas. Nevertheless, in rich countries the declining but still vocal textile lobbies have been whingeing; and poor countries that have used the quotas to build textile industries have also been fretting about the Chinese threat” (1). Many would agree that the predominant textile and clothing players have for too long relied on the

handicapped advantage provided by quotas, rather than seeking to prepare themselves for the certain expiration of these quotas.

Nevertheless, fearing the coming tidal wave of Chinese exports cresting in the distance, the Italian and other European Union textile and clothing lobbyists are pleading “S.O.S.” as a means of trying to get quotas reinstated. The 2005 article “A Knotty Problem” explains the resurgence of quotas:

Like a badly stitched dress, global textile trade is fraying at the edges. Five months after the death of the quota regime that had for decades governed and distorted the world’s textile industry, those dastardly quotas are making a comeback, at least as far as China is concerned. The result is rising tempers and name-calling on all sides. (1)

While many cheered the progress of the 1995 Agreement on Tariffs and Trade and the staged elimination of quotas from this highly regulated sector, the free market utopia proved short-lived. In recent years the debate has heated up as quotas have returned in attempts to stem the inevitable surge of Chinese exports. The next section will discuss the return of quotas, after the quota elimination deadline of January 2005, and the Asian response to these reinstated quotas.

8.6 In and Out like the Tides: The Return of Quotas for Textiles and Clothing

With the final stage of quota elimination set to take place in the beginning of 2005, many in the textile and clothing industries were resistant to let them go without a fight. These industries lobbied ceaselessly for their return in Europe and were successful in their endeavor. According to the 2005 article “Textile Trouble,” the plight of rigid industry lobbyists was heard and answered: “An example of the European Union at its finest: that was how Dominique de Villepin, France’s prime

minister, greeted the deal in June [2004] to limit Chinese textile exports to the EU. Ten weeks later, only a diehard Europhobe could be satisfied” (1). The quotas were back.

The return of quotas was signed into agreement in June of 2004. According to one author, the renewed agreement imposed “new quotas on ten categories of textile goods, limiting growth in those categories to between 8% and 12.5% a year. The agreement, which runs to 2007, was to give domestic manufacturers time to adjust to a world of unfettered competition” (“Europe’s” 1). Peter Mandelson describes the mutual benefits of this new quota agreement, stating that it “will give players on both sides clarity, certainty and predictability” (“Textile” 1). However, the impact of reneging on the agreement to end the quota system has severely affected retailers who had been prepared to stock their shelves with Chinese merchandise, which had already been contracted to them. After the reinstatement of the quota system, more than eight million Chinese produced clothing items were impounded “because they exceeded the quota” (“Textile” 1). And that was just the beginning.

The new round of quotas re-instated in 2005 was to be phased out by the beginning of 2008. Nevertheless, “safeguards” can be invoked against any Chinese goods until the end of 2013, if they can be proven to cause “material injury” to producers in importing countries (“Knotty” 1). This safety measure for competing countries has been worked into the agreements made within the World Trade Organization. The author of “A Knotty Problem” explains, “The re-emergence of quotas should surprise no one. The rules of the agreement surrounding China’s accession to the World Trade Organization (WTO) specifically allow such

‘Safeguards’ against Chinese products” (1). The author goes on to provide a concise explanation of the stipulations attached to the safeguard measures for textiles specifically: “Safeguards can be imposed almost automatically whenever imports create or threaten to create ‘market disruption.’ There are limits: Chinese exports must be allowed to rise 7.5% a year; the controls must last only one year, although they can be renewed; and the safeguards must go by the end of 2008” (2).

These new quotas incense Chinese producers because they forestall China’s ability to realize its rightful dominance, according to the invisible hand of free market economics, in this dynamic market. Ever since joining the WTO, China has been eager to enter this lucrative niche. One writer notes, “The prospect of rapid growth in the labour-intensive textile sector was one of the most attractive aspects of WTO membership for China. Not surprisingly, China’s textile industry is furious about the safeguards” (“Knotty” 2).

The response from China has been very vocal since the return of restrictive quotas on Chinese textile and clothing exports. When discussion of renewed quotas became public in 2005, China decided to be less sympathetic and cooperative with the pre-planned transition phase and even went so far as to stage its own retaliation. The author of the 2005 *Economist* article “A Knotty Problem” describes the situation: “Furious at what it regards as ‘unreasonable’ protectionism that ‘lacks legal grounding,’ China announced on May 30th that it was immediately scrapping export tariffs it had introduced earlier this year on 81 textile products to slow the surge in exports” (1). The *Economist* writer goes on to explain that only ten days prior to China’s retaliatory maneuver it had been discussing increasing taxes on 74 of the products, including some increases upwards of 400 percent (1). The quick

and complete abandonment of such a strategy shows that China was not willing to give into the new quotas without a fight.

In December of 2008, EU protectionist measures, which had been choking off Chinese imports for years, finally ended. As of the writing of this paper, no known quotas have re-emerged. Italy and other European countries no longer seem to have the ability to stem the inevitable economic forces at play. Furthermore, the European Union has decided to shift its resources towards helping industries adjust to globalization rather than fight it. On September 28, 2008 a European press release announced that 5,955 Italian textile workers would receive assistance, totaling roughly thirty-six million Euros, from the EU Globalization Fund. The funds are intended to help these workers return to employment (“5,955” 1). European Employment Commissioner, Vladimir Špidla, justifies the need for such assistance, “Globalised trade and production bring growth and employment for most of us, but some can also be negatively affected. These workers fall into the second category, and I’m pleased that we have been able to recommend the Italian applications to the Parliament and to the Council” (“5,955” 1). This is a watershed for Italy and the European Union: rather than attempting to fight, or at least delay, the forces of globalization, they are now refocusing their efforts on ways to deal with the realities of world economic trends.

Another attempt on the part of Italian textile lobbyists to bolster their prospects has been to plead for greater transparency in the manufacturing process and for more clarity regarding the “Made in” labels found on garments. In late October, 2007 Luca Marco Rinfreschi, a representative of the Italian Chamber of Commerce, addressed both the European Economic Social (EESC) Committee and the Consultative Commission on Industrial Change (CCIC) about the need for greater

traceability of textile production. Believing in the power of the “Made in Italy” tag, and the quality and integrity which it implies, Rinfreschi demands that consumers be made more aware of the types of products they buy. He closes his speech with the following argument:

The invasion of cheap products on our markets is not the problem: it is a normal consequence of free competition. But the consumers must not be duped into thinking they are buying a product that has certain characteristics when they are actually buying something else. Everything has to be called by its proper name, every garment has to be identified for what it is. (2)

Although the primary focus of this paper is to analyze the effects of globalization on the Italian textile and clothing industry, it is important to note that this is a global phenomenon which has many other developed countries also up in arms to protect their domestic textile industries from China. In America we hear the same rhetoric, arguments and uproar as found in Italy. “The Looming Revolution” explains the hysteria on the American battleground of this quota war:

China has responded robustly, arguing the ‘safeguards’ were designed to correct actual import surges, not threats yet to materialise. American textile importers and buyers accuse their compatriot manufacturers of trying to achieve through government intervention what they have failed to manage through investment, planning and improving productivity: becoming internationally competitive. (2)

Although China continues to pay for the conditions of its accession to the WTO, there seems to be a consensus that it is time to wean developed countries off their reliance on trade protection. Be it permanent or just another ebb and flow of the tides of protected trade, there seems to be a glimmer of hope for free trade on the horizon. The author of the 2007 article “Global Agenda: China and Europe” describes the expected end to quota agreements:

On merchandise trade, freer imports of Chinese textiles remains a key issue. The EU will soon lift an annual cap that it had imposed on imported Chinese textiles since 2005. Following a recent agreement between the European Commission and the Chinese commerce ministry, the cap will be replaced by a textile-import monitoring system which will be put in place for 2008. (1)

Everyone can agree that quotas are a means by which to distort trade. In the case of textiles and clothing we have seen that quotas have helped less competitive countries maintain their market share within this industry, while severely stunting the growth potential of China's dominance in the area. The last section of this chapter will discuss the final actors who must be considered while liberalizing the global market for textiles and clothing: the other developing Asian countries.

8.7 The Other Players: Asian Developing Countries That Have Benefited from Trade Distortion in the Textile and Clothing Industry

Many other Asian countries also have an abundance of poor, unskilled laborers who provide cheap labor. As a result, many of these countries also have a comparative advantage over Western nations, even if it is smaller than the advantage enjoyed by China. In the wake of quota restrictions on Chinese textile and clothing exports, many of the countries have been eager to step in and fill the gap in this market. The article "The Looming Revolution" sums up the effects of past trade distortions in the textile and clothing industry on these other countries: "The quotas have restrained some countries' exports, but in others have created an export industry that might not otherwise have existed. China is definitely in the first category – its sales in America and Europe will surely grow once quotas are lifted" (1). The second category is comprised of those underdeveloped countries that emerged on the textile

and clothing scene to supply products for the excess world demand not satiated due to quota caps on Chinese products. The author continues:

It is not just the rich world's garment-makers that are alarmed. Trade associations from more than 50 countries have signed the "Istanbul declaration," asking the WTO to keep the quotas for a further three years. They include groups from poor and middle-income places such as Bangladesh, Sri Lanka, Indonesia, Morocco, Tunisia and Turkey.
(2)

Another author states, "For South Asia as a whole, the impact of the end of the quota regime is potentially enormous. In poor countries with small manufacturing bases and a vast rural majority, garment making offers a labour-intensive way of lifting people out of poverty" ("Looming" 2). It is not just countries in the developed world that are threatened by the expiration of quotas. If China's market share is allowed to grow, many developing countries will suffer as well.

Chapter 9

THE THEORY OF COMPARATIVE ADVANTAGE IN PRACTICE

The Heckscher-Ohlin theory of comparative advantage is widely used in international economics to explain why a country might have greater success than another country in the production of a specific good. According to the theory's architect, Bertil Ohlin, "Commodities requiring for their production much of [abundant factors of production] and little of [scarce factors] are exported in exchange for goods that call for factors in the opposite proportions. Thus indirectly, factors in abundant supply are exported and factors in scanty supply are imported." (Pugel 60). In his textbook *International Economics* Thomas Pugel provides a more concise and clear-cut explanation of this theory, "...the Heckscher-Ohlin theory predicts that a country exports the product(s) that use its relatively abundant factor(s) intensively and imports the product(s) using its relatively scarce factor(s) intensively" (60). This theory has been highly acclaimed by economists for making sense of variation trade patterns and economies of scale.

Most economic theory is difficult to apply to real-life scenarios as a result of many external factors, often held as constants in the economic model, which muddy the evidence and results of economic findings. However, the economic theory of comparative advantage is perfectly applicable in the world when assessing two countries with very different factor endowments. In her book *The European Union: Economics, Policies and History* Susan Senior Nello describes the usefulness of the Heckscher-Ohlin framework to assess international trade patterns:

This explanation works rather well in accounting for trade between countries with different endowments of factors of production such as land, labour, or capital. For example, it may explain certain trade flows between developing and industrialized countries. However, it works less well for trade between similar countries, such as most of those of Western Europe. (65)

The economic theory of comparative advantage is consistent with the story of what is happening to the Italian textile and clothing sector and explains the true reason why Italian companies are losing textile and clothing sector jobs to China. Robert J. Carbaugh breaks the Heckscher-Ohlin theory down even further: “The factor-endowment theory states that comparative advantage is explained exclusively by differences in relative national supply conditions. In particular, the theory highlights the role of nations’ resource endowments as the key determinant of comparative advantage” (63). In layman’s terms, a country will have a comparative advantage in the production of a good if it has a relative abundance of either capital or labor inputs that are required for the production of that good.

Although Italy has been spinning yarn and weaving textiles for centuries, it is known for its highly-skilled, innovative, artistic labor force. The Italians have been at the forefront of runway fashion, hand blown glass designs, paintings, sculptures, architecture and sleek automobiles, all of which require a high level of skill and exude quality and craftsmanship. Low-end manufacturing, in contrast, requires a large amount of non-skilled workers. Because unskilled labor is a primary input in the unskilled labor-intensive manufacturing process, comparative advantage suggests that a country will have a competitive advantage in unskilled labor-intensive manufacturing if that country is endowed with a relative abundance of unskilled labor. While Italy might have had a relative abundance of unskilled labor during the Industrialization era, economic growth spurred increases in education and training,

thereby decreasing the share of unskilled workers in the labor pool. The relative scarcity of unskilled workers in the Italian economy made unskilled labor-intensive production more expensive, thus providing an advantage to skilled labor-intensive manufacturing.

In comparison, China is a developing country that is currently going through the stages of industrialization and is now well on its way to becoming an economic superpower. China has been able to catapult its way onto the world market by utilizing its most prized endowed resource: cheap, unskilled labor. This high abundance of cheap labor gives China an automatic comparative advantage in low-end manufacturing, including the production of textiles and clothing.

As China moves through the stages of economic development, its citizens might opt for higher education rather than factory work. The Chinese population might change from largely unskilled, factory workers to highly-skilled entrepreneurs and the like. Although outside the scope of this paper, it is interesting to note that while China holds the comparative advantage in unskilled labor-intensive manufacturing, this advantage is expected to erode with greater economic, political and social development.

Chapter 10

CONCLUSION

The tidal force of competition coming from distant shores has battered the Italian textile and clothing industries. Entire textile towns have been wiped out, while others are still standing, albeit in need of great repair. Several factors have greatly contributed to the decimation of these industries.

First, the Italian government has not reformed the business sector sufficiently enough to encourage the type of vitality, flexibility, and competitiveness required for success in world markets. Although Berlusconi's administration has enacted a few labor and pension reforms in order to pay lip service to its "economic liberalist" political platform, the administration has not met the problem of greater international competition head on.

Second, the structure of the Italian textile and clothing districts has proven detrimental to the industry as well. Small, family-operated firms were able to produce the exclusive items of the fashion industry in past decades. However, as fashion houses decided to market their products in emerging markets and to broaden their consumer base to the middle-class lower-cost mass production became essential. Also, the family-run firms did not have the capital or financial resources to remain autonomous, and to stand by the high price-to-quality ratio and integrity of their products. In order to compete in the globalized marketplace, profit maximization was pursued at all costs.

Third, rather than focus their efforts on reinventing themselves, the Italian textile and clothing industry, along with their counterparts in other Western countries, spent time and resources lobbying for protectionist measures in order to keep foreign competition from breaching its borders. The quota systems that were implemented to reduce Chinese textile and clothing exports were always temporary measures. However, the Italian firms did not capitalize on their borrowed time.

While the Italian textile and clothing industry has sustained serious injuries as a result of increased competition from China and other developing nations, there is in fact a positive omen resulting from this wake-up call. Italy must stop running from globalization and find a way to embrace it. Rather than using its resources and political clout to impede international trade through trade barriers, the Berlusconi government ought to promote international competition by deregulating Italian business bureaucracy.

Along with globalization, the world community has become increasingly conscious of environmentalist and human rights issues throughout the world. Consumers are beginning to demand products that cater to these concerns. Salvo Testa of Università Bocconi predicts that there will be a new niche in clothing demand, “sustainable fashion/luxury products” and believes that Italy is in the perfect position to “pursue the model of ‘responsible luxury’” (1). He cautions, “But in order to do so, Italian luxury brands will need to return to the original causes of the success of Made in Italy: without giving up technological and managerial innovation, they will have to find once again the passion for the ethics of making things, thus building a stronger future for their firms” (1).

The Italian textile and clothing industries must stop trying to compete with China, and other developing countries with a comparative advantage in unskilled labor-intensive manufacturing, on mass production and price. Although led astray by shortsightedness, these Italian industries have the opportunity to get back on track and reclaim their position at the top of the high-end market. Fashion consumers around the world come to Italy for cutting-edge garments of superior quality. It is time for Italy to incorporate these attributes into its production processes once more by specializing in the elite high-end sector of these industries. Italy must focus on the skilled labor-intensive production for which it has a comparative advantage in world markets. Those companies that “catch the wave” of this exclusive niche, will adeptly surf the tides of globalization in the years to come.

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APPENDIX

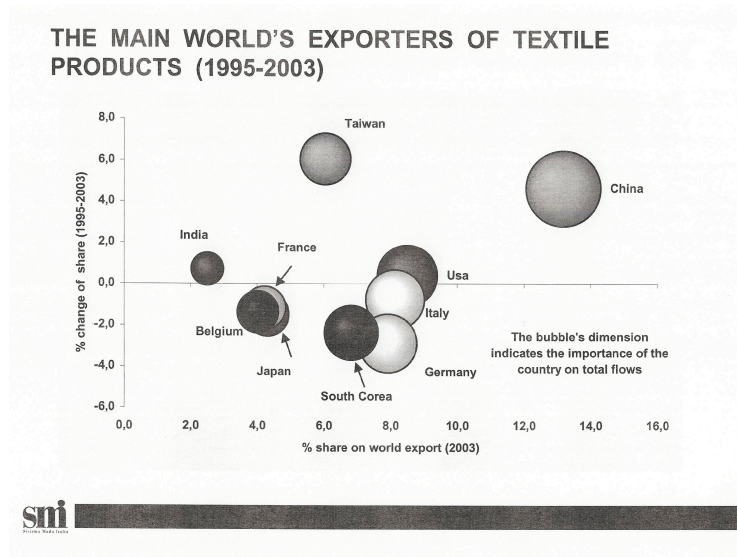


Figure 5 Exporters of Textile Products

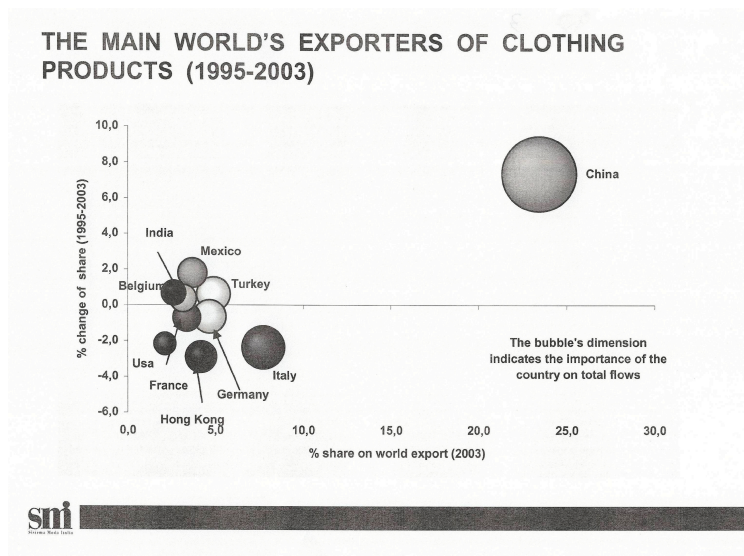


Figure 6 Exporters of Clothing Products