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# INTERNATIONAL COMPETITIVENESS AND EXPORT PERFORMANCE: The Case of Clothing and Textiles

Sally Weller\*

During the 1990s Australia followed a path of structural adjustment to improve the economy's international competitiveness.<sup>1</sup> While in general the government adopted a market-oriented approach (Garnaut 1989), a set of more interventionist policies were established to stimulate change in the previously highly protected textiles, clothing and footwear (TCF) and passenger motor vehicle (PMV) sectors.<sup>2</sup> A central objective of internationally oriented restructuring has been export market development. This study of the textiles and clothing industries' Import Credit Scheme explores the limitations of export-oriented policies and contends that the translation of the objective of 'international competitiveness' into industry policy has been deficient.

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- \* I would like to thank the three anonymous referees for their helpful comments on an earlier draft of this work.
- 1 In choosing its course, the government had before it two opposing approaches to change – the AMC's (1990) *Global Challenge* report, with its emphasis on interventionist policies, skill development, innovation and competitive advantage; and Garnaut's (1989) market-oriented, economic liberal approach grounded in the theory of comparative advantage.
- 2 With acceptance of the economic liberal agenda around 1986, policy increasingly emphasised 'microeconomic reform' and moved away from sectorally based strategies. Sectoral policies for the TCF have had a contradictory nature arising from the continuing tension created by superimposing interventionist policies on an economic liberal policy framework. Firms were urged to invest in quality improvement, quick-response, niche markets, and exports; but at the same time to implement cost-reduction strategies to meet international production benchmarks (Weiss & Mathews 1991).

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Before 1990 exporting activity by firms in the Australian textiles, clothing and footwear sectors was negligible. As a result of historically high levels of border protection, Australian production had focused on the domestic market and was not competitive at world prices. Despite border protection, however, imports had gradually increased their share of the market. The election of the Hawke Labor Government in 1983 marked the beginning of a new accumulation strategy based on engagement with the global economy. In a world of open trade, given Australia's high labour costs and the industry's labour-intensive production profiles, a local TCF production sector was unlikely to prosper. In 1988, following considerable public debate, the Government introduced a Plan to coordinate the sector's orderly contraction via gradual reductions in trade barriers, an interventionist industry development program and labour adjustment initiatives (Button 1986).

In response to tariff changes, the 1991-92 recession and intensifying competition, many domestic firms ceased production in Australia and relocated their manufacturing operations to low-wage countries.<sup>3</sup> In making this strategic shift, local manufacturing capital reinvented itself in logistics and supply chain management. As a result, import growth during the 1990s comprised, for the most part, of garments produced by offshore subcontractors on behalf of local firms.

As imports grew, policy encouraged local manufacturers to develop export markets. The textiles, clothing and footwear industries' Import Credit Scheme (ICS) rewarded export performance by enabling firms to earn a fully tradable 'import credit' on their exports.<sup>4</sup> Policy initially envisaged the Scheme would intervene to alter the strategies of individual manufacturing firms by promoting cost, quality and process improvements, widening production choices, promoting specialisation, and encouraging the substitution of imported for locally made inputs (Button 1991). Essentially, the policy was based on the notion that if the

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3 The process of relocation to low-wage countries began in the late 1970s, with early movers enjoying a sustained competitive advantage. The shift offshore accelerated after 1991 (Weller 2000, forthcoming).

4 Holders of Credits could reduce the amount of customs duty paid on eligible imported goods by an amount up to the value of the credit. See TCFDA and ACS (1995) and Thomas (1996) and for detailed descriptions.

competitiveness of firms could be improved, market forces would ensure their success and the economy would benefit from aggregate individual-firm-in-the-market gains. A second scheme, the Overseas Assembly Provisions (OAP), had similar objectives and encouraged firms to export labour-intensive tasks to low-wage countries (Button 1992). It allowed fabric to be exported, made up into clothing, and then re-imported to Australia with duty payable only on the value added offshore. Both initiatives were introduced following the 1991 March Economic Statement's acceleration of the tariff reduction schedule as part of a deliberate push to increase the rate of change in the sector. Both aimed to advance Australia's integration into the world economy by promoting both exports and imports. The TCF 2000 Plan (1995-2000) continued the internationalisation focus and set a target of \$A2 billion in exports by the year 2000.<sup>5</sup> In the interim, the World Trade Organisation outlawed subsidies of the type provided by the Import Credit Scheme. As a result, the Scheme will be phased out by June 2000.<sup>6</sup>

At face value, the ICS appears to have successfully stimulated a dramatic increase in TCF sector performance. The Industry Commission (1997), for example, uncritically equated increases in aggregate trade flows with export success. It reported that exports for all TCF products (less wool scouring) increased by 247.5% between 1988-89 and 1994-95, compared to a 78.4% increase for all of manufacturing in the same period. Export intensities increased from 1-2% of turnover in 1988-89 to 8-10% by 1994-95 (see Table 1). Similarly, Feaver *et al* (1998) presents the positive relationship between the introduction of the Import Credit Scheme and post-1991 export growth as evidence of the success of the export promotion program.

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5 According to the Department of Industry Science and Technology's *Annual Report 1995/96* (DIST 1996), the TCF 2000 Development Package, worth \$45 million, aimed to 'continue the process of restructuring in the industries, support the industries in their pursuit of efficiency and competitiveness, and prepare firms for the opportunities and challenges to emerge from Australia's integration with APEC'. The target of \$2 billion in exports was set in the Budget Papers. See also Cook (1995).

6 The World Trade Organisation has ruled that the ICS is an illegal export subsidy under the Agreement on Subsidies and Countervailing Measures, which bans subsidies contingent on export performance.

Table 1: Exports<sup>(a)</sup> by Industry (Current Dollars)

Industry	1988-89		1994-95		Export growth 1988-89 to 1994-95
	Exports (\$Am)	Export intensity <sup>(b)</sup>	Exports (\$Am)	Export intensity <sup>(b)</sup>	
Fibres yarns & woven fabrics <sup>(c)</sup>	78.0	n.c. <sup>(d)</sup>	268.3	n.c. <sup>(d)</sup>	243.9%
Textiles products	74.8	4.5	164.5	10.3	119.8%
Knitting Mills	18.7	1.6	83.2	8.4	345.3%
Clothing	54.1	1.5	267.2	8.1	393.7%

Source: Industry Commission (1997: Table 1.3), based on data from ABS, *International Trade Australia*, Magnetic Tape Service, Cat. No. 5464.0.

Notes: (a) including re-exports. (b) calculated as exports as a proportion of turnover. (c) excluding wool scouring. (d) not calculable.

These appraisals exaggerate TCF export success because they overlook the influence of trade with New Zealand, border-nation subcontracting and re-exporting. This paper shows that while the Import Credit Scheme was designed to promote exports it had two other major effects in practice: it facilitated the shift of Australian clothing firms offshore and it stimulated domestic restructuring. These effects occurred, it is argued, because the Scheme's conceptual foundations misunderstood both the nature of the industry and the dynamics of industrial change. This is revealed by a critical survey of theoretical approaches to the evaluation of export subsidies that emphasises the need to consider their structural impact. Export performance is then analysed from a perspective that understands the industry as an internationalised industry structured by firms linked in hierarchical commodity chain formations spanning from fabric inputs to consumers. This brings into question whether promoting exports of manufactured goods is the most appropriate approach to the internationalisation of this industry, and raises issues about the relation of national industry policy to firm strategy when firms' sphere of action permeates national boundaries.

## Export Subsidies in Trade Theory

Different trade theories diverge radically in their theoretical evaluations of export facilitation schemes. A neo-classical perspective views export promotion as distorting the operation of market forces, resulting in less productive use of resources, lower export commodity prices in the world market, and a reduction in national welfare. Export subsidies may also divert supplies from the domestic to the export market, drive up domestic prices, and discourage home consumption.

In strategic trade analyses, in contrast, export market development has been shown to benefit a home country in certain circumstances (Brander and Spencer 1984). These benefits include increasing the size of the market, liberating firms from the constraints of a small domestic market, providing opportunities to gain from economies of scale and scope, increasing the industry's 'critical mass', and providing dynamic gains through inter-firm synergies. Krugman (1979, 1980) has shown that increasing market size should produce gains from trade in sectors characterised by highly differentiated goods and monopolistic competition. An export promotion program such as the ICS could also be supported as an infant industry policy implementing Australia's new accumulation strategy based on international competitiveness.

Versions of strategic trade theory inspired by game-theoretic notions of industrial organisation evaluate trade policies in terms of market power and firms' strategic decision-making. Scholars of the neo-classical tradition dismiss these approaches as either ill-conceived (Siebert 1999), or as irrelevant to Australian policy given Australia's minimal power in world markets (Pomfret 1992). However, a focus on strategic interactions between firms and between firms and government provides a fresh perspective on export development. If it is accepted that the clothing industry globally is characterised by a buyer-led commodity chain structure dominated by powerful core firms, vertical supply chains and intense within-chain competition (Gereffi 1994, Bonacich *et al* 1994), then strategic interactions between firms, national governments, regional trade agreements and global regulations become crucial. The effectiveness of export subsidies will depend on their impact on firm behaviour: on whether profits shift from foreign to domestic firms, and

whether the national interest is served as a result (Grossman 1986).<sup>7</sup> By adopting a strategic approach, interest shifts from assessing the aggregate gain or loss from export promotion to a perspective that assesses *which* firms gain and why. On that basis, the Scheme's evaluation should highlight the competing and contradictory outcomes for different sets of firms, note its successes and failures, and monitor its impact on the structural composition of the local and global industry.

It is important too that analyses of export market facilitation take adequate account of sectoral characteristics, since the propensity to export depends on industry-specific factors such as the nature of competition, the ways in which different firms respond to competition, domestic consumption patterns and differences in production technologies in home and foreign markets (Grossman 1986:66, see also Noponen *et al* 1993). Sectoral peculiarities are particularly pertinent to clothing trade where a plethora of trade barriers and incentives govern global clothing trade flows. Various studies have shown that the correspondence between price and demand in the clothing industry does not follow neo-classical expectations, except in the most budget-conscious parts of the market (PSA 1993). In addition, dynamic gains through economies of scale are less likely in the clothing sector where production is highly differentiated and the imitation of successful designs quickly dissolves the advantages of innovation.

The assessment of a program such as the Import Credit Scheme therefore demands a finely tuned approach that examines the detail of the policy's impact. To evaluate the Import Credit Scheme in terms of its impact on firm strategy and industry structure, it is first necessary to describe how the Scheme operated in practice. The sections below consider in turn the three effects of the Scheme: first, its main function as a *de facto* offshore assembly scheme, second, its limited success as an export subsidy, and third, its role as a mechanism for promoting domestic restructuring.

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7 The notion of 'national interest' here follows Grossman's (1986) use of the term, which equates national welfare with national GDP growth. Discussion of the limitations of such a narrow definition, including its disregard of distributional issues, is beyond the scope of this paper.

## The Import Credit Scheme as an Offshore Assembly Scheme

The most significant effect of the Import Credit Scheme has been its use as a strategy of *border-nation* production, where fabric is exported for assembly into clothing and then re-imported for domestic consumption. By using the ICS in this way, Australian firms have reproduced supply structures developed in the United States and Europe.

In the United States, under s. 9802.00 of the Harmonised Tariff Schedule (formerly Tariff Item 807), firms are able to manufacture clothing destined for the US market in Mexico by subcontracting production to assembly firms in the tax-exempt Maquiladoras.<sup>8</sup> This trade has been stimulated further by Mexico's inclusion in NAFTA, the North American Free Trade Agreement. By using US-made cloth and shifting the labour-intensive parts of the process to low-wage locations, US firms have been able to compete profitably with imports from Asia.<sup>9</sup>

Border-nation assembly has been successful in the United States because textile mills in the southern states are well located geographically to supply Mexico-based contractors. Cloth can be trucked from, and completed garments to, the United States in 'quick response' production, and Mexico is close enough for United States firms to manage quality control and production schedules. Non-equity subcontracting relationships between core firms in the United States and assembly firms in Mexico minimise the core firms' exposure to risk, and the political environment ensures that US-based core firms are able to have their expectations met with minimum dispute. For US-based firms, supply

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8 In 1965 Mexico established a Border Industrialisation Program (BIP) that provided concessions to US firms. After the 1982 currency devaluation in Mexico, border manufacturing boomed. See Anderson (1990), Carillo (1994).

9 Asian-made products continue to face substantial trade restrictions. Under the GATT Multi-Fibre Arrangement the United States and European Union used a web of bilateral quota and tariff restrictions to limit imports from low-wage countries. Quotas will be phased out by January 2005 in accordance with the World Trade Organisation's Agreement on Textiles and Clothing (WTO 1999).

chains into Mexico are short in comparison to supply chains into Asian countries. Consequently, commodities flow more efficiently and supply chains are easier to manage.<sup>10</sup> Border-nation assembly schemes are also being used increasingly in Europe, where low-wage countries in North Africa and Eastern Europe provide a relatively low-cost labour source.

Border-nation production strategies have in common the intent to retain high skill or high value-added processes at home (textiles production and clothing design) while exporting low-skill labour-intensive processes (clothing assembly). They in general protect the domestic textiles industry at the expense of local clothing production. They appear to have become a globally preferred strategy for fashion-oriented production requiring quick turnaround and tight control by core firms. By the late 1980s, innovative Australian managers and clothing buyers with links to the global industry were well aware of the structure and provisions of such schemes.

Imitating the US scheme, Australia's Overseas Assembly Provisions (OAP) were introduced in 1992. Geography worked against the Australian version. Australian firms using offshore suppliers had to deal with the cost and risks of sea and air transport, and distance made control of the production process more difficult. Compared to the United States, too, Australian textile mills were not well placed, either geographically or in production cost terms. Textiles firms in Korea, Taiwan and the rapidly expanding Chinese textiles sector could supply materials for Australian firms making up clothing in China (or in Fiji) at a similar or lower cost than could most Australian textiles makers even with OAP assistance. This defeated the purpose of the scheme and meant that the Australian Overseas Assembly Provisions, in their pre-1998 form, were unattractive to most firms. In fact, the structure of the Australian OAP favoured vertically integrated producers such as Pacific Brands, which was one of the only firms able to profit from the Provisions. Australia's small market size was also an impediment to the success of OAP. Australian firms' orders to offshore suppliers were quite small compared

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10 For historical reasons, firms based in the United States continue to organise Asian production via intermediaries in Taiwan, South Korea and Hong Kong (Gereffi 1999).

to the volumes required by United States- and European Union-based core firms. Overseas 'make-and-trim' assembly firms accordingly placed less value on the Australian business, which in turn made it harder for Australian firms to maintain a high profile and have their needs met.<sup>11</sup> Australian OAP regulations also proved too restrictive, allowing only pre-cut cloth to be exported and limiting the extent to which finishing processes could be performed overseas. 'Make-and-Trim' assembly subcontractors, predominantly in China, were loath to accept pre-cut cloth for assembly because reselling off-cuts from the cutting process was a major source of their profit.

Although the Import Credit Scheme was intended to promote exports, clothing and textiles firms saw in it an opportunity to capture the advantages of border-nation assembly without the OAP's restrictive guidelines. Essentially, domestic firms transformed the export facilitation scheme into a flexible version of the Overseas Assembly Provisions, using it in conjunction with the regional trade agreement SPARTECA to establish and support export/re-import production structures based mainly in Fiji. With ICS assistance, cloth made by Australian textiles firms was exported to Fiji for making up in Fijian clothing factories. Finished clothing was then re-imported under the South Pacific Regional Trade and Cooperation Agreement's (SPARTECA) duty drawbacks.<sup>12</sup> Despite initial quality problems, clothing production in Fiji grew rapidly after 1986 (Slatter 1989). Before 1990, Fiji was not subject to quotas restricting exports to the United

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- 11 Large assembly firms direct their energies to capturing the business of large US-based clothing firms – for example, by setting machinery and threads to the US standard. Australian orders are not of sufficient volumes to meet the minimum order accepted by large China-based 'make-and-trim' firms.
- 12 SPARTECA was a non-reciprocal agreement established in 1980 to promote trade in the South Pacific. Duties between Australasia and Fiji ended in 1986, although local content rules—rules of origin—governed the conditions of garment production. These rules were liberalised in 1987 and again in 1994, as explained in Grynberg (1998). After the 1987 military coup, Fiji introduced Tax-Free Factories (TFFs) and other industrialisation incentives as it pursued an export-led development strategy (Robertson 1995). Growth in clothing production was underpinned by the availability of low-p+aid women to work in the factories (Slatter 1991).

States.<sup>13</sup> After quotas were put in place Asian assembly firms relocated production to Fiji and by 1997, Fiji exported 43% of its rapidly growing clothing output to the United States.<sup>14</sup> Most of the remainder supplied the Australian and New Zealand markets through subcontracted 'make-and-trim' production.<sup>15</sup>

Offshore assembly under the ICS was facilitated by cooperation between Australian textiles and clothing firms. Exporting textiles firms often promoted relocation of their clothing sector customers' production to Fiji and shared their ICS gain through lower fabric prices. Textiles firms argued that clothing firms could better manage their supply chains, in particular coordinating unique fabrics and finishes, if they used border-nation strategies as an extension of a domestically based supply structure. They stressed to clothing firms that although Fiji's labour costs are higher than costs in China, Fiji's English-speaking workforce would make it easier to organise production and maintain quality. In economic terms, Fijian production enjoyed low non-distance-related transaction costs. In fact, Gereffi (1999) has shown that language and cultural commonalities between buyer and supplier firms have shaped global clothing supply chain structures.

The cost of manufacture overseas using the Import Credit Scheme compared favourably with the Overseas Assembly Provisions, at least in the early years of the scheme.<sup>16</sup> Table 2 gives notional calculations of the comparative costs of production under ICS and OAP. It assumes that fabric costs are slightly less when the ICS benefit is shared and, for illustrative purposes, that labour costs in Fiji are exactly double those in

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- 13 The United States and Fiji agreed on voluntary restraints on in 1990, although Fiji was not party to the GATT Multi Fibre Arrangement (Robertson 1995:158)
- 14 Between 1987 and 1993, 17,000 work permits were issued to Asian workers in Fiji (Business Review Weekly 11/8/94:5). If, under the WTO's Agreement on Textiles and Clothing, the web of quotas that shape global production are dismantled, the incentive to produce clothing for the US market in Fiji will evaporate, and these firms will withdraw.
- 15 Sara Lee Corporation (Stubbies brand), and Kalacraft (Just Jeans, Target, Rip Curl, Stussy and Mambo) are major Australasian firms producing in Fiji. Most Australian production is carried out under subcontracting arrangements. In 1988, 75% of Fijian garment TFFs were either joint ventures or foreign owned (Slatter 1991).
- 16 The value of Credit reduced progressively each year to 2000.

China. In this example, Fiji-based production is only slightly more expensive than production in China despite the labour cost difference: OAP production in China is the least costly option (\$35.62) followed ICS in Fiji (\$36.19) and ICS in China (\$37.72).

**Table 2: Offshore assembly costs per garment:  
ICS compared to OAP (1994)**

Cost	OAP (China)	ICS (China)	ICS (Fiji)
Fabric cost per metre	\$11.00	\$10.00	\$10.00
Fabric cost @ 1.85 metre/garment	\$20.35	\$18.50	\$18.50
Local cutting	\$0.65	-	-
Freight to China/Fiji	\$0.30	\$0.30	\$0.15
Labour	\$10.00	\$10.20	\$20.40
FOB	\$31.30	\$29.00	\$38.95
Freight from China/Fiji	\$0.60	\$0.60	\$0.30
Landing charges	\$0.10	\$0.10	\$0.10
Aust. content for OAP purposes	\$22.69	-	-
OAP value for duty (F-1)	\$8.61	-	-
Duty @ 42%	\$3.62	\$12.18	-
Import credit (Fabric cost*0.3*0.75)	-	(\$4.16)	(\$4.16)
FIS	\$35.62	\$37.72	\$36.19

Source: Adapted from Innes (1994). These calculations ignore the tax incentives and infrastructure costs in the host country.

This calculation is sensitive to wages levels and to the amount of labour embodied in each garment.<sup>17</sup> Fiji's higher costs attract the production of less labour-rich and less complex garments, such as windcheaters and tracksuits. Fiji is also the preferred production site when shorter response times are demanded by the fashion cycle. Fijian suppliers also accept small volume orders. In general, the more irregular the

17 Contrary to the New International Division of Labour (Froebel *et al* 1980), which attributes global shift to labour cost differences, this calculation also reveals that comparative wages costs are not necessarily the primary determinant of industrial location decisions. A survey of Fijian garment firms reported by Grynberg (1998) found wage costs were less important than trade rules to employers' perceptions of competitiveness.

transactions (smaller batches, irregular and constantly changing orders) the less spatially extensive are the production linkages.

Static comparisons of production cost are not a sufficient explanation of sourcing strategies. While Fiji production is more expensive, its quicker turnaround time provides a quicker turnover of investment. All other things being equal, the location with a shorter production cycle provides a higher annual rate of profit (Sheppard & Barnes 1990:82). The shorter circulation time for capital invested also means that less capital needs to be advanced in production, making Fiji a more suitable option for smaller Australian firms. Even if all tariffs, duties and government incentives were removed, the differences in the circulation time of investment might still render Fiji a more profitable assembly location than China. Still, this example highlights the extent to which government incentives alter the viability of different production location options. It is probable, of course, that the Australian clothing firms relocating to Fiji would have relocated offshore anyway, on labour cost grounds — regardless of the existence of ICS or OAP. The ICS did not alter the imperative to find low-cost assembly sites,<sup>18</sup> but did influence firms' choice of assembly location by influencing them to elect Fiji rather than China. The ICS enabled the survival of textiles firms that otherwise would have failed as their clothing industry clients relocated to the alternative destination (China).

Overall, the structure of production by Australian firms using the ICS and SPARTECA in Fiji matched the structures developed between the United States and Mexico within NAFTA. Both have a regional free trade area, a liberal tax regime in the assembling country, a government subsidy, and a geographical location able to respond to the quick turnaround times demanded by fashion production. SPARTECA's restrictive rules of origin and greater distance-related costs are the main points of difference.

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18 It could be argued that this imperative had little to do with trade liberalisation. Larger firms such as Pacific Brands and Gazal Corporation were well established in China by 1988 and controlled much of Australia's TCF quota allocations in the 1980s. The immediate problem for local manufacturers in the late 1980s was competing with these pioneers of offshore production.

The ICS thus functioned as a border-nation assembly scheme, subsidising the competitiveness of domestic firms producing primarily for the local market. The use of ICS as a border-nation assembly scheme artificially boosted fabric exports. Table 3 decomposes fabric exports by destination to show that in 1996 Fiji accounted for 37.7% of Australian fabric exports, making it the largest fabric export destination. The next largest market was New Zealand with 15.7%. The United States and European Union combined accepted 25.5% of fabric exports, and the 'Rest of the World' the remaining 21.1%. Re-export trade accounted for 11.3% of aggregate fabric exports in 1996, with almost 20% of both New Zealand and 'Rest of the World' trade re-exports from a third country of origin.

**Table 3 Fabric Exports by Destination, 1996**

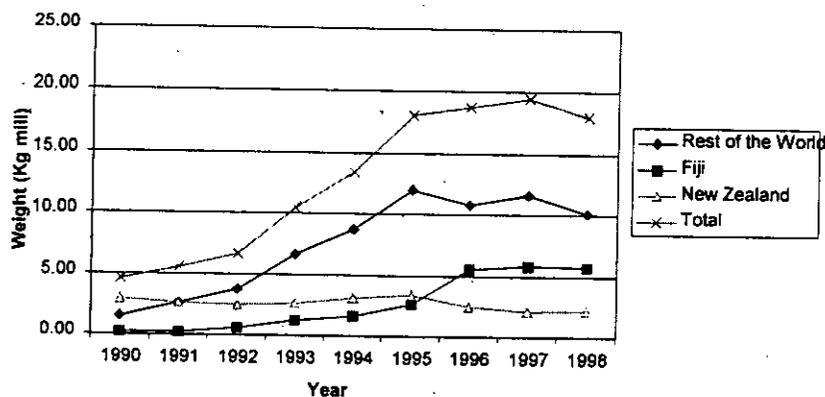
Country	Total Exports	Re-exports		Domestic Exports (Exports - Re-exports)	
		\$m	% of Total Exports	\$m	% of Domestic Exports
Fiji	76.3	4.5	5.9	71.7	37.7
New Zealand	37.6	7.7	20.5	30.0	15.7
Canada & USA	24.6	0.9	3.7	23.7	12.5
Europe	25.9	1.2	4.6	24.7	13.0
All other destinations	50.0	9.9	19.8	40.2	21.1
Total	214.4	24.2	11.3	190.2	100.0

Source: Unpublished ABS Data. SITC commodity class 652-656 (fabrics)

In 1996, total fabric exports were valued at \$214.4 million, but from Table 3 it is evident that only \$98.5 million (46.7%) of that value comprised exports to world markets (that is, not re-exports, or fabrics destined for New Zealand or Fiji). If subcontracting trade with China, Indonesia and Vietnam could be quantified and taken into account, perhaps less than 30% of total fabric exports were destined for world

markets.<sup>19</sup>

Figure 1: Fabric Exports by Weight



Source: Unpublished ABS Data ([www.tradedata.net](http://www.tradedata.net)). Fabrics are defined by the Standard International Trade Classification (SITC), 652 through 656.

Note: re-exports excluded. Data are shown by weight rather than by value because transfer pricing has inflated Fiji values.<sup>20</sup>

The importance of the Import Credit Scheme as a border-nation assembly scheme is highlighted in Figure 1, which excludes re-exporting activity. From negligible exports in 1990, Fiji trade grew rapidly in 1994-95, and by 1998 was the major destination of fabric exports with an export value of more than twice the next largest export destination. Growth of fabric exports to North American and European countries—the expected markets for less labour-intensive, knowledge-rich niche fabric products—has been modest despite export facilitation. Exports to ‘Rest of the World’ destinations have declined slightly after 1995.

In summary, many Australian clothing and textiles firms collaborated to use the ICS to switch from domestic to offshore production, while in general continuing to focus their sales on the domestic market. Since the

<sup>19</sup> It is not possible from current trade statistics to distinguish fabrics shipped to subcontractors working for local firms to supply the Australian market.

<sup>20</sup> The higher the value of exported cloth, the higher the value of the Import Credit earned.

funds provided by the Import Credit Scheme subsidised the production of clothing destined for the Australian market, the gains predicted by strategic trade theories—an overall increase in local output and productivity gains through economies of scale—did not occur. There was, however, a considerable labour cost saving to Australian firms and a loss of low-skill manufacturing jobs in Australia (Webber & Weller 1999). The border-nation assembly role of the ICS promoted the regionalisation of production in a manner similar to the structures evolving in Europe and the United States.<sup>21</sup> Unwittingly, this development enhanced international competitiveness by enabling Australian firms to imitate the strategies of leading firms in the United States and Europe, thereby consolidating their position in the domestic market relative to these rivals.

### **The Import Credit Scheme as an Export Subsidy**

The Import Credit Scheme also functioned as an export promotion scheme, although its success in this regard has been overrated. This role is exemplified by the patterns of trade in clothing, where export growth has been dominated by expansion into the New Zealand market, border-nation assembly and increasing re-export activity (Table 4). Border-nation assembly of clothing, where partially made garments are exported for additional offshore labour intensive processing (such as hand-embroidery) before returning to Australia for sale, has resulted in increasing clothing exports to Fiji and China.

New Zealand is nevertheless by far the largest market for Australian clothing exports. Under the 1988 revitalisation of ANZCERTA, all tariffs and import restrictions between Australia and New Zealand were abolished by July 1<sup>st</sup>, 1990. By 1995 the integration of the two nations was such that they were virtually a common market (Dunkley 1997:84). This 'instant' 20% increase in market size generated additional exports to and imports from New Zealand in the early 1990s, as clothing firms (on

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21 The emerging regionalisation of global clothing production systems is described in WTO (1998, 1995).

both sides of the Tasman) began to treat Australia and New Zealand as a single domestic market.<sup>22</sup>

**Table 4: Clothing Exports and Re-exports by Weight, 1990 and 1998**

Country	1990				1998			
	Export	Re-export	Total	Re-export as % of total	Export	Re-export	Total	Re-export as % of total
	Weight (kg mill.)			%	Weight (kg mill.)			%
China	0.00	0.04	0.04	99.8	1.89	0.16	2.04	7.6
Fiji	0.04	0.01	0.05	19.4	1.59	0.09	1.67	5.2
New Zealand	1.08	0.20	1.28	15.7	2.30	1.61	3.91	41.2
All Others	1.81	0.75	2.55	29.2	4.91	0.86	5.77	14.9
Total	2.92	1.00	3.92	25.5	10.68	2.71	13.39	20.3

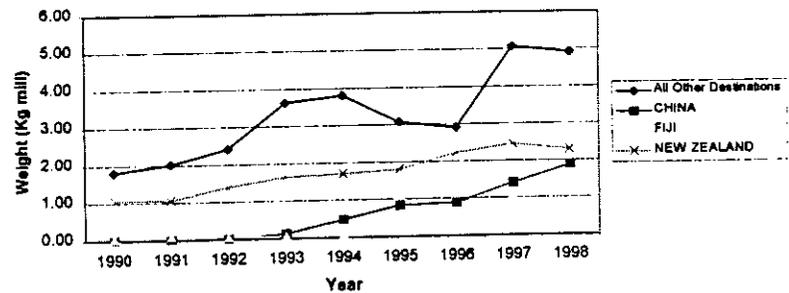
Source: Unpublished ABS data (www.tradedata.net). Clothing is defined by SITC Class 84.

However, much of the New Zealand clothing trade was in re-exported clothing (Table 4). Re-exports rose from 15.7% of total clothing exports to New Zealand in 1990 to 41.2% in 1998. Figure 2 shows that when re-exports are excluded, there has been only a small increase in Australian-made clothing exports to New Zealand. In addition to the incorporation of New Zealand into the domestic market, this result is the outcome of differences between Australian and New Zealand policies regarding SPARTECA. In 1994 Australia opted for more generous concessions on SPARTECA rules of origin compared to New Zealand, resulting in a reversal of supply chains to circle to New Zealand via Australia. Australian firms imported clothing made from Australian fabric in Fiji, and then re-exported it to New Zealand. External tariff and exchange rates differences between Australia and New Zealand, as well as new taxation policies in New Zealand stimulated the change (Grynberg 1998). In this sector, trade diversion routinely occurs in response to changes in

22 ANZCERTA is the Australia - New Zealand Closer Economic Relations Trade Agreement. The estimated 20% increase in the market is based on an Australian population of 17.5 million and New Zealand population of 3.5 million. Together with other harmonisations under ANZCERTA, the already substantial trans-Tasman trade grew rapidly after 1990. See Siebert (1999) for an exposition of the trade-enhancing impact of a common market.

regulation as firms strive to minimise costs. Therefore, through re-exporting activity the combination of ICS and SPARTECA inflated Australia's export performance in clothing as well as in fabrics.

Figure 2: Clothing Exports by Weight



Source: Unpublished ABS data ([www.tradedata.net](http://www.tradedata.net)).

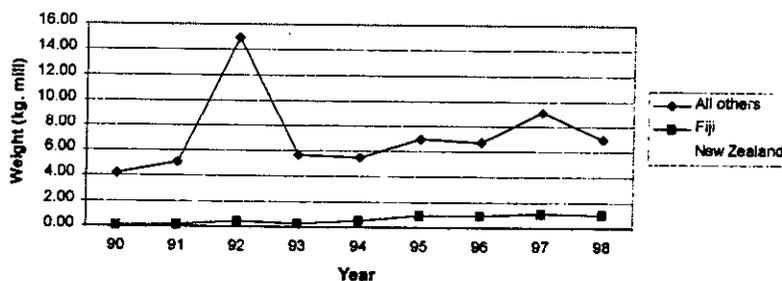
Note: Re-exports excluded. Clothing is defined by SITC Class 84.

Nevertheless, there has also been strong export growth in Australian-made clothing exports to world markets (the 'all others' category in Table 4). This represents about 40% of total clothing exports. As well as a large increase in exports to smaller nations, Australian firms have made modest progress in the United States' and European markets. Examination of ICS records shows that the clothing originating in Australia and destined for world markets comprised, in the main, of highly specialised sport-related apparel, such as mountaineering, cycling and equestrian clothing. These are the types of clothing exports in which Australia is competitive: higher technology, design-rich niche products destined primarily for high-income markets. Australian firms were also successful in products that exploit stereotypical views of Australia (outback/oilskins, beach/surfwear, sun/bold colours).

The sub-sector of industrial and household textiles has also experienced rapid export growth. Exports of industrial textiles increased by 120% and export intensity more than doubled (4.5 to 10.3) between 1988-89 and 1994-95. The magnitudes of these product exports are again inflated by New Zealand trade, border-nation assembly and re-exporting, although to a lesser degree than fabrics and clothing. New Zealand

accounted for almost half of the Australian-made export volume, and Fiji had a large share relative to its size (see Figure 3).

Figure 3: Exports of Industrial and Household Textiles



Source: Unpublished ABS data from the Tradedata database. ([www.tradedata.net](http://www.tradedata.net)). Industrial and Household Textiles are defined by SITC 658 and 657.

Note: Re-exports excluded. Export performance is gauged by weight rather than by value, since value quantities are sensitive to exchange rate changes and to the manipulations of transfer pricing. The reason for the large export volume in 1992 is not known.

Import credit scheme records show that industrial textiles exports predominantly comprised specialised knowledge-rich goods used in other industries, such as filters for the mining industry and felts used in the printing industry. These were exported with ICS support, as were exports of domestic textiles to the United States and Europe.

What then was the role of the Import Credit Scheme in export market development? The ICS did provide acknowledged support for firms embarking on the difficult process of establishing a reputation in international markets (where it represented only a small component of a longer term strategy). But exports to New Zealand, fabric exported under the Overseas Assembly Provisions, and re-exports were not eligible for import credits. Exports feeding the border-nation assembly trade, although supported by ICS, were not the type of exports intended by the Scheme's export facilitation objectives. If these components of clothing export performance are excluded from the total, real export growth has been modest.

This outcome is not unexpected. Since the Australian industry has exported production functions, international exports by Australian firms are most likely to be shipped directly to a third market from a low-wage assembly nation (eg Fiji). Such trade does not involve direct exports of clothing from Australia, although it is indicative of the increasing internationalisation of Australian firms. In addition, exporting is not necessarily the best method of establishing or maintaining overseas markets in the clothing industry, where licensing (the export of intellectual property) provides an effective means of adapting products to overseas local market preferences.<sup>23</sup> In their eclectic targeting of disparate markets, clothing firms effectively pursue Tomlinson's (1999) notion of globalisation as a 'complex connectivity' in which economic, cultural and political dimensions are inextricably linked. In general, exporting clothing from Australia is not necessarily the best policy for the clothing industry, nor is exporting activity the best measure of the industry's internationalisation. Export market development, then, is no panacea for the problems of the Australian TCF sector.

Popular misconceptions about TCF export performance arise from two sources: deliberate obfuscation by industry lobbyists and the difficulty of relating current trade statistics to real trade flows. Over-optimistic analyses of TCF export performance provided by the TCF Exporter's Forum, a Canberra-based lobby group representing ICS users, have swayed policymakers. At the same time, the national employer's association, the Textiles and Fashion Industries of Australia (a vocal public supporter of trade liberalisation reflecting the interests of member firms that source their products in China) has promoted the image of export success. Their knowingly distorted claims have been 'verified' by ABS trade data, which is unable to identify different types of trade interactions within aggregate trade figures.<sup>24</sup>

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23 Sydney-based Quiksilver International, makers of 'Australian' surfwear, for example, receives \$6 million each year in royalties from independently owned Quiksilver Europe, which has an annual turnover of \$250 million (Turnbull 1999).

24 See Bryan and Rafferty (1998) for a detailed analysis of the limitations of trade data.

### **The Import Credit Scheme in Industry Development and Restructuring**

In its third role the ICS stimulated domestic restructuring. It was expected that export development would improve the competitiveness of domestic firms by enabling them to exploit economies of scale, increase specialisation, innovate through exposure to different ideas, knowledges and techniques, and integrate into global supply flows via restructuring of production inputs. These dynamic gains, it was hoped, would promote industrial development toward more elaborately transformed manufactures (ETMs) (Feaver *et al* 1998:299). These objectives envisaged change occurring at the level of individual manufacturing firms as they responded to international pressures.

However, the relationship between exporting, specialisation and innovation is not as straightforward as the ICS policymakers imagined. It could be argued that the Import Credit Scheme did less to encourage firm-level innovation than it did to underpin the viability of already innovative firms marketing products with appeal to overseas consumers. The notion that trade liberalisation increases firm-level specialisation is derived directly from the theory of comparative advantage: firms specialise in their abundant factors. In this way, the Industry Commission described the Import Credit Scheme as a strategy to encourage firms to concentrate on areas of comparative advantage (Industry Commission 1997:293). Yet for specific firms in specific contexts, the validity of the proposition that engagement with global markets increases specialisation rests on the direction of causality (Bernard & Jensen 1998). In the Australian clothing industry it appears that innovative and competitive firms pursued export market development and used the Scheme to help them establish export markets for knowledge-rich niche products. Meanwhile, the majority used the Scheme to support their domestic market share through offshore assembly. The ICS hoped to stimulate innovative new manufacturing specialisations, but mainly encouraged specialisation away from manufacturing and into importing and supply chain management.

The scheme also aimed to internationalise firms' input structures. Firms engaged in exporting and offshore sourcing widen their knowledge and

information about potential sources of substitute inputs, indirectly increasing the likelihood of their importing inputs. Managers of those firms that continued to manufacture in Australia however claimed that design and style considerations are paramount in sourcing decisions, and that simple substitution of equivalent inputs is rarely possible in this highly differentiated sector. There is little evidence that the ICS had any role in directly altering individual firm's input sourcing decisions in any significant way.

The impact of the Scheme on the structure of production inputs was less important than its effect through trade in the Import Credits themselves. Credits were tradable and were routinely sold on to third-party manufacturing and importing firms. Local manufacturers (many of them outwork-based subcontractors) used the credits to reduce the duty they paid on imported inputs, especially imported fabrics. In theory, using the Credit in this way meant that the rate of duty paid on manufacturing inputs fell more quickly than the rate of duty on imported competing finished products, strengthening the position of local manufacturing firms relative to firms that specialise in importing. But clothing importers also used the credits to reduce the duties they paid on the import of finished garments, so their purchasing prices also fell. In 1994-95, 77% of credits were used to offset duty on garment imports (TCFDA 1995:42). The resale of Credits therefore helped both local manufacturers and local importers, partially cancelling out the ICS-derived advantage of Fiji-based manufacturers. In aggregate, then, the Import Credit Scheme reduced costs across the sector, and ultimately increased price-based competitive pressure in the domestic market. This spurred domestic restructuring, through the 'invisible hand' of the market, but not in the way the Scheme's planners intended.

Finally, the Import Credit Scheme influenced restructuring of the domestic manufacturing sector by increasing pressure on supplies of domestically produced inputs. Closer examination of ICS expenditures shows that, in addition to ETMs, the scheme subsidised exports of a wide range of basic semi-processed primary products, which accounted for an estimated 30% of the value of credits earned (see Table 5). The inclusion of products such as 'wet blue' hides, sheepskin and wool tops reflected the political compromises that were made to establish the

Scheme. Yet these commodities would have been exported in any event, in volumes governed by world demand, regardless of the export subsidy. Not only did the ICS provide a windfall gain to producers, but also the growth of these exports was sometimes detrimental to domestic manufacturers. In the case of 'wet blue' hides, for example, exporting pushed up domestic leather prices and created raw materials shortages for the local footwear and leather-goods industries.

**Table 5: Elaborately transformed manufactures under ICS, 1994-95 (estimated)**

Type	Value (SA 000s)	Value %
ETM exports	74,306.54	56.3
Semi-processed exports	39,883.61	30.2
Not known	16,865.42	12.8
Other <sup>(a)</sup>	902.90	0.7
Total	131,958.47	100.0

*Source:* Author's calculations based lists of ICS recipients published in Textiles Clothing and Footwear Development Authority and Industry Commission Annual Reports 1991-1996 and supplemented by telephone interviews with ICS recipients conducted in March 1999.

*Note (a).* These are rags and slops, mainly woollen knits exported for recycling in overseas mills.

## Export Promotion and Industry Policy

Through its three related effects—border-nation assembly, exporting and domestic restructuring, the Import Credit Scheme was an important force in reshaping the Australian clothing supply industry and facilitating Australian firms' exit from local factory-based manufacturing. By the late 1990s, restructuring of the Australian clothing supply industry had produced five distinct supply structures, each involving intensely competitive, hierarchically organised and buyer-led commodity chain formations dominated by a relatively small number of core firms. These include:

- Core firms (retailers and former manufacturers) that have become primarily importers. They purchase clothing directly from overseas (and overseas-based) firms or their agents in Australia, operating as buyers of the output of commodity chains based in other countries. This category includes importing by retailers owned by an overseas parent company (e.g. Prada or Nike). Such imports attract duties, and are becoming more competitive as tariffs fall.
- Core firms (retailers and former manufacturers) that now arrange for production to be carried out by offshore subcontractors in low-wage countries outside SPARTECA, in China and other parts of Asia. Tariffs, duties and various non-tariff barriers remain an impediment to this trade.
- Core firms (retailers and former manufacturers) that now subcontract production to offshore firms in low-wage Fiji within SPARTECA, where duties and tariffs are not an issue but other non-tariff incentives in both Fiji and Australia (particularly SPARTECA's rules of origin) have considerable influence.
- Core firms (retailers and former manufacturers) that now subcontract production to low-wage on-shore outwork subcontractors. Their competitiveness is contingent on industrial relations changes and on the implementation of the Homeworker Code of Practice (Weller 1999). The Australian Business Number (ABN) system introduced in conjunction with the Goods and Services Tax (GST) will reshape outworker-based supply chains.
- Manufacturers making clothing in Australia in factory premises, including firms manufacturing under licence for overseas-based firms. These generally have a brand or some other form of non-tariff protection that ensures their viability in the short term.

Firms' choice between the three subcontracting options (China, Fiji or outwork) has been determined by price (which depends primarily on labour cost, transport costs and tariff and duties) and the constraints of turnaround time and quality. The industry's logistics and supply chain managers make these cost/quality/time comparisons routinely and keep

an eye to the switching cost of changing their supply channels.<sup>25</sup> Decisions about sourcing reflect firms' expectations of the development of clothing markets and their own strategic horizons. History plays an important role. Larger firms such as Pacific Brands and Gazal Corporation, for example, have made major investments in China that locks them into China-based production in the medium term. Nevertheless, the absence of equity investment in most subcontracting relationships creates the potential for chaotic and rapid change. Phasing out the ICS will put price pressure on Fiji-based suppliers whose advantage against China-based suppliers is already declining as tariff levels fall.

The separation of the clothing industry into different supply structures has important implications for policy. Government policy settings are increasingly a part of the competitive environment: national firms are embedded in the regulatory structure, just as the regulatory structure reflects the needs of national firms (Strange 1994). As firms internationalise, their expectations of national government policy change and become more diverse. Milner (1988) has demonstrated that firms' attitudes to trade policy (and their lobbying of government on trade issues) are directly related to their business interests. Different patterns of internationalisation (characterised by different supply chain structures) produce different political objectives. In theory, firms that source in China would support trade liberalisation and the removal of impediments to the flow of goods between Australia and China. Firms that source in Fiji might be expected to support the continuation of tariffs and duties on Chinese imports. Domestic manufacturers might support trade liberalisation if they pay high duties on imported inputs but support high border protection when their inputs are obtained locally.

This presents some interesting dilemmas for policy development. The corporatist approach to industry policy sees government working closely with industry and moderating between competing interest groups (Katzenstein 1985, Underhill 1988, Capling & Galligan 1991). This

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25 Many core firms use more than one strategy depending on the market, input and production characteristics of different products in their range, but most have one dominant strategy.

approach has tended to assume that firms within an industry have common interests that can be represented adequately by peak bodies. Contrary to this model, the interests of firms following different supply models within the clothing industry are diametrically opposed and irreconcilable. A government taking a corporatist role would either listen only to the group in control of the peak employer body at any point in time, or be caught in the strategic battles between firms with different supply structures. Whatever policies the government adopts, regardless of their intended neutrality, particular core firms will be advantaged or disadvantaged depending on their sourcing arrangements.

In addition, uncritical reliance on firms' expressed interests is not an adequate basis for policymaking. Firms often have limited strategic horizons, focusing on their immediate battles with domestic competitors rather than on impeding changes to the regulations governing the structure of the global clothing industry. Industry groups also collude to manufacture their preferred public image. In the absence of an independent industry research capability with sectoral expertise, industry lobbyists have been free to create the image of 'export success', which has then been reproduced as widely as in the Industry Commission's (1997) Inquiry and the TCF Union's recent policy framework document (TCFUA 2000).

### **Future Directions**

During the first half of this year (2000), the Government has been negotiating a new set of arrangements to replace the ICS, which under WTO rules must end in June 2000. On the same day as the latest Fiji coup, Australia's announcement of a temporary extension of the ICS indicated that no new policy framework had yet been found. From Australia's point of view, finding a replacement for the Import Credit Scheme is important. In addition to the textiles production industry employment that is dependent on the ICS, there are some 10,000 high-skill jobs in the Australian clothing supply sector—that is, clothing wholesalers and the parts of the retail sector engaged in distribution and

supply chain management—that are at risk if Australian-based supply chains lose ground to overseas-based firms.<sup>26</sup> Maximising the number of high-skill jobs that remain in Australia requires identifying an appropriate mix of options that will secure the long-term strategic position of Australian-based firms.

A continuing border-nation relationship with Fiji would assist the continued viability of the Australian textiles and clothing supply sectors and keep Australian firms on par with firms in the United States and Europe. Unfortunately, the benefit to Fiji is not so assured. The particular characteristics of Fiji's 'export-led development'—in particular its reliance on Australian inputs—make it unlikely that Fiji's garment industry will provide a basis for growth through industrialisation (Robertson 1995). The dubious labour practices in Export Processing Zones is well documented, as is the fact that Fiji's Tax Free Factories are grounded on the exploitation of poor women's labour (Slatter 1991). However, Fijian workers' organisations have links with Australian, New Zealand and international unions, with the International Labour Organisation, and with anti-sweatshop lobbyists.<sup>27</sup> High rates of Australian and New Zealand ownership of Fiji garment factories increases the scope for action through ethical trade and consumer campaigns that could demand the inclusion of labour protection measures in SPARTECA (Blowfield 1999, Leckie 1992).

In designing a new Scheme, policy must not only be attuned to international regulations, but also to the ways firms respond to changes in regulatory arrangements. The United States' border-assembly arrangements within NAFTA are not considered to be export subsidies and are not under challenge in the World Trade Organisation. It seems

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26 See Webber & Weller (1999) for information on TCF wholesale/distribution employment. Global restructuring is resulting in a growing presence in the Australian market of retailers based in Europe, the United States and Hong Kong that market garments made-up in low-wage Asian countries. Their garments are produced in much larger volumes than those of the Australian-based firms making only for the Australian market and perhaps a small export market. Australian firms, therefore, will face intense new competitive pressures.

27 For example, through Australia insisting that firms bidding to manufacture clothing for the Olympic games meet minimum labour standards (*Fiji Daily Post* 28/10/99).

then that an effective extended offshore assembly scheme needs to mimic the United States policy structure sufficiently to guarantee compliance with WTO rules. Such intervention must recognise the importance of distance and the characteristics of SPARTECA, and also incorporate measures that will complement other initiatives directed to the welfare of Fijians. The alternative is the loss of employment in both Australia and Fiji.

### **Conclusion**

The different forms of internationalisation of the clothing supply system bring into focus the limitations of industry policy. Because the expectations that underpinned the ICS relied on firm-based innovation and the allocative efficiency of market forces, firms' tactical re-positioning to take advantage of the Scheme was not anticipated. Policy also underestimated the political sophistication of local firms as they re-invented the ICS export promotion scheme to suit their own ends. From a Hayekian perspective, their activities would be thought of as rorting the system and their rent-seeking condemned for diverting energy from the important tasks of innovating and improving productive efficiency. But this is not the only interpretation. The activities of TCF sector managers are also entirely consistent with the widely publicised advice of Porter (1985), whose work encourages managers to view their field of action as extending to and exploiting opportunities external to the firm, including those arising in the regulatory regime. From this perspective, finding low-cost paths around regulations while exploiting government incentives is the name of the game: the re-invention of ICS can be understood as the innovative response of creative managers who were familiar with best practice in border-nation assembly overseas. What is most disappointing about the Import Credit Scheme as an exercise in policy development is that firms have preferred to play along with the rhetoric of 'international competitiveness' and 'export promotion' rather than explain to policymakers the nature of globalisation in this highly specialised cultural knowledge-intensive industry. Firms' re-invention of the Import Credit Scheme was also a direct response by firms to unworkable Overseas Assembly Provision guidelines. Instead of

revising the guidelines of both programs, there emerged an unspoken permission to allow the ICS to be used as an unofficial substitute offshore assembly scheme. Political naivety aside, the problem lay in policy's attempt, through OAP, to implement a program developed for a different time and place without thinking through its local application, and to an inadequate understanding of the processes of industrial change.

The example of the Import Credit Scheme also reveals the limitations of viewing the manufacturing industry as a collection of independent firms operating in a competitive and rapidly liberalising global market. Policy did not recognise that the process of internationalisation involved much more than the globalisation of markets, but was centred on more fundamental changes in the production structures of firms. Nor did policy see that the industry was re-organising itself to comprise a relatively small number core firms and their supply chains – re-organising in a way that transcended the imposed distinctions between manufacture-wholesale-retail and between production and service sectors that shaped policy thinking. As a policy the ICS was also locked into a narrowly national perspective that assumed impermeable boundaries between nations would be bridged by 'exports'. Policy did not perceive that the operating sphere of firms had already extended beyond the national, and that an internationalised perspective already framed their responses. Nor did policy anticipate that border-nation subcontracting was becoming fundamental to the competitive position of firms in high-wage countries and an effective defence against trade liberalisation.<sup>28</sup>

Finally, the example of the Import Credit Scheme demonstrates the difficulties of framing effective national policy when firms (even those with relatively modest ambitions) are no longer operating in a national context. This highlights the interconnectedness of policy and action through relationships between firms and government at international, regional and national scales. First, the Scheme was shaped by international regulations as its status as an export subsidy was debated in the World Trade Organisation, an issue that arose after overseas firms

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28 By the same token, when Australia entered SPARTECA in 1980 nobody envisaged it as a threat to Australian manufacturing employment.

complained about the Scheme to their governments.<sup>29</sup> Second, in its border-nation role developed to complement SPARTECA, firms transformed the Scheme to take advantage of opportunities created by a regional trade agreement. Third, within the SPARTECA-Fiji arrangements, the shifting direction of trade flows was the outcome of differences in policy between Australia and New Zealand, demonstrating the influence of bilateral relationships between nations. The global shift of clothing production into Fiji from Australia and other places underlines the propensity of internationally aware firms to take advantage of national differences in regulations and standards, including labour standards. At the national level, micro-economic policies in Fiji, New Zealand and Australia all had an impact on the practical implementation of the scheme through Fiji's tax-free factories and Australia's unworkable Overseas Assembly Provisions, for example. Again at the national level, while ICS was an initiative in the industry portfolio, it has become a major issue in trade policy and impinged on other foreign policy areas, not the least of which is the stability of the Pacific region. Clearly, it is no longer possible to frame industry policy in isolation.

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29 The case of Howe Leather's exports to the United States is well documented, see the case study in Feaver & Mahmood (1997). More recently Leading Synthetics' products have been effectively excluded from the European Union (*Australian Financial Review*, 20/5/2000:5).

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