

**Evolution of Local Systems in
the Context of Enlargement**

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Abstract

The aim of this paper is to outline the main patterns of change at the local level in the most important Italian shoes district in relation to the transition process occurring in the Central and Eastern European Countries. The increased economic integration raises the necessity to conceptualise the industrial district as a part of a wider framework of production.

The internal reorganization at the local level is interpreted combining two different theoretical approaches: the territorial perspective that is rooted in local development literature and the 'productive stages' perspective typical of the value chain analysis. The systemic characteristics that underpin both of them suggest integrating the two points of view.

After an overview of the main characteristics of the two complementary frameworks I will try to provide an interpretation of the recent evolution of the shoes industrial district.

The information presented in the empirical session is based on a field study carried out in the Italian shoes industrial district of Marche during the period from December 2000 to August 2001¹. The research method relied on in-depth interviews with 35 local entrepreneurs and other key informants (local institutions namely 'local industrial association' Unione Industriali del Fermano).

Key words: Local economic development, Value chain analysis, Location determinants, Social capital.

¹ The field study was conducted under the supervision of Antonio G. Calafati within the project 'Vantaggi competitivi dinamici e apprendimento collettivo nelle economie locali: aree di specializzazione e aree ad elevata diversificazione produttiva a confronto', national coordinator Roberto Camagni, local coordinator Giuliano Conti (Murst 40%, 1999).

Introduction

In this paper I will describe a particular form of the process of globalisation that is taking place in the most vital Italian footwear industrial district. Some of the firms operating in this area have been outsourced part of the production process in order to benefit from the opportunities offered by some low-wages countries.

The transition process that Central and Eastern European Countries have been experiencing in the last decade has opened a range of new *location possibilities*. At least the geographical proximity and the consequent low transportation costs represent a source of comparative advantages compared to the opportunities offered by other developing countries.

When the increasing attention of local firms to 'cross-border' relations arose as important competitive strategy, the main concern of local development research – namely the focus on the internal structure of industrial districts- turned out to be a shortcoming. In fact in the literature on industrial district the external relationships of local firms have been disregarded or taken for granted as market-based relations.

The value chain analysis, mainly focused on global relations of production, provide a useful framework to a better understanding of the recent evolutions of industrial districts.

The outsourcing processes take the form of a geographical concentration instead of spread around the world. I will try to justify why the outsourcing process is working toward new *growing points* in Central and Eastern Europe in term of *social capital theory*.

As a matter of fact, when the relocation process originates from territorial units characterised by a high social capital and highly specialised such as industrial districts, at the microeconomic level the imitation represent an importance factor underpinning the emergence of a *twin cluster* in the area of destination.

From the standpoint of the local production systems emerging in CEECs it is interesting to understand the development possibilities arising from these 'historical accidents'.

At the level of the firm the possibilities of upgrading are related to the way they are inserted in the global (European in this case) value chain.

Moreover relocation could be regarded as a source of activation of backward and forward linkages. It may raise the demand for intermediates, which cause the domestic production of intermediate goods to expand. Other channels are supposed to affect positively the regional development in the absence of backward and forward linkages: increased competition, technology transfer, increased access to world markets due to spillovers to local firms, work training.

Integrating local development theory and value chain analysis

Industrial district literature

During the late 70s a new strand in regional economic development arose in Italy. The empirical observation of unexpected paths of development experienced by clusters of small and medium enterprises was the starting point of the literature on industrial district.

Local productive systems were mainly located in the so-called Third Italy, an expression coined by Arnaldo Bagnasco to emphasise the necessity of reconsidering the previous dominant perception of a North-South duality in the Italian regional landscape. From a geographical point of view the area overlap the NEC² Italy, the North Eastern and Centre part of the country.

The Italian experience attracts the attention of social scientists at the international level. Piore and Sabel gave the spur of a research on industrial districts in different advanced countries. Some forms were found in North America and Europe, particularly in West Jutland in Denmark, Baden-Württemberg in Germany and several regions in Spain.³

The acknowledgement that the industrial district is not a perfect model did not prevent further research focused on the possibilities to apply the positive perspectives and lessons to developing countries. The aim is to discover existing dormant clusters and turn them into viable local systems.

The literature on industrial district intersects a number of issues that have been developed in the theory of development, having some point of contacts with the economic geography.

One can say that local economic development is a branch or subsection of development and institutional theory⁴. The similarities can be found either at the level of the relevant research questions or at the methodology level.

The systemic perspective is one of the main characteristics of the local development approach. In contrast to the methodological individualism of the mainstream economics, in the industrial district literature each economic agent has been regarded as part of a local network.

The methodological holism is one characteristics; the disciplinary interaction among social scientists arose from the acknowledgement of the blurring boundaries among disciplines. In this field of study researchers focused the attention not merely on the

² This expression was instead coined by Fuà. Fuà G. (1983), 'L'industrializzazione nel Nord Est e nel Centro' in Fuà G. and Zacchia C. (1983), *Industrializzazione senza fratture*, Il Mulino, Bologna, p.7.

³ Pyke F. and Sengenberger W., eds, (1992), *Industrial districts and local economic regeneration*, International Institute for Labour Studies, ILO, Geneva,.

⁴ I refer basically to Veblen and the New Institutional Economics, and to Myrdal, Hirschman, Polanyi.

local economic processes. A coherent relationship between the productive level and the social level was regarded as a significant asset.

The anthropological perspective is related to the institutional foundations of the literature on local economic development. The economy is embedded in the cultural environment and values and informal institutions are recognised as casual factors of economic development.

The international debate has provided contributions to this field of study and has identified main attributes of an industrial district: the concentration of the same industrial sector, the geographical proximity, trust and cooperation in some economic relations in a general competitive local environment, the social embeddedness of economic agents, adaptable workforce.

The *collective efficiency* is one of the most important systemic properties outlined by the literature. This relational asset encompasses both intentional and unintentional characteristics (joint action and external economies).

The industrial district is not a static system as it is endowed with a set of evolutionary properties both in its internal organisation and in its relations with the external environment. In recent years the forms and structures of industrial districts have changed. Two basic modifications are evident, one in the internal organisation and the other in the external relationships with other localities.

Firstly, the homogeneity and unity assumed by the external observer rarely exists. The internal heterogeneity is a common characteristic of several industrial districts both in developed and developing countries.⁵ Local firms are different not only as far as the dimension is concerned, but also in the governance of the relationship among them and with wider value chains.

Secondly, firms are experiencing a spatial extension of the network they refer to. This expansion can be *passive* or *active*. The first case occurs when a firm feed into high value chain, while the second is when the firm decide to extend its network for example by outsourcing part of the production process.

Within the recent tendencies the main shortcoming of this field of study has been brought to light. When the integration of economic processes was increasing it became evident that the main focus of the analysis on the internal organisation was not sufficient to understand the development pattern of industrial districts.

Nevertheless in the Italian literature on industrial district the external relationships of localities were not completely disregarded.

The industrial district was conceptualised as an open system because of its relations with the wider political, economic and social environment and with other local systems. Indeed the difficulty in drawing its territorial boundaries is a clear evidence of its openness.

⁵ Rabellotti, R., and Schmitz, H. (1999), 'The internal Heterogeneity of Industrial Districts in Italy, Brazil, Mexico', *Regional Studies*, Volume 33.2, pp. 97-108.

The metaphor of network was the focal reference of the theorisation on the 'cross-border' relationships. A locality was envisaged as a *node* of a global network and the self-organisation at the local level was considered to be dependant on the coherence with the whole network (regional, national or international).

Starting from a territorial point of view Dematteis pointed out not only the embeddedness of an industrial district in a territorial basis but also the necessary existence of linkages with other local systems. According to him 'Local development is nothing but the valorisation of given environmental conditions and endowments (*vertical relationships*) through the interaction with networks of production and exchange of a wider spatial extension (*horizontal relationships*)'⁶. In other words the vertical relationships are the linkages with the territory so they can be defined as self-contained relations within the local system while the horizontal relationships are the connections with other local systems.

Sometimes the linkage with the global environment was envisaged as a source of disruption of local knowledge. Becattini e Rullani tried to overcome this misleading perspective stating that the more a local system is willing to face the global competition the more it increase its viability.⁷

⁶ Dematteis G. (1989), *Contingenza ambientale e ordine economico, lo sviluppo locale in una prospettiva geografica*, in Becattini G., (a cura di), *Modelli di sviluppo locale*, Il Mulino, Bologna, cit., p. 135.

⁷ Becattini G.-Rullani E. (1993), 'Sistema locale e mercato globale', in *Economia e politica industriale*, n.80, p. 42.

Value chain analysis

The value chain analysis represents a complementary framework that can provide valid contributions to understand the recent pattern of development of different localities. In the value chain analysis each *filière* (local, European or global) is an inclusive process describing the full range of activities related to production, exchange, distribution and consumption of a given product or service.

This allows examining the mosaic of territorial inequality in terms of the way in which the value embodied in the commodities flows between different localities where production and consumption processes are located.

The global commodity chain literature is the starting point of the following evolution towards the value chain analysis. The definition of global value chain provided by Gereffi is related to three different level of analysis: a productive perspective, a territorial perspective and a governance perspective.

The first dimension recalls the backward and forward linkages analysis⁸. As a matter of fact global commodity chains have a specific input-output structure, which links various modes of production, distribution and consumption into a chain of economic activities in which value added is produced.

The second level is connected with the literature on local development. Global commodity chains have a territoriality in the sense that the various activities, nodes and flows within a chain are geographically situated, with implications for the levels and processes of development depending upon the position of localities within a chain.

The level of the governance is defined as the authority and power relationships that determine how financial, material and human resources are allocated and flow within a chain. In this respect Gereffi formulated a distinction between *producer* and *buyer-driven* chains: in the first case the producer is the leader of the chain while in the second case the control belong to the buyer. This division allows accounting for the dependency of some localities inserted out of the leadership position within the value chain.

Evolution of the relationships in these three levels is an important process to understand the changing territorial landscape in Europe. As a matter of fact the inclusion in a node of a value chain is not a static matter because many chains evolve over time as well as the trajectories of the governance level.

The upgrading strategy represents one of the main opportunities of a firm and a locality to overtake a pattern of dependency. Humphrey and Schmitz provide a firm-centred typology for upgrading. *Process upgrading* occurs when the reorganisation of the production system allows to transforming inputs and outputs in a more efficient.

⁸ Hirschman A. O. (1958), *The Strategy of Economic Development*, Yale University Press, New Haven.

This process takes place mainly by introducing superior technology that turn out to increase the competitiveness position in relation to rivals.

Product upgrading deals with the movement into more sophisticated lines of products. *Functional upgrading* is related to the change of the range of activities undertaken by the firm. It usually involves the acquisition of new functions (*core competencies*), or the focus on the higher value added activities such as design or marketing. *Organisational and managerial upgrading* is the acquisition of new forms of organizational and managerial methods, such as teamwork, involvement of workers, application of ISO that allow to improving the efficiency and effectiveness of production and non-production activities.⁹

Governance along a value chain represents another interesting level of analysis. Governance involves the coordination between economic actors located in different stages of the value chain. In order to understand the governance it is useful to think about who take the decision about parameter setting and enforcement, especially decisions about what and how to produce, and how the flow of the product along the chain has to be handled.

The reasons of coordination is to contain risk.

Humphrey and Schmitz have identified four types of relationships:

Arm's length market relations. Market coordination underpins the relations between buyer and supplier. They are connected in *open linkages* because the buyer's requirements could be met by a range of firms as the object of transaction is a standard product. (potential multiplicity/multiple relations)

Networks. The relation between firms is close and even. Cooperation on product development and production scheduling is widespread, as well as interdependence and the sharing of competencies. The buyers may set specific product or process standards but the supplier has to be able to work out how to met them.

Quasi hierarchy. Asymmetrical relationships underpin the linkage between economic agents. One firm exercises a high degree of control over the others by specifying the characteristics of the product, the production process or the control mechanisms. This form of coordination arise when there are some doubts about the competence of the supplier. This is the typical form of governance in a *buyer-driven value chain*.

Hierarchy. Firms are *vertically integrated* so that the lead firm takes the direct ownership of the operations along the chain.¹⁰

According to Humphrey and Schmitz¹¹ only the last three categories can be considered as economic governance. Governance is therefore the coordination of activities *through non-market relationships*.

⁹ Humphrey, J. and Schmitz, H., (2001), *How does insertion in global value chains affect upgrading in industrial clusters*, mimeo, www.ids.ac.uk/ids/global/vwpap.html, . p. 2.

R. Kaplinsky, M. Morris, J. Readman, *The globalisation of product markets and immiserising growth: Lesson from the South Africa furniture industry*, <http://www.ids.ac.uk/ids/global/pdfs/rkmmjr.pdf>

¹⁰ Humphrey, J. and Schmitz, H., (2001), *How does insertion in global value chains affect upgrading in industrial clusters*, mimeo, www.ids.ac.uk/ids/global/vwpap.html, . p. 7.

¹¹ *Ibid.*, p.3.

A wider definition of governance is provided by Williamson: in this case governance is defined as any type of coordination including markets, firms and networks. In a narrow perspective governance are identified only with the network form.

Kaplinsky who proposes three types of value chain governance instead of two reconsidered Gereffi's dichotomy between buyer-driven and producer-driven value chain. The first form is *Supplier-pulled chain that arises when the producer* plays a key role because of his technology endowment, automobile assemblers and consumer electronics manufacturers are example of this category. The second form is *Producer-pushed chain*, which is characterised by governors that push change up the chain towards their customers. The third form is and *buyer-pulled chains*. In this case the final retailer is the governor of the chain, even if it has little knowledge about the challenge at the producers stages.¹²

The value chain analysis has identified a number of tendencies in the world towards quasi-hierarchy. Gereffi emphasised the importance of what he called 'buyer-driven global commodity chain' in which the parameters are specified by large retailers or brand-name companies organising production systems that integrated producers in different countries but without themselves owning any manufacturing facilities.

The governance represents an interesting connection between the two strands. The type of governance along the value chain shapes different relations between places. It therefore gives rise to hierarchies of places or networks among places (a sort of core-periphery relation). So the levels and processes of development depend upon the position of localities within the chain.

Even if it provides a useful starting point the global commodity chain analysis is affected by some limits. The first major limit is that 'it does not take under consideration processes that are external to the particular chain under analysis and internal to the 'nodes' or sites of production and retailing within the chain'. In other words institutional and local characteristics are neglected because the focus of the value chain is only in the production structure.

This perspective leads for example to a lack of attention to labour processes and conditions of work within the nodes in the chain. Instead in the local economic development literature labour is not merely a factor of production but it recovers its qualitative dimension. The expertise and flexibility are recognised as important characteristics of the workforce capable to affect the district's adaptability to external changes. In recent years the dispersion of specific skills and know-how is becoming one of the main concern of local firms.

A second limitation is linked to an excess of stylisation; indeed the dichotomy between *buyer-driven* and *producer-driven* modalities is not supported by the empirical evidence. As a matter of fact the two ideal-types may coexist within sectors and product markets across diverse national contexts and they may also change.

¹² Kaplinsky, R., *What can we learn from value chain analysis*, <http://www.ids.ac.uk/ids/global/conf/pdfs/rk1.pdf>, p. 3.

A third concern is related to the multilevel embeddedness of value chains. The global dimension seems to be the most important one in the value chain analysis; instead it is necessary to place emphasis to the dialectic relationships between chains and their national, regional and local contexts¹³.

Definition of the research problem

From a local perspective the transition process occurring in Central and Eastern Europe can be conceptualized as a modification of the external environment of the Italian district. Basically these changes in the external environment lead to an internal restructuring of production. In order to cope with the new global competition, local firms chose to take part in global value chain so that the external linkages turn out to be more important than self-containing relationships. As the district is naturally conceptualized as an open system, its boundaries are blurring because the level of openness has increased.

The reaction of local firms to new global opportunities and challenges leads to the necessity of considering the district beyond its local dimension. Even if *proximity* continue to play a significant role it is also important to consider clusters as part of a wider value chain to understand the evolution of competitiveness strategies.

In this regard the value chain analysis is important to explore the way in which emerging and longstanding localities feed into global or European value chain. The subdivision of the different functions along the value chain is important to understand the governance of the value chain. For example, the specialization in a low value added phase of production leads the system to functional downgrading.

Most of the Marche shoes enterprises adopt a diversification of risk strategy by operating in different chains. For example the same firm can be involved in two different value chains because it manufactures two different lines of product: a high quality line and an economic line. Even if the reality is complex it is possible to outline three main options undertaken by firms.

The first strategy is the insertion in *top brand value chain* that result in functional downgrading for local firms. Indeed, this option involve becoming subcontractor of high fashion companies located either inside the district or outside its boundaries. In this case the value chain is a *buyer-driver* type, therefore the firm loses the direct contact with the market lowering its degree of independence.

The second one is the choice to operate for *buying groups* and in this case the result is functional upgrading because the core competencies (like branding, marketing, advertising) are maintained within the district boundaries¹⁴.

In this paper the main focus is on the *outsourcing processes*, which represent the third option. This strategy leads to *Functional upgrading* and *product downgrading* of local actors. In fact firms decide to delocalise only the manufacturing activities, retaining

¹³ A. Smith, A. Rainnie, M. Dunford, J. Hardy, R. Hudson, D. Sadler, 'Where the jobs will be in the United States of Europe': Networks of value, commodities and regions in Europe after 1989. p. 9-17.

¹⁴ It depends on the dimension of the local firm, I came across with small firms that were operating for buyers and they considered themselves as an appendix, it was a typical buyer-driven relationship.

the strategic activities like marketing, distribution. Nevertheless, outsourcing result in a lowering of the quality of the product that the firm receives and sells to consumers.

From the standpoint of the emerging local system (towards which relocation is directed) a central question is whether the dependant take off could turn out to be the first stage of a self-sustained path of development. Therefore it is important to transform the local system of arrival into a *learning region* avoiding path dependency and lock-in that could arise from an initial development based upon this modality. The nature of the outsourcing processes from Western towards Eastern countries as an opportunity or as a threat cannot be anticipated. From a theoretical point of view delocalisation can be regarded as a source of *backward* and *forward* linkages in the host region so that a circular causation process could start¹⁵. The effect depends on how the new economic activity intermingle with social and cultural factors (the institutional environment).

Beside the outcome in the regional distribution of economic activities depends on the relative dominance of spread (centrifugal) and backwash (centripetal) effects.¹⁶ It is therefore difficult to anticipate if the ‘gemination’ of industrial production due to relocation process will result in concentration in localities or diffusion of development.

In the case analyzed in this paper concentration seems to arise. One of the main reason is the lower wages in Romania compared to other CEECs. Although, it is possible to argue that the *preferential direction* of the outsourcing process toward a well-defined area in Romania is rooted in the social structure of the local system of origin. As a matter of fact the predilection for a particular locality can also be explained in terms of social capital theory.¹⁷ The presence of trust in social and economic relations and the ease of the flow of information are causal factors of imitation either in the assessment on the outsourcing strategy or in the location option.

Empirical research methods

The following observations are based on empirical research conducted in the shoe district of the Marches, in an area between the provinces of Macerata and Ascoli Piceno in which almost all the Marches firms operating in this sector are concentrated. The empirical research aimed at identify the principal characteristics and evolutionary tendencies of the processes of internationalisation of the production process, that are acting in the main manufacturing sectors of the Marches economy, organised in the form of districts, with reference to the countries of Central and Eastern Europe and in particular with the so called ‘candidate countries’. The majority of attention was placed on an analysis of the integration of the productive dimension – rather than on commercial expansion towards the area of interest. The research method is based on a fieldwork conducted in the well-defined territorial area that corresponds to the ‘shoe-manufacturing district of the Marches’. It constitutes, together with ‘Furniture’, the

¹⁵ Hirschman A. O., *Ibid.*, and Myrdal G. (1957), *Economic Theory and Under-developed regions*, Duckworth & Co., London.

¹⁶ Myrdal, *Ibid.*, pp.27-31.

¹⁷ A synthetic survey of the social capital theory as developed in different authors (Jacobs, Coleman, Putnam and Fukuyama) is contained in Bagnasco (1999), *Tracce di Comunità*, Il Mulino, Bologna.

main economic sector of the region. Thirty-five in-depth interviews, directed at the leader firms in the district were conducted.

Research findings and interpretation

General remarks

Considering the exchange rates and the level of domestic prices, all the countries of Eastern and Central Europe are potential 'objectives' resulting from the processes of delocalisation of the network of firms operating in the local Italian systems, or in other words the '**lower**' phases of the productive process. The fact that these areas are potential 'objectives', in the light of the two above mentioned factors must however be reinterpreted on the basis of a complex combination of factors that exist both in the countries of departure and the countries of arrival.

The shoe-manufacturing district has to deal with typical problems of sectors that have reached a mature phase and have to undertake process and organisational upgrading in order to satisfy a final demand that is more and more sophisticated and unpredictable. These problems require the formation and activation of a twofold strategy, that, on the one hand aims to combine flexibility and high quality of the final product, and on the other hand must contain costs of production, particularly with reference to some initial phases, at a low knowledge level, of the production process. Delocalisation is exactly one implementation of the dual strategy. When firms positioned in high quality value chains outsource some phases of the production the process contrasts theoretically with the idea that delocalisation leads to product downgrading.

In general, the decentralisation of production towards the countries of Central and Eastern Europe is part of the dual strategy that has just been described. It constitutes an innovation of location that modifies the vertical (along the value chain) and horizontal relations (within the industrial district) of the firms involved. While, in past decades, the vertical disintegration of the production process in the local context provided the reduction of costs, through external economies, today, the externalisation occurs in a national or international context. It does not represent a change of strategy, it only represents a spatial extension of the production network that is being referred to.

However, the delocalisation is not a simple territorial transformation from a local division of labour to an international fragmentation of the productive process. In fact it brings about a reorganisation of the local economic structure. Firstly, delocalisation determines the substitution of some local subcontractors and a selection by firms of a local network that is able to realize the highest levels of qualitative performance and productive efficiency.

Table1.a: Substitution of local subcontractors due to outsourcing process (actual)

	Frequency	Percent	Valid Percent	Cumulative Percent
No	13	59.1	59.1	59.1
Yes	9	40.9	40.9	100.0
Total	22	100.0	100.0	

Table1.b: Substitution of local subcontractors due to outsourcing process (prospective)

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	14	63.6	63.6	63.6
No	8	36.4	36.4	100.0
Total	22	100.0	100.0	

Secondly, at a systemic level, as competition of price has increased a *crowding out* of firms producing a low quality product is occurring inside the district.

The substitution and the crowding out effects can undermine the stability of the district. From a systemic perspective, the more the structure of a network is complex and interconnected the more it is indifferent to the rupture of a particular linkage. However, if the alteration involves some *sensitive points* it could turn out to be deeper than any other changes taking place in any other point of the network.¹⁸

One of the differences between the vertical disintegration that is taking place inside the district and delocalisation is rooted in the different entity of *transaction costs*¹⁹. One of the firms that were interviewed brought up the problem of the lack of information about subcontractors that operate outside the district particularly in Eastern Countries. However, one can say that the lower prices of unfinished goods offset the higher transaction costs.

The main characteristics of the sample

The sample of firms was composed of 35 firms that specialize in the production of medium to high quality goods located in the shoes industrial district of Marche. In the

¹⁸ Waddington, C. H. (1977), *Tools for Thought*, Basic Books, New York, pp.91-92.

¹⁹ Williamson defined transaction costs as market frictions of economic system. They are affected by the specificity of the object, by the frequency and uncertainty of the negotiation. See Williamson O. E. (1985), *The economic institution of capitalism. Firm, markets, relational contracting*, New York, p. 52.

course of the history of the firms, 22 of them have activated strategies of delocalisation in at least one phase of the production process. Of these 22, 20 have expressed an interest to move further along in this strategic direction.

On the basis of the data collected through the empirical research the size of the firm seems to be a relevant factor for undertaking strategies of outsourcing. It would seem that having reached a certain size threshold, firms begin to activate strategies of delocalisation – at least when looking at the background of the institutional conditions that have been prevalent in the last decade. The turnover threshold that permits or inhibits relocation is 1 millions Euro. This result emerges from the relation between the level of turnover and the propensity to delocalisation highlighted in table 2. It is worth noticing the rank between 7.5 and 15 millions Euro, in which 89% of the firms have delocalised. A general remark is that this result is consistent with the general absence of delocalisation in artisan firms and in firms that make products of very high quality.

From an economic point of view, for some economic operators it has been a reaction to the strategies of pioneer entrepreneurs rather than a ‘free choice’. This has highlighted how the process is fed by positive feedback²⁰, derived from processes of imitation in order to continue to be competitive.

From a wider perspective, social capital theory provide a useful framework to understand either the self-reinforcing process underpinning the relocation strategy or the preferential connection with an emerging cluster in a particular host country. Trust behind economic and social relations among local actors in the system of origin and the ease of exchange of information is leading to a ‘precipitation’ of the outsourcing process toward a well-defined area.

²⁰ Waddington, *Ibid.*, p. 91.

Table 2 -Range turnover (Millions of Euro) * Outsourcing Cross tabulation

		Outsourcing			
		Yes	No	Total	
Range turnover (Millions of Euro)	Less than 1	Count		4	4
		% within Range turnover (Millions of Euro)		100.0%	100.0%
		% within Outsourcing		30.8%	11.4%
		% of Total		11.4%	11.4%
From 1 to 2.5		Count	1	1	2
		% within Range turnover (Millions of Euro)	50.0%	50.0%	100.0%
		% within Outsourcing	4.5%	7.7%	5.7%
		% of Total	2.9%	2.9%	5.7%
From 2.5 to 5		Count	5	1	6
		% within Range turnover (Millions of Euro)	83.3%	16.7%	100.0%
		% within Outsourcing	22.7%	7.7%	17.1%
		% of Total	14.3%	2.9%	17.1%
From 5 to 7.5		Count	2	4	6
		% within Range turnover (Millions of Euro)	33.3%	66.7%	100.0%
		% within Outsourcing	9.1%	30.8%	17.1%
		% of Total	5.7%	11.4%	17.1%
From 7.5 to 15		Count	8	1	9
		% within Range turnover (Millions of Euro)	88.9%	11.1%	100.0%
		% within Outsourcing	36.4%	7.7%	25.7%
		% of Total	22.9%	2.9%	25.7%
From 15 to 30		Count	2	1	3
		% within Range turnover (Millions of Euro)	66.7%	33.3%	100.0%
		% within Outsourcing	9.1%	7.7%	8.6%
		% of Total	5.7%	2.9%	8.6%
More than 30		Count	4	1	5
		% within Range turnover (Millions of Euro)	80.0%	20.0%	100.0%
		% within Outsourcing	18.2%	7.7%	14.3%
		% of Total	11.4%	2.9%	14.3%
Total		Count	22	13	35
		% within Range turnover (Millions of Euro)	62.9%	37.1%	100.0%
		% within Outsourcing	100.0%	100.0%	100.0%
		% of Total	62.9%	37.1%	100.0%

Incentives and obstacles to relocation of production

With reference to the sample of firms interviewed, the main reason that attracts entrepreneurs toward CEECs is the lower level of wages compared to their national context. Other advantages are connected to legislation regarding trade unions and mandatory costs that are less restrictive²¹.

The availability of workforce in CEECs is another reason strictly connected to the skill mismatch between demand and supply in the local labour market. As a matter of fact the structural shortage of unskilled labour in the local context (given that the district is located in a region characterised by full employment) is coupled with the presence of skilled workers that regard jobs footwear industry as a not appealing in terms of pay and working conditions.

As far as the firms that have been contacted are concerned, delocalisation does not seem to be considered as a mean for access to market. Some obstacles to outsourcing exist however. The most important complication seems to involve the possibility to reach the desired standards of quality. In general, the firms that do not resort to international fragmentation are those producing very high quality goods. Firms that produce goods of very high quality tend to privilege the district of which they are a part when constructing a network. Another obstacle – or implicit cost – brought up by some entrepreneurs who were interviewed is connected to the subject of technical assistance. The machinery used for production must be repaired in quick time. This does not lead to a problem within the district, while it becomes an obstacle in non-district contexts. In the latter situation, to recruit technicians and to send for replacement parts from Italy requires time, in this way preventing firms from fulfilling the forecasted production times.

If we shift our attention from the local system of arrival to the local system of departure, other reasons emerge that prevent firms from resorting to delocalisation. It involves a reluctance to go outside the boundaries of the district because of what we can define as '*territorial loyalty*'²². Although they are aware of the disadvantages in terms of lowering costs some entrepreneurs do not opt for international fragmentation because of a sense of belonging to the territory. They are against the dispersion of the material heritage that has developed in the district over time. In these cases delocalisation is not undertaken on the basis of considerations that are not strictly economic.

Sometimes they undertake product upgrading by acquisition of licensed brand: they feed into higher quality value chain becoming subcontractors of one or more high-fashion company. In this way they avoid relocation of production but they result in functional downgrading²³.

²¹ And the less strict custom controls too.

²² We can define *territorial loyalty* the desire of social actors to express and fulfil their development projects in their own community.

²³ The same process is now taking place in the industrial district of Brenta, in the Veneto case the relative importance of the two processes (relocation of production and the inclusion in high fashion value chain) is reversed in the sense that the latter is more important than the former compared with the present case. The difference is probably rooted in the different dimension of the two local systems. See Roberta Rabellotti, 'The Effect of Globalisation on Industrial Districts in Italy: The Case of Brenta', *IDS Working Paper*, November 2001.

When territorial loyalty is a determining factor in the localisation choice, it influences both the decision making process regarding the opportunity to de-locate and regarding the intensity of the process of vertical dis-integration that is activated through decentralisation. Concerning this last aspect, one can observe that the only firm that, even if the loyalty feature is presents, has decided to decentralise, has only externalised one phase. However, a threshold exists beyond which territorial loyalty ceases to be a relevant factor in strategies of delocalisation.

Table 3 - Incentives and obstacles affecting the decision process about relocation

	Incentives	Obstacles
<p><i>In general</i></p> <p>Microeconomic level</p>	<p>Availability of work force</p> <p>Lower labour costs</p>	<p>Transaction costs</p> <p>Lack of information</p> <p>Low level of quality</p> <p>Technical assistance</p> <p><i>Territorial loyalty</i></p>
<p><i>Romanian case</i></p>	<p>Presence of <i>know how</i> (legacy of the planned economy system)</p>	<p>Lack of trust in the partner</p> <p><i>Moral hazard</i> associated with quality control</p>
<p><i>In general</i></p> <p>Macroeconomic and Institutional level</p>		<p>Political and social instability</p> <p>Institutional uncertainty</p> <p>Lack of personal security</p>
<p><i>Romanian case</i></p>	<p>Less restrictive legislation regarding trade union and mandatory costs</p> <p>Less strict custom control</p> <p><i>Cultural affinity (especially linguistic affinity)</i></p>	

The intensity of the process of vertical disintegration

From the perspective of the firms located in the Italian local system the relocation process is a source of *functional upgrading*. A partial internationalisation (involving only some phases of the production process) is the most widespread modality observed in the sample. Only three firms of the sample have delocalised the entire production process.

Table 4 - Intensity of the outsourcing process

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	The whole production process	3	14.3	25.0	25.0
	Two stages	6	28.6	50.0	75.0
	One stage	3	14.3	25.0	100.0
	Total	12	57.1	100.0	
Missing	System	9	42.9		
Total		21	100.0		

As a matter of fact all the firms interviewed relocate the manufacturing phases (namely sewing/hemming), an element that was observed in all the firms is the maintenance, in the local system of origin, of the strategic functions such as planning, design, commercialisation and management of credit. When this is not possible, in the case for example, of quality control – Italian management are entrusted with it in the area of relocation²⁴.

Table 5 – Ownership rights

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Ownership	3	13.6	14.3	14.3
	Participation with italian partners	1	4.5	4.8	19.0
	Majority participation with partner of the host country	2	9.1	9.5	100.0
	Indirect relationship	15	68.2	71.4	90.5
	Total	21	95.5	100.0	
Missing	System	1	4.5		
Total		22	100.0		

²⁴ One of the entrepreneurs told that the quality level of the good received is strictly linked with the presence of Italian controller.

The forms of juridical relations and property rights that underlie the integration of production with countries of Central Europe and the Balkans are strictly connected to the intensity of the process of vertical disintegration that has been realized. Forms of property and shared property with Italian partners are more common within the firms that outsource the whole production process. Those that decentralise only some phases of production (in general the labour-intensive ones) use less restrictive relationships like *international subcontracting* that provides a softer relationship. Very often the organisations that are entrusted with the work belong to Italians that reside in the foreign countries involved.

Table 6 - Relationship between property rights and outsourcing intensity

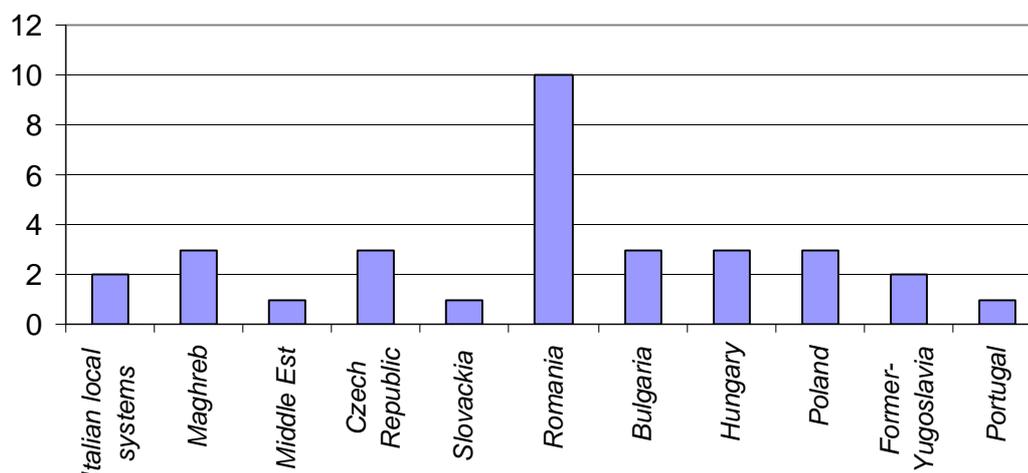
		Outsourcing intensity			
		Whole process	Two phases	One phase	Total
Ownership rights	Ownership	Count	1	1	2
		% within Ownership rights	50.0%	50.0%	100.0%
		% within Outsourcing intensity	33.3%	16.7%	16.7%
		% of Total	8.3%	8.3%	16.7%
	Shared ownership with Italian partners	Count	1		1
		% within Ownership rights	100.0%		100.0%
		% within Outsourcing intensity	33.3%		8.3%
		% of Total	8.3%		8.3%
	Majority control, partners of the host country	Count	1		1
		% within Ownership rights	100.0%		100.0%
		% within Outsourcing intensity	33.3%		8.3%
		% of Total	8.3%		8.3%
Indirect relations	Count		5	3	8
	% within Ownership rights		62.5%	37.5%	100.0%
	% within Outsourcing intensity		83.3%	100.0%	66.7%
	% of Total		41.7%	25.0%	66.7%
Total	Count	3	6	3	12
	% within Ownership rights	25.0%	50.0%	25.0%	100.0%
	% within Outsourcing intensity	100.0%	100.0%	100.0%	100.0%
	% of Total	25.0%	50.0%	25.0%	100.0%

The preference for Romania and the exploration of new directions

The delocalisation process seems to work in multiple directions, 9 firms have only one place of outsourcing (one nation), and the other 8 have multiple relations.

The choice of the area of delocalisation seems to be influenced by a cyclical process that favours from time to time areas that are characterized by a combination of advantages relating to labour costs and transport costs as well as institutional factors. One can observe an obvious preference for Romania when looking at the strategies of the firms interviewed. Romania²⁵, in the last decade has been the main country for delocalisation in the shoe- making district of the Marches.

Graph. 1 – Directions of relocation of production in the sample



The choice of Romania is rooted in lower wages compared to other countries of the area. There are however other factors that increase the interest in Romania as a country of arrival for processes of internationalisation. Satisfying production standards, due to the existence of *know how*, is among these factors. The availability of skilled labour is the legacy of the planned economy system. Large state run factories in the shoe- manufacturing sector operated in this area. Finally, a proximity factor, both in its geographical and social connotation, is another relevant factor. The accessibility in term of transport system seems to be of a significant importance. Besides the presence of a cultural affinity – especially a linguistic affinity – that facilitates communication play a relevant role.

²⁵ It seems that a *twin local system* is arising in Romania (particularly in and around Timisoara), One of the entrepreneurs that run a commercial firm of shoes accessories within the Italian district opened a retailer branch in the Romanian town in order to carry out the same function.

One can however observe that the second factor that have just been mentioned are considered to be reproducible and also the obstacles posed by cultural and linguistic differences can be overcome.

In spite of a preferential direction of the outsourcing process towards a Romanian local system, recently new changes on the direction of delocalisation have emerged. Other countries of Central and Eastern Europe are becoming interesting. The new tendencies involve firstly Hungary, Poland, Czech Republic and secondly Bulgaria, Macedonia and Serbia. Not only the saturation of the Romanian market but also the negative experiences of some entrepreneurs are the cause of the current widening of the area that is attracting relocation of production. It seems that a process of activation is occurring. Some productive structures located in Poland, Bulgaria and Hungary have contacted some of the interviewed firms, proposing themselves as subcontractors.

The main reason from a microeconomic perspective that has induced some firms to interrupt their experience of delocalisation consists in the lack of trust in the partner. At a macroeconomic level the main reasons involve the presence of political and social instability, institutional uncertainty, and the lack of personal security in some countries. The experiences of failure are especially connected to Romania. The insufficient level of quality and the untrustworthy behaviour of the partner are the main motives that have induced at least four firms of the sample to change track.

The experience of one of these firms is particularly interesting. In the course of the years 1995-1996 it made two attempts at delocalising in Romania. Both practises failed because of the absence of people who were responsible for production *in loco*. The firm had to deal with problems related to the level of quality of the delivery, which was strictly dependent on the presence of an Italian supervisor. For this reason, the firm decided to delocalise in Poland, Tunisia and Southern Italy.

Connection between processes of delocalisation and processes of commercial penetration

The above example gives us an opportunity to introduce the subject of the *substitution effects* that operates within the delocalisation process. When looking at the investments made in the countries of the EU and the countries of Eastern and Central Europe no substitution effects were revealed. These effects exist instead with other developing countries or with spatial extensions of the network that concern the area of Southern Italy.

Two of the 3 firms of the sample that have not delocalised in the countries of Eastern and Central Europe have made investments or installed subcontracting relationships with partners located in Southern Italy.

Table 7 - Main Geographical area of destination

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Central and Eastern Europe	14	63.6	77.8	77.8
	Maghreb	1	4.5	5.6	83.3
	South Italy	1	4.5	5.6	88.9
	Middle Est	1	4.5	5.6	94.4
	Far Est	1	4.5	5.6	100.0
	Total	18	81.8	100.0	
Missing	System	4	18.2		
Total		22	100.0		

In general Eastern and Central Europe are considered more interesting as areas of decentralization of production rather than as a potential market. The main export market continues to be the EU. In the CEECs some cautious attempts at commercial expansion have been made in the expectation that such countries will be able to offer a sustained demand in the future. The strategies of commercial expansion are especially oriented towards Russia and Poland where sophistication of consumers' tastes is occurring.

From the field-study no strict synchronisation between relocation and commercial penetration seems to exist. In general the two strategies are disconnected.

Table 8 - Relationship between relocation and export towards CEECs

			Outsourcing process towards CEECs		
			Yes	No	Total
Range EE/TE	Less than 25%	Count	10	15	25
		% within Range EE/TE	40.0%	60.0%	100.0%
		% within Outsourcing process towards CEECs	71.4%	71.4%	71.4%
		% of Total	28.6%	42.9%	71.4%
	From 25 to 50%	Count	4	5	9
		% within Range EE/TE	44.4%	55.6%	100.0%
		% within Outsourcing process towards CEECs	28.6%	23.8%	25.7%
		% of Total	11.4%	14.3%	25.7%
	From 75 to 100	Count		1	1
		% within Range EE/TE		100.0%	100.0%
		% within Outsourcing process towards CEECs		4.8%	2.9%
		% of Total		2.9%	2.9%
Total		Count	14	21	35
		% within Range EE/TE	40.0%	60.0%	100.0%
		% within Outsourcing process towards CEECs	100.0%	100.0%	100.0%
		% of Total	40.0%	60.0%	100.0%

EE/TE= Export toward Central and Eastern Europe*100/Total Export

For example a firm that was interviewed exports 70% of its turnover to the CEEC but has not activated delocalisation. Another firm that, after experiences of failure to delocalise, chose instead to enhance the level of quality of the product, producing entirely in the district exports 20% of its turnover to Central and Eastern Europe.

This disconnection does not take place in only one case. This case involves a firm that constitutes an exception both for the intensity of the process of delocalisation and for the connection between delocalisation and commercial penetration. The firm we are referring to has had a relationship with Czechoslovakia since 1976, holding 55% of the capital of a firm that had recently been sold. In 1989, the same firm bought a plant in Hungary, situated near the border with the Ukraine. The Italian firm deals with planning, the making up of the collections, the commercialisation of the product, the management of credit, financing, obtaining credit and contacts with clients. The place of production represents, in part, the destination of the product – that is not imported in Italy- since the quota of shoes produced in Hungary is sold directly in Hungary. Another quota is exported in Poland and in Russia, the latter market being the one that absorbs the highest percentage of production.

Conclusions

The exploratory case study presented in this paper has revealed the relevance of the transformation processes that the industrial district of Marche has been experiencing in the last decade.

The area of destination of outsourcing in the sample is mainly Central Europe and the Balkans. A preferential territorial linkage has been established with the twin Romanian cluster of Timisoara and Arad. The disconnection at the microeconomic level between relocation and export directions shows that Central and Eastern Europe is more interesting as area of outsourcing rather than a potential market and that the relocation is not functional to the search of access to market as stressed in the literature.

The size of the firm seems to be a relevant factor for undertaking strategy of delocalisation. The relocation of one or two stages of the production process is the widespread modality. A close relation between type of ownership rights and intensity of the process of relocation has emerged as a characteristic of the governance of the relations. As a matter of fact the more the relocation of production is extreme the more the juridical relation is restrictive.

The decision process of local firms about relocation is driven by incentives such as the availability of work force and the lower labour costs, the presence of *know how*, less restrictive legislation and custom controls, cultural affinity. Nevertheless relocation assessment is constrained by transaction costs, lack of information, low level of quality, delays related to technical assistance, moral hazard behaviours, territorial loyalty, political and social instability, institutional uncertainty. The coexistence of positive and negative aspects of relocation make it difficult to envisage the final outcome of the process and the existence of a stable equilibrium.

Outsourcing has some effects on the internal organisation of the industrial district of Marche. Firms that are following this option result in functional upgrading and product downgrading. In contrast, firms that choose to feed into high fashion value chains are experiencing functional downgrading and product upgrading. Firms that undertake neither the first strategy nor the second one are exposed to the risk of being crowded out by the increased competition emerging from the transformation processes. The substitution of local subcontractors by overseas subcontractors is shaping a selection process and is producing indirect effects on local employment.

There are two levels of further developments that should be considered to a better understanding of the recent transformation processes arising as a consequence of the increasing economic integration.

At the empirical level taking a twofold perspective raises the necessity to undertake a case study focused on the area of arrival rather than looking at the evolving relationship only from one locality viewpoint.

Further developments have to be considered at the theoretical level as the related literature is at an early stage. As a matter of fact, as far as delocalisation is concerned, economists and geographers are still in search of a theory.

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