



Many economists think that only the USA and Japan will remain in the current top six economies worldwide by 2050. The others will be replaced by Russia, China, India and Brazil (the BRIC economies). There is every reason to think that the leather industry in Russia is slowly but steadily gearing up to play its role in that economic dominance.

Russia steps up to the challenge

When we looked at Russia a year ago the complexity of what has been going on since the fall of Communism was apparent. The domestic production of leather and leather products was failing to meet demand, and legal and illegal imports from China were filling the gap. The growth in consumerism is continuing to fuel demand and there are now real signs that domestic production is starting to move forward strongly.

Reports on the country's light industry production show that production rates have started to grow—for the first time in seven years. Compared with the first seven months (January to July) of 2005, the production of leather, leather goods and footwear increased 12.4%. Almost all types of leather and footwear manufacture posted growth: chrome-tanned leather goods went up by 20.8%; leather goods by 6.4%; so-called coarse-leather goods rose by 31.3%;

footwear production saw a 9.3% increase; and highlighting the global trend, the production of ladies' fur coats rose 126.4%. In spite of this apparently positive trend, one major issue that still needs to be tackled effectively, in terms of the Russian economy, is the establishment of a 'civilised' internal market for consumer goods, as the volume of counterfeited and smuggled products on the Russian market continues to hinder the development of domestic light industry. ►



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Cracking down on counterfeits

According to reports from the Russian Ministry of Industry and Energy (Minpromenergo) light industry is one sector that is particularly affected by the level of 'civilisation and transparency' of the market, which is not currently protected from illegally manufactured or smuggled products. In response to this continuing problem, the Department for Economic Analysis and Prospective Planning has now implemented a 'goal-oriented' project in an attempt to eliminate illegal manufacturing and contraband. And, according to the head of the office for supervision of priority directions of industry policy at the department, Mikhail Orlov, the work project has already yielded positive results.

Minpromenergo has also implemented a plan aimed at boosting the existing potential and competitive edge of the industry over the next two years. Measures in the plan include assisting innovation; promoting investment; developing the raw materials base; and promoting exports. And far from being a case of politicians blowing hot air in attempt to appease those in the affected industries—including the leather sector—it appears that the government is addressing this problem with actions rather than words alone.

Russian officials announced changes in tariff duties on exported leather products at the ACLE leather fair in Shanghai, China, abandoning the 10% tariff on exported leather and the 5% duty on imported leather raw materials as of mid-August. It is also hoped that Russia's decision to join the World Trade Organization (WTO) will create further opportunities to boost the country's economy and international trade.

Russia's economy at a glance

GDP:

Purchasing power parity	\$1.589 trillion
Official exchange rate	\$740.7 billion
Per capita	\$11,100
GDP real growth rate	6.4%

Inflation: 3.0%

Unemployment: 7.6%

(plus considerable under employment)

Budget:

Revenues	\$176.7 billion
Expenditure	\$125.6 billion
Public debt	12.9% of GDP

Industry:

Growth rate	4.6%
Exports	\$245 billion
Imports	\$125 billion

*2005 estimates

A leviathan landscape

Russia is the largest country in the world in terms of area at just over 17 million square kilometres and covering 11 time zones. It stretches from Europe in the west, through Northern Asia bordering the Arctic Ocean, to the North Pacific Ocean in the east. However, this also means it has relatively poor access to the major sea lanes of the world. Despite its vast size, much of the country lacks suitable soil and climatic conditions (it is often either too cold or too dry) for agriculture, with the result that only 7.17% is available as arable land and 0.11% under permanent crops (2005). The country does, however, have extensive natural resources including major deposits of oil, natural gas, coal, minerals and timber. Unfortunately, the climate, terrain and the huge distances involved still create obstacles to the full exploitation of these assets.

Siberia, where most major oil and gas deposits are located, has a particularly severe climate with sub-Arctic winters and dry summers leading to fires that destroy huge tracts of forest. The prevailing permafrost is a formidable obstacle to extracting these deposits and, once extracted, they must be piped huge distances in order to be exported. On the other hand, the gradual melting of the permafrost with global warming is one of the world's major environmental worries, as more melt methane will be released to the atmosphere worsening the warming problem and likely making it irreversible.

The harshness of so much of the environment also means that huge stretches of the country are virtually uninhabited. The total population is only 143 million and is shrinking at a rate of 0.37% per year (2006 estimates).

Balancing the economies of scale

Although it is evident that the government is taking real steps to foster the economy, some significant problems still exist. Economic growth slowed to 5.9% in 2005 and inflation remains high. Oil, natural gas, metals, and timber account for over 80% of exports, leaving the country at the mercy of fluctuations in world prices and the economy is not currently bolstered by a strong manufacturing sector—which, to all intents and purposes, is stagnant at present. This sector will require a great deal of modernisation if the country is to achieve significant economic growth on a broad-based scale. But, rather than reporting growth, official statistics since 2002 reveal a worsening scenario. The automobile industry has probably been worst hit as the decline in output has been accompanied by a rapid increase in imports. A similar, though less pronounced, trend can be seen in footwear, textiles and clothing.

Other negatives include a weak banking system, a business climate that is fairly unappealing to both domestic and foreign investors at present, and corruption and a general mistrust of institutions.

Background to leather

The leather industry and market in Russian Federation has a long history; and it is known traditionally as a large-scale producer of natural leather and leather goods. It also has a number of establishments that unite leather professionals including the Union of Russian Tanners, the Shoemakers' Union, and the Russian Chamber of Commerce and Industry.

At the start of the 1990s, the production of leather goods in Russia was scaled down. As the USSR fragmented, a number of leather companies went to nearby countries, whilst those that remained decreased their production dramatically. Following this period, leather was mainly exported as raw stock, whilst a considerable volume of finished goods was imported, which led to many businesses that had served the domestic leather goods market ceasing their operations. A significant problem for the leather industry has been the supply side. The national herd shrank in 2005, leading to a sharp increase in hide prices. This brought them in line with the average European levels thus exports fell and imports increased. A report on the Russian leather industry and market—recently produced by the Indian Council for Leather Exports (CLE)—estimated that the import of leather goods to Russia continues to grow faster than domestic production.

The China connection

About 70% of the leather garments sold in Russia are made in Türkiye, which benefits from its geographical proximity and a mix of modern design and high quality. Pakistani leather exporters have also found success in the Russian market, as they offered many of the same advantages as Türkiye but their goods were even cheaper. Pakistan's leather industry flourished on exploiting the Russian market, until it was superseded by China.

The Chinese economy began its spectacular growth at the same time that Russia's sank. Although the countries ➤



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had always traded, the relationship was by no means warm, particularly as the two countries were at times on the verge of warfare. Once things eased, small-time traders from Russia began conducting regular business with China. Many arrived with large suitcases, filled them up, paid in cash and returned home. While this method of doing business did not last long overall, much of the trading at the low-end of the market is still thought to continue as it meets the needs of Russia's less affluent eastern provinces.

Meanwhile, an increasing number of Russian buyers from the western provinces are now looking to supply an increasingly affluent section of society that demands levels of quality and design similar to Western markets. There is money to pay for it and the buyers themselves are in a better position to travel in order to find the right products. Moreover, the cost of moving goods between Russia's eastern and western regions is apparently greater than importing directly from overseas, even from China. It is therefore no surprise that this has led them to Hong Kong and, increasingly, China. But, whereas much of the business was initially done in towns along the border, they now go to places such as Shanghai, Wenzhou and Guangzhou.

Changing circumstances

The fur trade offers a typical insight into how this works. Despite having a sub-tropical climate Hong Kong is the global centre for processing fur, including dressing (tanning), garment manufacture and the development of new products. This came about because many refugees who fled northern China to Hong Kong when the Communists took over in 1950 were in the fur business. They initially catered for a tiny local demand, and then for tourists and visitors, but they soon developed export markets where they exhibited a marked feature of Hong Kong business people: an ability to learn and understand the different requirements of different markets.

Their big break came with the opening up of China's economy, the development of which began in the south, adjacent to Hong Kong. The Hong Kong fur business together with many other light industries relocated manufacturing to the mainland. This offered an enormous price advantage while, at the same time, they could keep abreast of market developments from Hong Kong. However, it was not always easy and during the 1990s the anti-fur



Following the global trend, fur is most definitely back in fashion in Russia. (Image Vilniaus Kailai, Lithuania)

campaigners turned the market down throughout much of the high-end western markets.

While fur continued to be popular in cold climates such as Japan, Korea, Russia and parts of North America, it was faux fur that captured much of the market elsewhere.

Fur has now re-emerged as a fashion material, with several leading design houses featuring fur trimming and even entire garments. The new trend for fur coincided with Russia's emergence as a major new market for quality furs and, as with leather garments, Russian buyers descended on Hong Kong. Indeed, at one particular fur trade fair the number of firm orders placed was so high that the organisers went out of their way to play it down. Although the event undoubtedly benefited from the global resurgence in fur as a fashion item, many of the hard orders came from Russian buyers.

The 'up-side' of this from a Hong Kong perspective, was that overseas buyers could deal with experienced Hong Kong companies while still enjoying low prices. The 'downside' was that sooner rather than later those same buyers—including those from Russia—sought out mainland-based sources that were able to offer even lower prices. Initially, such prices came at the cost of uncertain delivery schedules, variable quality and an enormous amount of red tape, but that has all changed and China now has a number of excellent fur manufacturers. But, where will the fickle buyers and their bulging wallets go next?

Leather footwear and fancy goods

manufactured in China (legal and illegal) are now said to constitute 70-80% of the entire Russian market.

Another problem is that a large quantity of the higher quality leather raw stock, is still exported, leaving only 20% of low-grade raw stock remaining for domestic manufacturers. The government recently levied a duty on the export of raw stock of up to €500 per ton and as a result, raw stock exports decreased by 20%. The industry is also facing a deterioration in the quality of raw material due to an abrupt increase in cattle illnesses (e.g. skin gadfly, mange, itch-mite, scab) which, combined with the decline in the size of the herd, makes things hard for tanners.

Progress at home

It may seem contradictory but in spite of this surge in imports of value-added leather goods and a fall in the quality and number of Russian hides available, the production of Russian leather footwear, fancy goods and leather garments has started to expand again during the past few years. At present, Russia's leather and footwear industry is represented by 50 leather and 206 footwear manufacturers with a diversity of ownership forms.

The annual increase in the production of leather footwear and fancy goods is 10-15%, although the growth in the manufacture of leather garments is insignificant.

Overall leather market (million sq. ft.)

	2004	2005
Output	30.40	30.04
Export sales	4.79	3.32
Domestic sales	25.61	26.72
Imports	3.88	5.11

The major output is chrome-tanned materials. It is estimated that chrome-tanned leather is manufactured at 31 factories with 16 of them producing 93% of the total volume of manufacture. The largest volume is produced in the Tver region (Ostashkovsky kozhzavod), the Ryazan region (Russkaya kozha), and the Yaroslav region (Khrom LLC).

There are also two other important products: 'juft' and soling leather. Juft leather, a term that refers to a heavy type of leather for work and military footwear, is unique to the Russian leather industry, combining high substance, heavy fatliquoring, hard wear and low cost. It was traditionally popular with local shoemakers, but its manufacture is now ➤



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concentrated at twelve tanneries and output fell by 20% in 2005. The largest producers are located in the Kirov region (Vakhrushi-yuft), the Yaroslavl region (Rybinsky kozhzavod), and the Nizhniy Novgorod region (Khromatin—a closed joint-stock company).

The production of soling leather has declined dramatically over the past few years and fell a further 15% in 2005. A major reason for this has been the ever-increasing imports of footwear from countries such as China and, as a result of this many soling tanners have now switched production to chrome leathers. Sole leather

is made at 15 factories of which, the five largest produce 72% of the total volume manufactured. The largest volume is produced in the Voronezh region (Shevro).

Footwear fights back

Although there is no escaping the impact of Chinese imports, Russian footwear production has steadily increased over the past few years. According to figures released by the State Statistical Bureau, footwear production increased 15% in 2002 to 42.2 million pairs, and experts believe that a fairly equal amount of unaccounted footwear production also

Leather production 2005 (million sq. ft.)

Chrome	26.91
Juft	2.13
Soling	1.01

exists. Thus, the true production volume can be estimated at about 80 million pairs. Two-thirds of Russian footwear is manufactured in two federal regions, namely, the Central (32%) and South regions (32%). Another 20% is manufactured in the Volga region.

Until relatively recently, Russia's footwear manufacturing capacity remained predominantly under the control of state-owned corporations. In most cases, investment had been stagnating for years, so equipment was old and out-dated. There was also extensive over-staffing which, combined with the poor plant, saddled producers with a high cost base. While local hide prices remained low, this was concealed to a degree, but once hides had risen to European rates, these large factories could no longer survive. Management was also stuck in a state-controlled mindset and lacked the initiative to fight for change. The industry either had to change fundamentally or disappear completely.

The past two years, however, have presented something of a turn around and the country exported 12 million pairs of leather shoes worth \$172 million in 2005. The large state-owned corporations have been privatised and are now operated by younger owners or managers with far more entrepreneurial flair. Moreover, the average size of footwear production facilities has been reduced to around 300 to 500 employees, down from 1,500 to 2,000. In addition, a considerable number of small companies have also been established, reflecting a new found confidence in the country's economic prospects.

As the legal position improves, and investment and innovation is promoted further, through schemes such as those set up by Minpromenergo, the prospects of creating profit in the leather and leather-related sectors look promising at present—particularly as the growth in consumerism in Russia, as wealth rises, continues to fuel demand. Recent events in the oil industry have scared off some foreign investors and, although industry experts do not feel they are likely to ever impact the leather industry, most investors are likely to be domestic... but this may be an advantage as it could further strengthen Russia's position as one of the top economies of the future. ☺

**XXIX IULTCS Congress and
103rd ALCA Annual Meeting**
June 20-24, 2007
JW Marriott Hotel
Washington, DC, USA

Schedule
Wednesday, June 20
Registration, Welcome Reception

Thursday, June 21
*Heidemann Lecture,
John Arthur Wilson Memorial Lecture
Technical Sessions, Visual Displays, Fun Run*

Friday, June 22
*Technical Sessions, Visual Displays,
Golf Tournament, Explore Washington*

Saturday, June 23
*Technical Sessions, Sports/Social Activities Luncheon,
Reception, Banquet, Closing Ceremony*

Additional Social Activities
*DC After Dark Bus Tour
Wine & Cudrítés Reception at Historic Home*

Guest Activities
*Lunch on the Potomac River
Arlington Cemetery and DC Monuments Bus Tour*

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