



Coping with Change

Twelve years after the implosion of the old Soviet Union in December 1991, Russia is still struggling to establish a modern market economy, modernise its industrial base, and maintain strong economic growth. From 1992 until 1998, the country had a poor business climate, with a deterioration in the already reduced living standards. Modern market reforms were not very visible, but since 1999 conditions have improved markedly, with annual output growing by an average 6% and with progress in structural reforms. But serious problems persist.

Russia remains heavily dependent on exports of commodities, particularly oil, natural gas, metals, timber, and hides and skins which account for over 80% of exports, leaving the country vulnerable to swings in world prices. Its dilapidated industrial base

needs to be replaced and modernised if the country is to maintain strong economic growth. There are, of course, other problems of concern, including widespread corruption, a lack of a strong legal system, capital flight, and a drain of talent to other countries. And for those dealing with the country, there is the continuing problem of getting clear, accurate and up-to-date information. (*See tables.*)

The Russian Federation is blessed by an abundance of natural resources of every description. This includes rich agricultural land with livestock as one of its main products. Since economic reforms began in 1991, most agricultural land has been transferred to private ownership, but there remain problems with the land reform programme whose resolution is one of the present government's economic priorities. Agriculture accounts for 7% of total economic output, but remains an important employer with over a quarter of the labour force working in the sector.





Country Commentary: Russia

The former Soviet Union's leather industry was developed rapidly in the 1970s and 80s with huge investments in tanneries, the majority being built with Italian assistance in both machinery and technology. The capacity of any single tannery was enormous with hundreds of tonnes of raw material being processed daily, reflecting the super power ambition of the former communist country. The total leather capacities planned at some 44 million sq.m of finished leather a year have never been 'fulfilled', as is also the case with the exaggerated plans to manufacture 160 million pairs of shoes in a year (currently only about 33 million pairs).

Under utilised capacity

Officials with responsibility for light industry openly admit that both leather and footwear production capacities are currently under-utilised at only 20-25% of capacity. Only about 220 footwear manufacturers and some 50 leather companies survived 'perestroika' and the introduction of the market economy.

Huge tanneries, now mainly in private hands, have, for many reasons, no possibility of using their muscle, starting from problems with raw material, poor technology (especially in finishing stages) and low demand for leather on the domestic market. This has resulted in the majority of tanneries being involved in purchasing raw hides and processing them to wet blue only, with limited quantities reaching the finishing stage.

Russia therefore became a substantial raw material exporter especially of hides and skins in the wet blue, particularly since last year's adoption by the government of a €500/tonne (\$592.7/tonne) tax on wet salted hide being exported from the country. The Russian Union of Leather Manufacturers, which was actively lobbying in favour of the new regulation in the state parliament, the Duma, has also appealed to the neighbouring Belarus parliament to make the same move. The reason behind that appeal is that Russian wet salted hides have been illegally smuggled into Belarus, gathering Belarus origin certificates and then being exported to the West as Belarus hides.

Briefly, the main reasons behind the limited production of leather in Russia are technological inadequacy among the majority of tanneries, and problems in raw material purchasing due to a scarcity of raw hides and skins. But cash flow issues, high levels of illegal production, huge imports of low quality footwear and leather products, etc., add to the problems.

Table 1a: Livestock population (Russian Federation)

Cattle	27.11 million
Pigs	16.05 million
Sheep	13.04 million

Source: FAO

Table 1b: Estimated production in 2000

Bovine hides:	15.6 million pieces
Sheepskins:	8.5 million pieces

Source: FAO

Table 1c: Exports of raw hides and skins (Russia is estimated to be the 8th largest exporter in the world)

Principal markets by %

Italy	67.3
Spain	5.4
Lithuania	4.0
Slovakia	3.7
Poland	2.8
Belarus	2.3
Thailand	2.0

(In 1999, FAO estimated that the Russian Federation exported 200,000 tonnes of wet salted hides.)

Table 2: Imports of raw hides and skins

Principal suppliers by %

Italy	30.0
Australia	29.9
Kazakhstan	23.1
Turkmenistan	6.3
Spain	3.0
Moldavia	2.1

(All statistics based on information available in early 2002.)

Table 3: Imports of tanned and finished leathers

Principal suppliers by %

Italy	26.8
Ukraine	18.5
China	11.7
Türkiye	9.8
India	6.5
Germany	4.6
Spain	4.5
Poland	3.3
Finland	2.7

Table 4: Imports of footwear

Principal suppliers by %

China	25.7
Ukraine	14.5
Moldavia	12.1
Italy	11.0
Germany	6.1
Türkiye	3.2
Ireland	2.9
Bosnia-H	2.5
Poland	2.4

Table 5: Imports of leathergoods

Principal suppliers by %

China	56.6
Türkiye	10.4
Italy	7.7
Germany	4.4
France	4.0
Australia	2.1
Finland	2.0

When pollution and property meet

A further major problem is the environmental pollution caused by the majority of tanneries. For instance, the Ruscon tannery - one of the biggest chrome tanneries in Russia, manufacturing over 1.2 million sq.m - is located in the centre of Moscow. The tannery, together with its subsidiaries, occupies a huge area and has a capacity of easily 3.7 million sq.m of finished leather a year. The effluent from the beam house and finishing plants,

however, goes directly into the Moskva river with little purification.

The Ruscon tannery also reflects the problem of perceived widespread corruption in Russia. The tannery has been taken over by private investors (a building company, rather inexperienced in leather production) in somewhat mysterious conditions, and the main reason behind the move appears to be the takeover of the huge area of very valuable land in the city centre. (Moscow is today one of the most



expensive cities in the world.) The regular 'escape' of the leather production to other large tanneries seems to confirm those rumours.

Another reason behind the poor demand for leather in Russia is the low production of footwear and leather goods. The country, with a population of 145 million, produces only just over 30 million pairs of shoes a year, with the ambitious plan to produce some 35–35.5 million by the year 2005. Such low production figures mean substantial imports of shoes and leather goods. Although the Russian government last year introduced a 15% import duty, this did not result in any dramatic increase of domestic production.

Illegal imports problem

Russian leather experts estimate that up to 90% of shoes, leather garments and leather goods are imported into Russia illegally, mainly from China, south east Asian countries and Türkiye. This causes heavy losses to the state budget as well as to the domestic leather sector. Probably for

the first time in their history this resulted in organised protests by the Russian Union of Leather Industry Workers, Union of Footwear Manufacturers and Russian Union of Garments manufacturers. More than 800 delegations gathered in Moscow last year to protest against illegal imports and the widespread 'grey' area in the leather and textile industries.

The protesters blamed so-called shuttle-traders or luggage traders for the huge inflow of leather goods to Russia. According to the law, each individual is now allowed to import personally only up to 50kg of goods of value not exceeding \$1,000. Earlier many individuals possessed respective powers of attorney from relatives and friends enabling them to carry multiple 50kg packages. For example, whole trains coming from China (via Mongolia and Kazakhstan) were full of 50kg (\$1,000 value) packages owned in fact by one single person. Double invoicing, tax evasion, sales without invoices and artificial lowering of footwear value are still common procedures.

The Russian Ministry of Economic

Development expects the so-called light industry sector (leather and textile) to grow. This year's plans state that a 3-5% growth may be expected. In 2005 the production growth should exceed the 2001 production levels by some 12-19%, reaching production of only some 35-35.5 million pairs. In 1992, the Russian Federation had produced nearly 220 million pairs of leather shoes. By 1998, this had fallen to 27 million pairs. (The population of Russia is estimated at some 145 million which would leave vast scope for footwear imports of all kinds.)

However, the figures are determined by the availability of leather and raw materials and further increases of customs duties and taxes on the export of raw materials, especially of wet salted and wet blue hides and skins. There are many factors, however, such as the technology of tanneries, the need to replace old machinery, and the relatively low demand of the domestic market (with 40% of the population living below the poverty line) that may undermine the government's plans. ●