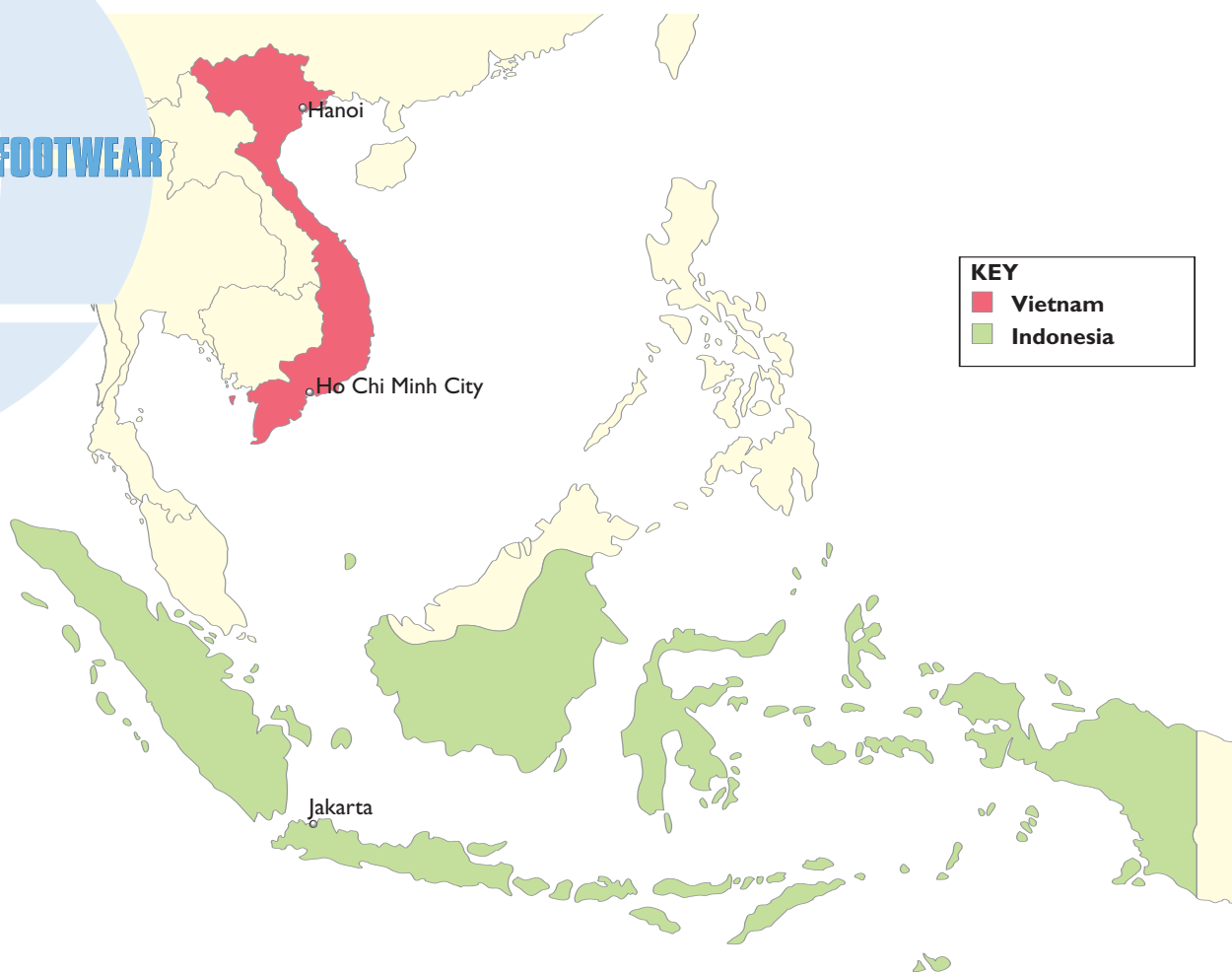


WORLDFOOTWEAR



An economy waiting for the green light

Vietnam hasn't really, like, you know, well, 'happened'. Following the eventual normalisation of relations with the US a decade or so back, great things were predicted for this small country with a troubled past.

Few would doubt its potential: a hardworking, disciplined people, stable, and, apparently, anxious to reap the benefits of a global economy.

The problem lies with the politics. Similar in certain respects to China, with an all-powerful Communist party desperate to retain its privileged position and a centrally controlled economy, except that the Chinese leadership (initially, under the then paramount leader, Deng Xiao-ping) recognised the time had come for the Party to offer its population something more substantive than mere promises of a better future.

The Chinese authorities welcome foreign investment of capital, technology and management technique: the leadership in Hanoi seems suspicious at best. The Chinese leadership was prepared to take risks: the Vietnamese

were not. Whereas in China it seems to consist of two bold steps forward followed by one shuffling step back, for Vietnam it looks much more like one tentative step forward with a full reverse following almost immediately. The 1997 Asian financial crisis highlighted the problems in the Vietnamese economy but, rather than prompting reform, reaffirmed the government's belief that shifting to a market-oriented economy would lead to disaster.

Thus far the Chinese approach—keeping the lid on firmly politically, but permitting change economically and socially at a steady pace—would look the more successful model.

Still, things are changing in Vietnam. The pace may be glacial, but they are there. Many leading footwear manufacturers, including Nike, Reebok, adidas, Diadora, Timberland and Clarks have some production capacity in the country and footwear production is rising. Leather manufacture is on the increase too.

In 2003 Vietnam possessed a

production capacity of 390 million pairs of footwear, 32 million square feet of leather, and 35 million units of bags and handbags. The major portions of each sector are for the lower end of the market. Export sales were hardly stellar but totalled some \$2.3 billion and offered employment to just under half a million people.

Comparative statistics anticipated for 2004 are 430 million pairs of footwear; 35 million square feet of finished leather, and 37 million units of bags; all with an export value of around \$2.5 billion. Those employed in the industry should rise from just under half a million to something slightly in excess of that figure. All of which would indicate that—as with so many developing economies—the leather industry in Vietnam is a substantial employer and a valuable resource for export development.

LEFASO, the Vietnam Leather and Footwear Association which was formed back in 1990, noted in its report of footwear exports in July of this year that Vietnamese footwear is facing stiff ➤

Footwear Imports into the enlarged EU. Top 10 EU-25 suppliers (in 1000 pairs)

	1999	2000	2001	2002	2003	share of imports	% growth 1999-2003
World	984,492	1,033,823	1,160,619	1,239,987	1,442,316	100.0%	46.5%
China	367,695	384,239	415,855	468,704	676,097	46.9%	83.9%
Vietnam	196,148	211,925	275,312	284,028	282,798	19.6%	44.2%
Romania	42,941	51,046	60,988	66,505	72,013	5.0%	67.7%
Indonesia	66,948	66,911	66,105	62,552	53,074	3.7%	-20.7%
India	28,889	29,966	32,789	36,064	41,967	2.9%	45.3%
Thailand	35,442	35,973	36,393	37,428	34,964	2.4%	-1.3%
Türkiye	15,775	14,139	20,081	25,893	30,883	2.1%	95.8%
Hong Kong	30,426	16,757	28,514	26,077	24,944	1.7%	-18.0%
Malaysia	6,991	10,145	14,925	23,076	24,754	1.7%	254.1%
Taiwan	58,256	61,424	50,493	39,824	22,942	1.6%	-60.6%

Products covered : CN Codes 6401-6405. Share of imports: the country's individual share of total EU imports. Source: Eurostat

competition from China in key markets such as the EU and US, and that this competition continues to grow in intensity. Onerous technical barriers applied in those markets only add to the problems.

Nonetheless, during July footwear exports to the EU, the industry's number one market, grew although this was probably due to EU enlargement in the main. The Japanese market and others remained stable, fortunately. More good news comes with the export value in the first seven months of 2004 reaching over \$200 million, equal to 70% of the total footwear export value for 2003.

At present, about 80% of Vietnam's businesses in the sector are involved in contractual production with foreign partners. As a result they are largely dependent on foreign partners for technical equipment, technology, product design, raw material and chemical supplies and, of course, markets. Vietnam regularly imports annually between \$170-230 million worth of imitation leather and between \$80-100 million worth of leather, mainly from Thailand, Taiwan and Korea.

Vietnam Leather & Footwear Association President, Phan Dinh Do, says the leather and footwear industry will concentrate on rising in the ranks from its current eighth place in the league of leading footwear exporters. He pointed to the implementation of five major measures originally laid out in the Association's 2002 blueprint. These consist of:

One: the industry intends to make better



use of its human resource advantages by increasing the training of skilled labour and strengthening managerial techniques so they can operate in a market economy.

Two: capital investment will be intensified and technology up-dated.

Three: more investment will be channelled into developing raw material production and design creativity improved.

Four: the industry will strive to reduce the volume of contractual production and increase direct exports of its products to customers.

Five: product outlets, especially in the US market, will be developed and, at the same time, the industry will continue to improve product designs to meet the demand of domestic customers.

These are long-term measures to realise the industry's development strategy to achieve an export turnover of \$4.7 billion by 2010, according to Mr Do. Of course China is doing much the same, but with the added advantage of a vastly bigger domestic market to tap into while competing economies such as Thailand are already well travelled along this route.

Hopes for a resurgent Vietnamese economy are likely to remain marred by a lack of economic freedom. Transparency International (TI) gave the country a mere 1.3 rating for Economic Freedom in 2003, which put it in the number 138 slot (out of 161).

TI's Corruption survey of 145 economies placed Vietnam at 102, alongside the Philippines. In other south-east Asian countries Indonesia was far worse (133) but Thailand managed 64. More worrying is that arch-competitor China rated 71—not great, but considerably better than Vietnam.

These results, while not crippling in themselves, reflect a perception of Vietnam that is not encouraging. It has been suggested that as costs in China rise—as indeed they are—more foreign investors will look to countries like Vietnam for future development. The notion that China will become uncompetitive contains a fair bit of wishful thinking. Even if true, substantial changes need to be in effect for Vietnam to be ready to take advantage of such a development occurring. 

Indonesia—struggling to maintain its industry

Indonesia has a market-based economy in which the government plays a significant role. It has more than 164 state-owned enterprises and administers prices on several basic goods, including fuel, rice and electricity. In the aftermath of the financial and economic crisis that began in mid-1997, the government took custody of a significant portion of private sector assets through the acquisition of non-performing bank loans and corporate assets through a debt restructuring process.

Background

During the 30 years of president Suharto's 'New Order' government, the economy grew from a per capita GDP of \$70 to more than \$1,000 by 1996. Inflation was held in the 5-10% range, the rupiah was stable and predictable, and the government avoided any domestic financing of budget deficits. Much of the development budget was financed by concessional foreign aid.

In the mid-1980s, the government began eliminating regulatory obstacles to economic activity. The steps were aimed primarily at the external and financial sectors and were designed to stimulate employment and growth in the non-oil export sector. Annual real GDP growth averaged nearly 7% from 1987-1997, and most analysts recognised Indonesia as a newly industrialising economy and emerging major market.

High economic growth from 1987-1997 masked structural inadequacies. The legal system was weak and there was—and remains—no effective way to enforce contracts, collect debts or sue for bankruptcy. Banking practices were very unsophisticated, with collateral-based

lending the norm and widespread violation of prudential regulations, which included limits on connected lending. Non-tariff barriers, rent-seeking by state-owned enterprises, domestic subsidies, barriers to domestic trade and export restrictions all created economic distortions.

The regional financial problems that swept into Indonesia in late 1997 quickly became an economic and political crisis. The initial response was to float the rupiah, raise key domestic interest rates and tighten fiscal policy. However, the rupiah failed to stabilise for any significant period of time and Suharto was forced to resign in May 1998. In August 1998, the IMF agreed an Extended Fund Facility (EFF) that included significant structural reform targets. In January 2000, the IMF agreed a further EFF with the government of President Abdurrahman Wahid, with a range of economic, structural reform and governance targets.

The effects of this financial and economic crisis were severe:

- Real GDP in 1998 contracted by an estimated 13.7%
- The economy bottomed out in mid-1999 with real GDP growth at 0.3%
- Inflation reached 77% in 1998 but slowed to 2% in 1999
- In 1998 the rupiah fell from 2,400/USD in 1997 to 6,500-8,000/USD (It has remained at 6,500-9,000 ever since and with significant volatility)

Current situation

As of early 2005, Indonesia's economic outlook is more positive. Economic growth accelerated to about 5% in 2004, is expected to accelerate further in 2005 and GDP per capita has reached pre-crisis levels. Growth is driven primarily by domestic consumption, which accounts for roughly three quarters of Indonesia's gross domestic product. The Jakarta Stock Exchange was the best performing market in Asia in 2004 and gained some 42%.

Problems that do continue to put a drag on growth, however, include a

sizeable budget deficit of over 1% of GDP, low foreign investment levels, bureaucratic red tape and widespread corruption. There is, nonetheless, very strong optimism as a result of the peaceful elections held during 2004 and the election of the reformist president Susilo Bambang Yudhoyono.

Investment

Since the late 1980s, Indonesia has made significant changes to its regulatory framework to encourage economic growth. This growth was financed largely from private investment, both foreign and domestic. US investors dominated the oil and gas sectors and undertook some of the largest mining projects. In addition, US banks, manufacturers and service providers, expanded their operations. Other major foreign investors included Japan, the UK, Singapore, Hong Kong, the Netherlands, Taiwan and South Korea.

The economic crisis made continued private financing imperative but problematic. New foreign investment approvals fell by almost two-thirds between 1997 and 1999. The crisis further highlighted areas where additional reform was needed. Frequently cited areas for improving the investment climate were the establishment of a well-functioning legal and judicial system, adherence to competitive processes, and the adoption of internationally acceptable accounting and disclosure standards. Despite improvements in the laws in recent years, Indonesia's intellectual property rights regime remains weak; lack of effective enforcement is a major concern.

Under Suharto, Indonesia had moved towards the private provision of a public infrastructure, including electric power, tollroads, and telecommunications. The financial crisis brought to light serious weaknesses in the process of dispute resolution, particularly in the area of private infrastructure projects. Although Indonesia continued to have the

The tsunami of December 2004 wreaked overwhelming human havoc and tragedy on Indonesia. The impact on the nation's economy will be felt for many years, too. Fortunately the country's manufacturing base was largely unharmed.

advantages of a large labour force, abundant natural resources and modern infrastructure, private investment in new projects largely ceased during the crisis.

In May 2004, an Indonesian court may have compounded the country's problems in attracting foreign investment when it ruled in favour of a petition by Indonesian chemical company, Tri Polyta, that a bond issue be declared illegal and nullified, freeing that company of its obligation to repay its debts.

Problems for the footwear industry

In an effort to prevent Foot and Mouth disease from infecting Indonesia the Department of Agriculture is only allowing leather to be imported from America, New Zealand, Canada, Australia, Argentina, Germany and Ireland. As imported leather makes up 40% of the raw materials footwear manufacturers need, this has created a serious problem.

At the same time, the Shoe Manufacturing Association (APRISINDO) has stated that material shortages and political instability have added to the global economic slowdown to cause a serious drop in foreign orders. By November last year, material shortages had resulted in the cancellation of 6,390,000 pairs, which at an average value of \$13 represents \$8,300,000,000 in lost revenue.

At the moment Indonesia's economy and government are very unstable, with widespread public unrest and infighting within the government itself. International fears are causing buyers to switch orders to China, Thailand and Vietnam. APRISINDO has warned the government that Germany, Switzerland, Italy, Japan, Taiwan, Thailand and Singapore have all put Indonesia on their lists of the most dangerous places to invest. Footwear and petroleum are Indonesia's most important exports, and the association fears the entire footwear industry could be at risk if the situation is allowed to continue.

In addition, labour and management disagreements during the past two years have caused many shoe manufacturers to leave Indonesia for China, Malaysia, Thailand and Vietnam. Other major industries such as computer chip and electronic component makers are also reported to be planning to follow. If



the government fails to solve all these problems, foreign investment will abandon Indonesia all together, putting it in serious danger of economic collapse. At its peak in 1996, Indonesia exported 250 million pairs of shoes valued at nearly \$2.2 billion. Last year (2004) it was only \$1.3 billion.

The results

Indonesia's recent experience clearly demonstrates that the path to development is not a one-way street. It also questions the once-popular 'flying geese' theory of economic development according to which, less-developed countries like Indonesia, Thailand and Malaysia follow richer nations such as Japan and Korea up the production hierarchy on an inevitable path to industrialisation. Indeed, the shoe business moved from Japan in the 1960s to Korea, to Taiwan in the 1970s and to China and Indonesia in the 1980s.

The biggest problem is political turmoil as much as economic mismanagement and for which it has only itself to blame. For 32 years, until 1998 under President Suharto, Indonesia failed to build such key institutions as a functioning judiciary and still remains unable to lay down clear and consistent policies. Many say that succeeding governments have compounded Indonesia's problems by effectively unleashing labour unions—whose power was restrained under Suharto—and by implementing regulations that have raised wages substantially and made it harder to fire workers.

This has not only made low-wage China and Vietnam more appealing; some footwear manufacturers have moved to Thailand, where wages are higher than in Indonesia but the investment climate more hospitable. Worse, for Indonesia, there's no evidence that better-paying, higher-tech jobs are replacing the jobs being lost—central to the flying-geese model. All in all, not a happy picture.

REGIONAL SURVEY: INDONESIA

Statistics (2004 estimated)

GDP purchasing power parity	\$758.8 billion
GDP real growth rate	4.8%
GDP per capita purchasing power parity	\$3,200
Consumer inflation	6.6%
Labour force	105.7 million
Unemployment rate	8.7%
Budget—revenue and expenditure	\$40.91 billion and \$44.95 billion

The big players

Branded shoes like Nike, Reebok, and adidas are constant leaders. The footwear industry is dominated by these three brands, which between them provide over 95% of all footwear exports. Korea is the largest investor and mostly in sports shoes. Italy is a growing presence, but mostly in non-sports shoes. However, footwear is now losing its popularity for foreign investors due to its decreasing competitiveness compared to China and Vietnam.

The domestic shoe market has also been hard hit by cheap imports from China and Vietnam, many of which are said to enter the country illegally in order to keep the price artificially low. To protect the domestic market from this type of import, the Indonesian shoe industry—through APRISINDO—will shortly submit a safeguard petition to WTO. Some local brands like Bata, Piero, Specs, Spotec and Newera continue to prosper, but for how long is not clear.

What now?

Almost all sectors of the footwear industry—a significant employer of labour—now face the problem of being less competitive. This is not only apparent in the global market but also at home. A flood of low-priced footwear of all kinds from China has also made a serious impact on local production.

The government is at last taking steps to repair and balance domestic production by strengthening upstream supply in order to support the development of high value downstream manufactured products. All manufacturing industry will be encouraged to utilise local resources wherever possible and the Department for Industry has created a blue print strategy for developing the footwear industry through to 2015. 