



FOOTWEAR: TRANS-PACIFIC PARTNERSHIP

The signing of the Trans-Pacific Partnership could lead to \$450m in annual savings for US brands, says FDRA, as Vietnam-made shoes become tariff-free and sourcing shifts from China.

‘We can’t overemphasise the impact this will have’

After years of delays, debates and frustrations, the 12 countries negotiating the Trans-Pacific Partnership (TPP) have signed a preliminary deal, and for the footwear industry it signals the start of what could be a big shift in sourcing from China to Vietnam. While this has been gradually happening over the past few years, when the deal is finally passed the zero percent tariff to countries included in the deal will further accelerate the trend.

Of the countries included in the deal – Australia, Brunei Darussalam, Japan, Canada, Chile, the US, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam – it is the China-Vietnam-US shift that will affect footwear the most. Wages are around 40% cheaper in Vietnam than China and investment is flooding in.

In the year to the end of September, footwear exports from Vietnam to the US rose 21% in volume and 26% in value – the fourth consecutive year of around 20% growth. It is the

second largest exporter of shoes after China, and while this still falls a long way behind its larger neighbour (China supplies 80%), this is expected to change.

“Historically, Vietnam has been a country that has produced athletic shoes – Nike, adidas, Asics, New Balance and Under Armour have been there for many years – but now we’re seeing a lot more movement to other types of product, so there’s mass footwear now being produced for companies such as Target and Walmart, as well as fashion and leather,” says Matt Priest, president of the Footwear Distributors and Retailer of America (FDRA) which counts 80% of the US footwear industry as members. “While it can never replace China in terms of sheer volume of product, it is becoming an important part of our sourcing paradigm and the growth is really important.”

The FDRA estimates that in the first year alone, the savings will amount to \$450 million for US importers, and more than \$6 billion over

Container ships at Cat Lai port on Sai Gon river, Vietnam, which is set for increased traffic once the TPP is ratified.

 xuanhuongho
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the 12-year deal period. This will result in more jobs along the supply chain as the volumes of imports increase, according to the organisation. "This is a once-in-a-generation opportunity for us to cut into that \$2.5 billion duty bill and that means more innovation in the supply, for mass retail it means lower prices, more footwear jobs, more product coming across our borders so ports are more active, truck drivers are more active, distribution centre workers are more active. We can't overemphasise the impact this will have throughout the supply chain."

From 120 footwear classifications (at the 8 digit level), 108 will be tariff free from the day the TPP goes into force. Eighteen lines were deemed sensitive by the US government and the domestic footwear industry, but even for those, there will be substantial cuts. "For certain athletic lines, we have a 40% cut," adds Mr Priest. "This will create a lot of growth in the industry once it's passed."

Sourcing shift

Vietnam has been preparing for the deal since before negotiations began in 2008. Investment has been pouring in from Taiwanese, Thai and Chinese corporations, building footwear factories in anticipation of the benefits and taking advantage of 'push factors' such as rising wages and skills shortages in China. Wolverine announced last year that while 75% of the company's supplies come from China, it will cut this to a third by 2020 and leave the rest to Vietnam.

However, while many brands have been sourcing from there for decades, questions have been raised over whether Vietnam has the infrastructure and supply chains to cope with much larger volumes of product. There have also been some issues with strikes over wages, although not as many as in neighbouring Cambodia, and the minimum wage was raised 15% to around \$145 from January 2015, which some manufacturers' associations worried could deter brands.

Of course, the tariffs apply to apparel sourcing, too, and here a major sticking point in the TPP negotiations was the 'rules of origin' – namely, how much of the garment had to originate in Vietnam for it to qualify: do the yarn and the textile have to be made there, or can the material be imported, and the garment just cut and sewn? While final details have yet to be released, it seems likely the 'yarn forward' rule will apply, which means Vietnam won't be able to import material from China to qualify, for example, but could import cotton textiles from the US. The Textiles and Apparel chapter includes a "short supply list," which provides TPP partners with flexibilities in cases where members do not produce enough of a particular fabric or yarn to meet production needs.



Matt Priest, president of the Footwear Distributors and Retailer of America, describes the deal as a 'once in a generation' opportunity.

FDRA

For footwear, there was a similar debate. The conclusion was that it depends under which part of the agreement the component falls. For example, leather and rolls of PU will be able to be brought into Vietnam, as they are not classified in Chapter 64 of the Harmonised Tariff Schedule. However, many footwear components such as heels do fall under this category and will have to originate from Vietnam.

"My suspicion is that most of our members will be in a position to use the first rule of origin; it's less onerous, there's less bookkeeping and less dots to connect from a supply chain perspective," says Mr Priest. "There is a lot of fully integrated footwear production; from the material level on, there is everything you need. So you may need to bring in rolls of leather, or PU or zips, but once you get it in you will be able to ship the shoes duty free. The rules are pretty flexible in terms of opportunities."

This will help leather shoe manufacturers: Vietnam's leather supply chain is not as robust as China's, as there are fewer tanneries operating in the country. Observers have suggested the country will need 45% more leather between now and 2020 to service demand. This opens opportunities for other countries to supply the material. India's Council for Leather Exports is targeting a 20% increase in its exports to Vietnam and Brazilian tanneries have been courting manufacturers in the country. Exports of leather shoes from China fell 11% in volume in the first eight months of 2015 compared with the same period in 2014, according to the China Leather Industry Association (CLIA), which could open further opportunities for Vietnam to step in.

Vietnam is also set to benefit from the ASEAN

Economic Community (AEC), which was due to be established by the end of 2015 (although this might run over the deadline). This deal will offer duty-free access to Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Cambodia, Laos and Myanmar. Vietnam achieved shoe sales of \$1.8 billion in ASEAN partner states in 2014, making the prospects for growth under the AEC strong.

Additionally, the European Union and Vietnam last summer agreed in principle to a free trade agreement, which will remove nearly all tariffs on traded goods. The deal, which took more than two years to negotiate, is expected to conclude in late 2017 or early 2018, with some tariffs eliminated gradually over a 10-year period.

Vietnam's leather and footwear association, Lefaso, estimates that the 600,000 footwear workers will increase to around 1 million once these deals are passed.

Losers?

While the TPP represents something of a coup for footwear manufacturers and brands in Vietnam, it might harm trade in other areas.

Indonesia and Cambodia, both of which have burgeoning footwear industries, are not included in the deal, and it could make them less competitive in terms of importing to the US and Japan. Indonesia and South Korea have recently expressed interest in joining.

"Indonesia is the number three supplier to the US market so it's an important aspect," agrees Mr Priest. "As we get close to the end, those that made the decision to sit out are maybe regretting that decision because there's a lot of opportunity. The agreement foresees this kind of dynamic, where countries can join in later, but that is something that's years down the road."

As well as exporting countries, it could also have an effect on countries such as Mexico whose domestic manufacturing will be in competition with cheaper Vietnamese imports. Manufacturing countries outside of the deal might also feel the pinch. For instance, UK-made leather shoes will be at a disadvantage to US shoes in Japan, an important market.

Within the US, there have also been opponents to the TPP. Even though New Balance imports 75% of its shoes, it vocally opposed the deal because of the effect it could have on its domestic operations in Skowhegan, Norridgewock and Norway [Maine] and Massachusetts. "Vietnam doesn't need a reduction in tariffs to continue to thrive," said its director of public affairs, Matt Le Bretton, during negotiations. "We need tariffs to remain in place for our ability to continue to operate here. It is a very simple argument."

Even US-based outdoor brand Patagonia voiced concerns about whether environmental and labour protections will be enforced under

the deal. "The question, ultimately, isn't whether trade is free, which it mostly is around the globe, but who benefits from a new trade pact," stated its CEO, Rose Marcario. "Does it serve the many, in our country and abroad, or only a few – those who have the economic and political muscle to get their interests written, opaquely and without public oversight, into law?"

Increased innovation?

Mr Priest is in no doubt who the deal will serve: brands, retailers, the supply chain and even consumers in the US, he says. If the shoes retail at the same price, there will effectively be higher margins for brands. Where there is a lot of competition between retailers, prices might fall as a bargaining tool.

"It will create innovation and increase revenue for the brands and we're not ones to shy away from counting that as something that's valuable to the industry because of the jobs that our industry creates, and the jobs that depend on our ability to import product, so there will be a lot of benefit to consumers and a lot of benefits to the overall supply chain."

As well as potentially freeing up more money for 'innovation' in the athletic and outdoor footwear sectors, it might also be apparent in terms of less restrictive designs. The current tariff system, which involves 436 categories and is described by Mr Priest as "arcane", means designs are bound by where they falls in the tariff code and how much that duty rate is going to be. For example, boots that are lined with an insulator carry 37.5% duty rate, but if the fur or insulating product stops at the ankle the rate is 10%. "In cold weather it might be nice to have the additional protection but you are currently penalised by adding value in the boot," explains Mr Priest.

However, TPP is not a done deal. All participating countries still have to pass it through their parliaments and agree on the final terms, which could take many more months. In the US, the backdrop of the presidential elections next year could mean debate will get swallowed up, and the further into the next year it gets, the more difficult it might be to finalise under Barack Obama's term, say observers. But Mr Priest is adamant the administration is working "pretty aggressively", publishing the text just a month after the announcement, while the president notified Congress of his intent to sign within 90 days.

"All those things are positive and there's going to be a really aggressive push. That's why we're not waiting to see what happens, we're getting our members excited about it now, so that when the time comes, this thing is teed up and ready to go," he says. "As of now I'm optimistic; if it gets to February and nothing much has changed, we might be having another conversation." 