



**Kommerkollegium**  
*National Board of Trade*

## Adding value to the European economy





# **Adding value to the European economy**

*How anti-dumping can damage the supply  
chains of globalised European companies*

*Five case studies from the shoe industry*

## Executive Summary

The aim of this study is to examine whether anti-dumping measures, traditionally used against industrial goods like steel, are suited for modern globalised trade with consumer goods. We show, using five cases from the shoe industry, that European companies are damaged, not protected, by anti-dumping.

The European industry has become increasingly globalised with supply chains stretching far outside of Europe. Competitive pressures requires successful companies to outsource labour intensive activities to low cost countries. However, just because a shoe is manufactured in, for example, China, does not mean it is a “Chinese shoe”.

The concepts of “production” and “manufacturing” are perceived as the same thing, but manufacturing is often only a relatively limited part of the entire production process, which also contains research, development, design, logistics and marketing, etc. These mostly creative parts of the production process usually add more value than manufacturing and they are mostly carried out in Europe.

We found that, even for a low price shoe, EU value added is above 50 %. For the medium price range EU value added can reach almost 70 % and for up-market shoes, with high design and marketing costs, the EU value added can surpass 80 %. This means that a shoe manufactured in China still can be regarded as a “European shoe”.

Nevertheless, in determining what should be regarded as the community industry, and thereby who should be “protected” against whom, only manufacturing counts. Most of the value added is disregarded, and as a result, shoes that are mostly made in Europe are seen as foreign and run the risk of being subject to anti-dumping. When that happens it means that the EU imposes anti-dumping against itself. At the same time, traditional importers, who are supposed to be the targets for anti-dumping, are probably not as severely affected.

Also in other sectors, such as textiles, furniture and electronic appliances, European companies are potentially negatively affected by anti-dumping. The measures, supposed to affect *imports* to consumers, are often instead affecting the physical *inputs* to a creative European industry. The Lisbon agenda is ill served by deliberate acts to increase the prices of inputs and, in the process, making business more unpredictable.

Our conclusion is that anti-dumping decisions must take economic growth more into consideration. This can perhaps be dealt with by introducing a new community interest test, with focus on preventing that globalised European companies are damaged by anti-dumping.

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## 1. Introduction

The reality of a globalised economy, often talked about in the media and in academic circles, is rarely discussed in relation to anti-dumping. But the question is if globalisation, and in particular outsourcing, has changed the reality in which business operates in such a way that anti-dumping measures lead to new and unexpected consequences? That is the issue we are addressing in this report. This is done by focusing on the difference between manufacturing and the full production chain, and especially on how and where value is created in the consumer goods industry. For the shoe industry, studied in this report, imports are often input goods to the European industry and that changes the way anti-dumping affects business.

We hope our report can contribute to an emerging consensus on how anti-dumping can affect the European consumer goods industry. In a wider perspective we want to connect the discussion on the proper use of anti-dumping with the growth agenda.

### Background

The use of the anti-dumping instrument is controversial. It seems that as soon as the word is mentioned a fierce debate is unleashed between those who favour the use of this trade policy instrument and those who oppose it. There is a fundamental divergence of opinions on the role of the anti-dumping instrument in the world trading system. Is it a necessary instrument, to be used in lack of an international competition authority, in order to prevent companies from engaging in anti competitive behaviour, for example predatory pricing? Domestic companies supposedly can not compete in a fair manner against imports sold at an artificially low price. If so, it can be argued that anti-dumping measures uphold the principles of free trade by trying to correct price distortions. Those with a differing view counter that the anti-dumping duties are part of the problem, not the solution. The duties distort trade by imposing sudden, often arbitrary, duties that serve to protect markets from cheap foreign competition.

In anti-dumping terminology, if the *export price* of a product is less than the *normal value* of an identical product (the domestic price in the exporting country's home market or the price on a third market) then the product is considered to be dumped. After various adjustments have been carried out, the remaining difference between the export price and the normal value is the *dumping margin*. If the domestic industry (the industry producing the like product in the importing market) is suffering injury and that can be shown to be caused by dumping, then anti-dumping measures can be imposed. Normally measures take the form of a duty. Anti-dumping duties are temporary duties levied at dumped goods in order to increase their price.

The use of anti-dumping is regulated in the WTO Anti-dumping Agreement from 1995<sup>1</sup>. The agreement leaves large room for manoeuvre to the individual WTO-members on how to legislate and implement anti-dumping rules. The EU has adopted its own regulation, known as the Basic regulation<sup>2</sup>, outlining procedures for how to manage the anti-dumping system.

With some modifications the Basic regulation remains the same now as when it was adopted in 1995. At the same time the economy has progressively been transformed by globalisation and information technology. Maybe the regulation needs to be adapted to take these changes into account? The Commission has published a green paper<sup>3</sup> which touches upon a wide range of issues for potential changes. It has also invited stakeholders to contribute to the process by replying to the Commissions green paper questionnaire. However, this paper is not a formal part of the consultation process<sup>4</sup> and we are not attempting to directly answer any of the questions posed by the Commission.

### **The European shoe industry as an illustrative example**

Normally, Sweden and the National Board of Trade have argued the case of the consumers. Anti-dumping duties increase import prices which leads to higher consumer prices in the end. Therefore we have argued that regardless of the positive impact anti-dumping *may* have on the industries receiving some breathing room from allegedly unfair competition, it is often wrong to impose anti-dumping. On the whole anti-dumping risks harming the consumers more than it protects the companies and therefore becoming a welfare loss to society as a whole. However, in this study we will focus at the interests of the producers, *the European industry*, and not the consumers.

We have chosen to study the shoe sector, to be more precise the industry producing leather shoes. This is a sector which recently has got much attention as very debated anti-dumping duties were imposed against China and Vietnam. The industry is a *consumer goods* industry, which distinguishes it from the industrial goods industries traditionally most affected by anti-dumping. Shoes are low tech products and we will argue that any problems found in the shoe sector can also possibly emerge in other more advanced consumer goods industries. We argue that shoes are just an illustrative example.

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<sup>1</sup> The formal name for the Anti-dumping Agreement is the "Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994".

<sup>2</sup> Council regulation (EC) No 384/96, 22 December 1995

<sup>3</sup> Europe's trade defence instruments in a changing global economy, 6.12.2006, COM(2006) 763 final

<sup>4</sup> Sweden has sent a formal reply to the Commission in March 2007.

### **Our method: focusing on value added**

Since the concept of *value added* is central to our study it needs to be defined. The value added is the sum of the processes that are applied to input goods, adding value to them and ultimately transferring them into another product. In the case of the car industry, for example, a company buys aluminium for 10 000 euros and makes a vehicle out of it for a price of 20 000 euros the value added is  $20\,000 - 10\,000 = 10\,000$  euros. The 10 000 euros goes to wages for workers and to various forms of capital returns for owners, investors, banks etc. The government gets its share in the taxes paid by both workers and capital owners.

If the difference between price and costs for inputs increase then value added is growing. Taken together, all such activities in the economy create growth and raise GDP. The *Gross Domestic Product (GDP)* is the sum of all value added in a country during a year. An economy striving to achieve high growth, which the EU has committed itself to in the Lisbon agenda, must aim to increase value added activities or, to use a common phrase, “climb the value added chain”.

We found a wider statistical study to be unfeasible as the information we wanted is not available at the aggregate level but requires a deeper understanding of the costing models of the companies from the perspective of the individual company. In order to look closer at the realities of how value is being created in the companies we carried case studies, i.e. interviews with representatives for companies.

For the purpose of helping us with the interviews and understanding the business models of the companies involved we hired a consultant, Paul Verrips of the Netherlands. Mr Verrips has a long background in the shoe industry, in several leading positions and most recently as secretary general and one of the founders of FAIR<sup>5</sup>. Without his expert knowledge and contacts in the business community the study would not have been possible. Mr Verrips has however not contributed as a co-author and the views expressed are those of the National Board of Trade.

We use cost approximations provided to us by the companies to create models which shows how much a certain value added activity in the production process is worth and where it is carried out. By doing this we can show how much of the value (expressed in percentages) is being created in Europe and how much is being created outside of the EU. With this information at hand a discussion is then waged on how the anti-dumping measures affect European production.

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<sup>5</sup> FAIR is the Footwear Association of Importers and Retailers in Europe

### Our five case studies

We have talked to representatives of five companies<sup>6</sup>. The companies have been chosen with a number of criteria in mind. We wanted companies from different countries in the EU, aiming at different market segments (price/quality segment is important for this study) and with different sourcing strategies. The sample should also include small as well as large companies. The companies should be neither pure importers nor traditional European manufacturers. It is the globalised companies we are interested in. Below the companies are listed, and their nationalities, turnover and price/quality segments summarised. We do not claim that these companies are fully representative for the entire European shoe industry. They are just illustrative examples.

Company	Country	Turnover	Price/quality segment
Brownings	UK	12 million pairs	Low to mid
Camper	Spain	3 million pairs	High to very high
DC Company	Italy	2 million pairs	High to very high
Heerkens	Netherlands	1 million pairs	Mid to high (boots)
Intermedium	Netherlands	20 million pairs	Low to high

**Table 1.** The companies included in the study.

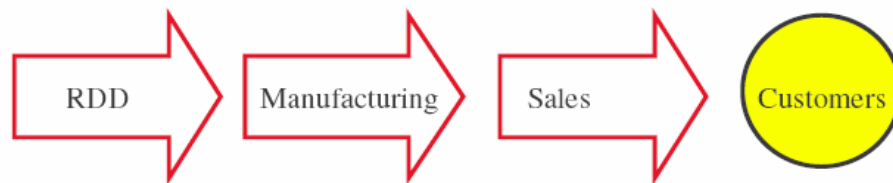
### Three sourcing strategies

To explain our reasoning better there is a need to show what the new globalised business model with outsourced manufacturing looks like. We do this below by discussing three different sourcing models and how they are related to the present anti-dumping regulations.

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<sup>6</sup> Apart from the companies mentioned in the table, we have also been in contact with Nike, but they declined to provide us with any figures.

The present anti-dumping regulations basically divides companies into “European companies” producing in the EU, and importers. The former supposedly have all stages of their production process in the EU and are therefore truly companies with deep roots in the economy of their home country and/or other EU countries. The latter are old fashioned importers, buying goods from abroad and importing them into the community. The “European companies” supposedly contribute more to the European economy than the importers. If some of the importing companies import dumped goods and that constitutes a problem for the European producers, they could ask the commission for anti-dumping duties to be imposed. The commission could decide that there was dumped imports and that they did injure the producers. Anti-dumping could in such cases, at least in the short term, help the affected European producers.



**Business model A.** The traditional European producer.

In order to fully understand how the companies are operating we use three graphical models. Business model A above is a simplified production process, probably possible to apply to shoes as well as to almost any other manufactured goods. It consists of three phases, which we can call pre-manufacturing, manufacturing and post-manufacturing. In reality goods are not produced like this in a chronological order with phase one before phase two, but it serves as a model.

RDD stands for research, design and development. These are activities going on between an idea and actual manufacturing. In the case of the shoe industry, a decision is taken to produce a certain model of shoe with certain design, durability and quality characteristics, certain leather or other materials, and then a prototype is sent to the factory.

Before manufacturing can begin the materials have to be purchased. In the manufacturing stage of the process the shoes are actually manufactured in a factory. Between the manufacturing phase and the sales phase there is also logistics involved.

Finally, the shoes are to be sold. For this a continuous process of marketing is going on with the aim of selling, either directly to the consumers, if the company has its own shops, or indirectly to the retailers.

Another way to look at this is to divide the process into two, namely the tangible manufacturing and the intangible (creative) value added in the RDD and sales phases. In the tangible part of the process the most important input is manual labour whereas in the intangible part the most important input is human capital.

Now, let us look at the case of the traditional importers. What do their business model look like? Again, very simplified, pictured in model B below, their activities are concentrated in the last phase of the process, i.e. sales. They do not create the shoe (no RDD) and they do not manufacture it. This is done by their trade partner, the exporting company. Marketing is still important for them as is arranging the logistics, but much of the value added in the shoe are produced in the pre sales phases. The operation of a importer business is much less complicated than to control a full chain of all stages of production in house.



**Business model B.** The traditional importer.

Then we have the case with the globalised company which is depicted in model C below. The same phases as above are necessary to produce the shoe, but it is not necessary to choose to be fully domestic or to be a pure importer. In order to keep costs low the preferred option for many companies today is to outsource<sup>7</sup> the manufacturing stage to a low cost country. The tangible part of the production process moves away from Europe whereas the intangible remains.



**Business model C.** The modern globalised company.

### What is the community industry?

We have been inspired by some of the questions posed in the green paper questionnaire, in particular those related to the concepts of “community industry” and “community interest”.

<sup>7</sup> Another option is to offshore manufacturing instead, as Danish shoe producer Ecco does. That means not buying from a supplier in a low cost country but to own a factory directly instead. However, this is much less common as many companies consider it inflexible.

In article 4 of the Basic Regulation the concept *community industry* is defined. As it is presently defined this naturally include companies in model A above. Such companies are the traditional European producers, the core of the community industry.

Importers, model B above, are not part of the community industry. Much of the activities related to the goods they deal with are carried out abroad and they do not contribute as much value to the European economy as the domestic producers. This is of course *strictly from a production based value added view* and not in any way an attempt to downplay the vital contributions to the European economy by the importers.

Companies in model C are also not regarded as part of the community industry. If you are importing goods you are not part of the community industry and since these companies have outsourced their manufacturing, they are importers and as such they can be subject to anti-dumping in order to protect their (still fully) European competitors from unfair competition.

The *Community interest* is a public interest test, taking the domestic industry, users and consumers into account. Ideally, with the EU's overall economic interest in focus, it should prevent introduction of anti-dumping measures in cases where, regardless of the interest of the complaining industry, one can "clearly conclude that it is not in the community interest to apply such measures"<sup>8</sup>.

We have shown above that production is not only about manufacturing. By defining "production" as "manufacturing" one risks ignoring most of the value added in many companies and the definition of the term *community industry* risks becoming flawed. We want to show that modern globalised companies are, if not formally a part of the community industry, then at least a vital *community interest*, and that they too add value to the European economy. Perhaps they contribute more to the competitiveness of Europe than the group of companies labelled "the community industry"?

Regarding concrete proposals we will not suggest any drastic new proposals for reforms in the Basic Regulation. We leave it to others to continue research in this area and in the meanwhile, the reader can draw his own conclusions.

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<sup>8</sup> Article 21 of the Basic Regulation

## 2. The European shoe industry and anti-dumping

### The evolution and structure of the European shoe industry

Footwear (or shoes as we call them in this report) covers many types of men's, women's and children's shoes and also more specialised products, like hiking and protective shoes. A range of materials, like leather, textiles, plastics and rubber, are used in the production. Fashion is changing very quickly and companies involved in the sector need to be very customer oriented and able to adapt to changes rapidly. Generally, a shoe is a more complex product than textiles and requires more advanced skills to develop and produce.

Shoes are produced and sold in a very large variety of designs and qualities and the price range can be wide. An extremely low priced pair of shoes can cost no more than 10 euros in a cheap retailer. Otherwise cheap shoes are sold for prices up to 30 euros, mid range shoes for 30-70 euros and high priced shoes cost above 70 euros. There is also a small exclusive market segment for shoes in the range above 140 euros. This different price quality segments are important for our analysis.<sup>9</sup>

Most European production<sup>10</sup> is centered in a few countries, with Italy by far being the largest producer, producing no less than 47 per cent of the EU production in 2003. Italy is followed by Spain and Portugal. The latter is also, together with Romania, and followed by Slovakia, the countries most dependent of the shoe industry for their GDP.

All production figures are hard to interpret as parts of the shoes are often produced outside of the EU, meaning that the figures may well be quite overstated. Companies sometimes outsource the manufacturing of the uppers, which they then import to be assembled with the soles in the EU. A significant proportion of "European made" leather shoes are not fully manufactured in Europe, and actually they are not even mostly manufactured in Europe. Statistics confirm this<sup>11</sup>.

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<sup>9</sup> This information according to Mr Veripps.

<sup>10</sup> All the statistical information comes from the European Commission.

<sup>11</sup> According to Eurostat, the EU imported 66 000 tons of shoe parts in 2005. Half of these imports was leather uppers. If we assume a leather upper on average weigh 150 grams around 220 million uppers was imported in 2005. That is enough for 110 million pairs of shoes. With a production figure from 2005 of 642 million pairs of shoes this constitutes a sizeable part of the EU shoe production. Considering not all shoes are leather shoes and also having in mind the falling production levels and the increasing imports of leather uppers it is obvious that a large proportion of "European made" leather shoes are not completely manufactured in the EU. It is also interesting to note that almost two thirds of the imported uppers go to Italy, meaning that the Italian industry is quite dependent on outsourcing their uppers.

In 2003 there were some 27 000 companies, most of them quite small, active in the footwear industry in the EU25. They were employing about 361 000 workers. The turnover for the industry that year was 26.7 billion euros. Within the overall EU manufacturing industry, the footwear industry accounted for 0.5 per cent of the value added and 1 per cent of employment<sup>12</sup>.

As can be seen by the figures the industry is labour intensive, employing more people than its share of the value added would suggest<sup>13</sup>. This is also the reason why productivity lags severely behind average EU manufacturing productivity. Labour intensive industries can not easily increase their productivity the way capital intensive ones can.

As a result of the Asian competition the European industry is clearly an industry in decline. Between 1995 and 2005 the number of shoes produced in the EU fell from 1.1 billion to 642 million pairs, despite increased consumption. Import penetration is growing and already in 2003 75 per cent of all shoes purchased in Europe were imported shoes. The number of employees have been falling even faster than production and exports are also falling.

### **Distinction between producers and importers blurred**

Up until the end of 2004 the EU had shoe quotas against China. These are now entirely gone. With free trade Chinas share of EU imports (in pairs of shoes) rose from 50 per cent in 2004 to 65 per cent in 2005<sup>14</sup>. The clear number two is Vietnam, with a share of 14 per cent, followed by India and Indonesia. No other country had more than 2 per cent of the EU import shares. Hence, EU imports of shoes is very concentrated to China and Vietnam.

With unlimited sourcing possible from China the European industry finds itself in a new reality. Large scale outsourcing to low cost countries had already taken place<sup>15</sup>, but the possibility of unlimited sourcing from China has proven dramatic. Some companies see big opportunities whereas others see a threat from what they regard as artificially cheap production in China.

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<sup>12</sup> It is likely that these figures also include other activities than just manufacturing in the shoe industry.

<sup>13</sup> With the expansion of the EU to Bulgaria and, in particular, Romania these figures have changed. Romania is a big shoe producer.

<sup>14</sup> Unlike textiles, quotas for footwear was only applied by the EU against China and not other countries. Before 1994 each EU-country had their own quota arrangement and then various measures were imposed also against other countries.

<sup>15</sup> Some of this outsourcing was to other parts of the EU, especially the new eastern members and lately notably Romania. However, for the purpose of this study, we are concerned with outsourcing to countries outside of the EU27.

In February 2006 the European Commission proposed anti-dumping measures against China and Vietnam. This was followed by a prolonged and quite aggressive debate, with quite a few twists and turns, on whether or not to impose such duties and which products to include. The result was an anti-dumping duty, provisionally imposed in April and definitively so in October, against leather shoes of 16.5 per cent against China and 10 per cent against Vietnam.

A number of lobby groups in Brussels, representing the interests of importers versus European producers, tried to influence the final decision. It seemed to be a traditional struggle between the interests of the importers and the interests of the domestic industry. However, things are much more complicated in reality than they might appear.

It could very well be that a significant part of the European shoe producers, represented by their main lobby group CEC<sup>16</sup>, have outsourced parts of their manufacturing. Many of them have also probably partly gone outside of the EU. It is very hard to keep all labour intensive stages of manufacturing in Europe and remain competitive, which we will get back to later and which is also discussed in appendix 6. This means that a significant part of the CEC members are, to some extent, importers. At the same time, quite a few of the members in the importers lobby FAIR<sup>17</sup> are not only importers but also domestic producers as they keep part of their manufacturing within the EU. Some companies are members in both the CEC and FAIR, even though that may appear contradictory. This is a result of rapid globalisation and re-structuring of the business, with companies no longer easily divided into “importers” and “domestic producers”. The phenomenon probably also exists in other sectors of the economy.

Obviously, globalisation makes any clear distinction between domestic producers and importers hard to make. And it therefore gets increasingly hard to say who will get damaged and who will benefit from anti-dumping.

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<sup>16</sup> European Confederation of the Footwear Industry. The abbreviation CEC is for the french: Confédération Européenne de l'Industrie de la Chaussure.

<sup>17</sup> Footwear Association of Importers and Retailers in Europe. There are also other groups representing the interests of shoe importers: FESI (Federation of the European Sporting Goods Industry), FTA (Foreign Trade Association) and Eurocommerce.

### 3. Shoe production adding value to Europe

#### A basic cost build-up model

Table 2 illustrates the costing model of a pair of cheap Chinese made women's summer shoes<sup>18</sup>. The figures have been provided by the Dutch company Intermedium and are based on the costing of a pair of real shoes, to be sold in the EU-market in the summer of 2007<sup>19</sup>. We have rearranged the figures a bit and changed some of the presentation in order for it to better fit the purpose of this report but every figure is real and our way of presenting the figures have been approved by Intermedium.

We will use this basic model as a base for further calculations below. As we will change the inputs (various costs) we will see how the output (the final price) changes and how much value is added to the EU-economy. All the other cost calculations presented later in the analysis are *not* based on real shoe models. Rather, they are approximations provided to us by the companies. The actual figures are not presented in the text but in the appendixes.

Table 2 shows the production process in the same three phases (depicted as boxes) as in the introduction, with a pre-manufacturing phase, a manufacturing phase and a post-manufacturing phase. Again, this is a simplification. It can be argued where some of the costs items should be placed. Maybe they should be moved or maybe they should be distributed in two phases etc? But where a cost item shows up does not matter for our calculations as long as the cost in itself is correct.

The pre-manufacturing costs we have divided into RDD and production and quality controls. RDD involves the work of shoe designers, often travelling around (mostly in Europe) to get inspiration. It also involves developers who focus on such things as choosing the appropriate leather and stitching techniques for a particular design. The designers and developers need to work together to make a shoe which carries the right image and feeling at the same time as it must be physically well constructed<sup>20</sup>. Intermediums design and development takes place mostly in the Netherlands and Italy but also in Germany and the UK<sup>21</sup>.

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<sup>18</sup> When we refer to a shoe we actually mean a pair of shoes.

<sup>19</sup> It should be emphasised that the shoes are from their low cost assortment and that this company is also active in more up market segments.

<sup>20</sup> Also research (the R in RDD) is carried out in the shoe sector but not for every new shoe model. Rather it is a continuous process of researching new materials, etc, that once in a while changes production processes.

<sup>21</sup> A small percentage, negligible for the calculation, of the RDD takes place in Asia as well.

Production controls are checking that production is efficient and on time etc whereas quality controls focus on the quality of the goods. Especially in the beginning of the process, when sample shoes are produced, quality control is essential. Intermedium has a factory of their own in China for making samples.

Furthermore, we have the costs for manufacturing. Intermedium has located 95 per cent of the manufacturing to China. For a detailed view at manufacturing costs, see appendix 1, which shows the costs from the factory in China in Renmimbi. First, we have the materials the shoes are composed of. Intermedium informs the Chinese manufacturer where to find the right kind of leather. Often it comes from Pakistan. Altogether, materials constitute well more than half of the manufacturing costs. In this case, it was a mixed leather-textile shoe. If it had been pure leather shoes the materials' part of the total would have been much higher.

	Euros	Share EU
<b>Pre-manufacturing costs</b>		
RDD	0.90	0.90
Production and quality controls	0.10	0.05
Total pre-manufacturing	<b>1</b>	0.95
<b>Manufacturing</b>		
Materials	2.18	0
Labour	0.93	0
Other costs	0.44	0
Profits	0.37	0
Sales price factory	3.92	0
Sea freight	0.46	0.23
Insurance	0.04	0.04
CIF Europe	<b>4.42</b>	0.27
<b>Post-manufacturing</b>		
Tariffs (8 %)	0.35	0.35
Logistics	0.22	0.22
Sales and administration	0.43	0.43
Profits (gross)	0.23	0.23
Total post manufacturing	<b>1.23</b>	1.23
<hr/>		
<b>SALES PRICE TO THE RETAILER</b>	<b>6.65</b>	2.45
Total value added	4.47	
Retail price (3 times over )	19.95	

**Table 2.** Total costs for a pair of cheap, Chinese made, womens summer shoes. Source: Intermedium.

Then there are labour costs, which includes both manual labour and overhead costs, i.e. administration and management, etc. On top of that there are social costs, for example health care.

We also have a range of other costs. Water is needed for all industrial production and so is electricity. In China an export license is also needed for exports and often trade has to go through companies which have access to these licenses. Then there is the usual depreciation of the value of the machinery as well as interests and taxes.

A price is negotiated between the factory in China and Intermedium. The Chinese factory tries to get a 10 per cent profit margin and in this case they got 9.5 per cent profit out of the total price. The agreed price is then 39.25 RMB for the pair of shoes.

39.25 Renmimbi equals roughly 3.92 euros. That is the sales price from the factory. Then there is the freight to Europe. It is usually carried out by multinational shipping companies, in this case very often Danish owned Maersk. The last part of the costs in phase 2 is insurance, a very small part of the costs.

Turning to the third and last phase the shoes arrive in Europe. The CIF-value<sup>22</sup> is 4.42 euros and, as the tariff rate (not including anti-dumping) for a pair of imported leather shoes in the EU is 8 per cent<sup>23</sup>, the tariff becomes 0.35 euros. After this there are costs for intra European logistics, like depacking and transports to the retailers.

The finally negotiated price between Intermedium and the retailer is 6.65 euros. Since price competition is fierce for mass produced shoes like this, the room for price negotiation is very limited.

When all previous costs have been accounted for there is some money left. In the Intermedium case two thirds of this is required to cover the sales and administration costs. These are costs for marketing and general administration of the business, i.e. overhead costs that needs to be spread out across all products. One third of the remaining money is the profit. Intermediums aim is to have a gross profit margin of 5 per cent of the final price to the retailer. In this case they did not reach the target and got only a  $(0.23 / 6.65 =)$  3.4 per cent gross profit.

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<sup>22</sup> CIF is an Inco term meaning Cost Insurance and Freight. It includes the costs of the manufacturing as well as shipping to an agreed destination. The tariff is calculated with this value as a base.

<sup>23</sup> For shoes made of textiles, plastic and rubber the tariff rate is around 16-17 %.

The retailer, in this case, adds up the price three times and in the shops the shoes are sold for 19.95 euros, a psychologically important price just below 20 euros. Companies in other segments of the market indicated lower mark ups, closer to two times and not three, but that it is not important for the purpose of this report<sup>24</sup>.

### **What is the European value added?**

Now, let us sum up how many percent of the above value added that is European, i.e. how much of the money ends up in Europe (as wages to workers and capital returns to the owners / investors). For each part of the cost build-up process above we will indicate with an underlining how many euros are EU value added. The figures can also be seen in the last column in table 2.

First, RDD is an entirely European affair, adding 0.90 euros to the EU economy. Then production and quality controls we assume are 50 per cent European. The controls must take place where the manufacturing physically is located in China, but it is to a large extent Europeans that are carrying out the controls. Accordingly, we add another 0.05 euros to the European value added.

Manufacturing is an entirely non European affair, but for the freight we make another 50 per cent assumption. The ships are European but the crew normally mostly non-European and the vessels are registered outside of Europe. Where they pay their taxes is difficult to assess. We just add another 0.23 euros. Most European companies of Intermediums size hire European insurance companies, so we add 0.04 euros more for the European insurance.

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<sup>24</sup> Regardless of the origin of a shoe it must in the end be sold by a retailer and therefore at that point of the chain any differences between European made shoes and imported shoes end. The retailer mark up discussion thus falls outside the scope of the report.

Finally, as the shoes arrive in Rotterdam the importer pay tariffs and pay for logistics, both costs totally European<sup>25</sup>. The costs for sales and administration are European as well as the profits go the European owners of the company (and the tax authorities). Consequently, all costs in the third phase contribute value to the European economy. Another 1.23 euros is added. To add up the EU value added of this pair of shoes then:  $0.90 + 0.05 + 0.23 + 0.04 + 1.23 = 2.45$  euros.

How large a part of the total value added does the European value added constitute? To calculate the total value added we must first subtract the costs of the inputs from the sales price to the retailer<sup>26</sup>. The total value added is then  $(6.65 - 2.18 =) 4.47$ . If we divide the EU value added with this we get  $2.45 / 4.47 = 55 \%$ .

Is our 55 per cent shoe a European shoe or not? There is no clear answer to this as there are no overall applicable percentage rule in the EU general rules of origin. If one looks only at the value added of the manufacturing then of course the answer is no. If one looks at the entire process, as we have done, one might say it is *mostly* a European shoe. Most of the value added is European.

The EU value added can clearly be lower than 55 per cent, i.e. we can have globalised European companies with shoes that are mostly not “made in the EU”. Nevertheless, it is hardly possible that a pair of shoes can be produced by a globalised European company with less than 40 per cent at a minimum of the value added ending up in the European economy. In appendix 2 we show a hypothetical calculation for this.

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<sup>25</sup> Concerning tariffs we have a special situation. From the perspective of our method, the higher tariffs the better, i.e. more EU value added. And anti-dumping duties would of course make this even better. However, if the tariffs were lowered or removed then these money would be spread out over various items in our model. Some of it might go to the Chinese producer who could charge more, but much of it would still end up in Europe with the industry, being able to cut costs, and consumers, hopefully getting a lower priced pair of shoes. The part of the gains going to the consumers would not affect our calculation as all it would do is to reduce the overall value added. As for the Chinese manufacturers getting a part of the gains, that would lead to lower EU value added in the shoe with a couple of percentages. However, for higher quality shoes, with more value added in the pre- and post-manufacturing phases, these effects get smaller as the tariff is only based on the CIF price (manufacturing and freight/insurance).

<sup>26</sup> In our case the inputs consists of materials such as leather, textiles, rubber etc, but also electricity and water. We need to distinguish between the former and the latter in this case though. The materials are all traded on internationally competitive markets. If you are a shoe manufacturer in China or if you are in Europe does not matter when you buy the leather you need. For an identical quality you pay basically the same price regardless of where in the world you are situated. Regarding electricity and water there is no international competitive market with similar prices. On the contrary, prices for electricity in China is much different from Europe and to subtract this from the value added would inflate the EU value added. Therefore, we keep those costs in the total value added.

Let us now use this costing model as a basis for various experiments. We start with the lowest possible EU value added, the case of the pure traditional importer (model B in the introduction), and work ourselves upwards all the way to the traditional European producer (model A in the introduction). Along the way we will look at various companies. We will see how much value they create for the European economy and if they are affected or not by the anti-dumping duties.

### **The traditional importer**

Our basic example could be compared to the case of a pure importer, where the only EU value added is in the post-manufacturing phase and to some extent the freight and insurance. The percentage EU value added in a pair of imported shoes of this model is  $(0.23 + 0.04 + 1.23) / 4.47$  which is 34 per cent. Even a pure importer is contributing value to Europe.

The importers are naturally affected by the anti-dumping. But these companies often have no long standing relationships with their suppliers the way the globalised companies have. The globalised company lets someone else manufacture their shoes whereas the importer buys shoes someone else has designed so it is not “their own shoes”. They are therefore more free to “shop around”, finding the right shoes in a shoe fair, for the best offers available at the moment. If the best offers, due to anti-dumping, are not in China or in Vietnam it is easier for them to move their supplies somewhere else. This means that some of the companies that the anti-dumping measures were supposed to affect can probably avoid the worst consequences better than the globalised companies.

### **The boot producer**

Heerkens International Shoe Trade (HIST) is a Dutch family company, founded in 1990 and mainly focusing (70 per cent) on high quality leather boots under their own brand, *Orizonte*. HIST has high quality requirements. Due to the fact that a boot requires more leather than a shoe, material costs are significantly higher than the material costs for an average shoe. An important part of the HIST business model, which distinguishes them from most of their competitors, is that they (due to the superior quality) purchase leather in Italy which is then transported to China where their (almost) sole supplier manufacture the shoes.

The example provided to us by HIST is from their medium quality assortment, sold in the shops at around 90 euros. These boots require limited design and development (for a higher quality boot, RDD would increase though), comparable to Intermedium and Brownings. However, costs for materials increase dramatically, six times more than for Intermedium. Labour costs in China also rise as it takes longer time to manufacture a boot than a shoe, but the profit margin for the supplier remains the same as in the basic example. In Europe costs for logistics increase as boots require more space. Marketing costs are higher for a small company wishing to expose their products, but at the same time profits are higher too for this, more unique boot. See appendix 3 for the calculations.

The sales price to the retailer is 30.03 euros and the value added is 16.47. The EU value added is 9.57 euros and thus the share of total value added attributed to Europe is  $(9.57 / 16.47 =)$  58 per cent. For a pair of boots from their high quality assortment the EU value added would be higher. Also, if one looks at the *value* of the boot, and not the value added, it is even more of an European boot since it is made out of Italian leather. 77 per cent of the value of this boot is made in Europe, including Italian tanneries.

Heerkens was seriously affected by the anti-dumping duties. Considering their reliance on one single factory in China, to which they have such a close relationship that the two companies have almost merged, it was hard for them to avoid. As they had long run contracts, with fixed prices to honour, they suffered losses.

### **The large quantity producer**

There are companies with business models not too unlike the importers. They keep design costs low and instead follow the prevailing trends, and they also keep development costs low. Such a company is Brownings Enterprises. It was founded in 1986 and is based in London, the UK. It is a medium size company active in the low to mid-segments of the market. Unlike the importers, Brownings have their own brand and they also have licenses for other brands. Around 60 per cent of their manufacturing takes place in China and most of the rest in Vietnam<sup>27</sup>.

The example Brownings provided us with is for a shoe in the mid quality segment. It is sold in the shops for around 45 euros, more than double the price of the Intermedium shoe in our basic example.

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<sup>27</sup> A few percent of the shoes are manufactured in Brazil and in Portugal too.

Costs for pre-manufacturing is doubled compared to our basic example. The manufacturing costs are kept down by putting in very large orders and by bulk buying raw materials. Still, the costs for materials are much higher than in our basic example. Mid quality leather simply costs more than low quality. But competition in China and Vietnam is fierce and the profit margin for the suppliers remain the same as in the basic example. In the post-manufacturing phase, costs for marketing are kept down by going directly to the retailers (as well as owning retail outlets themselves) instead of mass marketing directly to the consumers. Nevertheless, it costs considerably more than for Intermedium. See appendix 4 for figures from Brownings.

All in all, the sales price to the retailer is 15.3 euros and the value added is 9.91 euros. The EU part of the value added is 6.68, which means the EU share of value added is  $(6.68 / 9.91 =)$  67 per cent. This is a much higher figure than for Intermedium and Heerkens, which shows that medium quality sometimes has about the same “European content” as low quality (Heerkens close to Intermedium), but sometimes it is much higher.

Brownings was saved from any great losses by the anti-dumping due to its quick turn around. They can get a new shoe on the market in four to six weeks, which can be compared to the sporting shoes industry where it can take several years. Shortly after the anti-dumping had been imposed the company already had a new collection, with newly negotiated prices, coming. As a result, direct losses were limited.

### **The Italian design based producer**

Moving up the price/quality ladder and going to the centre for the European shoe fashion industry, we find the DC Company. It is situated in Merone, north of Milan in Italy, and is a fairly small company producing shoes of high and also super high quality and pricing. They are European license holders of shoes for US brands Levis and Spalding and they also have their own brand, U-roads, with a patented technology with soles made out of recycled tires. Most of their manufacturing takes place in Vietnam but they also produce in China. They still keep some manufacturing in Europe, in Portugal and Romania, but they closed operations in Spain in 2005. It had become too costly.

The example provided to us by the DC Company concerns a shoe from their high quality, but not super high quality, assortment. It is sold in the shops for 149.95 euros. DC shoes require much larger costs for RDD than in our basic example. Design costs are very high. Costs for pre-manufacturing increases *26 times*. Manufacturing costs in Vietnam also increase markedly, almost nine times. Some of this is attributed to higher labour costs associated with higher skilled workers and longer production hours, but the overwhelming part of the increased costs for manufacturing has to do with vastly higher costs for leather. These kind of shoes require top quality inputs. For our calculation this means that the costs in Vietnam are still kept down compared to the costs in Italy as the leather is not part of the value added. Finally, for the post-manufacturing phase the big differences compared to the other companies is marketing and logistics. Obviously, Levis shoes require expensive marketing but also, as the shoes are sold in such small quantities, they need to be stored in warehouses, which is very expensive. Logistics for the other companies is leaner and based on large quantities and thus cheaper. For the figures from DC, see appendix 5.

The sales price to the retailer for these shoes is 77.79 euros and the value added is 50.79, after having deducted for the leather. The EU value added is 40.37 so the EU share of the total value added is  $(40.37 / 50.79 =) 79$  per cent. This is much more than for the low- and medium quality segment of the market discussed above. Is it an Italian or Vietnamese shoe? There is no answer to that, but the case shows the point that, for high quality consumer goods, value added mostly stays in Europe even if manufacturing is outsourced.

The DC Company was affected by the anti-dumping duties. They could not pass the price raise on to the retailers as they had already agreed on the price for the season. As a result, they suffered a loss. An anti-dumping duty in the order of 40-50 per cent would, according to the company, effectively have put them out of business.

### **The life style brand**

Camper (meaning peasant in Catalan) is a Spanish company, based in Palma de Mallorca. It was founded in 1975 but its roots as a family company goes back 120 years. In the 1980s the company went into retailing and started their own shops, which then expanded internationally all over the world in the 1990s. This means that, unlike the other companies in our study, Camper exports outside of Europe. Today Camper is one of Spain's leading shoe producers and retailers.

The company produces a wide variety of shoes in the high end part of the price quality range. Half of the manufacturing takes place in China and the other half in nearby Morocco. The shoes require high costs for design and Camper was awarded the Spanish National Design Award in 1998, not for a particular design but for the entire design concept of the company. The company today portrays itself not as a mere producers of shoes but as a modern healthy life style company with an environmental profile, and has also diversified into the hotel and restaurant business. To convey a united message of the lifestyle the company tries to project requires expensive marketing. Camper needs to keep its brand strong and has sponsored various athletic activities and more recently cultural events.

Camper declined to provide us with any figures. Instead we showed them our model and asked them to calculate themselves, based on an average shoe of theirs (high but not very high quality) without revealing any costs for the activities. The figure for EU value added they came up with was roughly 80 per cent. This is in the same level as the DC Company, which is not surprising as the companies compete in the same high end part of the value chain. However, it does not mean that Campers costs and cost structure is similar to DC, it only means that 80 per cent of the value added is European.

Due to the fact that half of their shoes are manufactured in Morocco Camper managed to avoid much of the anti-dumping. However, for the Chinese part of the manufacturing they had to absorb a loss.

### **The traditional European manufacturer**

There are still producers with all manufacturing in Europe. Some of them are very traditional companies, keeping all stages of the process in the home community, but there are also many cases companies outsourcing within the EU. Italian shoe companies have recently moved much of their manufacturing to Romania<sup>28</sup>. Whether this is a viable strategy or not, and the wider question if shoes (except very up market ones) can be manufactured in Europe at all, is outside the scope of this study. However, in appendix 6 we discuss this topic.

Obviously, the traditional manufacturers were not negatively affected by the anti-dumping duties. If they manufactured the shoes fully within the EU they were considered part of the community industry. These companies got a short breathing space and they can get a boost from the fact that they can avoid a cost that many of their competitors can not avoid.

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<sup>28</sup> According to ISAE, already in 2004 53 % of shoe companies in the Italian shoe manufacture centre of Montebelluna had moved some or all manufacturing abroad.

### The effects of anti-dumping

Provisional anti-dumping duties were imposed in April 2006, followed by definitive duties in October. Naturally, and as intended, the measures did not affect the traditional European manufacturers but they did affect the traditional importers. The fact that anti-dumping measures risk leading to welfare losses for Europe is of course well known but it is a risk a majority of member states have chosen to take. What is not so well known is the damage it might inflict on the globalised firms.

We are not going to go through how much anti-dumping duties each company had to pay. But let us use the Intermedium case as an example. Assuming everything else stays constant, then, with a China (Vietnam) anti-dumping rate of 16.5 per cent (10 per cent), the tariff to be paid is 0.73 (0.44) euros. Now the shoes would have to be sold in the shops for 22.14 (China) or 21.28 (Vietnam), which, according to Intermedium is clearly not possible with such low quality shoes. The psychological impact of raising a price from just below 20 euros to a bit above should not be underestimated. Consumption may well drop dramatically if the price passes a certain psychological threshold.<sup>29</sup>

Consequently, something needs to be squeezed. There are a range of possibilities: lower prices paid to the factory in Asia, lower profit margins for Intermedium, lower profit margins for the retailer and, finally, higher consumer prices. A combination of some or all of these changes are likely to occur.

However, so far damage might have been limited and the squeezing have been moderate. Several companies stressed that they have been saved by the dollar. The anti-dumping duties were offset by the depreciation of the dollar. However, imagine what would have happened if the dollar instead had appreciated. The double effect of duties and dollars may then have forced companies out of business. At least this is what some of the companies indicated.

The impact of even a small change in costs can thus be considerable on a competitive market. Nevertheless, all the companies pointed at uncertainty as the worst part of all this. As one company puts it “We can share the burden of anti-dumping but the uncertainty we have to pay for ourselves”. For business, uncertainty is often the worst possible situation as it makes investment decisions and all commercial planning hard. It delays and complicates the activities of the companies to such an extent that it is harmful.

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<sup>29</sup> This is calculated as a percentage on top of the CIF-price and then this sum is added to the sales price to the retailer, who sells the shoes with his original three times mark up.

### Summing up the companies and strategies

In table 3 we have listed the companies (or sourcing strategies) according to the share of the value added they produce that contributes to the European economy and where the shoe has been manufactured (“made in”). As can be seen, where the shoe has been manufactured has little to do with where the value has been created. In all the globalised companies EU value added is above 50 per cent. As discussed in appendix 2, EU value added can go below 50 per cent, even though it is unlikely. It is more likely that it for many companies goes above the 50-70 per cent range where the low- and medium quality shoes in our case studies end up.

Company	Share EU value added	“Made in”
Traditional manufacturer	100 %	The EU (Italy, Spain etc)
Camper	Roughly 80 %	China and Morocco
DC Company	79 %	Vietnam and China
Brownings	67 %	China and Vietnam
Heerkens	58 %	China
Intermedium	55 %	Almost only China
Traditional importer	34 %	Mostly in China and Vietnam

**Table 3.** How much of the value added of a shoe is produced in the EU? And where is the shoe manufactured? The table only shows figures for individual companies and sourcing strategies, not for overall EU-production.

We also met representatives from Nike. They could however not provide us with figures so we could not include them in the study. Nevertheless, it deserves to be mentioned that what is extremely costly in the case of sports brands is the costs for marketing. They sponsor everything from major sport events and super stars to local soccer clubs. They also invest comparatively much in RDD, and hold several patents for their shoe technology. It is reasonable to assume that sport brands would end up with very high EU value added if we could have made the calculations.

Intuitively one might react to table 3 and think that 100 per cent is better than any figure below 100 per cent. If we are aiming for maximum EU value added we should go for 100 per cent and nothing less. So we should support the traditional manufacturers. Perhaps they should be protected from supposedly dumped shoe imports? From the very limited and purely value added perspective we have used in this study, disregarding all other arguments against such a policy, that seems reasonable. But such a policy is not possible, unless the EU would use very drastic measures, since inexpensive production capacity of the kind offered in East Asia is not available in Europe, at least not to the extent necessary. There is room in the market for some traditional shoe manufacturers but the room is limited. It is simply too costly, as discussed in appendix 6. Instead it is the globalised companies that offer the best realistic possibility to retain value adding activities in Europe.

#### 4. Anti-dumping and European competitiveness

Traditionally, anti-dumping has mostly been used in the steel and chemicals sectors, where companies operate more as pure importers with a totally different structure of their value added. In the case of steel, it needs little design. Development, if needed, often takes place in the exporting country. It also certainly needs less marketing, geared as it is directly to the industries. In contrast, the costs of manufacturing can be high. For example steel production is very energy intensive. Consequently, the manufacturing costs constitute a larger part of the total value added. It is likely that the majority of the value added of the steel imports are produced outside of the EU. If anti-dumping is imposed against steel, then the EU does not risk injuring the European steel industries value added as much as in the case of shoes. This particular problem of anti-dumping gets smaller. We can therefore draw the conclusion that anti-dumping is better suited, from a strictly value added perspective, to deal with steel and chemicals than shoes.

This study has focused on the shoe industry but we clearly believe that the discussion could be applied to most other sectors of the EU consumer goods industry as well. Although few consumer products have been affected yet by anti-dumping the risk is that they will be targeted. There is a rising trend, beginning in the middle of the 1990s and accelerating in the 2000s, in consumer products being subject to anti-dumping. Products as diverse as bicycles, colour television receivers, side-by-side refrigerators, low energy lamps and bed linen have been affected. For most of these goods the imposed duty has also been considerably higher than in the shoe case.

The figures on value added for other consumer goods industries would of course differ a lot, but the basic situation remains the same. Manufacturing is relatively expensive in most of Europe. Even if opportunities exist to manufacture inexpensively in some of the new member countries, as discussed in appendix 6, the opportunities are limited. Therefore companies are moving such manufacturing out of Europe to low cost countries, mostly in East Asia. Precisely because the costs for manufacturing are so low in these countries the part of manufacturing in total value added becomes low. For many goods therefore, manufacturing constitutes only a minor part of the total value added. Most of the value added remains in Europe in the phases preceding and following manufacturing. We can perhaps not see it as easily as before, as the factories have closed. But value is still being created in Europe and in many cases it is probably more value than before. Old industrial jobs vanish, but new jobs, often better paid, are created.

Let us mention a few examples of other sectors that could potentially be affected. An industry similar to the shoe industry is the clothing and textiles industry. It has also to a very large degree outsourced manufacturing, mainly to China, whereas design and marketing remains in Europe. So far anti-dumping cases have been quite rare in this sector, but knowing that that the temporary import restraint towards China will cease the 1<sup>st</sup> of January 2008, this might soon change. The risk is that European designed and marketed clothes will become more expensive if the supply chains are disrupted by anti-dumping or threat of anti-dumping.

The furniture business is another business that could be under threat. Some furniture is quite up-market, hand made products, perfectly possible to manufacture in Europe, but there is also a large market for mass produced furniture, sold at very low prices, and impossible to produce in most of Europe in a competitive way. Also here value added consists of design and development, probably constituting a large part of the value added of the chairs, tables and cup boards Europeans have in their homes and work places. As with shoes and clothing we argue that the actual furniture, or pieces of furniture, are inputs in the production of European goods.

Shoes, textiles and furniture are all low tech goods. For high tech consumer goods research costs are much higher. As research is carried out in Europe this implies that the EU value added easily can surpass the figures we got for the shoe industry. Europe has a viable industry for electronic consumer goods, like mobile phones and other gadgets and household appliances. Apart from research and development their value added consists of design and marketing. The actual physical product, for example a mobile phone manufactured in Malaysia, is often not very important for the GDP of the EU (but it is for Malaysia). By imposing anti-dumping duties against electronic consumer goods that are “too cheap”, input costs go up for companies active in an already very cost conscious market, and it indirectly aids Europe’s American and Japanese competitors. Maybe workers in an assembly line in Europe can retain their jobs for some time, but the cost might be that engineers lose theirs. And that could clearly be a net loss for Europe.

The examples mentioned in this chapter are not researched. However, it would be interesting to have a closer look at this and to learn more about the value added activities in different sectors of the European economy. Such studies should be linked with a discussion on anti-dumping in order to focus on the connection between growth and trade defence measures.

## 5. Conclusion

The fairly simple question of what it means to produce in Europe, and be a part of the community industry, can no longer easily be answered. Equating production with simply manufacturing means ignoring a large and important value adding activity in Europe.

In today's globalised economy the production of goods is often spread out across several countries. Manufacturing is only one part of the whole production. For many consumer goods, manufacturing takes place in low costs countries whereas the phases of production preceding and following manufacturing takes place in Europe. Such, often quite "creative" activities, include research, design and marketing. Since the creative parts of production is not as visible this leads to the European industry producing goods that are "European" but seen by many as "foreign" just because they are manufactured abroad.

Concerning companies in the modern globalised European shoe sector, manufacturing is to a large extent carried out in China and Vietnam. Costs for manufacturing in these countries are low and this means manufacturing as a part of total value added is low. Even for a cheap shoe, with low costs for research, development, design and marketing, most value added does not lie in manufacturing. More than 50 per cent of the value added is in Europe. For shoes of medium quality, manufactured outside of the EU, the European value added in our study ranges between almost 60 per cent to almost 70 per cent and for high quality shoes it can surpass 80 per cent. For high tech goods, with European based research and development, it is not unlikely that these figures can be even higher. Most value added is in the creative phases of production, and those phases are mostly performed in Europe. They contribute jobs, incomes and know-how to the European economy.

In the debate on globalisation the argument is often heard that Europe should concentrate on activities adding maximum value and leave the low value adding activities, such as manufacturing shoes, to low cost countries as the best way for Europe to stay competitive. If Europe "climbs the value added chain" it spurs growth and it will take Europe closer to reaching the targets of the Lisbon agenda.

However, value added is not a factor taken into account in the application of the anti-dumping regulation. As a result, companies in an industry such as the shoe industry, that contributes to the European economy, can have their supply chains damaged by the very same measures that are supposed to protect the industry. What is believed to be *imports* competing with European producers is actually often rather physical *inputs* to the European industry. When anti-dumping measures are imposed against such goods it means the EU is using the instrument against itself. The industry is then not protected by anti-dumping but rather damaged by it. More expensive inputs makes the European industry less competitive and this in turn can contribute to losing market shares and thus value added.

Those who argue that the anti-dumping duty is only a small extra cost, only based on the small costs of manufacturing, are partly right. But competition is fierce and a few per cent extra can make all the difference in some sectors. What is perhaps more important is the unpredictability caused by anti-dumping. For companies, the world economy is volatile enough as it is to not also have to deal with lengthy political processes that may end up with an anti-dumping measure of unknown size and scope.

The main problem is that decisions on anti-dumping do not take the economic growth agenda into consideration. Companies that add value to Europe are being, or risk being, damaged. Clearly, the globalised companies and their interests must be given a much larger weight in the decision making process. Their competitiveness should also be in focus, not only the traditional manufacturers.

This must probably be addressed by looking at the concepts of community industry and community interest and the definitions of those terms as well as how they are applied. A way to take the globalised companies more into account is to reform the community interest test. The test has been established in an attempt to balance the interest of various economic actors. It could be refashioned to much more than today take into account the globalised companies and the value they are creating. It should also ensure that vital supply chains are not damaged and that the wider competitiveness of the EU economy is not injured.

One way to put it would be to say that the community interest test should ensure that the desire to protect EU manufacturing from foreign dumping must be subordinated to the wider aim of protecting value adding activities in Europe. If the EU can not *protect manufacturing from dumping at the same time as it protects value added from anti-dumping*, the EU should refrain from using anti-dumping.

More research and discussion is needed. We have identified a problem, one that might grow over time, and we want to establish a common understanding that this really is a problem. By establishing two basic facts we have come some way. First, *manufacturing is not the same as production* and, second, *imports, even if they appear to be consumer goods, are often inputs*. If this is ignored and the EU continues to use anti-dumping against an increasing number of consumer goods, just like it has been used earlier against industrial goods like steel, it will damage European competitiveness.

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## Appendixes

### Appendix 1. Costs of Intermediaries Chinese supplier

<b>Materials</b>	<b>RMB<sup>30</sup></b>	
Upper	8.19	
Linings	1.29	
Soles	6.67	
Gold glue	0.80	
Stitching thread	0.20	
Other materials	0.17	
Export cartoon pairbox	2.60	
Transport cost	0.40	
Development costs	1.50	
<i>Materials. Total</i>		<b>21.82</b>
<b>Labour</b>		
Labour (workers)	5.32	
Labour (overhead)	3.50	
Social costs	0.50	
<i>Labour, total</i>		<b>9.32</b>
<b>Other costs</b>		
Water	0.15	
Electricity	0.50	
Export license cost	0.50	
Equipment rate	0.35	
Interest rate	0.50	
Profit tax	2.39	
<i>Other costs, total</i>		<b>4.39</b>
<b>Profit margin</b>	9.5%	<b>3.72</b>
<b>Final sales price factory</b>		<b>39.25</b>

Manufacturing costs for a pair of cheap women's shoes from China.  
Source: Intermedium.

<sup>30</sup> Exchange rate march 2007 approximately 1 EURO = 10 RENMIMBI

## Appendix 2. As low European value added as we can get...

For production of *very* cheap shoes to be possible costs need to be squeezed all over. In Europe one can lower the profit margins or decrease marketing costs. One can also more or less imitate other companies designs and by doing so decrease costs for RDD. In doing all this “the European content” in the shoes can fall below 50 per cent.

There is also the possibility of cost increases in China or wherever the shoes are manufactured. Let us make the unrealistic assumption of a tripling of manufacturing costs in China. Labour costs in China are indeed rising, as a result of tighter supply of labour. Annual wage rises of 10 per cent have been reported<sup>31</sup>. The various items under the heading other costs can change too. Most likely they will not fall but they may rise. Water may be scarcer and more expensive and carbon taxes might increase the costs for electricity. Interest rates may rise too, as the Chinese government tries to cool down the economy. Also, profit taxes might increase.

Nevertheless, a tripling in costs for manufacturing is not realistic in any way. It only serves as an experiment. The company in Europe would now have to pay (see sales price factory)  $3.92 * 2 = 7.84$  euros more than before. More tariffs revenue is collected in Europe (8 per cent of the new price is 0.98) which increases the EU value added with  $(0.98 - 0.35 =)$  63 cents. The new EU value added is then  $(2.45 + 0.63 =)$  3.08. The final price as the good is sold to the retailer is  $(6.65 + 7.84 + 0.63 =)$  15.12. This price minus the costs for materials is  $(15.12 - 2.18 * 3 =)$  8.58. The new EU value added is thus  $(3.08 / 8.58 =)$  36 per cent. This does not take changes in the profit margin into account. The profit is assumed to stay the same in euros, but would sink dramatically in percentages. No company could accept such low profits and therefore the profits would have to rise and thus EU value added increase. Otherwise, the company might go bankrupt. Therefore it is highly unlikely that EU value added could be pushed below 40 per cent.

There are also other external factors, outside the control of the company, than manufacturing costs that could change. What would happen if oil prices doubled? The answer, for our calculation, is probably very little<sup>32</sup>. Concerning changes in the tariffs it is hard to say how they would affect the outcome, but also here the likely effect is small<sup>33</sup>.

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<sup>31</sup> New Economist

<sup>32</sup> With our assumption of 50 % EU value added for the freight any change in this cost will not alter the outcome. And the freight is such a small part of the total costs that trade will not easily be affected. Concerning internal EU logistics only some of it is dependent on oil prices. Warehouses and depacking are not.

<sup>33</sup> This is because the money not collected in tariffs would be spread between the manufacturers in China, who could charge more, and the importers in Europe, who could pay less. Also, hopefully, the European consumers would gain.

**Appendix 3 – Costs for Heerkens (HIST)**

	Euros	Share EU
<b>Pre-manufacturing costs</b>		
RDD	1.24	1.24
Production and quality controls	0.1	0.05
Total	<b>1.34</b>	1.29
<b>Manufacturing</b>		
Materials	13.56	0
Labour	3.75	0
Other costs	0.41	0
Profits	2.52	0
Sales price factory	20.24	0
Sea freight	0.33	0.16
Insurance	0.04	0.04
CIF Europé	<b>20.61</b>	0.20
<b>Post-manufacturing</b>		
Tariffs (8 %)	1.65	1.65
Logistics	0.46	0.46
Sales and administration	2.49	2.49
Profits (gross)	3.48	3.48
Total	<b>8.08</b>	8.08
<hr/>		
<b>SALES PRICE TO THE RETAILER</b>	<b>30.03</b>	9.57
Total value added	16.47	
EU part of total value added (9.57/16.47)	58 %	
Retail price (3 times over)	89.95	
EU value (9.57 + 13.56 ) / 30.03	<b>77 %</b>	

#### Appendix 4 – Costs for Brownings Enterprises

	Euros	Share EU
<b>Pre-manufacturing costs</b>		
RDD	1	1
Production and quality controls	1	0.5
Total pre-manufacturing	<b>2</b>	1.5
<b>Manufacturing</b>		
Materials	5.38	0
Labour	0.95	0
Other costs	0.87	0
Profits	0.7	0
Sales price factory	7.9	0
Sea freight	0.45	0.23
Insurance	0.05	0.05
CIF Europé	<b>8.4</b>	0.28
<b>Post-manufacturing</b>		
Tariffs (8 %)	0.67	0.67
Logistics	0.22	0.22
Sales and administration	2	2
Profits (gross)	2	2
Total post manufactruing	<b>4.9</b>	4.9
<hr/>		
<b>SALES PRICE TO THE RETAILER</b>	<b>15.3</b>	6.68
Total value added	9.91	
EU part of total value added (6.68/9.91)	<b>67 %</b>	
Retail price (3 times over)	44.95	

## Appendix 5 – Costs for the DC Company

	Euros	Share EU
<b>Pre-manufacturing costs</b>		
RDD	23	23
Production and quality controls	3	1.5
Total pre manufactruing	<b>26</b>	24.5
<b>Manufacturing</b>		
Materials	27	0
Labour	4.2	0
Other costs	1.1	0
Profits	3.3	0
Sales price factory	35.6	0
Sea freight	0.45	0.22
Insurance	0.05	0.05
CIF Europé	<b>36.10</b>	0.27
<b>Post-manufacturing</b>		
Tariffs (8 %)	2.9	2.8
Logistics	5.0	5
Sales and administration	4.3	4.3
Profits (gross)	3.5	3.5
Total post-manufacturing	<b>15.69</b>	15.60
<hr/>		
<b>SALES PRICE TO THE RETAILER</b>	<b>77.79</b>	40.37
Total value added	50.79	
EU part of total value added (40.37/50.79)	<b>79%</b>	
Retail price (2 times over)	149.95	

This is Levis, not U-roads, i.e. high but not very high quality.

## Appendix 6 - Manufacturing in Europe

Wage rates, as well as other labour costs like social contributions, varies enormously across Europe and to compare with manufacturing in China one must have a comparable EU wage rate. According to UBS the average wage, including social contributions, for an unskilled worker<sup>34</sup> in Shanghai in 2006 was 2 499 USD. In the interior of China that can be halved<sup>35</sup>. That could be compared with some of the cities in the main shoe producing countries in Europe: Milan (28 602), Rome (27 342), Barcelona (34 034), Madrid (28 084), Lisbon (14 036), Bratislava (12 423) and Bucharest (7 392), which is the cheapest one can get in the EU.<sup>36</sup>

This means that average labour costs in Italy are around 20-25 times higher than in the interior of China. If we instead choose to compare labour costs in relatively cheap Romania with relatively expensive coastal China then Romania is only three times more expensive.

But we also have advantages of manufacturing in Europe. Keeping manufacturing to Europe means not having to pay for freight and tariffs. More importantly, productivity is higher in Europe. Let us make the assumption that the average European is three times as productive as the average Chinese<sup>37</sup>.

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<sup>34</sup> Figures are for a construction worker but as close to a worker in the shoe manufacturing industry as we can get.

<sup>35</sup> New Economist.

<sup>36</sup> These wages rates are not, as for China, for unskilled workers but for skilled. The reason for this deliberately asymmetric comparison is that shoes are produced by different kind of labour in China and Europe. In China it is typical with young unskilled workers, whereas in Europe a typical shoe factory worker is a skilled craftsman with many years in the business.

<sup>37</sup> This is based on data from the OECD. We have compared GDP per hour worked between EU14 (EU15 minus Austria) and Mexico, used as a proxy for China. The average European worker is 5 times as productive as the average Mexican. However, for the same monthly wage the Chinese workers work more hours so if we adjust for that, then perhaps we can say that for a given wage a European is three times as productive as a Chinese.

Now, compare Europe's foremost shoe manufacturers Italy and Spain with the interior of China, which is where the manufacturing is now moving. 20 times higher labour costs, adjusted for Europeans being three times as efficient, means 7 times higher labour costs in Europe. For the shoes in our basic example that would mean  $(0.93 * 6 =) 5.58$  euros higher costs. At the same time tariffs, freight and insurance would disappear and the new price for the shoes as they are sold to the retailer would be  $(6.65 + 5.58 - 0.35 - 0.46 - 0.04) = 11.38$ . It should be emphasised that this is not in any way an exaggeration, quite the contrary. We have ignored other cost driving factors than labour<sup>38</sup>.

If the retailer wants a three times profit margin on that he would have to sell the shoes for 34.14 euros<sup>39</sup>, which is a 75 per cent increase of the original price. So if labour costs increase seven times this results in at the very least a 75 per cent increase of the retail price. Would the consumers buy these shoes? One has to remember that this was really low priced and low quality shoes, supposed to be sold to price conscious consumers. According to the companies, they would not buy it. The retailer might have to cut a bit in the profit but even if he were to accept to much lower margin the shoes would still be markedly more expensive than if they had been made in China. And for cost conscious consumers even small price differentials can make all the difference.

Consequently, the business of manufacturing such shoes in Western Europe is not viable. Instead of ending up with 100 per cent EU value added we get no value added at all. A welfare loss for the European economy, as shoes which could have been produced were not produced.

What about outsourcing within the EU then? Let us move manufacturing to Romania. Let us also compare with relatively high cost Shanghai instead of the interior of China. Romania is only three times as expensive as China. Unfortunately, we have no productivity figures for Romania so we can not compare actual production costs. However, considering that Romania is much poorer than the rest of the EU, it is likely that the productivity gap to China is not very large. Maybe the increased costs for producing in Romania and the productivity differential almost cancel each other out, making Romania a viable option to China? If our assumptions are right that means manufacturing of cheap shoes in Europe is possible after all. And this is not only in theory, it is happening.

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<sup>38</sup> Electricity, water and VAT would probably be higher as well as the profit, as a 10 % profit on top of high labour costs is more than 10 % profit on top of low labour costs.

<sup>39</sup> Intermedium also calculated on this and came up with a similar approximation, with a retail price of 38.46 euros.

However, Romania is only to some extent an alternative to China and not a substitute. Romania attracts large investments from richer European countries, not least from the Italian shoe industry, wanting to benefit from the cheap labour. At the same time the labour force of Romania is very limited, shrinking, aging and moving west. The supply of craftsmen appropriate for shoe manufacturing is, to say the least, quite limited. Romania will for some time be an alternative for EU manufacturing of low cost goods, including shoes, but it will not last. Also, Romania is an exception to the rule that clearly says that *cheap consumer goods can not be manufactured in Europe at competitive prices*.

### **About the study**

The study was conducted in the spring of 2007.

The National Board of Trade is the governmental agency in Sweden dealing with foreign trade and trade policy. The Board provides the Swedish government with analyses and input on trade policy matters.

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