To compete with imports, domestic producers must have access to cheap good quality textiles and this is not possible so long as the textile industry in Egypt is protected and remains predominately publicly owned.

Policies to Revive Egypt's Ready Made Garment Industry

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Three sets of policies are essential to the revitalization of Egypt's ready made garment industry- the country's second largest sector in term of output and employment-: (1) Trade liberalization of the textile industry (2) reform of labor laws so that wages can be tied to productivity (3) reduction of red tape facings foreign retailers in Egypt. In order to assess the importance of this policy mix to the revitalization of this industry it is necessary first to examine how producers in this sector adjusted to competition from imports following gradual trade liberalization under the GATT and the coming into force of the Egypt EU association agreement in 2004 which gradually dismantles tariffs on imports of manufacturing originating from the EU. In particular it is the constraints that firms faced during the process of adjustment to trade liberalization that will highlight the importance of this policy mix.

To begin with, firms usually have to choose from a number of adjustment strategies opened as trade is liberalized, given certain market characteristics pertaining to the type of equipment used, the degree of product differentiation, the degree of scale economies and the separability of stages of production as is evident from Table 1.

Table 1

Adjustment Options

	Exit	Revitalization Better quality/price Combination	New Market Niche	Reduced Factor Reward	Protection
Market Characteristics					
Equipment					
a)For specific use		X		X	X
b) Easily transferable	X		X		
Degree of product differentiation					
a)Very low	X			X	X
b)High		X	X		
Degree of Scale Economies					
a)Zero	X				X
b)Considerable		X	X		
Separability of stages of production					
a)Yes		X	X	X	
b) No	X				X

Source: Economic Council of Canada, 1988. Adjustment Policies for Trade Sensitive industries. A research report prepared for the Economic Council of Canada. Canada.

Table 1 shows that the set of feasible adjustment strategies opened for firms range from exit to revitalization and finally to request of protection. In turn, revitalization includes offering a better price/quality combination, finding a new market niche or reducing factor rewards. As evident from the table, the specificity of equipment, the degree of product differentiation, the degree of scale economies and the separability of stages of production are important factors that influence the choice of adjustment strategy. For example, if equipment has specific use and thus not easily transferable to other uses, then firms will avoid exit since it will be costly and instead will either choose one of three options: to offer a better price/quality combination, or reduce factor rewards or request protection.

In the case of the readymade garment industry, since equipment is in general specific, there is considerable scope for product differentiation as well as for economies of scale and stages of production can be separable, one would expect revitalization based on offering a better price/quality combination or finding a new market niche to be the preferred adjustment strategy by firms. Unlike exit, such an adjustment strategy is particularly attractive since it results in minimum adjustment costs at least when it comes to employment and output. Moreover, unlike request of protection which serves to delay adjustment - only to increase the magnitude of adjustment costs in the future as argued by the World Bank 1991-, revitalization means that only efficient firms can survive.

Despite of low labor productivity that tend to erode Egypt's comparative advantage based on cheap labor, according to a survey conducted in by Elshennawy, 2009 some firms in the readymade garment sector opted for revitalization as the preferred adjustment strategy in response to efforts to liberalize trade in this vital sector. Differentiating between large (employing more than 99 employees) which constitute 4% of all establishments in this sector according to the most recent census in 2006 and small firms (employing 1-9 employees) which constitute 96% of all establishments is crucial to understand how the proposed policy mix can help firms in their quest for revitalization. In the case of large firms that continued to produce for the domestic market, competition with imports was mainly based on offering a better price/quality combination. This was particularly true for firms that are vertically integrated in textile, finishing, dying etc. Large firms are in a better position to be able to take advantage of economies of scale especially in textiles. Vertical integration in textile was helpful given the existence of tariffs and non- tariff barriers to trade in this sector. . Currently, tariffs on textiles stand at 10% plus a value added tax of 13%.

On the other hand, Liberalization of trade in retail and distribution services brought with it lean retailers whom - as widely recognized - make out of proximity of the producer to the retailer, the new bases for comparative advantage. To elaborate, factors other than low wages have come to influence the competitive position of producers in the apparel industry. This is related to phenomenon known as lean retailers whereby the retailer owns only the products displayed. Once sold, the retailer asks the manufacturer - whose warehouses and distribution centers act as warehouses and distribution centers for retailers - to replenish the product. Such a process must be completed in a time period sometimes as short as three days. In reality, this shifts the risk from the retailer to the supplier and involves significant costs that can go beyond the traditional costs of wages, intermediate inputs and shipping. Proximity plays a major role in reducing such risks and costs associated with it and is considered one of the main reasons some producers in the US market were able to withstand competition from imports. (Abernathy et al, 2005). It is also considered one of the main reasons why some Egyptian producers were able to withstand competition from imports in the domestic market.

Because managing these supply chains requires not only sophisticated technology, but also specific managerial logistics, foreign rather than domestic services providers are more likely to engage in such activities. Over time, spillover effects from the foreign lean retailer to domestic retailers can further increase the scope of this phenomenon – in the sense of domestic retailers becoming also lean retailers- and continue to enhance competitiveness of domestic producers vis a vis imports. Trade liberalization therefore should not be confined to just trade in goods as has been frequently argued in the literature, but must be also extended to trade liberalization in services since - as evident from the Egyptian experience- it can be instrumental in helping domestic producers withstand competition from imports.

Trade liberalization in services has turned out to be of crucial importance to the readymade garment industry due to the poor state of the retail sector in Egypt. In particular, the underdeveloped state of the retail industry reduces the effective market size for the firm and renders these firms unable to exploit economies of scale. While Egypt has liberalized the retail sector and allowed foreign retailers to locate in Egypt as explained above, they still however face enormous red tape and bureaucratic obstacles. For example only companies that are 100% Egyptian can import. Also it is hard to find good locations and thus rents are very high which means that these foreign retailers – and the same for domestic ones - have to sell at higher prices to cover these costs.

In the case of producers serving lean retailers, the problems stemming from a protected textile industry emerges once again. The ability of producers to deliver the product in such a short time to the retailer depends on the availability of inputs - particularly textiles - from the domestic market because importing takes time. Domestically produced textile inputs in Egypt are very low in quality as mentioned earlier. So far, this has not been a problem because the few lean retailers present in Egypt cater the lower segment of the market and in general the firms that served them are vertically integrated in textiles, finishing, dying etc. In other words the firms that served them are large in size.

Low quality domestic textiles can also act as a major setback to competitiveness, particularly in the case of exports which continues to be a very popular adjustment strategy to take advantage of preferential treatment granted in EU and US (through the Egypt EU Association Agreement and Qiz Agreement). In other words, firms adjusted to competition from imports in the domestic market by exporting instead. In the post MFA era, the wide spread of lean retailers worldwide have provided Egyptian exporters- precisely large firms that are vertically integrated- with a new and sustainable basis for comparative advantage – based on proximity rather than unit labor cost only - in the EU and US markets, the two biggest markets for Egyptian exports of textile and readymade garments relative to producers in East Asia. Exporters that are not vertically integrated will, however, be unable to take advantage of proximity since they don't have access to good quality inputs from the domestic market. Once again, only large firms can take advantage of the opportunities offered by real retailers on world market.

In contrast to large vertically integrated firms, adjustment to import competition was in many respects not an easy task for small firms. Unable to integrate vertically into textiles, these firms faced problems adjusting to free trade as they did not have access to cheap and better quality textiles from world market. The inefficiency of the textile industry arising as a result of protection was further compounded by the fact that it is predominately publicly owned. Serving lean retailers is not possible since orders are usually large in size. Specializing in the fashion segment of the market– since orders are usually small in volume - along with what Indian small scale firms successfully did was not a viable option again given domestic low quality textiles and expensive imported ones. Faced with these constraints, many firms will be forced to exit the market rather than revitalize.

For others, informality was their gate to survival. Being informal, these firms do not abide by tax or labor laws. Compared to large firms operating in the formal sector, these firms thus pay lower wages and workers do not receive any other benefits like social or health insurance. In addition, such firms are free to base the entire wage – not just a fraction of it as stipulated by the labor law - on the number of pieces a worker can produce and are free to hire and fire. It is needless to mention that strict hiring and firing procedures along with the inability to adjust wages according to productivity are considered as two of the main factors underlying low labor productivity by producers in the formal sector. Taken together, these factors have enabled small enterprises to survive competition from cheaper imports despite low labor productivity.

To summarize, to be able to compete with imports, domestic producers whether large in size or small must have access to cheap good quality textiles and this will not be possible so long as the textile industry in Egypt continues to be protected and remains predominately publicly owned. Red tape discouraging foreign retailers from locating in Egypt should be reduced to increase market size and enable producers to exploit economies of scale. Finally labor laws that constraint firms from basing wages on productivity and renders firing and hiring difficult should be modified.

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