Changes have been experienced by the Egyptian Textile Industry over time. The related Ready Made Garments (RMG) industry has had problems but there are means to overcome these.

**Ready Made Garments (RMG) Industry:**

Is There a Way to Save It?

*Egypt Network for Integrated Development*

**Policy Brief 011**
Ready Made Garments (RMG) Industry: Is There a Way to Save It?

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Introduction
The textiles industry has been among the most important industries in Egypt from economic and social perspectives. Historically, it has been the largest employer in the manufacturing sector, a major recipient of domestic and foreign investments, and the most significant contributor to foreign exchange earnings among the manufacturing industries. Over time the industry experienced several changes due to the shifts in global and domestic circumstances, and the governmental policy actions which affected its performance. In this policy brief we identify the changes experienced by the industry over time, whether in policies or performance, while focusing on the Ready Made Garments (RMG) industry. We mainly stress the problems experienced by the RMG and suggest means to overcome them.

On the global level, the factors governing the manufacturing process in the industry itself have been continuously changing the landscape of industry, and hence Egypt’s position. On the one hand, the changes in the multilateral rules governing the industry starting the mid-1990s with the gradual elimination of quantitative barriers (the end of the Multi-Fiber Agreement) and ending in the mid-2000s (when the global quotas were completely eliminated) have had a huge impact on the industry in Egypt with a strong pressure to change its orientation from the domestic market to the export market. On the other hand, the global RMG industry is governed by a number of practices which also affect the performance of the industry. The industry is governed worldwide by the so called buyer-driven value chains where global trade worldwide is increasingly controlled by a number of powerful buyers who coordinate the different processes of design, production, and distribution. Moreover, the industry is characterized by the rise of lean-retailing phenomenon where the sourcing of products privileging the speed of delivery and the fragmentation of sourcing patterns on geographical basis take place as the most important determinants governing outsourcing. Finally, the largest two global markets, namely the US and EU remain different in nature of demand with the large buyers in the US focusing on large scale supply of standard products whereas the EU market remains highly segmented on national and fashion lines (Abugattas and Moustafa, 2009). Such changes have had a paramount impact on the Egyptian RMG industry.

The domestic factors have also had a significant impact on the textiles industry. Some domestic factors have enabled the industry to achieve all the necessary conditions that allow it to enjoy a comparative advantage including the relatively low labor costs, geographical

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2 The textiles industry encompasses spinning, weaving, dyeing, and finishing, home textiles, technical textiles, and ready-made garments (RMG). When textiles and RMG term is mentioned we intend to separate the RMG from the rest of the textiles industry in general.
proximity with EU as a major market, vertical integration of the industry, and the historical importance of the industry which allowed the existence of the necessary skills. Yet, other domestic factors have acted against the development of the industry and deprived Egypt from enjoying its comparative advantage including structural problems associated with low productivity, lack of investments in the public sector, difficult access to finance, poor infrastructure, and long lasting problems with cotton policy.

**Importance and Current Status of the Industry**

*Overview and Performance*

The Egyptian textiles industry is among the oldest industries in Egypt and dates back to the 19th century when Mohamed Ali introduced the production of long staple cotton in 1828, and the first textiles mill was established in 1899. The industry flourished under the private sector leadership from the 1920s to the 1950s, and continued to perform efficiently during Nasser’ era despite the dominance of the public sector (Kheir-El-Din and Abdel Fattah, 2000). During Sadat’s era the private sector started to gain a significant share particularly in the RMG whereas the public sector continued to expand, for social rather than economic reasons but mainly in the upstream segments of the industry (Amcham, 2004). Currently, the textiles industry remains dominated by the public sector, especially in the production of yarn, and fabrics, spinning and, weaving. The private sector has the lion’s share (more than 70%) in the RMG. The public sector is highly vertically integrated, which is not necessarily the case of the private sector where the knitting sector is reasonably vertically integrated whereas the weaving sector is not (Ministry of Public Enterprise, 2003; Kheir-El-Din and El Sayed, 1998; Madger, 2005; and Ghoneim, 2009).

The textiles industry represents almost one third of the manufacturing value added and around 3% of GDP, making it the third largest contributor to GDP after tourism and Suez Canal. During the period 2005-2010, the industry on average contributed by 18% to industrial value added, and by 28% of total non-oil exports (CAPMAS, 2013)\(^3\).

The textiles industry has been also a major employer ranking the first together with the food processing industry as the largest industrial sector employers (Sakr and Abdel-Latif, 2000). Precise data on the number of workers in this industry is not available, but some estimates put it between 400,000 thousands and 1.2 million direct labor and between 800,000 thousands and 1.2 million in related sectors (Tolba, 2013; Kassem, 2013). The industry is also the largest contributor to wages in the industrial sector representing around the quarter of wages paid (Fawzy and Massoud, 2003). Following the latest Census of Establishments of CAPMAS in 2006, the textiles industry absorbs around 20% of the industrial labor force. Yet, other studies have

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\(^3\) According to the CBE, Time Series Statistics; and the data available on the Ministry of Trade and Industry, the ratio of exports to total non-oil exports is 14% in 2012.
put the industry to absorb a range of 18-30% of the industrial labor force (Pigato and Ghoneim, 2006; Abugattas and Moustafa, 2009; Metwally and El-Migharbil, 2009; CAPMAS, 2013)\textsuperscript{4}.

The EU and US markets have remained the major markets absorbing Egyptian RMG exports. Egypt has enjoyed a revealed comparative advantage in textiles and RMG, however its revealed comparative advantage in textiles has decreased over time especially between the 1990s and 2000s (Fawzy and Massoud, 2003). Nevertheless, such high contribution to the Egyptian economy in general, and to Egypt’s non-oil exports in specific are not translated to a significant share in the world market (figure 1). Egyptian textiles and ready-made garments remain in the neighbourhood of 0.3-04% of the total world exports (Madger, 2005; UNCTADStat\textsuperscript{5}) divided between 0.2% for textiles (down from 0.5% in early 1990s) and 0.12-0.19% for RMG (Fawzy and Massoud, 2003; UNCTADStat). The trade balance has always been positive till 2010/2011 where exports of textiles and RMG have always exceeded imports as shown in figure 2. In 2011/2012 the imports exceeded exports, which is mainly attributed to the surge in RMG imports.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure1.png}
\caption{Egypt’s Exports of Textile Fibres, Yarn, Fabrics and RMG and its Share of World Exports (2000-2012)}
\end{figure}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure2.png}
\caption{Trade Balance of Textiles Industry (2003/04-2011/12)}
\end{figure}

\textsuperscript{4} Metwally and El-Migharbil (2009) put the contribution of the textiles industry at 18.7% of total employment in the industrial sector in the year 2006/2007 surpassed only by food processing and beverages which contribute to 20% of total employment in industrial sector in the same year.

\textsuperscript{5} These figures are calculated for the product group “Textile fibres, yarn, fabrics and clothing (SITC 26 + 65 + 84)”. Textiles represents the summation of (SITC 26 and 65). Readymade garments (SITC 84)
The problems faced by the industry remained structural and have not significantly changed over years. Among such problems have been low productivity of labor, poor maintenance of machines and unutilized capacity especially in the public sector, absence of economies of scale in weaving, poor dyeing and finishing leading to higher waste, and absence of modern specific production management (Gherzi, 2006). Moreover, the industry has been faced with a number of external challenges including the global slowdown, erosion of preferences in US and EU markets due to their conclusion of several preferential trade agreements, WTO free quota system following the abolishment of the Multi-Fiber Agreement and its successor Agreement on Textiles and Clothing in 2005, constrained policy space due to obligations of several multilateral and regional agreements, and a fast changing business environment (Abugattas and Moustafa, 2009). The current political and security situation, following the aftermath of the 25th of January revolution 2011, has negatively affected the industry. Increased transaction costs associated with securing consignments, delays in shipments, and delayed government decisions have negatively affected the industry (focusing on the exports market). Moreover, there have been increasing worries of smuggled products penetrating the market (Al Ahram newspaper, dated November 11th, 2013) due to the lax security on the borders which has also affected the industry (focusing on the domestic market). The estimates of smuggled imports are not available but it was guess estimated to be 50% of the imported RMG in Egypt, which in general have been on a rising trend since 2005 (figure 3). The down turn in 2012 shown in figure 3 is associated with the devaluation of Egyptian pound which took place in December 2012 as well as the incompleteness of the value for the whole year of 2013. The higher the transaction costs associated with red tape measures, government bureaucracy, and high cost inputs have shifted the incentives to import rather than to manufacture.

Figure 3: Egyptian Imports of Textiles and RMG (2005-2012)

Source: General Organization for Export and Import Control, Foreign Trade Statistics.
Cost Structure Analysis

The wages in the industry do not seem to constitute a major issue impeding the industry from flourishing. Yet in relative terms wages in Egypt are higher than its competitors, whereas productivity is lower. For example, in the case of Bangladesh, wages are between 25-40% lower than Egyptian wages and productivity is between 25-50% higher (wages in Bangladesh range around 76 US$ whereas they are between 100 and 120 US$ in Egypt). The same is true for other competitors as Vietnam and India (Tolba, 2013; Kassem, 2013). Data on wages in the public and private sector show an extent of variation as revealed by CAPMAS. Such variations are partially due to the differences in categorization of labor, as well as the devaluation effects. Yet, what counts here is that wages do not constitute a major proportion of costs’ structure and are not considered as an impediment in the RMG private sector (which is not the case in the textiles public sector where high wages and low productivity are major concerns), especially that value added per worker in RMG has been on a rising trend, which is not the case of textiles dominated by the public sector and suffering from excess employment (Madger, 2005). The relatively high social security contributions which increase wage levels especially in the public sector are circumvented by concluding temporary contracts for employees in the private sector which can extend for five renewable years. Yet, the recent talks on increasing the minimum wage in general without accompanying measures to enhance productivity will negatively affect the competitive position of the industry, especially in light of the declining productivity as a result of the recurrent obstacles to the working environment in Egypt.

Among the other cost components are the domestic raw cotton, cotton yarn and fabrics whose costs are considered considerably high in Egypt. They have accounted for nearly 15% of total manufacturing costs which is higher than that prevailing in Indonesia and Turkey (Sakr and Abdel-Latif, 2000). It has always remained cheaper to import cotton yarn and fabrics from Pakistan and India than buying local yarn and fabrics (AmCham, 2004). Such situation has become more acute after the 25th of January, 2011 revolution due to the increasing transaction costs facing RMG manufacturers. The relatively high cost of domestic cotton is closely associated with the governmental policies adopted in cotton pricing and remains a major bottleneck affecting negatively the competitiveness of the public sector firms which are forced to buy it. Importation of cotton yarn and fabrics is affected by a wide array of non-tariff barriers which add to the costs of production.

External Challenges

The signing of the Qualifying Industrial Zones (QIZ) Protocol between Egypt, Israel, and the US in December 2004 has saved Egypt’s RMG industry from collapsing due to the heavy orientation towards the US market (which cannot be easily replaced by other markets). It has guaranteed a duty free market access of the Egyptian RMG exports to the American market, hence helping the industry to maintain a competitive position in one of the major exporting markets (being shielded from other strong global exporters by the relatively high tariffs imposed on RMG in the

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6 According to some estimates wages constitute around 80% of sales revenues on average in the public sector and do not exceed 10% of sales in the private RMG sector.
7 Social security contributions reached 24% of the basic wage, and 11% of the variable wage all paid by the employer and 14% paid by the employee.
US). Available studies (Refaat, 2006; Ghoneim, 2009) confirm the positive impact of the QIZ on preserving the market access of the Egyptian RMG exports in the US market. Yet, the long term effect of the QIZ has remained questionable in terms of its negative impact on enhancing the domestic vertical integration of the industry and sourcing of Egyptian inputs, which remains affected by the aforementioned structural problems. In other words, The QIZ negative effect on vertical integration of the industry will only materialize if other problems have been solved. As long as the competiveness of the Egyptian industry remains weak, then QIZ acts as an important safety valve for the survival of the Egyptian RMG in the US market. The extension of QIZs to include Upper Egypt governorates was thought of to be positive in terms of achieving developmental goals. Yet, the outcome in terms of factories moving there or opening new affiliates was limited due to weak infrastructure, insufficient trained labor, and modest work ethics prevailing there (Tolba, 2013).

**Latest Developments in the Industry**

The 2008 global financial crisis represented the first negative exogenous shock for the RMG industry after signing the QIZ. The fear of losing competitiveness in the export markets has forced major Egyptian competitors to devalue their currencies which was not matched by a similar devaluation in the Egyptian case. Though this might have had a negative impact on Egypt’s external position, the QIZ has played an important role in preserving the market access of Egyptian RMG exports in the US market (Ghoneim, 2009). The second shock which affected the industry has been domestic, and it was represented in the negative circumstances prevailing after the 25th of January revolution. The overall exports of the industry declined and the QIZ exports also declined (figures 4 and 5). The weak security position (which led to higher transaction costs at roads, port gates, and closing of Owga port dealing with QIZ) and the labor associated problems (demonstrations, declining productivity, and asking for wage increases) have affected the industry, which was partially accommodated by the devaluation happening in December 2012. Moreover, the state of flux affecting the economic policy making in Egypt has affected the ability of the players in the market to discuss their problems with relevant policy makers. The government has been retreating from supporting the industry where all facilities and export support means have been stalling and extra costs have been imposed. Finally, the inflow of smuggled imports of RMG has surged, which has affected mainly the informal sector focusing on production for the local market in Egypt.
To sum up, the RMG industry still remains highly protected using high tariffs and different non-tariff barriers, an aspect which has had a negative impact on consumers and invited a wide practice of smuggling. The problems of the industry remain deeply rooted in aspects related to overstuffed public sector, lack of investments, problems associated with access to finance, and inefficient cotton policies.

**Why Has It Remained Difficult to Reform the Industry? A Political Economy Perspective:**
A full comprehensive reform agenda for the sector as whole was never achieved. The case has always remained segregated among different reform plans that were rather characterized by being ad hoc and focused on certain segment of the industry. An overall strategic reform plan that takes in consideration the different dimensions of the industry including private and public segments, the vertical integration aspects, the consumer versus producer aspect, the domestic oriented versus exporting producers dimension, etc remained absent. This is partially a result of the multifunctional role of the industry in the Egyptian society where including all its economic, social, and political dimensions in one reform package seems to be difficult, if not an impossible task. Moreover, the responsibility of designing a reform plan that takes in consideration the interests of all stakeholders cannot be assigned to one ministry. The industry’s issues are diffused by nature and spread among different ministries and governmental agencies where cotton issues are overseen by the Ministry of Agriculture and Land Reclamation, the public sector which dominates spinning and weaving is overseen by the Ministry of Investment, and finally the private sector which dominates the production of RMG is overseen by the Ministry of Foreign Trade and Industry. In many cases the interests of the different stakeholders do not converge and due to the absence of a national point of view for the whole industry, reforms are always incomplete.
Cotton policies and pricing remain a major issue that requires a comprehensive view. On the one hand, there is a unique position for Egypt in producing long staple cotton, which has been known historically as the white gold, and that is competed worldwide by relatively few varieties especially the American Pima. On the other hand, the high prices of cotton fibre were accepted by the spinners and weavers to keep their production units operating, but they were unable to pass the increase in prices to their downstream customers which ended up in accumulating losses. In fact the public firms were forced to buy cotton fibre at a high price. The private firms working as knitters and weavers try to depend on the imported cotton fibre to be able to compete in the external market. The private sector in RMG cannot compete worldwide if to depend on the Egyptian long staple cotton.

Another major problem in this industry is the reform of its public sector. The government has stopped investing in this sector since the early 1990s as it slated the firms for privatization. The sector contains a number of “too big to fail” companies in the textiles sector, where the huge number of workers and geographical concentration of such firms (as in Mahalla El Kobra) implied major difficulties in undertaking privatization fearing from negative political and social consequences. Hence, the public sector reform stumbled where it is squeezed between relatively high wages, obligatory purchase of buying expensive cotton, lack of new investments, and overstaffing.

How to Save the Industry
This part will try to focus on the specific efforts needed to enhance the role of RMG. It does not tackle the general business environment aspects and macroeconomic issues that cut across all industries and sectors.

Have a comprehensive reform plan for the whole sector
The plan should tackle several aspects including the adoption of a new cotton policy which should encourage the production of other types of cotton fibre (medium and short staple), while allowing such types to be easily imported without making the spinners and importers incur huge costs. Moreover, the plan should tackle enhancing of productivity through training and education in service-related skills such as quality control, retail distribution, and design. Most importantly, the plan should deal with the ills of the public sector by ensuring the availability of needed investment. Geographical extension of planting cotton and inclusion of new geographical areas, as for QIZ in Upper Egypt need to be complemented by providing the needed infrastructure (roads, hotels, etc.) and upgrading of productivity of labor. The existing National Strategy of the Textiles Industry: Vision of 2025 for the whole sector should be enforced.

Make finance available
The majority of firms in Egypt have been suffering from a credit crunch associated with the reluctance of banks to provide corporate loans due to the gloomy economic situation. Moreover, trade finance has always been absent. The Central Bank should undertake specific initiative to support major exporting industries including RMG, especially in the aftermath of the 25th of January 211 revolution where provision of finance became more constrained despite
the urgent need for it. Availability of finance is among the most important constraints facing the industry at this stage of time. Some sort of Central Bank guarantee for banks providing loans to specific industries should be provided to ensure preserving their export potential.

Deal with the existing trade agreements and negotiate better rules of origin
There is a need to renegotiate the rules of origin with the EU, which has been restrictive and have prevented the Egyptian exporters from utilizing their export potential in the EU market. Moreover, no serious moves whether on behalf of exporters or governments have been undertaken to make use of the positive potential effects of diagonal cumulation of rules of origin under the auspices of Agadir agreement, although some studies have showed that the potential expected gains from such cumulation are rather modest (Ghoneim, 2003). This focus of exporters should change in the future whereby the American market importance should be preserved but the attention should be devoted to where the Egyptian exports enjoy a competitive advantage not related to tariff preferences. Hence the issue of geographical proximity to the EU and the ability to cumulate inputs (for example using the Turkey-Egypt free trade area or Agadir agreements) should be better utilized (Al-Ayouty, 2010).

Focus on new niches
Egypt should start focusing on new niches in the field of so called technical textiles8. This type of industry is still highly concentrated in developed countries. Given the competitive advantage that Egypt enjoys regarding labor and geographical proximity to the EU and given that other main competitors are focusing on the traditional textiles then Egypt should take the lead by getting engaged with the retail distributors in the developed countries and have a market share in the global market. The proximity to the EU is still not well utilized and the phenomenon of “lean retailing” where proximity to the market plays a critical role is still not efficiently utilized in Egypt.

Enhance subcontracting and integrate SMEs
To widen the scope of subcontracting in the RMG industry, several steps are needed. The first is to create a comprehensive database that is shared among different players in the market, the second is to upgrade the capabilities of SMEs in the sector, and the third is to provide match makers while providing incentives (through means of export support or financing schemes) for contractors and subcontractors to join efforts, with the ultimate goal of creating functional clusters. Moving to Upper Egypt is a step in the right direction where clusters should be established there making use of vast majority of land and availability of cheap labor. However to succeed there is an urgent need to enhance quality of labor and ensure the availability of infrastructure and public utilities. In other words, integrating SMEs in the value chain needs prudent actions to ensure its success and help upgrading the industrial clusters looked for (Al-Ayouty, 2010).

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8 “those textile materials and products manufactured primarily for their technical and performance properties rather than for their aesthetic or decorative characteristics” (OECD, 2004)
Tackle export related problems
The exporters of RMG suffer problems associated with duty draw back and temporary admission. Those are recurrent problems that have always happened and have changed slightly with the change of government officials in charge and in fact have been extravagated after the 25th of January 2011 revolution, where the delay of paying export support joined the set of problems. There is a need for establishing an institutional setup to avoid the discretionary power exercised by government officials who change the rules and affect negatively the industry.

Overcome lack of public services and infrastructure in industrial zones and QIZ areas
The inclusion of Upper Egypt in QIZs and enhancing the role of industrial zones need to be accompanied by serious efforts to upgrade the quality of public services provided (e.g. electricity, water, housing facilities to workers, etc), infrastructure (roads, ports, rail, hotels).

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