EGYPT AFTER THE END OF THE MULTI-FIBER AGREEMENT: A COMPARATIVE REGIONAL ANALYSIS

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Abstract

This study evaluates the early impact of the phase-out of the Multi-Fiber Agreement (MFA) on the textile and clothing sectors (T&C) in Egypt, Jordan, Morocco and Tunisia (MENA-4), with a focus on Egypt. Based on the assessment, the paper offers a number of recommendations to maximize the benefits from liberalization of international trade in T&C. In particular, it finds that the phasing-out of the MFA had a mixed impact on the T&C sectors of the MENA-4. In order for these countries to capture the full benefits from the phase-out, the paper stresses the importance of improving export competitiveness and growth through diversifying export markets, reducing the cost of T&C inputs, easing restrictive rules of origin, improving trade logistics, and pursuing deeper integration both regionally and internationally. For Egypt, the study specifically highlights the need to restructure the T&C industry, improve the export subsidies program, enhance training and education in the T&C industry, encourage the production of other types of cotton, and upgrade port facilities.

ملخص

تقوم هذه الدراسة بتقييم الآثار الأولية لإنهاء العمل باتفاقية الألياف المتعددة على قطاعات المنسوجات والملابس الجاهزة في أربعة بلدان هي مصر، والأردن، والمغرب، وتونس؛ مع التركيز على حالة مصر. وفي ضوء هذا التقييم، تطرح الورقة مجموعة من التوصيات بهدف تعظيم الاستفادة من تحرير التجارة العالمية في المنسوجات والملابس الجاهزة. وقد وجدت الدراسة أن انتهاء العمل بهذه الاتفاقية كان له آثار متفاوتة على قطاعات المنسوجات والملابس الجاهزة في البلدان الأربعة. وكي تحقق هذه البلدان أقصى استفادة من انتهاء العمل بهذه الاتفاقية، تؤكد الدراسة على أهمية تحسين تنافسية ونمو الصادرات وذلك من خلال تنويع أسواق التصدير، والحد من تكاليف المدخلات المستخدمة في صناعة المنسوجات والملابس الجاهزة، والتخفيف من صرامة قواعد المنشأ، وتحسين آليات التجارة، والسعي إلى تعميق الاندماج على المستويين الإقليمي والدولي. وبالنسبة لمصر، أكدت الدراسة على ضرورة إعادة هيكلة الصناعة، وتطوير برنامج دعم الصادرات، والاهتمام بالتدريب والتعليم في مجال صناعة المنسوجات والملابس الجاهزة، وتشجيع إنتاج أصناف مختلفة من القطن، وتحسين خدمات الموانئ.

I. INTRODUCTION

On January 1, 2005, the phase-out of the Multi-Fiber Arrangement (MFA) under the Agreement on Textile and Clothing (ATC) was completed (see box 1.1). Data for 2005 suggest that the lifting of all quotas has already resulted in a significant price decline of textile and clothing (T&C) products, benefiting consumers worldwide, and has brought tremendous pressures on retailers, distributors and producers alike. However, contrary to earlier fears, massive restructuring and job losses around the world have not materialized. Some of the most efficient and formerly quota-restricted countries, such as China and India, have already increased their market shares in major importing markets. The environment for policy reform is also changing. Because demand is no longer inelastic and there are no longer sheltered markets, the economic cost of distortive domestic policies is increasing, with strong international competition threatening countries that are not competitive.

This study investigates the impact of the quota removal on the T&C sectors of four MENA countries (hereafter MENA-4), Egypt, Jordan, Morocco, and Tunisia.[1] The T&C sectors play a crucial role in trade, foreign exchange earnings and job creation in these countries. Furthermore, these countries are key partners in the process of Euro-Mediterranean integration and in their own regional integration, through the Agadir Agreement, within the larger Greater Arab Free Trade Area (GAFTA) group. There are, therefore, specific industry and trade policies that these countries could undertake with mutual benefits to maximize the opportunities from the MFA removal. Moreover, the study conducts a detailed analysis of the case of Egypt, which has one of the oldest textile industries in the world covering the entire spectrum of cotton processing operations, and a well-developed clothing industry. Yet, the T&C sector is still highly regulated and Egypt's world market share in T&C is insignificant. This study will discuss the key issues Egypt faces as it confronts a changing global marketplace with no quotas. It will also suggest a number of public and private sector strategic policy options to enhance the competitiveness of Egypt's exports. The study depends on comparative data analysis for the countries complemented by interviews with exporters and producers of textiles and ready-made garments in Egypt.

[1] This study is based on a larger study conducted by the World Bank (2006) on the Impact of the End of the Multi-Fiber Agreement on Egypt, Jordan, Tunisia and Morocco.

II. Background

The Importance of T&C in MENA-4 Countries

Textiles and clothing are of crucial economic importance for MENA-4 countries, contributing between 3 percent (Egypt) and 9.4 percent (Jordan) of GDP in MENA-4 (see table 1). In all MENA-4 countries, the T&C sector absorbs a large share of low-skilled workers and affects, directly and indirectly, the incomes of millions of people. In Egypt, the sector absorbs as much as 30 percent of the country's industrial labor force. In Morocco and Tunisia, more than 200,000 workers depend on T&C for their livelihood and income. Although relatively young, Jordan's T&C industry provides about 30,000 jobs in the country. The gender structure of employment varies across countries, by sector (textile or clothing), and firm size. However, in all countries women tend to represent between 65 percent and 80 of employment in the clothing sector (and a somewhat lower percentage in textile) and up to 90 percent of workers in micro and small enterprises.

Table 1.Contributions of T&C in MENA-4 Economies

	Morocco	Tunisia	Egypt	Jordan
Contribution to overall GDP (%)	5.1	5.6	3	9.4
Contribution to industrial value added (%)	17	42	30	20
Employment (number)	203,800	220,000	1,000,000	30,000
Share of clothing in T&C employment (%)	45	nd	30	20
Share of women in clothing employment (%)	65	80	70	70

Source: World Bank (2006).

The T&C sector is a major source of foreign exchange for the MENA-4 countries. In 2004, about 58 percent of Tunisia's total non-oil exports were represented by T&C goods. In Egypt and Morocco, the sector accounted for 24 percent and 42 percent of non-oil export earnings, respectively. Even in Jordan, where the rise of the clothing sector dates back to 1997, 32 percent of non-oil exports come from T&C. Clothing accounts for about 95 percent of total T&C exports in Jordan, Morocco, and Tunisia, while in Egypt, clothing represents 46 percent, yarn and fabrics some 38 percent, and carpets about 16 percent of T&C exports.

Box 1. The ATC Phase Out

The ATC came into force in 1995 with the WTO agreement (Uruguay Round Agreement) and created special interim rules to govern trade in textiles and apparel among WTO countries. It provided for the gradual elimination of quotas on textiles and apparel established by the United States, the EU, Canada, and Norway under the Multi-Fiber Agreement (MFA), an arrangement that governed most world trade in textiles and apparel between 1974 and 1994. The quota system under the MFA violated GATT's nondiscrimination obligation and contradicted GATT's general principle of abolishing absolute quantitative limits. The objective of the ATC was thus to bring trade in textiles and clothing under GATT discipline.

The WTO 1995 agreement required countries to integrate textile and apparel products into GATT 1994 in four steps over a 10-year transition period ending on January 1, 2005. As they did so, countries were required to eliminate any quotas on such goods and could not establish new quotas on the integrated products, except as provided under normal GATT rules. For quotas that were not eliminated in one of the first three stages of integration, the ATC required importing countries to increase the base annual growth rates applicable to each such quota, which were specified in the bilateral MFA agreements in place in 1994.

The table shows the specified timetable by which both the integration and the quota expansion were to be undertaken. In the first stage (1995–97), WTO members were required to integrate not less than 16 percent of the level of their 1990 imports of textile and clothing products. On January 1, 2005, all remaining products (up to 49 percent) were to be automatically integrated.

Steps of the ATC Phase-Out Process

	Starting date	*Share of trade to be integrated (%)*	*Increase in quota growth rate (%)*
Stage 1 (1995–1997)	January 1, 1995	16	16
Stage 2 (1998–2001)	January 1, 1998	17	25
Stage 3 (2002–2004)	January 1, 2002	18	27
Stage 4	January 1, 2005	49	----

Source: Uruguay Round Agreement on Textiles and Clothing (www.wto.org).

The ATC provided importing countries considerable flexibility in selecting the specific products for GATT integration at each stage. Although it requires them to integrate products from each of four categories (tops and yarns, fabrics, made-up textile articles, and apparel) at each stage, it does not specify any allocation percentages. Because the major importing countries deferred integration of the most sensitive products until the end of the 10-year transition period, what could have been a gradual adjustment turned into a major shock at the beginning of 2005.

MENA-4's performance in the EU market before the end of the MFA

Strong competition has been the main feature of the EU market since the end of the 1990s. Between 1997 and 2004, average free-on-board (FOB) prices in the T&C sector declined by 59 percent (table 2). Greater China,[2] the largest European Union supplier, increased its market share, as did South Asia, now the second world largest exporter to the European Union. However, the evolution of market shares between Turkey and Eastern Europe, on one hand, and North Africa, on the other, is striking. Despite similar geographical advantages with respect to the EU market,

[2] Despite the fact that China, Hong Kong, and Macao are all now integral parts of the former People's Republic of China, Hong Kong and Macao are often treated as separate economic units in trade analyses. However, the garment industries in all three territories have long been completely integrated. Treating them as separate entities implies a loss of information on the different adjustment dynamics followed by each of them in the post-MFA scenario. For the purpose of our analysis of the competitive impact on MENA-4 they are lumped together unless otherwise indicated.

Turkey and Eastern Europe (i.e., Bulgaria and Romania)[3] managed to sharply improve their positions during 1997–2004 while Morocco and Tunisia's shares declined.[4] Egypt's market share increased only slightly. In 1997, the overall share of MENA-4 stood at 105 percent of Turkey's share and by 2004 had dropped to only 70 percent.

Table 2. Export Values and Market Shares of Major Suppliers in the EU Market (1997 and 2004)

Exporting country or region	1997		2004	
	Export (million US$)	Market share (%)	Export (million US$)	Market share (%)
Greater China	13,486	23.3	25,390	26.9
South Asia	9,020	11.2	16,063	15.5
Turkey	6,646	11.1	13,347	15.0
Eastern Europe	3,596	7.4	8,474	11.2
North Africa	5,723	11.5	7,934	10.6
Tunisia	2,652	5.7	3,736	5.1
Morocco	2,384	5.3	3,399	4.8
Egypt	662	0.5	785	0.66
Jordan	23	0.05	13.7	0.02

Source: Eurostat.

Note: Eastern Europe = Bulgaria, Croatia, Romania, Russia, and Ukraine, South Asia = Bangladesh, India, Pakistan, and Sri Lanka, Greater China = China, Hong Kong, and Macao, North Africa = Egypt, Morocco, and Tunisia.

MENA-4's performance in the US market before the end of the MFA

US demand for T&C imports has increased dramatically over the past 15 years. However, annual rates of increase in the value of imports have declined in recent years, contributing to a steady fall of FOB prices. Between 1997 and 2004, average FOB prices dropped by about 50 percent in the US market. Greater China, Mexico, and the Central America Free Trade Area (CAFTA) countries, have dominated the US market since the early 1990s, representing a cumulative market share of 48 percent in 2004. Mexico and CAFTA, prominent proximate suppliers to the United States, significantly increased their market share in the US market during the 1990s, before experiencing a sharp decline since 2000. As a result, the shares of both Mexico and CAFTA were lower in 2004 compared to 1997. On the other hand, China's share of the US market increased from 21.5 to 23 percent in that period (table 3).

Tunisia and Morocco are small players in the US market and have insignificant market shares. In sharp contrast, Jordan, with a market share of 1.5 percent in 2004, is now a significant

[3] As new EU members, the Czech Republic, Hungary, and Poland have been excluded from this list.

[4] Romania, the dominant Eastern European exporter and one of the fastest-growing suppliers in the EU market, now accounts for 7.4 percent of the EU market, up from 4.2 percent in 1997.

exporter to the United States, a marked achievement for a country that was quasi-absent from that market in 1997. Jordan's exports to the United States stood at $1 billion in 2004 from $4 million in 1997. Egypt's small share in the US market (0.65 percent) and in the European Union (0.66 percent), underscores the high domestic market orientation of Egypt's T&C industry.

Table 3. Export Values and Market Shares of Major Suppliers in the United States (1997 and 2004)

Exporting country or region	1997		2004	
	Export (million US$)	Market share (%)	Export (million US$)	Market share (%)
Greater China	14,613	21.5	24,856	23
CAFTA-DR	7,247	16.4	9,984	14.7
Mexico	6,541	14.8	8,701	10.0
South Asia-4	6,813	10.5	11,124	10.5
Jordan	4.2	0.01	1,006	1.48
Egypt	410	0.72	601	0.65
Morocco	55.6	0.12	80.2	0.11
Tunisia	14.5	0.03	50.3	0.07

Source: Eurostat.

Note: South Asia-4 =Bangladesh, India, Pakistan, and Sri Lanka, CAFTA-DR = Costa Rica Salvador, Guatemala, Honduras, and Nicaragua, plus the Dominican Republic and Caribbean Basin Initiative (CBI) countries, Greater China = China, Hong Kong, and Macao.

III. Early Impacts of the Complete Phase-Out of Quotas

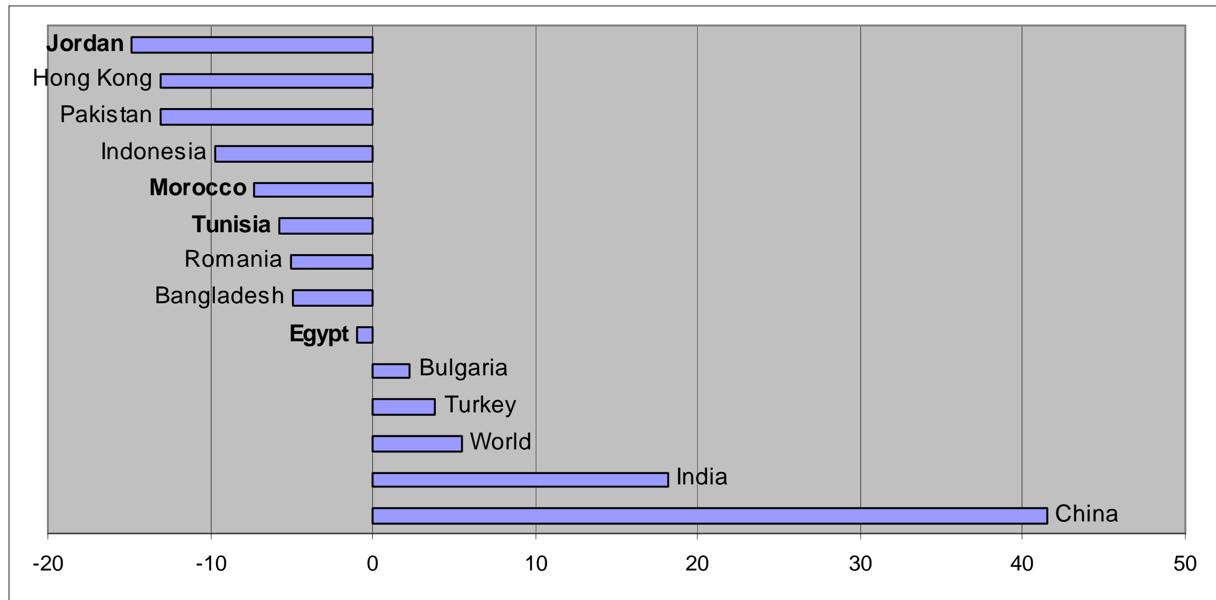
World trade in T&C fundamentally changed with the abolition of MFA quotas in January 2005. This section discusses the impact of the quota phase-out on exports and prices of the MENA-4 countries, in both the EU and US markets.

Impact of Quota Removal on Exports and Prices in the EU Market

Data on the EU market for 2005 suggest that all MENA-4 countries performed poorly after the removal of the quotas. Figure 1 shows the changes in EU imports of all textiles and clothing during 2005 compared to 2004. During this period, EU imports increased 3.7 percent in value and 4.9 percent in volume, reflecting a small decline in unit prices (-1.1 percent). Among MENA-4 countries, Jordan suffered the largest decline (-13.4 percent), followed by Morocco (-7.4 percent) and Tunisia (-5.8 percent). Egypt witnessed a small 1 percent drop in its exports to the EU market. These declines occurred against the background of a dramatic increase in Chinese exports (41.5 percent), a significant rise in Indian exports (18 percent) and the good performances of Turkey (3.8 percent) and Bulgaria (3.2 percent). In absolute terms, the largest declines in EU imports were experienced by Hong Kong and Macao. The sharp decline of exports from Hong Kong and Macao

was expected. Indeed, before January 1, 2005, considerable quantities of China-made garments were transshipped through other countries—notably but not exclusively—Hong Kong and Macao.[5]

Figure 1. Changes in the Euro Value of Exports to the EU Market, 2004–2005



Source: Eurostat database.

The observed trends in exports hide the good overall performance of MENA-4 on the 35 product categories that were liberalized in January 2005. To illustrate the effect of quota removal, table 4 shows the change in the export value of the 35 categories that were liberalized in 2005 and compares them with those that were already quota-free.[6] Chinese exports of the recently liberalized products increased by 82 percent (against 12.7 percent on the unrestricted products). Tunisia experienced a drop in exports of only 3.7 percent, compared to a decline of 12.3 percent in quota-free products. Similarly, the drop in Egypt's exports was significantly less pronounced for the newly liberalized products. Morocco is the only MENA-4 country for which the decline in the liberalized products was larger than that for the quota-free products. Morocco's poor performance reflects the high proportion of exports that fall in the low-end of the market and are therefore in

[5] Because these territories were less quota-constrained than China, Chinese exporters used to find it worthwhile to perform some operations in Hong Kong, thus establishing origin in Hong Kong, and then to move the unfinished garments to China where the other operations—often the greater portion of work—were carried out. The result was a garment that was legally "made-in-Hong Kong" with a high percentage of Chinese content. In 2004, China's share in the total exports of Greater China (i.e., China, Hong Kong and Macao) was 85 percent compared to 13 percent for Hong Kong and 2 percent for Macao.

[6] Reflecting the heavy back-loading of the MFA removal, the EU's total imports of the newly liberalized products represented 64 percent of total EU imports in 2004.

competition with Asian products. Unlike Morocco, large Asian suppliers have sharply increased the volumes exported, enough to compensate for lower prices. Moreover, while low-price supplier countries have witnessed sharp price declines, higher-price suppliers have experienced an increase in unit prices. These asymmetric movements of prices and volumes are at the heart of the observed changes in export values. Indeed, high-price suppliers have, without exception, all seen a drop in the volume exported, largely mitigated or compensated for by price increases.

Table 4. Changes in the Value of Exports for Liberalized versus Quota-Free Products (EU Market)

Country	All products: % change 2004-2005	Products liberalized in January 2005 % change 2004-2005	Products unrestricted by quotas prior to January 2005 % change 2004-2005	% of liberalized products in Jan.–June 2005
Morocco	**-7.4**	**-8.9**	**-1.2**	**80**
Tunisia	**-5.8**	**-3.7**	**-12.3**	**74**
Egypt	**-1.0**	**-0.9**	**-1.4**	**77**
China	41.5	82.0	12.7	40
India	18.1	18.2	18.0	61
Turkey	3.8	4.3	2.2	76
Romania	-5.1	-7.4	3.7	77
Bangladesh	-5.0	-5.6	7.4	94
Pakistan	-13.1	-11.2	-17.8	na
Total import change EU25	5.5	6.7	3.3	63

Source: Eurostat.

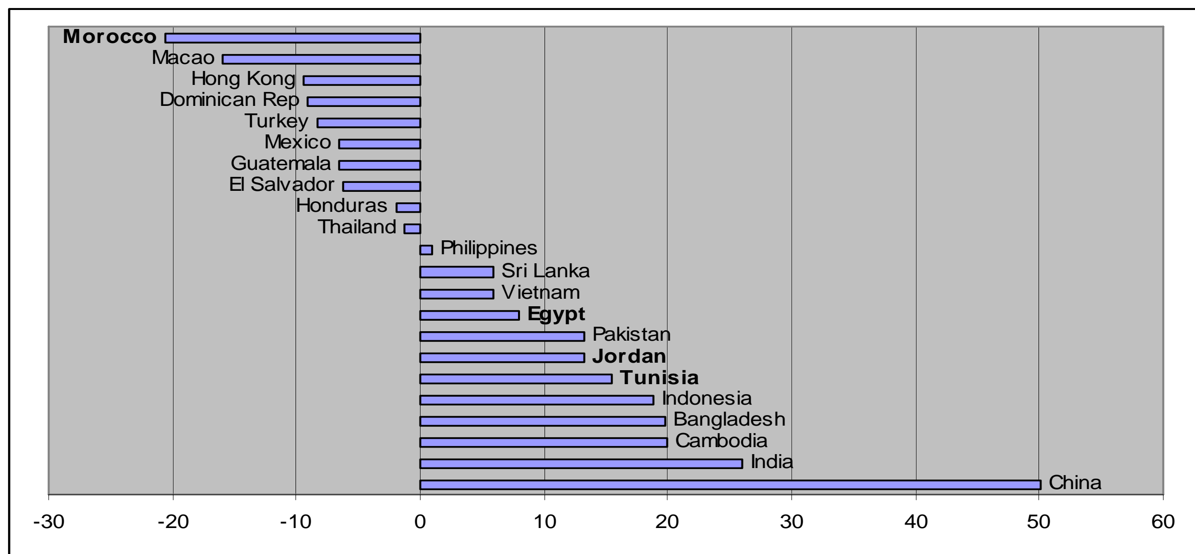
Impact of Quota Removal on Exports and Prices in the US Market

Jordan and Egypt experienced impressive export performances in the US market after the MFA removal. In the US market, the distinction between different segments of the market is less clear cut and price differences among suppliers are narrower. T&C exports from China and India expanded dramatically after the quota removal, increasing by 50 percent and 26 percent, respectively.

Exports from Morocco and Tunisia in 2005 sharply contrast with one another. While Morocco's exports fell sharply (20.6 percent), Tunisia's increased significantly (15.5 percent). However, these sharp changes reflect the tiny level of these countries' exports in the US market. Exports of Morocco and Tunisia to the United States stood at $60 million and $54 million respectively. Clearly, a small variation in the value of exports induces large proportionate changes from one year to another. Jordan and Egypt increased their exports (13 and 8 percent,

respectively). Egypt's good performance is largely due to the QIZ protocol (see Section IV). According to the protocol, Egyptian garments containing 11.7 percent Israeli inputs can enter the US market duty-free. Jordan enjoys lower labor costs than Morocco and Tunisia, and has signed a QIZ protocol with the United States, which allows duty-free access for made-in-Jordan garments. The exceptional feature of this agreement is its liberal rules of origin which allow Jordan to source cheap inputs from anywhere in the world and still qualify for duty-free access to the United States.[7] Jordan also signed an FTA with the United States in 2001 and as a result all duties and commercial barriers to bilateral trade between the United States and Jordan will be eliminated within 10 years. The QIZs, however, have better market access provisions than the FTA. Thus, most exports are likely to continue to be produced under the QIZ arrangements over the next five to 10 years. By 2011, the full FTA with the United States will be implemented and the QIZ will no longer be as important.

Figure 2. Changes in the US Dollar Value of Exports to the United States, 2004-2005



Source: U.S. International Trade Commission (USITC) dataweb statistics (www.usitc.gov).

Table 5 shows the average FOB prices in the US market in the first half of 2005. FOB prices do not include the duty paid or shipment costs and thus are used here as an imperfect proxy of unit

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[7] The liberal nature of ROOs in the QIZ protocol is motivated by the need to enhance the Jordan-Israel partnership and plausibly quantifies the dividends from the peace process that accrue to the two countries. It is unlikely that the same set of preferences can be replicated for the other MENA-3, as one can see from the Morocco-US FTA. In the QIZ protocol between Jordan and the United States, the only major requirements for garment exports to enter the United States duty-free are (a) that garments should be produced in qualifying industrial zones (QIZs) (these QIZs must be registered and licensed) and (b) that the final product contains at least 8.5 percent Israeli content. However, some small restrictions exist. For instance, some garments can be produced outside the QIZs, but not all of these garments can be imported into the United States duty-free.

prices. Nevertheless, they provide some indication on the final prices. The table shows that the distinction of low-price versus high-price suppliers is not so clear cut. Both proximate suppliers (Mexico and CAFTA) and many distant suppliers, such as India, Jordan, and Sri Lanka, are among the high-cost producers. Also, the distributions of gains and losses of market share following the MFA removal cut across the market segmentation. The scope for competition in the US market is thus larger than in the EU market.

Table 5. Average FOB Prices of Garments in the U.S. Market

Country	Average FOB price Jan–June 2005	Market share in US market Jan-June 2005
Morocco	**1.9**	**0.08**
Bangladesh	2.0	4.6
Egypt	**2.1**	**0.57**
Pakistan	2.1	1.7
Tunisia	**2.4**	**0.09**
CAFTA	2.4	13.8
Greater China	2.9	28
Mexico	3.5	8
Sri Lanka	3.6	3.4
India	3.7	4.6
Jordan	**4.1**	**1.5**

Source: U.S. International Trade Commission (USITC) dataweb statistics (www.usitc.gov).
Note: Unit totals for FOB prices for total garment imports to the US are measured in $ per square meter equivalents.

The trends described above confirm important differences between the EU and US markets. The EU market remains highly segmented along national lines, requires fast turnaround, and is less reliant on huge orders that are typical of US retailers. Other characteristics of the EU market include an increased customization of orders to the needs of consumers and the emergence of products that require fashion adjustments within one single-season. These characteristics tend to favor efficient and specialized proximate suppliers with the ability to respond quickly to orders and to cut lead time. In the US market, the sizes of orders are generally large, and significant efficiencies and economies of scale can be achieved. The scope for competition is thus much larger and even distant suppliers may not be at a disadvantage, as the success of Jordan shows, if they are extremely efficient.

In June 2005, the European Union re-imposed quantitative restrictions on Chinese exports of 10 product categories in accordance with the safeguard provisions listed in paragraph 242 of

China's WTO accession agreement.[8] The 10 specific categories addressed by the Memorandum of Understanding (MOU) are T-shirts, pullovers, men's trousers, blouses, bed linen, dresses, bras, table linen, kitchen linen, and flax yarn. In the first half of 2005, these MOU products represented 40 percent of Chinese exports to the European Union. For MENA-4, the MOU accounted for 59, 56, 44, and 23 percent of exports of Morocco, Tunisia, Egypt, and Jordan, respectively. Following the EU's lead, in July 2005 the United States imposed quotas on China on six strategic categories: cotton T-shirts, cotton trousers, woven shirts, underwear, synthetic fiber female T-shirts, and synthetic fiber female trousers. Of the categories put under quota, all but category 340/640 (cotton shirts) were embargoed between early July and early August. However, seven additional safeguard actions were subsequently requested by the US T&C industry in October 2005.[9] Preliminary data suggest that in both markets China's exports to the United States decelerated during the July–December period but still enjoyed a high rate of growth. However, countries with competitive garment industries, such Bangladesh, India, Indonesia, and Sri Lanka, increased their market share.

Recent Evolution of Investment and Employment in the T&C Sector

An analysis of investment flows in Morocco, Tunisia and Egypt suggests that there has been a healthy process of creation and destruction in the T&C sector of these countries. In Tunisia, more enterprises were created than closed in 2005. In Morocco, some new investments are being made with considerable technical change and innovation. However, Morocco registered a higher number of firm closures compared to the number of new firms. In the first half of 2005, 67 enterprises were either created or extended, compared to 74 closures, restructurings, or downsizings. But new projects are in development, particularly in the textile segments of yarn spinning and fabric weaving. In Egypt, the export-oriented sector is dominated by the private sector and mostly operates within the Egypt free zones[10] or in the newly-created QIZs. Many new investment projects were created after the end of the MFA.

Mirroring the gloomy predictions on the export side, many analysts predicted large employment losses in MENA-4 countries. However, the picture is nuanced. Employment in

[8] This MOU allows WTO members who are threatened by market disruption from increased Chinese exports to re-impose quotas on China on specific products until 2008 (WTO 2002). The significance of this transitory safeguard mechanism lies in the fact that, contrary to normal WTO safeguard measures, it is discriminatory and does not require a lengthy investigation to prove injury to an import-competing industry.

[9] Decisions are pending for the imposition of safeguard quotas on nine additional categories; however, the total export value is relatively small and the expected quota will be quite large. As a result, these additional limitations will simply keep Chinese exports at the 2005 level.

[10] As per Law no. 8/1997 and its executive regulations.

Tunisia's T&C sector during the first eight months of 2005 declined by -1.1 percent. This decline represents about 3,500 jobs, a number far lower than what had been predicted. Available statistics show a sharp decline in employment in the Moroccan T&C sector, but new jobs are being created as well. In Egypt, employment creation in the QIZs and free zones has continued, even after the MFA removal. From a policy standpoint, it is important that decision makers in these countries devise accompanying policies to help mitigate the impact of employment losses.

IV. Egypt's History with the MFA and the Effects of its Phase Out

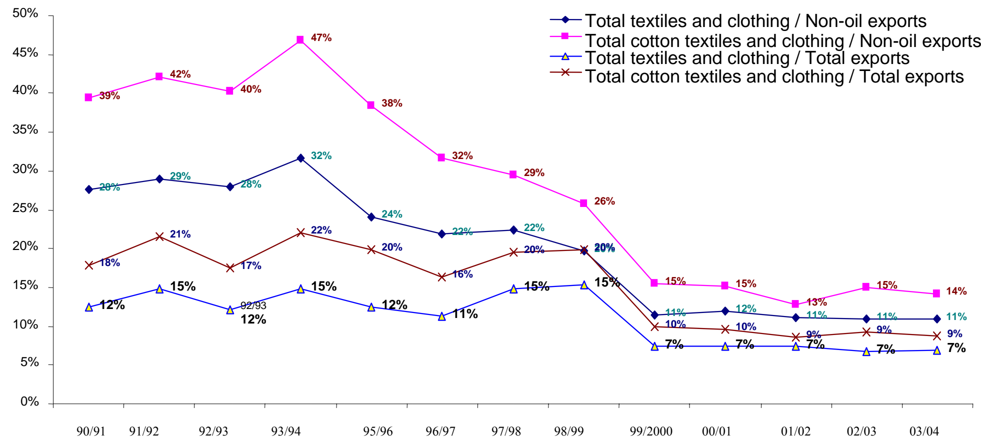
The Importance of the T&C Industry in Egypt

The Egyptian T&C industry is of vital importance for the Egyptian economy both from an economic perspective—as it is among the major contributors to foreign exchange earnings, and an absorber of large amounts of domestic and foreign investments—and from a social perspective—as it is the largest employer in the economy. Egypt is also the only country in MENA with a large fiber, yarns, and fabric industry. The industry represents 27 percent of the total manufacturing production in Egypt ranking second after the food industry, but in terms of value added it ranks first. The T&C industry represents 30 percent of total manufacturing value added (Sakr and Abdel-Latif 2000) and about 3 percent of GDP (surpassed only by tourism and Suez Canal revenues as main contributors to GDP), and it is the largest employer in the industrial sector absorbing 30 percent of Egypt's industrial labor force in 2004 (Ministry of Foreign Trade and Industry 2005a).

The industry receives on average between LE 13-17 billion yearly in investments contributing about LE 1 billion as wages (Gillani 2002) making it the largest provider of wages in the industrial sector (23 percent of wages) (Ministry of Foreign Trade and Industry 2005a). It is highly integrated, and has strong forward and backward linkages (Sakr and Abdel-Latif 2000). Exports of T&C reached $1.4 billion[11] in 2004, representing 24 percent of total non-oil exports revenues for Egypt (up from 17 percent in 2001) (Ministry of Foreign Trade and Industry 2005a). Figure 3 outlines the relative importance of T&C exports to total non-oil Egyptian exports. On average, the importance of the T&C exports as a share of total merchandise exports has been on a declining trend.

[11] It is worth noting that previous studies such as AmCham 2004 and Fawzy and Massoud 2003 have reported higher US figures for previous years.

Figure 3. Position of the T&C Industry in Trade



Source: Central Bank of Egypt (CBE). 2004. *Annual time series.*

The great importance of the T&C industry to the Egyptian economy does not translate into Egypt being a big player in the international market. Egypt's exports do not represent more than 0.3 percent of the total world exports (Madger 2005) divided between 0.2 percent for textiles (down from 0.5 percent in early 1990s) and 0.12 percent for clothing (Fawzy and Massoud 2003). Moreover, in all the sub-categories of T&C exports, Egypt has a lower share than its competitors in the region (including Jordan, Turkey, Morocco, and Tunisia) with the exception of cotton.

Egypt has never enjoyed preferential duty treatment under the Generalized System of Preferences (GSP) as the United States does not include textiles and clothing under this regime. Under the MFA regime, Egyptian exports have faced quotas in both the United States and in the European Union. Available data show that the quotas have not been binding and, with few exceptions, they have been underutilized. In fact, Egyptian exports have enjoyed high growth rates in countries allocating such quotas but not in open and competitive markets (see for example Kheir-El-Din and Abdel-Fattah 2000). In a few instances, US quotas have hindered the growth of some competitive clothing products such as T-shirts, cotton and man-made-fiber shirts, and ladies woolen trousers. However, negotiated increases in quotas have alleviated such constraints (Kheir-El-Din and Abdel-Fattah 2000).

At various times, the Egyptian T&C industry has represented a potential threat to the European Union and as a result it has been subject to surveillance and extra inspections for a number of exported products. Of the six antidumping cases raised against Egypt by the European

Union in the 1990s, four related to textiles (Ghoneim 2000).[12] Reference quantities have also been established by the European Commission for imports of certain products from Egypt (see Inama and Jachia 2000). In fact, during the period 1989-2005, Egypt exceeded its EU yarn quota for two years (1989 and 1994) and fabrics for three years (1989, 1993 and 1994) (see Kheir-El-Din and El-Sayed 1998). In all other years, the quota did not represent a major constraint on Egyptian exports as it has for other countries.

Adjustments Undertaken in Preparation for the End of the MFA

As seen in Section III, the end of the MFA did not have a major impact on the Egyptian T&C industry. Egypt suffered losses in the EU market and significant gains in the US market. This section explores the institutional and policy changes that were made in preparation for the end of the MFA.

Reducing protection

The T&C industry has historically been one of the most protected and domestically-oriented in Egypt. Even when it was forced to abandon quantitative restrictions (in 1998 for textiles and in 2002 for clothing), it imposed "specific" tariffs rather than ad-valorem tariffs.[13] In the early 2000s, the European Union and the United States challenged these "specific" tariffs on grounds that they were not in line with Egypt's commitments in the WTO. In some cases, the tariff exceeded 100 percent when it should not have been more than 40 percent[14] and the specific tariffs placed on garments translated into an ad valorem equivalent of 627 percent despite Egyptian commitments to significantly reduce bound tariffs by January 2005.[15] It was only in 2004 that Egypt replaced the specific tariffs with appropriate ad valorem tariffs, after the United States and European Union had already asked for consultation under the WTO dispute settlement mechanism (see WTO 2004).

[12] The four cases were related to cotton yarn (raised in 1990), unbleached cotton fabrics (1996), bed linen (cotton type) (1996), and cotton fabrics (1997).

[13] When the Egyptian government lifted bans on most textile imports in January 1998, important new non-tariff barriers were introduced. These include excessive technical certification (quality control) requirements and cumbersome and costly marking requirements. For example, the name of the importer is required to appear on every 30 meters of fabric. The technical barriers add tremendously to the costs of importing inputs. Mandatory inspection fees of 1 to 4 percent on some textile products further add to costs.

[14] The ad valorem effective rates of the per item tariffs were estimated to have been 100 to 150 percent, though the United States Trade Representative alleged that the ad valorem equivalent of the Egyptian tariffs ranged from 141 percent to a high of 51,296 percent (WTO 2004).

[15] From 45 percent on yarns, 60 percent on fabrics, 65 percent on made-ups, and 70 percent on clothing to 15 percent, 30 percent, 35 percent and 40 percent, respectively (Kheir-El-Din and Abdel-Fattah 2000).

In January 2004, Egypt reduced the tariffs on apparel to 40 percent, on home textiles to 35 percent, on fabrics to 22 percent, and on yarn to12 percent. Additional tariff reductions were made for textile machinery and spare parts. Duties on other inputs to the industry were also reduced. In September 2004, Egypt undertook unilateral tariff structure reform, reducing the number of tariff brackets from 27 to 6 and eliminating service fees and import charges that ranged from 1 to 4 percent. Moreover, it reworked its national tariff structure under the Harmonized System (HS), from 13,000 to 6,000 tariff headings at the 10-digit level. The new structure also introduced lower tariff rates, ranging from 2 percent on raw materials to 40 percent on consumer durables, bringing the estimated weighted average tariff down from 14.6 to 9.1 percent, and removed all related administrative fees and surcharges (Ministry of Finance 2004).

Notwithstanding the recent liberalization, it can be said that the government has always tried to delay tariff reduction and has complied with its commitments only after experiencing external pressure. Nonetheless, the effective rate of protection in the clothing industry was kept high. Even after the recent tariff reductions, the clothing sector enjoys the second highest effective rate of protection in the manufacturing sector (see table 8). Besides tariffs, the industry continues to be protected by labeling requirements (writing the brand name and country of origin in Arabic) in addition to other technical measures that affect the import of other segments of the industry to ensure its protection (Ministry of Foreign Trade and Industry 2005b).

Historically, trade policy has been used to achieve social aims, but the high concentration of labor accompanied by high geographical concentration of textile factories made the issue highly political and socially sensitive (El-Mikawy and Ghoneim 2003). Because of WTO commitments and external pressures, the industry has started to focus on enhancing exports. However, the government is still in a transitional period, trying to dismantle the historical high protection enjoyed by the industry with the least social costs while at the same time increasing the export capability of the industry; an equation that is extremely difficult to maintain. For example, exporters are reimbursed the duties paid on imports of inputs used for exportable products through a duty drawback system. But poor implementation often leads to delays in payment and as a result, exporters incur other costs in terms of paperwork and time.

Table 6. Developments in Nominal and Effective Rate of Protection

	Nominal		Effective	
	2000	**2004**	**2000**	**2004**
Manufacturing simple average **(%)**	21.2	13	23.3	14.3
Food Processing	10.4	7.8	15.4	9.3
Textiles	24.0	9.2	27. 6	10.3
Ready-made Garments and Footwear	38.3	26.7	43.4*	31.6
Leather Products (excl. footwear)	30.0	29.5	34.4	36.1
Wood Products	12.9	7.3	12.4	6.9
Paper & Printing	15.6	10.2	15.0	9.7
Chemical Products (excl. oil refining)	10. 6	4.8	8.9	3.2
Rubber & Plastic Products	29.1	13.6	32.7	14.9
Non-metallic Products	23.1	14.7	26.2	16.7
Metals and Iron Products	12.5	5.9	11.0	3.7
Machinery & Equipment	14.3	8.7	14.1	8.8
Transportation Means	33.6	18.1	38.3	20.4

Source: Galal and Refaat (2005).

*The ERP is calculated based Egypt's commitments and not on the applied tariff.

Signing the QIZ Protocol

As part of the government's efforts to preserve jobs in the T&C industry and enhance exports, in December 2004 Egypt the United States and Israel agreed on the QIZ protocol. The Egyptian government has estimated that the protocol would inject $2 billion into the Egyptian economy over two years, mostly directed toward the T&C industry, and create 150,000 to 250,000 new jobs (Madger 2005). As reported by interviews with firms and as discussed in section III, the QIZ protocol was able to overcome the negative effect of the MFA removal, especially in downstream industries. Hence, no negative economic impact of the MFA abolishment was felt at least by the private sector business located in the qualifying zones. The government has announced that it will negotiate with the United States to add more qualifying industrial zones. Currently, there are seven qualifying industrial zones and they are located in three large geographical locations: the greater Cairo region including the 10th of Ramadan City, 15th of May City, Shoubra El Kheima, Industrial Nasr City and south Giza; the greater Alexandria region including El Amreya (Borg El Arab); and the Suez Canal region, which includes Port-Said Industrial City. On October 31, 2005, the Minister of Foreign Trade and Industry announced the success of Egyptian government negotiations with their counterparts in the United States on adding new locations to be included in the QIZ and widening some of the existing ones. As a result, a total of 4,500 firms employing around 350,000 workers will benefit. The new locations were extended to the governorates of Gharbia, Dakahlia,

Menoufia, and Damietta, which host well known textile production areas such as Mehala-El-Kobra, Qouissna, and Shebin-El-Kom. In addition, some existing locations were enlarged such as the Greater Cairo area and the Suez Canal area, the latter of which was expanded to include Suez and Ismaila (besides Port Said which was included from the beginning).

Despite the recent success, it is important to remember that the preferences of the QIZ are likely to be eroded over time due to the proliferation of free trade areas that the United States is signing, which implies that the preferential treatment of Egyptian exports will be negatively affected. Moreover, the QIZs do not solve the main supply-side problems of the industry, which range from lack of investments to poor cotton pricing policy to inability to deal with mega public factories. The next section discusses how Egypt can benefit from the end of T&C quotas. We focus on policy issues that are related to the removal of the MFA and not on general policy implications that cure the ills of this industry.

How Can Egypt Benefit from the End of the MFA?

Diversify into new markets

While the importance of the US market should be maintained, more attention should be given to diversifying exports to markets where Egyptian products enjoy a competitive advantage not related to tariff preferences. Hence the issue of geographical proximity to the European Union and the ability to source inputs in cheaper countries (e.g., when the Turkey-Egypt Free Trade Area is concluded or as a result of the Aghadir or GAFTA Agreement) should be better utilized. Such issues related to competitive advantage as geographical proximity and cumulation of rules of origin are relatively more important than tariff preference as they are likely to last for a longer period of time and are not subject to abrupt changes or tariff erosions.

Negotiate better rules of origin

Restrictive ROO often force suppliers to forego cheaper inputs from third-country suppliers in order to qualify for duty-free entry to the importing country.[16] Egypt, like many other Mediterranean countries, has signed an association agreement (AA) with the European Union, according to which tariff barriers to trade in merchandise goods will be fully eliminated within a

[16] ROO define the conditions that a product must satisfy to be deemed as "originating" and thus qualify for preferential market access. Preferential (i.e. less than MFN tariffs) access to US and European markets is guaranteed only if the ROO provisions embedded in the FTAs are satisfied. In general, both the United States and the European Union specify certain production processes that must be used in order to qualify for preferential treatment.

12-year period.[17] The EU ROO in T&C require that two stages of production be undertaken in the partner or qualifying area to confer origin. For example, for the yarn to be allowed duty free access, it should be produced from Egyptian fibers, whereas the fabrics have to be made of Egyptian yarns in addition to two specific industrial processes. As for ready-made garments, the so-called yarn forward rule is to be applied which is known to be restrictive (Ministry of Foreign Trade and Industry 2005a). Thus, clothing products using fabrics imported from third countries, such as China, do not satisfy the EU rules of origin and do not qualify for tariff reduction.

For Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia, Turkey and the West Bank and Gaza Strip taken together, the AAs with the European Union allow, in principle, for diagonal cumulation.[18] However, it will take some time for this to happen. In fact, for diagonal cumulation to take place it is necessary that the association agreement between the European Union and EuroMed Partners are implemented and that there is uniformity in the ROOs between each pair of member states. Egypt signed an FTA with Turkey on December 27, 2005, and this implies that Turkish inputs can be sourced and transformed into clothing in Egypt that can then be exported duty free to the European Union.[19] While diagonal cumulation is important, there is no doubt that a third-party rule that would allow the flexibility to source fabric from anywhere in the world would be superior. Comprehensive (PanEuroMed) gains from complete utilization of diagonal cumulation in the PanEuroMed area will take time to be fully reaped, since they depend on the signing of numerous FTAs. Using the Agadir Agreement as a framework, Egypt, Morocco, Tunisia and Jordan should address this issue and look for simpler ways to realize diagonal cumulation. In the longer term, they should negotiate a third-party rule with the European Union that permits the flexibility to source fabric from anywhere in the world.

Reduce the costs of domestically-produced inputs

Focusing on the export market requires bringing in know-how and foreign expertise by encouraging joint venture and subcontracting schemes. But the hope of maximizing the benefits from subcontracting schemes should be considered with caution as the restrictive ROOs of the

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[17] Phase-out schedules vary by country. Tunisia signed the AA with the European Union in 1995 and started its implementation unilaterally in 1996. Morocco signed its AA in 1998 and began its implementation in 2000. Jordan is part of the Euro-Mediterranean process and signed an FTA with the European Union in 1997, which has been in force since May 2002. The Egypt-EU Association Agreement was signed in 2002 and has been in force since June 2004 (the chapter relative to T&C has been in force since January 2004).

[18] It is worth noting that both Cyprus and Malta joined the European Union in 2004.

[19] Tunisia's agreement with Turkey entered into force in July 2005, and Tunisian exporters are already benefiting from cheaper inputs from Turkey. For Morocco, the agreement entered into force in January 2006.

preferential agreements of the EU and US reduce the benefit of preferential access. Egypt should be in a better position than most of its competitors in MENA, including Morocco, Tunisia, and Jordan, as it has its own domestically-originated inputs. However, domestically-produced cotton remains expensive. For example, while cotton yarn from India and Pakistan can be imported at $2.75/kg, local yarn is sold for $4.5/kg (AmCham 2004). Egypt is unable to produce cotton and other inputs at low price because although the cost of labor is similar to or lower than that of most Asian exporters, Egyptian companies exhibit low levels of productivity both in labor and capital utilization. This performance is largely the result of over-employment and underinvestment in public sector firms, which represent a large segment in Egypt's upstream textile companies. The process of privatizing public companies has been slow and pursued in a piecemeal fashion, delaying the needed restructuring of the sector. Hence the Egyptian exporter is left with the option of either importing expensive inputs (because of high tariffs and restrictive rules of origin) or using very costly domestically-produced inputs. Both of these options have a negative impact on export competitiveness.

Exploit new niches and the advantages of proximity

Some studies claim that countries like Egypt should move into new fields, such as the so-called technical textiles. These are textile materials and products manufactured primarily for their technical and performance properties rather than their aesthetic and decorative characteristics (OECD 2004). As reported by the OECD (2004) this type of industry is still highly concentrated in developed countries but a few developing countries are finding successful niches.

Other studies have emphasized the need to focus on the products with short lead time (Nathan Associates 2004; Madger 2005) making use of the geographical proximity to the European Union. Proximity allows buyers and suppliers to build strong relationships and permits a better understanding of customer preferences. Egypt, like other countries in MENA, can be competitive in exporting time-sensitive, replenishable products to the EU market because it has inventory costs and risks that are lower than those of distant suppliers. Firms can exploit the advantages of proximity by focusing more on products with a short lead time that need to be replenished quickly during the selling season. Reducing lead time—the time that is needed to turn around a product from receipt of orders to shipment to markets—is a winning strategy. By contrast, more standardized, non-replenishable apparel will increasingly face competition from cheaper labor locations. Given the competitive advantage that Egypt enjoys regarding labor and geographical proximity with Europe, it should seek to engage with retail distributors in developed

countries and compete in this segment of the market. As identified by private sector interviews, the proximity to the European Union is still not well utilized despite the fact that empirical evidence has shown that it plays a crucial role in enhancing the competitive advantage in this industry (WTO 2004).

Make use of the AGOA

Egyptian exporters have not taken advantage of the African Growth and Opportunity Act (AGOA), an agreement with the "third-country fabric" rule where Egypt could develop ties with the 38 African countries that are eligible for the free quota and duty free access to the United States. Now that the decision has been made to extend the "third-country fabric" rule to the end of 2007[20] (Institute for Social, Behavioral, and Economic Research 2005), the Egyptian government and business community should make use of this opportunity, especially for the firms that have not enjoyed the benefits of the QIZ protocol. The AGOA provides an excellent opportunity for the Egyptian industry to become integrated in the value chain of a new entry point to developed markets. The special and preferential treatment that the least developed countries in Sub-Saharan Africa enjoy, whether in terms of the AGOA or any other scheme, should be built upon by the Egyptian government as well as the business community. Cumulation of inputs is the key to success in this new global market.

V. Conclusions and Policy Implications

This paper has shown that the end of the MFA has had a mixed impact on the Egyptian T&C sector, as well as on other countries in MENA. During the first year without quotas, the T&C sectors of all MENA-4 countries lost ground in the EU market. This performance is no different from trends in recent years when a relative decline in exports occurred, however it sharply contrasts with that of countries such as Romania, Bulgaria and Turkey, which enjoy similar proximity advantages as MENA but have seen an increase in their market share. The performance is worse for products that fall in the low-end of the market and therefore compete directly with China.

In the US market, Egypt (and Jordan) experienced impressive export performances after the MFA removal. There is no doubt that the QIZ protocol has saved the prospects of the industry's exports in the short run, however, this does not imply that it has cured the ills of the industry.

[20] In July 2004 a decision was made to extend AGOA until 2015 and extend the third country fabric rule to September 2007.

Moreover, it may be too early to attribute the upsurge of exports after the end of the MFA to the QIZ effect alone as there might have been some contracts that took place beforehand. The T&C industry in Egypt is in transition, becoming more export oriented and less protected. Hence, the industry is in need of a new overall strategy that builds on its competitive advantages.

In a market where technological advances and overall liberalization have increased competitive pressures, the long-term challenge facing the T&C firms in MENA-4 is to work towards the creation of new opportunities by improving both process productivity and product quality. However, the future of the sector depends in no small measure on government policies. Below we mention some of the issues that the Egyptian government should take into consideration in designing a strategy for this industry to flourish.

- The restructuring of the T&C industry should take into account the costs of creating a job in the different segments of the industry. According to the Ministry of Foreign Trade and Industry (2005a), the cost of creating a job in the ready-made garments sector is the least costly (LE 40,000) when compared to the cost of creating a job in the yarn and textiles sector (LE 150,000) and the dying sector (LE 100,000).
- Egypt has much to lose from keeping the still-high levels of protection on imports of textile inputs and should deepen efforts toward tariff reduction and rationalization. Furthermore, special effort should be taken to remove the remaining non-tariff obstacles to foreign cotton imports. Recent reforms include the simplification of customs procedures and a reduction in the number of required documents for the import and export process. As a result, import and export processing times have been lowered. These reforms need to be continued and deepened. This is crucial to enable firms to act swiftly, efficiently and predictably.
- The export subsidies program, which started in 2001, needs to be better implemented. The government has established an export promotion fund aimed at enhancing exports through the provision of subsidies ranging between 4-10 percent of the invoice value. According to interviews with T&C firms, the export program has helped them overcome the transaction costs they incurred due to bureaucratic procedures as well as the high transport costs. However, delayed payments to exporters by up to 2-3 months resulted in a discount in the value of the subsidies by 3-4 percent. Hence, a better implementation of the program would certainly help to expand exports.

- Appropriate implementation of the Egyptian cotton logo is needed. The first step of actually establishing the logo was crucial; however the follow up steps of maintaining the system and registering the logo in different countries (which preserves the right of the logo) requires a substantial amount of funds that are not available to Egyptian authorities. Collective action between the government, private sector and donors is needed in this regard.
- There is an urgent need to enhance training and education in the T&C industry. Despite the well-known fact that Egypt has an adequate labor force, the interviews showed that there is a lack of skilled labor and trained engineers. Some training is provided for workers through the Mubarak-Kohl Initiative—a joint German-Egyptian project to provide education services and grants—however it remains inadequate in meeting the needs of the industry. Moreover management, dyeing, and designing skills remain scarce in Egypt. As such, it is important to establish vocational centers concerned mainly with training labor in this field, especially where the industry is densely concentrated (Cairo, Alexandria, Gharbia, Kalyubia, and Giza), while developing undergraduate and/or graduate departments for textiles engineering at some of the engineering faculties in Egypt.
- It is necessary to adopt a new cotton policy that encourages the production of other types of lint cotton (medium and short staple), while allowing such types to be easily imported without making the spinners and importers incur the costs of fumigation.
- There is an urgent need to upgrade port facilities including handling and customs procedures, especially if the industry is to capitalize on the geographical proximity to the European Union. The transaction costs associated with handling in ports (air and maritime) and the inefficiency of the firms undertaking such activities are relatively high. Research has shown that issues related to trade facilitation such as inefficient road systems, outdated trucks, and lack of facilities at ports significantly add to the costs incurred by Egyptian producers and exporters. Several measures have been undertaken to resolve these issues, but much more needs to be done. Studies have shown that geographical proximity does not count for much if the lead time in Egypt is much longer that in other countries.
- Export processing zones are another channel that can be better used to enhance exports. In line with government initiatives to overcome bureaucratic impediments of the market,

export processing zones should be efficiently utilized since they suffer less bureaucratic impediments and have better access to technology given the multinationals operating there.

- The Partnership Agreement with the European Union and its program to upgrade the T&C industry should be made more efficient and flexible from both Europe and Egypt in order to speed up the process of structural adjustment required by the industry.
- There is an urgent need for restructuring public firms into small units, each with its own specialization to avoid cross-subsidization and bad management. This is not necessarily associated with the privatization program and may be undertaken by redesigning the management and legal system[21] Moreover, injecting investments into public sector firms whether or not they will be privatized should be seriously investigated by the government and the allocation of investments should be carefully designed to avoid misallocation.

[21] This has been undertaken recently in the air transport sector where Egypt Air has been restructured into several firms and a holding company was established.

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