

## Logistics Hub Strategy of the GCC Countries and Policy Implications: with a Focus on Saudi Arabia and the UAE

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### Introduction

The aim of this research is to review strategic policies on creating a logistics hub in the GCC which includes infrastructure and hinterland development, and to suggest government policies to enhance industrial and logistics cooperation between Korea and GCC countries. In particular, logistics hub policies being promoted in Saudi Arabia and UAE are analysed as case studies to elicit implications for bilateral cooperation policies in the logistics sector. By doing this, it will be emphasized that a logistics hub strategy of the GCC countries should be understood as industrial policies to diversify their economic structure by expanding the private sector.

According to the data published by the governments of the GCC countries, the oil and gas sector in the GCC countries represent about 40% of GDP with the manufacturing sector accounting for about 10%, which shows that GCC economies remain highly dependent on the oil and gas sector. Moreover, in cases of major oil-exporting countries like Saudi Arabia, Qatar and Kuwait, the share of the oil and

gas sector in total exports is more than 80%. This feature is contrasted with the Korean one that most export products belong to the manufacturing sector including automobiles, TVs, steel products, clothes. This gave rise to budget burden and macro instability to the oil-exporting countries when international oil prices are falling down after the second half of 2014.

The high dependence on the oil and gas sector is reflected in the employment structure of the GCC countries. For example, the nationals preferred the public sector including the oil and gas sector since it provides better working conditions and higher level of wages compared to the private sector. This aggravates unemployment because of limited capacity for job creation of the public sector although GCC governments promoted employment policies which increase the share of nationals, and replacement of foreign workers, in the private sector.

Economic diversification policies of the GCC countries are designed to reduce the degree of dependence on the hydrocarbon sector. In oth-

er words, they are being implemented to increase production and exports by non-hydrocarbon sectors, and ensure sustainable economic growth and stable employment that provide good income.

## Saudi Arabia's Strategy for Building a Logistics Hub

The logistics hub policy of Saudi Arabia focuses on fostering not only the manufacturing industry for the industrial diversification but also industrial and economic cities to export products and raw materials more efficiently.

Although the Saudi government is trying to improve logistics infrastructure, it shows low level of competitiveness on the world stage at present. According to Logistics Performance Index (LPI) of the World Bank, most sub-indices in LPI of Saudi Arabia maintain an average level of six countries of the GCC. Among sub-indices in Doing Business in Saudi Arabia, although paying taxes is quite efficient, resolving insolvency, getting credit and enforcing contracts are time consuming and costly. Global Competitiveness Index (GCI) of Saudi Arabia shows no indications of significant improvement of transportation infrastructure.

The Saudi government is pursuing improvement of its overall logistics infrastructure. Saudi airport authority has been increasing investment in expansion of existing airports and construction of new international airports to become a regional hub of airline traffic in the long term. The railroad infrastructure of Saudi Arabia has been developed with the purpose of connecting industrial cities and other logistics infrastructure. Although the Saudi government is making an effort to make

up for the weak points and investing in logistics infrastructure, the efforts are currently moving at a glacial pace.

Foreign companies have entered Saudi Arabia with the purpose of using port hinterlands, logistics facilities and the country's relatively large market for the region. S&TC, a Korean company mainly producing equipments used in petrochemical, power and natural gas plants, also decided to enter Saudi Arabia to utilize many advantages offered by the Dammam Industrial city, a famous port hinterland in Saudi Arabia. Henkel, a world leading brand in laundry & home care, beauty care and adhesive technologies, set up a corporate body in 1998 to reduce distribution costs with the localization of manufacturing facilities in Saudi Arabia. Toys "R" Us, a famous company selling toys and baby products, established a distribution center to expand market share in Saudi Arabia.

The strengths of Saudi Arabia as a logistics hub are its geographical advantage that can link Africa, Asia and Europe and the relatively larger domestic market than other GCC countries. Its weaknesses, on the other hand, are that its logistics infrastructure was developed much later than the UAE and Qatar. However, major opportunities include high growth potential in the logistics industry due to bold investment, increasing trade volume of petrochemical products and manufactured goods, and efficient connectivity with other GCC countries. The major threats are its intensifying competition with other neighboring countries for the development of logistics infrastructure and possibility of shrinking government investment amid falling oil prices.

It is required for Korean companies to consider entering Saudi Arabia analyzing strengths, weaknesses, opportunities and threats in the

logistics sector. Also, Korean companies can cooperate with Saudi Arabian companies in the field of energy intensive industries and project logistics sectors. The Korean government could support Korean companies to participate in the PPP (Public Private Partnership) projects by providing co-financing for Korean companies in Saudi Arabia and cooperate with PIF (Public Investment Fund) and SIDF (Saudi Industrial Development Fund) which are supportive funds for the investment in Saudi Arabia.

## United Arab Emirates' Strategy for Building a Logistics Hub

The United Arab Emirates (UAE) has become a world leading logistics center, covering the Middle East, Africa, and Europe. The UAE has developed its port and airport infrastructure, and has enhanced business environments with legislative reform and logistics-supportive policies.

According to the World Bank's Logistics Performance Index (LPI), the UAE ranked the highest among the Middle Eastern countries, and 27th among 160 world nations. The UAE has shown the best performance in logistics among the six countries of the GCC including trade related institutions and regulations. Although the size of its domestic market is small, the UAE has become the largest re-exporting country with the help of well-established infrastructure and free trade zones in Abu Dhabi and Dubai.

Free trade zones and industrial zones in Dubai and Abu Dhabi forms a multi-modal logistics platform linking ports, airports, and production facilities. In 2013, transshipment traffic of

the UAE ports recorded 19 million TEU, which accounted for 34.7% of the container traffic in the Middle East. In 2013, Dubai international airport was the seventh-busiest and the fifth-busiest airport in the world in terms of international passenger volume and cargo traffic respectively. Of the top 10 international airports, Dubai international airport showed the highest growth rates in both passenger and cargo traffic.

The UAE is one of the world's largest re-export hubs providing many advantages and tax incentives. The free trade zones mostly offer 100% foreign ownership, no customs duties on imports and re-exports, and exemptions from corporate taxes. Many goods imported into the UAE are re-exported to Iran, Saudi Arabia, Turkey, Iraq, and Oman. Specifically, Iran, on the other side of the Strait of Hormuz, is the UAE's largest re-export destination accounting for 16.5% of the total.

The strengths of the UAE as a logistics hub are geographical location at the crossroad of the Middle East, Africa, and Europe; well-developed infrastructure such as ports, airports, road networks, and special economic zones; and a business-friendly taxation regime. Its weaknesses include a small domestic market, weak manufacturing infrastructure, and low but probable geopolitical instability of regional militant groups and the Strait of Hormuz, where Jebel Ali, the largest port, is located. The opportunities include a likely increase in demand for re-export to Iran after lifting economic sanctions against Iran, and the expansion of Jebel Ali terminal 3 leading to enhancement of its container handling capabilities. As for risks, there are probability of further oil price declines, and increased competition among its constituent emirates to build logistics infrastructure.

Many foreign companies have taken advantage of the UAE as a logistics hub for assembling semi-finished products and then re-exporting to the Middle Eastern and African countries. They are categorized into two types: logistics-hub-based manufacturing companies and logistics companies. Canon Middle East in Dubai is an example of logistics-hub-based manufacturing companies. It regards Jebel Ali as not only a transit point, but also a regional production facility for assembling and shipping directly to the Middle East, Africa, and even Europe. Pantos Logistics shows an example of the other type of company. In order to expand logistics operation services including air/ocean freight, customs clearance, and warehousing, Pantos Logistics has established the Middle East Logistics Belt connecting Turkey, Saudi Arabia, Oman, and the UAE.

Korean companies planning to enter the UAE logistics market could expand regional networks through M&A and joint ventures with local logistics companies, especially Halal food companies. It would be helpful for manufacturing and logistics companies to enter the UAE together. The Korean government could help Korean companies by easing regulations on M&A between logistics companies, and by allowing logistics companies to grow sufficiently large to be able to survive in the international logistics market.

## Concluding remarks

Logistics hub strategy of the GCC countries aims not only to promote the logistics sector but also to strengthen the basis for economic diversification. This creates business opportunities to expand bilateral cooperation between Korea and the GCC countries. First, the logistics sector should be considered in connection

with industrial sectors, as logistics hubs have been developed as tools for economic diversification. In other words, free trade zones and industrial cities should be explored as a productive platform to add value to the products exported from Korea.

Second, logistics hubs in the GCC countries could be used as a base to (re)export Korean products to the Iranian market after international sanctions against Iran are removed. Moreover, Iran can serve as a gateway to Central Asian countries through Turkmenistan, and the Caucasus region through Azerbaijan, creating more logistics demand.

Third, investment by Korean companies is necessary for the establishment of joint ventures between Korea and GCC countries in logistics-related business activities. They could invest in projects incorporating processing facilities in the free trade zones and logistics infrastructure. For these investment projects, various financial support scheme should be developed by Korean and GCC financial institutions including some sovereign wealth funds for development.

Fourth, logistics information platform should be established in major logistics hubs in the region for Korean companies seeking information on logistics demand and cooperative partners in the GCC market. This will facilitate, particularly, the entry of small and medium sized enterprises into the market. **KIEP**