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Middle East Transport and Logistics at A Crossroads
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MIDDLE EAST TRANSPORT AND LOGISTICS AT A CROSSROADS

The Middle East region is in the middle of exciting global, regional, and local developments in terms of transport and logistics. Beginning in the first century AD, the Silk Road brought intense trade and substantial wealth to the region, and the fundamental drivers for this traffic have not changed since then. Today, the region is still located halfway on the trade lane between Asia and Europe and provides a multitude of land and sea connections linking those economic mega-agglomerates. What has changed since then is the advent of air transport, but even this development plays in favor of the region, as will be explained later. Hence, with the explosive growth of global and regional trade, and especially the trade between Europe and Asia and within the broader region, the Middle East faces unprecedented opportunities to capitalize on the unique strength of its favorable geographic location.

Transport and Logistics: A Unique Opportunity for the Middle East
The Middle East region’s excellent geographic location and very good accessibility by air, land, and sea have brought it to the top of the agenda for global logistics as the strong growth of global trade requires efficient transport and logistics structures. Hence, from a global perspective, the region has a set of three unique opportunities.

First, the region can benefit from the strong growth of volume in the trade lane between Europe and Asia. Because the Asian region has become a key production and manufacturing region for the rest of the world over the past decade, trade volumes between Europe and Asia have grown significantly, both in air and sea freight. Traditionally, air freight carriers have used a stopover in the Middle East, halfway along this trade lane, to refuel and thus maximize freight loads on their aircraft. Air freight growth on the trade lane therefore translates into growth in stopover traffic. This does
not hold true for the majority of shipping volume, however, which is transported via sea freight and does not require a stopover.

Second and more important, the Middle East will benefit from the volume growth on the Europe–Asia trade lane as shippers use larger vessels and apply more advanced logistics concepts. Both factors are driving the need for hubs along the trade lane—and making it increasingly favorable for that hub to be right in the middle.

Basically, there are two logistics concepts around how to organize optimal loading and unloading runs for vessels. In the first instance, the vessel can make a so-called milk run along a set of different ports in the originating region (for example, loading subsequently in Copenhagen, Hamburg, Rotterdam, and finally The Hague), then make the long-distance journey to the destination region, and finally do a similar milk run in the destination region. This requires the vessel to stop at a multitude of ports, increasing loading time and incurring port-handling fees at each stop, as well as leaving the vessel at less than full capacity over a series of these stops.

Although this may be the most cost-effective approach for lesser volumes and smaller vessel sizes, another logistics concept—the hub-and-spoke approach—becomes more favorable as volumes and vessel sizes increase. In this model, the volume from one origination point is loaded onto a vessel irrespective of its destination and then transported to a central node—the “hub.” In the hub, freight to different destination points is unloaded and newly grouped, so that freight to only one destination point is reloaded on each vessel.

With respect to the Europe–Asia trade lane, both regions are multicentered and have a broad portfolio of sea and airports. Hence, if volumes and vessel sizes achieve a certain threshold size, a hub-and-spoke approach is the ideal logistics concept to achieve cost-effective transport. However, the hub can be located in the originating or the destination region as well as on any location along the trade lane. Current hubs in Europe are Rotterdam and Hamburg on the port side and London, Amsterdam, and Frankfurt on the airport side. In sea freight, volume and vessel sizes have not yet achieved sufficient scale to make a hub-and-spoke approach cost-effective; for the time being, sea freight will likely continue to make several stops in the regions of origination and destination. In air freight, however, a single hub along the trade lane is the more favorable option because of different economics, freighter sizes, and time sensitivity. Given the already-existing need for a refueling stopover halfway along the trade lane, this situation yields a strong demand for air freight hubs in the Middle East.

The Middle East faces unprecedented opportunities to capitalize on its geographic location.
Finally, there is a third driver of the Middle East as a growth area for global logistics along the Europe–Asia trade lane: the need for multimodal hubs. Historically, shippers have had one fundamental choice to make well before they began transport: did they want to ship their goods quickly and expensively via air freight, or slowly but less expensively via sea freight? Most shippers went—and still are going—for the latter. In doing so, they need to accept larger stocks and a slower speed to market. As product cycles speed up, demand becomes less predictable because of a broader variety of products, and companies manage stock more closely. Sea freight transport increases the risk of outdated stock or foregone profits due to the inability to meet market demands in a timely manner.

Still, for most goods, a complete airfreight transport is much too expensive to be viable. Hence, a new transport concept that we call “acceleration in motion,” offering a conversion from sea transport to air transport at a certain point along the transport route becomes more important. Such a service allows the shipper to start with cost-effective sea freight transport; if need arises—from better sales or unexpected additional demand, for example—while the goods are already in motion, the shipper can manage almost in real time how fast additional supplies will be brought to market. In sum, this allows the shipper to achieve better tradeoffs on speed to market, stock availability, and transport cost. Given the transport lengths and times between Europe and Asia, the Middle East is a natural location to do the sea-to-air transport conversion, for three reasons:

1. The Middle East is already the natural hub for refueling stopovers for the air freight industry.
2. The region is easily accessible by sea and is increasingly becoming a hub for the sea freight industry.
3. “Acceleration in motion,” if done in the Middle East, achieves attractive reductions in transport time—approximately five to seven days—while still conserving the cost-effective sea transport rates for half of the total transport.

In fact, Dubai has already made significant infrastructure investments to integrate its airport and seaport into a multimodal hub. With an annual volume of more than 100,000 tons of freight converted from sea to air, this operation proves the viability of the concept.

However, there are a limited number of opportunities to establish global multimodal logistics hubs in the Middle East. To be successful, such a hub must attract enough carriers for volumes to be easily transferred from one carrier to another. Even on a global scale, there are very few true global hubs—Los Angeles, New York, Amsterdam/Rotterdam, and Singapore. We predict that, at the most, there is an opportunity to establish two global hubs in the region; one position will soon be taken by Dubai, when its new airport becomes operational and its port expansion is completed.

But the Europe–Asia trade lane is not the only opportunity for the Middle East to capitalize on global trade. Its favorable geographic location provides a strong opportunity to establish the leading transport and logistics hubs for the broader region serving northern and middle Africa in the southwest, Pakistan in the east, and the Caucasian countries of the Commonwealth of Independent States (CIS)—such as Kazakhstan, Turkmenistan, and Uzbekistan—in the north. Three key factors act in the region’s favor for such a positioning.

First, the Middle East has the advantage of a geographic location
with equal proximity to all these markets and very good connectivity by road and short sea transport. The Caucasian CIS markets and middle African markets in particular currently lack accessibility from competing regional logistics centers, such as Europe and South Africa. For example, the Caucasian CIS markets are not yet developed enough to make significant investments in local logistics networks; at the same time, they require very long and complex transport by road and rail if they are directly served from the European logistics centers. However, these markets can be quite easily accessed from the Middle East. Similarly, the northeastern and inner African markets are far away from European and South African regional logistics centers while also being easily accessible from the Middle East.

Second, the trend for regionalizing logistics and distribution structures drives the allocation of regional headquarters and distribution centers in the Middle East. Global and larger regional industry players in particular are increasingly focused on optimizing their logistics and distribution chains, as they have identified these as key drivers for additional value and profit generation and enhanced customer service. Such optimizations include implementing sophisticated management systems, training regional and local logistics managers, and consolidating stocks formerly managed locally into one regional distribution center. After having restructured the logistics operations according to these principles in their core markets in Europe, North America, and the Far East, the larger industry players increasingly focus on the secondary markets. In essence, these optimizations yield a strong focus on regional logistics and distribution structures located in the markets with excellent accessibility to all means of transport and the most liberal trade policies.

The third factor supporting the allocation of regional logistics and distribution centers for the wider region is the positive economic outlook for consumption and increasing production in the Middle East. Because the Middle East already contains the strongest economies in the broader region, efforts to extend the local production base will provide substantial growth potential for equipment and industrial products. The corresponding population growth and increasing potential for per capita consumption also foster the positioning of the Middle East as a core business market with a need for a strong logistics sector.

Even though limited in number, there are several opportunities to establish specific countries or areas as regional logistics and distribution centers. On the one hand, a substantial part of this opportunity will be driven by global and larger regional industry players coordinating a mostly global production network. On the other hand, even though there are substantial efforts to grow the domestic production base, the broader region will, for the foreseeable future, still be strongly dependent on global imports, especially with respect to equipment, industrial, and more sophisticated consumer goods. Hence, excellent global accessibility based on an extensive logistics infrastructure of seaports, airports, and road networks will be crucial for the establishment of such regional centers. This already qualifies the global hub locations, such as Dubai, to play a significant role in regional distribution. Beyond these hubs, a few further locations with strong local consumption markets and very good logistics infrastructure—such as the key Arabian Gulf, Mediterranean, and Red Sea port locations—could qualify to become regional centers.
Beyond the opportunities arising from the rapid growth of global trade and enhanced regional logistics structures, which will be implemented primarily by global or larger regional industry players, a strong and sophisticated transport and logistics sector will be essential for the future economic development of countries in the Middle East.

There are four macroeconomic elements making a strong and efficient transport and logistics sector a strategic necessity:

- The enhancement of economic activity
- The enhancement of industry competitiveness
- The growth of the logistics industry sector
- The generation of sustainable job opportunities

The Enhancement of Economic Activity
Accessibility of markets is fundamental to enhancing economic activity. In every market—whether local, domestic, regional, or global—easy market access and an efficient flow of goods are essential. If these are not present, industry value is not generated and business potential is foregone. Hence, strong and efficient transport and logistics service offerings are essential to provide quick and cost-effective access to markets for domestic trade and manufacturing and enhance economic activity. At the same time, the availability of efficient transport and logistics services is increasingly a key decision criterion for foreign direct investment, in addition to competitive factor costs and availability of skilled resources. This is especially true in industries with sophisticated supply chain requirements, including industrial equipment, automotive, electronics, and downstream petrochemicals.

The Enhancement of Industry Competitiveness
Opening markets and the abolition of import customs duties increasingly expose domestic industries to global competition. Hence, local manufacturers compete with the global “best in breed” mix of factor costs, skilled labor, production standards, and supply chain excellence. As transport, logistics, and the supply chain service levels of globally distributed production capacities increasingly determine the overall production costs and are a key driver for product variety.
and customer value generation, the availability of such high-quality services has a major impact on the competitiveness of companies. For the Middle East, these realities have ramifications on two levels. First, the effective removal of import barriers, as promoted by the World Trade Organization, exposes local and domestic markets to global competition; thus Middle Eastern manufacturers face increasing competition in their home markets. Second, Middle Eastern manufacturers face stronger competition in their international export markets as global logistics and supply chain services become more sophisticated on a global scale.

The Growth of the Logistics Industry Sector
The transport and logistics sector itself provides an attractive opportunity to enhance economic activity. In mature markets, such as those of North America and Europe, the growth of the transport and logistics industry has outperformed overall GDP growth in the last several decades and represents a substantial part of the economy. A key driver for such strong growth potential is the ongoing disaggregation of value chains on the domestic, regional, and global levels.

Although this growth potential holds true in most markets, the Middle East’s opportunities globally and in its own broader geographic region, described earlier, make a strong transport and logistics sector crucial for the Middle East in particular.

The Generation of Sustainable Job Opportunities
Finally, besides providing a key building block for growing economic activity in manufacturing and other sectors and hence providing a basis for increasing employment levels, the growth of transport and logistics itself will provide the substantial potential for employment growth for which Middle Eastern countries are eagerly looking. Being a service industry with relatively limited investment requirements compared with other industries, as well as limited automation possibilities, transport and logistics is a labor-intensive economic sector with a strong focus on a less-skilled workforce. And while other industries in the more mature North American and European markets have seen high levels of cyclical or, even worse, have faced substantial relocation to emerging markets, the transport and logistics sector in most cases has mostly profited from such developments and provided a sustainable basis for employment and employment growth. As in other emerging markets, an additional supporting factor of the industry’s employment potential is the Middle East’s competitive labor cost, which reduces pressure for automation and workforce efficiency.

Each of these four macroeconomic elements provides rationale enough on its own for the Middle East to position the development of the transport and logistics sector very high on the government agenda; they are even more compelling in combination.
BUILDING BLOCKS OF A GOVERNMENT STRATEGY FOR THE TRANSPORT AND LOGISTICS SECTOR

As Middle Eastern governments embark on the development of the transport and logistics sector, it should be clear that—although there is generally a broad set of opportunities for the sector—these opportunities are not equally available to all countries in the Middle East. First, certain elements of the sector’s development require preferred geographic locations, such as seaports. Furthermore, certain opportunities, such as the development of a global multimodal hub, are limited in number and require huge infrastructure investments—as can be seen in the historical and current infrastructure investment budgets of Singapore, the Chinese ports, and Dubai.

Hence, governments should consider and decide on a set of five building blocks for their transport and logistics sector strategy. They should:

- Choose a strategic play for the sector on a global level
- Focus infrastructure investments to fit the chosen sector play
- Adjust policies and regulations to promote sector development
- Optimize government services to meet the demand of the logistics sector
- Promote the development of national transport and logistics champions.

**Choose a Strategic Play for the Sector on a Global Level**

Fundamentally, there are three different strategic plays that governments can pursue for the transport and logistics sector. The options for governments are:

- A global multimodal transport and logistics hub
- A regional logistics and distribution hub
- A domestic-focused transport and logistics service sector

These options are described in detail in the following paragraphs.

1. The global multimodal transport and logistics hub strategic play is the most demanding strategy for sector development. It must be built on a preferred geographic location, and it requires huge investments in infrastructure. Furthermore, it requires a multitude of factors that have to be coordinated and strategically aligned, including—

- An economic environment that attracts foreign direct investment by allowing for full ownership of the local entity
- The availability of a large free zone around the port–airport infrastructure, adhering to global quality standards
- A track record indicating that the port and airport operator can manage complex processes smoothly
- Highly competitive handling charges
- The provision of living standards that can meet the demands of a large expatriate community

In terms of the airport and port infrastructure, a multimodal hub requires both operations to be playing—in both capacity and utilization—within the top league of their respective segments to provide capacity and attractiveness for several dozens of the global and regional transport carriers and logistics service providers. The only way to compete...
with the emerging global hub in Dubai and to mitigate the existing scale economies there is to have a more preferred geographic location—for instance, Oman on the Indian Ocean, or, to a lesser extent, the greater Jeddah area on the Red Sea. However, as hubs encounter a self-enforcing virtuous circle—that is, the more connections that are provided by the hub, the more attractive the hub becomes, and the more carriers want to be connected to it—the required number of global multimodal hubs in the Middle East seems to be limited to a maximum of two.

2. In general, the regional logistics and distribution hub strategic play requires the same critical success factors as a global multimodal hub, as key tenants will also be global and larger regional industry and logistics service players. Although the criteria are less demanding in terms of overall size and multimodality, the quality of services and processes must nevertheless adhere to global standards. As can be seen in both the greater Rotterdam/Amsterdam region and in Dubai, global hubs tend to simultaneously become natural regional hubs. As hubs pursue specialization strategies, such as a specific industry focus or a focus on a subregion, the consolidation of the regional logistics and distribution centers into one single location is not as imperative. Hence, it seems that a few traditional gateways to the broader region—such as the Nile delta, the Red Sea areas, the Kuwait area, and the northern shores of the Gulf—additionally qualify for such a positioning.

3. Finally, if a country does not have the qualifying factors to meet the criteria of a global or regional hub play, the government should focus its sector strategy on the development of its domestic transport and logistics services sector. This still requires a demanding setup of appropriate infrastructure, such as excellent connections between the ports of entry/exit and the consumption or production markets in the inner country, as well as the provision of bonded or free zones near the consumption markets.

The most difficult decision from a government perspective is the correct choice of the strategic play for the sector development agenda. The choice must be based on a thorough and honest assessment of how well it achieves the qualifying factors. Countries with tight budget constraints that do not match the qualifying factors for the global or broader regional play need to resist the temptation to establish mega-infrastructure projects that will never become economically viable. Instead, they should focus on a broad set of local developments, providing excellent connections to the global and regional hubs and nurturing the domestic development of the sector.

Such a broad set of local development initiatives can be quite easily decided and executed in the smaller Middle Eastern countries, such as Bahrain, the United Arab Emirates, or Qatar, with clear decision ownership. In contrast, a well-coordinated development program in the larger countries, with a multitude of stakeholders and local and regional decision makers, is much harder to pursue. Hence, the ministry of transport should be tasked in such situations to develop an overall transport and logistics master plan, strongly involving policymakers at different levels; the ministry should also be responsible for execution oversight. In such complex political decision situations, enforcement of the implementation of a coordinated master plan usually is difficult. Hence, the government should consider providing the respective financing budgets to create positive incentives.
for all stakeholders to comply with the overall strategy chosen.

**Focus Infrastructure Investments to Fit the Chosen Sector Play**

It seems obvious that the development of a global multimodal hub strategy requires a strong and unambiguous focus on the development of a single mega-infrastructure incorporating a world-class integrated airport and port zone. As the development of such a strategic play will span a very long time period, the investment plan and execution of the investment need to be followed through and subjected to regular reviews.

In contrast, the ideal development of a regional logistics and distribution hub play is less obvious: It is not easy to measure the competing demands of providing infrastructure against less tangible factors, such as investment environment. However, it is clear that the infrastructure potential needs simultaneously to allow for very good connections to global hubs and exporting countries and excellent connections to the neighboring regional markets. This requires the establishment of an appropriate road and short sea infrastructure on a regional level. On the level of global connectivity, multimodality is of lower importance, and port and airport facilities need only to accomplish the requirements of an originating or destination point of a strong trade lane.

Finally, a domestic-focused transport and logistics services play requires the most humble infrastructure development plan—although even this is complex, comprising a multitude of local developments. The development of road infrastructure, for instance, should model the actual flow of trade and goods within the country.

In addition, the road and port infrastructures should be focused to provide excellent connectivity to the regional hubs. The port infrastructure especially requires a delicate balance to provide efficient handling of short sea transport while simultaneously allowing for dedicated connections to long sea connections. Besides the basic road, seaport, and airport infrastructure development, free zones in the inner country, close to the relevant consumption and production markets, are of significant importance.

**Adjust Policies and Regulations to Promote the Sector Development**

Again, the set of policies and regulations necessary for the development of both global multimodal and regional hub strategies seems to be obvious and can easily be adapted from world-class players such as Rotterdam, Singapore, or Dubai. In essence, these policies and regulations should promote foreign direct investment, provide a liberal economic environment, and allow for full foreign ownership of the respective entities, as competition for tenants happens on a global level and hence needs to adhere to the global standards.

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*Strategies can easily be adapted from world class players such as Rotterdam, Singapore or Dubai.*
But which set of policies is appropriate for promoting sector development on a domestic level? Again, the more mature markets in North America and Europe can provide model cases of a clear liberalization strategy with thorough and consistent regulatory oversight. In these markets, liberalization and the removal of market entry barriers have resulted in substantial productivity gains, service level improvements, and volume growth.

As global and larger regional service providers compete in other markets on global quality and service standards, their investment and corporate activity should also be actively pursued. This will allow the sector to develop toward such standards and educate a workforce in the respective business and process areas.

Finally, to ensure a level playing field for all industry participants, the government should establish thorough economic regulatory oversight, independent of strategy setting and policy definition. The most prominent examples for such a structure are the postal, road, and railway regulators in the most liberalized markets in Europe.

Optimize Government Services to Meet the Demand of the Logistics Sector

The key government services required by the logistics sector fall into three groups: business and equipment licensing, regulatory oversight and competitive regulation, and customs services. The former two have standards similar to those for other industry and service segments; optimization of government services in these areas should be part of a broader economic development program that promotes and fosters entrepreneurial activity.

Customs services, however, are substantially different; furthermore, they are essential to foreign trade and hence significantly affect the performance of the transport and logistics sector. From the perspective of a logistics service provider, customs declaration is a purely transactional process, though it is resource-consuming and time-critical. Thus, optimizing government services requires the provision of processes that are highly automated and seamlessly integrated into the logistics service providers’ order-management system. Hence, governments should pursue the basic principles of e-government, such as provision of Web-based applications, modularity, and thorough and seamless internal automation.

Promote the Development of National Transport and Logistics Champions

In most Middle Eastern countries, the industry structure of the outsourced transport carriers and logistics service providers is highly fragmented and often not at all well developed—dominated on one side by the leading global transport and logistics service providers and on the other side by a vast number of “mom-and-pop shops,” while lacking a strong base of nationwide, medium-to-large logistics service providers.

In addition, the outsourcing level of transport and logistics services is still very low across the Middle East compared with global standards, standing at approximately 12 percent; Western Europe, for instance, has outsourcing levels of approximately 25 to 30 percent. Hence, large industry players in the region operate significant own transport and logistics businesses. Within such an industry structure, the development of high-quality, efficient transport and logistics processes and structures is substantially hampered: small enterprises do not have the means to establish sophisticated logistics processes and service offerings, whereas industry players focus predominately on their core business, often neglecting the optimization and sophistication potential of the logistics processes. Global players are also often hampered by agent laws in broadening their businesses and bringing more sophisticated concepts and processes to the market.

Hence, the development of the transport and logistics sector also requires an industry structure in which medium-to-large logistics service providers play a more
prominent role. Even with a liberal market approach, governments can actively promote and influence the development of the industry toward such a target structure using three focused measures:

- First, governments can carve out, consolidate, and subsequently privatize the logistics functions of large state-owned industry enterprises. In most Middle Eastern countries, a quite substantial industry base is government-owned. Government-owned entities include enterprises such as national oil and basic industry companies in the GCC countries or enterprises in the steel, mining, cotton textile, and retailing industries in Egypt. Most of these enterprises still own substantial transport and logistics operations. For these enterprises, the government could pursue a comprehensive carve-out strategy integrating the transport and logistics operations into dedicated entities of substantial size. Once the consolidated entities have been formed and operations have been restructured, privatization could provide the desired medium-to-large logistics service providers able to compete on a global level.

- Second, governments can expand state-owned transport players, such as post offices, railways, and port/airport operators, into the logistics business. In Europe, entities such as the Swiss post, the Swedish post, the German post, and the German railways have successfully embarked on such an expansion strategy to develop a broader transport and logistics service offering. In doing so, they have become substantial players in their respective transport and logistics markets, on a domestic, regional, or global level. However, a word of caution is necessary: Almost all of these expansion strategies have been the growth part of a fundamental restructuring program. Because they had previously been performing poorly and sustaining losses as government-owned authorities, a fundamental restructuring of the core business was necessary before they “earned the right to grow.”

- Finally, governments should also pursue a “soft strategy” to promote outsourced logistics and logistics service providers. Two levers are necessary to make such a strategy successful. First, the government—namely, the ministry of transport and the ministry of economic development—should develop a consistent communications strategy toward shippers to promote outsourced logistics and leverage their influence on business leaders to implement these concepts. Second, governments could also award logistics contracts—such as contracts for military logistics, construction, or health care—to those players that provide the most promising platform for becoming a market leader.
SUMMARY AND CONCLUSIONS

The Middle East region is favorably located along the substantially growing Europe-Asia trade lane and in the middle of a broader region spanning from northern Africa to the southern borders of Russia and to Pakistan. This location provides a broad variety of opportunities for the Middle East to gain a fair share of the global and broader regional transport and logistics business. In addition, the development of a strong domestic transport and logistics sector is a strategic must for further economic development of the Middle Eastern countries, to enhance their industry competitiveness and to build a strongly contributing and growing sector that provides sustainable employment opportunities.

Governments of Middle Eastern countries should therefore embark on a well-defined development strategy for the sector, comprising the best choice of a long-term strategic play adapted to each particular country, the appropriate focusing of infrastructure investments, the adjustment of policies and regulations, and the optimization of government services to support the chosen strategic play. In addition, they should promote the development of national transport and logistics champions.

There are several examples of successful implementation of a comprehensive development strategy for the transport and logistics sector in different geographies; these include Belgium, Dubai, the Netherlands, and Singapore. All of these cases are based on a favorable geographic location, a carefully considered strategic play for the sector, and consistent execution over time.

From the experience of these cases, it seems obvious that only the interplay of a clear and well-thought-out strategy with excellent execution will finally achieve the desired results and economic benefits.
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