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**TRADE LOGISTICS IN THE ARAB REGION:
CHALLENGES AND POLICY OPTIONS**

Note: This document presents an overview on the findings of a study on Trade Logistics in the Arab Region: Challenges and Policy Options for exclusive use in the fifteenth session of the Committee on Transport (Rabat, 27-28 January 2015). The full report is being finalized and will be available soon.

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Introduction

1. Trade logistics is a broad concept encompassing such widely varying fields as infrastructure, governance, sustainable development, human resources, finance and regulations. It takes in all the processes related to the physical transfer of a given product from seller to buyer. In the context of international trade, it involves, for instance, inland transport from the factory to the airport or seaport, contact with the forwarding company or agent for customs procedure at the port of departure, cargo insurance, freight, customs clearance and administrative procedures at the arrival port (including determining the correspondent rule of origin, applied standards and required controls) and finally transport of the merchandise to the beneficiaries. The logistical chain involves many other tasks, including the payment system; distribution (to wholesalers and retailers); the use of information and communications technology in trade; warehousing; and cargo consolidation.
2. Efficient trade logistics has many positive effects, including higher economic performance, government efficiency, business competitiveness and good infrastructure services in both quantity and quality. Conversely, inefficiencies undermine competitiveness through a direct negative impact on trade costs and time frames, especially for exporting firms. Persistently inefficient logistics can constitute a considerable entry barrier for domestic and foreign investors.
3. As international trade grew and regional integration accelerated after the Second World War, emerging international bodies concentrated on lowering tariff barriers, which at the time were seen as a major impediment to international trade. The considerable progress made in lowering tariff barriers, particularly for industrial products, has led to a rise in the relative share of non-tariff measures in total trade costs. The focus has thus shifted over the past two decades to addressing non-tariff barriers, which include logistics costs. Behar and Venables (2011) cite the cost of transporting products to foreign markets in terms of freight costs and transport delays as an example of such barriers.
4. Another strand of public policy, broadly known as trade facilitation measures, has come to the fore to further lower trade costs. The World Trade Organization and European Union define trade facilitation as the simplification and harmonization of international trade procedures, including import and export procedures (the collection, presentation, communication and processing of data required to move goods in international trade). An extended definition includes trade finance. The United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT)¹ defines trade facilitation as “the simplification, standardization and harmonization of procedures and associated information flows required to move goods from seller to buyer and to make payment”.
5. In the study on Trade Logistics in the Arab Region: Challenges and Policy Options, ESCWA investigates the relationship between efficient trade logistics and economic performance using a dynamic computable general equilibrium model and taking Tunisia as a case study. The analysis focuses on the impact of additional investments in trade logistics capital stock on key macroeconomic indicators. A simulation scenario explores the potential impact on the Tunisian economy of it catching up halfway in logistics terms to the United Arab Emirates, the top performing Arab country as measured by the World Bank Logistic Performance Index (LPI). The scenario simulates a boom in trade logistics infrastructure. The choice of the infrastructure component of trade logistics rather than efficiency was dictated by the weakest links identified among Tunisian LPI subindices. One key contribution of this study is the modeling of the cost side of the desired change in trade logistics rather than opting for “free” technology improvement typical of other studies.

¹ UN/CEFACT establishes electronic data interchange standards for electronic trade documents in XML format.

6. This document presents the main findings of the study. The results are based on responses to a questionnaire sent to Arab companies operating in three different sectors in six countries. The full report is being finalized.

I. LOGISTICS PERFORMANCE OF ARAB COUNTRIES

7. The Arab region's share in global trade stood at 4.3 per cent in 2010, unduly low given its potential and resources. A growing body of evidence suggests that the figure could largely be due to the effect of poor infrastructure and organization on logistics chains, causing trading costs to soar. Numerous trade performance studies have underlined the need to improve trade logistics in the region in order to support growth in non-oil exports and attract more export-oriented FDI. Hoekman and Zarrouk (2009), citing a survey of trading firms in nine member countries of the Pan-Arab Free Trade Area (PAFTA), conclude that tariffs have mostly been removed on intra-PAFTA trade and that customs procedures are much less of a problem than in the late 1990s. In 2001, tariffs were ranked as one of the most important barriers to intraregional trade but in 2008 they were ranked last. Instead, transport-related infrastructure and real trade costs, related to trade facilitation issues, were considered the biggest constraints.

8. Wide-ranging economic reforms over the past two decades remain insufficient. For instance, transport and logistics reforms have been limited to reducing or eliminating some monopolies, failing to boost competition or reduce trade costs significantly. Telecommunications reform is advanced in many countries but lags behind in others. Broadly, most Arab countries have yet to accept that generating monopoly profits or accommodating public sector inefficiencies is inappropriate in the area of logistics, which should rather be a means of promoting trade through efficiency.

9. Priorities for improving trade logistics are determined by the level of development. In low-income countries, the largest gaps tend to be in infrastructure and border procedures. Middle-income countries need more competitive logistics services to meet growing demand for such services.²

II. EFFICIENCY OF TRADE LOGISTICS IN SELECTED ARAB COUNTRIES

10. Inefficient logistics is detrimental to trade. Several indicators, notably those featured in the World Bank's *Connecting to Compete* and *Doing Business* reports, provide valuable benchmarking tools for assessing the trade and transport friendliness of countries, and challenges and opportunities, but they also leave potentially important gaps.

11. The questionnaire that was developed for this study was sent to Arab companies operating in different sectors in six countries to assess their logistics performance. In the context of an international environment that is increasingly fragmented and where goods cross multiple borders, three sectors that are key to the participation of Arab countries in the global value chain were selected: textiles and processed food on the exports side due to their contribution to economic growth in Arab countries; and electronics on the import side, as they are a key to the competitiveness of Arab firms. The survey sheds light on the performance, bottlenecks and opportunities in the logistics sector, analysing the organizational and behavioural characteristics of companies, governance, the quality of institutions and other elements specific to the logistics chains in Arab countries.

12. Some of the main features of the logistics chains in the countries surveyed and recommendations based on results of the survey are set out below.

² Jean-Francois Arvis and Christina Busch, "Connecting to compete: the 2014 Logistics Performance Index", presentation made at the Kühne Logistics University, Hamburg, 31 March 2014.

A. MAIN FEATURES OF COMPANY LOGISTICS MANAGEMENT

13. At the international level, firms increasingly outsource logistics services, which are regarded as a supporting activity more than a core function. In the Arab region, however, logistics is still largely internalized, as evidenced by the finding that around half of respondent firms have a logistics department. That is partly due to the poor quality of logistics services provided by third parties. Nevertheless, 51.6 per cent of respondents are dissatisfied with their own logistics services. Most logistics activities, except customs clearance, are carried out by firms internally, sometimes in cooperation with a third party when the activity requires specific and costly capital investments, as is the case with inbound transport and distribution to customers. There is thus ample room for improving the quality of logistics activities in Arab countries. The degree of satisfaction of firms seems to depend largely on their own behaviour.

B. PROCUREMENT PERFORMANCE

14. Respondent firms place an average of 210 purchase orders annually, two thirds to national suppliers and the rest to international firms. Those shares vary substantially across sectors. Approximately 82 per cent of the orders are sent using an immediate and traceable means of communication such as fax or email; the remainder are placed by phone or in person.

15. In general, the procurement process is not dynamic. More than half of the respondents said that they did not look for new products and/or suppliers frequently. Most of the 34.6 per cent of the surveyed firms actively searching for new opportunities find new suppliers at international exhibitions (53 per cent) or through market research (30 per cent) done internally or by a third party. In the Arab region, the behavior of procurement managers seems to prevent firms from seizing existing opportunities to reduce costs, as they opt for the easiest and least expensive investigation methods rather than comprehensive, better documented and more reliable ones. International exhibitions visited by Arab procurement managers tend to be held in Europe, where the presence of Arab firms is usually limited. That further reduces the chances for Arab firms of finding partners in their own region.

C. PERFORMANCE OF CUSTOMS AND TECHNICAL CONTROL PROCEDURES

16. According to the survey, firms rated the efficiency of customs clearance at sea ports and border stations as average (48 per cent and 43 per cent of respondents respectively) or inefficient (28 per cent and 43 per cent of respondents respectively). Airports fared relatively well with a 44 per cent satisfaction level. The dispersion of ratings by the surveyed firms is low. Only three firms rated the efficiency of airport customs clearance as very high, and two rated efficiency at border stations as very low. The transparency and fairness of customs valuations is regarded as often satisfying by more than half of respondents and sometimes satisfying by 39 per cent. Only 7 per cent rank the customs valuation process as rarely transparent and fair. Customs clearance in Arab countries seems to function well, except for cargo dwell time, which lasts from 5 to 10 days (80 per cent of respondents), well above international standards. One of the main reasons is the high incidence of physical inspections: roughly half of shipments are inspected.

D. PERFORMANCE OF TRANSPORT AND DISTRIBUTION ACTIVITIES

17. The survey shows that around 65 per cent of respondents purchase materials from abroad on an ex-works or free on board basis, meaning that they arrange the freight themselves. The process of selecting freight forwarders is competitive. The quality of the investment made in IT solutions for tracking shipments seems to be crucial to the satisfaction of firms. Much remains to be done in that area. Although freight forwarders perform reasonably well in terms of quality, with 57 per cent of respondents satisfied, the expectations of firms are not being met in terms of cost and reliability.

18. The survey reveals that transportation solutions are far from optimal. Transport and distribution activities are mainly internalized. The average estimated value of transportation fleets is high at 450,000

United States dollars (US\$). On average, firms own 12 vehicles but fleet sizes among respondents range from 2 to 55 vehicles.³ Vehicles are rather old (10 to 15 years in 39 per cent of cases). Goods delivery is subcontracted only in 10 per cent of cases and around 4,000 tons of goods are transported annually by firms themselves, as opposed to only 425 tons by third parties. Their annual fuel expenses are 7.5 times higher than the annual bill for third party transportation and distribution services.⁴

19. In addition to improving the quality of their fleets and turnaround intensity or driver skills, Arab companies should look at their cost management practices. By favouring higher quality services with lower prices, they could boost competition in the transportation sector, thereby accessing a wider range of transport options and lowering costs.

E. PERFORMANCE OF STORAGE AND WAREHOUSING ACTIVITIES

20. Responses to the questionnaire show that companies own on average three storage facilities with an available surface of 4,000 square meters valued at around US\$1.2 million, storage equipment valued at US\$96,000 and software solutions valued at around US\$1,500. Subcontracting activities are scarce and only 0.4 of storage facilities (around 468 square meters) is rented for US\$8,700 a year on average.

21. Firms generally rate storage facilities positively in terms of availability, quality and security. Some 94 per cent of respondents are satisfied with the equipment in storage facilities and 65 per cent rank the level of security in storage facilities as good.

22. Overall, the storage needs of firms seem to be met. Effective IT solutions for inventory management, however, are still missing. More than half the respondents complain about time-consuming random searches.

F. PERFORMANCE OF SUPPORTING TECHNOLOGY AND FINANCIAL SERVICES

23. A closer analysis of investment by companies in dedicated software to help manage logistics reveals interesting patterns. Apart from customs clearance, all other logistics-related tasks are largely handled using basic software. Dedicated applications are preferred for production planning and scheduling, warehousing and materials handling, or transport and fleet management.⁵ The use of basic software for monitoring logistic activities represents a loss in productivity for firms, which fail to benefit from the specific features generally offered by dedicated IT solutions.

24. The survey confirms that difficulties in accessing credit constitute a major impediment to the development of firms and their capacity to innovate, and therefore hamper competitiveness in the Arab region. The flow of information between market actors does not seem to be an issue. Some 83 per cent of respondent companies know of domestic lending opportunities that would facilitate expansion of their export base without the need for mortgages. The problem is that firms face obstacles in accessing them.

III. CONCLUSION

25. The survey shows that 75 per cent of logistics costs are spread evenly between transportation, warehousing and inventory carrying. In Europe, 60 per cent goes on transportation costs alone. The

³ Transport vehicles include only means of transport used to carry goods, not tourism vehicles for executives or managers. The sample includes manufacturing firms requiring large transport fleets (food processing and textile sectors) and small retailers (electronics). As a result, there are major disparities between respondents.

⁴ Due to differences in the sectors' structure, huge disparities exist among the pooled firms but also within countries.

⁵ Custom clearance usually requires a specific electronic interface connecting firms to the customs administration for custom declarations and custom duties evaluations. Because these activities are usually subcontracted, firms do not invest in dedicated software.

difference is mainly explained by the energy subsidies in Arab countries, as well as low wages and social charges.

26. Responses to the questionnaire show that externalization of logistics activities in the Arab region is limited, except with regard to transport, distribution and customs clearance procedures, which are generally entrusted to third parties. The presence of a structured logistics department within a company has a positive impact on the performance of its logistics activities through better control and mastery of logistics costs. However, the competitiveness of companies is hampered by an insufficiently proactive procurement process, especially in exports-oriented sectors that work more intensively with foreign countries, and poor subcontracting habits. Logistics internalization brings with it the maintenance of a large, old and costly transportation fleet and large storage capacities.

27. The survey shows that the process of customs clearance is less problematic than in previous years but that much remains to be done, especially regarding the time factor. Responses show that significant cargo dwell time is likely as a result of frequent physical inspections and the inappropriate behaviour of customs agents. The information collected also shows that firms all too often still rely on basic software to fulfill their logistics functions, which generates a significant loss of time and efficiency. Finally, firms are suffering from limited financial resources to cover their export transactions.

28. Subcontracting more logistics tasks would allow Arab firms to optimize the cost and organization of production, based on the comparative advantage of each economic agent. Such restructuring would encourage firms to specialize along the logistic chain, reduce costs through economies of scale and knowledge accumulation, improve competitiveness, and generate economic activity and jobs.
