The Economist INTELLIGENCE UNIT

QFZ هيئة المناطق الحرة - قطر Qatar Free Zones Authority

The power of proximity: Localising supply chains in the Middle East

Supply chains are at a historic inflection point.

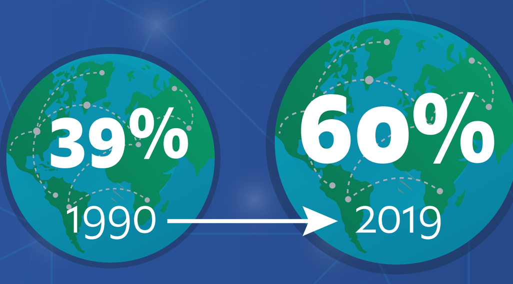
Over the past 30 years, the proliferation of free trade agreements, investment liberalisation and enhanced logistics have facilitated the globalisation of supply chains.

However, since the 2008 financial crisis, risks ranging from climate change to government protectionism, and most recently COVID-19, have led countries and companies in the Middle East and elsewhere to move towards supply chain localisation.

1 Supply chain transformation

THREE DECADES OF GLOBALISATION HAVE EXTENDED AND DISPERSED SUPPLY CHAINS ACROSS THE WORLD:

Expanded trade links and the shift in supply chains abroad contributed to an increase in global trade from 39% of global GDP in 1990 to 60% in 2019.[1]

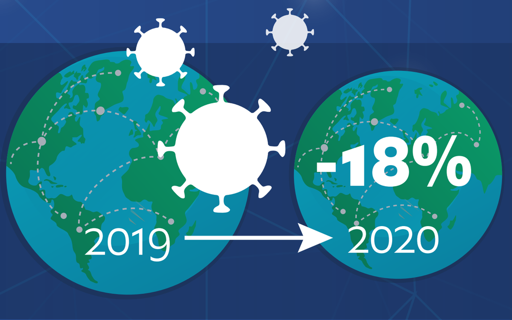


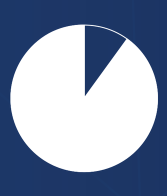
Companies, driven by the pursuit of lower costs, set up production in locations with cheaper costs, manufacturing goods in multiple countries.

IN RECENT YEARS, HOWEVER, GOVERNMENTS AND COMPANIES HAVE BEGUN MOVING TOWARDS THE LOCALISATION OF SUPPLY CHAINS TO SUPPORT NEW STRATEGIC INTERESTS:

Companies are moving towards supply chain localisation to minimise their exposure to a host of risks, including extreme weather events, cyber-attacks, and public health disruptions

The EIU estimated in 2020 that the volume of world trade in goods would contract by 18% due to the COVID-19 pandemic's disruption of global supply chains.[2]





90%

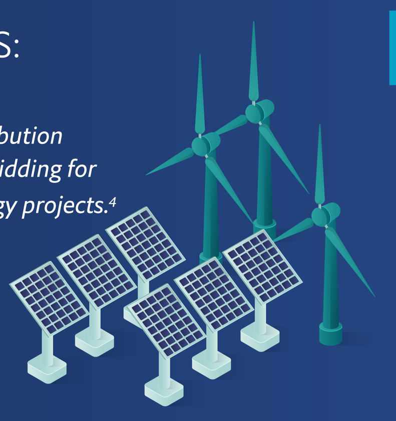
of investors in Asia, Europe and the Americas in 2018 were implementing or considering localisation strategies due to geopolitical and climate risk.[3]

In the Middle East, governments are implementing policies to promote localisation in order to:
- Capture more of the global value chain
- Diversify their economies
- Minimise the risk of external macroeconomic shocks

2 Factors driving supply chain localisation in the Middle East

LOCAL CONTENT POLICIES:

Jordan requires 20% local contribution in competitive bidding for renewable energy projects.[4]



PRIORITISATION OF AGILITY, RESILIENCE AND CUSTOMER CENTRICITY AMONG BUSINESSES:

Over 50% of MENA consumers

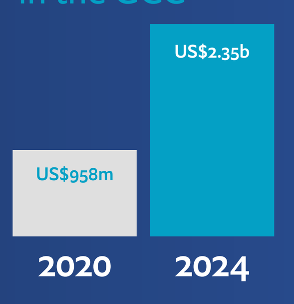
will support domestic brands produced locally over the long term.[5]

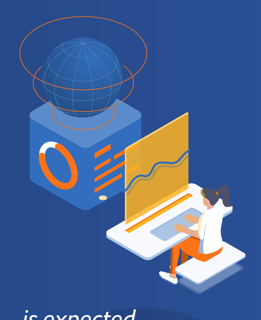
IMPROVEMENTS TO TECHNOLOGIES IN THE MIDDLE EAST:

The smart factory automation market in the Middle East

was forecast to reach a record high of $17 billion in 2020.[6]

The public cloud market in the GCC





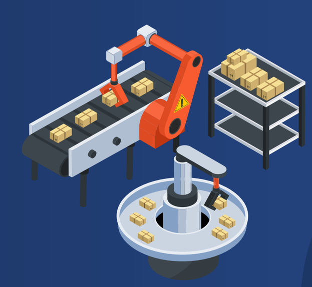
is expected to more than double in value by 2024.[7]

The MENA smart cities market

is expected to reach US$2.7 billion in 2022.[8]

IMPROVEMENTS TO MIDDLE EAST STATES' LOGISTICS:

DHL Express is investing US$33 million to set up a world-class major logistics facility in Qatar's Ras Bufontas Free Zone.[9]



International logistics companies, including DHL and Kuehne Nagel, operate out of the Bahrain Logistics Zone.[10]

3 Key sectors for localisation in the Middle East

FOOD AND AGRICULTURE

Governments are prioritising food security through domestic food production and international companies are localising production to meet the preferences of local consumers.

Cargill, Nestlé, and Unilever have all established halal portfolios in recent years and Cargill has localised production in the region to launch products faster.[11,12]

MANUFACTURING

International manufacturers are setting up facilities in the Gulf thanks to automation and advanced manufacturing eroding the GCC's relatively high cost manufacturing base.

Unilever established a personal care products manufacturing facility in Dubai which has been recognised as one of the world's most advanced factories by the World Economic Forum.[13]

ENERGY

Governments are seeking to enhance local participation in oil and gas and ramp up domestic renewables capacity, in turn attracting international companies to the region.

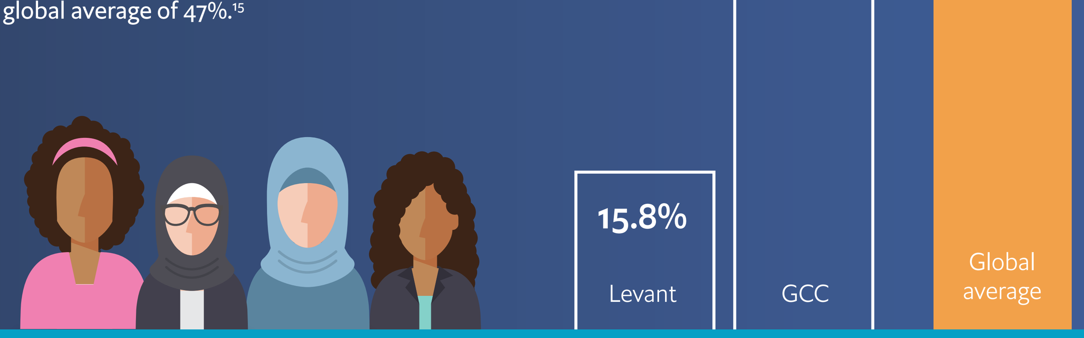
Baker Hughes' multi-modal facility in Saudi Arabia has over 90% Saudization and more than twenty local suppliers supporting its operations.[14]

4 Main challenges to supply chain localisation in the Middle East and potential responses

CHALLENGE Nº1

Limited labour force availability and skills: Having the right local workforce in terms of size, skill and cost is critical to encouraging global companies to localise their supply chains.

The Middle East lacks full labour force participation of certain groups, particularly women. The Levant has the lowest regional female labour participation rate globally at only 15.8%, and the GCC's female labour participation rate of 43% is below the global average of 47%.[15]



Potential response

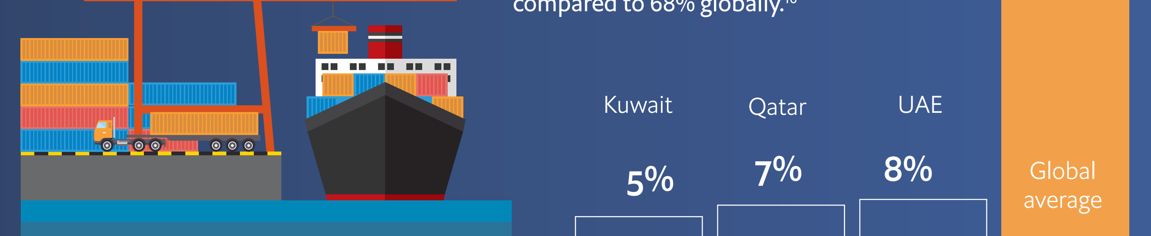
Governments in the Middle East could enhance the skills of the local labour force by enhancing linkages between school, university and vocational education centers and the private sector.

Policymakers could establish or enhance their open migration policies to allow global talent to enter the country, as well as limit the imposition of hiring quotas for citizens.

CHALLENGE Nº2

Limited industrial clustering: Having a high concentration of manufacturing plants and component suppliers is critical to attracting global companies as it takes an ecosystem of manufacturing capability to produce complex products.

In 2019, manufacturers' exports accounted for only 5% of total merchandise exports in Kuwait, 7% in Qatar, and 8% in the UAE, compared to 68% globally.[16]



Potential response

Governments could support the development of industrial clusters by building out capabilities in sectors where they have comparative advantages.

For example, they could expand policies that promote the development of infrastructure, technologies and skills in areas such as logistics or renewable energy, while drawing on the strengths of leading firms to support emerging businesses.

CHALLENGE Nº3

Restrictive business environments and limited regional integration: Having a business-friendly environment, consistent regulations, and regional commercial integration are critical to attracting global companies.

Regional markets in the Middle East are fragmented owing to the prevalence of conflict and a lack of functioning regional trade agreements. In the EIU's business environment rankings, the UAE ranks 22nd out of 82 countries measured, with Qatar 37th, Bahrain 41st, Kuwait 46th, Saudi Arabia 48th, and Jordan 58th.

Potential response

Policymakers in the Middle East could invest in the broader FDI landscape by implementing business-facilitating reforms, such as measures to
1- strengthen access to credit,
2- increase protection for minority investors, and
3- stimulate entrepreneurial activity.

Governments could enhance regional integration by ensuring the full implementation of existing regional, sub-regional and bilateral trade agreements, such as the Agadir Agreement.

BUSINESS ENVIRONMENT RANKINGS

Which country is best to do business in?

TOTAL	UAE	Qatar	Bahrain	Kuwait	Saudi Arabia	Jordan
82	22nd	37th	41st	46th	48th	58th

1 https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?end=2019&start=1990
2 https://www.eiu.com/n/middle-east-post-covid-19-supply-chains/
3 https://www.kearney.com/web/global-business-policy-council/article?/a/competing-in-an-age-of-multi-localism
4 https://www.irena.org/publications/2018/Oct/Evaluating-renewable-energy-manufacturing-potential-in-the-Arab-region
5 https://www.ey.com/en_ly/news/2020/08/ey-69-of-mena-consumers-believe-that-the-way-they-live-has-changed-for-the-long-term-due-to-covid-19
6 https://www.arabnews.com/node/1707126/corporate-news
7 https://www.constructionweekonline.com/business/268040-gcc-cloud-market-expected-to-hit-23bn-by-2024
8 https://assets.kpmg/content/dam/kpmg/ae/pdf/wgs-kpmg-2019-.pdf
9 https://m.gulf-times.com/story/654546/DHL-Express-to-establish-major-logistics-facility-in-Qatar-Free-Zones
10 https://www.commitbiz.com/bh/bahrain-logistic-zone-blz
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14 https://www.euro-petrole.com/bhge-recognized-for-localization-efforts-in-saudi-arabia-n-i-17833
15 https://data.worldbank.org/indicator/SL.TLF.CACT.FE.ZS
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