High fuel prices could lead to global supply chain restructuring

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As *Transport Intelligence* has pointed out on a number of occasions, the 'above trend' growth seen in the logistics sector across the world has been predicated on the expansion of globalisation. For example, a realisation by western corporations that assembly processes could be extracted from existing assembly plants and relocated to China led to a huge boom in demand for all types of logistics services from and to that market.

But nothing lasts for ever. More indicators have emerged over the past few weeks about how the world economy is changing and what it means for the logistics sector.

Figures produced in a report by Canadian investment bank CIBC (authors Jeff Rubin, Benjamin Tal), for example, suggest the price of oil is now having a substantial effect on the level of exports between China and the US. Quoting its own economic model, CIBC asserts that "Over the last three years, every one dollar rise in world oil prices has fed directly into a 1% rise in transport costs". The report points out that the cost of moving a container from eastern China to the eastern seaboard of the US, for instance, has risen by more by 100% and says the impact is already being seen in falling import volumes for commodities such as steel, which is at present declining by 20% on an annualised basis.

The result of these higher costs, argue Rubin and Tal, could be similar to the experience after the oil shock of the early 1970s. They state that "between 1960 and 1973, exports as a share of world GDP rose by over 50%, a function of both falling trade barriers and cheap transport costs when oil prices averaged less than $16 per barrel (in today's prices). Similarly 1987-2002 saw another quantum leap in world trade, spurred not only by a 30% drop in tariffs but by still relatively cheap transport costs grounded by an average $27 (constant dollars) per barrel oil. In sharp contrast, exports as a share of world GDP went absolutely nowhere between the first OPEC shock and the aftermath of the second, despite a 25% reduction in global tariffs."

The two economists suggest that the effects on geographical sourcing might be a little different this time, with cheap production locations nearer to big markets, such as Mexico, benefiting as alternatives to China. Indeed, they suggest there is already evidence that this is happening.

Of course the price of oil may soon fall, in which case we may all return to the *status quo ante.* But if not, the logic of higher fuel may well begin to assert itself in new supply chain structures that have a lower transport component. This could prove to be a big opportunity for the many poorer and therefore generally lower cost countries on the edge North America and Europe. However, will it be bad news for the big global logistics players who have ridden the world trade wave of the past two decades?

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