Soaring fuel prices have yet to dent demand for freight transport

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Britain has become the latest country to experience public protests over fuel prices, with truck drivers yesterday (May 27) blocking major roads into London with their vehicles.

Trade bodies representing that country's road freight industry are urging the government to cut the tax on diesel. The British International Freight Association, for example, is demanding the abolition of a planned 2p (£0.02) increase in fuel duty this October and the introduction of an "essential user rebate". The association's director general, Peter Quantrill, said "such moves would give a very positive signal to freight forwarders and other businesses whose services are so highly dependent on fuel and play such an important role in the UK economy and international trade". Britain has some of the most expensive fuel in the world, with prices now over US$9 a gallon.

Public protests against fuel prices have also occurred in countries where fuel is cheaper than in Britain. In France, for instance, the government seems to be reacting to demonstrations by contemplating a reduction in VAT (sales tax) after fishermen blockaded French ports. That sort of action is thought likely to be about to occur elsewhere in Europe.

Although public protests are a recent development, the impact of higher fuel prices on the logistics sector has been noticeable for some time, with aviation fuel now accounting for more than 30% of air freight costs while rising 'bunker fuel' prices have led some container shipping lines to slow their vessels by 10% to save fuel.

What the long-term implications of high fuel prices will be for the logistics sector is a complex question. For many LSPs (logistics service providers), for example freight forwarders, the immediate issue is the rapid rate of the fuel price hikes. In the long term, they will be able to increase the fuel surcharge, as will the major express integrators. In the short term, though, they cannot renegotiate their contracts fast enough to keep up with the pace of soaring fuel costs.

Contract logistics players are in a slightly different position. Those with 'open book' contracts in place with their clients will pass on any fuel increases directly.

Those parties which are currently protesting most vociferously – such as road hauliers − are often in a weaker competitive position, with higher fuel prices highlighting their poor negotiating hand. There is a high correlation between the rising cost of fuel and the level of company failures at this level as clients simply refuse to accept the full increase. This is due to the fragmented nature of the industry, with hyper levels of competition. Medium sized companies are usually amongst the first to feel the economic pain, as they are often highly leveraged and need to maintain significant overheads. Owner drivers are the next group to be affected, with the fall out from the market, in theory, leading to a re-adjustment in the supply and demand ratio i.e. those left have a greater chance of being able to push through price increases. Such a paradigm shift within the market would only occur if the re-structuring was systemic. And indeed there are signs that this could be occurring, with reports in the US media that the trucking fleet is undergoing its biggest downsize since de-regulation in 1980s. It is reported that thousands of independent truckers are selling their rigs due to their inability to make a living.

It might be considered that higher transport rates caused by higher fuel prices ought to reduce demand for logistics services. Yet the present picture on this is very mixed, with sea freight and, to a lesser extent, air freight volumes still growing modestly. Leading global container shipping companies such as NYK and NOL/APL (*Ti Logistics Briefing, Briefing, May 20*), for example, have both recently reported robust demand in most areas of their business.

What has not happened, apparently, is any change in behaviour in the transport market. There is anecdotal evidence that some major shippers are considering adapting their inventory policy to reflect higher transport costs, yet objective evidence of demand does not indicate this. It seems shippers are absorbing some logistics costs in markets which still have sufficient demand.

Financial sector bulls such as Goldman Sachs are suggesting there has been a structural change in the energy market which will lead to much higher fuel prices for much of the next decade. That may be so. However, it has yet to feed through into lower demand for freight transport. For the time being the market will continue to be characterised by rising demand being out-paced by rising prices. What will worry many companies is the scenario of an economic recession combined with increased prices. If this occurs there will be far-reaching consequences for many parts of the logistics industry.

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