

Advertisement

*The Outer Banks*  
OF NORTH CAROLINA

Your Island getaway, so close to Home.

TRAVEL SPECIALS & MORE

outerbanks.org



Powered by Clickability

# Transport costs could alter world trade

By David J. Lynch, USA TODAY

On the high seas, giant vessels stuffed with furniture, toys and electronics are slowing down in a bid to conserve fuel.

Customers are pulling packages from costly air shipments and sending them by ship instead.

And some are beginning to wonder what an era of persistently high oil prices will mean for the multinational corporations that have come to rely on globe-girdling supply chains.

Crude prices have backed off last month's run toward \$150 a barrel. But they persist above \$110 a barrel, a level that was hard to fathom even a year ago. The end of cheap oil heralds a potentially dramatic reshaping of the globalized trade flows that have emerged in the past two decades. Rising transport costs are suddenly a key factor in decisions about both where to place factories and how much inventory to stockpile.

For now, the trend seems to favor the United States. Swedish furniture maker Ikea opened a new plant in Virginia. Midwestern steelmakers are thriving. And consumer products giant Procter & Gamble is considering new distribution centers. All, some say, because the cost of moving things from far-away places is beginning to trump the savings involved in using far-away, low-wage workers.

"Globalization is reversible," says Jeff Rubin, an analyst at CIBC World Markets in Toronto.

Well, maybe. No one predicts a wholesale return of manufacturing jobs to the United States. And there are other forces at work, including a weak dollar, which boosts exporters. But today's oil prices act like a tariff on global commerce, discouraging long-distance shipment of some components and finished goods, Rubin says. Shipping a standard 40-foot container from Shanghai to the U.S. East Coast in May cost about \$8,000, vs. \$3,000 eight years ago, when oil was around \$20 a barrel.

If long-term trends push oil prices near \$200, as some analysts expect, sending that shipping container halfway around the world would cost a staggering \$15,000.

At such prices, the calculations that drove a doubling in global trade volume since 2000 and the establishment of far-flung supply networks might require rethinking. Orders might be placed with factories closer to home. Shuttered assembly lines could be given new life. And suddenly, the confident claims of globalization's cheerleaders that distance doesn't matter would ring hollow.

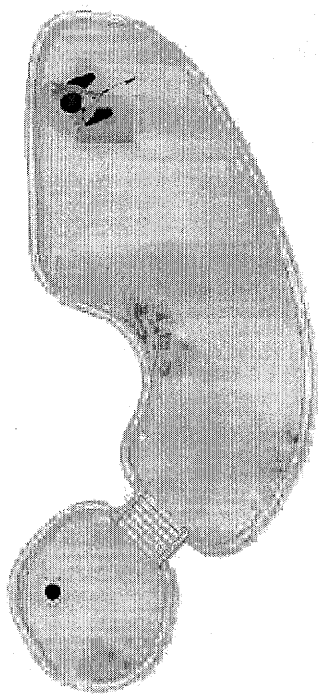
"The low-hanging fruit of globalization has been picked. ... Now, things are changing," says Stephen Jen, currency strategist for Morgan Stanley in London.

At UPS, executives are nervously eyeing emerging shifts in trade between continents, which could require swapping the shipper's largest cargo aircraft for smaller planes on some ocean-spanning routes. UPS also is looking ahead to the potential impact of \$200-a-barrel oil, examining the possibility that manufacturers might relocate some production closer to the USA.

Advertisement

**ORBITZ**

**ROLL INTO GREAT TRAVEL DEALS**



**ROLL OVER TO PLAY**

**ORBITZ**

"If we see prolonged very high oil, you may see trade lanes change. You may see more near-sourcing in the future, people building the goods closer to the end consumer," CEO Scott Davis told analysts on a July 22 conference call.

### **Offshore momentum slows**

Higher shipping costs are casting a chill on what had seemed an unstoppable trend toward the offshoring of U.S. jobs and production. In an April survey of nearly 1,000 companies by RSM McGladrey, the number planning to move offshore fell by 20% from a year earlier.

A follow-up report that the Minneapolis-based consultants released on July 31 showed that businesses are increasingly focused on their transportation costs. In a survey of 357 small and midsize businesses, 52% said they expect "dramatic increases" in their freight costs, vs. 20% that identified transport charges as a worry three months earlier.

"Where things are being made is going to change," says McGladrey executive Tom Murphy. There already are tentative signs that well-established patterns are in flux. Through July 19, U.S. railroads had carried 5 million shipping containers, down 3.4% compared with the same period last year.

In May, Swedish furniture maker Ikea announced plans for a 930,000-square-foot manufacturing facility in Danville, Va. The company decided to open its first U.S. production facility in part because the cost of shipping its Expedit bookshelves, Lack coffee tables and Besta entertainment centers exceeded the cost of making them, says spokesman Joseph Roth.

One industry already might be benefiting from near-sourcing, Rubin says. The first four months of this year, U.S. steel imports from Australia and five Asian nations (China, South Korea, Japan, India and Taiwan) fell 14.6%. That's helped domestic steel producers, such as U.S. Steel, Nucor and AK Steel. Last month, AK Steel of West Chester, Ohio, reported a record second-quarter profit of \$145.2 million, up 32% from the year-earlier period.

For the first time in more than 10 years, rising transport costs are overwhelming the advantages of cheap foreign labor, making made-in-the-USA steel products more competitive in the domestic market, says Rubin. And the same thing is likely to happen in other industries where transport costs represent a significant share of the final price, such as furniture, apparel and footwear. More than half of China's manufactured exports to the USA are similarly "freight-intensive," he argues.

"I'm not saying all of that's coming back to Pittsburgh. ... But this is something that's already started," he says.

Still, it's far from clear that the rise in transport costs explains what's happening in global trade patterns. The decline in container shipments might reflect the slowing U.S. economy. Some companies are relocating production because inflation in developing countries such as Vietnam and China is elevating costs. And the domestic steel industry's improving outlook might owe more to the falling U.S. dollar, which makes U.S.-made products more attractive to foreign buyers, and to changes in Chinese policy that began discouraging runaway steel exports in the middle of last year.

"I'm not sure we would attribute much to the higher shipping costs. ... I don't think that's a significant factor," says AK Steel's Alan McCoy.

### **No big turnaround expected**

Likewise, Yossi Sheffi, a professor at the Massachusetts Institute of Technology, doubts there will be a wholesale return of manufacturing to the USA. In part, that's because countries such as China and India now offer more than cheap labor. Increasingly, their product design and engineering expertise are winning business. "They're going up the value chain. They're starting to provide things that are just good," says Sheffi, director of MIT's center for transportation and logistics.

Shippers' response to higher fuel bills is prompting a rethinking of the lean inventory approach that has dominated business strategy for years. From consumer products to autos, companies are proliferating distribution centers so they're closer to customers, Murphy says. That means inventories, whether in warehouses or floating on ships that are moving more deliberately across the waves, will be higher than in the past.

Consumer products giant Procter & Gamble began readying itself for this new era even before the past year's doubling in crude oil prices. In the past, the cost of building a factory or distribution center far outweighed the costs of moving goods from there to customers, says P&G spokesman Paul Fox.

"That is going to flip flop. Transportation costs are now going to be critical to the distribution of products," he says.

### **Bloc by bloc**

Morgan Stanley's Jen anticipates higher fuel costs eventually reshaping global trade into regional blocs. Instead of relying so heavily on imports from Chinese factories 7,500 miles away, the U.S. will source from Mexico. Western Europe will rely upon suppliers in the former Soviet bloc or Turkey. And Asia will orient itself around the ever-larger Chinese economy, expected to be roughly as large as the U.S. economy by 2030, according to a new Carnegie Endowment study.

If Mexico stands to benefit, China's role as factory-to-the-world faces challenges. Wages for factory workers in export centers have been ticking higher. The full impact of higher world oil prices has not yet been felt in export factories, thanks to government energy subsidies. But that protection is scheduled to be withdrawn, meaning Chinese factories will face higher energy bills. Higher wages, electric bills and shipping costs — all will eat into Chinese manufacturers' profit margins.

"Many companies want to be in China anyhow to serve the domestic market. The question is whether China is the best place to serve the U.S. market," says economist Marc Levinson, author of *The Box*, a history of the shipping container.

Whatever the long-term results, higher fuel bills are affecting shipping lines and others involved in moving products from point A to point B. At NYK Line, captains are slowing their container ships, while executives consider retrofitting or scrapping older, thirstier models.

Slowing a giant oceangoing vessel to a speed of 23 miles per hour from almost 29 mph can lead to fuel savings of at least 20%, says Peter Keller, president of NYK Line. But to maintain the same level of service on a given route, the shipping line must add a ship. NYK also has raised prices and is scouring its fleet for older ships that can be made more efficient or that must be retired.

Older vessels, such as the *Iris*, built in 1983, carry a little more than 2,000 20-foot containers. Newer models, such as the NYK *Vesta*, christened last year, tote four times as many.

Still, Keller is skeptical that higher transport costs will turn back the clock to an era when the world economy was much less integrated. "The case for globalization is so strong. ... Personally, I don't think we'll go back," he says.

**Find this article at:**

[http://www.usatoday.com/money/industries/manufacturing/2008-08-11-cargo-costs-oil\\_N.htm](http://www.usatoday.com/money/industries/manufacturing/2008-08-11-cargo-costs-oil_N.htm)

Check the box to include the list of links referenced in the article.

Copyright 2008 USA TODAY, a division of Gannett Co. Inc.