Overview of the Logistics Sector

- The logistics sector contributes over £121 billion Gross Value Added (GVA) to the UK economy, equating to 11 per cent of the UK Non-Financial Business Economy[1];
- Excluding the wholesale sector, the logistics industry contributes £45.5 billion to the UK economy;
- Turnover is £1 trillion;
- There are 172,345 logistics enterprises [2];
- 1.77 million individuals are directly employed within the logistics sector. More broadly, in 2016 the number of individuals working in logistics can be expressed as around 2.54 million individuals, which equates to approximately 8 per cent of the UK workforce;
- Of the 2.5 million people employed directly or indirectly in logistics, approximately 365,000 (14 per cent) are non-UK nationals of which 290,000 are EU nationals (11 per cent) and around 75,000 (3 per cent) are non-EU. The reliance on EU workers is particularly acute in the warehousing sector where 21 per cent of forklift drivers are EU nationals and 23 per cent of those working in elementary storage occupations come from the EU.

Priorities

1. The Autumn Statement 2016 takes place against a backdrop of a UK economy that has grown steadily for 14 consecutive quarters with Q2 2016 tertiary estimates indicating that GDP output rose by 0.7 per cent between April and June 2016. The annual GDP growth between Q2 2015 and Q2 2016 was 2.1 per cent. Retail sales grew by 6.2 per cent in August 2016 compared to August 2015 which is the 40th consecutive month of year-on-year growth. In August 2016, UK inflation remains comparatively low but has been generally above the rates seen in 2015. In the year to August 2016, food prices fell 1.9 per cent and prices of motor fuels fell by 2.6 per cent. Historically, price movements for these two groups have been among the main causes of inflation. Inflation was, on average, flat for most of 2015. The Government's preferred measure of inflation (the Consumer Prices Index (CPI) was 0.6 per cent in August 2016, unchanged from July 2016. Inflation has remained well below the 2.0 per cent target for two years now. The headline figure for average earnings was 2.3 per cent higher in the three months to July 2016 than in the same three months a year earlier, down from 2.5 per cent in the three months to June 2016. Regular pay rose at an annual rate of 2.1 per cent in the three months to July 2016, down from 2.3 per cent in the three months to June 2016.

2. Real wages are rising and living standards are improving because inflation is comparatively low rather than because earnings growth is accelerating. The unemployment rate in the UK was 4.9 per cent in the three months to July 2016, down from 5.0 per cent in the three months to April 2016, and the lowest it has been for 11 years. There were 31.77 million people in work in the three months to July 2016, 174,000 more than the previous three months and 559,000 more than a year earlier. Higher employment and a reduction in joblessness should mean that companies are having to compete harder to find workers from a shrinking pool of labour, with wage settlements rising as a result. Although lower oil prices in the last two years have been good news for the freight industry in terms of lowering fuel costs; it faces skills shortage issues, which place an upward pressure on overheads through increased wages and limit

[1] Annual Business Survey 2014, published November 2015
[2] Table UKBAA01a: *UK Business: Activity, Size and Location, 2015.*" Office for National Statistics.

the amount of savings which can be passed on to customers. The National Living Wage will drive further salary increases in the UK, presenting challenges for logistics organisations in 2017.

3. Transport prices, overall, increased by 0.9 per cent between July and August 2016, air fares were the main contributor to this increase. Fuel prices on the other hand decreased by 1.3 per cent between July and August 2016, however this is a smaller fall than that seen in the same period a year earlier. Net trade is likely to have had an impact on UK economic growth in Q3 2016. The UK's trade deficit widened by £3.3 billion in the three months to August 2016 to £34.5 billion compared to the previous three months. There were increases in the export of machinery and transport equipment, fuels and material manufactures, partially offset by falls in the export of unspecified goods. There were increases in the import of semi manufactures, oil, machinery and transport equipment and unspecified goods, partially offset by falls in the import of miscellaneous manufactures.

4. Against this economic background FTA's submission to the Chancellor outlines recommendations to stimulate growth by ensuring that the key cost inputs such as fuel, vehicle parts and tyres are contained and the competitiveness of the logistics industry supported.

The Chancellor must:

I. Ensure that Brexit negotiations enhance the UK economy by

- minimising the burdens placed on businesses moving goods globally. British goods need to be no more costly to export or burdened with any more red tape than they are now;
- delivering access to services serving global destinations through a truly global airport hub such as Heathrow;
- facilitating access to staff from outside the UK – particularly where there are quantifiable labour shortages in the British market.

II. Help industry to tackle the current skills shortage by

- ensuring that the Apprenticeship levy – and the training funding it will provide – is flexible enough to meet businesses' needs;
- providing a policy framework and sufficient funding to support the provision of new and improved roadside facilities for drivers.

III. Ease cost pressures on domestic road freight and stimulate economic growth by

- reducing road fuel duty by three pence per litre, with commensurate reductions in the duty rate for gas oil;
- re-instating the duty differential for used cooking oil as a bio-fuel in commercial vehicles;

IV. Ensure the UK has the infrastructure networks necessary to support a growing economy by

- protecting the Roads Investment Strategy and ensuring it continues to provide sufficient funding to deliver the full approved programme of road improvements;

- enhancing revenue budgets to allow for improved maintenance of existing roads on both the strategic and local authority road networks

- protecting funding for the Strategic (rail) Freight Network; and

- taking a decision in favour of an additional runway at Heathrow.

Commercial environment

5. The UK's freight transport sector continues to face a challenging business environment with businesses having to contend with high operating costs and uncertain levels of business activity.

6. World oil prices fell in the second half of 2015 as demand from Europe and China continued to weaken. The falls continued into January 2016 with the price of oil reaching $28 a barrel, the lowest it had been since late 2003. There has been some recovery in prices since then with the price of oil per barrel in September 2016 averaging $47 which is almost three per cent lower than the price of $48 seen in September 2015. The Brexit vote has significantly weakened Sterling on the foreign exchange markets. Sterling is currently trading around 10 per cent lower against the US Dollar than before the vote and 14 per cent lower compared to a year ago. As oil is priced in US Dollars, falls in the oil price have been significantly reduced for UK importers by the fall in the value of Sterling after the Brexit vote. At an average of 87.98 pence per litre (ppl), UK bulk diesel prices in September 2016 were 1.8 per cent higher than a year previously. The short-term outlook is for continuing comparatively low fuel prices, however, in the longer-term there is a concern about the UK's reliance on imported fuel with 45 per cent coming from foreign suppliers. In the case of road freight, fuel represents around 31 per cent of the operating costs for a 44 tonne gross vehicle weight hgv. Fuel costs for one such truck are around £41,500 per annum[3].

7. According to FTA's Manager's Guide to Distribution Costs[1], FTA members indicated an average increase of 5.1 per cent (where reported) in the costs of tyres during the first six months of 2016. Tyre prices remain high despite the fact that the price of the rubber used in their manufacture has been falling steadily over the past five years. Costs for external workshop charge-out rates have also increased by an average of 3.2 per cent during the first six months of 2016.

8. In a low margin business (around four per cent[4]) such as logistics it is vital that operators remain competitive and as a result, any cost savings have a strong chance of being passed on to customers. However, savings from reduced operating costs due to lower fuel prices are unlikely to be passed on automatically in basic pay rises when there is the risk in the future that when fuel prices recover their margins are squeezed even further. If operators choose to increase staffing levels then they run the risk of redundancies down the line when costs inevitably rise again. According to FTA's Manager's Guide to Distribution Costs[1] in the year to 1 July 2016 total operating costs for a 44 tonne gvw artic fell by 0.7 per cent with rises in most input costs being offset by a 5.7 per cent reduction in the price of fuel. Haulage rates rose by an average of just 0.1 per cent in the first six months of 2016. In fact, FTA members reported that the majority of domestic haulage rates had not changed since the start of 2016, and 10 per cent of the sample of rates had dropped reflecting the impact of lower fuel costs compared to last year. This extremely tight operating margin coupled with broadly unchanged haulage rates is illustrative of an industry that is in desperate need of growth stimulus.

[3] FTA Manager's Guide to Distribution Costs July 2016 Update
[4] http://motortransport.co.uk/top100/top-100/motor-transport-top-100-2015/

9. Rail freight continues to be a marginal business for non-bulk freight flows such as containers and its ability to compete with road transport is particularly vulnerable to changes in its cost base. Many locomotives run on low-taxed gas oil, making operating costs even more exposed to world oil price fluctuations. Recent figures published by the Office of Rail and Road for Q2 2016 show the lowest freight moved total on record since Q4 2000. This is due to the continual decline in the amount of coal transported over the last three years, down 61.4 per cent from the same quarter in 2015. During Q2 2016 domestic intermodal services accounted for the largest proportion, 40.2 per cent of freight moved, 1.69 billion net tonne kilometres, followed by construction which accounted for 25.3 per cent.[5]

10. As a part of its "Agenda for More Rail Freight" FTA identified six key targets to grow UK rail freight. To achieve Network Rail's rail freight growth forecasts, rail freight will need to increase by 6 per cent per year.

    i. Cost reduction by 15 per cent based on current costs plus innovation
    ii. Six hour response time to service and alteration requests
    iii. Seven day railway capability
    iv. Standard train lengths should be increased by 17.5 per cent
    v. 400 per cent increase in terminal capacity
    vi. Reduce intermodal transfer costs by £50
    vii. Reduce Channel Tunnel rail freight charges and rates by £50

11. FTA members reported in the July 2016 Quarterly Activity Survey (QTAS) that business confidence within the domestic freight sector improved even though the outturn growth of activity reported was lower than the expected level of growth anticipated in the previous survey. Respondents reported that they expect robust growth in activity levels to continue in Q3 2016.[6] Figures published by the Insolvency Service in July 2016 revealed that the number of road freight operators declaring insolvency was unchanged in Q1 2016 compared to Q4 2015 and was 28 per cent lower than a year ago. The long-term trend since the end of 2011 has generally been downwards and the number of road freight operators declaring insolvency in Q1 2016 was over 60 per cent lower than that seen at the peak of the economic downturn[7].

12. According to FTA's Logistics Industry Survey[8], fleet investment intentions while showing improvement were less than expected in 2015. In Q2 2016, SMMT reported a rise of 8 per cent in hgv fleet acquisition (vehicles over 6 tonnes gvw) compared to a year earlier and FTA members indicated that demand for new commercial vehicles was set to improve in Q3 2016, reflecting the steady growth in the UK economy.[9] Expected levels of fleet investment for 2016 are generally higher than 2015 indicating that there is an anticipated requirement for increased capacity in line with an expectation of increased business volumes for the coming year. However other forms of large-scale investment plans for 2016 are downscaled from 2015, these in turn were downscaled in the previous two years. This indicates that while the business outlook is still positive, there is increasing uncertainty around the mid to long-term [10].

[5] ORR Freight moved Q2 2016 (Apr-Jun)
[6] QTAS, July 2016, FTA
[7] https://www.gov.uk/government/statistics/insolvency-statistics-april-to-june-2016
[8] FTA Logistics Industry Survey 2015/2016
[9] QTAS, July 2016, FTA
[10] FTA Logistics Industry Survey 2015/2016

Supporting skills development

13. The logistics industry is currently experiencing a shortage of around 35,000 professional drivers caused at least in part by the cost of acquiring the necessary hgv licence. Since 1997 new drivers have to be fully qualified in a lower category of (driving licence) entitlement before seeking entitlement in a higher category. This means that the cost can be approximately £3,000 per driver to gain an hgv licence. These costs can be prohibitive for prospective employees to self-fund, especially if that person is unemployed or has been earning a minimum wage. In addition, margins for logistics businesses are very tight and as a result finding funds to invest in training for prospective employees is difficult and carries the risk that benefits may not accrue to the company if the employee moves to a different employer.

14. Tackling the skills shortage is a key priority for FTA. But achieving success requires action in a number of areas (from reducing weighting times for driving tests and driver medical assessments to improving the image of the industry) and involving all key players including FTA, industry itself and of course Government. There has been some welcome success to date with shortage estimates reducing from 45,000 last year to the current 35,000. But this still represents a considerable problem and the Brexit vote could exacerbate the issue if access to non-UK employees becomes more difficult. The wider logistics sector relies heavily on EU workers with around 10 per cent of HGV drivers; 21 per cent of fork-lift drivers; and 23 per cent of warehouse workers being EU nationals.[11]

15. In the summer 2015 budget the Government announced the Apprenticeship Levy. This is aimed to encourage businesses to increase apprenticeship opportunities and help achieve the Government's target of 3 million apprenticeships by 2020. Since the initial announcement and subsequent consultation the following details have been confirmed.

    - The levy will come into effect in April 2017
    - The levy will be set at 0.5 per cent of an employer's paybill
    - The levy will only be paid on all annual paybills in excess of £3 million (including agencies)
    - Each employer will receive an allowance of £15,000 to offset against their levy payment
    - The levy will be payable monthly through Pay As You Earn (PAYE) and will be payable alongside income tax and National Insurance
    - In England, employers will be able to claim back the levy via a digital voucher system to fund apprenticeships within their business
    - Details with regards to Scotland, Northern Ireland and Wales will be announced at a later date

16. Some good progress is being made in determining how this programme will be delivered. For example, FTA has welcomed the approval of the Trailblazer LGV Driver Standard which means that industry will have a useable apprenticeship option to develop drivers. In addition, FTA is pleased that no age restrictions will be applied to apprenticeship funding as this will help industry make best use of this option. Therefore it is crucial this flexibility is retained.

17. However, we do have some concerns about the levels of funding which have been proposed. For example, the proposed funding level for LGV Driver Standard is £5,000, whereas the cost to deliver training for the apprenticeship is £7,500. Thus the Chancellor must reconsider this funding level.

[11] Source: Repgraph analysis of ONS Labour Force Survey for Q2, 2016

18. Of course the system will only deliver benefit for businesses – especially those paying the Levy - if there are sufficient volumes of quality apprentices available to fill these positions. Therefore Government must do more to promote apprenticeships within schools

19. Despite these positive developments, it is clear that not all valuable training can be made to fit within the apprenticeship model. Many businesses have already incurred significant costs developing in-house training schemes for employees which, under current Levy rules, will no longer qualify to be funded. While the drive to grow apprenticeships is laudable in principle, this cannot be allowed to be achieved at the expense of other beneficial types of vocational training. The Chancellor should consider greater flexibility for the utilisation of levy funds to cover all approved vocational training

The Chancellor must ensure that the Apprenticeship levy – and the training funding it will provide – is flexible enough to meet businesses' needs

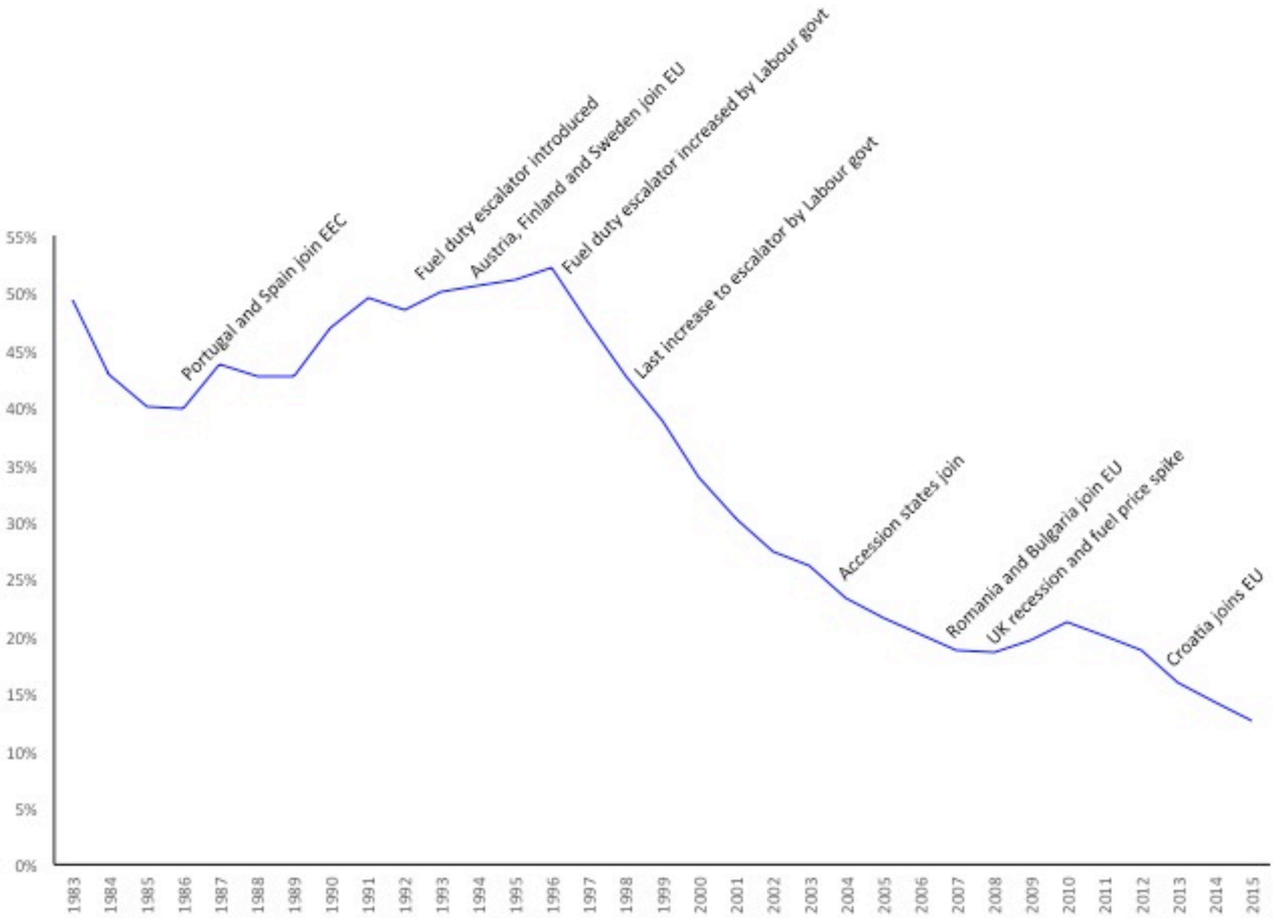
Taxation measures

Fuel duty

20. FTA has welcomed the Chancellor's successive decisions to freeze fuel duty since 2011 and the announcement in the March 2016 Budget that duties would not increase in April 2016. Fuel accounts for around 31 per cent of the cost of running a 44 tonne truck currently, but it had been around 40 per cent just two years ago and the cost has risen dramatically over the past 20 years. FTA estimates that just one penny increase in duty adds around £470 per year to the cost of running one of these trucks. However, many FTA members run fleets numbering hundreds – or sometimes thousands – of such vehicles. The current rate of fuel duty costs industry around £7.0bn a year or £120.76m per penny.

21. In determining its approach to fuel duties, Government needs to be mindful of the negative effect comparatively high levels of duty has had the competitiveness of UK logistics. This is demonstrated most starkly by the numbers of UK registered vehicles travelling to mainland Europe. The fuel duty escalator was introduced in 1993 and increased in 1996 when, just over half (52 per cent) of all powered vehicles travelling to mainland Europe were UK registered, by the end of 2015 that figure was 12.54 per cent. In the 20 years to end of 2015, the number of UK registered powered vehicles travelling to mainland Europe fell by nearly half whilst the number of foreign registered powered vehicles quadrupled (figure 1).

Figure 1: Proportion of UK-registered vehicles travelling to mainland Europe 1983-2015



22. Thanks to the action already taken by Government fuel duty is far lower than it would have been – in fact saving industry £8.48bn in extra duty had the previously planned increases been introduced. Government is to be commended for providing this much-needed relief. However, FTA believes the Government should go further. FTA is a key funder and supporter of the campaign by FairFuel UK for fuel duties to be reduced. As part of that campaign, two studies have been commissioned – the first by CEBR[12] (Centre for Economics and Business Research) and the second (on Treasury's recommendation) by NIESR[13] (the National Institute for Economic and Social Research) – looking at the economic impacts of a freeze in fuel duties and then of a cut in duties. What both pieces of work demonstrate is that a change of approach could deliver significant benefits including creating jobs, boosting GDP, and in some circumstances, delivering a net increase in tax revenues. The modelling shows the effects to be optimised at a reduction of three pence per litre. It is our contention that taken together these increases in disposable income for consumers and free cash for businesses will be spent or invested elsewhere in the economy leading to the re-ignition of economic growth that has so far eluded us.

Government should cut fuel duties by three pence per litre, with commensurate reductions in duty for gas oil, in order to stimulate consumer spending and business investment and re-ignite economic growth

[12] Report by CEBR
[13] "The Impact of Fuel Duty on the Macro-Economy" NIESR, September 2012

Encouraging alternative fuels

23. Until April 2012, operators that made use of used cooking oil as a bio-fuel in commercial vehicles were encouraged to do so by a 20ppl lower fuel duty. This duty differential meant that the price of used cooking oil was within 1ppl of that of conventional diesel. Used cooking oil is mixed with conventional diesel typically at a blend of 30 per cent, with no impact on vehicle performance **and in some cases 100 per cent blends are used**. Where access to used cooking oil is possible, operators make use of the fuel as part of their commitment to reducing greenhouse gas emissions as the emissions created are broadly offset by the original crop growing process. Several businesses have invested heavily in processing and refueling infrastructure to support collection of used cooking oil from restaurants and other business premises and in its conversion to a low-carbon fuel to help meet the UK's greenhouse gas reduction targets.

24. When the duty differential was abolished in 2012, Government announced that it would double the RTFO credits for such fuels. However, the value of those credits is insufficient to compensate for the loss of the duty differential. Without the differential, operators currently face the choice of shouldering the significant extra costs associated with continued use of this fuel – at a time when they can least afford it - or switching back to conventional diesel. **At a time when Government is under pressure to meet renewable transport fuel targets,** not only does this contradict what Government is seeking to achieve through its wider carbon agenda, it also undermines business confidence in Government's willingness to 'see through' policies designed to encourage investment in untested technologies or practices for the good of the environment.

The Chancellor must re-instate the duty differential for used cooking oil as a bio-fuel in commercial vehicles

Infrastructure Investment

25. On 1 December 2014 the Government announced the contents of its Roads Investment Strategy (RIS); FTA supported the establishment of the Roads Investment Strategy and welcomed the RIS as good news for the freight and logistics sector. Following this first roads investment programme RIS 2 needs to be developed in order that work on delivering long-term improvements to our roads can continue seamlessly beyond 2020. There are a number of steps that need to be completed leading up to 2020, which can be summarised in three phases of: research, decision making and mobilisation.

26. The research phase of RIS 2 is current being undertaken with the main sources of information for this research being the 6 strategic studies together with programme of refreshed route strategies covering the entire Highways England network. The Association believes that most of the freight needs for the SRN are covered by the six feasibility studies which are likely to form the bids for the next funding period between 2020/25. Additionally Highways England is reviewing its route based strategies by taking evidence from Local Enterprise partnerships and local highways authorities.

27. In recent years, FTA members have reported (via a quarterly survey) that they believe the performance of the road network has deteriorated with a reduction in reliability of 42 per cent on the motorway network and 40 per cent on urban roads reported in Q2 2016.[14].

28. Efficient and effective road networks are crucial for the logistics industry to be able to support the needs of UK businesses. More than 80 per cent of goods go by road and as the economy recovers, the demands placed on the road network will only increase. In

[14] QTAS, July 2016, FTA

addition pressure will also be brought to bear through more road works that will inevitably come with increased investment in the network.

The Chancellor must ensure that the Roads Investment Strategy remains protected and provides sufficient funding to deliver the full approved programme of road improvements. In addition, it is essential that local authority funding is sufficient to allow them to support road enhancements to deliver improved connectivity to/from the Strategic Road Network and key freight generators (such as ports, airports, strategic interchanges etc.)

29. While the capital funding for road improvements and new build is important, maintenance of the existing network must not be overlooked. It has become too easy to look to the revenue budget for maintenance and cut that allocation only for the network to deteriorate and become unsafe and defective. Despite the government's commitment to £6 billion of funding for local road maintenance between 2015 and 2021, according to the ALARM[15] survey of local highways departments in England overall budgets have dropped by 16 per cent. The government's announcement of a £50 million Pothole Action Fund for England in 2016/17 is welcome news but more investment is needed to prevent potholes in the first place.

The Chancellor must ensure that both the Highways England's and local authorities' revenue budgets are maintained to allow for adequate maintenance of existing roads

30. Similarly a lack of good quality, safe and secure roadside facilities for lorry drivers to take the breaks required of them by law acts as a deterrent to new drivers – particularly female – entering the profession. With the industry suffering a driver shortage it is essential that concerted efforts are made to make the industry attractive to potential employees.

The Chancellor must ensure that both Highways England and local authorities have sufficient funding available to support the development of new, and improvement of existing roadside facilities for drivers

31. Rail freight is receiving public sector investment to help optimise Britain's mixed use rail network for freight. Recently, this has partly been through the Strategic Freight Network (SFN) scheme incorporated into the High Level Output Specification (HLOS) for England and Wales for Control Period 5 (CP5) 2014–2019, which was announced on 16 July 2012 by the Secretary of State for Transport.

32. Plans for the construction of High Speed 2 faced intense political and public scrutiny and its promoters and supporters claim freight will benefit from capacity that will be released on the existing network once the high speed line is built. However, there is apprehension that pressure from towns along the southern West Coast Main Line for more connecting services to London, through concerns that they become economic backwaters because they are not on HS2, could put this released capacity 'at threat'. Also, north of the HS2 junction with the West Coast Main Line where HS2 trains will run up the classic network indicative timetable modelling shows a deterioration of Anglo-Scottish freight journey times and a constraint on the capacity for such services.

33. *Developing Rail Freight in Control Period 5 (CP5)* set out proposed freight schemes from 2014–2019.These routes identified in CP5 form key arterial corridors for Britain's supply chain and connection with the global economy. Investment in 'gauge enhancement' to

[15] http://www.asphaltindustryalliance.com/alarm-survey.asp

allow the more commonplace, taller shipping containers to be transported, or investment in capacity improvements to improve increased throughput of freight trains, will help improve efficiency and reliability in the supply chain. Through wider Network Rail problems identified ion the Hendy and Bowe Reviews there were cost and delivery issues in delivering these schemes. Some have had to be deferred to CP6 and it is important that these go ahead.

34. A key element of CP5 was the setting of Freight Track Access Charges (TAC) that freight train operators pay to Network Rail to use their infrastructure. These access charges, which in GB are controlled by the Office of Rail and Road (ORR), are a component of the cost that is difficult for logistics to control. In 2012,TACs were the subject of the Periodic Review by ORR, which advocated increasing future access charges for 'captive' traffic, such as coal for electricity generation and iron ore. This will not only have an impact on those industries but will negatively affect other potential users of the mode, particularly intermodal customers. The commercial position of rail freight and its social and environmental benefits are acknowledged in EC Access Charging Directive 2001/14 which sets the framework for freight's use of rail across Europe. This sets marginal cost as the default charging regime. Track access charges need to remain marginal or there will be risk to prospects for growth in the mode. With ORR now conducting the next review of Network Rail finances for CP6 it is really important that such policy mistakes are not repeated.

The Chancellor must ensure that the outcome of the current reviews into the Railways does not undermine the delivery of the Strategic Freight Network and that freight track access charges to remain at a marginal cost

Freight Transport Association

Freight Transport Association is one of the UK's largest trade associations and represents over 15,600 members relying on or providing the transport of freight both domestically and internationally, to or from the UK. Our members include hauliers, freight forwarders, rail and air freight operators, through to customers – producers, manufacturers, wholesalers and retailers. They cover all modes of transport – road, rail, air and sea. FTA members operate over 210,000 commercial goods vehicles in the UK, approximately half of the UK fleet of goods vehicles, 90 per cent of goods moved by rail and around 70 per cent of goods moved by air and sea.

Freight Transport Association
Hermes House, St John's Road, Tunbridge Wells, Kent, TN4 9UZ

October 2016