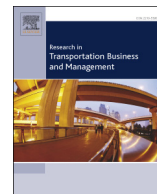




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How competition is driving change in port governance, strategic decision-making, and government policy in the United States

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ABSTRACT

The period from 2007 through 2016 saw little change in the fundamentals of port governance in the United States. Instead, increased competition resulting from the consolidation of the ocean carrier industry, a slower forecast for U.S. container trade growth, port congestion on the U.S. West Coast and the potential for shifting trading lanes from an expanded Panama Canal became the predominant force driving change in the U.S. port industry. Recognizing the competitive threats, the U.S. government responded through increased funding, greater agency engagement, modest reform of the harbor maintenance tax and legislation regarding the establishment and reporting of port performance metrics. State governments invested and took steps to position their ports to withstand increased competition. At the local level, ports responded through strategic collaborations and by shifting from traditional landlord roles to supply chain participants. The West Coast Ports exhibit greater efforts at strategic collaboration than the East Coast Ports that are actively competing for cargo through an expanded Panama Canal. Some East Coast port investment is speculative and out of scale with market and financial conditions. The potential of over-investment, stranded assets or market share losses could drive more ports to consider regional collaboration, governance changes or creative leasing strategies to facilitate terminal collaboration to enhance their market power.

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1. Introduction

Fawcett (2007) provides the historical context and founding principles that explain the genesis of the decentralized control of the seaports in the United States. U.S. commercial seaports are owned and managed by governmental agencies, either a state, city, bi-state agency, or special district. The cargo-handling terminals within the port jurisdiction are typically leased to private operators although, in a few cases, the governmental port authority operates the terminals. Brooks and Cullinane noted in 2007 that port governance in the U.S. was stable compared with other regions of the world. This statement is still valid today. U.S. port governance continues to consist of a mixture of public and private services, as defined by Baltazar and Brooks (2007) and Brooks and Cullinane (2007).

The vast numbers of private and public organizations found operating within U.S. seaports, often with conflicting priorities, create a highly competitive environment (Brooks & Pallis, 2011). Inter-port competition has intensified as improved inland freight infrastructure provides port users the ability to substitute ports to reach hinterland markets (U.S. Department of Justice and the U.S. Federal Trade Commission, 2011). Competitive forces become more pronounced when economic

conditions and market forces threaten a seaport's cargo volumes. The downturn of 2007–2009, combined with slower growth in world trade meant many U.S. seaports experienced their first declines in cargo volumes in decades. In 2009 container traffic on the U.S. West Coast dropped nearly 14%, non-containerized cargo fell by 23% and work opportunity for longshore personnel fell by 21% (Pacific Maritime Association, 2010). This decline in cargo volume, coupled with the corresponding loss of revenue, created financial challenges for ports that needed investment to remain competitive. In response, the U.S. federal government began to increase funding for port projects, individual U.S. states are becoming more proactive to ensure the competitiveness of their ports and some ports have intensified their collaboration to reduce market risk.

The objective of this paper is to examine how competition is impacting governance and strategic decision-making at U.S. seaports as well as driving change in government policy. This paper begins with an overview of recent trends in the maritime industry that are affecting U.S. seaports with emphasis on how these trends are creating an increasingly competitive marketplace. Responses to these trends will then be examined at three levels: 1) efforts of the U.S. federal government to respond to the needs of the U.S. seaports; 2) examples of actions taken by state governments to address their ports competitive issues; and, 3) examples of actions taken by individual ports to position themselves to preserve or grow their market share of U.S. trade.

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2. Market trends affecting U.S. seaports

As public entities, the U.S. seaports have the dual role of providing for the needs of maritime commerce while at the same time serving the public interest, often with varying demands to drive economic development and job creation in the surrounding region. Seaports are also expected to be stewards of their environment. Seaports react to changes in the maritime industry, expanding facilities to accommodate trade. The shipping lines order larger ships and the seaports respond. If navigation channels needed deepening, seaports seek federal dollars or fund the dredging themselves. Historically, seaports made these investments and received a return on their investment by long-term leasing of the facilities to a terminal operator that often had strong ties to a shipping line or by leasing directly with a shipping line. The traditional port business model, therefore, depends on a long-term commitment of cargo movements that produces a revenue stream lasting long enough for the port to retire its debt.

With more modest trade projections, competition among the U.S. seaports has intensified. By the end of 2015, not all ports have achieved their pre-recession cargo volumes, particularly on the U.S. West Coast, although the value of goods moving through the U.S. seaports increased by \$400 million between 2007 and 2014 (Martin Associates, 2014). Containerized volume through Los Angeles and Long Beach peaked in 2006 at 15.76 million teus, declined to 11.8 million teus in 2009 and slowly recovered, reaching 15.3 million teus in 2015 (Knatz, 2016). Inter-port competition intensified as predatory pricing practices shifted cargo from one port to another in the same region. For example in May 2009, the Port of Long Beach adopted a 10% fee reduction in wharfage rates for any incremental increase in intermodal containers moved through its port by its customers (Port of Long Beach, 2009). Los Angeles countered with incentives of its own, with slight variations or at slightly higher amounts (Port of Los Angeles, 2013). Competition spread from seaports within a specific region to competition between coastlines due to the Panama Canal expansion.

On the U.S. East and Gulf coasts, the expansion of the Panama Canal is viewed as an economic opportunity for port cities, stimulating port facility development to handle a potential increase in cargo. Recognizing that the full benefits of an expanded canal could only be realized if U.S. ports were equipped to handle the larger ships, the Panama Canal Authority (ACP) encouraged the U.S. East and Gulf Coast ports to invest in their own facility development. The ACP negotiated over 25 Memorandums of Understanding (MOUs) with East and Gulf Coast seaports, large and small, beginning in the year 2003. The renewal of many of those agreements over the past few years creates a perception that the Panama Canal expansion provides business opportunities for numerous ports of various sizes and attributes. The sheer number of MOU's runs counter to the concept of a strategic network that warrants concentrating and accelerating investment for dredging and landside improvements in a fewer number of ports.

While the economic downturn had a great impact on tempering port growth, the ocean carrier industry, long plagued by financial stress, took actions to increase their efficiency and reduce costs. The global ocean carrier industry is an asset-intensive business, and the ocean carriers have been hard pressed over the past decade to sustain a profit. The size and strength of ocean carriers is measured by ship capacity (the number of container slots it owns on ships), not by utilization of its capacity. Ocean carriers have continued to order new ships, despite an existing oversupply of vessel capacity. Excess vessel capacity results in rate wars as shipping lines lower their rates to fill ships. Characterized as a "race to the bottom," these shipping lines financial losses are self-inflicted by the ship supply/ship capacity imbalance. The Journal of Commerce (JOC) reported in November 2014 that the revenue per TEU for the world's largest shipping lines declined for the three prior years due to excess capacity in the shipping fleet, despite growth in container volume. JOC reported in February 2016 this trend continued through 2015. Ocean carriers survived the downturn by slow steaming,

restructuring debt, government subsidies, and seeking reductions in port charges.

Rather than curb their appetites on ship purchasing, the ocean carriers sought to restore profitability by doing three things: 1) ordering larger ships to achieve an economy of scale; 2) rationalizing use of their assets by creating alliances with other shipping lines; and, 3) calling at the most efficient port terminals, with continual reevaluation of terminal selection. The third action was significant for seaports, as ocean carriers restructured or divested of their obligations to call at specific terminals. This action undermined the port's ability to bind an ocean carrier's volume through a long-term lease. The "super" alliances created by the world's largest shipping lines can control a significant share of trade in a trade lane, increasing their leverage in negotiating with seaports and terminal operators. As the negotiating leverage of the alliances increases, the negotiating power of the seaport and their terminal operators is diminished.

The rate at which container ship size increased over the period 1996 through 2015 has accelerated. The average size of a container ship between 2001 and 2008 was 3400 teus, rising to 5800 teus between 2009 and 2013. Today the largest ships are 21,000 teus with the average size at 8000 teus (International Transport Forum, 2015). These large ships only achieve an economy of scale if they sail full, reinforcing the benefits of shipping alliances which fill ships by consolidating cargo from among their alliance partners, optimizing the use of vessel fleets on specific trade routes.

Ocean carriers now prefer short-term agreements with terminal operators because of the flexibility to move their ships from one port terminal to another. Short-term agreements are a significant departure from the model that seaports traditionally used to finance their investments by locking in a shipping line's business for 30 years. Investments in port infrastructure come with greater risk when made without the safety net of a long-term cargo volume commitment. Seaports and the U.S. federal government could fund a channel deepening project and find that the cargo has shifted to another port. Yet, ocean carriers still expect the seaports and the U.S. Federal government to continue to make significant infrastructure investments. Notteboom and de Langen (2014) noted that European container seaports face similar challenges as ocean carrier alliances maximize the efficiency of their terminal network on a global basis, leaving ports with little leverage in assuring cargo moves through their terminals. The result is that the traditional business model landlord ports have used to develop, lease and finance terminals is outdated and must adapt to the changing business model of their customers.

The American Association of Port Authorities (AAPA) surveyed its 83 members, which represent nearly all of the leading US seaports along all coasts in the United States, to identify the capital expenditures planned for each port region (American Association of Port Authorities, 2015). The survey results indicate that U. S. public seaports and their tenants and customers plan on investing approximately \$9 billion each year for the period 2012–2017, for a total investment of 46 billion as compared with a total port investment from 1946 to 2005 of \$30 billion (in current dollars). Note these surveys are based on a port's current perception of its needed improvements in the coming years. These capital plans are continually revised as market conditions change and are generally subject to annual budget approval by the relevant governing body. Much of this investment is for seaports that hope to increase market share as a result of the Panama Canal expansion. Thus, the shipping lines are striving for efficiency by rationalizing their assets while seaports, at least on the U.S. East Coast, in their quest to service cargo through an expanded canal, still seek to duplicate assets. AAPA released an update of this survey in April 2016 for the period from 2016 through 2020. The total planned investment was \$154 billion, heavily weighted toward energy projects in the Gulf Ports (Table 1).

The U.S. Maritime Administration Panama Canal Expansion Study, Phase I Report (U.S. Maritime Administration, 2013) predicted that with the expanded canal, ocean carriers are likely to replicate the west

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