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PNW Seaport Alliance: Stakeholder's benefits of port cooperation☆

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ABSTRACT

The introduction of containerization in the 1970's was a classic disruptive change to an industry that was ripe for innovation and standardization. It facilitated the growth of seaborne trade and landside movement of cargo via rail and trucks. But it also became increasingly difficult to differentiate services throughout the supply chain. In response, every segment of the container supply chain sought to rationalize by merging and forming strategic alliances. However, ports have been the one notable exception. While most ports remain unique because of location; changes in demographics, trade patterns, and other external factors are causing the overlap of service areas for some neighboring ports. Such was the case for the Ports of Seattle and Tacoma located just 30 miles from each other. This paper outlines the background and circumstances that made the ultimate formation of the PNW Seaport Alliance so compelling. It also summarizes the key components of the Alliance. Since each situation between neighboring ports is unique, a standard template for assessing feasibility would not be practical. However, it is hoped that sharing the experiences of these two ports forming an Alliance would be of interest and help for many ports in the world facing similar circumstances.

> "Competition has been shown to be useful up to a certain point and no further, but cooperation, which is the thing we must strive for today, begins where competition leaves off"
>
> Franklin D. Roosevelt

Ports have served as the gateway for commerce for most major cities and regions in the world since the inception of international trade hundreds of years ago. Because of the importance of these gateways, most ports are public entities that operate to benefit a multitude of stakeholders. It is clearly in the public interest for ports to be strategic and to be operated efficiently. A key strategic element is to recognize that definition of competition must change with a dynamic competitive environment. In the Pacific Northwest, the Ports of Seattle and Tacoma have competed against each other for prominence in the container business for decades. But as the competitive situation along the entire West Coast of North America evolved, the two ports grudgingly recognized that the competition was not each other but other ports outside of Puget Sound. Therefore, on August 4, 2015, the two ports set aside a history of distrust and resentment and took a strategic and courageous step to position both ports towards long-term viability by forming the PNW Seaport Alliance. The competition for both ports is no longer each other, it is now Canadian ports to the North, California ports to the South, and even ports on the East Coast now more accessible from Asia through the newly expanded Panama Canal. Though this was a bold step, the circumstances requiring a change in defining competition and the need to form such an Alliance is not unique. As the world shrinks with faster transport and improved efficiencies driven by advanced technologies, ports must regularly assess how these dynamics may be changing the way they should define competition in the future.

1. Background

The dramatic increase of global ocean shipping over the past few decades has been driven by the introduction of containerization as well as growth in international trade spearheaded first by the "Asian Tigers" and later by China. Containerization drove down the cost of shipping cargo by ocean carriers and enabled every player in the supply chain to take advantage of standardization and enhanced security. These advantages notwithstanding, containerization also brought inherent competitive challenges. As containerization standards became tighter, differentiation of services became increasingly difficult; and many of

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the links in the supply chain became vulnerable to commoditization. In this environment, companies were forced to pursue scale while driving down unit costs to compete. During this same time, there was a wave of deregulation that both enabled and encouraged numerous consolidations of service providers throughout the supply chain. But while railroads, marine terminal operators, and trucking firms consolidated and ocean carriers formed alliances, notably, only a handful of ports did anything to rationalize operations. It is also worth noting that ports are the only players in the supply chain that are typically government owned, though most contract out terminal operations to private entities.

The most important competitive factor of any port is its location which is defined by proximity to a population base, access to freight transportation infrastructure, and strategic position relative to critical trade lanes. Because each port is unique by virtue of location, one might conclude that the typical pitfalls of commoditization would not apply, i.e. pressures to increase scale and protect declining profit margins. However, when two or more ports are located too close to each other and are in the same business segments such as containers, a "local commodity" situation will exist and price becomes the over-riding factor. Such was the case with the Ports of Seattle and Tacoma. When these two ports were founded over 100 years ago, the 30 miles that separated them was a significant differentiator. Hauling large and cumbersome non-containerized cargo such as logs over 30 miles could be the difference between getting some business or not. Both ports were necessary to serve their respective local economies. Today, though logs are still generally handled by bulk ships, the vast majority of general cargo is containerized. That same 30 miles has now become increasingly insignificant in the highly standardized container trade. As an example, for a customer in Hong Kong exploring ways to move containers through the PNW, it is difficult to differentiate services between the two ports.

2. Ports of Seattle and Port of Tacoma

The "local commodity" nature of the two container ports in Puget Sound made both vulnerable to pricing pressures, particularly since ocean carriers themselves were under enormous pressures due to excess capacity of container ships. Ocean carriers took advantage of this situation in the PNW by playing one port off against the other. This resulted in a downward spiral and a race to the bottom in terms of pricing. This pricing problem created insufficient returns for the ports to pay for investments necessary to accommodate the bigger ships that ocean carriers continued to build. Bigger ships required deeper channels and berths, bigger container terminals, larger gantry cranes, stronger pilings to support heavier cranes, and bigger rail yards. In fact, though not an issue in Puget Sound, some ports have had to raise bridges to increase air draft to accommodate bigger ships. Ports are a classic example of a capital-intensive business. In the long term, this downward pricing trend would not generate sufficient capital to enable the ports to remain competitive. Eventually, the service providers and the users of the PNW supply chain would be forced to seek other alternatives to the detriment of the Ports of Seattle and Tacoma and the surrounding region.

While this fierce competitive situation had existed for a couple of decades, the consequences remained largely hidden and ignored due to the continuing growth of the container business along the entire West Coast. While the Ports of Seattle and Tacoma lost market share in the West Coast, they both continued to grow at a moderate pace. However, due to several converging factors, the growth in container traffic through the West Coast ports began to unevenly slow down. This slow-down in growth contributed to the increased understanding and visibility of the problem associated with dysfunctional competition in the PNW. Several factors contributed to the slow-down of containers through West Coast ports, but three stand out as the most significant. First, while China had experienced double-digit economic growth for more than a decade, there were internal dynamics such as increasing wage rates and their growing domestic economy that began to impact their international trade growth rate. As China's growth rate moderated, West Coast ports' growth rate also moderated. Second, there was a contentious lockout of longshore dock workers in 2002 that caused carriers to shift cargo to East Coast ports to avoid labor problems on the West Coast. Some of the cargo that was shifted to the East Coast never shifted back to the West Coast when the labor issues were resolved. And finally, there was some shifting of cargo in anticipation of the expansion of Panama Canal locks to accommodate bigger ships. Precise amount of cargo that was shifted because of labor issues and the Panama Canal is difficult to ascertain. But from the ocean carrier's perspective, it made sense to pursue a strategy of diversification of trade lanes to reduce reliance on ports and labor on one coast versus the other.

The impact of the slow-down was unevenly distributed among the West Coast ports. The large ports complex in Los Angeles and Long Beach continued to have the advantage of the largest adjacent consumer base as well as their huge investments in mega-terminals, rail yards, and the Alameda Corridor connecting both ports to downtown Los Angeles and beyond. As the slow-down of growth continued, ocean carriers were forced to protect their minimum annual guarantee obligations at their largest terminals in LA or LB. This occurred at the expense of other ports in the West Coast including the PNW ports. In addition, at any given range of ports, the ones positioned to be the first and last call have built-in advantage for imports and exports respectively. Ships connecting North America to much of Asia typically use the big circle that goes North along the Aleutian Islands. For years, before the recent growth of Canadian ports at Vancouver and Prince Rupert, the PNW ports benefitted by effectively being the Northern-most ports on the West Coast of North America. However, with the expansion of Canadian ports on the West Coast, the PNW ports have effectively been outflanked and no longer benefit from status as first or last call. In addition, all US ports are subject to the Harbor Maintenance Tax which helps pay for dredging. There is no comparable cost for Canadian ports. So as the Canadian ports began to increase market share from the West Coast ports, it was mostly from the PNW ports because of proximity. However, these factors noted above notwithstanding, the recession that began in 2008 was the big jolt that caused a near melt-down in the container shipping industry. It caused the industry to lay-up 12% of their combined container carrying capacity to align supply and demand. While the decision to lay-up ships was difficult for ocean carriers, it also created excess capacity issues at most ports handling containers. Each time there was a supply/demand problem in the shipping industry, the ports became the down-stream recipient of capacity problems and pricing pressures. For the Ports of Seattle and Tacoma, the "local commodity" competitive problems were exacerbated by excess capacity and even more intense pricing pressures. While the trends working against the PNW ports were readily evident for years, the response continued to be incremental with the negotiation of each new lease and renegotiation of existing leases which invariably pitted one port against the other. It took a crisis to make the two ports finally take a leap of faith and form the Alliance.

3. Challenges/impediments to cooperation

Though Seattle and Tacoma are only 30 miles apart and share shorelines to Puget Sound, there are several significant differences. Tacoma is the crown jewel of Pierce County which boasts a population of about 860,000 and has historically been industrially based. As such, the Port of Tacoma is embedded in an industrial area and is blessed with opportunities to expand its footprint. Seattle is the heart of a much larger King County with a population of over 2.1 million and has recently emerged as a technical center and tourist destination. The Port of Seattle is located in the heart of the city and is effectively enclosed by commercial and residential developments that would make further contiguous expansion virtually impossible. There were several practical