Implications for the Region of the Panama Canal Expansion and Increasing Vessel Sizes

As we speak the global economic woes continue. In their May 2012, Global and Latin American Editions – Business Monitor International country headlines tell the story regionally and internationally with the all catching headline being –"the global economy continues to muddle through". A cross section of countries sampled in the Global Edition, the story was pretty much the same.

"...***Netherlands*** – Heading into recession..."

"...***Japan*** – the perils of demanding inflation..."

"...***Asia*** – North East Asia property markets facing strain..."

The Caribbean mirrors what has been happening on the international scene as indicated in some headlines from the Latin American Edition:

"...***Barbados*** – long road to balanced budget..."

"...***Puerto Rico*** – subdued growth ahead..."

"...***Jamaica*** – recovery under threat..."

"...***Guyana*** – no fiscal surplus on the horizon..."

From the preceding, it is clear more than ever that some major catalysts are needed to spur global economic growth. Following the decision taken by the Panamanian Government in 2006 to expand the Panama Canal at a cost of US$5.2bn, could this be a silver bullet to economic and trade growth post 2014 that the world is looking for?

Indeed the contribution to direct and indirect revenue for Panama cannot be overestimated. Canal related revenue alone contributes 30% to the country's GDP, while with support services the contribution is closer to 60%.

Jumping ahead to 2014 with the completion of the third set of locks, the size of container vessels that can be accommodated will increase from 5,000 teus to 12,500 teus or other vessels types of equivalent size. This is expected to be a revolution in cargo transport. Also, within the first 11 years after completion of the expansion programme, the direct contributions to the Panamanian treasury will more than triple to over $US4.2bn.

The Canal has come a long way from the initial opening in 1914 to present times. Although it is considered a bottleneck to shipping in some quarters, its current overall benefit in promoting world trade is incalculable.

The Canal facilitates substantial connectivity across various trade routes facilitating 34 liner services for most of the major shipping lines utilising over 284 vessels. This translates into approximately 100 ports being connected on a weekly basis across the major routes below:

- Asia <> United States East Coast
- South America West Coast <> Europe
- Pendulum Service U.S. West Coast <> US East Coast

Vessels that traverse the Canal each save on average 8,000 miles per annum by virtue of not having to utilize alternative routes. Apart from the obvious facilitation of global trade, economic benefits further include foreign direct investments, employment generation, revenue generation and spinoff value added services.

Regional economies will have to prepare for the impending changes being brought about by the expansion and larger vessels being placed in service or face the consequences such as loss of business to other ports such as those on the U.S. East Coast. Someof these East Coast ports already have the required infrastructure or will have it in place by fourth quarter 2014. Several of the West Coast Ports are already prepared due to the Asia <>U.S. West Coast trade that already utilise the larger vessels.

A few regional ports are also expanding, for example, Jamaica with the Port of Kingston (maximum draft of 15 metres) hasplans for a joint venture arrangement with CMA-CGM with an investment of $100m. The Port of Freeport, Bahamas is the only other regional port with a draft of 15 metres.

The threats to regional ports due to increasing vessel sizes cannot be overstated as many newbuilds are on the way for a number of reasons that include:

- The changing trade routes being precipitated by the Canal expansion and larger vessels that can be accommodated.
- Improving technology that facilitates the construction of larger and larger vessels thus ensuring more competitive per unit transportation costs.
- Improved technology providing more fuel efficient engines or alternatives to the traditional types of fuel.

As an example, during 2011 Maersk Line unveiled plans to construct 20 x 18kteu vessels and more recently Evergreen announced their decision to charter 10 x 13.8kteu vessels with delivery starting Q4-2013.In fact current statistics from Drewry Shipping Insight May 2012 puts the issue squarely into context.

Currently, large class container vessels and above (8kteus+) represents 8% of all containerized vessels and 26% of global capacity (15.6mteus) of vessels currently in service.

However the order book for 2012 to 2016 paints an interesting picture, where there are 556 vessels on order representing 3.8mteus. Of this number, 44% represents the large class and above and 72% of the new capacity. This trend will definitely continue as lines seek to place themselves in a more competitive position.

Are smaller vessels under threat and with it the viability of regional ports and by extension their economies? What is for certain is that failure to adapt will have a negative effect on growth not just due to lost business opportunities but also because handling of cargo could ultimately become more expensive, due to reduced rotation of smaller vessels and difficulty in getting goods to their ultimate regional locations and the effect of fuel prices (82% annualised increase over the last 7 years) on less efficient smaller vessels.

Throughput at Caribbean ports as a percentage of the World total has remained relatively constant (at 3.65% over the last 5 years)without any substantial impetus to propel growth. As it stands, many pundits predict that the expected change in trade routes will happen very quickly once the third set of locks is opened. This should aid in pushing the percentage of the global total toward 5% within the first three years after the Canal opening providing the required changes are made.

Some factors that further underscore the potential that the Canal expansion creates for the region are:

- The region (Latin America and the Caribbean) represents a very large trade block with a population in excess of 600million persons.
- Brazil is one of the stars for global economic growth (being part of the BRICS block of nations).
- Major markets in the region have projected combined growth rates in 2012 of 4.6% and 2013 of 4.8%, compared with 3.5% and 4.1% globally.

The factors outlined above will in turn precipitate some key positions:

- Opportunitiesfor development of additional or expanded transhipment hubs
- Decreased costs of goods and cost of trade from exploitation of economies of scale
- Optimising of trade routes
- Development of interlinked business relationships

Placing the spotlight on the creation of hubs it must be noted that not all ports need to adjust to facilitate the "very large" class vessels that require depths alongside of 15 metres and above. However, future development must be seen in the context of, current feeder vessels becoming obsolete, current mainliners becoming feeders and the "very large" class vessels becoming the predominant mainliners. This in turn has to factor in for the potential initiatives such as niche marketing and development, cooperation among territories and joint venture arrangements.

It must be noted that creation of a transhipment hub will not in isolation, dramatically transform a regional economy, but rather it is the spinoffs that can potentially create the exponential economic growth. One such spinoff is the creation of logistics and consolidation services. For example, in the case of Panama development of its free zone, which is now the second largest in the world, was due to the existence of the Canal. Commensurate with its thrust to reinvent and reposition itself,the Panamanian Government,in February 2012, formalised the process for development of Panama as a logistics and commercial hub by launching a Logistics Cabinet that consists of persons in both the public and private sector. The grouping is charged with the responsibility of ultimately developing a master plan that promotes Panama as a logistics and commercial hub.

Development of similar type enterprises could be executed to provide complementary services in the Caribbean and the Americas with eventual expansion to service parts of West Africa.Apart from the well know names such as UPS, FedEx and DHL there are a number of third party logistics providers that stand to benefit from serious expansion considerations in the region. The top 25 global logistics providers have seen average annual revenues in the region of US$3.5bn.Other viable services could potentially include vessel repairs, bunkering services, finance and insurance and ship registry and crewing.

None of thepreceding can be achieved without paying attention to the critical success factorsof the following along with related strategies:

- Training
- Security
- Cooperation among states
- Regulatory adjustments
- Competitive financing
- Technology
- Labour reform
- Trade reform

The process however,is linked to Government initiatives and Government to Government arrangements and ends with a formalised strategy to drive development and execution.

In closing it must be noted that historically, ports and related infrastructure adapt to maritime transport and trade, not the other way around. It is important that regional economies learn from the historical perspectives.

The time to act is now!