Panama Canal Expansion:

Impact on the Volume of Imports to Southern California

The Panama Canal connects the Atlantic Ocean and Pacific Oceans through the Caribbean Sea. This ocean “shortcut,” completed in 1914, made it possible for vessels to avoid sailing around Cape Horn or through the Straights of Magellan at the tip of South America.

Currently, large cargo ships – those that can carry 12,500 or more containers – are too wide, deep and tall to maneuver through the 51-mile Panama Canal. However, the Panama Canal expansion project, currently underway, will double capacity by allowing more and larger ships to transit.

As we prepare for the opening of the expanded Canal sometime near the end in 2014 or early 2015, there is concern that the project will result in a reduced volume of imports arriving through Southern California. Many people (particularly representatives of ports east of the Canal) have suggested that a significant percent of import freight would shift to Gulf Coast or East Coast ports, closer to populated markets in the eastern U.S.

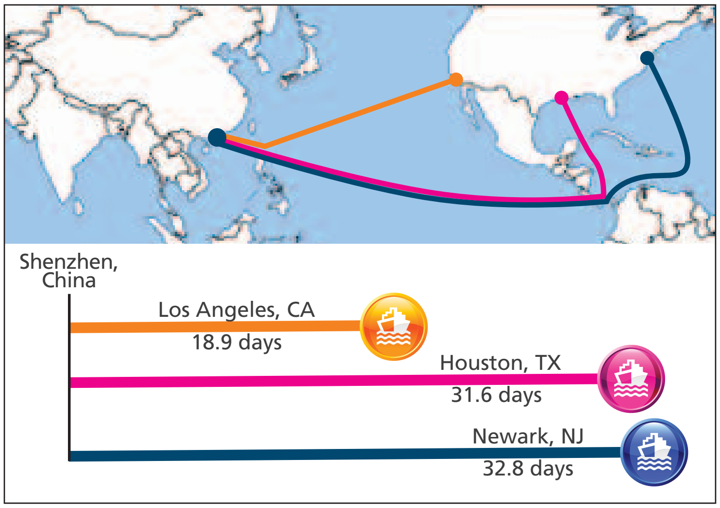
We don’t agree.

Here are three reasons why a major shift to ports east of the Panama Canal is unlikely after the Canal expansion:

1. Increased time to market will require more inventory and drive up supply chain costs.

Every importer wants products to reach markets quickly and cost effectively. The added time to ship goods from Asia to eastern ports – up to two weeks longer than LA (see map below) – would require importers to carry significantly more inventory. These added "cycle time" costs could increase inventory carrying costs by as much as 30%. As a result, the total costs to ship products through the Panama Canal to an eastern port would exceed the benefit of having products "land" closer to populated eastern U.S. cities. Railways and trucking companies are reasonably inexpensive when compared to these added costs.

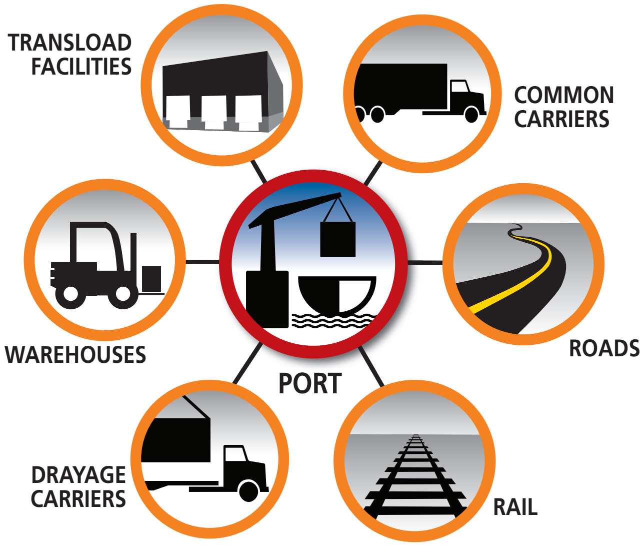
Wei Jiafu, chairman of COSCO Group, China's largest shipping company, agrees. "West Coast ports are the nearest ports to Asia and the sea costs are lower than East Coast ports," said Jiafu in a comment to the Journal of Commerce.



Transit times from China will increase up to two weeks if importers elect to reroute Southern California freight to Gulf Coast or East Coast ports. (source for transit times: SeaRates.com)

2. Gulf Coast and East Coast ports are playing catch-up, and will be for some time.

The logistics infrastructures at many U.S. ports are still in development. In contrast, Long Beach and Los Angeles have deep water ports capable of servicing huge container vessels and, over the past 50 years, have developed a complex supporting infrastructure to accommodate the huge import and export volumes shipped between the U.S. and Asia. This infrastructure includes roads, warehouses, trucking terminals, rail terminals that run directly to the vessels at the ports, and the logistics companies and experienced workers to service high and fluctuating volumes.



It takes more than a deep water port to process huge volumes of import freight efficiently.

Eastern ports like Savannah, Tampa, Norfolk, Baltimore and New York are just developing an ability to receive larger cargo vessels, and they do not yet have the complex supporting infrastructure to move goods efficiently from the port to the retail shelf quickly and efficiently. These infrastructure changes take years to complete. They involve dredging harbors to accommodate the deeper vessels, building larger bridges to accommodate the taller heights of the "super vessels," building roads to accommodate increased heavy vehicle traffic flows, adding rail lines, and building warehouse facilities. Such projects are also very expensive and the costs, no doubt, will translate into additional fees and taxes to the ship lines and, ultimately, higher costs for U.S. importers and exporters.

Another area where Southern California ports are well ahead of other ports is pollution mitigation. The California Air Resources Board (CARB) determined that Southern Californians paid between $100 million and $590 million annually in health impact costs related to port-related truck pollution. The Clean Trucks Program was begun in 2008 to address this problem and set out to ban the oldest, most polluting trucks from Southern California ports. Starting January 1, 2012, all trucks that did not meet the 2007 Federal Clean Truck Emissions Standards were banned. As a result, container freight is now being moved by newer, cleaner vehicles. In 2012, the first year of full program implementation, port truck emissions were reduced by more than 80%. Establishing the Clean Truck Program was costly. Other port cities will need to make these investments in order to meet future health and environmental mandates. Being environmentally ahead of the rest of the country is a big advantage for Southern California.

Port Consultant John Martin says the idea that the Panama Canal expansion will instantly bring more business to eastern seaports is not feasible. "Whatever business the Atlantic ports could easily take from Los Angeles and other Pacific cities has already moved east," he says.

3. Shifting cargo to ports with a "developing" capability involves risk, and companies don't like risk.

A change in supply chain strategy that includes transporting goods to Gulf Coast and East Coast ports and away from Southern California has implications for many aspects of logistics management. Warehouse distribution networks must be reexamined and reconstituted, freight lanes must be determined, new carrier partners must be vetted and chosen, and new rail partnerships must be established. All this involves effort and risk. Today's leaner supply chains are not designed to absorb major delays and interruptions. So companies will think long and hard about changing a successful supply chain process to one that leverages ports and surrounding service infrastructures that are scrambling to expand and add new capabilities.

Other areas of risk include:

- **Canal operations** – Will an increased volume of freight flow smoothly through the Canal, and will the political climate remain stable in the region?
- **Future costs** – How will rising costs for fuel, for Canal use, and for ocean carriers impact total costs?
- **Inventory** – Will the need to increase inventory result in higher write-offs in the event of a business downturn?

Continued investments solidify future of Southern California ports

In April of 2012, Port of Long Beach officials and executives from the shipping company Orient Overseas Container Line (OOCL) formally signed off on the Port's biggest ever lease agreement. The deal commits OOCL to a $4.6-billion, 40-year lease of the Port's new Middle Harbor container terminal, currently under construction.

"I can't overstate the significance of this agreement," said J. Christopher Lytle, executive director of the nation's second-busiest cargo container port. "It is the largest and most far-reaching terminal lease ever at the Port of Long Beach."

Other shipping companies are also expanding capital projects to support their Southern California port presence, amounting to billions of dollars in investments. Companies simply would not invest to this level without a strong belief in the continued growth of Southern California as an import hub.

Southern California is the gateway to North America for Asian shippers today. Why? Because importing through Southern California is less expensive, faster, cleaner and more efficient than using Gulf Coast and East Coast port cities. The expansion of the Panama Canal will not change this. The Ports of LA and Long Beach will continue to be North America's freight gateway long after the Canal expansion is completed.