PANAMA CANAL EXPANSION:

CHANGING THE CHANNEL

A wider and deeper passage may encourage shippers to consider alternate sourcing and routing options.

For U.S. shippers and consignees, it's the million-dollar question: Will the Panama Canal expansion significantly impact supply chain flows and distribution patterns?

It has been nearly one century since the Panama Canal stirred so much intrigue. After France's initial failed attempt at burrowing a passage through the Panamanian isthmus in the late 1800s, the United States took over the project and helped bring the canal to reality in 1914.

The current $5.25-billion project—which adds a third set of locks, and further deepens and widens existing infrastructure—continues to divide opinions as the 2015 expansion deadline approaches.

The extent to which the Panama Canal expansion alters sourcing and routing decisions has been widely debated over the past decade. Following the 2002 West Coast port lockout, and after recurrent congestion issues, some shippers welcomed the opportunity to explore all-water sailings through the Panama Canal to the East Coast. Expectations were further stoked in 2006 when Panamanians overwhelmingly approved a referendum to move forward with the canal renovation.

As the U.S. and global economies receded, a major East Coast shift never materialized. That, however, did little to stem the tide of optimism rippling around the Panama Canal expansion. In 2008, an Army Corps of Engineers report noted "the expansion of the Panama Canal will have significant impacts on shipping routes, port development, and cargo distribution"—but the Corps hedged against making any definitive predictions because the scope of such impacts was still nebulous.

Moreover, a 2011 Jones Lang LaSalle paper reports that "without a doubt, it's a global game changer," suggesting that the expansion will impact the supply chain as well as the industrial real estate space.

The Other Side of the Issue

Optimism aside, the canal expansion has also been met with measured skepticism. Dr. Jean-Paul Rodrigue and Dr. Theo Notteboom, professors at Hofstra University and the University of Antwerp, respectively, suggest that while the Panama Canal may

Scheduled for completion in 2015, the ongoing $5.25-billion Panama Canal expansion project adds a third set of locks, and further deepens and widens existing infrastructure, allowing larger, higher-capacity ships to traverse the waterway.

indeed be a game changer, the rules of the game are changing. Countless factors in the global economy could shift the balance one way or the other.

"Global freight distribution, the strategy of maritime shipping companies and terminal operators, and supply chain management have become so complex and interrelated that it is unclear for many actors how the expansion will pan out," Rodrigue and Notteboom wrote in a 2011 op-ed titled *The Panama Canal Expansion: Business as Usual or Game-changer?*

"While what is known is fairly straightforward, such as the operational characteristics of the expanded canal, it is by far supplemented by what remains uncertain – namely trade flows, shipping network configurations, and the growth of the amount of transshipment in the region," they stated.

Evaluating the X-Factors

The known quantities, as Rodrigue and Notteboom propose, are matters of fact. Larger ships transiting the canal and calling on U.S. ports will increase economies of scale for shippers and consignees, reducing per-unit shipping costs. Transshipment activities will likely grow in deep-port locations such as Jamaica and the Dominican Republic, which could impact U.S.-based value-added activities and create new sourcing and distribution alternatives.

Other less tenuous considerations will tip the scales in either direction. For example, the performance of the global economy greatly influences Asia-to-U.S. trade flows.

"Shifts in the global trade pattern—such as the projected growth of the Latin American market, or the prospects for increasing nearshoring in countries such as Mexico instead of producing in China—could diminish the use of the canal," says Craig Stoffel, vice president for Omaha-based third-party logistics provider Werner Global Logistics. "Alternative West Coast gateways including Prince Rupert, Lázaro Cárdenas, and Manzanillo have created new land bridges that also present growing competition."

Stoffel contends the Panama Canal will impact lane preferences in terms of efficiency and price competitiveness. To that end, major steamship lines such as Maersk have been gravitating toward the Suez trade for the same reasons.

What remains to be seen is how ocean carrier rates serving West Coast ports will flex if East and Gulf Coast ports siphon Asian volumes. Panama Canal tolls are increasing as well.

The timeliness factor still favors West Coast intermodal land bridge options, which account for 18 to 20 days connecting Shanghai to Chicago—including 13 to 14 days of maritime shipping and five days of rail. All-water routings can take up to four weeks.

Despite the considerable transit time gap, shippers and consignees have become increasingly receptive to slow-steaming options because of the cost and sustainability benefits they offer. Businesses that have adequate supply chain visibility upstream and downstream can manage longer lead times.

Midwest Centricity

At the very least, the Panama Canal expansion provides U.S. companies incentive to explore other options. To varying degrees, shippers and consignees have been shifting their focus eastward over the past decade. Even as the Asia-to-U.S. West Coast trade dominates cargo flows, supply chains have become more sensitive to demand and disruptions.

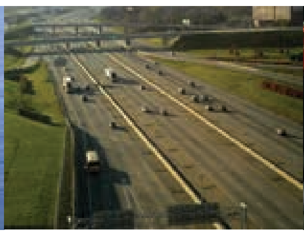
AGRI SHIPPERS HOPE FOR GROWTH

While much attention has been paid to how the Panama Canal expansion will impact U.S. container imports, U.S agriculture exporters also may benefit in spades. As global grain consumption continues to grow, the U.S. Midwest and Mississippi River basin could be in the middle of a purple patch as growers keep pace with demand.

The Panama Canal handles three out of every 10 bushels of grain and soybean exports from the United States, with more than half the exports through the Center Gulf, one-tenth of the Texas Gulf exports, and nearly 30 percent of the Atlantic Coast exports, according to an Informa Economics 2011 report, *Panama Canal Expansion: Impact on U.S. Agriculture*.

Shippers will benefit from increased loadings, larger vessels, reduced canal transit times, and lower transportation costs. With U.S. grain and soybean exports forecast to grow 25 percent between 2011 and 2021, additional bandwidth at the Panama Canal is favorable for Midwest intermodal corridors and Gulf Coast ports vying with Pacific Northwest interests for a greater share of the volume.

Increasing U.S. soybean exports could lead to additional traffic flowing through the Panama Canal.


Single-source strategies through exclusive East or West Coast ports are less common. Businesses want to pull product closer to demand centers and reduce overland drays—and the U.S. Southeast is one of the fastest-growing population areas in the country. And given the threat of labor stoppages and weather-related disturbances at U.S. ports, companies are building contingencies into their network design.

That's why Rob O'Brian, president of the Joplin, Mo., Chamber of Commerce, views the Panama Canal expansion as an opportunity for companies traditionally beholden by distribution networks that "flow toward the coast" to consider a more centric approach.

Opening up the canal will inevitably release and/or absorb more freight volume while expediting transit. The Gulf Coast is positioned as a primary gateway to and from the U.S. hinterland for U.S. imports and exports. (*See sidebar, pg. 50.*)

"We're evaluating how the Panama Canal might change shipping patterns to Gulf Coast ports," says O'Brian. "The expansion presents an opportunity for shippers to better utilize the middle part of the country, taking advantage of a rail and highway network that connects with the ports."

Riding the Rails

As capacity concerns linger, and trucking costs rise, shippers may give greater consideration to all-water sailings to and from Gulf Coast ports. Rail accessibility is a strength. The Kansas City Southern is the only Class I railroad that was built on the premise of moving north and south. It has created a niche serving Mexico's Pacific Ocean ports, presenting yet another alternative to the U.S. West Coast.

Stoffel suspects West Coast volumes will be somewhat affected by the Panama Canal dynamic, which may play out on the tracks. "Many analysts see an emerging dichotomy between the East and West Coast Class I railroads," he says. "The railroads will remain highly competitive in maintaining their individual advantages."

While uncertainty surrounds the Panama Canal expansion's immediate effects, they will likely have far broader implications over time.

As far as regional impact, Stoffel says the Gulf Coast boom will be influenced more by new energy transport opportunities than by increases in container activity from the Panama Canal.

"The real area of competition will be in the upper Ohio Valley, close to the population center of the United States," he notes. "Efficiencies may be more important than costs. As time goes on, more manufacturing and warehouse distribution activity is taking place in mid-America as operations on the coasts become more expensive."

The extent to which shippers realign their sourcing and distribution strategies around an East or Gulf Coast revival ultimately depends on their target market segments—where they are bringing raw materials from and where their consumer base is located.

"The Midwest is an obvious choice for companies with a limited number of facilities," says O'Brian. "They have opportunities to close obsolete plants and consolidate where they have the most reach."

While uncertainty surrounds the Panama Canal expansion's immediate effects, there is some consensus that even if changes are negligible, they will have far broader implications over time. And this may have little to do with how much freight eventually flows to the East and Gulf Coasts.

Change will likely be evolutionary rather than revolutionary, and volume shifts will probably be incremental. Nonetheless, some Southeast U.S. ports have noted that mere percentage point container gains over the West Coast would be considered notable wins.

The Port of Virginia, along with other East and Gulf Coast destinations, may gain a competitive edge thanks to the Panama Canal expansion.

Causes and Effects

"The expansion of the Panama Canal will not create additional demand, but will eventually alter trade lanes," reports an Informa Economics study conducted on behalf of the United Soybean Board,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U.S. Soybean Export Council, and Soy Transportation Coalition in 2011. "Because the changes are dependent on previous change, the transportation system will have to evolve.

"The first step in the evolution was container ships increasing size. The second step is the expansion of the Panama Canal, which has given a reason for East Coast ports to expand," the report continues. "For example, the ability to unload larger ships on the East Coast will increase the odds of a large retailer building a major distribution center in the eastern United States. The new distribution center enables ocean carriers to add a string of ports to call. The new availability of containers, load out times, and increased destination ports expand backhaul opportunities."

The Panama Canal project has already triggered this cascading series of causes and consequences. Expectations alone set some in motion—notably the investments ports such as New York and New Jersey, Savannah, and Miami are making to accommodate new Panamax container ships.

But even prior to the Panamanian referendum, shippers were looking eastward. The U.S. Southeast's booming population growth has lured big box DCs to port cities during the past decade. Increased use of the Suez Canal—and farther afield, emerging trade opportunities in Eastern Europe, Western Africa, and perhaps Cuba—are among other possible developments.

Thus far, Werner customers show little reaction to the Panama Canal expansion, says Stoffel. He acknowledges that a more productive East Coast alternative may impact the site selection decision for future investment by demonstrating potentially lower transportation costs and improved efficiencies. Some companies might even reconsider existing facility locations.

In the short term, Stoffel expects East Coast volumes to increase, accompanied by new capital investments that boost efficiencies and productivity. A bigger impact might be felt outside the United States—in Panama. "We anticipate significant growth in Panama as a logistics hub for Central and South America," he notes.

In some ways the Panama Canal's impact has already been realized. Up, down, and around the East and Gulf Coasts, ports, terminal operators, railroads, public warehouses, truckers, and third-party logistics providers are primed and positioned to move freight to and from the hinterland faster and more economically.

Even if the Panama gold rush doesn't pan out as many predict it will, shippers can still expect to capitalize on efficiency gains and infrastructure improvements already taking hold. ■