The Global Economic Crisis and the Future Vitality of the Port Economy

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In order to fully understand the recent rise and potential future of maritime ports as economic engines (or Jaxport as an economic engine for the northeast Florida region), it is useful to place the analysis in the larger context of the global and national economy. This requires a consideration of how the process of globalization, and the supporting institutional infrastructure, have contributed directly to the expansion of port economies and the rise to prominence of the logistics and supply chain management industry. As we enter a period of global economic crisis, many of the same factors and conditions that fueled the expansion must be considered in assessing the future vitality and viability of global transport and logistics. This paper will outline a model of economic crisis and the key forces and processes that have fueled the expansion of port economies and the supporting logistics infrastructures, and then consider some of the evidence for potential stagnation and decline. We consider the possibility that the current global crisis may be deeper and more severe than past crises as a result of changing institutional conditions characterizing globalization and US capitalism. Many of the factors that may be responsible for the extended severity of the current crisis may also contribute to the greater economic exposure and vulnerability of the logistics industry, supply chains, and maritime ports. The paper concludes with a brief discussion of the potential impact of the current crisis on the Jacksonville port economy.
A Theory of Capitalist Crisis and the Current Crisis

One powerful theory of economic crisis is based on a central contradiction between the two necessary conditions for capitalist growth and expansion (Amin, 1977; DeJanvry, 1981). The first condition – the capacity to produce – requires an environment favorable to capitalist investment. Capitalists must believe that their investments will yield a sufficient profit. Otherwise, there is no capital investment, no production, no jobs, and no growth. A key aspect of the capacity to produce is the cost of production generally and, for many sectors, the cost of labor in particular. All things being equal: the lower the costs of production, the stronger the capacity to produce.

The second necessary condition is the capacity to consume. This refers to the level of aggregate demand. If producers are to realize a return on the investment in the production of commodities, there must be effective demand. This requires sufficient wages and salaries, and discretionary income, to fuel consumer spending. The contradiction between the necessary capacities centers around labor costs. While low wages help the capacity to produce, they hurt the capacity to consume; on the other hand, high wages strengthen the capacity to consume, but hurt the capacity to produce.

Within this framework, major economic crises are the result of imbalances between the two necessary capacities for production and consumption. When the capacity to consume is stronger than the capacity to produce, there tends to be disinvestment and the emergence of a supply-side crisis. When the capacity to produce is stronger than the capacity to consume, there is an inability to sell the commodities that are produced and the emergence of a demand-side crisis.

In many ways the seeds of the current crisis were planted by the economic policies instituted to get the U.S economy out of the crisis of the 1970s. By the time the
mid-1970’s rolled around, the long term culmination of Keynesian-style government spending and programs (designed to address the previous crisis of the 1930s) contributed to higher wages, higher taxes, and expanded government regulation which, in turn, depressed the capacity to produce. Owners and producers became increasingly hesitant to invest in commodity production where costs, taxes, and regulations were viewed as excessive. These condition contributed to the supply-side crisis of the 1970s.

The 1970s economic crisis was tackled head-on by neo-liberal economic policy. There are two major components to the neo-liberal approach. First is “market fundamentalism” – the belief that markets can do no wrong, government can do no right, the best solution is always a market solution, and markets are self-correcting. The second component of neo-liberal policy is supply-side economics which argues for removing all obstacles, impediments and unnecessary costs to business so that they will be encouraged to invest in, and supply, the economy (this is best exemplified in the neo-liberal mantra – less government and lower taxes).

Neo-liberal doctrine dominated economic policy in the U.S from 1980 to 2008 through four (three Republican, and one Democratic) administrations. During this period manufacturing experienced a steady decline as a proportion of national economic output, with large segments of manufacturing production shifted abroad to low-cost and low-wage locations, particularly in Asia. At the same time there was a rise to dominance of the financial sector (hence the labels for our economy such as “paper capitalism”, “finance capitalism”, “casino capitalism”, and the “financialization” of the American economy). The deregulation of the banking industry (also consistent with neo-liberal economic policy) in the 1990s further fueled the financial sector and allowed banks to get in on investment banking and the creation of a wide range of innovative and exotic financial investment instruments that attracted the growing supply of surplus capital.

Finally, neo-liberal policy had a clear social class bias in favor of capital over labor
translating into record corporate profits alongside a declining and stagnant standard of living for most workers. A few statistics are indicative. From 1990 to 2005, corporate profits increased by 107%, the Standard and Poor index rose by 261%, and average CEO pay was up 298%. Over the same period, average worker pay increased by an anemic 4.3% and the value of the minimum wage actually declined by 9.8%.

It would seem that these neo-liberal policies would create a sharp imbalance between the capacity to produce and the capacity to consume. How could such a system have been sustained without generating a massive demand-side crisis? As Robert Reich (2008), the former labor secretary, has noted, working families tried to support their consumption in three ways: First, by increasing the number of breadwinners per household. Indeed, there was a sharp increase in the labor force participation of married women and mothers contributing to the “two paycheck household”. Second, workers took on overtime and second jobs (thus the term “the overworked American” to describe increasing work and declining leisure). Third, workers supported their consumption through borrowed and accumulated debt from credit cards and, most important, home equity lines of credit. From 1980 to 2005 consumer debt as a percentage of disposable income increased from 69.5% to 127.2%. The housing bubble allowed the debt-driven consumption to last much longer than would normally be the case. Given the macroeconomic significance of home-secured debt, it is not an overstatement to say that the capacity to consume, rather than based on rising earned income or shared prosperity from record corporate profits, was propped up artificially. The collapse of the housing market and financial sector has exposed the sharp imbalance between the capacity to produce and the capacity to consume. Not only are there are no further substitutes for higher income and salaries, but consumers find themselves facing foreclosure, negative equity, and mountains of debt. For all these reasons, the current crisis is, first and foremost, a demand side crisis of monumental proportions.
The Rise of Port Economies

We can now return to the state of port economies and their relationship to the boom and bust cycle of the past twenty years. The growing significance of maritime ports tracks closely with the structural changes to the global and US economy since the 1980’s. More specifically, maritime port economies have benefited from several factors. First, the global dispersion of production and the subsequent increase in the geographic distance between the point of production and the point of consumption amplifies the importance of transportation and logistics. “Global commodity chains” (Gereffi & Korzeniewicz, 1994) rely heavily upon ocean carriers to move the freight from the low wage point of production to the inflated point of consumption. Second, the development of shipping container technology both facilitates and enhances the rapid and efficient movement of products from one global region to another. Container terminals and container throughput become the coin of the realm for the most dynamic port economies. Third, the development of a comprehensive national intermodal logistics infrastructure allows for the inland transport of containers and cargo to final destinations across the United States. Fourth, and following from the previous point, the intermodal system grants shipping lines greater latitude over a range of ports of call for the “discretionary cargo” that is not tied to any geographically concentrated consumer market location.

However, at an even more fundamental level, the entire edifice of the port economy rests upon and has been fueled by a healthy capacity to consume; i.e. a large and growing demand for durable and discretionary goods. In fact, the entire hyper-globalization process over the past twenty years or so may have been uniquely driven by an unusual combination of factors that have subsequently contributed to the current crisis and which may be unable to be replicated in the future. These factors are the low
interest rates and loose monetary policy of the Federal Reserve Bank, inflated real estate values, the availability of home equity lines of credit, the associated availability of credit card debt, and the translation of these into the hyper-consumption of imported goods by US consumers. As outlined, the current demand-side crisis is a direct result of the collapse of this unsustainable bubble economy (see Notteboom & Rodrique, 2009 for further details on this process).

As nodes in a global production and logistics system, maritime ports are highly dependent upon -- as are the backward and forward links in the intermodal supply-chain (ocean and land-based carriers) -- the continuous importation of products. The massive levels of debt-led consumption, which meant the importation of goods manufactured elsewhere, particularly Asia, was a boon for the shipping lines, ports, and the entire logistics industry. One measure is the steady increase in shipping containers filled with consumer durables that flooded through U.S. ports. At Los Angeles/Long Beach, the nation's largest port complex, and the logical point of entry for much of the imported goods from Asia, container TEUs increased by 282% from 1990 and 2005.

As West coast ports in the United States were reaching capacity and experiencing high levels of congestion, East coast ports saw an opportunity to serve as additional and alternative ports of entry for imported goods from Asia (see Jaffee, 2009). One notable example is the Port of Savannah that saw a 20.6% increase in 2006-2007 placing it in the position as the fourth largest container port in the nation (Johnson, 2008). Major investment projects for port expansion and modernization at East and Gulf coast ports total over $10 billion (Johnson, 2008). In Jacksonville Florida the Jacksonville Port Authority (herein “Jaxport”) signed contracts with two of the world’s largest shipping lines – Mitsui MOL and Hanjin – to build two new container terminals that would increase the total container TEU throughput by 1.6 million.
The ports have, not surprisingly, also attracted financial institutions interested in container port terminals as investment outlets for the massive surpluses accumulated during this period. In 2006 American International Group (AIG) bought six U.S. terminals from Dubai-owned company DP World. In that same year, Goldman Sachs acquired Associated British Port Holdings, and in 2007 the investment bank bought a 49% share in Carrix, a subsidiary of SSA Marine, the largest US-based terminal operator. As reported in the business press at that time, “Ports and port operators have become the hottest investment targets for fund managers across the world...” (Arabian Business 2006). Like other sectors of the US economy, finance capital flowed into those areas where it was assumed growth and expansion would continue in a linear fashion. Projections for more containers, more ships, and more port terminals were based on the faulty logic of extrapolation forward from – and in this case highly anomalous -- short-term trends.

Crisis and Ports

The global crisis, first and foremost a demand-side crisis, has dealt a severe blow to the shipping lines, port economies, and entire transport logistics chain. As outlined in Figure 1, levels of ocean container throughput are tied closely to the “buyer-driven” commodity chain (Gereffi & Korzeniewicz, 1994) that has been fueled by the endless expansion of retail consumption which, in turn, was financed largely through debt and the related housing bubble. In this model, once the capacity to consume is choked off, bad things are sure to follow. There are several indicators of the severity of the impact on shipping and ports. First and most obvious is the sharp record decline in global container traffic. Port Tracker reports container volume at the busiest U.S ports. As the crisis began in Fall 2008, there was an immediate impact with a 10.37 percent decline in twenty-foot-equivalent units (TEUs) at those ports from October 2007 to October 2008.
More recently, container tonnage figures for the two largest U.S. ports – Los Angeles and Long Beach -- saw declines from January-February 2008 to January-February 2009 of 20.9 and 31.7 %, respectively (Notteboom and Rodrigue, 2009). With first quarter revenue among the world’s largest lines down 35% from the same period in 2008, Drewry Shipping Consultants has estimated combined losses of $20 billion before taxes and interest for 2009 (Barnard, 2009a). Drewry has also revised their estimate of the decline in global container volume from 5.7 percent at the start of 2009 to 10.3 percent in July.

Another widely followed measure of the health of global shipping is the Baltic Dry Index. The index is regarded as a powerful leading indicator for the direction of global economic commerce. It is based on the supply of and demand for dry bulk vessel capacity (weighted composite of rates for cape, panamax, and supramax vessels). It reached a peak in May 2008, driven by factors outlined above, but plummeted by 94% in December of 2008 to its lowest level since 1986. The index is also closely aligned with the cost of ocean transport of goods and thus what shipping lines can expect to receive for their services. Over the short-term this suggests sharp declines in revenue and profit, an end to orders for new container ships and, a third significant indicator, the removal of vessels from active transport.

Alphaliner, a Paris-based consulting firm is estimating that idled container ship capacity will reach more than 2 million TEUs by the end of 2009 (Barnard, 2009b). In addition to idling, there is also a high level of ship scrapping due to overcapacity. Alphaliner reports that 300,000 TEUs of container ship capacity is scheduled for demolition this year which is “ten times more than the historical average and would be the highest level of scrapping ever recorded in liner shipping” (Barnard, 2009c). All this leads The Journal of Commerce, a leading source for research and reporting on the
transport logistics industry, to conclude that 2009 is “shaping up to be the worst year in modern liner shipping history.”

Again, the driving force for this massive decline in maritime economic activity is located in the retail sector. As one National Retail Federation executive has noted, “cargo volume at the ports reflects retailers’ anticipated sales, and NRF expects that sales will get worse before they get better. Retailers are only going to import what they can sell” (National Retail Federation, 2009).

There are several additional consequences for the ocean carriers as a result of the economic crisis. First, whatever advantages the carriers might have had during the mid-2000’s -- when global demand for goods reached a peak and ocean transport capacity was pushed to the limit -- has disappeared with the current excess shipping line capacity. Carrier supply now far exceeds demand, and shippers will be working to extract low cost services from transport providers across the entire supply chain (Caplice, 2009). Second, stemming directly from the first, competition between carriers will intensify in the effort to secure shrinking and less profitable opportunities. Third, there is likely to be some further consolidation as the most powerful global players in the field pick up the smaller competitors. In terms of the larger logistics industry, there are equally strong competitive pressures that will encourage the low cost provision of services in order to survive.

While all parties are searching for the elusive “green shoots” in the hope that “things have bottomed out”, there are reasons to expect that this particular crisis may be deeper, more prolonged, and severe than anticipated; and especially so for the shipping and port economy sectors. These expectations are related to the following characteristics of the current U.S economic situation and structure:

1. Under our prevailing consumer capitalist economic system, that is more pull than push, the economy can only get kick started when there is significant activity at the point of consumption and surplus inventories of products leave the shelves of
the retailers. Until that time there are no signals communicated to source suppliers down the chain to restart manufacturing production. Until these signals are sent, the entire supply chain is relatively dormant and this includes, of course, transport and maritime logistics. It also follows from this analysis that retail-driven supply chains will be the last sector of the economy to benefit from a recovery. See Figure 1.

2. Because retail pull depends upon the capacity to consume, unemployment is one of the most critical indicators of potential recovery. Unfortunately, this has been the most stubborn area of economic progress with the June 2009 unemployment data actually indicating a rise in joblessness. As noted by the chief economist of the National Retail Federation, “Although several economic indicators are starting to show signs of improvement, it is going to take a few more months – maybe longer – for people to feel comfortable spending again. High unemployment and other uncertainties will continue to impact consumer spending through the remainder of this quarter” (Frank, 2009).

3. Keynesian economists have identified a tendency among consumers during periods of recession – what is referred to as the “paradox of thrift” – of diminished consumption stemming from actual or fear of unemployment, declining real incomes, and lack of consumer confidence. This gives rise to more savings and less spending. It is paradoxical to the extent that a reduction in spending can have a net effect of decreasing aggregate savings and, as a consequence of withholding spending, also aggravate the length and depth of recession. Since we are experiencing a demand-side crisis, this tendency can be especially damaging for the prospects of economic recovery.

4. Because the port economy and logistics industry are goods-moving rather than goods-producing economic sectors, and the majority of the goods moved are
imported consumer durables, anything that undermines, dampens, or stifles consumer spending will have a disproportionate impact on this sector of the economy.

5. Given the prevalence of the just-in-time inventory systems that drive supply chains, it is unlikely that there will be any desire to re-stock until all inventories have been fully exhausted. This could be a further factor contributing to a delayed recovery in the port logistics sector.

**Impact of Crisis On Jaxport**

What, if anything, does the global economic crisis and the sharp declines in global cargo mean for Jaxport over the short-run and long-term?

First, in the context of the earlier discussion, it is worth considering that the vast investment in the Jaxport infrastructure, involving the construction of two large container terminals and long-term lease agreements with two of the world’s largest Asian shipping lines -- Mitsui MOL and Hanjin -- was based on projections extrapolated from the go-go mid-2000’s when consumer demand and imports were surging. Jaxport expansion followed closely the analysis and advice in 2005 by Martin Associates:

Clearly the most robust growth market with respect to containerized cargo is the Far East...With more shippers looking for diversification from the West Coast ports, other North and South Atlantic ports stand to benefit from the growth. JAXPORT appears to be a potential candidate due to the fact that it possesses the key factors that are attractive to Far East Carriers... It is recommended that the Port maintain its landlord status and focus on a shared investment with a tenant in the development of Dames Point. A long term lease with a carrier or terminal operator would then provide JAXPORT with the critical service to further develop distribution center activity in the Jacksonville region, further stimulating additional Asian carrier service, but also providing jobs to the local and regional economy.

At present, the net result of following this recommendation is the completed 158-acre TraPac container terminal (at a cost of $230 million) leased by Mitsui MOL
and a second 90-acre Hanjin container terminal (original expected cost of $300 million) slated for construction, both at the newly developed Dames Point location.

In the case of both ports, the economic crisis has already exacted an impact. While the TraPac terminal is capable of reaching a throughput of 800,000 TEUs, expectations were for a modest 300,000 TEUs in 2009. However, this has been scaled back further as a result of declining cargo traffic associated with the global recession.

Similarly, the Hanjin terminal, since the original plan was announced, has been scaled down in size and cost (last reported to be $208 million) and has been delayed from a 2011 to 2013 opening. The delay in construction is reported to be the result of “lengthier permitting” and a request by Hanjin to have separate bids for the design and construction projects. Further, Hanjin has asked Jaxport to cover the costs of construction and design to avoid placing these expenses on their balance sheets for 2009. Jaxport will then be reimbursed through terminal operations revenue (Szakonyi, 2009). These developments, and revisions to the original arrangements and plans, are symptomatic of the economic difficulties currently facing all shipping lines. Hanjin has reported a $325 million loss for the second quarter of 2009.

In the last fiscal year, Mitsui’s profit dropped by a third and container revenue dropped by 6.9% (Leach, 2009). Mitsui has also been leading the effort to reduce excess shipping capacity through liner scrapping and demolition. According to Clarkson, a leading London shipbroker, Mitsui is demolishing some of the youngest ships to be scrapped since the market downturn, "That 16-19 year old ships are being sold for scrap demonstrates the effect that the trade downturn is having on some boxship owners who have imminent deliveries to balance with existing idle capacity" (Barnard, 2009c).
Given what we have already reviewed regarding the larger shipping industry, and the unsustainable and unrepeateable conditions responsible for the boom period in the earlier part of the decade, one must consider the extent to which overcapacity will plague the shipping industry even after the global economy recovers. The future of Jaxport may depend on the simple laws of supply and demand. An oversupply of container ships as well as port terminal space and infrastructure in the face of stagnant global trade and commodity imports could result in widespread underutilization and fiscal crises for all maritime ports.

For Jaxport, such a possibility -- underutilized infrastructure coupled with lower than expected levels of container throughput -- may also impact the ability to secure funding for the critical dredging project to deepen the St. Johns River. The local port economy may be caught in a cruel Catch-22 in which the low container traffic at the Dames Point terminals weakens the justification for a costly dredging project while the inadequate depth of the river makes it impossible to attract the post-Panamax carriers.

In the end, for the port as well as the larger U.S. economy, much will depend upon whether the capacity to consume can return to pre-crisis levels. For this to occur, the U.S. would either have to return to the debt-fueled economic arrangement that contributed to the crisis or there will have to be a significant increase in working and middle class buying power supported by earned income.
References


Figure 1. The Demand-Side Driven Container Traffic Chain

$\$$ Capacity to consume $\$$

1. Communications to supplier

2. Offshore manufacturer

3. Ocean carrier

4. Maritime Port

5. Inland Logistics Supply Chain

6. Retailer