Hearing on the Impact of U.S.-China Trade and Investment on Pacific Northwest Industries

Before the U.S.-China Economic and Security Review Commission

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Panel VI: Shipping/Maritime
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Thank you very much for the opportunity to address this commission this afternoon. I would like to begin today's testimony by offering you a very brief background on the Port of Portland.

In 1891, the Oregon legislature created the Port of Portland to dredge and maintain a shipping channel from Portland to the mouth of the Columbia River. Today, the Port owns and operates several marine terminals, four airports, including Portland International, and seven business parks. Our marine business activity consists of containers, finished automobiles and bulk commodities.

From time to time, the Port is asked to participate on panel discussions focusing on topics dealing with international trade and cargo flows. When the topic of China is the focal point, I like to remind participants that China is in fact not emerging, but re-emerging. It is easy to forget that China led the world in GDP production up until the eve of the industrial revolution.

Interestingly, 800 years ago in 1275, when Marco Polo visited China, he was impressed with Chinese ocean-going ships which were far larger and more sophisticated than anything found in Europe at that time. Chinese mariners worked deep sea trade routes between Sumatra, Ceylon and southern India. They already had the magnetic compass, a navigational aid not available to European seafarers until the 15th century. In the 15th century, Chinese merchants ships were very large -- up to 540 feet long with a capacity of 1,500 tons. European ships at the time were typically only 100 feet long with 300 tons capacity.

While it will take some years before China surpasses the United States in GDP output, it is abundantly clear that the Chinese economy has certainly re-emerged and is doing so at a pace that has exceeded all forecasts. By the end of 2003, China GDP grew at an annual rate of 10%. In economic circles, the focus now is on how to ensure a "soft landing" given fears of an over-heating economy.

China’s economy, which today has full access to global information technology, modern productive capacity, rapidly developing transport infrastructure, advanced educational institutions, and evolving financial markets, continues to attract significant quantities of foreign direct investment. The Federal Reserve Bank of San Francisco reports that foreign investment grew at a pace of 17% over the last 4 years; exceeded 25% last year and jumped more than 40% when compared to 1st quarter of 2004. Also contributing to this GDP growth is significant and sustained export growth which has been rising at rate close to 30% over the last two years.

Given both the scale and speed of China’s economic re-emergence, it is appropriate for this Commission to be seeking input on the possible impacts of U.S.-China trade and investment on Pacific Northwest industries.

My comments to you this afternoon will focus on the following areas:

1) Impact on marine activity at the Port of Portland
2) Possible impacts on Pacific Northwest Agriculture
3) The possibility of a sudden downturn in China's economy and the potential impact to world shipping and West Coast ports.

There is little doubt that growth in the Chinese economy is having profound impact on the region and the State of Oregon. At the same time, some caution is offered so as to avoid the easy tendency to oversimplify causal relationships. While China figures prominently in many aspects of international trade, it is by no means the only economic force responsible for all the gains associated from trade nor all its losses.

Historically, Oregon’s largest trading partner, as measured by commodity value, has been Canada. In East Asia, the largest trading partner has and continues to be Japan. This is then followed by S. Korea, Taiwan and then mainland China. The dominant trade flows in Oregon continue to be exports and not imports, which happens to be counter to the national trend. This is mainly attributable to lower population densities when compared to other regions of the country. S. California, for example, has a consumption region that includes over 20 million people.

The commodities making up this export trade are primarily computer and electronic products, agricultural products, transport equipment/machinery, chemicals and paper products and other wood products.

While working from a smaller base, exports to China have experienced growth in 2004. In 2004, we expect final trade numbers to show that Oregon exports to China will total $800 million in value. This is up from only $71 million in 1997.

It should be noted that export volumes tend to fluctuate significantly and are influenced by a variety of factors including exchange rates, harvests and global commodity prices.

As is well known to many of you present today, most of the talk on China trade concerns our nation's growing trade imbalance. China clearly figures prominently in this imbalance. I will not dive down on the numbers in too great a detail. However, it is important to note that when just isolating container volumes from Asia, shipments from mainland China accounted for over 60% of all cargo originating from Asia, inclusive of the Indian Subcontinent. Nationally, containerized cargo flows from China exceed those from Japan and South Korea combined, by a factor of 6. The growth in containerized shipments from China to the U.S. has been nothing short of dramatic. In August of 2004, for example, the rate of growth in containerized exports from China to the U.S. was just under 40%.

While export volumes from the Pacific Northwest remain strong, the primary Asian destination remains Japan. This is especially true, as noted earlier, for Oregon.

For the Port of Portland, these dynamics have contributed to the following developments:

1) As demand for cargo space on vessels from China has increased, the relative freight rate gap between imports and exports has sharply increased. The freight rates on cargo originating from Asia moving to the U.S. West Coast now exceed the corresponding freight rates from the U.S. West Coast to Asia by a factor of 4. In some cases the gap is wider. While there has always been a freight rate differential between the higher valued import cargo with that of exports, this gap has increased consistent with the large growth in U.S. imports. In the transpacific trade, for every 3 import containers moving to the United States, there is only 1 full export container. The bulk of our "exports" are now empty containers being returned to Asia, notably China.

This gap has been one of the contributors to recent losses in direct container service coverage to Portland. Our traditional export dominated cargo no longer presents an economic value proposition to shipping companies sufficient to sustain multiple weekly port calls. Shippers, especially agricultural exporters, must use more expensive truck/rail services to Puget Sound ports in order to obtain ship capacity to Far East markets.

I would note, however, that Portland's experience on the West Coast is more the exception. Ports to the north and south of Portland are experiencing near record volumes. Nevertheless, the trends described earlier contributed to our reaching a “tipping point” with respect to service coverage.

2) The significant growth of the China trade, not only between China and the United States, but between China and the world, has contributed to a high demand and short supply for both container and bulk vessels. For smaller niche container carriers, this has caused an escalation in daily charter hire rates has led to reductions in the number of ports-of-call and in the number of ships deployed in some container service rotations. As a result, the Port of Portland has seen additional suspensions of container services as vessels have been re-deployed to more profitable markets.

Moreover, with China markets booming and with few or no vessels available to add services or expand port calls on existing services, carriers desiring to expand China service have had little choice but to drop ports. As a result, smaller container ports such as Portland have struggled to maintain direct service.

While Portland’s recent loss of some container services may be reason for alarm, over the longer term the expectation for continued growth in the China trade does bode well for some recovery of service frequency to the port.

3) While the overheated vessel market, caused in large part by the China boom, has hurt the Columbia River in container shipping, it is helping us in bulks. The high charter hire market for bulk vessels has contributed to a resurgence of grain and oilseed exports from both the Columbia River and the Puget Sound. The spread in panamax bulk freight rates between the Gulf coast and the PNW averaged about $20 per ton in 2004. Historically, we have seen Midwest corn and soybeans flow to the PNW when the spread exceeds $10 per ton.

China has been the 800-pound gorilla for PNW grain. The behavior of the gorilla can make or break us, and that behavior in the past has been erratic and unpredictable. The good news is that PNW grain exports are currently benefiting by China's trade behavior. U.S. exports of wheat to China will exceed 2 million tons in 2004/05, up from virtually nothing just a year or two ago. PNW exports terminals are also seeing increasing volumes of soybeans to China, and this looks to be a long-term trend. Finally, China is exporting less corn to it's Pacific Rim neighbors, and this has led to increases in corn exports from PNW ports to destinations such as South Korea.

But we should be cautious in predicting a long-term grain export boom based only on the near-term behavior of the Chinese economy. We have seen similar situations like this in the past, only to witness a sudden and often unpredictable collapse of the market.

Turning to agriculture in general, we can say that the picture in the Pacific Northwest is mixed. A popular book written by Steven Blank is entitled "The End of Agriculture in the American Portfolio." The premise is simple: The U.S. has lost its comparative advantage in agriculture and should divest.

If you accept the premise, as many do, it would be difficult to lay blame on China. Agriculture in the PNW is varied and is still evolving. But a certain pessimism does permeate the region. Dr. Desmond O'Rourke needs to be acknowledged for his keen insights into the changing nature of PNW agriculture. His work has been extremely helpful in organizing my thoughts for this segment of the testimony.

The situation for Pacific Northwest Agriculture is clearly changing. Post WWII, agriculture in the region was nurtured by many dam and irrigation projects, access to cheap land, coupled with low energy and water costs. This attracted and sustained agricultural interests, particularly large food processors. These developments also led to a robust packaging and food storage industry which had access to new and highly efficient transport infrastructure. Science and technology also contributed to the development of the region's agricultural industry and state resources where deployed to help market the productive capacity. The establishment of overseas development offices is but one example.

By the 1990's, the region's comparative advantage began to systematically erode. From a pure economic perspective, access to low cost labor, energy and water began to be an issue. The region's strong environmental focus has and continues to call into question the need for dams, irrigation networks and river navigation.

At the same time, mass markets are changing and becoming increasingly fragmented. Scale is king. Retailers are dominating the food supply and their market dominance is causing significant fall-out. Fewer, but larger suppliers remain. What Wal Mart successfully did for retail, they are also doing to food.

Internationally, the picture is also evolving. New competitors, including China, have access to cheap land, labor and water. Environmental policy in China is either lax or non existent. We are, as an example, in year 15 of a project to deepen the Columbia River to 43 feet from the existing 40 feet. As of today, though ecosystem restoration components of the project have begun, the construction of the navigation project has yet to begin due to environmental impact concerns. In Asia, especially China, modern transport infrastructure is rapidly being developed. Asia leads the world in infrastructure projects, which include among other things, ports, bridges, roads, and airports. These are all enablers for global trade.

Nationally, goods movement infrastructure is in crisis. Our situation in the PNW is better than other parts of the country. But new investment and maintenance is required to sustain and grow transport capacity. We are living on borrowed time!

Additionally, access to new and updated post-harvest technology is allowing developing countries to meet internationally recognized food-grade quality requirements. This is a fundamental paradigm shift that has taken place over the last 5 years at a scale that is still not fully understood nor appreciated. It should therefore not be surprising to learn that the U.S. will soon be experiencing a trade deficit in agriculture for the first time in our nation's history during this calendar year. Food imports are flooding the U.S. at levels never before experienced. The American consumer is demanding it and the world is producing it and shipping it efficiently and cost effectively.

Consolidation is impacting PNW agribusiness and the pain is clearly being felt in rural areas. Some of the most common explanations for plant closures are:

1) Excess capacity
2) High minimum wages
3) Foreign competition
4) Energy costs

In the agricultural sector, the international players are varied. China is prominent in apples and juice concentrate, but it is by no means the only country in play. S. America is now a source for many agricultural products as is South East Asia.

Not all PNW agricultural is equally in crisis. Some sectors are better prepared to survive than others. But without major adjustments, the sector will continue to lose employment.

In closing, I would like to discuss how the recent resurgence of China, while providing opportunities to the port and maritime industry, also brings with it some risks. After a decade of rapid industrial growth (13.9 percent per annum since 1990), it's worth asking how long will China's expansion last and how volatile will it be. China's economy has a history of boom and bust, so growth will not necessarily be the upward straight line we have seen in recent years. China still exhibits the traits of a transitional economy and is therefore more prone to "crises" than more mature economies.

The focus by carriers, ports, and transportation service providers has been to invest in systems and infrastructure to meet current and future demand stimulated by the China boom. The general belief is that there is great risk that we will be unable to build fast enough to meet projected growth. The Port of Portland subscribes to this belief. But we must acknowledge that, given the past volatility of China's economy, there remains a risk that it will abruptly enter a down cycle, as it did only six short years ago.

If we were to experience such a downturn in the near future, the impact to world shipping could be devastating. Carriers and vessel owners, who have abundant new capacity coming on line over the next three years, are particularly vulnerable. The potential impact on West Coast ports is less clear, but the overwhelming reliance of West Coast liner trades on Chinese imports is concerning. What is certain is that, for better or worse, the destinies of West Coast ports are now meaningfully linked to China.

In closing, I would like to return to my observation that China was the maritime epicenter in the 15th century. For the past 500 years, this epicenter has moved steadily west from China, to Italy, to Belgium, to London, then across the Pacific to North America in the 19th century. Now, in 2004, more than 500 years after it left China, the maritime epicenter has returned to China. But we shouldn't despair on being left behind. If this trend continues, we can look forward to a shipbuilding boom on the West Coast of North America sometime in the 26 century!

This concludes my comments.