



Keynote Luncheon Remarks of

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We are here today at the start of a new decade – a decade with a name, unlike our past ten years. As we start our interaction with these new times, what can we foresee, other than our apprehension about dealing with anything named the “teens”?

From the perspective of international trade and transportation, we can start by recognizing the foundations of what brought us to this new decade – the adoption of free trade principles, and the development and operation of an efficient transportation network. Freer global trade has enriched every nation on Earth. Free trade has lifted more people out of poverty than any other development in human history. Free trade has raised living standards and given consumers a range of choices at affordable prices that were unimaginable only twenty years ago. Free trade has increased GDP and national prosperity. For example, exports are one of the leading drivers in this country’s nascent economic recovery.

Transportation is the central enabler of this increased prosperity. The modern global economy would not exist were it not for the introduction of the container and the liner shipping industry’s efficient movement of containerized goods between any two points on the globe. And the efficient connection of this international system to adequate ports, roads and rail systems is what completes this seemingly seamless intermodal system – a system that operates with such efficiency and reliability that in most parts of the country the average citizen is

unaware of its workings. People simply don't have to think about how their food, their appliances, their clothes and other possessions ever get to them. That is of course, until some disaster like the Haitian earthquake strikes, and society is crippled without a functioning port and transportation infrastructure.

At a time when trade and transportation have never brought as much in the way of benefits and choice to people, we face a challenge that most people take trade and transportation benefits for granted and assume they will continue to receive these results without having to think about it or tend to the policies that got us here.

Much of the developing world is not making that mistake. Most of the world sees that trade and transportation efficiency are keys to unlocking greater prosperity. Even a casual observer of China will see the commitment of that nation to its future prosperity and the development of the necessary infrastructure to achieve that prosperity. Prosperity can not be assumed into existence. It has to be created and fostered with appropriate policies.

How the United States will address these trade and transportation challenges in "the teens" is not entirely clear, but today I will offer a couple of preliminary observations about some of these issues – including the state of the industry, environmental policy, security policy, and transportation infrastructure.

### **State of the Industry: Economic Duress Continues**

With the exception of the rail industry that appears to be weathering the recent economic recession comparatively well – as Warren Buffet's investment has demonstrated, most asset-based transportation providers have been hurt badly by the recession. Liner shipping has been affected deeply and will probably take longer to recover than other transport modes.

From the birth of containerization in April 1956, when the world's first container ship unloaded 58 containers at the Port of Houston, the liner shipping industry has grown steadily. For most of the last three decades (1982-2007), container volume grew roughly 10% per year on average, which was more than three times the average growth rate for world GDP. Orders for additional capacity were placed with shipyards based on these historical growth rates.

Since the second half of 2008, however, we have seen a 10% global volume decline and an industry order book for more than 30% additional capacity – a debilitating combination.

In 2008, roughly 13.2% additional containership capacity was added to the fleet. 2009 saw the carriers receive from shipyards roughly 5.6% additional capacity. It is projected that for 2010, 9.9% additional capacity will be delivered. For 2011, 10% additional capacity. And for

2012, 5.3% additional capacity. These numbers show that the industry has had some limited success with delivery cancellations and postponements, with roughly 80 ships (400,000 TEU capacity) planned for delivery in 2010-2011 being delayed a year. But previously ordered capacity growth continues to outstrip growth in demand.

The greatest increase is in ships larger than 4000 TEU, which is as much about carriers seeking to lower their costs as it is about adding capacity. The total containership order book as of January 1 was 770 ships, of which about 68% (or 520) were greater than 4000 TEU. A rough estimate of the cost of order book is \$65-70 billion.

Liner shipping is a low margin business, even in profitable times, and very expensive to operate. *American Shipper* estimated that in 2008, 16 of the top 20 carriers combined made \$2.3 billion in operating profit (including their logistics business). Sound like a lot of money?

- That equated to about \$144 million annual profit per carrier
- Those carriers average weekly operating costs were \$160 million per week
- That means that the average operating profit for the year of 2008 was not enough to pay the average cost of operation for a week.
- That was for 2008.

2009 was a financial disaster for liner shipping. Estimates are that the industry losses for 2009 might be as high as \$20 billion.

Volume forecasts for the next couple of years, while showing positive growth, fall well short of the capacity increases scheduled for delivery.

There is no magic to what the industry needs to do and will continue to try to do -- Increase revenue and lower costs.

- Revenue: is rate per unit times volume of units. Carriers will need to raise rates. There is little a carrier can do about trade volumes. This year's Trans-Pacific contract rate negotiations will be important.
- Costs: Carriers will continue to try to reduce the cost of existing operations. Carriers have laid-up ships ( 11% of capacity fleet wide); delayed deliveries of new ships; cancelled services; rationalized services; reduced headcount, and reduced or eliminated discretionary spending and capital spending – and they will continue to do that.

The shipping industry continues to face the most difficult times since containerization was invented. It is not “out of the woods”. It is in duress, and while 2010 may not look as bleak as 2009, the industry does not have a speedy escape from its problems. While there are

encouraging signs of economic recovery, the supply and demand imbalance in liner shipping will take several years to be addressed.

Shipping lines will be more cautious about what and where they invest. Some carriers have already indicated that they are more likely to invest in marine terminal operations or non-asset based logistics, which are more profitable, than in shipping assets. It means carriers will have no choice but to continue to seek cost cutting from their suppliers, including port service providers. It will mean equipment and space may become a challenge for some export trade lanes, because some exports are still the lower-paying back haul trades and lines cannot afford to add round-trip capacity on the basis of back-haul economics.

2010 will see the industry continue to try to work through its financial challenges, while at the same time addressing a number of important policy topics, including the environment, security transportation infrastructure and trade policy, which I will now briefly turn to.

### **Environmental Policy**

The environmental agenda continues to be quite active, and the most active environmental issue is air emissions – an important topic in Houston. A strong new international agreement, MARPOL Annex VI, has established aggressive limits on those vessel air emissions that can adversely affect human health and air quality, namely NO<sub>x</sub>, SO<sub>x</sub> and particulate matter (PM). In addition, pursuant to Annex VI, the United States and Canada have proposed an emission control area that would apply to vessels within 200 nautical miles of North American shores, including the Gulf Coast, which will establish further restrictions on permissible sulfur levels in fuel, as well as more restrictive NO<sub>x</sub> standards. The proposal is expected to be formally adopted at the next session of the IMO's Marine Environmental Protection Committee in March 2010, and will take effect in August 2012. These changes will be important elements in Houston's and other ports' achievement of their air quality goals.

The Port of Houston will have the industry's support as it moves forward with its Clean Air Strategy Plan. The World Shipping Council and its member companies have supported the stringent Annex VI regime for ships, which will improve regional air quality with clear and effective international standards. The industry has also cooperated on the analysis of cold ironing options, is working with local EPA efforts on tests to analyze vessel emissions, and is cooperating on ways to reduce emissions from land side sources in port areas.

As Houston continues to consider the costs and benefits of other emission reduction options, particularly emission reductions from port trucking, it should be mindful of the mistakes made by the Port of Los Angeles when it chose to focus, not on the source of emissions from trucking or the required emission standard, but on political agendas relating to

the identity of who is driving the truck. That unsuccessful LA effort -- shot down repeatedly in court and exposed for what it really is -- has damaged the perception and credibility of the port, produced no environmental improvement that was not achieved without rancor by its neighbor Port of Long Beach, and consumed time and resources that would be far better spent on other port needs.

An air emission challenge that has not yet found a resolution is carbon emissions. Although CO<sub>2</sub> emissions do not impair air quality or human health as NO<sub>x</sub>, SO<sub>x</sub> and PM can, governments around the world continue to consider how to reduce CO<sub>2</sub> emissions as a way to address climate change. Shipping, like all industrial sectors, is wrestling with the best way to address this question.

During the December Copenhagen climate conference, governments considered the question of whether specific carbon emission reductions targets or emission caps should be established for the global economy, as well as for international aviation or international maritime shipping, but there was no decision to do so. Nor was there any agreement to construct a global carbon cap and trade system that shipping and other industrial sectors might be expected to participate in. Nevertheless, the World Shipping Council believes that the International Maritime Organization (IMO) should continue to address this topic directly as it moves forward with its discussion on this issue this March. The establishment of consistent, international standards is essential to intelligently address this international issue.

In addressing carbon emissions from shipping, it is important to consider the broader context of carbon regulatory practices addressing all transportation emissions. Transportation produces roughly 27.7% of the world's CO<sub>2</sub> emissions. Roughly 21.3% of those emissions are from road transportation (trucks and cars), 2.6% from aviation, .5% from rail, 2.7% from international maritime shipping, and .6% from domestic shipping and fishing.

Maritime shipping, however, is the most carbon efficient way to transport goods. Because maritime transportation is the most energy efficient way to transport goods, it should be encouraged, not treated less favorably than other forms of transportation. This conclusion is not merely a convenient point to be promoted by those interests involved in maritime transport; it is sound environmental policy.

As the discussion at the IMO proceeds, it is helpful to consider how carbon emissions from other transport modes are being regulated. For those governments which are seeking to reduce carbon emissions from transportation sources, the approach is generally through vehicle or conveyance emission and/or efficiency standards applicable to the design and manufacture of individual vehicles and conveyances. Establishing absolute emission limits on

the actual operation of the transport sector as a whole has not been deemed practical or appropriate. This is true, even in the European Union, where an emissions trading scheme was put in place in 2005.

While some governments have proposed that international aviation and international maritime shipping should be subjected to a specific emissions cap, few, if any, have proposed that carbon emissions from their domestic surface modes of transport be capped at a particular level. For example, few, if any, governments are proposing that automobiles, trucks, or railroads must be limited pursuant to an emissions cap or ceiling on those sectors.

Establishing carbon reduction targets for transportation sources may be appropriate, but we must also be cognizant of the environmental and economic equity of establishing reduction targets for a specific transportation mode in light of the goals to be achieved by transportation sources broadly. For example, some have advocated a 20% reduction in emissions from shipping, while proposing that aviation should be subject to a 10% reduction, and proposing no specific target for land based transportation. The resulting economic and environmental incentives would be both odd and illogical, when one considers that aviation is the least carbon efficient mode of transport -- with carbon emissions that are roughly 47 times greater than those produced in moving the same goods by sea.

The discussion of an emissions “cap” applicable to shipping could be meaningful in the context of a global, cross-sectoral emissions trading regime, which would cap carbon emissions and provide for trading of emission allowances in a broad, defined, and commonly regulated international market. However, as I noted earlier, an international, cross-sectoral emissions trading market does not currently exist, and was not agreed to in Copenhagen. Establishing and overseeing a system that is truly cross-sectoral in application is beyond the competence of the IMO to establish or regulate. Carbon emission caps and trading have not yet been agreed to or established within most Annex I countries represented at the IMO, within any non-Annex I countries, or for other transport sectors. If such an international regime and market were created, the maritime industry could assess how shipping may function within such a system; however, discussion of a “cap” on shipping emissions is not appropriate absent a broader global framework that has established emission caps applicable to the broader economy and to other transportation modes.

That does not mean the industry is opposed to addressing carbon emissions. The World Shipping Council and its members fully support the establishment of an effective global regime addressing CO<sub>2</sub> emissions from ships, and we believe that IMO is the most appropriate forum for developing such an agreement. We believe that the IMO should move forward with adoption of a global system that will further increase the efficiency of the world’s maritime

fleet. Improved energy efficiency for shipping will serve society well, will reduce CO<sub>2</sub> emissions from shipping and improve global environmental results, and will reduce resource consumption while continuing to foster trade and improved quality of life. Last week, WSC submitted a proposal to the IMO for how this might be done (which can be found on our website), and we look forward to the discussions at the March IMO meeting.

### **Security Policy**

Events in aviation at Christmas demonstrated the need for continued vigilance against terrorist threats. For shipping, well developed security regimes by the Coast Guard and Customs and Border Protection will be substantially supplemented tomorrow when Customs' begins enforcement of its new "10 plus 2" regulations, requiring carriers and importers to provide substantially more information about containerized ocean shipments prior to vessel loading.

WSC has supported this initiative and the strategy behind it since 2004 when WSC, together with other members of the trade community, recommended this initiative as a way for Customs to improve its advance cargo risk assessment capabilities. While admittedly imposing significant, new information filing obligations on carriers and importers, this approach is logical and presently feasible, in contrast to the idea that 100% of all containerized cargo shipments are going to be effectively scanned and inspected at all the world's ports prior to vessel loading. And for those U.S. port representatives who occasionally indicate that they think they would like to address container security questions with the idea of all U.S. import containers being inspected overseas, remember that the U.S.'s trading partners would respond by demanding that all U.S. export shipments be treated the same way – something no port in the U.S. could even begin to handle.

The "10 plus 2" regulation is the most significant change ever made to how U.S. ocean containerized import commerce is to be documented and screened, and we commend CBP for the way it has cooperated with and prepared the trade community for this new security regime.

### **Transportation Infrastructure: Unclear Direction in Washington**

As I noted at the beginning of my remarks, some governments have a very clear and well defined commitment to expanding their transportation infrastructure and trade handling efficiency. No maritime infrastructure plan or vision is likely to have a greater potential impact on the Houston area than the new, larger locks being built for the Panama Canal. Scheduled for completion at the end of 2014, these new locks will allow much larger ships to transit the Canal -- more than doubling the maximum containership capacity from 5,000 TEU ships today to 12,000 TEU ships. This will encourage an increase in all-water volumes to U.S. East and Gulf

Coast ports from Asia. How much volume diversion from U.S. West Coast ports to U.S. East and Gulf ports is hard to predict, but will in the end be based on the total cost of the cargo's transportation from origin to its destination. Planning for the Panama Canal expansion has led U.S. East and Gulf Coast ports to expand capacity and has caused U.S. West Coast ports to be mindful of the more competitive Panama Canal transits that will be available after 2014. Houston is obviously well positioned to take advantage of the efficiencies that the larger vessels will be able to offer.

While improving transportation infrastructure to better handle trade is clearly a top national priority in Panama, China and other trading nations, the policy direction in Washington, D.C. remains uncertain.

We have over recent years witnessed the inability of the U.S. government to enact a long-term surface transportation funding bill, with the result that it is forced into a series of short term extensions of the program without providing any answers or commitments regarding the long term direction of the program. This has frustrated the states (which spend more on the national highway system than the federal government, but still need to know with confidence what the federal revenue share is going to be on projects they must manage within their borders) and has frustrated highway users. Some of this concern has been mitigated by money in recent economic stimulus legislation being designated for infrastructure, but most of those funds are not for public highway or trade infrastructure, and these ad hoc infusions of funding are certainly not a long term policy answer.

The trucking industry and leaders of the business community have repeatedly stated that they could support an increase in the present fuel tax system as the way to pay for the necessary increased public highway funding, so long as those revenues were dedicated to highway improvement projects. It is quite interesting that so much of the private sector is willing to call on the government to institute such a tax increase to get the job done.

The current and past Administrations have been unreceptive. The past Administration preferred using private capital, rather than increased tax revenues, to build public infrastructure. The present Administration has simply refused to address the issue. The Congress, fearful of being seen as advocates of tax increases, provides little direction other than to encourage discussion of various ideas about new and different taxes to fund an even wider range of projects. From a trade and transportation perspective, this is discouraging at several levels.

First, the highway trust fund's principal revenue source – the fuel tax – is the best and closest thing one can reasonably implement as a reasonable "user fee". The collection system is in place, it is simple, and it works. The amount one pays is directly correlated to actual

highway use. The transportation and trade community is open to the idea of increasing it so long as the funds are used to improve highways. The fact that cars like the Chevy Volt and hybrids may get a cost advantage is virtually irrelevant. Such cars are a small percentage of the vehicle users; furthermore, a higher gasoline/diesel fuel tax would be an appropriate environmental and energy policy incentive for the purchase and use of such vehicles.

Second, the alternative revenue sources being suggested are unlikely to provide the solution and are false hopes. Taxing freight transportation bills would be hideously complicated, and engender modal conflict and confusion. Taxing a vehicle for miles driven would be very complicated and require a new bureaucracy; furthermore, the existing fuel tax is already an effective charge per mile driven, only with the arguable advantage over a flat mileage tax of providing an additional cost incentive and reward by varying according to the energy efficiency of the vehicle driven.

The idea of container taxes is a poor idea and a distraction. The fact is that, as important as liner shipping is, it has a marginal role in this debate. The U.S. transportation system moves roughly 20 billion tons of goods a year. Of that amount, only 10% is international freight. When you subtract air cargo, NAFTA cross-border cargo, and pipelines from that international freight number, you cut that 10% number roughly in half -- meaning about 5% of the freight being transported in the U.S. is non-NAFTA, international maritime cargo. When you then subtract bulk, breakbulk, and ro-ro maritime cargo, you get an even smaller portion of the total freight that is being transported via ocean containers. And of that total, a substantial share of that maritime containerized cargo is moving by rail to its inland destination, rather than by highways. Import and export containerized freight is too small percentage of the freight using the nation's highway system to be a logical revenue source for funding highway construction -- especially when considering that the highway system is generally built for and used mostly by automobiles and that domestic freight far exceeds cargo in international containers. Trying to tax this small portion of America's freight commerce as a way to pay for highway construction would also face a number of legal impediments, including such a charge being challenged as unfairly discriminatory, the Constitution's prohibition on taxing exports, the World Trade Organization's restrictions on discriminating against imports, and international container conventions that guarantee tax free admission of containers.

Third, what is increasingly clear is that the lack of action on a new transportation funding bill is not simply the result of a debate about finding new revenues to build needed public highways, but about the strategic objective of the next surface transportation funding bill. If the debate were only about how to find sufficient revenues for funding the construction of improvements to the national highway system, adjusting the fuel tax is an obvious answer. But there is more at play than how best to fund the nation's public highways or current mass

transit programs. There are efforts to change the focus regarding what kind of projects should receive federal funding. For example, the trucking industry is not about to agree to pay higher fuel taxes to fund private rail infrastructure projects. But more than the truck-rail issue, it is increasingly evident that a growing coalition of interests are really not all that interested in substantial, new highway infrastructure funding, but want funding in the next transportation bill to be used for light rail passenger projects, high speed rail passenger projects, bike lanes and trails, more mass transit, “walkable” and “livable” communities, and alternatives to more public roads. Determining how to fund that agenda, however laudable one may think it is, will present greater complexities, and it will cause the trade and freight transportation community to consider what their position with respect to a new federal transportation bill should be.

Further, although there is much discussion about the importance of improving “freight mobility”, there is not much clarity about exactly what this means, what kind of projects this envisions, or whether such projects are intended only for freight movement or are to be shared public infrastructure uses by automobiles and non-freight users.

The national highway system, as envisioned by President Eisenhower and as funded for decades, is now being characterized by many as an outmoded, “20<sup>th</sup> century” initiative. How the efficient transportation of goods on the nation’s public roads, and the resulting economic prosperity that flows from such commerce being moved efficiently, will be facilitated by Washington in the future remains an unanswered question. Few expect the answer before the November 2010 elections.

### **Some Concluding Observations**

This conference is interested in the Texas port community, port users, and government planners working to meet the region’s future transportation and infrastructure needs. I have noted some of the challenges we currently face. Some of the challenges will be harder and take longer to address than others. At the same time, the “can do” attitude that generally prevails in Texas is an important indicator that the challenges can be met and that Houston will continue to grow in importance as a trade center. In doing so, we should expect:

1. Investment capital will be more cautious. The exuberance that led to huge prices for marine terminal businesses has been tamed. Carrier profitability will remain dubious for awhile, and therefore its capacity to invest will remain temporarily constrained. Nevertheless, projects that have solid, reliable economic benefits are likely to find available capital, as full page ads for infrastructure capital in Washington papers by Goldman Sachs indicate.

2. Getting regulatory permission to proceed with infrastructure enhancement projects can be a more important hurdle than capital. One only has to look at the list of port improvement and expansion projects in California -- and the gauntlet of permitting and legal obstacles they have to run -- to appreciate this fact. California may be the "poster child" for permit inaction and roadblocks, but that unfortunate fact may present those ports that have supportive communities with some real economic development opportunities.
3. The industry and the ports will address the environmental challenges. The maritime industry's approach to environmental regulation is not to stonewall, but to address, these issues – through consistent internationally applicable standards whenever possible. Whether it is SO<sub>x</sub>, NO<sub>x</sub> or particulate emissions, or CO<sub>2</sub> emissions, or establishing standards for ballast water treatment technology, or cold ironing, or port trucking, we recognize that we need to find environmentally effective and efficient ways to address the issues. We will.
4. One probably should not at this time count on Washington to provide significantly more money for transportation infrastructure improvements. Money in existing trust funds for dredging continues to be diverted by Congress from port usage. The federal highway program's future is unclear, and it is not currently a political priority. This policy gridlock may result in more States simply deciding that Washington is not going to be the solution to their infrastructure needs, and undertaking their own additional funding initiatives. Congress is likely to insist that states get almost a dollar back for every dollar they put in the highway trust fund anyway, so frustration with Washington's inaction on long-term policy may simply be one more reason for States to act on their own. They may decide that they can rely more confidently on an increase in state fuel taxes to fund their infrastructure needs than they could on an increase in federal fuel taxes coming back to them – a trend that has been evident for several years. Or they may embrace infusions of private capital into building and operating public roads. Such discussions are not only occurring in Texas but in other parts of the country as well.
5. Houston is well positioned to be a trade and growth center. The Panama Canal expansion, the service of its Class I railroads, the population growth in the Southern U.S., and the establishment of so many large distribution centers in the area – all these things ensure continued opportunities for Houston and its port community. In the end, the ports and the carriers don't decide where the cargo is routed; the customers do. The Houston area's success in getting distribution

center infrastructure commitments from major shippers to use the port are long term use commitments and will prove to be a very important foundation for the future.

6. Finally, the fact that Texas is interested in creating new jobs will be an advantage for it. Not all ports have that kind of backing, and the message is not lost on the trade community as it makes its long term investments.

2010 is going to be a very difficult year for the liner shipping industry. Do not underestimate that. At the same time, do not underestimate the resilience of the industry and its commitment to serving the nation's trade efficiently and effectively. The industry looks forward to continuing its role as one of the most important facilitators of the nation's and this region's economic growth and prosperity.

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