

## **PRIVATIZATION AND ITS IMPLICATIONS FOR U.S. PUBLIC SEAPORT AGENCIES**

**By**

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Though hardly a recent phenomenon, "privatization" of publicly owned assets has come increasingly into vogue as a solution to perceived problems of fiscal scarcity and institutional inefficiency. The underlying assumption appears to be that private sector participation is needed both to relieve governments of burdensome financial responsibilities and to promote investment and efficiency in a manner that the public sector is inherently incapable of providing.

Among the targets of privatization at the international level have been state owned enterprises such as banks; trading companies; telecommunications; utilities; steel and petroleum companies; and transportation entities such as railroads, shipping lines, highway systems, airlines and ports. The most obvious examples have been the transition to the free enterprise system of the communist economies of Eastern Europe, the former Soviet Union, and even the remaining communist states such as Vietnam and especially China. However, it is occurring with comparable rapidity elsewhere -- in Britain under the Conservative governments of Prime Ministers Thatcher and Major, Argentina under President Menem and the Mexico of former President Salinas, for example, -- with the reversal of socialist policies of the past by public divestiture of previously nationalized and other state-owned companies, and the adoption of policies aimed at encouraging rather than constraining market-oriented behavior in the private sector.

Public ports have become increasingly inviting targets of opportunity for privatization over the past decade. The first and arguably the most successful occurred in 1981 with the sale by the British government of the 21 ports controlled Transportation Board to a joint-stock company known as Associated British Ports Holdings. Other countries where port privatization is well underway are Argentina, Chile, Colombia, Malaysia, Mexico, New Zealand, the Philippines, and Venezuela. The process has accelerated within the last two years, according to the British trade journal Port Development International, which estimates that 30 ports worldwide "will, in some way or another, be privatized in the short-term."<sup>1</sup> In total, more than 40 countries are said to be pursuing "port privatization in one form or another."<sup>2</sup>

In the United States, privatization initiatives thus far have typically entailed the contracting out

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of to vendors of services handled by public employees such as solid waste disposal, nursing home operation, wastewater treatment, traffic adjudication, prisons, school lunch programs, and child support services.<sup>3</sup> Even the Federal Government has not remained immune. Examples include the sale to the private sector of Federal Barge Lines and Conrail; quasi-privatized institutions such as the U.S. Postal Service and the National Passenger Railroad Corporation (or "Amtrak"); and the recent proposal for privatizing the federal air controller service as part of the reorganization of the U.S. Department of Transportation.

Only recently, however, has the debate in this country begun to embrace the privatization of U.S. public port agencies. A 1993 study by The Reason Foundation which touts "greater private sector participation" as a solution to the "many problems" faced by U.S. public ports" such as "lack of exposure to full commercial competitive pressures .. to operate efficiently" and undue "political interference."<sup>4</sup> More specific proposals have come from the prospective Executive Director of The Port Authority of New York and New Jersey<sup>5</sup> and a re-organization plan for the Port of Los Angeles, which among other things, recommends the contracting out of certain "non-essential" port functions and the privatizing of others such as pilotage.<sup>6</sup>

The merits of these ideas can be effectively evaluated, however, only by precisely defining what is meant by privatization, actual privatization experiences elsewhere in the world, and how they relate, if at all, to the situation to public port governance in the United States.

"Privatization" simply stated means the transfer, sale, or lease of public assets, functions, or services to private sector entities. Furthermore, privatization defines not one but rather a spectrum of options ranging from the "complete" sale of public port assets on one extreme to contractual or leasing arrangements in which ownership remains in the public sector but operational control is delegated in some fashion to private sector concessionaires. A World Bank study<sup>7</sup> outlines these "progressively increasing degrees of private participation":

- (a) Publicly owned and operated port
- (b) Private stevedoring in publicly owned facility
- (c) Private shore-side cargo-handling and stevedoring in public facility
- (d) Private operating concession in public facility
- (e) Privately owned and operated terminal

A more recent delineation<sup>8</sup> predicts that port privatization ventures "to the year 2000 and beyond ... will not necessary entail a full-blooded switch from public to private ownership ... but [instead] will involve a broad based cultural change from public cost-benefit thinking to private sector commercial values." "Common strategies," beyond the "selling off [of] public ports lock stock and barrel" will include:

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"Partial privatization of terminal operations where the government retains an equity stake and exerts control in line with this.

"The full privatization of terminal operations where facilities are leased on a term basis and the role of the port authority becomes a management and coordinating one without direct involvement in operations.

"The port authority may opt to contract to perform other key functions, for example, towage duties, infrastructure and plant maintenance and navigation duties."<sup>9</sup>

Other, though less likely options, include:

"The contracting of private sector management expertise to run a given facility  
"The leasing of entire ports."<sup>10</sup>

A decision to privatize ports can be driven by a variety of forces. The most obvious is to relieve a financially strapped government by turning to the private sector for an infusion of capital required to modernize and sustain port operations -- or to bolster the national treasury. Another can be to seek the economic benefits from competition by cutting labor costs, eliminating publicly sanctioned monopolies, reducing bloated port labor forces, and removing other institutional barriers that discourage innovation and isolate and indeed protect port management from the exigencies of the global market place.

Inefficient and costly port operations can seriously impair the competitiveness of a nation's export industries and artificially raise the cost and thus constrain the availability of imported goods. Thus, privatization in certain circumstances holds the promise of stimulating economic growth and higher living standards for society at large as well as those whose livelihood depends directly on port activity and trade.

However, privatization carries certain risks that must be carefully weighed before decisions or made. There is the danger, for example, as Britain's experience with certain of its "trust ports" underscores,<sup>11</sup> that the below-market sale of public assets can deprive government of the full value and thus the full financial benefit of a port asset divestiture.

Determination must be made as to what if any role should be retained by the public sector; what restrictions or limits should be placed on private operators; and, what safeguards are needed to prevent abuses. In this respect, it is important to note the recent emergence and expanding holdings on an international scale of fewer than two dozen privately-controlled terminal operating companies whose corporate headquarters are often far removed from the port properties they own or manage.<sup>12</sup> These entities have typically been the successful

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bidders of late for terminal concessions in Latin America, Asia, and Europe. While these companies have much to offer in the form of capital, managerial expertise, and market acumen, their interests are global rather than local or regional, corporate rather than public, profit maximization rather than economic benefit -- factors that argue well for adequately safeguard public and national security interests in any port privatization strategy.

It should also be remembered that ports are but one link in the international trading system and that care should be taken to ensure that reform extends beyond the port itself. If, for example, inefficiencies or monopolistic practices are allowed to persist elsewhere in the system, the benefits from port privatization may be compromised or forfeited altogether. A modern, efficient container port serves no useful national purpose if it is served by poorly maintained or inadequate rail or highway facilities.

Similarly negative consequences can ensue from unnecessary and/or corruptly managed government regulatory practices, from a failure to trim bloated public port bureaucracies, to implement meaningful labor reform, or to sensitize port operations to market rather than political forces. Clearly, the challenge is to promote economic efficiency while preserving and protecting the public interest in a modern, viable port system. In the last analysis, the guiding strategy must be in ensuring the uninhibited flow of waterborne trade rather than short term and, one might say, short-sighted politically motivated fiscal goals -- the danger, as one astute commentator puts it, of "milking for cash, not trade."<sup>13</sup>

Port privatization experiences to date have for the most part focussed on the sale of operating concessions (in Argentina, China, Mexico, and the Philippines, for example)<sup>14</sup>, joint-public-private ventures (Malaysia and Vietnam)<sup>15</sup>, privately-oriented but port authority controlled operating subsidiaries (Saint Lucia)<sup>16</sup>, or the dissolution of government-owned cargo handling monopolies in favor of competitive private sector stevedoring companies (Chile and Dublin).<sup>17</sup> The "lock stock and barrel" sales of public ports in New Zealand and Great Britain are rather the exception than the rule. Only a few months ago, for example, "a barrage of criticism from users, unions, and shipowners" forced the Victoria State Government in Australia to abandon its pursuit of "port reform" through the sale of the shore-based and non-port-related assets of the Port of Melbourne Authority.<sup>18</sup>

Proponents of privatization argue that U.S. public ports many cases operate at a loss and, furthermore, "lack exposure to full commercial competitive pressures" which "may have reduced incentive to operate efficiently" and "are often subject to political interference."<sup>19</sup> They point with approval to privatization success stories in Great Britain and Malaysia, for example,<sup>20</sup> and in so doing imply that because port privatization is occurring elsewhere in the world, it ought to be done in the United States. The underlying assumption is that public ports systems are the same everywhere, and that what makes sense for Malaysia, Argentina, or

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Mexico, makes equally good sense for the United States.

That assumption is seriously flawed. Unlike most other port systems, particularly in the developing world, the U.S. port system is decentralized, highly competitive (which is the major reason why many have difficulty turning a profit), and is already "privatized" to a large degree. To say that U.S. public ports are unresponsive to competitive pressures is to ignore the billions of dollars they have invested in facilities and services to ensure that they do in fact remain competitive.

The operating philosophies of public seaport agencies in the United States are dictated largely by local circumstances -- by decisions of port managers as directed by their governing boards and the enabling charters of the agencies themselves rather than by administrative fiat of the national government. Indeed, in the United States, there is no single national port authority. Rather authority is diffused through all three levels of government -- federal, state, and local. This stems from the federal character of the U.S. Constitution, which reserves certain powers for the national government and delegates others to the states.

The U.S. Constitution grants the federal government exclusive jurisdiction over the navigable waters of the United States, including its deepdraft channels and harbors. However, landside port development, with certain restrictions, is a state and local government prerogative. Port authorities in the United States are instrumentalities of state or local government and established pursuant to laws or grants of authority extended by state legislatures.

Neither Congress nor any federal agency has the power, or even the right, to appoint or dismiss port commissioners or staff members, or to amend, alter, or repeal a port authority charter -- with one exception. That exception pertains to the enabling charters of bi-state agencies, which, because of their interstate character, are subject to Congressional approval. In addition, by federal law, ports may not give undue or unreasonable preference or refuse to deal with a person, locality or type of traffic. Port tariffs are filed with a federal regulatory agency to ensure compliance with the law, and lease and service agreements must be made available to the agency upon request.

However, port investment and management decisions are a local, state or private sector function. So far as port development and investment is concerned, the federal function has historically been restricted to navigation channel construction and maintenance. Shoreside development has been left to the non-federal public and private sectors. Indeed, the U.S. Constitution stipulates that the federal government shall give "no preference by any regulation or commerce or revenue to the ports of one State over those of another." Thus, port development in the United States is a shared responsibility between the federal government on the one hand, and local and state government and the private sector on the other. Because

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U.S. port agencies are state or local government entities, the decision to privatize rests with the legislatures and not with the federal Congress. This contrasts with the case in Britain where port agencies are subject to Parliamentary oversight.

Private sector terminal operations are widespread in the United States, occurring in virtually every port. These include private sector tenants of public port agencies as well as facilities which are both privately owned and privately managed. The latter are functionally, corporately, and legally independent of any public port agency, and may even compete with public port agencies. In addition, most port services such as railroads, trucking, towage, pilotage, bunkers, and so forth are typically private rather than public sector function.

As previously noted, port privatization elsewhere has typically favored the sale of operating concessions rather than the outright sale of public port assets, with the port authority as a landlord and terminal operations being formed by its tenants. This, in fact, is already a widespread phenomenon in the United States, particularly among though by no means restricted to the nation's largest container ports. A recent survey by the American Association of Port Authorities of its U.S. port members identifies 31 "operating", 34 "non-operating" (or "landlord") and seven "limited" operating port agencies.<sup>21</sup> "Operating" ports are those in which cargo handling inland from the pier are performed by port authority employees performed by employees of those agencies. At "landlord" ports, by contrast, these functions are performed by port authority tenants. "Limited operating" ports combine characteristics of first two categories, leasing some facilities and operating the others.

In several instances, a desire to commercialize public port operations have led U.S. port authorities to establish quasi-private operating subsidiaries. Examples include the Virginia Port Authority (Virginia International Terminals, Inc.), Maryland Port Administration (Maryland International Terminals, Inc.), Tampa Port Authority (Tampa Bay International Terminals, Inc.) and, most recently, the Delaware River Port Authority (The Ports of Philadelphia and Camden, Inc).

Longshore services, meaning the physical loading or unloading of vessels at pierside, are almost universally performed by private sector stevedoring companies -- at both landlord and operating ports. The terminal operator, be it the port authority or a port authority tenant, contracts with the stevedore, which in turn, hires longshore labor based on the terms of its contract with the longshore union -- the International Longshoremen's Association for ports on the Atlantic, Gulf, and Great Lakes Coast and the International Longshoremen's and Warehouseman's Union for ports on the West Coast. These labor agreements historically have been concluded between the unions and local terminal operator and/or steamship associations. Port authorities traditionally have been excluded from these negotiations, except in an observer status. This arms-length relationship with longshore labor negotiations

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appears to have been dictated by political sensitivities and in some cases by state laws that flatly forbid such involvement by state agencies (such as port authorities). Non-union terminals or terminals operated by unions other than the ILA or ILWU exist in some U.S. ports.

What is more, the U.S. public port system is vast and highly competitive, presenting shippers with an array of routing alternatives that include ports in neighboring countries. East coast ports, for example, compete with their West Coast counterparts and their Canadian counterparts for market share in the U.S. midwest. Terminal operators and other port service providers frequently compete with one another locally as well as with ports elsewhere. Thus the port monopolies that are often the target of port privatization in other areas of the world, particularly in the developing countries, simply do not exist in the United States.

As to the issue of subsidy, while it may occur, many port authorities no longer enjoy ready access to public funds, but are instead being forced to rely on what they generate from earnings to cover their costs and satisfy the exacting demands of private capital markets. In fact, what we are seeing, is growing instances of "reverse subsidy" such as in the recent case of California, with port authorities being called upon to bail out financially strapped state and municipal governments.

It is important to remember that port authorities were established in the United States to end private sector monopoly and abuse (particularly by railroads), to ensure equal harbor access, and to provide essential facilities and services that the private sector was unable or unwilling to provide. Public access to the waterfront and the discriminatory practices of port facility owning railroads were recurring issues at AAPA conventions in the years immediately following its founding in 1912.<sup>23</sup> While railroads monopolies are no longer at issue, there nevertheless remains an abiding public interest in the management of waterfront development.

Port activities create substantial economic and international trade benefits for the nation, as well as local and regional economies. According to the U.S. Department of Transportation, in 1992 commercial port activities generated 1.5 million jobs, contributed \$73.7 billion to the Gross Domestic Product, provided personal income of \$52 billion, generated federal taxes of \$14.5 billion, state and local taxes of \$5.5 billion.<sup>24</sup>

Facilities owned by public port agencies also serve nation's strategic interests as staging points for the deployment of U.S. Armed Forces in the event of war or other international military contingency. During the Persian Gulf conflict of 1990/91, for example, more than 3.0 million measurement tons of military cargo was loaded out of U.S. commercial ports in support of Operation Desert Shield/Desert Storm.<sup>25</sup>

The shoreside infrastructure requirements of waterborne commerce face growing competition for suitable waterfront land from commercial real estate developers, residential housing,

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recreation boating, historic preservationists, and other interests. Striking a fair and equitable balance that best serves the public economic growth and the quality of life as it related to harbor development is an ongoing challenge to ports and local government as well as those whose livelihood depends on maritime activity. A viable port authority helps assure that the requirements of trade do not go unheeded.

In brief, the private sector is already well entrenched in the U.S. port system. Furthermore, the highly competitive nature of the system obviates any danger from monopoly to the flow of U.S. waterborne trade. Further privatization of public ports is most likely to be selective -- security, pilotage and other discrete functions, along the lines of what is being contemplated in Los Angeles -- or the conversion to landlord status by operating ports.

Whatever the case, care must taken to protect and preserve the overriding public interest in the flow of waterborne commerce so vital to the nation's economy and security.

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**ENDNOTES**

<sup>1</sup>Robin Martens and Ed Boatman, "Trade Expansion Through Privatization," **Port Development International**, September 1994, p. P7.

<sup>2</sup>**Port Development International**, September 1994, p. P4.

<sup>3</sup>Peter Behr, "Solving the Privatization Puzzle," **Washington Business**, February 13, 1995, pp. 1, 12-13.

<sup>4</sup>David Haarymeyer and Peter Yorke, **Port Privatization: An International Perspective** (Los Angeles: The Reason Foundation, April 1993), p. 1.

<sup>5</sup>**The New York Times**, February 10, 1995, p. B4.

<sup>6</sup>Port of Los Angeles, Press Release, January 11, 1995.

<sup>7</sup>Zvi Ra'anan, **Port Administration: Should Public Ports Be Privatized?** (Washington, DC: The World Bank, March 1991), p. 15.

<sup>8</sup>Mike Mundy, "Port Development," **Lloyd's Nautical Yearbook 1995**, (Colchester, UK: Lloyd's of London Press, 1994), p. 97.

<sup>9</sup>Ibid.

<sup>10</sup>Ibid.

<sup>11</sup>**Port Development International**, May 1994, pp. 31-34.

<sup>12</sup>Mundy, pp. 104-105, 107-108.

<sup>13</sup>**Port Development International**, December 1994, p. 25.



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<sup>14</sup>**Port Development International**, September 1993, pp. P15, P20-P21.

<sup>15</sup>Haarmeyer and Yorke, pp. 5-6; **Port Development International**, December 1994, p. 5.

<sup>16</sup>**AAPA Advisory**, February 6, 1995, p. 6.

<sup>17</sup>**AAPA Advisory**, November 8, 1993, p. 4; Economic Commission for Latin America and the Caribbean, **The Distribution Chain and the Competitiveness of Latin American Ports** (Santiago, Chile: CEPAL, December 1989), pp. 25-26.

<sup>18</sup>**Port Development International**, December 1994, p. 3.

<sup>19</sup>Haarymeyer and Yorke, pp. 3-4.

<sup>20</sup>**Ibid**, pp. 5-6, 9-16.

<sup>21</sup>U.S. Constitution, Section 9, Article I.

<sup>22</sup>American Association of Port Authorities, **Annual Salary Survey** (Alexandria, VA: September 1994).

<sup>23</sup>See, for example, **Proceedings of the First Meeting of the National Association of Port Authorities of the United States Held at New York City December 9 and 10, 1912**, pp. 25-28. Note: The organization was renamed American Association of Port Authorities in 1914.

<sup>24</sup>U.S. Maritime Administration, **A Report to Congress on the Status of the Public Ports of the United States 1992-1993** (Washington, DC: U.S. Department of Transportation, October 1994), p. i.

<sup>25</sup>Rexford B. Sherman, "Ports at War," **Defense Transportation Journal**, April 1992, p. 10.