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A container ship from Hanjin Shipping Co

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World Economics 

Abandon Ship

Crisis and Consolidation in Global Shipping

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Until 1978, dozens of airlines flew the U.S. skies. Then, with the passage of the Airline Deregulation Act, competition increased and profits became scarce. Decades of consolidation



followed, as Allegheny, Eastern, Frontier, Ozark, Pan Am, and many other venerable names were merged out of existence or went bust. When the turbulence finally subsided, four giant carriers—American, Delta, Southwest, and United—controlled 70 percent of U.S. domestic passenger traffic and, through agreements with foreign carriers to share services, dominated international routes as well. Such measures have enabled the airline industry to rake in profits as never before.

Something similar is now going on in the world of container shipping. Excess capacity and slow-growing demand are forcing down the price of shipping, driving companies deeply into the red and bringing a wave of bankruptcies, mergers, and joint ventures. The August [bankruptcy of South Korea's Hanjin Shipping](#), the world's seventh-largest container carrier, and the announcement, in September, of the restructuring of [A.P. Moeller-Maersk](#), by far the world's largest, are signs of a consolidation process that still has far to go. And although the industry is likely to remain troubled in the short term, in the long term, today's troubles will lead to less competition among those carriers adept enough to survive. That in turn will mean higher rates for shippers, [increasing the cost of moving goods around the world](#).

TOO BIG TO SAIL

[Modern container shipping dates](#) back to 1956, when U.S. trucking magnate Malcom McLean refitted an aged tanker ship, renamed the *Ideal X*, to carry 58 truck trailers (minus their wheels) between the ports of Newark and Houston. Transatlantic service began in 1966, after the International Organization for Standardization agreed to standardize sizes and lifting mechanisms so that any crane in any port could handle any container. By the early 1970s, ships designed to carry nothing but containers were sailing all [the world's major trade routes](#), replacing costly service and unpredictable delivery times with cheap, reliable freight

transportation. The shipping container, seemingly the most mundane of inventions, made modern global supply chains possible.

Since its earliest days, however, container shipping has been a boom-and-bust industry. Before the container came along, most cargo ships had been small, inexpensive vessels left over from World War II; if business was bad, owners could simply dock their ships until conditions improved, removing excess capacity from the market. The new container ships and the onshore infrastructure to service them, by contrast, were expensive to build and finance. Even in a weak market, owners had to keep their vessels sailing in hopes of generating enough revenue to service their debts. In periods [when international trade grew strongly](#), freight rates climbed, and shipping companies responded by ordering larger and more expensive vessels. But by the time those vessels were ready to sail three or four years later, economic conditions often were very different, creating a surplus of capacity that would send shipping rates crashing and drive over-extended carriers to ruin.

This boom-and-bust story is repeating itself today with new twists. In the [wake of the recession](#) that wracked the Western Hemisphere, Europe, and parts of Asia in 2008-09, international trade stopped growing for the first time since World War II. In the worst year, 2009, the volume of exports worldwide fell by a stunning 12 percent. Container ship operators assumed that this situation was temporary, and that the boom in international trade that had preceded the crash would resume. They ordered a new generation of vessels, far larger than any that came before, to handle the expected flood of cargo. The biggest of these, which have come into use since 2013, can carry over 10,000 truck-size containers at a time, three times as many as the largest vessels in use in the early years of the twenty-first century.

Yet the flood of cargo never came. Instead of reverting to

the long-term average of seven percent annual growth, [trade has grown at a sluggish three percent annually since 2010](#). Last year, in an unusual development, the flow of merchandise exports and imports—that is, trade in tangible goods as opposed to services—actually grew more slowly than the world economy. As a result, the average cost of shipping a container has fallen by half since the start of 2015. As of August of this year, moving a container filled with millions of dollars of goods from Shanghai to Rotterdam cost as little as \$1,400, down from around \$2,200 two years ago. The shipping lines whose new \$200 million vessels are sailing the seas half empty are feeling the pain.

So are many of the ports that [invested in huge expansions and upgrades](#), often with taxpayers' money, at the behest of shipping companies. The latest generation of container ships requires deeper harbors, larger ship-to-shore cranes, and more expansive storage areas than earlier vessels. The local politicians who oversee most ports were warned that if they failed to provide such costly amenities, the new ships would pass them by, and they responded by funding dredging projects and the construction of container terminals to accommodate the very largest ships. Such lavish spending has left a surplus of port capacity on every continent. Container traffic fell nearly five percent last year at the port of Oakland, six percent at Tokyo, and roughly nine percent at Singapore, Hamburg, and Hong Kong. In many cases, port authorities are hard pressed to recover their costs: if they charge more for use of their ports, the shipping lines may take their business elsewhere.

WEATHERING THE STORM

With the [world economy growing slowly](#), international trade is likely to grow slowly as well; there is no impending surge of cargo that will put the shipping industry's excess capacity

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to use. Shipping lines have two strategies to deal with this. The first is mergers. In July, the German company Hapag-Lloyd, which had only recently merged with the Chilean carrier CSAV, agreed to buy the United Arab Shipping Company of Qatar, a deal that will make Hapag-Lloyd the world's fifth-largest container ship operator. In June, French giant CMA CGM became the third-largest by taking over Singapore-based Neptune Orient Lines, which owns the remains of the venerable U.S. company American President Lines. In January, two state-owned Chinese ship lines, Cosco and China Shipping, merged to become the world's number four. After these transactions, the five largest container lines now control about 54 percent of global capacity, compared to around 40 percent before the crash. Many of their remaining competitors have fleets of smaller, older vessels that are costly to operate, and survive by connecting major ports to smaller ones that the global ship lines are not interested in serving.

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The second survival strategy involves alliances among companies that are nominally competitors. There are now four such alliances, the most important being 2M, an agreement under which Maersk and Mediterranean Shipping Company, the world's two largest container carriers, will share 185 vessels on 21 routes until 2025. South Korea's troubled Hyundai Merchant Marine has said it hopes to join that alliance next year. Such deals, similar to the international code-sharing agreements familiar to air travelers, enable their members to collaborate in trimming capacity on certain routes in hopes of propping up prices. Four shipping alliances jointly control close to 90 percent of the trade that moves in container ships.

Alliances have greatly complicated the movement of goods in the short term. In many ports, the various members of a

single alliance have long-term commitments for loading and storage at different locations, and sharing a vessel requires that containers be trucked back and forth within the port each time the ship calls. In at least a few cases, ships have needed to make multiple calls within a single port, stopping at different terminals to load boxes off and on. Moreover, the alliances have enabled the carriers to amass sufficient cargo to justify the use of very large ships, which are extremely efficient at moving containers over water but can cause massive congestion on land when they discharge or load thousands of boxes at a time. [Long-distance supply chains](#) have become less reliable because of more frequent delays in transit, often due to inefficiencies and tie-ups at the ports. Companies that rely on cargo shipping, such as manufacturers and retail stores, have needed to hold larger inventories or simplify their supply chains just to reduce the risk of a shipping snafu leaving them without the goods they need.

The shipping industry's woes will not disappear overnight. Although scrappage—the demolition of old or unneeded ships—is at a record high, almost all of the container ships being scrapped are older, smaller vessels whose demise will remove little capacity from an oversaturated market, and so have little effect on prices. But the industry's prospects for a few years from now look very different. Mergers and alliances have meant a drastic reduction in the number of new containerships on order: why buy a costly new vessel when you can use your competitor's? With few new vessels coming on line, the gradual growth of international trade will bring container shipping supply and demand back into balance. Freight rates will rise, and the handful of dominant companies that survive the current ordeal will be able to dictate terms. It's a story that airline passengers know well. 🌐