

## **PORT PRIVATIZATION: AN INTERNATIONAL PERSPECTIVE**

by  
David Haarmeyer and Peter Yorke

### **EXECUTIVE SUMMARY**

By facilitating international trade, U.S. seaports play a significant role in shaping the country's economic health. All major U.S. ports are owned by public port authorities; many are also operated by public authorities. A 1990 report by the American Association of Port Authorities showed that 30 percent of the 66 port authorities surveyed were operating at a loss.

Government-owned and operated ports face many problems. Lacking exposure to full commercial competitive pressures, publicly owned and operated ports may have reduced incentive to operate efficiently and are often subject to political interference. These public ports can absorb scarce funds from local governments and drag down local economies. On the other hand, efficiently operated public ports, such as the ports of Los Angeles and Long Beach, are often targeted by cities that want to siphon off surplus funds.

Overseas, 36 governments including Argentina, Brazil, Hong Kong, Malaysia, Mexico, New Zealand, Panama, Singapore, and Venezuela are considering or are in the process of privatizing—through concessions or asset sales—some or all of their major shipping ports.

The 1985 divestiture of the container operations at Kelang Port Authority (KPA), Malaysia's principal port, resulted in more than a halving of repair, maintenance, and administrative costs. In 1983, the United Kingdom sold the 19 ports that formed the Associated British Ports. Asset-sale privatization enabled the ports to adopt efficient practices, diversify their assets, and increase capital investment.

The overseas trend in transferring government port operations and assets to the private sector suggests that U.S. public ports can benefit from greater private-sector participation. By improving incentives to perform, greater reliance on private management and capital will increase autonomy, efficiency, and competitiveness of U.S. ports.

## TABLE OF CONTENTS

I.	INTRODUCTION.....	2
II.	PORT PRIVATIZATION: A NEW CONSENSUS.....	4
	A. Privatization: Theory and Evidence .....	4
	B. Port Privatization Evidence: The Case of Malaysia .....	5
	C. Recent World Trends in Port Privatization .....	6
III.	CASE STUDY: BRITISH PORT PRIVATIZATION.....	9
	A. Reasons for Privatization .....	10
	B. Background .....	10
	C. The Process of ABP Privatization .....	11
	D. Trust Ports: Future Privatization Candidates .....	13
	E. Abolition of The National Dock Labor Scheme.....	13
	F. Conclusion: Was Privatization a Success? .....	14
IV.	CONCLUSIONS: LESSONS FOR THE UNITED STATES.....	16
	ABOUT THE AUTHORS .....	17
	ACKNOWLEDGEMENTS.....	17
	ENDNOTES AND REFERENCES .....	18

## **I. INTRODUCTION**

As important gateways to trade, seaports play a critical role in determining a country's competitiveness and economic health. In 1990, the 185 U.S. commercial deepdraft ports handled approximately 1.5-billion short tons of domestic and overseas commerce.<sup>1</sup> The value of U.S. waterborne foreign commerce (imports and exports) for 1990 reached \$438 billion. The value and magnitude of commerce that passes through the country's ports are determined by how well a port's resources—labor, port terminals, wharves, equipment, real estate, etc.—are managed.

Landside port property and fixtures of the country's major ports are generally owned by state and local governments with government port authorities acting as the governing entity. According to Erik Stromberg, president of the American Association of Port Authorities (AAPA), “there are approximately 115 state, local, county or independent public seaport agencies in the United States, 82 of which are AAPA members.”<sup>2</sup> In addition, because they are navigable waters, deepdraft channels and harbors are owned exclusively by the federal government.

The large number of ports owned and operated by different government and private entities indicates that the U.S. port system is relatively competitive. This industry structure contrasts with that in some other countries where ownership and/or operation by a single entity severely restricts competition. However, for U.S. publicly owned ports which have access to subsidies, the incentives for efficient operation generated under competition are weakened.

There is significant private-sector involvement in the U.S. port industry, which is in part a response to the industry's competitiveness. In addition to providing many port services, such as the provision of equipment and labor, pilotage, towage, trucking, and rail, some public ports lease the operation of their terminals to private companies. To reflect the degree of private-sector participation, port authorities are classified as landlord, operating, and limited operating. Landlord ports lease cargo-handling facilities and property to either ship owners or to commercial cargo-handling companies. Facilities and property under operating ports are managed exclusively by public-sector agencies. Under limited-operating ports, there is a mix of public and private operational responsibilities.

Almost half of the 82 AAPA members are landlord ports. Port authorities can greatly benefit from transferring port facility operations to the private sector through a lease or concession to a terminal operator. Research by University of Washington Professor Thomas Dowd indicates that the top 15 U.S. general cargo port authorities currently earn more from lease agreements and concessions than from actual operations.<sup>3</sup>

Still, fundamental limitations in government management and ownership of ports prevent U.S. ports from operating at their most efficient levels. This is indicated by the weak performance of ports generally, and specifically, the poor performance of ports which remain government managed. According to the AAPA's 1990 Finance Survey, 30 percent (20 of the 66 port authorities surveyed) were operating at a loss.<sup>4</sup> To cover losses, these ports required subsidies from state and local governments, many of which are experiencing financial problems themselves.

In some cases, such as the Ports of Seattle and Houston, a port authority has the power to levy property taxes. The use of tax revenue to offset operating and maintenance or capital expenses weakens the incentive to manage port operations efficiently and also distorts competition among ports. As part of multipurpose port authorities, some seaports operate jointly with other transport infrastructure such as airports and toll facilities. Besides the significant coordination and control problems involved in managing these large public enterprises, joint operations also raise the potential cross-subsidies that impair efficiency.

For U.S. ports generating net revenue, government interference in the form of confiscation of profits is a real threat to long-term port performance. In September 1992, for example, the California State Legislature passed a law that allows chartered cities to draw on the profits or "discretionary reserves" of their ports.<sup>5</sup> Standard & Poors, the municipal bond rating firm, immediately placed the ports of Oakland, Long Beach, Los Angeles, and San Francisco on CreditWatch, explaining that "the loss of fund balances for pay-as-you-go financing may limit their ability to provide adequate maritime facilities or increase debt load and, in the long term, impair their competitive position versus other west coast ports."<sup>6</sup> Similar proposals to siphon off port-authority revenue for use in reducing state-government deficits have surfaced in Massachusetts.

The poor financial performance of many U.S. ports, the poor financial condition of state and local governments, the likelihood of government interference in port operations, and growing international competition, suggest that both ports and state and local governments may benefit by transferring greater operational responsibilities and port assets to the private sector. National security and regional economic development are typically offered as arguments against privatization, particularly asset sales. Yet no persuasive evidence is given for why efficiently run private ports are inconsistent with either of these concerns.

Support for greater private-sector involvement can be found in the trend in both developed and developing countries to privatize port operations, and sometimes port assets. Over 36 governments worldwide are considering or are in the process of privatizing some or all of their major shipping ports. Among them are Argentina, Brazil, Hong Kong, Malaysia, Mexico, New Zealand, Singapore, and Venezuela.<sup>7</sup> In 1983, the United Kingdom sold 19 ports in a public share offering and continues to sell ports on an individual basis.

Driving this trend is the growing realization that government control of port operations and oftentimes ownership of port assets is not consistent with efficient, market-responsive port management. Lacking exposure to full competitive pressures (in both the product and capital markets), publicly owned and operated ports have weaker incentive to efficiently allocate labor and capital resources and are more likely to be subject to extraneous political influences.

In addition, while governments the world over face growing demands to develop transportation infrastructure as means of promoting trade and enhancing economic development, they lack the necessary resources to maintain and modernize these capital-intensive facilities. Increasingly, international competitive pressures encourage shippers and ship operators to direct cargo traffic to ports which have the most cost-effective industrial bulk-handling techniques and better intermodal coordination. These tend to be ports where private managers have greater autonomy and incentive to adopt technological changes and efficient labor practices.

An examination of international port privatization—both the economic arguments for greater private-sector participation and the consequences of greater private-sector involvement—is thus an essential step towards understanding how privatization can be a viable policy tool for strengthening this country's ports and improving the nation's competitiveness.

## **II. PORT PRIVATIZATION: A NEW CONSENSUS**

The need for operational and commercial flexibility by port management has thus dictated a progressive reduction of regulation and an increasing participation of the private sector and of port users, who often now set the pace for a port's progress. [Zvi Ra'Anan, World Bank]<sup>8</sup>

### **A. Privatization: Theory and Evidence**

Consistent with the worldwide trend to privatize the operation and often the ownership of airports, highways, water-supply, and wastewater treatment facilities, governments in developed and developing countries are turning over port operational responsibility and port assets to private enterprises. In most cases, the public sector retains responsibility for essential statutory functions such as general navigational safety regulations and contract monitoring and enforcement.

In all cases, the theoretical underpinning for privatization remains the same: compared to publicly owned enterprises, private companies face a fuller set of market disciplines to operate efficiently. Publicly owned and operated enterprises have diffused ownership structures in the form of individual taxpayers or ratepayers who have little incentive to monitor performance. By contrast, in the private sector, ownership is generally concentrated and hence control and accountability are clearer.

In addition, unlike private-sector companies, publicly owned and operated enterprises are not exposed to full competition in the product and capital markets. Similarly, unlike private companies, public-sector enterprises cannot go bankrupt. Finally, compared to private companies, public-sector enterprises are much more likely to experience both direct political interference in operating decisions and potential conflict between the government's role as an owner/operator of an enterprise and as a regulator. Consequently, the link between revenues (or rewards) and cost control (efficiency) is often weak or absent altogether in public-sector enterprises.

A number of studies and surveys provide evidence that privatization generally leads to improved performance over public-sector operations.<sup>9</sup> A 1992 report by the World Bank examining 12 divestitures of state-owned enterprises in four countries provides persuasive empirical evidence of the benefits of privatization.<sup>10</sup> In 11 of the 12 cases, the report found the net welfare change in terms of gains and losses to government, buyers, consumers, workers, and others, to be positive. Moreover, the magnitude of the gains were substantial.

As indicated in the World Bank study, whether it is full or partial (less than 100 percent of the shares transferred to a private firm), privatization generates efficiency improvements. Because it enables an enterprise to take advantage of the stronger incentives associated with private ownership, reduces the potential for political interference, and exposes the enterprise to the full range of capital market disciplines and financing alternatives, full privatization has the potential to yield substantially greater benefits than partial privatization.<sup>11</sup>

In recognition of privatization's important benefits to operational performance, the World Bank is beginning to condition the loans it makes available through its Public Enterprise Loans program on a developing country divesting the public sector of its ports. Loans for Venezuela and Colombia presently contain such a condition.

## **B. Port Privatization Evidence: The Case of Malaysia**

The above discussion indicates that the weaker institutional incentive structure associated with publicly owned and operated ports means that they will be less able to control costs, slower to adopt new technology and management practices, and thus, will be generally less responsive to port users than private port operators. This conclusion was tested by the World Bank in its analysis of the divestiture of the container operations at Kelang Port Authority (KPA), Malaysia's principal port. The World Bank's analysis, which is one of the 12 divestitures analyzed in its 1992 study, is important because it supports the theoretical and empirical evidence for privatization, and it indicates that *workers as a whole gain from privatization*.

In its detailed analysis, the World Bank found that the divestiture of the Kelang Container Terminal (KCT) benefited the government, buyers, consumers, and employees. Indeed, the World Bank called

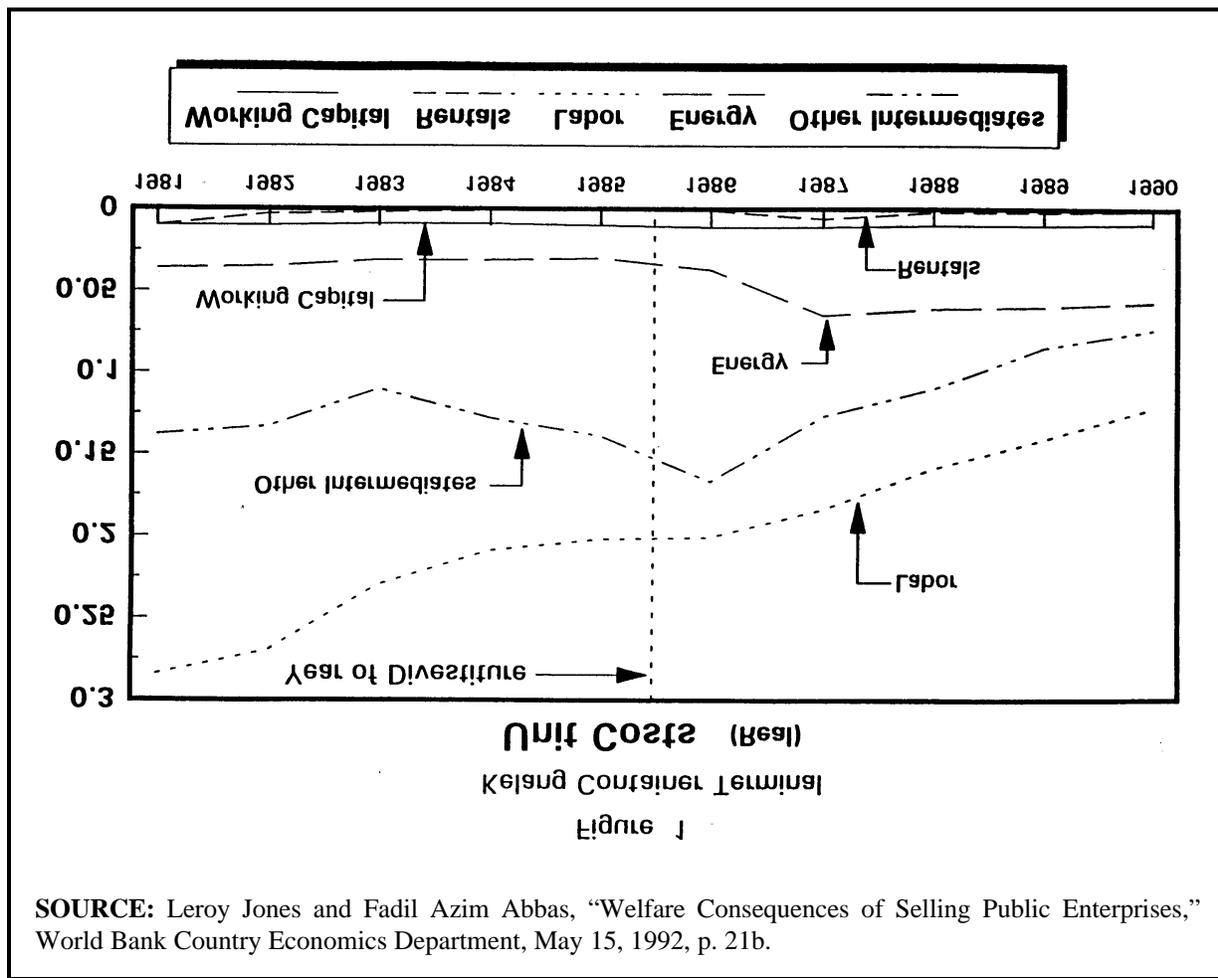
the divestiture an “unqualified success”<sup>12</sup> and found that of the 12 cases of divestiture it examined, privatization of the KTC led to the second largest net welfare improvement.

Kelang, which accounts for two-thirds of Malaysia's containerized trade, was the country's first sale under the government's privatization program. The privatization process started in 1985 when KPA incorporated KCT as its wholly owned subsidiary and awarded it a 21-year renewable lease and exclusive license to operate the container terminal (including storage terminals and wharf, container handling and marine services such as ship piloting). Under the lease/rental agreement, KCT pays KPA an annual rental payment plus a variable payment based on throughput.

In 1986, KPA sold 51 percent of KCT shares to Konnas Terminal Kelang (KTK) for approximately \$140 million. Legal problems of transferring title to land and the wharves limited the sale to the port's equipment. KTK was a joint venture between Kontenas Nasional (a Malaysian transport company owned by three Malaysian government enterprises) and P&O Australia Ltd. (an Australian container management company).

All 801 public-sector container employees were absorbed by KCT, which guaranteed employment for at least five years and the level of accrued pension benefits earned under KPA. For KCT employees, privatization turned out to be a boon. By 1990, KCT terminal compensation rates were 83 percent higher than their public-sector counterparts at KPA. Behind this dramatic rise in labor wages was an equally impressive rise in labor productivity.

In terms of total return to fixed factors, the annual average compound rate was 1.9 percent from 1981–1986, but grew to 11.6 percent from 1986–1990. This coincides with the 75-percent growth in container traffic measured in total tonnage cleared. As shown in Figure 1, real unit costs under management control fell. Indeed, four years after divestiture, repair, maintenance, and administration costs (“Other intermediates”), were more than halved.<sup>13</sup>



World Bank discussions with KCT union officials identified seven factors to explain increased productivity: 1) more labor input into decisionmaking; 2) improved marketing; 3) new feeling of "belonging" resulting in less loitering and absenteeism; 4) incentive bonuses; 5) new technology; 6) work-force restructuring; and 7) work-force flexibility.<sup>14</sup>

As a result of this positive experience, the World Bank notes that, "unions at both KCT and KPA have become advocates of divestiture, urging privatization of KPA and advising a Thai port union to support sale of its own organization."<sup>15</sup> The World Bank study concludes that "the KCT model of divestiture is one to be emulated, deserving the attention of proponents and opponents alike."<sup>16</sup>

### C. Recent World Trends in Port Privatization<sup>17</sup>

Port privatization is emerging as an international trend, with a number of countries moving ahead with plans to privatize ports despite protests in some instances by unionized port workers.

But as the case of Malaysian port privatization indicates, properly structured, port privatization can benefit workers and encourage them to become privatization advocates.

Asia's leader in port privatization, **Malaysia**, in early 1992 sold the second phase of Kelang Container Terminal to management consortium Konnas Terminal Klang for \$361 million. The divestment was supported by the port workers of Kelang. In December 1992, KCT's shares were listed on the Kuala Lumpur Stock Exchange.<sup>18</sup>

The Malaysian port of Bintulu in Sarawak, which is expected to be corporatized in 1992, will be privatized next. In keeping with the Malaysian government's plans to have the private sector operate and manage the entire transport system (including ports and airports) by the year 2000, the government is targeting the ports of Penang, Johor, Kuantan (the Royal Malaysian naval dockyard in Lumut), and the Brook shipyard in Kuching to be privatized.

In 1989, **Thailand's** government signed contracts with CT International Lines for private management of its new ports at Phuket and Songhla and reached an agreement with striking Bangkok port workers that only the container-terminal portion will be contracted out and the government's Port Authority will operate the general cargo terminal. Elsewhere, the Port of **Singapore** Authority announced in 1991 that it will sell shares in its port.

Build-operate-transfer (BOT) methods are giving the private sector a large role in developing and operating new port capacity. For example, in the **Philippines**, the Port Authority announced plans in 1990 to use the BOT method for a proposed \$150-million expansion of the port at Batangas, south of Manila. Also, in 1991, **Hong Kong's** government has used BOT methods and private funding for the majority of a large-scale, 15-year port expansion beginning with the development of the \$500-million Container Terminal No. 8.

A Hong Kong affiliate of Japan's giant Kumagai Gumi firm was negotiating in 1991 to develop a \$1.2-million deep-water port on **China's Hainan Island**, under a 70-year lease. In 1992, the Hong Kong firm Hutchinson Whampoa purchased 50 percent of **Shanghai's** container port for HK\$1.4 billion and promised to double container capacity by 1995.

By 1992, port privatization had begun to move forward in **Mexico**, with government plans to auction concessions to manage some or all of the 21 ports under the jurisdiction of Puerto Mexicanos (which is to be liquidated). Veracruz, the country's largest port, took the first step towards privatization by franchising three private stevedoring services in May 1991. Privatization will involve both franchises for private firms to own and operate docks and warehouses and long-term leasing of terminals and other facilities.

**Argentina** planned to sell franchises to operate all of its ports in 1992. Foreign investors were being offered 25-year concessions on six terminals in the port of Buenos Aires, which ships 98 percent of the country's container cargo. In late 1992, Argentine company Isaura acquired 70 percent of Puerto Rosales' maritime terminal for \$90 million.

**Brazil's** progress in privatization has endured fierce protest by government port workers. But Brazil pressed on in 1991 and permitted private investment in its port of Rio Grande, and the government's privatization agency Banco Nacional de Desenvolvimento Economico e Social (BNDES) is pushing for new legislation to clear the way for concessions to run ports.

Since the **Venezuelan** government dissolved the Instituto Nacional de Puertos, and turned responsibility of the country's ports to state governments in 1991, the country has made significant progress in privatizing its ports. According to Miguel Bocardo, president of the Asociacion de Navieras, which represents 30 of the country's leading shipping agents, "privatization has been a real success," and has "produced a 50 percent to 60 percent increase in productivity."<sup>19</sup> Other Latin American countries including **Panama** are embarking on major port privatization programs.

In 1986, **Sweden** privatized the Port of Gothenburg. In 1989, the Ijmuiden Fishing Port Authority in the **Netherlands** was sold to a private company, with the province and municipal governments holding minority shares. And **Hungary's** government is considering private financing for the river port on the Danube near Győr.

In Australia, state governments are also inviting private-sector participation. The **New South Wales** government announced plans in 1989 to sell the Port Kembla Grain Terminal. In May 1992, **Western Australia** issued a list of capital works projects over the next three years, with ports being among the first. Premier Carmen Lawrence said that encouraging major private-sector investment in infrastructure was integral to the state's economic strategy. In **South Australia**, Shadow Minister for Privatization Julian Beale, reinforced calls for privatization and competition of the docks in 1991. An April 1992 report by the Melbourne-based Tasman Institute recommended that port competition in the state of **Victoria** be stimulated by selling real estate and cargo handling equipment in the state's port and all the barriers to entry for the provision of port services be removed.<sup>20</sup>

In **New Zealand**, after successfully corporatizing the country's ports under the Port Companies Act 1988 and implementing new waterfront employment arrangements, a number of the country's major ports are preparing for share offerings. In 1992, a 44-percent share in the Port of Tauranga was sold for \$18 million in a public offer by the Waikato Regional Council, the government shareholder.

Finally, in early 1993, the government of **Pakistan** advertised for invitations for concrete proposals for the development of a deep seaport at Gwadar. Development would be on a build- own-operate (BOO); or build-operate-transfer (BOT); or a mixed funding basis.

### **III. CASE STUDY: BRITISH PORT PRIVATIZATION**

In my view, the argument about state versus private industry in the U.K. is over. Private ownership has won. . . . The reason that political contest over privatization came to an end is simply that implementation succeeded. Facts overtook the debate. [John Moore, former Financial Secretary to the Treasury]<sup>21</sup>

In a share-offering on February 1983, the United Kingdom privatized 19 of the country's government-owned ports. The sale was part of the country's program of denationalization, which began in the early 1980s. Although overshadowed by the sales of large enterprises like British Telecom (\$6 billion, 1984) and British Gas (\$9 billion, 1986), the sale of 19 British government ports was nonetheless an economic success.

The sale of the 19 ports which formed the Associated British Ports, yielded the government £80 million in gross proceeds. Over 10 percent of the shares were taken up by over 90 percent of the work force, and the offer of shares to the general public was oversubscribed on a scale that rivaled that of the larger privatizations. More important, the transfer of a large group of ports from the public sector to the private sector exposed the ports to commercial incentives, increasing accountability and improving performance.

#### **A. Reasons for Privatization**

Three reasons stand out as being important in the British government's decision to privatize the country's ports. One, before 1980, most port services were controlled by public harbor boards and trusts that restricted competition and increased the cost of port services. Two, to remain competitive with European ports and other British cargo transport systems, ports had to be able to quickly adapt to market conditions and implement new technology such as containerization.

Lastly, under the control of public harbor boards or trusts, the business that ports could enter was restricted. This meant that not only could publicly controlled ports not diversify into more profitable commercial ventures but that the real-estate assets owned by the British ports could not be transferred to more economically valuable uses.<sup>22</sup>

#### **B. Background**

In 1983, Britain had about 70 port authorities of commercial significance. Associated British Ports (ABP) was by far the largest, accounting for about a quarter of total port revenue, while the ten largest authorities accounted for about 80 percent of the total.<sup>23</sup>

Only three of the larger ports—Felixstowe, Liverpool, and Manchester—were then in the private sector. Many port authorities, such as the Port of London Authority and the Dover Harbour Board, were (and still are) public trusts constituted by Act of Parliament and managed by self-governing bodies. Other ports were owned by local authorities. A number of ports were also operated by state-run undertakings, the principal one being Sealink (a wholly owned subsidiary of British Rail), which owned seven ports. Sealink has now also been privatized, and these ports come under the management of a private company called Sealink Stena Line.

Table 1 provides comparative financial information on the 19 ports, which prior to 1983 operated as publicly owned ports under the direction of the British Transport Docks Board (BTDB) and thereafter became the privately owned Associated British Ports. ABP today represents the bulk of the private-sector ports that primarily handle freight traffic.

Table 1

<b>UNITED KINGDOM</b>					
<b>Comparative Financial Information for BTDB and Associated British Ports</b>					
Year	Operating Revenue <sup>1</sup> (millions)	Operating Expenses (millions)	Operating Profit (millions)	Operating Ratio <sup>2</sup>	Operating Profit/Employee (Thousands)
1978	\$166.9	\$124.7	\$42.3	0.75	0.06
1979	\$211.9	\$168.8	\$43.2	0.80	0.07
1980	\$244.3	\$217.8	\$26.6	0.89	0.08
1981	\$225.5	\$221.5	\$4.1	0.98	0.10
1982	\$241.2	\$217.2	\$24.0	0.90	0.09
1983 <sup>3</sup>	\$221.1	\$200.2	\$21.0	0.91	0.10
1984	\$185.3	\$194.2	(\$8.9)	1.05	0.13
1985	\$165.9	\$144.3	\$21.6	0.87	0.13
1986	\$208.7	\$147.6	\$61.1	0.71	0.11
1987	\$231.7	\$186.3	\$45.4	0.80	0.14

**SOURCE:** Ouellet, Raynald, "Privatization in the Transportation Sector," *Economic Analysis Transport Canada*, December 1988.

<sup>1</sup> Monetary unit is U.S. dollars at end of year exchange rate.

<sup>2</sup> Operating Ratio is defined as Operating Expenses/Operating Revenue.

<sup>3</sup> In February 1983, British Transport Docks Board (BTDB) was privatized and became Associated British Ports by Act of Parliament.

When the first block of shares of ABP was sold in 1983, the estimated cumulative value of the assets of the 19 ports was over £148 million (\$296 million at 1983 exchange rates).<sup>24</sup>

### **C. The Process of ABP Privatization**

A key element of British port privatization was the reorganization of port assets and liabilities along commercial lines, which facilitated the valuation and sale process. Under the 1981 Transport Act, the British Transport Docks Board, which governed the British publicly owned ports, was restructured into a state-owned company named the Associated British Ports. By the end of 1982, the capital structure of the BTDB was reorganized with the Secretary of State for Transport holding of all share capital in ABP Holdings, the holding company controlling ABP. The United Kingdom government's strategy in selling the 19 government-owned ports as a group was to ensure investor interest and hence, greater likelihood of the sale's success.

In February 1983, 21 million ordinary shares (about 51.5 percent of the total shares of the company) were offered at a price of 112p (about \$2.25 at 1983 exchange rates). The offer was heavily oversubscribed, with 45,300 successful applicants. The government retained the remaining 48 percent of the total shares. In addition to the public offer on the stock market, 1 million shares were offered free to port workers. All of these were taken up despite instructions by the port workers union not to do so. After the sale, port workers owned 2.5 percent of their own business.

In April 1984, the government sold its remaining 48.5 percent share (19.4 million shares of common stock) in ABP. This second offer also contained further incentives for employees to invest. In total, the privatization of the ports raised about £80 million (\$150 million at 1984 exchange rates) for the Treasury.

Employee share ownership played a vital role in securing employee cooperation in privatizing the ports and increasing the incentive to raise worker productivity. This was basically accomplished by strengthening the link between employee performance and reward. By aligning the interest of employees with that of the company, employee ownership gives workers a direct stake in a company's performance, and hence encourages employees to work more productively.

Today, two-thirds of ABP employees own shares, with an average holding of nearly 1,000 shares each.<sup>25</sup> Shares have also been issued as "matching offers,"

where one free share is issued for each one purchased. If an employee had taken up all of these matching offers his or her holding would be as indicated in Table 2.

For employees owning shares of the new port company, the benefits were significant. For example, the market value of 2,436 shares, the maximum amount of shareholding per person, is around £10,000 (September 1991 prices). This is based on an initial outlay of just £1,456. Effectively, employees who participated in all aspects of the sell-off will have increased their initial outlay sixfold.

#### D. Trust Ports: Future Privatization Candidates

As mentioned earlier, the Trust Ports were essentially self-governing government-owned ports. While Trust Ports such as Dover and London are among United Kingdom's busiest ports, and are designed to be profit-making enterprises, the absence of accountability to shareholders weakens their incentive to operate cost-effectively. Thus, unlike ABP, which faces strong capital market incentives to perform, control costs, and increase value, the Trust Ports can be expected to perform less efficiently.<sup>26</sup>

The most important question facing many Trust Ports now is whether to take advantage of the government's 1991 decision to let them become private companies with shares in their own right. The Port of Ipswich has already shown an interest and seems set to follow the examples of Tees &

Table 2

<b>EMPLOYEE HOLDINGS</b>		
	Maximum Number of Free Shares	"Matching" Paid-For Shares
1983 initial offer	106	0
1983 matching offer	400	400
1984 matching offer	530	530
1986 matching offer	164	164
1987 matching offer	71	71
<b>TOTAL</b>	<b>1,271</b>	<b>1,165</b>
<b>GRAND TOTAL</b>	<b>2,436</b>	

\* All shares adjusted for 1986 script issue which occurred in May 1986 when a one for one shares were issued and effectively halved the share price.

**SOURCE:** *Mechanics of Privatization*, Adam Smith Institute, 1988, p. 31.

Hartlepool and Bristol, which both self-privatized (1989 and 1990, respectively) and have since become financially successful ports. Tees and Hartlepool (sold for \$275 million) have increased their tonnage handled by 35 percent since privatization and Bristol achieved an increase of 27 percent.<sup>27</sup> In 1992, the ports of Tilbury, Medway, and Clyde were sold as a group for \$135 million during 1992 to management and employees.

### **E. Abolition of The National Dock Labor Scheme**

The ability of the ports to run as profitably as possible after privatization was hampered by the National Dock Labor Scheme (NDLS). Under the NDLS, unions were given joint control over port operations. Without full control over port operations, owners of the newly privatized ports were severely limited in their ability to efficiently manage ports.

The post-war-initiated NDLS basically gave the registered dock workers of the Transport and General Workers' Union exclusive rights (monopoly control) of all dock work. By restricting competition for dock work, the Scheme led to inefficient labor practices, chronic overmanning, and generally higher cost of operating the ports. One report estimated that the Dock Labor Scheme cost the United Kingdom economy more than \$800 million over its 42 year existence.<sup>28</sup>

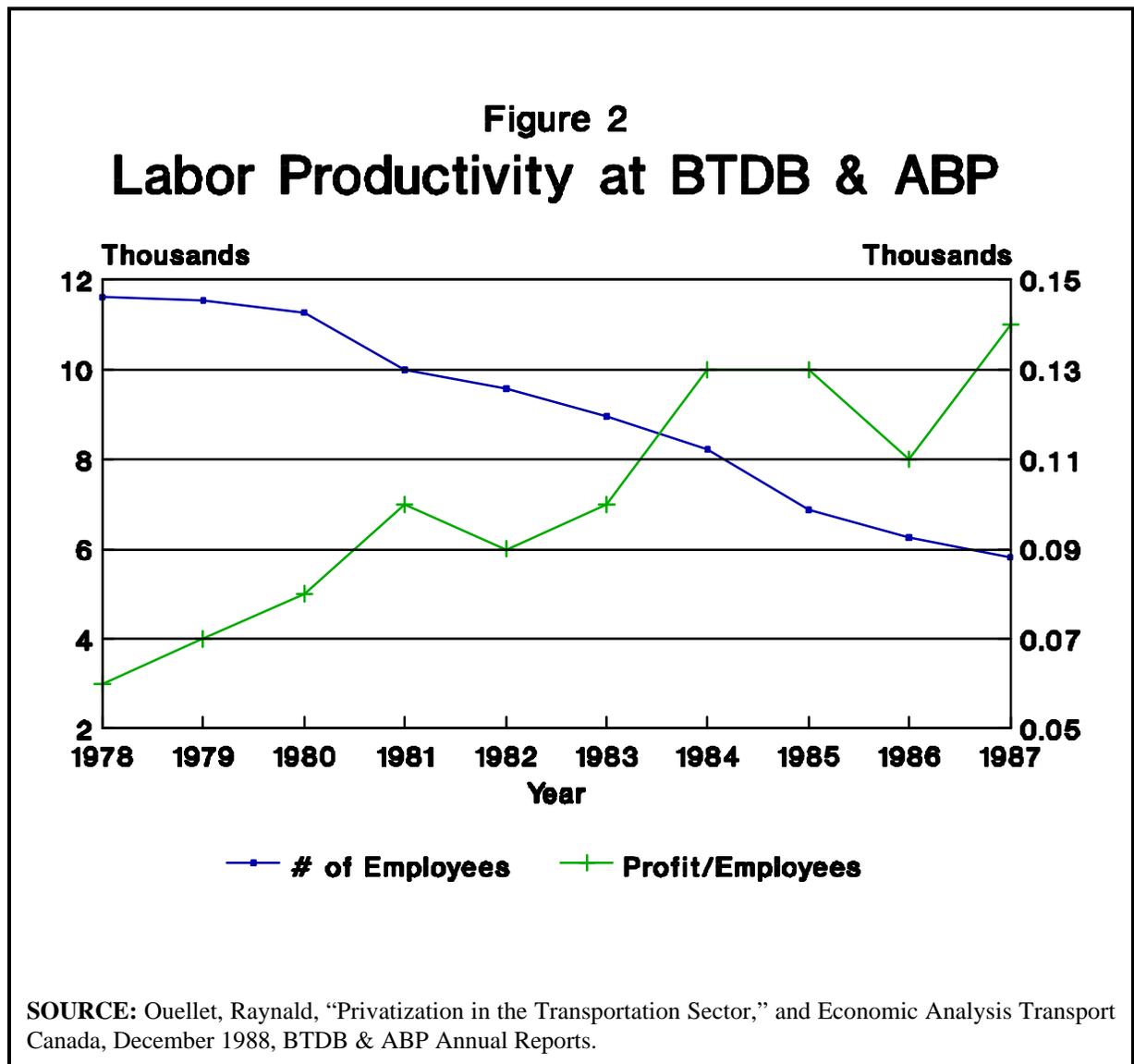
In 1988, the National Association of Port Employers requested that the government abolish the NDLS. While threatened by a national strike called by the Transport and General Workers' Union, the British government on August 1989 passed the necessary legislation to abolish the NDLS. The national strike never materialized but the union's monopoly control of Britain's waterfront workers was ended.

As a result of gaining more freedom to manage ports, the ABP was able to better utilize dock workers, streamlining the labor force by about 65 percent, and increasing port productivity. One measure of the magnitude of the productivity gain achieved by abolishing the NDLS is indicated by improved profitability with fewer workers: in 1981, the ABP made a profit £1 million with 9,300 workers, in 1990, the ABP's profit was £60.2 million with only 3,633 workers.<sup>29</sup>

At least for the privatized ports which instituted employee share ownership programs, the confrontational relationship between labor and management, which was fostered by the NDLS, was replaced by one which rewarded cooperation and the adoption of efficiency-enhancing employment practices.

### **F. Conclusion: Was Privatization a Success?**

Privatization of the Associated British Ports had three beneficial economic impacts. As discussed above, through employee share ownership, privatization led to a more cooperative and productive work place. Figure 2 shows that ABP was able to achieve rising labor productivity (higher operating profit/employee) through the steady downsizing of the labor force. Over the same period (1978-1987), cargo tonnage handled at the 19 ports rose from 78-million metric tons to 90-million metric tons.



Second, privatization eliminated the restrictions on diversification imposed by the 1962 Transport Act and hence provided opportunities for profitable investment outside core port functions. Third, by accessing private capital markets and facilitating the disposal of assets, privatization made more resources available for capital investment.

The rise of ABP's share price and market capitalization provides a clear indication that the overall impact of privatization was positive. From the company's original offer price of 112p in 1983, the shares reached 386p by February 1993. In terms of the market value of the shares, market

capitalization went from £44.5 million in 1983, to over £720 million 10 years later—an over 16-fold increase in value.<sup>30</sup>

This strong performance came despite the 12-month miners' strike in 1984, which severely hurt the ports that relied heavily on the shipment of coal. The effect of the strike on profitability was drastic. In 1982, ABP's profit was £5 million. After privatization this leapt to £15 million in 1983. However, due in part to the effect of the strike, profits in 1984 fell to only £2 million.<sup>31</sup>

An increase in capital investment was essential to the continuing success of ABP. In 1990, the current assets of the company stood at £272.7 million, more than double that at the time of privatization. This surge came from a number of places. By far the two largest sectors were investment in the ports themselves and property development.

The ports have all been upgraded. In 1991, ABP reopened the old 190-acre Alexandra Dock at Hull, which represented the single greatest expansion of port capacity in four years. Future expansions at Immingham, Kings Lynn, and Port Talbot are now also expected because of the 1990 Associated British Ports Act, which broadens ABP's ability to participate in development. At Southampton, new plans for waterside development have been announced that would involve the building of a new pier and the reclamation of land to construct a marina.

Port asset diversification through property development has been extensive. In the 1970s the Port of Southampton was used for the sole purpose of two daily car-ferry journeys to Normandy. Today private development firms have transformed some of the port's real estate into a thriving marina, shopping malls, and new residential areas. At Hull, St. Andrew's Quay has been developed into a retail warehouse and leisure park with plans to include residential housing and a hotel. Further expansion in retail schemes have occurred at Torquay, Colchester, and Central London. The aggregate level of investment since privatization is £205 million.<sup>32</sup> This compares with a figure of less than £60 million in the ten years preceding privatization.<sup>33</sup>

As indicated in Table 3, the performance of the ABP since privatization has been positive, with profits doubling in the period and being matched by a similar increase in earnings per share and the dividend value.

In sum, privatization of the ABP has not only resulted in more profitable and efficiently operated ports, but by enabling port assets and property to be better utilized, privatization has helped revitalize the local and regional economies surrounding ports.

Table 3

<b>POST-PRIVATIZATION PERFORMANCE OF ABP (£ Millions)</b>					
	1986	1987	1988	1989	1990
Turnover	157.1	196.7	211.8	213.0	211.3
Profit Before Tax*	26.0	38.1	46.5	57.2	60.2
Severance	(3.7)	(6.0)	(5.0)	(5.1)	(2.2)
Earnings/Share	11.2p	14.8p	18.1p	22.0p	22.5p
Dividends	3.0p	3.8p	5.0p	6.3p	7.3p

\* After deducting voluntary severance.

**SOURCE:** *ABP Holdings Plc Annual Report 1990*, p. 5.

#### **IV. CONCLUSIONS: LESSONS FOR THE UNITED STATES**

During the past few years an increasing number of countries have restructured their shipping ports into commercial companies and begun to transfer operation and ownership responsibilities to the private sector. The critical role of ports in facilitating trade and economic development means governments must ensure that ports are managed efficiently.

A growing body of theoretical and empirical evidence supports this trend. Studies by the World Bank and others indicate that private firms have stronger incentives to manage resources efficiently than public enterprises because they are exposed to competition in the product and capital markets, can go bankrupt, and are less vulnerable to political interference.

As shown by the detailed study of the partial divestment of the Port of Kelang in Malaysia, port privatization can benefit governments, buyers, as well as government port workers. By improving incentives and increasing autonomy, divestment encourages the adoption of better labor management practices and technology, enabling workers to be more productive and, in return, earn higher compensation.

The United Kingdom's experience selling the 19 ports that made up the Associated British Ports also provides insight into how, in addition to achieving more competitive and efficient ports, privatization can directly benefit workers and surrounding local economies. By giving workers a direct stake in a

port's performance, employee share ownership as initiated by the British government secured worker cooperation and raised productivity. And port diversification, especially through property development, was successful in reallocating port property to more efficient use, thereby stimulating local economies.

For U.S. ports considering privatization, the above lessons and experience are important especially given that the poor fiscal condition of state and local governments means that they will increasingly be in less of a position to contribute to funding port investment. Indeed, if the California legislature's 1992 action to allow cities to draw on the profits of their ports is any indication, ports in other states are likely to come under increasing pressure to transfer surplus funds to cities. By threatening port investment, this trend could have serious negative consequences for the future competitiveness of the U.S. port industry.

Thus, port privatization provides a credible means for U.S. ports to gain both political and financial autonomy, while at the same time providing the necessary incentives for improved port performance. State and local governments could also significantly benefit from privatizing their ports. According to an earlier study by the Reason Foundation, the 45 major shipping ports in the United States that handle 10 million tons or more of freight per year are together likely to be worth around \$11.4 billion.<sup>34</sup>

By transforming physical capital into financial capital, cash-strapped cities could gain significant financial flexibility and improved port operations. Sale proceeds could be invested and earnings designated to address critical needs for education, police, and fire protection, and to pay down bonded debt (reducing interest expense and restoring borrowing capacity for future municipal projects). Free from government interference and financially self-sufficient, new private port owners would face powerful incentives to manage port resources efficiently.

## **ABOUT THE AUTHORS**

David Haarmeyer holds an M.A. in economics from Clemson University and is a Reason Foundation Senior Policy Analyst. He is managing the Foundation's project on utilities and water policy and covers port privatization in the *Privatization Watch*, the Foundation's monthly newsletter. Peter Yorke is a research assistant at the London-based Adam Smith Institute.

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## ENDNOTES AND REFERENCES

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14. Leroy Jones and Fadil Azim Abbas, “Welfare Consequences of Selling Public Enterprises: Case Studies from Chile, Malaysia, Mexico, and the U.K.” World Bank Country Economics Department, May 15, 1992, p. 20.
15. *Ibid*, p. 31.
16. *Ibid*, p. 32.
17. Information for this section was taken primarily from recent issues of the London-based newsletter *Privatisation International*.
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22. Diversification was restricted in two ways. The Treasury imposed controls on spending and borrowing and an act of legislation prevented public ports from using their land for other purposes. The 1962 Transport Act, passed by a Conservative government, set down two firm rules for the port industry. They were that the industry could only use its assets to handle passengers and cargo and that it could employ people for these activities.
23. *1983 Prospectus for the Privatization of Associated British Ports*, p. 6.
24. Associated British Ports are made up of the following ports; Ayr, Barrow, Barry, Cardiff, Colchester, Fleetwood, Garston, Goole, Grimsby, Hull, Immingham, King's Lynn, Lowestoft, Newport, Plymouth, Port Talbot, Silloth, Southampton, Swansea, Teignmouth, and Whitby have all been added since the original privatization.
25. *Mechanics of Privatization*, Adam Smith Institute, 1988, p. 30.
26. By creating financially stronger ports, privatization has worked to put competitive pressure on the Trust Ports and thus encourage them to raise their performance through increased capital investment and imposition of structural changes.
27. Figures are for 1991 and were obtained by Peter Yorke from United Kingdom Department of Transport.
28. *Structural Changes in Ports and the Competitiveness of Latin American and Caribbean Foreign Trade*, United Nations, Economic Commission for Latin America and the Caribbean, Santiago, Chile, 1990, p. 10.
29. *1983 Prospectus for the Associated British Ports*, and the *1990 Annual Report of the Associated British Ports*.
30. Sir Keith Stuart, Chairman of Associated British Ports, "Making the Ports Private," in *The Mechanics of Privatization*, edited by Eamonn Butler, Adam Smith Institute, 1988, p. 45, and *Financial Times* (London), February 2, 1993.
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required. This led to a number of new projects such as ABP's £5 million roll-on, roll-off ferry service introduced at Hull.

32. *Annual Report of Associated British Ports*, 1990.
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