



## **FROM EXPANSION TO EVOLUTION: THE PANAMA LOGISTICS HUB IN THE NEW PANAMAX ERA**

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“National prosperity is created, not inherited.... A nation’s competitiveness depends on the capacity of its industry to innovate and upgrade.”

*Michael Porter*

On June 26, 2016, the first transit through the Third Set of Locks of the Panama Canal is scheduled. On one hand, this moment represents the culmination of a process that started over a decade ago when the Panama Canal Authority led an exhaustive evaluation of the Canal expansion alternatives, and almost ten years after the Panamanian people backed the Project through a national referendum on October 22, 2006.

On the other hand, that moment marks the beginning of a new era for our nation as a logistics hub. A beginning on which other countries have put their bets on, making extensive investments in their infrastructures and strengthening the commercial ties to their strategic partners, aiming to take advantage of the positive dynamics that are expected to be generated by the expansion.

Panama has always been a country at the service of the world. It says so in our coat of arms, and it’s embedded in our culture. This service calling has resulted in a focus of our economy, which has benefitted from the exponential growth of world trade, and has allowed us to create an enviable logistics service platform.

However, our current position in the global logistics map is not guaranteed, nor does it capture the true potential our country has as a world-class trade hub. It’s up to us, as a nation, to push forward our economy by properly taking advantage of the freight flows converging in the country after the expansion, strengthening and diversifying the service portfolio –including services to ships and cargo— offered in the area surrounding the Canal.

### **Impact of the expansion**

The fluctuations in fuel prices, technological advances, market scale (which has recently been in contraction, resulting in overcapacity), port capacity investments, and shipping line alliances all affect the global structure of maritime routes. However, the capability of transit for vessels up to 13,000 teu in capacity between the Atlantic and Pacific oceans relaxes one of the most critical constraints in the trade system, which was the inability to take advantage of the economies of scale that for the last decade had driven the building of larger vessels.

With this ability of passage, the ports on the East Coast of the United States –and, by extension, some ports in the Caribbean— gain competitiveness to cover certain parts of the North American markets, which represent one of the main consumption zones for goods transiting the Canal. Figure 1 depicts the boundary of the catchment areas of the different east and west coast U.S. ports, where the areas defined by the lines represent the zones in which that port represents the best point of entry based on total transportations costs, including sea and land segments.

As can be seen, even without considering other market and operational factors that could affect the reconfiguration of freight services and flows, the Canal expansion represents an increase of the catchment areas for some east coast ports. This situation occurs in other markets, where the expedited pass through the Isthmus expands other trade frontiers, as is the case of natural gas from the Gulf of Mexico, crude from Trinidad and Tobago, or agricultural exports from Costa Rica.

### **From point of transit to service platform**

Beyond the market potential created by the transit of large vessels, the true sustainability of the maritime-logistics cluster centered on the Canal is in it's capability of evolving, assuming a position of leadership in the services it offers to clients.

Although Panama has –to a certain extent— taken advantage of the transit of good through the Isthmus, we haven't used this privileged position fully to develop other sectors within the country. It's impressive what nearby countries have achieved in recent years, and how they have responded to the expansion with optimism and –perhaps more importantly— with investment that seeks to exploit the business the enhanced waterway will create.

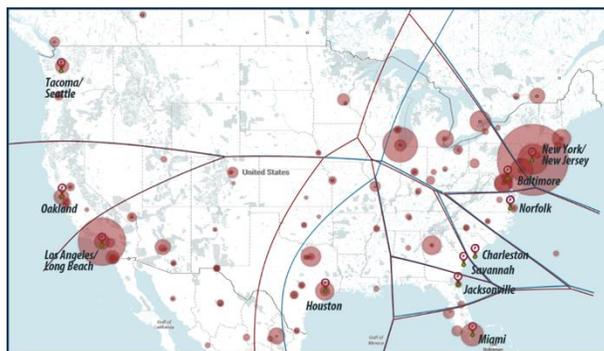


Figure 1: Coverage boundaries and catchment areas for the main U.S. ports. The current boundaries are in blue, with red marking the estimated boundaries considering the change in costs caused by the Canal expansion. Image developed by J. Bartholdi and A. Ramudhin, “The Panama Canal and the Race Among US East Coast Versus West Coast Ports”, [www.gatech.pa](http://www.gatech.pa), August 2014. It’s worth mentioning that this analysis predates the publication of the new Canal toll structure, which would influence the location of the boundaries.

Without adequate cohesion between the elements composing the Panama Canal maritime-logistics cluster, and without an aggressive strategy for modernizing and diversifying the services offered to cargo transiting the Isthmus, we won’t generate the reinforcing loop that should be associated to a growing cluster.

### **Evolution towards value-added logistics services: A great business opportunity**

The first objective of the National Logistics Plan (PNLOG) is the development of the value-added logistics services hub. These services can progressively grow from managing inventory for retailers in centralized warehouses for regional distribution (such as for Amazon), to consolidation and deconsolidation operations, to customized packing and product information for destination markets, to the finishing of products to comply with local specifications in destination countries.<sup>1</sup>

The companies offering such logistics services require of significant space to develop, and the freeing of 12 km<sup>2</sup> on the western bank of the Canal due to expansion activities constitutes a great opportunity for such businesses.

For this opportunity to really take off, a strategic decision and commitment is required from the National Government to make the proper investments in infrastructure (roads, energy, water, communications, etc.) within a master plan for land use.<sup>2</sup> Secondly, parallel to investments, a systematic effort is required to attract world-class firms to come to Panama and locate operations in this new area of development, providing added legitimacy to the cluster. Finally, the government must assure a series of additional conditions beyond infrastructure that help make the location decision more attractive.

### **Consolidation of the cluster: The role of government**

Government is key in the development of logistics clusters. Fundamentally, a company makes the choice of locating in a country/cluster based on the impact that decision has on its global supply chain costs. This cost is affected by the speed and reliability of operations within the country, and the cost of doing business there.

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<sup>1</sup> Light manufacturing benefits from the numerous advantages the logistics cluster offers to companies located within. The location of 3M in Panama Pacifico is a case of reference.

<sup>2</sup> ACP has opened a bidding process for a Master Plan for the Interoceanic Zone of the Panama Canal.

Government policies affect these variables through its handling of physical infrastructure (roads, logistic nodes), the services offered (customs processes, permit and certification emission, etc.) and the regulations concerning market competition and environmental protection.

Additionally, the consolidation of the cluster will require qualified human resources at all levels (vocational, technical and professional), as well as high-level researchers that contribute to the generation and transfer of knowledge which can help companies within the cluster become more productive.

Finally, there is a need for direct (e.g., fiscal benefits) and indirect (e.g., labor mobility) incentives linked to investment and high-value job creation by companies. These incentives impact operational costs but, because of their easy replicability by competing countries, they have less strategic value than the quality of available infrastructure, government policies, and the availability of competent human capital.

It's fundamental that the National Government has an effective understanding of its central role in the development and consolidation of the logistics cluster, and in making the most out of one of the most promising opportunities arising for our country from this new era led by the Panama Canal expansion.