אוניברסיטת חיפה
University of Haifa
جامعة حيفا

HMS
מרכז חיפה למחקרי מדיניות ואסטרטגיה ימית
Haifa Research Center for Maritime Policy & Strategy

MARITIME STRATEGIC EVALUATION FOR ISRAEL 2016

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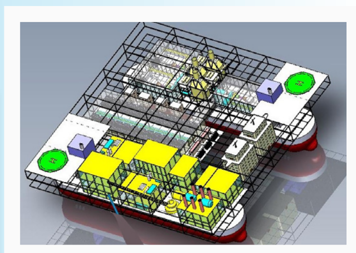

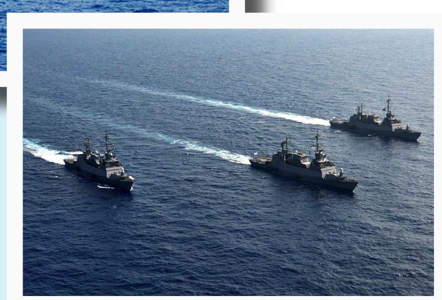

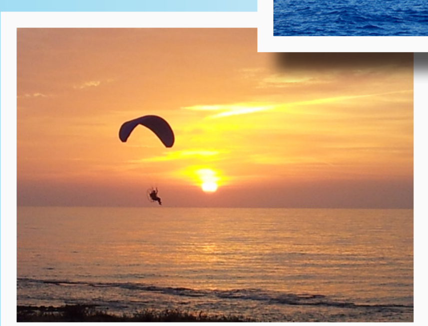

Chapter 10: Shipping and Ports

Aryeh Rona

The shipping infrastructure in Israel is composed of the ports, the shipping companies and the ships, both Israeli and foreign, that visit Israel’s ports. The ports are an important link in the logistic chain that Israel is a part of, with about 98 percent of Israel's trade (by volume) being carried by sea.

In recent years, emphasis has been on the development of the ports. The development of the *Hamifratz* port in Haifa and the *Hadarom* port in Ashdod began already in 2015 and by 2021 these ports will have the capacity to handle container ships that are larger by tens of percent of the ships handle today, which will make transshipment possible on a large scale in Israel's ports.[1] In parallel to the development of the ports, there is a significant downward trend in the number of ships under Israeli ownership or controlled by Israeli companies, as well as a reduction in the number of Israeli seamen.

Regional maritime trade in recent years

About half of global trade, and primarily trade between Asia and Europe, passes through the Suez Canal. The location of Israel near the northern end of the Canal, along with the fact that Israel is characterized by the rule of law and political stability (especially relative to the upheavals in the region since 2011), create the potential for Israel's ports to become significant centers for transshipment in the Eastern Mediterranean. This can serve to link the Israeli economy—which is dependent on foreign trade—to the global trade chain, to reduce the price of sea transport for Israeli importers and exporters and to expand the industries that provide services to the shipping industry.

Currently, Israel is in the process of developing two ports—*Hadarom* and *Hamifratz*—in order to increase the capacity to absorb large container ships of up to 18,000 TEU.[2] Starting from 2021, the expansion of the two ports will solve the problems being experienced in the Haifa and Ashdod ports, which are not properly equipped to deal with transshipment and loading due to the growing dimensions of

1 The unloading of cargo from one ship to another in order for it to be transported to its destination.

2 A 20-foot container. This size serves as a measure of volume of containers and container ships. TEU=twenty foot equivalent unit.

ships currently sailing from Asia to Europe.[3] The inability to handle transshipment also exists in other Middle East ports.

Starting from 2011, the Middle East has suffered from a lack of political stability. This has led to terrorist activity that affects maritime trade and investment in the development of new port infrastructure, as well as creating an atmosphere that hampers the international cooperation needed for modern shipping. According to Yigal Maor, the Managing director of the Shipping Ports Authority, the threat of a boycott still hangs over Israel[4] and the efforts of the BDS movements against Israel (such as boycotting ZIM ships in the US) have also impeded cooperation in the region.[5] Nonetheless, it is worth mentioning that this has involved only isolated incidents so far.

The attacking of ships in the Suez Canal and tankers in the Straits of Hormuz has also harmed the stability of shipping in the Middle East.

These events increase the rate of shipping insurance. In this context, it is worth mentioning the events of the Second Israel -Lebanese War (2006), during which the prices of insurance soared to the point that the State had to provide alternative insurance (by means of the Inbal government insurance company) and a special arrangement was reached with Lloyds through an official Israeli delegation, with the goal of reducing the insurance costs of ships calling at Israeli ports.

Egypt, under the leadership of President el-Sisi, is completing the development of a huge infrastructure project in the Suez Canal area (called the SCZ project) with the goal of significantly expanding the canal and Egypt's revenues from it. This includes, among other things, the construction of an industrial zone along the canal.[6]

According to Egyptian sources, the Suez Canal project will create about one million additional jobs in Egypt. The project will also have economic advantages for Israel.[7]

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3 Froilanger Dov, Vice President for Development in the Israel Ports Company; interview on July 3, 2016. The "planning" ship for the ports being constructed is 18,000 TEU.

4 Maor Yigal, "Implications of the political events in the Middle East and the Red Sea on Israel", *Strategic Assessment*, Volume 18, Issue 2, July 2015, pp. 41–51.

5 Ibid., p. 43.

6 Ibid., pp. 46-47.

7 Maor Yigal, CEO of the Shipping and Ports Authority in the Ministry of Transport, in an interview on June 29, 2016.

Global trends in shipping that affect Israel

Up until the beginning of the 2000s, the shipping industry was subject to cyclical fluctuations. In 2007, there was a sharp increase in the demand for new ships. The orders of new shipping capacity reached 67 percent of the existing global shipping capacity, while global trade grew by only about 5 percent annually. In 2008, with the onset of the global financial crisis, a downtrend appeared in global trade.

In the same year, the shipping conferences in Europe were canceled, which led to a drop in shipping costs.[8] The low shipping prices have continued until today, as has the low level of new container ship construction. This is in spite of the fact that in previous downturns the shipping companies have taken advantage of the lower costs of construction to equip themselves with new ships.[9]

The implication of these trends is that maritime shipping prices have remained low during the past decade despite the aforementioned cyclical influences.

In order to minimize economic losses, the shipping companies have taken a number of steps: limiting the speed of voyages in order to save fuel (in addition to introducing improvements in ships' engines in order to save fuel and prevent polluting emissions) and the addition of smaller vessels in order to maintain weekly services (i.e. a schedule in which a ship visits a port once a week, on a fixed day, in order to create reliability in container service).[10]

Tonnage tax as an incentive for shipping

There is strategic importance to having a merchant fleet flying under the Israeli flag. The Israeli economy is dependent on foreign trade (imports and exports). Due to Israel's geopolitical position and its lack of access to land trade routes, 98 percent of Israel's trade is carried by sea.

In the global shipping industry, the norm has developed of registering ships under flags of convenience, which is manifested in the "flight" of merchant fleets to countries with the most convenient tax and regulatory environments. As a

8 Shipping conference – an arrangement between a number of shipping companies in order to set shipping prices. It was cancelled by the EU and also by Israel. A number of Israeli shipping companies were members of the European conferences. In Israel, the conferences were cancelled in 2012.

9 A ship with a capacity of 12,000 TEU could be built for a cost of about $172 million, while a year into the downturn the price had dropped to only $105 million.

10 Zeva Yoram, President of the Israeli Chamber of Shipping, interview on July 4, 2016.

solution to the flags of convenience problem and the manning of ships by foreign crews, Europe has developed an incentive in the form of a tonnage tax which is imposed on the capacity of vessels owned by each company (a lower rate of tax that encourages an increase in tonnage), instead of a corporate income tax at a higher rate (about 26 percent in Israel). This tax regime, which is to the benefit of shipping companies, is accompanied by a commitment on the part of ship owners to maintain partially national crews (in our case, Israeli crews) and to participate in the cost of training lower-level officers.[11]

Many countries have adopted a tonnage tax in order to preserve their national fleet. In Israel, the proposed legislation is in the process of being passed. In 2016, a memorandum of the law was published for comments by the public and the law will likely go into effect at the beginning of the 2017 fiscal year.

The Israeli merchant fleet

The shipping industry is one of the most globalized industries in the world since it necessarily requires a connection between a shipping company's country of registration, the ships' country of registration (the ship's flag) and the country receiving the service. This is one of the reasons, as mentioned, for the flight of ships to registration under flags of convenience in order to reduce taxes and regulation. Therefore, when analyzing the Israeli merchant fleet, one needs to distinguish between a vessel under the Israeli flag (according to the Law of Shipping (shipping vessels), 5720 – 1960) and a ship under a foreign flag but under Israeli control (according to the Law of Shipping (all foreign vessels under the control of an Israeli entity), 5765 – 2005).

At the beginning of 2016, there were 36 ships under Israeli ownership or control, with a deadweight tonnage (DWT) of 2,127,012 tons, of which 10 ships, or 18 percent of the fleet, flew an Israeli flag.[12]

ZIM Shipping Services: Includes 8 ships with DWT of 434,000 tons which are owned or controlled by ZIM, all of which are container ships. Of these, three fly the flag of Israel. The company also operates ships under lease for various short-term periods.

11 As of February 22, 2016, the Israeli merchant fleet numbered 36 ships with deadweight tonnage of 2,127,012 tons. In 2011, the fleet numbered 56 ships with deadweight tonnage of 3,265,581 tons. According to the report of the Shipping and Ports Authority dated January, 2011 and also the Statistical Yearbook of Israeli Ports 2015, p. 95. On government assistance to shipping, see the section on maritime manpower.

12 Statistical Yearbook, Shipping and Ports 2015, the Shipping and Ports Authority, pp. 95-96.

XT Maritime Ltd.: The company has 13 ships with DWT of 1.235 million tons, of which 9 are container ships, three are coal bulk carriers, and one is a tanker. Two ships fly the flag of Israel.

Other companies: Six general cargo ships, two bulk carriers and one coal carrier. Overall tonnage of 457,000 tons. Five ships fly the flag of Israel.

The share of ZIM, which was in the past the dominant carrier of the Israeli merchant fleet, has fallen from 36.4 percent to 20.4 percent, while other companies have increased the number of ships they maintain. It should be mentioned that relative to 2011 the Israeli merchant fleet has shrunk significantly.

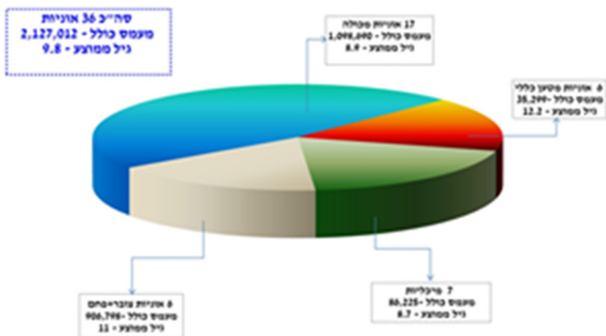

Figure 10.1 Ships in the Israeli merchant fleet by type, DWT and age – February 22, 2016[13]

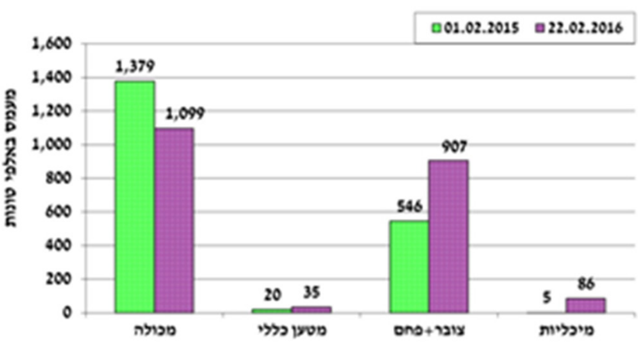

Figure 10.2 Total tonnage of the Israeli merchant fleet – comparison to previous year

13 Statistical Yearbook, Shipping and Ports 2015, p. 95.

Manning the merchant fleet

The reasons that led Israeli shipping companies to switch to flags of convenience include the reduction of ships' operating costs and the high salary costs of Israeli officers and seamen relative to those recruited from the Third World.

The government of Israel has subsidized the shipping industry in order to maintain the existence of an Israeli merchant fleet, including ships and seamen. This was accomplished in a number of government decisions[14] that imposed an obligatory minimal Israeli crew (officers only) and provided subsidization and financial support and tax exemptions; however, these measures were not sufficient to prevent the decline in the number of ships flying the Israeli flag or that are under Israeli control.

As of 2016, the Israeli merchant fleet had 630 seamen, of which 207 were Israelis. There included 255 active officers, of which 166 were Israeli; all of the cadets are Israeli. There are 355 ratings, only one of which is Israeli.[15]

The coastal shipping industry (gas drilling services) is growing and there is a trend taking shape of the entry of Israelis into the industry. In the future, the Ministry of Transport will need to establish regulations and criteria for the employment of foreigners in this industry.

There are a small number of cadets in the merchant fleet (about 40) and the small number of ships under the Israeli flag hinders the recruitment of new cadets and the opening of courses at the School for Training of Maritime Officers in the city of Acco. As the number of ships that are required—according to the shipping regulations— to have Israeli officers declines, it will become more difficult to recruit and train cadets, who constitute Israel's future maritime reserve of manpower.

The shortage of maritime manpower also has implications for the operation of the ports in Israel and for the supervision by the Israeli government (i.e. regulation) of the shipping industry. In order to operate the ports, there is a need for

14 Government Decision 1178 from 1996 reduced the minimal number of Israeli crew members to 10 officers and ratings (out of 20 crew members). Government assistance totaled NIS 35 million over two years. In 1999, Government Decision 4797 provided the shipping companies with NIS 20 million for a period of 4 years. In parallel, the obligation to man a ship with Israelis was restricted to only officers and Israeli ratings were gradually removed from the equation. Government Decision 1107 from 2013 promised additional assistance until 2016, changed the tax regulations and raised the rate of depreciation on ships up to 20 percent.

15 Statistical Yearbook, Shipping and Ports 2015, pp. 97-99.

experienced maritime officers to fill jobs such as pilots and controllers and they must be recruited from within the maritime manpower employed in shipping.

Activity in Israel's ports

There are five ports in Israel, three of which are commercial (Haifa, Ashdod and Eilat) and two of which are energy ports (Hadera and Ashkelon–Trans-Israel Pipeline). In 2015, 5,893 ships visited the ports of Israel (apart from coal and fuel carriers). This is somewhat less than during the period 2011–14. Most of the ships were container ships.

Most of the cargo arriving and leaving Israel is carried by sea. This amounted to about 70 million tons during the past year, of which 27 million was fuel and coal (most of which passed through the two energy ports of Hadera and Ashkelon).

In February 2005, the government carried out a reform of the ports. The Ports Authority was dismantled and instead three companies were established in its place: the Port of Eilat, the Port of Haifa and the Port of Ashdod, as well as one asset-holding company (the Israel Ports Company). The government remained the regulator of the ports by means of the Ministry of Transportation (the Shipping and Ports Authority). Meanwhile, the port of Eilat was privatized, and so was Israel Shipyards, which are active as private companies in Israel's ports.

In 2010, a reform of port fees went into effect, with the goal of simplifying the fee system and thus encouraging competition between the port companies and the signing of commercial agreements with the shipping companies in order to create a continuum of operations.

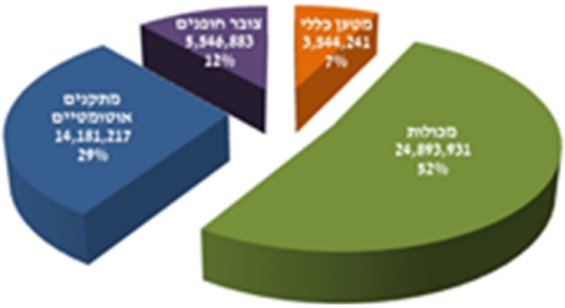

Figure 10.3 Breakdown of cargo moved through Israel's ports – 2015[16]

16 Ibid., p. 14.

Development of the ports

The development of the *Hamifratz* port in Haifa and the *Hadarom* port in Ashdod will make it possible to accommodate ships with a capacity of 18,000 TEU. The ports are being built on the landlord model, according to which the State is the owner of the port (the land) and builds the port, while a concessionaire that is chosen by tender operates it.

The two ports will be operated by two international operating companies who are signed on 25-year contracts. Each of the ports will be able to handle about one million TEU's annually.

It is planned that the *Hamifratz* port will accept its first ship in 2021. In the first stage, it will have 800 meters of piers for container ships. The cost of building the port is about NIS 35 billion. The operator of the port is the Shanghai International Port Group. As mentioned, the port will be able to handle ships with a draft of 17.3 meters.

The *Hadarom* port, which will also accept its first ship in 2021, will be operated by TIL, a subsidiary of MSC, which operates 30 ports worldwide.

These ports will have the capability of transshipment, which is a guarantee that large ships will visit and that trade services will be provided. Transshipment can also help to create subsidiary industries. Without transshipment, a situation may arise in which only small and medium-size ships will visit Israel's ports. Such a phenomenon will lengthen shipping times and will increase costs to the economy due to the dependency on transshipment ports close to Israel.

Conclusion and recommendations

In view of its political situation, Israel must take responsibility for maintaining a minimal merchant fleet, which means maintaining the ships and maritime manpower that currently exist.

The golden share, which was part on the privatization of the ZIM company, was intended to some extent to maintain this situation. However, in our view, it does not provide a sufficient solution to the decline that is occurring in the size of the Israeli merchant fleet and its manpower.

In this situation, Israel is liable to become dependent on foreign shipping even for its most essential needs.

It should be remembered that foreign shipping companies as a rule raise their prices during times of emergency and this is felt in the insurance premiums in our region, which has been declared a war zone.

The operation of the existing and future ports (which will be inaugurated in 2021) require trained maritime manpower, including pilots and other professionals. They naturally are recruited from among the officers of the merchant fleet. The declining number of ships and the difficulty in training cadets is liable to create a shortage of trained maritime manpower in the ports in the future.

The development of coastal shipping connected to gas exploration and drilling constitutes an opportunity to train Israeli manpower for this developing industry.[17] Nonetheless, it should be remembered that this is a limited alternative that cannot serve as a substitute for the training of maritime manpower for the merchant fleet.

The institution of the tonnage tax regime is likely to encourage shipping companies to increase their activity and the fleet they operate. This measure has not yet been implemented in Israel, but even if it is there is no guarantee that it will lead to an increase in the merchant fleet. Nonetheless, it should be mentioned that the tonnage tax instituted in other maritime countries has indeed led to an increase in the merchant fleet and has significantly encouraged the development of maritime manpower.

The reform in port fees also led to increased competition between the ports. This policy will allow the ports to sign independent agreements with the shipping companies and create a situation in which a ship visits on a fixed day in the week.

The development of the ports and the exploitation of existing infrastructure is already encouraging competition over transshipment cargo, which currently accounts for 12 percent of container cargo (most of it in the Haifa port).

17 The issue of splitting ZIM into two companies, one Israeli and one foreign, was discussed already in 2003. According to the opinion of the Ministry of Justice, it should be ensured that the company will remain a "going concern", in order that the core fleet, i.e. the number of essential ships, will be effective. This was also reflected in the "Ministers' Letter" which was published a day after the opinion, on October 27, 2003, and which stated that in the event that the company is split, the core fleet should be increased to 18 ships. The letter made clear statements as to maritime training and ZIM was required, in the event of a split, to maintain ZIM Israel as a going concern. In addition, the Ports Authority released a position paper on September 16, 2003 which stated that "…the goal is to maintain an infrastructure of Israeli maritime manpower, ships and seaman, as a strategic asset and without Israeli owned or controlled ships, it is doubtful that this can be done."

The infrastructure under construction will require the *Hadarom* port and the *Hamifratz* port to compete for transshipment cargo with the ports in the Eastern Mediterranean.

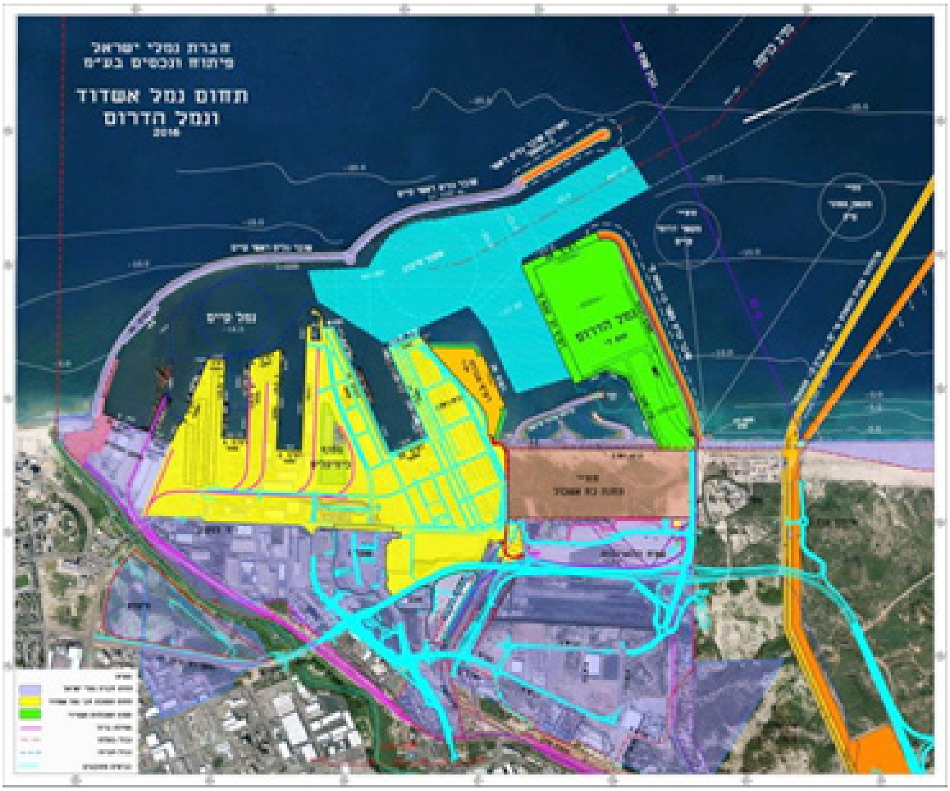

Figure 10.4 Map of the port of Haifa

Figure 10.5 Appendix B: map of the port of Ashdod