

ISLAMIC REPUBLIC OF IRAN.

Trade and Transport Facilitation: pre-diagnostic.

This short diagnostic is the output of a short investigation in Iran by Jean-François ARVIS (PRMTR) between April 25-29 2004. It is part of a transport sector assessment led by Hedi Larbi, sector manager MNSIF. The mission also comprised Jean-Charles Crochet (MNSIF), Michel Bellier (MNSIF), Karim Budin (consultant) and Tony Bliss (TUTDR).

This work was facilitated by the Transport and Terminal Organization (TTO) in the Ministry of transportation of the Islamic Republic of Iran. It was executed in parallel with a TTO-World Bank seminar.

The information has been gathered through public agencies or interviews of stakeholders in the private sector. No investigation could be done outside Teheran, within the short time span of the mission. Few statistics were available in English and no pre-existing report relevant for transport and trade. All these factors are serious limitations to the significance and accuracy of the present diagnostic.

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1 Iranian trade: trends and patterns

In 2003 Iran imported 22.3 Billion USD of goods and exported 27.4 Billions USD.

After the Revolution, Iran developed a very closed trade regime. Until 2002, this trade regime was based on bans and authorization. Except for emergency imports, most consumer goods were banned (on religious grounds), as well as products that directly compete with local productions (e.g. cars). Priority was also given to the needs of the local industry.

Trade policy, in Iran, has radically improved over the last two years. Iran is maintaining severe limitation on imports. However, it is moving gradually towards a more modern trade regime: a tariff system is being substituted to the authorization system. Emergency products (notably food products (11%), machinery (44% of imports) and raw material (27%) for the industry are opened for importation. Consumer goods and manufactured in competition with the local production face high or punitive tariffs. The average customs duty is 7%

The exchange control regime is complex and severely constrains trade operations. The present system discriminates in favor of public buyers or State Owned Enterprises who are allocated foreign exchange revenues generated by oil sales. Private buyers must find, at a cost, foreign exchange receipts from the non oil sector. In addition, the importer must go through a complex import licensing process depending upon the Ministry of Commerce and other agencies.

For many years, this restrictive trade regime has been an encouragement for parallel activities. For instance, there are illegal exports of refined products (subsidized in Iran) to neighboring countries where they are expensive, such as Turkey. On the import side, the majority of illegal imports are the smuggled consumer goods from Dubai. It is said that a substantial channel of smuggling is going through Kish Island in the Persian Gulf, where Export Processing Zone (EPZ) duty exemptions are available and used in fact to cover imports going into the country. The estimates of smuggled imports vary from 3 to 8 billion USD a year. However, the shift in trade policy from a ban towards a tariff regime made smuggling much less attractive for a number of goods due to the increase of logistical costs along the smuggling routes.

We could not consolidate trade statistics in volume accurately. Port volume activity was around 40 Mt in 2002 (World Bank, transport sector review). Transit volumes were 8 million tons in 2003. Import and transit flows have been growing rapidly during the last few years: port volumes have been growing at a 10% rate since 1997.

2 Infrastructure and Transport Services

The general situation of road transport in Iran is characterized by:

- A very rapid growth of the automobile fleet (roughly 1 M vehicle per year)
- A parallel decline of the public transportation network
- An obsolescence of the truck fleet (median age 21 years) of 200 000. This obsolescence is on the rise as the replacement level is only 3000 per year: a reflection of Iran production and the market structure
- A protected market for national manufacturers (mostly SAIPA, Iran Khodro and Peugeot).
- A subsidized price of gas and diesel. Gas is 7 cents/liter, Diesel is 3. The level of subsidy is estimated at 10 cents a liter.

These trends result in major congestions in the cities and an alarming increase in traffic casualties. There is no incentive for a rational maintenance and management of plan for the fleet: For instance, the average gas consumption of passenger cars in Iran is 18 liters per 100 km (12 mpg), however the typical Paikan in Iran is much smaller than an Humvee!).

They also have significant macro-economic implications on two grounds:

- First, subsidizing oil consumption costs a lot to Iranian economy (10 billion USD/year). Indeed, Iran has not reconstructed its capacity for refined oil, so they have to import half of their refined oil consumption. (Iran needs 11 barrels per habitant per year).
- As there is no fuel levy, users of cars or trucks are not paying for the maintenance of roads. There is no road fund either. This should not come as a surprise in a country where 80% of the fiscal revenues are coming from oil.

Iran has a rather well developed road network of more than 65000 km, not including rural and access road. The arterial roads used for the main freight traffic amount to 7000 km including 850 km of freeways. After the revolution, absolute priority was given to the development of rural roads, essentially on political grounds, initially under the supervision of the Ministry of agriculture. This happened at the expense of development and maintenance of arterial links. In the absence of a good maintenance policy the long term impact of the over-investment in rural road is mixed. Recently the government gave the control of all the roads to the Transport and Terminal Organization It resulted in a shift of priorities. Priorities now deals with investment to improve safety and eliminate widespread congestion on the arterial roads and improve maintenance.

The railroad is operated by the National company (RAI)¹. There are about 7100 km of standard gauge main lines. Out of which only 1000 km are double line, essentially extending West East from Teheran in the West to Mashhad. There have been steady extensions and improvement in the network over the years. A shortcut from Bafgh to Mashhad is being completed, that can prove critical for multimodal operations on the South-North corridor. The doubling of the line from Bandar-Abbas to Bafgh will also ease operations along the Bandar Abbas Tehran corridor. Despite competent operations RAI is only carrying a small and declining part (10%) of the trade cargo to Iran or in transit. Especially the container handling capacity can only handle a fraction (we estimate it at 200 000 TEU maximum) of the booming container activity.

Road haulage is the dominant mode of cargo transportation in Iran and has captured most of the recent increase. Without doubt trucking activity is boosted by the virtually non-existent cost of diesel fuel. However this also allows the persistence of an obsolete fleet and of an archaic market organization. There are about 200 000 trucks in Iran. Most of them (90%) are owned by individuals or families.

Transport of cargo is arranged by forwarders. There are about 5000 of them in Iran, mostly private. 13 million Bills of Lading are issued every year. Individual truckers are (loosely affiliated) with the forwarding companies. But apparently many of them are opportunistic. As a result of this organization backloads are very poorly managed (30 % according to TTO).

¹ Railways are the object of a separate report.

The “Terminals” play also an important role in helping the supply meet the demand. It has not been investigated into detail, but terminals are where the truckers are meeting the demand, apparently under some form of tour de role. Terminals have also facilities for the truckers.

The booming transit activity is more exclusive as it involves about 8000 trucks commissioned by very few forwarders (10 to 15 are really active in this business.)

One major problem is the very old age of the fleet: the **median age is 21 years.** (average age?) There is no consistent public policy to help the renewal of the fleet as:

- The protection of local assembly limit the local capacity of trucks at 3000 units a year.
- Financial support to buy new trucks (such as guarantees or subsidized loans) have been granted by priority to individual owners, as a matter of policy choice (there is also suspicion of patronage). Instead of this, A policy aiming at consolidation and modernization would have helped the emergence of organized companies. However the social and economic importance of **surface transport (= road transport?)** in Iran (7-8% of GDP but 10-11% of the labor force) preclude an aggressive policy of changes.

The level of utilization is very low. We were mentioned that on average the Iranian truck is running 50 000 km a year. Still maintenance costs amount to 40% of operating costs of the fleet (which reflect not only the obsolescence of the fleet but also the very low fuel and personnel costs).

Port Infrastructure.

Ports in IRI are under the jurisdiction of the Ports and Shipping Organization (PSO). As far as trade facilitation is concerned, Bandar Abbas is by far the most important gateway for imports and transit of goods and is capturing most of the increase. Bandar Khomeini is more an oil terminal. Its position, at the end of the Persian Gulf, makes it a less desirable gateway for imports and transit. Iran has two main ports on the Caspian sea: Anzali in the West and Amirabad in the East.

The present organization of port activities raises a number of questions. PSO is assuming all responsibilities from regulations to port operations. Furthermore, according to the private sector it seems that there are rivalries within PSO between the head-office in Tehran and operational units in ports, especially Bandar Abbas. This maybe an informal unbundling or responsibilities within the organization, however it is detrimental to decision making for instance in the area of PPI.

Container operations are possible in all of these ports. By far the most active containeroperations are in Bandar Abbas (1.6 MTEU in 2003 and a capacity of 3 MTEU). PSO is in the process of concessioning part of the operations for the new container areas. A first tender was not completed successfully. Due to a number of reasons, including lack of practice for such deals in Iran, it seems that this process had been chaotic for Ports operations and containers. A second tender is to be closed in October 2004. This investment is apparently much needed, as a congestion of 2-3 days is mentioned by container operators.

Shipping

IRSL is the dominant shipping line in Iran. It has a fleet of 114 ships and controls 60% of the Iranian markets (shipping in and out of Iran). Shipping between third countries amounts to

40% of its activities(including a quasi monopoly with Lybia). IRSL used to be directly owned by the government. It is now controlled nominally by two local “Pension funds”. The fleet is relatively old (40 ships older than 22 years), which makes it possible to have relatively low shipping rates. IRSL is now engaged in an active renewal and investment strategy. So far, the company does not appear to have financial constraints partly because of its status and partly because of relatively easy access to export finance (notably Hermes in Germany)

IRSL is considering multimodal operations with Iranian railways.

3 Business environment and its impact on transport and trade

Many features in the investment climate of Iran are not conducive of trade logistics. First of all, 80% of the economy is still controlled by the state under two competing provisions:

- State owned enterprises controlled by the ministers.
- Religious foundations, which are holdings active in many areas.

The payment systems and banking have problems going much beyond trade facilitation. The most obvious manifestation is the non-recognition of credit cards in Iran. Banks need typically 2-3 days to process a payment. Electronic signature is not recognized. However, some banks (Sama, Agriculture Bank and Koran Bank) are working with the central Bank (Bank Markazi) to set up electronic systems.

foreign companies are very critical of the present business culture, often referred to as Bazari culture. It is difficult to find trustworthy partners and contracts are difficult to enforce. Widespread corruption is reported as well as anti-competitive practices (discrimination against private or foreign companies in favor of SOEs including the payments of fees to public organization).

Iranian private sector also tends to overreact to perceived opportunities, which may have direct consequences for trade logistics. For instance, in 2002 the Central Bank changed the rule for opening a letter of credit to import goods. Instead of bringing 100% of down payments, merchants were allowed to bring only 10% to the Bank. As a result there was a surge in LOC and a rush to buy imports of consumer goods. However a number of importers did not have the funds to pay the remainder of the LOC and instead stored their containers in the ports waiting for the merchandise to be sold. This doubled the average storage time in Bandar Abbas to 45 days, some containers were stored for up to one year. PSO had to double the storage charges to reverse the trend and bring back the average storage time to 22 days.

Iran productive sector is marred by the under-development of services. There are very few integrated logistics services available in Iran and companies are hardly aware of new management techniques. For instance, we found that the concept of **supply chain**?? is not commonly translated into Parsi. The overall business culture is still very much an old style engineering culture that has not captured the major evolutions in management that happened during the last thirty years.

Probably one of the most open and modern segment of the productive sector is the automotive industry. Although not fully linked to the world market (due to the protected internal market), automotive is very much influenced by foreign investors; there are many joint ventures (JVs) with European companies. At present the typical inventory of raw materials in the industry is

4-6 months. Auto manufacturers and part manufacturers are working on a new organization with dedicated companies managing the logistics of parts.

4 The cost of logistics.

Iran is not handicapped by high transport costs. Truck transport is the cheapest in the world (1.2 cents per ton/ Km!), railroad transportation costs are equally low but not cheaper than road, which is exceptional.

Shipping rates to Bandar Abbas are not excessive. This results from a combination of factors:

- fast growing traffic volumes (especially for containers) which makes the port develop as a quasi-hub connected to major destinations and
- aggressive pricing by national shipping lines (IRISL).

Sources are not fully consistent, but it seems that rates for Bandar Abbas are now close to that of Dubai. As one expects, given the unbalance of volumes, export rates are much cheaper (50%) than imports rates. Also the shipping costs with Asia are much lower than with Europe

Typical export freight rate from Bandar Abbas (40' container), in USD

Dubai	350	Durban	3344
Singapore	600	Genoa	1820
Jakarta	650	Valencia	1820
Shanghai	520	Rotterdam	1750
Kobe	580	Gothenburg	2000

Shipping a container from Bandar Abbas to Tehran costs typically €600 and half this price on the export direction. The journey takes 4 days by train and a typically one day less by road.

In the case of Iran low costs do not mean sound logistics. First the relatively low cost of freight is the result of market distortions (cf. gas price). Second, large shippers, especially international operators are increasingly looking at reliability/predictability of services as a factor as important as costs. Unfortunately, there is much evidence there is no culture of modern logistics in Iran. Services are underdeveloped, trading or industrial corporations are not paying enough attention to supply chain management (during a discussion we found that there is no translation of “supply chain”!). Excessive inventories due to poor logistics are apparent: for instance importers tend to keep their goods store in port facilities is very common (up to one year has been mentioned).

Market structure of road transport is a major problem as it inhibits the emergence of competitive carrier and beyond integrated logistic services. For a number of reasons the government has encouraged the ownership of trucks by individuals, with transport services arranged by forwarders. This organization cannot provide reliable hauling services and prevent the emergence of large carrier that can also extend their services beyond transport.

5 Facilitation of trade logistics.

The initial interest from the government of the IRI was on transit facilitation. Transit raises specific issues. However, it is part and cannot isolated from the broader issue in trade logistics. Competitive transit needs seamless facilitation that will result from measures in various areas

(ports, customs, technical regulation, finance, IT...), especially soft measures that are essentially independent of the final destination of goods.

The two main agencies influencing trade facilitation in Iran are customs and ports.

Notwithstanding the findings of deeper investigations, we can risk few observations:

- Public agencies involved in trade operations (ports, customs, railroad, technical agencies) seem to provide reasonably functional services.
- Given the past trade policy, Iran has not developed yet a culture of facilitation, one of the main issue being the apparent lack of interagency cooperation. The perception of private companies is that the various agents (public or private) along the supply chain are not working together as they should do to facilitate trade.
- Organization of some services is outdated (confusion of regulatory and operational activities especially for ports)
- Despite very laudable recent efforts (see examples below) the performances are still lagging beyond World standards and even beyond countries in the MNA region of the same level of development.

As a result, there is a significant potential in Iran for measures, especially soft measures, in trade logistics.

In customs.

Nevertheless, there have been genuine effort of modernization such as the implementation of Asycuda ++ and its transit module by the customs. There have been recent effort to facilitate trade such as:

- Increase availability of services (24/24) at several border posts.
- Application of risk management techniques, the time realize reported by the private sector is 48 hours.
- Creation of a facilitation committee.
- Scanners in B.A. and Doqaroon (Afghanistan)

Still we heard a number of complains from the private sector regarding: frequent conflict on valuation of product (including apparently for transit of goods), and cases of corruption.

In ports.

The port and shipping organization has recently reviewed its policies to make it more consistent with World practices. This contributed to make Bandar Abbas a competitive port of call. The PSO is also exploring the potential for PPI to enhance services (container handling in B.A.). The total transit time has been halved in two years to 22 days.

Beyond the modernization effort of individual agencies there is also room for improvement by making the trade community working better together, taping the potential of information technology (EDI). For instance PSO is tramitting e-manifest to the customs in B.A.

6 Transit; the North-South Corridor.

The government wants to develop the transit activity in Iran, including by developing transit from ports to Central Asia and Russia. The North South corridor was much debated during the seminar. Indeed the transit volumes have been increasing very fast (a doubling in two years). Last year volume was 8 Mtons, out of which 3.8 Mtons were oil swap with central asian countries (Iran is buying oil in central Asia for the needs of northern Iran paid in kind with Iranian oil sold internationally). Out of the about 4 Mtons of merchandises:

- Most of them are containerized in 40' (more than 600 000 TEU per year)

- Main gateways are Bandar Abbas (where a large part of the container activity is for transit, Bazargan (Turkey) and Savaks (Turkmenistan).
- 40 % of the transit goods are coming from the UAE, and to a smaller extent from Europe by road.
- The main destinations of goods are Afghanistan (about one fourth) and central Asia.

Procedures.

Iran went into a number of bilateral agreements with other countries on transit. Apparently the agreements are working very smoothly with Turkey and less so with countries in Central Asia. For instance, insurance green card is not always mutually recognized. There is a complex and discriminatory system of transit fee that differentiate with the origin of truck. The fees are supposed to cover the difference in fuel price paid in the country of origin and in Iran. For instance, a Turkish truck pays 30 cents per km while, one from central Asia 12, one from Russia 0.

Customs have implemented a rather effective transit system:

- Asycuda's transit module has been deployed at main gateways.
- Time release for transit is between 2 hours and one day (source customs).
- 5% of the truck are controlled.
- There are preferred routes for trucks in transit, with a maximum time allowed for the journey. Police/customs may checked that vehicles are on their route.
- National transit is possible, but according to the private sector not developed enough: one reason is that it is most needed for the delivery on site of machinery, for which the customs is not prepared.

There is a dual customs guarantee systems:

- TIR carnets are available. The national guarantee association is the Chamber of Commerce. Unfortunately the systems is working mostly for Iranian, Turkish or European trucks
- For non TIR and national transit an old-fashioned but effective coupon system is in force. The operator must buy coupons from one of four approved insurance companies. Each coupons cost 50000 rials (€5) and covers an incremental amount of 10 million rials of goods . Coupons are stamped at the beginning and the end of the transit operation and sent back to the insurance for discharge.

Overall, transit procedures themselves sound correct, the most important problem being the harmonization of procedures between countries and better cooperation between border posts.

The North South Corridor.

There is a lot of interest for the development of the North Corridor. Iran is formally the depository of the transit instrument and is actively managing the corridor organization. Transit flows of 20 million tons are envisioned within a few years.

On one hand, supporting the importance of the corridor, there is an undeniable dynamic. The flows have been doubling in two years; some operators are investing on the route (including a terminal in Astrakhan Russia by the IRISL, Russian companies have been investing on Ro-Ro boats). On the other hand, most of the transit flows are remotely linked to the corridor, at least beyond transit in Iran itself (goods are coming from or going to the neighboring country and the route to Northern Europe is a distant prospect). At present the potential of the market served by the route is limited. There are some inherent obstacles for the development of the

route such as its inherent complexity. To be competitive the corridor needs very high degree of performance of ports and railroad². Given the distances on the North South Route and the high degree of containerization this is an opportunity to experiment multimodal operation management with the railways and shipping companies.

The mission could not find a detailed business case for the corridor. Such an in depth analysis is much needed to assess the potential to make sure the present dynamic is sustainable.

7 Recommendations.

At the present stage of investigation, the World Bank is not position to outline with precision what would be an action plan for the improvement in facilitation of trade, transport and transit. The priority should be probably given to soft measures (reforms, modernization, and promotion of new activities...) over physical investment. Despite numerous and commendable initiative to make services to trade more effective, Iran has to catch up with the global effort in trade facilitation. With the increase in trade and transit volume bottlenecks may appear, especially in the main gateways. Typically, bottlenecks are a combination of soft and hard issues. Iran should avoid over-investing in physical infrastructure or equipment to solve soft problems.

In the short term priority should be given to regulatory, procedural and administrative issues dealing with the movement of goods entering, exiting or transiting Iran. Such measures include simplification of documentation and procedures, seamless cooperation between public agencies (e.g.; ports and customs). Fluidization of the circulation of information between the various participants to the supply chain (including also forwarders, carriers, shippers...) should benefit from the implementation of information technology. Such measures could be achieved gradually through pilot experiments, especially in Bandar Abbas. Harmonization of documentation and procedures and border crossing coordination such as those existing with Turkey should be sought after with all countries.

Modernization of activities such as port, customs, and technical control at the border will have a major impact on facilitation. Reforms may include unbundling of responsibilities such as regulatory duties and operational activities or corporatization of public entities (including price reforms of some services to follow international standards).

Iran should also improve the investment climate for the development of logistics services. The encouragement of private participation in multimodal activities (sea-rail is seriously envisioned by shipping lines and the railways). Transit between Persian Gulf and Caspian Sea can be a natural application.

In the longer term socially more difficult reforms should tackle the organization of road transport. New policies should encourage the concentration of truck ownership into the hand of organized companies that can provide reliable and quality services especially for long distance haulage. Energy pricing is an issue, which goes much beyond facilitation.

Next steps.

² One obstacle is the change of gauge at the border with the former Soviet Union.

According to the conclusions of the discussion with the client, the Bank may consider supporting the transport sector through a TA loan. Such an activity will rather concentrate on soft components rather than on physical investment, a perspective consistent with the above developments. A full-fledge Trade and Transport Facilitation Audit (FY05) could help bridge the many gaps on knowledge and provide the necessary background for loan preparation in FY06. The TTFA should look at Iranian trade as well as transit trade.

For a number of reasons, beginning with the size of the country, a TTFA is a complex undertaking. There are several trade and transit routes. There are many facilities to visit in the course of such an audit. Given the present preliminary information, virtually all sub-area in trade logistics need to be assess in depth: procedures, customs, market structure of transport services, management of key infrastructures... Such a work should be carried out by a multidisciplinary team of international and local experts under close World Bank supervision. It is also desirable that the work stimulates transfer of knowledge to the client (seminars for instance). We estimate the very minimum budget for a TTFA in Iran at \$150 000.

A French consulting firm (EGIS-BCEOM) is a natural candidate to carry the work as it has been contracted by the Ministry for creating a master plan of transportation in Iran. The total amount of the contract is €4 millions. This work is just beginning and according to the TORs will cover much of the information needed for the TTFA, EGIS will for instance assess border crossing activities for the main land and sea gateways. Therefore, a natural option to carry out the TTFA will be to ask EGIS to extend its scope of work and prepare a TTFA along Bank prepared TORs. This solution must be consensual with the Iranian parties involved, which may not be the case. It may also make sense to have another party review the data and improve it. Should we go with the EGIS solution, preliminary contact with the French authorities raised the prospect of a financial contribution to this extension (up to 200-300 K€).

People interviewed.

Transport and Terminal Organization (TTO)
TTO, Mr. Karaoui (Director)

Head of North South Corridor (in TTO) project Mr. Attrchian

Ports and Shipping Organization:

G Sasani DG Transit

M.R. Ghaderi DG international maritime agencies

Customs

Mr. Kiani (transit)

Forwarders

Shib MR. Homayoun Assadi

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Shipping lines

Maersk René Seidel

IRISL M.H. Pajang CFO

Chamber of Commerce

ICCIM Dr Rejab, Managing Director

Industrial companies

Iranian Auto Parts Manufactures Association Mr. Manesh

Iran Fanar Lool Mr. Morshedi (President)

National Informatics Corporation Mr. Azgomi (Banking affairs)

Al Mafaza general trading corporation Mr. Hosseini, Managing Director

EXAMIE (Exporters Association For Mining, Industrial Product and Engineering services)

Mr Hadavi

Others

French Commercial Section Mr. Michel Lallemand.