

Report No. 70645-AF

# **Afghanistan Diagnostics Trade Integration Study (DTIS):**

November, 2012

**Poverty Reduction and Economic Management Unit**

**South Asia Region**

**The World Bank**



## ABBREVIATION AND ACRONYMS

AAA	Analytical and Advisory Activities
AfTel	Afghan Telecom
ANDS	Afghan National Development Strategy
ANSF	Afghan National Security Force
ARTF	Afghanistan Reconstruction Trust Fund
ATRA	Afghan Telecom Regulatory Agency
CPI	Consumer Price Inflation
CSO	Central Statistics Office
DABS	Da Afghanistan Breshna Sherkat
DTIS	Diagnostics Trade Integration Study
DSA	Debt Sustainability Analysis
GDP	Gross Domestic Product
GoA	Government of Afghanistan
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communication Technologies
IMF	International Monetary Fund
ISPs	Internet Service Providers
MCC	MCC-Jiangxi Copper Consortium
MCIT	Ministry of Communication and Information Technology
MDGs	Millennium Development Goals
MEW	Ministry of Energy and Water
MOF	Ministry of Finance
MOH	Ministry of Health
MoM	Ministry of Mines
MoPW	Ministry of Public Works
NEPA	National Environment Protection Agency
NPP's	National Priority Programs
NRRCP	National and Regional Resource Corridor Program
O&M	Operational Maintenance
UNODC	United Nations Office on Drug and Crime
VAT	Value Added Tax
WB	World Bank

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## Executive Summary

*Trade enables countries to import ideas and technologies, realize comparative advantages and economies of scale, and foster competition and innovation, which in turn increases productivity and achieves higher sustainable employment and economic growth. Countries open to international trade tend to provide more opportunities to their people, and grow faster.*

**Afghanistan could derive far more benefit from its international trade opportunities than it does at present.** This DTIS report is intended to identify concrete policy actions in three areas of endeavor: lowering the transaction costs of trade, increasing Afghanistan’s competitiveness in world markets, and providing an analytical foundation for Afghanistan’s National Trade Strategy. The study examines how to do this, looking not only at trade performance and policy, but also at three sectors with great export potential: agriculture, gemstones and carpets, as well as the investment climate, customs as a driver of trade facilitation, and on promoting infrastructure services. Key recommendations for growing trade and the role it could play in raising incomes and reducing poverty are summarized here. Annex I provides a more comprehensive policy action matrix.

All five chapters in this report provide a detailed and comprehensive analysis of trade issues intended to reduce the transaction costs of trade. Chapter 2, in particular, looks at Afghanistan’s export competitiveness through three case studies (agriculture, carpets, gemstones), which in a sense cover the country’s export base, and sets out a strategy for trade development and export promotion.

### ***Afghanistan’s Macroeconomic Environment***

*Growth in Afghanistan has been strong and volatile because of its heavy reliance on agriculture. Now it faces a transition: prospects of a drawdown of international military forces and a decline in civilian aid by 2014. The transition will change Afghanistan’s economic landscape, while security issues and political instability will likely remain a risk to macroeconomic prosperity.*

**Afghanistan is one of the world’s poorest countries.** After nearly a decade of strong growth, GDP in 2010 was US\$15.9 billion (excluding opium production). With an estimated population of 30.6 million and per-capita GDP of US\$528, it is one of the world’s ten poorest countries. Since 2001 the country has seen improved development outcomes, such as rapid economic growth (with large fluctuations), relatively low inflation (after hyperinflation in the 1990s), better public financial management, and gains in basic health and education. Key social indicators, including life expectancy and maternal mortality, have improved markedly (though from an extremely low base), and women are participating more in the economy.

**Afghanistan has seen exceptionally high economic growth, averaging 9 percent annually.** But this has been highly volatile because of its heavy reliance on agriculture and, to a lesser extent, aid flows that have driven demand for services. While it is dependent on international trade, on imports of fuel, raw materials and food, trade is not a main driver of growth. The so-called Transition—the full assumption of responsibility for security by end-2014, the drawdown of international military forces and likely reduction in overall assistance—will profoundly alter Afghanistan’s economic landscape beyond 2014. Even with favorable assumptions, the WB projects real GDP growth may fall from the average of 9 percent per year of the past decade to 4-6 percent during 2013-18.

**The country needs to ensure its long-term economic growth prospects.** In view of Afghanistan’s rapid population growth (around 2.8 percent) and GDP growth of around 6 percent, progress in raising average per-capita incomes and reducing poverty will be limited and slow: it would take approximately 22 years, a generation, to double current per-capita income. Current drivers of growth, i.e., agriculture and mining, therefore are insufficient on their own to provide income for the increasing number of young people joining the labor force (400,000-500,000 per year) and lift the existing large number of poor out of poverty.

**With fiscal pressures, authorities will need to do “more” with “less” in terms of trade and export promotion initiatives.** The Afghan budget will continue to rely heavily on the donor community to pay for most security costs (salary and non-salary), and on civilian aid for development and operations & maintenance (O&M) needs. While customs is currently one of the main drivers of domestic tax collections, its contribution is likely to decline because of the contraction in demand for transport services and trade associated with the donor withdrawal of aid during the Transition.

**Security issues and political instability could undermine Afghanistan’s Transition.** Such threats could harm not only economic growth, but a deterioration would repel private-sector investment. A resource corridor is critical to leverage private sector investment in Afghanistan's mineral wealth, and associated activities, for broader economic development and to grow mining revenues in order to bolster public services. Regression would also weaken trade flows and the ability of firms to grow and break through to international markets.<sup>1</sup>

### **Trade Performance and Policy**

*Afghanistan is underperforming in exports relative to GDP, with an unusually narrow export base, concentrated in few markets. While the country relies heavily on imports, amounting to three times the value of exports, some imported goods could be produced for less cost domestically. Afghanistan’s trade strategy should focus on private sector development to produce cheaper quality goods—promoting an attractive investment climate and lowering costs for quality inputs, and promoting exports by facilitating breakthroughs into international markets by established, competitive Afghan firms.*

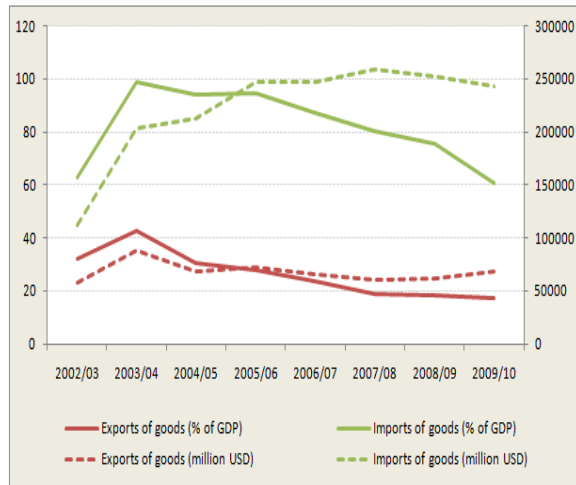
**Afghanistan’s import-heavy trade balance reflects the large aid flows to the country’s reconstruction and recovery efforts.** While the trade gap has steadied, the relatively high import level has been driven in the last five years mostly by the demand for goods in donor-funded projects—particularly oil, machinery, household items and food (80 percent of incoming goods).<sup>2</sup> Import values today are more than three times the size of exports.<sup>3</sup> The current account deficit, excluding grants, went from 70 percent of GDP in fiscal year 2007 to 34 percent in 2012, and was financed, as in previous years, by grants. These grants are spent mostly on imports of goods and services; thereby not only financing the trade deficit but contributing to it (Figure S.1).

<sup>1</sup> A June 2012 IMF/WB Debt Sustainability Analysis identifies significant risks stemming from the very high security and development spending needs. Should donor support be insufficient to meet the country’s financing needs, security fail to stabilize, or structural reforms and governance improvements fail to materialize, Afghanistan’s debt burden would become unsustainable, and the government would be forced to undertake significant fiscal adjustment.

<sup>2</sup> Official export figures are underestimated and do not account for smuggled products and transit trade.

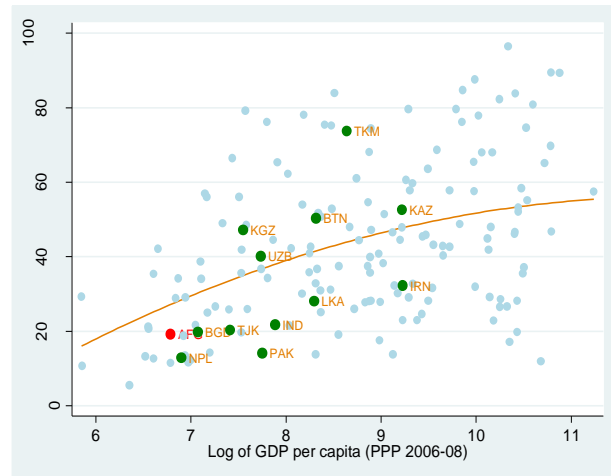
<sup>3</sup> While it is difficult to estimate the share of imports not captured in official figures (excluding opium, See Box 1.1, Chapter 2), it is significant and has increased over the past 4 years, which to a certain extent explains some the decline of import values as a percentage of GDP. Another factor is the effect of Transition, the uncertainty of future donor funding and the closing of some donor projects that have impacted the demand for imported goods & services.

Figure S.1: Export and Import Trends



Source: WDI, WB calculations.

Figure S.2: Export Ratio



**Relative to its GDP, Afghanistan is underperforming in exports and their survivability is a challenge.** With its income level, the export-to-GDP ratio—which indicates the importance of exports of goods and services in an economy—should be close to 30 percent, but it is only 20 percent (Figure S.2). Generally, countries tend to trade more as their per-capita income rises, though at a decreasing rate, but this is not Afghanistan’s experience.<sup>4</sup> Afghan export flows to individual countries between 2005 and 2009 have often faltered and disappeared, especially those to the EU that accounted for about 20 percent of the country’s export growth. Growth in carpet exports to Pakistan, also, dropped by 45 percent.

**Afghanistan’s export base is unusually narrow, with few tradable products going to few markets.** Carpets and dry fruits account for close to three-quarters of total exports. The country exports only to 35 destinations, well below the average of about 90 markets for other LDCs. However, it has reduced dependence on Pakistan and strengthened trade with the MENA region. The composition of exports has changed in the last 10 years, with dry fruits & seeds becoming the largest official Afghan export.

**Exports sectors that did grow did so mainly because of new product sales to Asia and the Middle East/North Africa (MENA).** Over the last five years, Afghan exports to these two regions have grown the most, followed by exports to Europe and Central Asia (ECA). Afghan trade growth to MENA countries was due to a combination of new products and new markets, while growth in Asia and ECA was mostly new products going to existing partner countries, and intensifying trade of traditional exports (intensive margins). In the USA, exports of new products drove growth, particularly for oil seed and lac, gums, and resins. Meanwhile, Afghanistan lost ground in traditional exports to the EU (Figures S.3 and S.4).

<sup>4</sup> Figure 1.4 presents this relationship through a scatter plot comparing the average export-to-GDP ratios with the log of GDP per capita (in PPP constant international dollars) for several countries in the region during 2006–2008.) The broken line indicates the world median income. The curve is an ordinary least-squares (OLS) regression line of the trade-to-GDP ratio on the log of GDP per capita as well as its squared value.



Figure S.3: Margins, by region, 2005-09

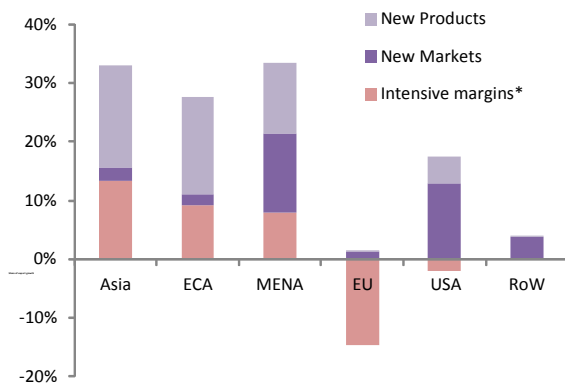
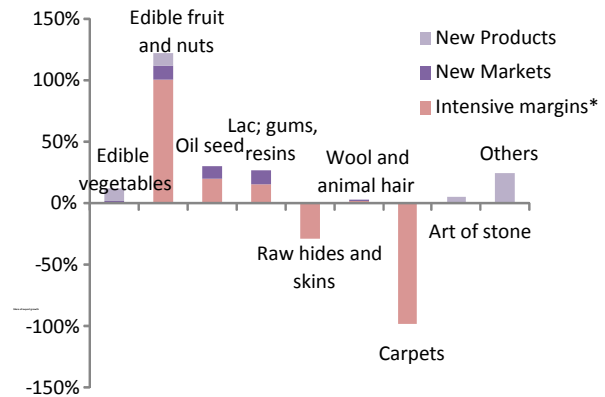


Figure S.4: Margins, by product 2005-09



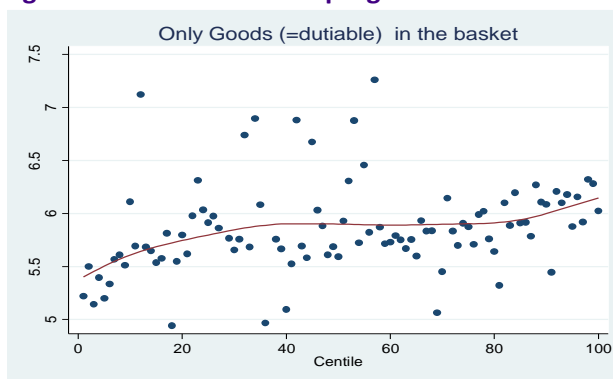
Source: World Bank, based on CSO. \*Note: "Intensive margins" refers to existing trade flows.

*Afghan trade policy overall is conducive to growth, but trade could play a greater role in economic development.*

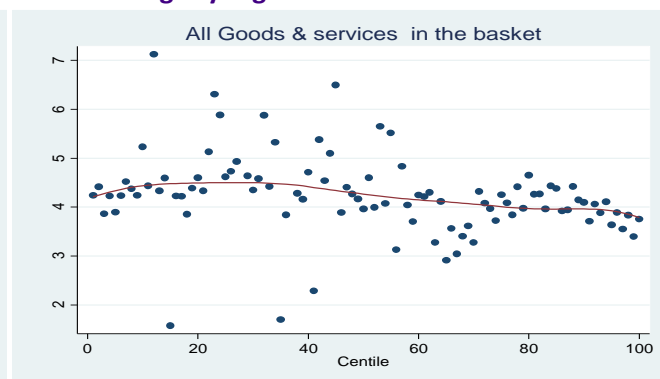
**Imports, being an input to production, have direct impact on domestic production and export performance.** Thus, private sector and export development in Afghanistan requires facilitating access to quality and low-cost imported inputs across sectors, and there is potential for substitution of imports with cheaper domestically produced goods.

**Afghanistan is one of the more open economies in the region and its tariff structure is below average among LDCs.** Few products are taxed above 15 percent. The tariff structure is slightly progressive and richer groups tend to pay higher duties for their imports, according to household consumption data for a basket of basic goods from the 2008 National Risk Vulnerability Assessment (NRVA).<sup>5</sup> Notably, richer households in Afghanistan consume a larger share of services, thus, when including services within the basket of goods, the impact turns from progressive to regressive (Figure S.5).

Figure S.5: Tariff structure progressive...



...or slightly regressive



**Afghanistan's tariff structure is subject to significant exemptions.** These exemptions collectively represent a loss of about one-third of import duties and other taxes. They are mostly linked to imports from ISAF and NATO security forces, development partners, and goods and services related to

<sup>5</sup> According to WB calculations using the 2008 National Risk and Vulnerability Assessment (NRVA) household data

government- and donor-funded projects. The process of granting exemption privileges invites rent-seeking, and industries that import goods under exemptions have an advantage. Therefore, while some exemptions may not be modified as they involve bilateral agreements with ISAF and donor countries, careful review of the exemption list could identify ways to broaden the tariff base.

**The concept of “quality” standards is not well defined in Afghanistan's legal framework and often is confused with safety and protection of health.** The new SPS and TBT laws, however, will draw a clear distinction between these concepts. Afghanistan intends to draft a law on food safety, and producer declarations/certificates will be considered for low-risk food products. The country aims also to intensify efforts in the coming years to harmonize quality standards and guidelines with international standards (OIE, IPPC, Codex Alimentarius, and ISO). In March 2011, the Afghanistan National Standards Agency (ANSA) produced the Strategic Plan for the Development of a National Quality Infrastructure in Afghanistan to organize activities in metrology, accreditation and standardization processes.

### *Opportunities and Recommendations*

- **Develop a capacity-building plan for trade policy evaluation within the Ministry of Commerce & Industry (MOCI).** This could include building capacity to analyze indicators and monitor results of policies and investments in trade negotiation, impact evaluation techniques, and economic modeling of trade policy impacts.
- **Develop a trade database to inform policy analysis.** The database should compile trade information from agencies such as the CSO, ARD, and donor-funded surveys to enable the MOCI to make informed policy decisions. Building capacity at the MOCI to maintain the database will be crucial, as it would enable technical units within the MOCI to analyze trade data trends for management.
- **Conduct a review of items exempt from tariffs with the aim of broadening the tariff base.** This will lessen revenue loss, currently estimated to be one-third of import revenues. However, minimum-consumption basket food items should remain exempt in order to protect the poor.

### *Private Sector Development*

*An attractive investment climate would incentivize private commercial activity and encourage Afghan firms to make medium-term investments, which would create jobs.*

**The National Trade Policy, and its export component, should establish a climate in which the Afghan private sector can flourish.** Regulation is important in this sense; it must be transparent, accessible, and efficiently implemented in order to encourage growth, job creation and poverty reduction. A World Bank assessment of the business climate in Afghanistan in 2011 recommended reforms in nine of the ten indicators of the Doing Business Report.<sup>6</sup> This DTIS places special emphasis on a subset of these indicators in an effort to boost private sector development and export generation through (i) starting a business, (ii) protecting investors, and (iii) enforcing contracts. Chapter 2 provides diagnostics across this subset.<sup>7</sup> Chapter IV, meanwhile, examines infrastructural elements that directly affect the investment climate, such as access to roads, telecoms penetration, and electricity.

<sup>6</sup> This section is based on the “Improving the Ease of Doing Business in Afghanistan Reform Memorandum”, WB-IFC, February 2012.

<sup>7</sup> The recommendations are based on comparative best practice on investment climate regulation, and reflects discussions between the World Bank Group, government agencies and stakeholders during a Bank Group mission to Kabul (September 16-23, 2011).

## Opportunities and Recommendations

### Starting a business

- **Short Term:** Speed up investment license renewal and reduce renewal's cost and frequency. AISA could charge a small, flat administration fee to renew, instead of basing the fee on sector or firm size.
- **Medium Term:** Reorganize the MoCI and AISA relationship to enable entrepreneurs to deal with only a single agency for registration and licensing. The government should strive in general for single-point interaction between it and entrepreneurs for all information, registration, licensing and fees.

### Investor protection

- **Short Term:** Amend both the Joint Stock Company Law and the Corporations and Limited Liability Companies Law to align their investor protection and disclosure requirements more completely with international best practice. The amended legislation should also mandate independent auditing of large related-party transactions before the transactions take place. Shareholder approval of large related-party transactions should also be a requirement. Article 50 of the Corporations and Limited Liability Companies Law, dealing with conflict of interest in transactions, should be amended to increase public disclosure requirements in annual reports in cases of related-party transactions. The corporation's law currently requires only boards of directors' approval in cases of large related-party transactions (above 5 percent of the company's assets). To better protect minority shareholders, these transactions should be approved at the shareholders' meetings.
- **Medium Term:** To make it easier for investors to protect their rights through the courts, interested parties should be allowed access to relevant non-confidential company documents without having to file suit or having to identify specific documents. Parties to a trial should be allowed to question (orally or in writing) the opposing party or witnesses during trial without prior submission of the questions to a judge. To facilitate access to evidence at trial, minority shareholders' lawyers should be allowed to directly question defendants and witnesses.

### Enforcing contracts

- **Medium Term:** Explore setting up an alternate dispute-resolution mechanism to improve efficiency of commercial judgments. Mediated solutions are generally faster, less expensive, and more likely to allow parties to resume business with each other.

### Export Promotion

*Exporting from Afghanistan is expensive; trade diagnostics suggest barriers lie mainly on the supply side.*

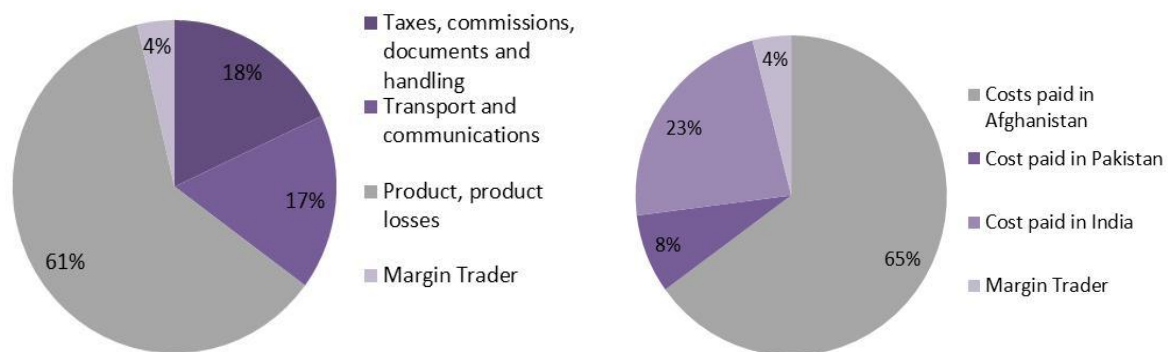
**Afghan exports trade at unduly high prices because they are heavily import-dependent for raw materials for production, and are prone to product loss through time delays, transport and warehousing practices.** These issues all conspire to drive up the end price. Evidence suggests that Afghanistan is losing potential export opportunities because of (i) higher costs through microeconomic and, to a lesser extent, macroeconomic issues, (ii) low added value, and (iii) institutional constraints.

**Security risk is the main cost driver for traders, both directly and indirectly.** The single greatest hindrance to private-sector and trade development remains the indirect constraint of markets due to conflict.

**Overall, macroeconomic factors are not a binding constraint on export development, but do contribute to export costs.** The fact that monetary policy in the country has significantly reduced exchange rate volatility is an accomplishment of the Central Bank. The Afghani is relatively strong compared to other South Asian currencies, thus, Afghan exports are comparatively more expensive. The trade balance remains heavily weighted towards imports, thanks to the large aid flows to the country's reconstruction and recovery efforts. Meanwhile, the cost of unskilled labor in Afghanistan is relatively high by other countries' standards, and wages are no incentive for private investment.

**The high cost of exporting from Afghanistan means that traders must depend on small profit margins.** Therefore, the only way to increase the number and value of products produced, number of markets served, and survival rate of exporters is to drive down the costs. Sending Afghan pomegranates to India, for instance (Figure S.6), an Afghan exporter trader retains just 3.7 percent profit, after paying over 61 percent of the price on production costs and product losses, and a further 18 percent on taxes and commissions, and 17 percent on transport before the fruit even leaves Afghanistan. By comparison, the costs paid in India are just 23 percent, and in Pakistan 8 percent.

**Figure S.6: Export Costs and Margins: The Example of Pomegranate Exports to India**



Source: Lieshout, June 2011.

**Afghan exports have little added value.** For some commodities, Afghanistan has goodwill in the market and customers are willing to pay a premium for higher quality—as is the case with Afghan carpets, for instance. However, the bulk of Afghanistan's exports are primary products and therefore vulnerable to commodity price fluctuations.

**Informality in the private sector is a constraint on long-term growth,** because informal businesses tend not to expand in size nor invest in technology, and face difficulties breaking into export markets. The informal economy, accounts for some 80-90 percent of the total economy (including drugs). It is flexible in responding to shocks and to short-term opportunities, but is subject to the conflict. While informality provides a source of income for the poorest Afghans, it sidesteps customs, evades taxation, and poses security and health risks because it leads to uncontrolled movements of goods. In this sense, coping with such high levels of informality will be a challenge for Afghanistan.

**Private investment is risky because of a lack of the rule of law.** There is insecurity of contracts, a weak legal framework which is impartially enforced, shaky or absent formal justice system, non-functioning commercial courts, and no real commercial insurance system.

**The Export Promotion Agency of Afghanistan (EPAA) was established in 2006 to increase Afghan exports in foreign markets, but it has languished since the institutional arrangements were changed.** Its creation was a step in the right direction, and in 2008 it received an international award. The idea was to provide exporters with assistance in marketing, foreign markets, regulations, to help develop contacts with foreign importers, and to be a one-stop agency for all export-related documents. However, the EPAA lost its independence when it was turned into the Export Promotion Directorate of the MOCI. It no longer provides the scope of its original services; its new role and direction have not been clearly defined, and the definition of functions between all three directorates is ambiguous.

**As the EPAA defines its new role, it could support activities aiming to develop local export services.** These could be promoted through implementation of the “export step-by-step” process that the EPAA developed in 2007. Development of a matching grant scheme, based on the Tunisian experience, could do much to boost exports (see Box 5.1, Tunisia Export Market Access Fund (EMAF), Chapter 2). The EMAF successfully used matching grants to help service-sector enterprises develop a network of local exporting consultants to help companies succeed abroad.

**Afghanistan is already internationally competitive in the agri-business and carpets sectors where it could successfully climb the value chain.** The agriculture and agri-business sector has great potential if attention were to be given to generating value, increasing storage capacity and improving packaging. There is potential also in the carpet sector, through the development of a cut and wash industry, and in gemstones through the development of cutting and polishing services. The marble sector could become a driver of SME development, and the construction sector, particularly building, also holds promise, since most of the bricks and simple tools now imported could be more cheaply manufactured at home. The development of a National export strategy should focus on strengthening sectors like these that show great export potential.

### ***Opportunities and Recommendations***

- **Define the new role and activities of the EPAA.** If this directorate is to have any impact on export promotion in Afghanistan it needs a mandate beyond being just an information center. It could be playing a far greater role in export promotion, support services, technical assistance, capacity building, and marketing.
- **Explore ways to develop a matching grant scheme for export promotion based on the success of the Tunisian experience.** This subsidized scheme should be targeted and aligned with the objectives of export diversification and export development for SMEs.
- **Prepare a National Export Strategy as a stand-alone document to support the National Trade Policy.** This strategy should identify key sectors in which Afghanistan has comparative advantage and that are labor-intensive so as to generate more jobs in the Transition. The document would be strengthened with clear steps to increase the competitiveness of Afghan firms, particularly SME’s, helping them to break through and survive in international markets.

## Customs Reform Will Strengthen Trade Facilitation

Ongoing customs reform has reorganized customs procedures, improved border facilities, and expedited clearance. When fully operational, the modified customs department, the Asycuda system and new customs procedures will further lower transaction costs, and improve trade facilitation and security.

**Modernizing customs and border management will likely have the greatest impact on lowering trade costs in Afghanistan, as it would help facilitate and integrate trade.** Customs efficiency has improved dramatically in recent years, with various indicators suggesting real progress in facilitation and movement of goods across Afghanistan. In the long term, however, Afghanistan needs to strengthen its border management institutions, change transport regulation policy, and invest in trade-related infrastructure.

**Major customs reforms have been initiated and implemented.** These include (i) introduction of the Afghanistan National Tariff Schedule, which classifies goods according to international standards, (ii) procedures to control and monitor exemptions, (iii) roll-out of the Automated System for Customs Data (ASYCUDA), (iv) capacity-building and training of customs officials, (v) infrastructure development at main customs stations, and (vi) the establishment of regional customs valuation and post-clearance control units in the major provincial centers. As a result, customs revenues have risen 16-fold in the last eight years, an increase that eclipses the seven-fold rise in imports, to contribute 36 percent domestic of revenues collected in fiscal 2012.

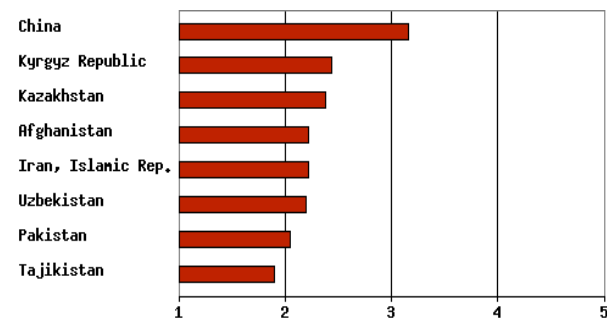
**Customs reforms have significantly improved trade and logistics indicators for Afghanistan.** Customs now performs better overall than its counterparts in such countries as Uzbekistan, Iran, Tajikistan, and even Egypt, according to the World Bank's Logistics Performance Indicator (LPI, Figures S.1 and S.2).

**Table S.1: Logistic Performance Index**

	Afghanistan	
Overall LPI	score	2.24
	rank	143
<b>Customs</b>	score	<b>2.22</b>
	rank	<b>104</b>
Infrastructure	score	1.87
	rank	139
International shipments	score	2.24
	rank	141
Logistics competence	score	2.09
	rank	141
Tracking & tracing	score	2.37
	rank	128
Timeliness	score	2.61
	rank	146

Source: World Bank LPI 2012

**Table S.2: LPI Ranking for Customs**



**The productivity of the customs administration has significantly improved.** An indicator of customs administration efficiency is the average number of declarations processed per customs officer in one year. This figure was 300 in 2004 and had risen to 500 by the first half of 2010. The average economic

cost per declaration has constantly decreased, from US\$6.87 in 2005 to US\$4.98 in 2009.<sup>8</sup> Similarly, the comparison between total customs cost and total revenue collected has declined, from 0.98 percent in 2005 to 0.42 in 2009. In both cases, these figures compare favorably with the rest of the world (internationally, the customs cost/revenue ratio ranges between 0.5 and 2.0 percent, and the average economic cost per declaration often far exceeds US\$10).<sup>9</sup>

**In 2011, implementation of Asycuda had expanded to cover 95 percent of customs houses** (and 90 percent of foreign trade value processed). The gradual coverage of the entire country has closed many gaps through which importers try to avoid control, and partly explains the progress in revenue collection.

**The reform needs to be consolidated, however, and there are opportunities for improving customs administration.** These can be grouped into three themes: (i) **Improved customs procedures**, in order to define the clearance model for Afghanistan for the future design of reform, make existing declaration forms compatible, improve valuation and compliance by traders, and increase the rate of physical inspection; (ii) **Better organization and human resource management**, in order to strengthen oversight and improve staff morale; and (iii) **Greater interagency coordination**, in order to reduce disruption from overlapping mandates. Most reforms that would be necessary to upgrade the ACD to a level comparable to other countries are outside the control of the customs department.

### **Opportunities and Recommendations**

- **Customs procedures should be made less cumbersome, globally aligned and transparent.** In Afghanistan, various clearance procedures exist all over the country, which are neither internally, nor regionally, nor globally aligned. While computerization is slowly resolving this, a coordinated effort to review, revise and audit these clearance procedures should be undertaken. An exercise akin to the GATT assessment should be undertaken at customs house level, to identify a “critical path” for reforms. The role of clearing agents—and their responsibilities—should be better defined.
- **Defining the clearance model for Afghanistan will have an impact on the design of its customs administration.**
- **Every reform or modernisation operation should factor in the anti-corruption dimension.** A review of governance issues, including interference of outside bodies and institutions in areas that fall under the customs domain, and a clear organisational and staffing policy, would help strengthen the institutional side, while embracing anti-corruption measures. In general, anti-corruption initiatives under the umbrella of customs reform, including those in Afghanistan, should rightly focus on four types of measures: (i) **Computerization**, to eliminate discreet direct interface between officials and those carrying fungible wealth, and to leave an audit trail; (ii) **Staff policies**, ranging from ethics to salaries and incentives, which also implies an audit capacity; (iii) **A multi-tiered investigative capacity** that must involve specialized anti-corruption customs units, and external auditors and investigators; and (iv) **Involvement of the private**

<sup>8</sup> This cost is based on the ratio between the total running cost of the ACD and the total number of declarations processed, which is considered an output of the customs administration.

<sup>9</sup> Regionally, latest-available figures show customs cost/revenues of 1.78 in the Kyrgyz Republic, 3.95 in Kazakhstan, 1.14 in Pakistan, and 1.77 in Iran. The economic cost per declaration in these countries ranges from US\$163 in Kazakhstan to US\$18.10 in Pakistan.



**sector**, with adequate legislation to deter corrupt practices and bribery. Technical assistance and policy advice is currently being provided to the GOA and ACD in these areas.

- **The ACD and neighboring countries' customs agencies need to cooperate better.** This absence of cross-border information linkages has clear fiscal, social and trade facilitation dimensions. Of the total commercial imports, estimated at US\$7.87 billion in 2008, approximately US\$7.71 billion moved over land routes from surrounding countries. The ACD needs to exploit this advantage to improve its governance and control, and needs to further improve cooperation with the customs agencies of neighboring countries. This should be the result of a CBM strategy.

### **Infrastructure Services**

*A major constraint to the supply side and for private sector development in Afghanistan is the provision of infrastructure and infrastructure services. With a wide infrastructure gap, investment across three sectors would have the greatest impact on developing trade services: (i) electricity, (ii) telecommunications (ICT), and (iii) roads (transport).*

**The under-provision of infrastructure services not only affects production costs and delivery times, but takes a toll on the competitiveness of Afghan firms.**<sup>10</sup> Thus, investments in the country's infrastructure, in a sustainable way that assumes its periodic maintenance over the medium term, could make a big difference to the costs of trading.

### **Electric Power**

*Access to reliable power has not only a direct effect on business creation and productivity, but the most significant impact on poverty reduction.*

**Investments in electricity reduce poverty by fostering productivity and production of value-added goods, and increasing productive hours beyond daylight. They also improve communities' access to communications and benefit healthcare by enabling refrigeration (of specialized equipment), while also promoting gender equality by relieving women of fuel- and water-collecting tasks.** Providing better quality electricity services requires a better understanding of the existing challenges and potential for electric power infrastructure issues in Afghanistan, such as generation, transmission, and distribution.

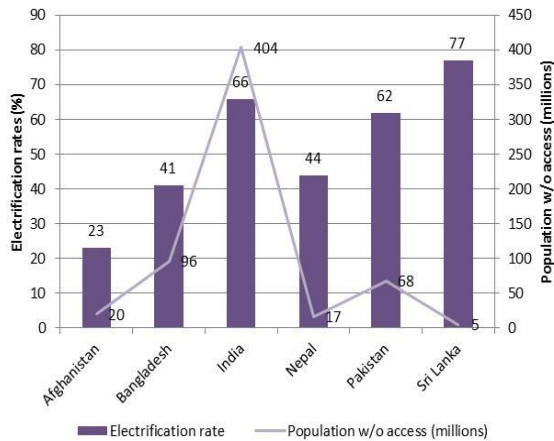
**Insufficient access to electricity is a major constraint to local businesses and households and a driver of production costs.** In 2009, the electrification rate in Afghanistan was estimated to be just 23 percent overall and 10 percent in rural areas (Figure S.7). Some 20 million Afghans still do not have access to reliable electricity, mostly in rural areas. The Business Environment and Enterprise Performance (BEEP) survey 2009 estimated power outages wiped out more than 10 percent of companies' annual sales. About 70 percent of Afghan firms own their own private power generators to back up the grid supply, which increase production costs. About 20 percent of firms surveyed had no access to electricity, and 20 percent pointed to weak electrification as the most serious constraint to business (Figure S.8).

<sup>10</sup> Limão and Venables (2001) show that if a country's infrastructure improved such that the country moved from being at the mid-point (median) among 64 countries to being among the top 25 per cent of those countries, this would reduce transport costs by an amount equivalent to 481 km of overland travel and 3,989 km of travel by sea.



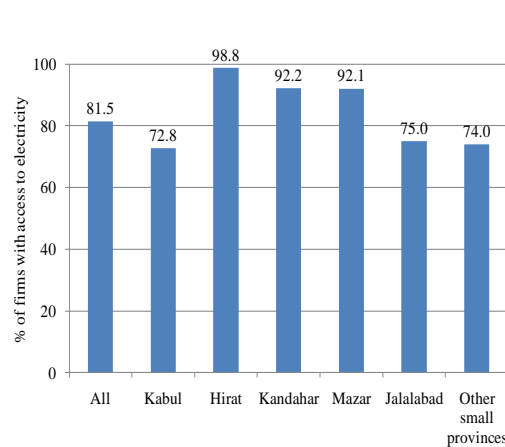
**Afghanistan's domestic power generation capacity remains below the country's potential demand, indicating the transmission and distribution networks need upgrading.** The country is believed to lose as much as 30-40 percent of generated or imported energy, for technical and nontechnical reasons. The most recent power sector investment program envisaged a total investment and recurrent cost of US\$1,720 million between 2004 and 2010, or about US\$250 million annually. Half would have to have been spent on power generation; the rest split evenly between transmission and distribution.

**Figure S.7: Electricity Access, South Asia 2010**



Source: IEA 2010 and WB staff calculations

**Figure S.8: Electricity access, Afghan businesses**



Source: BEEP, Afghanistan 2009.

**The agency that delivers electricity, Da Afghanistan Breshna Sherkat (DABS), lacks sufficient finances to operate and maintain the nation's electricity infrastructure and cope with the existing demand.** In Afghanistan, only 70 percent of energy is billed, and only about 60 percent of bills are collected.<sup>11</sup> Tariff collection from end users seems to remain below the full cost recovery. Thus, it is heavily dependent on international aid for investment to rehabilitate the country's damaged electricity infrastructure assets. Grid capacity has more than doubled in the last 10 years, putting DABS's maintenance costs alone at between 0.05 percent and 0.2 percent of GDP.

**There are alternate ways to increase the supply of electricity services.** On the macro scale, regional power trading—sharing of power generation and networks with neighboring countries—is an essential means for Afghanistan to expand and improve its national electricity coverage, as well as the financial sustainability of DABS. Moreover, local communities can play an important role in spreading rural electrification, as the government tries to promote the development of micro-hydro plants (MHPs). In rural Afghanistan, most poor households and communities typically rely on firewood, bush, animal dung, kerosene and private diesel generators.

### **Opportunities and recommendations**

- **Continue to expand domestic power-generation capacity.** This will require technical assistance and support for the implementation of the newly-generated capacity.
- **Enhance regional power trading.** Regional power trading can provide significant opportunities for Afghanistan to purchase electricity at cheaper prices. The country may also gain transit fees if regional power trade takes place between its neighboring countries. This will require physical

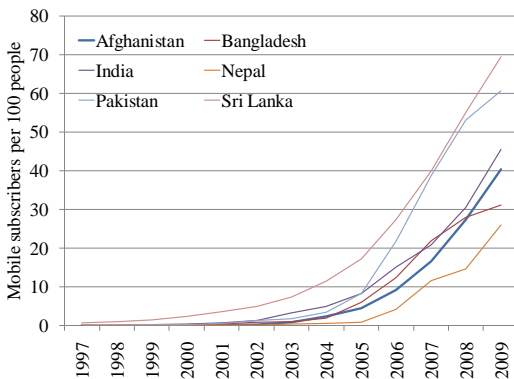
<sup>11</sup> ADB Report No. 42094.

interconnections to be completed and upgraded. Institutionally, the government should establish sound partnerships with neighboring countries to manage the risks of energy security, price volatility and uncertainty in international power trading.

### Information and Communications Technology

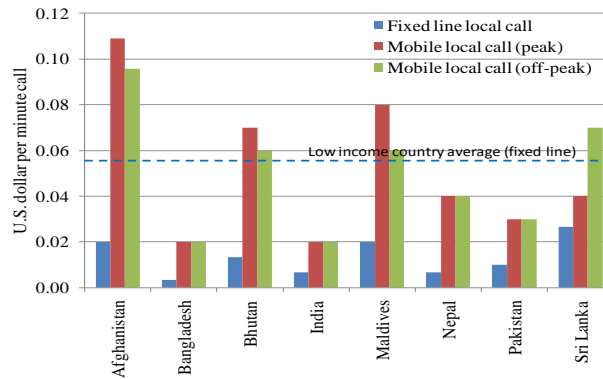
Access to telecommunications reduces the operating costs of international trade and increases a country's accessibility to the rest of the world, a truism widely supported by empirical studies.<sup>12</sup> Cross-border trade in services relies largely on telecoms as the medium for transactions.

Figure S.9: Mobile Teledensity



Source: World Development Indicators.

Figure S.10: Average Telecoms Tariffs



Sources: Based on operators' websites for Afghanistan; ITU database for other countries

**The Afghan mobile telecommunications market has grown vigorously in recent years, with significant progress in adopting mobile technology to build a national fiber-optic backbone that connects most provinces and neighboring countries.** This gives Afghanistan an opportunity to leapfrog to the most advanced technology in the sector. While fixed-line telecommunications remain minimal, mobile teledensity has increased dramatically, from virtually zero in 2002 to about 40 percent in 2009. By 2011, two-thirds of the Afghan population subscribed to mobile telephone services,<sup>13</sup> and two-thirds of households surveyed by the Asia Foundation reported own at least one mobile phone.<sup>14</sup> This compares well with other low-income countries. (Figure S.9)

**The ICT sector needs to be developed and expanded, but one of the biggest constraints is affordability.** In comparison to other countries in the region, Afghanistan's users pay the most (Figure S.10). Only three people per 100 in Afghanistan use the Internet, and broadband Internet subscription is virtually zero outside of the larger cities. To improve the coverage of ICT in Afghanistan, the Ministry of Communications & IT, which supervises the sector and must draw up the national sector development strategy, reform licensing and improve market competition. It must also establish pro-competitive and transparent interconnection arrangements, establish a transparent cost-based interconnection regime,

<sup>12</sup> Jansen and Nordas 2004 found a strong, positive correlation between the density of fixed and mobile telephone lines and trade relative to GDP, in which the supply response to a reduction in tariffs is larger the higher the penetration rate of telecommunications. Along these lines, a study of the impact of the Internet on US trade in services found that trading partners' Internet penetration had a significant impact on US imports of business, professional and technical services. In the US and most OECD countries, the Internet is the cheapest and most widely used medium to exchange information and services. Therefore, higher internet penetration and access to telecom directly affects the development of trade.

<sup>13</sup> <http://mcit.gov.af/en>

<sup>14</sup> <http://asiafoundation.org/publications/force-download.php?f=%2Fresources%2Fpdfs%2F2FTAF2011AGSurvey.pdf>

and ensure timely and independent dispute resolution. Aside from the ministry, the broader government could provide incentives by lowering ICT company tax rates, and implementing the “open access” policy on the national backbone network.

### *Opportunities and recommendations*

**Lower ICT tariffs.** To facilitate tariff reduction in ICT, it is essential to keep competitive pressure in the market. To this end, the government should focus on two issues: (i) enabling greater competition through reforming and unifying the licensing regime, and (ii) an “open access” policy.

- **Reform licensing to enable greater competition:** Issuance of new licenses should address earlier differences between GSM license terms and authorize the introduction of broadband wireless services to promote competition. The government should consider unifying licenses to make them technology- and service-neutral.
- **Consider implementing an “open access” policy to ensure access to the national backbone network, irrespective of ownership:** Open access to the backbone network for transparent and fair prices is essential to the sector’s future development. This would make capacity available to competitive service providers on a non-discriminatory basis with transparent and cost-based tariffs and serve national development objectives. Developing the Internet market in Afghanistan will require continued affordability in the wholesale market to foster competition and growth in the retail market. The NBN, therefore, is being constructed with public funds to serve the public interest.

### *Roads*

*Investment in better Afghan roads will pay off in the form of lower inland transport costs and delivery time, but this must be done in a way that ensures O&M liabilities are sustainable.*

**As a landlocked country, Afghanistan’s trade depends on its roads infrastructure network.** Access to quality roads stimulates economic growth in several ways. Good roads typically help firms to reduce transportation and transaction costs and minimize their inventory and distribution costs. A good road infrastructure, therefore, attracts foreign direct investment with likely increase in exports.<sup>15</sup>

**Afghanistan’s 42,150 km road network is in serious need of rehabilitation.** It is expected to have grown by an additional 7,000 km by 2014. Yet, the road density of 6 km per 100 square km of land area remains one of the lowest in the region. Only 30 percent of all roads are tarred. However, investments of about US\$4 billion in the last ten years has greatly improved the network, notably the national ring road, which connects Kabul, Kandahar, Herat, and Mazar-e Sharif. Road travel times between Kabul and Kandahar have dropped from 19 to 5 hours and between Kabul and Herat from 44 to 12 hours. The fastest-growing contributor to Afghanistan’s GDP between 2003 and 2009 was services, led by transportation, communication and storage, followed by construction, government services and manufacturing.

**Given the limited resources available and the weak implementation capacity at the local level, rural road development will likely remain challenging.** Reconstruction or rehabilitation of just 10 percent of the existing road networks would cost more than US\$394 million. The government needs to prioritize

<sup>15</sup> World Bank, 2009

road projects, and develop a sustainable funding mechanism for periodic road operations and maintenance.

### *Opportunities and Recommendations*

- **Prioritize road projects:** Given the limited resources available for road development, it is important to prioritize road projects.
- **Adequate funding and periodical road operation and maintenance:** Maintaining the existing road network, with routine and periodic maintenance, is the best strategy to avoid costly investments in rehabilitation. In the long run, the government should develop a sustainable mechanism to finance road maintenance, and new road investments should factor in these costs so as not to put undue fiscal pressure on an already-high O&M bill.

### *Why Regional Cooperation is Important for Afghanistan*

*For a landlocked country, regional cooperation is essential. Afghanistan would benefit greatly from improved access to markets and reduced financial, political, and security risks of large-scale investments. Afghanistan has taken important steps towards greater regional integration by seeking both North-East and South-South preferential regimes.*

**The Afghanistan-Pakistan Transit Trade Agreement (APTTA), that became operational in June 2011, will ensure greater access to ports.** Under the “Everything But Arms” (EBA) initiative, Afghanistan qualifies for duty-free and quota-free access for all of its goods to the European market. The United States grants duty-free access to 5,000 Afghan products under its Generalized Scheme of Preferences (GSP). Though Afghan goods face a higher tariff rate in the US than in the EU, the tariff is significantly lower than that applied to similar products from other LDCs.

**Afghanistan will benefit from its ratification of the South Asia Free Trade Area (SAFTA) agreement.** A World Bank Tariff Reform Impact Simulation Tool (TRIST) exercise<sup>16</sup> suggests that the ratification of the SAFTA agreement will bring benefits to Afghanistan’s export base in the medium term with relatively low cost in terms of lost revenues and rising imports—due to the current distribution of Afghan imports, tariff structure, and terms of the agreement.<sup>17</sup> Fiscal revenues may even increase if some existing informal imports become subject to Afghan custom procedures. This is because the agreement’s lower duties and taxes would likely reduce costs relative to the risks of informal trade. However, the agreement would more substantially boost Afghan exports through privileged access to other SAFTA countries. This would be important particularly for future trade with Pakistan and India which are relatively protected markets (both with average tariffs over 12 percent).

**Development of the mining investments in the coming years will provide Afghanistan with a window of opportunity.** The success in resource ventures will depend largely on how efficiently the products can be brought to market; as a landlocked country, Afghanistan’s resource corridor approach has an

<sup>16</sup> The WB TRIST tool is a partial equilibrium model that quantifies the effect of trade reform scenarios on imports, revenues and production. It uses actual trade flows and applied tariffs instead of the statutory tariffs (official commitments) and aggregated trade flows from international databases. This is important because, in the case of Afghanistan, exempted imports would account for over 45 percent of total tariff revenue, while other import taxes (and duties) account for almost 50 percent of fiscal revenue from imports. (For more on the results of the TRIST estimation, see Chapter V.)

<sup>17</sup> This simulation is based on customs administration data for fiscal 1389 (2010), and includes transactions at the tariff line level for 87,657 usable records, based on the Harmonized System nomenclature, 2007.

important regional cooperation dimension and its choice of logistical corridor will have an economic and political impact regionally. For its successful and sustainable exploitation, the resource corridor approach must combine multiple sectors and take proper account of infrastructure development, social and environmental impacts, and private-sector development and involvement. A resource growth corridor aims to exploit resource potential while avoiding resource dependency. It represents a combination of efforts to leverage a large extractive industry investment, and its requirements for infrastructure and goods and services, into viable economic development and diversification.

**The government's National and Regional Resource Corridor Program (NRRCP) focuses on developing the critical infrastructure needed to realize the mining sector's full potential.** However, at the moment, the NRRCP's targets are primarily an ambitious list of "hard" infrastructure projects in road, rail, and air. These targets should be supplemented by "soft" infrastructure—in particular, community development, land management and acquisition, the mitigation of environmental impact, enterprise development, and institutional capacity. If this soft infrastructure is not addressed simultaneously with (or before) physical infrastructure, the full potential of the investments may not be realized.

**Afghanistan is benefitting, through its WTO accession process, from a review of existing laws and regulations to ensure consistency with international standards and WTO requirements.** The country attained observer status to the WTO in December 2004 and is in the process of accession to full member status. The working group for WTO accession has focused mainly on issues such as the fixed 2 percent tax rate on imports, the process of import licensing, rules of origin, and customs and food-safety laws.

## Lowering the Transaction Costs of Trade in Afghanistan

### *Introduction*

**Trade is essential to national prosperity and key to fighting poverty and achieving the Millennium Development Goals.** Trade enables countries to import ideas and technologies, realize comparative advantages and economies of scale, and foster competition and innovation, which in turn increase productivity and achieve higher sustainable employment and economic growth. Countries open to international trade tend to provide more opportunities to their people, and grow faster. The Commission on Growth and Development has noted that all developing countries that have experienced sustained periods of high economic growth have done so by being open to global markets.

**This Diagnostics Trade Integration Study (DTIS) aims to better understand the drivers of import and export costs, issues that hamper Afghanistan’s integration into regional and global markets, and identify growth opportunities for the existing and potential export sectors.** Because these areas will have the greatest impact on trade development in Afghanistan, exploring the constraints on competitiveness in the supply side and understanding the opportunities from the demand side will give direction to the country’s National Trade Strategy. This report is intended to identify concrete policy actions in three principle areas of endeavor, to (i) lower the transaction costs of trade, (ii) increase Afghanistan’s competitiveness in world markets as a tool for economic growth and poverty reduction, and (iii) provide an analytical basis for Afghanistan’s National Trade Strategy. Trade cooperation and integration would play a strong role in promoting welfare in Afghanistan and greatly enhance prospects for peace and security in the country.

**The Afghanistan Diagnostics Trade Integration Study is divided into five chapters.** Overall, all five chapters provide a detailed and comprehensive analysis of issues directly related to the objective of reducing the transaction costs of trade. Chapter 2 in particular, looks at the issue of competitiveness of Afghanistan’s export sectors and suggests a strategy for trade development and export promotion.

### *Afghanistan’s Macroeconomic Environment*

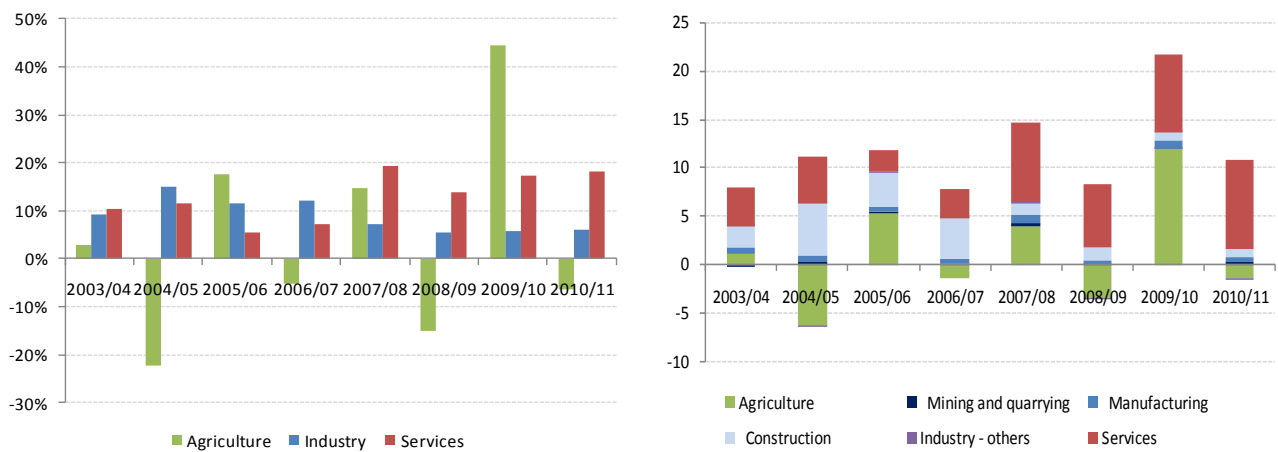
**Afghanistan is one of the poorest countries in the world.** After nearly a decade of strong growth, GDP in 2010 was US\$15.9 billion (excluding opium production). With an estimated population of 30.6 million, the country’s per-capita GDP of US\$528 places it among the world’s ten poorest countries. In spite of encouraging progress, social indicators remain dismal (and show wide gender gaps): 36 percent of people are poor and about three-quarters are illiterate.

**The country has seen exceptionally high economic growth** since the fall of the Taliban in 2001. Real GDP grew at 9.1 percent annually through fiscal 2004–2011 (Figure 0.1, graph A). High growth rates are not unusual for post-conflict countries. Conflicts often result in massive physical and human capital destruction, and during the recovery phase, investments – often financed by foreign aid – generate high returns to capital accumulation relative to the country’s normal situation. This leads often to higher-than-average growth immediately post-conflict. Although the economic performance of post-conflict

countries displays considerable heterogeneity, Afghanistan's has been much stronger than many (see Chapter I).

**Afghanistan needs to ensure its long-term economic growth prospects.** In view of Afghanistan's rapid population growth at around 2.8% annually, with GDP growth of around 6% progress in raising average per-capita incomes and reducing poverty would be very limited and slow: it would take approximately 22 years, a generation, to double current per-capita income. Relying on current drivers of growth, i.e. agriculture and mining will therefore be insufficient to provide income for the increasing number of (young) people joining the labor force (400-500,000 per year) as well as lifting the large numbers of poor people out of poverty.

**Figure 0.1: Growth of valued added by Sector** **Fig 0.2: Sector contribution to GDP growth (in %)** (2003/04-2010/11).



Source: IMF, CSO, and World Bank staff calculations.

Note: Excludes opium production.

**Growth in Afghanistan is extremely volatile, mainly because of its heavy reliance on agriculture.** Agricultural production is highly susceptible to weather and in fiscal 2011 contributed 23.3 percent of total value added. The services sector, too, has been a strong driver of the economy. In 2010/11 services constituted 51 percent of GDP, and contributed 9 percentage points of the 8.4 percent real growth (Figure 4). Agriculture, the second largest sector, shrunk in 2010/11 due to adverse weather conditions and reduced overall growth by 1.5 percent. Overall, agriculture value added has been fairly constant in absolute terms but declining as a share of GDP. Manufacturing (mainly food and chemicals) accounted for only 12 of GDP. The construction sector has been growing strong (6.3 percent of GDP in 2010/11) and feeding growth in manufacturing through demand for building material. Contributions from mining are almost negligible, but are expected to surge over the next decade. Wholesale and retail trade also play an important role, but mainly through weight in total services rather than strong growth.<sup>18</sup> (Figures 0.1 and 0.2)

<sup>18</sup> The United Nations Office on Drugs and Crime estimates that the farm-gate value of opium in fiscal 2010 was 8 percent of GDP, and the overall contribution to GDP (including processing, distribution, etc.) was close to one-third of output.



## Outlook

The World Bank conducted a study assessing the medium- to long-term impacts of declining aid and military spending (which can be expected to accompany the transition) on economic growth, poverty, fiscal management, service delivery, and government capacity in Afghanistan.<sup>19</sup> The government of Afghanistan, the World Bank and the larger donor community agreed that this analysis should strongly influence development policy, in conjunction with the Enhanced Integrated Framework (EIF), to enable Afghanistan to successfully navigate the challenges ahead. Here follows a summary of the findings of the study and examination of Afghanistan's trade prospects for trade in light of the upcoming growth and fiscal management challenges.

**The extremely high level of current annual aid (estimated at US\$15.7 billion in 2010) is roughly the same as Afghanistan's GDP and cannot be sustained.** Aid in Afghanistan has funded the delivery of essential services, including education and health, infrastructure investments, and government administration. But these inflows, mostly outside the Afghan budget, have been so high that aid dependency and use of parallel systems to circumvent limited government absorptive capacity, have impeded the building of a more effective Afghan state. The level of public spending – both on and off budget – that has been financed by such high aid flows will be fiscally unsustainable for Afghanistan once donor funds decline. Lesser amounts, matched by more effective aid delivery could lead to some more positive outcomes. But the key issue is how to manage this change and mitigate the adverse impacts and put aid and spending on a more sustainable path for the longer term.

**The impact of declining aid on economic growth will be less than superficial readings may suggest.** This is because most international spending “on” Afghanistan is not spent “in” Afghanistan, and much of what is spent in Afghanistan leaves the economy through imports, expatriated profits and outward remittances. Nevertheless, projections suggest that even with favorable assumptions real GDP growth may fall from the average of 9 percent per year experienced over the past decade to 4-6 percent during 2011–18. Given Afghanistan's annual population growth of 2.8 percent, this would mean only limited improvement in average per-capita income, continuing high rates of underemployment and little progress in reducing poverty. Only growth at the upper level of the range of plausible scenarios would enable Afghanistan to meaningfully reduce poverty and achieve higher per-capita incomes. For example, with real GDP growth of 6 percent per year, average per-capita income – currently one of the world's lowest, at US\$528 dollars – would take 22 years, or about a generation, to double.

**Economic growth would be even lower under less favorable scenarios.** The World Bank's growth projections up to 2014, and beyond, to 2022, are based on a set of assumptions (scenarios) related mainly to security, sources of growth, aid levels, and changes in investment climate. If the assumptions in the less favorable scenarios materialize – if, for example, agricultural performance is poor, major mining investments (Aynak for copper and Hajigak for iron ore) do not materialize, and if aid declines precipitously in the period – then growth could drop to 3-4 percent. Deteriorating security and

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<sup>19</sup> World Bank 2012, Transition in Afghanistan (forthcoming)



governance would lead to further economic decline. The underdeveloped financial sector and low rates of financial intermediation leave little scope for helping Afghan businesses adjust to slowing growth. Conversely, the decline could be partly mitigated by reducing aid in a gradual, planned manner, and by increasing the amount of aid that is actually spent within Afghanistan, and channeling as much as possible through the Afghan budget.

**Underemployment will increase because the activities affected by declining financial inflows (services and construction, mainly) are labor intensive.** Unemployment and especially underemployment in Afghanistan – estimated at 8 percent and 48 percent respectively – are already high, even with today’s rapid economic growth. Roughly 6 – 10 percent of the working population has benefited from aid-financed job opportunities, mostly in short-term employment. Declining aid, therefore, can be expected to exacerbate underemployment levels, with fewer casual labor opportunities and lower pay for skilled employees.

**The worst impact of the transition will be on the fiscal situation, with a projected financing gap of 25 percent of GDP by 2022.** Even if the ambitious targets for robust growth in domestic revenue are met (with a projected rise from 10 percent of GDP to more than 17 percent a decade from now) there will be an unmanageable financing gap. This gap will arise primarily as a result of operations and maintenance (O&M) spending and the wage bill for security, which together will be 17.5 percent of GDP by 2021.<sup>20</sup> Therefore, to close this financing gap, Afghanistan will continue to rely on donor funding to pay for most security and development costs.

**Customs is currently one of the main drivers of domestic collection, but its contribution will likely be affected by a contraction in demand for transport services and trade after the transition.** Annual growth in customs duties will most likely fall from the current 23 percent per year. However, the effective collection rate will most likely continue improving slightly – primarily due to better border controls, documentation of imports, and collection efficiency.

**With such pressures on public finances, resources for trade incentive schemes will be scarce.** This implies that going forward Authorities will need to do “more” with “less” in terms of trade and export promotion initiatives to avoid generating additional fiscal pressures over time. Along these lines, new infrastructure investments, which would be a driver of future growth and required to improve the competitiveness of the private sector, will need to ensure recurrent costs are adequately funded and will not worsen the O&M bill.

**Security and political instability pose a risk during Afghanistan’s Transition period.** Not only would they have an adverse effect on economic growth, but risk deterring private sector investment.

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<sup>20</sup> The civilian wage bill will increase to 9 percent, the non-security O&M expenditure to 4 percent, other operating spending to 2.5 percent, and the core development budget to 10 percent of GDP. (For a deeper discussion see: “Afghanistan in Transition: Looking Beyond 2014,” WB 2012)

Leveraging the private sector is key in the development of a resource corridor initiative to extract Afghanistan mineral wealth and to generate inclusive growth and for mining revenues to drive public finances. It will also impact trade flows and the ability of firms to grow and breakthrough to international markets. The recent Debt Sustainability Analysis (June 2012)<sup>21</sup> identifies significant risks stemming from the very high security and development spending needs as well from the vulnerabilities to the macroeconomic outlook. Should donor support be insufficient to meet the country's financing needs, security fail to stabilize, or structural reforms and governance improvements fail to materialize, Afghanistan's debt burden would become unsustainable, and the government would be forced to undertake significant fiscal adjustment. The analysis also underscore the importance of substantial long-term grant financing, in combination with a strong reform agenda and progress in security and governance reforms.

Afghanistan is heavily dependent on international trade, on fuel, inputs & raw materials, and food imports, but trade is not a main driver of growth. This would suggest that trade policy in itself is not the most pressing obstacle for growth in the country at this time. However, there are certainly areas where progress could be made and Afghan trade could play a greater role in raising incomes and reducing poverty, particularly with the uncertainty of the upcoming Transition period. But, to understand where these opportunities lie requires a look at the country's past trade performance and its trade policy. Such is the focus of the following chapter.

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<sup>21</sup> IMF- World Bank, Debt Sustainability Analysis, 2June 2012

Table 0.2: Selected Macro-Economic Indicators

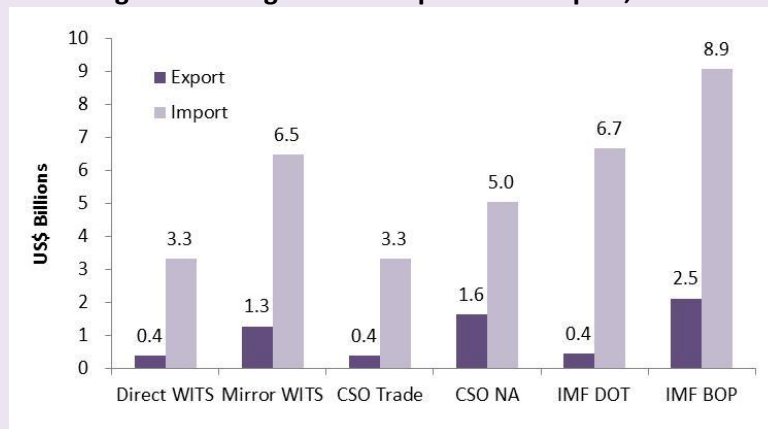
in % of GDP unless otherwise indicated	2007/08	2008/09	2009/10	2010/11	proj. 2012	proj. 2013	proj. 2014
<b>Real Sector</b>							
Nominal GDP (in billion Afghanis)	436	534	615	730	1,009	1,133	1,260
GDP (in billion US\$)	8.7	10.5	12.5	15.9	20.1	21.9	23.6
Real GDP growth (%)	13.7	3.6	21	8.4	7.5	5.1	5.8
GDP per capita				528	612	637	
<b>Money and Prices</b>							
CPI inflation (average, %)	13	26.8	-12.2	7.7	9.1	6.7	5
Broad money (M2) (in billions Afghani)	119.6	162.5	226.4	277.5	...	...	...
<b>Investment and Saving</b>							
Gross Domestic Investment	40.6	36.4	31.7	26.5	25.4	24.2	23.3
o/w: private	8.6	9	8.7	8.4	8.6	8.9	10.4
Foreign Direct Investment	2.8	2.9	2.4	2	2.1	2.3	3.3
<b>Government finance</b>							
Domestic Revenue	7.7	7.8	10.3	11	10.9	11.4	12.9
Total Core expenditure (Gov. Expenditure)	22	21.7	22.1	21.1	23.2	24.2	24.9
Overall balance (incl. grants)	-2	-4.1	-1.6	0.9	-0.4	-1.1	-0.2
<b>External Sector</b>							
Current account (excl. grants)	-68.1	-59.6	-51.3	-44.6	-44.9	-41.3	-39.4
Exports FOB (in million US\$) 1/	1,854	2,465	2,517	2,836	2,651	2,560	...
Imports FOB(in million US\$)	7,794	8,945	8,872	9,139	9,174	9,232	...
Gross reserves (months of imports )		5.3	6.0	6.4	7.2	7.6	7.7
<b>Total External debt</b>							
Total debt stock(in million US\$)	2,012	2,061	1,147	1,280	1,678	1,908	...
Debt-to-GDP Ratio (%)	23	19.7	9	8.2	7.2	7.2	7.2
<b>Memorandum items</b>							
Population (in millions)	27.41	28.36	29.27	30.18	...	...	...
Exchange rate, average (Afs/US\$)	50	51	49	45.8	45	45	...

Source: IMF, MOF, CSO, DABs, WB staff calculations, 1/ IMF BOP

### Box 1.1 Trade data in Afghanistan.

Analyzing and reconciling trade data in Afghanistan is a challenge. While the country has made progress in strengthening the quality and reporting of official statistics, trade data, official export and import flows, vary widely depending on the quality of the reporting, the methodology used, and the cited source. Official export figures in 2009, for example, differed significantly from \$400 million reported by the Central Statistics Office (CSO) to over \$2 billion reported by the IMF and the Central Bank for the same year. Such variances and misunderstandings over the different methodologies pose a constraint on the ability to use trade data as a tool for policy analysis.

**Figure B.1. Afghanistan Exports and Import, 2009**



**Table B.1. Difference Across Trade Data, 2009**

Includes estimates for:	Export	Import
Duty Free Imports	-	IMF BOP & DoT, WITS mirror data
Transit Flows (re-exports)	IMF BOP & DoT, WITS mirror data	IMF BOP & DoT, CSO National Accounts
Smuggling	IMF BOP	IMF BOP, CSO National Accounts,

This report attempts to better understand these differences across methodologies, which depend on the inclusion (or exclusion) of 3 factors within estimates: i) duty free non domestic imports, ii) transit flows, also called “re- exports,” and iii) estimates for “smuggling.” Table B.1 maps the differences across definitions for sources reporting Afghan trade flows.

The analysis on Chapter I relies on trade figures from the Central Statistics Office (CSO) and the Afghan Customs Department Trade (customs data). Together, these are the only two sources that report historical data over 2004-2010 and allow a breakdown by country and by product at the (HS 6 digit).<sup>22</sup>

<sup>22</sup> Direct data in WITS starts in 2008

## Chapter I: Trade Performance and Policy in Afghanistan

*Over the past decade, Afghan exports have underperformed and import values today equate to three times that of exports. It is the reflection of the high level of donor aid. The export base is unusually narrow, with few tradable products, concentrated in few markets, and trade data trends raise doubts about their long-term survivability. Afghanistan is one of the more open countries in the region and its tariff structure is below average compared to other LDCs. Few products are taxed above 15 percent, and while trade policy overall is conducive to trade development, trade is not a current driver of growth. Interestingly, trade policy is slightly progressive and richer groups tend to pay higher duties for their imports; an important finding, given the country's dependence on food imports.<sup>23</sup>*

### **Trade Performance**

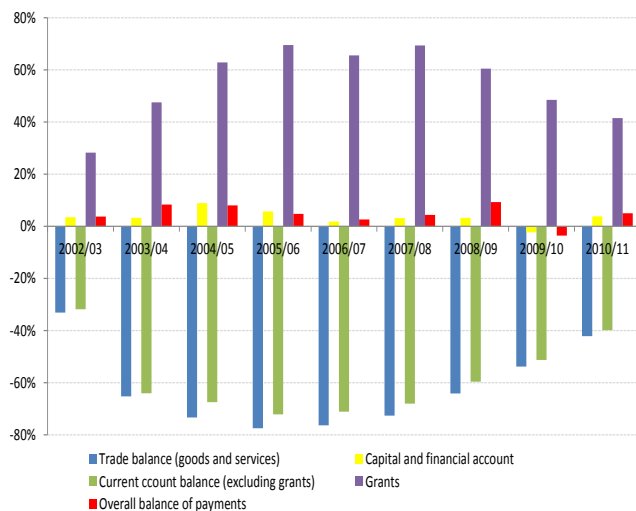
**Afghanistan's trade balance is heavily skewed towards imports, reflecting the large aid flows for the country's reconstruction and recovery efforts,** which generate direct and indirect demands for imported goods. However, the trade deficit has declined continuously in recent years. The current account deficit (excluding grants) went from 70 percent in fiscal 2007 to 34 percent in fiscal 2012, and was financed, as in previous years, by grants. These grants are spent mostly on imports of goods and services, thus, the grants not only finance the trade deficit, but also contribute to it.

**Afghanistan's import and export values have declined relative to GDP over the last five years.** While the trade gap has steadied, the relatively high import level has been driven in the last five years mostly by the demand for goods in donor-funded projects – particularly oil, machinery, household items and food (i.e., 80 percent of incoming goods). However, official export figures are underestimated and do not account for smuggled products and transit trade. In FY2011, import values estimated at US\$ 9 billion, amounted to more than three times that of exports (US \$3 billion). The overall trade balance narrowed in 2011 due to blockages at the Pakistani border, and disruptions of fuel imports with Iran; exports grew at 3 percent, while imports grew marginally by 0.2 percent and declined as a percent of GDP. While it is difficult to estimate the share of imports not captured in official figures (excluding opium, See Box 1.1), it is significant and has increased over the past 4 years, which to a certain extent explains some the decline of import values as a percentage of GDP. Another factor is the effect of Transition, the uncertainty of the withdrawal of troops and donor funding and the closing down of some donor projects, have impacted the demand for imported goods & services. (Figure 1.1 and 1.2)

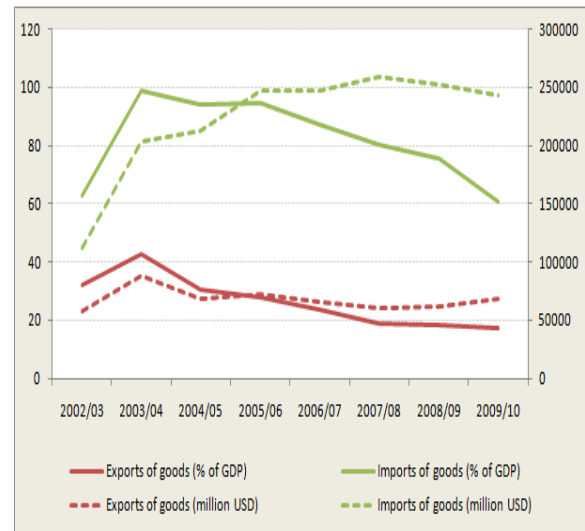
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<sup>23</sup> According to WB calculations using the 2008 National Risk and Vulnerability Assessment (NRVA) household data

**Figure 1.1: Balance of Payments, FY2003–2011  
(% of GDP)**



**Figure 1.2. Export and Imports trend**



Source: IMF

### Box 1.1. The Opium economy

The illicit production of opium<sup>24</sup> continues to play a significant role in agriculture as it produces nearly half of overall agriculture production but on a much smaller portion of arable land. The Opium economy is estimated at around 9 percent of GDP, when measured at farm-gate prices, and in 2011, export earnings from opium production represented around \$2.4 billion (15 % of GDP).<sup>25</sup> However, a significant share of these resources is expatriated and does not filter into the Afghan economy. The illicit nature of opium makes it difficult to quantify the size of the market and its contribution to output.

However, overall, from a macro-perspective opium is not a significant contributor to growth, while it may be a significant contributor to income of poorer groups in rural areas.

Current trends, however, indicate that opium production is on the rise again – a reflection of higher prices for opium and lower prices for wheat which skewed farm incentives towards opium production.

The farm-gate value of opium increased by 133 percent in 2011. According to the survey carried out by United Nations Office on Drugs and Crime (UNODC), This is the biggest difference in income (farm-gate) since 2003. The Two main factors contributed to the trend: In 2010, plant disease nearly halved crop production leading to crop scarcity. The resulting high price speculation motivated farmers to increase opium cultivation. This was compounded by a decline in international wheat prices, which resulted in a larger relative profit margin and a higher incentive for opium production. Gross income from opium was 11 times higher than for wheat in this fiscal year, thus making opium a much more attractive crop to harvest. Consequently, land used for opium cultivation increased by 7% and opium production

<sup>24</sup> Opium production is not included in the GDP figures in this section.

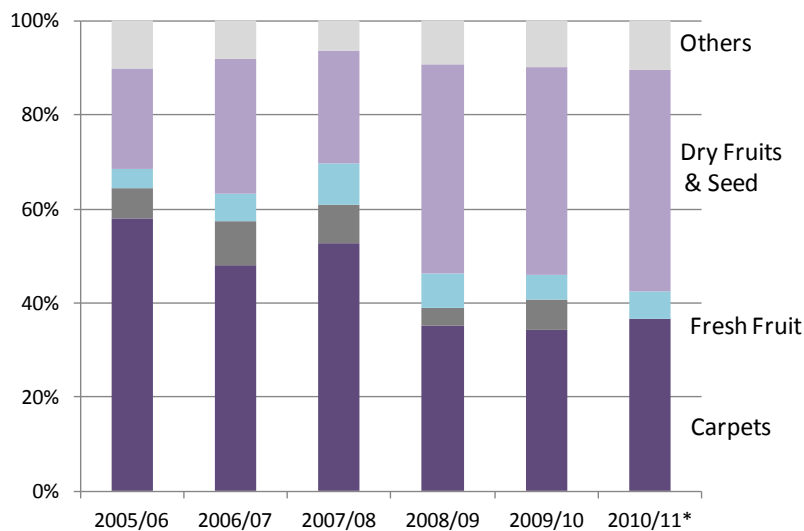
<sup>25</sup> UNODC, Opium Survey, 2011

increased by 61% in 2011.

**Afghanistan is heavily dependent on imports for inputs & raw materials, oil, machinery, and food.** Most of its food imports come from neighboring Pakistan and as a result, it has experience periods of high inflation, particularly during the early 2008 food crisis and after the Pakistani floods in 2010. Consequently, as an input to production, imports have a direct impact on domestic production and export performance.

**Private sector development in Afghanistan requires facilitating access to quality and low cost imported inputs.** This diagnostics study places significant importance on the removal of import-related constraints as a step to promote private sector development, exports, and inclusive growth. However, across certain sectors there is potential for substituting inputs with cheaper domestically produced goods. (For a deeper discussion on private sector development see Chapter II.)

**Figure 1.3: Composition of Exports**



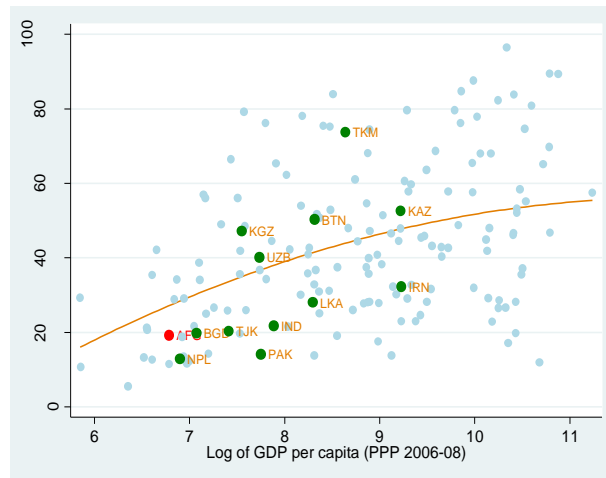
Source: CSO

**Over the past decade the composition of exports has changed, with dry fruits & seeds becoming the largest official Afghan export.** Through fiscal 2006–2010, exports of dry fruits and seeds grew to account for half the total exports, surpassing carpets, which dropped from 60 percent to 38 percent of exports (Figure 1.3). In addition, the export of fresh fruits accounted for just 6 percent of export trade, reflecting the limited infrastructure (cold storage facilities) available for handling fresh produce. The remaining 10 percent of exports comprised leather, spices, and medicinal plants.

**Trade in Afghanistan is largely informal.** It is estimated that the Afghan informal economy roughly accounts for some 80- 90% of the total output (including drugs). It is flexible in responding to shocks and to short-term opportunities, but also a reflection of the conflict. While the informal sector provides a vital source of income for the poorest groups, it can become a constraint on long-term growth because informal businesses tend not to expand in size, do not invest in technology, and face difficulties breaking

into export markets. Furthermore, informality sidesteps Afghan customs, evades taxation, and poses security and health risks because of the uncontrolled movements of goods. Informal traders take advantage of arbitrage opportunities offered by the widely diverging trade regimes in the region, thereby mitigating the distortionary effects of the more restrictive trade regimes. For Afghanistan, coping with such high levels of informality will be a challenge.

**Figure 1.4: Export ratio**



Source: WDI, WB calculations.

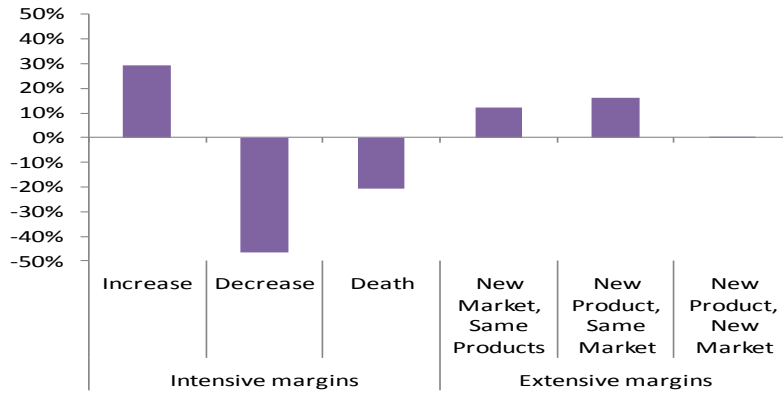
**Relative to its GDP, Afghanistan is underperforming in exports.** The country's exports lack diversity and carpets and dry fruits account for close to three-quarters of total exports. Its poor export performance in recent years has further weakened the balance of payments position. In this sense, one would expect Afghanistan's export-to-GDP ratio – which indicates the importance of exports of goods and services in an economy – close to 30 percent relative to its income level, but is only 20 percent. While the empirical evidence suggests that countries tend to trade more as their per-capita incomes rise, though at a decreasing rate, this is not happening in Afghanistan.<sup>26</sup> (Figure 1.4 presents this relationship through a scatter plot comparing the average export-to-GDP ratios with the log of GDP per capita (in PPP constant international dollars) for several countries in the region during 2006–2008.)

**The survivability of Afghan exports is a challenge.** A closer look at bilateral flows, of Afghan exports to specific countries, shows that between 2005 and 2009, disappearing trade flows, mostly toward EU, represented around 20 percent of export growth. In carpet exports to Pakistan alone, trade flows dropped sharply by 45 percent of export growth. In the countries where Afghan trade flows did increase, it was due mostly to larger volumes of traditional exports (intensive margins, same products to existing markets) and a smaller share of new products being exported to traditional markets (extensive margins). (Figure 1.5).

**Figure 1.5: Breakdown of Export growth**

<sup>26</sup> The broken line indicates the world median income. The curve is an ordinary least-squares (OLS) regression line of the trade-to-GDP ratio on the log of GDP per capita as well as its squared value.

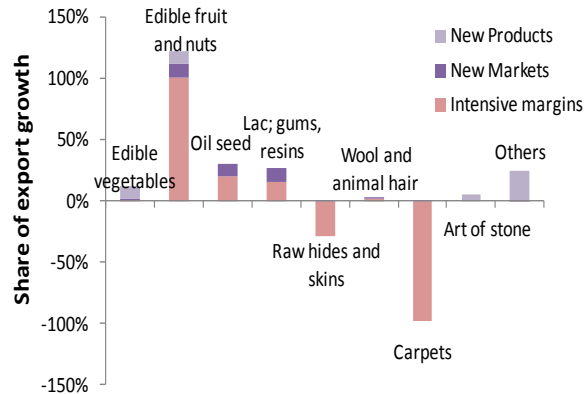
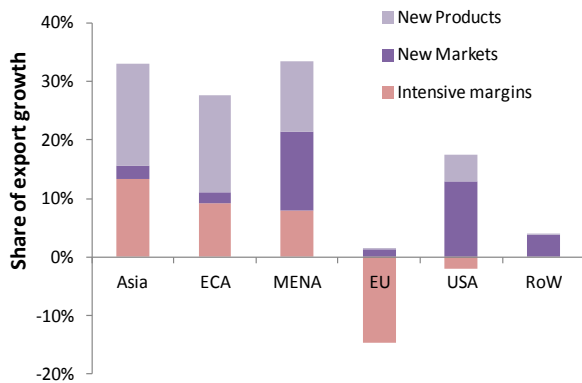




Source: CSO, World Bank calculations

**Across sectors that did reflect export growth, new products to Asia and the Middle East/North Africa (MENA) drove the increase.** Over the last five years, Afghan exports to these two regions have grown the most, followed by exports to Europe and Central Asia (ECA). The Afghan trade growth to MENA countries was a combination of new products and new markets, while growth in Asia and ECA was mostly new products to existing partner countries and intensifying trade of traditional exports (intensive margins). In the USA exports of new products drove growth, particularly for oil seed and lac, gums, and resins. Meanwhile, Afghanistan lost ground in traditional exports to the EU. (Figure 1.6 and 1.7)

**Figure 1.6: Breakdown of Margins, by region, 2005-09** **Figure 1.7: Breakdown of Margins, by product**



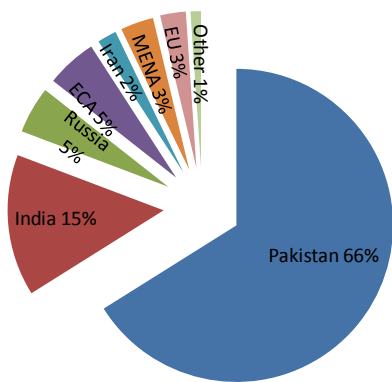
Source: World Bank, based on CSO. Note: Intensive margins refer to increasing existing trade flows.

**Diversification**

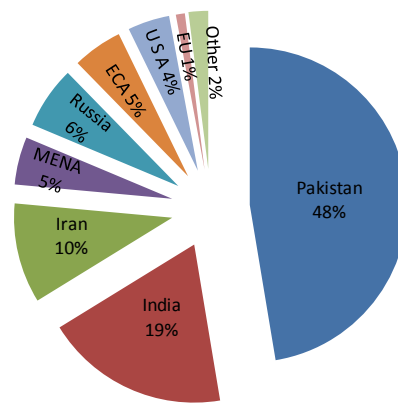
**Afghanistan’s export base is heavily concentrated on few products to a small number of markets.** The country exports only to 35 destinations, which is well below the average of about 90 markets for other LDCs. Given its level of GDP, Afghanistan is highly dependent on regional partners for trade and 80 percent of its exports reach only three markets. In 2010, carpets and dry fruits & seeds accounted for two thirds of total exports. (Figure 1.3).

**Afghanistan has reduced dependence on the Pakistan market and strengthened its trade with the MENA region.** Export trade shares shifted significantly between 2005-09, with exports to South Asia dropping from 80 to 65 percent and those to MENA increasing to a 15 percent share of total exports. Pakistan remained the biggest trade partner, with 48 percent of exports in 2010, but values dropped from US\$300 to 191 billion between 2005-10. This was followed by exports to India with a 19 percent share, to Iran at 10 percent, and to Russia a 6 percent share. The most notable change was the increasing share of exports to Iran, from US\$9 to 41 billion between 2005-10, while exports to Russia and India remain roughly the same, at US\$ 70 billion and 25 billion respectively.

**Figure 1.8: Export Partners, FY2006**



**Figure 1.9: Export Partners, FY 2010**

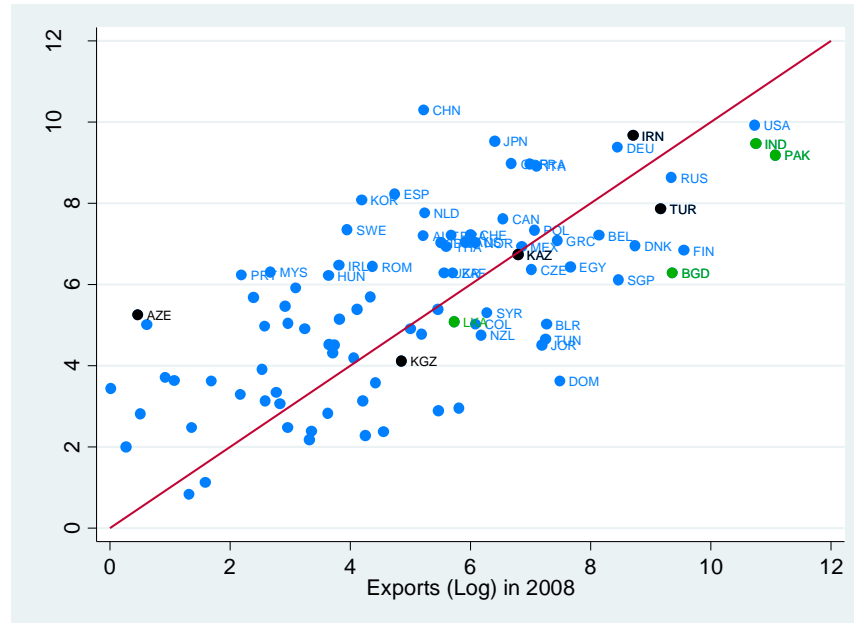


Source: CSO

**Afghan exports could diversify further by exploring opportunities with other EU and East Asian countries.** Gravity models are one way to better understand where more exports “ought” to be going, and a disaggregated analysis can highlight large markets, as well as and fast growing destinations. Given its level of GDP, Afghanistan could trade more with EU countries, particularly Spain, Sweden, Netherlands, and France (located above the 45-degree line), but also China, Japan and Korea provide great growth potential (Figure 1.10).<sup>27</sup> A rough estimation of exports to predicted exports shows a correlation between Afghan exports and predicted export to MENA (Tunisia and Jordan), South Asia, and EU countries such as Denmark, Finland and Belgium. (For a discussion on dynamic new markets for Afghan products and sector export potential see Chapter II)

**Figure 1.10: Predicted vs. Actual Exports with Partners**

<sup>27</sup> Figure 1.10 applies a gravity model for Afghanistan to indicate the extent to which it “over-trades” or “under-trades” with notable export destinations. It plots actual export amounts (divided by 1000, and then converted to log) earned in those markets against amounts that were predicted by a regression model.



Source: World Bank based on Comtrade with World Integrated Trade Solutions (WITS)

### *Afghanistan's Trade Policy*

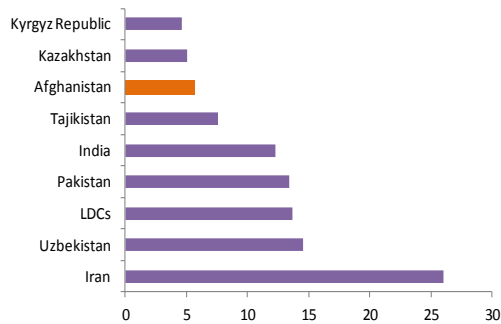
**Afghanistan is one of the more open countries in the region and its tariff structure is below average compared to other LDCs.** In general, trade policy is more business-friendly and conducive to economic growth when it is open, transparent, and predictable. In terms of trade policy, Afghanistan has taken important steps in establishing an enabling environment that fosters trade. Interestingly, household data suggest its tariff structure is progressive, and richer groups tend to pay higher duties for their imports; an important finding, given the country's dependence on food imports.

#### *Tariff Policy*

**In the past decade, the tariff structure has undergone consolidation.** Afghanistan's tariff regime was recently reformed, and now is characterized by overall low tariffs and a limited number of tariff bands. The country increased its maximum tariff on all goods (excluding alcohol and tobacco) from 25 percent to 40 percent in 2008, but the vast majority of goods fall into the 2.5–5 percent tariff band.

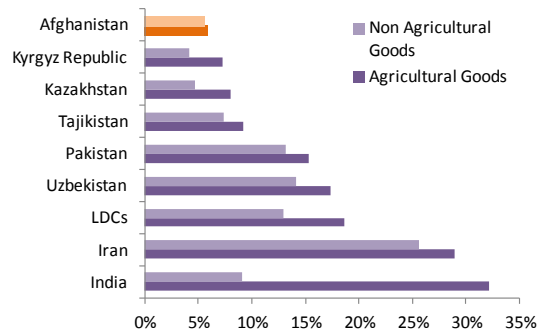
**Tariffs in 2010 are significantly lower than the average for low-income countries.** There were 10 tariff bands in 2010 and the simple average of the most-favored nation (MFN)-applied tariff rate has remained stable in the past few years, at 5.6 percent. This is significantly lower than the average 13.7 percent for low-income countries and South Asia (Figure 1.11). The tariff rates for agricultural and non-agricultural goods are nearly identical (5.8 percent and 5.5 percent respectively). The high tariff faced by Afghanistan on agricultural products on regional markets highlights the importance of regional trade agreements (Figure 1.12).

Figure 1.11: MFN-applied Tariff (%)



Source: World Trade Indicators (World Bank).

Figure 1.12: Tariffs by Type of Goods



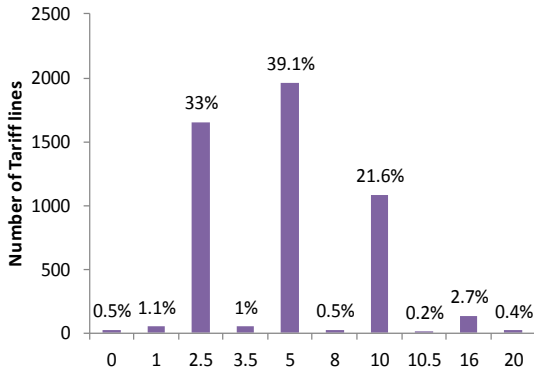
Note: Simple average, all goods

**Compared to other developing countries, the list of products with tariffs higher than 15 percent is small.** The maximum rate in 2010 was 25 percent and applied primarily to motor cars and vehicles. Over a third of the resources from customs are attributed to duties on motor vehicles and parts. The 20 percent bar covered products such as water and non-alcoholic beverages and building stone (e.g., marble). The list of 136 products subject to a tariff higher than 15 percent comprised mostly products Afghanistan currently exports, such as fresh or dried fruits, apparel and textiles, and emerging sectors producing flowers and plants, beauty and hair products. (Figure 1.3)

**Afghanistan has lower tariff dispersion than other low income countries.** (Figure 1.14) This is a positive finding and tariff dispersion refers to the disparity of protection across commodities within the same country. The higher the dispersion of tariffs, the higher is the deviation of activities from their most efficient use.<sup>28</sup> High dispersion in tariffs is more harmful than high protection in itself because if all industries are protected to the same extent, then resource flows will be neutral among sectors. It also gives rise to higher administrative costs and opportunities for rent-seeking behavior with relation to tariff classification as well as incentives for lobbying for protection. With 33 percent of Afghan tariff lines subject to a 2.5 percent duty and 21.6 to a 10 percent duty, Afghanistan ranks better than other low-income countries and 49<sup>th</sup> when measured by the coefficient of variation.

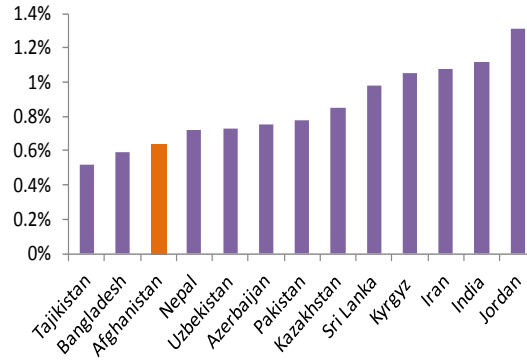
<sup>28</sup> A high level of protection on sugar compared with cereals, for instance, may discourage domestic use of sugar and increase the use of substitutes, such as cereal syrups, and restricting market access for sugar. Trade distortions resulting from such disparities can be more severe than those resulting from a slightly higher but balanced overall level of protection.

Figure 1.13: Tariff Distribution



Source: World Trade Indicators (World Bank)

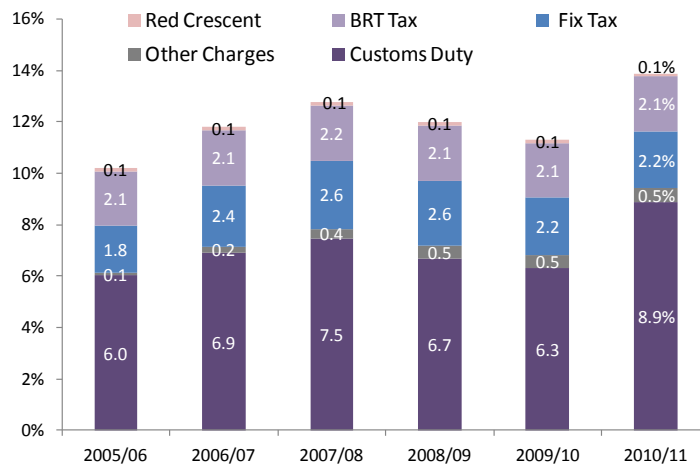
Figure 1.14: Tariff Dispersion



Source: TRAINS, WITS (World Bank)

**Afghanistan’s tariff structure is subject to significant exemptions.** Together, these exemptions represent a loss of about one-third of import duties and other taxes. Mostly, these are related to imports from ISAF and NATO security forces, development partners, embassies, and goods and services related to government- and donor-funded projects. Goods may be included in the exemption list upon recommendation of the Minister of Finance and approval by the Council of Ministers. The processes of granting exemption privileges invite rent-seeking and those industries that import goods under exemptions have an advantage, **Therefore, while some exemptions may not be modified as they involve bilateral agreements with ISAF and donor countries, a careful review of the exemption list could serve to identify ways of broadening the tariff base.**

Figure 1.15: Customs Revenue on the C.I.F. Value of Imports (%)



Source: ARD, MOF

**Afghan importers are taxed in ways that effectively raise the duty on goods entering the country.**

Customs collect around 5% as duty, 2% as fixed tax and 2% as International Red Crescent levy and with additional taxes it brings the total rate to about 11 percent of the import value. If Afghan importers have registered for a business license at AISA they pay 2 percent and those without it pay 3 percent. This is the incentive for traders to register, which in turn implies paying annual income tax. In addition, a 2 percent Business Receipts Tax (BRT) is collected at the border for all imported goods and traders report having to pay illegal levies to mustofiats and for the clearance of goods at customs. (Figure 1.15 and Table 1.1)

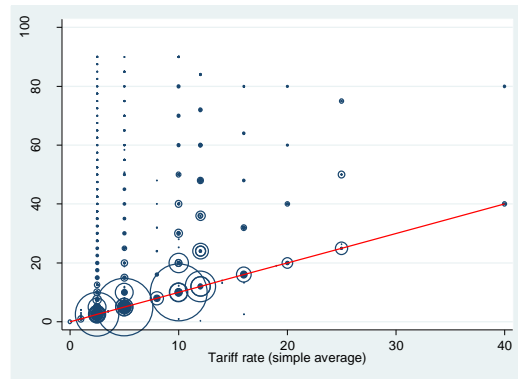
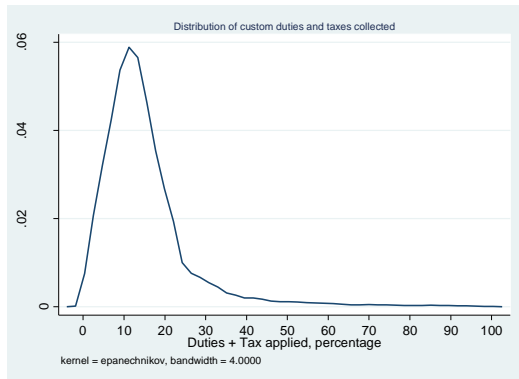
**Table 1.1: Import Taxes**

Type	Rate	Note
Tax benefiting Afghan Red Crescent Agency	2% of customs duty	All imports except food items.
Fixed Tax	2% (customs duty + customs value) or 3% of (customs duty + customs value) if no business license	All imports. The 2% can be claimed as credit in the calculation of the annual income tax assessment.
Business Receipt Tax (BRT)	2% of (customs duty + customs value)	Cannot be claimed as credit.

Sources: Customs, World Bank calculations

**Overall, customs data suggest transactions conform to the tariff rates in the books.** In fiscal 2011, imported goods paid on average about 14.8 percent of their value, of which 9.8 percent were customs duties. The mode of distribution was around 12 percent, through a combination of customs duties and other taxes. But a number of transactions paid above that rate (Figure 1.16). Comparison of actual applied tariffs with those in the tariff book shows a high rate of compliance (Figure 1.17). As expected, most transactions fall either on or below the red diagonal, indicating goods that are not tax-exempt. However, some data appear above the red diagonal, indicating that at least some goods were taxed above their stated import values. Further research would be required to better understand the reasons for this anomaly, as it could be caused by several factors: possibly flawed customs data, or regulatory non-compliance, or a more serious issue, such as goods being undervalued in declaration forms yet somehow attracting higher duties.

**Figure 1.16: Distribution of Collected Revenue (Duties & Taxes)** **Figure 1.17: Ratio of Duty Collected (Duties & Taxes)**



Source: Customs, WB Staff calculations

### Developing government capacity for trade policy evaluation is key to take informed policy decisions.

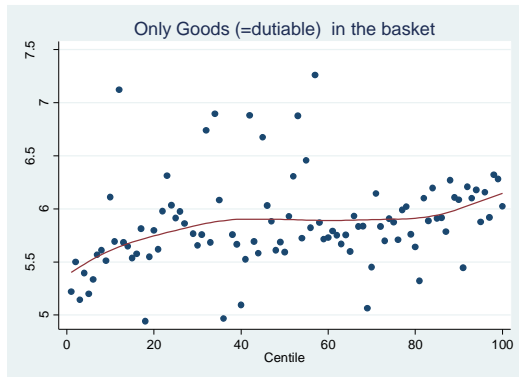
While Afghanistan's trade policy overall is conducive to trade development, in order to take informed policy decisions going forward, strengthening the capacity of MOCI to evaluate the impact of different trade policy alternatives is important. This could include building capacity: to analyze indicators and monitor results of policies and investments, on trade negotiation, impact evaluation techniques, and economic modeling of trade policy impact. However, it would require developing and maintaining a database with trade data to inform such policy analysis. The database should compile trade information from different agencies including data from the CSO, ARD, and existing donor-funded trade-related surveys). With such tool, the technical units within MOCI would be able to prepare periodically bulletins analyzing trade data trends for management. Thus, building capacity at the MOCI to maintain the database is key.

### Impact of Afghanistan's Tariff Structure on Poverty

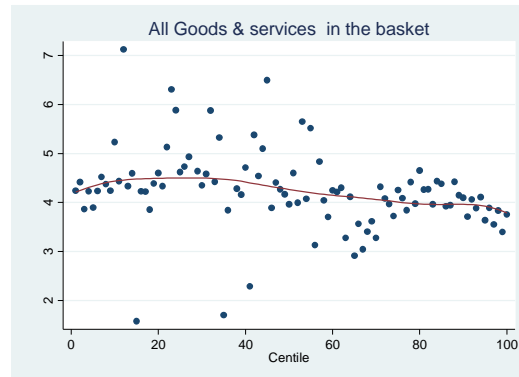
**Afghanistan's tariff structure is slightly progressive.** Household consumption data for a basket of basic goods from the 2008 National Risk Vulnerability Assessment (NRVA) suggest that tariffs are biased in favor of lower-income households. For a country with great food insecurity and a net importer of food, this is a promising finding. The average tariff paid by the poorest households (Figure 1.18) was below 6 per cent, whereas wealthier households paid a much larger share.<sup>29</sup> To some extent it is reflected by lower taxation on food imports compared to taxes on other imported goods, consumed by richer segments of the population and services. Notably, richer households in Afghanistan consume a larger share of services, thus, when including services within the basket of goods, the impact turns from progressive to regressive.

<sup>29</sup> The data used from the NRVA 2008 included 90 food products (staples, meat, fish, beverages, processed food, etc.), 20 goods (soap, toothpaste, detergent, clothes, fuel, mobile phones) and 20 types of services (including personal grooming, doctor fees, education, etc.).

Figure 1.18: Tariff structure progressive...



...or slightly regressive



Sources: World Bank, based on TRAINS and Household Survey

The government of Afghanistan has taken important steps to increase the transparency of cross-agency coordination for tariff policy and customs revenue collection. Relevant information is posted regularly on the websites of the Ministry of Commerce and Industry (MoCI) and the revenue department responsible for customs. However, greater coordination across government agencies responsible for designing and implementing trade policy is needed. For example, the MoCI is responsible for negotiating trade agreements and tariffs with partner countries, while the Ministry of Finance (MoF) is responsible for the customs law and overall customs duty collection. Greater coordination across these two ministries and other government agencies involved are being considered within the WTO accession process.

### Non-Tariff Measures

Most non-tariff measures in Afghanistan are to prohibit imports of goods on the basis of compliance with moral, security, and religious beliefs. Non-Tariff Measures (NTMs) have risen in importance worldwide as a result of multilateral rounds and preferential agreements that have pressured countries to reduce their tariffs. In Afghanistan, NTM are not widespread and the Customs Law (Art 53/2005) explicitly places restrictions on trade on the basis of compliance with public morality, public security, environmental protection, health and life of humans, animals or plants, protection of national treasures, and protection of industrial and commercial property. This amounts to the prohibition of imports of alcoholic drinks, live pork and pork meat, narcotics, and ammonium nitrate. However, other commodities in the prohibited list suggest the protection of certain domestic industries – for instance, restrictions on the trading of cotton seeds, gypsum, anhydride, plaster, and salt. (For a list of Non Trade measures, see Annex II)

The importation of the following goods into Afghanistan is further subject to substantive and procedural limitations:

- Medicines, subject to permissions and regulations of the Ministry of Public Health and the Ministry of Agriculture;



- Armaments and military equipment, subject to regulations for the import of arms, ammunitions, military equipment, spares required for their manufacture, military-related scientific-technical information, subject to a special permit from the Ministry of Defense; and
- Goods subject to measures determined by the Ministry of Finance. These non-tariff measures include quantitative restrictions, absolute prohibition, quantity control measures, technical measures, discretionary import licenses, import licensing, automatic import licensing, non-automatic licensing prior to authorization for sensitive products, inspection, and quarantine

### **Standards**

**While tariff and quota barriers to trade in many agricultural, food, and manufactured products have declined, international trade is governed by an increasing range of product and process standards and technical regulations.** Standards and technical regulations, whether for products, labor, or for the environment, are applied to mitigate against health and environmental risks, to prevent deceptive practices, and to reduce transaction costs in business by providing common reference points for notions of 'quality', 'safety', 'authenticity', 'good practice', and 'sustainability'. In practice, however, standards and technical regulations may be used strategically to enhance the competitive position of countries or individual firms.

**The concept of “quality” standards is not currently well defined in Afghanistan's legal framework and is often confused with safety and protection of health.** Thus, the new SPS and TBT laws will draw clear distinction between these concepts. Afghanistan intends to start drafting a law on food safety and producer declarations/certificates will be considered for low-risk food products. In addition, it aims to intensify efforts in the coming years to achieve greater harmonization of the quality standards and guidelines that follow international standards (OIE, IPPC, Codex Alimentarius, and ISO).

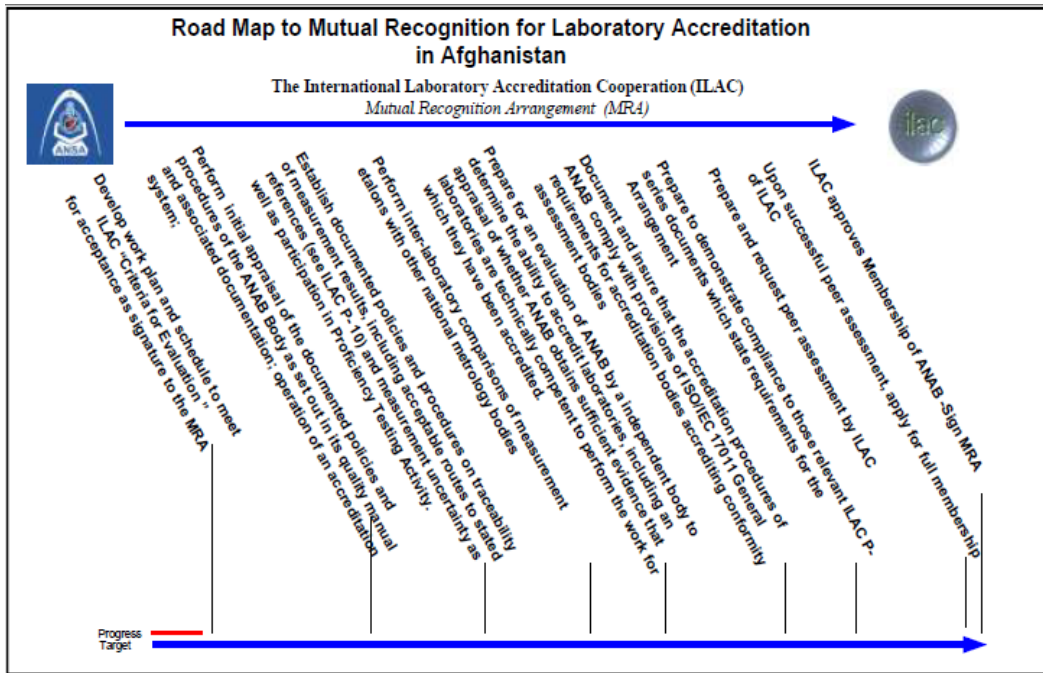
**As part of the WTO accession process the government through the Afghan National Standards Authority (ANSA) and the MOCI are working on developing a regulatory framework.** This aims to develop a framework for standards and technical regulations and comprises the preparation of: a Standard Law, a Law on Plant Protection and Quarantine prepared by the Ministry of Agriculture (MAIL), a law on animal health and veterinary services is being prepared by MAIL, amendments to the 2005 customs law prepared by the Ministry of justice, a law on control of trade in strategic goods and services being developed by MOCI, and a law on metrology being developed by ANSA. These laws are undergoing revisions at the ministries and are in draft form. (For a discussion on WTO accession see Chapter V).

**The ANSA was established in 2004 with a mandate to enable quality control of commodities and services, consumer protection and environment protection.** In March 2011, it introduced the Strategic Plan for the Development of a National Quality Infrastructure in Afghanistan that attempts to organize activities in the areas of metrology, accreditation and standardization processes. The plan is aimed at ensuring that standardization activities are organized to improve access to existing and new markets for Afghan goods and services. ANSA has also set up technical committees to develop National Standards

for petroleum products, food and agricultural products, pharmaceuticals and cosmetics, construction materials, textile, environment and electro-technical.

**The ANSA is working towards achieving the accreditation of the Afghan National Accreditation Bureau (ANAB).** Accreditation is the international recognized procedure demonstrating the competence of a laboratory or certification body. Thus, establishing an accreditation system, based on international standards and linked with membership of the International Laboratory Accreditation Cooperation (ILAC) and the International Accreditation Forum (IAF), will provide mutual recognition and assure trading partners tests and certificates are competent. The road map to achieve recognition is below (Table 1.2).

Table 1.2. Roadmap for Laboratory Accreditation by ILAC



Source: ANSA Report 2011

**Veterinary certificates are required for the export of animals and animal products.** These are issued by the General Directorate (DG) of Animal Health under the MAIL, while the phytosanitary certification for exports of plants and plant products are under the Directorate for Plant Quarantine (following the IPPC standards). The quality permits required for the imports of non-processed agricultural products (except live animals and live plants), agrochemicals, and chemical fertilizers are issued by the DG of Food Security and Quality Control, which is responsible for carrying out a physical inspection at the border and examines the quality certificate issued by the exporting country (a mandatory requirement to import) It is also responsible for issuing the Quality permits required for the export of all non-processed agricultural food products (except live animals and live plants). Finally, the Quality certificate for export of fresh fruits, dried fruits, and vegetables is issued the Afghan Raisin, Fruits and Vegetables Promotion Association. In practice, however border control for the movement of animals to and from Pakistan and the import of products of animal origin is rarely enforced.

### *Opportunities and Recommendations*

**Develop a capacity building plan for trade policy evaluation in the directorates responsible for designing and evaluating trade policy within the MOCI.** In order to take informed policy decisions, strengthening the capacity to evaluate the impact of different trade policy alternatives is important. This could include building capacity on to analyze indicators and monitor results of policies and investments, on trade negotiation, impact evaluation techniques, and economic modeling of trade policy impact

**Develop a database with trade data to inform policy analysis.** The database should compile trade information from different agencies including data from the CSO, ARD, and existing donor-funded trade-related surveys). Building capacity at the MOCI to maintain the database will be key. On the basis of this database, the technical units within MOCI would be able to prepare bulletins analyzing trade data trends for management.

**Conduct a review of current items exempt from paying tariffs with the aim to broaden the tariff base.** This will lessen the impact from foregone revenues, which is estimated at a third of import revenue, but minimum consumption basket food items should remain exempted in order to protect the poor.

**Monitor the elimination of Non-trade barriers.** Identify NTMs implemented by all government agencies and make information on them readily available to the private sector, as there is lack of clarity over requirements. By making the implementation of NTMs more transparent the private sector will be in a better position to comply with them. Identify NTMs implemented by all government agencies and streamline related procedures in terms of time and cost. Conduct a firm survey on NTMs faced by importers and exporters and set up a public-private NTM Review Committee to discuss less trade distorting alternatives.

If Afghan trade policy overall is conducive to growth, then why is trade not playing a greater role in economic development? The findings from this chapter suggest that while trade is underperforming in terms of its potential contribution to economic growth and welfare, there is, in general, a policy environment for its development. The following chapters attempt to answer this question by having a closer look at the supply side constraints, trade facilitation systems in place for effective customs and logistics, infrastructure services and private sector development. Thus, the subsequent chapter aims to understand the existing Afghan customs systems in place and the status of the ongoing customs reform, which will have great impact on improving trade facilitation.

## Chapter II. Trade Development and Export Promotion

*Afghanistan's national trade strategy could focus on private sector development to produce cheaper quality goods, promote an attractive investment climate and lower costs for quality inputs. It could also promote exports by facilitating breakthroughs into international markets for established competitive firms. Exporting from Afghanistan is expensive; trade diagnostics suggest the principal barriers lie on the supply side. This implies that export support will be most effective when geared towards raising the competitiveness of firms. The literature on sectoral and value chain analysis shows that competitiveness across potential Afghan export sectors is hampered by (i) high costs due to microeconomic and lesser extent macroeconomic fundamentals, (ii) low value added, and (iii) institutional constraints.*

**This chapter aims to inform the process of developing a National Trade Policy for Afghanistan.** It is essential to set a direction and role for trade to contribute to the country's economic development. The first section of this chapter discusses the role of the public sector in private-sector development and proposes concrete measures to improve the overall business climate. A second section explores the role of export promotion and current barriers to export development in Afghanistan. The third, final, section examines sector-specific actions that could impact growth and draws lessons from a rich literature of sectoral reviews and value-chain analysis.

**Afghanistan is heavily reliant on imports of goods, some of which would be cheaper to produce domestically.** To achieve export-led growth, public policy generally looks for ways to increase the ability to sell domestically produced goods and services on global markets. Exports become the target and ultimate goal of economic policy, which is beneficial because exporting generates positive externalities and increases firms' competitiveness. Afghanistan, however, would benefit from a two-pronged trade development strategy: (i) focusing on private-sector development and on producing cheaper quality goods domestically, and (ii) facilitating the breakthrough into international markets of established and competitive firms ready to expand. Measures to achieve the first prong focus mostly on reducing the costs of imports of quality raw materials and with improving the business climate (see first section, below). To achieve the second prong, export promotion measures are more relevant, such as marketing, branding, and creating added value (see second section, below).

### *Private-Sector Development*

#### *The Role of the Public Sector*

**National Trade Policy, and its export component, should aim to set an enabling environment for the private sector to flourish.** Public policy can enable the private sector to become a motor of growth when it corrects instances where markets fail to allocate resources efficiently. It should aim to minimize price distortions faced by both producers and consumers, while promoting inclusive growth. In practice, this translates into interventions in several dimensions:

- i) Correcting for externalities, which requires making people pay (or be paid) for the cost and benefits of their actions—for example, discouraging the over-use of fertilizer leading to pollution, or rewarding advances in R&D with a patent;
- ii) Providing for public goods that are not efficiently and sufficiently produced by the market—for example, providing security, building rural roads and irrigation systems, and funding R&D);
- iii) Addressing information asymmetries, eliminating information gaps so that producers and consumers can make informed decisions on what to produce, with what level of inputs, and at what price—for example, certifying products with input and output quality standards, ensuring plant and animal health, providing information to potential exporters about demand in foreign markets; and
- iv) Regulating against monopolistic behavior that reduces social welfare through lower outputs sold at higher prices.

**An attractive investment climate will set incentives for private activity to grow, for firms to invest over the medium term, which in turn will translate into new job opportunities.** In this sense, regulations play an important role, and if transparent, accessible, and efficiently implemented these will stimulate growth, job creation and poverty reduction. As one measurement of the investment climate, the World Bank's Doing Business indicators provide a set of benchmarks to help governments identify areas where regulatory reform can help foster private-sector growth.<sup>30</sup>

**A World Bank assessment of the business climate in Afghanistan in 2011 recommended reforms in nine of the ten indicators of the Doing Business.**<sup>31</sup> This DTIS places special emphasis on a subset of these indicators in an effort to boost private sector development and export generation through (i) starting a business, (ii) getting credit, (iii) protecting investors, and (iv) enforcing contracts.<sup>32</sup>

**Afghanistan, represented by Kabul in Doing Business 2012, ranked 160th out of 183 economies and last among the eight economies that make up the South Asia region.** This was well behind countries such as Maldives (79), Sri Lanka (89), Pakistan (105), Nepal (107) and Bangladesh (122). The country's performance was uneven across the Doing Business indicators. It ranked relatively high in starting a business (30) and paying taxes (63), but last (183) in protecting investors, and poorly in indicators such as trading across borders (179), registering property (172), dealing with construction permits (162), enforcing contracts (161), and getting credit (150). These rankings reflect outdated regulations and unnecessary bureaucracy that create significant barriers for Afghan businesses.<sup>33</sup>

<sup>30</sup> The Doing Business methodology is one of several measures of an investment climate. Other areas important to a business are not included, such as a country's proximity to large markets, the quality of its infrastructure services (other than those related to trading across borders), the security of property, transparency of government procurement, macroeconomic conditions, financial market regulation and the underlying strength of institutions. (See [www.doingbusiness.org](http://www.doingbusiness.org)).

<sup>31</sup> Improving the Ease of Doing Business in Afghanistan Reform Memorandum, WB-IFC, February 2011.

<sup>32</sup> The recommendations are based on comparative good practices on investment climate regulations, and represent the conversations the World Bank Group had with government agencies and stakeholders during a World Bank Group mission to Kabul from September 16-23, in 2011.

<sup>33</sup> The Doing Business data findings are further bolstered by the World Bank Group's Enterprise Survey, which asked 535 firms to list the most problematic factors for doing business: 53 percent identified corruption, 37 percent said access to finance, and 30 percent pinpointed obtaining a business license and the permitting process as major constraints.

**Improvements in the Doing Business rankings are difficult to predict for Afghanistan or any other country.** Rather than aiming for specific advancements in the rankings, the government should promote reforms to improve the investment climate. A rigorous reform effort will likely improve Afghanistan's Doing Business rankings and—more importantly—provide a better business environment, more conducive to economic growth and private-sector development.

Starting a business

**Business entry in Afghanistan has been simplified in recent years by taking company registration out of the commercial courts and establishing an Afghan Central Business Registry (ACBR).** The Registry acts as a one-stop shop, combining company registration, tax registration, publication in the official gazette, and charges a flat registration fee. While these reforms are a leap forward, the process to register and operate a business is still encumbered with bureaucracy and unnecessary licenses. Presently, all businesses, regardless of sector or risk to public health or environment, have either to get a trader's license from the Ministry of Commerce and Industry (MoCI) or an investment license from the Afghan Investment Support Agency (AISA). This is in addition to sector-specific licenses from respective ministries. Businesses are also instructed to renew their licenses every year, which takes three months, with renewal fees ranging from 25-100 percent of the original license fee (according to sector).

**The need for further business entry reform is pressing because the majority of Afghan enterprises are small and medium firms.** Studies have shown that regulatory costs are more burdensome for small firms than larger ones.

**Speeding up the process to renew investment licenses and the frequency of renewals would reduce costs.** AISA mandates the yearly renewal of licenses, with the stringent renewal fees mentioned above, and amounts from US\$25 to US\$500 (according to firm size). This does not include the cost of a copy of the certified license (US\$10) or the fees paid by construction companies to publish in the Ministry of Justice's gazette (US\$32). AISA could charge a small, flat administration fee to renew licenses, instead of fees based on sector or firm size. Authorities maintain that the renewal helps the Ministry of Finance's auditing process, and helps monitor tax compliance. Firms have complained about the 3-4 months renewal process, during which they cannot apply for bank loans, thereby disrupting their business activities. Expediting the annual license renewal will save firms time, helping them focus on more important functions. Speeding up the process will involve setting thresholds for which companies' books get inspected (e.g., only for those with turnover exceeding US\$100,000), streamlining the inspections process at AISA and eliminating the requirement for gazette publication altogether. Reducing the frequency of renewal to every two years would also reduce the burden on businesses.

**The Ministry of Commerce & Industries (MoCI) and AISA should synchronize so that entrepreneurs deal only with a single agency for registration and licensing.** Presently, entrepreneurs have to deal with several agencies for business entry: the ACBR, AISA and the MoCI's licensing department. The process is confusing and duplicative. The government of Afghanistan may consider a single point of interaction

between it and the entrepreneur, where all the information and fees are collected, and registration certificates and licenses are dispensed.

### *Access to credit*

**Doing Business covers two aspects of regulation that affect the availability of credit: the quality of credit information and the strength of the legal rights of borrowers and lenders.**<sup>34</sup> Afghanistan ranks 150th globally in this indicator, and 7th in South Asia. The country's score on the strength of legal rights index (6 out of 10) indicates that debtors and creditors enjoy some legal guarantees to borrowing and lending. The depth of credit information index (0 out of 6) indicates a significant dearth of credit information and much room for improvement in information sharing.

### *Investor protection*

**Afghanistan ranks last globally and regionally on the strength of investor protection.** The Doing Business measure ranked the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain. The overall index of investor protection is an average of three sub-indices, including disclosure, director liability, and shareholder suits, in each of which Afghanistan scored 1 out of 10.

**Amendments must be made to both the Joint Stock Company Law and the Corporations and Limited Liability Companies Law to align their investor protection and disclosure requirements more completely with international best practice.** In 2009, Afghanistan amended the Joint Stock Company Law to require greater corporate disclosure in company annual reports. The amended law should also mandate an independent auditor review of large related-party transactions before the transactions take place. Shareholder approval of large related-party transactions should also be a requirement. Article 50 of the Corporations and Limited Liability Companies Law, dealing with conflict of interest in transactions, should be amended to increase disclosure requirements to the public and in the annual reports in cases of related-party transactions. Currently, the corporation's law requires only the board of directors' approval in case of large related-party transactions (above 5 percent of the assets of the company). However, in order to better protect minority shareholders, these transactions should be approved by the shareholders' meeting.<sup>35</sup>

**It should be easier for investors to enforce their rights through the courts.** In the case of a mismanagement suit against a company's director, interested parties should be allowed to access

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<sup>34</sup> The first aspect, measured by the depth of credit information index, includes the coverage, quality and accessibility of credit information available through public credit registries and private credit bureaus. The second, measured by the strength of legal rights index, evaluates the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders.

<sup>35</sup> In Albania and Rwanda, related-party transactions representing more than 5 percent of a company's assets must be approved at a shareholders meeting. If the transactions represent less than 5 percent of assets, they must be approved by the board of directors. This dual model allows a company the necessary flexibility to conduct its daily activities, and ensures that minority shareholders are involved in major decisions. In the UK, minority shareholder approval of such transactions is always required.



relevant non-confidential company documents without having to file suit, and without having to identify specific documents. Parties to a trial should be allowed to question (orally or in writing) the opposing party or the witnesses during trial without prior approval of the questions by the judge. In order to facilitate the access to evidence during the trial, minority shareholders' lawyers could be allowed to directly question the defendant and witnesses during a trial.

### *Enforcing contracts*

**Measuring the efficiency of Afghan courts in resolving commercial disputes, the country is close to the bottom of the ranking in the enforcing contracts indicator—161 out of 183 economies, and 6th in South Asia.** On average, it costs 25 percent of the claim value and takes 47 procedures and 1,642 days to resolve a commercial dispute at the Kabul Commercial Court. According to the Enterprise Surveys, only 17 percent of firms believed the court system was fair, impartial and uncorrupted.

**In post-conflict Afghanistan, many courts are inoperable and those that do function are understaffed.** Insecurity, lack of proper training and low salaries has driven many judges and prosecutors from their jobs. Those who remain are susceptible to bribery. As a result, the public has lost confidence in the formal justice system, and disputes are resolved through notables or in the private sector by traders. The patchwork of laws adopted over three decades of conflict, combined with a multi-layered system of jurisprudence (secular, Sharia and customary or traditional tribal law) has confounded investors and challenged international legal standards.

**Setting up an alternate dispute resolution mechanism could improve efficiency of commercial judgments.** Alternate dispute resolution systems offer disputants a chance to avoid the often long and expensive process of taking a case through the formal judicial system. Mediated solutions are generally faster, less expensive, and more likely to allow the parties to return to doing business with one another. This has long been an important part of dispute resolution in many developed countries and is becoming increasingly important in developing countries as they attempt to reform their judicial systems.

### *Opportunities and Recommendations*

#### *Starting a business*

**Short Term:** Speed up the process to renew investment licenses and reduce cost and frequency of renewals. It is recommended that AISA charge a small, flat administration fee to renew the licenses, instead of a fee based on sector or firm size.

**Medium Term:** Re-organize the MoCI and AISA so that entrepreneurs will only deal with a single agency for registration and licensing. The government of Afghanistan may consider a single point of interaction between the government and the entrepreneur, where all the information and fees are collected, and registration certificates and licenses are dispensed.



### *Investor protection*

**Short Term:** Amend both the Joint Stock Company Law and the Corporations and Limited Liability Companies Law to align their investor protection and disclosure requirements more completely with international best practice. The amended law should also mandate an independent auditor review of large related-party transactions before the transactions take place. Shareholder approval of large related-party transactions should also be a requirement. Article 50 of the Corporations and Limited Liability Companies Law, dealing with conflict of interest in transactions, should be amended to increase disclosure requirements to the public and in the annual reports in case of related-party transactions. Currently, the corporation's law requires only the board of directors' approval in cases of large related-party transactions (above 5 percent of the company's assets). To better protect minority shareholders, these transactions should be approved by the shareholders' meeting.

**Medium Term:** To make it easier for investors to enforce their rights through the courts, interested parties should be allowed access to relevant non-confidential company documents without filing suit, and without having to identify specific documents. Parties to a trial should be allowed to question (orally or in writing) the opposing party or the witnesses during trial without prior approval of the questions by the judge. In order to facilitate the access to evidence during the trial, minority shareholders' lawyers could be allowed to directly question the defendant and witnesses during a trial.

### *Enforcing contracts*

**Medium Term:** Explore setting up an alternate dispute resolution mechanism to improve efficiency of commercial judgments. Mediated solutions are generally faster, less expensive, and more likely to allow the parties to return to doing business with one another.

**While the recommendations above offer a concise set of actions for Afghanistan to improve its business environment, they are but a subset within a much wider reform process facing challenges.** Despite these difficulties, reforming the investment climate now—while security and infrastructure are still recovering—will help prepare the country for a stable economic future.

For established and competitive firms ready to expand, the public sector can help facilitate their breakthrough into international markets. Through interventions that address market failures, governments can reduce the risk of taking this important step and, therefore, promote export growth.

### *Why Export Promotion is Important*

**The economic justification for public sector involvement in export promotion is linked to existing information asymmetries.** Before investing, private companies need to know the prevailing consumer preferences in foreign markets, business opportunities, the quality and technical requirements, and regulations. Not only do firms hesitate to invest in such research and marketing costs, it is easy for competitors to free ride -the efforts of pioneer exporters. Thus, export promotion agencies play an important role by providing firms with knowledge and expertise on foreign markets.

**Export support is more effective when it is geared towards raising the competitiveness of firms.** This means that export promotion needs start at home, focusing on supply-side issues and enhancing the overall business climate. Consequently, an export promotion agency can act as an adviser to the government on foreign trade and related matters, while being an interlocutor for the export community. In practice, the activities of an export promotion agency should focus on (i) developing a broad awareness of export opportunities and on stimulating interest for export in the business community, (ii) assisting firms in the planning and preparation (e.g., developing export action plans), (iii) providing technical expertise during the process, (iv) supporting breakthroughs into foreign markets with cost-sharing programs that mostly subsidize the initial market entry costs, and (v) providing information on markets and country-specific issues to domestic and international actors.

### *The Role of the Export Promotion Agency (EPAA) in Afghanistan*

**The Export Promotion Agency of Afghanistan (EPAA) was established in 2006 to increase Afghan exports in foreign markets, but it has languished since the institutional arrangements were changed.** Its creation was a step in the right direction, and in 2008 it received an international award. The idea was to provide exporters with assistance in marketing, foreign markets, regulations, to help develop contacts with foreign importers, and to be a one-stop agency for all export-related documents. However, the EPAA lost its independence when it was turned into the Export Promotion Directorate of the MOCI. It no longer provides the scope of its original services; its new role and direction have not been clearly defined, and the definition of functions between all three directorates is ambiguous.

**If EPAA is to have an impact on export promotion in Afghanistan it needs to define its new role and activities, and have a mandate beyond being just an information center.** It is important for this new directorate to place particular emphasis on promotion, export support services, technical assistance, capacity building, and marketing. The Tunisian example is instructive, for it shows the importance of providing support services to firms through technical assistance and capacity-building to develop concrete export action plans (Box 5.1). It shows that firms need support for marketing abroad, which has been shown to be one of the major constraints on Afghanistan's exports.

**In Tunisia, a program providing matching grants for export services and technical assistance had a positive impact on export promotion.** It did so because public funds complemented rather than substituted private funding. In order to minimize the effects of subsidizing activities that firms would have paid for anyway, the beneficiaries were identified and received matching grants only for interventions aligned with the program's objectives: export diversification and SMEs with potential to export. The eligibility criteria allowed for only one, first-time subsidy for an enterprise to participate in a trade fair or similar activity. The Tunisian access fund, EMAF II, paid particular attention to measuring results, and incorporating an *ex ante* evaluation strategy to help inform redesign of the program's second phase.

#### **Box 5.1: Tunisia Export Market Access Fund**

In 2000, the Tunisian Ministry of Commerce and Artisans established a new support tool for exporters, an export-promotion, matching grant fund. The Tunisian Export Market Access Fund (EMAF) and its

second phase, the EMAF II, started in 2005 and lasted four and a half years. With a budget of US\$25 million, it successfully diversified and promoted Tunisian exports.

The idea to establish the EMAF came from two simple observations. Firstly, firms needed support to penetrate new markets, as over 80 percent of Tunisian exports were concentrated on four countries. Secondly, many SMEs with great potential were not exporting. Based on these observations, the objectives of the program were defined to (i) support 350 enterprises to export and diversify their markets, (ii) provide them with subsidies at a ratio of US\$1 subsidy for every US\$10 in exports, and (iii) to stimulate development of a local consultancy sector in the process.

The EMAF program provided non-reimbursable co-financing, matching grants, to assist investments in market research and programs to increase export market access at the firm level. It first helped firms define their objectives and formulate an exporting action plan. During this phase, technical assistance and a subsidy of 70 percent of contracting services (to a maximum of US\$8,000) was provided. In the second phase, the support focused on implementing the action plan with a subsidy of up to 50 percent of the implementation costs (with a ceiling of US\$80,000). The program's technical assistance focused on actions that were deemed most likely to succeed in entering international markets. These supported actions included: the preparation of a website, or product catalogue; prospecting missions, visits or participation in professional trade shows; invitations to buyers; and the adaptation of products and packaging to the tastes of the targeted country. In essence, the EMAF's performance targets were determined by value of exports, destination markets and product diversification.

A post-impact evaluation of the EMAF II program suggests it was highly successful between 2004 and 2008. By December 2009, of the 1,710 firms (mostly SMEs) that had applied, 72 percent had been accepted. One-third of these had been in EMAF I, while 167 dropped out without disbursements. The estimates suggest that participation in EMAF II led to increased growth in the firms' overall exports: annual export growth of EMAF II-assisted firms was 38.9 percent higher than non-EMAF II firms of similar propensity. Annual growth in destination markets reached was 4 percent higher for firms assisted by the EMAF.

The impact varied widely among different types of firms, with new exporters, representing about 30 percent of beneficiaries, faring the best. Thus, one might say that EMAF II was the key in helping to establish a new class of exporters. Firms that expanded their markets (50 percent of all beneficiaries) experienced positive results, but those who expanded their product line (20 percent of beneficiaries) did not do better than non-beneficiary firms.

The EMAF experience shows that a public-private approach is more effective in export promotion and offers important lessons for Afghanistan. Firstly, the scheme was demand-driven and the private sector paid for half of the costs of the implementation of their export plans. Secondly, the program's design was a determinant of success; it was targeted, not all firms were eligible for matching grants, only new exporters and firms seeking greater market diversification based on the objectives of the program. Thirdly, the export plans allowed the results of EMAF's assistance to be measured. Finally, the development of a market for exporting services was important, as firms could rely on technical expertise to develop and successfully implement their action plans.

Source: "Ex-Post Impact Evaluation of an Export Promotion Matching Grant: Tunisia's EMAF II", World Bank, 2011.

**The EPAA could support activities aiming to develop local export services.** These could be promoted through implementation of the Export Step-by-Step process that was developed by the EPAA in 2007. Delivering such a “training for trainer” module would foster a private-sector export consultancy service comparable to the successful Tunisia Export Market Access Fund experience. Working in tandem with service enterprises, Tunisia’s EMAF contributed significantly to the development of the local consultancy sector. It built a network of exporting consultants, working alongside the EMAF, to prepare export plans and follow-up, coaching and technical assistance from fulltime, EMAF-employed experts, and export-process training. The Ministry of Commerce and Artisans even created a special job category, export consultant, and the enabling legislation provided tax incentives to professionals and experts in the exporting domain.

### *Opportunities and Recommendations*

**Define the new role and activities of the EPAA.** If this directorate is to have any impact on export promotion in Afghanistan it needs to have a mandate beyond becoming just an information center. It should be placing emphasis on: promotion, export support services, technical assistance, capacity building, and marketing.

**Explore ways to develop a matching grant scheme for export promotion based on the success of the Tunisian experience.** This subsidized scheme should be targeted and aligned with the objectives of export diversification and export development for SMEs.

**Prepare a National Export Strategy (NES) as a stand-alone document to support the National Trade Policy.** This strategy should identify key sectors with potential, in which Afghanistan has comparative advantage, and that are labor-intensive so as to generate more jobs during the transformation era. It would be bolstered by measures focused on increasing the competitiveness of Afghan firms, particularly SME’s, and their breakthrough and survival in international markets.

**Some of the constraints to export development identified here are not specific to Afghanistan,** but recur in trade diagnostic studies of many least-developed countries; others are relevant only to specific exporting sectors. In this sense, the following sections present lessons drawn from DTIS studies in other least-developed countries which are relevant to Afghanistan. These are followed by a discussion on specific sector constraints and opportunities, as identified through a rich literature on value-chain analysis and sectoral reviews in Afghanistan.

### *The Barriers to Export Development*

**The consensus among the DTIS studies is that the principal barriers to export development lie on the supply side.** There are four important lessons that stand out across most DTIS diagnostic work. Firstly, macroeconomic stabilization and trade liberalization help, but are not enough to promote sustained export expansion and diversification. Secondly, the growth outcomes produced by trade liberalization depend on how reductions in import restrictions affect the economy. If trade liberalization stimulates a modest increase in traditional exports, but causes a decline in the industrial base, without sufficiently stimulating new non-traditional exports, then future exports will be disappointing. Thirdly, customs

reform plays a central role, as time delays, handling costs, hassles, and bribes involved in trade logistics services are major constraints. Finally, proactive policies and measures to overcome institutional issues are crucial. In general, the DTIS literature shows that government institutions involved with formulating and implementing trade policy require significant technical assistance.

**Exports will only be a motor of growth when certain fundamental conditions are in place.** This is a common finding shared by DTI studies<sup>36</sup> in over 40 least-developed countries. The most pressing barriers to trade integration are the high costs of producing goods and services for export and the ability to deliver them to foreign markets, rather than trade policy per se. Factors such as import tariffs, export taxes, or quantitative trade restrictions matter, but are not the main constraints to exports. This is an important lesson for Afghanistan, as it implies that an export strategy should be bolstered by measures promoting competitiveness and lowering production and transaction costs of the private sector.

### ***Factors Influencing the Competitiveness of Afghanistan's Export Sector***

**To better understand the constraints to export development, this report reviewed the existing literature on sector analysis and value chain analysis for Afghanistan** for the carpets, gemstones, pomegranates, agriculture products, grapes & raisins, marble, and cashmere, sectors. While the findings are sector-specific, common constraints to competitiveness are apparent in the form of (i) higher costs due to microeconomic, and to lesser extent macroeconomic issues, (ii) low value added, and (iii) institutional constraints.

#### ***Higher costs harm competitiveness***

**Security is the main driver of costs and a factor for economic improvement and investment.** The Afghanistan economy continues to struggle with the misallocation of resources, weakening security situation and the drug trade. Security burdens traders both directly and indirectly. It is a burden on private firms that competitors in neighboring countries do not endure, having to pay to protect their daily operations. But, its biggest burden is indirect, in the limitation of markets and, with few firms thriving and inputs not readily available, stunted market competition. Underdeveloped markets lead to limited logistics services, limited warehousing facilities, and production cost increases, all factors that increase export costs.

**Overall, macroeconomic factors are not a binding constraint on export development, but do contribute to export costs.** The fact that monetary policy in the country has significantly reduced exchange rate volatility is an accomplishment of the Central Bank. The Afghani is relatively strong compared to other South Asian currencies, thus, Afghan exports are comparatively more expensive. The trade balance remains heavily weighted towards imports, thanks to the large aid flows to the country's reconstruction and recovery efforts. Meanwhile, the cost of unskilled labor in Afghanistan is relatively high by other countries' standards, and wages are no incentive for private investment.

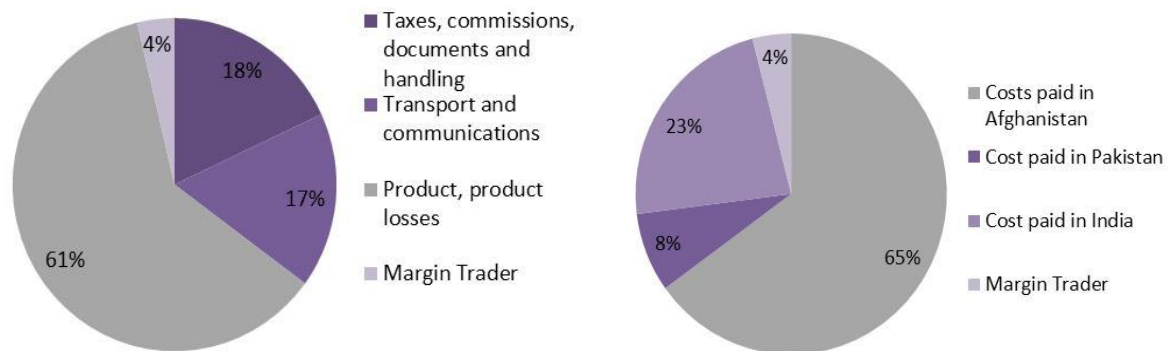
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<sup>36</sup> (Biggs, February 2007); (Bank, September 28, 2007)

**Exporting from Afghanistan is very expensive.** While there are many drivers of costs, Afghan commodities trade at higher prices because they depend heavily on imports of raw materials and inputs for production. Traders face high product losses due to transport and warehousing issues, which all drive up the final price.

**The high cost of exporting from Afghanistan means that traders must depend on small profit margins.** Therefore, the only way to increase the number and value of products produced, number of markets served, and survival rate of exporters is to drive down the costs. Sending Afghan pomegranates to India, for instance (Figure 5.1), an Afghan exporter trader retains just 3.7 percent profit, after paying over 61 percent of the price on production costs and product losses, and a further 18 percent on taxes and commissions, and 17 percent on transport before the fruit even leaves Afghanistan. By comparison, the costs paid in India are just 23 percent, and in Pakistan 8 percent.

**Figure 5.1: Export Costs and Margins: The Example of Pomegranate Exports to India**



Source: Lieshout, June 2011.

**The lack of packaging and cold storage infrastructure facilities harms the development of agri-exports and perishable commodities.** The lack of cold storage facilities is one of the reasons why Afghanistan mostly exports “dry” fruits as opposed to “fresh” fruits. This translates into product losses and lower product quality for traders. There is a limited supply of refrigerated trucks around the country for cold storage transportation. Improved logistics and investment in cold storage facilities would lower prices and improve the quality of agriculture goods.

**Poor packaging limits agriculture export development too.** It is estimated that some 20-40 percent of post-harvest horticulture products are damaged en route to markets because of poor packaging.<sup>37</sup> This could be rectified with improved packaging and plastic tunnels to extend the freshness of vegetables such as cucumbers and tomatoes, for example. Plastic as opposed to the widely used wooden crates, preserves freshness, maintains hygiene, and provides higher quality products for international export.

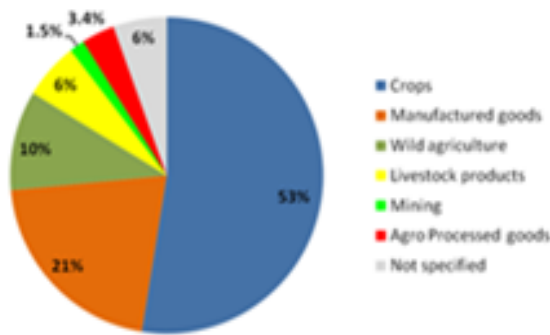
<sup>37</sup> UNDP/Altai 2004.

*Afghan exports have low added value*

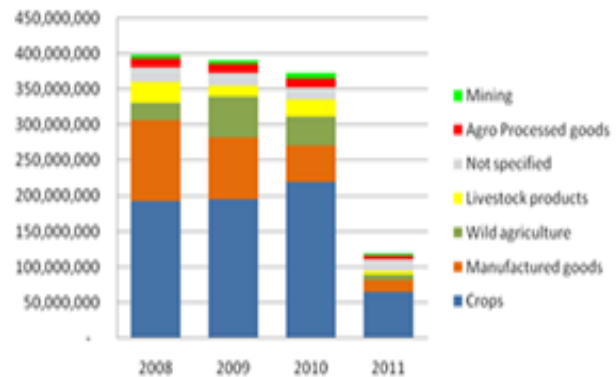
**Afghanistan exports mostly primary products that are vulnerable to commodity price fluctuations.** This makes trade very sensitive to prices and often volumes drop when goods can be easily substituted with cheaper imports from neighboring countries. In the period 2008-2010, unprocessed goods accounted for 98 percent of the exported volume and 70 percent of the value, according to CSO data. The average price for primary products, the bulk of exports, was US\$1.24 per kg compared to the average price of processed goods at US\$34.80 per kg. Although the latter accounted for only 1.2 percent of the export volume, it represented 24 percent of the value. Moving to higher value-added products is therefore vital for further export growth. For certain commodities, Afghanistan has goodwill in the market and customers pay a premium for what is perceived as higher quality, as is the case with Afghan carpets.

**Value is added to Afghan goods in Pakistan and other neighboring countries, which is where the profit is captured.** By repackaging, relabeling, and minor processing, these countries re-export Afghan goods for higher prices. In the carpet sector, for example, about 85-90 percent of carpets imported by the EU were originally Afghan made, but washed and finished and sold as Pakistani. The carpet sector is trying to address this by focusing on the development of the “Made in Afghanistan” brand that consumers can associate with higher quality. This is a step in the right direction to retain the premium enjoyed in the market, but addressing the issue structurally will require developing an Afghan cut-and-wash industry.

**Figure 5.2 Exports by Sector, FY 2008-2011**



**Figure 5.3 Export Values, FY 2008-2011**



Source: CSO

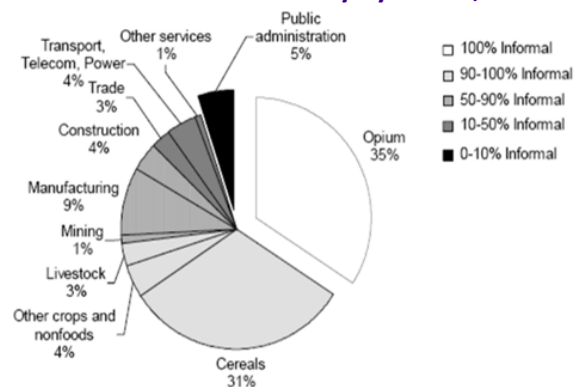
*Informality and institutions are a challenge*

**Afghanistan’s economy is dominated by the informal sector.** The informal economy, accounts for some 80-90 percent of the total economy (including the drugs trade). It is flexible in responding to shocks and short-term opportunities, but reflects the state of conflict. Political and social uncertainties, erosion of rule of law, and lack of public services, have kept entrepreneurship informal, and relatively small. The informal sector can be a constraint on long-term growth, because informal businesses tend not to expand in size, but they do not invest in technology, and face difficulties breaking into export markets.



The system also hinders revenue mobilization, state building, and security. In this sense, coping with such high levels of informality is a challenge for Afghanistan.

**Figure 5.4: The Informal Economy by Sector, Share of GDP**



Source: World Bank 2005

Note: Shading refers to rough estimates of the scale of informality

**The lack of rule of law is a constraint to private-sector development.** In Afghanistan the lack of rule of law—the insecurity of contracts, lack of a legal framework impartially enforced, weak or absent formal justice system, weak commercial courts, and the lack of a functioning commercial insurance system—makes private investment risky. This reinforces the adverse impact of security and puts great uncertainty on daily activities, such as decisions over permits, investment licenses, tax laws and their application. Such institutional constraints erode the competitiveness of private activity and constrain firms from investing and growing. The underdeveloped justice system contributes to the informal nature of business activity.

**One of the greatest impediments to private investment is the difficulty in accessing land for commercial purposes.** The process of transferring and registering land titles is cumbersome, time-consuming and costly. Property and land rights are unclear and enforcement mechanisms weak. Almost half of Kabul’s residents are under threat of eviction or relocation; with such uncertainty, agents cannot use land as collateral for credit. Uncertainty of property rights has reduced the amount of land in the market, which has become an issue in major urban centers such as Kabul, especially. Rural land tenure, too, is subject to a vast, disaggregated regime of formal and informal mechanisms, hampering the setting up of businesses.

**Limited access to credit and financing constrains investment.** The lack of bank support, particularly in longer-term investments and export financing, is a serious constraint. Only a few commercial banks are operating, many of which do not lend to private businesses at all, or only on a highly restricted basis with uncompetitive interest rates. Lack of external finance is one of the main constraints cited by business people. Afghanistan ranked 122<sup>nd</sup> out of 155 countries in the Doing Business rankings for access to credit. Access to finance is particularly limited in rural areas.

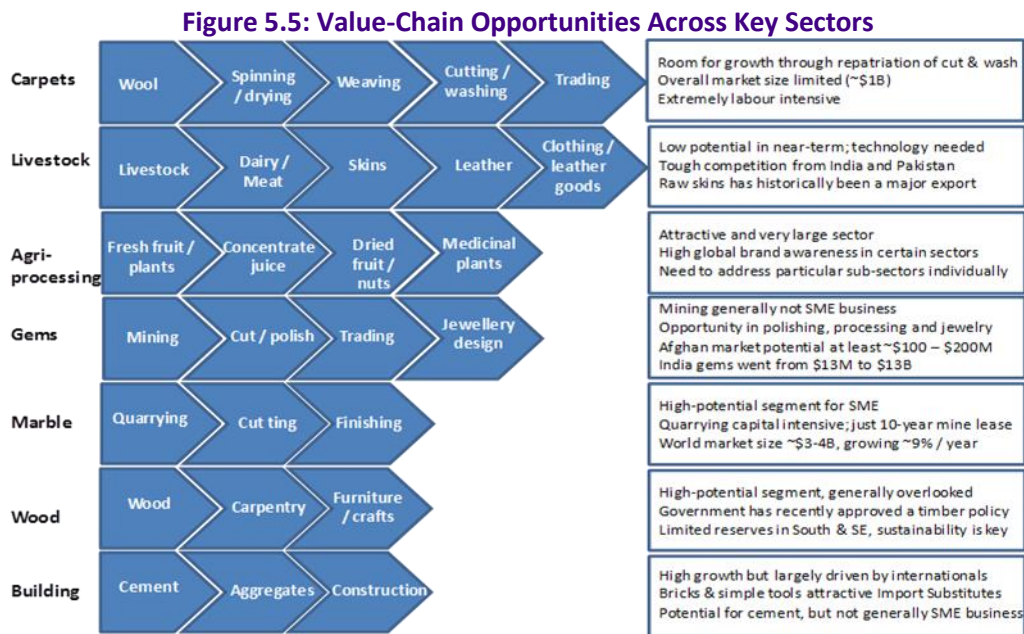
**Supporting export growth requires closer examination of the challenges within sectors with great potential.** This DTIS identifies three key sectors with important export potential: agriculture and agri-



business development, gemstones, and carpets. The following section focuses on the challenges and opportunities for export-led growth within these areas.

**Case Studies: Opportunities for Export Growth in Key Sectors**

**Afghanistan is internationally competitive in several exporting sectors and could successfully move up the value chain in others.** Value chain analysis and sectoral reviews suggest that the country has expansion potential in agriculture & agri-business through improved packaging and storage facilities, the carpet sector through the development of a cut-and-wash industry, gemstones through the development of cutting and polishing services, and the marble sector, with great prospects for SME development. The construction sector, particularly building, also presents great potential, as most of the brick and simple tools now imported could be manufactured domestically for less cost. This section explores opportunities for promoting (i) agriculture, (ii) gemstones, and (iii) carpets.



Source: SME Development Strategy, MOCI

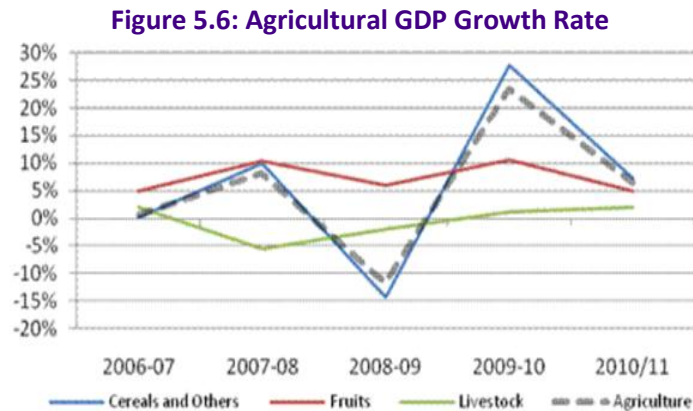
**Agriculture and Agri-Business**

**Agricultural products are the backbone of Afghanistan’s exports.** Agriculture accounts for one-third of Afghanistan’s gross domestic product (GDP), and about 90 percent of the country’s licit exports,<sup>38</sup> and employs about 80 percent of the country’s poor. Commercial agriculture in Afghanistan is dominated by horticulture and livestock, with product sales in domestic and export markets. Productivity and product quality standards have declined over the past five years; damaged irrigation systems and inadequate

38 National Agricultural Development Framework, Economic Regeneration Program, April 2009. It should be noted that this figure includes textile products such as wool and leather, and carpets that are considered “agricultural” under the classification developed by MAIL.

access to technical and market support are estimated to account for some 30-40 percent of postharvest losses.<sup>39</sup>

**Agricultural growth is highly volatile.** This is because it depends on climatic condition, as only 3% is irrigated land. Cereal sector growth was the major contributor to the explosive growth in agriculture in fiscal 2010, although the fruit and livestock subsectors also grew, by 10 percent and 1 percent. In general, the country's rural economy is dependent on small producers, mainly lightly-mechanized family-based businesses that trade commodities with little value added.



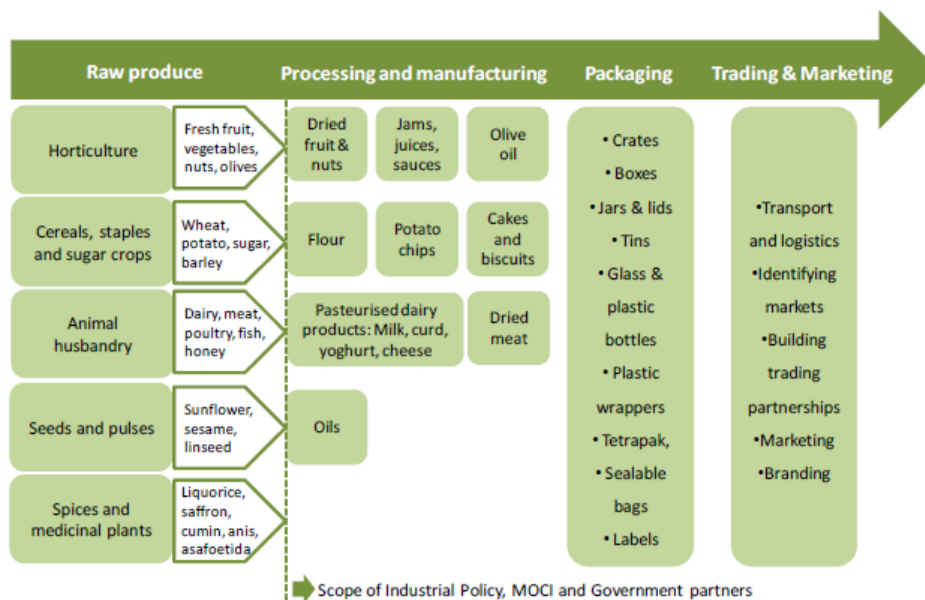
Source: CSO Statistical Yearbook

**Promoting agricultural growth has a gender effect, as about 54 percent of Afghanistan's agricultural workforce is female, most prominently in horticulture.** For example, women make up most of the lower tiers of the grape/raisin, almond, and saffron value chains. They carry out most tasks in irrigation, weeding, harvesting, and minimal processing, such as drying and packing raisins and almonds, at household level. This division of labor is largely a reflection of social and cultural norms, which do not allow women to interact with men, travel by themselves, or own land.<sup>40</sup>

**Figure 5.7: Agricultural Value Chain**

<sup>39</sup> World Bank, 2011

<sup>40</sup> World Bank, 2011



Source: MOCI

**The agri-industry has enjoyed successful investments in recent years.** Agri-business and agri-processing provide an array of exciting investment opportunities.<sup>41</sup> The industry has first-mover advantages for investors in modern processing techniques involving cleaning, sorting and grading, as well as packaging plants that incorporate quality-control measures such as hygiene and traceability. Presently, the wheat milling industry is the largest agri-based industry in Afghanistan. State-owned mills built by the former Soviet Union only partially operate and are used mostly for storage. Recently other agri-industries have appeared, particularly in processing fresh and dried fruits and nuts for export.

**Fruit juices constitute the fastest-growing market for processed food in Afghanistan.** The quality and variety of fruits have the potential to make Afghanistan a leader in juices, nectars (fruit purees) and concentrates. The market value for juices in Afghanistan is approximately US\$20 million, with a yearly growth of about 15 percent.<sup>42</sup> Local and regional demand for fruit juices, the potential for import substitution and growth at current consumption trends and rising income, and the many opportunities for production (such as bottling factories and sorting facilities) make fruit juice processing a highly attractive enterprise. Investment in this area would have high initial costs due to technology and machinery needs, but the potential for profit is significant.

**Raisin exports are struggling to regain market share after returning a long absence from international markets.** In the 1980s more than 30 raisin processing factories existed in Afghanistan, but only eight are now operational. These factories are using outmoded machinery; capital investment for newer and cleaner drying techniques is sorely needed. Raisins are a labor-intensive crop, because manual sorting is

<sup>41</sup> Over 600,000 farmers produce horticultural products in Afghanistan (FAO agriculture surveys, 2003). Of these products, only five types of fruit and vegetables represent 90 percent of the area cultivated, which indicates a need for crop diversification. Afghanistan's climate is ideal for such diversification and there is great investment potential for the private sector if it is willing to take full control of the production, processing and distribution steps required.

<sup>42</sup> UNDP/Altai Consulting Market Sector Assessment in Horticulture (Phase 1, Market Research, June 2004).

preferred to laser sorting. This makes the raisin processing industry potentially valuable for employment of unskilled farm labor. However, to realize the sector's potential, producers would need to invest heavily in (i) machinery and fruit-drying technology, (ii) on-farm processing knowledge, (iii) upgraded sanitary facilities, (iv) packaging warehouses, and (v) product marketing.

#### Sector Challenges

**A complex amalgam of constraints hampers the full exploitation of the agricultural sector. The main cross-cutting issues are:**

**Low productivity in the farming of commercial crops:** Raising productivity of the agricultural sector is crucial. This would require adoption of modern farming methods and ensuring an adequate supply of quality inputs (seeds, water systems, etc.) in rural areas. However, weather conditions will remain an impediment to productivity.

**Poor infrastructure:** Inadequate infrastructure weighs on productivity, as water and electricity supplies govern production. It is particularly important in agri-processing to minimize shipping times and costs and to be able to access roads and irrigation systems.

**Outdated or non-operational agri-processing facilities:** Many facilities operate without sanitary floors and covered areas, proper drainage and clean water, or waste-collection systems.

**Inadequate food safety and certification:** Without accredited food safety and certification laboratories in Afghanistan it is difficult for agriculture exports to meet international standards and regulations in other markets.

**Research & development:** There is little innovation in Afghanistan. The development of cultivation practices and crop diversification is constrained by low levels of investment in R&D.

**Limited access to quality inputs:** Supplies of fertilizer, quality seeds, and other major inputs for agricultural production are limited, and have stifled outputs.

**Poor intensive-farming practices and limited extension services:** Production is undermined by a lack of pruning and soil testing, inadequate irrigation and plant spacing due to insufficient extension services to educate farmers in the better farming practices.

**Access to credit:** Farmers have limited assets and the informality of land tenure restricts access to credit. Lending is crucial in agri-business as it enables farmers to build storage facilities, buy or lease equipment, and purchase inputs, etc.

**Limited access to irrigation systems:** Water supplies are limited in Afghanistan and farmers struggle to carry out irrigation. Over half of the irrigation systems are broken and in need of rehabilitation. Kandahar and Ghazni are two regions with the highest water insecurity rating in northern and western Afghanistan, making them ideal candidates for water reservoir development.

Packaging procedures are outdated, leaving fresh goods to perish en route to markets: Improved packaging, therefore, is crucial for export growth. This offers great opportunity for investors, as demand for Afghan agricultural goods is high. But some 20-40 percent of post-harvest horticultural products are wasted because of poor packaging.<sup>43</sup> Plastic tunnels, rather than the currently-used wooden crates, could be used to extend the freshness of vegetables such as cucumbers and tomatoes. The plastic would help to extend freshness, maintain hygiene, and provide the highest quality products for international exports. Furthermore, plastic containers are more easily reusable and encourage creative product advertising.

**Cold storage and refrigerated transportation is another advantageous opportunity for investors while helping farmers to avoid losses and improve product quality.** The best opportunity for cold storage is at the end of the season, before trading partners such as Pakistan are ready for their own production. In refrigerated transportation, there are currently fewer than 50 refrigerated trucks available in the country. Improved logistics would also help farmers obtain better prices for their exported products.

### *Opportunities and Recommendations*

**Fruit and vegetable storage facilities should be established through public-private partnerships in Kabul and other major urban centers.** This will help address the limited storage capacity, and reduce post-harvest losses and higher costs.

**Industry leaders should establish standards for packaging and identify packaging needs.** This would reduce product damage, and cut losses for exporters by lower export costs and raising the quality of products for the final destination. Packaging can be a way of promoting products by highlighting market-specific price premiums, health benefits, and organic cultivation.

**Streamlining of food safety management, inspection, and certification, in a transparent manner, would be a crucial step** in redressing current weak controls. This would require ANSA to review and strengthen current food control standards in Afghan laboratories.

**Afghan exporters should focus on premium segments for large importer countries.** Over the medium term, organic is an attractive and growing market, but it would take 3-4 years for Afghanistan to receive certification.

### *Gemstones*

**Afghanistan is rich in gemstone deposits and there is great potential for growth in production over the medium term.** The country's deposits are distributed throughout the country, notably the Panjshir Valley (emeralds), Jegdalek (rubies and sapphires), Nuristan (emeralds, rubies, aquamarine, tourmaline, kunzite, and spodumene), Helmand (flourite), Herat (aquamarine and tourmaline), and Badaskhan (sphene, peridot, aquamarine, ruby, spinel, lazurite and lapis lazuli).<sup>44</sup>

<sup>43</sup> (UNDP/Altai Consulting Market Sector Assessment in Horticulture (Phase 2- 3, Feasibility studies and Business Plans), August 2004)

<sup>44</sup> This section draws on the Policy Framework and Road Map for Afghanistan's Gemstone Sector 2011-14 developed by MOCI.

**Afghanistan is not fully exploiting its gemstone mining potential.** The country’s gemstone industry could be worth up to US\$300m per year,<sup>45</sup> but it is currently achieving only a fraction of this value domestically. Insufficient cutting, polishing and marketing skills within the country ensures that about 80-95 percent of Afghan production is exported in rough form to Pakistan where it is sent to cutting centers such as Jaipur, Bangkok, and further afield internationally. The stones are then cut and marketed by foreign dealers who reap the fruits of higher profits.<sup>46</sup> The USAID has estimated that, with reforms, the gemstone industry in Afghanistan could generate as many as 30,000 to 50,000 direct and indirect jobs.<sup>47</sup> Increased mining opportunities and skills would do much to reduce poverty in gem-rich districts within Nuristan, Kunar, Panshir, Jegdalek and rural Badakhshan.

**The government is in the process of formulating a gemstone policy and strategy.** This is a step in the right direction, as it contains an action plan that will require close coordination and definition of roles between the ministries of mines and commerce & industries. The policy aims to distinguish between “upstream” production (mining) and “downstream” production (processing and manufacturing) of gemstones. Its principal objectives are (i) employment generation, (ii) minimal environmental impact, (iii) improving the living conditions of gemstone-mining communities, (iv) improving the quantity and quality of gemstones mined, and (v) increasing the capacity for value added within Afghanistan.

**Table 5.1: Gemstones and Mining Regions in Afghanistan**

Province	Primary Type of Gem Mining
Panjshir	Emeralds
Kabul	Rubies & Sapphires
Badakhshan	Lapis Lazuli & others
Kunar	Tourmaline, Aquamarine, Morganite, Kunzite & others
Laghman	Tourmaline, Aquamarine, Morganite, Kunzite & others
Jalalabad	Processing office for Kunar & Laghman
Nuristan	Aquamarine, Kunzite, Spodumene, Tourmaline
Bamyan	Turquoise

Source: MOCI “National Strategy for Afghanistan’s Gemstone and Jewelry Sector: April 2011 – March 2013”

**If Afghanistan could secure even a small share of the rising demand for gemstones in international markets, it would make a big difference to the sector, and the country.** Pakistan currently is Afghanistan’s main export market, with some 90 percent of all gemstones channeled through Peshawar. Peshawar will remain an important gemstone market, but there is high growth potential further afield. In 2009, imports to markets in Asia, the Middle East and East Asian countries (UAE, India, Thailand, Hong

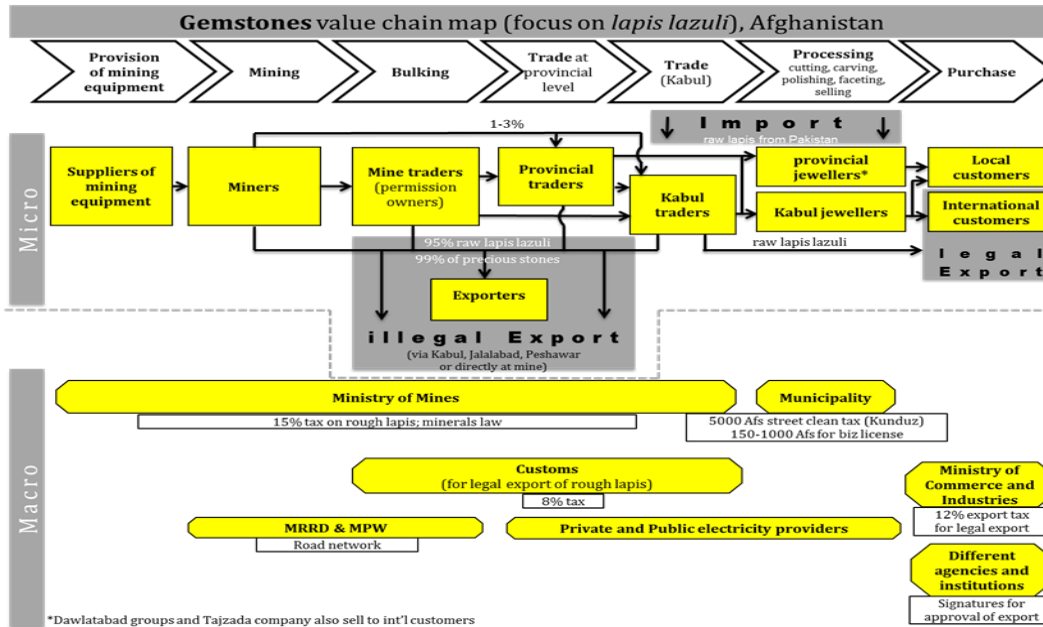
<sup>45</sup> It is difficult to establish the size of the Afghan gemstone market because there is limited export data and smuggling. Gemstone exports are not included in the CSO’s Statistical Yearbooks. The estimates on how much is effectively exported illegally vary but range from 90 to 99 per cent for lapis lazuli, and from 98 to 100 for all other gemstones. ASMED Gemstone Sector Strategy, May 2009.

<sup>46</sup> Sibley International Corp., Assessment of the Afghanistan Gemstone Industry. DAI/USAID June 2007.

<sup>47</sup> Altai Consulting, USAID-DAI ASMED, Gemstones, May 2007.

Kong, Singapore, China and Japan) brought about US\$1.27bn in revenue. The United States alone accounted for US\$658 million and Switzerland \$378 million.<sup>48</sup> To realize and expand these opportunities would require development of firm business relationships and more careful tailoring of products to the specific needs of each market.

Figure 5.8: The Gemstone Value Chain



Source: Gemstone Value Chain Analysis, North Afghanistan, Ralf Arning

### Sector Challenges

**For Afghanistan's gemstone sector to fully realize its potential it will have to overcome several challenges.** The public sector must take the lead in overseeing and regulating activities, both upstream and downstream, and provide technical assistance and training to improve sector performance and to focus on increasing the value added from cutting, polishing, and jewelry manufacture and design.

**Institutional and legal constraints:** The lack of a clear legal framework inhibits the development and formalization of the sector. It fosters illegal and unsafe trading, and constrains medium-term investment. Extractive resources are public assets and as such require laws and regulations to ensure transparency and public accountability.

**High royalties and taxes:** The cost structures of both mining and trading are high and are exacerbated by government-imposed taxes and illegal informal levies at the local level, which reduce profit margins. A royalty of 15 percent imposed by the Ministry of Mines, an export tax of 12 percent, as well as

<sup>48</sup> Afghanistan's Gemstone Sector Policy Framework and Roadmap 2011-14, MOCI.



unofficial costs imposed by the institutional operating environment combine to impose tax exceeding 50 percent on gemstone exporters.

**Cumbersome export procedures:** Export procedures are complicated, expensive and time consuming. The legal export of finished jewelry requires 12 signatures from various departments in the ministries of commerce, finance, and mines. Even the Kabul museum is involved, in certifying that the exported jewelry is not antique.

**Corruption:** Many of the gemstone resources are under the control of armed groups, powerful warlords and corrupt local officials who extort large sums from miners and traders, benefit from the informal nature of the sector, and are likely to resist attempts to formalize it.

**Lack of reliable infrastructure:** The lack of road, energy, and water systems, constrain growth of mining operations. For example, the emerald mines in Khenj, in the Panjshir Valley, are accessible only by a three-hour uphill walk. The miners have to use small electricity generators because mainline electricity and water supplies are located down in the valley.

**Accessibility of adequate mining explosives.** Since Afghanistan banned the importation of ammonium nitrate fertilizer in January 2010, which was widely used in artisanal mining, many mines have closed, especially in Kunar and Nuristan. The widespread use of dynamite and inadequate explosives pose safety concerns.

**Safety is comprised by inadequate mining techniques.** Improper mining techniques, including the unsafe use of explosives, poor tunneling, lack of ventilation, etc. are compromising safety in mining extraction, and frequently lead to injury and sometimes death. These practices also undermine the value of the gemstones, which are often damaged in extraction.

**Limited gemology skills:** Miners, traders and staff from the Ministry of Mines have limited gemology skills to properly value rough gemstones. Few gem cutters in Afghanistan can cut to international standards, and most local jewelers are unable to produce export-quality products. This is the major obstacle in trying to develop a cutting industry and generating greater value-add for the country.

**Quality control:** The public sector needs to enforce quality controls; without them the industry will remain compromised by artificial or treated stones and glass fakes. Quality certification is a requirement in international gemstone trade. This requires the establishment of a gemstone laboratory, internationally accredited, to certify export stones.

**Lack of access to finance:** Miners, gem-dealers, jewelers, and trainers say lack of access to capital is hampering their ability to develop their businesses. Some do not wish to take bank loans as they consider paying interest to be against the laws of Islam. Others say that banks charge unreasonable rates of interest or require collateral that they cannot guarantee.

**Overall, the sector requires a proper governance regime based on laws, rules and regulations that ensure legal mining activities with reliable security of tenure and relatively free of corruption.** This



should accord with the Minerals Law of 2010 and associated regulations and procedures, and address the negative environmental and health and safety effects associated with gemstone mining. Furthermore, it must address the issues discussed above in order to grow, generate jobs, leverage long-term investment and enjoy the benefits the sector has to offer.

### *Opportunities and Recommendations*

**In collaboration with the private sector, develop capacity-building programs for gemstone valuation and a cutting industry.** To develop a cutting and polishing industry it will be necessary to train miners, traders and staff from the Ministry of Mines in gemstone valuation and international cutting standards. With a more skilled business environment, the gemstone industry will gain added value and be able to export cut, quality products for higher prices.

**The road map within the National Gemstone framework should be implemented so as to establish an Afghan Gemstone Hub.** The gemstone business community should work together to implement the gemstone action plan that sets out to formalize the sector's business activities. The plan spells out a direction for the next five years, and regulates the responsibilities of government agencies, including ministries of mines and commerce & industries. Several issues will require more in-depth consultation, such as promoting a PPP business model, incentives, a vocational gemstone training curriculum, and leveraging private sector investment.

**A gemstone quality control agency should be established.** The agency, in the form of a public-private partnership, could certify the quality of gemstones. Also, it could monitor the domestic market through inspections, while registering certified gemstone sellers and exporters and reducing uncertainty in business operations. It should also provide quality gemstone services training.

### *Carpets*

**The carpet sector in Afghanistan has great potential for export growth.** Afghanistan has a long tradition of handmade carpets, including chob rung (pile and knotted carpets made of wool, silk and cotton), kilims (non-pile fabric woven carpets), and felted woolen carpets. Over one million Afghans work in producing carpets, and hundreds of thousands more in related industries, such as wool production, cut-and-wash, and design. More than 95 percent of Afghan production takes place in homes, on one or two looms operated by family members.<sup>49</sup> Most Afghan carpet production is located in the north of the country, which is best-known for its traditional and newer-style chob rung weaves. Kabul is a relatively new center of production, also focusing mostly on chob rung carpets.

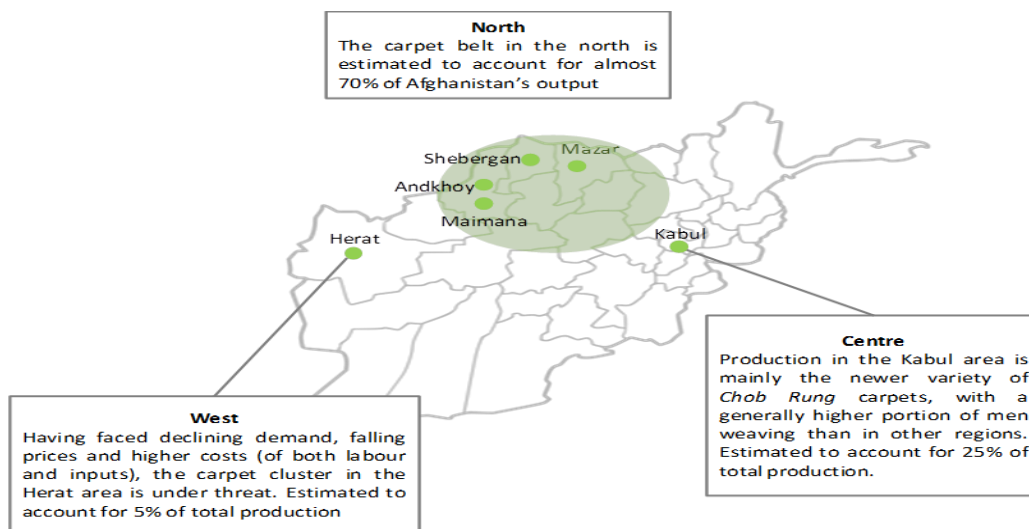
**The carpet sector represents one of Afghanistan's largest official exports,** generating US\$150 million annually and constituting 15 percent of carpet exports globally. In the period 2000-05, the sector reported an average 2 percent yearly growth. However, during 2006-2010, official carpet exports dropped as a share of total exports from 60 percent to 38 percent, and dry fruits & raisins became the

<sup>49</sup> An Analysis of Business Opportunities within Afghanistan's Carpet Sector, The McCord Group, May 2007.

country's major export. The years 2008-10 were particularly challenging for the sector because of the drop in foreign demand and low levels of consumer spending. Nevertheless, industry experts predict strong growth in the handmade carpet segment over the next five years.<sup>50</sup>

**Afghanistan competes with five other major carpet-making nations:** Iran, India, China, Nepal and Pakistan. It is worth noting that the recent decline in Afghanistan's carpet production may be due to several reasons; price-demand imbalance may be one of the most important factors, and the fact that many of the female Hassara weavers are leaving the sector for better-paying jobs elsewhere.

**Figure 5.9: Key Locations for Afghan Carpet Production**



Source: Implementing SME Strategy: An Action Plan for Developing Afghanistan's Carpet Sector, May 2011-April 2013, MOCI

**Since 2006, the carpet sector has become more competitive, with strong support from the Export Promotion Agency of Afghanistan (EPAA), and donor investment.** The Afghan carpet sector's quality of hand-knotted, natural dyed, and designs, received an award from the largest trade fair in Europe, Domotex/Germany, in 2008. In 2010, Afghanistan's carpet sellers registered US\$12 million in sales, a 400 percent increase over 2009. The sector has become more innovative, initiating demonstration visits to the Afghan Craft Cut-and-Wash Facility in Jalalabad, and improving its communication outreach. A wider use of natural dyes would lessen the environmental impact and move the sector closer to achieving green certification.

**The Kabul Carpet Association (KCA) has begun exporting to new markets such as Russia, and has established a showroom in the Istanbul Free Zone.** Members of the KCA have established investment groups and have launched marketing efforts in Russia and countries of Africa. The Turkmen carpet business community has established the Afghan Carpet Federation with the goal of improving the enabling environment for carpet traders in Afghanistan, opened in a Free Zone a show room in Dubai.

<sup>50</sup> Global Industry Analysts, Inc., 2010.

### *Sector Challenges*

**Inadequate access to finance is constraining Afghan carpet traders.** Pakistani carpet traders are more competitive largely because they receive government support in the form of initiatives such as long-term financing of exports, freight subsidies, sales tax facilitation and export incentives. As a result, Pakistani traders are able to offer international trading partners better long-term finance deals, such as after-sale payment deferrals for up to 12 months.

**Strengthening the cut-and-wash industry will increase profits and jobs.** Although, much work has been done in this segment, such as the opening of the cut and wash facilities in Kabul, Mazar, Jalalabad and Herat, approximately 85-90 percent of Afghan production still is exported to Pakistan where it is finished and re-exported as Pakistani carpets. This is mostly because Pakistan is more competitive, having access to cheaper chemicals, more cut-and-wash expertise, and a climate that enables year-round sun drying of washed carpets. Nevertheless, there is room to expand Afghanistan's cut-and-wash industry in order to add value, and thus higher profits, to carpet exports. USAID estimates suggest that improved carpet finishing (cut-and-wash) and trading in Afghanistan could create about 7,000 jobs.<sup>51</sup>

**Improved trade and marketing will strengthen the "Made in Afghanistan" label and ensure a premium in international markets.** Traders have to invest in marketing in order to enjoy the value of direct sales in end-markets and acquire the hands-on knowledge to be able to keep abreast of market trends.

### *Opportunities and Recommendations*

**Promote and further develop the domestic cut-and-wash industry.** Much work has been done in this segment, such as the opening of the facilities in Kabul, Mazar, Jalalabad and Herat, but there is much room for further investment that will add higher value to carpet exports and profits. The EPAA should play a leading role to leverage private investment and support growth in this segment.

**Strengthen market linkages with international buyers.** It is important to identify and nurture market linkages through (i) maintaining participation in key trade fairs, (ii) sponsoring Afghan companies to attend national and international trade shows, (iii) promoting business trips, tours, and buyer missions both to and from the country in order to foster closer direct links between producers and buyers.

**Export promotion activities could explore on the possibility of establishing warehouse facilities within and close to target markets broad.** Working with private investors and the Afghan government, carpet exporters would do well to set up regional warehousing or re-export facilities at important trade hubs such as Dubai, and the UAE, and to expand Afghanistan's existing warehouse facilities in Istanbul.

**Bolster security protection of carpet exports at airports and borders.** Carpet traders have reported costly losses and damage to products during inspection procedures.

<sup>51</sup> Ministry of Commerce and Industry, SME Strategy, DAI, USAID, November 2009.

**Government and the private sector should work together to promote regional design centers and develop new carpet designs.** Carpet weavers need constant education in international fashion trends, sizes and colors. The industry support could focus on (i) technical training at design centers in computer-aided design and software innovations, and (ii) scholarships to the Indian Institute of Carpet Technology (IICT). Only through enhanced investment in design will Afghan carpet exports regain and retain their share in global markets.

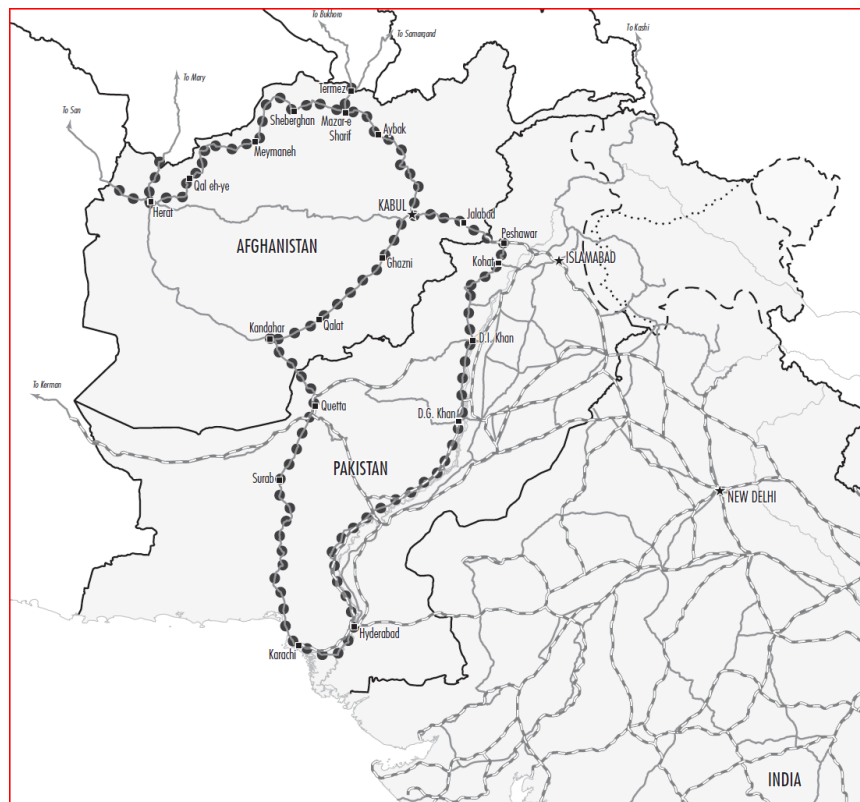
**Promote the use of domestically-produced wool over imported wool.** Afghanistan could triple the value of its carpet revenues using locally produced wool. This would require the private sector establishing wool association and collection centers (warehouses) for wool cleaning, washing, and packing in the central and southern regions. Technical support would also be necessary for existing wool spinning and dyeing factories, and financial support for opening new facilities in the northern and western regions.

**Develop an export-finance scheme for experienced carpet exporters.** This would enable Afghan exporters to compete with their Pakistani competitors in offering buyers favorable financial terms.

### Chapter III: Customs Reform Will Strengthen Trade Facilitation

*Customs and border management modernization will most likely have the greatest impact in terms of lowering transaction costs on trade in Afghanistan, by easing trade facilitation and strengthening trade integration. A trade supply chain is only as strong as its weakest link and countries that aim to improve trade logistics are faced with the need to reform and modernize border management institutions, change transport regulation policy, and invest in trade related infrastructure. Ongoing customs reform in Afghanistan aims to reorganize customs procedures, improve border facilities, introduce risk management programs to expedite clearance, and when fully operational, will lower transaction costs and improve trade security.*

**Figure 2.1. Afghanistan's Main Trade Corridors.**



**Afghan trade transits mainly through Pakistan and Iran through the border link roads.** Thus, goods to Pakistan travel either through the Kabul–Jalalabad–Torkham–Landi Kotal– Peshawar–Karachi corridor, a distance of 1800 Km, or through Kabul–Kandahar–Spin Boldak–Chaman–Quetta–Karachi distance of 1,500 Km.<sup>52</sup> (Figure 2.1) These two roads have the potential of becoming important links for transit of

<sup>52</sup> Detailed breakdown of the cost and time associated with complying with import and export formalities are not available for Afghanistan's transit corridors. In view of the importance of these transit corridors to Afghanistan, time-release studies (from the time goods reach the gateway port to the time taken to reach final destinations in Afghanistan) could inform policy making.

goods and vehicles from Pakistan and third countries (Turkmenistan, Uzbekistan and Tajikistan). A third corridor to Iran connects Kabul–Heart–Islam–Qala Road–Bandar Abbas, a distance of 1,200 K. This is a viable alternative for transit trade going through Afghanistan to Central Asia.

### ***Customs Performance Significantly Improved Since 2003***

**Analysis of different indicators suggests real progress in trade facilitation and the movement of goods across Afghanistan.** However, many challenges lie ahead. To some extent, the customs success story in this country is due to considerable donor support for infrastructure improvement and operational technical assistance over the past ten years.<sup>53</sup>

**Customs revenue collection has soared.** Customs revenue increased from US\$ 75 million to US\$ 938 million during 2002-09, with a provisional figure of US\$ 1.05 billion for the first six months of 2010. Collections have thus multiplied 16-fold in eight years. Revenue targets are being met and even overshot. Overall, more than half of the resources from customs are attributed to duties on motor vehicles and parts, and fuel imports (see Trade Performance, pg. 8). Collection efficiency also increased. The total value of imports rose 78 percent, denoting improved valuation procedures with customs officers assessing more duty per import declaration, and declared values better controlled. The consolidated effective collection rate, which was 3.63 percent of the declared values in 2004, is now at 13.83 percent. The quality of statistical reporting has significantly improved over the past years, yielding more reliable returns and measurable results.<sup>54</sup>

**The productivity of customs administration has significantly improved.** An indicator of customs administration efficiency is the average number of declarations processed per customs officer in one year. This figure was 300 in 2004, dropped to 164 the following year, but has steadily increased to 500 in the first six months of 2010. During the same period the total staffing of the Afghan Customs Department (ACD) was stable, with an average monthly salary cost of USD 160.<sup>55</sup> As a result, the average economic cost per declaration has constantly decreased, from US\$ 6.87 in 2005 to US\$ 4.98 in 2009.<sup>56</sup> Similarly the comparison between total customs cost and total revenue collected has declined, from 0.98 percent in 2005 to 0.42 in 2009. In both cases, these figures compare favorably with the rest of the world (internationally, the customs cost/revenue ratio ranges between 0.5–2 percent, and the average economic cost per declaration often far exceeds US\$ 10). Regionally, according to the latest

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Time release studies are undertaken to measure the time taken for complying with the procedural requirements for the release of imported goods to the domestic trader/customs broker/ customs agent from the arrival of goods at the port/airport/ and inland borders. In the case of exported goods, the time taken when exported goods enter customs controls to the departure (defined as the time of vessel or aircraft departure when the exported cargo leaves the customs control).

<sup>53</sup> Including the Asian Development Bank, DFID, the EU Commission, Governments of Germany, Italy, Iran, Japan, Pakistan, and the USA, USAID, and the World Bank.

<sup>54</sup> The World Bank's customs projects are the Emergency Customs Modernisation and Trade Facilitation Project (ECMTPF), and the Second Customs Reform and Trade Facilitation Project (SCRTFP).

<sup>55</sup> This represents the total salary costs of the ACD divided by its number of employees, and may include social and other contributions which are not immediately paid to staff.

<sup>56</sup> This cost is based on the ratio between the total running cost of the ACD and the total number of declarations processed, which is considered an output of the customs administration.

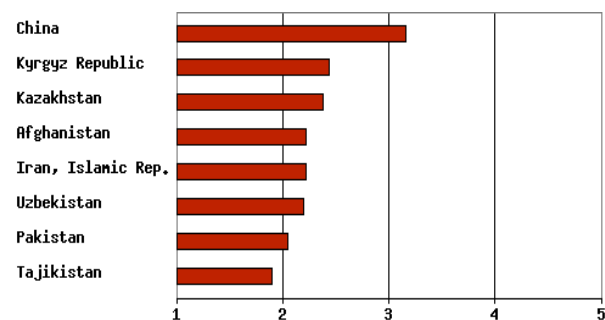
figures available, customs cost/revenues are 1.78 in the Kyrgyz Republic, 3.95 in Kazakhstan, 1.14 in Pakistan, and 1.77 in Iran.<sup>57</sup> The economic cost per declaration in these countries ranges from US\$ 163 in Kazakhstan to US\$ 18.10 in Pakistan. (Table 2.6)

**Trade and logistics indicators for Afghanistan have improved.** Customs performs better within the components that are assessed in the World Bank's overall Logistics Performance Indicator (LPI) ranking, which placed Afghanistan 143rd out of 155 (Table 2.1), and 104<sup>th</sup> in customs performance (Table 2.2), ahead of countries such as Uzbekistan, Iran, and even Egypt.<sup>58</sup>

**Table 2.1 Logistic Performance Index**

	Afghanistan	
Overall LPI	score	2.24
	rank	143
Customs	score	<b>2.22</b>
	rank	<b>104</b>
Infrastructure	score	1.87
	rank	139
International shipments	score	2.24
	rank	141
Logistics competence	score	2.09
	rank	141
Tracking & tracing	score	2.37
	rank	128
Timeliness	score	2.61
	rank	146

**Table 2.2: LPI Ranking for Customs**



Source: LPI index 2010 (World Bank), out of 155 countries assessed.

**Border procedures and inland clearance take place fairly swiftly and clearance and transit delays are acceptable.** Afghanistan's customs performance compares favorably with that of other countries, especially those of the former Soviet Union. Such are the findings of the WB's customs project performance monitoring indicators. Thus, the average customs clearance for trucks at Torkham was around 50 hours. Consequently, transit times, based on the issuance and/or discharge of transit forms, between Islamqala and Herat (bordering Iran) averaged 3.7 days, between Hayratana (bordering Uzbekistan) and Mazar\_i\_Sharif 2.1 days (50:5 hours), and 3.7 days for Torkham to Jalalabad (the border with Pakistan). These results compared to other countries, in particular those of the former Soviet Union, are generally good, and show that border procedures and inland clearance take place fairly swiftly.<sup>59</sup> (Tables 2.3 and 2.4)

<sup>57</sup> Figures may not be totally up to date, but correspond to a minimum estimation.

<sup>58</sup> Egypt was ranked under the World Bank's other indicator, Doing Business, as the best Customs reformer a few years back. This may also show the limits of qualitative performance assessment.

<sup>59</sup> The performance-monitoring indicators and targets for border and inland clearance times from the ECMTFP and SCRTFP projects involved (i) identifying customs sites at both inland clearance stations and border posts, considered representative of overall performance, (ii) carrying out a baseline survey of these sites, and (iii) regularly measuring results. The baseline was



Table 2.3 – 2007 Values (hh:mm)

Types of vehicles	Overall Time	Customs Processing Times
Trucks/trailer, not covered	69	61
Trucks/trailer, covered with a tarpaulin	56	44
Trucks/trailers carrying containers	57	46
Average (unweighted)	61	50

Source: ADB 2007

Table 2.4 – Transit Times (days)

Corridor	Average transit time
Islamqala/Herat	3.7
Islamqala/Kabul	99.7
Hayratan/Mazar	2.1
Hayratan/Kabul	19.4
Torkham/Jalalabad	3.6 9
Torkham/Kabul	19.4

Source: Asycuda 2007

**Major reforms have been initiated and implemented.** A 2007–2012 Five-Year Strategic Plan was adopted to provide a framework for comprehensive and phased reforms. The strategic plan was also intended to channel donor inputs in a coordinated manner. The Afghan Ministry of Commerce and Industry’s Memorandum on the Foreign Trade Regime (March 2009) listed the major achievements in recent years as:

- Introduction of the Afghanistan National Tariff Schedule, which reduced the number of tariff bands from 25 to 6, subsequently increased to 12. The schedule classified goods according to international standards and mandated the use of the official exchange rate as set by the central bank for valuation purposes;
- Introduction of new procedures to control and monitor exemptions;<sup>60</sup>
- Implementation of several modules of Asycuda (Automated System for Customs Data);<sup>61</sup>
- Infrastructure development at main customs stations;
- Capacity building and training of customs officials;
- Enforcement of mobile verification teams operating at important customs points and along transit routes;<sup>62</sup>
- Support to facilitate legitimate trade and transit, including the introduction of the bonded carrier system;<sup>63</sup>

established using three separate sets of three-day measures to find an average value. Subsequent measurements could cover a shorter period as long as there were no major discrepancies. Independent observers were posted at entry and exit gates of the facilities to measure the times of entry and exit – thus using a “black box” concept, where the breakdown of time taken by various administrations was discounted. Monitors distinguished between processing times by customs and non-customs offices at inland clearance stations. The locations selected in Afghanistan were Kabul inland clearance station, Kabul airport, Torkham border station, and Islamqala border station (subsequently replaced by Hairatan). Recently, a computerized survey of transit times was added, for the corridors of Islamqala to Herat and Kabul, Hairatan to Mazar and Kabul, and Torkham to Jalalabad and Kabul. An international corridor (Karachi to Torkham) is also being considered.

<sup>60</sup> Only partially implemented and computerised.

<sup>61</sup> Asycuda is a computerized customs management system that covers most foreign trade procedures. It handles manifests and customs declarations, and accounting, transit and suspense procedures. It also generates trade data for statistical economic analysis. UNCTAD developed the software using international codes and standards of the International Organization for Standardization, the World Customs Organization, and the United Nations. It is being used in over 90 countries and regions.

<sup>62</sup> This is a timid approach to proper customs enforcement.

<sup>63</sup> Not adequately implemented yet.



- Increase in the number of licensed customs clearing agents; and
- The establishment of regional customs valuation and post clearance control units in the major provincial centers.

**In 2011, implementation of Asycuda had expanded to cover 95 percent of customs houses** (and 90 percent by value of foreign trade processed). The gradual coverage of the entire country has largely closed the gaps through which importers tried to avoid control, and can partly explain the progress in revenue collection. However, the system also requires further extensions: Other functions (including valuation control, risk management, and exemptions) should now be introduced.

**Computerization was successful.** The Asycuda transit module was deployed between Torkham, Jalalabad, and Kabul at a very early stage in the reform process, as a way to urgently establish a reliable method for recording entry of goods into the country. In general, when clearance takes place inland, it is essential to ensure that what is seen at the point of entry is properly reported on arrival. In the case of Afghanistan it is estimated that about 40 percent of transit – i.e., border to inland movements of uncleared goods – failed to reach the official point of inland clearance. The issue going forward is to reduce the share of uncleared goods missing the inland clearance point. (Box 2.1)

#### **Box 2.1 The Asycuda Transit Module in Afghanistan**

The transit module was the first application of Asycuda to be introduced in Afghanistan. This is not the usual approach, but was recommended for Afghanistan, as transit leakages were a serious problem, and there was potential for cross-border cooperation. Between May 6, 2006, when a transit corridor between Torkham and Jalalabad and Kabul was launched, and August 2006, about 30,000 T1 transit documents were issued. (This averaged 600 per day, which subsequently went down to 400, indicating attempts by traders to import through other border locations which were not yet computerized, thus strengthening the case for rapid deployment of the Asycuda transit module to all corridors through Afghanistan.) The next locations where the transit module was introduced were Islam Qalah and Herat. Overall, the success of the scheme has comforted the policy of the ACD to clear goods and collect revenue at inland locations.

Importers quickly realized they were being monitored for all shipments entering the country and some noncompliant firms had shipments held by customs pending payment of earlier evaded duty. The ACD also has plans to establish a transit follow-up unit to investigate cases of un-discharged T1. Based on ACD data about 1,900 of T1 documents were not discharged properly, of which only 200 shipments were purely commercial. The overwhelming majority of consignments were destined to the International Security Assistance Force (ISAF) or under ISAF contracts. The ACD's reasons for lack of discharge were: (i) negligence at the receiving end, with officials not stamping T1 forms when the trucks arrived, or not verifying the integrity of the consignment; (ii) abuse of the system by sub-contractors, including duty-free outlets in Kabul; and (iii) smuggling, especially of oil shipments that had been rejected and subsequently disposed of on the domestic market.

Control over the issuance of forms is performed through reconciliation with bank deposits. The ACD aims to introduce smartcards to replace paper forms, T1, which has no watermark and can easily be forged. The added advantages of the smartcard are that the truck driver does not know what information is on the card, cards can be recycled, and can only be read by specialized apparatus,

including hand-held devices, thus limiting the current interference by the road police and other agencies on transit traffic.

Source: World Bank mission report, August 2006.

**While the customs reform has made great progress in establishing a system that facilitates the effective movements of goods across Afghan borders, there are opportunities for improvement.** These can be grouped around three themes: i) customs procedures, ii) organization and human resource management, and iii) interagency coordination.

### ***Reforms in Basic Customs Administration Need to be Consolidated***

#### ***Improving Customs Procedures***

**While processing times are acceptable there is room for improving the quality of customs services.** A more detailed review of user perception surveys, combined with objective performance indicators, show that user satisfaction has not improved, although border processing and clearance are now better expedited. Anecdotal evidence suggests that importers have learned to avoid lengthy control procedures by: (i) offering bribes to key customs officials; (ii) limiting the negotiation process when declared values are challenged by customs; and (iii) taking advantage of legislative restrictions to avoid customs control altogether.

**Current custom revenue collection is below potential.** Analysis of transit data shows that imports for fiscal 2009 could be valued at US\$ 7.87 billion, versus officially declared values of slightly less than US\$ 4.9 billion.<sup>64</sup> By extrapolation, the figures for imports for fiscal 2011 would be in the region of US\$ 11 billion, against the officially declared value of US\$ 6.9 billion. Potential exists, therefore, for increased duty collections, especially because over the past two years the growth in customs duties has slowed down, but other taxes, BRT, Red Cross contributions, have stepped in to fill in that gap. (Table 2.5)

**Defining the clearance model for Afghanistan will have an impact on the design of its customs administration.** Two options for the place of clearance can be envisaged, at the border or inland clearance.<sup>65</sup> In Afghanistan this is yet to be decided, but it's an important policy decision, as it will affect the design and capacity of its infrastructure going forward. Although, at first sight, border clearance would appear a convenient solution, as it theoretically limits the risk of diversion of goods under an inland transit scheme, it also implies that the duties should be paid at the border. But, this may pose later problems of transfer of funds to the State budget.<sup>66</sup> The second option is to establish customs control over the goods at the border, transfer them under an inland transit scheme to the point of final

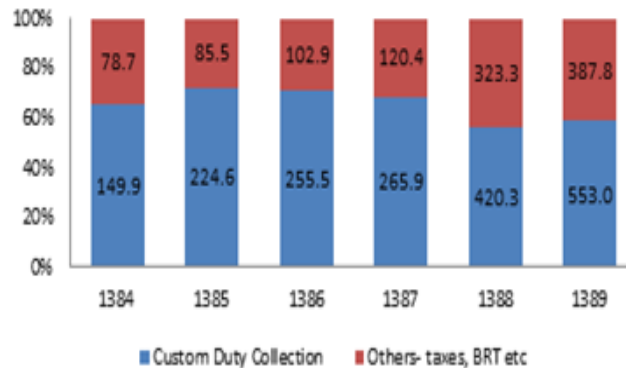
<sup>64</sup> Based on computerized clearance data and comparing with export data from countries exporting to Afghanistan: World Bank, December 2009.

<sup>65</sup> The initial Afghan approach in 2003 was to clear everything at the border. It is international best practice to clear as close as possible to the point of destination, with the possible exception of very large countries where journey times are considerable and border delays only represent a fraction of the overall transit time.

<sup>66</sup> Another option would be to impose advance payment of duty at the final point of destination of the goods, but this would raise serious assessment and reconciliation problems, and would considerably delay clearance procedures.

consumption, and clear them on arrival there. This allows the operation of a “fast track” at the border, where vehicles under a pre-approved transit scheme may be released with minimal verification, and avoids the construction of extensive unloading, storage, and control infrastructure.

**Table 2.5: Customs Duty Collection and Other Revenue (BRT, taxes, charges, etc.)**



Source: ACD

**Clearance at the point of destination is more economical for importers**, as they do not need to have an intermediary at the border. Thus, unloading for customs inspection can take place, in certain cases, at the premises of importers. However, it is essential that there should be a well-functioning transit system, with reliable guarantees and the ability for customs to perform roadside checks on vehicles in transit.<sup>67</sup> At the same time, it would create the conditions for Afghanistan to gradually develop its position as a major transit country. It was agreed with the authorities several years ago that inland clearance would be the default option (with possible exceptions for perishables, undocumented goods, and consolidated shipments, which, for the time being, would continue to be cleared at the border). In addition, some border locations (e.g., Hayratan), where there is a change in mode, would still be points of clearance. Unfortunately, because a clear decision has not been made, the divergence between donor subcontractors has led to alternation between the two options.

**Import procedures are still a challenge.**<sup>68</sup> Even streamlined with computerization, there are numerous lingering manual features. For example, the introduction of Asycuda should have led to a more-or-less paperless environment, where importers would lodge declarations remotely, and receive, in most cases, a release on their office computers, thus eliminating personal contact with customs officers. In practice, while clearance at many customs houses is computerized, those who submit declarations must report to a guard at the customs house, who directs them from one position to another. Declarations are submitted in hard copy, and the main role of each control officer is to compare the data on the paper entry to the computer record. Each step of the process is isolated, and when the goods are finally cleared, the importers must visit the customs house chief, who re-inspects the declaration. Importers

<sup>67</sup> Which is now the case with the transit module, but there are still no guarantees, and *en route* enforcement is practically non-existent.

<sup>68</sup> It is the universal experience that, in order to improve export procedures, import operations must be first modernized.

then apply to the archivist, whose signature is indispensable for the release of the goods. This process is prone to rent-seeking, and does not reap the benefits of streamlined computer clearance.

**The declaration forms are not yet compatible.** The uniquely Afghan forms and documents for lodging an import declaration were replaced in an effort to align customs documentation to international standards. In particular, this replaced the customs declaration (“Bar Nama”), which was not a real declaration, with a standardized declaration form, called the “Afghan Customs Clearance Declaration” (ACCD). Unfortunately, this form had few features of the internationally used customs “Single Administrative Document” (SAD), notably codification protocols and description of fields. As a result, it was not compatible with the international computerized clearance system, and therefore Afghanistan was at one time using three different customs declaration forms (the Bar Nama, the ACCD, and the SAD when computerization came). Furthermore, these forms were not compatible, could not be reconciled, and their data could not be downloaded automatically in to the computerized data base.<sup>69</sup> This is gradually being corrected with the roll-out of the Asycuda software, but the legacy statistics require practically a manual entry, thus preventing the use of a historical data base which would be useful for control purposes. (Box 2.2)

#### **Box 2.2 Introducing a Single Administrative Document – the Albanian Experience**

When Albania computerized its customs in 1991, there was no proper customs declaration form in use. So it was decided to introduce the SAD immediately, to avoid any compatibility issues.

As the customs systems in use at the time were extremely basic, many of the fields of the SAD could not be filled. For example, Albanian customs officers were incapable of classifying goods according to the complex international Harmonized System (HS), which uses six-plus digits to precisely identify goods. As a result, it was decided that certain fields on the SAD would be left blank, pending capacity build up, and the tariff classification would be limited to the first two digits of the HS (i.e., corresponding to the very broad category of goods). As competences grew, customs officials started adding more digits. The same happened with the other fields, and when the basic PC Trade system was replaced by Asycuda, officials and clearing agents were fully accustomed to the SAD declaration.

The only limitation was the absence of detailed statistical data for the first few years. But, whatever information was available was reliable, and could be integrated in to the Asycuda data base when the system became operational.

Source: IMF/FAD mission to Albania, June 1992.

**Compliance by importers on valuation is very low.** It is estimated that 90 percent of all invoices submitted with declarations are forged. When detected, they are routinely discarded by officials, who arbitrarily uplift the values (usually after a non-transparent negotiation process). No action is taken

<sup>69</sup> The ACCD was introduced in the early stages of customs modernisation by one donor agency that felt, rightly, the customs department had insufficient capacity to process the more complex SAD form. The agency assumed – wrongly -- that customs officials and importers/clearing agents would be unable to use the complex international codification for goods classification.

against importers who deliberately submitted forged documents, mainly because the penalties incurred, if any, are minimal.<sup>70</sup>

**Valuation is undermined by the way in which declared values are controlled or approved.** The system of customs valuation in Afghanistan is in line with the general principles set out in the Agreement on Implementation of Article VII of GATT (WTO). Valuation is based on the transaction value of the goods subject to adjustments due to the inclusion of cost insurance and freight charges. In case of dispute over accuracy of the transactions value, one or more of standard GATT valuation options are to be used. There is no value-added tax and excise tax applicable at the customs stations. However, the major issue is the way in which declared values are controlled or approved. Initially, the valuation of goods declared for imports was assessed by the Chamber of Commerce. This responsibility was handed back to the ACD. However, in the absence of adequate expertise in the ACD, valuation checks were delegated to officers employed by donor subcontractors. Thus, the transfer of skills to staff in the ACD has not taken place. In the current process, importers must, before lodging declarations with customs, report to a separate office where declared values are approved or uplifted by a team of contractors. This does not offer the guarantees of the WTO's valuation code and the valuation team does not have access to Asycuda's historical valuation data base, which severely limits the application of some of the WTO's methods of evaluation (notably those based on the earlier import of similar or identical goods). Customs officers are not allowed to adjust these certified values, and the valuation teams do not receive feedback from customs inspections or controls. While the system serves the objective of maximizing duties, but does not allow a fair clearance process.

**Most shipments are cleared with no inspection.** In Afghanistan, efforts have been made to reduce the rate of physical checks on declared goods, from nearly 100 percent to a more reasonable level (usually between 10 and 30 percent<sup>71</sup>). This is based on the compliance record of importers and other risk factors. All declared goods must be inspected, except for those imported under an exemption scheme. However, inspections in Afghanistan often do not happen mostly because of the high workload of staff. Most shipments are therefore cleared with no inspection. Not surprisingly, almost all counter-inspections performed by audit teams have found undeclared items of a much higher value than that entered in the declaration. If examinations were carried out on a targeted basis, customs revenues would most likely increase.

**Risk management is absent, but could be immediately available.** The introduction of the risk management module of Asycuda is considered an important feature of the ACD's computerization. Unlike in other countries, where risk management is a tool to reduce inspections, in Afghanistan it is more intended to help the ACD to identify shipments where an inspection should be mandatory, and thus increase the rate of examination.<sup>72</sup> The module is not active yet, but UNCTAD have confirmed it

<sup>70</sup> In most other countries, producing forged documents with a customs declaration is a felony.

<sup>71</sup> This ratio is much lower in OECD countries.

<sup>72</sup> For customs (and other border agencies) risk management implies, inter alia: (i) selectivity and targeting to determine if declared goods, vehicles and persons fully comply with all governmental requirements, and based on that determination selecting shipments, vehicles or persons for customs inspection, and deciding upon the extent of the inspection; (ii) detecting suspect illegal activity (contraband smuggling, illegal immigrants); and (iii) identifying potential weaknesses in supply chain security. While risk management can operate in a manual environment, the use of information technology greatly enhances the

could be activated now. Even if not all the risk parameters are available or tested, the module itself is fully operational.

**Some customs procedures are missing altogether.** These procedures include warehousing, free-zones, temporary import and inward processing operations supporting such fledgling home industries as repackaging operations, assembly operations, sewing or knitting of ready-made garments, home manufacture of carpets, etc. The essence of these schemes is that duty is suspended on components and raw materials used to produce finished exported goods. Duty is paid however, if the finished goods are diverted to the home market. The Asycuda system offers facilities to control warehousing, temporary import, temporary export and inward processing procedures.

**The green channel at Kabul International Airport (KAIA) could be revived.** As in most countries, Afghanistan tried to introduce a green channel procedure at the airport, through which travelers with nothing to declare could pass customs subject to targeted or random checks. Passengers carrying goods to declare are expected to select the red channel, where all passage is checked. When the system was introduced at Kabul airport, it was put on hold due to the disagreement across agencies favoring a 100 percent screening of passengers.

#### *Organizational and Human Resource Management in the Afghan Customs Department*

Improving the management oversight and governance structure of the ACD administration will be important in order to consolidate the customs reform and roll out the new systems.

**Human resource management is important for effective customs performance.** Because of the nature of their work, customs officers face continuous political pressures and life-threats, which have led to poor job satisfaction and low morale within the institution. Also, remuneration packages and benefits are low for officers, an issue not specific to the ACD, but to the overall public sector that the GoA is trying to address through a pay & grading reform for the civil service. However, it is a pressing issue for customs because of the rent-seeking opportunities.

**The focus on meeting revenue collection targets distracts attention from wider reform efforts.** The ACD is driven largely by a collection-target syndrome. This dilutes its commitment to structural reforms; the public mandate of the ACD becomes one exclusively on revenue objectives. Local staff performance is evaluated mostly on the ability to achieve targets. As a result, when the target is met local officials tend to relax their controls. If the target is not likely to be achieved, customs officials may go to great lengths to persuade importers to pay more or to make advance payments.

**The organization of customs is in conflict with reality on the ground.** Limited communications with headquarters has meant that managers are not receiving immediate reports from their field staff. Local officials and some provincial governors in Afghanistan are having direct influence over regional customs operations. In some instances, local directors are expected to report to them, and some governors tend

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effectiveness of risk management systems and should form a part of any enforcement strategy. Effective application of risk management techniques also supports trade facilitation by expediting compliant (low risk) shipments.

interfere in the hiring and dismissal of customs officials. For example, in some instances employees dismissed by customs headquarters on grounds of corruption were reinstated by governors in their original positions. This ambiguity in the governance structure of the customs administration undermines the performance of customs officials on the ground.

**Customs management oversight could be strengthened.** Afghanistan's geography and current environment (conflict, opium trading and weak governance) makes it difficult for the ACD to provide the required oversight over its operations across the Afghan customs territory. Thus, unannounced site visits and inspections, which are an essential part of the chain of command, are often not possible, due to the security situation. Despite this, modern information and communication technologies, often part of the computerization of, or linked to, automated information capturing equipment, can help improve and provide this supervision

**Customs lacks the powers and credibility to impose compliance by importers.** To be more effective, and further improve revenue collection, the ACD would need to increase its border control over goods and people, and the vehicles carrying them. Customs needs the ability to operate throughout the customs territory to prevent, detect, document, and prosecute violations of the customs law. A clear example of this is the fact that 90% percent of submitted invoices are forged without any serious consequences for repeating offenders.

### Box 2.3 – Customs Clearing Agents (Brokers)

Facilitated and expedited customs clearance is usually obtained through a licensed clearing agent. The agent knows the customs procedures and systems, acts on behalf of clients, and lodges declarations under their own responsibility exercising due diligence. Thus, clearing agents help save time by playing an important role as auxiliaries in the logistics chain, often combining Customs brokerage with freight forwarding, and are appreciated by both Customs authorities and clients because their work helps save time.

In Afghanistan, the clearing agent's approach is rather different. First, agents see themselves as "facilitators" rather than professional experts. Second, they do not take responsibility for the declarations and documents prepared for the clients, which means they do not provide a risk management service. Third, the fees charged depend on the complexity of procedures, which has created an incentive for them to lobby against simplifying existing systems. For example, one of the major delays in the installation of the Asycuda system at the Jalalabad Customs house was related to tensions with organized clearing agents groups protecting an existing monopoly.

Similar challenges have been overcome in other countries by developing a more professional cadre of clearing agents. The establishment of a professional association or institute of chartered Customs brokers that continually tests their customs skills is a step in the right direction. Professionalism can be developed by ensuring the functions of the agents go beyond that of secretaries, typing declarations or advising on ways to avoid paying duties. They need to lodge a financial security to be allowed to declare on behalf of their clients and should face internal disciplinary proceedings in case of fraud.

Source: Asycuda



### *Interagency Coordination is Important*

**The level of interagency cooperation will determine the quality of the customs service provided.** Customs, being at the crossroads of trade, taxation, evasion, and regulation, has to interact with other agencies and. Basic activities, including arrival procedures for goods and cargo control, post-release verifications and investigations, or the management of transit or other suspense regime, all have a high impact on the efficiency of the customs authority and the level of duties paid. These are among the most difficult to implement in Afghanistan due to institutional overlaps.

**Most reforms that would be necessary to upgrade the ACD to a level comparable to other countries are outside the control of customs.** In Afghanistan, several agencies are involved in areas which in other countries are the traditional domain of customs. This is partly a legacy of the Soviet system, where borders were closed and foreign trade tightly regulated. The procedure for examination of goods by government officials is blurred because several agencies and local authorities may conduct inspections and it increases processing times. For instance, oil imports by rail from Uzbekistan are reported to a Ministry of Commerce official who receives the train manifests, and extracts from them the data which is subsequently provided to customs. There is no mechanism for the ACD to ensure that all oil imports were reported. Another example, the Ministry of Transport collects revenue through road fees, which are required to obtain a weight certificate. Until recently, the Ministry of Foreign Affairs issued transit permits – at a cost of US\$ 100 per permit – from diplomatic posts abroad.

**Corruption both in and outside the ACD remains an issue.** Reducing opportunities for corruption should be a priority for the government. This can only be done by ensuring meaningful and independent oversight of ACD operations and acceleration of ongoing reforms to streamline and automate procedures and reduce the interface between customs officers and clients. A comprehensive anti-corruption strategy, including action plan, should be developed with the support of the Independent Monitoring and Evaluation Committee (I-MEC) to ensure effective implementation and oversight.

### *Opportunities and Recommendations*

**The role of the customs department should be defined in line with (i) the Afghan environment, and (ii) global trends in the evolution of customs administrations.** The approach should be agreed between the government and donors, and among donors to rationalize technical assistance and equipment inputs.

**Customs procedures should be made less cumbersome, globally aligned and transparent.** In Afghanistan, various clearance procedures exist all over the country, which are neither internally nor regionally or globally aligned. While computerization is slowly resolving this, a coordinated effort to review, revise and audit these clearance procedures should be undertaken. An exercise akin to the GATT assessment should be undertaken at customs house level, to identify a “critical path” for reforms. The role of clearing agents – and their responsibilities – should be better defined.

**The concept of “collaborative borders management” (CBM) would help limit interference from other government entities in customs matters.** The term CBM is gradually replacing the notion of “Integrated border management” (IBM) as it is seen as going beyond mere coordination of effort between border



agencies and is less threatening than IBM, which brings with it a strong connotation of organizational integration (such as the U.S. Homeland Security department). The collaborative border management concept is based on the premise that agencies and the trading community need to work together to achieve common aims that benefit all parties. Such a model suggests that border management agencies can increase the level of control, while simultaneously providing a more efficient service to customers and can do so while retaining their own organizational integrity.<sup>73</sup>

**Defining the clearance model for Afghanistan will have an impact on the design of its customs administration.**

**Every reform or modernisation operation should factor the anti-corruption dimension.** A review of governance issues, including interference of outside bodies and institutions in areas that fall under the customs domain, and a clear organisational and staffing policy, would help strengthen the institutional side, while embracing anticorruption measures. In general, anti-corruption initiatives under the umbrella of customs reform should rightly focus, including those in Afghanistan, on four types of measures: (i) computerization, to eliminate discreet direct interface between officials and those carrying fungible wealth, and to leave an audit trail; (ii) staff policies, ranging from ethics to salaries and incentives, which also imply an audit capacity; (iii) a multi-tiered investigative capacity that must involve specialized anti-corruption customs units, and external auditors and investigators; and (iv) the involvement of the private sector, with adequate legislation to deter corrupt practices and bribery. Technical assistance and policy advice is currently being provided to the GOA and ACD in these areas.

**The ACD and neighboring countries' customs agencies need to cooperate better.** This absence of cross-border information linkages has clear fiscal, social and trade facilitation dimensions. Of the total commercial imports, estimated at US\$ 7.87 billion in 2008, approximately US\$ 7.71 billion moved over land routes from surrounding countries. The ACD needs to exploit this advantage to improve its governance and control, and needs to further improve cooperation with the customs agencies of neighboring countries. This should be the result of a CBM strategy.

**The customs law (and possibly other laws) would need to be updated.** The two objectives would be to promote voluntary compliance (with swifter and probably increased penalties), and to provide the customs authorities with an enforcement capacity that is absolutely essential for the ACD to perform according to international standards.

**Greater interagency cooperation will improve the quality of the customs services provided.**

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<sup>73</sup> From McLinden, Gerard and Tom Doyle. *Border Management Modernization: A Practical Guide for Reformers*. International Trade Department, World Bank.

**Table 2.6. Overall Performance Indicators for the Afghan Customs Department (ACD)<sup>74</sup>**

	2002	2003	2004	2005	2006	2007/1387	2008/1388	2009/1389	2010/1390
Total Customs revenue (US\$ Million)	64.99	77.16	137.59	223.79	309.91	399.34	773.75	938.37	1052.19
Total Customs cost (US\$ Million)	0.56			2.12	2.17	3.11	5.19	7.84	4.38
Total Customs staff	1,379	1,100	1,174	1,876	1,876	1,876	1,935	1,899	1,756
Total Customs salaries (US\$ Million)				1.65	1.65	1.75	2.10	3.02	3.37
Annual number of declarations	4,530	100,000	352,749	308,391	359,009	379,196	454,743	774,685	879,262
Import	4,512		352,749	298,335	344,648	347,549	431,521	756,190	862,964
Export	18			10,056	14,361	31,647	23,222	18,495	16,298
Imports (US\$ Million)	1,271.07	2508	3,786	3,803	3,972	4,560	6,081	6,763	7,609
Exports (US\$ Million)		1291	1,894	100	168	246	307	233	233
Total (US\$ Million)		3,799	5,680	3,903	4,140	4,806	6,388	6,996	7,842
Revenue collected/Customs staff	47,128	70,145	117,198	119,291	165,197	212,868	399,871	494,139	599,197
Total Customs cost/Revenue collected	0.86%	0.00%	0.00%	0.95%	0.70%	0.78%	0.67%	0.84%	0.42%
Salaries/Revenue collected	0.00%	0.00%	0.00%	0.74%	0.53%	0.44%	0.27%	0.32%	0.32%
Trade volume/Staff (USD)			4,838,160	2,080,490	2,206,823	2,561,834	3,301,292	3,684,044	4,465,923
Declarations/Staff	3	91	300	164	191	202	235	408	501
Economic cost per declaration	123.62			6.87	6.04	8.20	11.41	10.12	4.98
Average monthly salary cost				73.29	73.29	77.74	90.44	132.53	159.93
Average revenue per dec.			390.05	750.13	899.21	1,149.02	1,793.08	1,240.92	1,219.27
Average value per declaration			10,732.84	12,747.41	11,524.80	13,120.45	14,092.01	8,943.52	8,816.98
Ratio (effective rate)			3.63%	5.88%	7.80%	8.76%	12.72%	13.88%	13.83%

<sup>74</sup> These indicators are computed by the World Bank in most countries where a customs support project operates.

## Chapter IV: Infrastructure Services

**A major constraint to the supply side and for private sector development in Afghanistan is the provision of infrastructure and infrastructural services.** These directly affect production costs and delivery times and play a key role in determining the competitiveness of Afghan firms. While the needs in Afghanistan are pressing and there is a wide infrastructure gap, this diagnostics study identifies three sectors that could have the greatest impact on developing trade services: i) electricity, ii) telecommunications (ICT), and iii) roads (transport). Thus, the following sections present an overview of the current coverage across them, the current challenges, and the opportunities for development that could greatly impact international trade in Afghanistan.

### *A: Electricity*

**While access to reliable power has a direct effect on firm creation and productivity, perhaps the most significant impact from increasing access to electricity is on poverty reduction.** It does so not only through fostering productivity and production of value-added goods and increasing productive hours beyond daylight, but can also give communities access to communications, improve healthcare by enabling refrigeration (of specialized equipment), and promote gender equality relieving women of the drudgery of water collection. Providing better quality electricity services requires a better understanding of the existing challenges and potential for electric power infrastructure issues in Afghanistan.

**In Afghanistan, access to electricity is a major constraint to local businesses; households also have limited access.** In 2012, the electrification rate in Afghanistan was about 23 percent (Figure 3.1), which is amongst the lowest in the world and unfavorably compared to other developing countries in the region (e.g., 41 percent in Bangladesh, 62 percent in Pakistan and 66 percent in India).<sup>75</sup> Only one-tenth of the rural residents have access to electricity in Afghanistan.<sup>76</sup>

**On the nonresidential side, about 20 percent of firms have no access to electricity** (Figure 3.2). Obtaining a new electricity connection takes on average two months. Because of the limited coverage of the grid, some businesses must wait until the system is extended to their area, or need to acquire a diesel generator. All these add costs to the business.

**Electricity is identified as the most significant business constraint in Afghanistan,** with the quality of its supply also an issue. According to the 2009 Business Environment Performance (BEEP), 20 percent of firms surveyed identified electricity as the most serious constraint for their businesses (Figure 3.4). Power outages are frequent, and certain parts of the country may receive on average just 11 hours of electricity per day.<sup>77</sup> On the business side, about 60 percent of enterprises experienced power outages in 2009 (Table 3.1) – scarcely an improvement on the reported 68 percent of firms reporting service

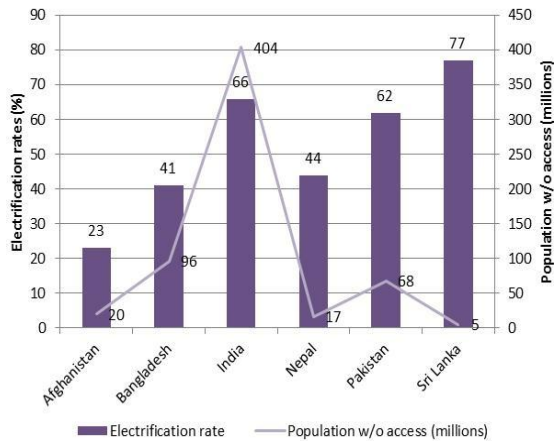
<sup>75</sup> WB estimates for Afghanistan are based on 2012 customer data from DABS, 887,000 households and assumes a population of around 26.5 million and an average household size of 7 members.

<sup>76</sup> GTZ. 2010. *Survey Report on Micro Hydro Power Plants: Takhar Province, Afghanistan*.

<sup>77</sup> Afghanistan Government Coordination Committee. 2009. *Afghanistan National Development Strategy: First Annual Report 2008/09, Part I*.

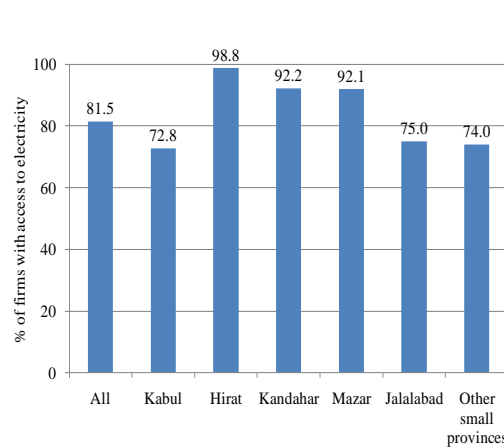
breaks in 2005. Firms say they experience outages every other day, and it can take over 10 hours before service is restored (Figure 3.3). Common fluctuations in the voltage and frequency of electricity supply that can damage equipment or impair processes are a concern for consumers. Voltages frequently decline to as little as 40% of the nominal level and frequency excursions are often well beyond the 50 Hz  $\pm 0.5$  Hz range in which much equipment is designed to operate.

Figure 3.1: Electricity Access, South Asia 2010



Source: IEA 2010 and WB staff calculations

Figure 3.2: Electricity access, Afghan businesses



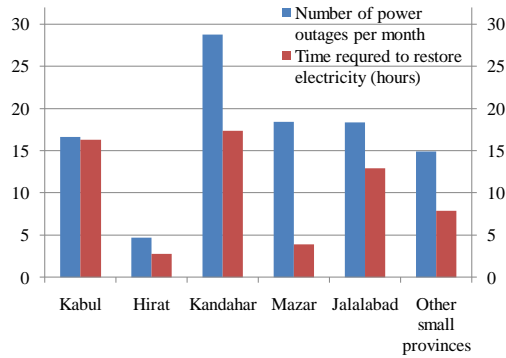
Source: BEEP, Afghanistan 2009.

**The unreliable and limited electricity supply is taking a toll on competitiveness by increasing costs for Afghan businesses.** On average, electricity accounts for 7 percent of total operating costs for Afghan firms, and even higher for firms that are more electricity intensive. About 10 percent of manufacturers and retailers are spending more than 20 percent of their costs on electricity. The BEEP 2009 estimates losses caused by power outages accounting for more than 10 percent of the annual sales of firms. (Table 3.2). In addition, about 70 percent of Afghan firms own their own private generators to back up the electricity supply, which translates into higher costs considering that small privately owned diesel generators cost about \$0.5 per kWh (based on the light diesel fuel costs).<sup>78</sup> Firms must also invest in additional equipment, such as voltage stabilizers, to protect their systems against the poor quality of supply.

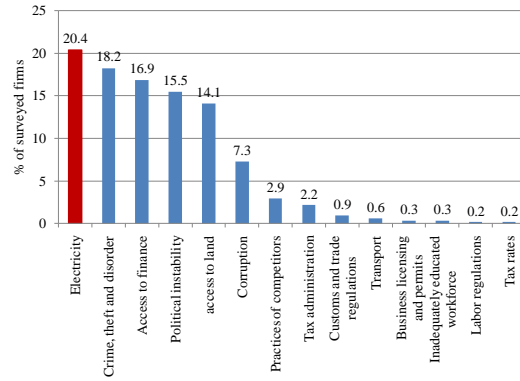
Figure 3.3: Power Outages by Region

Figure 3.4: Most Significant Business Constraints

<sup>78</sup> World Bank. 2007. *Development of Electricity Trade in Central Asia- South Asia Region*. Washington, DC: World Bank.



Source: BEEP, Afghanistan 2009.



Source: BEEP, Afghanistan 2009.

**Table 3.1: Power Outages for Firms in Afghanistan**

	2005	2009
Experiencing power outages (% of total firms)	68.1	59.2
Number of power outages in a typical month	...	16.6
Time required to restore electricity (hours)	7.3	11.2

Source: BEEP, Afghanistan 2009.

**Table 3.2: Losses from Power Outages vs. Private Power Generation in Afghanistan**

	2005	2009
Losses caused by power outages (% of annual sales)	18.3	11.7
Share of firms that own or share a power generator (%)	76.2	70.4

Source: BEEP, Afghanistan 2009.

**Afghanistan's domestic generation capacity is below the country's demand.** The government has made efforts to reconstruct and expand the nation's infrastructure to meet rapidly-growing demand, brought about by both economic growth and the program to increase the number of connections. Although demand forecasts are difficult to come by, the current Power Master Planning exercise being undertaken by MEW and financed by ADB suggests that demand will rise from the 4.4 TWh forecast for 2012 to 7-9 TWh by 2020 and as much as 12-19TWh by 2032.<sup>79</sup> To meet demand, Afghanistan currently has about 477MW of installed capacity connected to the grid, which it supplements with a further 605MW of power imports from its neighbors. Domestic generating capacity and imports available, however, stood at 341MW and 558MW respectively<sup>80</sup>. In 2011, 73% of electricity supplied was imported.<sup>81</sup>

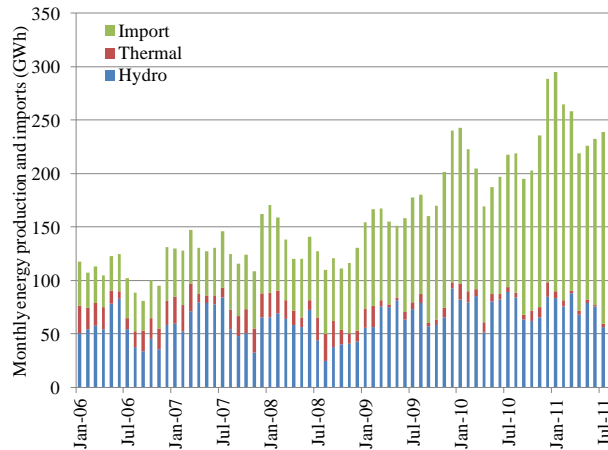
<sup>79</sup> Few demand estimates are available in Afghanistan. But according to the Afghanistan National Development Strategy: Power Sector Strategy (2007), the demand for electricity in the northeast region (which includes the capital, Kabul) was estimated at about 1,320GWh in 2010. The actual electricity supply was about 530GWh, only about 40 percent of the projected demand.

<sup>80</sup> In addition to the on-grid capacity, a further 134MW of installed capacity is operating off-grid, of which 115MW is available. As load shedding is not monitored, it is not possible to estimate the amount of load not served, but anecdotal evidence suggests that there is considerably higher demand than currently supplied.

<sup>81</sup> Afghanistan Ministry of Energy & Water. 2007. *Power Sector Strategy for the Afghanistan National Development Strategy*.

**Such a level of dependence on imports is rare and presents risks.** The country's growing dependence on electricity imports forecasted to reach 77 percent in 2012 is rare. It creates the risk that changes in the demand patterns in neighboring countries or deteriorating trade could widen the gap between supply and demand. Afghanistan needs to consider what level of energy autarky is appropriate to its circumstances, trading off independence and the additional capital requirements that would result from investing to increase generation capacity.

**Figure 3.5: Energy Production and Imports in Afghanistan**



Source: Afghanistan Energy Information Center (AEIC).

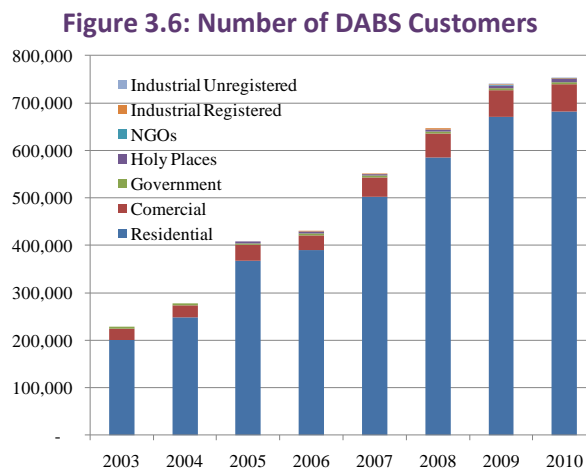
**The transmission and distribution networks present great challenges.** The country's heavy dependence on imports means that the domestic power system cannot be operated as a single entity. Instead, several areas are operated as 'islands' because the countries from which Afghanistan imports are not all synchronized with one another or with domestic Afghan generation. Matching the supply parameters agreed with each exporting country, as these vary daily and seasonally, creates significant operational challenges for Da Afghanistan Breshna Sherkat (DABS). For example, Herat and North-West Afghanistan, which are served by Iran and Turkmenistan, are effectively an extension of the Iran/Turkmen grids.

**Technical and non-technical losses of electricity in the Afghan distribution system are high.**<sup>82</sup> Some estimates put them as high as 50 percent in certain areas supplied by DABS; typically a figure of 10 percent is easily achievable, and most utilities strive to reduce non-technical losses to zero. (Figure 3.7).

<sup>82</sup> Technical losses refers to losses in generation, in the transformation of electricity from one voltage to another, in the power lines that move the electricity from generator to consumer, and reactive power losses that result from the nature of the load being served. These are highest in systems with ageing or underperforming equipment. Non-technical losses arise mainly from theft, poor equipment maintenance (especially measuring equipment), calculation errors and accounting mistakes.

There are a number of ongoing projects funded by donors to rehabilitate and expand transmission and distribution networks in major and secondary cities.<sup>83</sup>

**The DABS is playing an important role in generating and delivering electricity to Afghan people.** In May 2008, the DABM was incorporated and replaced with Da Afghanistan Breshna Sherkat (DABS). It remains integrated, state-owned utility providing electricity. With about 6,000 employees, and substantial government support, has seen impressive growth of its customer base nationwide, from about 227,000 to 753,000 between 2003 and 2010. (Figure 3.8). While the Ministry of Energy & Water (MEW) continues to be responsible for policy and investment planning and implementation, the DABS is responsible for operating the power system including generation, transmission and distribution, billing and collection.



Source: Afghanistan Energy Information Center (AEIC), DABS customer database.

**DABS's is still far from being fully commercialized and its operational capacity remains a challenge.** Given its rapidly expanding operations, there is a shortage of qualified staff with competent technical and managerial skills. In Afghanistan, only 70 percent of energy is billed, and only about 60 percent of bills are collected.<sup>84</sup> Therefore, better and more commercially-oriented management is needed for DABS to address issues in the areas of: daily operations, metering, billing and tariff collection. To increase productivity, it is essential to retain well-qualified employees on both technical and nontechnical sides. However, the average salary of engineers at DABS is estimated currently to be 10 percent below the market rate in the country.<sup>85</sup> In addition to ongoing efforts toward expanding the supply capacity on the physical side, these institutional issues need to be addressed to ensure financial sustainability in the electricity sector.

**DABS lacks the financial means to operate and maintain the nation's electricity infrastructure.** Tariff collection from end users seems to remain below the full cost recovery and without adequate tariff levels and collection, sustaining current operations or system expansion in the long term will be

<sup>83</sup> ADB Report No. 42094.

<sup>84</sup> ADB Report No. 42094.

<sup>85</sup> ADB Report No. 42094.

unviable. In addition, the company is heavily dependent on international aid for investment to rehabilitate the country's damaged electricity infrastructure assets. Operation and maintenance costs have increased significantly over the past decade. The fact that capacity in Afghanistan more than tripled over the last 10 years, from the meager 240MW reported in 2002, is translating into operation and maintenance requirements at around \$194 million annually or 1.2 percent of GDP in 2011.<sup>86</sup>

**Table 3.3: Electricity Tariff Structure in Major Provinces (October 2011)**

Customer group	Kabul (Central)	Balkh (N.W.)	Kunduz (N.E.)	Heart (West)	Helmand (S.W.)	Kandahar (S.E.)	Nangarhar (East)
	US\$	US\$	US\$	US\$	US\$	US\$	US\$
<b>Residential</b>							
Up to 300 kWh	0.031	0.092	0.051	0.041	0.031	0.031	0.031
301 - 700 kWh	0.082	...	0.051	0.041	0.082	0.082	0.082
Above 701 kWh	0.123	...	0.051	0.041	0.123	0.123	0.123
<b>Manufactures (registered)</b>	0.123	0.184	0.143	0.123	0.123	0.123	0.205
<b>Commercial</b>	0.205	0.246	0.143	0.143	0.205	0.205	0.205
<b>Governments and others</b>	0.205	0.246	0.143	0.143	0.205	0.205	0.205

Source: DABS

**Over the medium term, establishing the financial viability of DABS will be an important step to ensure an adequate supply of electricity across important urban centers.** Afghanistan's energy sector will need to focus on reducing revenue losses. This means improving the administrative capacity at DABS to improve its billing and collection losses. Currently, electricity is sold domestically at around \$0.08 per kWh,<sup>87</sup> but the cost of fueling and operating domestic diesel plants, range between \$0.20 and \$0.46 per kWh.<sup>88</sup> Given that electricity imported from neighboring countries can be purchased at between \$0.03 and \$0.06 per kWh,<sup>89</sup> efforts to build domestic revenue capacity, particularly through large-scale diesel generators, may be fiscally unsustainable.<sup>90</sup> (Table 3.4)

<sup>86</sup> World Bank, Transition in Afghanistan: Looking Beyond 2014, 2012

<sup>87</sup> Altai Consulting, 2011, p. 11

<sup>88</sup> SIGAR, 2010, p. 5

<sup>89</sup> Altai Consulting, 2011, p. 11

<sup>90</sup> Domestic hydroelectric generation has the lowest operational costs, ceteris paribus, estimated at \$0.03 / kWh ( Trofimov, 2010), but the remote locations of large-scale hydroelectric facilities, combined with the poor state of Afghanistan's transport infrastructure and the lack of security in many rural areas, results in high costs of construction, operation, and maintenance. Efforts to rehabilitate the Kajaki Dam, summarized in (Zorpette, 2011), are a case in point.



**Low electricity tariffs also send a wrong signal to customers, encouraging them to overuse limited energy.** Thus, the tariff structure can be designed in ways to motivate consumers to use electricity wisely and to contain, to some extent, a growing demand while also providing revenue for further investment.

**There are a variety of tariff practices in the region.** Universal metering is a first fundamental step towards better demand management. To reduce illegal connections and nonpayment, strong measures need to be taken, such as disconnection and prosecution to recover the cost of theft. Prepaid metering is another instrument, as utilized by the Bangladeshi utility DESCO. Regular (normally monthly) billing and tariff collection are also important to avoid nonpayment and late payment, particularly by poor households, because they often cannot afford a one-time payment for several months.

#### *Alternate ways of increasing the power supply*

**Local communities are playing an important role in rural electrification, based on micro-hydro plants (MHPs).** In rural Afghanistan, most poor households and communities typically rely on firewood, bush, animal dung, kerosene and private diesel generators. To modernize such energy sources, the government has been promoting micro-hydro development in rural areas. Under the National Solidarity Program, more than 500 MHPs have been developed since 2003.<sup>91</sup> The generation capacities of these MHPs are normally small, but the communities are responsible for constructing and maintaining them. In the Takhar Province, for example, 85 percent of MHPs have a capacity of 10-50kW. Overall, these have proven to be a viable alternate solution to supply electricity to some remote rural areas deprived of electrification.<sup>92</sup>

**Regional power trading can improve economic efficiency for Afghanistan and its neighbors.** It would benefit not only Afghanistan, but also Pakistan since both countries are highly dependent on energy imports. Of several regional energy schemes in discussion, the Central Asia-South Asia (CASA) 1,000 MW scheme is the most advanced and could make such exchanges possible (see Box 3.1, below).<sup>93</sup> However, any regional power scheme will face challenges. The current electricity surplus in the Central Asian countries will decline over time, which would require investment in building additional capacity. Moreover, ensuring the physical security of assets in Afghanistan, whether for electricity or gas, will be crucial to enable such exchanges and to attract foreign investment. In addition, policy predictability overtime and the ability to enforce of contracts will be key determinant factors for leveraging greater private sector investment.

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<sup>91</sup> Afghanistan Ministry of Energy and Water. 2007. *Afghanistan National Development Strategy: Power Sector Strategy*.

<sup>92</sup> GTZ. 2010. *Survey Report on Micro Hydro Power Plants: Takhar Province, Afghanistan*.

<sup>93</sup> Several projects have been proposed to bring electricity generated in the Central Asian States to Pakistan with some proportion made available to Afghanistan. The "Uzbekistan-Afghanistan-Pakistan Electricity Supply and Trade Project" would aim to deliver 100MW (915 GWh) to DABS at a substation North of Kabul and 900 MW to Pakistan in the Peshawar area. Another proposal would deliver surplus hydro power from Tajikistan and Kyrgyzstan. Afghanistan Resource Corridor Report 2012

### *Opportunities and recommendations*

Afghanistan has opportunities and challenges in trying to ensure a reliable and affordable electricity supply. It could do so by (i) exploring ways to expand domestic capacity, and (ii) deepening regional power trading.

**Deepen investment in domestic power generation capacity.** On the technical side, this will require technical assistance and support for the implementation of this newly generated capacity.

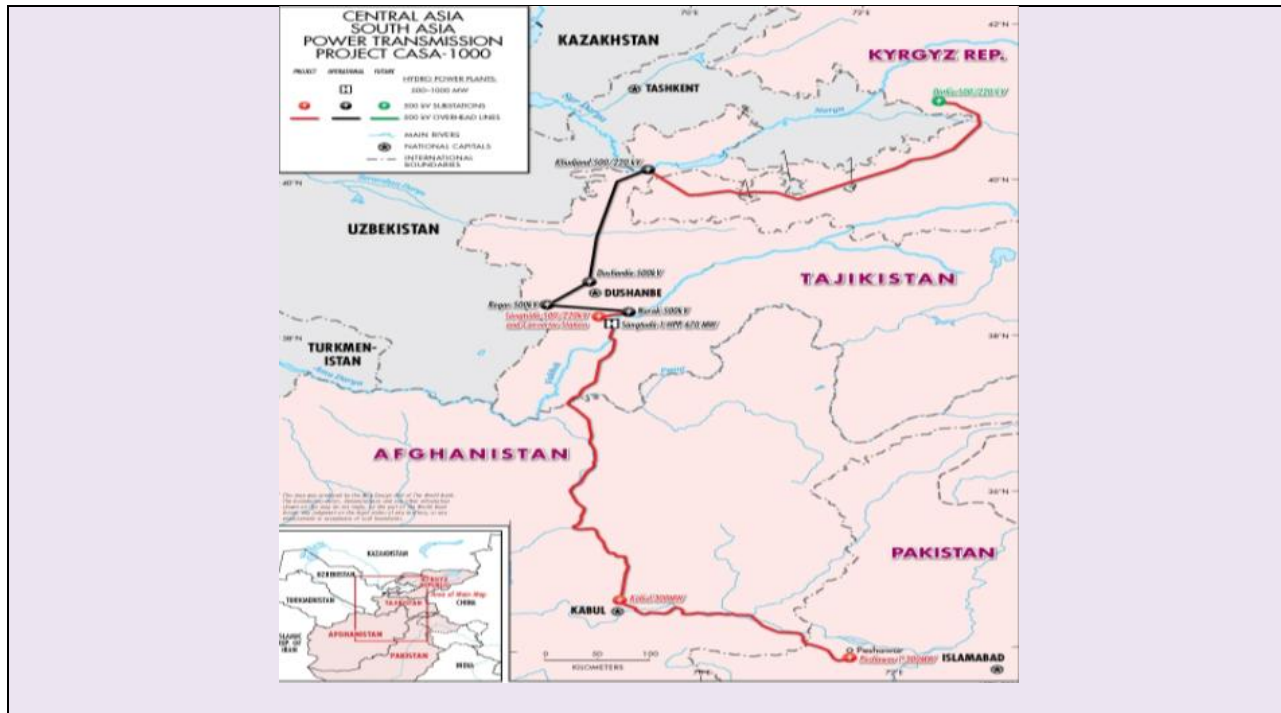
**Enhance regional power trading.** Regional power trading can provide significant opportunities for Afghanistan to purchase electricity at cheaper prices. The country may also gain transit fees if regional power trade takes place between its neighboring countries. This will require physical interconnections to be completed and upgraded. Institutionally, the government should establish sound partnerships with neighboring countries to manage the risks of energy security, price volatility and uncertainty in international power trading. It will necessarily require regional dialogue, cooperation and strong political leadership from the countries involved.

#### Box 3.1: An Integrated Regional Electricity Market – The CASA 1000 Project

The CASA 1000 project is an effort to develop trans-regional electricity trade across South Asia and aims to increase electricity flows by 1,300 MW. It is the first phase of what is planned to be the Central Asia South Asia Regional Electricity Market (CASAREM). Electricity would flow from the Kyrgyz Republic and Tajikistan to Afghanistan, which would import about 300 MW, and on to Pakistan, which would absorb most of the rest. This ambitious project would ultimately link energy supplies between the Urals and South Asia, ensuring a revenue stream to Tajikistan and the Kyrgyz Republic, while helping to alleviate electricity shortages in the southern countries. Currently, both Afghanistan and Pakistan are heavily dependent on costly oil-based generation to meet their electricity needs in Winter.

The project's feasibility study was updated and endorsed in 2011. It shows that the CASA 1000 would be technically feasible, providing a rationale to invest in the transmission interconnection. This is based on the expectation that sufficient surplus power would be available from the countries in the north to trade with the countries in the south, at a cost below the long-run marginal cost in the receiving countries. However, more information is needed from the feasibility study to understand the costs and economic benefits for Afghanistan, like a distributional analysis, and realistic forecasts of tariff proposals. All member countries signed a MOU to fast-track its preparation in September 2011.

The commercial negotiations are scheduled to conclude by October 2012, with contract award in the second half of 2013. Unfortunately, there is uncertainty as to the implementation of the CASA-1000 project. However, though a long-term endeavor, development of a regional electricity market would bring economic growth to all parties and strengthen economic ties across the region.



### ***B: Information and Communication Technology***

**Cross-border trade in services largely depends on telecommunications as the channel for transactions.** Access to telecom reduces the cost of engaging in international trade and increases a country's openness towards the rest of the world, a finding that is widely supported by the empirical literature. Jansen and Nordas 2004 found a strong and positive correlation between the density of fixed and mobile telephone lines and trade relative to GDP, where the supply response to a reduction in tariffs is larger the higher the penetration rate of telecommunications.<sup>94</sup> Along these lines, a study of the impact of the Internet on US trade in services found that trading partners' Internet penetration had a significant impact on US imports of business, professional and technical services.<sup>95</sup> In the US and most OECD countries, the internet is the cheaper and most widely used channel of exchange of information and services. Therefore, higher internet penetration and access to telecom directly affects the development of trade. This is why this section highlights the development of ICT services as a driver of trade in Afghanistan; it discusses an overview of the sector, the challenges, and opportunities to capitalize on its potential.

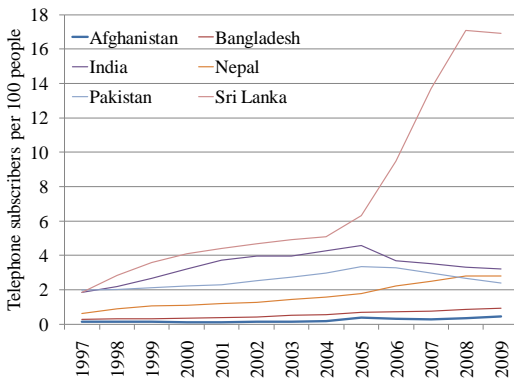
<sup>94</sup> Jansen and Nordas, 2004, found a positive correlation between trade flows and telecom. They establish a relationship between mobile plus fixed telephone lines per 1,000 inhabitants and openness when controlling for market size, own and trading partners' tariffs, with dummy variables for islands and landlocked countries respectively, and the distance from the equator is included as a proxy for distance to major markets. Their estimated regression explains 35 per cent of the variation coefficient on telephone density is significant at a one percent level.

<sup>95</sup> WTO, Trade Report, 2004. Freund and Weinhold, 2002

**The Afghan mobile telecommunications market has seen vigorous growth in recent years.** Since 2001, Afghanistan has made significant progress in adopting mobile technologies, including since 2012, advanced broadband wireless technologies. This gives Afghanistan an opportunity to leapfrog to the most advanced technology in the sector. While fixed-line telecommunications remain minimal in Afghanistan, mobile teledensity has increased dramatically, from virtually zero in 2002 to about 40 percent in 2009 (Figures 3.9 and 3.10). As of 2011, two-thirds of the Afghan population subscribes to mobile telephone services,<sup>96</sup> and two-thirds of households surveyed by the Asia Foundation report owning at least one mobile phone.<sup>97</sup> This compares well with other low-income countries.

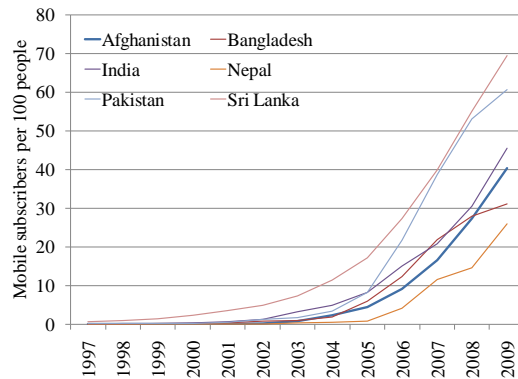
**Advanced ICT needs to be developed and expanded.** The Government and private sector have made significant investments in networks; over US\$1.7 billion between 2001 and 2011. For example, the Government has invested over US\$100 million to create a national fiber optic backbone network that connects most provinces and links with four of its neighbors. Yet more needs to be done to spur Internet use. Only three people per 100 in Afghanistan use the Internet (Figure 3.11). Broadband Internet subscription is virtually zero in areas other than large cities (Figure 3.12). The limited availability and use of advanced ICT is restraining business opportunities for Afghan firms. While mobile telecommunications are widely used for business, only 40 percent of the surveyed firms use e-mail, and only 20 percent have a websites (Figure 3.13). Broadband-based ICT markets can reduce transaction costs of businesses and open unexploited business opportunities. The introduction in 2012 of high-speed wireless broadband networks could help drive growth, at least initially in urban areas.

**Figure 3.7: Fixed Line Teledensity**



**Figure 3.9: Internet Use**

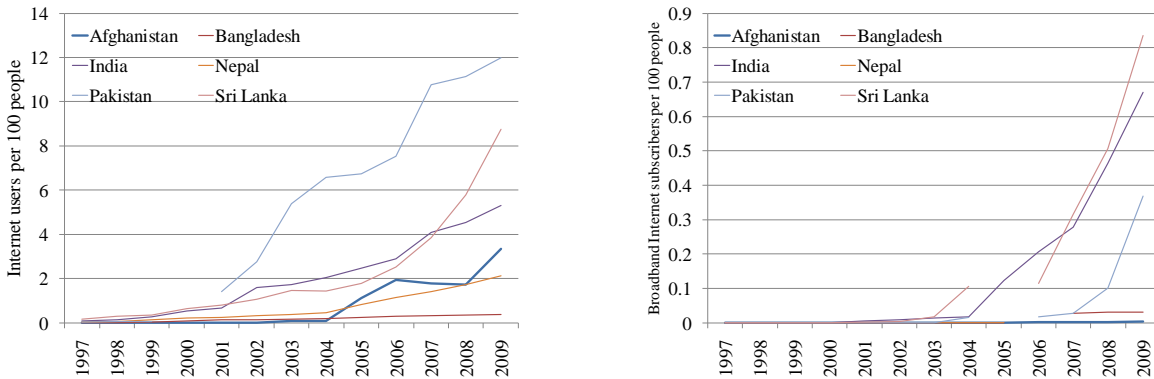
**Figure 3.8: Mobile Teledensity**



**Figure 3.10 Broadband Internet Use**

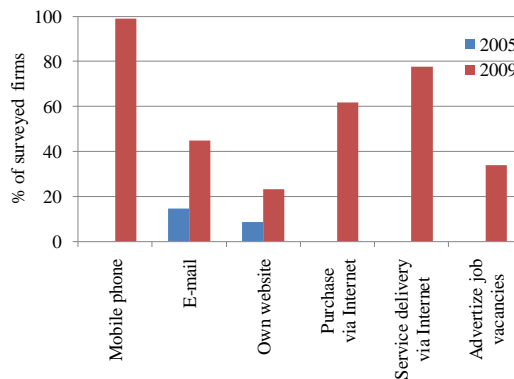
<sup>96</sup> MCIT, <http://mcit.gov.af/en>

<sup>97</sup> Asia Foundation, 2011



Source: World Development Indicators.

Figure 3.11: ICT Use by Afghan Firms



Source: BEEP, Afghanistan 2009.

Five privately-owned firms, with foreign partners, and one state-owned corporation are competing in the mobile telephony market (Table 3.8). The first private firm, Afghan Wireless Communications Company (AWCC), launched its services in 2002, followed by Roshan a year later. In 2006 and 2007, two more mobile operators entered the market, MTN and Etisalat. The fifth company, Wasel Telecom, was given a local license for unified telecommunications services. There is no capital restriction by nationality in Afghanistan, and they have invested about US\$1.7 billion in the country in the past 10 years.

Table 3.4: Private Mobile Carriers Operating in Afghanistan

Operator	Contract period	Cumulative investment (\$ million) 1/	No. of customers (million) 2/
Afghan Wireless Communications Company	2002-2017 15 years	450	4.2
Roshan Telecom	2003-2018 15 years	450	5.2
Areeba Afghanistan (MTN)	2006-2021 15 years	218	4.4
Etisalat Afghanistan	2007-2022 15 years	300	5.1
Wasel Telecom 3/		8.3	0.4
<b>Total</b>		<b>1,426.3</b>	<b>19.3</b>

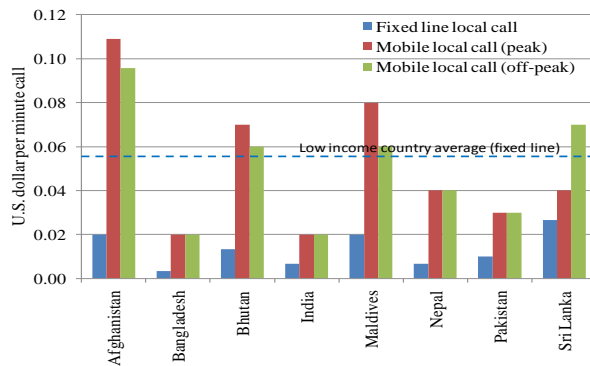
1/ Based on Private Participation in Infrastructure database.

2/ Based on Wireless Intelligence database (June 2011).

3/ Wasel Telecom has a non-national unified license to provide fixed-line, wireless and data telecom services.

**Affordability of services remains a challenge in Afghanistan.** Market growth in access and services, and intensified competition has significantly lowered telecommunication prices in absolute terms. However, the average mobile tariffs remain relatively unaffordable for many citizens (Figure 3.16). Both peak and off-peak rates are much higher than those in neighboring countries, aggravated by the fact that the Afghan GDP per capita is just US\$490 – about half that of Pakistan, one-third that of India and one-fourth that of Sri Lanka. If an Afghan mobile subscriber were to call 100 minutes per month, it would account for 2.2 percent of national income per capita<sup>98</sup> – much higher the 0.2-0.8 percent in the other countries. Similarly, while the prices of Internet services have reduced over time, they remain high due to constraints ISPs face in accessing international capacity markets. This is due to both the landlocked position of Afghanistan as well as the limited competition in domestic wholesale connectivity (Table 3.9).

**Figure 3.12: Average Telecommunication Tariffs**



Sources: Average tariff based on the operators' websites for Afghanistan; ITU database for other countries.

**Table 3.5: Prepaid Mobile Tariffs (Afs/minute)**

	On-net		Off-net	
	Peak	Off-peak	Peak	Off-peak
<b>Afghan Wireless</b>				
<b>Roshan</b>	5.5	5.5	5.5	5.5
<b>MTN</b>	5.5	3.0	5.5	5.5
<b>Etisalat</b>	3.5	3.5	3.5	3.5

Source: Mobile operators' websites.

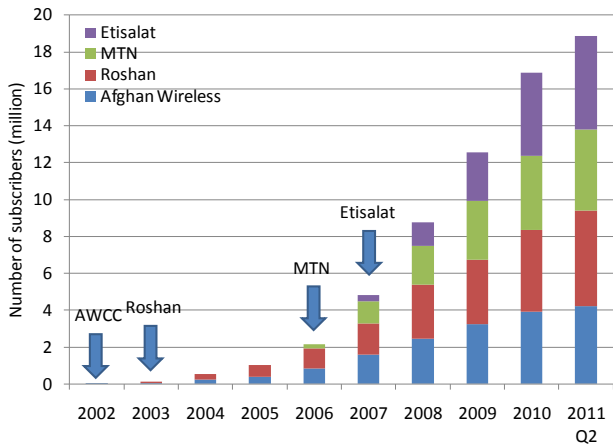
**The advanced ICT market remains thin in Afghanistan.** With higher-speed, third generation (3G) networks that have been introduced in 2012, it is possible that the use of Internet services over mobile networks may grow. In India and Sri Lanka about 15 percent of mobile connections are already based on 3G technologies.

**The policy and regulatory framework aims to develop a competitive ICT marketplace.** Afghanistan's National Telecommunications Policy aims to establish a level playing field for fair, transparent and market-based competition. It states that new entrants are invited to the market through open and transparent international competitive bidding. The new entrants in 2006-2007 injected competition into a previously duopolistic mobile market, contributing to an expansion of mobile access in Afghanistan (Figure 3.14). The new carriers have installed networks in both urban and rural areas. By June 2010, about 80 percent of the total population was estimated to be covered by at least one mobile network

<sup>98</sup> According to the Wireless Intelligence database, the monthly rate of use per user is 100 minutes in Sri Lanka, 200 minutes in Pakistan, 230 minutes in Bangladesh, and 360 minutes in India.

(Figure 3.15).<sup>99</sup> New carriers have tended also provide advanced services, such as per-second billing, international roaming and caller identification. While the mobile telephony and Internet services markets are competitive, the fixed line and wholesale markets remains dominated by state-owned corporation Afghan Telecom, which has the sole national unified license.

**Figure 3.13: Mobile Subscribers per Operator**



Source: Wireless Intelligence.

**Figure 3.14: AWCC Mobile Coverage**



Source: Mobile World Live.

**Reforming the licensing regime by unifying licenses would enable greater competition.** The Government has recently offered new licenses that address earlier differences among GSM license terms and authorized the introduction of broadband wireless services. There is now an important opportunity to unify the licensing regime and liberalize the market fully, allowing any unified provider to offer the widest range of services without restrictions on technology choices or market segments. Currently, while local fixed-service providers are granted unified licenses for all telecommunications services (including fixed, data and wireless), the mobile network operators and ISPs are not allowed to construct wireline facilities and offer some services. Currently, ISP licenses do not allow investment in the operation of international gateways.<sup>100</sup> This imposes a serious supply-side bottleneck for ISPs, deterring them from investing in a wider range of attractive services with lower cost. Advanced technologies cut across traditional and often outdated market segmentation, like the separation of internet service provision from mobile telephone services. Limits on the types of services hold back market development and restricts the level of competition in some markets, and could limit potential private investment.

**Establish a competitive and transparent cost-based interconnection regime.** Interconnection is important to ensure efficient connectivity, fair competition and tariff reductions in the ICT markets. High interconnection charges are usually a barrier to entry the market because, given asymmetric call traffic, smaller firms often have to pay a significant part of their expenditure to incumbent operators as connection charges. The Afghanistan Telecom Regulatory Authority (ATRA) set an interconnection

<sup>99</sup> TeleGeography. 2011. *GlobalComms Database: Afghanistan*.

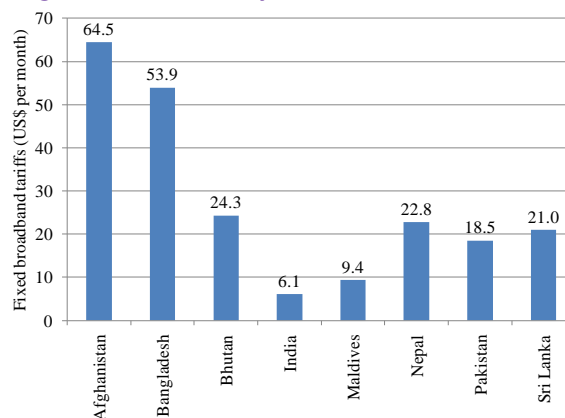
<sup>100</sup> TeleGeography. 2011. *GlobalComms Database: Afghanistan*.



charge of US\$0.029 per minute in 2007, and decreased it to US\$0.026 per minute in 2009.<sup>101</sup> This level may compare favorably to the international norm for now, but yet, the norm of interconnection charges in Europe, for call termination on mobile networks, is about 0.05-0.08 euros per minute.<sup>102</sup> ATRA should aim to evaluate and if possible decrease this to reflect appropriate costs; it is possible the charge could reduce to less than US\$0.015 in the medium term.<sup>103</sup> Interconnection charges should reflect long-run incremental costs of essential facilities and other costs that can ensure forward looking investment to provide the services. These charges should be open, transparent and nondiscriminatory, for there is the risk that incumbent operators would dispute some technical problems and methodological errors to court in order to prevent new entrants from expanding operations. In Afghanistan, the first two incumbents, Afghan Wireless and Roshan, complained to the ATRA that the regulated rates were too low. The dispute resolution process is still far from transparent.

**The Internet-related industry is underdeveloped.** There are seven Internet service providers (ISPs) operating in Kabul and 20 ISPs across the country currently.<sup>104</sup> The government aims to increase household broadband access to 50 percent by 2014. However, all of the networks are still fragmented, and are not licensed to construct wireline retail or backbone networks. This limits the speed and quality of service provision to what is attainable over wireless systems. Internet tariffs still remain high. For instance, as of 2011, Afghan Telecom was offering an ADSL service with a downstream speed of 256kbps at US\$65 per month – far higher than the regional standard (Figure 3.17). As a result, Internet use remains minimal in Afghanistan; the TeleGeography database lists only 4,500 broadband subscribers in Afghanistan as of March 2012. Afghan Telecom, which manages the national backbone network, has consistently reduced prices for wholesale connectivity. However, the lack of competition in that market and the disadvantages of being a landlocked country—forcing Afghanistan to source capacity from other operators as opposed to directly from international carriers—have still kept prices relatively high.

**Figure 3.15: Monthly Fixed Broadband Tariffs**



Sources: ITU Yearbook of Statistics, 2009; TeleGeography, 2011.

<sup>101</sup> TeleGeography. 2011. *GlobalComms Database: Afghanistan*.

<sup>102</sup> European Commission (INFSO/B), 2010

<sup>103</sup> In Europe, for instance, the norm of interconnection charges for call termination on mobile networks is 0.05-0.08 euros per minute, compared to an equivalent fixed termination rate of about 0.008 euros per minute (European Commission (INFSO/B), 2010).

<sup>104</sup> TeleGeography. 2011. *GlobalComms Database: Afghanistan*.



**Telecom services are taxed at a higher rate than other industries**, which is contributing to higher prices for services. At present, in addition to paying 20 percent of general corporate income tax, ICT service providers pay a 10 percent Business Receipts Tax (BRT), while other “general” businesses are subject to 2 percent. Thus, a tax reduction could be a way to foster competitiveness within the sector and reduce prices. There is an opportunity to simplify and even reduce some of the charges and fees levied on various telecommunications providers including ISPs. While the government may forego revenues by reducing the BRT and/or customs duties, in the long run, the incentive could facilitate further development of the industry and the government could collect more from broadening the tax base.

**ATRA will need to consider competition and coverage boosting measures such as mobile number portability (MNP) and domestic roaming.** Many countries delay its implementation mostly because incumbent operators complain about the costs of additional facilities or technical incompatibility. It is essential to curb the costs and duration required for porting numbers, which should be less than US\$10, and take less than five days to make effective. Domestic roaming could help boost coverage in areas where only one mobile network is present. Supporting discussions among mobile networks, the regulator can encourage operators to share their network and, hence, extend coverage into poorly covered areas. Setting up such an arrangement will need to be transparent and consultative, ensuring that it does not favor operators that can “free ride” on others’ networks without sharing their own.

**The Ministry of Communications & IT (MCIT) supervises the overall ICT sector and develops the national sector development strategy.** In the 2008 Afghanistan National Development Strategy (ANDS), the MCIT identified ICT as an important strategic sector through which to make affordable information and communication services available to everyone. The government aims to increase digital literacy and connections in every village, and to foster ICT-enabled businesses and services, and the public sector.

**The government’s “e-Afghanistan” initiative was identified as a national priority program in 2010.** The initiative aims to create ICT jobs, connect 75 percent of the population to the telephony network, and deliver Internet access to 25 percent of the population by 2013. To this end, the Government has continued to invest to build the 5,000 km national fiber optic backbone network; 2500 km of this network has now been constructed.

**The regulatory framework supports competition and has enabled significant private investment in telecommunications.** This investment had reached US\$1.7 billion by mid-2011. In 2003, an independent regulatory body, the Afghanistan Telecom Regulatory Authority (ATRA), was established by Presidential decree. While it functions autonomously, the ATRA board is appointed by the Minister of Communications & IT. The ATRA is funded through regulatory fees collected and its main responsibilities are to (i) issue licenses for the provision of mobile, fixed and other network services and Internet service providers, (ii) set rules regarding interconnection between licensed operators to ensure that interconnection is available on a fair and non-discriminatory basis, (iii) regulate tariffs, (iv) resolve disputes between service providers, and (v) set consumer protection rules and technical standards.

**To ensure continued open access to the national backbone network irrespective of ownership, the Government has defined a policy and now needs to have regulations that guarantee competitive**

**access at reasonable prices.** “Open access” refers to a policy that allows multiple downstream competitors to share an upstream bottleneck facility, which is an input for services provided by downstream competitors. The NBN is a strategic national resource, critical to provide affordable and high quality access for all telecommunications providers in the country. The future development of the Internet market in Afghanistan will need continued affordability in the wholesale market for competition and growth in the retail market. Moreover, the NBN is being constructed using public funds and will likely remain the largest optical fiber network in Afghanistan for some years. It has the majority of market share in subscriptions, capacity, and revenues in the wholesale market and a dominant position in the international market. Therefore, access to the network should be open to both private and public actors. This will ensure capacity will be available to competitive service providers on a non-discriminatory basis at transparent and cost-based tariffs and serves national development objectives. The MCIT issued an open access policy in July 2012 and now ATRA will need to develop transparent and robust regulations to implement that policy.

**The e-Government initiatives and demand-side measures should be expanded.** Realizing the government’s ambitious broadband strategy will require a boost in the demand for broadband-based ICT services. In order to increase broadband penetration to 50 percent by 2014, users need Internet literacy and greater awareness of the usefulness of ICT. The e-government initiative and e-bidding or e-procurement could generate new demand for ICT services. This has great potential in Afghanistan because its public procurement market is estimated to be about 10-15 percent of GDP.<sup>105</sup> E-procurement would also increase transparency, reduce public procurement costs, and prevent collusive bidding and corruption. Broadband technologies can be used to support e-education and e-training in the education sector and for other public services, such as tax payment and registration services. The creation of an overall broadband ecosystem of affordable and high quality network services, the availability of locally relevant applications, and local content and services will all serve to foster greater demand.

### ***Opportunities and recommendations***

Afghanistan has the opportunity to capitalize on its progress and leapfrog to new technologies that help build knowledge- and service-oriented economic activities. Cheaper and more advanced ICT services will help to improve competitiveness of the overall economy. This will require lowering ICT tariffs and creating the conditions for greater competition and innovation in products and services. Specifically:

**Lower ICT tariffs.** To facilitate tariff reduction in ICT, it is essential to keep competitive pressure in the market. To this end, the government should focus on two issues: (i) enabling greater competition by unifying the licensing regime, and (ii) implementing the “open access” policy.

**Reform licensing to enable greater competition.** The recent issuance of new licenses that address earlier differences among GSM license terms and also authorize the introduction of broadband wireless

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<sup>105</sup> The Afghan government’s spending on goods and service purchases is about 3 percent of GDP. In addition, its development expenditure accounts for 8-10 percent of GDP (IMF Country Report No. 10/22).

services can boost the level of competition. The Government could now consider unifying licenses to make them technology and service neutral. This will also encourage service providers to develop innovative services and products that leverage advanced technologies. The license award process should be transparent, competitive, and seek to balance the objectives of revenue-generation with improving access to affordable and high-quality ICT services for all Afghans. Promoting competition and coverage boosting measures such as number portability and domestic roaming will be important for continued growth.

**To ensure continued open access to the national backbone network irrespective of ownership, ATRA should focus on implementing the Ministry’s “open access” policy.** Open access to the backbone network at transparent and fair prices is essential for the sector’s future development. This will ensure capacity will be available to competitive service providers on a non-discriminatory basis at transparent and cost-based tariffs and serves national development objectives. ATRA regulations will implement the policy and will ensure access to the backbone remains non-discriminatory, transparent, and cost-based.

### ***C: Roads***

**As a landlocked country, Afghanistan’s trade depends on its road infrastructure network.** Investment in better Afghan roads will pay off in terms of lower inland transport costs and time for traders, but these need to be made in a sustainable way ensuring their O&M liabilities can be adequately funded overtime. While there is a lot of interest on exploring alternate transport solutions, the proposed railways that will connect the new mining projects of Aynak and Hajigak and other airport projects for intermediate cities, the truth is roads will remain the main and cheapest mean of transport for Afghan trade over the medium term. This is why this diagnostics work places a particular focus on the potential and challenges for roads as the backbone of the transport sector.

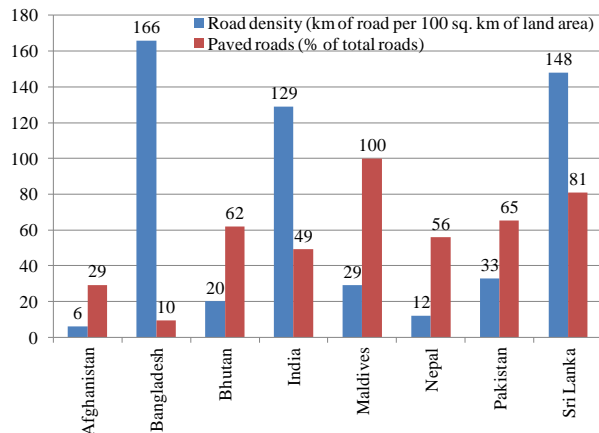
**Better access to quality roads stimulates economic growth in various ways.** Good roads typically help firms to reduce transportation and transaction costs and to minimize their inventory and distribution costs. Thus, a good road infrastructure serves to attract foreign direct investment and will most likely lead to increasing exports. Exporting firms generally prefer close access to motorways and accessibility to interregional demand. (World Bank, 2009).

**Investments at around US\$4 billion have greatly improved the road network.**<sup>106</sup> The most prominent work has been on the national ring road, which connects Kabul, Kandahar, Herat, and Mazar-e Sharif. Thus, the travel times between Kabul and Kandahar have fallen significantly from 19 hours to 5 and between Kabul and Herat from 44 hours to 12. In addition, a substantial number of road features, including culverts (3,229), retaining walls (716), and bridges (255) have been built over the last ten years, and are expected to grow another 22 percent by 2014. Not surprisingly, during 2003–2009 the fastest growing subsector contributing to Afghanistan’s GDP has been services, led by transportation, communication and storage, and followed by construction, government services and manufacturing.

<sup>106</sup> Information sources for this subsection include USAID (2010 and 2011, b) and Altai Consulting (2011).

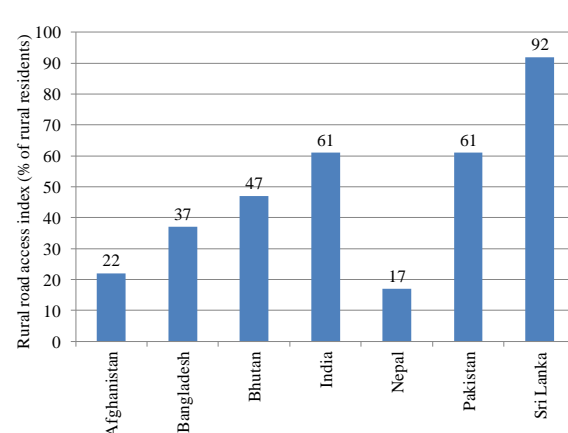
However, only 30 percent of all roads are paved. Afghanistan's 42,150 km of road network is in serious need of rehabilitation, and by 2014 it is scheduled to grow by an additional 7,000 km.<sup>107</sup> Still, with a road density of 6 km per 100 square km of land area, Afghanistan's is among the lowest in the region (Figure 3.11 and 3.12). The 2008 National Risk and Vulnerability Assessment (NRVA) has found that nearly 60 percent of Afghan villages do not have all-season road access.<sup>108</sup> Despite the rehabilitation of 18,000 km of road in the last three years, currently 54 percent of roads in Afghanistan require full rehabilitation.<sup>109</sup>

Figure 3.16. Road Density and Share of Paved Roads



Source: World Development Indicators.

Figure 3.12 Rural Road Index



Source: Roberts, Shyam and Rastogi, 2006.

**A significant amount of resources would be needed to rehabilitate road networks in Afghanistan.** Given the resources available and the weak implementation capacity at the local level, rural road development remains challenging. Reconstruction or rehabilitation of just 10 percent of the existing road networks would cost more than US\$394 million, based on the past project experience.<sup>110</sup> These figures include routine, periodic, and emergency maintenance activities but not the enormous rehabilitation requirements noted above. In Africa, for instance, it is estimated that about US\$40–45 billion was lost in road assets because of inadequate maintenance, which would have cost just US\$12 billion in the 1970s and 1980s (Harral and Faiz 1988). (Table 3.12)

<sup>107</sup> Roads are categorized three ways: primary, secondary and tertiary, based on frequency of use and construction materials. Primary roads include national and regional highways and urban roads, secondary roads include all provincial roads and tertiary roads include all rural roads.

<sup>108</sup> PID Report No. AB3278. *Afghanistan National Emergency Rural Access Project*.

<sup>109</sup> The National Rural Access Program (NRAP) – run jointly by the Ministry of Public Works (MPW) and Ministry of Rural Rehabilitation and Development (MRRD) – has served as the primary means for rehabilitating sub-primary roads. Road construction, rehabilitation, and resurfacing on secondary and tertiary roads are implemented by international and local private contractors through the MPW and MRRD, or by donors directly and off-budget. Works on tertiary roads are generally carried out by community-based contracting, using community development councils, through the National Solidarity Program.

<sup>110</sup> The project costs would vary depending on local conditions and project specifications. Table 3.12 shows the simple average costs per km according to the Road Costs Knowledge System (ROCKS) database.

Table 3.11: O&amp;M Needed for Road Infrastructure (US\$ million)

Year	Primary	Secondary	Tertiary	Bridges	Total
2011	169	29.9	52.7	38.3	289.9
2014	180	155.7	58.7	47.4	441.8

Source: WB staff calculations

Table 3.12: Road Investment and Maintenance, unit costs in South Asia

	Road procurement cost (2000 US\$ per km)		
	Reconstruction/ Rehabilitation	Upgrading	Periodic O&M
Afghanistan	150,427		
Bangladesh	370,147	230,652	80,853
Nepal			71,597
Pakistan	234,677	206,460	
Sri Lanka	105,025		

Source: Road Costs Knowledge System (ROCKS) database.

**Developing a sustainable funding mechanism for the long-term maintenance of existing road assets should be a priority.** The government of Afghanistan is committed to establishing a national road authority, which could centralize transport-related revenue collection and contract maintenance works using a performance-based model. In the meantime, sufficient operating and maintenance resources must be allocated to prevent further deterioration, and the additional allocations to the MPW in the 1391 budget fall well below likely requirements.

**One of the significant challenges for road maintenance will be to ensure the financial sustainability of periodic maintenance.** In many cases, road maintenance tends to be subordinated to new investment. In Afghanistan, the financial capability of local governments or communities to raise revenues for road maintenance is still limited. Therefore, in the short to medium term the central government will continue to play an important role in financing rural road development and maintenance, given the external funding.<sup>111</sup>

### Opportunities and Recommendations

**Prioritize road projects.** Given the limited resources available for road development, it is important to prioritize road projects, i.e., urban versus rural roads, and resource corridors versus domestic roads.

**Adequate funding and periodical road operation and maintenance.** Maintaining the existing road network is the best strategy to avoid unnecessary public spending to rehabilitate damaged infrastructure. Potholes, cracks and wide joints are the places where water infiltrates the road surface, accelerating the deterioration of road conditions. In the long run, the government can develop a more sustainable mechanism to finance road maintenance. In Afghanistan, US\$300 million, or 2.5 percent of GDP, would be required to carry out road maintenance, if it is assumed that the nation's road network is required to be maintained every ten years, on average. Road maintenance would cost US\$70,000–80,000 per km in the region (Table 3.12). In general, there are many ways of financing public roads, for example, through fuel levy, toll road or cordon pricing, parking fees, vehicle sales taxes, and vehicle

<sup>111</sup> PID Report No. AB3278. *Afghanistan National Emergency Rural Access Project.*

registration or inspection fees. As the economy grows, these instruments can be taken into consideration.

The development of better infrastructure services and challenges discussed in this chapter illustrate the importance of strengthening regional cooperation amongst Afghan neighbors. In a region with great potential and trade opportunities, the country needs to better integrate itself to ensure improved access to markets and ports and to make a reality several of the major regional infrastructure projects on the planning board, which could generate greater investment. Why is regional cooperation important to Afghanistan? This is the question the next chapter attempts to answer, while discussing on ways to capitalize on such opportunities. Thus, a closer look at preferential transit and trade agreements and the need to develop a “resource corridor” initiative in order to maximize the benefits of extracting Afghanistan mineral wealth, in an inclusive way, may provide some answers.

## Chapter V: Why Regional Cooperation is Important for Afghanistan

*For a landlocked country, regional cooperation is essential, and Afghanistan could benefit greatly from reduced financial, political, and security risks associated with large scale investments. The country has taken important steps towards greater regional integration by seeking both North-East and South-South preferential regimes. The recently operational transit agreement with Pakistan (APTTA) will ensure greater access to ports, while its ratification of the SAFTA agreement will bring benefits to its export base in the medium term and at a low cost in terms of revenue losses and imports (as suggested by a TRIST simulation exercise). Afghanistan is in the process of gaining access to the WTO, which will ensure its regulatory framework is consistent with international standards.*

**Afghanistan's geostrategic location is an asset for regional cooperation.** It is at the heart of Eurasia, with neighbors, Iran, Pakistan, China, Uzbekistan, Turkmenistan, and Tajikistan, and with close access to the markets of India and China, which represent trade opportunities in a market of around 4, 8 billion people.

**Afghanistan's neighboring countries are economically diverse.** Neighboring countries differ greatly in population, GDP, and levels of development (in both per-capita GDP and human capital), and economic structures. This diversity presents challenges for greater regional integration. In general, Afghanistan's neighbors have underdeveloped transport systems and share a commodity-oriented structure of exports. With large public sectors and direct public intervention in economic activity, some markets face price distortions deter greater trade flow exchanges. In addition the large informality of economic activity across most trade partners presents challenges to deeper private sector development.

### **Existing Trade Arrangements**

**Afghanistan has taken important steps to promote regional cooperation and regional integration.** The Regional Economic Cooperation Conference on Afghanistan (RECCA) provides a platform for regional countries to express their views on regional matters, with regard to Afghanistan. Since 2005, when Afghanistan hosted the first RECCA, regional partners have continued to discuss ways to promote greater energy, trade, transit and transport exchanges. Regional cooperation is a crosscutting theme in the Afghanistan National Development Strategy (ANDS) with all sector expected to incorporate the Regional Cooperation Strategy of the ANDS in their policies and programs.<sup>112</sup>

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<sup>112</sup> The Regional Cooperation Strategy of the ANDS discusses key priority policies and objectives that include (i) establishing the uniqueness of Afghanistan's region, with parts of South Asia, Central Asia, the Far East and the Middle East, (ii) pursuing proactive and creative regional cooperation, (iii) turning development (as opposed to politics) into a primary axis of regional cooperation, (iv) working through regional and sub-regional organizations, (v) shifting from a refugee orientation towards economically-motivated flows of labor and the need for well-functioning regional labor markets, (vi) building institutional and human capacities for regional cooperation, and (vii) developing annual plans of action for regional cooperation initiatives.

### *North-East Preferential Regimes*

**Afghanistan, like all LDC's, has free market access to the EU.** Under the Everything-But Arms (EBA) initiative, Afghanistan is eligible for duty-free and quota-free access for all goods to the European market. Since 2004, all LDCs face zero duty in the EU market; thus there is no specific advantage for Afghanistan. Since many LDC's share Afghanistan's export structure, based on few primary commodities, Afghan exports tend to be at a disadvantage because of their higher prices in EU markets.

**The US Generalized Scheme of Preferences (GSP) provides duty-free access to 5,000 Afghan products.** A 35 percent value addition is required. Afghanistan also qualifies for additional products, such as milk, yogurt, food preparations with flour, candy (candied nuts, sugar candy, chocolate) and government-certified handicrafts. Even though Afghan goods face a higher tariff rate in the US than in the EU, the tariff is significantly lower than that applied to similar products from other LDCs. (Table 4.1). In that sense, the US market provides greater incentives and preferential treatment to Afghan exports than does the EU. Furthermore, Afghan exporters benefit from duty- and quota-free market access to Canada, and Japan, and Afghanistan also has a bilateral treaty with Germany.

**Table 4.1: Weighted Average Tariffs in EU and US Markets**

		2003	2004	2005	2006	2007	2008	2009
<b>USA</b>	LDCs	5.12	4.56	3.63	3.32	3.03	2.52	3.35
	AFG	0.2	1.52	0.16	0.2	0.44	0.18	0.29
<b>EU</b>	LDCs	2.33	0.15	0.11	0.08	0.06	0.03	0.02
	AFG	1.38	0	0	0	0	0	0

Source: TRAINS

### *South-South Preferential Regimes*

**The Afghanistan-Pakistan Transit Trade Agreement (APTTA) was an enormous step toward greater regional cooperation, but implementation is difficult.** The deal, that became operational in June 2011, gives Afghan goods greater access to the port of Karachi and the Wagah border with India (Indian exports to Afghanistan are still excluded). The agreement is central to Afghanistan's trade, as it aims to take advantage of preferential tariffs with India for five years, and constitutes an important step in linking trade with the South and the Central Asia economies. However, substantial differences in interpretation of the agreement have led to trade blockages at the Karachi port during the first eight months. The areas of contention, based on Pakistani concerns about smuggling of re-exported goods, are bank guarantees, international requirements for sealed trucks, biometric systems for customs verification and security, and the installation of tracking systems.

**Afghanistan, as a member of the Economic Cooperation Organization, signed the ECOTA trade agreement that aims to reduce tariffs across all traded goods.** With the exception of goods included in the agreed negative lists, the agreement sets gradual reduction targets for tariffs in eight equal annual



stages.<sup>113</sup> Afghanistan was allowed a longer, 15-year, period to implement tariff reductions. The ECOTA trade agreement established a 15 percent maximum tariff reduction for the highest-tariff brackets for all other members for eight years and aimed to cover at least 80 per cent of the goods, in the case of Afghanistan. However, as few products qualify for the 15 percent threshold, the positive list of products submitted for tariff reduction includes only 50 products. The ECOTA agreement is at an early implementation stage. However, today only five countries have ratified the agreement: Afghanistan, Iran, Pakistan, Tajikistan and Turkey, and members are in the process of preparing preliminary sensitive lists (which cannot exceed 1 percent of the six-digit tariff lines). Therefore, it will take time for this agreement to be implemented and for it to really impact Afghan exports in the medium term.

**The SAFTA free trade agreement was formed to increase the level of trade and economic cooperation among the SAARC members.** As the eighth member state of the South Asian Association for Regional Cooperation (SAARC), Afghanistan ratified the South Asian Free Trade Area (SAFTA) protocol in May 2011. The agreement requires the more developed members – India, Pakistan and Sri Lanka – to reduce tariffs on intraregional trade to 20 percent during an initial phase that ends in 2012. The following phase requires further duty reductions to zero, in a series of annual cuts. As for other members classified as LDCs – Nepal, Bhutan, Bangladesh, Afghanistan and Maldives – there is an additional three-year period to enforce such tariff reductions. Currently, all countries have ratified the agreement and have submitted their negative and positive lists, but these are still under negotiation. In the case of Afghanistan, the sensitive list covers 1,070 products and almost 50 percent of its imports. Given that members have made progress during the first phase of implementation, and because of the shorter time-span for reform, if things go ahead as planned, the SAFTA could increase Afghan trade flows in the medium term. However, tariff reductions could also decrease customs revenue collection and increase Afghan imports.

### ***Impact of the SAFTA Agreement on Afghanistan's Imports and Fiscal Revenues***

**The SAFTA agreement seems to be a win-win for Afghanistan.** A World Bank Tariff Reform Impact Simulation Tool (TRIST) exercise suggests that SAFTA would have a modest negative impact on Afghanistan's fiscal revenues and rising imports. This is because of the current distribution of Afghan imports, its tariff structure, and the terms of the agreement.<sup>114</sup> Thus, fiscal revenues may even increase if a portion of existing informal imports become subject to Afghan custom procedures. This is because the agreement's lower duties and taxes would reduce costs relative to the risks of informal trade. However, the agreement would more substantially boost Afghan exports through privileged access to other SAFTA countries. This would be important particularly for future trade with Pakistan and India which are relatively protected markets (both with average tariffs over 12 percent) and which already account for over 60 percent of Afghan exports.

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<sup>113</sup> ECOTA member countries are Iran, Pakistan, Turkey, Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

<sup>114</sup> This simulation is based on customs administration data for fiscal 1389 (fiscal 2010), including transactions at the tariff line level for 87,657 usable records (based on the Harmonized System nomenclature, 2007).

The TRIST tool is a partial equilibrium model that quantifies the effect of trade reform scenarios on imports, revenues and production.<sup>115</sup> It uses actual trade flows and applied tariffs instead of the statutory tariffs (official commitments) and aggregated trade flows from international databases. This is important because in the case of Afghanistan exempted imports would account for over 45 percent of total tariff revenue, while other import taxes (in addition to duties) account for almost 50 percent of fiscal revenue from imports.

**Imports from SAFTA countries comprise a small share of total Afghan imports.**<sup>116</sup> In fiscal 2010, records on formal transactions show that imports from the SAFTA member states represented less than 10 percent of total Afghan imports. Thus, Afghanistan actually imported from only two of the seven SAFTA members: India, and Pakistan. Even if one only counts products that were actually exported by SAFTA countries to Afghanistan (1,151 products), SAFTA's share of total imports is below 13 percent.

**Table 4.2: Origin of Afghan Imports and Share of Total**

	All Imports			SAFTA Exported Products		
	AFN (millions)	US\$ (millions)	Share	AFN (millions)	US\$ (millions)	Share
<b>Bangladesh</b>	21.1	0.43	0.0%	21.1	0.43	0.0%
<b>India</b>	1,801.50	36.47	2.3%	1,801.50	36.47	3.0%
<b>Pakistan</b>	5,611.90	113.60	7.0%	5,611.90	113.60	9.4%
<b>Sri Lanka</b>	11.2	0.23	0.0%	11.2	0.23	0.0%
<b>TOTAL SAFTA</b>	<b>7,445.80</b>	<b>150.72</b>	<b>9.3%</b>	<b>7,445.80</b>	<b>150.72</b>	<b>12.5%</b>
<b>Rest Of the World</b>	72,491.30	1,467.44	90.7%	52,233.20	1,057.35	87.5%
<b>TOTAL</b>	<b>79,937.10</b>	<b>1,618.16</b>	<b>100.0%</b>	<b>59,679.00</b>	<b>1,208.08</b>	<b>100.0%</b>

**Exemptions in Afghanistan represent a revenue loss of about one-third of total import revenue.** However, this level of exemptions is in line with what has been found in other TRIST studies in low-income countries. Afghanistan is losing about 45 percent of the total tariff revenue collected.

**The TRIST simulation shows that the implementation of the SAFTA agreement would have little negative impact on total Afghan trade.** Imports increased just 0.06 percent, with a 1.8 percent decrease in customs revenue. Because the implementation schedule spreads over ten years, the adverse impact of SAFTA is diluted and is practically unnoticeable. This result is not surprising because Afghanistan's tariff structure is already low and to some extent already in compliance with many of the terms of SAFTA's new tariff structure.<sup>117</sup> There are three reasons driving the limited negative impact: (i) SAFTA

<sup>115</sup> The model relies on the following key assumptions: (i) it is derived from standard consumer theory, and elasticities play a central role in determining the magnitude of demand response to price changes; (2) there is imperfect substitution between imports of any given product from various countries (Armington), but no substitution between various products; and (3) the considered country is a so-called price taker, i.e., its economy is so small that changes in domestic demand do not affect world prices.

<sup>116</sup> SAFTA Member countries: Nepal, Bhutan, Bangladesh, Afghanistan, Maldives, India, Pakistan and Sri Lanka.

<sup>117</sup> Under the SAFTA agreement, Afghanistan is a Least Developed Contracting State (LDCS), and as such is subject to several tariff adjustments: (i) a reduction from existing tariff rates to 30 percent within two years from the date of coming into force. If actual tariff rates on the date of coming into force of the agreement are below 30 percent, there will be an annual reduction,

countries play a limited role in Afghan imports; (2) the average level of protection of Afghan imports is low and there is not much to cut, notably with regard to goods from SAFTA partners; and (3) the extent of the list of sensitive products, those excluded from tariffs, represents 48 percent of SAFTA imports and would account for 52 percent of revenue. Consequently, the impact on imports would be the strongest (though very modest) in the second phase of implementation, from year three and thereafter.

**It is expected that the adverse effects on fiscal revenues overall would be largely compensated by underlying import growth.** The loss of fiscal revenue would be compensated mostly by a stronger increase in the demand from imports following the tariff cuts. Still, projections suggest that import growth would be modest under SAFTA over the ten-year implementation period.

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on a margin of preference basis, of 5 percent on actual tariff rates for each of the two years; (ii) a subsequent tariff reduction by the LDCs from 30 percent or below to 0-5 percent within a period of years. Thus, the LDCs are encouraged to adopt reductions in equal annual installments, not less than 10 percent annually. The World Bank's TRIST simulation translates these terms for Afghanistan over a ten-year period according to the profile below, with the exception of products under the sensitive list:

Year 1: A 5 percent cut for tariffs strictly below 30 percent; remaining products unchanged.

- Year 2: A 5 percent cut for tariffs strictly below 30 percent; 30 percent cap for the remaining products (tariffs  $\geq$  30 percent).
- Year 3 to 9: An annual 10 percent cut for all other products.
- Year 10: A 10 percent cut for all other products and tariffs still above 5 percent are capped at 5 percent.

**Table 4.3: Overall Impact of the Implementation of the SAFTA Agreement**

Impact on imports:	AFN (millions)	US\$ (millions)
<b>Imports pre</b>	79,939.3	1,618.2
<b>Imports post</b>	79,990.5	1,619.2
<b>Change in imports</b>	51.1	1.0
<b>% change in imports</b>	0.06%	0.06%
Impact on Revenue:		
<b>Tariff revenue pre</b>	5,768.0	116.8
<b>Tariff revenue post</b>	5,662.1	114.6
<b>Change in tariff revenue</b>	-106.0	-2.1
<b>% change in tariff revenue</b>	-1.84%	-1.84%
<i>Total Tax Revenues on Imports</i>		
<b>Total revenue pre</b>	10,795.1	218.5
<b>Total revenue post</b>	10,688.0	216.4
<b>Change in Total revenue</b>	-107.1	-2.2
<b>% change in Total revenue</b>	-0.99%	-0.99%
<i>Collected Tariff rate:</i>		
<b>Collected applied tariff rate pre</b>	7.2%	7.2%
<b>Collected applied tariff rate post</b>	7.1%	7.1%
<b>% change in collected applied tariff rate</b>	-1.90%	-1.90%

### **WTO Accession**

A critical element in Afghanistan's strategy to expand international trade is successful accession to the **World Trade Organization (WTO)**. Afghanistan was not a member of the earlier General Agreement on Tariffs and Trade (GATT), but reached observer status to the WTO in December 2004. As a relatively small country, Afghanistan stands to benefit from the reliance on well-established rules concerning international trade among WTO members and from equal access to the markets of the member countries.

The **Ministry of Commerce & Industries (MoCI)** is the lead ministry for WTO accession and aims to embark on a government-wide reform process to implement the Afghanistan legislative plan for WTO

**conformity.** The international legislative requirement for accession to the WTO is driven by the centrality and importance of an applicable zero-tariff regime and minimal protection against offshore products. Afghanistan's trade and tariff regime will require tailoring align with WTO fundamental standards for activities such as cross-border trade, trade facilitation, and trade border operations. To achieve this, the ministry aims, over the next three years, to (i) implement the Afghanistan legislative plan for WTO conformity, (ii) expand the WTO unit within the ministry and build its analytical and technical capacity to better coordinate the accession process, (iii) establish a Trade Policy Analysis Unit, (iv) implement a tariff-reduction program in line with WTO standards, (v) prepare market-access offers on goods and services, and documents for agricultural negotiations, (vi) complete a quantitative impact assessment of WTO membership, (vii) secure Afghan membership of the International Standards Organization, and (viii) make progress in removing trade barriers.

**One benefit in the WTO accession process is the review of existing laws and regulations to ensure consistency with international standards and WTO requirements.** Afghanistan's trade in goods and services, and protection of intellectual property rights, are both currently under-regulated. These and other aspects of national legislation and regulation are being strengthened and reformed in order to meet international and WTO standards.

**To provide overall guidance, a Presidential Commission on Afghan WTO Accession was established in the Office of the President.** This Commission regularly briefs the President and the Cabinet on trade-related issues during the accession process and serves as the principal point of contact between the WTO and the Afghan government. The MoCI is the institutional focal point for the development and implementation of Afghanistan's trade policies, while the ministries of Finance, and Economy also provide institutional support to the commission.

**The working group for the WTO accession has focused mainly on issues such as the fixed tax rate of 2 percent on imports, the process of import licensing, rules of origin, and the customs and food-safety laws.** The Afghan team is also putting together an action plan for accession and a list of current Technical Barriers to Trade (TBT) agreement. Such agreement would aim to ensure that technical regulations, standards and procedures for assessment of conformity do not create unnecessary obstacles to trade. At this stage the sensitive lists are still pending. The pending law on standardization, called the Afghan National Standards Authority (ANSA), would establish and maintain the WTO (TBT) Enquiry Point (EP). EPs are set up to manage the notification procedure, to respond to information requests, and to coordinate government comments on proposals notified by third countries. The EP also exchanges information with its counterparts abroad.

### ***Resource Corridors***

**The resources sector offers a window of opportunity and challenges.** The existing geological studies that span over 25 years suggest that Afghanistan's mineral wealth is worth at least several hundred billion dollars. In 2008, mining rights at Aynak, a large-scale copper mine in Logar province, were

awarded to a consortium led by China Metallurgical Group Corporation (MCC). In November 2011, three blocks of mining rights at Hajigak, a large iron-ore deposit, were awarded to the Afghan Iron and Steel Consortium, led by the Steel Authority of India, and one block to Kilo Goldmines of Canada. Oil exploitation in Amu Darya and gas in Sheberghan are expected to begin within five years. Successful development of these two mines and the oil and gas blocks will bring significant revenue and growth, and could be the catalysts to unlock much broader potential if security stabilizes.

**Success in resource ventures such as those described above will depend largely on how efficiently the products can be brought to market.** As a landlocked country, Afghanistan's transportation options have to be analyzed in a geopolitical and regional context. Similarly, the choice of the logistical corridor will have an economic and political impact regionally. Transport infrastructure will have sub-optimal impact if regulatory and other obstacles to trade persist – for example, the ongoing difficulties with the Afghanistan-Pakistan Transit Trade Agreement. Thus, greater regional cooperation will be a key to ensuring that Afghanistan benefits from the most viable logistical options, importing what it requires, and making sure the natural resources reach global markets.

**Development of the mining investments in the coming years will provide Afghanistan with a window of opportunity for the socio-economic development of its people.** For Afghanistan to use the earnings from its resources to improve the livelihoods of its people will depend on how well it progresses in several interrelated endeavors. These include (i) the relative efficiency with which fiscal revenues are used for social development of the majority – in particular, finding an appropriate balance between investment and recurrent spending, (ii) the ability of local firms to enter the mining value chain, or to take advantage of new or upgraded infrastructure, (iii) handling of issues of community development, land acquisition, compensation and resettlement, (iv) upgrading of skills and capabilities of local labor in the long term, both at basic and senior technical levels, and (v) whether incremental investments in infrastructure to support shared use will be realized. For instance, although MCC has agreed to build a transmission line that will pass close to Kabul on its way from the power plant to the Aynak mine, it is not clear if Kabul's existing distribution network has sufficient capacity to deliver the power where it is needed, or how the MCC plant will be integrated into the national grid.

**To realize the mining sector's full potential, hard and soft infrastructure must be combined along a "resource growth corridor".** Such a corridor would aim to exploit resources' potential while escaping resource dependency. It represents a combination of efforts to leverage a large, extractive-industry investment, and its requirements for infrastructure and goods and services, into viable economic development and diversification. For a number of reasons, especially in a low-income country, economic linkages between mining and the rest of the economy will not naturally occur through market forces. When the barriers to wider benefits are not addressed, the local economy is unlikely to take advantage of the opportunities to supply goods and services to the mine or other resource-based investment, or take advantage of any potential to use its products and its associated infrastructure. In particular, there is a need to rapidly prepare the fledgling Afghan private sector to reap the downstream benefits generated by the large mining projects, and generate jobs, taking into account the challenging investment climate.

**The Government’s National Regional Resources Corridors Program focuses on developing the critical infrastructure needed to realize the mining sector’s full potential.** A resource growth corridor aims to exploit resources’ potential while avoiding resource dependency. It represents a combination of efforts to leverage a large extractive industry investment, and its requirements for infrastructure and goods and services, into viable economic development and diversification.

**The launch of the National and Regional Resource Corridor Program (NRRCP) represents a response to these challenges.** However, at the moment, the NRRCP’s targets are primarily an ambitious list of ‘hard’ infrastructure projects in road, rail, and air. These targets need to be supplemented by “soft” infrastructure, in particular, community development, land management and acquisition, the mitigation of environmental impact, enterprise development, and institutional capacity. If this soft infrastructure is not addressed simultaneously with (or before) physical infrastructure, the full potential of the investments may not be realized. The WB, with AusAID support, has launched a program to support the NRRCP Secretariat and Government more broadly to define and undertake actions to build such soft infrastructure.

**The next few years, while mining investments are still ramping up, represent a window of opportunity to lay the foundation for long-term sustainable growth in the sector.** Achieving a more optimal outcome for the livelihoods of the Afghan people will depend on making progress from the start across several interrelated factors. These include:

- **Infrastructure development.** Assets such as roads, rail, power, water, and ICT should be used to leverage private investment into public goods, through public-private partnerships where possible. Infrastructure development (particularly rail) requires regional coordination (with neighboring countries), a multimodal approach, and must combine hard and soft infrastructure for maximum benefit, i.e., transport routes should be complemented with trade facilitation services. Operations and maintenance (O&M) requirements must also be assessed, especially since O&M expenses are already projected to be a key driver of fiscal deterioration;
- **Social and environmental aspects.** The focus should be on pre-conditions for resource corridor development, providing immediate benefits for and involvement of communities around the corridor. Improved land administration is a particularly pressing issue, and should include a cadastre of all land within the resource corridor, rationalization of land management, and a revised legal framework for land acquisition, resettlement and compensation. Other key social and environmental issues include mitigation of environmental impacts, building the capacity of the National Environmental Protection Agency, and the preservation of cultural heritage and archeological sites;
- **Private sector development.** This should be encouraged throughout the mining value chain, as well as agriculture and agribusiness along the corridor, and skills and capabilities development;
- **Governance and institutional arrangements.** These should enable successful implementation of the resource growth corridor approach. This would include capacity building, means for institutional collaboration among sector ministries and across central to

decentralized levels down to the community level, and strengthened public financial management (especially regarding mineral revenues).

- **The government of Afghanistan has already recognized that a corridor approach will be essential and has launched the National and Regional Resource Corridor Program (NRRCP).** The NRRCP was presented at the Kabul Conference in July 2010 as one of the national priority programs, and the government recently established a secretariat to coordinate ministries and related institutions across the region. Currently, the NRRCP's targets are mostly an ambitious list of "hard" infrastructure projects involving road, rail, and air. These targets need to be supplemented by "soft" infrastructure – in particular, community development, mitigation of environmental impact, enterprise development, and institutional capacity. If this soft infrastructure is not addressed simultaneously with (or before) physical infrastructure, the full potential of the investments will not be realized and the corridor approach will fail.



**Annex I. Policy Action Matrix and Recommendations**

Objectives	Recommended Actions	Implementing Institutions	Time Frame	Tentative Donor funding from
<b>Macroeconomic Environment</b>				
Promote greater domestic content within public procurement	Develop a policy that promotes domestic procurement of goods & services, when possible and without compromising on quality, to ensure public funds and donor aid has a greater share of local content.	MOCI, MOF	Priority	
Prepare for the management of mineral revenue	Technical assistance regarding best practice in the medium to long term management of incoming mineral revenues and royalties.	MOF, MOM	Priority	
<b>Trade Performance and Policy</b>				
Strengthen trade policy capacity; rationalize institutions and practices	Develop a capacity building plan for trade policy evaluation covering the directorates responsible for designing and evaluating trade policy within the MOCI. This could include building capacity: to analyze indicators and monitor results of policies, on trade negotiation, impact evaluation techniques, and economic modeling of trade policy impact	MOCI	Medium term	
Develop a database with trade data to inform policy analysis.	Develop a database with trade data to inform policy analysis compiling trade information from different agencies, including data from the CSO, ARD, and existing donor-funded trade-related surveys). Building capacity at the MOCI to maintain the database will be key. On the basis of this database, the technical units within MOCI would be able to prepare bulletins analyzing trade data trends for management.	MOCI	Immediate, Ongoing	HARAKAT
Monitor the elimination of Non-Tariff Measures	Monitor the elimination of Non-trade barriers. Identify NTMs implemented by all government agencies and make information on them readily available to the private sector. Streamline related procedures in terms of time and cost. Conduct a firm survey on NTMs faced by importers and exporters and set up a public-private NTM Review Committee to discuss less trade distorting alternatives.	MOCI	Priority	

Conduct a review of tariff exemptions	Given that import tariff revenue is such a large share of total domestic revenues, conduct a review of tariff levels and tariff exemptions so as to balance the trade-offs of a broad tariff base and efficiency costs of taxes on international trade. Minimum consumption basket food items should remain exempted in order to protect the poor.	MOCI	Priority	
<b>Private Sector Development</b>				
<b>Doing Business Indicators</b>				
Starting a Business	Speed up the process to renew investment licenses and reduce cost and frequency of renewals	MOCI	Priority	USAID
	Re-organize MOCI and AISA so that entrepreneurs will only deal with a single agency for registration and licensing.	MOCI, AISA	Medium term	USAID
Investor Protection	Both the Joint Stock Company Law and the Corporations and Limited Liability Companies Law address investor protection and could be amended to improve investor protection by mandating international best practices.	MOCI	Priority	USAID
	To make it easier for investors to enforce their rights through the courts: In the case of a suit against a company's Director, interested parties should be allowed to access relevant non-confidential company documents in cases of suspected mismanagement without filing suit, and without having to identify specific documents	MOCI, Kabul Bank	Medium term	USAID
Enforcing Contracts	Explore setting up an alternate dispute resolution to improve efficiency of commercial judgments.	MOCI	Medium term	USAID
<b>Export Promotion</b>				
Define the new role and activities of EPAA.	Define EPAA's mandate beyond becoming an information center, placing particular emphasis on: promotion, export support services, and marketing activities. PPP with the private sector should be envisaged, as a way to leverage private sector participation	MOCI, EPAA	Priority	GIZ
Develop a National Export Strategy	Prepare an National Export Strategy (NES) as a standalone document as to support the National Trade Policy (see ITC NES examples)	MOCI	Priority	GIZ

Explore developing a matching grant scheme.	Explore developing a matching grants scheme for export promotion informed by the experience of the Tunisian Export Market Access Fund (EMAF). The EMAF was a public-private approach and the private sector paid for a share of the costs of developing export action plans, technical assistance, and for half of the costs of the implementation.	MOCI, EPAA	Priority	WB/ MOCI New Market Development Project
<b>Case Studies</b>				
<b>Agriculture</b>				
Post-harvest handling and cold chains, increase storage capacity	Establish post-harvest handling and cold chains, through Public Private Partnership in Kabul and other major urban centers. This will help address the limited storage capacity, which increases post-harvest losses and leads higher costs.	MOCI, PS	Medium, Long term	
Develop standards for packaging.	Identify specific packaging needs required to support agricultural products of high export potential. This will reduce product damage and cut losses for exporters, which will translate in lower export costs and higher quality products reaching the final destination.	ANSA	Priority	
Standards, improve quality control and food standards	Build agriculture extension services, with a view to SPS and TRIPS application in agriculture. Establish streamlined and transparent food safety management, inspection, and certification systems. This will help address weak quality control. It will require a review of food standards in existing laboratories in Afghanistan and investment in upgrading facilities.	ANSA	Medium term	
Generating greater value added in agriculture	Afghan exporters could focus on premium segments in large importer countries. Identify processing activities with high value added and export potential. In the medium term, organic is an attractive and growing market, but it would take 3-4 years for Afghanistan to receive certification.	MAIL, MOCI, PS	Medium term	
<b>Gemstone</b>				
Capacity building	In collaboration with the private sector, develop capacity-building programs for gemstone valuation and a cutting industry.	MOCI, EPAA,PS	Medium term	
Implementation of the Gemstone Policy Framework and Roadmap	Implement the road map of the National Gemstone framework with the aim to establish an Afghan Gemstone Hub.	MOM , MOCI	Medium term	

Establishing a Gemstone Quality Control Agency.	The quality control agency, established in the form of a public-private partnership, could certify the quality of gemstones. Also, it could monitor the domestic market through inspections, while registering certified gemstone sellers and exporters and reducing the reduce uncertainty in business operations. Further, it should aim to provide quality gemstone services training.	MOM , MOCI, PS	Medium term	
<b>Carpets</b>				
Branding and Market Linkages.	Develop a branding strategy in collaboration with EPAA and Kabul Carpet association	MOCI, EPAA,PS	Medium term	GIZ
Strengthen market linkages to international buyers	Identify and nurture market linkages by: i) Continuing to have a presence in key trade fairs , ii) Sponsor Afghan firms in national and international trade shows, (under a defined strict eligibility criteria) iii) Promoting business trips, tours, and inward buyer missions to foster more direct links between producers and buyers.	MOCI , EPAA,PS	Medium term	
Export promotion. Warehouse facilities in overseas markets	Work with private investors and the GoA to establish regional warehousing/re-export facilities at important trade hubs such as Dubai, UAE and/or expand Afghanistan's warehouse facilities in Istanbul.	MOCI , EPAA ,PS	Medium term	
Review security procedures at airports and borders	Review current security procedures with the aim to reduce time and costs (through damage) to exporters.	MOCI, MOF (ARD)	Priority	
Promote a domestic cut and wash industry.	Promote a domestic cut and wash industry. The EPAA should play a leading role to leverage private investment and support the growth in this segment.	MOCI, EPAA,PS	Medium term	
Improving Product Design	Work with the private sector to promote regional design centres to create new carpet designs and educate carpet-weavers on international trends, sizes and colors. In particular: i) technical training to design centres on the usage of design software, ii) scholarships to the Indian Institute of Carpet Technology (IICT).	MOCI, EPAA,PS	Medium term	
Promote substitution of imported to locally produced wool	Work with the private sector to establish wool association and collection centres (warehouses) for wool cleaning, washing, and packing in the Central and South Regions	MOCI, EPAA,PS	Medium term	
	Provide technical support to existing wool spinning/dyeing factories and support the opening of new facilities in the Northern and Western Regions.	MOCI, EPAA, PS	Long term	

Explore the development of an export finance scheme for experienced carpet exporters	An export finance scheme for carpet exporters would increase their competitiveness, in terms of financial terms offered to buyers	EPAA, PS	Priority	
<b>Customs Reform and Trade Facilitation</b>				
Define competencies across agencies involved in customs	Clarify mandates across agencies enforcing customs administrations to reduce current overlaps.	MOFA, MOCI, ACD, MOT	Priority	
Simplify customs procedures	Undertake an exercise akin to the GATT assessment at the customs house level to identify critical reforms. Customs procedures should be made less cumbersome, globally aligned and transparent. Currently, clearance procedures differ within Afghanistan and these need to be internally and regionally aligned.	MOF, Customs	Priority	
Develop missing customs procedures.	Develop customs procedures for warehousing, free-zones, temporary import and inward processing operations (supporting such industries like repackaging operations, assembly operations, sewing or knitting of ready-made garments, home manufacture of carpets, etc.)	MOF, Customs	Medium term	
Define the role of clearing agents	The responsibilities of clearing agents need to be better defined. Facilitate the establishment of a professional association or institute of chartered customs brokers that continually tests their customs skills.	MOCI, MOF	Priority	
Strengthen the cooperation with customs agencies of neighboring countries	Facilitate greater cooperation between the ACD and customs agencies of neighbors. Stronger cross-border information linkages will have fiscal, social, trade facilitation, and security dimensions	ACD	Priority	
Ensure every customs reform or modernization operation addresses anti-corruption issues	Conduct a review of governance issues, with a focus on interference of outside bodies and institutions, develop a clear organizational and staffing policy.	MOF	Priority	
Conduct a review of customs laws / Customs institutional reform.	Update the customs law (and possibly other laws) to i) promote voluntary compliance (with swifter and probably increased penalties), and ii) provide the customs authorities with an enforcement capacity. Both are essential to perform according to international standards. Develop customs clearance, non-compliance audit and investigation capability within customs. Provide training in Post Entry Audit, Investigations and Intelligence, Create a Post Entry Valuation section.	MOF	Medium term	

Ensure customs authorities have enforcement capacity to ensure regulatory compliance	Custom authorities require enforcement capacity in order to effectively administer customs operations, to reduce corruption, and deter repeating offenders.	ARD, MOI, MOCI, MOF	Priority	
<b>Infrastructure Services</b>				
<b>Electricity</b>				
Expanding domestic power generation capacity	Technical assistance to develop ways of expanding domestic power generation capacity and its implementation.	DABS, MWP	Medium Term	
Enhance regional power trading	Promote regional power trading by deepening partnerships with neighboring countries. These need to manage the risks of energy security, price volatility and uncertainty in international power trading.	MEW	Medium Term	
<b>Information and Communication Technology</b>				
Reform licensing to enable greater competition.	Reform licensing to enable greater competition. The recent issuance of new licenses that address earlier differences among GSM license terms, while authorizing the introduction of broadband wireless services, can boost the level of competition. The Government could consider unifying licenses to make them technology and service neutral to encourage service providers to develop innovative services and leverage advanced technologies. The license award process should be transparent, competitive. Promoting competition and coverage boosting measures such as number portability and domestic roaming will be important for continued growth.	MCIT	Priority	
Promote continued open access to the national backbone network irrespective of ownership. ATRA should focus on implementing its “open access” policy.	ATRA should focus on implementing the Ministry’s “open access” policy. This will ensure capacity will be available to competitive service providers on a non-discriminatory basis at transparent and cost-based tariffs. ATRA regulations will implement the policy and will ensure access to the backbone remains non-discriminatory, transparent, and cost-based.	MCIT, ATRA	Priority	
<b>Roads</b>				
Invest in road rehabilitation	Invest selectively in road rehabilitation projects to reduce a deteriorating infrastructure.	MOF, MRRD, MPW, MOT	Priority	

Ensure adequate financing of periodic O&M	Developing a sustainable funding mechanism for the long-term maintenance of existing road assets. Ensure all future road investments have included O&M costs. Conduct an assessment to determine the most cost-effective way of financing public roads that explores the impact of different options.	MOF, MRRD, MPW, MOT	Priority	
<b>Regional Cooperation</b>				
Development of intra-regional trade	Adoption and gradual implementation of existing trade protocols related to subregional trade (SAFTA, APTTA, ECOTA)	MOCI, ARD, EPAA	Medium term	
Build trade negotiation and follow-up capacity for regional agreements	Build capacity in the MOCI to analyze and evaluate the impact of trade agreements and to build a highly qualified negotiation team.	MOCI	Medium term	
Finalize the review of existing laws and regulations to ensure consistency with WTO requirements	Finalize the ongoing regulatory review that ensures consistency with WTO requirements and international standards, a requirement to move from the current Observer Status to full WTO membership. (Implementing the Afghanistan legislative plan, customs and food safety laws, rules of origin, technical barriers, import licensing.)	Office of the President, TAFA, MOCI	Long term	USAID

Immediate/ Ongoing : refers to actions to be undertaken over the following 6 months

Priority: Actions to be undertaken within the following 12 months

Medium Term: Actions that will require within 12 to 36 months

Long Term: Actions that will require, could be undertaken after 36 months or more.

**Annex II. Afghanistan's Non- Tariff Measures<sup>118</sup>**

No.	HS Code 4 digit	HS Description	NTMs Description	Source of Identification
1	01.03	Live swine	Prohibited	Religious purposes
2	01.05	Live poultry	Quality inspection is required	MAAH
3	02.01	Meat of bovine animals, fresh or chilled	Quality inspection is required	MAAH
4	02.02	Meat of bovine animals, frozen	Quality inspection is required	MAAH
5	02.03	Meat of swine, fresh, chilled or frozen	Prohibited	Religious purposes
6	02.04	Meat of sheep or goats, fresh, chilled or frozen	Quality inspection is required	MAAH
7	02.08	Other meat and edible meat offal, fresh, chilled or frozen	Quality inspection is required	MAAH
8	02.09	Pig fat, fresh, chilled, frozen, salted, in brine, dried or smoked	Prohibited	Religious purposes
9	03.01	Live fish	Quality inspection is required	MAAH
10	03.02	Fish, fresh or chilled,	Quality inspection is required	MAAH
11	04.01	Milk and cream,	Quality inspection is required	MoPH
12	04.03	Buttermilk, curdled milk and cream and yogurt	Quality inspection is required	MoPH
13	04.04	Whey	Quality inspection is required	MoPH
14	04.05	Butter and other fats and oils derived from milk	Quality inspection is required	MoPH
15	04.06	Cheese and curd	Quality inspection is required	MoPH
16	04.07	Birds' eggs, in shell, fresh	Quality inspection is required	MoPH
17	05.02	Pigs', hogs' or boars' bristles and hair and waste thereof	Prohibited	Religious purposes
18	08.02	Almonds, walnuts	Prohibited	MoCI
19	12.11	Liquorice roots	Prohibited	MoCI
20	15.01	Pig fat including lard	Prohibited	Religious purposes
21	16.02	Hams and cuts thereof	Prohibited	Religious purposes
22	22.03	Beer made from malt	Prohibited	Religious purposes
23	22.04	Wine of fresh grapes, including fortified wines	Prohibited	Religious purposes
24	22.05	Vermouth and other wind of fresh grapes flavoured with plants or aromatic substances	Prohibited	Religious purposes
25	22.06	Other fermented beverages (for example, cider, perry, mead); and mixtures of fermented beverages	Prohibited	Religious purposes
26	25.01	Table salt	Prohibited	MoM
27	25.15	Marble and travertine	Prohibited	MoM
28	25.20	Gypsum; anhydride and plasters	Prohibited	MoM
29	27.10	Petroleum oils (Aviation Fuel, Petrol, Diesel, Kerosene)	Quality Inspection is required	MoCI
30	29.03	Halogenated Derivatives of hydrocarbons	Import is subject to product registration, labeling, advertisement control, inspection and quarantine requirement	National Ozone Unit
31	29.15	Acetic anhydride and other precursors/narcotics	Controlled item	Narcotics Law
32	29.39	Alkaloids of opium and their derivatives; salts thereof	Controlled items	MoPH
33	30.04	Medicaments	All importations of pharmaceutical products are subjected to test on samples compulsorily	MoPH
34	31.03	Mineral or chemical fertilizers, phosphatic	Quality inspection is required	MAAH
35	31.04	Mineral or chemical fertilizers, potassic	Quality inspection is required	MAAH

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36	31.05	Mineral or chemical fertilizers containing two or three of the fertilizing elements nitrogen, phosphorus and potassium	Quality inspection is required	MAAH
37	38	Insecticides, fungicides, herbicides, disinfectants	Testing, inspection and quarantine requirements	MAAH
38	41.13	Leather of swine	Prohibited	Religious purposes
39	49.01	Printed books, brochures, leaflets and similar printed matter	All books are subjected to take certificate from the Ministry of Culture and Information	Ministry of Culture and Information
40	52.01	Seed cotton	Prohibited	For protection of human health
41	57.01	Carpets and rugs of wool or fine animal hair	Prohibited	MoCI
42	84	Up to five years new machinery	Despite zero import duty rating certification is needed	AISA/MoF
43	84.18	Refrigerators and freezers of compression type-CFC	Prohibited	NOU
44	85	Telecommunication apparatus, equipments,	All telecommunication apparatus and equipments are subjected to take certificate from the Ministry of Communication and Technology	MoCT
45	85.24	Indecent or obscene records, tapes and other recorded media	Prohibited	For Moral Protection
46	93.01	Military weapons	For Security Purposes	Mol/MoD
47	93.02	Revolvers and pistols	For Security Purposes	Mol/MoD
48	93.06	Bombs, grenades, torpedoes, mines, missiles and similar munitions of war and parts thereof; cartridges and other ammunition	For Security Purposes	Mol/MoD
49	97.05	Collections and collectors' pieces of zoological, botanical, mineralogical, anatomical, historical, archaeological, palaeontological, ethnographic or numismatic interest	Import license is required	Ministry of Culture and Information
50	97.06	Antiques of an age exceeding one hundred years	Import license is required	Ministry of Culture and Information

Acronyms: MoF = Ministry of Finance, Mol = Ministry of Interior, MoD = Ministry of Defense, MoCT = Ministry of Communication and Technology, MAAH = Ministry of Agriculture and Animal Husbandry, MoCI = Ministry of Commerce and Industry, AISA = Afghanistan Investment Support Agency, NOU = National Ozone Unit

Types of Non-Tariff Measures (NTMs) = Quantitative Restriction, Total/Absolute Prohibition, Quantity Control Measure, Technical Measures, Discretionary Import License, Import Licensing, Automatic Import Licensing, Non-Automatic Licensing prior to authorization for sensitive product, Inspection, Export restriction, Acceptance under defined condition, Quarantine, Multiple Exchange Rates, etc.,

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