

**Trade Promotion in Afghanistan:
Roles for Infrastructure and Institutions**

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Abstract

Promoting trade in Afghanistan will have wide-reaching benefits in increased government revenues, economic growth and job creation. While Afghanistan suffers from a land-locked geography, administrative delays and informal payments can account for a majority of transit time and half of transit costs. While investment in transportation infrastructure is needed across Afghanistan, institution building has the potential to achieve larger reductions in logistics costs. This paper will review political-economic trends affecting trade in Afghanistan and its major trading partners since 2001. Inside Afghanistan, urgent attention is needed to remove informal checkpoints from highways, expedite customs administration and introduce containerized shipping. Within the region, U.S. economic policy background, enabling role focused balancing and inter-connecting neighboring country initiatives.

Introduction

The fall of the Taliban and absence of outright hostility between Afghanistan and its neighbors has created a new opportunity for economic cooperation and integration between South and Central Asia. However, opportunity is no guarantee that governments will cooperate or markets will be created in the face of nationalism, rent-seeking institutions or boundary disputes. Increased direct and transit trade will assist Afghan state-building through increasing government revenue via tariff collection,¹ creating constituencies for peace-building, and mainstreaming informal economic activity. Decreased logistic costs and increased economic growth from trade will also lead to wider benefits in development, refugee resettlement and counter-narcotics objectives. Moreover, building infrastructure and institutions for regional economic integration will have immediate impacts in developing a national market and governance in Afghanistan. Countries in the region have already engaged in infrastructure investments and economic cooperation measures in pursuit of national interests. This paper will

¹Customs revenues are the largest revenue source for the Afghan central government's budget, amounting to 53percent of central government revenues in fiscal year 2004. World Bank, *Afghanistan—State Building, Sustaining Growth, and Reducing Poverty* (Washington, DC: World Bank, 2005), 57

review recent political-economic trends affecting trade in Afghanistan and its major trading partners and outline constructive U.S. policy interventions. U.S. diplomatic and security policies can support Afghan economic growth by reducing the political and security concerns which have hampered regional economic cooperation. Moreover, U.S. development assistance can be most effective at promoting trade when used to fund infrastructure projects which balance and compliment regional initiatives.

According to a World Bank report on regional trade in Central Asia noted that developing countries “with poor transport networks and inadequately developed logistics’ systems” face logistics costs which can add up to 50 percent of the sale price on basic commodities such as grain and cement.² In addition to transportation, logistics costs also include formal charges for port handling, customs, loading and transshipment and road tolls; as well as informal costs for bribes and protection rackets. Landlocked developing countries pay 50 percent higher freight costs, amounting to 15 percent of import values and 18 percent of export values³. The World Bank estimates that logistics costs account for 13 percent of Afghanistan’s entire economy.⁴ Moreover, the rate of GDP growth in landlocked developing countries was 1.5 percent slower than coastal countries⁵. Trade delays are especially punishing for the agricultural sector; as each day of delay is estimated to reduce the volume of trade in perishable products by 3 percent.⁶ However, logistics costs can be halved by investments in infrastructure and logistical services

² World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, By William McCarten and Javier Suarez, (Washington, DC: World Bank, 2004), 28

³ William Byrd and Martin Raiser, *Economic Cooperation in the Wider Central Asian Region* (Washington, DC: World Bank, 2006), 52

⁴ Import values include Cost, Insurance and Freight (c.i.f.). In contrast, coastal developing countries pay freight costs approximating 7 percent on imports and 9 percent on exports. Ibid.

⁵ Ibid., 52

⁶ World Bank and International Finance Corporation, *Doing Business in Landlocked Economies 2009* (Washington, DC: World Bank, 2008), 1. Trade in other goods is estimated to fall by 1 percent for each day of delay.

which facilitate transit trade, as seen in other landlocked countries such as Switzerland, Laos and Uganda.⁷

Facilitating trade in and through Afghanistan requires investment in constructing, rehabilitating and maintaining roads, bridges, mountain tunnels, border and customs facilities, electric transmission lines, railroads and possibly natural gas pipelines. A 2004 World Bank study found it took 12 days to ship cargo from the port of Bandar Abbas, Iran to Kabul (through Herat) at a cost of \$120 per ton. Shipments from the port of Karachi, Pakistan to Kabul (through Peshawar) took 14 days and cost \$52 per ton.⁸ The Asian Development Bank has identified 52 road corridors, running 3,657km long, which connect Afghanistan with its neighbors at eight border crossings (see chart 1). If these corridors all were built at a cost of approximately \$5 billion *and* customs procedures were streamlined to eliminate delays and rent-seeking, Afghanistan stands to reap considerable gains. The study estimated that in a best case scenario exports would increase by 202 percent, imports would increase by 54 percent, customs revenues would double to \$200 million, per capita GDP would increase by 36 percent and 771,000 full time jobs would be created over five years.⁹

While the prospect of building “New Silk Roads” has an immediate appeal, a considerably larger share of work is needed in reforming policy and building institutions to draw merchants onto Afghan trade routes. The greater part of logistics costs for land-locked countries are actually man-made; transaction costs and rent-seeking at border crossings, made acute when one trading partner holds monopoly power over world market access. Total logistics costs are

⁷ World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, 28

⁸ Ibid. 30

⁹ Mohiuddin Alamgir, “Report on the Economic Impact of Central-South Asian Road Corridors.” (paper presented at the Second Ministerial Conference on Transport and Trade in Central and South Asia at the Asian Development Bank, Manila, Philippines, 3-4 March, 2005). Quoted in Nicklas Norling, *First Kabul Conference on Partnership, Trade and Development in Greater Central Asia* (Washington, DC: Central Asia-Caucasus Institute, 2006), 30

often distorted by arbitrary non-tariff barriers and informal payments demanded at border crossings and internal checkpoints. The cumulative effect of informal payments can add 50 percent to logistics costs. For example, World Bank researcher William Byrd estimates informal payments increase the cost of shipping a 40-ton truckload from Central Asia to the port of Bandar Abbas, Iran from \$4000 to \$6000.¹⁰ Similarly, the International Monetary Fund has noted that Afghan exporters are disadvantaged by container shipping costs and delays which are double the regional average.¹¹

The involvement of former warlords in trade and economic activities is a mixed blessing for Afghanistan's political-economy. Kimberly Marten notes that central governments have to be able to successfully cull warlords by gaining the support of "strong aggrieved economic interest groups" and advocating "transformative ideas from outside the existing culture that supported those groups' aims and convinced an increasing literate population of the desirability of change."¹² This dynamic concisely explains the rise of the Taliban in 1994, who offered an ideology of austere Islamic governance over warlord lawlessness and cleared roads for the Pakistani transport mafia and the Bhutto government who were anxious to secure a corridor to Central Asia.¹³ However, after observing the marked stability which Afghanistan experienced after the fall of the Taliban, Antonio Giustazzi noted "[t]he dominant interaction between ex-combatants and business resulted in the emergence of consolidated mafia networks that, while contributing to a reduction in levels of violence, have evolved into forces that reduce

¹⁰ William Byrd and Martin Raiser, *Economic Cooperation in the Wider Central Asia Region*, 55

¹¹ International Monetary Fund, *Staff Report for the 2007 Article IV Consultation, Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion* (Washington, DC: International Monetary Fund, 2008), 22

¹² Kimberly Marten, "Warlordism in Comparative Perspective" *International Security* 31, no. 3 (Winter 2006/2007), 41

¹³ Ahmed Rashid, *Taliban* (New Haven: Yale Nota Bene, 2000), 26-27

opportunities for longer-term growth and a more rounded social role for business¹⁴. Given the low social mobilization of Afghan society and the infeasibility of social revolution as a policy option, these cartels may be effective (or least worst) constituencies for supporting market reforms and trade promotion.

Even before suffering thirty years of war and an accompanying “combat economy”,¹⁵ Afghanistan was one of the world’s least developed countries. In the late 1970s Afghanistan’s major exports were natural gas, agricultural products and their derivatives, such as raisins, other dried fruit, nuts, seeds, furs, skins, animal hairs and carpets.¹⁶ However, any immediate recreation of those markets is unlikely. During this period, about 70 percent of Afghan trade was routed to the Soviet Union, 20 percent to Pakistan and 10 percent to Iran.¹⁷ Years of conflict and isolation have reduced the physical and human capital base of Afghan firms and regulatory institutions. Regulatory agencies or credible industry organizations are needed to assure compliance with quality and sanitary standards as a precondition for agricultural exports to more developed countries. During this time competing firms in other countries have upgraded their production, distribution and marketing capabilities which will make it difficult for Afghan firms to retake their former market share.

Today, the Afghan economy remains largely agricultural—World Bank estimates place opium as the largest portion of GDP at 35 percent, followed by agriculture (primarily cereals) at

¹⁴ Antonio Giustozzi, “Afghanistan: exploring the peacebuilding potential of the private sector” Case Study in *Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector* (London: International Alert, 2006), 226

¹⁵ Jonathan Goodhand distinguishes the combat economy, shadow economy and coping economy in Afghanistan. The combat economy “includes the production, mobilization and allocation of economic resources to sustain a conflict and economic strategies of war aimed at deliberate disempowerment of specific groups”, which tends to support warlords and criminals at the expense of peace building and the centralized governance. See “From War Economy to Peace Economy?: Reconstruction and State Building in Afghanistan” *Journal of International Affairs* 51, no. 1 (Fall 2004), 157

¹⁶ World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, 12

¹⁷ *Ibid.*, 29

32 percent with manufacturing, construction, trade, transport/power/telecommunications and public administration each comprising less than 10 percent of GDP.¹⁸ Moreover, some 80-90 percent of economic activity occurs in the informal sector, which ranges from the outright illegal (narcotics traffic) to irregular and extra-legal activity in otherwise legal markets (shuttle trade, hawala finance, undocumented businesses and illegal exploitation of natural resources) to traditional, in-kind agriculture and craft work.¹⁹

Afghanistan's balance of trade is heavily slanted towards imports. According to the Asian Development Bank statistics, Afghanistan has run trade deficits each year since 2002,²⁰ largely financed by foreign aid inflows. In fiscal year 2007, Afghanistan exported \$188 million in goods, two-thirds of which were vegetable products, with smaller quantities of textiles, hides and skins, mineral products and prepared food stuffs. During this same time, Afghanistan imported goods worth \$3,261 million, mainly minerals products, machinery, textiles, base metals and vegetable products.²¹ Over the last three years, Pakistan was Afghanistan's primary trading partner, followed by China, Japan, Uzbekistan, Iran, India and Russia (see chart 2 for breakdown).

Exploitation of heretofore untapped natural resources offers the potential for near-term economic growth, likely with greater impact on government revenues than industrial productivity. Informal logging and mining operations have continued under mujahedeen commanders and warlords, albeit with scant attention to sustainability or environmental impact. The U.S. Geological Survey discovered new potential natural gas and oil reserves, although

¹⁸ World Bank, *Afghanistan-State Building, Sustaining Growth, and Reducing Poverty*, (Washington, DC: World Bank, 2005), 5

¹⁹ *Ibid.*, 7-9

²⁰ Asian Development Bank, "Key Indicators for Asia and the Pacific 2008: Afghanistan," http://www.adb.org/Documents/Books/Key_indicators/2008/pdf/AFG.pdf (accessed 1 April 2009)

²¹ For a by-sector breakdown, see chart 3. Afghanistan. Customs Department. *Trade Statistics: Per Product*. <http://www.customs.gov.af/trade-statistics/perproduct.asp> (accessed 1 April 2009)

exploiting these will require investment in extraction wells, pipelines to export markets and substantial improvements in security.²² Foreign investors have shown some interest in industrial-level mining operations, which carry more modest security and infrastructure prerequisites than hydrocarbon extraction. Significantly, a Chinese mining company has signed a contract to develop the world's second largest copper mine in Logar Province.²³

Trade with Pakistan

Afghanistan's trade through Pakistan is based on the 1965 Afghanistan Transit Trade Agreement (ATTA), which encompasses tariff rates and exceptions, routing, trucking and port procedures. The Government of Afghanistan has proposed a successor agreement, the Afghanistan Pakistan Transit Agreement (APTA) to account for changed business practices and obtain more favorable terms, which the two governments are still negotiating. Afghanistan has proposed two significant changes to the agreement: to allow Afghan trucks to drive to the port of Karachi while restricting Pakistani trucks carrying transit trade to Kabul²⁴ and removing with Pakistan's ability to place goods on an embargoed "negative list", which Pakistan claims is sometimes necessary to stop smugglers from re-exporting Afghan-bound goods into Pakistani black markets.²⁵

²² Science Daily, "USGS Assessment Significantly Increases Afghanistan Petroleum Resource Base", *Science Daily*, 15 March 2006. <http://www.sciencedaily.com/releases/2006/03/060314231913.htm> (accessed 1 April 2009). During the 1980s, Afghanistan exported its natural gas to the Soviet Union at concessional prices, though the old wells were sealed during the Soviet withdrawal. Future gas exports would likely be exported through Pakistan, following the Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline over which Unocal and Birdas intrigued during the late 1990s.

²³ Quqnoos, "Work on Aynak copper mine to begin soon" *Quqnoos (Kabul)*, 27 November 2008. http://quqnoos.com/index2.php?option=com_content&task=view&id=2136&pop=1&page=0&Itemid=73 (accessed 22 April 2009).

²⁴ The current agreement allows Pakistani trucks to move freely through Afghanistan while Afghan trucks can only travel from Torkham to Peshawar. Trade at the Spin Boldak-Chaman crossing must be transferred to the Pakistani shippers.

²⁵ Sohail Sarfraz, "Kabul wants its vehicles allowed up to Karachi under Apta" *Business Recorder (Pakistan)*, 23 January 2009. <http://www.brecorder.com/index.php?id=868253> (accessed 1 April 2009). Business Recorder, "Under APTA: Afghanistan proposes complete withdrawal of 'negative list'" *Business Recorder (Pakistan)*, 6 January 2009. <http://www.brecorder.com/index.php?id=861016> (accessed 1 April 2009).

Afghanistan has traditionally relied on Pakistan as its main trading partner; according to official Afghan statistics in 2005 through 2007, 23percent of Afghan trade was with Pakistan. Pakistan offers Afghanistan its most direct route to the sea and world markets through the ports of Karachi. Indeed, Pakistan was the primary conduit for Afghan transit trade during the Taliban years and since 2006.²⁶ However, Pakistani authorities have occasionally interfered with Afghan transit trade for geopolitical reasons. During a 1963 conflict over the Afghan-Pakistan border (Durand Line), Pakistan blockaded Afghan transit trade and contributed to the fall the Afghan Prime Minister.²⁷ In what was apparently a response to Afghanistan's signing trade deals with Iran and India, Pakistan National Railways doubled freight charges and delays were imposed on Afghan goods in 2003.²⁸ Similarly, Afghanistan-India transit trade routed through Pakistan is subject to fluctuations in the Pakistan-India bilateral relationship and is usually routed through Iran instead.²⁹ Aside from deliberate government action, insurgencies along Pakistan-Afghan transit routes also reduce trade, by increasing protection and insurance costs or by causing temporary road closures.³⁰

Governments in Pakistan have treated trade with Afghanistan with a mixture of less than benevolent paternalism and wariness. In the 1990s, the Benazir Bhutto government sought to

²⁶ Afghanistan. Customs Department. *Trade Statistics: Imports Per Customs House*.

<http://www.customs.gov.af/Documents/Trade-statistics/importprintout86.pdf> and

Afghanistan. Customs Department. *Trade Statistics: Exports Per Customs House*.

<http://www.customs.gov.af/Documents/Trade-statistics/export%20printout.pdf> (both accessed 22 April 2009).

²⁷ Marvin G. Weinbaum and Jonathan B. Harder. "Pakistan's Afghan Policies." *Contemporary South Asia* 16, no. 1 (March 2008), 28

²⁸ "Afghanistan may not have considered such a course [towards Iran and India] had it not been for the ambiguity of Pakistan policy toward the new government in Kabul." Ahmed Rashid, "The Great Trade Game." *Far Eastern Economic Review (Hong Kong)*, 30 January 2003.

<http://proquest.umi.com/pqdlink?did=282204131&sid=1&Fmt=4&clientId=5241&RQT=309&VName=PQD> (Accessed 23 April 2009)

²⁹ Afghan exports are usually allowed to transit through Pakistan to India, though Pakistan does not allow transit trade in the opposite direction.

³⁰ The Torkam-Khyber border crossing was closed due to Pakistani security force operations in June 2008 and February 2009. Previously, fighting in southern Afghanistan caused traffic to re-route through Torkham-Khyber. Pakistani Balochistan, where Gwadar is located is affected by a different, nationalist insurgency.

use Afghanistan as a pathway into Central Asia, resulting in early Pakistani support for the Taliban, who were seen as a means to clear checkpoints from Afghan roadways for the benefit of Pakistani trucking cartels and to impose enough stability to allow construction of a proposed natural gas pipeline to be run from Turkmenistan through Afghanistan into Pakistan.³¹ Soon after the fall of the Taliban, the Musharraf government, with substantial Chinese financing, constructed a \$1 billion port at Gwadar in Baluchistan Province. The “inaugurated”, but non-operational port is intended to handle the anticipated energy trade with Central Asia and drive economic development in the restive province.³²

However, since the fall of the Taliban, Pakistan’s strategic and commercial interests have diverged in Afghanistan. During the Taliban’s rule, Pakistan had a client government in Kabul which could provide Pakistan with provide “strategic depth” vis-à-vis India and not pose irredentist challenges to Pakistan’s ethnically-Pashtun areas. After 2001, the new government in Kabul pivoted away from dependence on Pakistan towards closer relations with Iran and India, who had previously sponsored the Northern Alliance. Pakistan began to fear India’s expanded diplomatic and development efforts in Afghanistan as cover for Indian intelligence operations directed against Pakistan. Conversely, Iranian businesses began taking market share from Pakistani firms as the Afghan economy became more open. Marvin Weinbaum and Jonathan Harder describe Pakistan as currently running a “two-track” Afghan policy, where different parts of the Pakistani state work at cross purposes: diplomatic and commercial engagement with the Kabul government, as well as varying degrees of support to the Taliban and likeminded militants.³³ Continued recriminations between Kabul and Islamabad reduce the chances of

³¹ Ahmed Rashid, *Taliban*, 167

³² Hugh Barnes, “A vision of the future” *New Statesman (UK)*, 30 April 2007.

³³ Marvin G. Weinbaum and Jonathan B. Harder. “Pakistan’s Afghan Policies.” *Contemporary South Asia* 16, no. 1 (March 2008), 26-28

effective economic and border cooperation measures, especially when the border itself is in dispute.

Trade with Iran and India

India is Afghanistan's second largest export market, while Iran is both Afghanistan's fifth largest import and export market.³⁴ Between 2005 and 2007, 12 percent of Afghanistan's external trade was conducted with Iran and India. The two countries are discussed together here because Indian trade to Afghanistan is routed through Iran and the two countries have worked together on infrastructure projects. In January 2003, Iran and Afghanistan reached a deal where Afghan businesses could use the Iranian port of Chabahar with a 90 percent discount on customs and port fees for non-oil goods and a 50 percent discount on warehouse charges, as well as transit rights on Iranian roads for Afghan trucks³⁵. In a related deal, India obtained similar preferences from Iran and Afghanistan for Indian through Chabahar and Afghanistan to Central Asia.³⁶ The majority of Afghan transit trade was routed through Iran for several years after the fall of the Taliban due to a combination of Iranian incentives and Pakistani intransigence.³⁷

Iran's efforts in infrastructure development and trade facilitation in Afghanistan have been more direct and constructive in comparison to Pakistan. Iran has heavily invested in the Herat region, building transport infrastructure, broadcast media, telecommunications and electricity transmission lines linked to the Iranian grid.³⁸ While Iran has deported Afghan refugees and migrant workers as a coercive tactic, Tehran has never threatened to close the

³⁴ Afghanistan. Customs Department. *Trade Statistics: Per Country*. <http://www.customs.gov.af/trade-statistics/percountry.asp> (accessed 22 April 2009)

³⁵ Ahmed Rashid, "The Great Trade Game." *Far Eastern Economic Review (Hong Kong)*, 30 January 2003. <http://proquest.umi.com/pqdlink?did=282204131&sid=1&Fmt=4&clientId=5241&RQT=309&VName=PQD> (Accessed 23 April 2009)

³⁶ Ibid.

³⁷ Daud Khan, "Transit trade diversion: Pakistan mulls new ATTA", *Pajhwok Afghan News*, 1 July, 2002. <http://www.e-ariana.com/ariana/eariana.nsf/allDocs/5141F77089EE0427872571A9007003B4?OpenDocument> (accessed 22 April 2009).

³⁸ Moshen M. Milani, "Iran's Policy Towards Afghanistan", *Middle East Journal* 60, no. 2 (Spring 2006), 251

border. In contrast to Pakistan's "two-track" policies towards Kabul and the Taliban, Iran-linked areas such as Herat and the Hazarajat have remained among the most reliably anti-Taliban (if not pro-government) in Afghanistan.

In 2003, Iran and India began a program of infrastructure improvements to tie Afghanistan into Iran's road and rail networks. In August 2008, construction was completed on an Indian financed and engineered road which connects the Afghan Ring Road at Delaram to Zeranj on the Afghan-Iran border.³⁹ Iran and India have also built out railroads and roads within Iran to cut travel times from the Afghan border to Indian Ocean ports.⁴⁰ More ambitiously, Iran is building a railroad from northeast Iran to Herat, which is planned to ultimately extend into Tajikistan.⁴¹ If completed, the railroad would tie the relatively developed provinces of northern Afghanistan closer to Iran (and Tajikistan), with which they already share linguistic bonds. While lower transport costs would definitely be welcomed by firms around Herat and Mazar-e-Sharif, a railroad could also exacerbate unresolved tensions between Kabul and the provinces in governance and revenue sharing in the North, or feelings of exclusion in the South.

Afghanistan's greatest benefit from Iranian transit trade is that it injects competition into the Afghan-Pakistan transit trade relationship, which was essentially a monopoly under the Taliban. Presumably, competition would cause Pakistan to offer more concessional terms of trade in the ongoing Afghan Pakistan Transit Agreement negotiations. Additionally, the Afghanistan-Iran border areas are generally more stable than the Afghanistan-Pakistan border. The border crossing at Dogharum-Islam Qala in Herat, one of the most developed and stable

³⁹ Saboor Hamdam, "Road opens Afghan market to Indian goods", *Quqnoos (Kabul)*, 6 August 2008. http://quqnoos.com/index2.php?option=com_content&task=view&id=1319&pop=1&page=0&Itemid=73 (Accessed 1 April 2009).

⁴⁰ Abbas Maleki, "Iran" in S. Frederick Starr (ed.), *The New Silk Roads: Transport and Trade in Greater Central Asia* (Washington, DC: Central Asia-Caucus Institute, 2007), 187

⁴¹ Fars News Agency, "Iran-Afghan Railway Nearing Completion" *Fars News Agency (Iran)*, 10 October 2008. <http://english.farsnews.com/newstext.php?nn=8707281452> (Accessed 1 April 2009).

provinces in Afghanistan. The Milak-Zaranj crossing is in a remote area, though insurgents have attacked trucks travelling on the road from Delaram.⁴²

India's trade and development assistance programs in Afghanistan have essentially reversed Pakistan designs for "strategic depth" and gained entry to markets whose direct access was blocked by Pakistan. Engagement in Afghanistan allows Iran to check U.S. containment, prevent other powers from dominating Afghan resources, look after Afghan Shi'ia interests and participate in Central Asian trade and energy markets⁴³. Moreover, economic growth in Afghanistan could have positive spillovers for Iran by creating alternative livelihoods to narcotics production and in motivating the 915,000 Afghan refugees in Iran to repatriate⁴⁴. In many ways the most problematic aspect of Indian and Iranian economic initiatives in Afghanistan is their success, which has reinforced Pakistani motivation to at least partially play the spoiler.

Trade with the Central Asian Republics

Afghanistan's commerce with Russia and the three bordering Central Asian Republics, Turkmenistan, Uzbekistan and Tajikistan amounted to 15 percent of Afghan trade from 2005 to 2007. In comparison, between 1970 and 1977 the Soviet Union was Afghanistan's largest trading partner, receiving 30-40 percent of Afghan exports.⁴⁵ Tajikistan is the only country in the world with which Afghanistan is running an official trade surplus, whereby Afghanistan exports

⁴² Jalal Mirzad, "Afghan-Iran Highway Boosts Business" *Quqnoos (Kabul)*, 19 March 2009.

http://quqnoos.com/index.php?option=com_content&task=view&id=2714&Itemid=48 (Accessed 1 April 2009)

⁴³ Abbas Maleki. "Iran", 176-178

⁴⁴ Mark Sappenfield, "Is Iran meddling in Afghanistan?", *Christian Science Monitor*, 8 August 2007.

<http://www.csmonitor.com/2007/0808/p06s01-wosc.html?page=1> (Accessed 1 April 2009)

United Nations High Commissioner for Refugees (UNHCR), *UNHCR Global Appeal 2008-2009*, 8 August 2007.

<http://www.unhcr.org/home/PUBL/474ac8e00.pdf> (Accessed 1 April 2009)

⁴⁵ World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*. 12

agricultural goods for industrial imports.⁴⁶ The U.S. and other donors have funded the construction and rehabilitation of bridges across the Panj River to reconnect Tajikistan with Afghanistan⁴⁷ (see chart 1). Iran has already funded the construction of road tunnel at Anzob, Tajikistan which gives northwest Tajikistan year-around access to Dushanbe, Afghanistan and Iran.⁴⁸ Afghanistan concluded trade and transit agreements with Uzbekistan and Turkmenistan in July 2007 and is negotiating one with Tajikistan.⁴⁹

Transport of energy presents the greatest medium-term opportunity for transit trade through Afghanistan. The Central Asian Republics hold reserves of natural gas, oil and potential hydroelectricity which be sold at prices five times higher to South Asia than to Russia. Afghan trade with Turkmenistan is now within an order of magnitude of the other Central Asian Republics, but would increase geometrically if a natural gas pipeline were built through Afghanistan carrying Turkmen natural gas exports. Currently Uzbekistan and Iran export electricity to cities in Afghanistan near their borders. Tajikistan and Kyrgyzstan have agreed to sell hydroelectricity to Afghanistan and Pakistan, though the donor funded transmission lines have not yet been built.⁵⁰

Regional trade within Central Asia has tended to decline since the dissolution of the Soviet Union, due to policies of “self-sufficiency, import-substitution, ad hoc import controls, stricter, [and] more complicated border controls.”⁵¹ Afghanistan will probably serve as an East-

⁴⁶ Uzbekistan is better developed transit trade outlet for Tajikistan, but political tensions with Uzbekistan have caused re-routing through Afghanistan

⁴⁷ Khojamakhmad Umarov. “Tajikistan” in S. Frederick Starr (ed.), *The New Silk Roads: Transport and Trade in Greater Central Asia* (Washington, DC: Central Asia-Caucasus Institute, 2007), 124

⁴⁸ Khalid Mustafa. “Report Says India, Iran, Afghanistan Tried to Foil Gwadar Port Project”, *The News (Pakistan)*, 2 July 2007. Downloaded from World News Connection.

⁴⁹ *Afghanistan National Development Strategy: 2008-2013*, (Kabul: Government of Afghanistan, 2008), 93

⁵⁰ Saad Hasan, “Central-South Asia power project gets going” *The News (Pakistan)*, 23 May 2008.

http://www.thenews.com.pk/daily_detail.asp?id=114156 (Accessed 1 April 2009).

⁵¹ Manmohan Parkash, *Connecting Central Asia: A Road Map for Regional Cooperation* (Manila: Asian Development Bank, 2006), 6-7

West transit trade corridor (between Tajikistan, Uzbekistan and Iran) given the greater pre-existing cultural and economic connections between some of the provinces of northern Afghanistan and those countries and the absence of Taliban/Pashtun insurgency. Establishing a North-South corridor between Central Asia and South Asia will be dependent on security improvements in the Afghan south and/or east.

Trade on the Black Market

Absent from Afghanistan's official trade statistics are illicit and informal activities which from individual shuttle traders dodging import duties to world-class narcotics syndicates. The International Monetary Fund estimates that Afghanistan's unofficial exports (including opium and smuggling duty-free goods) are five times larger than the country's official exports.⁵² Afghanistan has perverted the fortune of being the world's largest exporter of opium products, with predictably bad cascading effects for the country's political-economy as the prevalence of a single export places appreciating pressure on the Afghani, harming the export prospects of legitimate goods. Worse, the illegal and highly remunerative nature of the drug industry feeds into official corruption. Smuggling activities earn "as much as \$1 billion per year or more" by dodging tariffs outright and exploiting arbitrage opportunities against Pakistani price controls.⁵³ Pakistan subsidizes staple goods, which are smuggled into Afghanistan for consumption and has high tariffs on manufactured goods, which can be imported into Afghanistan at lower tariffs and illegally re-exported to Pakistan.⁵⁴ Afghanistan's stated overall economic philosophy, as well as tax and tariff rates, is conspicuously more liberal than the surrounding region, and there does not

⁵² International Monetary Fund, *Staff Report for the 2007 Article IV Consultation*, 23

⁵³ World Bank, *Afghanistan-State Building, Sustaining Growth, and Reducing Poverty*. (Washington, DC: World Bank, 2005), 9

⁵⁴ Interestingly, Iran has even higher import tariffs than Pakistan, but Asian Development Bank and World Bank reports only recount complaints by Pakistani and Uzbek businessmen about Afghan shuttle traders.

appear to be political will by local population or external donors to push for convergence to reduce arbitrage.

Given the urgent challenges posed by narcotics traffickers and insurgents, Afghan border security would be strengthened by creating incentives to shift the shuttle trade away from smuggling routes and through officially recognized border crossings. Mainstreaming informal traffic in otherwise legal goods increases contact between Afghan citizens and their government and allows Afghan Border Police and customs inspectors to focus enforcement efforts on purely illicit traffic. Presently, unlicensed traders pay a three percent customs surcharge on imports.⁵⁵ Incentives can reduce the costs paid by small-time shuttle traders by setting lower customs rates for small traders, establishing/condoning bazaars in border areas where imported goods can be legally sold at reduced tax rates and by reducing transaction costs at border crossings (i.e. delays and bribes). Depending on rates of compliance and volume, the Afghan government could gain revenue from mainstreaming shuttle traders by increasing the size of the tax base

Trade Hardware: Infrastructure and Facilities

The most prominent transport infrastructure in Afghanistan is the Ring Road, which connects the country's major cities, such as Kabul, Kandahar, Herat and Mazar-e-Sharif and totals 2,700 km in length. Afghanistan's national road system fell into disrepair during the civil war, and an assessment in 2002 found 54 percent of national roads in "poor condition."⁵⁶ The U.S., Japan and multilateral development agencies have financed repairs of Afghanistan's national highways, with the Kabul-Kandahar segment of the ring road being completed in

⁵⁵ Anna Paterson, *Going to Market: Trade and Traders in Six Afghan Sectors* (Kabul: 2006, Afghan Research and Evaluation Unit), 33

⁵⁶ Grant Curtis, "Building Roads, Changing Lives", *Asian Development Bank Press Release*, January 2008. <http://www.adb.org/Documents/Periodicals/Impact/AFG/200801.asp> (accessed 1 April 2009).

2004.⁵⁷ Other donor-funded programs are (re)building secondary and farm to market roads to facilitate rural livelihoods and extend the writ of government. Concurrent with roads construction is the need to institute maintenance programs to ensure upkeep.

Within the next ten years, air and rail transport can become viable alternate means of transport for certain commodities, offering speed or cost advantages and a technical workaround to problem of informal checkpoints. Air transport is viable for niche high value, low weight commodities such as cut flowers or seasonal produce for intermediate range markets such as Dubai and Moscow. However, the air transport industry in Central Asia remains heavily protected, with Ariana Afghan Airlines a state owned enterprise and Afghan airports subject to international control, national regulation and local corruption.⁵⁸ Civil air transport in Afghanistan is in dire need of supporting institutions to regulate the safety of air travel and export quality and sanitation.

In contrast to the time of Abdur Rahman Khan, the current Afghan government supports in principle the extension of railroads from neighboring countries into Afghanistan.⁵⁹ Rail transport offers great cost savings in the transport of high volume, containerized cargo. However, Afghanistan's neighbors use three incompatible rail gauges, with Iran and China on standard gauge, the Central Asian republics on Russian gauge and Pakistan on Indian gauge.

⁵⁷ USAID, "Roads Improve Journey from Kabul to Kandahar", *USAID Press Release*, 1 April 2004. <http://afghanistan.usaid.gov/en/Article.80.aspx> (accessed 1 April 2009).

While an early success, the Kabul-Kandahar road project was criticized for its contractor management and high costs, amounting to \$1 million per mile.

⁵⁸ For a profile of Mohammed Atash, the President of Ariana Airlines who resigned in 2006, see Michael Weiss, "An Afghan Reconstruction Horror Story", *NewMajority.com*, 13 March 2009. <http://www.newmajority.com/ShowScroll.aspx?ID=1614a46d-978a-4e82-a774-3f46e706e590> (accessed 22 April 2009).

⁵⁹ See Wali Mohammad Rasooli, Afghan Technical Deputy Minister of Public Works, "Railway Development Plans" (presentation, Seventh Ministerial Conference on Central Asia Regional Economic Cooperation (CAREC), 19-21 November 2008. <http://www.adb.org/documents/events/2008/7th-CAREC-Ministerial-Conference/AFG-railway-devt-plans.pdf> (accessed 22 April 2009); which outlines the path of an East-West railway which runs from Northeast Iran across northern Afghanistan, with branches to Tajikistan and Torkham, Pakistan.

These differences in gauge complicate near-term connections, though Afghanistan may someday be able to use its central position to develop regional dry port facilities. At present, the only functional railroads in Afghanistan were built during the Soviet occupation and terminate at railheads at Hairatan on the Uzbek border and Turgundi on the Turkmenistan border. Iran has begun building a standard gauge railroad across northern Afghanistan,⁶⁰ and a Chinese state-owned firm has pledged to build a railroad connecting a copper mine southeast of Kabul to Pakistan (Torkham) and Uzbekistan (Hairatan).⁶¹ Pakistan National Railways conducted a feasibility study extending Pakistani rail 60 miles north of Chaman, Pakistan to Kandahar, though there has not been inter-governmental agreement to begin construction.⁶²

A more pressing near-term problem affecting Afghan trade infrastructure is the “high incidence of truck-to-truck transshipment at the Afghan border must be unique in international transit systems”.⁶³ Having to physically unload goods from one truck at the border and load them onto another imposes additional delays and transaction costs, as well as opportunities for rent-seeking and pilferage. Transshipment is currently required due to non-tariff barriers, differences in mode of transport,⁶⁴ counter-narcotics measures, protectionism by national trucking cartels and lack of regional cooperation. Non-tariff barriers include different levels of regulation on trucking and road safety, which serve legitimate purposes but may reinforce

⁶⁰ Fars News Agency, “Iran-Afghan Railway Nearing Completion” *Fars News Agency (Iran)*, 10 October 2008. <http://english.farsnews.com/newstext.php?nn=8707281452> (Accessed 1 April 2009).

⁶¹ Quqnoos, “Work on Aynak copper mine to begin soon” *Quqnoos (Kabul)*, 27 November 2008. http://quqnoos.com/index2.php?option=com_content&task=view&id=2136&pop=1&page=0&Itemid=73 (accessed 22 April 2009).

⁶² Muhammad Bilal “Chances of Pak-Afghan rail link dim due to Kabul’s cold response”, *Business Recorder (Pakistan)*, 3 December 2005. <http://www.brecorder.com/index.php?show=detail&id=360082&currPageNo=1&query=kandahar&search=1&term=2004-10-01|2006-12-31&supDate=> (Accessed 1 April 2009)

⁶³ World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, 31

⁶⁴ I.e. road to rail or between different rail gauges (i.e. Iran and Turkmenistan)

national protectionism as well.⁶⁵ For example, Iran permits Afghan truckers to drive across the border to Iranian ports, but Iranian has European-level road safety standards which are far more stringent than Central Asia.⁶⁶ Afghanistan's truck fleet would need substantial upgrades to realize the benefits of open access to more developed countries in practice. William Byrd suggests establishing a donor trust fund to modernize public and private trucking fleets⁶⁷ while McCarten and Suarez suggest dedicating a road corridor from Afghanistan to the Iranian port of Chabahar where "Central Asian" trucking standards would be permitted.⁶⁸

Use of sealed, containerized cargo would allow Afghan traders to reap the efficiency benefits of modern logistics. McCarten and Suarez state "without a bond/guarantee system, customs control of corridor scheme would be limited to a costly and inefficient convoy system....at a very basic level, shippers need to be able to insure their cargo and use containers."⁶⁹ Indeed, the economic damage from the loss of a shipping container can be twice the value of the physical container. In Afghanistan, security risks drive the transit bonds up to the full value of the container and goods, and the underdevelopment of the financial sector leads to costly delays in bond recovery. A near term solution for reducing the private sector's risk in shipping cargo through Afghanistan is to allow firms to internalize the risk and carry cargo end-to-end from seaports in Iran or Pakistan to Afghanistan. This could be accomplished through reciprocal access agreements for national firms or the establishment of local subsidiaries.

⁶⁵ Afghanistan and the Central Asian Republics have looser safety and environmental standards, including higher permitted weight-to-axle loads which reduce freight costs but damage well-maintained roads.

⁶⁶ The Transports Internationaux Routiers (TIR) regime was established by the United Nations Economic Commission for Europe (UNECE) to facilitate international logistics and customs clearance. It establishes a single customs control document (carnet), provisions for sealed containers and minimum standards for truck fleets.

⁶⁷ William Byrd and Martin Raiser, *Economic Cooperation in the Wider Central Asian Region*, 90

⁶⁸ World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, 39. The concept of a reduced-standards corridor might also work for Pakistan's port of Gwadar, which is also in a relatively unpopulated area and intended to accommodate Central Asian trade.

⁶⁹ *Ibid.*, 37

Creating opportunities for integrated cross-border logistics will threaten trucking cartels in Afghanistan and Pakistan who can be expected to resist weakening of their protections.

Trade Software: Trade and Economic Policy

The government of Afghanistan passed significant economic reforms in 2003-2004, that simplified the domestic tax code, streamlined processes for business incorporation, established a Central Bank and rationalized the tariff code. Beyond these accomplishments, Afghanistan's economy remains burdened by the legacies of a communist-built bureaucracy and short time horizon war economy. The impact of formal liberalization by the central government is often overshadowed by arbitrary local implementation, incidents of protectionist lobbying and informal payments to checkpoints and protection rackets. A 2008 World Bank survey of economic regulations ranked Afghanistan at the bottom in seven of eleven areas, including "trade across borders" due to extensive time required for document preparation and bureaucratic clearances."⁷⁰ Similarly, in commenting on Afghanistan's prospects for economic development, William Byrd wrote "the fact that even transport-protected activities are not taking off suggests that other constraints on business are operative."⁷¹

In 2004, the Afghan tariff system was greatly simplified. The previous Afghan customs regime was comparable in restriction and complexity to neighboring states. Tariffs were nominally high, averaging 43 percent, and ranged from 7 to 150 percent across 25 categories. The new customs regime was simplified into five bands ranging from 2.5 to 16 percent, with

⁷⁰ According to the survey, it took three times longer to export goods from Afghanistan compared to Pakistan or Iran, and two-three times longer to import goods into Afghanistan compared to those same countries. Of the 77 days required for imports, 49 were needed for documentation; export times were comparable. See World Bank and International Finance Corporation, *Doing Business 2009: Afghanistan Country Profile* (Washington, DC: World Bank, 2008), 39, 69-70 and World Bank and International Finance Corporation, *Doing Business in Landlocked Economies 2009*, 33.

⁷¹ William Byrd and Martin Raiser, *Economic Cooperation in the Wider Central Asian Region*, 36

tariffs averaging just 5.3 percent.⁷² Following the customs reforms, the IMF rated the Afghan trade regime the most liberal in South and Central Asia, with a comparable openness to the U.S. and EU.⁷³ The Government of Afghanistan then raised tariff rates again between 2006 and 2008, to increase government revenues and lightly manage industrial policy. As of April 2008, Afghanistan had nine tariff bands ranging from 1 percent for raw materials to 25 percent for motor vehicles. The average tariff under the new system is slightly higher at 5.7 percent.⁷⁴

Trade facilitation efforts have contributed to Afghan state-building elsewhere as well. During 2004-2005 the Kabul government recovered tariff revenues withheld by regional power holders in Herat, Kandahar and Mazar-i Sharif.⁷⁵ In 2004, the Afghan Customs Department began implementing the ASYCUDA information system in its offices to make customs collection and data sharing more efficient.⁷⁶ Additionally, the post-Taliban transition period saw removal of roadblocks which charged illegal taxes and discouraged trade, possibly due to the connivance of warlords looking to profit on their new business/mafia connections.⁷⁷ Improved data collection from private sector merchants and logisticians on border crossing delays and informal payments is critical to monitor the effectiveness of policy implementation and to estimate the payoff for potential investments.

Many of the outstanding policy outcomes needed to facilitate trade are also required to accomplish other critical areas of state building and economic development: an efficient and

⁷² World Bank, *Afghanistan: Managing Public Finances for Development Volume I*. Washington, DC: World Bank, 2005), 35-36

⁷³ In comparison, Tariffs in Iran range from 17.3 to 200 percent and tariffs in Pakistan run from 31 percent to 150 percent. Perversely, Afghanistan's liberalization has also created greater incentive for shuttle traders to smuggle goods from low-tariff Afghanistan top into higher tariff neighboring countries. See World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, 11

⁷⁴ International Monetary Fund, *Staff Report for the 2007 Article IV Consultation*, 15

⁷⁵ Ahmed Rashid, *Descent into Chaos*, (New York, NY: Viking, 2008), 187

⁷⁶ Automated SYstem for CUstoms DAta was developed by UN Conference on Trade and Development (UNCTAD). See ASYCUDA, "Afghanistan Page." <http://www.asycuda.org/dispcountry.asp?name=Afghanistan> (Accessed 23 April 2009).

⁷⁷ Antonio Giustozzi, "Afghanistan: exploring the peacebuilding potential of the private sector", 215

predictable civil bureaucracy, a police force able to keep highways clear and safe, development of a modern financial sector, and of course security. While Afghanistan has many urgent and competing priorities for domestic policy attention and international assistance, trade facilitation should remain a focus due to its direct impact of trade on central government revenues, the close correlation of “beyond the border” trade facilitation tasks with establishing a national market and governance and the positive spillovers of economic growth on counternarcotics.

U.S. Policy Options

International trade and infrastructure development efforts in Afghanistan will garner the greatest impact by seeking to reform or remove the man-made barriers that are exacerbating Afghanistan’s geographic isolation from world markets. Afghanistan’s mountainous, land-locked geographical position is a competitive disadvantage, but more than 70 percent of the time required for shipping goods into Afghanistan occurs due to paperwork and inspections.⁷⁸ Therefore, while Afghanistan’s potential net economic gains from trade are considerable, through transporting Central Asian energy exports, supplying raw materials to China or food to India, their realization will not be automatic. Beneficiaries receiving rents under the status quo, such as cartels, smugglers and corrupt officials can be expected to oppose liberalization and integration measures. William Byrd has suggested prioritizing transit infrastructure spending in Afghanistan for “bold strokes” which encourage policy change as a quid-pro-quo for liberalization or to create alternate routes around recalcitrant actors.⁷⁹ Given Afghanistan’s investment needs outstrip available international funds, prioritizing infrastructure projects

⁷⁸ World Bank and International Finance Corporation, *Doing Business 2009: Afghanistan Country Profile*, 37

⁷⁹ William Byrd, *Responding to Afghanistan’s Development Challenge: An Assessment of Experience During 2002-2007 and Issues and Priorities for the Future*, PREM Working Paper Series No. SASPR-11 (Washington, DC: World Bank, 2007), 2

towards bilateral corridors and provinces where complimentary trade liberalization and anti-corruption reforms are in place.

The United States government's economic policy goals in Afghanistan should be modest and regionally focused. For the foreseeable future, political-military issues related to counterterrorism, counterinsurgency, national governance and regional stability will dominate U.S. policy attention towards Afghanistan. For one rough measure, since the start of Operation Enduring Freedom in 2001, U.S. military spending in Afghanistan has exceeded Afghanistan's entire formal GDP each year. Similarly, while the U.S. Agency for International Development has played a major role in Afghan reconstruction, its total spending in Afghanistan amounts to 2 percent of what the Department of Defense has spent.⁸⁰ In U.S. trade policy towards Afghanistan, material policy changes have lagged behind rhetoric; U.S. legislation to create "Reconstruction Opportunity Zones" which allow wide-ranging duty free imports from Afghanistan and parts of Pakistan has been featured in State Department talking points since 2006, but has not been passed into law as of April 2009. Expanding duty-free exports from Afghanistan to the U.S. is easy to implement means to encourage sustainable development and would set an example to encourage other donor countries.

The U.S. can play a unique role in leveraging its political interest and economic disinterest in Afghanistan by balancing and integrating transit and trade projects by neighboring states. Afghanistan has historically been both wary of economic integration if it led to certain provinces moving closer to neighboring co-ethnic states, yet also willing to play foreign powers against each other to bid up aid and rents. U.S. economic diplomacy should focus on enabling Afghanistan's who neighbors are better-motivated and positioned to engage in foreign

⁸⁰ Amy Belasco, "The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11", *Congressional Research Service Report No. RL 33110* (Washington, DC: Congressional Research Service, 2008)

investment and trade opportunities as the security environment improves. By encouraging an open environment in Afghanistan for third country trade and investment, the U.S. can more readily deflect accusations that U.S. military deployment there serves a unilateral agenda.

Afghan sovereignty and national integration stand to gain from projects that link Herat closer to Iran, Balkh closer to Uzbekistan, or Kandahar closer to Pakistan as long as those corridors ultimately run through Kabul in geographical routing and customs revenue flow. The physical topology of such a strategy would be a continuation of present USAID funded efforts to rehabilitate the Afghan ring road, perhaps with a greater priority in upgrading the links between Herat to Kandahar and Mazar-e-Sharif to Kabul. The development of multiple transit corridors through several countries gives Afghan merchants greater bargaining power to demand lower prices from their counterparts in port countries. Redundant transit corridors will reduce the impact if a corridor is closed due to coercion from or conflict within the port country, as had happened with Pakistan during boundary disputes.

As a corollary to encouraging constructive regional economic competition in Afghanistan, the U.S. may in some circumstances need to intervene to ensure the competition remains constructive. Afghanistan, Iran and India have developed amicable diplomatic and economic relations without positive U.S. involvement.⁸¹ However, U.S. intervention may be needed to realign Pakistan's Afghanistan policies as part of a wider diplomatic and development strategy. Given Pakistan's relative loss of political influence and economic leverage with the Karzai government, measures to encourage Afghanistan-Pakistan trade are a potential means of giving Pakistan a stake in a stable and prosperous Afghanistan. Two possible avenues for renewed Afghanistan-Pakistan cooperation are completing negotiations for a new Afghan-

⁸¹ See Sheryl Gay Stolberg, "Bush Differs with Karzai on Iran", *New York Times*, 7 August 2007. http://www.nytimes.com/2007/08/07/washington/07prexy.html?_r=2&oref=slogin (accessed 23 April 2009)

Pakistan Transit Agreement (APTA) and upgrading infrastructure and border facilities for the Spin Boldak-Kandahar transit corridor.

While increased trade and economic growth would reduce the incentives for Afghans to work as poppy growers or insurgent foot soldiers, Afghanistan's recent notoriety as a source of opium and militant Islamic insurgency has encouraged neighboring countries to impose severe border controls.⁸² U.S. and international security assistance programs must include removing the most egregious barriers to trade as part of their objectives and metrics. Defending the ability of businesses to earn profits does not directly contribute to population security, but creating an environment secure enough for business will help Afghan government authorities to co-opt the Taliban's promise of being a "law and order" provider. Advisory efforts within the Afghan National Police (especially the successor units to the Afghan Highway Police) need to aggressively clear "informal" checkpoints from the roads. A means to provide local incentives for securing commerce is also necessary, such as a centralized system of returning a portion of customs revenues to the provinces or construction of legitimate tollbooths on major roads.⁸³

In the micro-economy, international assistance to trade facilitation efforts should focus on enclaves and niches. While Afghanistan's development needs are great, its human capital available to staff public administration and business management are currently limited. Focusing microeconomic policies on developing pockets of excellence can demonstrate near-term economic while creating learning opportunities for individuals and institutions. One way to focus facilitation efforts is in the establishment of industrial parks, where the Afghan government and international donors can provide baseline infrastructure (perimeter security, electricity,

⁸² World Bank, *Trade and Regional Cooperation between Afghanistan and its Neighbors*, 49

⁸³ Encouraging predictable, stationary banditry would be an intermediate step between the current situation and the Westphalian ideal. See Mancur Olson, "Dictatorship, Democracy, and Development," *American Political Science Review* 87 (September 1993)

water, road access) and institutions (clean property titles, streamlined bureaucratic attention) to establish or expand businesses in the formal economy. The donor-backed Afghan Investment Support Agency is currently constructing five industrial parks outside of Kabul, Jalabad, Kandahar, Herat and Mazar-e-Sharif.⁸⁴

Similarly, focusing export promotion on specific, traditionally competitive sectors as pomegranates, dried fruit and cut flowers, with donor supported quality and sanitary assurance by industry associations or government agencies can facilitate building up the reputation of Afghan products in foreign markets. Functionally and physically concentrating industry in Afghanistan may also reduce the collective action burden for the business community to voice concerns to the government, contributing to civil society promotion. Afghanistan is also in need of trade-related financial institutions to handle international payments, transit bonds and insurance, though encouraging more regional banks to open branches in major Afghan cities will be faster than developing domestic capacity.

Conclusion

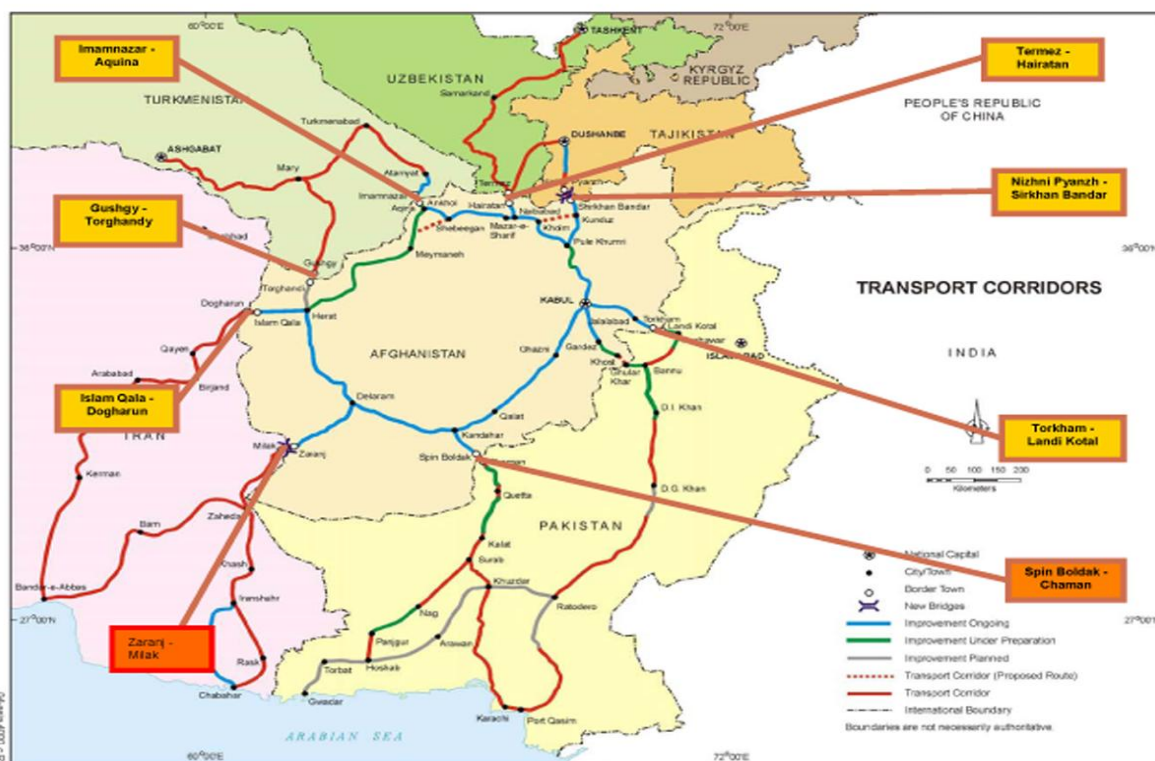
Trade promotion and infrastructure building offer great potential in helping Afghanistan build a functional state and growing economy. While the disadvantages of Afghanistan's rugged, land-locked geography are stark; the tyranny of weak institutions is more punishing to trade than the tyranny of distance. Promoting trade is tightly linked to developing sustainable state capacity in Afghanistan, since the majority of domestic government revenue comes from customs. In addition to economic growth, creating export niches will generate political support for the Kabul government and provide alternative livelihoods to workers currently in the opium sector. Establishment of a moderately responsive, non-predatory public administration on

⁸⁴ Afghan Investment Support Agency, "Industrial Parks." <http://www.aisa.org.af/ind-parks.html> (Accessed 1 April 2009).

Afghanistan's border crossings and highways is critical for reducing transaction costs and delays. Over time, supportive regulatory institutions and financial intermediaries will also need to be needed to expand the market share and scale of export operations.

Regional geopolitics will continue to cast a shadow on the prospects for economic cooperation. Afghanistan can potentially benefit from closer integration with its neighbors, so that neighboring countries see investment in Afghanistan in their competitive self-interest and no long single country is able to monopolize transit trade. The U.S. should attempt to insulate Afghanistan from the effects of regional geopolitics by segregating its Afghanistan policies from potential bilateral tensions (such as with Iran or Russia) and by playing a supportive role vis-à-vis Pakistan to give Islamabad incentives for constructive engagement.

Chart 1: Afghan Transport Corridors and Border Posts



Source: UNCTAD http://r0.unctad.org/ttl/ppt-2007-09-27to28/Natl_Exp_Afghanistan_Sept07.pps

Chart 2: Main Afghan Import & Export Partners

	March 2005 - March 2006		March 2006 - March 2007		March 2007 - March 2008	
	Imports	Exports	Imports	Exports	Imports	Exports
Pakistan	30,912.48	2,571.36	37,241.77	3,772.76	38,718.51	3,354.79
China	28,264.60	61.78	35,716.49	32.39	35,772.05	25.81
Japan	26,718.97	0.00	7,603.10	16.31	9,824.69	25.52
Uzbekistan	6,920.96	85.12	13,863.24	150.44	15,920.82	66.73
Iran	14,019.21	203.98	9,852.98	264.22	8,188.25	492.37
India	5,087.31	1,221.34	6,770.17	2,321.63	10,491.64	2,220.65
Russia	8,032.74	147.47	7,614.73	316.31	7,879.40	334.95
UAE & Dubai	4,594.04	216.87	6,394.81	176.33	7,666.45	577.84
Turkmenistan	2,912.78	3.56	4,879.46	22.09	2,749.49	146.25
Tajikistan	322.81	164.59	450.06	388.74	652.37	1,065.08
TOTAL	159,409.49	5,316.03	161,007.74	8,419.15	169,584.11	9,766.73

Source: Afghanistan Customs Department
<http://www.customs.gov.af/trade-statistics/percountry.asp>

Notes: Figures are in millions of Afghanis (Afs).
 For the entire period the exchange rate has been approximately 50 Afs to 1 USD
 The ten countries above account for 81 percent of foreign trade.

Chart 3: Top Five Sectors in Afghan Trade – March 2007 to March 2008

Exports from Afghanistan	million Afs	% total
Vegetable products	6,330	64.8%
Textiles and textile articles	765	7.8%
Raw hides and skins, leather, furskins and articles thereof	605	6.2%
Minerals products	731	7.5%
Prepared foodstuffs	362	3.7%
Imports to Afghanistan	million Afs	% total
Minerals products	23,812	14.0%
Machinery and mechanical appliances	22,673	13.4%
Textiles and textile articles	18,582	11.0%
Base metals and articles of base metal	17,012	10.0%
Vegetable products	16,786	9.9%

Source: Afghan Customs Department
<http://www.customs.gov.af/Trade-Statistics/perproduct.asp>

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