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**Trade & Transit Cooperation with
Afghanistan: Results from a
Firm-level survey from Pakistan**

By:

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Abstract

This paper aims to inform academia and policymakers about ways and means to first increase trade with Afghanistan, and second, to discuss trade-related procedures and processes that could be streamlined for reducing the cost of doing business (with Afghanistan). Using a firm-level survey of exporters, traders, transporters and distributors, it also discusses how best the Pakistani business community can position itself under various economic scenarios in Afghanistan. It also contends as to how the increased cost of doing business is already hurting the competitiveness of Pakistani manufacturing and trading community. Besides highlighting upcoming competition from Iran and India, the paper argues that small improvements in transit facility for Afghan goods (via Pakistan) may lead to more commercial trade prospects between the two countries.

JEL: F13, F21, F23, F43, F53, F55, C83

Keywords: Pakistan, Afghanistan, Trade, Asia, economy

1. Introduction

Afghanistan's exports of goods and services were recorded around USD 500 million whereas the imports rose from USD 3 billion in 2009 to USD 10.6 billion in 2014. The current account balance remained negative and decreased over the years. These statistics, however, do not account for the substantial informal trade between Afghanistan and Iran, and Afghanistan and Pakistan. Trade activity has been on the rise for the most part of the last decade. Pakistan remains the largest trading partner of Afghanistan with a share of 28 per cent followed by the United States, which has a share of 17.8 per cent.³ Afghanistan was the third largest destination for Pakistani exports in 2012-13.⁴

Since 2006 both the trading nations have been managing to keep collective export and import value above USD 1.5 billion. Though Pakistan's growth rate of exports to Afghanistan has slightly decreased since 2011, Afghan exports to Pakistan have steadily been on the rise (Box 1). There is, however, competition for Pakistan as exports from Iran and India have risen. Additionally, differential treatment by Pakistani authorities, longer clearance time at the port, high demurrage charges, and issues related to transit guarantees in Pakistan are some factors which make transit via Iran relatively more attractive.

³ Eurostat, European Commission (2013)

⁴ State Bank of Pakistan Annual Report (2012)

The top products exported from Pakistan to Afghanistan in the last seven years include milk, cream and sugar, animal and vegetable oil, cement, crude oil, wheat and rice, and household furniture. Analysis of a wider list of export items in 2014 reveals the dominance of cement, food, and oil supplies. However items in the export basket are subject to substantial variation due to the fast changing demand in Afghanistan.⁵

Box 1: Export Patterns of Key Partners for Afghanistan



Source: World Development Indicators 2014, State Bank of Pakistan

The Afghanistan Pakistan Transit Trade Agreement (APTTA), signed in 2010, allows Afghan trucks to use the seaports of Karachi, Port Qasim, and Gwadar via the Torkhum and Chaman border points. Replacing the Afghanistan Transit Trade Agreement (ATTA 1965), APTTA allowed the Pakistani traders to export their goods to central Asia via Afghanistan. It was also agreed to constitute a joint

⁵ For example a number of high-end food items were destined as supplies for the ISAF. The value of such items is subject to the number of ISAF personnel on-ground. Another example is Kerosene Type Jet Fuel, which had negligible export demand from Pakistan to Afghanistan in 2013 and this jumped to USD 83 million a year later.

co-ordination committee comprising government officials and private stakeholders from both sides to address the issues related to the transit trade agreement.⁶

The agreement has attracted the attention of other landlocked countries. On the request of Tajikistan to be the part of this arrangement, an expert level group meeting on Trilateral Transit Trade Arrangement among Afghanistan, Pakistan, and Tajikistan was held on 3rd January 2015 in Islamabad. In another meeting of the commerce secretaries from seven Central Asian countries (held on 7th March 2015 in UAE and facilitated by the World Bank), Pakistan has offered similar arrangement to these countries.

A key challenge is whether the imports of Afghanistan from India or elsewhere are making their way into Pakistan through illicit or even legitimate means, posing a threat to the indigenous industries in Pakistan.⁷ It has been reported that Pakistani traders with the help of Afghan traders, import goods under transit trade, ship them to Afghanistan and then smuggle them back into Pakistan. Another factor is that a number of cargo containers that were imported under transit trade go missing and their products end up selling in the Pakistani markets. The incentives to smuggle also arise because of Pakistan's trade restrictions on Indian imports. It is likely that once such restrictions are relaxed, informal imports or smuggling from Afghanistan may also decline.⁸

Independent studies⁹ point out that often the goods imported in Afghanistan are in excess that's why the surplus is sent to Pakistan through illicit trade. Black tea is not commonly used in Afghanistan, as green tea is preferred, yet a large quantity of tea was reported to be imported in Afghanistan for sending back to Pakistan. Similarly a large quantity of electronic goods is also smuggled back to Pakistan.

⁶ Article 34, Section X of APTTA 2010. APTTCA shall be established to monitor, facilitate, and effectively implement APTTA 2010. APTTCA to be co-chaired by Deputy Commerce Minister (Afghanistan) and Secretary Commerce (Pakistan). For further details please see: <http://www.commerce.gov.pk/Downloads/APTTA.pdf>

⁷ Interviews conducted with SAARC CCI.

⁸ Afghanistan has also complained regarding transit goods from Pakistan finding their way into Afghanistan's market. See Ahmed et al. 2015 for details.

⁹ PILDAT (2012) Pak-Afghan Trade. Discussion paper by Pakistan Institute of Legislative Development and Transparency www.pildat.org

Further analysis though shows that there is a substantial decrease in the Afghan commercial as well as non-commercial transit trade via Pakistan. Compared to 2009-10 the commercial transit (as measured by the number of containers) has dropped to half from more than 75,000 to just above 35,000 in 2014. However, according to an anecdotal source, the dollar value of the transit trade has increased over the years. This may have been due to better and increased valuation by Pakistan Customs for the sake of obtaining transit guarantee. Given the uncertainty, surrounding International Security Assistance Force (ISAF) withdrawal from the region, non-commercial transit has decreased to 6000 containers in 2013-14.¹⁰

Recent empirical literature points towards the following additional challenges in the way of expanding trade ties with Afghanistan:

- Higher compliance costs of trade and transit related documentation (PILDAT 2012)
- Weak road and ports related infrastructure to support an increased transit flow (Shabbir and Ahmed 2014)
- Frequent changes in on-ground customs regime specific to Afghanistan (Hussain 2008)

Thriving trade via informal channels reduces incentives for formal trade (Hameed 2012). Estimates of informal trade between Afghanistan and Pakistan vary across anecdotal evidence. This amount is said to be equivalent to or greater than formal trade between both countries.

The latter sections in this paper will discuss the emerging economic scenarios in Afghanistan and the corresponding effects on regional economies and businesses. It will also examine Pakistan's role as a conduit, i.e. opportunities of scaling up efforts for South and Central Asia economic corridors and measures to mitigate these risks. Finally, we make a case to extend the bilateral economic cooperation to cross-border investment in supply chain linkages and trade in services.

2. Methodology

For this paper, we adopted a methodology that directly surveyed the business community about the above-mentioned issues affecting them and the specific reforms they would like to be put in place. Using a mix of desk review, qualitative and quantitative survey, this paper aims to:

- Explore perceptions regarding economic opportunities and major challenges in Afghanistan and their impact on Pakistan and other actors in Central Asia. The term 'actors' here is not limited to

¹⁰ The International Security Assistance Force (ISAF) was a NATO-led security mission, established by the United Nations Security Council for Afghanistan.

states or their institutions. Efforts of multilateral organizations and the private sector in the region were also explored.

- Review estimates from recent studies highlighting expected changes in Afghanistan-Pakistan commercial and transit (commercial and non-commercial) trade flows following ISAF drawdown in Afghanistan
- Review perceptions regarding current arrangements and future possibilities of strengthening bilateral trade arrangements and agreements between Afghanistan and Pakistan

The firm-level survey helped in estimating the firm income models as well as the investment and expenditure functions (of these firms). In order to have a representative sample we have interviewed 260 firms.¹¹ These firms were:

- split across exporters who are also producers (and not traders)
- owners of businesses falling under wholesale trade, retail trade, transport, distribution and warehousing
- Firms acting as clearing agents.

Such a sample distribution allowed observing both: the impact of ISAF drawdown on industries servicing the transit trade, and the impact of perceived political or security related upheavals on formal trade and commercial transit.

We have tried to ensure that the sample is representative of the firms currently trading with Afghanistan and Central Asia. As a starting point we resorted to the directory available with the Pakistan Afghanistan Joint Chamber of Commerce and Industries. This directory was further augmented through information about 2013-14 membership provided by Chambers of Commerce in Karachi and Peshawar. This consolidated list was split into 3 categories namely: a) exporters (manufacturing community), b) trade, transport, distribution & warehousing (TTDW) sector, and c) clearing agents. Next we split each of these lists according to the cities where each category is concentrated. For example, the exporter's list was split across Karachi, Quetta and Peshawar. Given the resource and time already invested to reach each of these cities, we acquired equal responses from the each city. In our opinion, this should not influence our policy conclusions given the objectives of this survey were only to record current and future perceptions. Finally under each category and city, random selection was ensured.

¹¹ Interested readers can request a copy of the questionnaire administered from the research team at SDPI.

Figure 1: Study Methodology

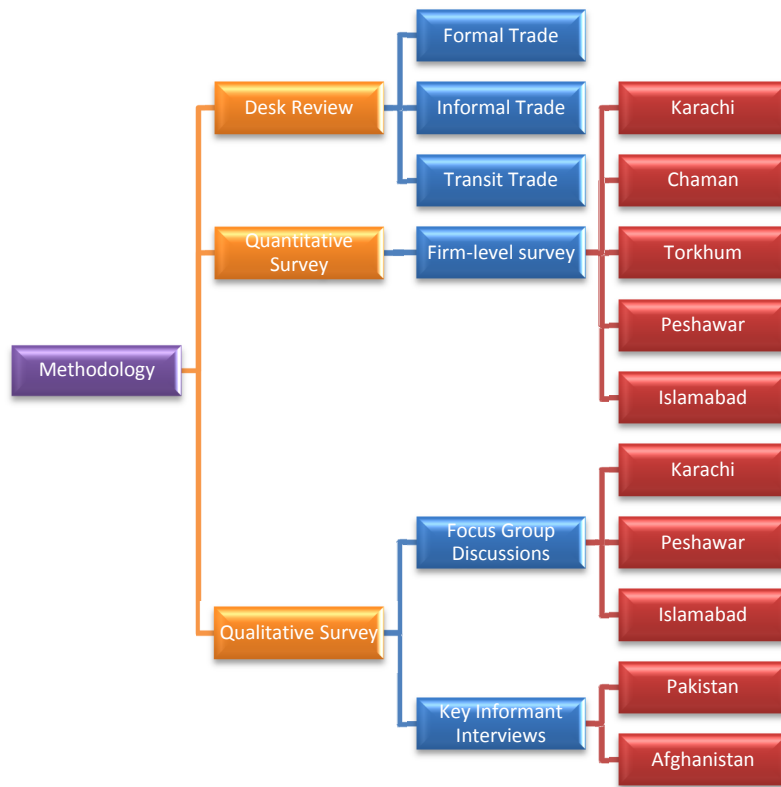


Table 1: Number of Respondents by City and Category

City	Exporters*	TTDW**	Sector	Clearing Agents	Total
Karachi	30	30			60
Chaman		20		20	40
Quetta	30	30			60
Peshawar	30	30			60
Torkhum		20		20	40
Total Sample					260

*These will be producer-exporters, ** TTDW= Trade, Transport, Distribution & Warehousing

3. Survey Results and Findings

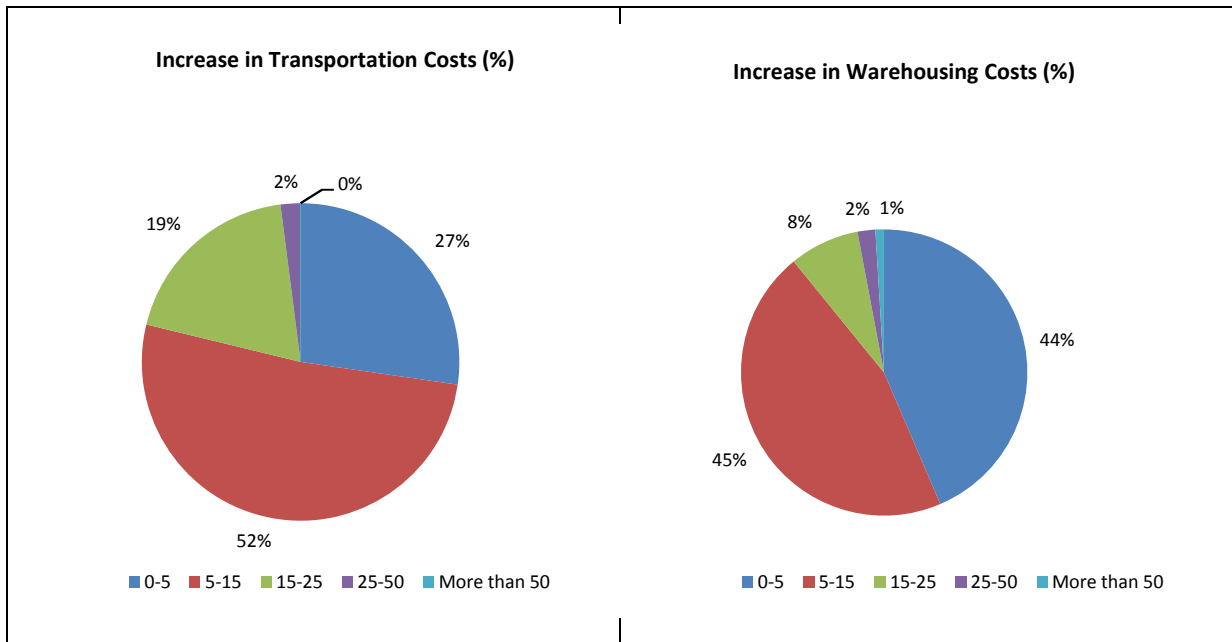
Most respondents said that to realize the USD 5 billion target of bilateral trade between the two economies (as set by the two Ministries of Commerce), the share of manufactured products needs to increase.¹² For this to happen, one needs to start by looking at how Pakistani firms compete in Afghanistan.

- Around 25 per cent of the revenues of firms sampled are from sales abroad. Given the energy crisis faced by the firms in Pakistan, annual turnover and exports have decreased. This is particularly the case for firms in Balochistan and Khyber Pakhtunkhwa provinces. Most respondents reported highly increasing costs of doing business. Some of these costs are discussed below.
- There was a consensus that the cost of electricity is prohibitively high for doing business and efficiency. Both India and Iran (who are competitors for Pakistani products) heavily subsidize their energy sectors. However, Pakistan due to its weak budgetary position cannot match such subsidies. In a more recent reform under the IMF programme, Pakistan is expected to further phase out subsidies and increase both power and gas tariffs. However, subsidies should be phased out gradually as the energy sector is deregulated in order to allow the private sector to enter and create competitive pricing for consumers. This requires investing in long-term energy needs of firms wishing to scale up exports to Afghanistan. Most of these firms are still classified as SMEs and can be helped through export-related rebates on the consumption of energy.
- 52% of firms reported that transportation costs have increased by 5-15% during the past 12 months (Figure 1)¹³ However, for 19% of the firms the increase in these costs was between 15-25%. Similarly in the case of warehousing, 45% firms reported an increase in such costs to the tune of 5-15% and 8% firms saying that these had increased between 15-25%. Most of the latter firms were from the agriculture sector that faces a high risk of loss in perishable merchandise.

¹² Pakistan's exports still largely focus on agriculture and livestock in Afghanistan while there is a growing industrial sector in Afghanistan which is projected to contribute to processed food manufacturing (particularly in the case of fruits and vegetables).

¹³ The survey team was mobilized in June 2014. Therefore past 12 months refer to the period prior to June 2014.

Figure 1: Magnitude of Change in Logistics Costs



Source: SDPI Monitoring & Evaluation (M&E) Unit 2014

- In the past year (2013-14), the cost of inputs has risen more than 20 per cent and the prices of finished products increased as a result.¹⁴ For the same period firms reported a rise in increased wage bills and spending on power and gas.
- 60 per cent of firms have outsourced transportation and warehousing services. The transportation costs of goods had increased due to increase in oil prices in the international market during 2013-14.¹⁵ Businesses' expressed concerns that as international oil prices fall in the coming months, the federal government will not pass on the full effect of the price decline.
- 58% of firms reported that the insurance cost of trade consignments has significantly risen in the past 12 months. In some cases, the insurance cost was almost one-third of the consignment cost, discouraging smaller traders specifically. These increases in trade costs have made it difficult for exporters to compete in Afghanistan with pressures from India and Iran. Most

¹⁴ Firms producing and exporting cement, milk and sugar, rice, animal and vegetable oil, and petroleum extracts were interviewed. Thus, inputs here refer to the raw material used for the different products.

¹⁵ For economy-wide impacts of fuel price shocks in Pakistan, see Ahmed and O' Donoghue (2010).

established insurance enterprises in Pakistan are not providing these services for trading with Afghanistan, and any Afghan trader wishing to import from Pakistan is also expected to arrange their own transport and logistics services. The lack of an EXIM bank that can facilitate trade-related guarantees also exacerbates the problems of traders wishing to export higher value merchandise.

- 30 per cent of the firms reported that they wanted to see an increased supply of skilled labour (for servicing trade, transport and warehousing sectors). However, 95 per cent of firms also reported an increase in their wage bills since December 2013. This rising cost of doing business has forced firms to restructure their human resources and reported lay-offs (i.e. 30% of their skilled employees). 85 per cent of the overall lay-offs comprised clerical and support staff.¹⁶
- A better law and order situation is imperative for the firms to flourish as 50 per cent of the firms indicated that they bear the damage costs. The damage costs include theft of goods, missing containers, damaged containers comprising the quality of products being exported particularly in cases where containers are set on fire. The skilled labour also moves out as law and order deteriorates. Security remains a major concern for businesses, particularly those requiring fixed investments from abroad. Exporters consider the law and order of the region to be the most significant hurdle to smooth and efficient trade. Security in general is a hindrance and the trade routes are not considered secure. The threats are not just to the trucks passing across the border. There is also the issue of theft and pilferage.
- Half of the respondents reported that APTTA has led to an increase in informal trade and smuggling.¹⁷ Pakistani businessmen are of the view that significant portion of goods imported in Pakistan for onward transmission to Afghanistan get lost in Pakistan and never enter Afghanistan, and those that do, sometimes come back into Pakistan. It is felt that it has severely hampered the domestic and international business in Pakistan and prospects for enhanced transit and trade relations. There are no evidence based estimates of either the informal trade or smuggling.

¹⁶ The estimates regarding the unskilled and semi-skilled workers getting unemployed, are weak as many are not registered with the labor market institutions.

¹⁷ Informal trade may not be pure smuggling of goods if it comes under extra-legal trading and tolerated in practice by the State even if illegal by law. Our distinction between informal trade and smuggling follows Taneja and Pohit (2004).

- Trolleys and trucks are at times delayed by two to three days because the clearance system installed at Torkhum is not very much organized and systematic. At the time of this study, the customs automated Weboc facility on the Pakistani side of the borders does not synchronize with the automated facility at the border crossings in Afghanistan.
- Respondents stressed the need for expediting the various promised infrastructure related projects by the Government of Pakistan. They explained that if trade with Afghanistan is to be scaled upwards, the road networks that need to be urgently revamped include the Indus Highway (N-55), Regional Cooperation for Development Highway (N-25) connecting Karachi to Chaman via Lakpass, Lakpaas-Taftan (N-40), Sukkur-Quetta (N-65), and Nowshera – Dir – Chitral (N-45) Highway, Gwadar – Hoshab – Khuzdar – Ratodero Motorway (M-8) and Hasanabdal – Mansehra Expressway. Additionally, if increased trade and transit traffic is to be facilitated across Afghanistan-Pakistan border, then a diversification of transport modes is required particularly in favour of railways. Railways will add to economies of scale for any trading activity in future. The security of cargo is also relatively better in the case of railways.
- Despite the lack of infrastructure, the private sector representatives explained that it takes less than 20 hours for transit from Torkhum border to Tajikistan and then other parts of Central Asia. Pakistan already has a 60 per cent share of the cement used in Tajikistan construction. Pakistan has shown through the signing of APPTA and extension to Tajikistan the seriousness for expanding regional trade. However the progress seen on the eastern border has yet to be seen on the western side. For example, the development on Wagah border with India has been exceptional with five lane crossing points and scanner machines that scan the trucks without opening the containers.
- An example of upgrading infrastructure, particularly for transit trade, is the road from Jamrod to Torkhum, from a single road to a dual carriage road with security. While USAID has attempted to fund and implement this it remains incomplete. Both cash strapped governments may not be able to afford such investments. There is a great scope for the private sector in Pakistan to complete or undertake initiatives such as this.
- Our discussions with Ministry of Commerce and Trade Development Authority of Pakistan revealed that the government has recently approved the plan to operate trains twice a week under the APTTA. One of the abandoned projects of rail links between Chaman and Spin Boldak, which was approved in 2004, is now being reconsidered. After re-evaluating the cost of the project, the proposal is under consideration. This rail link was the first phase of the three phase project that will join Pakistan to central Asia via Spin Boldak – Kandahar – Herat to Turkmenistan. The funding agency is yet to be finalized. Furthermore, on the request of Afghanistan, Pakistan is considering extending technical support and trainings for capacity building of the staff of the newly-established Afghanistan Railway Authority (AFRA).

- The business community also felt that both Pakistan and Afghanistan need to diversify the transport infrastructure, thus including not just road linkages, but rail, seaport infrastructure (from Pakistan) and air.
- Almost 48 per cent of the survey respondents benefitted from APPTA, despite the fact that many of the respondents believed that their businesses were adversely impacted due to the inefficient and opaque practices of customs. Similarly, more than 50 per cent were not satisfied by the examination of goods undertaken by the customs authorities. Only 15 per cent of the firms had been able to file any complaints against APTTA due to the cumbersome grievance redressal mechanisms (entailing high transaction costs). There also appears to be a communication gap between the business community and the relevant authorities, as 80 per cent of the complaints were never addressed by the relevant authorities.

In summary, the following are the key issues raised by firms engaged in commercial trade with Afghanistan:

- Securing en route merchandise and at borders
- Missing border-related trade infrastructure
- Inadequate banking facilities
- Weak Marketing of 'Made in Pakistan' in Afghanistan
- Weak road and rail networks to facilitate any expansion in bilateral trade and transit
- Lack of harmonized customs operations at Torkhum and Chaman

Similarly, following is the summary of issues raised by firms engaged in transit trade:

- Torkhum terminal for passengers and cargo is still awaiting finances to be completed
- Multiple costs borne by Afghan importers, including transport, warehousing, tracker cost, and insurance guarantee cost
- There is a maximum limit of 40 feet containers. The charges are established according to weight; and the average charges from Karachi to Peshawar is PKR 110,000 per container. However, for Afghan transit, these charges are higher by a variance of PKR 10,000-20,000 per container.
- Multiple containers under one importer are processed all together. In the case of a missing container, the entire shipment is blocked. The traders have the option to either file individual declarations for each container, but as this increases the cost, hence single declaration is filed for a consignment which may contain multiple containers.
- Online system (WeBoC) is not yet synchronized with the Afghan system resulting in time delays because of requisite clarifications from exporters or their agents. Respondents were also not satisfied with the examination of goods at various stages of transit. Around 80 per cent revealed that complaints were not addressed by the relevant authorities.

- Pakistan transit goods to central Asia have 110 per cent insurance costs in violation of APTTA 2010.
- Small and medium scale traders have stopped trading after the dollar regime.¹⁸ As formal money exchange companies at border points are missing, Pakistan should not expect to apply the same trading rules to Afghanistan that are present for more advanced economies.
- Exporters reported the need for some compensation in the cases where shipments were lost or stolen.¹⁹
- Pakistan Railways recently announced that it will operate two trains per week from Karachi to Peshawar to facilitate goods under APTTA. However, traders were apprehensive that railways as per the past record may have more uncertain timings than the trucking sector.

3.1. Institutional Analysis

As part of this paper, we also organized focus group discussions and consultations in Islamabad, Karachi and Peshawar to tap into qualitative knowledge available with various stakeholders for promoting the bilateral economic cooperation. We have particularly taken into account (in this subsection) interventions by the government. There was a general consensus that while there is immense potential for trade with Afghanistan, Pakistan currently lacks a coherent diplomatic and economic foreign policy approach.

3.1.1. Increasing use of technology:

For the efficient and smooth flow of trade, border crossing points require modern technology. Pakistan aims to build state-of-the-art border stations at Torkhum, Chaman, Wagah, and Taftan. The Electronic Data Interchange will be developed to provide online real time information of bilateral and transit trade. The issue of registration of Afghan importers is being expedited to resolve issues of partial shipment and undue shipment delays at border crossing points. The issue of multiple tracking devices on Afghan transit freights and requirement of jawaznama by Pakistan is being revisited.

¹⁸ Traders now have to conduct trade in USD.

¹⁹ Currently in the case of loss even because of a terrorist activity there is no relief to the owner of shipment. The bonded carrier also does not pay compensation. Earlier Pakistan Railways use to compensate some fraction of the loss. However FBR had reversed the provision.

The trader community felt that Pakistani authorities can make an effort to harmonize automated customs processing platforms through appropriate ICT tools and providing technical assistance to the Afghan side, ensuring greater compatibility in systems and procedures. Also, the introduction of such technology will assist in curbing informal trade and provide incentives for businesses to use the formal channels for their goods and services. Similarly, at the moment there is little monitoring of consignments arriving through the personal baggage.

3.1.2. Tariff Reforms for Afghanistan and Central Asia:

The customs duties levied on imports from Afghanistan are acting as a constraint on improved trade relations. A reduction in tariffs could also prove beneficial especially given the Indian example, where the Indian Government reduced customs duties and taxes by 50% on Afghan origin goods, leading to an increase in bilateral trade. There is a fast booming plastics, rubber, paper and paper board industry in Afghanistan. However, these sectors face comparatively higher tariffs in Pakistan. The average tariff on plastics and rubber in Pakistan is 17% and 15.8% respectively. The same in the case of India is 9.5 % and 9.1 % respectively.²⁰

3.1.3. Outreach Programme:

The Government of Pakistan has started realizing the difficulties that are faced by the private sector. In the context of bilateral trade with Afghanistan, the current issues that the Ministry of Commerce, Federal Board of Revenue and other relevant institutions in Pakistan are working towards are: Customs cooperation agreement for data exchange, resolving issues related to re-exports, expanding trade facilitation available at the trade gates (Torkhum and Chaman), and build an integrated customs and border management facility. While this is being done an outreach programme by the Ministry of Commerce is important so that the private sector is on-board for these reforms.

3.1.4. Trade in Services:

The regulatory regime for the services sector will also need to be revisited. There is a lot of room for service sector exports in Afghanistan. Pakistan's service sector has proven effective and seen high returns in Pakistan. There is a scope for Pakistani businesses to use their knowledge and experience to invest and work in the service industries in Afghanistan. TDAP may take a lead in linking Pakistani service providers in Afghanistan. Trade in services will also require an agreement on treatment of double taxation. This can be done as part of the PTA process. A

²⁰ Ahmad (2015)

study to quantify the potential of services trade between Afghanistan and Pakistan is also required.

3.1.5. APTTA and Inclusion of Tajikistan:

APTTA perhaps provides the greatest promise of cross border trade and forward trade for both governments. It provides realistic and sustainable steps for increased trade for Pakistan. The stagnation has resulted from the lack of political will in the past to carry it forward – a trend that exporters are expecting to change given the current relations between Pakistan and Afghanistan. The following are the gaps and areas for improvement:

- Pakistan and Afghanistan have different tariff regimes for the same class of products. Both governments, with the help of technical assistance, should consider some harmonization of tariff regimes. SAFTA provides a good framework even for bilateral harmonization. A PTA between both countries could address this point, or at least provide the basis to a solution.
- Pakistan should consider acceding to TIR convention (Convention on International Transport of Goods Under Cover of Transports Internationaux Routiers Carnets, 1975) to simplify guarantee procedures and smoother movement of transit transport across borders.
- In the next round of improvements in APTTA, multiple stakeholders should be invited and their recommendations should be considered. The PAJCCI is of the view that the consultation process was not thorough in the finalisation of APTTA. Similarly, the business community favours transit facility for Tajikistan, however said that they were not consulted fully before inviting Tajikistan for the January 2015 trilateral meeting in Islamabad.

3.1.6. Making Joint Economic Commission (JEC) Effective:

For streamlining the implementation of bilateral economic cooperation reforms, it is important to make the JEC more effective and the following are the key recommendations:

- The JEC should meet on a half yearly basis with pre-determined schedule of meetings
- The JEC should also invite members of Pakistan Business Council, PAJCCI, consumer associations and think tanks in the meetings to discuss outstanding issues faced by civil society stakeholders of both the countries
- The JEC should become the main forum to review status of large-scale projects that impact both the countries, including CASA-1000, TAPI, road and rail networks.

3.2. Uncertain Role of Statutory Regulatory Orders (SROs)

Another area of concern highlighted by the respondents were the opaque and cost prohibitive SROs issued by the Federal Board of Revenue (FBR) which are hurting bilateral trade with Afghanistan. The government of Pakistan is now deciding to enter into a preferential trade agreement (PTA) with

Afghanistan. A draft PTA has already been shared with the Afghan counterparts. This paper while encouraging such steps recommends conducting a detailed analysis of those SROs which are impeding bilateral trade and hurting government's revenues. From key interviews and survey respondents, a number of examples are highlighted below.

For example, wheat is a staple commodity in Afghanistan and important for its food security. The government in Pakistan under SRO 1185(I)/2007 imposed 35% ad valorem regulatory duty on the export of wheat products. This not only reduced the wheat exports to Afghanistan in value terms (and thereby a disadvantage to Pakistani farmer) but also raised the price of the commodity for Afghan consumers. Even in times of a bumper crop, the government of Pakistan remains reluctant to relax this duty. Recently, when the Afghan government wanted to import wheat from India due to a lower price vis-à-vis Pakistan, the latter did not allow transit of Indian wheat in to Afghanistan. This is not only the case with wheat but also several other agricultural items. Another example with high demand in Afghanistan is pulses. The SRO 492(I) 2006 imposes a 35% ad valorem regulatory duty on the export of pulses. Afghanistan has at times demanded removal of such duties citing food security reasons in the country.

Afghanistan also has a fast emerging industrial sector with a boom in the production of several fast moving consumer goods (FMCGs). However Afghan importers face high duties on the imports of key raw materials used in their production process. An example was given where SRO594(I)/2009 imposes 25% ad valorem regulatory duty on the export of lead, scrap and waste. Similarly in the case of the textile sector (another fast growing sector in Afghanistan) SRO 323(I)/2010 imposes 15% ad valorem regulatory duty on all types of yarn.

Pakistani exporters reported that there are also some SROs acting as a barrier for new Pakistani exporters to Afghanistan. Under SRO 888(I)/2009 the 'Export Oriented Units & SMEs Enterprise Rules 2008' SMEs are allowed export-related incentives in sales tax and federal excise duty. However 80% of firm's production for other countries has to be certified by the Engineering Development Board (EDB) for the last three years. Respondents believe that such a condition can only be met by large and already established exporters. Mostly SMEs in Pakistan do not have export capacity, however in the case of Afghanistan, several SMEs in Pakistan have prospects due to proximity economies. Such firms cannot however arrange for the EDB certification as they are merely starting to export.

It was also reported that Pakistani exporters had received orders from Afghanistan for winter supplies, which could not go through due to the unfavourable SROs. The SRO1080 (I)/2005 issued after the earthquake in Pakistan (October 2005) requires that exports of blankets, tents, and tarpaulins will require approval of Federal and Provincial Disaster Management Authorities. It has

been over nine years since the earthquake and these SROs are still in place and acting as a barrier to seasonal exports to Afghanistan (e.g. in winter season).

The nascent leather industry in Afghanistan has exhibited large growth in several sub-sectors. The SRO 1011(I) 2005 imposes a 20% ad valorem regulatory duty on export of raw and wet-blue hides. Owing to the energy shortages in Pakistan, the domestic leather value added sector has not been able to benefit from the increased inventory of such hides. However making the exports expensive through regulatory duty has also deprived the exporters of hides from catering to the foreign demand.

Importers in Pakistan also reported a lack of knowledge with the customs authorities regarding SRO provisions under SAARC and ECO. For example, the SRO 558(1)/2004 allows vegetables and fruits to be exempt from customs duties. However, Pakistani officials lacked the knowledge of specific vegetables under SAARC and Afghanistan's status in SAARC. This sometimes leads to unnecessary delays at the border checkpoint and can result in decaying of perishable items. Similarly, 'Olive oil' is exempt from customs duty for ECO countries but not for Afghanistan. The reason provided was that Afghanistan now comes under SAARC provisions. This will then have to be allowed to other SAARC member countries as well. Importers recommend that such anomalies under the SROs should be carefully checked and Pakistani consumers and exporters should not have to pay the price of such inconsistencies in customs rules.

There is also a dedicated SRO related to firms engaged in tracking and monitoring of cargo. Respondents informed that willing bidders at the time of application are not asked for specific type GSM/GPRS technology to be used. The FBR also has no mechanism for random physical audit whether such technology has been upgraded. Some older specifications are also allowed which becomes a key reason of pilferages. This SRO also requires an annual turnover of PKR 350 million to complete registration with FBR. This is a barrier to entry for new and smaller firms who have better technological solutions. The Ministry of Commerce is now keen to scale up railways operations for catering to transit demand. However under this SRO there is no room for private rail carriers.

Finally, we discuss some SROs which delay the arbitration process in trading with Afghanistan. Under the SRO 888(I)/2004 FBR has a comprehensive list of business persons in the Alternative Dispute Resolution (ADR) committee. But most of these business persons were not found to have current experience of Afghan trade.

The SRO 487(I)/2003 notes the 'Takeover of Imported Goods Rules 2003' which is heavily misused in the case of Afghanistan. The discretion of border authorities is absolute and needs to be matched with exporter's safeguards. Respondents even informed of physical abuse to their clearing agent or representative during the time their merchandise was being inspected. The authorities have little

monitoring on consignments arriving through the personal baggage. It was reported that 55,000 people daily pass through the land route at Torkhum (three-quarters without a visa). However those in formal sector trade are being penalized in the form of visa and merchandise delays.

3.3. Preferential Treatment for Afghanistan

The data on the top five imports of Pakistan from Afghanistan include vegetables, fruits, raw cotton, carpets, rugs, hides, and skins. If the government of Pakistan has to embark on a PTA with Afghanistan, a key question will be how Pakistan can leverage the PTA for greater access to other markets and deepening the basket of goods that Pakistan utilizes through this PTA. Through the survey administered, data collected and key interviews with stakeholders, a number of issues have been highlighted below:

- A starting point for Pakistan could be to invest in increasing production capacity of these sectors in Afghanistan. For this, the Board of Investment will have to allow 'automatic route' investment on both sides and SBP will need to relax rules for transfer of foreign exchange. The Afghan government will need to reciprocate (an issue which Ministry of Foreign Affairs can take up with their counterparts).²¹
- The State Bank of Pakistan will need to ease capital repatriation rules for dollar-denominated profits and also improve L/C's processing and rules. There is a reported delay of several months in L/Cs processing if trading via Chaman. These L/Cs carry financial limits and therefore need to be broken into smaller denominations. The businessmen resort to Hawala system and there are no banks near Chaman. Formal sector traders are required to travel back to a main city for banking transactions.
- Afghanistan and Pakistan should incorporate provisions for supply chains under the PTA. This will also require removal of double taxation in services trade between both countries.
- Afghanistan already has LDC status which can be utilized by Pakistani investors willing to enter into value chain arrangements. This will allow Pakistani manufacturers in Afghanistan duty free access to more advanced economies with the added advantage of repatriation of profits back to Pakistan.

To date, there is no study that quantifies potential investment from Pakistan to Afghanistan or the preparedness of Pakistani investors (e.g. in the mining sector) for investing in Afghanistan. Several countries in the region have already started ensuring the presence of their investments in

²¹ This recommendation also applies in the case of other countries with whom Pakistan wishes to pursue investment cooperation. See Ahmed et al. 2015b.

Afghanistan. China has invested USD 3 billion to develop five million ton copper deposit near Kabul. Several EU countries have expressed interests in tapping other natural resources. They are also willing to assist Afghanistan in consumer industries. For example, the plastics industry is getting established gradually within Afghanistan resulting in decline of plastics exports from Pakistan.

Pakistan's private sector still finds it difficult to carry out projects inside Afghanistan. This will require an amendment in foreign currency rules (by SBP) and provision of 'automatic-route' investments by Board of Investment in Pakistan.

SBP's information portal on Pakistan's bank branches currently informs us that Bank Al Falah has two branches one in Kabul and Herat each. Habib Bank has one branch in Kabul and National Bank has a branch in Kabul and Jalalabad each. Though, the research team was trying to access these branches, only Bank Alfalah was found fully operational while the rest of the bank branches could not be accessed or did not have a full portfolio of services. They also maintain a weak presence on web sources.

The above-mentioned measures for value chain linkages will remain critical if Pakistan wishes to increase its potential for trade-led investments in Afghanistan. Furthermore, these measures will have important and favourable implications for improving trade in services with Afghanistan.

4. Conclusion

This paper discusses various issues that require negotiation between Afghan and Pakistani trade officials including: customs clearance process; insurance of transport vehicles, safety of containers and consignments; tracking and monitoring of consignments; role of SROs hurting bilateral trade; credit facility for traders; currency swaps; sluggish progress on port, road and rail projects; high costs of air cargo; and lack of banking channels. In order to strengthen the Afghanistan-Pakistan economic cooperation, this concluding section points towards increased efforts required to strengthen the institutional framework of trade diplomacy.

- Pakistan has to have a very cogent Afghan policy and this policy must have inputs from its economic, foreign and security advisors. The recent increased and more cordial dialogue between the two countries provides hope for collaboration in the future. Once a cohesive policy is put in place, Pakistan must follow it accordingly. Of course, the cornerstone of this policy should be to improve relations with Afghanistan and to support them in their development and progress.
- The Ministry of Finance in both the countries, the Planning Commission, and multilateral institutions should develop a 'first loss' equity fund, particularly for medium sized entrepreneurs. A good example of such a fund which can provide the basis of this arrangement

can be extracted from OPICs (Overseas Private Investment Corporation) example. Similarly, for addressing the issue of lack of insurance facilities while trading with Afghanistan, a proposal to expedite the creation of an EXIM bank should be considered.

- Expediting work on ongoing road and railways projects linking the various cities across the Afghanistan-Pakistan border
- The civil society and think tanks working on Afghanistan-Pakistan trade cooperation should be strengthened by the governments and development partners. They should independently hold annual Afghanistan-Pakistan trade summits which also benefit from the presence of investors and business community of both sides. As Pakistan is hosting the 2015 Heart of Asia meeting, it is recommended that civil society think tanks should facilitate in holding first annual summit before the Heart of Asia meeting. Supporting Afghan think tanks will also help in building a constituency for Pakistan's view point in Kabul.
- Independent think tanks should be supported to host an annual Afghanistan-Pakistan Economic Summit which not only bring together the government and business community in a track-II setting, but also help strengthen a community, which can undertake long-term work on bilateral cooperation.

Both Afghanistan and Pakistan will require technical and financial assistance in expediting reforms towards bilateral economic cooperation. Following is a list of initiatives required on urgent basis.

- The Ministry of Commerce in Pakistan should institutionalize a dedicated Afghanistan desk with research, monitoring and evaluation capabilities. This unit will:
 - a) coordinate the implementation of decisions undertaken at various government forums
 - b) undertake specific research tasks related to Afghanistan-Pakistan bilateral trade and investment cooperation.
- Pakistan's Ministry of Commerce, in collaboration with the customs officials, needs to update current assessments on the missing facilities curtailing cross border transit and commercial trade.
- Support will also be required for undertaking tariff and tariff-harmonization reforms.
- The current project tracking mechanisms within the federal government are weak and stronger support may be required for monitoring the progress of ports, road and rail infrastructure promised in the context of Afghanistan-Pakistan bilateral cooperation.
- FBR may be supported to undertake a study on the identification of specific regulatory, tariff and non-tariff measures, which may be reformed in order to formalize the currently growing informal and illegal trade.
- The planned trans-boundary cooperation projects in the Central Asian region should go beyond the currently ongoing work on CASA-1000, TAPI and some road sector projects. A high-powered

working group comprising experts from Afghanistan, Pakistan and select Central Asian countries should be facilitated so that an inventory of projects can be planned. Such projects will strengthen economic and political interdependencies in the region.

The elected public representatives from Afghanistan and Pakistan need to fundamentally agree on the steps to resolve the trust deficit. The trust deficit is actually not that wide – especially if benefits are emphasized. The Pakhtun areas of Afghanistan have very good ties with the Pakhtun areas of Pakistan whether in Balochistan or Khyber Pakhtunkhwa (Hussain 2000). Another benefit that Pakistanis have at the Chaman border is that the people there are also well versed in Dari language. Trade should leverage these linkages while addressing the trust deficit as well. At the moment while India is perceived to be both a better and efficient partner in Afghanistan, there is a much scope and potential for trade and business linkages between Afghanistan and Pakistan.

Pakistan has shown its willingness to address the security threats. In June of 2014, Pakistan started a major army operation in North Waziristan. Increasing trade to a very large extent is dependent on the success of this operation and the future stability of the security situation. Furthermore, capacity building for the police and other non-military law enforcers is vital. This however is a long-term process and to the extent possible lies beyond the gamut of this paper. Of course, as the security situation improves, the Pakistani private sector, along with the aid organizations and government authorities will be able to undertake their duties more freely and effectively especially to increase economic activity in conflict zones.²²

Finally, for creating investment and services trade linkages between both countries, Afghanistan will require support in strengthening the regulatory institutions, particularly those related to competition policy, oil and gas, and mining regulatory authorities. Pakistan's recent experience and the evolution of Competition Commission of Pakistan have been cited in recent literature as a regulatory success. Pakistan should offer formal support in building such institutions for Afghanistan with possible financial support from development partners.

This paper has also pointed towards some research gaps which may be addressed in future studies:

- A research study is required to look into the enhanced security measures for merchandise trade along Afghanistan-Pakistan border. UNODC in Pakistan already has a baseline analysis on this subject which may be updated in the context of cross-border trade and investment activities.
- To date, there is no study that quantifies potential investment from Pakistan to Afghanistan or the preparedness of Pakistani investors (e.g. in the mining sector) for investing in Afghanistan.

²² See Khan and Ahmed 2014 for role of private sector in conflict zones.

This is despite the realization in Pakistan that the business community would benefit from Afghanistan's LDC status for leveraging export revenues. A value chain analysis of Pakistani SMEs currently trading with Afghanistan is also missing.

- There are no evidence based estimates of either the informal trade or smuggling.
- While Pakistan has undertaken tariff harmonization exercise with respect to South Asian countries, there is a need to undertake a similar exercise with Central Asian Commerce Ministries. The increased trade diplomacy with Tajikistan and Kyrgyz Republic will also prompt a similar requirement.
- The documented Grievance Redressal Mechanism in Afghanistan-Pakistan Trade and Transit is rarely practiced. It is important to analyze the current challenges before PTA is signed and transit facility is extended to Tajikistan.
- The Commerce Ministries of Pakistan and Tajikistan have agreed to conceptualize in the coming days the Peshawar – Dushanbe Economic Corridor project. It is important at this stage to quantify potential gains from this corridor in trade, cross-border investments and infrastructure cooperation (e.g. in energy and petroleum products).
- As a result of decline in NATO transit trade, the corresponding estimates regarding unskilled and semi-skilled workers facing unemployment or underemployment are weak as many are not registered with the labour market institutions. It is important that the Government of Khyber Pakhtunkhwa along with the federal government put in place alternate livelihood schemes to preserve peace, increase the overall economic wellbeing, as well as improve the quality of life.
- A study to quantify the potential of services trade between Afghanistan and Pakistan is also required. Such a study should highlight regulatory issues such as the desired agreement to resolve double taxation.

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