Going to Market: Trade and Traders in Six Afghan Sectors

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About the Afghanistan Research and Evaluation Unit (AREU)

The Afghanistan Research and Evaluation Unit (AREU) is an independent research organisation that conducts and facilitates action-oriented research and learning that informs and influences policy and practice. AREU also actively promotes a culture of research and learning by strengthening analytical capacity in Afghanistan and by creating opportunities for analysis and debate. Fundamental to AREU’s vision is that its work should improve Afghan lives. AREU was established by the assistance community working in Afghanistan and has a board of directors with representation from donors, UN and multilateral organisations and non-governmental organisations (NGOs).

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Glossary

bhatas  furnaces for baking bricks
gazoli  slang term used for “petrol people”
karez   drainage channel
Kuchi   nomadic people
lagharian or term used for smugglers, meaning “unregulated commission agents”
karaya dar
qaraqol  lamb skin used for many traditional wool products

Acronyms

AISA Afghanistan Investment Support Agency
ANSA Afghanistan National Standardisation Authority
API Avicenna Pharmaceutical Institute
AREU Afghanistan Research and Evaluation Unit
ATTA Afghan Transit Trade Agreement
DGPP Department for General Petroleum Products
ECO Economic Cooperation Organisation
ECOTA Economic Cooperation Organisation Trade Agreement
GDP gross domestic product
IANDS Interim Afghanistan National Development Strategy
IMF International Monetary Fund
MoC Ministry of Commerce
MoPH Ministry of Public Health
MSH Management Sciences for Health
NGO non-governmental organisation
SAARC South Asian Association for Regional Cooperation
SOE state-owned enterprise
UAE United Arab Emirates
UNDP United Nations Development Programme
UNODC United Nations Office on Drugs and Crime
WHO World Health Organisation
WTO World Trade Organisation
Executive Summary

The legacy of more than two decades of conflict in Afghanistan has had a destructive impact upon economic institutions, businesses and the infrastructure on which the private sector relies. However, there is a persisting misconception that the conflict and Taliban period left the Afghan economy as a “blank slate”. The conflict years did not damage all business interests; instead, they created opportunities for production of and trade in some commodities, as they closed opportunities for others. Afghanistan’s shifting geopolitical relations with its neighbours in the region have also affected trading relationships and import/export routes for commodities.

In 2004 and 2005, the Afghanistan Research and Evaluation Unit undertook a series of focused studies of commodity chains in six key sectors to gain an insight into the experience of Afghan businesses. Specifically, the studies investigated trade routes for the commodities, the number and types of market players, choice of products and the role of the state in setting regulations and standards. Examined as a whole, the studies concluded that:

• Great hopes are invested in Afghanistan’s potential as a hub of regional trade. Regional trade integration amongst Afghanistan’s neighbours has been modest to date and although Afghanistan itself has a liberal trade regime, trade is far from free in the wider Central Asian region. Delays and heavy bureaucracy at border ports is common. There is a strong case for concentrating on “win–win” measures where there is potential for medium term success, such as with the creation and extension of cross-border zones.

• There are a large number of players involved in Afghan markets, yet many of these are making negligible margins and are trapped at a micro-level of activity. Other marginalised players include producers who have limited access to markets and are trapped in disadvantageous trade relationships. Meanwhile, many markets are dominated by a very few large players at the top, with consequent instances of anti-competitive behaviour. All investors in Afghanistan face a host of obstacles to doing business, from insecurity of land tenure to the absence of a developed formal banking system.

• There is generally a lot of choice on the Afghan market. Many products are very cheap, if of questionable quality, though some, including the key commodity, petroleum fuel, are not outstandingly cheap by regional standards. The relatively high real exchange rate of the Afghani has contributed to higher costs of labour an other inputs and has affected the competitiveness of Afghan producers. Prices are not freely or competitively set and there is evidence of price fixing by traders and apparently also by municipalities.

• Government has an important role in encouraging domestic producers and exporters, in gathering revenue from industry and trade, issuing licences, monitoring business practices and ensuring that imported products meet basic standards. In practice, government regulation of markets is bureaucratic, confused, contains many inappropriate and overlapping functions shared by different ministries and hence is often used as a means of rent-seeking by officials. Where regulation is really
needed, such as in the sphere of basic standards and gathering public revenue, there is no capacity to enforce rules and regulations even when they exist. There is a need for ministries clearly to define and to streamline their regulatory role in relation to private sector activities in their areas of responsibility.

The expectations placed on the private sector in Afghanistan are high. The private sector is expected to help fill the gap left by the opium sector by delivering sustained high levels of growth in an extremely difficult investment environment, and, moreover, this growth should be “pro-poor” in nature. There are fears that Afghanistan may not achieve the hoped-for sustained growth rates of 7–9 percent per year of licit GDP as the immediate recovery period passes and the high real exchange rate, the decline of the multiplier effect of the opium economy, and lack of economic diversification take effect. There is a real need for further investigation of these growth expectations, to assess whether they are realistic.

High levels of GDP growth in the medium and long term will be vital to Afghan reconstruction and development. However, some aspects of economic policy relating to growth need to be clarified. Since “pro-poor growth” is such an important aspect of Afghan development as envisaged by government and its development partners, the meaning of this phrase should be more clearly defined and agreed by policymakers, and its policy implications operationalised in a systematic manner. There may be a case for research into growth strategies and poverty reduction in Afghanistan, incorporating the wider Asian experience of growth and its impact on poverty.
1. Introduction

This paper is based on six case studies published by the Afghanistan Research and Evaluation Unit (AREU) in 2004 and 2005, each focusing on the market for a specific commodity. These studies sought to investigate the real structures of markets in Afghanistan. Researchers attempted to gain an insight into the experiences of Afghan businessmen: how numerous the players were, where the greatest margins were made, what connections there were between market players and what, if any, barriers were faced by new entrants. For detailed information on any of the markets considered here, the case studies should be read individually. The purpose of this paper is to draw out the main themes and policy implications of the case studies as a whole. Together, the six studies provide interesting insights into markets across some key sectors of the Afghan economy, from agricultural ( raisin) and craft ( carpet) producers to the import markets for important commodities such as fuel, pharmaceuticals and vehicles, and the market for construction materials, which contains a mixture of domestically produced products such as bricks and imported materials.

1.1 Markets as social arrangements

Markets are social arrangements allowing private buyers and sellers to make voluntary and informed exchanges of goods. While markets operate in a variety of spaces (including virtual), the Afghan markets in this study fit the more traditional, physical realm where traders meet to make face-to-face transactions. Most markets require the existence of currency or another form of money, but barter continues to be a common form of exchange in Afghan transactions.

According to economic theory, markets rely on adjustments in price to influence individual decisions which ultimately bring supply and demand into balance. For example, if demand exceeds supply for a commodity, the price rises, signaling the commodity’s scarcity, making it more expensive to buy (reducing the number of buyers) and more profitable to sell (encouraging additional sellers). If supply of a commodity exceeds demand, the price of the commodity drops, similarly making the choices of buyers and sellers more compatible; i.e., increasing the number of buyers and discouraging sellers. According to theory, these price signals lead to efficiency. This perceived “natural” efficiency of the market is a fundamental tenet of economist-philosopher Adam Smith’s observation that, given certain conditions, the market functions as an “invisible hand” that guides countless apparently uncoordinated individuals to the optimum achievable social result. The implication of this argument is that markets should be allowed to function freely and without state intervention, except in special cases of so-called “public goods” (i.e., national security or law and order) which the market is unable to provide, or in cases where conditions don’t allow markets to function and where they are therefore considered to have “failed”.

Adam Smith also noted, however, that individuals have a tendency to band together in order to manipulate market outcomes, and that this tendency had to be carefully watched.

Even for confirmed believers in the magic of the market, perfect functioning of markets requires certain conditions. These include access to complete information, perfect competition and complete and consistent reach of markets. In reality, markets are often imperfect. This can happen when traders and buyers lack complete knowledge of the market and of possible alternative sources or customers; when competition is skewed by a seller or a group of sellers with a monopoly or an oligopoly or a buyer with a monopsony; or when a market does not have complete reach, so that a functioning market for bread today might not exist when winter comes, or in a neighbouring province.

The conditions in which markets function in Afghanistan are unique, often not uniform across the whole country, and in many cases not conducive to achieving “natural” efficiency.

The Afghan Constitution enshrines the free market, with minimal intervention by the state, and the development of the private sector as the main provider of goods and services as the basis of economic development and reconstruction. But Afghan economic policy has long been influenced by non-market, state interventionist policies, as this paper illustrates.

1.2 History of Afghan markets

Afghan markets bear the hallmarks of Afghanistan’s modern history. Years of conflict have had a destructive impact on economic institutions, businesses and the infrastructure.
on which the private sector relies. However, it is a common misconception that the conflict and Taliban period left the economy as a “blank slate”. The conflict did not damage all business interests; instead it created opportunities for production of and trade in some commodities, as it closed opportunities for others. Afghanistan’s shifting geopolitical relations with its neighbours in the region have also affected trading relationships and import/export routes for commodities.

For example, the contrast between the world standing of the Afghan raisin market in the pre-conflict period and its current condition shows the destructive effects of war and drought on Afghan agricultural production and exports. Raisins are economically the largest part of the Afghan horticultural crop. During the 1960s and 70s, Afghanistan had strong exports of raisins, but this market is now dominated by exporters such as Turkey and the US. Official statistics on raisin exports over the past ten years suggest a strong link with political events, with a robust recovery from low levels of raisin production in 1997/98, accompanying the Taliban consolidation of control over the country and a dramatic fall in production in 2001/02, followed by an equally dramatic recovery in 2002/03. Drought also had a serious impact on crops such as grapes. Over the recent years of drought, many grape growers in the Kandahar and Zabul areas drilled wells for the first time, lowering the water level and causing the drying of very old drainage channels (karezes). This resulted in the total loss of many old vineyards, although some have been brought back since the end of the drought.

Political events have had a similarly strong impact on the carpet market. Carpet production fell in the immediate aftermath of the Soviet invasion and resulting war, but began to rise due to the road container service established by the Soviets to London and European destinations. The container service also resulted in a shift of production from the north of the country to Kabul. However, increasing migration to Pakistan resulted in a much larger shift of production to Peshawar, Pakistan and elsewhere. The chaos that emerged after the Soviet withdrawal, combined with price inflation, insecurity and the collapse of infrastructure, led to a progressive isolation of the north from the carpet markets and an increasing control of the carpet market by Peshawar. Yet families in the north of Afghanistan continued to produce carpets, often as coping strategies during times of drought and hardship. In addition, since 2001, many carpet producers have returned from Pakistan and established businesses in Afghanistan. Nonetheless, Pakistan’s role in producing and trading Afghan carpets, acquired during the conflict period in Afghanistan, remains today, as reflected in statistics for carpet production, which show Pakistan as the fifth largest carpet exporter after Iran, India, China and Nepal. The conflict also broke the important linkage between sheep herding and hand-spun wool as a high quality raw material for carpet production; imported wool now dominates Afghan carpet production.

While the years of conflict and subsequent isolation of the Taliban period closed certain commercial opportunities, they created others. Thus, according to most respondents, the second-hand vehicle market was at its most vibrant during the Taliban period. Many importers in the used vehicle market were from trading families with a long history of trading in different commodities along different trading routes according to the opportunities and constraints of geopolitics, such as the opening and closing of borders. Traditional routes for importing used cars, such as the northern routes for import of vehicles manufactured in the former Soviet Union, and the overland route made popular in the 1970s from Europe (often Germany) via Turkey and Iran, were overtaken in recent years by a newer route for importing Japanese vehicles via large second-hand car markets in Dubai, by ship to Bandar-e-Abbas on the Iranian gulf coast and then overland to Islam Qala. This route was part of the flourishing
re-export trade between Dubai and Iran that began in the 1990s. The Taliban period appears to have been a particularly good time for the vehicle business, during which there was a vibrant transit trade in right-hand drive vehicles transported through Afghanistan for re-export to Pakistan. The ban on import and registration of right-hand drive vehicles to Afghanistan in the summer of 2004 appears to have all but killed off this trade, although the trade in spare parts destined for Pakistan is still flourishing.

There is no more obvious example of the impact of recent political events on the economy than the conspicuous boom experienced in construction since the beginning of the post-Taliban reconstruction. Nearly 50 percent of new investments approved by the Afghanistan Investment Support Agency (AISA), the body that registers new businesses, is in the construction sector. This boom has included residential, smaller and larger retail buildings and hotels, but the market is dominated by large donor-funded and military contracts that are arguably distorting competition in the construction sector. The boom in the construction sector has been reflected in the official statistics for imports of materials such as cement but also suggests that the sector was growing during Taliban times, showing a strong growth curve starting in 1999, and becoming steeper from 2001. Parts of the construction materials market have been closely tied to large scale smuggling, which provided and continues to provide an income for local commanders and other figures and was part of the trade which accompanied and supported conflict.

1.3 Formal and informal markets

The Afghan economy is overwhelmingly informal, unrecorded and untaxed by the state. Not only does this undermine the state-building and the reconstruction process by affecting government revenues, it also leads to unreliable and incomplete statistical information, making it harder to understand what is really happening in the economy. The World Bank has defined a range of informal economic activities in Afghanistan, with varying potential for formalisation, as summarised in Table 1.

Table 1: Range of informal activities as defined by the World Bank\(^5\)

<table>
<thead>
<tr>
<th>“In kind” activities</th>
<th>More or less legal. Examples: subsistence agricultural output; sharecropping; services such as blacksmith, carpenter, thresher; non-monetized exchange of goods and services between households.</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Extra-legal” activities</td>
<td>Output and production with potential for formalisation. Small scale transactions often involving casual labour. Examples: money exchange dealers; small shops and traders; small manufacturing; agricultural production; construction; registered NGOs that are actually for-profit entities; economic activities of Kuchi.</td>
</tr>
<tr>
<td>“Irregular” activities</td>
<td>Further away from legality. Production and transactions that break aspects of Afghan law. Examples: trade in illegally exploited resources, such as illegally harvested timber or illegally mined emeralds; illegal use of gravels and construction materials; smuggling; re-export of Pakistani imports back into Pakistan.</td>
</tr>
<tr>
<td>“Illegal” activities</td>
<td>Output that is outright illegal. Examples: opium; bribe taking by officials; human trafficking; prostitution; forced labour; excavation and theft of archaeological artefacts; arms trafficking; land seizures. Activities encompass “war economy” (financing war and insurgency) and “black economy” (run for profit).</td>
</tr>
</tbody>
</table>

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The case studies considered here did not attempt to place these markets within the range of the World Bank typology, nor determine whether the markets studied were “formal” versus “informal”. Rather, this research sought to obtain an understanding of how markets were functioning on the ground. The markets considered here were all technically licit markets, dealing in commodities that are fully legal. However, both formal (registered and tax-paying) and non-formal (unregistered and non-tax-paying) players were involved in these market chains. So, for example, most large scale importers of petroleum fuels from Central Asia or Pakistan were registered and paid taxes, but the smaller vendors of petroleum fuels were overwhelmingly non-formal. It is likely that the same players are often involved in both formal and non-formal transactions, so a trader who is registered and nominally pays customs taxes may still take advantage of opportunities to under-report transactions or under-pay taxes. Non-formal activities in the markets addressed here crossed the spectrum of informality as defined by the World Bank and have variable potential for eventual enticement into the formal economy. Thus, the trafficking of spare parts from Iran, across Afghanistan and into Pakistan, is profitable largely because of non-payment of Pakistani customs taxes and may therefore have limited potential to become formal. Similarly, the theft of aviation fuel from official consignments by under-reporting of volumes or other methods is outright illegal and cannot be formalised. However, importers of pharmaceuticals into Afghanistan would be more likely to follow customs procedures were delays at customs to be reduced.

The largest economic activity by far in the World Bank’s illegal category is the opium trade. The studies considered here did not directly address the opium economy in Afghanistan. However, it is impossible to ignore a sector which according to United Nations Office on Drugs and Crime (UNODC) accounted for 47 percent of licit GDP in 2004-5.6 Researchers did not ask questions about opium, and links between opium markets and licit markets were identified only in a few cases, when information was volunteered by respondents. For example, there was some suggestion that the vehicle market in Afghanistan is also used as a means of laundering incomes from illegal sources, including the opium trade. The purchase of electronic appliances, spare parts or vehicles, which can be procured with little or no scrutiny from official bodies, represents a potential means of moving significant amounts of money and disguising its origin. These commodities have the benefit of being easily movable and can also be quickly resold and the resulting profits declared as a legal transaction. A group of motorcycle traders told researchers that opium money-laundering had distorted the market and had made business less profitable for legitimate traders, as those laundering money through motorbikes could undercut the market price for these vehicles. More recent AREU research on opium trading systems in Helmand and Ghor has suggested that some opium dealers are also dealers in motorbikes and imported cars.7

The most important link between markets in licit commodities and the opium sector is that the growth generated by the latter sector clearly feeds in to growth in the former, notably in construction and transport. Thus, it is difficult to say how much licit production and trade can compensate for the contraction that will be caused by the eradication of the opium sector, when this trade will also be affected by the contraction. As well as providing incomes for a large number of participants in the farm and trading sector, opium is a large stimulus to other economic

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activities and has linkages to the non-opium economy in the sphere of consumption, stimulation of domestic production, investment, balance of payments and the value of assets such as real estate.  

1.4 Private sector development

The development of the private sector is central to the Afghan government’s policy and its vision of the future of Afghanistan. There are some real gaps in Afghan economic policy in relation to private sector development between what is hoped for and the reality on the ground. The private sector is seen as the engine of economic growth, upon which sustainable reconstruction will ultimately depend. Moreover, the private sector is expected to deliver growth that is broad-based and “pro-poor” in nature. The full meaning and policy implications of promoting “pro-poor” growth are rarely detailed, but this is clearly an important dimension of Afghan economic policy if the country is to achieve its poverty reduction goals.

Although post-conflict growth rates have been high, licit economic growth has declined from 28.6 percent in 1381 (2002/03) to 15.7 percent in 1382 (2003/04) and 7.5 percent in 1383 (2004/05). Real growth is forecast at 13.6 percent for 1384 (2005/06). The Interim Afghanistan National Development Strategy (IANDS) in February 2006 expressed government concerns that “growth rates may slump with the exhaustion of the immediate recovery period, the corrosive effect of the high real exchange rate, the decline of the multiplier effect of the opium economy, and lack of economic diversification”. Nonetheless, the Afghan government and its international partners remain committed to high levels of GDP growth, at 7-9 percent of licit GDP per year in the medium term to achieve stability and compensate for the contraction that will be caused by the elimination of the narcotics sector. The consequences of not meeting these targets are rarely elaborated.

Finally, Afghanistan has committed to a diversified economy and promotion of labour intensive, export-oriented manufacturing. Again, the reality is much more problematic. Imports far outstrip exports in Afghanistan, which posted a huge trade deficit of US$2.69bn or 45 percent of GDP in 1383 (2004/05). Domestic producers struggle to navigate the difficult investment climate in Afghanistan and to compete with the cheap imports that dominate the Afghan market.

It was against this background that the six case studies brought together here considered how markets were currently functioning in Afghanistan, their existing structures, the extent to which they benefited poor or marginal players and the barriers to their growth and expansion, all of which are discussed in the remainder of this paper.

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10 Ibid, 74.
11 Government of Afghanistan (GoA), March 2004, Securing Afghanistan’s Future. Accomplishments and the Strategic Path Forward, Kabul: GoA.
2. Trade Routes and Relationships

The functioning of Afghan markets is significantly impacted by formal and informal trade relationships with neighbouring countries and is also particularly vulnerable to the host of existing obstacles to competitive trading across borders. Traders in both export and import markets reported delays at borders due to poor infrastructure for transit and other trade, the number of bureaucratic stages to be fulfilled and bribe-seeking. Borders were sometimes completely closed by periodic disputes between trucking unions. Traders in many sectors, and especially petroleum fuel traders doing business in Turkmenistan and Uzbekistan, reported that obtaining visas for neighbouring countries was often difficult.

Business development service providers in Afghanistan make much of linking Afghan producers to wider potential markets in the region and beyond, and rightly so. But the obstacles summarised above mean that it is often far from simple for Afghan products to reach these markets in practice. Regional trade integration among Afghanistan’s neighbours has been modest to date and although Afghanistan itself has a liberal trade regime, trade is far from free in the wider Central Asian region. As a recent World Bank paper on regional economic cooperation has noted, the obstacles to such cooperation are in part physical and financial, but to a large extent, political. The same document makes a compelling case for a concentration on “win–win” measures where there is potential for medium term success, based on mutually beneficial, less controversial projects. For example, the creation and extension of cross-border zones relating to countries with more restrictive trade regimes would allow people and goods to move more easily across these borders.\(^{12}\)

Afghanistan’s landlocked status, size and geography pose real logistical problems for the regular import and export of many key commodities. The cost of being landlocked has a negative impact on development and is compounded by poor infrastructure, the absence of a rail network and dependence on road transport across difficult and often badly maintained roads.\(^{13}\) As a result, exporters risk an end price for Afghan products that is uncompetitive, or even, in the case of raisins, for example, the destruction of the product en route. For imports, the risk is that they can be subject to price hikes and insecurity of supply, which is especially damaging to the economy in the case of a key commodity such as fuel.

In spite of disadvantages and increased transport costs incurred due to geography, Afghanistan’s geographical position could be turned into an economic advantage given improved infrastructure and regional cooperation. Afghanistan currently has a small share of overall regional trade, and non-opium trade accounts for only some six percent of the Afghan economy at present. Nonetheless, the case studies assessed here, especially those dealing with import markets, revealed that commodities are being traded along all of Afghanistan’s borders, both through official entry ports and by unofficial means. Commodities are entering and leaving Afghanistan from all directions and the improvement of road infrastructure will make many routes more viable. Some products are imported into Afghanistan for re-export to a third country, such as spare parts or Iranian smuggled fuel imported to Pakistan, via Afghanistan.

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13 Ibid, Annex B.
2.1 Formal routes and agreements

Afghanistan has a large number of ports/formal border crossings with most of its neighbours that facilitate trade in the region. The country’s main ports in the north are Turghundi and Akina on the Turkmen border, Heiratan on the Uzbek border and Sher Khan Bandar on the Tajik border. Soviet era railroads terminate at Turghundi and Heiratan. Major border ports with Pakistan include Torkham on the Kabul–Peshawar highway, Nowapass, Marawara, Barikot and the key port of Chaman in Kandahar Province. By far the largest trading border port with Iran is at Islam Qala outside Herat, although there is also a crossing at Qatat-e Nazar Khan in Farah and the opening of a new bridge in Zaranj, Nimroz, may facilitate greater trade through this crossing. The main internal highway is the ring road linking Kabul to Kandahar in the south, Kandahar to Herat in the west, Herat to Mazar-i-Sharif in the north and Mazar to Kabul. The reconstruction of Afghan road infrastructure has made significant progress, but continues to be slowed by security concerns in the south of the country. Although air transport has become an option for importers and exporters, as airlines such as the national carrier Ariana have begun to offer cargo shipping to international destinations, the commodities studied in this research were not being imported or exported by air. The one exception was aviation fuel, which one large company reported shipping by air as a one-off (and prohibitively expensive) measure when land routes from Pakistan were closed.

As well as bilateral trade agreements with neighbours discussed briefly below, Afghanistan is involved in a number of regional and multilateral trade organisations, a short list of which is available in Appendix A. However, Afghanistan is not in a strong position to negotiate favourable trading agreements with its neighbours or to further the cause of a more unified economic space in the region. Membership in regional groups is a definite step in the right direction, but these organisations are sometimes of limited effectiveness. Neighbouring countries have differing economic policies and stronger lobby groups for their domestic producers and hence more obstacles to liberalising their own trade regimes or to greater regional trade integration. In the meantime, many countries in the region take advantage of Afghanistan’s liberal trade regime to flood the Afghan market with cheap products, made cheaper by the relatively high exchange rate for the Afghani.

One of the trade agreements to which Afghanistan has subscribed is the Economic Cooperation Organisation Trade Agreement (ECOTA), which has not been signed or ratified by a number of other ECO members partly due to discomfort with the provision in the agreement for anti-dumping measures. The flooding of the Afghan market with cheap goods certainly has some advantages for the poor, but has serious implications for the competitive viability of Afghan producers and also for quality and standards. Nonetheless, in spite of the political difficulties facing regional trade cooperation, the existing and developing regional trade groupings, especially those that include wider regional players, could be harnessed as vehicles for greater integration, looking forward. Current patterns of trade, which show that trade between Central Asian region countries and their second-tier neighbours such as China, India, Russia, Turkey and the UAE is much higher (50 percent of total trade) than trade between the countries of the immediate region, indicates that here would be key gains from reducing the costs of trade with the wider regional neighbours.\textsuperscript{14}

Formal trading agreements between governments are significant. For example, the trade agreement signed with India in

\textsuperscript{14} As pointed out in Byrd, et al. Prospects for Regional Development and Economic Cooperation in the Wider Central Asian Region, 5–6.
March 2003 allows Afghan raisins, for which India is a major market, to be imported at a lower rate than even India’s Most Favoured Nations duty. However, informal trade relationships are arguably as important as formal ones for cross-border trade in Afghanistan. For all the trade routes described below, personal, in some cases family, contacts emerged as an important factor facilitating trade. These were the contacts that had allowed trade to continue during times when formal relations between Afghanistan and its neighbours were complicated by conflict. In Iran and Pakistan, such contacts were often made during periods of time spent as refugees. Carpet traders reported using contacts in Peshawar to export Afghan-made carpets, destined for further export to third countries. Pharmaceutical traders and small producers reported that they used family business ties in Iran to procure finished pharmaceuticals as well as raw materials and machinery. Afghan diaspora communities are also an important resource for traders. Second-hand vehicle traders often reported that they had representatives in Dubai, where there is a large Afghan community. In a similar way, the large community of Afghan traders based in Moscow and in Siberia, rich in wood and iron, is used to import certain construction materials. These informal ties are likely to remain a key part of Afghan business practices and are not incompatible with formalisation of economic exchange.

Formal agreements that exist between Afghanistan and its immediate neighbours (Central Asia, Iran and Pakistan) are described in detail below.

Central Asia

Afghanistan has trade and transit agreements with Uzbekistan and Turkmenistan and a draft transit agreement with Tajikistan.

For the six commodities studied, Turghundi and Heiratan were particularly important ports of entry for fuels such as petrol, diesel and aviation fuel from the former Soviet Union. These were delivered by rail and then unloaded onto trucks or stored in the storage tanks available at both border ports. AREU research estimated that a third of total petroleum fuel consumption comes from these northern routes. The origin of petrol products imported into Afghanistan over the border with Turkmenistan and Uzbekistan is sometimes difficult to judge due to the “oil swapping” that occurs between Iran, Turkmenistan, Kazakhstan and Russia, but a significant amount is thought to come from Turkmenistan. The fact that there were contracts to import Turkmen fuel and other commodities into Afghanistan under the Taliban, when borders with other western and northern neighbours were closed, may have consolidated some business relationships between Afghan and Turkmen players. One large importer, who now uses several ports, reported that in Taliban times he had imported only from Turghundi on the Turkmen border and had enjoyed a virtual monopoly of imports from this route. The import of fuel appeared to researchers to dominate trade at these two ports, although a vibrant trade in imported scrap metal was reported and observed at Turghundi. There is evidence that small numbers of luxury European and American vehicles are also being imported into Afghanistan from Russia, and through the northern routes.

Iran

Iran and Afghanistan have signed two trade agreements and a Memorandum of Understanding on transit. Afghanistan is allowed use of the Bandar-e Abbas Iranian port under a transit agreement dating to 1974, and thanks to the bilateral transit agreement can now also use the Iranian port of Chabahar. However, many issues remain unresolved, such as the ability of Iranian trucks and containers arriving at Iranian sea ports to enter Afghanistan.

Researchers visited two border entry ports with Iran, Islam Qala and Zaranj, of which the former is the largest and most important by far. According to official statistics, the
Herat customs house, which deals with products passing through Islam Qala, processed the largest volumes of exports of all Afghanistan’s customs houses in 1383 and 1384 (February to February 2003–04 and 04–05) by a large margin. The dominance of imports into Afghanistan as opposed to exports passing through Islam Qala is obvious on observation of the port, which has a large market selling Iranian consumer goods, and indeed in Herat, where shops are dominated by Iranian imports. This port was particularly important for the case study on second-hand vehicles, as the market-dominant Japanese and Korean vehicles come into Afghanistan via this route. These are imported into Afghanistan from auction houses in Japan, via vast showrooms in Dubai, from where they are shipped to Bandar-e Abbas on the Iranian gulf coast. Then they are transported, often still in containers or loaded on lorries, overland to Islam Qala on the border with Afghanistan just outside Herat. Although most vehicles come to Afghanistan via Dubai and Bandar-e Abbas, other import routes are also used and there is some evidence that these routes are becoming more popular since the ban on right-hand drive vehicles. Vehicles from Germany are typically driven over land and often also enter Afghanistan through Islam Qala. The number of vehicles coming through other Iranian ports, such as Zaranj, may increase, especially given the recent renovation of the bridge at Zaranj, making the border crossing navigable by road.

Around a third of total petroleum fuels comes into Afghanistan through Iran, but Iran’s share of petroleum imports to Afghanistan would be significantly smaller were it not for the extensive smuggling of Iranian fuel into the country, discussed later in this report. Official consignments of Iranian fuel come into Afghanistan through Islam Qala.

Pakistan

As Section 1.2 on history and geopolitics indicates, trading relationships with Pakistan emerge as particularly important. This is consistent with official statistics, which show Pakistan as Afghanistan’s largest trading partner. These statistics do not show trade volumes with Iran, possibly due to incomplete reporting from Islam Qala in 2004, and are therefore not entirely reliable. Nonetheless, Pakistan shares a longer land border with Afghanistan than any of its other neighbours and Pakistan connects Afghanistan to sea ports such as Karachi. Afghanistan’s traders have a history of reliance on Pakistani markets, roads and financial institutions dating back almost three decades. Pakistan is a particularly important recipient of Afghan exports and statistics show that the Kandahar customs house, the provincial customs house for routes to Spin Boldak and Quetta, was the largest in terms of volumes of exports processed in 1383 and 1384.

The Afghan Transit Trade Agreement (ATTA), adopted in 1965, allows a list of goods to be transported from Pakistan into Afghanistan duty free, as part of Afghanistan’s privileges as a landlocked country consistent with customary international law. However, Pakistan has over the past 20 years created a list of products exempt from the ATTA, contravening the spirit of the agreement. This list currently includes four items, but at one time extended to 24. However, bilateral trade relations between the two countries appear to be improving, with more customs checkpoints on the border, and the upgrading of existing checkpoints in the pipeline. The ATTA has created incentives for smuggling since the 1970s, when merchants began smuggling duty free goods for export to Afghanistan under the agreement back across the border to be sold in Pakistan’s markets.

15 Afghanistan imports by customs house in millions of Afs. 1383 and 1384. MoF website, www.mof.gov.af
16 Afghanistan Statistical Yearbook 2004, Table 12.7.
17 Afghanistan exports by customs house in millions of Afs. 1383 and 1384. MoF website, www.mof.gov.af
Official trade across the Afghanistan–Pakistan border is sometimes affected by disputes and bureaucratic delays. The border areas with Pakistan are sometimes closed to trucking traffic due to disputes of one kind or another, and import of petroleum fuels through these routes is sometimes affected by closures or reductions mandated by the Pakistani government. For example, at the time of publication of the petroleum fuels case study in October 2005, the Pakistani government had announced a temporary reduction of quotas for exports of aviation fuel in order to deal with the increase in domestic air traffic during the Hajj. In 2002–03, Afghanistan was the second largest importer of Pakistani petroleum products after the UAE and Pakistan accounts for one third of fuel imports to Afghanistan. Were it not for the large contracts represented by Coalition Forces and the international community in Afghanistan, particularly for aviation fuel from Pakistan, the Pakistani share might be much lower.

Pakistan is a significant recipient of Afghan exports, both for domestic consumption and for re-export to markets such as India; this is the case for both Afghan carpets and raisins. Most carpets are exported to Pakistan before being exported to third countries and this is where final cleaning and processing is carried out, although there is a carpet washing and processing plant in Mazar-i-Sharif. Many carpets are relabelled in Pakistan to make it appear that they were produced there, thus undermining the Afghan “brand” for this traditional product and making the statistics on Afghan and Pakistani carpet exports unreliable. Afghan traders buy from producers or smaller traders on the Afghan market and sell to traders in Peshawar, often using contacts established in Pakistan during time spent there as refugees. Even larger traders who export to European destinations themselves often do this via partners in Peshawar.

Export of Afghan products, especially perishable goods, to or through Pakistan is not an easy process. The case study on raisins found that there was a high risk of damage to or even total loss of raisins imported into Pakistan through Kandahar/Chaman and destined for shipment to third countries via ocean-going containers from Karachi. The risks were posed by loading and unloading in the border area and long delays in sealed rail cars, sometimes in extreme temperatures. Goods were often held for a long time in the Afghan Transit Trade Zone warehouse from where they were eventually reloaded into containers for shipment. Access to the shipment as it sits in the Afghan Trade Zone in the Karachi port was usually denied by Pakistani port authorities. Therefore damaged packaging and products could be shipped “as is” to a customer, resulting in lost business or customer demands for discounts. At the time of this research, the largest risk facing Afghan raisin or grape traders during the whole production and export process was outside Afghanistan, during this transit process. Export to India via Pakistan was less problematic, as Pakistani trucks collected the product at the border, conveying it directly to the Indian border at Lahore.

2.2 Informal cross-border trade

There are several types of informal trade taking place across Afghanistan’s borders. By far the largest type in terms of value is trade in commodities that are outright illegal, mostly in opium but also in illegally logged wood. These activities, which can never be brought into the formal economy, are not explored in any depth in this study. There is also trade in commodities that are not themselves illegal, but which are only profitable for traders when they are traded informally. At the other end of the spectrum, there is trade which is currently not recorded or taxed by the state, but which could be brought into the formal economy given the right trends and incentives. A typical incentive used in other countries to formalise shadow economies is to liberalise tariff regimes. This is not an option for Afghanistan, which already has low tariffs.
In the case studies considered here, the fuel and pharmaceuticals sectors exhibited the largest proportions of informal trade. Where fuel is concerned, it is the subsidising of petroleum in neighbouring Iran that provides the economic incentive for smuggling. Domestic consumers in Iran pay a fraction of the cost of petrol and diesel. At the time of the petroleum market research in summer 2005, Iranian customers paid 40 cents per US gallon of diesel, which equates to just 4.5 Afghanis a litre, compared to an average price of 23 Afghanis per litre in Kabul at the time of research. Fuel smugglers are active along the Iranian border and were observed by researchers in Nimroz. It appears that the smugglers import only small quantities of fuel each, but are very numerous and could collectively account for a large share of fuel imports from Iran, especially if the numbers observed by researchers are similar along other portions of the border.

Outright smuggling is not the only means of appropriating larger quantities of fuel or other commodities without paying full taxes or contractual payments. The amount of fuel intended for sale in a technically legal contract can be exaggerated, and then the difference between the contracted amount and the amount actually bought can be sold or re-exported to its country of origin at a profit. Similar methods are used to garner extra profit from other types of consignments, such as cement. Half of the contracted amount of cement for export from Pakistan to Afghanistan can be presented for verification and stamping of export documents in Afghanistan, and the other half of the truck filled with sand. The remaining half is sold in Pakistan, avoiding the high levels of taxation normally applied to cement in Pakistan. This over-invoicing appears to be a problem primarily in Pakistan, and the taxation losses are incurred by the Pakistani authorities.

The pharmaceutical sector had the largest estimated proportion of informal trade of all six case studies. With most respondents estimating that between 60 and 80 percent of all medicines on the market were smuggled, this sector appears to have a much higher level of informal activity than the average 10–50 percent for the trade sector. One Ministry of Public Health (MoPH) official told researchers that Afghanistan’s porous borders had allowed “practically anyone” to bring medicines into the country, especially before 2002. Medicines are probably smuggled into Afghanistan by large and small players. Some larger scale importers may not bring their products through customs or MoPH procedures or be registered with the authorities. In addition, as pharmaceuticals are a high demand, high value commodity that is small, light and easy to transport, it is likely that individuals bring small amounts of medicines into the country on an ad hoc basis. Most smuggled medicines are likely to come from Pakistan and Iran, in that order. Counterfeit medicines must, by definition, circumvent official procedures in order to come into the country, as these could not be officially registered and would not pass the MoPH tests of medicines brought through customs. These counterfeit medicines are either manufactured in Pakistan or come from China and India, often via Karachi. The opinions of importers, wholesalers and retailers on smuggled medicines differed. Many were concerned about the unfair competition posed by such imports. Others said that while some of these illegal imports were of poor quality, some smugglers brought high quality products that were needed in the Afghan market.
Measures for bringing informal cross-border traders into the formal sector could include facilitation of more trade exchange in border regions, for example by extending officially authorised cross-border bazaars. The trade routes utilised by businessmen reflect the scale at which particular players operate. More about the types of market players engaged across the six commodity chains studied is included in the next section.

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3. Market Players

To understand how markets function in Afghanistan it is crucial to examine the factors that affect people’s choices to invest in business, as well as to look at where people fall along the spectrum of market players. There are a large number of players involved in Afghan markets. This is a feature that can be observed across Afghan cities, where bazaars bustle with large numbers of people involved in economic activity. Figure 1 illustrates the complicated network of relationships operating in many Afghan markets, as demonstrated specifically in the fuel sector.

However, many market players in Afghanistan are making negligible margins and are trapped at a micro-level of activity. Other marginalised players include agricultural and craft producers who have limited access to markets and are trapped in relationships with middlemen that are not always advantageous. It could be said that this is typical of markets for agricultural commodities where producers are small-holders in developing countries, and even of agricultural commodity markets in developed countries, where producers often receive a fraction of the final retail value of a product. However, these relationships may not help in developing markets in a pro-poor fashion—which requires poor and marginalised players to reap the benefits of growth. Moreover, the disadvantages faced by Afghan producers are compounded by a number of other factors, such as lack of information on alternative markets for their goods, and ties of personal trust which lock them into relationships with certain traders and indebtedness. In order to overcome these problems, and especially in an environment seeking to find alternatives to opium poppy for agricultural producers, interventions could focus more attention on establishing cooperatives of producers. Projects involving the construction of processing factories locally, to maximise the value added to the product at or near the site of production, would also bring greater benefits for downstream players.

Meanwhile, many markets are dominated by a very few large players at the top, with consequent instances of anti-competitive behaviour.

Figure 1: Example of players in Afghan markets: the fuel sector
## 3.1 Choosing to be a player in a difficult investment climate

One of the keys to understanding the breakdown of market players is an awareness of what factors prevent people from entering business in the first place, and what keeps small businessmen locked in small scale production. Investors of all sizes face a formidable list of obstacles to doing business, and to expanding their business, over and above the issues dealt with in other sections, such as favourable trade agreements, delays at borders, and political closure of markets. Medium-sized enterprises are particularly vulnerable, since they are not sufficiently small enough to slip through the net, but not large or well connected enough to navigate obstacles easily. It is not the purpose of this study to exhaustively list all the obstacles to doing business in Afghanistan, which have been amply described elsewhere, notably in the recent World Bank survey *The Investment Climate in Afghanistan: Exploiting Opportunities in an Uncertain Environment*. The main findings of this report were that in spite of positive steps by the government, including in the sphere of tax reform, a number of significant constraints remain. The survey on which this report is based found that the five largest reported obstacles were, in order of magnitude: electricity, access to land, corruption, access to finance and anti-competitive practices. Perceived obstacles in this survey were similar across all areas of Afghanistan, with only slight regional differences. Electricity, for example, was less of a problem in Herat, which has good electricity provision from Iran. Anti-competitive practices were cited more frequently in Mazar-i-Sharif than elsewhere, possibly reflecting “deeply entrenched local business interests that use their close ties to powerful political patrons to restrict competition”.

Electricity was certainly a challenge mentioned by businesspeople in AREU’s research, particularly for small manufacturers. All businesses rely on generators, which are a significant added overhead. However, generators can be factored in to a business plan with some degree of predictability. Access to finance was also frequently mentioned by businesspeople as one of the factors that could facilitate expansion of a business. Nonetheless, the overwhelming majority of businesspeople interviewed had hitherto relied on informal systems of credit. Anti-competitive practices were certainly revealed as a significant phenomenon and are dealt with in Section 3.3.

Two of the major constraints cited by business people across the studies were access to land and bureaucratic delays. Because these have the potential to put an entrepreneur out of business or stall a new business completely, they are discussed in detail below.

### Access to land

As the World Bank survey points out:

*In many countries, access to land is a problem only for firms wanting to significantly expand. In Afghanistan, even the majority of existing firms find accessing land, especially serviced land, a serious problem—which indicates just how severe a constraint it is. Nearly 56 percent of the surveyed firms who had tried to acquire new land in the past three years were unsuccessful and more than 10 percent reported having ongoing land disputes.*

Land was the number one issue for six registered 100 percent Afghan-owned pharmaceutical production sites visited by researchers in Kabul. Most were operating

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22 Ibid, iv.
23 Ibid.
on a small scale, employing between five and 60 staff. The fact that many were based in rented accommodation in residential areas meant that many were trapped in a cottage industry scale of production. Insecurity of tenure was a disincentive to growth and development, as there was little point in investing in and installing expensive new machinery when the company might have to move premises at any time. All manufacturers planned or hoped to move to more secure accommodation in an industrial park. One manufacturer had been promised a plot in an industrial park but the plot had not materialised and a second manufacturer was in the process of applying for a plot. Another manufacturer was involved in a dispute over a piece of land for which he had paid 25 percent of the total cost 10 years previously but had since been unable to claim. There was a mechanism for claiming land, the manufacturer claimed, but the process was difficult, as many plots of land under disputed ownership were already occupied and the municipality and the police needed to negotiate with these residents in order to free up the land.

Land and security of tenure was also an issue for fuel wholesalers, whose market in Kabul had been moved by the municipality three times in 15 years. Similarly, second-hand vehicle markets in Kabul and in Herat had reportedly been moved progressively further out of the centres of these cities. Retail outlets were also affected by tenure insecurity and rising rents. Those shops that own rather than rent their own buildings are in a far more advantageous position. Owning a building in Kabul is a significant investment and one vendor of traditional medicines of Indian descent told researchers that while most of his family had immigrated to India during the years of conflict in Afghanistan, his brother had stayed in Kabul to make sure that no one else occupied the family shop there. One pharmacist in Zaranj, Nimroz, reported that he had been moved out of his previous location by the landlord, who had noticed how profitable the pharmacy was and decided to set up his own pharmacy in the shop space.

**Bureaucratic delays**

The Afghanistan Investment Support Agency (AISA) was established in 2003 as a “One Stop Shop for Investors”, charged with the responsibilities of registration, licensing and promotion of all new investments in Afghanistan. AISA has, by common consent, greatly improved the process of finding contacts, registration, and navigation of bureaucratic hurdles and avoidance of corruption for domestic and foreign investors. So much so that Afghanistan now ranks among the best countries in the World Bank’s 2005 Doing Business indicators of firm registration. Nonetheless, AISA has limited reach outside Kabul and tends to register larger firms. Moreover, registration is not the final bureaucratic hurdle for businesses, which require a host of permissions and other requirements before they can begin production. These permissions are particularly numerous in certain sectors.

Afghan firms complained of arbitrariness in bureaucratic procedures and bribe-seeking. But bureaucracy also affected foreign direct investors, encountered in this research in the petroleum fuel and pharmaceuticals markets. The pharmaceuticals investors, in particular, highlighted the bureaucratic delays that can hamper investment in Afghanistan. There are two foreign investors who have recently begun production of pharmaceuticals. The German-Afghan investor, Hochpharma, has resumed production in the Hoechst factory, in a venture with the Ministry of Public Health, which retains a 15 percent stake. Three years had passed since the investor began negotiations to the stage of closing the deal in August 2005. This was partly due to the complicated process of bidding for the tender to win the government shares in the plant. American Afghan United Incorporated Pharmaceuticals, housed in a new factory in Kabul, is a 100 percent private, foreign-owned enterprise with a planned total investment of US$2-5m. The start date for
production had suffered two years of delay due to the complicated bureaucratic process of obtaining all the necessary paperwork and permissions and during this time, money for rent and salaries had been wasted every month with no returns. However, in November 2005, the company was granted official permission to begin production of five products.

Labyrinthine bureaucracy appears in the above cases to have been more of an inhibitor of foreign direct investment than the other obstacles frequently cited, such as the absence of a banking system, the legislative backlog for basic commercial laws or the security situation. Understandably there must be an added layer of regulation in the pharmaceutical production sector, in order to ensure that safety standards are met. However, there is a general problem with unclear and prohibitive layers of bureaucracy facing investors, which appears to be reflected in other sectors. Foreign entrepreneurs who are in Afghanistan attempting to set up businesses have probably already considered the obstacles of security, banking and weak infrastructure, and a streamlined bureaucratic process would help to keep such potential investors and their investments in the country. Streamlining the process of bureaucratic permissions for foreign and domestic investors would also limit the opportunities for corruption and bribe-taking.

3.2 The importance of networks for all players

You can’t even buy vegetables at the right price without proper contacts here.

Peshawar trader, 2004

The importance of personal contacts and trust emerged as a critical factor for small and large players in all markets. Whether for a street vendor, who was able to buy fuel from a wholesaler on informal credit, or for a car salesman starting in the business who was assured by friends that they would buy his vehicles if he was unable to sell them, personal relationships with other market agents were raised as an important factor in setting up or expanding a business. These connections may be compensation for the absence of formal credit or insurance systems.

Market players cooperated with each other in more profound ways than simply granting credit: fuel wholesalers reported that they would sometimes club together to meet a large order of fuel from a buyer, and there was also evidence of collusion among fuel traders in setting prices. In the construction materials sector, traders in one market were found to be acting more collaboratively than competitively. Often they had a single supplier (who might also be trading in that market) and sometimes even provided a safety net for each other, with regular payments to a common fund from which any one of them who ran into difficulties could take a loan.

On one level these types of networks are a vital and positive force allowing poorer people to become entrepreneurs:

Dense and overlapping social networks increase the likelihood of economic cooperation by building trust and fostering shared norms. The social capital generated within and between firms is especially important for lowering risk and uncertainty at the local level... Repeated transactions and business reputation provide the necessary incentives for parties to act in mutually beneficial ways.24

However, these types of personal trust networks can also have a negative effect on the competitiveness of markets. If networks of personal contacts and trust become vital to entering markets, then new entrants

without such “social network capital” can be barred, especially where larger market players are concerned. These networks can also lead to anti-competitive practices where pricing is concerned, and groups of market actors can collude together to artificially inflate their own margins.25

Recent AREU research on opium trading in Helmand and Ghor revealed that networks of traders and relationships of trust were also key to the operation of opium markets. These relationships help to mitigate risk in a market where risks of theft and seizure are significant. Opium markets also displayed some of the same types of informal regulation as the raisin and fuel markets. Thus, “when it is known that outside buyers (from Iran or Pakistan) are in the market, the market price rises quickly”, due in part to collusion on the part of key traders holding significant stocks. This reminds us that the division between a legal and illegal market is an artificial one, and the fact that opium is an illegal commodity does not mean that, left to its own devices, the market for it functions in a dramatically different way to other markets.26

3.3 Marginalised players at the bottom

Although, as mentioned above, many players are involved in Afghan markets, the vast majority of these players are very small in scale. Many market players are not in a position to maximise the returns from their work, either because they are trapped on a micro-scale of activity and are unable to invest capital in growing or specialising their business or because, as small scale producers, they lack direct access to markets. In terms of numbers, most Afghan entrepreneurs likely fit this profile.

The following sections describe some of the characteristics of these small scale players, and how they adapt to market conditions despite their marginalised status.

**Gender and ethnicity**

The only case study in which women were present in the supply chain was the carpet study. Although women traditionally were (and to an extent still are) producers, drought and the refugee experience led to the increasing involvement of men in carpet production, as other labour opportunities diminished. However, the sale of carpets and transactions with traders associated with carpet production remained exclusively male. What was unclear was the gendered basis of decisions and power in relation to sale price and decision-making power over cash generated from sales. There was anecdotal evidence that in some cases women do have a say on both the price gained from the sale of the carpet and how the proceeds were to be spent. There was also evidence from a Group Guaranteed Lending Scheme in Andkhoy that while access to credit for women provided the means to continue weaving, the fact that they continued to do so under deteriorating terms of trade, forced them into longer and longer working hours and forms of self-exploitation.

In some markets, the type and size of business has a clear ethnic dimension. In the carpet study, for example, producers in Andkhoy were from Turkmen families and, especially after their experience of exile in Pakistan during the conflict period, Uzbek families. In the second-hand vehicle study, it appeared that a number of large traders were Pashtuns from old trading families. However, the case studies broadly found that no single ethnicity dominated one trade throughout the country. Having said this, larger scale trade across specific borders is often dominated by ethnic groups who have the strongest links in the countries with which they are doing business.

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Thus it clearly easier for an ethnic Uzbek to do business across the border with Uzbekistan and for Pashtuns to do business through the port of Torkham bordering Pashtun areas of Pakistan, whereas potential traders from other groups would likely be disadvantaged.

**Producers without market access**

In the case studies on the carpet and raisin markets, producers made the smallest margins in the supply chain and were sometimes indebted to intermediary traders.

Carpet weaving has traditionally been used to supplement other incomes, such as from agricultural labour, but reliance on carpet weaving as a coping strategy has increased during times of conflict or drought and as a result, overall carpet production has increased since the 1970s. There is evidence of a decline in terms of trade for producers as households coping with drought, which ended in 2001, scaled back production, which served to deepen market inequalities. Weaving households became increasingly dependent on credit for raw materials for weaving and food in order to survive. Naturally, all players in the carpet supply chain are vulnerable to shocks in the market. For example, the margins of local traders were certainly under pressure, as carpets being sent south have during certain periods experienced problems with customs and have sometimes been delayed for several months. However, such shocks result in an even greater reduction in returns to producers.

One of the reasons producers face difficult terms of trade is that most lack the capital to produce carpets independently, purchasing their own materials, and even those families who can produce independently lack direct access to markets. Families who cannot afford the price of raw materials either receive these on credit from a trader or a wool merchant, or, more and more commonly, operate on a wage labour basis where the work is paid on a by piece basis. This method avoids some of the uncertainty over final prices and marketing associated with other methods, but final prices are still not guaranteed, as the traders know that producers have no means of selling carpets on the market themselves and reportedly sometimes use design and weaving flaws to reduce the final price to producers.

Grape farmers are similarly dependent upon traders to give them access to markets and typically lack packaging materials so almost always feel some compulsion to engage a packer/shipper. This relationship is particularly urgent where fresh grapes are concerned, since this product has only around one week to get from vineyard to retail outlet before perishing. Farmers will normally negotiate the fresh grape price and terms of sale with the packing/shipping contractor in August, before the beginning of the harvest, with some proportion of the payment usually made upfront. However, as with carpet producers, grape growers are vulnerable to re-negotiations of these arrangements by traders. It is common for the packer to delay payment, misrepresent the weight of the grapes or attempt to re-negotiate on the basis of poor market conditions or not to pay for a portion of the grapes harvested. Few growers see these arrangements as preferable, but since they are not usually well connected to markets and do not themselves have the necessary downstream contacts, they accept the cost and sell to the packer/shipper. There is no plausible legal recourse for the farmer if he thinks he has been cheated. If he has some patronage from a local commander or other local leader, the shipper may be less inclined to exploit the farmer, but if it is the shipper who has this patronage, then the farmer is vulnerable indeed. This system also mitigates against the development of strategies to add value to the end product, which would require cooperation between the farmer and the shipper. The grower only has a genuine incentive to use value and quality increasing horticultural techniques if he knows that he will be rewarded for improved quality and be fairly treated by the shipper/packer.
Farmers are in a more powerful position when selling raisins, as these can be stored and strategically sold when prices are high, when the farmer needs the money, or when he needs the storage space for next year’s crop. Indeed, farmers with a little cash will sometimes invest in “speculations” on the raisin market, buying raisins when prices are low and selling when prices are high. Nonetheless, growers remain dependent upon packers and shippers to export, and these are relationships based on reputation and trust. The pitfall is that even if trust is abused, the grower may not be inclined to rupture a longstanding relationship and a farmer may not change the person he contacts the following year even if he has had a bad experience with the contact in the previous year.

It must be emphasised that many of the intermediary traders, especially in agricultural sectors, are probably not significantly more powerful than the producers themselves. However, in some sectors, producers may lack sufficient information to have the choice of selling their products at the optimum price and are often tied into relationships with existing intermediaries. Dominance of a small number of middlemen can close a market, as observed in some sectors, such as saffron production in Afghanistan, where a UNDP report identified the small number of packers and exporters who had locked the saffron market in Afghanistan as an obstacle to the development of this sector.  

**Street vendors**

Small scale business in Afghanistan often is used as a “coping strategy” for poor and vulnerable populations, with small players buying and selling or reselling a small quantity of goods, sometimes making negligible margins. This phenomenon was observed in the three import markets; in the fuel and pharmaceutical markets there were many street vendors and in the second-hand vehicle market, “bargainers” proliferated. Some small scale actors do graduate to become larger and more profitable market players. Nonetheless, the number of market actors reduces considerably and the barriers to entry increase further “upstream” in the supply chain. This was especially the case in the petroleum fuels market, where the number of importers was very small. In the fuel and pharmaceuticals markets, street vendors buy small amounts of these commodities to sell on the street. Since it is harder to buy a small amount of a vehicle, small players in the second-hand car market tend to be “bargainers” who work on trading sites, interacting with customers and earning either a flat rate or a small commission from each sale.

In the fuel sector, street traders typically sell 10- or 20-litre plastic jerry cans and metal drums of diesel. Some have small shops or kiosks on the roadside, while some simply sell from a cart. Those with their own shops or kiosks often also sell gas canisters. Street sellers buy their diesel from pump stations or sometimes from wholesalers and even directly from smugglers. Street traders offer their customers the convenience of buying from a local trader, rather than visiting a pump station which may involve a longer journey. Those who owned their own kiosks in Herat reported that their business had been affected by the construction of pump stations, many of which had opened only over the past one to two years. However, street sellers remain a conspicuous part of this market in all cities where research was undertaken. Fuel street vendors are commonly based inside cities, along main roads on the outskirts of cities, and in the vicinity of fuel wholesale markets.

Some street vendors, especially those who own kiosks, may be making a reasonable living but others are likely making negligible gains.

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Going to Market: Trade and Traders in Six Afghan Sectors

Margins. It is clear that there are many market actors who are involved in opportunistic fuel trading on a very small scale, especially in border areas where fuel is imported. In Islam Qala, the main crossing on the Iranian border near Herat, small crowds of people can be observed buying fuel from the tanks of Iranian truck drivers in jerry cans and other kinds of small plastic containers— even soft drink bottles. Also in Islam Qala, ten women were observed begging for petrol or diesel from Iranian drivers, hoping to sell it to tankers or other buyers.

Medicines are also commonly available on the street, sold by vendors who congregate in busy street markets and sell a variety of medicines by blister strip. These medicines are bought from pharmacies or wholesalers. Many of these vendors are children and two interviewed in one area of Kabul were aged 12 and 14, respectively. The vendors reported that they could make up to 300 Afghanis (US$6) per day by selling medicines on the street. An article from 2004 records some adverse reactions experienced by customers buying medicine from street vendors and also confirms that many such vendors are very young. The article relates that a 17-year-old describes his main patrons as “the poor and the uneducated”.

Thus, in this case the poor and uneducated are attempting to make a living selling to the poor and uneducated.

The aforementioned AREU research on opium trading in Helmand and Ghor revealed that just as some players are involved in small scale opportunistic trading of commodities such as fuel and pharmaceuticals, this phenomenon also existed in the opium trade:

*In Helmand it was clear that when the opium poppy market was open and legitimate, many were involved in opportunistic trading, even if on a very small scale.*

Small scale middlemen

The use of middlemen to conduct day-to-day transactions is particularly apparent in the used vehicle business sector. When visiting second-hand car markets, it is notable how many people there are gathered in the offices of each business. This is because owners of vehicle-selling businesses in car markets do not necessarily involve themselves in the daily business of selling each vehicle in their lot. Rather they frequently use “bargainers” who operate on these sites as the interface with the customer, negotiating prices, clinching deals and arranging payment methods. Sometimes, these bargainers are employed for a small wage by the owner of the shop or lot, but often they are effectively self-employed. It appears that some bargainers are paid a small flat rate per vehicle sold, some are paid a commission and some are paid a small wage and a commission. One importer in Herat said bargainers received a standard fee of 1,000 Afghanis (US$20) when they sold a vehicle. A bargainer in Kabul reported that he was paid one percent of the vehicle’s price, approximately US$50 from the sale of a US$5,000 Toyota Corolla—a reasonable wage, assuming that a bargainer can sell sufficient numbers of vehicles. One Herat bargainer claimed that this was a good trade as he could earn up to 16,000 Afghanis (US$320) per month. However, a number of bargainers said they were having difficulty selling vehicles. There can be as many as seven bargainers in each vehicle trading centre, and centres outside Kabul said that a week could pass with no sales.

Many bargainers reported that they had started in the car trading business because they had no income. These small scale opportunistic market players are likely to be hit hardest by a contraction in the market. Such players could theoretically simply move to another more profitable trade, but some

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bargainers suggested that they had accumulated debt and were now trapped in this occupation. No further details were given, but one can speculate that bargainers might attempt to buy vehicles on informal credit, perhaps from their employer, and could then become indebted if they could not sell the vehicle quickly enough or for the right price.

**Smugglers**

Another type of small scale middlemen encountered in these studies were smugglers, who earn a small flat rate or commission for the sometimes dangerous task of transporting goods across borders illegally.

Fuel smugglers were interviewed by researchers at two points near the border with Iran in Nimroz. Groups of smugglers carrying empty jerry cans were observed in teams beside the river waiting to cross the river in boats at night. Fuel was their main smuggling commodity and they claimed to be known as *gazoli* or “petrol people”. Smugglers crossed the river in ferries carrying donkeys laden with empty containers ready to cross into Iran on the other side.

The smugglers do not appear to make any margin themselves from the difference between the subsidised price of fuel in Iran and the higher fuel price in Afghanistan. Rather, they reported that they are paid a flat rate by wholesalers and larger traders of diesel and petrol, who then collect the fuel from them. They were also granted some protection by these “employers”, who paid to ensure they are not harassed on their riverside plots as well as give them money to bribe border guards. Nonetheless this is a precarious occupation and the smugglers related that their colleagues have sometimes been shot at by Iranian border police.

In the spare parts trade over the Afghan—Pakistani border, small scale individual smugglers were known as *lagharian* or *karaya dar* or “unregulated commission agents”. These smugglers earned a flat rate of 600-1,500 Pakistani rupees (US$10-25) to cross the border and deliver smuggled merchandise to businessmen on the other side. They were also provided with money to cover bribes for officials on both sides of the border. Large and well connected smugglers can afford to transport spare parts in trucks along main highways, by paying bribes. The phenomenon of using marginalised players to transport commodities over borders has been noted by other researchers, and one has observed that children often act as porters, carrying a range of commodities from scrap metal to drugs across the border at Torkham on the Jalalabad to Peshawar route.  

3.4 Top players and the risk of anti-competitive behaviour

While there were large numbers of players at the bottom of many market supply chains, in some supply chains the number of players at the top was very small. In these markets, research highlighted the risk of anti-competitive behaviour by larger players.

The petroleum fuels market had the smallest number of importers of the three import markets investigated. This reflects both the difficulty of securing contracts to import large quantities of fuel from neighbouring countries, the logistical difficulty of storing and distributing fuel in the Afghan context, and an uncompetitive market. Diesel and petrol imports from Pakistan and Central Asia and official imports from Iran are therefore dominated by a very small number of actors.

It is difficult to ascertain exactly how many Afghan commercial importers of fuel there are. The Department for General Petroleum Products (DGPP) in the Ministry of Commerce reported that more than 30 import companies of various sizes were registered to import

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fuel. AISA has 21 registered importers of fuel, 12 of which are Afghan companies. In reality, the number of Afghan importers bringing regular significant consignments of fuel into the country is probably much lower than 12. It is likely that many medium-sized fuel dealers import their own fuel only in irregular instalments, and then supplement this with fuel bought from a larger importer.

There are a small number of large Afghan importers who dominate official imports from each main import route. Larger importers often have their main offices in Dubai. It is at this end of the petrol and diesel market that players are fewer in number and more powerful. Cross-border trading in larger quantities of diesel or petrol involves access to large contracts in the country where the fuel is sourced, as well as the capacity to store, transport and distribute fuel in very difficult terrain once it reaches Afghanistan. Anecdotes suggest that the large fuel importers that dominate the market are politically well connected at a high level both in Afghanistan and in the countries where they procure fuel. Significantly, large scale players do not have to be long-established businessmen in this sector and indeed some long-standing fuel traders are now facing competition from relatively recent entrants into the market who benefit from influential sponsorship. Afghanistan is not the only country where political connections can be instrumental in the success of a businessman. Experience in other countries shows that excessive reliance upon such contacts can introduce an element of unpredictability into economic development, tying major businesses to the shifting fortunes of political actors and affecting the openness and competitiveness of the market. Dominance of fuel imports by a small number of players using the same routes also has a potential impact on security of supply and protection against price shocks in the Afghan fuel market, since the loss of a contract by one of these dominant players would have a disproportionate effect on the supply of fuel on the market.

The dominance of smaller numbers of large players was mirrored in other sectors. In the
raisin sector, researchers found that personal and family relationships between Afghan traders and Afghan—Russian companies had enabled two large operators based in Mazar-i-Sharif to increasingly dominate this route for raisin export, squeezing out smaller operators with weaker links, or less efficient partner organisations. In the carpet case study, research found that the market was, if anything, characterised by the absence of competition. Small traders were locked into relationships with larger traders and complained repeatedly of the difficulty of building up a capital base. Small traders claimed that larger traders were able to manipulate prices and control the supply of wool and dyeing materials. Large traders would sometimes split orders between smaller traders, thus supporting their business, but also ensuring that no trader received a disproportionately large contract, allowing them to break rank. Small numbers of large players similarly dominated in the construction materials sector, where import of Pakistani cement to Afghanistan was found to be increasingly controlled by a few large companies, including one owned by a large Dubai-based businessman.

The below quote from Harris-White, describing the Indian informal economy, has real resonance in the Afghan context:

"Market structures that constrain competition are ubiquitous, masked by the appearance of crowding...An oligopolistic elite coexists with petty trade in complex marketing systems littered with brokers and giving the impression of competitiveness...Sellers can be tied to credit obligations...Interlocked contracts limit or exclude choice in the markets that are linked in this way. Large firms may keep petty ones alive while at the same time preventing them from accumulating by controlling the terms and conditions of their acquisition of information, contacts, credit and storage."  

It is perhaps natural that large players, with established and powerful contacts and relationships, dominate in a market environment that has experienced over 23 years of conflict. However, the potential for anti-competitive behaviour and the type of business environment that this could produce in the post-conflict period are issues that should be addressed in policies and programmes supporting private sector development.

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4. Prices, Regulation and Standards

While the last chapter described the role that social networks and anti-competitive behaviour play in shaping the numbers of businessmen across market sectors, there are numerous other external factors that impact on the participation of market players. Uncompetitive pricing and price controls and the legacy of state regulation can have negative repercussions on market practices, as the next sections illustrate.

4.1 How integrated are Afghan markets? Choice and price

The six markets studied confirmed the general impression given by visiting an Afghan urban bazaar, namely that many different types of commodities are available on the market. However, the majority of products on sale are imported, as confirmed by the official statistics, which show the size of Afghanistan’s trade deficit running at US$1.9bn in 2003. There are a large number of very cheap Pakistani and Chinese products on the market, which make it difficult for Afghan producers to compete. The relatively high real exchange rate of the Afghani has contributed to higher costs of labour and other inputs and has affected the competitiveness of Afghan producers. Nonetheless, the logistical difficulties of importing to a land-locked country, and the impact of inflation, mean that even those markets favouring cheap products may not be outstandingly cheap by regional standards.

The vehicle market in Afghanistan favours cheap, and sometimes very old, models. Japanese cars dominate, of which the majority are Toyotas, and the most common vehicle is the Corolla sedan passenger car. The Toyota Corolla is also one of the best selling passenger cars worldwide. Japanese second-hand cars are affordable, and, significantly, spare parts for these vehicles are easy to find. The price range found in Afghan markets of US$3,325 to US$6,800 for Toyota Corolla models from 1991 to 1997 compares to price ranges of US$2,575 to US$6,325 for models of the same age span advertised on the Internet. Prices are not very cheap in Afghanistan by international standards, especially given average Afghan incomes and the quality of vehicles on sale. However, traders reported that the price of a vehicle was becoming more affordable for Afghan customers. Prices are cheaper in Dubai, presenting an incentive for importers. A study of purchasing power around the world in 2003 compared the prices of a popular standard (four to five door) mid-range new car model in 68 cities. The price in Dubai was in thirteenth place, and in first and cheapest place was Bucharest.

The pharmaceutical market contains a number of cheap products, but has a very large degree of choice. There is a bewildering array of pharmaceuticals from different countries, at different prices, of different strengths and qualities available on the Afghan market. Management Sciences for Health (MSH) staff told researchers that there may be up to 5,000 different items in the private pharmaceuticals market in Afghanistan. The most expensive medicines across the board were found to be those coming from Europe or produced by multinational companies in Pakistan, followed by drugs manufactured in the Middle East. The cheapest medicines across the board were unbranded Pakistani medicines and Indian and Chinese drugs.

32 Afghanistan Statistical Yearbook 2004
34 UBS Wealth Management Research, 2003, Prices and Earnings, A comparison of purchasing power around the world, Zurich: UBS.
Iranian medicines were in the middle price range in all categories.

Prices of pharmaceuticals are regulated in almost all countries except for the United States. Every country has a different mechanism for pricing pharmaceuticals. Prices of pharmaceuticals in Afghanistan are capped by the MoPH, with importers and retailers allowed to make between 10 and 15 percent margin on the sale of medicines, and wholesalers allowed to make an 8-10 percent margin, but many importers and pharmacies implied or even stated outright that they did not follow the official pricing guidelines. Most of these traders argued that prices should be unregulated and market-driven now that Afghanistan had a “free market”. Some importers complained that the government cap on pharmaceuticals prices was a disincentive to the import of higher quality, but more expensive medicines into Afghanistan. This was because “the government might stipulate that a brand of European paracetamol should cost the equivalent of US$1 on the Afghan market, but this product might cost US$3 on the European market, so there was no profit to be made in importing it to Afghanistan.”

Other evidence suggests that it is the vigorous competition in the market and the demand for cheap medicines that leads to the large share of low quality medicines on the market. As a report by MSH notes: “Competition, and the desire to keep prices low, are suspected as contributing to poor drug quality.”

There is ample evidence that Afghan customers prefer cheaper products. Research in Jalalabad found that the high prices of pharmaceutical products produced by multinational companies encouraged customers to look for cheaper substitutes and that as prices for medicines generally rose, customers were increasingly opting for cheaper brands that could be of questionable quality.

Retail prices of commodities in different locations gathered for the fuel, pharmaceuticals, second-hand vehicles and construction materials studies revealed that prices were not dramatically different in different parts of Afghanistan. Predictably, prices for Pakistani construction materials are cheaper in Jalalabad and Russian construction materials are cheaper in Mazar than in areas further from the border. Likewise, vehicles are cheaper in Herat, near the point of entry for most vehicles into Afghanistan, than in Kabul. Indeed, many people travel to Herat to buy their vehicles. However, there does not appear to be consistently or dramatically large differentials between price and availability in cities, suggesting that these urban markets are reasonably integrated nationally. Petroleum products are one potential exception, as many respondents reported that winter weather conditions and occasional disputes over contracts could cause fuel shortages in some regions and hence temporary price differentials between regions. Petroleum products were also cheaper across the board in Zaranj, Nimroz, possibly reflecting the large quantities of fuel smuggled from Iran into this region. Other studies have suggested that markets for some commodities may be far less integrated than the markets considered here. A 2004 survey of the wheat trade industry in Afghanistan found that there was reason “to view the grain markets in different parts of Afghanistan more as subregional markets rather than a single national market...it may be the case that these [subnational provincial markets] are better integrated into the markets of neighbouring countries than they are with markets in other parts of Afghanistan.”

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High fuel prices pose inflationary risks

The relatively cheap prices of many commodities can be undermined by the inflationary costs of fuel used to transport goods throughout the country and across borders.

As recorded by the Kabul Consumer Price Index in 2004/05 (see Figure 2), petroleum products bucked the general inflationary trend in the capital.

The average price of a litre of diesel in Kabul was the equivalent of US$0.48 in June 2005 according to AREU research, compared to a retail cost of US$0.60 in the US during the same period. By October 2005 there were reports that the rise in international fuel prices had driven the Afghan retail price up to 29 Afghanis (US$0.58) per litre for diesel and 27 Afghanis (US$0.54) per litre for petrol in Kabul. Since October 2005, the increase in world oil prices has caused further hikes in prices of petroleum products in Afghanistan. As the International Monetary Fund (IMF) noted in November 2005, possible second-round effects of oil price increases poses an upward risk to inflation.

Prices for products refined from petroleum oil are linked to the price for oil on international markets. As there is no government subsidy or intervention in petrol prices in Afghanistan, changes in world oil prices are passed on via importers and retailers to the customer of refined petroleum products. As a general trend oil prices on international markets have been rising since 1999. Demand for petroleum products is fairly inelastic, as consumers will continue to buy these products in spite of increases in price. The retail price of petrol products is an important economic issue for developing countries, especially those that are oil importers and that have low per capita incomes. In these countries, petroleum prices can have a serious impact on livelihoods, consumer income and private sector development. Oil price shocks in such countries can affect economic growth. Many developing countries which are net importers

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40 International Monetary Fund (IMF) Research Department, December 2000, The Impact of Higher Oil Prices on the Global Economy, Washington: IMF.
of petrol regulate prices either at the retail or ex-refinery level.

In Afghanistan, the logistical difficulty of importing and distributing fuel, especially in winter, adds to the retail cost of petrol products and also compounds the existing volatility of fuel prices. Several interviewees reported instances of fuel shortages during winter months. As well as the seasonal price fluctuations, instability of fuel supply and price can be caused by disputes over contracts for petrol imports. One possible means of protection against price fluctuation and petrol shortages is the existence of strategic petroleum products storage, especially in net importing countries such as Afghanistan. The Asian Development Bank has pledged US$18m for the reconstruction and development of petroleum storage facilities. However, public sector strategic storage of petrol products also has its own costs and inefficiencies and building reserves at a time when world fuel prices are so high could result in large fiscal losses.

Uncompetitive pricing and continued price controls

The fuel study found some evidence of price setting by wholesalers and retailers of fuel. One group of wholesalers described how the price of fuel was negotiated between them in a daily meeting, explaining “there is a small OPEC here every day”. The Kabul wholesale market reported that petrol pump station owners from Kabul would send representatives to the Kabul market every morning to check the price of fuel and decide on their own prices. One wholesaler explained that buyers would often buy fuel from several traders if they needed a large consignment, a system which increases the incentive for traders to agree with each other on pricing. In one Mazar pump station, researchers were told that there was limited scope for reducing the price of petrol and diesel, explaining: “If we reduced the price too much, other pump stations would come and complain.”

This lack of competitive pricing in bazaars in Afghanistan was reflected in the raisin market. Within local and provincial raisin wholesale markets, a complex system of price setting was found to be at work, in which prices could rise or fall frequently, sometimes within the space of a single trading day. In local markets, farmers often sold to small and large traders, who in turn sold to large wholesale markets or directly to commission agents of exporters. Farmers could also sit in the market with their gunny sacks and sell raisins in small amounts to retail customers, taking their pricing cues from other products already on sale in the market. Pricing systems in local and wholesale markets sometimes acted as a disincentive to bulk buying for large orders, since sellers tended to respond to buyers interested in large lots of raisins by increasing, rather than decreasing, the price. Large customers were therefore forced to cloak their procurement behind purchasing agents buying small lots at irregular intervals. This self-defeating market behaviour made it difficult for traders to procure products opportunistically to meet large overseas orders. A further disadvantage of this system was that exporters could not easily deal directly with producers over, for example, quality of the product. As soon as it is known that a large order is in the offing (particularly from an international company), then the price inflates to a level that is beyond the buyer’s reach. Some have suggested than an auction system, such as those used in most wholesale markets for fresh produce worldwide, would be a more effective way of selling raisins.

In addition to these unorthodox pricing mechanisms, there continues to be some control of prices of commodities by local governments in Afghanistan, at least in theory. Kabul municipality has a price control department, which technically sets and inspects prices for a list of commodities in the city’s bazaars. In June 2004, Kabul bakers went on strike to protest the municipality’s decision to reduce naan prices and to price...
bread by weight rather than by size. Bakers alleged that the city did not have enough inspectors to thoroughly regulate bread prices and so this was frequently used as an excuse to demand bribes.41

“Dutch disease”, prices and competitiveness

Afghan manufacturers, represented here in the pharmaceuticals sector, complained of the low cost of imported products, which made it difficult for domestic producers of similar products to compete. This is partially due to Afghanistan’s liberal trade regime, as well as smuggling, but is also affected by the relatively high real exchange rate of the Afghani. Over the 30 months up to September 2005, the Afghani appreciated by around 20 percent in real effective terms, contributing to higher costs of labour and other inputs for Afghan producers. The relative strength of the Afghani has been the result of a number of factors, including the large inflows of hard currency from the opium trade and from international aid. This effect is similar to the “Dutch disease” experienced in countries where the discovery of natural resources raises the value of the country’s currency, making manufactured commodities less competitive, boosting imports and reducing exports. The term “Dutch disease” was coined after the Netherlands suffered from this phenomenon following its discovery of North Sea gas. The IMF has recommended that other factors reducing competitiveness, such as low productivity of labour, poor infrastructure, lack of electricity and absence of transparency should be addressed, rather than any exchange rate intervention.42

4.2 Free market, or free for all? Government regulation

Government regulation of markets in Afghanistan is bureaucratic, confused, contains many inappropriate and overlapping functions shared by different ministries and hence is often used merely as a means of rent-seeking by officials. Where regulation is really needed, such as in the sphere of basic standards and gathering public revenue, there is no capacity to enforce rules and regulations even when they exist. This is the worst of all worlds.

Government has an important role in gathering revenue from domestic industry and trade, issuing licences to traders, monitoring business practices to ward against anti-competitive trends, and ensuring that imported products meet basic standards. Government also has a responsibility to encourage and support Afghan producers and exporters especially in the traditionally important raisin and carpet sectors. However, the Afghan government faces serious difficulties in fulfilling all of these functions, due to lack of capacity, heavy bureaucratic procedures, bribery and corruption. There is also a need for ministries to clearly define and explain their regulatory role in relation to private sector activities in their areas of responsibility. For example, there is a real conflict of interest in the fact that responsibility for licensing and quality testing for private companies and traders is held by departments running State Owned Enterprises (SOEs) which themselves import or produce commodities in at least two ministries (MoC and MoPH). Nevertheless the licensing and testing functions are important and should be housed in departments that have the capacity to carry out these functions once the SOEs are privatised and divested of this regulatory role.

Legacies of state control

Many sectors of the Afghan economy continued to exhibit traces of the government

41 Institute for War and Peace Reporting, 24 June 2004, Bakers Bring Capital to its Knees, Kabul: IWPR.
http://www.iwpr.net/?p=arr&s=f&o=153726&apc_state=heniarr2004
involvement in the economy until 1992. This was especially apparent in the import markets considered here, all of which had some degree of state involvement, and in the case of the petroleum import market, a state monopoly. This has left government bodies in some sectors which formally have a role both in producing or importing with granting licences for private producers or importers.

In the fuel market, there was dependence on the Soviet Union as a source of petroleum products until its disintegration in the early nineties and a strong legacy from the previous government monopoly on importing fuel. In March 1991, as part of the reforms of the Najibullah period, the privatisation of the fuel trade was announced. This did not prevent acute fuel shortages in 1992, as the regime’s fuel deliveries from the disintegrating Soviet Union fell short of the contracted amount by 90 percent. Private sector fuel traders and truckers filled the gap left by the state’s collapse during the mujaheddin period. The Taliban relied on fuel imports from Pakistan, some of which may have been in the form of aid, and also on contracted fuel imports from Turkmenistan. The fuel import market continued to be dominated by private actors.43

The former government import system possessed a storage, transportation and distribution infrastructure, designed to protect the country from fuel shortages and price fluctuations. Of the original strategic storage capacity owned by the Department of General Petrol Products (DGPP) less than a quarter is still available. Today, the DGPP is responsible for supplying fuel to ministries and other government departments, and in order to do this it uses a mixture of its own imports, the three percent in-kind charge which it levies on importers of fuel, and fuel which it buys on the open market. The DGPP also issues licences for private sector importers.

The pharmaceutical sector also bears the hallmarks of government involvement in manufacturing and import. From the 1970s until the end of the Najibullah period in 1992, Afghanistan was a producer of pharmaceuticals. Those pharmaceuticals that were imported from abroad mostly came through the MoPH, specifically through the SOE, Avicenna Pharmaceutical Institute (API), established in the 1970s. As well as importing and distributing pharmaceuticals, licensing and monitoring private sector imports, API also previously produced around 120 different types of pharmaceuticals. At this time there were few private importers. When this government system began to collapse in the early nineties, production capacity was dramatically reduced and individuals began bringing pharmaceuticals into the country privately. API no longer has any significant production, although it retains its factory buildings and is responsible for granting licences to importers throughout Afghanistan. API is on the list of SOEs to be privatised in Afghanistan.

**Customs procedures, other taxes and charges**

The IMF and the World Bank have been advising the government of Afghanistan on how to modernise the Afghan tax regime to produce a more effective and transparent system conforming to international standards. A new customs code has reduced and simplified the previously very large number of customs duty rates to six major categories: 2.5 percent (essential food and non-food products), 5 percent (raw materials and capital goods), 8 percent (petroleum sector), 10 percent (semi-manufactured products), 15 percent and 16 percent for respectively luxury and non-priority products.44 However, in spite of these advances, lack of human and technological capacity at border ports, convoluted bureaucracy, and rent-seeking by officials mean that the World Bank

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Investment Climate Assessment can record the following experiences of customs procedures:

Businesses report that customs officials continue to use wide discretion on the valuation and inspection procedures, which leads to corruption and delays. The investment climate survey found that on average it took firms nearly ten days to clear exports last year and about eight days to clear imports. Shipping agents report that this time could be lowered to a few hours if they were willing to pay a large enough bribe. Medium-sized firms complain about discrimination by the customs regime. Small traders can evade duties, taxes, and informal payments, and the very large companies, particularly foreign companies, are able to negotiate tax incentives. But the average small Afghan company is too big to hide and too small to fight, so it bears the burden of the government taxes and regulations.45

In all of the AREU commodity chain studies, lack of capacity in customs houses and convoluted customs procedures were a commonly reported problem. Researchers heard reports of nepotism and patronage in customs appointments at border ports, appointments which could provide rent-seeking opportunities for those inclined to take them. It was suggested that differential tax rates and tax exemptions were being granted to some traders without legal grounds and sometimes by officials who lacked the official authority to do so. Thus, the lack of enforcement capacity means that local customs officials may be granting unfair tax concessions to favoured traders.

In spite of the streamlining of customs taxes after the new customs code, the AREU studies found that businesspeople still had to pay a bewildering array of customs and other taxes and charges, which were collected in a variety of ways. Unofficial taxes were also reported in more than one sector. Demands for money at illegal checkpoints set up by local commanders or other power holders, reported in the raisin case study researched in 2004, is believed to be a diminishing problem.46 However, there is ample anecdotal evidence that unofficial “charges” levied by government employees and other players remain common, and one such example was encountered in the fuel sector in Nimroz.

The following categories of charges were encountered in the six case studies, illustrating that there is ample room for further streamlining and clarification of these charges and procedures, to entice traders into the formal economy.

Import duties and procedures

The eight percent customs tax on diesel and aviation fuel is variously levied at the border itself or at the nearest main inland customs office. A small number of border ports have facilities to process large tankers and have the authority to collect tax for fuel. Thus, the eight percent tax is collected at the border crossing itself in Turghundi and Islam Qala, but imports from Heiratan were paid for in the provincial customs office in Mazar-i-Sharif. A two percent transaction tax is also applicable to fuel importers and would normally be paid to the Ministry of Finance (MoF) at the end of the tax year. However, the Customs Department at the MoF reported that for fuel imports, this was levied at the border due to the difficulty of collection at the end of the year, so in this case customs was operating as a collection agent for the revenue department. There is also a tax of three percent which is levied at customs from importers who do not have a business licence, in an attempt to obtain revenue from transient traders. It is likely that the majority of, if not all, fuel importers do possess a

46 Ibid, 28.
business licence. Nonetheless, there are a number of unclear charges levied at customs.

Vehicles are taxed at between 10 and 16 percent according to model and year. Spare parts are taxed at a lower rate than complete cars, with the rate varying according to the type of spare part. The average rate is five percent. Lorries and buses are taxed at a rate of 2.5 percent. A database, based on market information from Afghanistan and abroad, is used to decide the value of imported vehicles and spare parts in order to calculate taxes. There is no pre-declaration of value of goods by importers. This sometimes leads to disputes between importers and customs over the latter’s valuation of goods. Right-hand drive vehicles have been impounded by customs since their import was banned in 2004. This was a cause of considerable complaint from a number of importers, who reported that they owned right-hand drive vehicles that were now stuck in the customs compound in Herat. Importers also complained that the process of extracting vehicles from customs could take weeks.

Importers reported that medicines were taxed at a rate of four percent and this tax was charged at the main customs offices. It is unclear how this fits with the six categories of taxation mentioned above. Chemical and pharmaceutical raw materials imports were taxed at 2.5–5 percent. Value-added tax was also charged on pharmaceuticals at two percent. As there are no laboratories for testing medicines or raw materials for pharmaceuticals production at border ports or in provincial customs offices, medicines and raw materials are held in these customs offices while samples are sent to the MoPH laboratories in Kabul to be tested. This process can be very lengthy and pharmaceuticals can be held for up to three months before being released from customs. As many medicines require refrigeration and some are damaged by extremes of heat or cold, many pharmaceuticals are damaged or destroyed while they are being held by customs. This represents a serious disincentive to involvement in official customs procedures for importers of pharmaceuticals.

**Charges by other ministries and duplication**

The MoC imposes a three percent charge for use of the petrol storage, loading and measurement facilities at border crossings that belong to the MoC, which is paid in-kind. This fee is variously paid at the border or in the nearest provincial capital and in Zaranj, where there were no government storage facilities, was not paid at all.

Some importers of second-hand vehicles said that they had sometimes been forced to pay customs taxes on imported vehicles twice, once in Herat and once in Kabul. The origin of this complaint was unclear. Vehicles need to be taken to the Kabul Province customs office before they can be registered in Kabul, and their documents checked. It is possible that during the period when Ismail Khan was governor of Herat, and some customs duties from Herat were not reaching the central government, Kabul customs compensated by charging duties on vehicles for which duties had already been paid in Herat.

Many importers of medicines reported that they sold, at a discounted price, 20 percent of the medicines they imported to the Department of Pharmaceuticals in the MoPH. Researchers were unable to find out whether this is a requirement for all importers and what is its legal and institutional basis.

**Unofficial charges**

It appeared that unofficial taxes were being paid by fuel traders in Nimroz. In Zaranj, the researchers were shown a document noting taxes paid to the “Nimroz Province Council of Rehabilitation”, even though by law all taxes raised (with the exception of municipal taxes) must be remitted to Kabul. Researchers received some reports of additional taxes for transporting fuel into different provinces, especially Kandahar.
**Export duties and procedures**

Customs tariffs and procedures have been changed since the research on raisins and carpets was conducted in 2004. Raisin exporters in the north reported that export taxes of 2.5 percent (for food products) had been temporarily removed by Presidential Decree on September 24, 2002, but a 0.5 percent tax had been re-imposed on all export and import operations and was paid to the Ministry of Finance (MoF) bank account in Mazar. But some exporters firmly asserted that they were still paying a 2.5 percent export tax.

The government has a responsibility to ensure that customs procedures on the Afghan side do not inhibit exports. Afghanistan’s difficulties in reaching markets beyond the immediate region are not confined to the transit and logistical issues described in the section on trade routes and relationships. Often, Afghan customs procedures are simply not geared towards the requirements of, for example, European markets. The recent experience of a consortium of Afghan carpet producers who attended the Domotex carpet fair in Hanover in January 2006 illustrates this point. The carpet producers experienced considerable problems with clearing their carpets through German customs. At the time of writing, one month after the end of the fair, the carpets had still not cleared. The main problem was the forms provided by Afghanistan. These had not been completed correctly—an error both of the party responsible for shipment and the responsible government authorities. Astonishingly, the paper which the Afghan government uses for the Form A document was rejected by German customs, and this paper was not available in Afghanistan at the time. If Afghanistan is to reliably export to Europe, these issues need to be addressed, ensuring that traders and the Afghan authorities are aware of European requirements and procedures, including the paper on which forms must be submitted.47

The IANDS has committed to further reducing the complexity and streamlining customs procedures and improving enforcement of the new customs code. The government also aims to move towards full computerisation and further improvement of border infrastructure.

### 4.3 Setting, testing and enforcing basic standards

The most conspicuous feature of standards or their absence is the lack of proper health and safety protection for Afghan workers and for foreign labourers in Afghanistan. Workers in wholesale markets for petroleum fuels told researchers they were not provided with protective clothing and none of these markets appeared to have facilities for dealing with fires or explosions. *Bhatas* or furnaces producing baked bricks in Pakistan or Afghanistan traditionally employ Afghan workers and are associated with poor pay, and poor conditions with a significant risk to

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47 Thanks to the On the Frontier (OTF) Group for sharing this information.
health. The construction industry is a similar cause for concern and the paucity of health and safety measures in construction projects can be easily observed on an average street in Kabul.

**Standards for imported goods**

The absence of basic specified standards for imported commodities into Afghanistan, or the capacity to remove sub-standard products from the supply chain, was a serious concern arising in all the case studies covering import markets. There are public health ramifications of failing to set and enforce standards, especially for products such as pharmaceuticals and food, which have the capacity to damage health directly if they are of poor quality. Standards of petroleum fuels and used vehicles also have a public health impact, as poor quality can lead to accidents and increased levels of urban pollution.

The issue of standardisation will be addressed by a new body, the Afghanistan National Standardisation Authority (ANSA), within the Ministry of Commerce, established as a result of work done by the National Commission for Metrology and Standards. This body has been created with the support of the World Bank Emergency Customs Modernisation and Trade Facilitation project and is also part of the UNIDO Post Conflict Assistance for Industrial Rehabilitation and Development in Afghanistan. ANSA will have a remit both for testing and regulation of consumer products in Afghanistan and is set to be the single national standards authority for all domains, as specified in the Presidential Decree 952. ANSA will eventually offer testing facilities for domestic producers, who will be able to pay for tests to certify the basic standards of good for export.

In the developed world, petrol and diesel imports must meet set specifications in terms of physical properties, chemical composition and performance tests. There is no specified standard of fuel that must be met upon import to Afghanistan, although when import companies register with the DGPP, they “commit” to importing high-quality fuel. There are laboratories for testing fuel at border ports, but the condition of their testing equipment is not known and anecdotes suggest these are practically non-operational. Currently, therefore, the only documentary assurance of standard is the certificate supplied by the importer from the source of the fuel. However, there are inadequate facilities for verifying these quality assurances.

Poor quality fuel continues to be a serious concern in Afghanistan. Many customers interviewed reported that fuel was sometimes mixed with water and that this caused it to freeze in engines in the winter. Diesel does naturally thicken in cold conditions, but it is possible that fuel is being adulterated with water and also with other substances. Kerosene sold for domestic heating and lighting is also sometimes mixed with aviation fuel, which is more flammable, leading to explosions and, in some cases, severe burns to consumers. Fuel for use in Afghanistan needs to take into account the differences in altitude in the country and the marked differences in climate between summer and winter. Higher altitudes require less volatile petrols and diesels, and different grades of diesels are required for summer and winter use. The use of poor-quality fuel involves both public health loss and also commercial loss for Afghanistan, as engines are damaged and energy efficiency is impaired. Use of poor quality or polluted aviation fuel can significantly reduce the life span of engines.

There is a risk that Afghanistan is becoming a dumping ground for poor quality vehicles. Many vehicles on the market in Afghanistan

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are very old. Old vehicles are potentially dangerous, both in terms of roadworthiness and accidents and in terms of harmful emissions. In the developed world, technological progress and stricter regulation to protect the environment have resulted in a considerable reduction in harmful emissions from road vehicles. In the face of floods of sub-standard vehicles, some governments in the developing world have imposed restrictions on the import of vehicles older than a certain date. Since Afghanistan does not have a domestic automotives industry, and has a continuing demand for affordable vehicles, strong restrictions may not be appropriate in this context. Nonetheless, the market might sustain some level of restriction or, at the very least, better regulation of quality through increased inspection, active enforcement of inspection by rejecting substandard vehicles, and servicing.

The extent to which the Traffic Department is able to ensure the road safety of second-hand vehicles is uncertain. It is not clear whether the department has the facilities to check if reconditioned vehicles have been involved in accidents, or whether speedometers have been altered to show a lower mileage reading. Since the ban on right-hand drive vehicles in July 2004, many altered steering Japanese vehicles have flooded the market and the Traffic Department also lacks the means to check whether the alterations have been properly carried out. Traffic Department officials reported that they did not possess facilities to check whether a vehicle might have been stolen in its country of origin. Some spare parts may be counterfeit, may have been taken from a vehicle that has been stolen and dismantled or from a vehicle that has been involved in an accident. Spare parts are subject to less inspection than complete vehicles as they do not go through the registration process.

Public and environmental health

The use of low quality and polluted fuel in old and poorly tuned engines combine to produce air pollution. That air pollution from petroleum fuels is a potential problem in urban areas of Afghanistan can be seen by anyone stuck in traffic in Kabul—in the emission from exhausts of diesel soot, which is suspected to be a carcinogen. There has been little research of air pollution levels in Afghanistan. A United Nations Environment Programme mission to Afghanistan in 2002 carried out some air sampling at urban sites in Kabul, Mazar, Herat and Kandahar and identified increasing vehicle density in urban areas and use of low-grade diesel as serious causes of air pollution. High levels of poly aromatic hydrocarbons (PAHs) “most likely originating from vehicle exhaust emissions” were discovered in some areas:

The highest concentrations were detected in Mazar-i-Sharif, where analyses show 13.6 Ng/m³. The WHO average values for urban areas range from 1 to 10 Ng/m³. Concentrations for Kabul and Kandahar were between these values, while those for Herat were below WHO average values.49

One of the PAHs discovered in the air during this sampling was identified as benzene-a-pyrene, a substance suspected of increasing the risk of lung cancer. The potential risk to human health of PAHs is increased by the presence of dust in the air, which binds hydrocarbon particles and prevents them from escaping into the atmosphere.50 There is a need for more research on pollution levels from car emissions in urban areas of Afghanistan. The Afghanistan Compact agreed in London in January 2006 has committed, in line with the country’s Millennium Development Goals, to an environmental regulatory framework and management.

49 United Nations Environmental Program (UNEP), January 2003, Afghanistan Post Conflict Environmental Assessment, Switzerland: UNEP.
50 Ibid.
services for the protection of air and water quality and pollution control at government and community level, by the end of 2007.\textsuperscript{51}

The danger of sub-standard pharmaceuticals to the consumer is particularly acute since these products are relied upon to treat ill health. In practice, the MoPH lacks the capability to regulate the wholesale, retail and particularly the import of medicines effectively. Samples of the medicines importers intend to import must be taken and these must pass tests at the quality control laboratory, based in the main building of the MoPH in Kabul. But the sheer number of imports brought unofficially into the country greatly outweighs the capacity of customs and border guards to control and so does not come to the attention of the MoPH until the smuggled products reach the shelves of wholesale and retail outfits.

Products of concern that are believed to be present on the market include: counterfeit medicines, expired medicines and medicines that have been banned in Afghanistan because of their adverse side effects. The WHO defines a “counterfeit” medicine as one that is produced with an intention to cheat. This can include mislabelling (including fudging expiry date), or use of no active ingredients, a wrong active ingredient, or the correct ingredient in an insufficient quantity. Both branded and generic products can be counterfeited according to this definition. Counterfeit medicines are distinct from substandard medicines, which are genuine medicines produced by legitimate manufacturers that do not meet the quality specifications that the producer says they meet.\textsuperscript{52} There is a large amount of anecdotal evidence that both substandard and outright fake medicines are available on the Afghan market. Counterfeits are often difficult to detect, especially in countries such as Afghanistan, where the regulatory system is weak. Only very small scale sampling has taken place of medicines on the market. It is possible that fake medicines are targeted at more remote and poor areas. As the WHO points out, “the main victims of this trade in the (developing) world are usually the poor, particularly in rural areas. They buy these drugs because they are often cheaper than the genuine products.”\textsuperscript{53}

The current quality control system in Afghanistan relies on the laboratory in the main building of the MoPH in Kabul. This laboratory has received some equipment from the WHO, but when researchers visited, staff reported that their capacity and equipment was not equal to the huge task of testing samples from customs offices and from the market. The Department for Pharmaceuticals has 66 inspectors, including 32 pharmacists,\textsuperscript{54} responsible for conducting visits to check the type, quality, date and price of medicines sold in wholesale outfits, pharmacies and reportedly even in grocery stores. If these inspectors find substandard or expired medicines on sale, they confiscate and destroy them. Inspectors are active in Kabul every day, and inspections are technically also conducted in the provinces, but it is unclear how widespread such inspections are outside of Kabul.

**Standards for producers**

Standards are also of vital importance for Afghan producers and exporters, especially to gain access to markets that demand high quality. Testing of raisins for export is conducted by two bodies. The first is the Afghan Raisin Export and Other Dry Fruit Export Promotion Institute, in the MoC, which

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\textsuperscript{52} World Health Organisation (WHO), May 2005, Counterfeit medicines - some frequently asked questions, http://www.wpro.who.int/media_centre/fact_sheets/fs_20050506.htm

\textsuperscript{53} Ibid.

has a small laboratory and issues a certificate of “quality control”, a procedure for which it charges 50 Afs/mt. Secondly, provincial departments of the Ministry of Food, Agriculture and Animal Husbandry also provide a certification service to exporters of raisins. When a trading company has its consignment ready to be shipped for export, this department sends a representative to the processing plant where he checks the quality of produce. The cost of the phyto-sanitary certificate is said to be 50 Afs. There is a combination here of poor capacity to deliver thorough testing and certification and institutional overlap in the delivery of this service. Afghan traders are currently unable to certify their product with international food safety bodies such as the Hazard Analysis of Critical Control Points, which is part of the International Standard Organisation 9000, and EurepGAP, the Euro-Retailer Produce Working Group certification of Good Agricultural Practices. This is partly due to lack of thorough planting and processing information.55

In the carpet market, the establishment and application of quality standards through labelling and certification could reinforce the traditional Afghan brand linked with a strategy to deliberately position Afghan carpets in a niche upper market segment. Such labelling could support the use of high quality raw materials (such as hand-spun qaraqol wool) and the development of traditional designs.

55 Thanks to OTF for this information.
5. Conclusions

5.1 Looking ahead: the government’s role in business

The Interim Afghanistan Development Strategy (IANDS) has specified numerous commitments relating to the private sector and economic development that will be important to Afghanistan’s economic future. First, the Afghan government has pledged to simplify and harmonise all legislation relating to investment by the end of 2006 and to implement this legislation by the end of 2007. The IANDS process also has made a commitment to “facilitate the enabling conditions for Afghanistan to resume its role as a land bridge between Central and South Asia in order to benefit from increased trade and export opportunities”. This is to be achieved through cooperative border management and other multi-lateral or bilateral trade and transit agreements. This is a complicated commitment, since it requires the cooperation of Afghanistan’s neighbours, some of whom have a vested interest in the current terms of regional trade.

Even if the wider picture of regional trade cooperation is hampered by political sensitivities, there is room for concrete progress on “win–win” trade facilitation steps, as recommended by the World Bank. One such step could be the creation and extension of cross-border zones allowing people and goods to move more easily across these borders and border zone bazaars, encouraging informal traders to use formal routes.56

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It will also be necessary to review existing regulatory practices and responsibilities of government bodies relating to the private sector. Duplicated roles or anachronistic practices such as any unwarranted price fixing activities by local government should be removed. Regulatory roles of SOEs should be re-housed in appropriate ministerial departments when these enterprises are divested.

Meanwhile, regulatory capacity should be increased where it is really needed, such as in the sphere of enforcing standards. There should be clarity over the institutions that have responsibility for setting and testing standards of different commodities. The Afghanistan National Standardisation Authority in the Ministry of Commerce, established with the support of the World Bank Emergency Customs Modernisation and Trade Facilitation project and also part of the UNIDO Post Conflict Assistance for Industrial Rehabilitation and Development in Afghanistan, could be an important body for setting baseline standards for imported and domestically produced goods. ANSA will develop laboratories that will have a regulatory and a commercial role.

Another legitimate aspect of regulation is the monitoring and addressing of anti-competitive practices to ensure the maximum realisation of the benefits of free market competition in terms of increased productivity and innovation for businesses and better value for consumers. Appropriate space should be maintained between senior politicians and other officials and large business players in order to reduce the improper patronage of some businessmen by political figures.

5.2 Promoting import substitution and exports

The strategy for providing licit livelihoods will focus on economic activities that produce import substitution or goods for export, not expansion of subsistence farming.


The case studies considered here reveal a truth that is reflected throughout the Afghan economy: namely, that it is easier to make money by importing commodities into Afghanistan than by investing in productive assets and attempting to manufacture goods on a commercial footing in such a difficult business climate. Afghanistan needs a diversified economy that relies not only on “import–export” activities that are often dominated by imports and re-exports. The government is already committed to an “export strategy”, initially to promote labour-intensive, export-oriented manufacturing. Carpet and raisin manufacturers and traders both fall into this category, but as outlined above, both face significant challenges to reaching their export potential.

There should be ample room in the Afghan economy for domestic production to substitute...
imports, but this is often prohibitively difficult in practice. This was evident in the pharmaceutical sector, where domestic producers, including two foreign direct investors, were attempting to navigate the bureaucratic hurdles necessary to compound medicines in Afghanistan to compete with foreign imports. Imports far outstrip exports in Afghanistan, which posted a huge trade deficit of US$2.69bn or 45 percent of GDP in 1383 (2004/5). This deficit is met by foreign donor aid, the operational spending of foreign entities in Afghanistan, remittances from Afghans abroad and opium exports. The foreign currency that has entered Afghanistan as a result has contributed to a high real exchange rate, making imports cheap and the relative cost of labour more expensive. The liberal trade regime, allowing countries that subsidise their own producers to import to Afghanistan cheaply, has compounded this problem.

5.3 Are we expecting too much from the private sector?

The expectations placed on the private sector in Afghanistan are high. The private sector is expected to help fill the gap left by the opium sector by delivering sustained high levels of growth in an extremely difficult investment environment, and, moreover, this growth should be “pro-poor” in nature.

It is not at all clear that the private sector has the capacity to deliver all these expectations. Targeted assistance for private sector actors is required. Many of the steps that entrepreneurs need are not very sophisticated. For example, government institutions supporting the private sector should ensure that Afghan procedures and paperwork are fully consistent with the countries whose markets Afghan traders are aiming for. Other steps, such as addressing access to land for entrepreneurs, are more complicated. The development of investment parks may be one medium-term solution, for those entrepreneurs who can secure a place in such a park.

What do we mean by “pro-poor”?

The Afghan government, with its development partners, has committed to the goal of a specific type of economic growth, variously described as “broad-based” (Securing Afghanistan’s Future), “equitable” (The Afghanistan Compact) and “pro-poor” (IANDS report). It is true that economic growth does reap benefits for all, and is a precondition for long-term poverty reduction and social development, but there is a growing consensus that growth alone is a rather blunt tool for poverty reduction. Policymakers in the Afghan context have gone further than to rely on growth alone, they have specified that growth must be pro-poor. The 2004 report Securing Afghanistan’s Future stipulated that “growth must be broad in the sense of being spread broadly across the country and throughout society; otherwise it may not help and could even be destabilising”. The IANDS report has elaborated that this will rest upon the following measures:

- Improving access to infrastructure such as electricity, roads, irrigation and drinking water.
- Access to education, including on-the-job and vocational training and improved access to health care, is also promised as a means of improving the productivity of labour and generating growth in new areas.
- The government has also pledged to progress with land registration to protect the assets of the poor and allow land

57 Ibid, 45.
59 GoA, Securing Afghanistan’s Future, 5.
assets to be used as collateral for investment in fixed capital.

- The government can improve the regulatory system for private financial markets, including micro-finance services that benefit the poor.

- The IANDS report mentions a planned programme of “value-chain” investments to stimulate rural economic activities such as horticulture and livestock.

All of these measures are of great importance in ensuring that the poor can participate in the private sector and in generating growth. However, many of these measures are rife with difficulties and potential delays. Land registration, for example, is a complicated issue, involving influential local power holders in many cases.

In the meantime, the private sector continues to operate in a way that does not necessarily benefit the most vulnerable groups in Afghan society. The case studies considered here do not reveal any particular pro-poor dimension of markets as they are currently functioning in Afghanistan. Marginal players are poorly remunerated, lack access to markets, are indebted or are trapped at a micro-scale of activity. This is not a fault of the private sector or of Afghan businesspeople. It is not the inherent role or purpose of markets to be pro-poor, since they rely first and foremost on the motive of profit.

Other government policies are also being described as pro-poor, such as the “pro-poor counter narcotics strategy”, which features in the Afghanistan National Development Strategy report. The use of this phrase in relation to the counter-narcotics strategy is questionable. Although it is true that this strategy can be conducted in ways that mitigate the damage to the poor (for example by concentrating efforts on traffickers) this is not a process that can realistically be called pro-poor. Eradicating opium from the economy will cause a contraction, and as is argued in the same document, growth is good for the poor; economic contraction is not. There is a danger that “pro-poor” is becoming no more than an adjective that is attached to policies, without tangible evidence that these policies will deliver maximum benefit to the poor. Without such evidence, the phrase loses its meaning.

Since pro-poor growth is such an important aspect of Afghan development as envisaged by the government and its development partners, the meaning of this phrase should be more clearly defined and agreed by policymakers, and its policy implications operationalised in a systematic manner. There may be a case for research into growth strategies and poverty reduction in Afghanistan, incorporating the wider Asian experience of growth and its impact on poverty. Such research could identify the possible impact of factors such as agricultural growth, employment, the trade deficit and opium eradication on poverty reduction in Afghanistan.

Perhaps the greatest expectation placed on the private sector is that it should contribute to economic growth at sustained high levels. Licit economic growth has declined from 28.6 percent in 1381 (2002/03) to 15.7 percent in 1382 (2003/04) and 7.5 percent in 1383 (2004/05). Real growth is forecast at 13.6 percent for 1384 (2005/06). Securing Afghanistan’s Future estimated that Afghanistan needed a sustained real growth rate of nine percent per year of licit GDP to

achieve stability and compensate for the contraction that will be caused by the elimination of the narcotics sector.\textsuperscript{63} This was based on UNODC data estimating the size of the likely contraction caused by elimination of opium from the economy in a gradual process, over 12 years, a process that is now expected to occur in a shorter time frame. The IANDS in February 2006 expressed government concerns that growth rates may slump.\textsuperscript{64} Nonetheless, the report continues to aim for high levels of economic growth in the medium and long term, hoping for levels of 7–9 percent in the long term.

There are many unpredictable factors in assessing growth prospects in Afghanistan. Strong growth in an immediate post-conflict setting, from a very low base and often boosted by large inflows of foreign aid, is a common phenomenon and does not guarantee sustainability of economic growth. The scale of economic contraction that will be caused by opium eradication according to its current timetable has not been clearly set out by policymakers. Finally, the agricultural sector accounts for the largest share of current economic growth (37 percent of estimated GDP in 2004/05)\textsuperscript{65} and is dependent upon climate. There is a real need for further investigation of growth expectations, to assess what is realistic.

\textsuperscript{63} GoA, \textit{Securing Afghanistan's Future}.


\textsuperscript{65} Ibid, 44.
Afghan participates in the following regional and multilateral trade agreements and organisations:

- The Economic Cooperation Organisation (ECO), established in 1985 as the successor organisation of the Regional Cooperation for Development, and now including Iran, Pakistan, Turkey, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. ECO has two transit trade agreements, agreed in 1995 and 1998. Afghanistan has signed the ECO Trade Agreement (ECOTA) of 2003, designed to reduce tariffs in the region but only five of the ECO member states have signed this agreement and only two have ratified it. ECO has yet to establish itself as a strong economic bloc and facilitator of trade in the region, due to internal differences.

- Afghanistan was admitted to the South Asian Association for Regional Cooperation (SAARC) in November 2005, joining Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. SAARC has a South Asia Free Trade Agreement which came into force on 1 January 2006.

- In November 2005, Afghanistan also was admitted to the Central Asia Regional Economic Cooperation, which facilitates greater policy coordination in former Soviet Central Asia.

- The Central and South Asia Transport and Trade Forum, established in 2003 and including Afghanistan, Iran, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan, is designed to improve transit corridors and promote equitable growth in the region. The Chairmanship and Secretariat are held by the Asian Development Bank.

- Afghanistan has also applied for membership of and has observer status at the World Trade Organisation (WTO). There are many institutional hurdles to be overcome before Afghanistan might be granted WTO accession, but the country does already possess a liberal trade regime with the lowest tariffs in the region.

- Afghanistan also has two trilateral Trade and Transit Agreements: one with Iran and India and another with Iran and Tajikistan.

In 2003, Afghanistan was granted preferential trade terms for exports, on the model of the Generalised System of Preferences by the EU, US, Japan and India.
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