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Trade and Regional Cooperation between Afghanistan and its Neighbors

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ACRONYMS AND ABBREVIATIONS

AAN	Afghanistan and Neighbors
ACCI	Afghan Chamber of Commerce and Industry
ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
ASYCUDA	Automated system for customs data
ATTA	Afghanistan Transit Trade Agreement
CAR	Central Asian Republics
DAB	Da Afghanistan Bank
ECO	Economic Cooperation Organization
FIATA	Fédération Internationale des Associations de Transitaires et Assimilés
IFI	International Financial Institutions
MFA	Multi-Fibre Agreement
NTBs	Non-Tariff Barriers
IFIs	International Financial Institutions
IRU	International Road Transport Union
SAPTA	South Asian Preferential Trading Arrangement
TIR	Transports Internationaux Routiers
TISA	Transitional Islamic State of Afghanistan
TRACECA	Transport Corridor Europe Caucasus Asia
TTF	Trade and Transport Facilitation
UNCTAD	United Nations Conference for Trade and Development
WCO	World Customs Organization
WTO	World Trade Organization

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TRADE AND REGIONAL COOPERATION BETWEEN AFGHANISTAN AND ITS NEIGHBORS

Executive Summary

Introduction

1. Afghanistan and its five closest neighbors, Iran, Turkmenistan, Uzbekistan, Tajikistan and Pakistan, have opened the way to cooperative efforts to foster transit trade and improve trade facilitation. Such initiatives rank among the most important actions that these countries can take to improve regional growth. The path on which they have set out is a long and difficult one, but it leads in a promising direction: toward shared growth through stand-alone and coordinated efforts to improve conditions for trade with one another and with the rest of the global economy.

2. In two joint policy declarations nine months apart, the countries of the region¹ have built from an initial pledge of non-interference to a more complex undertaking. See Annex I for details on the declaration signed by countries of the region in Dubai, UEA on September 21, 2003. The Dubai declaration, “noted the need to reduce the logistical cost of trade in the region, and assessed that improvements in trade and transport facilitation (including customs and border agencies reform and closer cross-border cooperation) could bring substantial benefits to the prosperity of the people of the region.” Among other things, the signatory countries have jointly agreed to adopt “the necessary measures” to improve “customs services” along Afghanistan’s borders,” to combine efforts to promote foreign investment, to “share knowledge and best practices” on standards applying to trade in consumer goods and to “consider” ways to advance “regional trade liberalization and increased integration into the world economy

3. These commitments are more than pro forma gestures. The five South and Central Asian signatories can draw on their existing transit-trade agreements and on broader regional institutions, such as the Economic Cooperation Organization (ECO) that links them with: Republic of Azerbaijan, Republic of Kazakhstan, Kyrgyz Republic, and Turkey. They can benefit from many recent initiatives such as establishing the Central and South Asia Transport and Trade Forum (CSATTF), with technical support from the Asian Development Bank (ADB); liberalization of quantitative restrictions under the Afghanistan Transit Trade Agreement (ATTA) between Afghanistan and Pakistan; recent trade and infrastructure discussions hosted by the World Bank and the Asian Development Bank; and support for the reconstruction of Afghanistan from the broader international community.

4. At the same time, these initiatives constitute less than a detailed agenda for joint and separate actions to improve export performance by reducing the aggregate transport and logistical costs of trade. Their translation into practical effect will require not only significant outside assistance for infrastructure investment, but also demonstrable progress, particularly within Afghanistan, to remove physical and political insecurity. It should be acknowledged that the countries of the region have had many previous transit and trade accords, but that these have not been fully enforced, in part due to inadequate monitoring mechanisms and a lack of high level policy commitment.

¹ The Transitional Islamic State of Afghanistan, the People’s Republic of China, the Islamic Republic of Iran, the Islamic Republic of Pakistan, the Republic of Tajikistan, Turkmenistan and the Republic of Uzbekistan. Their joint statements are the Kabul Declaration on Good Neighborly Relations (GNRD, December 22, 2002) and the follow on declaration, issued in Dubai September 22, 2003, on “encouraging closer trade, transit and investment cooperation.”

5. In anticipation of follow-on meeting of the six countries at the official level scheduled for early 2004 and a ministerial review of progress due one year after their September 2003 declaration, this report looks at prospects for and obstacles to cooperation in developing trade linkages in the region and integrating the region with the global markets. Because of Afghanistan's geographic position astride key North-South and East-West routes, the study emphasizes its role in transit trade and its urgent infrastructure needs. It also reviews the countries' trade and investment regimes and measures needed to make them more efficient, transparent and outward-looking.

Summary of Recommendations

6. The report envisages significant, medium-term benefits for Afghanistan and its neighbors from trade policy liberalization, from country-by-country reforms in trade logistics, and, especially within Afghanistan, from road rehabilitation and building a commercially-oriented enabling environment for trade, private investment and entrepreneurial development. The growth of regional and transit trade will boost private investment and growth in the short-to-medium term and help to realize the long-term vision for Afghanistan as a country moving toward middle-income status, based on sustainable development of its resources. For neighboring countries, sustained peace in Afghanistan, open trade and private sector-led growth facilitated by supportive public policies, institutions and social and infrastructure investments, will help secure higher growth and reduce the risk of future economic insecurity. Recent empirical evidence, based on global cross country data, indicates that landlocked countries are at a great natural disadvantage in achieving a competitive trade performance and thus require strong overarching commitments to excellence in trade logistics and effective regional cooperation to manage transit trade.

7. Recommendations focused on Afghanistan include calls for priority action, with broad support from the international community, aimed at:

- Improving security throughout the country both for persons and property;
- Completing the main road rehabilitation, extending telephone and other telecommunication systems and ensuring that after reconstruction maintenance is undertaken to sustain roads in good condition;
- Streamlining of border crossing procedures;
- Reestablishing formal financial and insurance systems including development of an effective clearance and settlement system;
- Implementing a national customs and transit system;
- Eliminating restrictions on direct transit;
- Removing internal checking-posts and en-route inspections; and
- Increasing domestic trucking competition.

8. To foster a strong, enabling environment for domestic and foreign trade, the study also advocates a set of immediate and short-term measures:

- Implement a functioning payments system for international and domestic transfers through the formal banking system;

- Make transit bonds and transport insurance available to shippers through the entry of companies capable of providing adequate coverage;
- Redefine the role of the Afghan Ministry of Commerce to emphasize its mandate in trade and investment promotion relative to its role in trade regulation;
- Support a larger role, distinct from that of government, for a private chamber of commerce to assist in export promotion;
- Design and implement major capacity-building programs to develop skills and professionalism in banking, insurance and customs;
- Encourage truckers and freight forwarders to establish national private industry organizations and to affiliate with international organizations.

9. Paralleling reforms in Afghanistan, its neighbors could facilitate intra-regional trade and with the rest of the world by taking steps to improve trade logistics and to reduce trade barriers, not least by liberalizing outright prohibitions on trade in many agricultural commodities. Specific measures for neighbors to consider include:

- Develop customs and related infrastructure by adopting classification system consistent with international standards, such as the Automated System for Customs Data ASYCUDA, a computerized customs management system developed by UNCTAD (Central Asian Republics (CAR)).
- Review outright trade prohibitions such as agricultural commodities (selected CAR countries) and review NTBs with intention to encourage border trade (all countries).
- Participate in transit trade and transport corridor strategy dialogue (all countries). Make border crossing rules and customs procedures public and easily accessible (all countries). Develop capacity to monitor trade logistics performance (all countries).
- Strengthen ECOs technical resources in areas of survey and monitoring (members of ECO).
- Reduce discriminatory measures against foreign transport operators (all countries).
- Improve telecommunication networks and access among the countries of the region.
- Encourage the development of national freight forwarding associations (all countries).

10. Reducing non-tariff barriers, particularly in the Central Asian Republics (CAR) where they appear to block trade the most, has the potential not only to support general economic growth, but also to encourage trade in labor-intensive commodities, such as agricultural produce and to stimulate growth in rural areas, where poverty is concentrated.

11. Better and more sustainable solutions to improve trade logistics and “behind-the-border” supports will be found, if changes in international transport and trade conditions are regularly measured through appropriate performance indicators and if the private sector is regularly consulted. In the short term, ensuring adequate transit-trade facilities to landlocked Afghanistan will be particularly important. Among the promising options that could promote this goal are focused, easily-monitored corridor agreements, similar to the East Africa’s Northern Corridor

Transit Agreement, which since 1985 has enabled the free movement of cargo and transit vehicles among the member countries, using a single transit document for goods covered by transit bonds. In South and Central Asia, such agreements could stimulate the growth of transit traffic through Pakistan and the greater use of Iranian ports for shipments from Afghanistan and the CAR. To the north of Afghanistan are similarly landlocked countries which are in need of major trade and transport facilitation reforms. Drawing on international research on the determinants of transport cost this study reports that shipping costs are approximately 50 percent higher for the median landlocked country than the median coastal country, but that the landlocked penalty can be significantly reduced with appropriate transport infrastructure investment and well-crafted and carefully implemented trade logistic systems.

12. Simple, short-term steps all countries could take to improve transit trade include actions to:

- publish and place on government webs border-crossing rules and customs procedures;
- develop capacity to monitor trade logistics performance and report findings;
- reduce discriminatory measures against foreign transport operators;
- participate in transit trade and transport corridor strategy dialogue.

13. **Next Steps** for the countries of the region will entail: (i) initiating discussions within governments and among governments and key stakeholders on potential reform measures discussed in this report and related reports prepared by other IFI and regional cooperation agencies; (ii) working to achieve consensus on the formal mechanisms needed to carry the regional cooperation dialogue forward; and (iii) developing a time-bound plan of action to implement consensus decisions once these have been taken. The impetus provided by the 2002 Good Neighborly Relations Declaration (GNRD) and the 2003 pledges on trade, transit-trade and investment can carry over into a number of other initiatives aimed at intensifying regional dialogue and cooperation.

Background

14. The prospects for stimulating poverty-reducing growth through trade expansion between Afghanistan and its neighbors and beyond have improved recently. GDP growth rates are currently over 5 percent in Iran, Pakistan, Tajikistan and Turkmenistan², and trade-reform measures are being implemented by Iran and Pakistan, Afghanistan's two most important trading partners. The most important foundation for reviving commerce along trade routes that date back centuries, is establishment of security and trade conducive enabling environment in Afghanistan itself. This will accelerate the rate of conversion from subsistence to commercial agriculture and encourage new investment in the private sector.

15. New opportunities exist for re-building and enhancing Afghanistan's transportation and energy infrastructures. These opportunities will help recreate previously established trade links between several countries in the region and also open up new trade routes. The promotion of regional trade will boost private investment and growth in the short-to-medium term.

² In a growth league of its own, China is also a signatory of the 2002 and 2003 declarations but, because of its very short and little-traveled frontier with Afghanistan, it is not a primary subject of this report.

16. The TISA has adopted a formal National Development Framework (NDF) that puts the country on the road to an economy where the private sector is the engine of growth and where government regulation is transparent and creates as little distortion in economic life as possible. Among other goals, the NDF aims at customs procedures that meet international standards, a market-determined unified exchange rate, the institution of modern banking laws, and new measures to prevent corruption. Substantial progress has been made on this agenda during 2003. The reestablishment of a professional central bank, the setting up of private banks, and the management of Afghanistan's new currency to maintain low inflationary are noteworthy steps, as are import concessions extended by industrial countries. However, the plan to simplify tariff law and streamline customs procedures to remove trade distortions and lay the foundation of efficient trade logistics has been implemented at a very slow pace. Achieving remedial progress in tariff simplification and customs administration reform will require a strong and sustained commitment from TISA.

17. Without adequate security and steady progress toward political normality, the prospects for the expansion of legitimate production and trade and for longer-term poverty reduction and economic development are not bright. As the transitional authorities work to reestablish political order, they and international donors face an economy characterized by: (i) forced urbanization through the destruction of rural employment; (ii) a lack of uniform application of laws, including taxation and commercial regulation, throughout the country; and (iii) a flourishing large underground economy based on smuggling, poppy cultivation, and narcotics trade that currently offers farmers much better livelihoods than the legitimate economy. These circumstances affect not only Afghanistan; they also generate spillovers in surrounding countries. Policymakers must address these concerns in order to make sustained headway on more traditional trade policy issues.

Trade Prospects and Patterns

18. Fortunately, trade reforms and economic progress underway particularly in Pakistan and Iran, as well as to a lesser degree in the CAR, are creating conditions that can reward progress on the challenges facing Afghanistan. Although the regional economies are improving, most of the countries have a history of difficulties in managing their external balances effectively and in maintaining the stability of their domestic economies in the face of volatile commodity prices for primary exports. Regional governments all face major challenges in designing contingency mechanisms that are effective in achieving multi-year expenditure smoothing, while still maintaining their commitments to open trade. Hence, the need for further reforms, including further trade liberalization, remains important.

19. Its neighbors share an obvious interest in Afghanistan's renewed prosperity, since a reconstruction that puts strong emphasis on rebuilding physical infrastructure has the potential to stimulate trade in the region and foster economic growth. Afghanistan's reconstruction process itself, should also provide opportunities for neighboring countries to supply construction materials and services needed to rebuild the country.

20. Current trade policies of the countries of the region vary substantially, mainly as a result of diverse historical circumstances. Iran and Pakistan are sizable exporters and are largely integrated into the world economy. Both countries have made significant efforts to streamline their trade regimes, with import duties being now the main trade policy instrument. In recent years, Turkmenistan and Uzbekistan, by contrast, have pursued policies intended to promote national self-sufficiency, rather than international integration. The extended use of non-tariff barriers, such as foreign exchange restrictions, import licensing or export restrictions, have made

tariffs largely irrelevant to them. These interventions to reduce foreign trade and establish domestic prices substantially different from world prices are likely to hamper economic growth, notably by limiting domestic competition and preventing an efficient allocation of resources. The desire of the Central Asian Republics to preserve their traditional industrial bases is understandable.

21. Lessons from other regions indicate that developing countries that increased their integration into the world economy over the past two decades have achieved higher growth in incomes and longer life expectancy. A strategy of non-discriminatory openness to global trade is likely to be the best path to capture opportunities for private investment and growth. To benefit from more open trade, countries have to see increased investment in the export sector and that investment has to be efficient. If the basic conditions for sound investment do not exist, such as endemic macro instability, weak governance or severely distorted price signals, then open trade at home may help little. But, if there is a sound investment climate, or as part of a development strategy that includes measures to improve the investment climate, trade is fundamental.

22. Regional cooperation is needed to capture enhanced access to more distant markets for all countries of the region. Regional confidence building initiatives to improve the trade and investment enabling environment will support the attainment of this shared goal. A much deeper participation in the multilateral trading system is an important long-run objective. Given prevailing economic and policy conditions in the region, however, the countries' primary focus should be on unilateral (or, as appropriate, on regional) measures that fit the objective of growing participation in the world economy. In particular, countries should pursue their efforts to increase the transparency and predictability of their trade regimes and limit the use of non-tariff measures to legitimate objectives (such as health, safety or environmental reasons.).

23. At present, intra-regional trade flows are relatively small. In 2002, Tajikistan, had the highest proportion of regional trade, over 20 percent, followed by Turkmenistan and Afghanistan - about 10 percent. For the two largest economies, Iran and Pakistan, regional trade amounted to only 2 percent of combined exports and imports. Pakistan, though, is an important export market for Afghanistan (about 27 percent of its total exports in 2002), and trade in energy products has made Tajikistan a significant market for Uzbekistan (about 18 percent of total Tajikistan's imports) and Iran an important customer of Turkmenistan (13 percent of Turkmenistan's exports).

24. A number of factors conspire to keep intra-regional trade levels low. These are poor transport infrastructure, trade barriers within the region and the similarity of the countries' economic structures. Limited by a narrow export base, the countries produce similar commodities (mainly energy and textile products) and look outside the region for their principal export markets and a broad range of goods they import. Consequently, even if transport links are improved or upgraded and trade barriers lowered, the scope for expanding intra-regional trade massively over the short term is limited. However, border trade in agricultural goods can have can contribute substantially to improved livelihoods and poverty reduction in rural areas. That assumption, however, does not rule out trade-related regional cooperation. Regional talking fora where discussions and cooperation can take place, have proven beneficial elsewhere in the world. The Association of Southeast Asian Nations (ASEAN) is an obvious example. By facilitating regional economic cooperation and providing a confidence-building forum, it has contributed to three decades of regional economic growth. Another example of regional cooperation that does not involve preferential tariff reductions is the Asia-Pacific Economic Cooperation (APEC), which has focused on trade facilitation issues: members have pledged to streamline customs procedures and improve port logistics, among other measures to reduce transaction costs associated with international trade.

Trade Logistics and Trade Infrastructure

25. Two decades of conflict have left Afghanistan with a severely deteriorated infrastructure, substantially reduced economic activity and a major decline in legitimate trade. Geo-political developments affecting neighboring countries, moreover, have led to major changes in transit-trade relations and shifts in the direction of trade flows. Current logistical support for traders is acutely underdeveloped, and a tough security problem compounds the challenge. As a result, trade logistics-related costs are substantial. Existing transit agreements have been ineffective. The deficiencies of current cross boarder trade logistic operations include protection of local trucking (transit permits, visa restrictions), unofficial and discriminatory charges, non-uniform duty standards and vehicle standards below international levels.

26. Streamlining Afghanistan's transit links with both regional and non-regional trading partners would reduce transport-related trade costs and facilitate the restoration of economic activity and its people's incomes. Moreover, the initial level of confidence has been very low concerning Afghan traders and transport operators due to historic perception that many shippers in Afghanistan are involved in smuggling or trafficking in illegal drugs. During the mid 1990s regional militias, who were dependent on an economy of smuggling arms and drug trafficking, rested control of much of the country from the government in Kabul. Many potential Afghan traders, expatriate Afghani and potential transit trade participants are reluctant to commit substantial resources to regional and transit trade until they are reasonably assured that history will not repeat itself. Hence reform measures to improve the effectiveness and efficiency of customs procedures in detecting and deterring illegal trade should go hand in hand with the reconstruction of infrastructure and the expansion of security throughout the country.

27. Problems of market access depend less on formal trade barriers and more on barriers to efficient trade logistics and weakness in the operation of market institutions. Although landlocked, Afghanistan is a potential avenue for traffic between Central and South Asia and to ports in both Iran and Pakistan. Routes through Afghanistan offer the CAR, for instance, shorter distances to the sea than land links to the Black Sea, Europe or China. But land distance is not the only determinant of transit cost and route choice: transport mode, border crossings, transit formalities and sea freight costs and times are also important. Roadblocks and arbitrary demands for payment within Afghanistan's borders, to the extent that these exist, are obviously major deterrents to trade.

28. Making Afghanistan part of an effective north-south route would generate direct and indirect economic benefits. With substantial donor support, Afghanistan is now undertaking a massive infrastructure investment effort to rebuild the network of roads that circle the country, a rehabilitation that will be an important factor in trade facilitation. Current plans call for the rehabilitate around 3,300 km, consisting of the ring road leading from Herat to Kandahar, Kabul, Mazar-e-Sharif, Sheberghan, Meymaneh and back to Herat, and six international routes to neighboring countries. A mid-term review of these road construction initiatives show the following progress:

- (i) In aviation: Kabul International Airport project completed feasibility stage (funded by Japan); construction to start end of 2004 while the old terminal is repaired for domestic flights;
- (ii) The Kandahar-Kabul Road (US\$180m funded by USA, Japan, Saudi Arabia) has receive first layer of pavement effective end 2003; expected to be completed by end Oct 2004;

- (iii) The Kabul-Salang Doshi road (US\$102m funded by WB) has been contracted to two Turkish companies;
- (iv) International Links: Kandahar-Spin Boldak road (funded by ADB) will be completed by Oct 2004. The first layer is to be completed by end of Dec 2003;
- (v) Roads: Kabul-Jalalabad road (US\$56m funded by EU) construction will begin mid-Oct 2003;
- (vi) The Jalalabad–Torkham Road is being upgraded with funding from the Government of Pakistan;
- (vii) Salang tunnel reopened by end of November 2003.

29. The Asian Development Bank has prepared a set of multiyear traffic and trade estimates for transit and intra regional trade by weight and route. These estimates indicate significant economic impact from a central-south Asia road corridor by 2010³. Specifically, a total of twelve routes were considered, six each connecting central Asia with ports in Pakistan through Afghanistan and with ports in Iran also through Afghanistan. Taking out the overlapping route segments, the total distance covers 7,964 kilometers. The combined lengths of corridors in each country are 2717 km in Afghanistan, 1941 km in Iran, 1670 km in Pakistan, 186 km in Tajikistan, 661 km in Turkmenistan, and 790 km in Uzbekistan. The ADB projects that real growth rate per annum differential between 2005-2010 from this investment would be a net increase of 5 percent per annum. Although this high case growth differential may be an upper bound estimate of what Afghanistan could achieve over the decade, the differential between cases is within the plausible range given the potential importance of improved trade infrastructure and trade logistics in influencing trade flows, provided that neighboring countries adopt key measures proposed in this report.

30. Private investors are also gearing up to provide a massive upgrading of Afghanistan's telecommunications capabilities. The country has just 26,800 digital fixed lines serving the capital Kabul and the main cities of Herat and Kandahar. The TISA plans to substantially expand the digital network. The first bidding for a project covering 87,000 lines for 12 of the country's 32 provinces has been completed. The Government has concluded negotiations with the World Bank on a three-year project which would include a government satellite Internet network to cover the whole country.

31. For its part, the Government of Pakistan has announced its intention to open a new border route that will reduce the distance for Afghanistan access to Pakistan ports. Pakistan Railways has lowered freight charges for Afghan transit goods by 25-to-30 percent and is giving Afghanistan national treatment. Pakistan Railways has also initiated a feasibility study for the extension of railway track from Chaman in Pakistan to Kandahar in Afghanistan. The two countries have taken a variety of other trade-enhancing steps. They have agreed, for example, to enhance air-traffic from Islamabad and Peshawar to Kabul and to open bank branches on a reciprocal basis in the two countries. Under another important, bilateral agreement, the Pakistani National Logistics Cell, would be permitted to send shipments from Karachi directly to Kabul and Kandahar and to establish a presence in Afghanistan. In return, Pakistan will offer greater access to Afghan truckers on Pakistan routes. Further, as part of its development of a new Port Special Economic Zone at Gwadar, Pakistan intends to improve transport connections between Gwadar and the ring

³ Asian Development Bank, Economic Impact of Central South Asian Road Corridor

road. Iran and Afghanistan signed a MOU and an agreement relating to the Port of Chabahar and the Chabahar Free Trade Zone (CFTZ) on September 15, 2003. The MOU covers reciprocal measures for business licenses issued to each others traders and businesses, improvements in security for transit routes and Iranian technical assistance to the Afghanistan Ministry of Commerce.

32. Welcome as these efforts are, Afghanistan cannot benefit fully from infrastructure investments until it establishes internal security and introduces trade facilitation systems with much higher service standards than those on competing routes. Transit trade will then become a two-way street, benefiting the neighboring countries through shorter trade routes as well as opening up new markets across the region.

33. In terms of direct income or fees, the benefits of transit traffic will be limited. Although, it will produce some income from services to transit vehicles as well as from transit fees and possibly commissions on transit bonds, this revenue could be offset by the damage which very heavy trucks do to roads. The indirect benefits derived from being the center of an efficient regional transit network are likely to be much more important. In particular, Afghanistan can reasonably expect improved access to the sea as a part of a broader regional or corridor transit framework from which all can benefit.

34. Once a corridor agreement for transit trade is implemented, the key short-term priority, future policy efforts in both Afghanistan and in the neighboring countries need to focus on improving trade logistics. This entails a combination of policy reforms to streamline and simplify procedures, to undertake substantial investment in infrastructure, and to build capacity for implementation. The broad range of trade logistics problems identified in this report requires a regional approach to finding solutions, including harmonization of customs procedures and documents, facilitation of border crossings, and the provision of security and transport insurance. A coordinated approach will also be needed to develop the road/rail network from sea ports to final destinations in the interior.

35. Among the many constraints to efficient and effective trade logistic services on routes through Afghanistan is cargo transshipment -- the rule, rather than the exception, for road cargo -- at the border. Internationally, road freight is normally carried in the trucks of either the country with sea access or the country of origin. However, much of the Pakistan/Afghanistan cargo destined for Kabul is transshipped at Peshawar; all cargo via Quetta is transshipped at the Spin Boldak border post; and all cargo from Iran is transshipped at the border. As of late 2003 Afghan trucks did not have authorization to move their cargo directly to Karachi. On the Kandahar route, all cargo must be transferred to national vehicles. Poor roads and political pressures also deter Iranian truckers from entering Afghanistan. In addition, the large differences in payloads encourage cargo consolidation at the border.

36. Reasons for transshipment include the shift in transport mode from rail to road and the reluctance to allow Pakistani drivers to enter Afghanistan. Whatever the causes, including legitimate concerns about the smuggling of illicit drugs and tax-evading, but otherwise legal commodities, the high level of truck-to-truck transshipment at the Afghan border may be unique in international transit systems. Transshipment increases handling costs, transit times and the risks of cargo loss and damage, and logistics suffer further from the limited training and poor working conditions of customs officials and from inadequate central control leading to major regional variation within Afghanistan in the way in which customs procedures are implemented. This problem is currently being addressed through reform of customs laws and the introduction of new customs procedures by TISA and through intensive technical assistance for customs officers.

37. The report finds that monitoring and performance-indicator reporting on customs procedures and general trade logistics can be of great assistance to government decision-makers particularly if comparative performance indicators are shared within the region. ECO could play a vital role in designing common monitoring standards and facilitating the exchange of information or even conducting its own survey with the endorsement of member countries. Since private-sector involvement to initiate reform in trade logistics is also important, authorities in the region would do well to foster the development of private associations of freight forwarders. Their support for the diffusion of modern logistics techniques can be reinforced by the affiliation of national associations in international bodies, such as the Fédération Internationale des Associations de Transitaires et Assimilés and international trucker associations.

38. As long as major shipping lines that own containers will not permit them to cross the Afghan border, Afghanistan will be denied the full logistical benefits of containerization. A change in policy by container owners will depend on the success of the authorities in creating an enabling environment for transit trade.

Domestic and Behind-The-Border Issues

39. In post-conflict circumstances it is often the vital institutions of the private sector that experience the most damage and are the hardest to reconstruct. Law and order, property rights, the legal and judicial system and cooperation of government with the business community and in the conduct of trade and commerce have been severely damaged. Afghanistan has reestablished its legal and institutional frameworks for the regulation of business and commerce based on the 1964 Constitution. The Government is in the process of reviewing much of law and related administrative procedures to ensure that they are appropriate within the context the current needs of Afghan society. In September 2003 the Government established the Afghan Investment Support Agency (AISA) to handle investment approvals and support investment activities for all local and foreign investors.

40. Institutionalized or formal banking has been profoundly dislocated by past conflict. Consequently, a dynamic, informal financial and trade network has grown up covering much of the region, especially the southern part of Afghanistan, the Gulf and South Asia. In such networks foreign exchange services are met by unlicensed curb traders outside the banking system or by utilizing offshore banks. Progress is being made in the Central Bank with respect to operations and procedures, assisted by bilateral donor support, but the operational policies of the commercial banks remain unreformed and ill-suited to the needs of providing financial services in support of trade. A similar diagnosis applied to the insurance industry which is dominated by a parastatal monopoly.

41. Afghanistan's formal financial sector remained virtually non-operational as of mid 2003. The lack of a fully-functioning banking system may be the greatest single institutional deficiency in the economy. Among the legacies of conflict are the complete disruption of domestic and international payments systems, the virtual cessation of all lending activities within the country, significantly reduced deposit-taking activities, and a loss of most international banking relationships.

42. Accordingly, financial sector reform is an area of strategic focus for the government. Fortunately many of the impediments to the development of a modern banking and financial sector have been removed with the end of conflict, the lifting of international sanctions, the articulation of a comprehensive strategy for future economic development by the TISA. Building on initial progress, the Afghan authorities now intend to create an appropriate environment for the

private, commercial banking sector rather than sustaining or encouraging direct public sector ownership and management. As a crucial cornerstone to financial sector reconstruction, TISA decreed new laws in September 2003 to clarify the governance of the Central Bank and to establish a sound regulatory framework for banks, both private and public sector institutions. This has been quickly followed by announcements that new private banks dedicated to community development and branches of regional and international banks will be established in Afghanistan.

Conclusion

43. The development of an efficient and flourishing transit trade through Afghanistan, a goal endorsed by its neighbors not least because of its likely benefit to them, can seem a distant one. Advancing toward it will depend on combining the efforts and adjusting the trade policies and practices of a number of countries, some more advanced toward trade liberalization than others. Above all, responsibility for progress rests with the Afghan authorities and their supporters in the broad international community. The dual challenges before them are the restoration of security along trade routes in Afghanistan and the physical and institutional rehabilitation of the transport and transport facilitation systems devastated.

Introduction

1. During the long Afghan conflict, spillover impacts on neighboring countries reduced the level of regional economic integration and eroded regional trust. Recent initiatives, such as the Good Neighborly Relations Declaration (GNRD) of 2002 by Afghanistan and its neighbors (Iran, Turkmenistan, Uzbekistan, Tajikistan, China and Pakistan) and the second declaration “On Encouraging Closer Trade, Transit and Investment” signed on September 22, 2003 are important steps in overcoming that legacy.⁴ Other initiatives aimed at intensifying regional dialogue and cooperation include: discussions within the framework of the Economic Cooperation Organization (ECO); the agreement on trade infrastructure and logistics subscribed by Afghanistan, Iran and Uzbekistan, liberalization of quantity restrictions under the Afghanistan Transit Trade Agreement (ATTA) between Afghanistan and Pakistan, and recent trade and infrastructure discussions hosted by the Asian Development Bank.

2. A preparatory meeting for this study was held Dubai in June 2003 at the request of Afghanistan and major donors involved in supporting the Afghanistan reconstruction effort and after consultations with countries in the region. At this preliminary Dubai meeting all neighboring countries -- Iran, Pakistan, Tajikistan, Turkmenistan and Uzbekistan⁵ -- reiterated strong support for regional cooperation to enhance trade and to assist in the reconstruction of Afghanistan. In response to the group’s request that the Bank prepare a discussion paper to identify key issues, this paper discusses the barriers that hamper regional trade between Afghanistan and its neighbors and adversely affect the region’s potential for global trade and sustained economic development. The analysis presented in this paper is preliminary, and conclusions are tentative and should be considered work in progress intended to stimulate further discussion.

3. A second Dubai meeting was held on September 22, 2003 in conjunction with the annual meeting of the Bank, at which time the participants plus China agreed to adopt “the necessary measures” to improve “customs services” along Afghanistan’s borders,” to combine efforts to promote foreign investment, to “share knowledge and best practices” on standards applying to trade in consumer goods and to “consider” ways to advance “regional trade liberalization and increased integration into the world economy.”

4. With Afghanistan entering a post-conflict era and enjoying the support of the international community, new opportunities exist for rebuilding and enhancing its transportation and energy infrastructure. These opportunities will help restore previously established trade links between several countries in the region and also open up new trade routes. As the Afghan economy recovers, security improves and the trade and logistics regimes of the countries in the region are modernized, trade will expand both within the region as well as with the wider global economy. This will have a positive impact on the countries’ efforts to expand employment opportunities and reduce poverty. In turn, this progress will strengthen interdependency among the regional economies and promote mutual trust. Recreating trade-based relationships is thus in the self-interest of all countries in the region.

⁴ This Declaration, a pledge of non-interference by Afghanistan’s immediate neighbors (Pakistan, Uzbekistan, Turkmenistan, China, and Iran) was signed in Kabul on 22 December 2002.

⁵ China, which shares a small border with Afghanistan, has not been included in this study .

5. Rebuilding the transport and energy infrastructure in Afghanistan coincides with substantial improvement in the economic prospects of the regional economies. Iran, Pakistan, Tajikistan and Turkmenistan have recently enjoying GDP growth rates of over 5 percent, Pakistan is well advanced on trade reform, and Iran has recently made substantial progress. The region's exports consist primarily of energy resources. But Pakistan exports a range of textile products and is gearing up to meet the challenges of a quota-free international textiles market. The principal trading partners of all the countries are outside the region, although Afghanistan and Pakistan have been important trading partners in the past. The opening of new cross-regional trade routes and streamlining of customs and trade logistics procedures can facilitate greater trade within the region as well as globally thereby promoting faster economic growth.

6. Given its geography, Afghanistan's economic recovery will be critical to the development of trade in the region. Although lack of security and weak infrastructure appear as the most immediate hindrances to the revival of formal trade in Afghanistan, other important issues that need to be addressed include complex administrative barriers to trade, new investment customs regulations, and customs administrative practices; restrictive trade policies; financial-sector weakness notably with respect to trade-related banking and insurance services; and smuggling of illicit commodities.

7. Transit trade through Afghanistan can develop in both a North-South direction to link the economies of Central Asia more efficiently with major sea routes in Iran and Pakistan and an east-west direction to link South Asia with the Middle East, Central Asia and Europe. The emergence and intensive use of a secure and reliable transit trade network would lead to declining average costs within trunk networks, producing spillover benefits for all users. Transit trade supported by such a trunk network could play an important growth-stimulating role for Afghanistan as well as expanding trade and trade logistical opportunities for the entire region.

8. All of the five economies contiguous to and accessible from Afghanistan participate in at least one of several regional cooperation agreements, involving each other and other trading partners in South Asia, the Middle East and the CIS. See Appendix C for a descriptions. Some of these agreements are accords intended to create enabling environments for trade facilitation, while others have the stated objective of evolving into preferential trade areas. But in most cases implementation of these agreements, even ones with modest aspirations to improve trade logistics, has lagged far behind their stated intentions. Therefore, achieving rapid growth in regional and global trade and supporting the regional reintegration of Afghanistan would appear to require institutional strengthening measures in addition to strong policy commitment.

9. The promotion of regional trade will help to realize the long-term vision for Afghanistan as a country moving toward middle-income status, based on sustainable development of natural resources, agriculture, light manufacturing such as processed foods and animal husbandry and improved export performance. For neighboring countries, sustained peace in Afghanistan, open trade and private-sector-led growth facilitated by supportive public policy and institutions, combined with the necessary investments in health, education and infrastructure, are needed to transform the region over the coming years and decades. This report argues that to support such a vision, there is a need for mutually supportive, outward-looking policies and institutional reforms.

10. The report is structured as follows: Section 2 briefly describes, for each country, the recent economic developments; Section 3 reviews current trade patterns and trade regimes and assesses prospects for furthering integration into world markets; Section 4 presents an overview

of trade logistics and transportation infrastructure in the region and assesses opportunities for transit trade; Section 5 analyses the enabling environment for trade and investment in Afghanistan. The main tentative findings and recommendations are summed up in Section 6.

Recent Economic Developments

11. The Afghanistan and neighboring countries (AAN) region is home to approximately 270 million people. Although cultural and economic ties have been strong within ethnic and linguistic sub regions, the region as a whole has not been closely linked by trade or commercial ties in recent years. For example, intraregional trade within the AAN zone accounted for just 2.6 percent of exports and 4.1 percent of imports averaged over the two years 2001 and 2002. In the recent past, Afghanistan's political isolation from the rest of the region and the rest of the world and its reputation as a source of trade in illicit goods have been major reasons for the neglect of trade and cooperation opportunities among this cluster of contiguous countries. Table 2.1 Selected Macro-Economic Indicators.

Table 2.1: Selected Macro Economic Indicators

	Population Million	PPP GNI per capita 2001 US\$	PPP GNI 2001 Billion US\$	Gross National Income 2002 Billion US\$	GNI per capita 2002 US\$
Afghanistan	22.0	N. A.	N.A.		170
Iran	65.5	5,940	383	108.7	1,720
Pakistan	145.0	1,860	263	60.0	420
Tajikistan	6.5	1,040	7	1.1	180
Turkmenistan	5.8	4,240	23	5.1	1200
Uzbekistan	25.3	2,410	60	11.5	460

Source: 2003 World Development Indicators and IMF.

12. The economies of countries in the region are tied to the exports of natural resources, particularly energy resources, and to products derived from agriculture or animal husbandry, such as cotton, processed textiles and carpets. Recently, petroleum products from Iran and Turkmenistan have come to constitute a greater proportion of their total exports by value due to rising world prices in the past decade. Nevertheless, all of the countries have large pockets of poverty and underemployed labor. All of the countries want to develop infrastructure, particularly in roads, telecommunications and power, with a view to attracting private investment and expanding employment opportunities. Yet public and private funding for new infrastructure projects is scarce within the region and proposals to develop infrastructure projects on a regional basis appear to languish rather than moving speedily to implementation. Additionally, many of the countries have a history of difficulties in managing their external balances effectively and in maintaining the stability of their domestic economies in the face of volatile commodity prices for primary exports. Regional governments all face major challenges in designing contingency mechanisms that are effective in achieving multiyear expenditure smoothing, while still maintaining their commitments to open trade.

13. This section briefly reviews the recent economic performance of the regions constituent countries with an emphasis on growth performance and prospects and policies for external balance.

Table 2.2 Annual Real GDP Growth Rates in Percentage

Country	1995	1996	1997	1998	1999	2000	2001	2002
Afghanistan	..	..	..	..	..	..	..	..
Iran, Islamic Rep.	3	6	3	2	2	5.1	5.4	6.8
Pakistan	5	5	1	2.6	4	4	3.5	5.1
Tajikistan	-12.5	-4.4	1.7	5.3	3.7	8.3	10.3	9.1
Turkmenistán	-7.2	-6.7	-11.3	7.0	17.0	17.6	20.5	14.9
Uzbekistan	-10.9	1.7	5.2	4.3	4.3	3.8	4.2	4.2

Source: World Development Indicators database and IMF staff estimates for Report on Progress under the CIS-7 Initiative and Pakistan Central Bank. For Turkmenistan and Uzbekistan – official statistics. Alternative estimates by international financial institutions indicate lower real GDP growth rates.

Afghanistan

14. The Afghan economy continued to recover during 2002/03 from the disruption caused by military conflict. Almost 2.5 million refugees had returned home by early 2003, indicating confidence in the capacity of the transitional government to ensure security. While there are no reliable labor force or employment statistics, unemployment clearly remains very high. UN agencies and non-government organizations have supported employment programs and food- or cash-for-work programs. Rough estimates suggest a 2002 GDP of about \$4.4 billion, with per capita GDP at \$170. Officially reported imports⁶ in 2002 (US\$851million) were up 50 percent over 2001. In addition, rapid surveys undertaken at the borders in September 2003 estimate these imports at US\$2.4 billion, reflecting the impacts of the increased aid, reconstruction activity, and the revival of commercial life. Evidence from physical reconstruction and market activities in cities, led by Kabul, indicate a strong recovery in 2002 and 2003, mainly in certain sectors such as services and construction.

15. Afghanistan's economy is primarily agriculture-based. Agriculture supports about 85 percent of the total population and accounts for about 50 percent of GDP.⁷ Farmers are beginning to shift back from subsistence to cash crops with the improvements in security in many parts of the country and the improved scope for agricultural trade within the country. Agricultural production in 2002 is estimated to be approximately 82 percent higher than in 2001.⁸ Abundant precipitation in 2002 and 2003 has eased the water scarcity caused by years of drought, and the increased supply of seeds, fertilizers, and other key inputs has resulted in robust yields for the country's major crops. Rain-fed wheat, recovered significantly in major growing areas of the northern and western provinces, though aggregate cereal production for 2002 remained about 4 percent below its 1998 level. Livestock provides a major source of cash income but the total livestock population in Afghanistan had declined by about 60 percent from 1998 levels. Many traditional specialty crops, such as grapes and pistachio nuts, will not reemerge as commercial crops until significant investment is made in replanting and new plants have an opportunity to reach maturity. Although a few large state-owned industries are operational, including cotton gins and granaries, the economy is dominated by small-scale production and informal sector trading, including such activities as handicraft manufacture, sewing, metal working, and machine repair.

⁶ Non-oil imports only

⁷ Based on 1993 estimates.

⁸ Derived from the annual food assessment of the Food and Agriculture Organization of the United Nations (FAO)

16. As the transitional authorities work to reestablish political order, they and international donors face an economy characterized by: (i) forced urbanization through the destruction of rural employment; (ii) a lack of uniform application of laws including taxation and commercial regulation throughout the country; (iii) and a flourishing large underground economy based on smuggling, poppy cultivation and narcotics trade that currently offers farmers much better livelihoods than the legitimate economy. Policymakers must address these concerns in order to make sustained headway on more traditional trade policy issues.

17. In addition to illicit poppy produced for heroin, a major agricultural output for Afghanistan, legal crops include wheat, cotton and a range of fruits and vegetables. The TISA issued a ban on opium poppy cultivation, processing, trafficking and consumption in January 2002, though the authorities' ability to suppress production is limited at this time. Estimates of the value of poppy and derivative production vary greatly, but they may have farm gate gross value in excess of \$1 billion.

18. Domestic revenues were estimated to reach about \$100 million for 2002-03, leaving an estimated financing requirement of \$225 million, which has been fully met. In March 2003, the Government announced a comprehensive government budget for FY2003, comprising an ordinary (recurrent) budget of \$550 million, of which \$350 million will be financed by external assistance, and a development budget of about \$1.7 billion. The budget policy and associated mechanism for channeling foreign assistance are intended to ensure a tightly coordinated and controlled reconstruction process.

19. Since the establishment of the TISA, exchange-rate and trade policies have changed radically. Many of the rules and regulations that applied in the past, although not formally rescinded in law, have been dropped in practice so that exchange and trade systems have become liberal. Afghanistan has a *de facto* unified exchange rate system. The central bank quotes a daily official exchange rate derived from the curb market rates for foreign exchange. This rate is used for all transactions conducted with the Government except customs valuation. The authorities are committed to establishing liberal and open exchange, payments and trade systems. The Da Afghanistan Bank intends to replace the existing set of rules and regulations for exchange and payments with simplified ones. Swifter progress is needed to pass enabling laws and regulation so as to bring current practice into harmony with the legal codes and to provide private businesses with the security of a transparent and legally based regulatory regime. Although the reform of the tariff structure has been widely studied and evaluated by the TISA, a new simplified tariff structure has not been implemented as of January 2004.

20. In recent years, Afghanistan has been underutilized as a trading partner and transit-trade route because of security concerns, the decayed status of its transportation infrastructure, the legacy of war including many million land mines, and frequent unofficial "tolls" charged by various regional authorities or unofficial interests. However, there has been a major increase in trade between Iran and Afghanistan, Pakistan and Afghanistan, and the CAR and Afghanistan since mid 2002, in part, stimulated by international funding for reconstruction. A coordinated approach is being taken to the reconstruction of the major ring road, principal interior roads and key bridges which will involve an investment in excess of \$700 million in the next few years. Segments of the road corridors are in different stages of construction or repair requiring different

levels of investments per kilometer. According to recent ADB estimates⁹ a comprehensive system of routes to support corridor agreements might cost as much as \$1,500 million.

Iran

21. Iran enjoys middle-income status, but its growth prospects remain heavily tied to the global price of petroleum products. However, the two provinces bordering Afghanistan, Khorasan and Sistan & Baluchestan, are among Iran's poorest and suffer from low social indicators. During 2002, Iran has achieved one of the highest rates of growth in the Middle East-North Africa region against the background of increased openness to international trade and investment, economic reforms and sustained high oil prices. The overall economic situation in 2002/03 was favorable, with high and broad-based real GDP growth, a decline in the unemployment rate, low external debt, and rising international reserves. Real GDP growth is estimated to have increased by 6.8 percent in 2002/03 and the momentum of investment and growth of the past few years is expected to continue.

22. Significant progress has recently been achieved in several areas of economic reform, including trade liberalization, the establishment of private banks, the approval of a revised foreign direct investment law and the amendment of tax laws. Trade restrictions have been relaxed. Iran has achieved a smooth transition to a unified exchange rate system. The authorities are contemplating the introduction of a broad-based, value-added tax within the next two years to improve the neutrality and buoyancy of indirect taxation. The recent strong economic performance has been facilitated by the government's decision to allocate increased oil revenue to pay down external debt, build international reserves, and accumulate savings in a stabilization fund.

23. The recent stability of the exchange rate and higher import levels have dampened inflationary pressure in the tradable goods sector. The stable exchange rate has also reduced foreign exchange risk for both exporters and importers. This is an important factor for those engaged in international trade in Iran who mostly lack access to financial instruments for hedging exchange rate risk. Potential pressure for the exchange rate to appreciate could challenge the export competitiveness of the non-oil export sector and may attract a disproportionate share of investment to the non-tradable sectors. Optimal management of Iran's oil resources to provide needed savings and achieve an optimal balance between consumption and savings requires that it allocate a much larger proportion of GDP to savings and investment and less to consumption. Substantial savings and adjustment could be derived from a pricing reform of Iran's energy subsidy system.

Pakistan

24. Pakistan, at the gateway of South Asia, is currently experiencing a strong recovery in growth and investment. Real growth of 5.1 percent in 2002 exceeded projected targets. This renewed growth has been broad based and uniformly spread across agriculture, manufacturing

⁹ Asian Development Bank Economic, 2003 Impact of Central South Asia Road Corridor , Ministerial Conference On Transport And Trade, Manila , July 31 – August 2003

and services. Pakistan's macroeconomic policies are broadly on track to foster continued high growth, reduce economic vulnerability and achieve sustainable fiscal outcomes. The current macroeconomic strategy is centered on maintaining a flexible exchange rate and using monetary policy to target a low inflation rate. However, high foreign remittances through the formal banking system and capital inflows are generating upward pressure on the rupee. The Government has a multiyear plan to achieve substantial fiscal adjustment and to reduce public debt by: (i) improving the administration of direct taxes to increase their relative contribution in the tax mix, (ii) liberalizing the oil and gas sectors through market-oriented pricing and (iii) restructuring of publicly-owned banks. The Government has just completed an ambitious trade reform with tariff reductions and elimination of most quantity restrictions, although many tariff peaks remain high.

25. Reduced demand for credit by government and the public sector is expected to stimulate private-sector credit demand, both by the corporate and consumer sectors, including SMEs and agriculture. Higher sustainable growth in the range of 5 percent to 6 percent per annum is envisaged as required to achieve visible progress in reducing poverty.

26. Expanded trade, including regional trade with Central Asia and the Middle East can play an important role in stimulating such growth. Pakistan has recently initiated measures, in consultation with Afghanistan, to revitalize official trade links between the two.

Central Asian Countries

27. The three Central Asian countries immediately to the north of Afghanistan remain in the midst of a complex transition to market economies. Their per capita incomes range from approximately \$1,000 in purchasing-power terms for Tajikistan to \$4,240 per capita in Turkmenistan. All are landlocked economies that are largely non-industrialized and dependent on natural resources and commodity exports. Most of the population of the Central Asian republics (CAR) lives in rural areas, with cotton and wheat being the most important crops. In the early years of transition, the Central Asian countries experienced major declines in output, and all have recent histories of relatively high inflation, but since the mid-to-late 1990s have returned to positive growth. Soviet-era achievements in universal education, health and infrastructure have been eroded.

28. In the early years following the dissolution of the former Soviet Union, all three countries saw major disruptions in their foreign trade with their traditional partners within the former Soviet Union. Since the mid-1990s the countries have experienced large swings in their foreign trade. External factors, including price volatility in the world markets for the region's main export commodities (cotton, gold, oil, aluminum), disruptions due to payment problems, as well as, in the case of Uzbekistan and Turkmenistan, significant formal and informal trade barriers and domestic policy distortions have contributed to this. The trade pattern has been gradually reoriented towards the hard currency markets of Western Europe and East Asia. However, there has been little development of new export commodities not tied to traditional strengths in natural resources and agriculture. Despite numerous regional trade agreements, important opportunities for regional trade are not being realized due to closed borders or very restrictive border access, export bans, and foreign exchange restrictions in Turkmenistan and Uzbekistan, as well as other administrative barriers. Security instability in Afghanistan and insufficiently developed transport infrastructure hamper development of trade between the CAR and countries to the South.

29. Although a very poor country, **Tajikistan** has enjoyed GDP growth of 9 percent per annum over the past three years. The revival in economic growth has been supported by increased production of key commodities (mainly aluminum and cotton) and strong domestic demand fuelled by increasing remittances from Tajiks working abroad. The improvement in growth has supported improvements in fiscal management, with the fiscal deficit achieving near-balance in 2002. Poverty remains widespread, with 83 percent of population living below the national poverty line. Protectionist trade policies of neighboring countries have hampered market access for Tajik goods. The exchange rate has been relatively stable, although concerns persist over inflation and the consistency of monetary policy. Tajikistan's economy is expected to slow gradually because its recovery phase is coming to a close and new investment has been limited. There are no functioning domestic equity markets and access to international debt/equity markets by Tajik enterprises is very difficult.

30. **Turkmenistan** has major reserves of hydrocarbons and in recent years has seen a rapid growth – 15 percent on average over the past four years according to official statistics – as a result of increased natural gas and oil exports. The significant foreign exchange earnings from these exports are directed primarily toward large investments in national prestige projects, industry and infrastructure, averaging 39 percent of GDP over the past 4 years. Turkmenistan has made limited progress in restructuring its economic system and remains the most heavily state-controlled of the Central Asian economies. The share of the private sector is estimated at just 25 percent of GDP. Basic commodities (water, energy, bread) are free or heavily subsidized. Practically all cotton and wheat crops are procured by the state through the state order system. Severe foreign exchange restrictions have resulted in the existence of the informal foreign exchange market where parallel exchange rates are four times the official rate. Notwithstanding the policy distortions, Turkmenistan's economic growth prospects appear favorable given the recently concluded long-term natural gas export agreement with Russia. However, an expansion of the capacity of existing export pipelines for natural gas and construction of new pipelines, such as the currently discussed trans-Afghan pipeline, is required to ensure hydrocarbon-led growth in the medium term.

31. **Uzbekistan**, with the largest population in Central Asia and borders with all other Central Asian countries, holds a strategic position in the region and plays a critical role in influencing the foreign trade and macroeconomic openness of its neighbors. However, it is also double land-locked and faces significant physical barriers in accessing international markets, a challenge that likely contributed to its adopted, soon after independence, of an import-substitution, self-sufficiency-oriented strategy. While this strategy brought about steady if unspectacular growth – averaging 4 percent between 1996 and 2001, it has not resulted in a major improvement in living standards and longer-term sustainability of this growth is questionable. Uzbekistan's exports shrank by 23 percent in value terms between 1997 and 2002, reflecting not only declines in world market prices of gold and cotton, but also the impacts of the restrictive foreign exchange regime and extensive state controls including the state orders system in agriculture and state planning of enterprise activities. Largely due to very restrictive regulatory policies foreign direct investment flows to Uzbekistan are the lowest of all transition economies on a per capita basis.

32. Since 2001 the Government of Uzbekistan has made progress in macroeconomic adjustment and structural reform. By the fall of 2003, the gap between the official and parallel market rates was nearly eliminated, and some restrictions on access to foreign exchange have been lifted. In 2003 Uzbekistan began participating in a dialogue with its neighbors and the IFIs on regional infrastructure improvements and shared use of water and energy resources. However,

newly adopted trade barriers, a tightening of access to domestic credit and new restrictions on non-official travel to and from neighboring countries have stunted a positive supply response to the exchange-rate adjustment. Future economic growth in Uzbekistan depends crucially on the removal of the above constraints and continuation of economic reforms.

Trade Regimes and Prospects for furthering integration into world markets

33. This section describes trade policy environment and current trade pattern in the region, and discusses the prospects for regional cooperation and trade integration and for furthering the integration of these economies into world markets.

Trade Policy Environment and Trade Patterns in the Region

34. Countries covered in this study appear broadly committed to market-based trade policies. But mainly as a result of diverse historical circumstances, their current national trade policies vary substantially. Iran and Pakistan, the only countries with direct access to the sea, are sizable exporters and are largely integrated into the world economy. Pakistan is member of the World Trade Organization (WTO) ; Iran, while not a member of the organization, appears willing to abide by WTO disciplines and has made significant efforts to streamline its trade regime. In these two countries, import duties appear to be the main trade policy instrument; their relative importance has increased as a result of the recent elimination of non-tariff barriers on several items and the tariffication process. Although efforts have been made to reduce tariff peaks and dispersion, tariff protection, notably for a few sensitive items in Pakistan, is still relatively high (Table 3.1).

35. Turkmenistan and Uzbekistan, in transition since their independence in the early 1990s, have retained many elements of central planning. In recent years, both countries have pursued policies intended to promote national self-sufficiency rather than international integration. The extended use of non-tariff barriers (NTBs), such as foreign exchange restrictions, import licensing, or export restrictions make tariffs largely irrelevant in these countries. These interventions hamper economic growth, notably by limiting domestic competition and preventing an efficient allocation of resources. Afghanistan's and Tajikistan's economies have been disrupted by conflicts, and their integration into world markets is rather limited, though both countries have committed to open and liberal trade regimes.

36. While facing different policy environments, these countries can all benefit from a more stable, prosperous and outward-looking regional trade outlook. Furthermore, as indicated by broad global findings, those developing countries that increased their integration into the world economy over the past two decades, achieved higher growth in incomes, longer life expectancy, and better schooling. Accordingly, regional countries that pursue efforts to increase the transparency and predictability of their trade regimes and limit the use of non-tariff measures to legitimate objectives (such as health, safety or environmental reasons) are likely to achieve higher growth performance.

37. The remainder of the Section details, for each country, the main features of its trade regime and patterns.

Afghanistan

38. As noted earlier, Afghanistan faces a complex political situation and difficult security problems. Without adequate security throughout the country and steady progress toward political normality, the prospects for the expansion of legitimate production and trade and longer-term poverty reduction are bleak. In addition to security issues, much of the country's physical and institutional infrastructure has been destroyed over the past twenty-five years. These circumstances affect not only Afghanistan but have also spilled over into surrounding countries, creating a legacy of mistrust in trade matters. Regional policymakers will have to give these concerns priority before they can turn their attention to more traditional trade policy issues.

39. These problems naturally make it difficult to assess current international trade flows. Officially reported trade data cover a small share of total trade; field survey data indicate that unofficial exports to Iran and Pakistan in 2000–2001 were ten times larger than the value of all official trade (UNDP/World Bank 2001). Even if the currently available data were more reliable, trade flows observed under wartime conditions do not accurately reflect Afghanistan’s underlying comparative advantage.

Table 3.1 Main Features of Countries’ Trade Regimes

Country	Tariff (1)		Non-Tariff Barrier	Remarks
	Average (%)	Maximum rate (%)		
Afghanistan	40	150		The exchange rate used for customs valuation reduces nominal tariff rates by a factor of 10
Iran	31	150	Import prohibitions maintained on religious precepts; import licenses required for goods subject to sanitary and phytosanitary regulations	
Pakistan	17.3	200	Import prohibitions or restrictions maintained on health, national security, environmental, or religious grounds	
Tajikistan	5	5	Foreign exchange restrictions to support the implementation of a capital-intensive, import-substituting industrial base	
Turkmenistan	6.1	100	Foreign exchange restrictions; compulsory import and export contract registration by the State Commodity Exchange; and export taxes on strategic products	Barter trade arrangements for natural gas exports still in place
Uzbekistan*	15.4	30	Foreign exchange restrictions; no formal import licensing mechanism but restrictions on access to foreign exchange and burdensome bureaucratic import procedures	

* Average and maximum rates are given for most favored (MFN) nations in accordance with Uzbekistan’s convention. For non-MFN nations, these rates are doubled.

Note (1) Based on 2002 tariff schedules for all countries, but Iran (2003).

40. One can make some inferences about possible future trade flows based on experience before 1978, the last period of “normalcy.” From 1970 to 1977, Afghanistan’s principal trade

partner was the Soviet Union. Between 30 and 40 percent of exports went to the U.S.S.R. each year (primarily natural gas); a slightly smaller (but usually the largest) share of imports originated there. The U.S.S.R. was followed by Europe, India and Pakistan on the export side and by Japan, India and Europe on the import side. Afghanistan was once Asia's largest producer of dried fruits. There were relatively high concentrations of exports, as measured by the revealed comparative advantage index (RCA),¹⁰ in fruits and nuts; seeds; furs, skins and animal hairs; and natural gas.¹¹ The only manufactured good with consistently high export RCAs during the 1970s was carpets. Using the equivalent measure, imports were concentrated in processed oils and fats; tea; yarns, fabrics and other garment inputs; and motor vehicle parts.

41. Can past export sectors be reestablished? Reviving natural gas production will require substantial capital investments and international agreements. Moreover, Afghanistan would face economic competition in this market from several neighboring countries. The revival of the carpet production and agriculture, including the dried fruit sector, will require less capital investment and will absorb substantial underemployed labor. As life in Afghanistan returns to normal, entrepreneurs may uncover other opportunities for the production of labor-intensive goods. The Afghanistan authorities should work towards establishing simple, transparent and predictable economic policies, which would enhance the business environment without trying to pick "winners" and promote specific activities. As discussed above, Afghanistan also faces import challenges with respect to trade logistics and transit issues.

42. Since 1978, many other labor-abundant countries have entered garment production, and it is reasonable to wonder whether this would be an option for Afghanistan. However, this is an avenue where Afghanistan should look with great caution. The market is becoming more competitive, both because of trade policy changes (elimination of quotas) and because of dramatic changes in business practices such as rapid replenishment, fragmented production and just-in-time inventory controls. It will take some time for general business conditions in Afghanistan to improve to the point where the country can become competitive in this market.

43. The authorities appear clearly committed to a liberal and open trade regime,¹² as part of which they are considering a new simplified tariff regime. Afghanistan's current tariff structure has 25 tariff categories with a maximum rate of 150 percent. The average tariff rate is about 40 percent, though due to significant exchange rate overvaluation for the purpose of assessing duties, effective tariff rates are reduced by an estimated factor of ten. Customs valuation is made on the basis of an assessment by the Afghan Chamber of Commerce and Industry (ACCI) and not on the basis of transaction value. The Ministry of Commerce charges a 2 percent fee to issue import licenses.

44. Since 2001, the authorities have also sought to further their integration into regional and global markets. For that purpose, Afghanistan entered several trade-related agreements, including a transit agreement with Iran, a Preferential Trade Agreement with India, and applied for WTO membership in April 2003.¹³ In most cases, implementation of these agreements has lagged behind the announced commitments. While pursuing increased market access to its neighboring countries, Afghanistan should maintain its ability to set its own tariffs and resist pressures to

¹⁰ The RCA for a good is computed as $RCA = \frac{\text{country's exports of a good}}{\text{country's exports of all goods}} \div \frac{\text{world trade in a good}}{\text{world trade in all goods}}$.

¹¹ This is based on calculations using international commodity trade data from the NBER Trade Database.

¹² See National Development Framework (April 2002).

¹³ Transit agreements in the region are discussed in section 4.

establish a more restrictive trade regime. It should, in particular, avoid entering a customs union with its neighbors and pursue favor free trade arrangements instead, because the former policy direction would likely lead to welfare-reducing trade distortion than to trade creation.

Iran

45. Iran is heavily dependent on oil exports, which account for the bulk of its export earnings. In 2001 over 80 percent of exports were petroleum products destined for markets in East Asia and Western Europe (Table 3.2).

Table 3.2 Main Exported and Imported Goods, Iran

Exports			Imports		
Product (2 digit SITC)	Value (million \$)	Share (%)	Product (2 digit SITC)	Value (million \$)	Share (%)
Petroleum and products	19,329	83	Iron and steel	1,886	12
Textile, yarn and fabric articles	674	3	Cereals/cereal preparations	1,445	9
Vegetables and fruit	654	3	Unspecified industrial equipment	1,302	8
Natural gas	426	2	Road vehicles	1,187	7
Total	23,292	100	Total	16,173	100

Source: UN COMTRADE database, data for 2001.

46. Countries in the region import little from Iran, relative to buyers elsewhere in world markets (Table 3.3). Given that other countries in the region already export textile products (or want to protect domestic markets from imports), there would not seem to be much potential for finding new textile markets in the region.¹⁴

Table 3.3 Principal Trading Partners - Iran (mirror statistics)

Exports			Imports		
Trading partner	Value (million \$)	Share (%)	Trading partner	Value (million \$)	Share (%)
Japan	5,022	25	Germany	1,693	13
China	2,424	12	Italy	1,041	8
Italy	2,112	10	France	1,025	8
Korea	2,099	10	Russia	892	7
Greece	959	5	China	889	7
World	20,405	100	World	13,530	100

Source: UN COMTRADE database, based on data reported by trade partners for 2001.

¹⁴ Since the most recent data submitted to the UN do not indicate the destination for over 80 percent of Iranian exports, mirror statistics are used to show the geographical distribution of Iran's international trade.

47. Though the scope for significant merchandise trade between Iran and the countries covered in this study appears modest, a more promising activity could be transit trade. Indeed, the port of Bandar Abbas (like Karachi, in Pakistan) presents one alternative to land routes through Russia for the landlocked countries in Central Asia. As pointed out in Section 4, however, several challenges would need to be addressed in order to realize this potential, including the adoption of common regional trucking standards and the issue of local monopolies that conspire to raise road transportation costs. The new rail link from Bafq to Mashhad (near Iran's borders with Turkmenistan and Afghanistan) could lower freight costs within Iran, making Bandar Abbas a more attractive seaport for Central Asian countries.

48. Despite the lack of accession to the WTO, the country has pursued policies to liberalize its trade regime in recent years. Iran has been steadily making progress in tariffication of its non-tariff barriers and has recently begun rationalizing its tariff schedule. At present, a uniform, 4-percent customs duty and a variable commercial benefit tax (CBT) — reflecting the tariffication on NTBs—are levied on all imported goods. The CBT has some 24 rates. The resulting simple average tariff rate (combining the customs duty and the CBT) is 31.4 percent.¹⁵

49. Oil is Iran's main export product and non-oil exports are bound by foreign exchange surrender rules, minimum export prices, mandatory certification procedures, as well as some export bans and licensing requirements. Restrictions on importation have been liberalized, and importers are no longer required to have a special license. Most exemptions and preferential tariffs have been eliminated. Tax collection is about 6 percent of the value of imports, of which the commercial benefit tax is 5 percent. Note also that sales and corporate income taxes are not neutral with respect to international trade.

50. Iran has made significant progress towards increasing the transparency of its economic policies, including its trade regime.¹⁶ The WTO accession process if carried forward, would likely result in further progress in that direction. WTO membership would ultimately be a formidable anchor for Iran's current outward-looking policies, which would also benefit neighboring countries. In the meantime, the authorities should consider further reforms aiming at developing private-sector activity and enhancing efficiency.

Pakistan

51. Textiles, garments and rice top the list of Pakistan's exports (Table 3.4). Like many other clothing and textile exporters, Pakistan faces a major challenge adapting to the end of MFA quotas in 2005. Many observers forecast that the most efficient producers – currently facing quantity restrictions – will likely crowd less efficient exporters out of the market. In that respect, Pakistani government is following a two-pronged strategy, encouraging investment in garment manufacturing to increase productivity on the one hand and promoting non-traditional exports on the other.

52. Pakistan's main export markets are the United States and Western Europe (Table 3.5). A second challenge relates to meeting increasingly high levels of product standards in developed

¹⁵ See Ministry of Commerce (2003), "Summary of Import and Export Regulations", note circulated at the Dubai I conference.

¹⁶ These progresses have been notably acknowledged in the concluding statement of a mission conducted in June 2003 under the Article IV of IMF's Articles of Agreement.

countries, where consumers, either through active lobbying of retailers and governments or consumption shifts, impose stricter standards on producers in developing countries. Though in most cases these standards remain voluntary, in practice, developing countries that are unable to adjust to this new demand might lose market shares.

Table 3.4 Main Exported and Imported Goods, Pakistan

Exports			Imports		
Product (2 digit SITC)	Value (million \$)	Share (%)	Product (2 digit SITC)	Value (million \$)	Share (%)
Textile, yarn and fabric articles	4,525	49	Petroleum products	2,870	28
Apparel, clothing and accessories	2,136	23	Industry special machine	721	7
Cereals and cereal preparations	606	7	Organic chemicals	639	6
Misc. unspecified manufactures	397	4	Fixed vegetable oils and fats	369	4
Total	9,178	100	Total	10,198	100

Source: UN COMTRADE database, data for 2001.

53. Pakistan is a member of the WTO. Overall, non-tariff barriers to imports are relatively low; however, actual protection from imports may be higher as a result of asymmetric collection of sales taxes and excise duties. Most tariff rates fall into four tiers (5, 10, 20 and 25 percent), though some tariff peaks and non ad-valorem duties still apply for a limited set of products. Certain barriers remain, however, both in the content of foreign trade rules as well as in the implementation of domestic taxes. Trade in certain goods (e.g. food grains) between India and Pakistan is heavily restricted. A complex system of exemptions and special regulatory orders persists in tariff collections. While in principle, the sales tax and advance income tax are levied on all goods; practical problems prevent the government from fully collecting these taxes on domestically produced goods. Hence the non-neutral treatment of imports and domestic production for a few commodities effectively transforms such taxes into instruments of additional protection.

Table 3.5 Principal Trading Partners - Pakistan

Exports			Imports		
Trading partner	Value (million \$)	Share (%)	Trading partner	Value (million \$)	Share (%)
United States	2,238	24	United Arab Emirates	1,340	13
United Arab Emirates	675	7	Saudi Arabia	1,142	11
United Kingdom	626	7	Kuwait	794	8
Germany	477	5	United States	569	6
Hong Kong	468	5	Japan	522	5
World	9,178	100	World	10,198	

Source: UN COMTRADE database, data for 2001.

54. Smuggling is prevalent along the Pakistan Afghan border owing to the high commodity tax burdens, particularly on luxury items, porous borders, the existence of a negative list of commodities prohibited from trade, and weak administrative controls. A large share of smuggled imports is believed to arise from commodities destined for Afghanistan that are imported in bond through Karachi. Such goods are free of customs duties and other import taxes under the Afghan Trade and Transit Agreement (ATTA). Many of these goods are smuggled back into Pakistan after crossing the Afghan border, and others are illegally unpacked from the containers en route inside Pakistan, or even at the port itself. Illegal trade has been a major concern for Pakistan because of included revenue losses, the associated governance problems and the competition of illegal imports with domestic. Reductions of customs duties and domestic excise taxes on consumer luxuries and transport-related commodities, such as tires, as well as tightening of customs controls, would reduce the incentives to smuggle. While Pakistan can discourage smuggling significantly through such unilateral measures, regional cooperation on border control procedures and to establish a strong administrative framework for transit trade also hold great potential.

55. As with Bandar Abbas, the port of Karachi offers Central Asian countries a possible alternative route to world markets. However, Pakistan must address several infrastructure and trade logistic problems before this opportunity can be fully developed. Port procedures in Karachi and railway services inside the country are reportedly inefficient; both add considerably to transit times and freight costs. Second, the government must find ways to reduce the persistent leakage of goods transiting the country. Without major efficiency gains in trade logistics and reduced port turnaround times this route could remain more expensive for Central Asian companies than existing rail routes through Russia to Western Europe.

Tajikistan

56. Although agriculture is the principal employer and source of income for most Tajik households, the domestic economy and international trade are dominated by aluminum (Table 3.6). Aluminum production is the largest contributor to GDP and makes up over half of official exports. It is sold predominantly to Netherlands, Turkey and Russia. Tajikistan is the only country among the AAN countries that conducts much trade with other countries in the group. It both exports and imports substantial quantities of electricity to and from Uzbekistan. There may be room to expand electricity and water exports to countries in the region, but because of the

country's topography; this would require substantial infrastructure investments and care to ensure that the environmental impact of these projects is properly assessed and taken into account.

Table 3.6 Main Exported and Imported Goods – Tajikistan

Exports			Imports		
Product (2 digit SITC)	Value (million \$)	Share (%)	Product (2 digit SITC)	Value (million \$)	Share (%)
Non-ferrous metals	372	54	Inorganic chemicals, ores	213	33
Electric current	92	13	Electric current	119	18
Textile fibers	84	12	Petroleum and products	87	14
Railway/tramway equipment	38	5	Cereals/cereal preparations	46	7
Total	692	100	Total	644	100

Source: UN COMTRADE database, data for 2000.

57. Cotton exports to Switzerland and Eastern Europe also contribute to export earnings (Table 3.7). One might have expected Tajikistan to export cotton to South and East Asian countries, given that several engage in textile and garment production on a large scale. Locally grown cotton is subject to mandatory sale through the Tajik Universal commodity exchange, by Government Decree No.237 of 8 June 2001. The same treatment holds for hides, wool, tobacco and scrap metal.

Table 3.7 Principal Trading Partners – Tajikistan

Exports			Imports		
Trading partner	Value (million \$)	Share (%)	Trading partner	Value (million \$)	Share (%)
Russia	259	37	Uzbekistan	185	10
Netherlands	178	26	Russia	104	6
Uzbekistan	98	14	Ukraine	84	5
Switzerland	72	10	Kazakhstan	82	5
Italy	20	3	Azerbaijan	63	4
World	692	100	World	644	100

Source: UN COMTRADE database, data for 2000.

58. Tajikistan maintains a floating exchange rate regime with full currency convertibility and relatively open trade policies. Before April 2002, the Tajik tariff schedule contained six tariff bands, ranging between 5–30 percent, with a simple average of 8 percent. In April 2002, a uniform tariff of 5 percent on all goods, with exceptions granting duty-free status to nine products and a 2 percent tariff on aluminum oxide, were adopted.¹⁷ According to the Memorandum of the

¹⁷ Government Decree No. 187 of April 30, 2002.

Foreign Trade Regime submitted to the WTO, the government introduced this as a temporary measure to simplify the process of customs valuation.¹⁸ Goods imported from two sets of countries enter duty-free: CIS countries, with many of which Tajikistan has signed either free trade or customs union agreements, and 45 Least Developed Countries to which Tajikistan has granted non-reciprocal duty-free treatment of goods.

59. As noted, this uniform tariff schedule is a temporary measure, since members of the Eurasian Economic Community, including Belarus, Russia, Kazakhstan, the Kyrgyz Republic and Tajikistan, agreed in 1999 to begin harmonizing their external tariffs. The treaty entered into force in 2000 and calls for a five-year transition period.¹⁹ Customs union members will be permitted to maintain different tariff rates on a limited set of sensitive items. Observers expect that Tajikistan - and the Kyrgyz Republic - will face pressure to raise their tariffs to the somewhat higher levels imposed by Russia, Kazakhstan and Belarus.

60. Current account restrictions have been retained to support implementation of a strategy directing resources from traditional exports (such as cotton, gold, minerals) to the development of a capital-intensive, import-substituting industrial base. Currently oil and coal are sold at a heavy discount from world market prices.

61. Tajikistan has applied to join the WTO, submitting its Memorandum of the Foreign Trade Regime in February 2003. The country will face a challenge in balancing WTO members' demands for tariff reductions with its existing commitment to harmonize tariffs with its customs union partners. Given its income and administrative resources, the country will need donor support to complete the accession process.

Turkmenistan

62. Like Iran, natural gas and petroleum products comprise around 80 percent of Turkmenistan's total reported exports (Table 3.8). Other important exports are oil and cotton fiber. Most natural gas is exported under intergovernmental agreements with around half of the exports paid in barter or through construction projects. In addition, the country has only two routes for natural gas exports – a pipeline to Russia and a low-capacity pipeline to Iran. This makes Turkmenistan overly dependent on Russia and vulnerable to export disruptions.²⁰ Main importers of Turkmenistan's natural gas are Ukraine, Russian and Iran. Turkmenistan has recently signed a natural-gas export agreement with Russia and is exploring export possibilities to South Asia through a proposed trans-Afghan pipeline.

63. Turkmenistan, like other countries in the region, also produces and exports cotton. The government continues to use a system of mandatory state purchases of cotton at below-world market prices, which depresses the incomes of cotton farmers and does not allow private sector entry and investment in the sector. In recent years, cotton exports have declined due to poor cotton harvests and policies to encourage domestic processing.

¹⁸ WTO document WTO/ACC/TJK/3, February 21, 2003.

¹⁹ This transition period might indeed be extended.

²⁰ In 1993, Gazprom blocked Turkmenistan's competing natural gas exports to Western Europe through the Russian pipelines. In 1997-98, Turkmenistan was forced to suspend natural gas exports almost completely due to payment arrears by the main consumer, Ukraine.

64. Turkmenistan is the only country in the region that has not applied to the WTO. Customs duties of up to 100 percent are levied on 94 commodity categories for domestic market protection. Officially no customs duties are levied on commercial transactions, though a 5 percent duty is levied on products imported by individuals. Imports (and exports) are also subject to a 0.4 percent customs fee payable jointly by contract parties. The government also uses excise taxes to protect domestic industry by imposing them selectively on imports but not on domestically-produced goods. All exports and imports require registration at the State Commodity Exchange and strategic exports (natural gas, oil, cotton, electricity) need Cabinet approval. Another important trade barrier is a restrictive foreign exchange regime. With the parallel market premium topping 300 percent foreign exchange is rationed by the authorities for priority imports, mainly by state-owned enterprises. Export bans on some goods such as foodstuffs are in place. State enterprises are subject to a 50 percent mandatory surrender requirement at the overvalued official exchange rate and natural gas, oil and cotton exports are subject to export taxes (e.g., cash proceeds from natural gas exports are subject to a percent sales tax payable to the Presidential Foreign Exchange Reserve Fund).

Table 3.8 Main Exported and Imported Goods – Turkmenistan

Exports			Imports		
Product (2 digit SITC)	Value (million \$)	Share (%)	Product (2 digit SITC)	Value (million \$)	Share (%)
Natural Gas	1,249	50	Industry special machine	256	14
Petroleum products	764	31	Unspecified industrial equipment	153	9
Textile fibers	240	10	Iron and steel	147	8
Textile, yarn and fabric articles	103	4	Road vehicles	129	7
Total	2,506		Total	1,786	

Source: UN COMTRADE database, data for 2000.

Table 3.9 Principal Trading Partners – Turkmenistan

Exports			Imports		
Trading partner	Value (million \$)	Share (%)	Trading partner	Value (million \$)	Share (%)
Russia	1,029	41	Russia	254	14
Italy	401	16	Turkey	253	14
Iran	242	10	Ukraine	214	12
Turkey	186	7	United Arab Emirates	159	9
Ukraine	165	7	Japan	144	8
World	2,506		World	1,786	

* Including natural gas exported to Ukraine via Russia.

Source: UN COMTRADE database, data for 2000.

65. Overall, Turkmenistan’s foreign trade regime is excessively restrictive and non-transparent. The high level of discretion that it gives customs might foster rent-seeking behaviors and largely discourage private sector activities. Turkmenistan’s economic performance would benefit from a more transparent and favorable trade and investment climate.

Uzbekistan

66. Uzbekistan’s main exports are gold, cotton fiber and natural gas, and its principal trading partners are Russia and the EU.²¹ Uzbekistan exchanges energy for electricity and water with neighboring CIS countries under intergovernmental agreements. Its railroad system could potentially serve as a regional transport hub and support transit trade to and from Afghanistan, given sufficient improvements in domestic infrastructure as well as the addition of new international linkages. TRACECA is exploring options to connect rail links from Western China to Uzbekistan (via the Kyrgyz Republic).

Table 3.10 Main Exported and Imported Goods – Uzbekistan

Exports			Imports		
Product (2 digit SITC)	Value (million \$)	Share (%)	Product (2 digit SITC)	Value (million \$)	Share (%)
Textile fibers	910	40	Industry special machine	180	10
Natural gas	230	10	Road vehicles	171	10
Textile, yarn and fabric articles	181	8	Iron and steel	126	7
Non-monetary gold	163	7	Industrial equipment	120	7
Total	2,252	100	Total	1,792	100

Source: UN COMTRADE database, based on data for 2000 reported by partners.

67. Like Turkmenistan, Uzbekistan still retains many elements of central planning and has pursued policies intended to promote national self-sufficiency rather than international integration. There are no formal import quotas but current account restrictions have been used to ration foreign exchange and channel it from traditional exports (such as cotton, gold, minerals) to the development of a capital-intensive, import-substituting industrial sector. Uzbekistan has three rates of customs duties ranging from 0 to 30 percent with the average duty of about 15 percent. There are numerous ad hoc exemptions for various categories of importers and goods, including vehicles meant for international cargo transport, technological equipment. As a result the trade-weighted customs duty is 4.5 percent. Excise taxes, many of which are set higher for imports than for domestically produced goods, are another element of protection in Uzbekistan. Individuals pay a 70 percent unified customs duty on non-food goods and a 40 percent duty on foods.

²¹ These figures are based on mirror/partner statistics since Uzbekistan does not publicly report its international trade data. The mirror statistics significantly underestimate both total merchandise exports and imports. According to official statistics provided to the World Bank, merchandise exports in 2000 were \$2,935 million, and merchandise imports – \$2,696 million.

68. Non-tariff barriers to imports are significant: customs clearance is bureaucratic; foreign certifications of technical standards are frequently rejected; and multiple documents issued by government agencies are required for clearance of imports. These policies tilt the playing field against legitimate small businesses operating in the formal sector, which is unfortunate because small businesses can act as a source of much technical innovation and employment generation. According to a recent IFC/SECO sponsored survey of SMEs in Uzbekistan, 99 per cent of smaller Uzbek firms are not engaged in any foreign trade activity. The monopoly position enjoyed by several larger domestic firms has justified the maintenance of price regulations. The lack of competitiveness that results from having few firms and low integration into the international economy is the key reason for the disappointing export performance despite the large devaluation. Rather than adding new administrative controls, which tend to increase rather than reduce incentives for informal activity, the priority should be to streamline existing regulations and equalize tax treatment for small and large businesses. Both would make entering the formal economy more profitable than remaining in the informal sector.

Table 3.11 Principal Trading Partners – Uzbekistan

Exports			Imports		
Trading partner	Value (million \$)	Share (%)	Trading partner	Value (million \$)	Share (%)
Russia	639	28	Russia	271	15
Italy	190	8	Korea	230	13
Tajikistan	185	8	Germany	166	9
Ukraine	178	8	United States	141	8
Korea	104	5	Kazakhstan	139	8
World	2,252	100	World	1,792	100

Source: UN COMTRADE database, based on data for 2000 reported by partners.

69. Since 1997, exports and FDI have contracted as Uzbekistan has become an increasingly closed economy. To fund domestic investment projects, the government guaranteed costly external borrowing. While maintaining stability, the centralized decision-making and state directives to all key sectors—agriculture, industry, energy, and banks—have discouraged private investment and employment generation. Experiences of other countries show that autarky is highly unlikely to support sustained poverty reduction and standard-of-living improvements for the majority of the population. Trade policies, indeed, have proven rather ineffective tools of social or industrial policy. Though Uzbekistan has applied for WTO membership, the negotiations are at very early stages, and its current trade policies appear largely at odds with WTO principles. Hence if WTO membership is a genuine high priority objective for the authorities, significant additional policy reforms should be envisaged as prior actions.

PROSPECTS FOR REGIONAL COOPERATION AND TRADE INTEGRATION

70. Countries in the region share an obvious interest in renewed Afghan prosperity. The reconstruction of the Afghan economy, with a strong emphasis on rebuilding physical infrastructure, has the potential to stimulate trade in the region and foster economic growth. Afghanistan's reconstruction process itself should also provide opportunities for neighboring countries to supply construction materials and services needed to rebuild the country.

71. Intra-regional trade flows are relatively small. In 2002, Tajikistan was the country with the highest proportion of regional trade - over 20 percent - followed by Turkmenistan and Afghanistan - about 10 percent (Table 3.12). Regional trade for the two largest economies –Iran and Pakistan–was only 2 percent.

72. In terms of bilateral trade flows, Pakistan is an important export market for Afghanistan (about 27 percent of its total exports in 2002); other significant flows, corresponding in large part to energy products, include Tajikistan imports from Uzbekistan (about 18 percent of total Tajikistan’s imports) and Turkmenistan exports to Iran (13 percent of Turkmenistan’s exports) (Table 3.13).

73. As noted earlier, poor transport infrastructure as well as trade barriers within the region might partly explain these low levels, though the similarity of these countries’ economic structures might also be an important contributing factor. These countries are characterized by a narrow export base and overlapping product composition (mainly energy and textile products). Their principal export markets are clearly outside the region. Similarly, the efficient suppliers of the broad range of goods imported are outside the region. As a corollary, it seems unlikely that intra-regional trade will expand massively. Indeed, even if transport links are improved or upgraded and trade barriers lowered, the scope for the establishment of a preferential trade agreement between these countries appears limited.

74. This assessment does not imply that there are no prospects for trade-related regional cooperation. Regional discussion fora have proven beneficial in other regions of the world. An obvious example is the Association of Southeast Asian Nations (ASEAN) which, by facilitating regional economic cooperation and providing a confidence-building forum, contributed to three decades of regional economic growth.²² Another example of regional cooperation that does not involve preferential tariff reductions is the Asia-Pacific Economic Cooperation (APEC), which has focused on trade facilitation issues: members have pledged to streamline customs procedures and improve port logistics, among other measures to reduce transaction costs associated with international trade.

²² The parallel between ECO potential and ASEAN achievements is mentioned in Pomfret (1999), *Central Asia Turns South? Trade Relations in Transition*, Central Asian and Caucasian Prospects, The Royal Institute of International Affairs.

Table 3.12 Intra-Regional Trade, 2002

	Afghanistan	Iran	Pakistan	Tajikistan	Turkmenistán	Uzbekistán
Exports						
Region	28	274	276	118	430	158
Rest of the World	76	25,890	9,610	619	2,280	1,605
<i>Regional share (%)</i>	<i>27</i>	<i>1</i>	<i>3</i>	<i>16</i>	<i>16</i>	<i>9</i>
Imports						
Region	284	468	240	195	136	101
Rest of the World	2,396	21,640	10,998	525	1,683	2,124
<i>Regional share (%)</i>	<i>11</i>	<i>2</i>	<i>2</i>	<i>27</i>	<i>7</i>	<i>5</i>
Total						
Region	312	742	516	313	566	259
Rest of the World	2,472	47,530	20,608	1,144	3,964	3,729
<i>Regional share (%)</i>	<i>11</i>	<i>2</i>	<i>2</i>	<i>21</i>	<i>12</i>	<i>6</i>

Note: Million of US\$ and percentages.

Source: IMF Direction of Trade Statistics, 2002.

75. An obvious candidate to play such a role in the region is the Economic Cooperation Organization (ECO) which includes Azerbaijan, Kazakhstan, the Kyrgyz Republic and Turkey in addition to the countries covered in this study.²³ The organization was launched in 1991 by Iran, Pakistan and Turkey, as a successor to the Regional Cooperation for Development established in 1964. The enlargement of ECO to Central Asia and Caucasus Republics and Afghanistan in 1992 gave a new impetus to the organization. In 1996, the organization established an ambitious economic cooperation strategy, where transport and communication, trade and investment, and energy were outlined as priorities. The strategy explicitly envisages taking measures toward progressive removal of regional trade barriers and simplification and harmonization of national procedures with respect to customs, transit of goods and investment promotion.

²³For an overview of ECO and a discussion of its prospects, see Pomfret (1997)[, *The Economic Cooperation Organization: Current Status and Future Prospects*, Europe-Asia Studies 49(4), June].

Table 3.13 Bilateral Trade Flows, 2002
Percent of Total Trade

Reporter	Partner Country					
	Afghanistan	Iran	Pakistan	Tajikistan	Turkmenistan	Uzbekistan
Exports						
Afghanistan	..		26.8	0.2		
Iran		.	0.7	0.1	0.3	0.0
Pakistan	2.3	0.4	..	0.0	0.0	0.1
Tajikistan	0.9	3.9	0.0	..	1.3	9.9
Turkmenistan	1.1	13.1	0.0	1.2	..	0.4
Uzbekistan			0.2	6.8	1.9	..
Imports						
Afghanistan	..		9.2	0.3	1.2	
Iran	0.0	..	0.2	0.1	1.8	0.0
Pakistan	0.3	1.8	..	0.0	0.0	0.0
Tajikistan	0.0	2.2	0.0	..	6.5	18.4
Turkmenistán	0.0	4.4	0.1	0.8	..	2.1
Uzbekistán		0.0	0.3	3.6	0.6	..
Total						
Afganistán	..		9.8	0.3	1.1	
Iran	0.0	..	0.5	0.1	1.0	0.0
Pakistan	1.2	1.2	..	0.0	0.0	0.1
Tajikistan	0.5	3.0	0.0	..	3.9	14.1
Turkmenistán	0.6	9.6	0.1	1.1	..	1.1
Uzbekistán		0.0	0.3	5.0	1.2	..

Source: IMF Direction of Trade Statistics, 2002.

76. In the area of customs in particular, the ECO has promoted programs on transit trade facilitation aimed at providing an enabling environment to intra-regional as well as inter-regional trade. The ECO has also been working closely with the World Customs Organization in training customs officials. In March 2003, the two organizations signed a Memorandum of Understanding which should result in further cooperation notably in the areas of customs capacity building, harmonization of customs procedures and customs valuation. Other trade-related international bodies with which ECO has been working in recent years include the International Trade Center, the UNCTAD, and the WTO.

77. The ECO can play an important instrumental role in facilitating trade in the region notably through the simplification and harmonization of national procedures, the promotion of transit agreements, and enhancing business mobility. In that latter respect, many AAN countries impose unnecessary restriction on the international travel of export/import business persons.²⁴ A

²⁴ For example, although a visa for a business visit to Tajikistan for a northern Afghani dealer costs approximately US\$30, surveyed business persons reportedly complain that to obtain the visa bribes ten fold higher are required (Pragma (2003), "Finding New Opportunities: Afghanistan Market Research Trip" p7.; similarly, the Afghanistan authorities restrict dealers' and businesspersons' access to passports by requiring special trade passports issued by the Ministry of the Interior. See Sutherland Miller III (2003), "Administrative Barrier to Trade: An Assessment of Constraints Related to Trader's Licensing and Import/Export Procedures", Report prepared by The Services Group, Inc. (TSG) for USAID p. 45.

well functioning regional forum would contribute to enhancing business mobility and reduce the discretion of different administrations notably by exchanging information on regulations among its members, streamlining the processing of short-term business visitor visas and procedures for the temporary residence of business people and maintaining a dialogue on these issues with the business community.

78. Even if product coverage and margin of preference were extended, the impact of tariff preferences on regional trade flows would still be constrained by other trade-hampering measures, including multiple exchange rates, licensing procedures, technical regulations, and other regulatory controls. Moreover, a comprehensive preferential trade agreement between ECO countries would result in the establishment of new rules of origin for intra-regional trade, which would add to the already complicated customs clearance procedures and further burden the limited capacity of customs administrations in the region. A new agreement would also potentially be in conflict with other bilateral and regional trade arrangements already subscribed by ECO members with countries outside the region (e.g. Pakistan and SAPTA, Uzbekistan and Tajikistan in the CIS, Tajikistan in EAEC, or Turkey's customs union with the European Union).

FURTHERING INTEGRATION INTO THE WORLD ECONOMY

79. Most countries covered in this study have made significant progress in reforming their trade and investment regimes to make the policy environment more conducive to fuller integration into the world economy. Regional cooperation, notably to increase the transparency of the trade regimes and promote trade facilitation within the region, would certainly contribute to furthering the integration of these countries with international markets. In that sense, at the 1998 ECO summit, the heads of government encouraged all ECO members who have not yet joined the WTO to take the necessary steps to do so.

80. At the present time, Pakistan is the only country that is a member of the WTO.²⁵ Uzbekistan and Tajikistan have submitted their Memorandum of the Foreign Trade Regime, one of the first major steps in the accession process. So far Turkmenistan has not taken this formal step.

81. WTO accession process and membership offers a unique opportunity for governments to consolidate and further trade liberalization policies and sensitize domestic producers to the trade opportunities offered in world markets. WTO discipline offers a lever to remove existing measures hampering trade and to increase transparency of the trade regime. As noted, in most of these countries, administrative procedures and requirements associated with importing are often burdensome, increasing the cost of imports, and therefore lowering the competitiveness of their products in world markets.

82. WTO membership also provides a more certain access to foreign markets, notably through access to WTO dispute settlement provisions. However, accession itself is a lengthy and

²⁵ Other ECO members that are already members of the WTO are: Kyrgyz Republic and Turkey. Azerbaijan and Kazakhstan have applied and are in accession process.

often arduous process for developing countries.²⁶ During the negotiations, the candidate country has to scrutinize every policy affecting trade and respond to countless questions from WTO members. Indeed, countries in accession process are or will be confronted with numerous implementation requirements, many of which require institutional reform and strengthening. The adoption of WTO disciplines, by and large premised on the existence of a market economy, will require substantial structural reforms, especially in transition countries that have retained many elements of central planning since gaining their independence (notably Turkmenistan and Uzbekistan). While ultimately beneficial, the process can severely tax the administrative capacity of developing country governments, especially those of Afghanistan and Tajikistan, the poorest countries in the region. This process will call for substantial technical assistance from foreign donors.

CONCLUSION

83. In sum, significant progress in terms of lowering intra-regional trade barriers is unlikely to occur in the short run, albeit participation in regional integration processes and regional organizations might prove beneficial in providing opportunities for confidence building initiatives and creating a more favorable trade and investment enabling environment. Participation in the multilateral trading system is an important long-run objective for these countries. Though, given prevailing economic and policy conditions in the region, and the complexity and lengthiness of the WTO accession process, countries may want to focus primarily on unilateral (or, as appropriate, on regional) measures that could yield more rapid results. Indeed, in most areas, important steps, notably to improve the predictability and transparency of the trade regimes, could be taken unilaterally.

84. In the short and medium run, the major challenges for all these countries, as well as for the international community, are ensuring security and reestablishing and improving physical infrastructure within the region. While the former falls beyond the scope of this study, the current conditions with respect to trade logistics and transport infrastructure in the region and the prospects for transit trade are reviewed in the following section.

Trade Logistics, Transportation Infrastructure and opportunities for Transit Trade

BACKGROUND

85. Two decades of conflict have left Afghanistan with a severely deteriorated infrastructure, substantially reduced economic activity and a major decline in legitimate trade. Geopolitical developments within neighboring countries have led to major changes in transit relations and shifts in the direction of transit flows. Streamlining Afghanistan's transit links with both regional and non-regional trading partners would reduce transport-related trade costs and facilitate the restoration of economic activity and incomes within Afghanistan.

86. While landlocked, Afghanistan is also a potential link in routes from Central Asia to South Asia and to ports in both Iran and Pakistan. The formation of the independent Central

²⁶ For example, the WTO working party considering Nepal's accession approved Nepal's candidacy in August 2003, 14 years after Nepal first applied for membership and 5 years after completing its Memorandum of the Foreign Trade Regime.

Asian Republics (CAR) has introduced new dimensions into regional relationships and is leading to demands for diversified trade and transit links, particularly through the creation of ocean transport links. Routes through Afghanistan offer shorter distances to the sea, for the CAR, in comparison with routes to the Black Sea, Europe or China. But land distance is not the only determinant of transit cost and route choice: transport mode, border crossings, transit formalities and sea-freight costs and times are also important. However, if Afghanistan became part of an effective route, direct and indirect economic benefits could be realized.

87. At the meeting of regional countries in Dubai on September 22, 2003 a number of initiatives were announced by participating countries to facilitate regional cooperation. The parties to the Kabul Good Neighborly Declaration of 2002 committed themselves to a second declaration “On Encouraging Closer Trade, Transit and Investment Cooperation Between The Signatory Governments of the Kabul Declaration On Good Neighborly Relations”. The signing representatives for this second declaration agreed on the need to forge new trade dynamics and foster investment among their countries. They noted the need to reduce the logistical cost of trade in the region, and indicated that improvements in trade and transport facilitation could bring substantial benefits to the prosperity of the people of the region.

88. The representatives resolved that their governments will take necessary measures:

- to cooperate closely in international fora on trade and investment issues;
- to support the implementation of Afghanistan’s National Development Framework by seeking to improve customs services at borders. The representatives also requested that international donors should make the implementation of supporting projects a priority;
- to consider the options for promoting regional trade liberalization and increased integration into the world economy;
- to request business associations and chambers of commerce in the region to educate their members about current border regulations and forthcoming change and to ask them to survey their members in order to establish a clear picture of the experiences faced by business people in using borders and channel this information to governments for use in policy design.

89. With substantial donor support, Afghanistan is now undertaking a massive infrastructure investment effort to rebuild the network of ring roads circling the country. The investment in infrastructure will be an important factor in trade facilitation. Current plans call for the rehabilitate around 3,300 km, consisting of the ring road leading from Herat to Kandahar, Kabul, Mazar-e-Sharif, Sheberghan, Meymaneh and back to Herat, and six international routes to neighboring countries. A mid-term review of these road construction initiatives show the following progress: (i) in aviation: Kabul International Airport project (funded by Japan), construction to start end of 2004; (ii) the Kandahar-Kabul Road (US\$180m funded by USA, Japan, Saudi Arabia) will receive first layer of pavement by end December 2003 and is expected to be completed by end October 2004; (iii) the Kabul-Salang Doshi road (US\$102m funded by WB) has been contracted; (iv) international links: Kandahar-Spin Boldak road (funded by ADB) will be completed by Oct 2004; (v) roads: Kabul-Jalalabad road (U\$56m funded by EU), construction will begin mid-October 2003, (vi) the upgrading of the Jalalabad Torkham road with Pakistan funding and (vii) Salang tunnel reopened end November 2003. Finally, Pakistan Railways with support from Afghanistan authorities will examine the feasibility study for extension of railway track from Chaman in Pakistan to Kandhar in Afghanistan.

OVERVIEW OF TRADE LOGISTICS

90. The costs of trade, as measured by cif/fob price gaps, do not consist simply of transport charges but comprise a large group of direct and indirect costs that are now generally termed “trade logistics costs”(Table 4.1). In a well-functioning market economy, with highly developed transport and distribution networks, measurable logistics costs are usually less than 10 percent of the sale price of manufactured goods. Improvements in trade logistics and the introduction of supply chain management has reduced costs and radically altered the methods and distribution of production. In developing or emerging economies, with poor transport networks and inadequately developed logistics’ systems, the costs can be very substantially higher. For raw materials or basic commodities such as grain or cement, the costs can exceed 50 percent of the sales price.²⁷ These are all examples of the types of interactions that tend to be ignored by national sectoral regulators and could be addressed more efficiently in a region-wide approach.

Table 4.1 Trade Logistics Costs

	Direct Logistics Costs	Indirect Logistics Costs
Overhead/opportunity costs	Inventory costs Management time IT costs	Lost sales Customer service Obsolescence IT maintenance
Activity costs	Transport and cargo handling Warehousing/storage Insurance Documentation Telecommunications	Packaging IT personnel Cost of capital employed Administration

91. Recent research, based on large samples of transport costs for developing and developed countries by Limao and Venables (2001), finds that landlocked countries are disadvantaged in trade competitiveness. This is so because they have to depend on the transport networks of third countries and their trade is often subject to additional administrative restrictions and procedures. Representative landlocked economies have average transport costs 50 percent higher and trade volumes 60 percent lower than the representative coastal economy. However, landlocked countries can potentially overcome a substantial proportion of this disadvantage by increasing their own and their transit countries' infrastructure and related logistical services. The most obvious success story on overcoming the handicap of landlocked states is Switzerland, but even, among less developed countries, landlocked Uganda and Laos are achieving success through diversification of transit routes and support for corridor agreements. Limao and Venables also find, for a sample of Sub-Saharan African countries, that poor performances on trade volumes and high transport cost margins are explained by poor infrastructure, and by a particular penalty on long distance trade in Africa. While the median landlocked economy's transport costs are found to be between 46 percent and 55 percent higher than the median coastal economy's improving own and transit country infrastructure to the 25th percentile from the 75th percentile as ranked by country cost competitiveness would reduce this penalty to 34 percent and 43 percent, respectively, and if both are improved the penalty drops to 31 percent.

²⁷ Francois and Wooton (2000) estimate that the welfare gains from trade liberalization (better access to markets) may be doubled if complementary actions are taken to increase competition in the shipping sector.

92. The broad policy inference of this analysis is that Afghanistan and CAR countries, in particular, could attain major reduction in overall transport logistics cost through infrastructure improvements and effective coordination with transit countries.

93. Transport costs are normally the largest single element of logistics costs and major investments may be required to reduce them. But very substantial reductions in total logistics costs can be achieved by streamlining the systems within which transport and trade operate. Unfortunately, the total logistics costs of trade are always difficult to assess as there is often a lack of transparency in prices and tariffs and informal costs can be important. However, on the basis of surveys and other sources, this study has developed order-of-magnitude costs for the major routes from Afghanistan and the Central Asian Republics.

AFGHANISTAN'S TRANSIT SYSTEM

94. Afghanistan's present dry cargo trade is concentrated along two main axes toward Pakistan and Iran (Table 4.2). The Pakistan route handles bilateral trade and most relief and donor cargo, while the Iranian route handles most of the commercial freight from third countries. Petroleum products are imported through Iran (50 percent) as well as from Turkmenistan and Uzbekistan; recently petroleum imports from Pakistan have increased.

95. Transit routing was very different in the late 1970s, when some 70 percent of such traffic was routed through the USSR, connecting at the railheads of Termez (linked to the river ports of Hairatan²⁸ and Shirkhan), or Torghundi. Approximately 20 percent of trade was routed to/from or through Pakistan and 10 percent through Iran, including some direct road transport with Europe. The railways still transport some fuel and relief cargo (e.g., grain from Kazakhstan), but the volumes are a small fraction of their previous levels, and there appear to be either major restrictions or a prohibition on the movement of commercial cargo. Afghanistan has recently announced its intention to join the Transport Corridor Europe Caucasus (TRACECA) which will provide an alternative rail route through the Black Sea ports.

Table 4.2 Afghanistan's Main Trade Transport Routes

Transit Country	Transit Port	Transit Route					Destination
Pakistan:	Karachi	→	Peshawar	→	Torkham	→	Kabul
		→	Quetta	→	Spin Boldak	→	Kandahar
Iran:	Bandar Abbas	→	Islam Qala	→	Herat	→	Kabul Kandahar

ASSESSMENT OF PRESENT TRANSIT ARRANGEMENTS

96. Afghanistan's present trade-transport systems are almost primitive and have been hardly touched by the transformation in trade logistics that has taken place elsewhere over the last 20 years. There is an urgent need to develop the enabling regulatory, physical and commercial

²⁸ A road-rail bridge has since been constructed across the river at Termez

environment for modern trade logistics within the region so as to assist both in reducing costs and enhancing fiscal control of trade revenues. Such an environment would also contribute to TISA's broader objectives of central revenue control, reduced opportunity for fraud, tighter control over drugs and arms and faster and more evenly distributed economic growth.

Transit Costs and Times

97. Afghanistan is a large country and different transit routes/ports may serve some regions better than others. Estimates of transit costs and times, by the different routes, are provided in Table 4.3.²⁹

Table 4.3 Afghanistan: Transit Costs (US\$) and Transit Times

		20ft Container		Bulk Cargo (ton)		Transit Time (days)	
		Border	Kabul	Border	Kabul	Border	Kabul
Pakistan*	Rail + Road	945	1990	27	51	16	20
	Road		2030	28	52	10	14
Iran	Rail + Road	1100	1500	80	95	15	20
	Road	1300	3000	50	120	7	12
Black Sea	Rail	1350		69			
Baltic	Rail	1800				21	

* Costs are only slightly lower on the Karachi – Quetta – Kandihar route

98. Transit costs via Iran are rather higher than through Karachi but transit time is quicker. The costs of road plus rail and direct road on the Karachi route are very similar, because trucking rates are so low. A very significant part of the transit cost is generated within Afghanistan from border formalities, poor road conditions, low vehicle speeds, road tolls/fees and, in the western region, the high rates charged by a trucking cartel. The alternative routes through to the Black Sea or the Baltic ports have higher land costs but these may be more than offset by lower costs on the sea links of the transport chain. The Baltic rail route would be particularly attractive for trade with Europe, avoiding sea freight costs of US\$825 and an additional three weeks transit time.

Transit Service Quality

99. Afghanistan's present transit arrangements are cumbersome and impose substantial constraints on the movement of goods and development of trade relations.

Commercial Cargo through Pakistan

100. Most transit commercial cargo during early 2003 was routed via Iran as the Karachi route has significant restrictions. In an attempt to reduce return shipments smuggled back to evade Pakistani domestic taxes, the Government of Pakistan has imposed a list of goods for which transit is prohibited. However, the list of prohibited items was substantially shortened in August 2003 and additional measures announced to encourage transit trade through Pakistan.

²⁹ Costs on potential routes, such as the Baltic Ports, have been obtained from costs to neighboring countries.

101. While direct road transport has been allowed for other cargo, commercial goods are still restricted to Pakistan Railways which provides a poor level of service, often loading delays and no significant cost saving. Some Afghanistan-based and Pakistan-based cross-border trucking activity is allowed to Peshawar, but no Afghan trucks can move to Karachi. On the Kandahar route, all cargo must be transferred to national vehicles. The local administrations in a few Afghan provinces, including Herat, have instituted their own regulations through the Department of Transportation which prohibit the use of foreign trucks in their region of Afghanistan. In the Kunduz, zone linking Tajikistan and Afghanistan, trucks are required to unload all their contents for Tajik and Russian border inspection as a measure to combat drug smuggling.

Transshipment at the Border and Trade Logistics costs

102. The high incidence of truck-to-truck transshipment at the Afghan border must be unique in international transit systems. For a variety of reasons, including the break of transport mode from rail to road and the restrictions on Pakistani drivers entering Afghanistan, almost all freight traffic is transshipped at Afghanistan's borders. Poor roads and political pressures also deter Iranian truckers from entering Afghanistan, though large differences in payloads encourage cargo consolidation at the border. Transshipment increases handling costs, transit times and the risks of cargo loss and damage. The increases in costs and trade flow complications arising from these transshipments requirements imply increases in almost all the components of direct and indirect trade logistics summarized in Table 4.3. Another contributing factor is the limited training, poor working conditions of customs officials and inadequate central control leading to major regional variations within Afghanistan in the way in which customs procedures are implemented. This problem is currently being addressed through reform of customs laws and the introduction of new customs procedures by TISA and through intensive technical assistance for customs officers. Additionally, a contributing cause of high trade logistics costs at international frontiers for the countries of Central Asia is the lack of experience of the newly established CAR customs services.³⁰

Container De-stuffing

103. Container shipment is particularly well-suited for transit traffic, but the international shipping lines do not allow the free movement of their containers into Afghanistan.³¹ The boxes have to be de-stuffed at the port or border and either repacked into local containers or shipped as break-bulk cargo. Much of the potential benefit of container traffic is thus lost. As a general rule of international shipping, shipping lines will only allow their containers to go inland when they move through a land transport operation, rail or road, controlled either directly or indirectly through a subsidiary land operator. Otherwise, shippers refrain from letting the container leave the port, or if they agree to shipment to an inland destination without full control, they usually require a large deposit equal to or exceeding the value of the container and dry box. The logistics of moving and repositioning empty containers that currently make up about 40 percent of all container traffic is at the core of shipping-line organization and often the key to profitability for many lines. Uncertainties about box recovery when containers go inland in large numbers can trigger significant disruption within the overall box management scheme of the company and generate high additional operating costs when boxes go missing. The potential economic loss of not recovering the box is more than the cost of the container (about \$1,000 for a dry box).

³⁰ See discussion in Constantine Michalopoulos (2002) "The Integration of Low-Income CIS Member in the World Trading System" presented at Lucerne Switzerland meeting on trade in Eastern Europe and Central Asia.

³¹ When containers are allowed to cross, deposits equal to the value of the container are required.

104. Consequently, without full control over container's distribution chain by international operator, the full benefits of containerization are unlikely to be realized by Afghanistan. A necessary condition for developing multi-modal transport operations with door-to-door delivery in developing countries is to enable international transport operators to control the inland delivery. One solution is to encourage international shippers, whose containers land in Iranian and Pakistani ports, to own and operate local subsidiaries in Afghanistan. This will require an appropriate enabling environment for such investment, including a reasonable degree of uniformity in the way in which the Afghanistan Ministry of Transport regulates road shippers throughout the country. TISA involvement, either through regulation or contracting out operational monitoring, will do little to quell the international operators' concern. Insurance schemes are also unlikely to be a viable alternative.

Transit and Customs Procedures

105. Documentation within the transit countries is not reported to be a major problem. More time-consuming and costly are the requirements at the Afghan border; on the Karachi routes, border clearance is estimated to take 1 – 2 days, and the documentation costs about US\$165/container. There is no transit system, within Afghanistan, to allow direct delivery to the final destination and customs' duty collection takes place at the nearest provincial capital to the border. The procedures for clearing commercial cargo through Afghan customs are complex and time-consuming, requiring about 26 different processes and numerous opportunities for rent-seeking. Moreover, it would appear that sub-national regional authorities introduce their own particular regulations, further complicating the system.

Cargo Insurance

106. It is impossible to get effective local insurance cover for the transport of goods in Afghanistan. Truckers increase their rates to cover their potential loss/damage liabilities or goods are shipped at owner risk.

Lack of Afghan Participation

107. With the exception of the Peshawar route, Afghan truckers play no role in external transit. Trucking is entirely provided by the transit countries. Normally, truckers in both the landlocked and sea-access countries participate in transit traffic. This lack of participation increases the demand for restricting foreign truckers from operating in Afghanistan. Such restrictions have already been imposed in Herat and Kandahar provinces.

Communications

108. The transit system is disjointed with transshipment, border formalities, customs clearance at provincial capitals and numerous check-posts en route. Coordination between transporters in Afghanistan and transit countries and between shippers and customs officials is poor because of the lack of professional transit agents and poor communications.

STREAMLINING AFGHANISTAN'S TRANSIT SYSTEM

109. Although truck explicit transport costs per kilometer as reported in Table 4.3 are not particularly high in the region, Afghanistan's total transit costs are relatively high and the service poor. The table does not capture the cost of time delays. Some major improvements to the Afghan transit system will require agreement with its transit partners and changes to the transit agreements and regulations. But much of the transit cost is incurred within Afghanistan and is thus under Afghan control.

**Table 4.4 Pakistan Route: Transit-Transport Costs - Container Traffic
(US\$/Box)**

	Kabul via Peshawar		Kandahar via Chaman		Kabul or Kandahar	
	Rail + Road		Rail + Road		Road	
	20ft	40ft	20ft	40ft	20ft	40 ft
Port Charges	195	330	195	330	195	330
Agency/Karachi						
Customs	210	230	210	230	210	230
Rail to Border	540	990	500	960		
Unloading/reloading	60	75	60	75		
Border Customs	165	180	165	180	165	180
Road to Afghanistan	500	875	430	735		
Direct Road					1140	1850
Road tolls/taxes	120	120	120	120	120	120
Unloading Afghanistan	200	250	200	250	200	250
Total	1990	3050	1845	2880	2030	2960

Source: Special survey for World Bank

Actions by Afghanistan

Improve Security

110. Improving security is fundamental for the revival of Afghanistan and the improvement of the transit system. Better security would help to: (i) encourage foreign truckers to make direct deliveries and thus reduce transshipment; (ii) reduce costs on some routes where trucks operate under convoy conditions; (iii) remove the prohibition on the entry of shipping line containers, or at least reduce the level of container deposits.

Complete the Main Road Rehabilitation and Extend Communication Systems

111. Better roads and communications will reduce costs, improve transit times and improve customer service. Though major road projects are underway and transport time between Kabul and Kandahar has already been reduced from days to hours, it will take a number of years for the main road network to be restored fully to reasonable condition. The Government will also need to ensure that, once rehabilitated, road condition standards are sustained through adequate routine and periodic maintenance. This will require systems for both maintenance funding and maintenance delivery. Road user charges in Afghanistan are well below the levels required for

financial sustainability in the sector, and both fuel taxes and vehicle license fees will need to be raised.

112. Decisions will also have to be taken regarding vehicle standards and permissible vehicle and axle-loads. At present, no standards or load limits are enforced, and very heavy vehicle loading contributes to the very low freight rates in much of the country. The Government will need to assess the optimum balance between the advantages of low road freight rates, the costs of road damage and poor road safety standards and the acceptability of Afghan trucks in neighboring countries.

Streamline Afghan Border Procedures

113. A high priority should be the streamlining of border crossing formalities and their reduction to a single document in order to reduce the documentation and high costs at the borders. Establishing a single document conforming to international conventions with multi-language instructions in regional languages might be taken up as a high priority institutional initiative either by the group of countries meeting in Dubai or by ECO.

Re-establish Formal Financial and Insurance Systems

114. Without the ability to provide transit bonds and insurances, Afghanistan will be restricted to rudimentary transit systems such as convoys or duty deposits. The reestablishment of financial institutions should have very high priority. Insurance for goods and containers would allow significant transport cost savings.

Implement a National Customs and Transit System

115. Present arrangements combine both national and regional rules and regulations. While primarily a fiscal issue, it has transit ramifications and reduces service quality. Government should introduce a uniform national system which allows the shipper to select whether to clear cargo at the nearest provincial capital or at the final destination. This reform should be accompanied by the provision of the legal framework for the freight forwarding and customs clearing which would, inter alia, establish the qualifications, experience and resources required for a C/F license. To help integrate Afghanistan into world trade, international C/F companies should be permitted.

Eliminate Restrictions on Direct Transit

116. While reciprocal open access should be sought, transshipment to Afghan trucks at the border has a net negative impact to the economy. Afghan truckers may gain, but their gains will be more than offset by the costs to the shipper and the domestic economy.

Remove Checking-Posts and En-route Inspections

117. Fuel tankers are stopped 16 or 17 times on a round trip between either Herat or Hairatan and Kabul and have to pay at least that number of taxes and fees. Trucks are stopped 4 or 5 times

on the road from Torkham to Kabul. The individual fees may be small but they delay the vehicles, provide the opportunity for informal payments and introduce uncertainty. These checking-posts should be removed and a single transit fee charged at the border.

Increase Domestic Trucking Competition

118. Throughout most of Afghanistan, trucking rates are set by the market, but competition is ineffective in the western region and trucking rates are 2 to 3 times higher than elsewhere. Reducing rates to market levels could lower the internal transit cost on the Iran route by some 60 percent.

Actions with Transit Partners

119. Developing and implementing an action program with transit partners is more difficult than taking unilateral action on internal constraints. Often the actions to benefit the landlocked country conflict with interests in the transit country and are resisted. There is, however, scope for agreements that would benefit both Afghanistan and its transit partners. Substantial improvements are possible to Afghanistan's transit-transport links, though agreement on revisions to the present transit arrangements might be problematic in a static geo-political environment. Fortunately, given Afghanistan's potential role in linking Iran and Pakistan to Central Asia, surrounding countries are likely to be interested in developing routes through Afghanistan and in negotiating mutually beneficial arrangements. In that respect the following actions should be envisaged.

Re-activating the Rail Route to Europe through Uzbekistan

120. The rail system from the CAR, through Russia, to Europe still provides a reliable and cost-effective route and dominates CAR's external transport. It would also provide a cost-effective routing for Afghan trade with Europe. Agreement needs to be reached with Uzbekistan to allow direct delivery and dispatch of wagons to/from Hairatan across the Friendship Bridge. Afghanistan should also try to participate in discussions to establish through rates on the rail network to replace the aggregation of individual national tariffs. Improved transit facilitation would increase traffic on Uzbek Railways and provide the environment for facilitating Uzbek transit traffic through Afghanistan. The reopening of the Salang Tunnel has been a major step forward to open road links with northern Afghanistan.

Streamlining Transit through Pakistan

121. The Karachi routes offer the lowest costs for much of Afghanistan. The basic arrangements were established in 1965 and need to be revised to reflect the changes in the transport sector. Three actions would substantially reduce costs and/or enhance the effectiveness/quality of the route:

- Remove the negative list of goods: while reducing transit through the Karachi route, there is little evidence that the policy is achieving its objectives. The policy might be modified to require shipment in customs-sealed containers.

- Allow direct road transit for all goods: Pakistan’s road infrastructure has improved and the performance of Pakistan Railways has declined since 1965. Transit costs and service quality would be substantially enhanced by extending direct road transit to all goods. This would need to be accompanied by an extension of the bond system on the basis of transporter, shipper or consignment.
- Increase Afghan participation: extending direct road transit to all commodities should be accompanied by allowing Afghan trucking companies to compete in the sector. The vehicles used by the trucking sectors in the two countries are very similar and there should be free flow of Afghan trucks to Karachi and free flow of Pakistan trucks to final destinations within Afghanistan. Transit fees for foreign registered trucks could be established based on truck-size and distance traveled.

122. In the longer term, if Pakistan decides to restructure its railways, the establishment of a private, joint-venture, rail-container company might be an attractive proposition.

Streamlining Transit through Iran

123. The Government of Iran is promoting the use of its ports for both Afghanistan and the CAR. The construction of the Bafq-Mashad rail link will substantially reduce rail distances and make rail a competitive mode for Afghan traffic to Bandar Abbas. The use of Chabahar is being encouraged, but the port has limited draft and infrequent vessel calls. The port may be an alternative for charter shipping but the shipping costs will be higher than to Bandar Abbas or Karachi because of vessel restrictions and slow off-loading rates.

DEVELOPING AFGHANISTAN’S TRANSIT POTENTIAL

Afghanistan’s Geographic Position

124. Afghanistan is strategically located for linking Central Asia with South Asia and the ports on the Persian Gulf and Arabian Sea. Other routes, through Iran or along the Karakoram Highway, are possible, but Afghanistan offers significant distance savings for some CAR (Table 4.4).

125. The Afghanistan route to Karachi, via Quetta, provides much of Central Asia with its shortest route to the sea. Afghanistan would also be crucial, if Pakistan expands its economic relations with Central Asia, a market of 57 million people and US\$42 billion.

Table 4.5 Central Asian Republics: Sea Access by Road (in kilometers)

		Bandar Abbas			Karachi		
		Turkmenistan*	Afghanistan			Afghanistan	
Route		I*	II*	III*	Peshawar	Quetta	
Almaty	3,600	4,610	4,020	3,810	4,010	3,380	
Tashkent	2,730	3,730	3,175	2,930	3,345	2,720	
Dushanbe	2,940	3,370	2,790	2,680	2,660	2,040	
Bishkek	3,270	4,330	3,750	3,530	3,730	3,100	

-
- * Route I via Kabul, Kandahar, Herat
 - * Route II via Kabul, Kandahar, Delaram, Zaranj
 - * Route III via Meymaneh, Herat, Delaram, Zaranj.

Present Transit Potential

126. Under prevailing conditions, the potential for transit traffic through Afghanistan appears negligible. The following major issues have to be resolved, before Afghanistan can really begin to utilize its geographic position.

Security

127. Irrespective of its infrastructure, Afghanistan has little transit potential until the security issue is resolved. There may be few security problems on the route through Peshawar, but on the Quetta route that offers major transit potential, security remains a major problem. Until these routes are perceived to be secure, through demonstrated actions by TISA with support of the international community, it is difficult to envisage the use of Afghan routes when other routes are available at relatively little additional cost.

Transit System

128. There is no operational system for transit through Afghanistan, notwithstanding the many accords, agreements and bilateral and multilateral declarations on the issue. There is no functioning formal banking or insurance sector to provide bonds or guarantees to cover the customs duties on goods in transit that have not cleared customs. Without a bond/guarantee system, customs control of corridor scheme would be limited to a costly and inefficient convoy system. The system needs to maximize the attractiveness of routes through Afghanistan. At a very basic level, shippers need to be able to insure their cargo and use containers, neither of which are possible at the present time in Afghanistan.

129. An efficient system within Afghanistan is not sufficient for through-transit; such a system has to extend from landlocked country to the seaport. The present transit agreements focus specifically on the arrangements for Afghan cargo and must be both extended and streamlined for third-country traffic.

Central Government Control

130. Central government authority is still limited and many decisions are being made at the provincial level. An effective transit system has to be predictable and uniform throughout the country. Arbitrary decisions, ad-hoc regulations and uncertainty would have a very negative impact on transit potential.

Cargo Transshipment

131. Most Afghan cargo is transshipped at the Afghan border. Local shippers have to accept transshipment, but it would be highly detrimental for the development of through-transit. Truck-

to-truck transshipment, other than switching trailers, is almost perverse. The opportunities for both direct transit and container shipment are crucial for the development of the routes.

Future Transit Potential

132. A recent study by the ADB suggests that the development of North-South road corridors could result in a major shift in trade - transit routing from Central Asia and have a very positive impact upon both employment and production in the region. Additionally, the Government of Iran envisages potential transit traffic of some 40 million tons from Central Asia. Although the private sector more conservatively estimates 8 million tons, even that volume would be a major increase on the present level of about 1.5 million tons. Both Iran and Pakistan have designated ports that they would like to see develop as major transit routes for the region, Chabahar and Gwador, and both countries are investing heavily in their transport systems to meet transit potential.

133. Choices between routes and modes are not based simply on price but on a combination of factors including cost, time, reliability and other service quality attributes. A survey of US shippers estimated that price accounted for only about a third of the choice decision. Price may be more important in poorer countries, but choices will undoubtedly be influenced by time, cost, and predictability in service delivery.

Transit Costs

134. Transit through Afghanistan will compete with other road routes and rail which carries 80 percent of the CAR non-oil external traffic. Afghanistan will be one link in a transit chain and its competitiveness will depend on costs throughout the chain, including any sea-links. The land costs will be substantially influenced by truck and payload regulations:

- Little regulation in Pakistan and road freight rates are extremely low: US\$0.29/TEU-km and less than one US cent/ton-km;
- European standards in Iran, a 22-ton payload limit, and much higher trucking rates: US\$0.48/TEU-km and two US cents/ton-km.

135. Transit costs for bagged cargo from Karachi to Tashkent or Dushanbe might be in the range of US\$35 – 40/ton-km, costs that would be very competitive with existing routes via the Baltic or Black Sea ports (US\$65 –70/ton-km). The route would even be competitive for Almaty and Bishkek. The road transport costs from Bandar Abbas through Afghanistan would be substantially more costly than all other routes, unless cargo was moved by rail through Iran or payloads were adjusted at the border.

136. The Karachi route has less advantage for containers, as payloads are restricted. Rail from Bandar Abbas would be the lowest cost land routing for most of Central Asia, although the Karachi route would still be competitive for Tajikistan and to a less extent Uzbekistan (Figure 4.1).

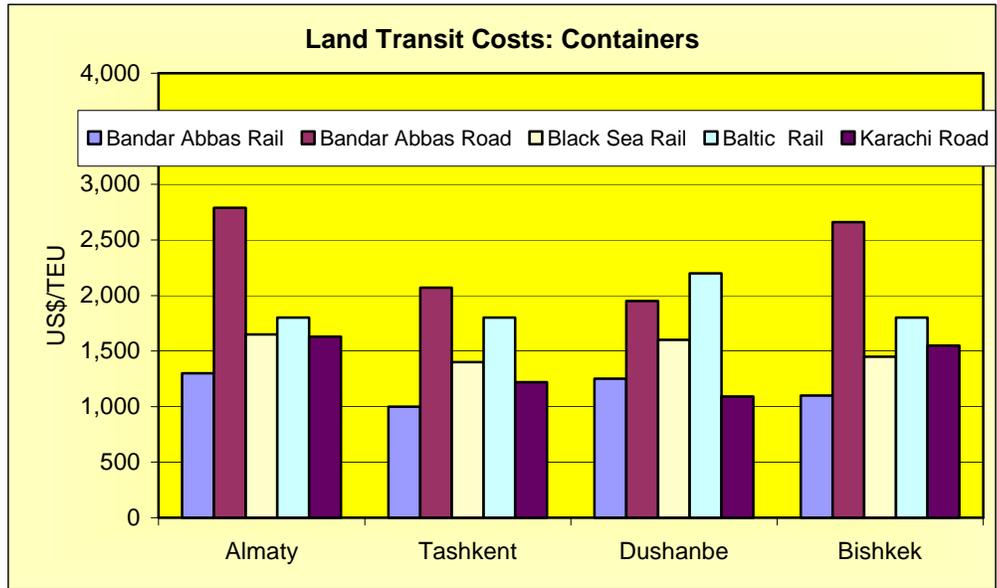
137. The routing of container traffic will also depend on shipping rates and the trading partner. It would seem very difficult to compete with direct rail for European traffic, unless very fast delivery was required, in which case direct road transport would be used.

138. If CAR countries accept Pakistani truck and payload standards, the transit routes to Karachi could be competitive. Such acceptance is unlikely in Kazakhstan, but relaxed regulation may increase the corridor attraction for those CAR countries whose domestic trucking fleets do not meet international standards. A regional agreement, based on regional standards, would allow CAR trucks to participate. In comparison, road routes through to Iranian ports would be high cost.

Transit Times

139. The current transit time from Karachi and to Kabul is about 10 days: (i) trucks travel via Peshawar; (ii) speeds are low; (iii) crossing the border and delivery to Kabul can take 3 – 5 days. On this basis, transit to Tashkent might take over two weeks. Transit times need to be reduced substantially to compete with other road routes such as Bandar Abbas (7 – 9 days) and even Europe (15 days). The rehabilitation of Afghanistan’s main road network will increase vehicle speeds but the key to reduced transit times will be streamlining border formalities so as to impose minimal delays. If truck utilization is increased to 450 km/day and border crossing restricted to a maximum of one day, transit times to Tashkent and Dushanbe would be 8-9 days.

Figure 4.1 Trade – Transport Costs: Central Asian Republics



Transit Facilitation

140. CAR countries are looking for alternatives to their present transit routes which have capacity but have become cumbersome:

- Long delays and high costs in obtaining visas
- Time-consuming border formalities

- Lack of respect for TIR, transit convoys
- Discrimination against foreign trucks
- Checking-posts, arbitrary delays and extensive informal payments

141. Regional politics have added a further dimension to transit decisions, and routes through Afghanistan will allow some CAR to bypass their present transit partners. But this attraction may be short-term, as tensions ease and politics change. Route sustainability will depend more on competitive costs, transit times and service standards.

142. Afghanistan's infrastructure is being improved, but there is a limit to the ability of investment to reduce operating costs. Major cost reductions can also be obtained, without large investment, through a transit system which is easy to operate, needs the minimum of documentation, allows rapid transit without bureaucratic delay and eliminates the cost and uncertainties of numerous checking-posts, fees and informal payments. If such a system can be developed by Afghanistan and its partners, then Afghanistan could become a significant transit route for Central Asia. Unfortunately, Afghanistan's internal transport system already exhibits several of the problems encountered on the other CAR routes.

Realizing Afghanistan's Potential for Regional Benefit

143. **Afghanistan** has to resolve its security issue and put in place systems with much higher service standards than those on competing routes. Transit trade then becomes a two-way street, benefiting the neighboring countries through shorter trade routes as well as possibly opening up new markets across the region. Nevertheless, the direct benefits of transit traffic will be limited. There will be income from services to transit vehicles as well as transit fees and possibly commissions on transit bonds, but this revenue will be offset by the road damage of very heavy trucks. Much more important may be the indirect benefits derived from being the center of an efficient regional transit network. Afghanistan can reasonably expect improved access to the sea as part of a broader regional or corridor transit framework from which all can benefit.

144. **Iran** is interested in attracting CAR transit traffic and expanding the use of Chabahar, but its regulations effectively exclude trucks from Afghanistan and the CAR and substantially increase trucking costs. There may be potential solutions:

- A rail-road system from Bandar Abbas with interchange at/near the Afghan border;
- A rail connection to Chabahar with interchange at/near the Afghan border. Plans are being developed for such a link;
- A road connection based on load consolidation at the Afghan border;
- A specified road corridor, linking Afghanistan to Chabahar, with Afghan and Uzbek trucks permitted to operate outside the regulatory norms.

145. The road corridor solution would help to offset, for bulk traffic, the disadvantages of Chabahar as a transit port and be perhaps the most attractive option for the landlocked countries.

However, Iran would also be interested in the use of the direct rail route to Central Asia through Mashad and Sarakhs.

146. **Pakistan** would like to strengthen its economic links with Central Asia, a potential market for Pakistani goods and a source of low-cost energy and raw materials. CAR transit traffic would also increase port revenues, encourage more frequent container services with larger vessels and provide additional demand for the trucking sector. But the present transit arrangement with Afghanistan is not a feasible basis for regional transit which needs both direct transit and reciprocal access to be competitive. Similarly, the concept of open access for the CAR but a negative list for Afghanistan is implausible. Pakistan will need to modify its transit position, if it wishes to develop its economic links and attract transit traffic. Pakistan's concerns about smuggling via transit trade are expected to be alleviated by improved customs administration, about to be implemented in phases by the TISA as part of a comprehensive customs reform agenda.

147. **Tajikistan**, like its neighbor Kyrgyz Republic, has major difficulty in deriving the potential benefits from increased regional trade. Both are limited by the restrictions imposed by their neighbors, especially Uzbekistan and Kazakhstan. Supporting a region-wide initiative to liberalize trade logistics within the AAN Group would have obvious benefits for southern directed trade and might encourage reforms in other directions as well.

148. Reintegration of Afghanistan with its neighbors through a revitalized, well-maintained road network will indirectly support implementation of construction of an east-west gas pipeline linking **Turkmenistan** and Pakistan.

149. **Uzbekistan** is interested in diversifying its transit routes and transit partners. While routes to Karachi would be shorter, the primary interest is reaching Iran through the completion of Afghanistan's ring road. Road transit to Iran will be a high-cost alternative that is presumably justified on the grounds of route diversification and enhanced security. In return for providing efficient transit facilities for Uzbek transit through Afghanistan, it would be reasonable to expect the simplification of border formalities at Termez and the provision of direct rail access for Afghan traffic at Hairatan.

Bilateral, Regional or Corridor Agreements

150. Afghanistan has bilateral agreements with two neighbors (Iran and Pakistan) and is negotiating with a third (Tajikistan). It is also a member of ECO and was previously a member of the International Road Transport Union (IRU) and Afghan trucks operated to Europe under TIR. Bilateral agreements have been necessary but tend to place the landlocked country at a disadvantage. More rewarding arrangements can be achieved by wider spatial agreements. The TIR convention has worked well in Western and Central Europe; Iran and some CAR are members. Pakistan is considering joining. But, TIR is not fully respected within the region and national formalities have been added. Regional transit, under TIR, may be desirable in the long-term, but regional trucking fleets, with the exception of Iran, cannot now meet TIR standards without substantial and costly modification.

151. A regional approach based on prevailing regional standards may offer a more immediate and practical approach to facilitating transit. Road freight dominates international transport in

regions without TIR. Very successful regional and corridor agreements have been agreed for international road transit, establishing the transit formalities and documentation, the limits on gross vehicle weights and axle-loads and the levels of transit fees. Such agreements apply regional standards to regional needs.

152. The Asian Development Bank has prepared a set of multiyear growth estimates for transit and intra regional trade by weight and route. These estimates indicate significant economic impact from a central-south Asia road corridor by 2010 . Specifically, a total of twelve routes were considered, six each connecting central Asia with ports in Pakistan through Afghanistan and with ports in Iran also through Afghanistan. Taking out the common route segments, the total distance covered is 7,964 kilometers linking Dushanbe-Karachi, Dushanbe-Gawador, Tashkent-Karachi, Tashkent-Gawador, Ashgabat-Karachi, Ashgabat-Gwador, Dushanbe-Chabahar, Dushanbe-Bandar Abbas, Herat and Zaranz, Tashkent-Chabaharand, Tashkent-Bandar Abbas, Ashgabat-Chabahar, and Ashgabat-Bandar Abbas. The combined lengths of corridors in each country are 2717 km in Afghanistan, 1941 km in Iran, 1670 km in Pakistan, 186 km in Tajikistan, 661 km in Turkmenistan, and 790 km in Uzbekistan. The ADB projects that real growth differential per annum between 2005-2010 from this investment would be a net increase of 5 percent per annum. Although this high case growth differential may be an upper bound estimate of what Afghanistan could achieve over the decade, the differential between cases is within the plausible range given the potential impact of improved trade infrastructure and trade logistics in influencing trade flows, provided that neighboring countries adopt key measures proposed in this report.

153. Specific corridor rather than regional agreements may have more immediate relevance:

- Iran has very different vehicle standards from the other countries, and it may be impossible to develop a uniform regional approach which facilitates transit;
- Uzbekistan is very interested in developing routes to Iran but not to Pakistan;
- CAR have signed several regional agreements, but, perhaps because they are too general in nature, they have had little impact.

154. Corridor agreements could target the conditions and needs on the individual routes. The Northern Corridor Transit Agreement in East Africa illustrates the type of approach (Box 4.1).

155. Two corridor agreements might possibly be contemplated for the Central – South Asia region, covering the most probable transit flows:

- The Pakistan Corridor Agreement including Afghanistan, Pakistan, Tajikistan and possibly Uzbekistan to cover the routes to Karachi, Port Qasim and eventually Gwador;
- The Iran Corridor Agreement including Afghanistan, Iran, Uzbekistan and possibly Tajikistan covering routes to both Bandar Abbas and Chabahar.

156. The other CAR would gain rather less from routes to the South. However Kazakhstan and Kyrgyzstan might wish to participate in one or both of the corridor agreements. Turkmenistan might be interested in the corridor agreement with Pakistan in order to facilitate bilateral trade.

**Box 4.1 Northern Corridor Transit Agreement Covering Kenya,
Uganda, Rwanda, Burundi and DRC**

Introduced in 1985, the Agreement establishes the principles, and the protocols provide the transit details for:

- Maritime Port Facilities
- Customs Control
- Transport by Rail
- Dangerous Goods
- Facilities for Transit Agencies and Employees
- Transit Routes and Facilities
- Documentation and Procedures
- Transport by Road
- Third Party Motor Insurance

There is free movement of cargo and transit vehicles, without permit quotas or other market restrictions. Transit agents can operate in all countries and through bills of lading have become standard. Goods travel under a single transit document accepted by each country and are covered by transit bonds, issued by banks or insurance companies. Bonds are cancelled when a copy of the transit document, endorsed by the exiting customs post, is returned. Truck standards are detailed in the protocols, together with maximum vehicle weights and axle-loads. A common policy is applied for transit fees, based on vehicle size and distance. The Agreement is monitored by a small Coordination Authority, financed by contributions from the contracting countries. The transit system is not perfect but the Agreement has substantially reduced border delays and documentation. There are now discussions on establishing regional rather than national transit bonds.

157. Corridor agreements have to be negotiated and agreed and their precise formulation will depend upon the particular circumstances. At a meeting with regional governments in July the Asian Development Bank (ADB) proposed establishing a Central and South Asia Trade and Transport Forum (CSATTF) to address sub-regional trade and transport issues. ADB held a follow-up meeting in December, 2003 to consider agreeing on protocols for the CSATTF and deciding on detailed plans for two transit corridor agreements. All the participating countries have to see mutual advantage and seek win-win solutions. Agreements and documentation will need to accommodate different languages and legal systems, but the problems are not insurmountable.

158. Several of the countries have either installed ASYCUDA for customs control or are contemplating its introduction. Pakistan has an indigenous system that delivers equivalent benefits. A similar system throughout the region would obviously have major potential benefits, not least because the documentation would be aligned and there could be interconnections between the systems for the clearance and monitoring of transit flows. Even if ASYCUDA is not introduced throughout the region -- and some countries are evaluating other systems -- it would be a tremendous advantage if basic system compatibility were achieved. Afghanistan will start its customs reform with a manual system based on international classifications, while planning to introduce ASYCUDA in the next 2 to 3 years.

159. Regional or corridor agreements alone will not improve transit efficiency, agreements will have to be implemented and monitored. There are likely to be vested interests in maintaining existing systems and practices, and they may resist the introduction of new systems that reduce their opportunities. New streamlined regional systems can be introduced but their impact would be negated if further additional requirements were introduced at the national level. Experience suggests that basic performance indicators that are easy to monitor should be a key element of the agreements and agreed at the outset, especially for customs formalities and border crossings. Such indicators provide the basis for identifying weaknesses in the approach or implementation and resolving any continuing problems within the system as well as providing basic accountability for performance.

The Enabling Environment for Trade and Investment

160. This section concentrates on behind-the-border or trade-enabling-environment issues in the context of the reconstruction of the Afghan economy. The section briefly summarizes trade-related regulatory institutions, the role of formal financial institutions and informal exchange services, proposals for changes to the regulatory framework for foreign investment and institutional gaps and impediments to trade. Other countries in the AAN region are in the process of reviewing and reforming policies and institutions that influence the enabling environment for trade. For Afghanistan's neighbors much has been written on the potential for domestic reforms and institutional capacity building in reports prepared by IFIs. Therefore, this section will concentrate solely on Afghanistan because it is the country in the region, where financial sector and other trade enabling institutions are least developed.

161. In post-conflict circumstances it is often the vital institutions of the private sector that experience the most damage and are the hardest to reconstruct. Law and order, property rights, the legal and judicial system and cooperation of government with the business community and in the conduct of trade and commerce have been severely damaged. Afghanistan has reestablished its legal and institutional frameworks for the regulation of business and commerce based on the 1964 Constitution. The Government is in the process of reviewing many of the laws and related administrative procedures to ensure that they are appropriate within the context of the current needs of Afghan society. Fortunately, the TISA is initiating an ambitious reconstruction program with the technical and financial support of bilateral donors and multilateral institutions.

162. On May 20, 2003, all provincial governors ratified a formal declaration drafted by the Security Council of the TISA committing governors to transfer all revenues from any provincial sources to the central government's revenue through their respective provincial agencies. The declaration also clarifies the powers of governors in undertaking expenditures and staffing by ensuring full compliance with national laws. This agreement strengthened the fiscal outlook for the central government and facilitated regional cooperation by clarifying the roles of subnational authorities.

163. Institutionalized or formal banking has been profoundly dislocated by past conflict. Consequently, a dynamic informal financial and trade network has grown up covering much of the region, especially the southern part of Afghanistan and including the Gulf and South Asia. In these informal financial networks foreign exchange needs are dealt with by curb traders outside the banking system or by utilizing offshore banks in Dubai and western Pakistan. Although progress is being made in the Central Bank with respect to operations and procedures, assisted by bilateral support, the operational policies of the commercial banks remain unreformed and ill-suited to the need of providing financial services in support of trade.

BANKING AND PAYMENTS SYSTEMS

164. After more than 20 years of conflict, Afghanistan's formal financial sector is virtually non-operational. The lack of a fully-functioning banking system would appear to be the greatest single institutional deficiency in the Afghan economy. Many of the impediments to the development of a modern banking and financial sector have been removed with the end of conflict, the lifting of international sanctions and the articulation of a comprehensive strategy for future economic development by the TISA. Specifically, during September 2003, TISA decreed

new legislation for the establishment and regulation of banks and for the governance of the Central Bank. Following this announcement, a number of foreign banks have indicated their intention to establish branches or subsidiaries in Afghanistan.

165. Among the legacies of conflict have been the complete disruption of domestic and international payments systems, the virtual cessation of all lending activities within the country, significantly reduced deposit-taking activities and a stoppage of most international banking relationships. Of the six banks in the country, only Da Afghanistan Bank, the Central Bank, has a truly national branch network, though Millie Bank has about eight or nine branches in provincial centers outside Kabul. Commercial banking and most importantly the extension of credit on commercial terms, has virtually been non-existent. Da Afghanistan Bank introduced the SWIFT system for international transfers in May 2003, though there is as yet no mechanism for transfers within the country.

166. Financial institutions in Afghanistan face five key constraints to renewal. These are: an outdated legal, regulatory and operational framework for banking activities;³² unskilled managerial and technical expertise and large numbers of untrained, inexperienced staff; nonexistent banking hardware and software, and poor (or nonexistent) telecommunications including lack of connectivity between Afghanistan and Central Asia, poor physical infrastructure and extremely weak banking security.

167. In the absence of a fully functioning formal banking system, a large and vibrant informal market has developed which supplies some, but not all modern banking services. Specifically, the informal market does not provide bank credit to industry, commerce or agriculture either as working capital or as long-term loans. Hence one of the vital requirements for dynamic private sector-led growth is missing. The limited financial sector infrastructure continues to be a major constraint to private sector development, with ordinarily routine tasks becoming major stumbling blocks. The lack of a functioning payment system for international and domestic fund transfers, for example, hinders the timely and effective delivery of reconstruction assistance and private-sector investment. Writing in the 1990s Fry (1997) identified reform of the clearing and settlement system as the measure that should be sequenced first for the modernization of the financial sector by Afghanistan.³³

168. Private-sector-led growth is likely to be greatly constrained unless a functioning banking system is developed to provide financial resources and support banking services to underpin these investments. Hence, the strengthening of the Central Bank and the commercial banking system and most importantly the re-establishment of domestic and international payment systems constitute a high priority.

169. The World Bank's Transitional Support Strategy (TSS) for Afghanistan identifies financial sector reforms as one of the areas of strategic focus. Building on the government's efforts to date, the TSS argues for the need to focus on creating an appropriate environment for commercial banking sector development rather than sustaining or encouraging direct public

³² Central Banking and Commercial Banking Legislation was approved by the TISA on September 15, 2003. These two laws provide for an independent central bank and establish the rule for the regulation of private and public sector banks and the rules for the establishment of foreign-owned banks.

³³ See Maxwell Fry (1997) "Financial Sector Development in Small Economies" in *Sequencing: Financial Strategies For Developing Countries*, eds. Alison Harwood and Bruce L.R. Smith.

sector ownership and management. A number of international agencies and donors have been helping the Da Afghanistan Bank improve its capacity to function effectively as a central bank. These include the DFID, IMF, and USAID (see Box 5.1). The World Bank has provided well-targeted policy advice to the Central Bank to complement the support being provided by others. In addition, it has conducted assessments of the commercial banking sector and made recommendations for reforms with respect to the six currently defunct banks (Millie, Pashtany Tejararty, Export Promotion, Agricultural Development, Mortgage and Construction, and the Industrial Development).

170. The financial sector reform options include: (a) the appointment of an external management team to manage the government's ownership interests in these banks; (b) separating the commercial banking functions from the central banking functions of Da Afghanistan Bank (in concert with the USAID team currently working in DAB); (c) bringing some of the informal participants (the *hawalas*) into the formal financial sector, and; (d) encouraging good name international banks to establish operations in Afghanistan. Action under (a) above would likely lead to the liquidation of bad assets and transfer of good assets into a commercially viable bank/banks, which meet the new bank licensing requirements to be propagated under the new banking law.

Box 5.1 Donor-Supported Efforts to Reform Afghanistan's Financial Sector

- *The International Monetary Fund:* The Fund has provided technical advice and expert support in a series of areas including Central Bank and banking legislation, Central Bank and financial sector accounting, banking supervision, payment system issues and overall Central Bank reorganization and modernization.
- *The USAID:* A wide-ranging USAID project includes: reorganizing the central Bank (DAB) using the IMF-provided blueprint; improving the payments system; separating DAB's commercial banking activities from its core central banking functions; improving the quality of banking supervision staff and capacity; enhancing macro monetary policy and statistics capacity; establishing an effective IT Department, and reestablishing a functioning accounting system.
- *The DFID:* DFID's work is currently focused on accounting and banking supervision reforms, particularly with respect to drafting operational manuals, training staff, departmental reorganization and reviewing operational policies and procedures and staff job descriptions and roles.

171. Wide-scale and immediate recapitalization of all state banks is not a prudent option, given the poor state of the commercial banks, the Government's limited financial resources and the poor experience world-wide with resuscitating state banks. Another option considered is the liquidation of all state banks, which would enable the Central Bank to concentrate on inviting new banks into the country. However, this option ignores the fact that new banks coming into Afghanistan, especially the foreign banks, are unlikely to open full-fledged banks with an extensive rural branch network or be interested in the development of credit services in all economic sectors.

172. Another institutional reform options is to focus on a few core areas in the Central Bank, while at the same time dealing with the problems of one of the larger commercial banks, as initial steps in the overall reform agenda. In the immediate future, the Central Bank may wish to concentrate on creating a functioning payment system. The Central Bank branches require better

communications, technology and transportation capacity to be able to transport physical cash when required. In the medium-to-long term, developing and strengthening commercial banking will be one of Afghanistan's greatest challenges.

173. Lessons from attempts to achieve financial sector reform in the CIS indicate that the lack of trained staff is a crucial handicap, irrespective of ownership. Prudential regulation is improving, but legislation has run ahead of observance or enforcement. The low number and quality of staff in bank supervision departments has been a major constraint. Stricter prudential regulations have often led to non-lending rather than better lending, so that banks are not playing the financial disciplining role that would be expected in a well-functioning market economy. This is also connected to the broader institutional issues of the enforcement of contracts and ability to foreclose on delinquent loans.³⁴ Programs to develop basic modern banking skills, potentially with additional technical assistance, warrant consideration in light of the binding constraint imposed on economic development by absence of diffuse and generally accessible banking services.

174. The recent growth in *hawala* transactions presents financial sector reformers with a dilemma. The burgeoning *hawala* market operates without any external regulatory or supervisory oversight. Regulating the *hawaladars* is a difficult task given that many of them are difficult to identify and locate, and they most often have no incentive to disclose their activities for external monitoring and supervision. The varied and multifarious transactions of the *hawaladars* and the weak capacity of the Central Bank to implement regulations add to the complexity of the problem. Attempts at regulation run the risk of pushing the *hawalas* farther away from the formal sector, especially as long as the primary reasons for its existence - foreign exchange arbitration opportunities and poor banking services - have not been addressed. At the same time, lack of regulation poses serious macroeconomic management problems for the country - the Central Bank would lack control over financial or monetary policy if most monetary activity in the country occurs outside its realm of influence. Moreover, a large informal financial system, with the potential to facilitate large anonymous financial transactions - particularly for the settlement process - makes the system itself and the country as a whole vulnerable to money launderers and those seeking to finance terrorism.

175. Given the country's socio-economic and political conditions, a comprehensive extension of existing banking regulations and supervision practices to the *hawaladars* is not a realistic option. At this time it may be most feasible for Afghanistan to implement a self-regulatory and supervisory framework instead of pursuing a banking-style model for the sector. Working with the informal Money Exchange Dealers Association, the Central Bank could consider exploring the benefits of a self-regulatory and supervisory framework as an interim solution.³⁵ At the same time, the Central Bank could move towards developing more sophisticated regulations for money exchange dealers, ones that accommodate external oversight. In the long term, the Central Bank

³⁴ Fry (1974) writing about the economy in the early 1970s (1350s in Afghan dating system) notes that banks were reluctant to extend credit facilities to industry and agriculture, owing to inadequate protection under existing law.

³⁵ Dealers are well placed to assist in detailing the different *hawala* typologies that require regulation and supervision. Most important, regional or local association committees can share the administrative and financial burden of ensuring compliance. Suitable incentives to the dealers are probably the key to the success of self-regulation.

may then consider encouraging some of the larger money exchange dealers to make the transition into the formal banking sector.³⁶

LEGAL FRAMEWORK FOR PRIVATE SECTOR ACTIVITY

176. Afghanistan has inherited many laws, regulations and procedures that tend to inhibit trade and investment instead of encouraging it. There is confusion about the interpretation and applicability of many laws, due in part to the discontinuity in the application of the 1964 constitution. Many laws, including those pertaining to trade and investment, are inadequate for a modern economy. There are many gaps in the legal framework for trade. For example, the current legal framework does not cover intellectual property issues beyond trademark protection. The Customs Law is inadequate and does not address important topics such as valuation and rules of origin.

177. Legal framework need to be built up that will facilitates commercial transactions, promotes private sector development and stimulates national and foreign investment. Businesses should be easy to start up, easy to comply with government regulation while they are in operation and easy to exit the market in a timely and low cost manner. The Government is currently in the process of reviewing many of the laws and related administrative procedures and it has established the Afghan Investment Support Agency (AISA) effective from September 2003 to support both foreign and domestic investment and to provide single window approvals.

178. In September 2002, the Government passed a new Law on Investment for both domestic and foreign investment. The Government, with the assistance of German donor funding, is establishing a “one-stop-shop” for foreign investment. The office is designed to cut through the red tape of investment. The Commercial Code is currently being revised by the Government with assistance from USAID and other donors.

179. The new investment law seeks to encourage foreign and domestic private investment and business activity in Afghanistan rather than control and limit private sector activity, as was formerly the case. While this is an improvement, the law has many flaws. The law, as well as its implementation guidelines, is vague in many places with many critical terms left undefined. This leaves open the possibility of enacting regulations in future that increase the regulatory and administrative burden on prospective investors. For example, it is not clear to whom the law applies (e.g., only newly licensed firms or existing firms as well). It requires approved entities to prepare accounts according to international standards and submit them to relevant authorities, but the relevant authorities and the required frequency in reporting are not specified. The law provides for the granting of tax waivers or holidays of different duration to three classes of investment: short-term, medium-term and long-term that may be granted on a case-by-case basis in accordance with “universal norms”. However, the three classes are not defined, nor are the “universal norms”. It is also not clear if this provision will apply to all types of taxes. The law states that the sale of an enterprise requires approval of the High Commission on Investment, but no criteria for approval are specified, nor whether approval is required for all investments, large and small, foreign and domestic. The law also stipulates that an investment with foreign ownership can only be sold to Afghan citizens or Government. This imposes an unnecessary

³⁶ This discussion of the informal financial sector is based on Samuel Maimbo, *The Money Exchange Dealers of Kabul: An Analysis of the Hawala System in Afghanistan*, World Bank Working Paper Series No. 13. . The paper contains further details on regulatory options for the sector.

restriction on foreign investors. Overall, this law fails to provide much legal protection to private investors, foreign or domestic.³⁷

ADMINISTRATIVE PROCEDURES AFFECTING TRADE AND INVESTMENT³⁸

180. The problems caused by a weak legal framework are compounded by a host of administrative barriers that affect entry and raise transaction costs, thereby reducing the competitive strength of the private sector. Many transactions, such as obtaining trade and investment licenses, or clearing exports and imports, are subject to procedures that are onerous, duplicative, often vaguely defined and not applied uniformly. This generates unpredictability and increases the scope for discretion and for corruption. Simple transactions may involve interactions with multiple agencies, as well as repeated dealings with the same agency. Small and medium enterprises, which typically lack connections and the resources to hire professionals and facilitators, usually bear a disproportionate burden emanating from administrative barriers.

Trade licensing

181. Firms need licenses to deal in imports and exports. Obtaining licenses is an onerous process requiring visits to multiple agencies, such as the Ministries of Commerce, Interior and Justice, the Commercial Court, *Mustofiat*, and a Central Bank office. The process is unpredictable and may take anywhere between 2 to 90 days. One of the first steps is an approval from the Minister of Commerce or his Deputy. This is a conditional approval, subject to approvals from the other agencies involved. There seems to be very little need for such a conditional approval that involves the use of scarce time of senior policymakers on a routine matter and introduces an additional bottleneck in the licensing process. More than a dozen fees are required to obtain a license, each of which requires a trip to a branch of the Central Bank. While the total amount of fees may appear to be modest, especially for larger traders and foreign investors, the number of trips required to various government offices makes this a very onerous process. Business licenses are required to be renewed every year and businessmen have to go through similarly complicated processes for renewal.

182. Approximately 3,600 licenses were given to foreign companies and individuals in the year ending in April 2003. The process of obtaining trade licenses needs to be streamlined. Desirable actions in this area include reducing the number of agencies to interface with, abolishing the need for pre-approval by the Minister of Commerce or his Deputy, imposing time limits on the completion of each step in the clearance process and extending the validity of licenses beyond one year. The Government may also consider eliminating the minimum capital requirement for obtaining a trader's license.

Customs procedures

183. Customs procedures are equally, if not more, cumbersome and technical advisors are working with the Afghan customs to adopt new policies, redesign procedures and improve agency

³⁷ The Law on Domestic and Foreign Private Investment is discussed further in the Annex.

³⁸ This section has benefited from work done by USAID consultants on the trade licensing, and exports and import clearance systems in Afghanistan.

capacity. Currently, however, the procedures remain onerous. Trade in Afghanistan suffers from the lack of a unified and integrated nationwide customs system.

184. Clearance procedures, including documents required, vary from one customs post to another. As a result, traders often have to go through duplicative clearance procedures and pay duties more than once because customs clearance in one province may not be recognized in another. As with trade licenses, export and import clearances require approvals from multiple agencies. For example, pre-shipment authorization from the Ministry of Commerce (Department of Foreign Trade) is required for every export and import shipment. Each proposed shipment is assessed on a case-by-case basis.

185. There are no transparent guidelines; for example, there is no publicly available negative list of prohibited imports. Providing information to importers and exporters on customs procedures, duties, penalties and other features of the law is an essential component of transparency, and at present there is a distinct lack of transparency in customs processing in Afghanistan.

186. Reportedly, the customs tariff schedule is not widely available and considered a secret document by customs. There is no guide for traders which would provide both brokers and importers with clear instructions. As a result, traders are at a distinct disadvantage when conflicts arise over the amount of duty owed. Customs needs to clarify the procedures and duties applicable for trade and create a publicly available guide to its clearance process. Posting such a guide on a government website would shift the cost of printing and reproduction to the private sector, making the undertaking relatively inexpensive.

187. Another requirement, which substantially increases the discretionary element of the system and appears to be unique to Afghanistan is the grant to the Afghan Chamber of Commerce and Industry (ACCI) of a monopoly to assigning values to import and export items. The ACCI has been given the right to value goods based on its own data and preferences. There are complaints that the valuation process is often discretionary and influenced by personal connections and negotiations. This is not a function performed by chambers elsewhere and the monopoly power given to the ACCI goes against the voluntary nature of such collective bodies elsewhere.³⁹ Moreover, the customs authorities also have a role in applying valuations, and these may differ from that of the Chamber.

188. The customs clearance process is lengthy, non-transparent and unnecessarily complicated. On average, export and import shipments take 1-2 weeks to clear. Custom clearance requires approval from several departments, each of which performs small and often duplicative tasks. Most individual shipments are physically inspected. Information on customs procedures, duties and penalties is not readily available. An outdated product classification scheme is used but this will be replaced as part of customs reform. Assessment of tariff rates can be arbitrary with very similar goods being assessed at different rates.

189. Considerable scope exists for streamlining the customs clearance process. The many approval steps could be merged or better integrated so that traders may interface with only one

³⁹ According to a new Customs law, currently under review, traders will have a choice of having their shipments valued by the Chamber or by Customs. It is an improvement over the current situation but it is not clear why the chamber should be involved at all. It remains to be seen how this law, if passed, will be implemented in practice.

point of contact. A risk-based inspection regime could be introduced in place of the current practice of checking every shipment.

190. There are other factors that inhibit trade. All export proceeds are to be repatriated by the end of the year in which the shipment is made. This unduly strict requirement does not take into account the fact that some exports may not generate sales revenue immediately (for example, sales on credit or for inventory buildup in the exporters' own wholesale or retail outlet abroad). Failure to meet this requirement usually blocks the required annual renewal of trading licenses. Exporters and importers have to pay a number of fees on top of customs duties and fees, such as fees charged by the ACCI and the Ministry of Commerce. These fees add to the costs of trade not only monetarily but also in terms of the time required to pay fees in multiple agencies. Many of the fees have to be paid up-front; this imposes a particularly heavy burden on small traders who usually do not have the cash reserves required to make such advance payments. Afghan exporters do not benefit from any of the customs rebates or duty drawback facilities common in other countries. Exports are required to be graded and valued by exports guilds. This quality certification process is usually very time-consuming as each individual shipment needs to be inspected by a guild representative.

191. In the area of customs clearance, the creation of a unified, nation-wide customs service that accepts the same document and follows the same procedures should be a top priority. The customs clearance process can be further streamlined. Steps in this direction could include abolishing the requirement to have Ministry of Commerce approval for each pre-shipment and instead relying on the customs for collection of necessary data, shifting from quality inspection of each individual shipment by the guilds to a system based on random sampling and reducing the number of offices within the Customs Department that a trader has to go to for clearance (preferably moving to a single window of clearance). Greater transparency should be introduced in customs processing – information on the procedures and applicable duties should be readily available. The ACCI's monopoly right to value goods should be eliminated. Commodities should be valued on the basis of commercial invoices. Overall, the Afghan customs authorities will need to be restructured, processes re-engineered and capacity built.

Insurance

192. Afghanistan is an acutely underinsured society. Earlier assessment of the Afghan insurance sector dating from the 1970s indicates that in 1972 the ratio of insurance premiums to GNP amounted to only 0.2%.⁴⁰ This relative underdevelopment of insurance coverage and the inefficiency of the insurance industry has inhibited the participation of Afghan truckers in transit trade to other countries. The Afghan National Insurance Company (ANIC), the only insurance company operating in the country, currently enjoys a monopoly on all insurance functions. It derives most of its revenue from the mandatory sales of automobile collision and casualty insurance. It does not actively solicit business. The ANIC suffers from a lack of trained staff, no opportunities for investing its premiums in fixed-income investment instruments and a poor track record in paying out on legitimate claims. An obvious and speedy remedy to this gap would be to open the insurance sector selectively or entirely to private competition including through the participation of foreign insurance companies with diverse experience in transport insurance.

⁴⁰ See Fry (1974) *The Afghan Economy* .

Export Promotion

193. The Export Promotion Department in the Ministry of Commerce has an explicit mandate to promote and facilitate exports. However, it suffers from weak capacity, including lack of many basic skills. Developing basic skills, such as training in English, basic business skills and computer and Internet literacy is of top priority. Developing these competencies should be followed or accompanied by development of specific, more sophisticated, promotion capacity. But it lacks much knowledge of international business practices, having lost contacts with developed countries after the shift in trade flows away from these countries during the 1970s.

194. Afghanistan also has five principal export-promotion industry associations attached to the Ministry of Commerce.⁴¹ Although their mandate is to promote exports, they also exercise a regulatory function. The associations certify the quality of exports as well as that of imported inputs used in their respective industries. In some cases, they certify prices as well. Their certification mandate covers both members and non-members. Alongside their control functions, the associations also provide trade facilitation and product-development assistance to their members. One of the associations, the Handicraft Promotion Center, also owns and profits from some production and marketing activities. In summary, the associations carry out a set of conflicting mandates which inhibits their capacity to effectively promote exports. With regard to their capacities, the Guilds are in worse shape than the Export Promotion Department. They lack the basic resources such as telephones, faxes, computers and Internet connectivity. They also lack the capacity to conduct even basic testing since most of the testing facilities have been destroyed or seriously debilitated.

195. Having lost contact with much of the international market place during the past two decades, these bodies lack understanding of the developments in international marketing and export promotion that has taken place during this period. They have virtually no knowledge of current quality standards with regard to product design and quality, and packaging. This greatly constrains their ability to design an export-development strategies.

196. The Afghan Chamber of Commerce and Industry (ACCI) is quite unlike its counterparts in other countries. As described above, it performs a significant control function with regard to exports and imports. This is indeed its primary role as it performs very few of the promotional activities that chambers in other countries typically do. The ACCI is an agency of the Ministry of Commerce, and its President is appointed by the Minister of Commerce. Unlike most other chambers whose membership is voluntary, membership in ACCI is compulsory for all companies with a trading license. Through its regulatory functions, the ACCI is widely considered to be a significant barrier to, not promoter of, trade. However, there is a parallel Afghan chamber of commerce with local chapters throughout the country to varying degrees. This is a truly representative body of the most prominent local businessmen. Unfortunately there is some degree of confusion both among internationals and locals as to the role and functions of these bodies. Redefining and renaming the two institutions with a view to nurturing the development of the representative Chamber of Commerce would likely foster international trade. Measures to encourage twinning arrangements with chambers of commerce in other countries, including equivalent organizations in other AAN countries, deserve to be explored.

⁴¹ These are the Carpet Producers' and Exporters' Union, the Raisin and Other Dried Fruit Export Inc., the Handicraft Promotion Center, the Afghan Plant Company and the Karakul Association.

197. Going forward, many steps are needed to develop an effective export-promotion capacity in Afghanistan. Firstly, the Ministry of Commerce needs to redefine its role from being a controller of commerce and trade, to being a promoter of trade and investment and an advocate for private enterprise in Afghanistan. To carry out this role, it will need to develop a sound policy analysis capacity. The Export Promotion Department has the right mandate but needs substantial institutional strengthening, including development of some basic skills, to carry out this mandate. The industry associations and guilds should divest their control functions, become independent, voluntary organizations and develop the skills and knowledge required to develop export promotion strategies for their industries and provide technical assistance to their members. Similarly, the Chamber of Commerce should cease to be regulatory body and become a voluntary business association that can effectively represent private sector interests. Finally, support infrastructure, such as testing facilities, need to be developed fast.

Recommendations

Summary of Recommendations

198. All countries in the region would benefit from more stable, prosperous and outward-looking trade relations with their neighbors. Lessons in other regions indicate that developing countries that increased their integration into world economy over the past two decades achieved higher growth in incomes, longer life expectancy and better schooling. Countries should thus pursue their efforts to further their participation in the world economy and adopt policies congruent with this objective. In particular, they should pursue their efforts to increase the transparency and predictability of their trade regimes and limit the use of non-tariff measures to legitimate objectives. In the short and medium run, however, the daunting challenges for all these countries, as well as for the international community, are ensuring security and reestablishing and improving physical infrastructure within the region. The summary of main recommendations for Afghanistan and Neighbors is contained in Table 1 below.

199. As noted, Afghanistan's present trade-transport systems are extremely underdeveloped. There is an urgent need to develop the enabling regulatory, physical and commercial environment for modern trade logistics which would further the integration of Afghanistan into the world economy. While important progress has been made by the Afghan government, there is still a long way to go in policy and institutional reforms. Importantly, Afghanistan must also address the substantial security concerns without which positive outcomes of reforms will be very limited.

200. Some major improvements to the Afghan transit system will require agreement with Afghanistan's transit partners and changes to the transit agreements and regulations, however, much of the transit cost is incurred within Afghanistan and is thus under Afghan control.

201. Priority actions by the Afghanistan authorities to streamline the transit system should aim at:

- Improving security;
- Completing the main road rehabilitation, extending communication systems and ensuring that once rehabilitated, the standards are sustained;
- Streamlining of border crossing formalities;

- Reestablishing formal financial and insurance systems with a high priority assigned to ensuring clearing and settlement;
- Implementing a national customs and transit system;
- Eliminating restrictions on direct trade;
- Removing checking-posts and en-route inspections; and
- Increasing domestic trucking competition.

202. Corridor agreements are a feasible immediate action for the countries of the region rather than very ambitious regional logistics agreements such as exist in the EU. Corridor agreements are more focused, more easily monitored and perhaps within such a framework it is easier to develop the stakeholder pressure needed to ensure that governments live up to their agreements. This approach has been discussed and endorsed at the recent ADB-sponsored conference on Transport and Trade in Central and South Asia. The corridor approach has been reasonably successful in East Africa, and a similar approach is underway in Southern and Central Africa. The Northern Corridor Transit Agreement in Africa introduced a single transit document, the RCTD, which is accepted by all countries along the corridor, replacing numbers of other documents.

203. There are a number of possible transit options that would benefit both Afghanistan and other partners. These include:

- **Rail Route to Europe through Uzbekistan.** The rail system from the CAR to Europe - through Russia - still provides a reliable and cost-effective route and could also provide a cost-effective routing for Afghan trade with Europe. In particular, an agreement would need to be reached with Uzbekistan to allow direct delivery and dispatch of wagons to/from Hairatan, across the Friendship Bridge. Afghanistan should also try to negotiate the establishment of through rates on the rail network to replace the aggregation of individual national tariffs.
- **Streamlining Transit through Pakistan,** notably to reduce costs and enhance the effectiveness and quality of the Karachi routes. Actions in that direction could include: the revision of the negative list of goods and its progressive phasing-out; allow direct road transit for all goods in conjunction with an extension of the bond system on the basis of transporter, shipper or consignment; and allow Afghan trucking companies to compete in the sector.
- **Streamlining Transit through Iran.** The Government of Iran is promoting the use of its ports for both Afghanistan and the CAR. In particular, the construction of the Bafq-Mashad rail link will substantially reduce rail distances and make rail a competitive mode for Afghan traffic to Bandar Abbas. The use of Chabahar is being encouraged, but the port has limited draft and infrequent vessel calls. The port may be an alternative for charter shipping but the shipping costs in terms of time and fees will be higher than to Bandar Abbas or Karachi because of vessel-draft restrictions and slow off-loading rates.

204. Beyond the security and trade logistics issues, trade enabling environment in Afghanistan will also benefit from reforms in banking and insurance. Governments should ensure that the banking systems are capable of making credit available to credit-worthy exporters in a manner consistent with WTO guidelines. Liberalization of the domestic market for insurance with the

termination of single-provider monopolies would encourage insurance product innovation, better risk assessment in designing premiums, risk pooling through domestic and international reinsurance, and competition for business.

205. Immediate and short term measures needed to foster a strong trade enabling environment include the following:

- Implement a functioning payments system for international and domestic transfers through the formal banking system;
- Make transit bonds and transport insurances available with entry of companies capable of providing coverage as subsidiaries or as joint ventures;
- Ministry of Commerce should redefine its role to promote trade and investment rather than being a regulator of trade;
- Support a larger role for a private chamber of commerce to assist in export-promotion activities and delineate clearly between the roles of government agencies and of a private chamber of commerce;
- Design and implement major capacity building programs to develop skills and professionalism in banking, insurance and customs.

206. Along with reforms in Afghanistan, neighbors could facilitate greater trade cooperation and integration within the region and with the rest of the world by taking steps to remove outstanding quantitative and other trade barriers and improving trade logistics. Reducing non tariff barriers, particularly in the CAR, where they appear to block trade the most, have the potential not only to support general economic growth but also to encourage trade in labor-intense commodities such as agricultural produce so as to foster poverty-reducing growth. Ensuring adequate transit trade facilities to landlocked Afghanistan will be particularly important. Simple short terms steps should include:

- Publish and place on government webs border crossing rules and customs procedures (all countries).⁴²
- Develop capacity to monitor trade logistics performance (all countries).
- Assign a high priority to the regional dialogue among IFIs and governments stemming from TTF national audits (CAR).
- ECOs technical resources in areas of survey and monitoring should be strengthened (members of ECO).
- Reduce discriminatory measures against foreign transport operators (all countries).

⁴² Customs organizations can provide references to these web sites containing regulations and procedures to their members Pakistan has a fully documented web site.

See www.cbr.gov.pk/newcu/potals.htm. The example is referenced from World Bank and IADB “ACV Implementation in Developing Country Problems and Possible Measures (2002)

- Develop customs and related infrastructure by adopting classification system consistent with international standards such as ASYCUDA (CAR). (Iran already have functioning ASYCUDA systems and Pakistan has its own system with similar capacities).
- Review outright trade prohibitions such as agricultural commodities (Uzbekistan, Turkmenistan).
- Review NTBs with intention to encourage border trade (all countries).
- Participate in transit-trade and transport-corridor strategy dialogue (all countries).

Conclusion

207. The development of transit trade through Afghanistan, a goal endorsed by its neighbors not least because of its likely benefit to them and the region, can seem a distant one. Advancing toward it will depend on combining the efforts and adjusting the trade policies and practices of a number of countries, some more advanced toward trade liberalization than others. Above all, responsibility for progress rests with the Afghan authorities and their supporters in the broad international community. The challenge before them is the restoration of security and efficiency along trade routes in Afghanistan and the physical rehabilitation of the transport system devastated by decades of fighting.

208. Progress has been occurring, especially on road rebuilding. Substantive discussions are under way among regional countries on a reform agenda to foster intra-regional trade and transit trade. But, even if the pace of infrastructure investment can be accelerated, intra-regional trade and transit trade are not likely to expand significantly until supporting reforms occur to enhance the efficiency of customs practices, to improve trade logistics, and to greatly enhance behind-the-border services in banking, insurance, trade promotion, and national investment approval processes.

TABLE 1: FRAMEWORK FOR REGIONAL REFORM PRIORITIES

AFGHANISTAN		
Countries	Trade Policies and Customs	Trade Logistics / Behind the Border
<p>Immediate and short-term actions</p>	<ul style="list-style-type: none"> - Strengthen customs administration with new and uniform procedures and reengineered processes and capacity building. - Adopt customs commodity classification system consistent with international standards. - Ensure that new procedures are ASYCUDA compatible even if implemented manually. - Implement a plan to simplify customs tariff system with a few bands and utilize the market exchange rate for valuation. - Formally abolish export taxes not tied to fees for services. - Begin to implement customs reform program with retraining and investment in new technology. - In consultation with neighbor countries develop transit trade and transport corridor strategy. 	<p>Trade Logistics</p> <ul style="list-style-type: none"> - Enable major shipping lines with sea linkages to establish transport or freight forward domestic subsidiaries so that they will permit their containers to enter Afghanistan. - Encourage freight forwarders and truckers to establish national private sector organizations and to affiliate with international organizations. - Initiate study to understand the dynamics of the truck transport industry in the Western zone and with the intention of identifying conditions that will enable containers to enter zone. - Develop capacity to monitor trade logistics performance starting with a Trade and Transport Facilitation national audit - Reduce discriminatory measures against foreign transport operators <p>Behind the Border.</p> <ul style="list-style-type: none"> - Ministry of Commerce redefine its role to a promoter of trade and investment, - Implement functioning payments system for international and domestic transfers. - Define and implement regulatory conditions and terms on which foreign banks or joint venture banks will be permitted to operate in Afghanistan - Make transit bonds and transport insurances available with entry of companies capable of providing coverage - Support a larger role for private chamber of commerce and consider twinning with foreign COC and support export promotion. - Major capacity building programs to develop skills and professionalism in banking, insurance and customs. - Develop standard setting capacity (ISO). - Establishment of multi-entry visa arrangements for professional drivers and simplify visa and passport procedures for business persons
<p>Medium-term actions</p>	<p>Develop domestic tax base such as domestic excises and user fees in phased manner. Modify foreign investment laws and avoid major tax concessions to new investors in the form of long-lasting tax holidays. Cross-border law enforcement co-operation for prevention of drug trafficking and smuggling.</p>	<p>Trade Logistics</p> <ul style="list-style-type: none"> - Enhance efficiency of transport and transit regimes. - Activate nationwide harmonization of transport regulation and remove cartel arrangements. <p>Behind the border</p> <ul style="list-style-type: none"> - Facilitate rapid development of formal sector banking and insurance institutions through liberal policies on entry and break up national insurance monopoly. - Implement a light regulation of <i>Hawala</i> system to deter money laundering. - Establishment of multi-entry visa arrangements for professional drivers can be implemented as an immediate action.

NEIGHBORS		
Countries	Trade Policies and Customs	Trade Logistics / Behind the Border
<p>Immediate and short-term actions</p>	<ul style="list-style-type: none"> - Develop customs and related infrastructure by adopting classification system consistent with international standards such as ASYCUDA (CAR). (Iran already have functioning ASYCUDA systems and Pakistan has its own equivalent system). - Review outright trade prohibitions, such as on agricultural commodities (Uzbekistan, Turkmenistan). - Review NTBs with intention to encourage border trade (all countries). - Participate in transit trade and transport corridor strategy dialogue (all countries) 	<p>Trade Logistics</p> <ul style="list-style-type: none"> - Publish and place on government webs border crossing rules and customs procedures (all countries). Pakistan has already establishes such a web. - Develop capacity to monitor trade logistics performance (all countries). - Assign a high priority to the regional dialogue among IFIs and governments stemming from TTF national audits (CAR). - ECOs technical resources in areas of survey and monitoring should be strengthened (members of ECO). - Reduce discriminatory measures against foreign transport operators (all countries). - Encourage the development of national freight forwarding associations (all countries). <p>Behind the border</p> <ul style="list-style-type: none"> - Take immediate steps to ensure telecommunication links with Afghanistan (Tajikistan and Afghanistan are not effectively connected). - Simplify visa and passport procedures for business persons (all countries).- liberalize access to foreign exchange for both importers and exporters (CAR)
<p>Medium-term actions</p>	<ul style="list-style-type: none"> - Cross-border law enforcement co-operation for prevention of drug trafficking and smuggling (all countries). - Achieve revenue gains from converting QRs into tariffs (Pakistan and Iran). - Achieve base-broadening and rate reduction in domestic taxes to discourage smuggling (Pakistan and Iran). - Maintain relatively low and uniform tariffs (all countries). - Progress on WTO-accession process (all candidate countries). 	<p>Trade Logistics</p> <ul style="list-style-type: none"> - Promote competition in transport service industries, including through FDI (all countries). - Liberalize and make transparent foreign-exchange access rules for importers (CAR). - Develop national strategies for TTF (all countries). <p>Behind theBorder</p> <ul style="list-style-type: none"> - Services liberalization; end monopolies; develop competition policy (all countries). - Strengthen standards setting and certification bodies (all countries). - Develop national capacity to design and enforce regulatory policies (all countries).

**DECLARATION ON ENCOURAGING CLOSER TRADE, TRANSIT AND
INVESTMENT COOPERATION BETWEEN THE SIGNATORY GOVERNMENTS OF
THE KABUL DECLARATION ON GOOD NEIGHBOURLY RELATIONS**

1. Representatives of the Transitional Islamic State of Afghanistan and the governments of the People's Republic of China, Islamic Republic of Iran, Islamic Republic of Pakistan, Republic of Tajikistan, Turkmenistan and Republic of Uzbekistan met in Dubai on 22 September to consider practical follow-up to the Declaration on Good Neighborly Relations agreed in Kabul on 22 December 2002, in the area of trade, transit and investment.
2. The representatives reaffirmed their countries' commitment to constructive and supportive bilateral relations based on the principles of territorial integrity, mutual respect, friendly relations, cooperation and non-interference in each other's affairs.
3. In accordance with these principles, the representatives agreed on the need to forge new trade dynamics and foster investment between their countries. They noted the need to reduce the logistical cost of trade in the region, and assessed that improvements in trade and transport facilitation (including customs and border agencies reform and closer cross-border cooperation) could bring substantial benefits to the prosperity of the people of the region.
4. The representatives noted the various bilateral initiatives underway in the region to promote investment and committed themselves to the development of an economic atmosphere and regulatory framework in their respective countries which encouraged trade and investment across the region in conformity with international treaties and conventions.
5. The representatives resolved that their governments will take necessary measures:
 - to cooperate closely in international fora on trade and investment issues;
 - to support the implementation of Afghanistan's National Development Framework by seeking to improve customs services at borders. The representatives also requested that international donors should make the implementation of such projects a priority;
 - to consider the options for promoting regional trade liberalisation and increased integration into the world economy;
 - to request business associations and chambers of commerce in the region to educate their members about current border regulations and forthcoming change, and to ask them to survey their members in order to establish a clear picture of the experiences faced by business people in using borders, and channel this information to governments for use in policy design;
 - to launch an investment promotion programme, sharing information and providing joint assistance to foreign investors. The representatives noted that successful foreign investors in the region could support the campaign with sponsorship and by sharing experiences and helping to identify opportunities;
 - to request chambers of commerce and business associations in the region jointly to host sector specific meetings to bring together companies with similar interests from around the region

and abroad so as to facilitate formation of joint ventures and intensify contact with potential foreign investors;

- in key infrastructure sectors where ownership is still in state hands, to take into account best practice and to share information when restructuring companies and improving standards;
- to accelerate reform programmes in these key sectors, so as to open the way to exploit regional opportunities;
- to standardise trade in services, competition policy and protect intellectual property rights in conjunction with internationally-accepted rules;
- noting that standards and measures vary between different countries, to share knowledge and best practice on standardization and certification, sanitary and phytosanitary measures, consumer policy and protection of consumer health;
- to task national regulators (including of energy, transport and telecoms sectors) to share information and seek to harmonize standards across the region; and,
- to task national air carriers to pursue methods for greater cooperation so as to improve security and improve services.

6. The representatives agreed their officials would take work forward in these areas and to hold a follow-up meeting at expert/official level by January 2004. They agreed that their governments should meet to review progress within one year of signature of the declaration.

7. The representatives called on international donors to support their efforts to foster closer trade, transit and investment cooperation, including by providing technical assistance.

8. The representatives noted the determination of their governments to identify further areas for regional cooperation, and agreed that a senior officials meeting followed by a Ministerial level meeting on counter-narcotics activity would be held in early 2004. Subject to consensus, a further meeting on the environment could also be held.

KEY FEATURES OF TRADE POLICY REGIMES IN AFGHANISTAN AND NEIGHBORING COUNTRIES

Afghanistan. The TISA is considering adopting a simplified tariff structures. However, as of December 2003 there are 26 tariff rates in the tariff structure with a maximum rate of 150 percent. The unweighted average tariff rate is 35 percent. Due to significant exchange-rate overvaluation for the purpose of assessing duties, effective tariff rates are reduced by an estimated factor of ten. A peculiarity of customs procedures is that invoice prices are not used; instead, duties are calculated on the basis of an assessment by the Chamber of Commerce (a government entity) which charges a fee of 2.5 percent. Moreover, the Ministry of Commerce charges a 2-percent fee to issue imports licenses. In addition, there is a “Red Crescent” fee of 2.5 percent (calculated using an exchange rate different from the official rate for other duties). Furthermore, “profits” from imports are taxed at a rate of 4 percent of the value of goods. Note also that a tax of 4 percent is levied on all exports. Currently, customs revenues account for up to 80 percent of central government revenues. However, the government of Afghanistan plans to follow an open free trade strategy, based on the private sector and low tariff protection. Smuggling of goods is substantial, with reports that traders import and re-export goods via transit agreements with Pakistan and Iran.

Source: “Afghanistan’s Trade Regime: Issues and Recommended Actions for Long-Term Growth and Stability”; study prepared by The Services Group, Inc. for USAID, Jan. 2003.

Iran. The main restrictions on imports are customs duties, licensing and exchange controls. Iran does not use the concept of a “tariff”. Instead, it imposes customs duties, import registration fees and commercial benefit taxes on imports. Import registration fees are small, and the real value of customs duties is diluted by use of an overvalued exchange rate. Thus the commercial benefit tax is the main tax on imports. Tax collection is about 6 percent of the value of imports, of which the commercial benefit tax is 5 percent. Approximately 52 percent of the tariff lines are subject to import duties of less than 15 percent and the unweighted average tariff is 31 percent. Moreover, the maximum tariff-equivalent rate ranges between 40–100 percent, while the minimum tariff-equivalent rate ranges between 1–20 percent. Note also that sales and corporate income taxes are not neutral with respect to international trade. Oil is Iran’s main export product and non-oil exports are bound by foreign exchange surrender rules, minimum export prices, mandatory certification procedures, as well as some exports bans and licensing requirements. Iran has created three free-trade zones to promote non-oil exports and employment (Kish, Qeshm and Chahbahar).

Source: “Trade and Foreign Exchange Policies in Iran”, Report No. 22953-IRN, World Bank, Nov. 2001.

Pakistan. The general maximum rate of customs duty on imports is 25 percent. The country is operating with a structure of four rates (5, 10, 20 and 25 percent) with the average protective tariff rate marginally exceeding 18 percent at the end of 2002. There was a decline in tariffs throughout the 1990s, with the contribution of tariffs to indirect tax revenue falling from 46 to 15 percent. Pakistan is a member of the WTO: about 37 percent of tariff lines are WTO-bound, with the average of WTO-bound tariff rates being 61 percent. Overall, non-tariff barriers to imports are relatively low; however, actual protection from imports may be higher as a result of asymmetric collection of sales and income taxes. All official import/exports monopolies, quantitative restrictions and export taxes have been removed. There are a number of export-subsidy schemes still in operation, including livestock and agricultural products. Trade in certain goods (e.g. food grains) between India and Pakistan is heavily restricted.

Source: “Trade Policies in South Asia”, draft Regional Trade Study, World Bank, Feb. 2003.

Tajikistan. There are a few high tariff barriers but not many non-tariff barriers to imports. Tajikistan has six tariff bands, ranging between 5–30 percent—the simple average of the bands is 8 percent. In 1998, a uniform tariff of 5 percent was applied to all major imports, while the effective rate was about 2 percent. However, the country’s participation in the Eurasian Economic Community means that there is pressure to “harmonize” external tariffs to the (higher) level of

GSTP	...	Member	Member	...	...	...
GUUAM	...	...	...	...	...	Member
SAARC	...	...	Member	...	...	...
SCO	...	...	...	Member	...	Member
WCO	Member	Member	Member	Member	Member	Member
WTO	Observer	Applicant 2000	Member since Jan. 1, 1995.	Applicant, July 18, 2001.	...	Observer

Notes:

CAF is the Central Asian Forum (formerly the Central Asian Economic Community). Members are Kazakhstan, Kyrgyz Republic, Tajikistan and Uzbekistan.

CIS is the Commonwealth of Independent States. Members are Azerbaijan, Armenia, Belarus, Georgia, Moldova, Kazakhstan, Russian Federation, Ukraine, Uzbekistan, Tajikistan and the Kyrgyz Republic. Established in Dec. 1994.

ECO is the Economic Cooperation Organization. Members are Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkey, Turkmenistan and Uzbekistan. Established in July 1992.

EAEC is the Eurasian Economic Community. Members are Belarus, Kazakhstan, Kyrgyz Republic, Russian Federation and Tajikistan.

ESCAP is the United Nation's Economic and Social Commission for Asia and the Pacific. It has 52 regional and extra-regional members, including Afghanistan, Bangladesh, China, India, Indonesia, Iran, Pakistan, Russia, Sri Lanka, Tajikistan, Turkmenistan and Uzbekistan.

GSTP is the General System of Trade Preferences among Developing Countries. Members include Bangladesh, Egypt, India, Indonesia, Iran, Iraq, Malaysia, Pakistan, Philippines, Korea, Singapore, Sri Lanka and Thailand, in addition to several other countries in Africa, Eastern Europe and Latin America. Established in April 1989.

GUUAM promotes cooperation in regional security, economic and political matters. Members are Azerbaijan, Georgia, Moldova, Ukraine and Uzbekistan.

SAARC is the South Asian Association for Regional Cooperation, established in Dec. 1985. SAPTA is the SAARC Preferential Trade Agreement, established in Dec. 1995. Members are Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

SCO is the Shanghai Cooperation Organization (formerly the Shanghai Five). Members are China, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan and Uzbekistan. It started as an organization to foster cooperation on security matters, but in July 2000 members discussed the possibility of creating an economic union.

WCO is the World Customs Organization. It has 161 members worldwide.

WTO is the World Trade Organization. It has 146 members worldwide.

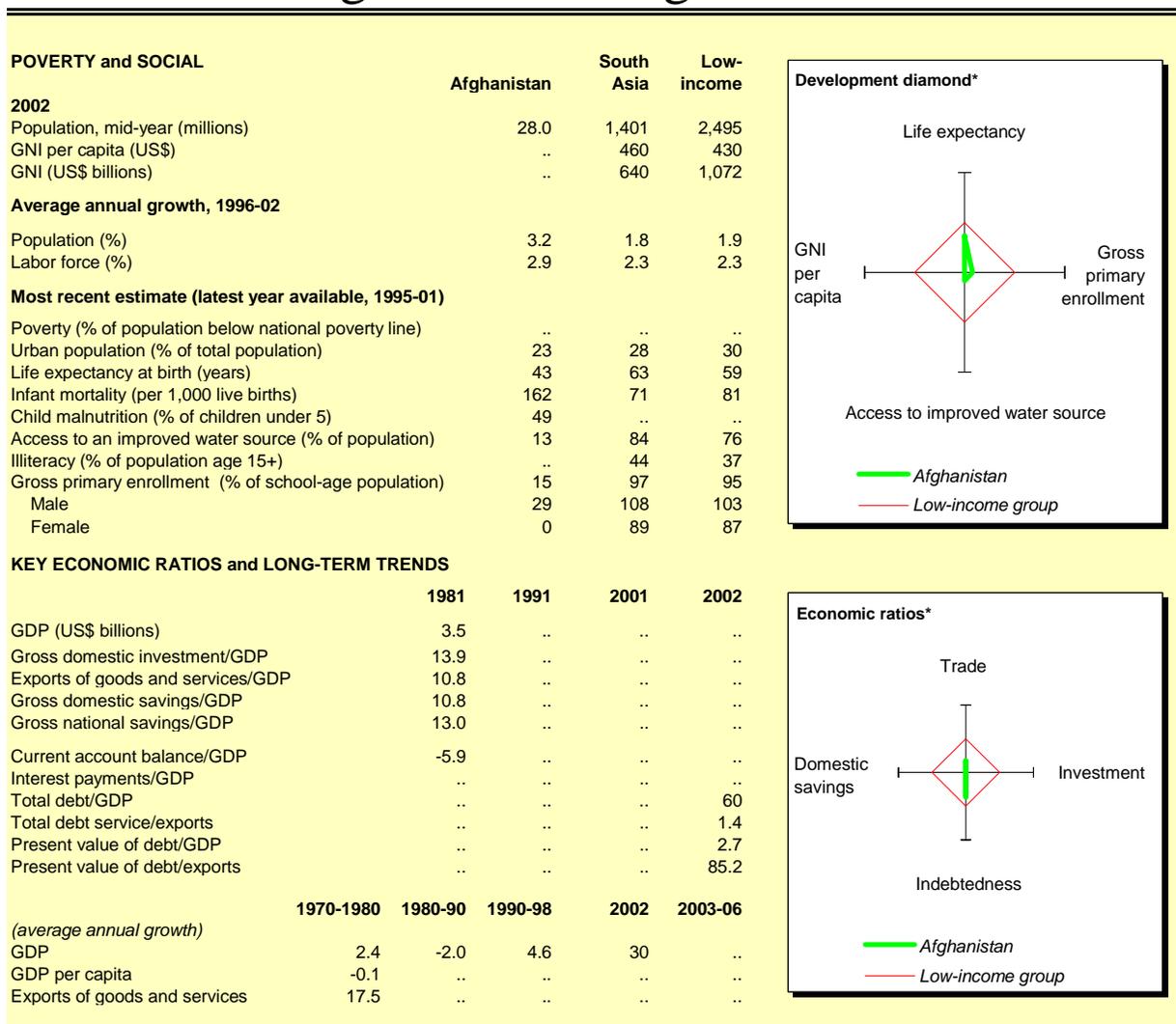
Sources: "Afghanistan Border States Development Framework: Approach Paper", World Bank discussion draft, Nov. 2001; "Preferential Trade Agreements in Asia and the Pacific" in Asian Development Outlook 2002, 157–196, ADB; "Asian Regionalism and Its Effects on Trade in the 1980s and 1990s", Clarete, R. et al, ERD Working Paper Series No. 30, ADB, Nov. 2002; "Transport and Trade Facilitation Issues in the CIS 7, Kazakhstan and Turkmenistan", Molnar, E. and Ojala, L., floor paper presented at the Lucerne Conference of the CIS 7 Initiative in January 2003; UNESCAP (<http://www.unescap.org/index.asp>); WCO (<http://www.wcoomd.org/ie/index.html>); and WTO (www.wto.org)

Technical notes

I.

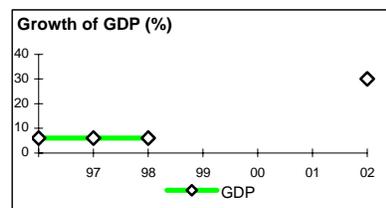
Afghanistan at a glance

9/2/03

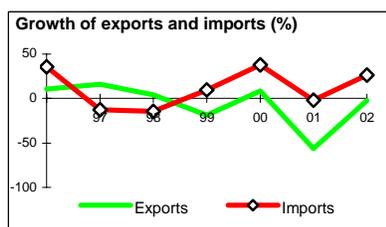


STRUCTURE of the ECONOMY

	1975	2001	2002
<i>(% of GDP)</i>			
Agriculture	52.5	..	..
Industry	13.0	..	..
Manufacturing	10.0	..	..
Services	29.3	..	..
Private consumption	86.1	..	..
General government consumption	5.7	..	..
Imports of goods and services	14.3	..	..



	1970-78	2001	2002
<i>(average annual growth)</i>			
Agriculture	2.5	..	..
Industry	5.0	..	..
Manufacturing	3.9	..	..
Services	4.8	..	..
Private consumption	6.6	..	..
General government consumption	12.2	..	..
Gross domestic investment	19.6	..	..
Imports of goods and services	9.8	..	..



Note: 2002 data are very preliminary estimates. Population does not account for recent refugee flows. See last page for sources.

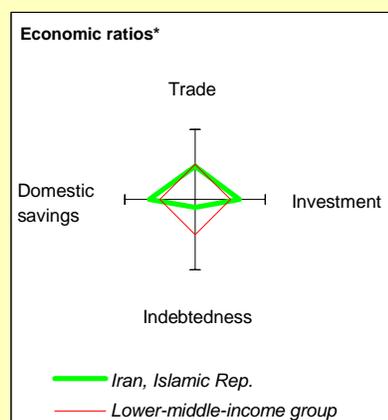
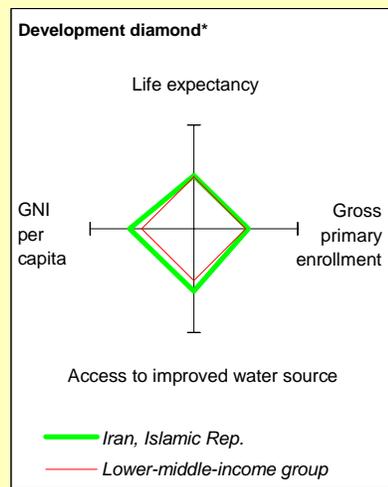
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[Technical notes](#)

Iran, Islamic Rep. at a glance

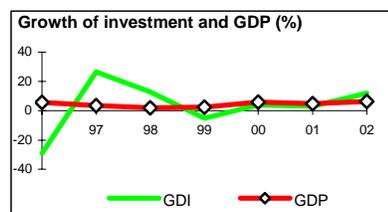
9/3/03

POVERTY and SOCIAL	Iran	M. East & North Africa	Lower- middle- income		
2002					
Population, mid-year (millions)	65.5	306	2,411		
GNI per capita (Atlas method, US\$)	1,720	2,070	1,390		
GNI (Atlas method, US\$ billions)	112.4	670	3,352		
Average annual growth, 1996-02					
Population (%)	1.5	1.9	1.0		
Labor force (%)	4.8	2.9	1.2		
Most recent estimate (latest year available, 1996-02)					
Poverty (% of population below national poverty line)	21	..	..
Urban population (% of total population)	65	58	49		
Life expectancy at birth (years)	71	69	69		
Infant mortality (per 1,000 live births)	30	37	30		
Child malnutrition (% of children under 5)	11	..	11		
Access to an improved water source (% of population)	98	88	81		
Illiteracy (% of population age 15+)	15	35	13		
Gross primary enrollment (% of school-age population)	117	95	111		
Male	120	98	111		
Female	113	90	110		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1982	1992	2001	2002	
GDP (US\$ billions)	124.8	93.1	114.1	107.5	
Gross domestic investment/GDP	15.9	35.4	29.3	31.1	
Exports of goods and services/GDP	16.4	15.2	28.1	26.8	
Gross domestic savings/GDP	20.4	30.0	35.8	34.5	
Gross national savings/GDP	19.5	31.4	35.2	35.5	
Current account balance/GDP	4.6	-7.8	4.4	3.7	
Interest payments/GDP	0.1	0.1	0.2	0.2	
Total debt/GDP	6.6	17.3	6.3	6.8	
Total debt service/exports	5.4	4.9	8.1	7.4	
Present value of debt/GDP	5.9	..	
Present value of debt/exports	25.1	..	
	1982-92	1992-02	2001	2002	2002-06
(average annual growth)					
GDP	1.8	3.5	4.8	6.3	5.8
GDP per capita	-1.2	2.0	3.4	4.7	4.5
Exports of goods and services	5.1	-0.7	9.7	2.1	4.7

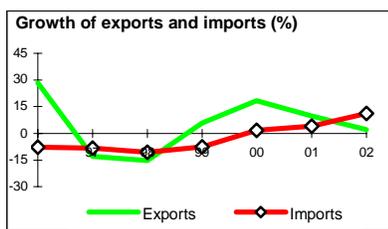


STRUCTURE of the ECONOMY

	1982	1992	2001	2002
(% of GDP)				
Agriculture	20.2	23.9	18.6	15.2
Industry	37.1	29.2	37.7	38.9
Manufacturing	9.6	14.3	16.3	13.9
Services	42.7	46.9	43.6	45.8
Private consumption	61.5	59.6	51.0	51.4
General government consumption	18.1	10.4	13.2	14.1
Imports of goods and services	11.9	20.7	21.5	23.3



	1982-92	1992-02	2001	2002
(average annual growth)				
Agriculture	4.3	3.8	4.7	6.1
Industry	3.0	-2.2	7.5	10.5
Manufacturing	6.5	5.6	10.0	11.0
Services	-0.5	7.8	4.8	5.1
Private consumption	1.9	3.4	5.1	6.3
General government consumption	-3.7	3.3	1.1	5.0
Gross domestic investment	1.2	4.7	3.0	12.0
Imports of goods and services	-0.7	-8.9	4.1	11.2



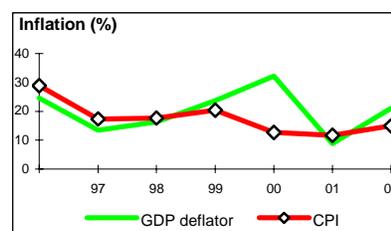
MNSEED. Note: 2002 data are preliminary estimates.

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Iran, Islamic Rep.

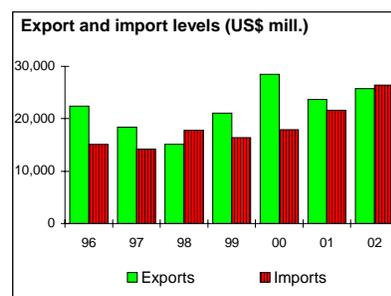
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices	18.2	25.8	11.7	15.0
Implicit GDP deflator	14.6	25.0	8.8	21.1
Government finance (% of GDP, includes current grants)				
Current revenue	..	7.1	26.5	27.6
Current budget balance	..	-6.2	9.0	4.8
Overall surplus/deficit	-5.7	-12.5	1.0	-2.5



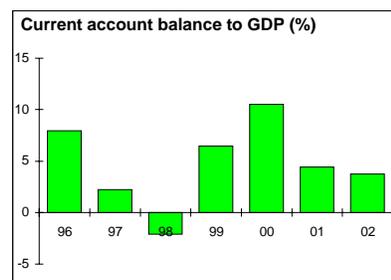
TRADE

	1982	1992	2001	2002
TRADE (US\$ millions)				
Total exports (fob)	20,452	19,868	23,716	25,761
Oil and gas	20,168	16,880	19,339	20,755
Textiles	..	..	..	662
Manufactures	..	..	..	1,227
Total imports (cif)	12,552	23,274	21,600	26,450
Food	..	..	..	1,932
Fuel and energy	1,000	400	625	643
Capital goods	..	..	..	15,829
Export price index (1995=100)	112	75	70	71
Import price index (1995=100)	49	62	58	59
Terms of trade (1995=100)	230	121	120	120



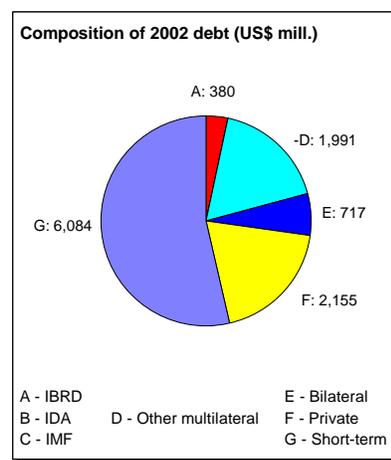
BALANCE of PAYMENTS

	1982	1992	2001	2002
BALANCE of PAYMENTS (US\$ millions)				
Exports of goods and services	20,961	20,427	26,020	28,439
Imports of goods and services	15,613	29,057	21,586	25,954
Resource balance	5,348	-8,630	4,434	2,485
Net income	385	130	225	294
Net current transfers	0	1,192	376	1,250
Current account balance	5,733	-7,308	5,035	4,029
Financing items (net)	-846	7,132	-9,976	-8,345
Changes in net reserves	-4,887	176	4,941	4,316
Memo:				
Reserves including gold (US\$ millions)	..	2,860	17,468	20,968
Conversion rate (DEC, local/US\$)	84.5	713.8	5,819.0	7,950.0



EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
EXTERNAL DEBT and RESOURCE FLOWS (US\$ millions)				
Total debt outstanding and disbursed	8,236	16,084	7,214	7,345
IBRD	467	133	380	380
IDA	0	0	0	0
Total debt service	1,172	1,071	2,168	2,168
IBRD	86	32	101	101
IDA	0	0	0	0
Composition of net resource flows				
Official grants	6	55	..	..
Official creditors	-70	49	..	..
Private creditors	-200	1,170	..	..
Foreign direct investment	..	..	500	750
Portfolio equity	0	0	0	0
World Bank program				
Commitments	0	432	0	0
Disbursements	0	114	31	31
Principal repayments	50	26	65	65
Net flows	-50	88	-34	-34
Interest payments	36	6	36	36
Net transfers	-86	82	-70	-70

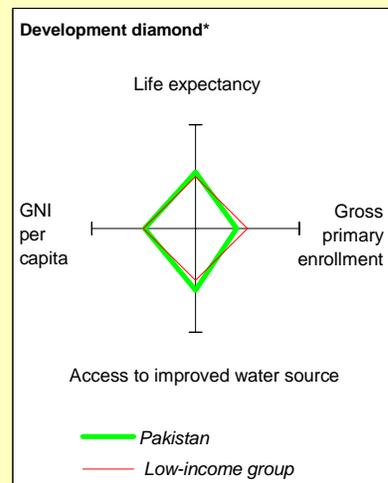


Pakistan at a glance

9/2/03

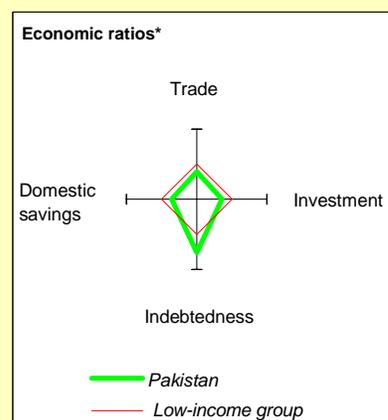
POVERTY and SOCIAL

	Pakistan	South Asia	Low-income
2002			
Population, mid-year (millions)	144.9	1,401	2,495
GNI per capita (Atlas method, US\$)	420	460	430
GNI (Atlas method, US\$ billions)	60.9	640	1,072
Average annual growth, 1996-02			
Population (%)	2.4	1.8	1.9
Labor force (%)	3.1	2.3	2.3
Most recent estimate (latest year available, 1996-02)			
Poverty (% of population below national poverty line)	33	..	..
Urban population (% of total population)	34	28	30
Life expectancy at birth (years)	64	63	59
Infant mortality (per 1,000 live births)	80	71	81
Child malnutrition (% of children under 5)	..	..	..
Access to an improved water source (% of population)	90	84	76
Illiteracy (% of population age 15+)	55	44	37
Gross primary enrollment (% of school-age population)	74	97	95
Male	93	108	103
Female	54	89	87



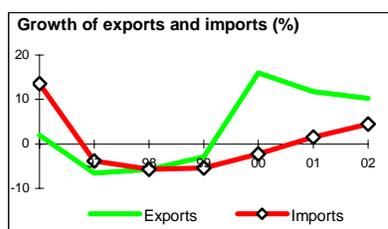
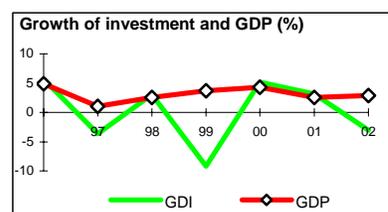
KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1982	1992	2001	2002
GDP (US\$ billions)	30.7	48.6	58.6	59.1
Gross domestic investment/GDP	19.3	20.2	15.5	14.7
Exports of goods and services/GDP	9.9	17.4	18.0	18.7
Gross domestic savings/GDP	7.4	17.1	14.2	14.4
Gross national savings/GDP	14.3	25.5	18.3	22.9
Current account balance/GDP	-3.6	-1.8	-1.9	2.7
Interest payments/GDP	0.8	1.4	1.3	1.5
Total debt/GDP	38.1	51.2	54.7	59.4
Total debt service/exports	16.2	23.6	25.7	21.4
Present value of debt/GDP	..	..	43.5	..
Present value of debt/exports	..	..	221.7	..
	1982-92	1992-02	2001	2002
<i>(average annual growth)</i>				
GDP	6.0	3.3	2.6	2.8
GDP per capita	3.3	0.8	0.1	0.4
Exports of goods and services	10.4	1.1	11.8	10.3



STRUCTURE of the ECONOMY

	1982	1992	2001	2002
<i>(% of GDP)</i>				
Agriculture	31.6	26.3	25.3	23.2
Industry	22.3	25.0	22.8	23.3
Manufacturing	15.1	16.9	15.9	16.1
Services	46.2	48.6	51.9	53.5
Private consumption	82.2	70.0	75.6	74.4
General government consumption	10.3	12.9	10.2	11.3
Imports of goods and services	21.8	20.5	19.3	19.0
	1982-92	1992-02	2001	2002
<i>(average annual growth)</i>				
Agriculture	4.5	3.6	-2.8	-0.1
Industry	7.2	3.5	3.8	5.4
Manufacturing	6.9	3.8	8.3	5.0
Services	6.1	4.1	4.1	4.1
Private consumption	4.4	4.0	1.5	1.4
General government consumption	7.8	1.0	-5.3	13.5
Gross domestic investment	4.7	0.6	3.1	-3.0
Imports of goods and services	2.7	-0.2	1.5	4.5

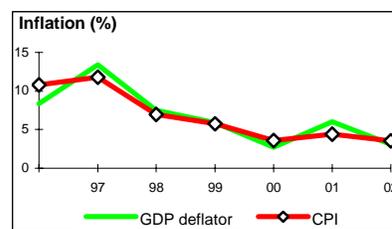


Note: 2002 data are preliminary estimates.

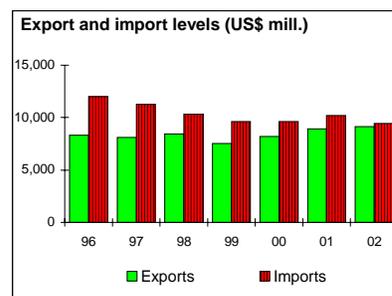
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PRICES and GOVERNMENT FINANCE

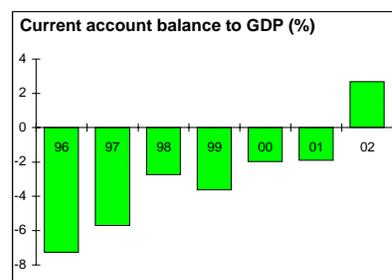
	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices	..	10.6	4.4	3.5
Implicit GDP deflator	9.4	10.1	6.1	3.1
Government finance (% of GDP, includes current grants)				
Current revenue	..	19.2	16.2	17.2
Current budget balance	..	0.1	-2.7	-2.1
Overall surplus/deficit	..	-7.5	-5.2	-6.7

**TRADE**

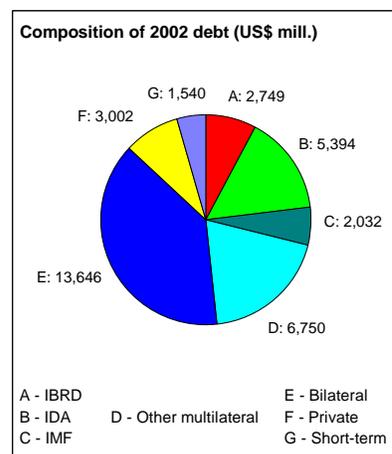
	1982	1992	2001	2002
(US\$ millions)				
Total exports (fob)	2,464	6,762	8,934	9,140
Cotton	..	518	139	18
Rice	..	416	525	448
Manufactures	1,600	3,618	5,820	5,368
Total imports (cif)	..	8,998	10,202	9,432
Food	..	978	579	413
Fuel and energy	..	1,377	3,327	2,664
Capital goods	..	2,985	2,687	2,594
Export price index (1995=100)	..	89	82	80
Import price index (1995=100)	..	95	92	90
Terms of trade (1995=100)	..	94	89	89

**BALANCE of PAYMENTS**

	1982	1992	2001	2002
(US\$ millions)				
Exports of goods and services	3,055	8,274	10,284	11,056
Imports of goods and services	6,686	11,468	12,535	11,646
Resource balance	-3,631	-3,194	-2,251	-590
Net income	-321	-1,266	-2,160	-2,319
Net current transfers	2,835	3,564	3,299	4,500
Current account balance	-1,117	-896	-1,112	1,591
Financing items (net)	..	1,026	2,200	1,491
Changes in net reserves	..	-130	-1,088	-3,082
Memo:				
Reserves including gold (US\$ millions)	..	1,730	3,810	4,810
Conversion rate (DEC, local/US\$)	10.6	24.8	58.5	61.4

**EXTERNAL DEBT and RESOURCE FLOWS**

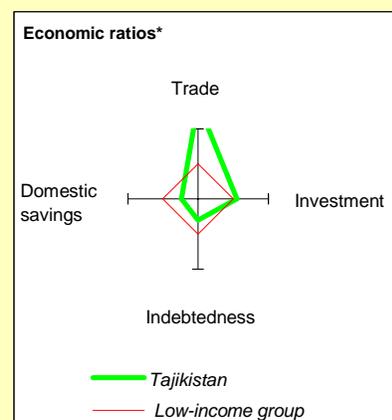
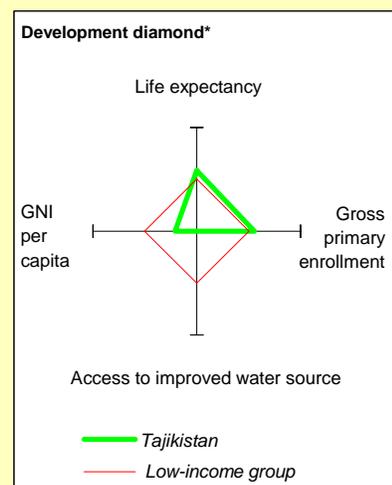
	1982	1992	2001	2002
(US\$ millions)				
Total debt outstanding and disbursed	11,704	24,918	32,028	35,113
IBRD	340	2,384	2,796	2,749
IDA	1,051	2,457	4,245	5,394
Total debt service	877	2,318	2,949	2,903
IBRD	53	296	390	367
IDA	11	41	96	111
Composition of net resource flows				
Official grants	419	450	839	1,495
Official creditors	648	1,009	1,080	758
Private creditors	445	625	-560	-389
Foreign direct investment	122	335	286	366
Portfolio equity	0	219	-142	-491
World Bank program				
Commitments	359	378	674	1,382
Disbursements	205	609	669	961
Principal repayments	32	150	300	318
Net flows	172	460	369	643
Interest payments	32	188	187	160
Net transfers	141	272	183	483



Tajikistan at a glance

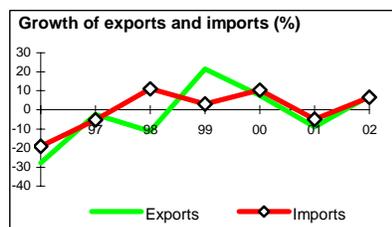
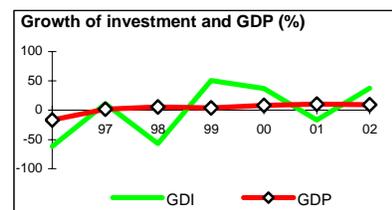
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POVERTY and SOCIAL	Europe & Central Asia				
	Tajikistan	Low-income	Low-income		
2002					
Population, mid-year (<i>millions</i>)	6.3	476	2,495		
GNI per capita (<i>Atlas method, US\$</i>)	180	2,160	430		
GNI (<i>Atlas method, US\$ billions</i>)	1.1	1,030	1,072		
Average annual growth, 1996-02					
Population (%)	1.1	0.1	1.9		
Labor force (%)	2.3	0.4	2.3		
Most recent estimate (latest year available, 1996-02)					
Poverty (<i>% of population below national poverty line</i>)	83	..	..
Urban population (<i>% of total population</i>)	28	63	30		
Life expectancy at birth (<i>years</i>)	69	69	59		
Infant mortality (<i>per 1,000 live births</i>)	21	25	81		
Child malnutrition (<i>% of children under 5</i>)	..	..	..
Access to an improved water source (<i>% of population</i>)	..	91	76		
Illiteracy (<i>% of population age 15+</i>)	1	3	37		
Gross primary enrollment (<i>% of school-age population</i>)	105	102	95		
Male	109	103	103		
Female	101	101	87		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1982	1992	2001	2002	
GDP (<i>US\$ billions</i>)	..	0.34	1.1	1.2	
Gross domestic investment/GDP	..	33.6	18.0	22.7	
Exports of goods and services/GDP	62.1	58.4	
Gross domestic savings/GDP	..	43.0	5.9	9.5	
Gross national savings/GDP	..	43.0	11.0	19.9	
Current account balance/GDP	..	-15.7	-7.0	-2.8	
Interest payments/GDP	..	0.0	1.8	1.0	
Total debt/GDP	..	2.9	103.1	88.9	
Total debt service/exports	11.5	9.2	
Present value of debt/GDP	78.3	63.5	
Present value of debt/exports	117.5	88.4	
	1982-92	1992-02	2001	2002	2002-06
(<i>average annual growth</i>)					
GDP	-2.8	-3.0	10.2	9.1	4.4
GDP per capita	-5.5	-4.2	9.2	7.5	1.7
Exports of goods and services	..	-2.0	-9.0	7.3	..



STRUCTURE of the ECONOMY

	1982	1992	2001	2002
(<i>% of GDP</i>)				
Agriculture	..	29.2	26.7	21.9
Industry	..	48.9	26.7	21.5
Manufacturing	..	39.3	22.6	19.0
Services	..	29.8	38.0	46.5
Private consumption	..	29.7	85.3	81.8
General government consumption	..	27.3	8.8	8.7
Imports of goods and services	..	..	74.2	71.6
	1982-92	1992-02	2001	2002
(<i>average annual growth</i>)				
Agriculture	-6.2	-1.4	0.0	..
Industry	2.1	-9.2	7.9	..
Manufacturing	1.5	-7.8	0.0	..
Services	-1.8	3.7	11.9	..
Private consumption	-8.4	7.3	30.6	4.7
General government consumption	8.9	-13.2	18.8	7.1
Gross domestic investment	-9.8	-18.4	-16.8	37.5
Imports of goods and services	..	-2.1	-4.9	6.5



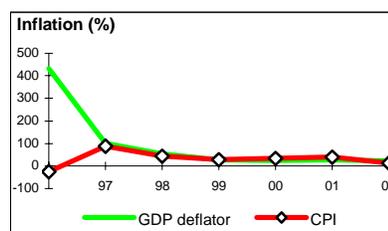
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Tajikistan

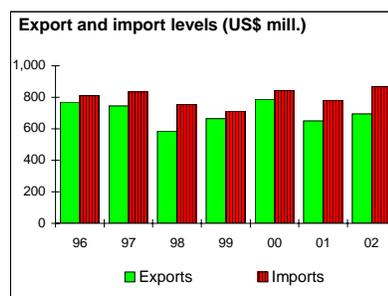
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices	..	1,363.8	38.6	12.2
Implicit GDP deflator	..	571.6	26.2	22.0
Government finance (% of GDP, includes current grants)				
Current revenue	..	35.3	15.2	16.7
Current budget balance	..	-21.6	2.0	3.0
Overall surplus/deficit	..	-30.7	-3.2	-2.4



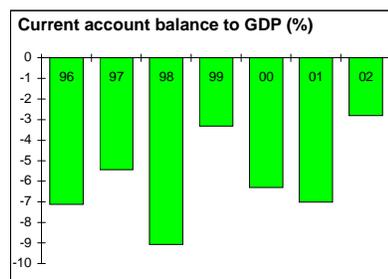
TRADE

	1982	1992	2001	2002
<i>(US\$ millions)</i>				
Total exports (fob)	..	185	652	696
Commodity 1	..	102	398	399
Commodity 2	..	28	72	128
Manufactures
Total imports (cif)	..	238	783	868
Food
Fuel and energy	..	64	203	174
Capital goods
Export price index (1995=100)	112	..
Import price index (1995=100)	99	..
Terms of trade (1995=100)	114	104



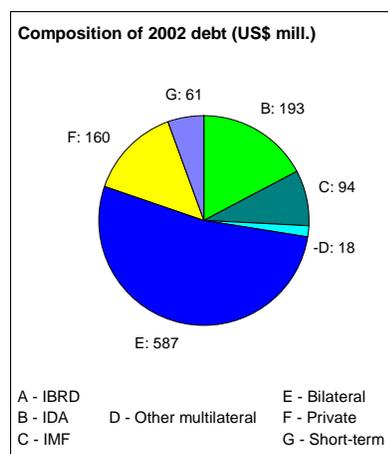
BALANCE of PAYMENTS

	1982	1992	2001	2002
<i>(US\$ millions)</i>				
Exports of goods and services	..	185	655	708
Imports of goods and services	..	238	783	868
Resource balance	..	-53	-128	-160
Net income	-77	-58
Net current transfers	131	184
Current account balance	..	-53	-74	-34
Financing items (net)	..	53	82	35
Changes in net reserves	..	0	-8	-1
Memo:				
Reserves including gold (US\$ millions)	..	0	96	96
Conversion rate (DEC, local/US\$)	..	1.92E-3	2.4	2.8



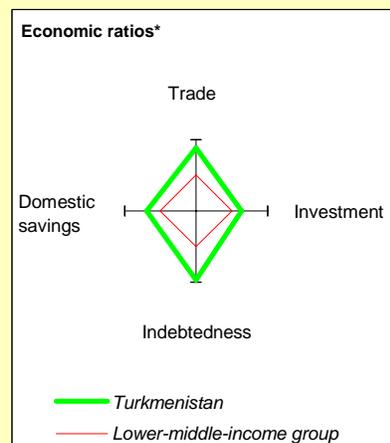
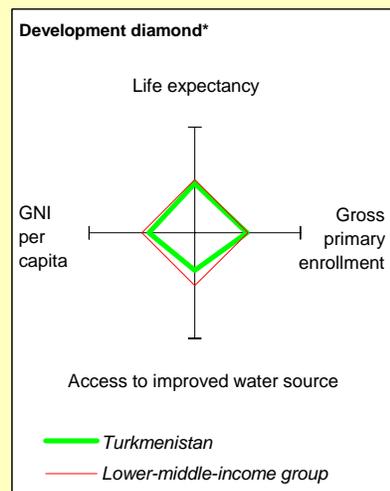
EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	..	10	1,088	1,077
IBRD	0	0
IDA	172	193
Total debt service	81	80
IBRD	0	0
IDA	1	1
Composition of net resource flows				
Official grants	81	..
Official creditors	..	10	36	12
Private creditors	17	-20
Foreign direct investment	9	36
Portfolio equity
World Bank program				
Commitments	..	0	53	53
Disbursements	..	0	35	10
Principal repayments	..	0	0	0
Net flows	..	0	35	10
Interest payments	..	0	1	1
Net transfers	..	0	34	9



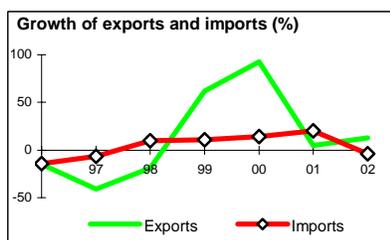
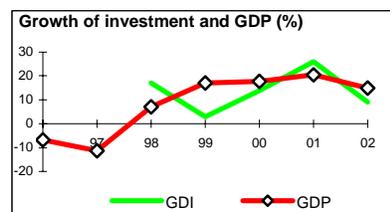
Turkmenistan at a glance

	Turkmenistan	Europe & Central Asia	Lower-middle-income		
POVERTY and SOCIAL					
2002					
Population, mid-year (millions) ^{1/}	5.8	476	2,411		
GNI per capita (Atlas method, US\$)	1,200	2,160	1,390		
GNI (Atlas method, US\$ billions)	6.6	1,030	3,352		
Average annual growth, 1996-02					
Population (%)	3.7	0.1	1.0		
Labor force (%)	3.8	0.4	1.2		
Most recent estimate (latest year available, 1996-02)					
Poverty (% of population below poverty line) ^{2/}	58	..	..
Urban population (% of total population)	45	63	49		
Life expectancy at birth (years)	65	69	69		
Infant mortality (per 1,000 live births)	69	25	30		
Child malnutrition (% of children under 5)	12	..	11		
Access to an improved water source (% of population)	58	91	81		
Illiteracy (% of population age 15+)	2	3	13		
Gross primary enrollment (% of school-age population)	109	102	111		
Male	109	103	111		
Female	109	101	110		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1982	1992	2001	2002	
GDP (US\$ billions) ^{3/, 4/}	3.1	4.0	
Gross domestic investment/GDP	36.9	31.3	
Exports of goods and services/GDP ^{5/}	46.6	..	
Gross domestic savings/GDP	36.4	..	
Gross national savings/GDP	35.6	..	
Current account balance/GDP ^{5/}	-1.2	..	
Interest payments/GDP ^{6/}	
Total debt/GDP ^{6/}	
Total debt service/exports ^{6/}	..	0.0	
Present value of debt/GDP ^{6/}	
Present value of debt/exports ^{6/}	
	1982-92	1992-02	2001	2002	2002-06
(average annual growth)					
GDP ^{7/}	-1.2	1.5	20.5	14.9	4.2
GDP per capita	-4.6	-1.8	15.7	9.3	2.9
Exports of goods and services	..	2.0	4.8	13.0	3.3



STRUCTURE of the ECONOMY

	1982	1992	2001	2002
(% of GDP)				
Agriculture	..	10.6	28.8	..
Industry	..	11.9	50.7	..
Manufacturing	40.3	..
Services	..	77.5	20.5	..
Private consumption	48.9	..
General government consumption	14.7	..
Imports of goods and services ^{5/}	47.1	..
(average annual growth)				
Agriculture ^{7/}	-0.9	-0.9	23.0	..
Industry ^{7/}	-8.8	1.0	16.8	..
Manufacturing ^{7/}	16.0	..
Services ^{7/}	5.3	-1.3	25.0	..
Private consumption
General government consumption
Gross domestic investment	..	13.6	26.0	9.0
Imports of goods and services	..	3.5	20.1	-3.7



Note: 2002 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

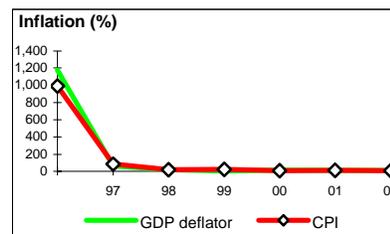
^{1/} According to official statistics. Alternative UN estimates indicate that Turkmenistan's population in 2002 was around 4.8 million people.

^{2/} According to the 1998 Living Standards Measurement Survey. The poverty line is defined as the official minimum wage at the time of the Survey. The Turkmen authorities suggest that another, relative poverty measure -- such as share of population with incomes below 50% of median per capita income -- may be more appropriate. Official statistics indicate that only 1% of population falls below such poverty line.

Turkmenistan

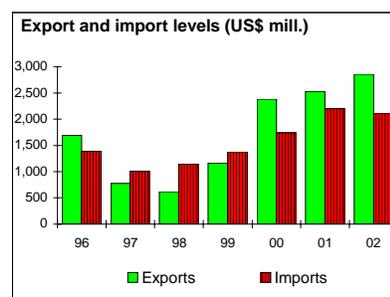
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices ^{8/}	..	492.9	11.6	8.5
Implicit GDP deflator	..	2,773.4	12.3	12.0
Government finance ^{9/} (% of GDP, includes current grants)				
Current revenue	25.1	..
Current budget balance	0.7	..
Overall surplus/deficit	0.9	..



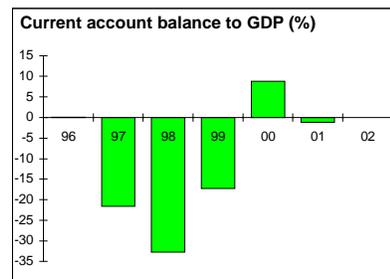
TRADE

	1982	1992	2001	2002
TRADE (US\$ millions)				
Total exports (fob)	2,526	2,856
Natural gas	1,398	1,656
Oil and oil products	751	742
Manufactures	311	412
Total imports (fob)	2,201	2,119
Food	154	170
Fuel and energy	0	0
Capital goods	814	572
Export price index (1995=100)	81	84
Import price index (1995=100)	111	113
Terms of trade (1995=100)	73	75

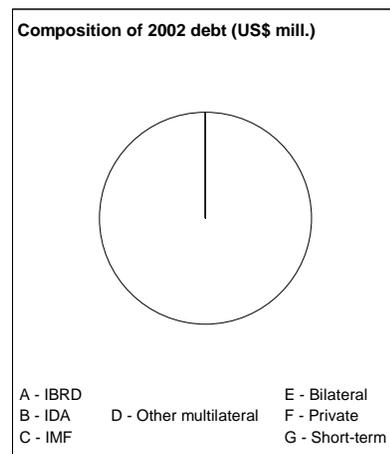


BALANCE of PAYMENTS

	1982	1992	2001	2002
BALANCE of PAYMENTS (US\$ millions)				
Exports of goods and services	..	2,149	2,777	3,138
Imports of goods and services	..	1,222	2,807	2,703
Resource balance	..	927	-31	..
Net income	..	0	-111	..
Net current transfers	..	0	68	..
Current account balance	..	927	-74	..
Financing items (net)	..	-1,035	337	..
Changes in net reserves	..	108	-263	..
Memo:				
Reserves including gold (US\$ millions)	2,021	..
Average official exchange rate (manat/US\$) ^{10/}	5,200	5,200

EXTERNAL DEBT and RESOURCE FLOWS ^{6/}

	1982	1992	2001	2002
EXTERNAL DEBT and RESOURCE FLOWS ^{6/} (US\$ millions)				
Total debt outstanding and disbursed	..	47	..	..
IBRD	..	0	30	31
IDA	..	0	0	0
Total debt service	..	0	..	..
IBRD	..	0	2	3
IDA	..	0	0	0
Composition of net resource flows				
Official grants
Official creditors	..	0	..	..
Private creditors	..	47	..	..
Foreign direct investment	134	..
Portfolio equity	0	..
World Bank program				
Commitments	..	0	0	0
Disbursements	..	0	3	2
Principal repayments	..	0	1	2
Net flows	..	0	2	1
Interest payments	..	0	2	1
Net transfers	..	0	1	0



^{8/} According to official statistics. Alternative estimates indicate higher consumer price inflation.

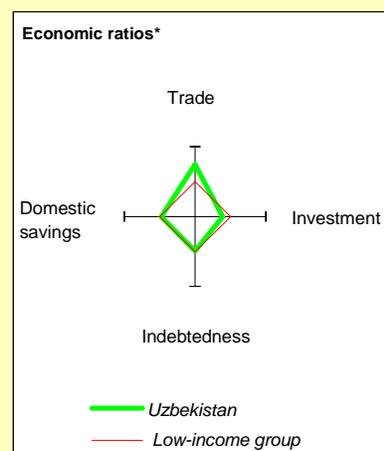
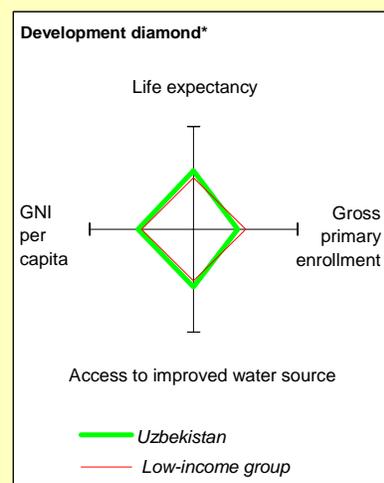
^{9/} Excluding operations of extrabudgetary funds and self-financing ministries.

^{10/} Turkmenistan does not have current account convertibility and an informal parallel market for foreign exchange exists alongside the official one. The exchange rate in the parallel market averaged around 21,500 manat per US\$ in 2002.

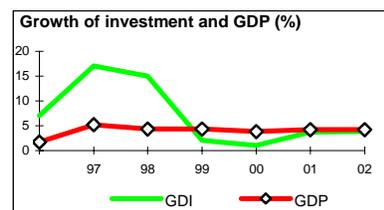
Uzbekistan at a glance

8/19/03

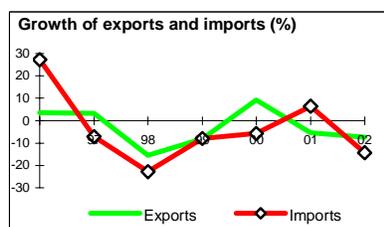
	Uzbekistan	Europe & Central Asia	Low-income		
POVERTY and SOCIAL					
2002					
Population, mid-year (millions)	25.3	476	2,495		
GNI per capita (Atlas method, US\$)	460	2,160	430		
GNI (Atlas method, US\$ billions)	11.5	1,030	1,072		
Average annual growth, 1996-02					
Population (%)	1.4	0.1	1.9		
Labor force (%)	2.4	0.4	2.3		
Most recent estimate (latest year available, 1996-02)					
Poverty (% of population below poverty line) ^{1/}	28	..	..
Urban population (% of total population)	37	63	30		
Life expectancy at birth (years)	67	69	59		
Infant mortality (per 1,000 live births)	54	25	81		
Child malnutrition (% of children under 5)	19	..	..
Access to an improved water source (% of population)	85	91	76		
Illiteracy (% of population age 15+)	1	3	37		
Gross primary enrollment (% of school-age population)	80	102	95		
Male	81	103	103		
Female	79	101	87		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1982	1992	2001	2002	
GDP (US\$ billions) ^{2/}	..	20.2	7.6	7.9	
Gross domestic investment/GDP ^{3/}	..	46.8	20.2	16.1	
Exports of goods and services/GDP ^{2/}	..	0.0	42.4	37.4	
Gross domestic savings/GDP	..	3.7	20.8	19.4	
Gross national savings/GDP	..	3.2	18.7	18.9	
Current account balance/GDP ^{2/}	..	-1.2	-1.5	2.8	
Interest payments/GDP ^{2/}	..	0.0	2.6	2.0	
Total debt/GDP ^{2/}	..	0.3	61.8	55.8	
Total debt service/exports	26.1	23.9	
Present value of debt/GDP ^{2/}	61.2	54.6	
Present value of debt/exports	143.6	144.5	
	1982-92	1992-02	2001	2002	2002-06
<i>(average annual growth)</i>					
GDP ^{4/}	0.5	2.3	4.2	4.2	1.8
GDP per capita ^{4/}	-1.8	0.7	2.9	2.9	0.6
Exports of goods and services	..	-2.1	-5.4	-7.4	5.2

**STRUCTURE of the ECONOMY**

	1982	1992	2001	2002
<i>(% of GDP)</i>				
Agriculture	..	34.8	34.0	34.6
Industry	..	35.8	22.6	21.6
Manufacturing	8.9	9.1
Services	..	29.4	43.4	43.8
Private consumption	..	75.1	60.9	62.4
General government consumption	..	21.2	18.2	18.2
Imports of goods and services ^{2/}	..	43.2	41.7	34.0



	1982-92	1992-02	2001	2002
<i>(average annual growth)</i>				
Agriculture	1.5	2.2	4.1	6.1
Industry ^{4/}	0.3	-0.2	2.9	3.4
Manufacturing	..	..	..	..
Services	0.0	3.5	5.2	3.7
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Gross domestic investment	..	4.0	3.7	3.8
Imports of goods and services	..	-4.1	6.4	-14.3



Note: 2002 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

^{1/} Poverty line is based on calorific food value.

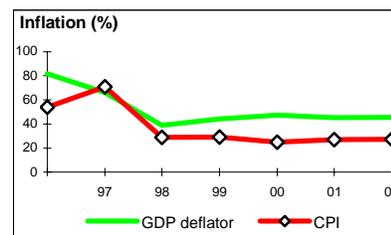
^{2/} At the indicative exchange rate defined as a weighted average of the official (60%), consumer goods/cash (10%), and parallel market (30%) exchange rates.

^{3/} Estimated based on available savings.

^{4/} According to official statistics. Alternative IMF estimates indicate lower real growth rates.

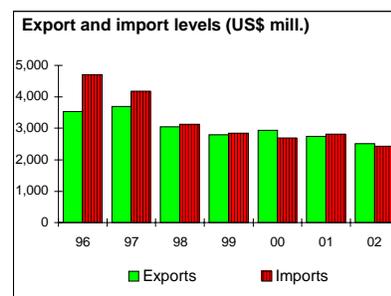
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices (% change)				
Consumer prices ^{5/}	..	645.0	27.2	27.3
Implicit GDP deflator	..	712.1	45.2	45.5
Government finance ^{6/} (% of GDP, includes current grants)				
Current revenue	..	31.5	26.1	25.8
Current budget balance	5.3	5.1
Overall surplus/deficit	..	-18.5	-1.3	-1.6



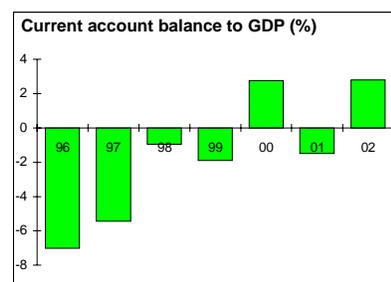
TRADE

	1982	1992	2001	2002
TRADE (US\$ millions)				
Total exports (fob)	..	1,424	2,740	2,510
Cotton fiber	..	861	699	669
Gold	776	844
Manufactures	209	205
Total imports (cif)	..	2,119	2,814	2,426
Food	..	780	339	339
Fuel and energy	..	540	60	35
Capital goods	..	194	1,292	1,123
Export price index (1997=100)	..	71	76	78
Import price index (1997=100)	..	81	89	89
Terms of trade (1997=100)	..	88	86	87



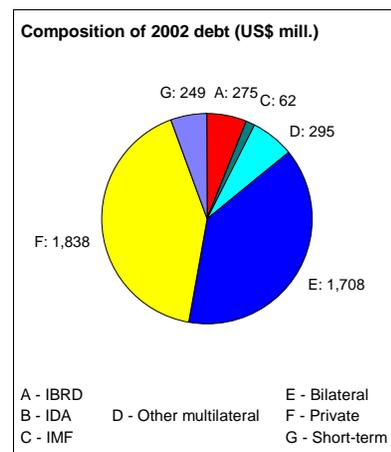
BALANCE of PAYMENTS

	1982	1992	2001	2002
BALANCE of PAYMENTS (US\$ millions)				
Exports of goods and services	3,201	2,965
Imports of goods and services	3,152	2,701
Resource balance	..	-227	49	264
Net income	..	-11	-205	-140
Net current transfers	43	98
Current account balance	..	-236	-113	222
Financing items (net)	..	766	97	-197
Changes in net reserves	..	-530	16	-25
Memo:				
Reserves including gold (US\$ millions)	..	526	1,212	1,215
Average official exchange rate (soun/US\$) ^{7/}	..	0.22	432.0	769.0



EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
EXTERNAL DEBT and RESOURCE FLOWS (US\$ millions)				
Total debt outstanding and disbursed	..	60	4,670	4,427
IBRD	..	0	237	275
IDA	..	0	0	0
Total debt service	..	5	840	718
IBRD	..	0	19	21
IDA	..	0	0	0
Composition of net resource flows				
Official grants	..	0	40	43
Official creditors	..	61	264	-49
Private creditors	..	0	-15	-113
Foreign direct investment	..	9	83	65
Portfolio equity	..	0	0	0
World Bank program				
Commitments	..	0	36	40
Disbursements	..	0	40	31
Principal repayments	..	0	8	9
Net flows	..	0	32	22
Interest payments	..	0	11	12
Net transfers	..	0	21	10



^{5/} According to official statistics. Alternative IMF estimates indicate higher consumer price inflation.

^{6/} Excluding extrabudgetary funds. With the extrabudgetary funds, government revenue and expenditure would both increase by 8 to 9% of GDP.

^{7/} Uzbekistan does not have current account convertibility and an informal parallel market for foreign exchange exists alongside the official one. The exchange rate in the parallel market averaged 1.308 soums per US\$ in 2002.

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