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Strengthening Trade and Economic Ties between Afghanistan and Central Asia

Session I: Reviving and Rebalancing Economic Growth: Review of Cross-Border Connectivity Initiatives and Priority Policy Reforms

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EXECUTIVE SUMMARY

A. AFGHANISTAN'S ECONOMIC PROSPECTS AND THE NEED FOR REGIONAL INTEGRATION

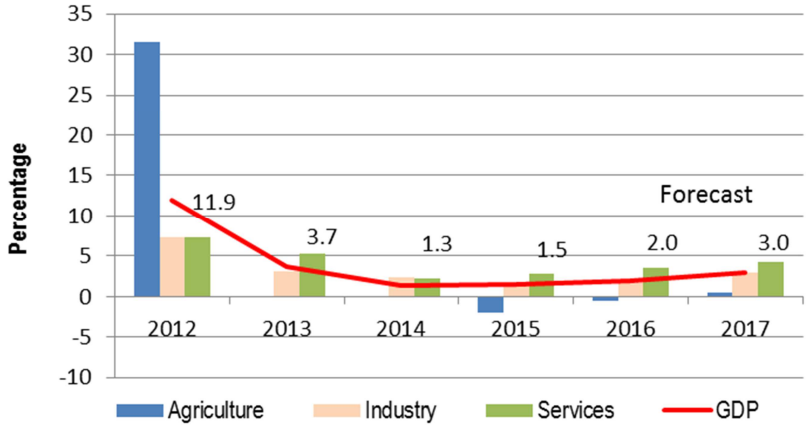
Afghanistan is undergoing an economic and political transition after decades of conflict. A key component in this process involves harnessing its geographic position to increase economic gains for the country. An enhanced regional integration and promotion of Afghanistan's trade are the pillars of country's development. Increasing integration can bring numerous benefits starting with better employment opportunities leading to greater household purchasing power. Broader and deeper linkages with trading partners can also play a role in facilitating economic diversification, thereby enhancing resilience to economic and other shocks that the country is subject to.

Afghanistan has made a significant developmental achievement over the last decade as its per capita income increased from $220 in 2004, to a peak of $730 in 2013 and then settled at $630 in 2015 (World Bank Development Indicators, 2016).[1] Despite this, Afghanistan is still one of the poorest least developed countries in the Asia-Pacific region. Factors such as the sustained warfare in the country since 2004 have contributed to challenging socio-economic issues. With the withdrawal of foreign security forces followed by a decline in donor funding, the country's economy has experienced a negative impact.

Economic growth in 2015 was estimated at 1.5%, slightly higher than the previous year and a steep fall from 11.9% in 2012. For 2016 and 2017 GDP growth is expected to be 2.0% and 3.0% respectively (figure A) (ADB, 2016).[2] It is expected that the formation of a new government can provide the requisite political stability and environment for the growth in industrial and services production.

The World Bank estimates that growth—after the transition to Afghan control of security—will be around 2.8% a year under the baseline scenario in the period 2016-2018.[3] This is a significant drop from the 9.4% average growth seen in 2003-2012, a period underpinned by donor assistance and security spending (World Bank Global Economic Prospects, 2016).

Figure A: Afghanistan's GDP growth, 2012-2017



[1] The data from Central Statistics Organization show a rise of GDP per capita from $281 in 2005 to the peak at $780 in 2012 and a level of $747 in 2014 (according to data published in Invest in Afghanistan, Brief version, 2016).

[2] Again, estimates and forecasts from other sources differ slightly. For instance, Invest in Afghanistan cites the World Bank estimating growth in 2015 at 2.5% and forecasting 5.00% growth in 2016.

[3] Forecast: 2016 (1.9%), 2017 (2.9%), 2018 (3.6%)

Despite being landlocked, Afghanistan has the potential to use its unique geographical position as a 'land bridge' linking Central and South Asia, whilst making use of its substantial natural resources. A successful regional framework can deliver on the region's trade, transport, and transit potential and provide specific benefits such as:

- economies of scale to increase local supply capacity and improve access to markets;
- integrated or harmonized treatment of trans-boundary issues such as trade, trade facilitation, regulatory frameworks and policies, and regional infrastructure; and
- management of shared natural resources.

Regional integration is a key part of managing a successful transition in Afghanistan; it promotes increased trade and connectivity within the region, creates links across the region to external markets and also enables broader integration with large regional markets and the global economy.

At present, Afghanistan's trade capability is hindered by issues such as:

- Large and longstanding trade deficits; Afghanistan's total merchandise exports were $470 million in 2015, only a small fraction of the value of imports which reached $5.6 billion. Afghanistan depends heavily on imports of fuels, food staples, processed materials, and manufactured goods, largely due to a lack of domestic infrastructure and processing facilities.[4] Exports, though low in overall volume, have grown in recent years, except in 2015. Merchandise exports fell in 2015 by 17.5%, after it grew at 10% in 2014 and 20% in 2013). Imports feel even more steeply by 27.9% in 2015, following a 10% contraction in 2014 in the aftermath of sudden hike in 2013 of 37% (WITS, 2014). The largest exported categories of goods included vegetable products; textiles; mineral products; briquettes; metals consisting almost exclusively of scrap iron and animal hides.
- Compounding this issue is the fact that trade remains highly concentrated in terms of both partners and products. According to WTO figures, Pakistan is Afghanistan's largest export destination by a big margin, accounting for 33% of exports in 2014 (Table A). It is also the second highest source of imports for the country, accounting for 15.4%, after having been overtaken by the Islamic Republic of Iran which, in 2014, was the highest source of imports for Afghanistan at 21.2%. It is important to note, however, that Pakistan's likely true share of both is higher as large shares of trade are not adequately recorded. As Afghanistan's major transit route to the sea, it is natural for Pakistan to play an important role in the country's trade. This makes the resolution of transit issues through Pakistan of critical importance for Afghanistan's trade strategy for the coming years. In contrast, exports to powerhouses like the European Union and China are considerably lower at 7.8% and 6.2% respectively.

- Levels of foreign direct investment (FDI) have significantly decreased despite considerable opportunities in the natural resources sector. Afghanistan at present receives relatively small amounts of foreign direct investment. Total greenfield FDI inflows for the period 2009-2015 were recorded at around $1.2 billion (FDi Markets, 2014). Over the period between 2009 and 2015, the United Arab Emirates became the largest source of inward FDI –accounting for $512 million. This was followed by China

[4] Observer of Economic Complexity, 2014. Its top imports are Refined Petroleum ($537M), Peat ($454M), Raw Sugar ($445M), Wheat Flours ($413M) and Ornamental Trimmings ($272M).

who invested $300 million -accounting for over three quarters of the total FDI figure to date. Chinese investment was primarily concentrated in natural resources, such as copper and gold. There is no record of Central Asian economies providing any inward greenfield FDI to Afghanistan over this period. Uncertainties over the legal regime governing resource extraction, as well as security concerns, appear to be delaying planned investment projects although the situation might be improving in the aftermath of establishment of the Afghanistan Investment Support Agency (AISA).

Table A: Afghanistan's exports and imports by major partner, 2014

Exports				Imports			
WTO data		Government of Afghanistan data		WTO data		Government of Afghanistan data	
Country	Share in %	Country	Share in %	Country	Share in %	Country	Share in %
Pakistan	33	Pakistan	30.7	Iran	19.4	Pakistan	21.2
India	28	India	19.4	Pakistan	17.3	Islamic Republic of Iran	15.2
Islamic Republic of Iran	5.8	United Arab Emirates	13.2	China	13.5	China	14.1
European Union	3	Islamic Republic of Iran	7.8	Japan	3.4	Turkmenistan	9.3
China	2.7	Iraq	6.2	India	1.4	Uzbekistan	4.8
Unspecified	27.3	China	3.6	Unspecified	44.3	Japan	4.8

Source: WTO, 2014; Government of Afghanistan, 2014.

B. ECONOMIC LINKAGES BETWEEN AFGHANISTAN AND CENTRAL ASIA AND REGIONAL COOPERATION

At present, trade linkages between Afghanistan and Central Asian countries are weak, however, there is potential for further development in sectors like energy trade, transit trade and informal border trade.

Afghanistan and the Central Asian countries face common challenges due in part to their landlocked geographic position and their need for greater economic diversification. The region is also far from major economic centers, and has relatively small populations and market sizes, underdeveloped infrastructure and political and security challenges that pose risks for human development (Mogilevskii, 2012).

Afghanistan is linked by a common border with 3 other Central Asian countries -Turkmenistan, Uzbekistan and Tajikistan – however, trade linkages remain extremely limited. Currently, there is no data recording any cross-border investment between these countries and Afghanistan.

Overall, Afghanistan imports considerably more from Central Asia than it exports in return. In 2011, the last year for which comprehensive bilateral data is available, less than 3% of Afghanistan's exports (worth $10.4 million) went to Central Asia with Tajikistan and Turkmenistan being the only economies to see imports of notable size. In contrast, roughly a quarter of Afghanistan's imports came from Central Asia, principally Uzbekistan (worth $1.64 billion).

In terms of imported products, energy tends to dominate. Afghanistan's largest import from four of the five Central Asian economies is refined petroleum. Petroleum gas is another major import category from Central Asia. In 2011, Uzbekistan was the largest source of imports with total imports worth ($732 million) followed by Turkmenistan ($353 million), Kazakhstan ($333 million), and Tajikistan ($226 million). No data was available for Kyrgyzstan in that year. WTO figures suggest that agricultural products such as potatoes, grapes, and citrus fruits account for the bulk of exports, alongside other products such as curbstones.

In addition to 'standard' trade, wherein data on the type of good, its origin, quantity, and price are recorded by border authorities, border trade, in which small merchants and traders cross borders to buy or sell generally small volumes of products, is also common in Central Asia and between Afghanistan and its neighbours. Such trade can have major positive effects on the livelihood of communities living near the border areas. This type of trade is difficult to record because of its informal. It is believed that 40% of Afghanistan's total trade by value is unrecorded (World Bank, 2012).

A study of Afghanistan's border trade with its Central Asian neighbours found that the bulk of trade with Uzbekistan and Tajikistan passes through only two crossing points: Hairatan and Sher Khan Bandar respectively. In general, border trading was found to be underdeveloped on account of several obstacles to the free flow of people and goods.

Regional energy trade also has considerable potential and can help both: (i) provide Afghanistan with electricity to meet acute domestic shortages and (ii) deliver benefits from Afghanistan's role as a 'bridge' linking the energy reserves of Central Asia with the growing demand of South Asia. Major energy projects like the Turkmenistan, Afghanistan, Pakistan and India Natural Gas Pipeline (TAPI) and the Central Asia – South Asia Electricity Transmission and Trade Project (CASA-1000) will help build regional connectivity in this area.

A number of major regional frameworks currently support regional cooperation between Afghanistan and Central Asia. These include: SPECA (the UN Special Program for Economies of Central Asia); RECCA (Regional Economic Cooperation Conference on Afghanistan), and CAREC (Central Asia Regional Economic Cooperation Program). There is also RECI (Regional Economic Cooperation and Integration), an initiative led by ESCAP but requested by its member States to enhance pan-Asia and Pacific cooperation.

United Nations Special Programme for the Economies of Central Asia (SPECA)

SPECA was launched in 1998 to strengthen sub regional cooperation amongst countries in Central Asia and to support their integration into the world economy. Current members of SPECA are: Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. SPECA is supported by both UNECE and ESCAP, in recognition of the sub-region's importance as a transport hub between Europe and Asia. SPECA provides a platform for annual Economic Forums and Thematic Working Groups, in which in 2015 it was agreed SPECA will serve as a cooperative mechanism to enhance subregional cooperation. Afghanistan became SPECA's latest member in 2005 and has benefitted from SPECA's infrastructure development initiatives, such as the Almaty Declaration of Land-Locked and Transit Developing Countries of 2003. SPECA strengths have been especially marked in the improvement of border-crossing procedures and transport data harmonization in the region. In December 2014, the SPECA Economic Forum took place in Ashgabat

under the chairmanship of Afghanistan. The theme of the conference was "Improving Connectivity: a key contribution of SPECA to the success of the Transformation Decade of Afghanistan."

Regional Economic Cooperation Conference for Afghanistan (RECCA)

RECCA serves as the coordination body for economic activities related to Afghanistan. The first RECCA took place in Kabul in 2005 and since then has been followed by four further conferences. The aim of RECCA is to achieve regional cooperation in the promotion of shared economic interests as well as better coordination of political and security initiatives in the region. RECCA has focused on expansion of infrastructure (transport and energy), development of human resources (education and training) and advancement of regional economic linkages (trade and investment). Within the framework of RECCA, Afghanistan completed a range of joint development projects with the governments of countries of Central Asia as well as expounding priorities and strategies for further economic activity in the region. In its objectives, RECCA acts as an extension of Afghanistan National Development Strategy and has channeled capital to facilitate the expansion of railroad networks, economic corridors and electricity transmission lines, connecting Afghanistan with Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. RECCA V, the latest conference that took place in 2012, laid down foundations for the "transformation decade" (2015-2024), during which Afghanistan's fiscal sustainability and strengthened economic links with its neighbours will permit it to become a well-integrated part of Central Asia, a primary destination for foreign direct investment and an export-oriented economy.

Central Asia Regional Economic Cooperation (CAREC)

CAREC was established in 1997, with China, Kazakhstan, Kyrgyzstan and Uzbekistan being the founding members, and since then has expanded its membership to 10 countries to include Afghanistan, Azerbaijan, Mongolia, Pakistan, Tajikistan and Turkmenistan. CAREC is additionally supported by six multilateral development institutions (ADB, EBRD, IMF, IDB, UNDP, and WB). The purpose of the organization is to cooperate on economic activities in Central Asia. 146 CAREC-related projects have been implemented so far in the areas of transport, trade facilitation, trade policy and energy, within the total budget of $22.4 billion. Since Afghanistan joined CAREC in 2005, it has received $2.6 billion in investment into 25 projects in the areas of trade, transport and energy, with 17 CAREC projects still ongoing. CAREC has achieved substantial progress in modernizing Afghanistan's customs processing, which resulted in faster transit of goods and services and strengthened capacity of customs institutions in Afghanistan. The organization was also instrumental in implementing the Regional Power Transmission Interconnection Project, whereby double-circuit transmission lines were developed between Afghanistan, Tajikistan and Turkmenistan. In 2013, the Trade Policy Strategic Action Plan for 2013-2017 was unveiled in Astana, in which plans for implementation of "Second Customs Reform and Trade Facilitation Project" for Afghanistan were outlined, which will result in the development of automated customs information systems and integrated border management for Afghanistan and is expected to boost overland trade with its neighbours in Central Asia. CAREC is also providing knowledge support to Afghanistan's Working Group negotiating accession to the WTO.

Regional Economic Cooperation and Integration (RECI)

Economically, RECI presents great economic value and intra-regional trade has great potential under RECI and this would be further enhanced with countries actively working towards decreasing trade costs and other barriers to trade. Foreign direct investment (FDI) which brings about skills and

technology transfer as well as infrastructure development finance can also play a part in promoting the development of countries in the region.

Afghanistan and Central Asia can benefit from a well-integrated transport network under RECI in order to increase economic interactions and improvements in general physical infrastructures will also go a long way towards addressing the institutional barriers to trade across borders. These include but are not limited to: inconsistent and complex border crossing procedures, restrictions placed on the entry of vehicles, and even issues such as the functions and effectiveness of border personnel.

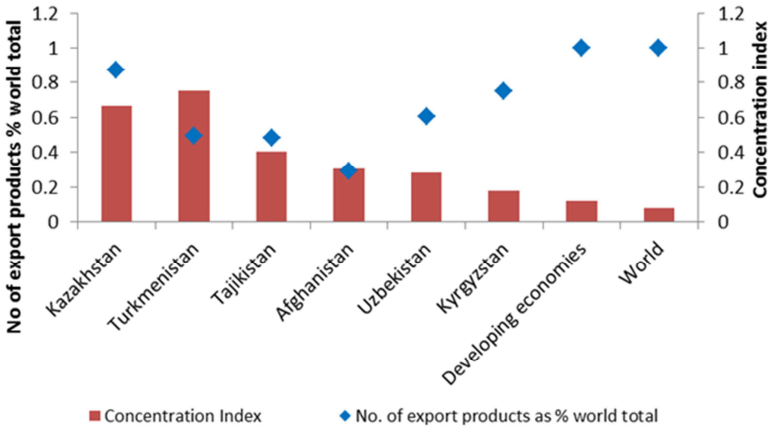
RECI encourages all subregions to improve energy security by exploiting the geographical proximity between countries to harness the varying potential for energy resources in an integrative manner. This can facilitate regional integration by fostering economic growth; optimizing resource allocation within the region; and improving economic and technical efficiencies. It is also important for the region to manage its shared natural resources efficiently as environmental issues can have a cross-border impact. The region can benefit from a strategy to address this "shared vulnerability" and mitigate negative environmental and socioeconomic impacts which might cross national borders.

C. IDENTIFYING AFGHANISTAN'S EXPORT POTENTIAL

Afghanistan and Central Asian economies are highly dependent on the export of a few commodities usually with low domestic value added. Export diversification into a wider—and more complex—number of products can help deliver more balanced growth. Diversification is, however, path dependent and will be influenced by existing capabilities.

The commodity concentration index, which reflects how both exports and imports are concentrated on a few products, is considerably higher in Afghanistan and the Central Asian economies than the developing country average (figure B).

Figure B: Diversification indices of merchandise exports and imports, 2014



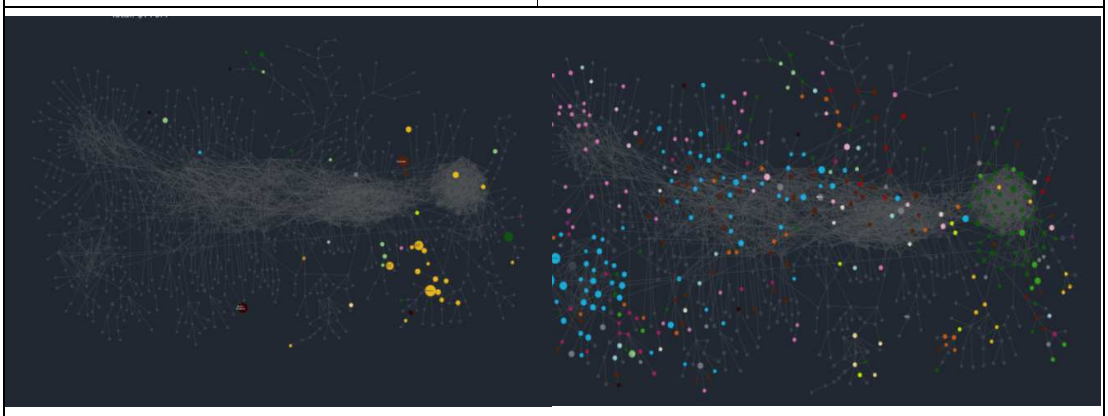
Source: UNCTADstat database. Accessed August 2016

Countries mainly dependent on earnings from primary sector can suffer particular disadvantages. For instance, the low income elasticity of world demand for primary commodities can lead to falling export revenues which can be exacerbated by historically downward trends in primary commodities' prices relative to manufactures. Further, primary commodity production for exports often has weak linkages to other sectors leading to little technological spill overs or learning.

Diversification is path dependent and does not occur at random. Instead, countries are likely to diversify into sectors that are related with their existing production base and product mix. Private firms are generally best able to spot export opportunities for expansion into new products. However, analysis of a country's competitiveness can help understand the blockages that may be preventing exports and prompt public intervention where there are public, market or information failures.

Afghanistan's product space shows that production is limited to a few products and that these are generally to the periphery of the global product space (figure C). This means that there are fewer 'nearby' products than in the dense centre of the product space; future diversification is thus harder. In contrast, as expected, the product space of China shows a much wider range of product types and more production of products which are closely linked with numerous other products.

Figure C: The 'product space' of Afghanistan and China compared (2014)

Afghanistan	**China**
	

Source: MIT Atlas of Economic Complexity (2014)

In and of itself, product diversification is important, however, it is also important to diversify into products which have a greater complexity than the existing production. 'Complex' products are defined as those produced by more diversified (generally higher income) economies. Therefore, it can be assumed that they embody a more sophisticated set of production capabilities. Because learning to produce these products entails the acquisition of new capabilities it opens the possibility of further new product production and diversification.

ESCAP 2014 and 2015 reports provided a detailed account of export products with potential to increase Afghanistan's exports in general and to Central Asia. Products identified include iron and steel based items such as flat rolled metals and wires; wood or paper based items like fibreboard and sacks; and some apparel items like gloves. Given the small size of the Central Asian economies

(and relatively small basket of products), it is unsurprising that the total export potential for identified products was considerably less than in the top five markets globally (see ESCAP 2015 for details). Of the Central Asian economies Uzbekistan is deemed to have the highest total potential for new Afghan products with an export potential value of $71 million.

To supplement the analysis that was undertaken in ESCAP 2014 and 2015 reports, this paper calculates an index of trade complementarity[5]. This index can provide useful information on prospects for intraregional trade in that it shows how well the structures of a country's imports and exports match (table B). It also enables values for countries considering the formation of a regional trade agreement to be compared with others that have formed or tried to form similar arrangements. Given that the value of the index ranges between 30 and mid-40, it indicates that there is no close match between what Afghanistan exports and what the Central Asian countries imports (or vice versa). Therefore, their future trade and investment integration will greatly hinge on their ability to diversify production and trade structures for a better mutual fit.

Table B. Trade complementarity between Afghanistan and Central Asian economies

	2012	2013	2014	2015
Kazakhstan	…	39.32	39.88	35.81
Kyrgyzstan	44.26	41.25	43.41	39.78
Tajikistan	…	…	42.57	35.42
Turkmenistan	40.7	36.96	39.39	31.33
Uzbekistan	42.81	39.58	41.86	35.11

Source: Downloaded using WITS.

D. TARIFF AND NON-TARIFF BARRIERS TO TRADE

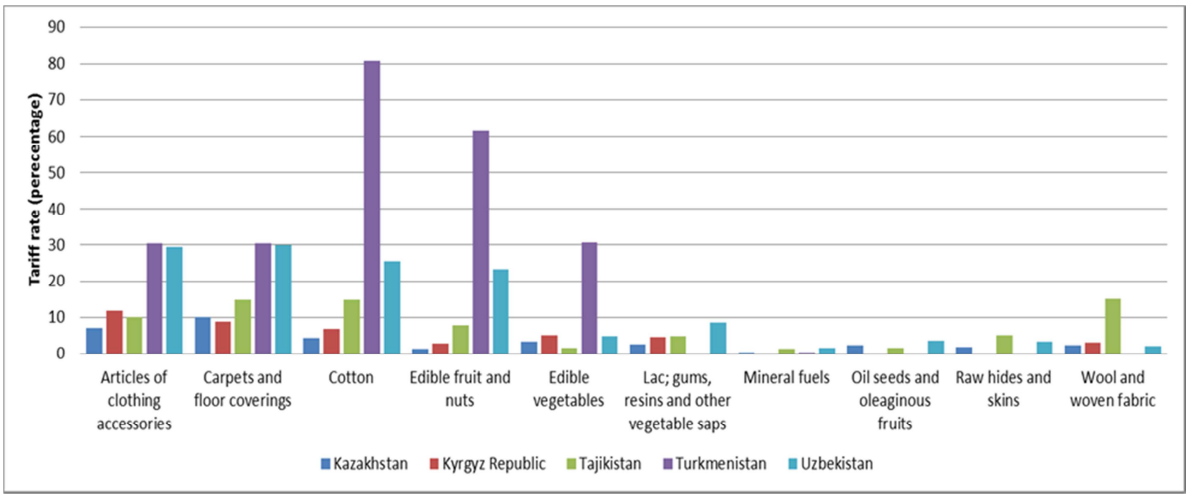
Average applied tariffs are fairly low across Afghanistan and Central Asia, however, high tariffs are applied on some key Afghan export items with potential deterrent effects on trade.

Average applied tariff rates are generally low in most Central Asian economies. Only Uzbekistan has an average applied tariff rate above 10%. However, some of Afghanistan's top export products do face higher than average tariffs in some Central Asian economies (figure D). Notably, cotton; fruit; vegetables; and carpets all face tariffs between 20% and 80% in Turkmenistan and Uzbekistan. Preferential access for Afghan traders to these markets might help encourage trade in these product sectors which are of considerable potential.

Afghanistan could benefit from the preferential market access that the Russia Federation offers to LDCs through its Generalized System of Preferences, launched in 2012. This offers Duty-Free Quota-Free access to a range of products from LDCs. At present the scheme covers 38.1% of tariff lines and excludes some products of interest to Afghanistan, including petroleum products, copper, iron ores, articles of leather, articles of apparel and clothing. There is scope for thus considering expanding the scheme to cover an even wider range of relevant products.

[5] The index of trade complementarity (TC) between countries k and j is defined as: TCij = 100(1 – sum(|mik – xij| / 2)) where xij is the share of good i in global exports of country j and mik is the share of good i in all imports of country k. The index is zero when no goods are exported by one country or imported by the other and 100 when the export and import shares exactly match. Source: WITS website.

Figure D: Tariffs imposed on Afghanistan's major export items by Central Asian partners



Source: TRAINS via WITS accessed in 2015.

Non-tariff measures are also an obstacle to intra-regional trade; in particular Sanitary and Phytosanitary Measures are problematic because of inefficient or inadequate inspection regimes and facilities at borders

Non-tariff measures include a wide range of policies, regulations and standards impacting trade. Data on the existence and impact of non-tariff measures on trade is harder to obtain than in the case of tariffs but their consequences can often be greater.

'Technical' non-tariff measures such as technical barriers to trade (TBTs) and sanitary and phytosantary (SPS) standards can be particularly disadvantageous for developing economies in general, and least developed countries like Afghanistan in particular.

NTMs are also frequently applied to those products which are of particular importance for developing economies like Afghanistan. For instance, food and agricultural goods—often sectors where developing countries have a comparative advantage—are some of the areas where NTMs—especially SPS measures—are the most prevalent.

There is some evidence that Afghan agricultural exports have been struggling to meet SPS standards abroad, including those of the Central Asia countries, or are suffering delays at the border caused by inefficient or inadequate inspection regimes and facilities.

This undermines the ability of export-oriented agriculture industries to supply their produce to the region. Indeed, trade across the region as a whole suffers from a number of impediments resulting from inefficient, outdated or uncoordinated SPS systems.

E. INFRASTRUCTURE AND TRADE FACILITATION

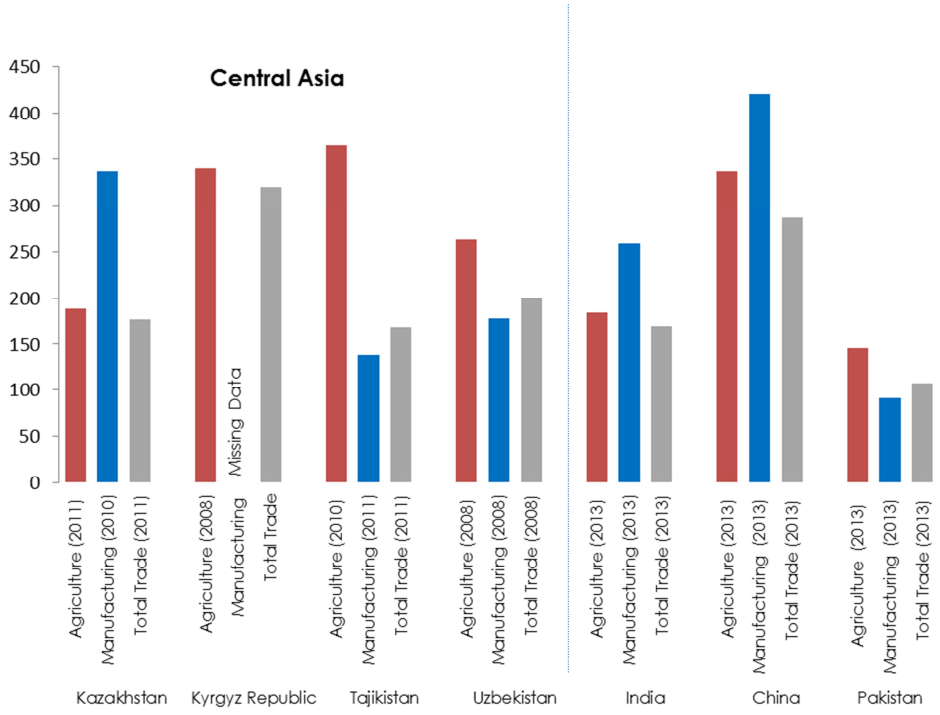
Infrastructure constraints, in particular the lack of road and rail connections linking Afghanistan with neighbouring countries continue to be a major obstacle to trade and contribute to high trade costs.

As a landlocked country, Afghanistan is dependent on road and rail links to transport or import good to and from neighbouring countries. However, lack of infrastructure prevents Afghanistan from reaching its trade potential. The mountainous nature of the country makes rail connectivity costly

and difficult; and inadequate road connectivity between large business centres and consumers and producers of raw materials at the towns and villages, remains a major challenge to doing business in Afghanistan. In 2014, the World Bank found that around 30% of firms in Afghanistan consider transportation a major constraint.

As a result, trade costs between Afghanistan and Central Asia, are extremely high: costs estimated as tariff ('ad valorem') equivalents are over 150% for all Central Asian partners for which data is available (figure E).

Figure E: Trade costs between Afghanistan and Central Asia in comparison with regional partners (Ad Valorem Equivalents)



Source: ESCAP - World Bank Trade Costs Database (Note: No data available for Turkmenistan)

Afghanistan currently has a road network of approximately 135,000 km (AIMS, 2014). Data suggests that around 70% of the interprovincial and inter-district roads remain in a poor state (ADB, 2014). Given the country's topography, a circular road network close to the borders is a priority for linking the country internally – this has been improved in recent years. Radial branches from this highway then link to neighboring countries. With the completion of the stretch between Herat and Qaiser (300 km), the road circle will be fully in place. The recently completed road radial from Zaranj-Delaram links the circular road with Iran and its port at Chabahar.

Given that the biggest share of Afghan trade is with Pakistan, transit links are crucial both for port access and to provide access to the Indian market. Afghanistan and Pakistan have concluded a transit agreement (APTTA). However, a major Afghan concern remains that implementation is lagging; cargo is often delayed at Karachi; and access to India is not permitted.

Land transit for trucks from India seeking to reach Afghanistan is a topic of discussion between Pakistan and India, at present though Indian trucks are not able to reach Afghanistan via Pakistan. Afghanistan also has trade and transit with Uzbekistan and Turkmenistan. A transit and motor

vehicle agreement, CBTA, was signed in early 2013, between Afghanistan, Tajikistan and Kyrgyzstan, in the same period a motor vehicle and tanker movement agreement was signed with Iran.

Historically, Afghanistan never developed a railway network of any scale. Afghanistan was also not one of the countries that negotiated and adopted the Intergovernmental Agreement on the Trans-Asian Railway Network. Currently, several initiatives are gradually changing the situation; future rail development could play a significant role in linking Afghanistan with other landlocked countries in Central Asia. One link has already been completed: in 2010 a 75-km single-track rail link was completed from Khairaton at the border with Uzbekistan to Mazar-i-Sharif. Iran is also now constructing a 205-km link between Sangan in Eastern Iran to Herat.

Trade facilitation, including more efficient border processes, is also needed

Facilitating trade at border crossing points is as important as the physical infrastructure that connects border crossings with cities and hinterlands. At present Afghanistan has relatively few sizeable border crossing points with Central Asian neighbours.

One of the most important crossings is Hairatan located at the Uzbek border as it is the only border crossing with efficient transport links with much of Central Asia and modern customs facilities. Before completion of the bridge at Sher Khan Bandar, Tajikistan, in 2007, Hairatan was the only major route to Central Asia. The Uzbek city of Termez, located a few kilometers from Hairatan, has railroad connections with both Dushanbe, the capital of Tajikistan, and Tashkent, the capital of Uzbekistan. Goods moving through the Hairatan BCP are mainly industrial raw materials (for example, fuels, glass, and iron bars), shipped to Afghanistan, and limited quantities of raisins shipped to Uzbekistan.

F. BUSINESS SECTOR ENVIRONMENT AND CAPACITY

The overall business environment needs substantial improvement

In 2016, Afghanistan ranked 177th out of 189 countries in the World Bank's Ease of Doing Business rankings, which is the lowest position in Asia-Pacific region. The country also dropped 10 places and now ranks as the 34th easiest country to start a business. In terms of access to credit, Afghanistan now ranks 89th thus access to finance is a major constraint; not least as many SMEs lack access to require collateral. Despite this, however, in other respects sustaining and profiting from a business in Afghanistan remains a challenge. The business environment in Afghanistan thus requires significant development and introduction of suitable legislation, particularly aiming at promotion of SMEs. Despite, employing 75% of Afghanistan's workforce and contributing around 50% to the country's GDP (Asia Foundation, 2013), SMEs in Afghanistan are facing various challenges.

The most onerous issues for Afghanistan's business environment are: poor enforcement of contracts, no protection of minority investors, lack of functioning property registration system at a national level and difficulties in obtaining construction permits.

Women-owned businesses can play a role, not only in empowering women but also in raising productivity more broadly. Gender-based asset inequality affects resource allocation within the household and labor productivity. In 2015, the World Bank found over 20 legal barriers which impede effective access to for women to form and sustain businesses in Afghanistan. Women's entrepreneurship can make a particularly strong contribution to the economic well-being of the family and communities, poverty reduction and women's empowerment, thus contributing to the

resources of the household, the pattern of consumption tends to be more child-focused and oriented to meeting basic needs.

The One Village One Product movement, which promotes rural production of products embodying traditional knowledge—for instance, handicrafts—for national and international sale could potentially be applied to Afghanistan. The movement has had considerable success in other countries including Thailand.

G. RECOMMENDATIONS AND PRIORITIES FOR REFORM

Realizing the potential for regional trade and integration requires action on: improving trade policies; facilitating trade and transit; investing in infrastructure and connectivity; creating the right regional business environment; and strengthening regional economic institutions.

This paper and the previous report (ESCAP, 2015) have documented the limited scale of existing trade, investment and infrastructure linkages between Afghanistan and Central Asia. However, there is also considerable potential for greater trade in certain sectors, identified by ESCAP analysis. Expanded intra-regional exports can thus play a role in Afghanistan's wider strategy of economic development and diversification. Realizing this potential will require action across a number of areas. Our recommendations, based on the analysis in the report, and summarized in Table C, suggest five priority areas for action to reduce trade costs, increase and improve productive capacity and smooth across the border transactions involving goods, services, technology, capital and people:

- Improving trade policies.
- Facilitating trade and transit.
- Investing in infrastructure and connectivity.
- Creating the right regional business environment. and
- Strengthening regional economic cooperation.

Under each area we suggest some specific actions for focus and identify priorities for Afghanistan and its regional partners in Central Asia. Further detail on each proposal is elaborated in the paper.

Table C: Summary of recommendations

Theme	Areas for focus	Priorities for Afghanistan	Priorities for regional partners
IMPROVING TRADE POLICIES	**Tackling tariff barriers to current trade and export diversification**	- Open discussions with regional partners on mechanisms for reducing tariff barriers	- Enter discussions on means of improving Afghanistan's market access, including tariff liberalization on key products of interest
	Streamline non-tariff barriers, especially SPS	- Survey business to uncover critical NTM measures in partner countries which are impeding trade, in particular for agricultural products	- Improve NTM systems with risk-based approaches and modernize processes in line with WTO guidelines - Work with Afghanistan on improving laboratory infrastructure for product testing
	Deepen and	- Identify priority products	- Consider whether expanded or

	expand existing regional trade agreements	that would benefits from preferential access	deepened new regional trade agreements, for instance SAARC, would boost regional trade and economic prospects
FACILITATING TRADE AND TRANSIT	**Improve and expand APTTA**	- Work with Pakistan to improve APTTA including thorough addressing issues such as illegal smuggling And issues with implementation of APTTA in practice.	- Work with Afghanistan and Pakistan on the potential expansion of APTTA to Central Asia
	Improve efficiency of border processes	- Invest in training and facilities, including single window systems	- Consider cross-border ID cards, and risk-management systems, to ease flows at border crossing points
	Encourage border trade	- Establish joint task-forces with partners focused on easing problems related to non-standard border trade	- Work with Afghanistan including on simplifying visa processes for same day returns and easing movement of small traders
INVESTING IN INFRASTRUCTURE AND CONNECTIVITY	**Road and Rail**	- Prioritize investment in rail and road links to key center - Develop network of dry ports at key crossings	- Continue to engage in regional efforts, e.g. CAREC, to bring links to the Afghan border
	Energy	- Complete existing proposals on TAPI and CASA-1000 and build momentum towards further projects	- Review impediments to further energy linkages with Afghanistan and South Asia
CREATING THE RIGHT REGIONAL BUSINESS ENVIRONMENT	**Improving the business and investment climate and access to finance**	- Prioritize reforms to the business and investment climate, especially clarifying rules governing resource investments - Boost access to finance, particularly for SMEs	- Organize regional 'matchmaking' services for Central Asian and Afghan businesses - Consider regional approaches to capacity building for the private sector, for instance on how to meet standards and regulations
	Building regional business linkages	- Link Afghan Chambers of Commerce and other private sector representatives with counterparts elsewhere	- Establish regional private sector forum to feed in business perspectives to regional gatherings i.e. RECCA and SPECA
	Support Women-owned businesses	- Remove legal and financial restrictions on female entrepreneurs and women owned business - Use online platforms to help women-owned businesses connect with each other	- Create regional women's business network to share contacts and provide mutual support
	Develop local production capacity utilizing traditional knowledge	- Launch OVOP-style programme to develop rural productive capacity based on traditional skills	- Share experiences of rural development and production capacity building
STRENGTHENIN	**Accelerate**	- Give higher priority to	- Work on a robust national trade

G REGIONAL ECONOMIC COOPERATION	**existing areas of cooperation and jointly develop a single regional economic strategy**	regional integration efforts on promoting trade and identify areas that can most effectively be tackled through regional cooperation	strategy -Work on a joint regional economic strategy for Afghanistan and Central Asia targeted at improving trade flows, informed by the views of the private sector and other stakeholders

Annex

ESCAP'S TRADE CAPACITY BUILDING PROGRAMME IN AFGHANISTAN (2013-2016)

ESCAP recognizes a pressing need to assist least developed countries and landlocked developing countries better integrate into global and regional trade and value chains. In view of these needs, ESCAP designed a special programme of capacity building activities, entitled Bridging the Gap, to assist least developed countries and landlocked developing countries in the period 2013 – 2015. Three characteristics distinguish our approach. Our activities are:

- **Demand driven** – Actions in response to specific requests for assistance from members.
- **Individually tailored** - No countries face exactly the same challenges, or face the same institutional, regulatory, economic and social circumstances thus we tailor our advice, training and assistance to the unique needs of each country.
- **Broadly based** - ESCAP's areas of assistance cover the full range of trade and investment policies including: development of analytical tools; trade negotiations; trade facilitation; SME development; and improving the business environment.

For Afghanistan, the Ministry of Commerce and Industry (MoCI), requested the assistance of ESCAP in initiating and organizing training programs in trade and economic analysis[6] as well as training and advice to: broaden understanding of WTO accession commitments' implementation and other post-accession issues among MoCI's technical staff; assist in the development of an effective national trade strategy; and provide training and information on tools relevant for ongoing trade policymaking and implementation.

ESCAP followed up the above requests, after consulting with MoCI and identifying specific needs ESCAP has delivered the following:

- An advisory study on the potential benefits to Afghanistan available through preferential trade schemes available for LDCs,
- Guidance on international best practice in trade promotion as inputs into Afghanistan's 2014 Trade Promotion Strategy,
- A successful 2 week Fellowship placement with ESCAP experts to identify critical issues for Afghanistan around WTO accession,
- ESCAP's sub-regional office for South and South-West Asia (ESCAP-SSWA) delivered a series of Technical Capacity Building (TCB) workshops (to over 100 officials) to support Afghanistan's accession to the WTO, with the latest delivered in December 2014,[7]
- ESCAP-SSWA prepared a study on 'Doing Business with Afghanistan: Harnessing Afghanistan's Economic Potential,' which provides an overview of the business environment in Afghanistan,[8]
- Preparation of report "Afghanistan and central Asia: Strengthening trade and economic ties," ESCAP (2015),[9]
- Policy Dialogue of Post-Accession for Afghanistan, organized in partnership with the WTO, 11-16 July 2016 in Bangkok.

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[6] Letter from Deputy Minister for Trade, MoCI, 17 May 2014

[7] This programme began in 2012 and is being delivered in partnership with the International Trade Centre, Geneva.

[8] This study was prepared in collaboration with the Federation of Indian Chambers of Commerce).

[9] This report was prepared for Regional dialogue on "Strengthening Trade and Economic Ties between Afghanistan and Central Asia" organized in 2015 by ESCAP's SONCA in partnership with the Russian Federation.