POLICY NOTE

OPPORTUNITIES TO ENHANCE PAKISTAN-AFGHANISTAN TRADE AND REGIONAL INTEGRATION IN THE NEW POLITICAL CLIMATE

VIEWS FROM KP BUSINESSES

FOREWARD

I welcome this policy note on leveraging Khyber Pukhtunkhwa's potential for trade with Afghanistan and, through it, to Central Asian countries. Afghanistan is an important neighbour and trade partner for Khyber Pukhtunkhwa, contributing to the livelihoods of many people in Pakistan, particularly in Khyber Pukhtunkhwa. Similarly, Pakistan is a source of essential imported products for Afghanistan, especially food and medical supplies, which are quite important in the country's present circumstances.

There are several recommendations here that the Government of Khyber Pukhtunkhwa can initiate work on immediately, not least of which is establishing a multi-department committee with representation from all relevant government departments. Through this committee, the private sector can hear the issues on the ground regularly and coordinate to resolve them timely and effectively.

This policy brief is based on a public-private dialogue series, spearheaded by SEED in collaboration with the Sarhad Chambers of Commerce and Industries (SCCI). I would like to appreciate the effort and affirm my commitment to ensuring that the views articulated in the consultative sessions are heard, and those policy decisions are made with due consideration to the issues faced by our business community on the ground.

SHAHAB ALI SHAH
ADDITIONAL CHIEF SECRETARY,
KHYBER PAKHTUNKHWA

FOREWARD

The importance of trade to the economy of Khyber-Pakhtunkhwa cannot be understated. For over 4000 years trade has been the lifeblood of this region bridging the gap between the Caucuses and South-Central Asia to the larger subcontinent. With the advent of the nation-state, modern government, and its consequent geopolitical constraints, have come the challenges of regulatory impediments to free trade. It is in this context, the importance of initiatives taken by programs such as SEED, undertaken by the FCDO and ASI, must be lauded.

Afghanistan, by all accounts, is one of Pakistan's largest trading partners with almost $920 million in exports and around US$390 million in imports in 2020. Given the SCCIs' mandate to facilitate the growth of local businesses, the SCCI recognizes the unparalleled importance of trade with Afghanistan as an engine for economic growth in Khyber-Pakhtunkhwa.

Khyber-Pakhtunkhwa as a province shares a natural boundary with Afghanistan, and it plays to the province's strength to take advantage of its proximity to Afghanistan and remove existing obstacles for exports and value-adding imports for local businesses to make Khyber-Pakhtunkhwa a hub of regional economic activity.

This policy paper aptly identifies the current challenges and key areas for improvement that need to be overcome to realize the true potential of the Pak-Afghan trade. Indeed, the policy paper should as such be used as a blueprint by stakeholders within the government to address the barriers facing Pak-Afghan trade. I appreciate SEED's contributions to this draft and for their partnership, and I look forward to seeing the recommendations be enacted for the benefit of the Pak-Afghan trade.

HASNAIN KHURSHID

PRESIDENT, SARHAD CHAMBER OF
COMMERCE & INDUSTRY
(SCCI)

FOREWARD

This policy note on the Pakistan-Afghanistan bilateral trade comes at a critical time when Afghanistan is passing through a political transition. At this time, trade with Afghanistan takes on not just a commercial angle from the perspective of businesses in Pakistan, but also a humanitarian angle for the Afghan people who depend on Pakistan to a large extent for imports of essential items.

The note is based on a consultative session with key stakeholders from the private sector, including the province's main traders and industrialists, as well as both the federal and provincial government including Customs, the FIA, the NLC, among various other departments. It is the first of three policy notes under 'Khyber Pakhtunkhwa Business Voice', a joint initiative of Sustainable Energy and Economic Development (SEED) and Sarhad Chambers of Commerce and Industry (SCCI). Khyber-Pakhtunkhwa Business Voice aims to bring the voice of Khyber Pakhtunkhwa's businesses to the Government of KP through a series of business perception surveys and policy notes based on consultative sessions with Khyber-Pakhtunkhwa's businesses.

The brief investigates opportunities to enhance the Pak-Afghan trade and foster further regional integration. It provides recommendations to relieve the impediments to trade that are creating losses at the border for both Afghans and Pakistanis, keeping bilateral trade from reaching its true potential. SEED is committed to supporting the Government of Khyber-Pakhtunkhwa, business chambers, and enterprises in Khyber Pakhtunkhwa to promote economic growth in the province. I hope that the recommendations made in this brief will be useful for all the stakeholders.

Omar Mukhtar Khan

DR. OMAR MUKHTAR KHAN

TEAM LEADER, SUSTAINABLE ENERGY & ECONOMIC DEVELOPMENT (SEED) PROGRAMME

POLICY BRIEF

OPPORTUNITIES TO ENHANCE PAKISTAN-AFGHANISTAN TRADE AND REGIONAL INTEGRATION IN THE NEW POLITICAL CLIMATE

VIEWS FROM KP BUSINESSES

Figure 1: The Durand Line Between Afghanistan and Pakistan

Abstract: Despite facing significant security and geopolitical challenges over the past several decades, the two border-sharing neighbours are intrinsically linked to one another in terms of determining mutually beneficial development outcomes. Pakistan has been an important trade partner for Afghanistan, at one time being the market's biggest exporter. With US withdrawal from Afghanistan and the formation of a new government in the country, Pakistan's Prime Minister Imran Khan has already opened dialogue with the new leadership - a vital initiative toward stability in Afghanistan that could benefit not only both countries and their people but also regional peace.

In that context, the focus must shift toward improving trade and economic ties between the countries, which will not only help rebuild Afghanistan but also carries enormous economic gains for both countries through bilateral integration and enhanced regional connectivity. Undeniably, improved economic ties with Afghanistan and leveraging the country's connectivity to Central Asia, coupled with the already massive economic potential of CPEC, presents unique opportunities for Pakistan in making it a truly integrated regional trade corridor.

This policy brief a) examines historical patterns of bilateral trade between Pakistan and Afghanistan, contextualising it with the political and economic developments of both countries b) documents long-running and current obstacles to bilateral trade from the perspective of Pakistani traders, clearing agents, and exporters c) identifies product lines where trade can be expanded d) suggests preliminary measures to reduce trade barriers to enhance bilateral trade.

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HISTORICAL PERSPECTIVE: TRADE WITH AFGHANISTAN

Pakistan and Afghanistan share a porous border spanning 2,640 kilometres and are connected not just through the flow of goods and people, but also through intersecting security and regional connectivity interests. A strong trade partnership, which includes bilateral trade and facilitation of regional connectivity for each other, hinges on political stability in Afghanistan. In addition, the trade partnership can be strengthened through a reduction in the significant barriers to trade that have hindered growth on both sides of the border.

A quick look at trade data[1] suggests that Pakistan has always been a prominent trade partner for Afghanistan, a key export market for Afghan goods, a major supplying market for vital commodities to Afghan consumers whilst also providing Afghan traders access to Pakistan's borders via which they export to many different markets abroad.

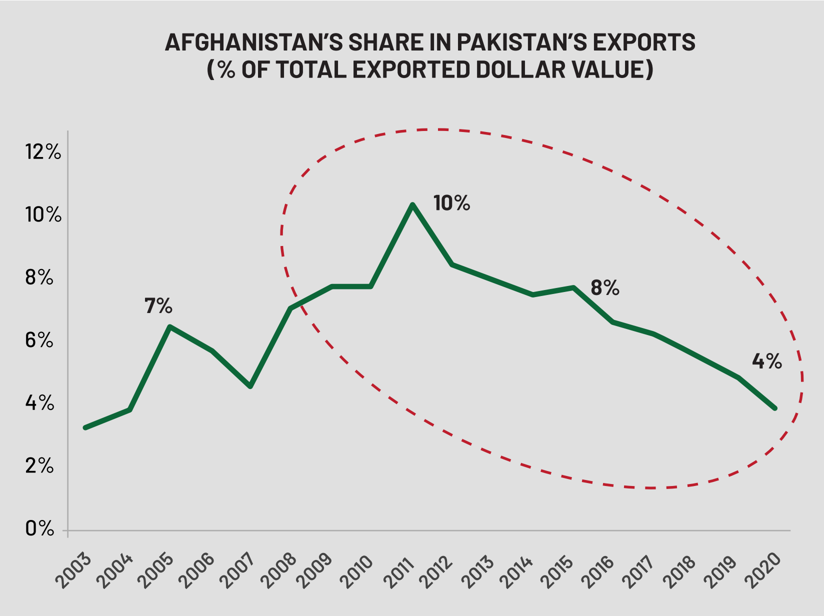

Figure 2: Pakistan's Exports to Afghanistan (Share of Total PK Exports)

However, there is a clear falling trend in most trade indicators. Pakistan's exports to Afghanistan have fallen both in dollar terms and as a share of Pakistan's total exports. In 2020, Pakistan's exports fell as low as $870 million from $2.5 billion in 2011. This is also evident when seen as a share of Pakistan's total exports (Figure 2), which shows a steady decline. Afghanistan now represents under 5% of Pakistan's exports. Consultations with various stakeholders suggest this share has fallen even further in 2021 due to the ongoing political transition.

There are multiple reasons for the steady decline in Pakistan's exports to Afghanistan. Not only has the political situation between the two countries deteriorated, often resulting in border closures, but Pakistani exports are also subject to implicit non-tariff barriers as well as consistent competition from India, China, Iran, and other countries as each vies for a share in the Afghan market.

As Figure 3 shows, China and Iran have gained significant ground in terms of share of Afghanistan's imports, while Pakistan (along with Uzbekistan) has lost market share.

Between 2012-19, Pakistan's market share in the Afghan market has gone down by 9 percentage points, while Iran, China, and India have gained 5, 8, and 3 percentage points, respectively. Notably, two other countries, Kazakhstan and Malaysia, have also gained market share during this time which shows that other countries have been finding welcoming market access in Afghanistan, and concentration in Afghan imports from the perspective of point of origin has reduced over the years.

[1] This data is from International Trade Center (ITC) Trade Map. There may be some reporting discrepancies between this and other sources. For the sake of consistency, in this report, we have sourced most data from ITC.

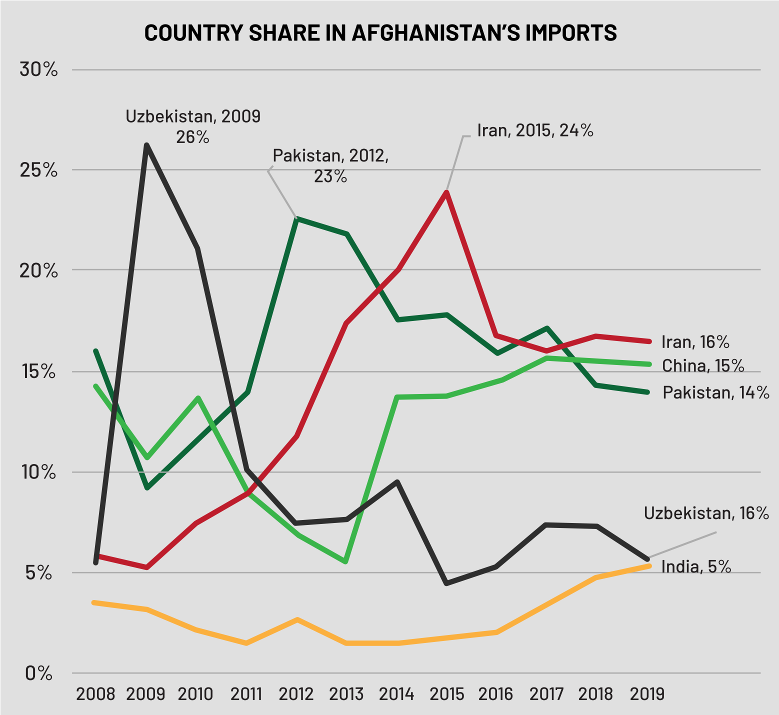

Figure 3: Afghanistan's Import Share by Country

Afghanistan and Pakistan have been signatories of two transit trade agreements, the first of which (Afghanistan Transit Trade Agreement-ATTA) was penned in 1965. The agreement allowed the movement of goods from and to Afghanistan through Pakistan by rail. Later in 2004, road transport was allowed as well. In 2010, the deal was substantially revised to incorporate multimodal transportation where Afghanistan received access to various transit routes through Pakistan (KPT, Port Qasim) from Chaman, Ghulam Khan, and Torkham. The agreement became fully operational in 2011, enabling Afghanistan to trade with the world using Pakistan's borders. From the outset, Afghanistan was supposed to be the primary beneficiary of the transit deal as the country is landlocked. Being a signatory to the UN Convention on Law of Sea (1958), Pakistan granted the transit facility to Afghanistan in accordance with international law. While Pakistan is the most significant transit route for Afghanistan, the country has similar transit trade deals with Uzbekistan, Tajikistan, Iran, and Turkmenistan.

BOX 1: PAKISTAN'S EXPORTS TO AFGHANISTAN AMID OTHER TRADE PARTNERS GAINING GROUND

Pakistan's falling share in Afghanistan's total imports is rooted in various geopolitical changes. Both Iran and India have been growing their trade and investment relations in Afghanistan—in fact, Iran has gained a significant share of the Afghan market which was enjoyed by Pakistani exporters before. By 2015, Iran's share in Afghanistan's imports had grown to 24 per cent from 6 per cent in 2008. Pakistan's share had climbed to 23 per cent in 2012 but slowly started to decline.

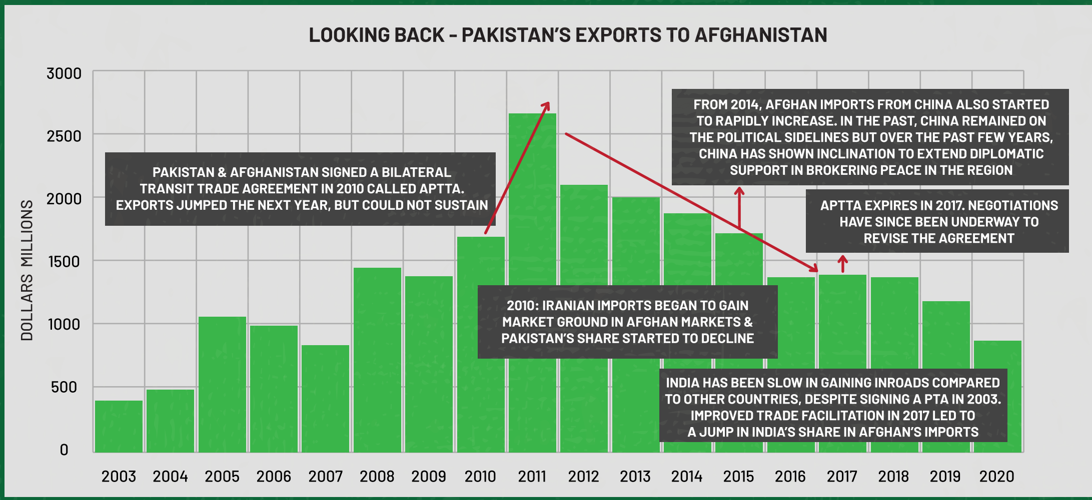

Figure 4: Historic View of Pakistan's Exports to Afghanistan

India has been growing its trade relations with Afghanistan as well. In the beginning, Pakistan had denied land connectivity between India and Afghanistan through its borders under the Afghanistan Pakistan Transit Trade Agreement (APTTA). The agreement permitted Afghanistan trucks access to the Wagah border with India, where Afghan goods are offloaded onto Indian trucks. It did not, however, permit Indian goods to be loaded onto trucks for transit back to Afghanistan. This became a significant point of contention in the renegotiation of the agreement. During the years, India has been diversifying its trade routes with Afghanistan by opening new channels. As a result, India's share in Afghanistan's imports has grown to more than 5 per cent by 2020, from 1 per cent a decade ago.

In 2017, India initiated an air-freight corridor that boosted its trade with Afghanistan. India has also made a large number of investments in Afghanistan (to the tune of $3 billion), and the Indian economy certainly has strategic reasons for nurturing its relations with Afghanistan. In the days following the recent Government takeover, the movement of goods from and to India was halted and there have been concerns on the Indian side that relations might not normalize, despite India being one of the largest trading partners of the country. This new political environment may pose a threat to existing and potential Indo-Afghan economic relations. This could also imply a greater share of trade for Pakistan, substituting the possible reduction in India-Afghanistan trade.

There is also a growing interest from China in Afghanistan, which fits into the country's broader ambitions for economic dominance in the region. The new Government has expressed interest in aligning with China, with the latter already extending its support to the country. China's exports to Afghanistan have been multiplying since 2014, as Pakistani exports went on the backburner, though not entirely substituting Pakistani goods. If leveraged effectively, China's interests in Afghanistan may further strengthen Pakistan's relations with the economy.

Pakistan is well-poised to become a hub for regional economic cooperation, especially with CPEC entering its second development phase. Pakistan has also become a signatory of UN's Transports Internationaux Routiers (TIR) Conventions, allowing free flows of goods to the world at meagre transport costs through shared borders. Meanwhile, Pakistan has signed multiple MOUs and agreements, including a tripartite multi-billion-dollar railway connectivity deal between Pakistan, Afghanistan, and Uzbekistan.

The improving position can be further harnessed through enhanced ties with Afghanistan. This would mean finalizing the renegotiations of APTTA, which has recently hit snags because of the evolving political situation in Afghanistan, and substantively eliminating barriers to trade with mutual understanding on both sides. It is beyond question that the success of projects such as the Uzbekistan-Afghanistan-Pakistan railway, Turkmenistan-Afghanistan-Pakistan-Iran oil pipeline, and the Central Asia-South Asia (CASA-1000) power transmission line depends on the strength and durability of the Pak-Afghan connection.

The renegotiation from the 1965 ATTA began in 2008, and the agreement was fully operational by 2011. The motivation behind the new deal was for Afghanistan to access Pakistan's seaports for the shortest and the most cost-effective route for Afghanistan's trade with the world. In addition, Afghanistan sought access to the Indian market. There were several provisions under the revised agreement that would benefit both countries. For instance, Afghan exporters were allowed to use their trucks to carry exports to Pakistani seaports and other routes, which was not the case before. An Electronic Data Interchange (EDI) was set up at all border crossings that would enable trade stakeholders such as transporters, importers, exporters, customs, and logistics providers to exchange more information and communicate efficiently, which would, in turn, lower costs by increasing processing speeds and reducing errors.[2]

In addition, while the ATTA did not provide reciprocal treatment to Pakistani exports from Afghan territory to Central Asian countries, the revised deal did. This, however, was never fully implemented to the detriment of Pakistani exporters. As a result, Pakistani exports are not reaching Central Asian markets through Afghanistan. Moreover, whereas the APTTA introduced counter-smuggling initiatives and commitment to strengthening customs facilities, reports suggest that the agreement lacked compliance. In fact, the guaranteed access on set routes was curtailed on both sides.[3] Issues such as costly documentation and inordinate delays seem to be prominent complaints by traders.

Another major issue that was never resolved and that has since hindered renegotiation of the now-expired APTTA (the deal has been under negotiation since 2017) was that while Pakistan permitted Afghan trucks access to the Wagah border with India, where Afghan goods can be offloaded onto Indian trucks, it did not allow for Indian goods loaded onto trucks for transit back to Afghanistan. A dominant reason for this is the fear of the local business community that it would allow Indian goods to be smuggled into the Pakistani market and give them undue competition.

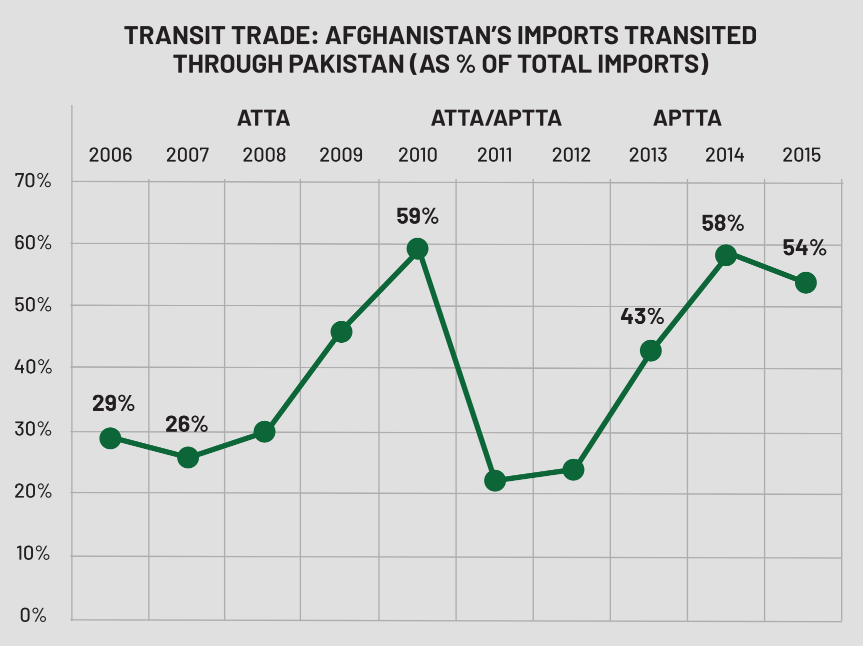

Figure 5: Afghanistan's Imports via Pak Transit Routes; Data Sourced from PBC's Report

However, despite challenges during ATTA and APTTA, Afghanistan has benefited substantially from the deal. According to a study conducted by the Pakistan Business Council (PBC) in 2016 using data provided by Pakistan Customs, Afghanistan's transit trade through Pakistan increased from $1.25 billion in 2008 to $3.48 billion in 2010—a growth of 178 per cent. During this period, Afghanistan's overall imports expanded by 63 per cent.[4] The study found that by 2010, 59 per cent of Afghanistan's imports from countries with which it did not share a border transited through Pakistan. This share dropped down to 24 per cent by 2012 but began to increase again. By 2014, the share had increased once again to more than half of all imports; This is despite Afghanistan's reported imports falling since 2012 as the economy struggled with the withdrawal of donors and foreign military forces. The United States was a major exporter that utilised the Pakistani transit route to reach Afghanistan, but by 2015, it no longer was a top trading partner with the country. This gap was filled by China and other exporting countries such as Malaysia.[5] As it stands, Afghanistan's imports have remained stagnant for the past several years.

[2] USAID Trade Project USAID/Pakistan. Office of Economic Growth & Agriculture. September 2014. https://pdf.usaid.gov/pdf_docs/PA00KC7F.pdf
[3] Elizabeth Threlkeld et al. "Afghanistan-Pakistan ties and Future stability in Afghanistan". August 2021. United States Institute of Peace (USIP)
[4] "Afghan Transit Trade through Pakistan & Pakistan Afghanistan Bilateral Trade". Pakistan Business Council (PBC). December 2016. https://www.pbc.org.pk/research/afghan-transit-trade-through-pakistan-pakistan-afghanistan-bilateral-trade/
[5] ibid

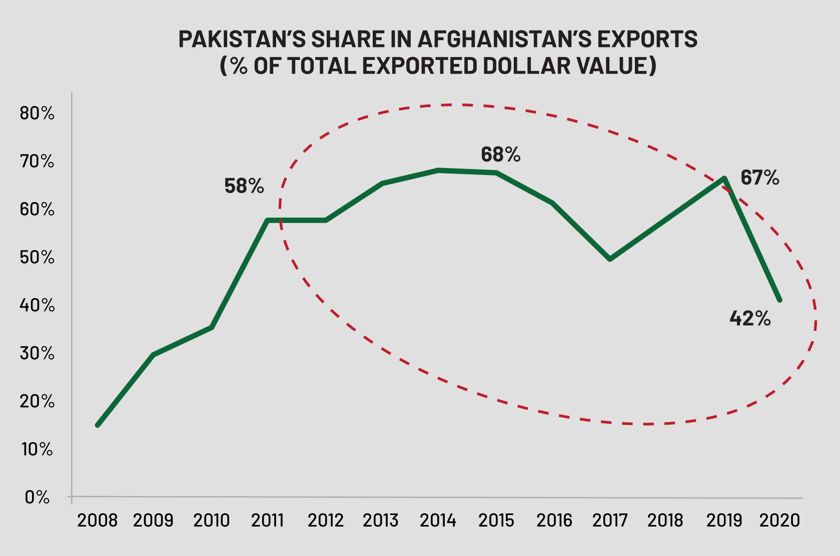

Figure 6: Pakistan's Share in Afghanistan's Exports

As for Afghanistan's exports, Pakistan is once again an important trading partner. Even though Afghanistan's overall exports have remained below $1 billion, Pakistan's share in Afghanistan's exports has remained upwards of 40 per cent. At one time, Pakistan received 67-68 per cent of Afghanistan's entire exports. This share has fallen to 42 per cent but still remains high.

The importance of a robust Pakistan and Afghanistan partnership cannot be underestimated. Along the Durand line, the two countries share communities where trade provides a vital income stream. According to a study conducted by Asia Foundation, 71 per cent of the business activity in border communities depended entirely or mainly on cross-border trade, 56 per cent of respondents indicated that the well-being of their household was largely dependent on the trade and just under half (47%) reported being dependent on trade for their job or professional occupation. Cross-border trade, therefore, is the primary source of local economic activity, especially for poor and underdeveloped households.[6]

The APTTA expired in 2017, but negotiations could not be finalised due to unresolved concerns on both sides. A new regime is certainly a fresh opportunity for Pakistan to tap not only into the evolving Afghan market but also Central Asian states with whom Pakistan does not share a border. Pakistan currently exports rice, cement, pharmaceutical products, plastics, wood, flat steel products to the Afghanistan market. The reconstruction of the Afghan land and infrastructure development that would take place presents opportunities for construction material manufacturers in Pakistan, while Afghanistan's shift away from India—due to predominantly political reasons—gives the Pakistani exporters the chance to realise the potential in pharmaceuticals and perishable goods. This opportunity, however, does hinge on how fast the country in transition begins to pick up its economic activity and consumption levels.

[6] Network, X-Border Local Research; aid, UK; acsor. "Trade and Livelihoods in the Afghanistan-Pakistan Borderlands". The Asia Foundation. August 2019. http://hdl.handle.net/11540/11224.

OBSTACLES TO TRADE WITH AFGHANISTAN: WHAT DO BUSINESSES THINK?

Though Pakistan is an important trading partner for Afghanistan, and the two countries have entered a number of trading agreements over the years, there is great potential for trade to improve further in a wide range of products. For instance, Afghanistan's total export potential to Pakistan stands at about $580 million, of which about 35 per cent remains unrealised. Moreover, there is a wide range of products where Pakistan could grow its exports to Afghanistan—most notably, citrus fruits, wheat, rice, medicines, and other fruits and vegetables (see details in the next section).

Despite this potential, there are many constraints pertaining to trade facilitation, logistics, trade controls and restrictions, banking and payment gaps, and smuggling that have been cited as barriers to trade.

To fully ascertain some of these challenges, a consultative session with KP businesses was held, which was attended by a large number of business leaders in KP, the province that shares four of the five border crossings with Afghanistan and thus is a gateway to developing Pakistan-Afghanistan relations. Not only does KP share a border, but it also shares similar cultural and social values as well as a shared language with communities across the border.

In general, KP businesses believe that better economic partnership with Afghanistan can be leveraged if businesses are heard at the government level. They expressed a great need for public-private dialogue, and regional stakeholders, especially the business community of KP, felt that they could make effective contributions to on Pak-Afghan trade at high-level committees, such as the parliamentary committee; it was also highlighted that interprovincial coordination was weak and there was very little knowledge sharing among provinces that hindered trade growth. In addition, the following impediments were specifically identified through the consultative session:

WEAK FINANCIAL INFRASTRUCTURE DETERS TRANSACTIONS

One of the most serious impediments identified during the sessions was the restriction on the movement of money across borders with very limited formal banking ties between Afghanistan and Pakistan. Traders felt at times that they had no choice but to rely on unofficial transfers, and that, coupled with fluctuations in exchange rates, hinders trade. The Central Bank has extended the facility of convertible cash currencies as export proceeds for the settlement of export to Afghanistan and the Central Asian States until the end of this year, but traders expressed a demand for a more sustained solution to ensure stability.

Stakeholders reported that at times the tradable currency was not available through the banking channels, especially during the current political climate in Afghanistan. According to traders, no money is being transferred from Afghanistan, except in cash, which is not accepted by the heavily regulated banking sector in Pakistan. This has pushed trade to informal channels (hundi/hawala). Meanwhile, for transactions that have been verified by the State Bank of Pakistan (SBP), traders complain that they are being questioned by other authorities, including FIA and NAB which, they believe, is discouraging business as it increases the risk and cost of doing business for them.

In addition, it was reported that the SBP has no dedicated cash counter at its Peshawar office to deposit and convert the export dollars into PKR-which causes delays and increases the cost of each transaction for a trader exporting goods to Afghanistan. Stakeholders claimed that they have raised this issue with the officials, but were informed that it cannot be resolved by the SBP on account of being short-staffed.

ILLEGAL TRADE CONTINUES, IN PART DUE TO PREVAILING EXPORT RESTRICTIONS

A large portion of trade between Pakistan and Afghanistan is informal. Smuggling is a major source of income for populations living on the borders, as documented for example, in a 2011 study conducted by Pakistan's Federal Tax Ombudsman. It estimated that APTTA was the source of three-quarters of the goods smuggled into Pakistan, including vehicles, cigarettes, and electronic items, and led to duty evasion. In most cases, traders do not distinguish between formal and illegal trade. Various estimates have been quoted by stakeholders concerning informal trade, smuggling, and under-invoicing. It has been suggested that such illegal practices have caused $1-$3 billion worth of losses to Pakistan's formal economy.[7]

During consultative sessions, stakeholders argued that over the years, greater custom regulations and restrictions/bans have encouraged illegal trade and smuggling. When informal trade thrives, it further discourages formalising. Unnecessary red tape, and specific bans on exports, for example on chicken, flour, and meat has historically also led to uncertainty and the inability of exporters to meet firm orders for which payments had been received in advance. Such restrictions push formal trade underground.

Another regulation that stakeholders found excessive and prohibitive is Form E which Pakistani exporters have to acquire to export to Afghanistan. They felt that this raises the costs of formal trade and disincentivises traders from using formal routes. Some stakeholders reported, moreover, that this has also led to an informal market of Form-Es which can be bought at a fraction of the original cost and allows goods to be processed to Afghanistan. Stakeholders also reported that the National Bank of Pakistan (NBP) at the Torkham border, which is responsible for processing these forms, has a limited operational capacity that may have aided in the continuation of such activities.

Stakeholders felt that the anti-smuggling security measures under APTTA were unnecessarily restrictive and cost-prohibitive as banking/insurance guarantee fees were excessively high and time-consuming, ranging from $970 to $1500[8] per carrier. Banks from both countries were also reported to be refusing to offer such guarantees, further delaying customs clearances.[9]

INEFFICIENT BORDER MANAGEMENT AND INFRASTRUCTURE RESULTS IN TRADE SLOWDOWN AND DIVERSION

The traders and exporters participating in the consultative session also felt that border management and the existing infrastructure at the borders need immediate attention. Visa on arrival available for Afghan traders was one suggested intervention that could facilitate trade. They also reported that it could take several days to clear a single truck at the border despite new border crossings being opened and the Torkham border operating round the clock. Such delays end up destroying perishable items, which in turn causes huge losses to traders. The borders were reported to be insufficiently staffed to deal with the flow of traffic and customs effectively. In addition, there is apparently only one scanner for inward and one for outward traffic that checks and examines vehicles, which is not sufficient to cope with the traffic flows. The traffic flow for the use of this scanner, moreover, is reportedly such that it adds unnecessarily to travel and processing time.

Often, different stakeholders, including traders, government officials, and security agencies, are not on the same page and this lack of coordination also causes unnecessary delays. At the same time, in the case of disputes, there is no dispute resolution mechanism in place.

During the now-ousted regime, a strong network existed between the local traders and authorities within the region which included Afghan customs and transport department officials. This network greatly facilitated and supported day-to-day trade activities at the border, but is no longer in place due to the regime change and, as a result, is posing renewed challenges for traders on both sides of the border.

TRANSPORT AND LOGISTICS INFRASTRUCTURE REMAINED WEAK

The use of outdated and underpowered trucks dominate the trade at the borders that lead to inefficient traffic flow leading to higher costs.

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7 Elizabeth Threlkeld et al. "Afghanistan-Pakistan ties and Future stability in Afghanistan". August 2021. United States Institute of Peace (USIP)
8 These figures have been converted to the dollar rate of 2015
9 "A Framework for Renegotiating APTTA". PBC. August 2020.
https://www.pbc.org.pk/wp-content/uploads/Framework-for-Renegotiating-the-Afghanistan-Pakistan-Transit-Trade-Agreement.pdf

Transportation is also expensive. Afghan traders, for instance, have claimed that the transit route through Iran is cheaper than Pakistan.[10] Prohibitive taxation on Afghan traders in the form of guarantee fees has also reportedly discouraged the use of Pakistan's transit routes. Stakeholders in Pakistan have highlighted that the National Logistics Cell (NLC) holds a monopoly over the terminals, which traders believe gives it undue negotiation power on prices.

Despite the two countries being signatories of the TIR conventions, which should provide an unencumbered route from Pakistan to Afghanistan and across, the same truck cannot move seamlessly between Pakistan and Afghanistan. The first consignment under TIR went in May-2021 to Uzbekistan from Torkham after prolonged delays, even though the TIR conventions had been signed in 2015. Stakeholders felt that, in practice, the TIR conventions have not been fully implemented.

It was argued by stakeholders that trade would be spurred if the three border crossings in Bajaur, Malakand Division are opened to facilitate the locals, who have trouble accessing the border crossings located in the tribal areas. Others argued that instead of opening new crossings, it would be better first to make the existing ones fully manned and operating efficiently.

PAKISTANI GOODS ARE NOT COMPETITIVE

Some traders noted that the cost of manufacturing in Pakistan is high, which makes manufactured goods uncompetitive in Afghanistan and beyond. For instance, the World Bank's Doing Business report estimated that Pakistan's energy cost was much higher than the South Asian regional average and significantly higher than that for OECD High-Income countries. In addition, the greater cost of imported raw material, which is not only subject to commodity price spirals but also rupee depreciation and greater incidence of import tariffs, translates to costlier goods production. Traders believe Pakistani manufacturers produce lower quality products due to the high cost of production and do not invest in technology or product innovation that resultantly, lead to the inability to meet the standards required to compete in the global markets. To compete in Central Asian markets, Pakistani goods must become more competitive, both from cost and quality standards.

[10] Shabir Khan et al. "Pakistan-Afghanistan Transit Trade: Pre & Post APTTA Scenario". Journal of Managerial Sciences, Volume XI Number 1.
https://qurtuba.edu.pk/jms/default_files/JMS/11_1/JMS_January_June2017_137-144.pdf

IDENTIFYING PAKISTAN'S TRADE POTENTIAL TO AFGHANISTAN AND CENTRAL ASIA

PAKISTAN'S POTENTIAL EXPORTS TO AFGHANISTAN

The current export profile of Pakistan to Afghanistan comprises mainly food and agricultural products, including wheat, sugar, rice, citrus fruits, bananas, potatoes, other vegetables, and tea. Meanwhile, petrol and cement are also major exports. (Figure 7). In 2019, total exports stood at $1.1 billion. There are a number of products where Pakistan can expand its reach to the Afghanistan market - mainly wheat ($15m), semi-milled/wholly-milled and broken rice ($11m), citrus fruits ($33m), medicines ($2m), bovine cuts ($2m), tents ($3.2m) and fruits such as guavas, mangoes ($3.4m) These products offer the highest potential to exports. These products have been identified using International Trade Center's potential export methodology.

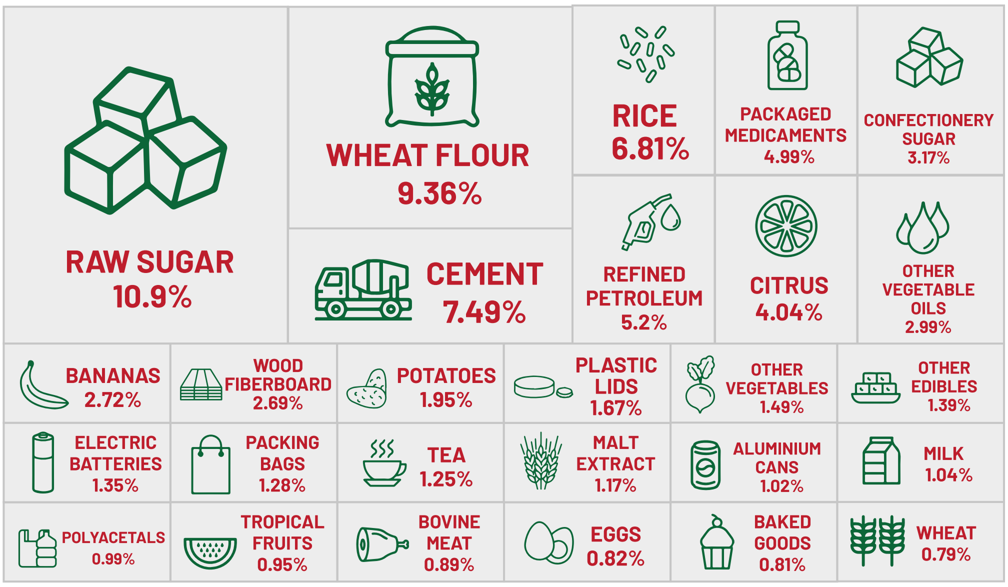

Figure 7: Pakistan's Exports to Afghanistan by Product; Data Sourrced from *The Observatory of Economic Complexity*

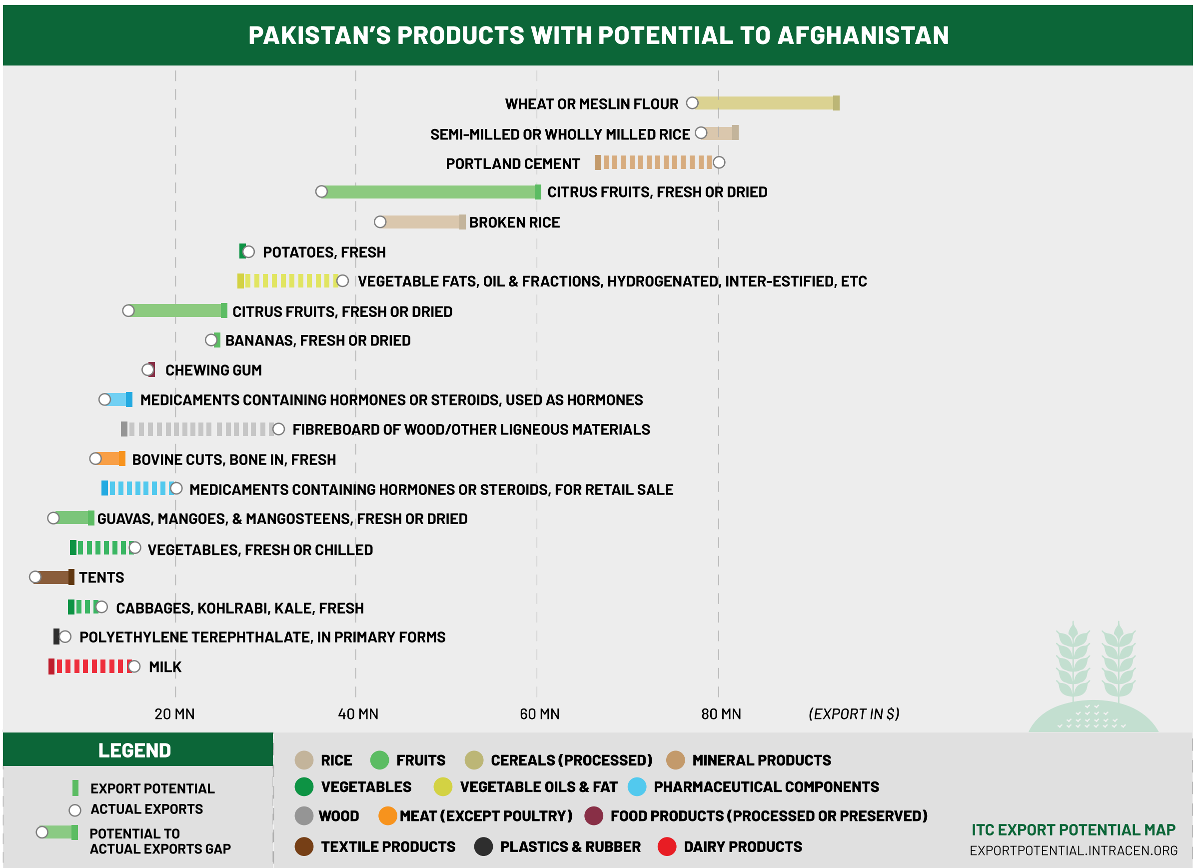

Figure 8: Pakistan Potential Exports to Afghanistan by Product

The ITC has developed an export assessment methodology that identifies products in which the exporting country has already proven to be internationally competitive and which have good prospects of export success in a given target market.[11] Therefore, Figure 8 shows products with the highest potential of export to Afghanistan and the ranking of these products by value.[12]

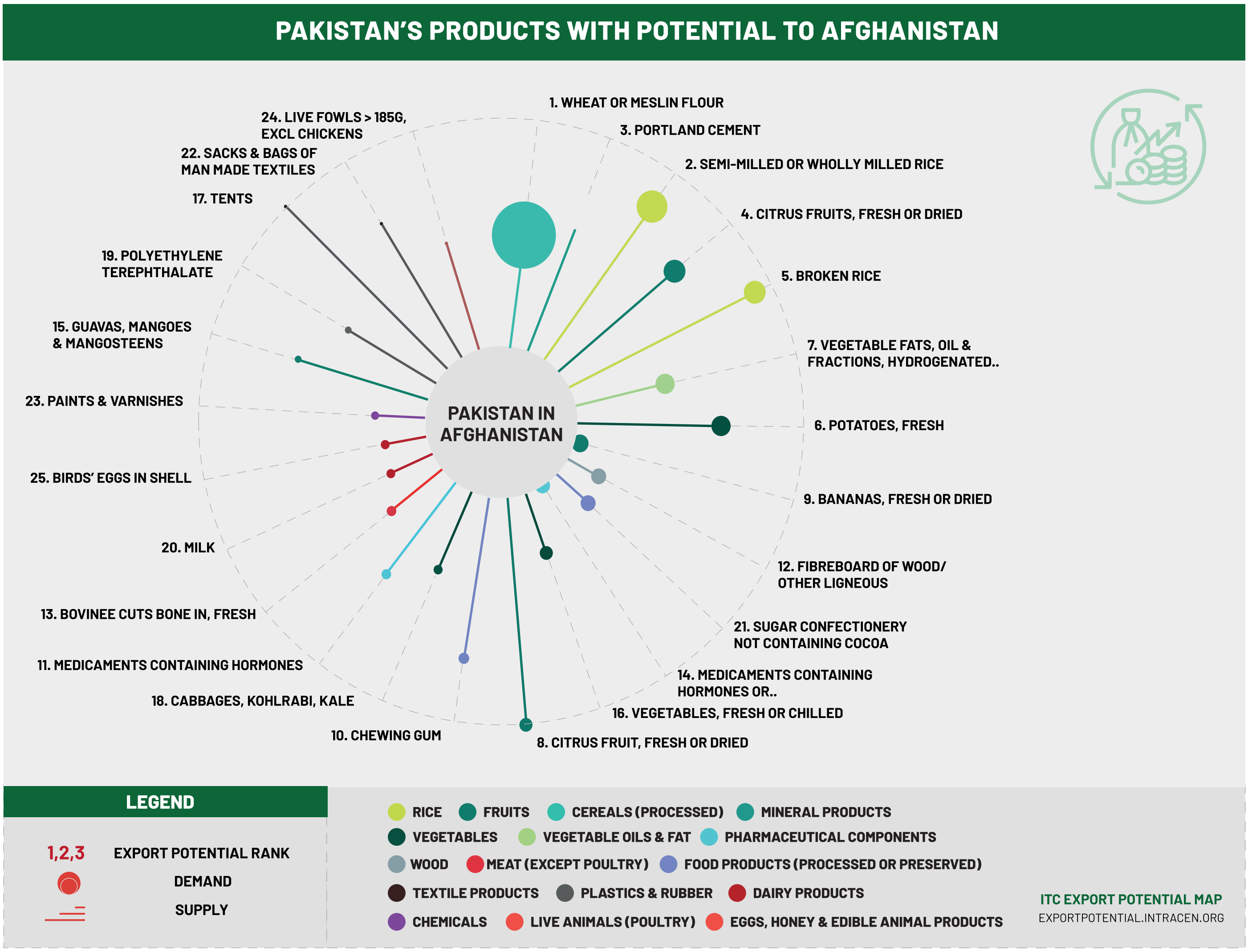

Figure 9: Where is Afghanistan's Strongest Demand?

Another way of ascertaining potential areas which Pakistan could tap is by looking at Afghanistan's demand for products. Here the ITC estimates demand for products using projected imports. Figure 9 shows the top 20 high-demand products. These include fiberboard of wood, sugar confectionery, medications, and a variety of different vegetables with the most demand in Afghanistan. Pakistan may not have adequate export potential in these areas, but these are the product lines that Pakistani exporters and traders could tap if they invested more in their production or diverted trade toward Afghanistan, given prospects of better market access.

[11] Yvan Decreux and Julia Spies. "Export Potential Assessments". ITC. December 2016.
https://umbraco.exportpotential.intracen.org/media/1089/epa-methodology_141216.pdf

[12] Potential export value of product k supplied by country i to market j, in dollars, is calculated as supply × demand (corrected for market access) × bilateral ease of trade. Supply and demand are projected into the future based on GDP and population forecasts, demand elasticities and forward-looking tariffs. The estimated dollar value serves as a benchmark for comparison with actual exports and should not be interpreted as a ceiling value. In reality, the actual trade value may be below or above the potential value. https://exportpotential.intracen.org/en/resources/learning/glossary#realized-potential

PAKISTAN'S POTENTIAL EXPORTS TO CENTRAL ASIA

A similar look at data as above for Central Asian and East European markets suggest Pakistan has the greatest potential in products such as apparel ($80m), home textiles ($67m), fruits ($19m), cotton fabric ($30m), leather and skins ($20m), vegetables ($13m), plastics and rubber ($18m) and so on.

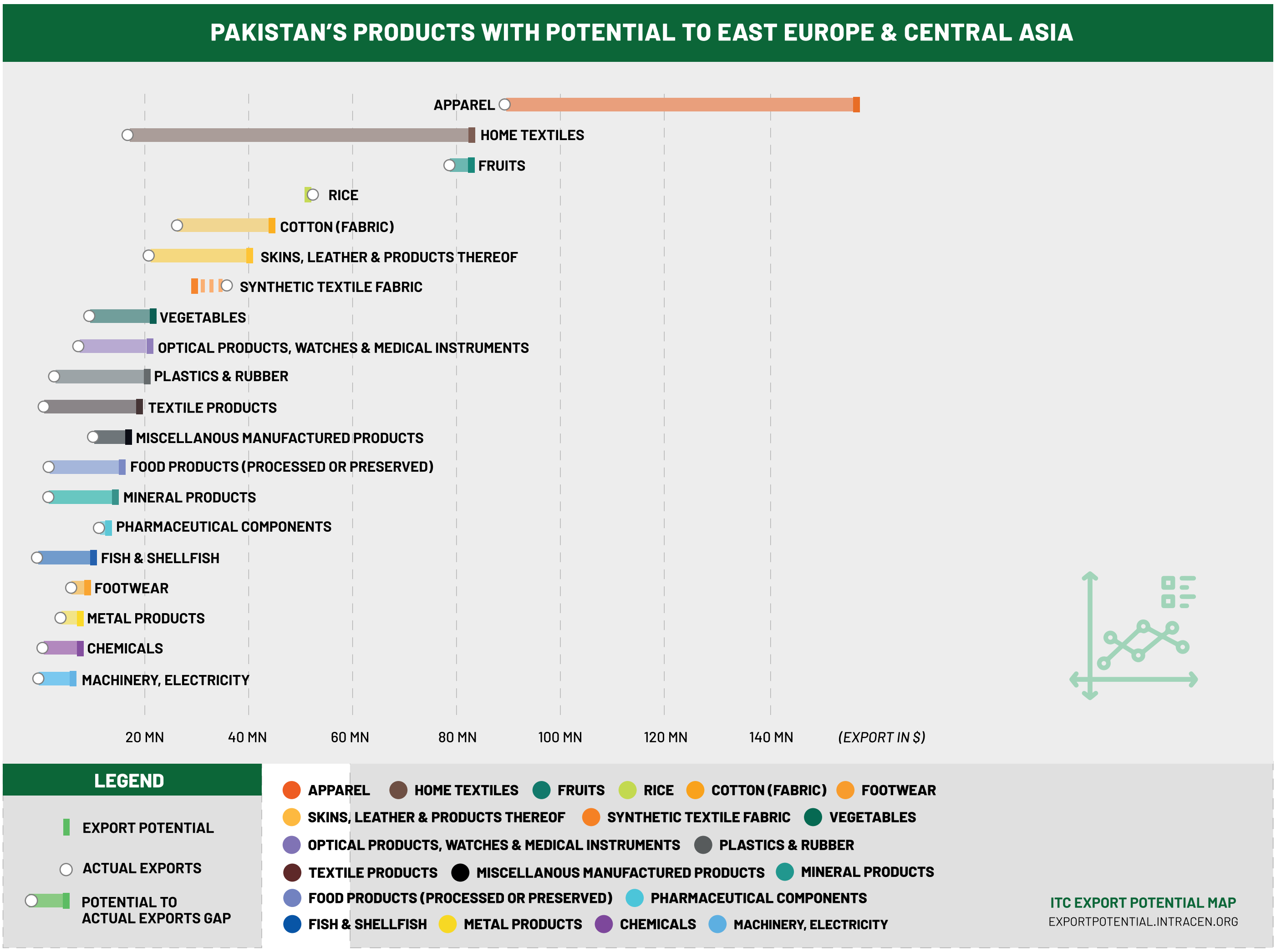

Figure 10: Pakistan's Potential Exports to Eastern Europe & Central Asia

Another way to look at potential areas of export growth is to see where the biggest demand currently exists and which product markets Pakistani traders could invest in and become more competitive. Here, aside from apparel, medicines, footwear, and medical instruments are high-demand products. Pakistan currently exports apparel and footwear largely to the EU countries, enjoying the GSP plus treatment. Countries such as Germany, Spain, Italy, the UK, France, and the Netherlands receive most of these products from Pakistan. It is evident though there is demand in many other destinations in Central Asia and East Europe, which Pakistani exporters could tap. (Figure 11).

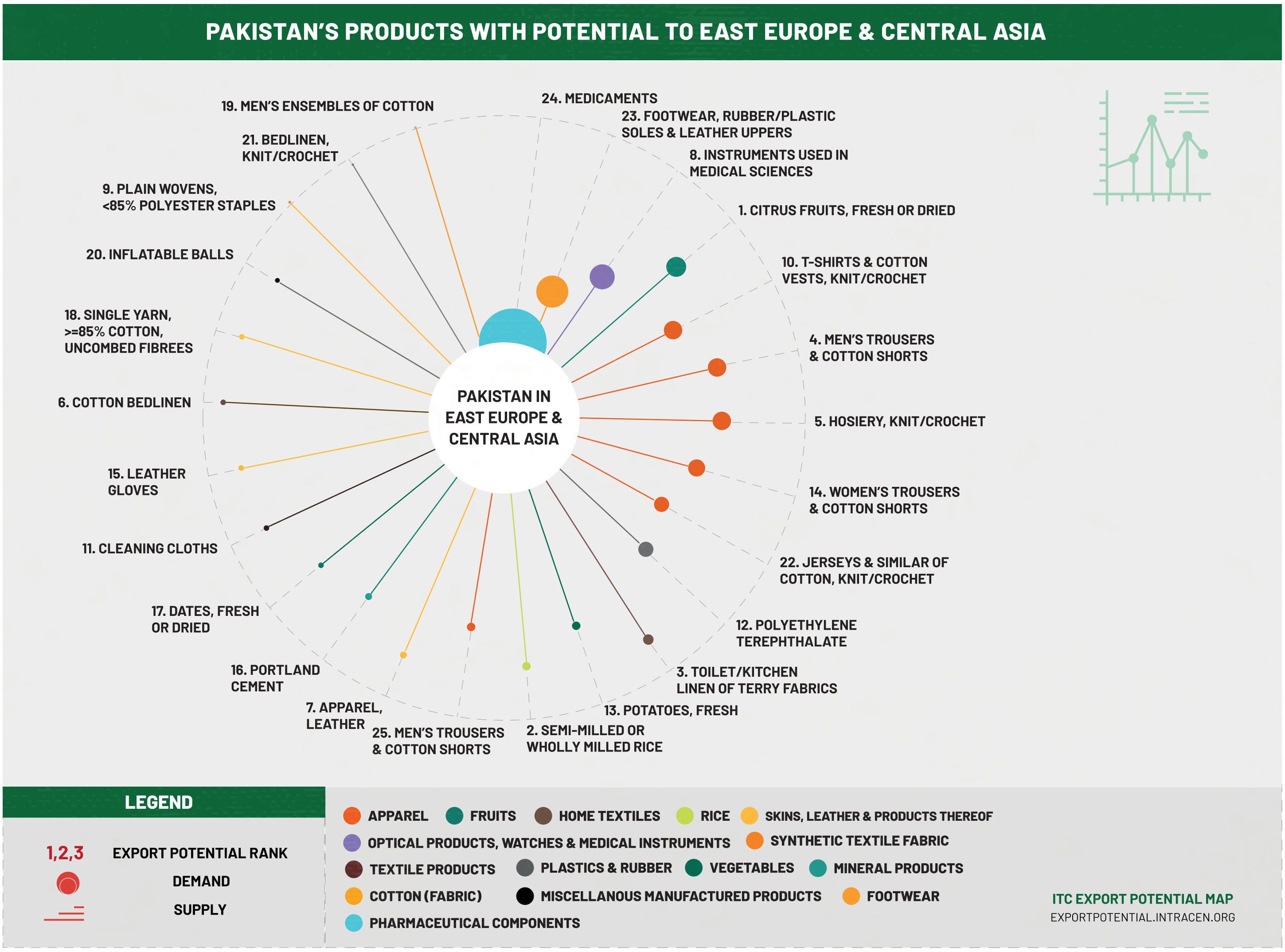

Figure 11: Where is Central Asia & East Europe's Strongest demand?

RECOMMENDATIONS FOR FURTHER DISCUSSION

1. DEVELOPING A FRAMEWORK TO RENEGOTIATE APTTA

The transit trade agreement, which is now up for renegotiation, has, for the most part, benefitted Afghanistan in gaining access to other markets and importing global goods. However, the implementation of the agreement has been inconsistent on both sides, and barriers to trade have persisted. Certainly, a transit route is beneficial for both Afghanistan and Pakistan in terms of growing their respective trade with the world. The renegotiation should open on a firm plan of action to allow ***Pakistan access to Central Asian countries.*** This should be easier now both countries have ratified the TIR conventions. (Key counterparts: **Ministry of Commerce, Pakistan Customs**)

The measures to curb smuggling under APTTA need to remain cognizant of the alternate informal routes available to traders and should keep the regulatory burden as low as possible to encourage formalisation. The agreement should focus on ***better enforcement and border vigilance***, but should also focus on making it easy and inexpensive to route trade through formal channels. (Key counterparts: **Pakistan Customs, FIA, Frontier Corps, KP Police, and National Logistics Cell**)

The banking channels between the two countries are very weak, and current payments are not going through as Afghanistan undergoes a regime change and wants to save its dollar reserves. A currency swap agreement has been proposed where each country would pay in their respective currency at a pre-determined exchange rate instead of using the US dollar. Such an agreement—if made part of the transit deal—could help save foreign exchange in the short run and strengthen both currencies in the long run. (Key counterparts: **State Bank of Pakistan**)

2. BRINGING LOGISTICAL EFFICIENCY AND ELIMINATING TRADE CONTROLS AND IMPLICIT NON-TARIFF BARRIERS

As suggested by multiple stakeholders during consultations, trade controls and restrictions (in many cases implemented to curb smuggling), as well as arbitrary trading bans, have been extremely prohibitive to growing trading ties. Many Afghan and Pakistani traders have moved to illegal trading channels because they find these controls very restrictive. Pakistan is also a costlier transit route for Afghan traders who have slowly been turning to alternative routes such as Iran. Many of these problems are compounded by the fact that a large share of Pakistan's bilateral trade with Afghanistan is in perishable items, which gets damaged due to delays and bans, causing substantial losses and wastage on both sides of the border.

The KP/Federal government needs to consult with traders on removing these barriers, investing in better technology at the border to reduce lead times especially at scanning stations, complete automation of clearance mechanisms with risk management systems, and setting up effective dispute resolution mechanisms to resolve problems at the border sites. The non-tariff barriers that exist on the Afghan side also need to be negotiated to discourage unnecessary delays. Meanwhile, for Pakistan to remain a prominent transit route for Afghanistan, transit and transportation costs and various compliance fees will have to be rationalised. This is where the KP government must coordinate with the federal government on building a more efficient transportation infrastructure that is also cost-effective. If bringing in private sector players will boost competitiveness, that option ought to be explored. (Key counterparts: **National Logistics Cell, Pakistan Customs, FIA, KP Police**)

3. FOCUSING ON THE COMPETITIVENESS OF KP BUSINESSES

As the transit deal is renegotiated, and trade controls and restrictions are alleviated, the regulator's job may get fulfilled but the policymakers' work is only just starting. Whereas potential exports to Afghanistan and other markets through Afghanistan is evidently substantial (see the previous section), and there is a wide variety of products where significant investments could be made, Pakistani goods need to become competitive to sell in markets where substantially cheaper and better-quality products are coming from China and many East Asian economies. These are the economies that have fast become the factories of the world as the Pakistani export market struggles to gain ground.

Competitiveness requires businesses to understand where investments need to be made and the government to incentivize these investments. While the larger role must be played by the federal government, the KP government could alleviate immediate cost concerns of KP businesses by implementing a wheeling mechanism for cheaper electricity, ensuring there is enough liquidity for producers and manufacturers by helping banks in providing access to finance to businesses. The KP government can also put aside funds to subsidise the cost of finance for exporters as an added advantage by curating refinancing or similar schemes.

Other measures such as providing better incentives for exporting industrial units under the Industrial Policy, overhauling the provincial tax system by removing inconsistencies and inefficiencies whilst also reducing the burden of taxation on the existing tax-payer and harmonising with other provinces will all pave the way for more business competitiveness. (Key counterparts: **KP Board of Investment and Trade, Bank of Khyber, PEDO, KP Oil and Gas Company**)

Furthermore, Pakistan needs to substantially improve the cost, speed, and reliability of transportation, logistics, and border handling to make the movement of goods and exports more competitive.

4. BRINGING BUSINESSES ON BOARD

KP businesses do not feel heard. This has been a recurrent theme throughout the activities undertaken by the SEED KP Business Voice program. In the first survey conducted in July, 90 per cent of businesses said they did not feel heard by the government. Later, the same concern was raised during a roundtable discussion on Budget 2021. This was once again highlighted during consultative sessions for the Pakistan-Afghanistan trade.

When business inputs are not sought, policymaking becomes less effective as policies do not reflect ground realities, and they don't provide concrete solutions to problems at hand. Relevant committees to discuss proposals and recommendations of businesses must be established so not only can a better trade deal be negotiated, but the government is acutely aware of which gaps need to be filled in order to be an efficient facilitator to traders and businesses. More than providing incentives, facilitating and providing a conducive and well-functioning regulatory environment that incentivises formal trade would be effective at expanding trade with Afghanistan. (Key counterparts: **KP Board of Investment and Trade, Sarhad Chamber of Commerce and Industry, Other KP trade bodies**)

5. STRENGTHENING COORDINATION MECHANISMS

While a number of coordination mechanisms exist to address various aspects of bilateral trade issues, the business community felt the need for a permanent problem-solving committee comprising various officials of the Federal and Provincial Government to resolve the operational problems facing the traders and businesses. The importance of Pakistan's trade with Afghanistan and onwards to Central Asia and its impact on KP's economy cannot be overemphasised.

It is recommended that a committee headed by Chief Secretary Khyber Pakhtunkhwa be established with representation from the Ministry of Commerce, Customs, FIA, SBP, P&D, Home Department, KP Police, and other law enforcement agencies, KPEZDMC, PEDO, C&W, etc. The committee should also comprise substantive representation from the private sector, especially Afghanistan focused trade and industry. The committee should meet every month and solve key issues facing traders and businesses in KP and try to facilitate them there and then.

CONCLUSION

In conclusion, to ensure a sustainably prosperous future in the region, it is imperative that regional integration predicated on economic activity and trade are promoted. Countries that are involved in mutually beneficial trade activities tend to establish a long-lasting strategic partnership. This can also potentially stand true for Pakistan and Afghanistan, and subsequently the Central Asian States. The five recommendations outlined above can prove to be the first steps towards the long journey of regional integration and socio-economic uplift of the people across borders. The KP government has the opportunity to initiate the process by taking the right steps forward that may also facilitate the federal government to lead impactful policy measures towards sustainable development outcomes and long-lasting prosperity in the region.

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