



The Future of Afghanistan-Pakistan Trade Relations

Published:

August 17, 2015

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Pakistan and Afghanistan are among each other's largest trading partners. Though an agreement was signed in 2010 to strengthen trade relations and facilitate Afghan transit trade through Pakistan, implementation has been mixed, with many on both sides of the border complaining of continued barriers to exchange. Both nations need to improve trade facilitation through streamlined payments settlement and improved insurance mechanisms, the use of bonded carriers, visa issuance, trade financing, tax collection, and documentation.



Summary

- Pakistan is Afghanistan’s largest trading partner, while Afghanistan is Pakistan’s second-largest export market.
- Both Pakistan and Afghanistan face significant challenges in their respective security, political, and economic realms over the coming years. The drawdown of NATO forces from Afghanistan has dealt a negative shock to both economies, particularly in the transportation sector.
- While an agreement was signed in 2010 to strengthen trade relations and facilitate Afghan transit trade through Pakistan, implementation has been mixed, with many on both sides of the border complaining of continued barriers to exchange.
- Peaceful economic cooperation between Afghanistan and Pakistan and improved trade and transit facilities could help connect South Asia with Central Asia.
- Both nations need to improve trade facilitation through streamlined payments settlement and improved insurance mechanisms, use of bonded carriers, visa issuance, trade financing, tax collection, and documentation.

About this Brief

This brief is based on primary research conducted by the Institute of Business Administration (IBA), Karachi, on future trade prospects between Pakistan and Afghanistan. The full study, to be published by IBA, couples detailed analysis of macroeconomic conditions and trade flows in the region with interviews of stakeholders in the public and private sectors on both sides of the border. Focus groups with the business community were conducted in Karachi, Peshawar, and Kabul in November and December 2014. Dr. Ishrat Husain is dean and director, IBA Karachi; Dr. Muhammad Ather Elahi is an assistant professor, IBA Karachi.

Introduction

Relations between Pakistan and Afghanistan have historically been tense. Cross-border infiltration, refugees, drug trafficking, militant groups, and disputes over counterterrorism policy and dialogue with terrorist networks have contributed to an entrenched trust deficit and have eroded relations. These issues have impacts beyond the security sector, complicating efforts to build stronger trade and economic ties. Despite tensions, Pakistan is today Afghanistan's largest trading partner, and Afghanistan is Pakistan's second-largest trading partner.

Aggregate demand in Afghanistan is expected to decline in the coming years as a result of reduced aid and other foreign exchange inflows, meaning Pakistan also needs to formulate strategies to mitigate the effects of this downturn on Pakistan's economy. As a landlocked country, Afghanistan will remain dependent on Pakistan and Iran for its overseas trade. Afghan stakeholders hoped to work on a joint economic zone that could greatly enhance the trade for both countries. There are potentially significant opportunities for Pakistani investors in Afghanistan, but these will not be realized until financial mechanisms are streamlined and infrastructure development and personal security are guaranteed.

Bilateral Trade Profile

Trade between Pakistan and Afghanistan has increased substantially, from \$0.83 billion in FY06 to \$2.1 billion in FY13.¹ Pakistan supplies the largest share of total Afghan imports, at 24.3 percent as of FY13,² but this share has declined since 2011 owing to a combination of factors, including political instability, customs delays, suspensions of NATO supply shipments, and other issues. While Pakistan's share in transit trade has declined, Iran's share has steadily increased. India, Iran, and Afghanistan have recently finalized a draft for a new transit trade agreement; the planned land route will run from Iran's Chabahar port, in the Gulf of Oman, connecting Afghanistan to the Persian Gulf and allowing the movement of goods from South Asia into Afghanistan and Central Asia.

Afghanistan's total reported exports are currently equivalent to only 5 percent of total imports, with exports amounting to \$363.70 million in FY13.³ Pakistan is the largest export destination, accounting for 32.2 percent of all Afghan exports; even without direct transit access, India forms the second-largest destination for Afghan exports, at 27 percent of the total.

Transit Agreements

Afghanistan's landlocked status means it relies on neighbors to facilitate the transit of its trade with the broader global economy. The two countries initially signed the Afghanistan Pakistan Transit Trade Agreement (APTTA) in 1965.⁴ The APTTA was redesigned in 2010 to allow the transit of Afghan exports through Pakistan to the Wagah border with India, and to the seaport cities of Karachi and Gwadar. Pakistani trucks in turn are allowed to move products to all regions of Afghanistan. The agreement also led to the formation of a joint chamber of commerce. In July 2012, Afghanistan and Pakistan agreed to extend the APTTA to Tajikistan, a first step in the establishment of a north-south trade corridor.⁵ The proposed agreement would allow Tajikistan to use Pakistan's Gwadar and Karachi ports for its imports and exports, while Pakistan would enjoy trade with Tajikistan under terms similar to the transit arrangement with Afghanistan. Recently, a ministerial delegation from Tajikistan arrived in Pakistan to explore trade prospects in various sectors.

During his visit to Pakistan in November 2014, newly elected Afghan president Ashraf Ghani highlighted Afghanistan's potential to function as a land bridge between Pakistan and Central Asia, and sought the same facility from Pakistan for trade with India. Ghani set a goal of increasing Afghanistan-Pakistan bilateral trade to \$5 billion by 2017. Pakistan in turn agreed to take measures to clear 95 percent of Afghan goods imported under the transit trade agreement within twenty-four hours, and to lower tariffs and charges for port and storage facilities.⁶

Points of Tension

Despite past agreements, continued tensions have prevented the full realization of Afghanistan and Pakistan's bilateral trade potential, and will have to be addressed if the goals set out during President Ghani's recent visit are to be realized.

Smuggling and Spillover. Afghan proposals to allow the transit of imports from India through Pakistan have been met with resistance, in part owing to Pakistani concerns that they may be dumped instead in Pakistan, affecting local industry. Illicit trade between Afghanistan and Pakistan is a long-standing concern on the Pakistan side; a 2011 study by Pakistan's Federal Tax Ombudsman noted that several high-tariff goods, including vehicles, cigarettes, and electronic items, were being smuggled from Afghanistan to Pakistan.⁷ Officials estimate that three quarters

of all goods smuggled into Pakistan come through the APTTA before being diverted to Pakistani markets, evading the imposition of customs duties.⁸ On the Afghan side, traders complain that Afghan-origin products are sold back to Afghanistan from Pakistan at higher prices, forcing Afghans to pay custom duties on their own goods. Afghan merchants also accuse Pakistani customs officials of regularly extracting bribes to clear the border or to obtain necessary visas or other paperwork. There are as well Afghan concerns about low-cost imports from Pakistan displacing Afghan production of agricultural and other goods.

Trade Controls. At the same time, efforts to control and combat smuggling and other misuses of the transit trade agreement provoked complaints from traders interviewed on both sides of the border. Requirements that traders obtain certified customs clearance documents, restrictions on partial shipments of goods that require all trucks of a given shipment to be present before trucks can cross into Afghanistan, and heavy security deposits, insurance, and shipment tracker installation costs all increase truckers' costs of operations and strain their limited working capital.

Formal banking ties between Afghanistan and Pakistan remain limited, with traders on each side of the border forced to rely on unofficial transfers, and with inconsistent exchange rates. Complaints were also reported regarding road and customs clearance infrastructure in both countries. According to business community interviewees, the current practice of checking all containers rather than a randomized selection slows the transit process, and repeat checks on both the Afghan and Pakistan side of the border add additional transit time. However, during an April 2015 visit to Kabul, Pakistani commerce minister Khurram Dastagir announced major steps to improve the situation. These include (1) allowing a system-based partial shipment of Afghan transit goods instead of manual processing; (2) a reduction in the share of Afghan cargo that is scanned, from 100 percent to 20 percent; and (3) a goal of increasing the clearance of almost 90 percent of Afghan cargo on the first day, with 80 percent cleared without scanning. The commerce minister also pledged to establish joint customs and clearing points for more efficient movement of cargo across borders.

Removal of Shipping Restrictions. In April 2015, it was also agreed that Afghan trucks bound for India would be allowed to reach the Wagah border crossing, and on their way back would be allowed to carry Pakistani exports to Afghanistan, a provision removing previous restrictions. This should help Afghan businessmen significantly reduce the cost of transportation. Similarly, Pakistan-origin trucks are allowed to transit through into Afghanistan without reloading. It is expected that customs revenues for Pakistan will increase as a result of more trade through

Wagah. The truck companies in Afghanistan can become the major beneficiaries of this relaxation by investing in the trucks and the transport systems.

Regional Transportation Impacts

For Afghanistan, the exit of foreign troops has strong implications for future security and stability in the region. The success of the new national unity government's vision of economic revival and attracting foreign investment will ultimately depend on an improvement in law and order and effective and strong governance that is able to maintain stability throughout the country.

Beyond the risk of refugee displacement or cross-border militancy in the event of a deterioration in the Afghan security situation, the NATO drawdown will also have direct economic impacts on Pakistan as the military stimulus to both countries' economies decreases. As an example, most of Pakistan's bottled water exports to Afghanistan were consumed by NATO forces.⁹

Major reductions in bilateral trade would also affect the Pakistani transit, warehousing, and construction sectors, which may have disproportionate impacts on the poorer inhabitants of Balochistan and Khyber Pakhtunkhwa provinces employed in these sectors. Many members of this lowest-quintile segment have been able to escape chronic and intermittent poverty as a result of increased trade between Afghanistan and Pakistan, underscoring the need to maintain and expand the gains from bilateral and regional integration.¹⁰

Conclusion

Peaceful economic cooperation between Afghanistan and Pakistan and improved trade and transit facilities would help connect South Asia with Central Asia. Export-led economic growth would be expected to increase domestic employment in both countries and provide foreign exchange to import commodities manufactured more cheaply somewhere else. Afghan officials see India and Pakistan as the two primary markets for Afghanistan but face obstacles in realizing this goal. Afghan officials, particularly in the Ghani administration, are seeking to position the country as a corridor linking Pakistan and Central Asia, but also seek gains of their own through reduced operational barriers to trade and uninterrupted trade access to India.

The governments of Pakistan and Afghanistan need to make further arrangements for mutually beneficial trade relations. The following recommendations can provide a path to the long journey ahead:

- People-to-people contact is a necessary condition for sustainable trade relations; therefore, business visa policy needs to be relaxed further. Various options, such as visa-on-arrival, long-term, multiple-entry visas, and investment-friendly visas for businessmen and skilled workers, could be explored and implemented in letter and spirit.
- A preferential trade agreement between the two countries that would give more market access to Afghan goods in the Pakistani market and address the issue of smuggling is the need of the day. This agreement should include a clear roadmap for tariff rationalization in the region and the removal of double taxation to facilitate investment in both countries.
- As part of this agreement, both sides should commit to support the transit of Pakistani exports through Afghanistan to Central Asia, and similarly the transit of Afghan exports through Pakistan to India.
- Nontariff measures also need to be improved, mainly at the customs checkpoints on both sides of the border. The operational and policy-level reforms should be implemented to facilitate trade by reducing overhead in checking and testing consignments and improving security conditions.
- The importance of modern infrastructure, including roads and the railway network, to trade relations cannot be overemphasized. Both countries should prioritize infrastructure projects to reduce the cost of transportation. It is important to mention here that the China-Pakistan Economic Corridor will be instrumental in the development of trade from Central Asia to South Asian countries.
- The provision of a financial mechanism for trade is mandatory. Instituting an EXIM bank for trade settlements in multiple currencies is recommended, as is an institutional arrangement for freight insurance and similar costs

Notes

1. Data from Pakistan Bureau of Statistics, www.pbs.gov.pk/sites/default/files//external_trade/8_digit_level/export/5_exp_2008-09_to_2012-13.pdf.
2. Data provided by Afghan Ministry of Commerce.
3. Data provided by Afghan Ministry of Commerce. Total Afghan exports are estimated by the World Bank and IMF to be over \$2 billion, with most of them unrecorded.
4. Pakistan is required to provide transit facility as per Article V of the GATT 1947, the New York Convention on Transit Trade of Landlocked Countries (1965).

5. Central Asia Regional Economic Cooperation.
6. Bakhtar News Agency.
7. Federal Tax Ombudsman, ISAF Container Scam, report prepared in response to a request by the Supreme Court of Pakistan vide suo moto case no. 16/2010 (Islamabad: FTO, 2011), [www.fto.gov.pk/files_upload/annualreports/Annual%20Report%20\(2011\).pdf](http://www.fto.gov.pk/files_upload/annualreports/Annual%20Report%20(2011).pdf).
8. Information was provided by industry officials in a focus group interview, Karachi, August 2014.
9. Saad Shabbir and Vaqar Ahmed, "Welfare Impacts of Afghan Trade on the Pakistani Provinces of Balochistan and Khyber Pakhtunkhwa," *Stability: International Journal of Security & Development* 4, no. 1 (February 2015): art. 6, pp. 1–16, doi: <http://dx.doi.org/10.5334/sta.e>.