

A photograph of a young boy in a blue shirt looking up at a soccer ball in the air, with a large, damaged building in the background. The scene is set in a dusty, open area, possibly a schoolyard or a public square. The building in the background has several windows and arches, some of which are missing or broken, suggesting it has been damaged by war. The sky is clear and blue.

BETWEEN WAR & PEACE

THE AFGHANISTAN ESSAYS

Pak-Afghan Trade Relations

Looking Ahead

Fahd Humayun

The Afghanistan Essays

This 2018 short-essay series by the Jinnah Institute (JI) reflects a range of Pakistani thought leadership on Afghanistan and its complex history with Islamabad. With the region in the current crosshairs of a seemingly intractable conflict, these essays attempt to spur old and new thinking on the history of Pakistan's relationship with Afghanistan and existing challenges. The essays cover a range of subject matter on Afghanistan-Pakistan including efforts for peace and reconciliation, threats to security, the broader geopolitical dynamic, and the role of civil society and economy.

This essay titled 'Pak-Afghan Trade Relations: Looking Ahead' explains the sharp decline in the volume of bilateral trade between Pakistan and Afghanistan from over \$2.5 billion in 2015 to \$500 million in the first half of 2018. It argues that efforts to transform historic and geographic proximity into economic synergies should compel Afghanistan and Pakistan to not only maintain, but also expand trade and transit cooperation.

About the Author

Fahd Humayun works for Jinnah Institute's Strategic Security Initiative (SSI). He is currently pursuing a PhD in Political Science at Yale.

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PAK-AFGHAN TRADE RELATIONS: LOOKING AHEAD

Fahd Humayun



Can Pakistan and Afghanistan benefit from increased trade and economic interdependence? While the effect of trade on conflict propensity has been extensively debated, threats from the western border, repeated border-closures, and new tensions between security forces have contributed to an alarming 80 per cent decline in bilateral trade between Islamabad and Kabul. The volume of total trade has gone down from over \$2.5 billion in 2015 to \$500 million in the first half of 2018.¹ These trends are alarming.

A sixteen year-old-war continues to be waged on both sides of the international border. The recent downturn in trade has coincided with a worsening of bilateral relations, and belies painstaking progress in trade and connectivity since 2006 that saw both sides manage to keep the collective value of imports and exports above \$1.5 billion.² Estimates suggest that potential trade between the two countries can be enhanced up to \$7.5 billion annually, if the two sides decisively addressed existing obstructions and leveraged a growing regional network of regional corridors and highways.³ This would require certain concrete steps: relaxing customs rules and modifying and updating the Afghan-Pakistan Transit Trade Agreement (APTTA) to protect and enhance the sustained flow of goods. But such steps require political will, a climate of greater strategic trust, and a public acknowledgment of the imperatives of geo-economic security.

The importance of trade has figured prominently in the Pak-Afghan bilateral context. It is also rooted in historical practices that predate 1947; the 19th century exports of dried and fresh fruits and nuts from Kabul and Kandahar to India ran through Peshawar, an important base for bankers and financiers involved in the exchange of goods. When it comes to Pakistan and Afghanistan, there is also a natural logic to thinking about trade as a precursor to stabilising a tenuous relationship that has a fraught political history. Afghanistan is landlocked, but divided tribes on either side of the border intermarry, trade and travel across a porous mountainous divide. Diplomacy geared at transforming natural historic and geographic proximities into economic synergies should compel Afghanistan and Pakistan to not only maintain, but also expand trade and transit cooperation.

1 <https://tribune.com.pk/story/1616577/2-bilateral-trade-pakistan-afghanistan-dropped-2b/>

2 https://www.sdpi.org/publications/files/Trade&Transit_Cooperation_with_Afghanistan_Results_from_a_Firm-level_survey_from_Pakistan_W-153.pdf

3 <https://www.thenews.com.pk/print/262213-pajcci-suggests-inclusion-of-pak-afghan-transit-trade-in-cpec>

From Geopolitics to Geo-economics

While Pakistan and Afghanistan share a complicated history, they remain wedded to the fluctuating geopolitics of a region in which the overhang of conflict looms large. Unregulated traffic across a rugged but porous border has been a sticking point and major security concern throughout Pakistan's foreign policy towards Afghanistan since 1947. In addition to an estimated 6,000 illegal border crossings per day, this unmanageable border facilitates a vast black economy that flourishes on illicit drug trade and smuggling.⁴

Afghanistan is more a prisoner of its geography than is Pakistan; landlocked nations rarely enjoy access to the markets, resources, and new technologies that they need to flourish in the global economy. For its part, Pakistan has steadfastly supported Afghanistan's economic survival: in 1965, Pakistan and Afghanistan signed the Afghanistan Transit and Trade Agreement (ATTA) to facilitate the flow of goods and services across their borders.⁵ ATTA was renegotiated in 2010 during the Pakistan People's Party (PPP)'s government paving the way for the establishment of the Afghanistan and Pakistan Transit Trade Agreement (APTTA), which provided both countries the right to use each other's specified land routes and ports for foreign trade. Based on Articles 3 and 4 of APTTA, Pakistan provides Afghanistan access to use Karachi, Qasim and Gwadar Ports, as well as the Wagah route for overland trade with India. In return, Pakistan is granted transit rights through Afghanistan's border crossings at Ai-Khanum and Sher Khan Bandar (with Tajikistan), Aqina and Torghundi (with Turkmenistan), Islam Qala and Zaranj (with Iran), and Hairatan (with Uzbekistan). In 2012, the Pakistan-Afghanistan Joint Chamber of Commerce and Industry (PAJCCI) and the Afghanistan-Pakistan Transit Trade Coordination Authority (APTTCA) were established to further facilitate and ensure and advance the implementation of APTTA.⁶

While the signing of the 2010 agreement led to a surge in the total volume of trade and transit between the two countries in the early years, APTTA's successes have been limited due to an unenviable, and seemingly endless, slew of political and security constraints. In 2016-17 the number of containers travelling to Pakistan fell to 70,305 against 84,583 containers imported the previous year, reflecting a decline of 16.9 per cent.⁷ Based on available data, Pakistan's exports to Afghanistan have declined by 36 per cent since 2010-11, while its imports from Afghanistan have risen by 169 per cent, with the overall trade balance heavily skewed in Pakistan's favor.⁸ However, mounting security concerns, together with Kabul's own political instability and policy gridlock, the continual threat of border closures, customs delays, and existence of non-tariff barriers (NTBs), will likely retard transit and bilateral trade further.

The Dividends of Connectivity: What's at Stake?

Despite enormous challenges, Pakistan today remains Afghanistan's largest trading partner.⁹ For Pakistan, Afghanistan ranks fourth in cumulative exports to major countries. The top ten exports of Pakistan to Afghanistan largely include consumer and food items: cereals including wheat flour, raw sugar, construction material including cement and plastics, fruit and vegetables, animal and

4 <http://hikal.gov.pk/index.php/layouts/item/109-border-management-the-case-of-pakistan-and-afghanistan-border>

5 <http://www.fto.gov.pk/userfiles/isaf/Annex-C.pdf>

6 <http://www.pajcci.com/>

7 <https://www.dawn.com/news/1363011>

8 <http://www.pajcci.com/Downloads/Pak-Afghan%20Quarterly%20Bilateral%20&%20Transit%20Trade%20Analysis-%20January%202017.pdf>

9 <https://www.usip.org/publications/2015/08/future-afghanistan-pakistan-trade-relations>

vegetable fats rice, petroleum etc. As far as services are concerned, Pakistan provides business and government-related services, telecommunications, information technology and transport, and health services.

While trade between Pakistan and Afghanistan has admittedly grown since 2001, much of this remains informal and hence does not translate into official statistics. The 1965 agreement, renegotiated in 2010, has yet to be revised even though discussions have been ongoing for several years, and Article 50 of the agreement requires the provisions of the deal to be revised and amended to facilitate transit trade. The Convention on International Transport of Goods Under Cover of TIR Carnets (TIR Convention), effective from January 2016, provides that goods travel in customs-secure vehicles or containers, and throughout the journey duties and taxes at risk be covered by an internationally valid guarantee.¹⁰ This amendment is expected to help Pakistan export goods to Central Asia without payment of duty and taxes via Afghanistan. In exchange, however, Afghanistan has been pushing Islamabad for Indian transit through Pakistan. The latter has proven to be a red line for Pakistan, with officials maintaining that APTTA, as a bilateral agreement, does not contain mechanisms to facilitate trade with India and that India has never officially demanded transit access.

It has also become increasingly clear in recent years that geographic contiguity and the volume of trade flowing to Afghanistan from Pakistan have not automatically translated into positive cross-border branding. In 2014, shortly after President Ghani's election, then Prime Minister Sharif reached out to the Afghan leadership to strike a number of trade deals to boost bilateral trade from the current \$1.6 billion to \$5 billion by 2017.¹¹ The agreements included reducing tariffs and granting each other preferential trade status. President Ghani offered Pakistani investors access to Afghanistan, including free industrial zones. The PML-N leadership also considered establishing an export bank and initiating a currency swap with Afghanistan. These promises, however, saw little follow-through.

Security problems on both sides of the border frequently serve to interrupt seasonal trade. Traders moving goods through Pakistan and Afghanistan often have to bribe militants and local leaders to ensure that their goods can move safely, which increases the cost of trade exponentially. Added to this is the fact that formal banking ties between the two countries remain limited, owing to which traders have to rely on unofficial transfers and work with ever-changing exchange rates.¹² Cumbersome customs delays owing to the practice of checking all containers rather than checking through randomised selection further slow down the process. There have been some small gains in this regard: Pakistan is presently working to computerise its systems to help remove hindrances in trade with Afghanistan. Afghanistan's Commerce Ministry has agreed to a paperless goods declaration processing system for non-commercial importers. In 2015, Pakistan announced a series of steps to address security concerns including allowing system-based partial shipment of Afghan transit goods instead of manual processes, and reducing scanning quotas for Afghan transit cargo from 100 per cent to 20 per cent.¹³ Though measures such as these are useful in facilitating trade, more work is needed to fully address existing deficiencies. Three quarters of all goods smuggled into Pakistan come through the APTTA before being diverted to Pakistani markets, evading the imposition of customs duties.¹⁴ Afghan traders, meanwhile, complain that

10 <https://www.thenews.com.pk/print/98997-Govt-to-revise-Afghanistan-Pakistan-Transit-Trade-Agreement>

11 <https://tribune.com.pk/story/791556/afghan-president-arrives-at-pm-house/>

12 <https://www.usip.org/publications/2015/08/future-afghanistan-pakistan-trade-relations>

13 <https://www.dawn.com/news/1159862>

14 <https://www.brecorder.com/2017/10/10/373935/conduits-of-smuggling-is-cpec-next/>

Afghan products are sold back to Afghanistan from Pakistan at higher prices, forcing Afghans to pay custom duties on their own goods.

The main beneficiaries of APTTA over the years have been Afghanistan's and Pakistan's private sectors, which have, unsurprisingly, found lucrative market alternatives to tap for import and export purposes. APTTA has also given ordinary households access to a wider basket of imported goods and services, leading to a drop in prices for goods. According to a report for the fiscal year 2015-16, more than 84,500 containers of goods traveled across the border that year, directly or indirectly supporting livelihoods in either country. These benefits notwithstanding, it is worth pausing to acknowledge the reasons for the downward trends in trade in recent years: heightened security protocols on the Pakistani side, improved manufacturing facilities in Afghanistan, the rise in Afghanistan's trade with Iran and other regional economies, and a growing reliance on informal trade.¹⁵

The India Question

India has long yearned for transit access to Afghanistan, an ask that sits uneasily with Islamabad which has legitimate security concerns about an enhanced Indian strategic footprint on its western front. The emergence of independent Central Asian Republics in the last decade of the twentieth century coincided with a rapid growth of the Indian economy, intensifying the desire for land access to energy rich countries in Central Asia. But any solution that includes India in a regional trade framework must also contend with Pakistani concerns about its industries remaining competitive, and not getting shut out of the Afghan market, as well as expectations that India will reciprocate in kind, e.g. by lowering high tariffs on competitive Pakistani goods.

In 2016, Pakistan and Afghanistan engaged in a six-month long pilot run of Afghan trucks from Torkham and Chaman up to Wagah, and Pakistani trucks from Torkham and Chaman to Sher Khan Bandar in Afghanistan.¹⁶ Even without direct transit access, India is the second-largest destination for Afghan exports. With the finalising of the trilateral Iran-India-Afghanistan Chabahar agreement in April 2016, Chabahar became operational with the maiden shipment of wheat from India to Afghanistan in October 2017, a major achievement in India's Afghan outreach aimed at bypassing Pakistan. India expects that granting Afghanistan access to the sea via Chabahar port will ease its dependence on Pakistani ports. Indeed, a growing part of Afghanistan's transit trade is presently being routed through the Iranian port of Chabahar, almost \$1.2 billion in the past couple of years by the estimates of Pakistani businessmen.¹⁷ In 2008-09 nearly 60 per cent of Afghan imports were transited through Pakistan. While this figure dropped to less than 30 percent in 2016, Afghan trade through Iran increased from 20 per cent to 40 per cent during the same period.¹⁸

Despite all this, the fact remains that without a clear economic rationale, Chabahar might do little more than embroil the region in unnecessary geopolitical competition. After all, the deal depends on Indian state investment, Iranian stability, and of course Afghan security. Kabul has reportedly warned India that the Taliban could attack trucks carrying Indian exports. This warning is given force by the fact that the Taliban control or contest most of the districts to the east or west of Delaram, the terminus of the Indian-built highway from Iran. Thus Indian goods traveling to Kabul or Herat will have to pass through, or close to, some of the most dangerous parts of the country. In June 2017 India established a pilot aerial corridor with Afghanistan and reported to

15 <https://tribune.com.pk/story/1556183/2-afghanistan-trade-pakistan-falls-grows-iran-2/>

16 <https://www.pajhwok.com/en/2016/02/18/boost-trade-trial-run-trucks-wagah-allowed>

17 <https://www.dawn.com/news/1363299>

18 <https://www.cacianalyst.org/publications/analytical-articles/item/13492-irans-chabahar-port-empowers-india-afghanistan-trade-at-pakistan-expense.html>

have imported 1,550 tonnes of fresh and dry fruits, handmade carpets and herbal to India. This first aerial saw the operation of 52 flights. New Delhi projects that the new corridor will boost annual trade between the two countries from \$700 million to \$1 billion in three years and give a lift to exports of Afghanistan's agricultural and carpet industries.¹⁹ But neither Kabul nor New Delhi can ignore facts pertaining to the commercially viability of sustaining imports via air – a practice that is unconventional and vulnerable to procedural delays and a shortage of cargo planes.²⁰

Future Prospects, Existing Bottlenecks

In early 2016, Islamabad and Kabul agreed to constitute a high-level committee to discuss issues relating to visas, road permits and guarantees for the implementation of the TIR Convention. But practical and political concerns remain. Although Afghanistan has been a key export destination for Pakistani goods for the past two decades, it is hard to ignore the drastic downside in trade between the two countries during the last five years. Over the last 15 years, the Torkham and Spin Boldak passes have often been closed, the primary ways for Afghanistan to reach seaports and Pakistani markets, detaining thousands of loaded trucks for weeks on both sides of the border. These sudden border closures cost Pakistan a reported \$3 billion in export losses.²¹ Farmers and small traders take an especially hard hit when a year's worth of work is wasted on loaded trucks stranded on the border.

On the Afghan side there are concerns vis-à-vis Pakistan's increasing customs tariff rates, now up to 150 per cent on 120 out of 741 Afghan goods being exported to Pakistan.²² Such perceptions have ramifications: in October 2017 President Ghani took the tripling of tariff rates on Afghanistan's exports as justification to ban the entry of Pakistani trucks to his country via the Torkham and Spin Boldak crossings.²³ He decreed that Pakistani trucks should unload at the border and their goods be carried to their destinations only by Afghan trucks, a convention that Pakistan follows with respect to trade between Afghanistan and India via Wagah. Afghanistan alleged that President Ghani's decision was justified based on Article 54 of APTTA, which states: "The contract (APTTA) will remain in to force for a period of 5 years from the date of its enforcement (2011) and shall automatically be renewed for a further period of 5 years unless terminated by either contracting parties with valid justification(s)."

It is also true that sustained mistrust has pushed both capitals to question the logic of geo-economic foreign policy prerogatives, and look for alternative routes for trade. Pakistan, as the main beneficiary of China's ambitious Belt and Road Initiative (BRI) and specifically the China-Pakistan Economic Corridor (CPEC), is gearing up on plans to fast-track access to Tajikistan via China using the Karakorum Highway that will in time make Tajikistan its gateway to Central Asia.²⁴ Meanwhile, Afghanistan has expanded its trade routes and partners in the region and beyond. Along with the partial opening of Chabahar Port and accession to the World Trade Organization in 2016, Afghanistan has signed 31 bilateral trade and investment agreements, 10 bilateral economic agreements and five tripartite agreements.²⁵

19 <https://www.voanews.com/a/india-afghanistan-air-freight-corridor-opens/3909537.html>

20 <http://www.thehindu.com/news/national/india-afghan-air-trade-facing-tough-times/article19446614.ece>

21 <https://www.tolonews.com/business/torkham-closure-racks-3bn-usd-losses-pakistan>

22 <https://www.tolonews.com/business/pakistan-triples-customs-duties-afghan-goods>

23 <https://www.tolonews.com/business/ghani-bans-pakistani-trucks-entering-afghanistan>

24 <https://www.dawn.com/news/1333101>

25 https://www.wto.org/english/thewto_e/acc_e/3_afganrta_e.pdf

However, long-standing trade relations and corporate and private consumers' reliance on these trade routes and products make the continuation of trade and transit between Pakistan and Afghanistan essential. As neighbors, both sides are intertwined economically to a degree that, at least in the short term, makes it unlikely that either will find an equally lucrative alternative trade route or partner. Geographic proximity and the relatively low costs of production of exported goods will always reduce the overall cost of bilateral trade. Furthermore, the South Asian Free Trade Area (SAFTA), a regional trade agreement between eight South Asian countries that was established in 2006 with the intention to promote and enhance trade and economic integration through tariff concessions, has almost failed to achieve its goals. Instead, over the last few years, numerous bilateral, trilateral and quadrilateral trade agreements have been signed, making the renewal and further extension of APTTA inevitable and indeed a singularly viable option.

What Next?

Among the reasons for the downturn in flow of trade in locally-produced goods and services, from 75,000 containers in 2010 to fewer than 49,000 containers in 2016, are NATO's reduced demand for transit services, the recent slowdown in Afghanistan's economy and higher flows of transit via Iran and Central Asia.²⁶

This said, there is consensus within economic and business circles that renewing APTTA can help buck recent headwinds and help shore up bilateral trust. The agreement could also, potentially, better serve the goal of regional and cross-regional integration between Afghanistan, Pakistan, India and Tajikistan, provided Pakistan's strategic concerns vis-à-vis India are also realised. The fact is that more robust economic and trade links can greatly help reduce poverty by spurring growth, impacting income, as well as and increasing investment and employment opportunity. Today while there are 11 notified trade routes between the two countries, trade is allowed only through three.²⁷ There is also a need to expand the presence of Pakistani banking networks in Afghanistan. To curb smuggling, Pakistan has already taken important steps in the way of paperless clearance and tariff rationalisation; that said, illegal trade can be further checked by improving border procedures and strengthening bonded transport to enable transit trade cargo to move more smoothly.

Similarly, the inclusion of Afghanistan in the China-Pakistan Economic Corridor could boost the country's economy, but its implementation will be difficult for Beijing without regional consensus and a green light from the US. The Chinese government has already said it is willing to bring Afghanistan into the fold of its nearly 60-billion-dollar project.²⁸ But this would necessitate, first, an improvement in bilateral ties between Islamabad and Kabul, with both sides taking steps to address existing grievances.

Political will is of course a necessary driver of change in any context, but there is little reason why Islamabad and Kabul should not make a joint bid to liberalise trade and devise mechanisms to facilitate the flow of goods, minimise tariffs and remove erstwhile barriers. If anything, the motivations for better economic relations are only too apparent: namely, regional peace, and political and economic stability, which are worth fighting to protect.

26 <https://www.pakistantoday.com.pk/2018/01/16/drastric-downslide-seen-in-pak-afghan-trade-sdpi-deputy-executive/>

27 <http://afghanstudiescenter.org/2018/01/17/better-trade-relations-between-pakistan-afghanistan-can-help-reduce-poverty-contains-crss-8th-pak-afghan-youth-dialogue/>

28 <http://www.dw.com/en/can-afghanistan-join-china-pakistan-economic-corridor/a-42094595>