



# AFGHANISTAN AND CENTRAL ASIA: Strengthening Trade and Economic Ties

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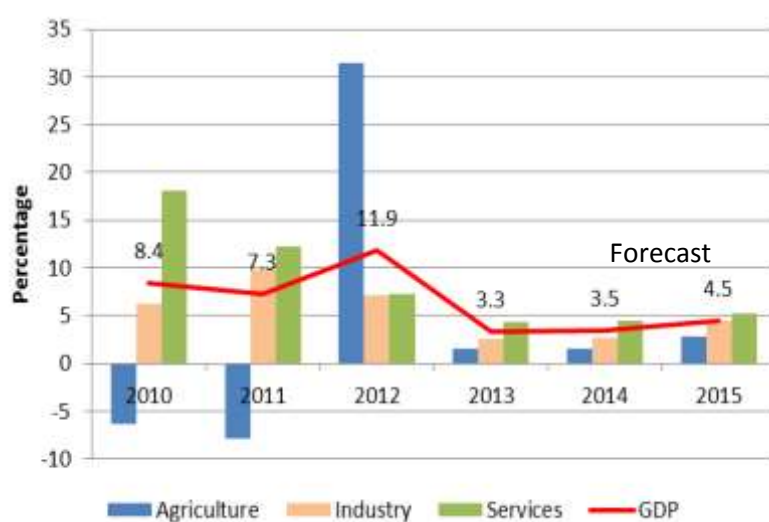
## 1. EXECUTIVE SUMMARY

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

*Afghanistan is facing a difficult period of economic and political transition; further regional integration, including with the countries of Central Asia, will be an essential element of any future development strategy.*

- Afghanistan has made significant developmental gains over the past decade. For instance, per capita income increased more than threefold between 2003 and 2013, rising from \$198 to \$678 (World Bank Development Indicators, 2014).
- However, Afghanistan remains among the poorest countries in the Asia-Pacific region with wide ranging social and economic challenges. Further, the country is now facing a difficult period of economic and political transition. The withdrawal of foreign security forces, alongside reductions in the volume of donor assistance, is already having direct impacts on economic growth.
- Economic growth in 2013 was estimated at 3.3% having fallen from 11.9% in 2012. For 2014 and 2015 GDP growth is expected to be 3.5% and 4.5%, respectively (figure 1.1) (ADB, 2014). The recent formation of a new government should remove some of the political uncertainties and support further expansion in industrial and services outputs.
- However, the World Bank estimates that growth—after the transition towards Afghan control of security—will be around 5% a year under the baseline scenario in the period 2015-2018. This is a significant drop from the 9.4% average growth seen from, 2003-2012 which was supported by donor assistance and security spending (World Bank Global Economic Prospects, 2014).

**Figure 1.1: Afghanistan's GDP growth, 2000-2015**



Source: ADB 2014

- To succeed in the coming years, Afghanistan should take advantage of its unique geographical position as a 'land bridge' linking Central and South Asia, as well as making use of its substantial natural resources. Considerable long-term benefits to employment, revenues and economic

growth are available, both to Afghanistan and its Central Asian neighbours, if a successful regional framework can deliver on the region's trade, transport, and transit potentials.

- Regional co-operation can bring specific benefits in terms of: economies of scale to increase local supply capacity and improve access to markets; integrated or harmonized treatment of trans-boundary issues such as trade, regulatory frameworks and policies, and regional infrastructure; and management of shared natural resources.
- For Afghanistan and Central Asia, particular opportunities exist in energy trade, transit trade, and border trade among populations close to crossing-points. Regional integration is thus a vital component in managing a successful transition in Afghanistan. The Russian Federation and South Asian countries are also integral to successful integration efforts.
- Indeed, for landlocked countries such as Afghanistan and the Central Asian Republics, regional integration is especially imperative: increasing regional integration not only encourages increased trade and connectivity within the region, but also, by creating links across the region to external markets, enables broader integration with large regional markets and the global economy more broadly.

*Afghanistan continues to run large trade deficits as exports are limited and trade remains highly concentrated by both partners and products. Levels of foreign direct investment are low despite considerable opportunities in the natural resources sector.*

- Afghanistan runs large and longstanding trade deficits. Afghanistan's total merchandise exports were \$515 million in 2013, whereas imports were \$8,724 million. Afghanistan depends heavily on imports of fuels, food staples, processed materials, and manufactured goods, largely due to a lack of domestic infrastructure for production and processing. Total imports have been generally rising since 2008 when they stood at \$3,019 million.
- Exports, though low in overall volume, have grown in recent years. Indeed, merchandise exports grew 20% in 2013 whereas imports contracted by 4%. This indicates weak links between imports and exports which is symptomatic of a lack of capacity to engage in many value-adding activities. The largest exported categories of goods included vegetable products; textiles; mineral products; briquettes; metals (10%) consisting almost exclusively of scrap iron. However, due to weaknesses in Afghanistan's border security and customs, an estimated 40% of total trade goes unrecorded (World Bank, 2013).
- In terms of partners, Afghanistan's trade in merchandise goods is heavily concentrated (table 1.1). Pakistan is by far the largest trading partner for Afghanistan, accounting for 47% of exports and 14% of imports in 2013 according to WTO figures. However, Pakistan's likely true share of both is higher as much trade is 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 but it also makes transit issues through Pakistan of critical importance.
- While not currently among Afghanistan's top 5 trading partners, the Russian Federation is also a potentially important partner. In 2013, the Russian Federation imported only \$14 million from Afghanistan. Over \$13 million of which were fruits and vegetables. In contrast, Afghanistan imported \$418 million from the Russia Federation. Over \$300 million of imports were for mineral fuels, other categories of significance were wood articles (\$55 million) and animal and vegetable fats (\$20 million).

- Afghanistan at present receives relatively small amounts of foreign direct investment (FDI). Total greenfield FDI inflows for the period 2009-2013 were recorded at around \$4.4 billion (FDI Markets, 2014). By comparison, Myanmar received over \$9 billion over that period.
- China was the largest source of inward FDI accounting for over three quarters of this total inflow. Chinese investment was primarily concentrated in natural resources, such as copper and gold. However, uncertainties over the legal regime governing resource extraction, as well as security concerns, appear to be delaying planned investments.

**Table 1.1: Afghanistan's exports and imports by major partner, 2013**

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	47	Pakistan	30.7	Pakistan	14.2	Pakistan	21.2
India	16.3	India	19.4	China	11.5	Iran, I.R.	15.2
Iran, I. R.	6.2	UAE	13.2	Japan	9.7	China	14.1
China	1.1	Iran, I.R.	7.8	Iran, I.R.	8	Turkmenistan	9.3
Saudi Arabia	0.4	Iraq	6.2	European Union	4.7	Uzbekistan	4.8
Unspecified	28.7	China	3.6	Unspecified	50	Japan	4.8

*Source: WTO Trade Profiles, 2014; Government of Afghanistan, 2014*

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

*Existing trade linkages between Afghanistan and Central Asian countries are weak, but potential exists for further development in a number of sectors, notably: energy trade, transit trade and informal border trade.*

- Afghanistan and the Central Asian countries all face common challenges related to their landlocked geographic position and need for greater economic diversification. The region is far from major economic centres, and has relatively small populations and market sizes, underdeveloped infrastructure and political and security challenges that pose risks for human development (Mogilevskii, 2012).
- Despite the long common border linking Afghanistan and three of the five Central Asian states (Turkmenistan, Uzbekistan and Tajikistan) trade linkages remain extremely limited. Likewise, in terms of cross-border investment projects, current international data does not record any flows between Central Asia 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 \$13.2 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 \$1.67 billion).

**Table 1.2: Afghanistan's exports to Central Asia (2011)**

	Kazakhstan	Kyrgyz Republic	Tajikistan	Turkmenistan	Uzbekistan
<b>\$ millions</b>	3.83	0.07	5.31	3.85	0.15
<b>% total</b>	0.70%	0.01%	0.97%	0.70%	0.03%

**Table 1.3: Afghanistan's imports from Central Asia (2011)**

	Kazakhstan	Kyrgyz Republic	Tajikistan	Turkmenistan	Uzbekistan
<b>\$ millions</b>	333.31	23.54	226.89	352.98	732.45
<b>% total</b>	5.22%	0.37%	3.55%	5.52%	11.46%

Source: UN COMTRADE

- 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. Uzbekistan is the largest source of imports among the Central Asian countries, with total imports worth (\$732 million) in 2011. Next is Turkmenistan (\$353 million), followed by Kazakhstan (\$333 million), and Tajikistan (\$226 million). Imports from the Kyrgyz Republic were valued at \$24 million.
- As noted, Afghanistan's exports to Central Asia are highly limited in terms of value and composition in comparison with imports. Official trade data is also not widely available. However, 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. Tajikistan has the highest recorded imports from Afghanistan in 2011, followed by Kazakhstan and Kyrgyzstan.
- In addition to 'standard' trade—in which data on the type of good, its origin, quantity, and price are recorded by border authorities—'non-standard' 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. Because of its nature, however, data is scarce. Some estimates are that around 40% of Afghanistan's total trade by value is unrecorded (World Bank, 2012).
- A study of Afghanistan's non-standard border trade with its Central Asian neighbours found that the bulk of trade with Uzbekistan and Tajikistan passes through only two crossing points: at 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).*

- SPECA was launched in 1998 in order to strengthen subregional cooperation amongst countries in Central Asia and to integration the subregion 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 and connectivity hub between Europe and Asia. 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 the Representative of Afghanistan. The theme of the conference was "Improving Connectivity: a key contribution of SPECA to the success of the Transformation Decade of Afghanistan."
- 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. Within the framework of RECCA, Afghanistan completed a range of joint development projects with the governments of countries of Central Asia. In its objectives, RECCA acts as an extension of Afghanistan National Development Strategy and has channelled 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).
- 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 also 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 initiative is to promote cooperation in 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

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