WTO Accession of Afghanistan: Costs, Benefits and Post Accession Challenges

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ABSTRACT

The paper undertakes cost-benefit analysis of Afghanistan's accession to WTO while attempting to shed light on the post accession challenges. For the empirical part of our analysis we have applied WITS/SMART model to assess the implication of WTO membership. Tariff cut is the independent variable and government revenue, trade creation, consumer welfare and general welfare of the economy. The results show that, Afghanistan consumers stand to benefits from tariff reforms with overall positive welfare gains to the economy. However a reduction in tariff will lead to fall in government revenue and substantial increase in imports which may raise some concerns over negative trade balance. The last section of the paper studies the post accession challenges of WTO accession with special focus to development, institutional, legal and environmental challenges. But our analysis based on the sectoral mix of Afghanistan's economy suggests that producers will lose out. Finding of this study supports the argument to maintain maximum policy space for Afghanistan for its long term development needs purposes.

Keywords: Liberalization, WTO Accession, Afghanistan Economy, Policy Space, Accession Challenges

1. **Introduction**

Having completed the bulk of the accession formalities[1], Afghanistan is scheduled to become the 35th Least Developed Country (LDC)[2] member of WTO. Afghanistan is a land locked country but strategically located at the heart of Silk Road[3] which even today can serve as "trade and transit hub" of Central Asia and South Asia[4]. It is believed that sustainable economic growth through attracting significant trade and investment cannot be achieved without broader integration into the world economy. Afghanistan National Development Strategy (ANDS) explicitly recognizes the role of trade for economic development and highlights Afghanistan's integration into the world economy as one of the key development goals for which membership to WTO is an essential step (ANDS, 2008). Economic Growth and Poverty Reduction is the core objectives of ANDS[5] which place greater emphasis on a free market and private sector-led economy.

With the belief that WTO will foster economic growth through increased exports and attraction of Foreign Direct Investment (FDI), Afghanistan applied for WTO membership. Almost all trading partners of Afghanistan at SAARC, Central Asia and West Asia are WTO are either WTO members or are in the process of accession, therefore WTO membership gives Afghanistan broader chance for fair trade through dispute settlement mechanism at WTO (MoCI, 2012). However, WTO accession requires extensive reforms to adjust to its rules and regulations to be compatible with multilateral trade regime under the WTO. These compliance requirements itself poses a real challenge to a Least Developed Country like Afghanistan. Keeping in view the development objectives of Afghan government, this paper undertakes a cost benefit analysis of Afghanistan's accession to WTO and assesses the challenges for post accession. The objective is to identify key sectors of the economy where policy space needs to be preserved to address future development challenges. Furthermore, the study provides an ex-ante and ex-post assessment of Afghanistan's accession to WTO. Cost and benefit analysis in this study is a pre accession stimulation, while in a separate section we study the post accession challenges.

The study is structured as follows: The second section of the paper presents an overview of trade and economic profile of Afghanistan. The third section briefly presents the WTO accession process of Afghanistan while the fourth section is devoted to empirical part of the study by undertaking

1 The fourth meeting of the Working Party was held on 25 July 2013 in which Afghanistan was urged to resolve outstanding technical issues, enact the few outstanding draft laws and conclude remaining bilateral negotiations to ensure that it remains on track to complete its accession process at the Ninth Ministerial Conference (MC9) in Bali.

2 There are 44 countries recognized as LDC by the UN, of which 34 countries are member of WTO. Eight LDCs including Afghanistan, Bhutan, Comoros, Equatorial Guinea, Ethiopia, Liberia, Sao Tome & Principe and Sudan are currently negotiating for WTO membership. Yemen is the recent LDC member of WTO.

3 The Silk Road was a network of trade routes that linked cities, trading posts, hostels and caravan-watering places. It was most active from about 300 BC to 200 AD and extended between the Eastern Roman frontier in the Middle East to the Chinese frontier, with other paths going north through Afghanistan from the Indian Ocean to the Siberian Steppe.

4 Afghanistan representative presentation to WTO, 2012

5 For details the reader can refer to ANDS Preamble

simulation of cost and benefits of WTO accession in terms of consumer and welfare gain and implication on government revenue. This will allow us to identify sensitive sectors of the economy. In section five, the post accession challenges are briefly discussed. Final section concludes with major findings of the paper.

2 Economic and Trade Profile of Afghanistan

2.1. Afghanistan Economy: A general Overview

Afghanistan is a land locked, war-torn and aid dependent economy. The total area of the country is 652864 square kilometres and population is approximately 30 million out of which 78% are living in the rural areas (AISA, 2013) and it is primarily an agrarian economy (75% of population; World Bank). The per capita GDP of the country amounted to 687$, GDP in 2012 with a staggering economic growth of 14.4%, real GDP growth for the same period was 9.2% and the inflation rate was 6.4% (CSO, 2013). In 2012 agriculture produce of the country contributed 24.6% to the GDP. Industry is at a very primary stage and more or less run at small scale. The industrial produce of the country includes textiles, soap, furniture, shoes, fertilizers, leather, non alcoholic drinks, cement, carpet and natural gas. The industrial products of the country are mainly meant for the domestic consumption and do not have much contribution to the foreign exchange earning of the country. According UN classification of countries, Afghanistan is one of the poorest countries in the world and it is classified both as a Least Developed Country (LDC)[6] and a Land-locked Developing Country (LLDC). Measures like Human Development Index (HDI) places Afghanistan at a very low level of human development when measured by health, education and living standards. These measures reflect the results of decades of conflict which has destroyed much of the agricultural and industrial capacity of the country.

Table 2-1 Structure of Afghanistan Economy for the year 2012

Indicator	Value/Percentage
Population	29.82 Million
GDP	20.5 billion
GDP Per Capita	687 USD
GDP growth	14.40%
Inflation	7.20%
Imports of goods and services as percentage of GDP	39.20%
Exports as percentage of GDP	5.50%
Current Account Gap	7.5 billion USD
Services as percentage of GDP	53.5
Trade in Services	25.90%
Agriculture Value added as percentage of GDP	24.60%
Industry as a percentage of GDP (2011)	22.50%
Source: World Bank (2013	

Even after several years of economic growth since international forces intervened and toppled the government in 2001, estimates place 42 percent of the population below the national poverty line. The

[6] The least developed countries (LDCs) are a group of countries that have been classified by the UN as "least developed" in terms of their low gross national income (GNI), their weak human assets and their high degree of economic vulnerability (Source: UN).

following World Bank sectoral analysis of the Afghan economy would further facilitate to understand the dynamics of economy and its position in international trade.

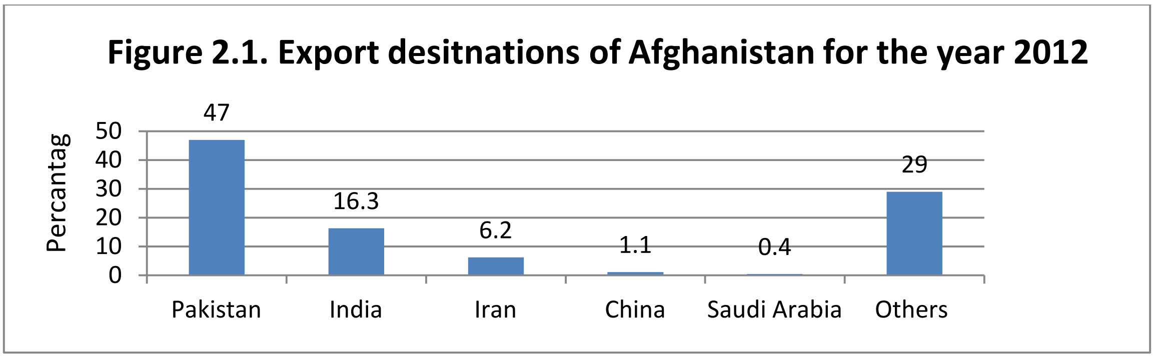
2.2. Exports and Imports

As of 2011 the export-import ratio of the country was 20% (as per World Bank data calculation). The larger portion of exports of the country is consist of dried fruits, saffron, fresh fruits, rags, leather and precious stone to the target markets such as Pakistan, India, United Arab Emirates, Kazakhstan, Uzbekistan and some other countries. Import portfolio of the country includes almost everything from food to industrial products, automobiles, heavy machines and energy. Since its establishment in 2002, the government of Afghanistan has understood the importance of trade with its neighbours and has tried to integrate with them through membership in regional organizations such as South Asian Association for Regional Cooperation (SAARC) to which Afghanistan became a member in the year 2007, and Shanghai Cooperation Organisation (SCO) in which Afghanistan is an observer from 2012.

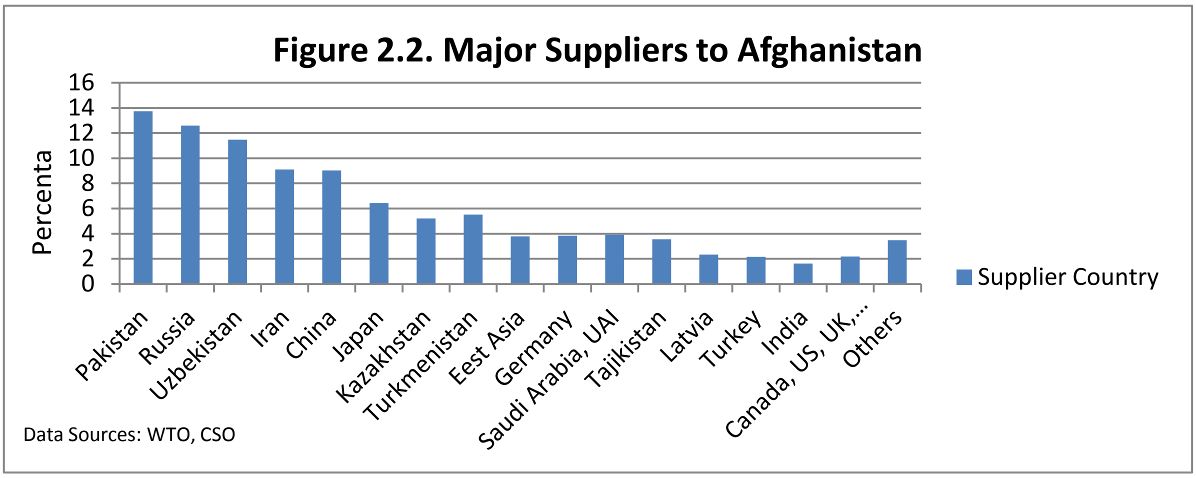
While the major trade partners are those which are members to regional organizations like SAARC and Shanghai with whom Afghanistan is already a trade partner, and has agreed on minimum tariffs. Yet, it has not been able to capture a significant share in these markets for its exports. SAARC member states have signed South Asian Free Trade Area (SAFTA) according to which the Non-Least Developed Contracting States (NLDCS) such as India, Pakistan and Sri Lanka and the other five Least Developed Contracting States (LDCs) including Afghanistan would bring down their tariffs to 20% and 30% respectively[7]. In addition to this Afghanistan has signed Preferential Trade Agreement (PTA) with India, according which it has agreed to reduce its tariffs for some necessary goods such as tea, medicines, sugar, cement imported from India.

Total value of exports of the country amounted to 370 million dollars in 2012 with a meagre share 0.03% of world exports. 86% of total exports earnings were from agricultural products while 14% was from manufactured commodities. Pakistan, India, Iran, Saudi Arabia, Russia and European Union are the major export destinations of the country (Figure 2.1). Afghanistan is a net importer sourcing almost everything from abroad, from heavy machinery, automobiles, and technology to textiles and food. The major supplying countries are Pakistan, China, Japan, Iran, India, European Union and some other countries (Figure 2.2)

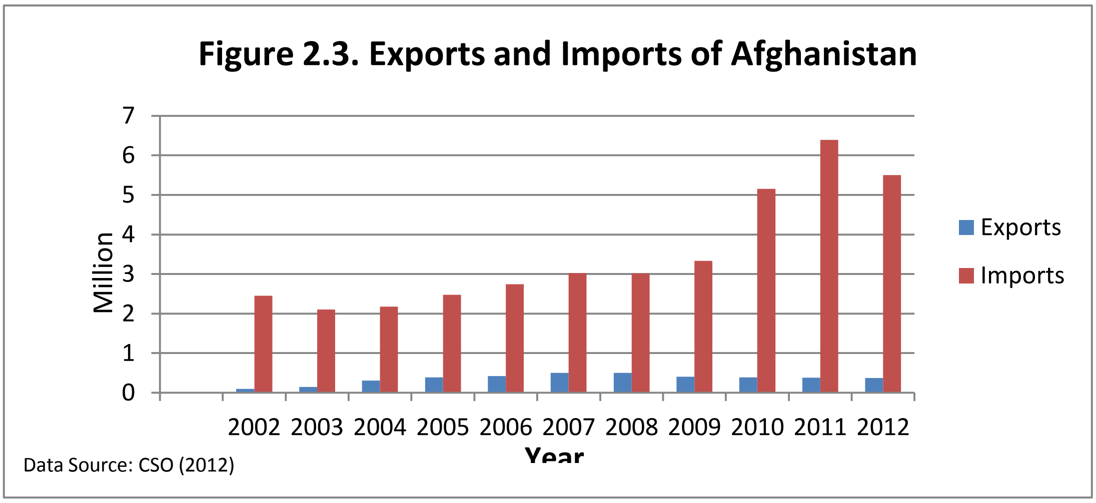
[7] Article 7 of the SAFTA Agreement



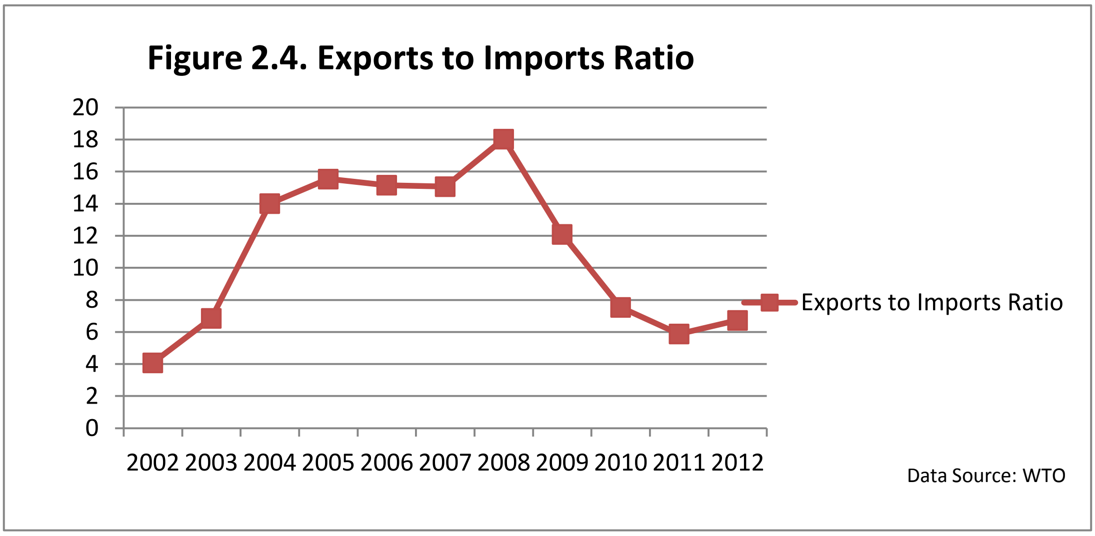
SAARC countries alone make up 60% of the export markets for Afghanistan (ADB, 2012) and Afghanistan imports 30% of its requirements from SAARC countries. The Afghanistan-SAARC trade intensity index has declined, but the trade growth has had fluctuations.



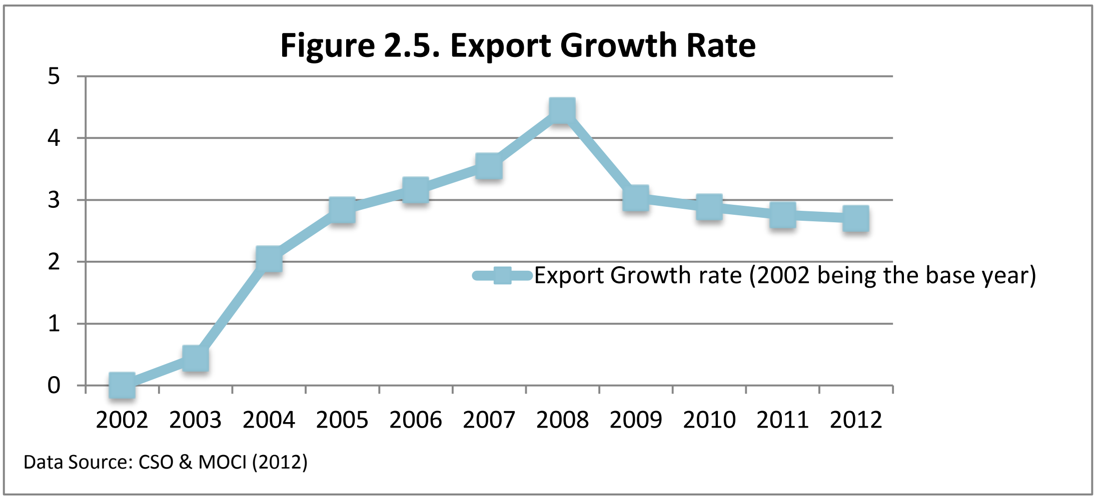
The export-import gap in Afghanistan is always very huge. The data for exports and imports is available for the years 2007 to 2012. The figure 2.3 depicts this gap.



Export-Import Ratio has always been very below 20 percent, for instance in the year 2002 when the country was just recovering from conflict and the foreign aid started flowing to the country the ratio was approximately 4 percent and it keep on normal increase till 2008 when the ratio was 18 percent, later on it started declining to 6.8 percent in 2012. The figure 2.4 depicts the export to import ratio trends for the last 10 years.

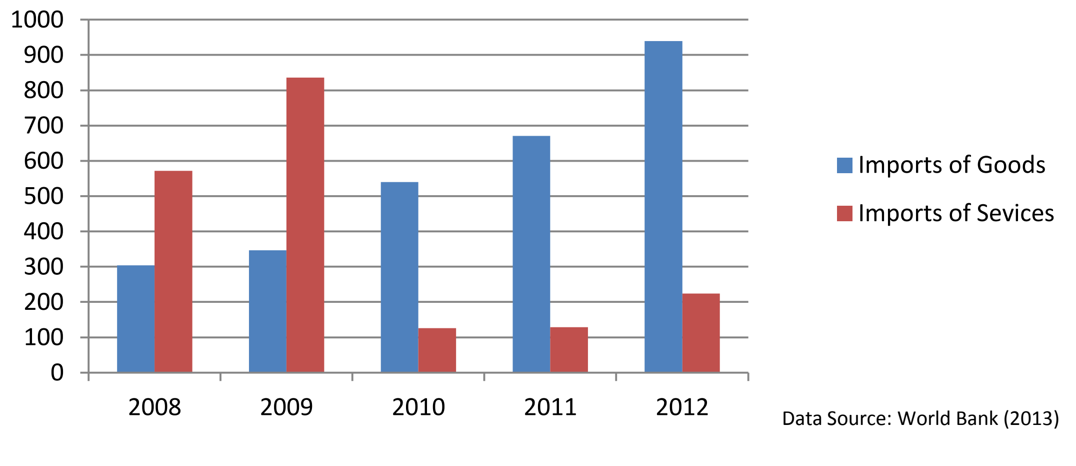


Export growth rate of the country has not been so fascinating as well. If we take 2002 as the base year for the country's export performance, again the data shows that this growth has been smooth till 2008 (4% growth in comparison to 2002) and then goes through a steady decline to 2 percent in 2012. The average growth rate of exports for this period is approximately 2.78 percent per year. The following figure shows the export growth trend of the country. One of the fundamental reasons for exports lagging behind imports is the fact the country heavily relies on the foreign aid and aid-funded projects constitutes the major portion of imports such as machinery and oil. The fiscal gap in 2007-08 was 70%, which reduced to 34% in 2012 and has been financed by aid throughout.



Imports of goods and services in Afghanistan changes depending on the circumstances, for instance till 2008, due to lack of capacity the country had to avail of foreign consultancy services in all walks of public management, and therefore the share of services is more than that of goods. While later on services imports decline and goods imports increases (Figure 3.6). However, the investment in services is one of the potential sectors to grow far better and attract FDI more than production sector in case Afghanistan accesses to WTO and reduces its charges for the foreign businesses in services.

Figure 2.6. Imports of Goods and Sevices (value in 100 million USD)



Data Source: World Bank (2013)

2.3. Tariff Profile of Afghanistan

Since the inception of the post-Taliban regime in Afghanistan, in order to maintain the prices at affordable level to the consumers, without regards to the current account deficit, the government of Afghanistan has maintained the tariff level to the minimum possible. The tariff structure maintained by Afghanistan National Tariff Schedule (ANTS) is based on a Harmonized Commodity Description and Coding System (HS 2012), and the tariff rates consists of 14 tariff bands which ranges from 0 to 50% (Table 2.2).

Table 2.2. Tariff Structure of Afghanistan for the year 2012

Serial No	Tariff Band	No of Tariff Lines	Share in Total
1	0.00%	27	0.502699683