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UNAUTHORIZED TRADE BETWEEN PAKISTAN AND AFGHANISTAN
A Preliminary Assessment of its Extent and Economic Impact

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UNAUTHORIZED TRADE BETWEEN PAKISTAN AND AFGHANISTAN: A Preliminary Assessment of its Extent and Economic Impact[1]

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ACRONYMS

ACD	Afghan Customs Department
APTTA	Afghanistan Pakistan Transit Trade Agreement
ATTA	Afghanistan Transit Trade Agreement
FAO	Food and Agriculture Organization
FY	Fiscal Year
GDP	Gross Domestic Product
GoP	Government of Pakistan
IMF	International Monetary Fund
MFN	Most Favored Nation
MoC	Ministry of Commerce
N/A	Non-Applicable
NGO	Non-Governmental Organization
NLC	National Logistic Cell
NWFP	North West Frontier Province
PCD	Pakistan Customs Department
PTP	Pakistan Trade Project
ROZ	Reconstruction Opportunity Zones
SAARC	South Asian Association for Regional Corporation
SAFTA	South Asia Free Trade Area
SRO	Statutory Regulatory Orders
SY	Solar Year
UAE	United Arab Emirates
UN	United Nations
US	United States
USAID	United States Agency for International Development
USD	United States Dollars
USG	United States Government
WB	World Bank

EXECUTIVE SUMMARY

BACKGROUND

The governments of Pakistan and Afghanistan are currently at the final stage of negotiations for the historic Afghanistan Pakistan Transit Trade Agreement (APTTA), a far-reaching successor to the 1965 Afghanistan Transit Trade Agreement (ATTA). APTTA will not only boost trade between the two countries, but it will also help lay the foundation for greater economic integration between the economies in Central Asia and South Asia –one of the least integrated regions in the World. Closer economic relations between the South and Central Asian regions make intuitive sense. Central Asia has some of the highest reserves of oil and natural gas, and it is also major source for industrial raw materials like bauxite and iron ore. South Asia is home to around 1.5 billion consumers who increasingly demand more energy and other industrial products. In essence, South Asia is the natural growth market for Central Asia and East Asian countries. For Pakistan, the successful implementation of APTTA would provide the opportunity to develop, over the longer run, as a trade and investment hub linking business networks in South and East Asia, Middle-East, and Central Asia. For Afghanistan, it would provide the external markets that are essential for a small economy to achieve sustainable levels of economic growth.

A paper produced for the USAID entitled "The Economic Impact of APTA on Pakistan"[2] has argued that APTTA offers significant gains to Pakistan in the short-run, and in the medium to long-term. It has also argued that the implementation of APTTA will ensure that unauthorized trade flowing into both Pakistan and Afghanistan will be substantially reduced with greater surveillance and control at the critical border posts. This paper draws heavily from the analysis provided in the earlier USAID paper.

An issue often raised in the negotiations has been the impact of 'unauthorized trade', on the Pakistan's economy, whereby goods that enter Pakistan for transit to Afghanistan are diverted to the Pakistani domestic market, and goods that legally enter the Afghanistan market are illegally diverted to Pakistan (re-exported) to avoid higher import tariffs. The conclusions of this paper and the earlier USAID paper indicate that APTTA will not at all have any adverse impact on Pakistan, and Afghanistan on account of this unauthorized trade. In fact, the trade and transport facilitation reforms embedded in the APTTA Agreement will ensure that smuggling is reduced with better manned and controlled border posts. While there is no reliable estimate of illegal trade (not including contraband items like drugs and weapons) between Afghanistan and Pakistan, it is roughly estimated to be around USD 2 billion. This paper has estimated that Pakistan is losing about USD 270 million as duty forgone from smuggling. The earlier referenced USAID paper had estimated a revenue gain of USD 135 million attributed to the implementation of the APTTA. The figure of USD 135 million of revenue gain is based on the assumption that half of the USD 2 billion a year illegal trade would cease to exist with the removal of the incentives to smuggle. This is based on the much higher import duty for some items in Pakistan relative to Afghanistan, which results in the smuggling of such items into Pakistan via Afghanistan, and the average MFN applied tariff average in Pakistan is about 13.5 percent (World Trade Indicators 2008). Most of this trade is carried out along the non-formalized border crossing between the two countries. If the APTTA formalizes a number of these border crossings, and harmonizes tariffs between the two economies in a manner that removes some of the incentives to smuggling, especially of such items as tea and electronic goods, it is likely that a large majority of the currently illegal trade would then come through official channels, allowing Pakistan to collect Customs revenues. Given the political sensitivity attached to currently reducing tariffs in Pakistan in light of the tight fiscal situation, the short-run revenue gain may be less than that amount in the long-run, though the revenue gain still will be very significant. In short, APTTA will not

[2] USAID The Economic Impact of APTA on Pakistan. 3 September 2009

aggravate the flow of unauthorized trade into Pakistan, but should help to reduce it with better trade facilitation efforts to be jointly undertaken by both governments.

The assessment in this paper corroborates these points with the use of available official data on the Afghanistan Transit Trade, and proposes a number of possible near-term and long-term interventions that could reduce the extent and impact of smuggling.

TRADE BETWEEN AFGHANISTAN AND PAKISTAN

Afghanistan and Pakistan have long been natural trading partners, and since the overthrow of the Taliban in 2002, formal trade between Pakistan and Afghanistan has ballooned, rising from a mere USD 3 million in 2002 to USD 1.72 billion in 2008/09. Pakistan is Afghanistan's largest trading partner, accounting for 24.8 percent of Afghanistan's imports in 2008/09, and 33.1 percent of Afghanistan's formal exports. The GoP has set the target of increasing exports to Afghanistan to USD 2 billion within the next several years.

In addition to being significant trading partners, Pakistan provides Afghanistan's most efficient route to the sea, and thus to global markets. In turn, Afghanistan provides Pakistan with a route to Central Asia, both a growing market for goods and services and a source of potential energy imports. Both countries have vital interests, economic and strategic, in ensuring an ongoing and vital transit trade. Transit trade with Afghanistan has almost certainly had a positive impact on the growth in bilateral trade between the two countries, and has the potential to yield growing economic benefits to both countries in the years to come. With competing transit routes to Afghanistan now nearing completion, including new roads to major Afghan cities from the Iranian port of Chahbahar, Pakistan has particular interests in undertaking the necessary interventions and reforms to ensure its ability to retain its status as the primary transit route to Afghanistan.

THE PROBLEM OF UNAUTHORIZED TRADE

While the 1965 Afghanistan Transit Trade Agreement (ATTA) has undoubtedly brought significant economic benefits to Pakistan, it was not able to arrest any significant amounts of 'unauthorized trade' taking place on account of poor implementation of trade facilitation at the borders. Such 'unauthorized trade' were conducted in two principal manners: **transit diversion**, whereby goods which are notionally in transit to Afghanistan through Pakistan do not in fact enter Afghanistan, being instead diverted for sale in Pakistan; and illegal **re-export**, whereby goods are transited and physically and/or legally enter Afghanistan but are subsequently smuggled back into Pakistan across the porous border. Some rough estimates suggest a 70/30 ratio in value terms for illegal re-export and transit diversion.

Goods that have been identified as particularly prone to smuggling through these means include:

- **Tea:** Although Afghans' preference is generally for green tea rather than black, large quantities of black tea were imported under the ATTA, much of which reportedly ended up in Pakistan's markets
- **Power Generators and Electrical Equipment:** As demand in Pakistan for electrical goods such a dry cell batteries, rechargeable lights, generators and uninterruptable power supplies increased significantly, so too did the import of such goods through Afghanistan, presumably destined for Pakistan's market
- **Tires:** It is argued that as much as 75 percent of the domestic demand for bus and truck tires is supplied through the Afghanistan transit trade
- **Air Conditioners:** in 1994, Pakistan recorded imports of Rs. 30 million in air conditioners, while Afghanistan, with little electricity and very low domestic demand, recorded imports of more than Rs. 1 billion. It was argued that a large share of the Afghan imports was re-exported, appearing in Pakistan's markets.

- **Textile (Cloth):** A common commodity re-exported illegally into the country in substantial quantities. It is being sold in various markets in Peshawar and its surrounding areas and is a major concern for the authorities. It is argued that the local textile industry is being damaged by this unauthorized trade.
- **Vehicles and Spare parts:** Another common item finding its way into the Pakistani markets and causing huge losses to the exchequer and the local industry. The high duty structure in Pakistan serves as a significant incentive for smugglers to bring the goods into the country. These items, however, do not transit through Pakistan but are rather imported through Iran from the Middle East.
- **Other items** commonly re-exported illegally to Pakistan albeit not necessarily in great quantities include mobile phones, blankets/quilts, cosmetics, arms and ammunition, lubricants, items of industrial use, plastics and finished goods, antiques, timber, betel nuts, spices and cooking oil.

EVIDENCE IN CUSTOMS DATA FOR UNAUTHORIZED TRADE

Analysis of Pakistan Customs Department and Afghanistan Customs Department data paints a picture of the transit trade that is consistent with Pakistani concerns regarding unauthorized trade. It is, however difficult to find conclusive evidence regarding the volume or impact of unauthorized trade through the official data. Further studies, in particular on a good-by-good basis based on comparing trade data of exporting countries, with that of Pakistan and Afghanistan, should be undertaken to assemble a more quantitative foundation of evidence regarding the size and impact of unauthorized trade. In addition, analysis of other factors/players influencing Afghan Transit Trade (ATT) needs to be thoroughly studied. But even short of that, the conclusions of this paper and the earlier USAID paper highlight that APTTA will help reduce the volume of unauthorized trade into both Afghanistan and Pakistan.

Results are available for a few products. What the official data do show is that synthetic fabric, along with various types of machinery and equipment represent the largest contributors to the.ATT. The GoP has also identified both of these categories as areas where products are likely to find their way to Pakistan's markets illegally. Other products, not necessarily transiting through Pakistan, include vehicles and spare parts.

Based on PCD's data, machinery and electrical equipment comprised around 13 percent of the transit trade in both 2007/08 and 2008/09, with the transit trade representing a rising proportion of total Afghan imports across the two years. Textiles, meanwhile, constituted 17 percent of the Afghan transit trade in 2007/08, rising to almost 20 percent in 2008/09, with the majority of these imports being synthetic fabrics. When compared to total Afghan imports of textiles, the recorded transit trade constituted 41 percent of total Afghan imports in 2007/08, rising dramatically to 81 percent in 2008/09. It is not clear from the data alone how significant these high ratios of transit trade to total Afghan imports are, with respect to evidence of unauthorized trade activity, although the large size of the transit trade relative to total Afghan imports would certainly appear consistent with concerns regarding both diversion and re-export.

While this high-level analysis of transit trade data from Pakistan, and import data from Afghanistan thus yields inconclusive results, item by item analysis may present a fruitful avenue for future enquiry to more concretely document the extent and impact of unauthorized trade. In the case of tea, for example, the Pakistan Tea Association estimates the total market size for tea in Pakistan to be approximately 175 million kilograms per year, or roughly 1 kg per person, some 70 kg greater than the official imports of 105 million kg. By contrast, Afghanistan, with a population of only 28.4 million, imported some 91 million kg of tea in 2007/08, and 112 million kg in 2008/09. If the demand estimate of 1 kg per person were also to hold for Afghanistan, that would suggest surplus supply in 2007/08 of 63 million kg, and of 84 million kg in 2008/09, available for elicit re-export to Pakistan. Because such analyses are highly sensitive to assumptions of per-capita market demand, they remain for the moment inconclusive, but demonstrate a fruitful path of future enquiry to more concretely document the impact of unauthorized trade between the two countries.

POLICY-BASED INCENTIVES FOR UNAUTHORIZED TRADE

More telling than the Customs data are the results of an analysis of the incentives for unauthorized trade between Pakistan and Afghanistan. In 2003, Afghanistan embarked upon a significant simplification of its tariff structure, and liberalization of its trade policy. Prior to 2003, Afghanistan had a complex tariff regime with 27 different tariff bands, and rates ranging from zero to 150 percent, and averaging 43 percent. By contrast, the post-2003 Afghan regime includes just 12 ad valorem bands, with 93 percent of all goods falling into the tariff bands of 2.5 percent, 5 percent and 10 percent, and an average tariff rate of just 5.5 percent.

While Pakistan has also undertaken significant trade liberalization in recent years, its average tariff remains significantly higher than that in Afghanistan. Pakistan has ended most forms of quantitative restrictions, leaving tariffs as the main trade policy instrument, with a regime of 14 different bands, ranging from zero to 90 percent, but at 14.5 percent, its average tariff is some 8.9 percent higher than that of Afghanistan.

Examining the goods that are argued to be particularly significant in the unauthorized trade, it quickly becomes apparent that tariff differentials on these goods provide a significant incentive to unauthorized trade. As the below table demonstrates, on all of these goods, tariffs are significantly higher in Pakistan, with all goods other than tea having tariff differentials of about 8.9 percent on average:

Goods	Tariff Differential (Pakistan Tariff less Afghanistan Tariff)
Electric Heaters	25%
Tires	22.5%
Electric Generators	17.5%
Synthetic Fabrics	12.5%
Tea	7.5%

Thus it appears that for the key goods where it is asserted that there are substantial leakages from the transit trade, significant incentives to unauthorized trade exist, in the form of tariff differentials. Electronic goods, textiles, tires and tea also all feature in the list of goods reported seized by Pakistan Customs. While in contrast to other items, like vehicles, the quantities of these goods seized are not large, this provides further evidence that is consistent with the view that these goods form significant part of unauthorized trade. It should, however, be noted that differentials with Afghan tariffs provide an incentive only for the re-export form of unauthorized trade, since only in this form are tariffs in Afghanistan actually paid. In the cases of transit diversion, the incentives for unauthorized trade rather concern absolute tariff levels in Pakistan, and their cost relative to the probability-weighted costs of indictment for smuggling.

The large volume of smuggling on account of huge tariff differentials can be reduced only when tariffs are harmonized between the two countries, along with implementation of the proposed trade facilitation reforms, including strict controls at the border posts. Pakistan will need to address the issue of further tariff rationalization in the medium-term when the fiscal situation improves in order to boost its sagging exports.

POSSIBLE REMEDIES AND RESPONSES

In response to the problem of unauthorized trade, a number of near-term and long term interventions could significantly reduce the incentives for unauthorized trade, both by increasing the costs of such smuggling, and reducing the benefits that accrue from it. In the near term, interventions focused on Customs processing systems and procedures to make trade diversion more difficult appear the most fruitful avenue for intervention. These policies should be embedded in the APTTA. Steps that warrant consideration in this regard include:

- **Improve Border Procedures including:** strengthening the role of Customs brokers; facilitating pre-arrival information and processing; use of targeting/selectivity/risk management; reducing dwell times; strengthening control of exemptions; implementing accountability measures; reducing full examinations by implementing an "authorized trader" scheme supported by post clearance audit; improving information sharing between Pakistani and Afghan Customs administrations. These interventions should be designed to reduce the opportunity to smuggle goods into Pakistan, and raise the costs to smugglers of doing so. A 'gap analysis' is currently underway in Pakistan to determine the current state with regard to Customs procedures for Afghan goods in transit, and compare these to a desired end state as envisaged in the APTTA. Similarly, a comprehensive assessment of the physical Custom infrastructure which supports the procedures should be carried out and any shortcomings should be highlighted for improvement in future, possibly as part of the APTTA.
- **Strengthen the Bonded Transport and Guarantee System:** In addition to improvements in the use of bonded carriers, an internationally, regionally or nationally valid guarantee system for transit trade is needed to safeguard revenue in case of transit diversion. Such a system does not currently appear to be in place. For such a system to be effective, reliable, and auditable, bonded carriers should be used to move the goods into Afghanistan, with goods travelling under a bond that is released once a verifiable and reliable Afghan Customs entry document is processed and communicated back to the point of origin.
- **Improve Entry Procedures at Karachi and Port Qasim:** This will be particularly important given anecdotal evidence that currently significant amounts of under-invoicing and mis-declaration is taking place. Improving accurate accounting of goods would reduce the scope for transit diversion, while increasing the prospects for revenue collection by Afghan Customs as well as ensuring that an appropriate amount is secured by a reliable bond guarantee in suspended regimes to protect Pakistan revenue. Development of an accurate post clearance audit function would also ultimately enable the development of a voluntary, incentive-based system whereby carriers with strong records for accurate declaration might be rewarded with expedited clearances and other benefits.
- **Explore alternative means for directly controlling ATTA imports:** In categories where unauthorized trade is deemed particularly problematic, use of a modern risk management system should be utilized in the medium term rather than use of a negative list or quantitative restrictions that are fraught with problems associated with discretionary controls.
- **Further tariff rationalization in Pakistan to make its exports more competitive:** As stated earlier, Pakistan should seriously consider reducing its tariff levels to those prevailing in the East Asian economies. This will boost exports, as well as reduce smuggling.

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INTRODUCTION

The governments of Pakistan and Afghanistan are currently engaged in negotiations for the Afghanistan Pakistan Transit Trade Agreement (APTTA), a successor to the 1965 Afghanistan Transit Trade Agreement (ATTA). APTTA will not only boost trade between the two countries, but it will also help lay the foundation for greater economic integration between the economies in Central Asia and South Asia—one of the least integrated regions in the world. And indeed closer economic relations between the South and Central Asian regions make intuitive sense. Central Asia has some of the highest reserves of oil and natural gas, and it is also major source for industrial raw materials like bauxite and iron ore. South Asia is home to around 1.5 billion consumers who increasingly demand energy and other industrial products. In essence, South Asia is the natural growth market for Central Asia and East Asian countries.

One issue that has been raised, concerns the extent and an economic impact of what is referred to as 'unauthorized trade' that takes place under the existing transit trade practices, and whether the APTTA will have any adverse impact as a result of increased smuggling. In this context, unauthorized trade generally refers to goods that enter Pakistan for transit to Afghanistan that are diverted before reaching the border as well as goods that enter Afghanistan (having entered through Customs or having turned back to Pakistan prior to reaching Customs) but are subsequently smuggled back into the country. The Pakistan government's principal concern is that Afghan transit trade is providing an unintended means for substantial amounts of smuggling to take place that significantly reduces revenues and undermines the ability of Pakistani traders and manufacturers to compete with this illegal trade. It would appear that the Afghan government shares concerns with respect to lost revenue due to diverted transit trade. However, Afghan trade policies aim at reducing the transaction costs of trade and one of their stated goals for the current negotiations is to improve the efficiency with which goods are imported and exported i.e. reduce cost of doing business[3]. Hence the Government of Pakistan requested that a study be completed of the unauthorized trade occurring between Afghanistan and Pakistan specifically in relation to the ATT, its extent and the likely impact on Pakistan's economy. This paper attempts to do that within limitations imposed by the severe data gaps.

Afghanistan and Pakistan are natural trading partners. After nearly three decades of conflict and turmoil in Afghanistan, opportunities for bilateral trade in goods and services have dramatically increased since the overthrow of the Taliban in 2002. Indicative estimates of the extent of formal trade between Pakistan and Afghanistan are[4]:

- USD 3 million in 2002;
- USD 492 million in 2003/04;
- USD 1.63 billion in 2005/06;
- USD 1.25 billion in 2006/07;

[3] See Ministry of Commerce and Industry, the Government of Islamic Republic of Afghanistan, *Trade Policy Framework*.

[4] Note that more than 90 percent of bilateral trade are exports from Pakistan to Afghanistan, reflecting a substantial and persistent trade surplus in Pakistan's favor. Estimates presented in this paper have been drawn from a variety of sources and require further verification for consistency and accuracy.

- USD 1.21 billion in 2007/08;[5]
- USD 1.72 billion in 2008/09.

The Government of Pakistan has set a target of increasing exports to Afghanistan to USD 2 billion within the next several years. The recent high rate of growth in trade between the countries suggests that this goal can be achieved if barriers to trade continue to be reduced while economic integration is strengthened, including through measures such as the effective implementation of the South Asia Free Trade Agreement (SAFTA).

Table 1 Trade with Pakistan

Proportion of Afghanistan's total trade	2007-2008	2008-2009	Change
Imports (%)	23.7	24.8	1.1
Exports (%)	33.1	26.1	36.4

Pakistan is Afghanistan's largest trading partner and its relative importance has increased steadily in recent years (see table 1 above). In 2007/08 Pakistan accounted for 23.7 percent of Afghanistan's total recorded imports; in 2008/09 this increased to 24.8 percent.[6] Pakistan is also the primary destination for formal Afghan exports. In 2007/08 this amounted to USD 67.1 million or 33.1 percent; in 2008/09 exports increased to USD 69.5 million but declined to 26.1 percent of total Afghan exports. (This was largely due to significant increases in exports to Tajikistan and India.) With the expected sustained high rates of economic growth of the region it is likely that the amounts of bilateral trade will continue to grow in the future.

In addition to being significant trading partners, Pakistan provides Afghanistan's most efficient route to the sea and the rest of the world's markets. Afghanistan provides Pakistan with an export route to the rapidly growing markets of Central Asia, a potential major supplier of energy. To provide a legal foundation for increased trade, Pakistan and Afghanistan entered into the 1965 Afghan Transit Trade Agreement (ATTA), which permits both countries to transit goods through their territory.

While this Agreement would appear to have largely achieved its objectives, it has not been able to arrest the considerable amounts of 'unauthorized trade' taking place, which in this context amounts to the diversion of Afghan imports transiting through Pakistan before reaching the border and/or the illegal re-export of goods from Afghanistan after physically crossing the border and/or after payment of duty in Afghanistan. There are a number of examples of goods which have reportedly entered Pakistan in these ways, including:

- **Tea:** Pakistanis prefer black tea while Afghans prefer green tea. Large quantities of black tea were being imported under the ATTA, much of which reportedly ended up in Pakistan's markets.[7]
- **Power generators and other types of electrical equipment:** Evidently in response to a significant increase in demand in Pakistan for these goods (e.g. dry cells, rechargeable lights,

[5] Note that the estimates for 2007/08 and 2008/09 are based on estimates for exports to Afghanistan from the Pakistan Federal Bureau of Statistics and estimates for Afghan exports, which are relatively small, from published estimates from the Afghanistan Customs Department.

[6] ACD estimates reported on www.customs.gov.af.

[7] See *The Impact of Afghan Transits Trade on NWFP's Economy*, by Dr Sayed Waqar Hussain, Edited by Alauddin Masood, Area Study Centre, University of Peshawar and Hanns Seidel Foundation, April 2004; and, more specifically with regard to tea, for example, the article published in The Daily News (Pakistan), "Traders demand rationalisation of ATT tariffs", 6th November 2009.

UPS, etc) imports of these types of goods through the ATTA increased substantially, presumably destined for Pakistan's market.

- **Tires:** It is argued that as much as 75 percent of the domestic demand for bus and truck tires is supplied through the Afghan transit trade.[8]
- **Cloth:** A common commodity re-exported illegally into the country in substantial quantities. It is being sold in various markets in Peshawar and its surrounding areas and a major concern for the authorities. It is argued that the local textile industry is being damaged by this unauthorized trade.
- **Vehicles and spare parts:** Another common item finding its way into the Pakistani markets and causing huge losses to the exchequer and the local industry. The high duty structure in Pakistan serves as an incentive for smugglers to bring the goods into the country. These items, however, do not transit through Pakistan but are rather imported through Iran from the Middle East.
- **Other items** commonly re-exported illegally to Pakistan albeit not necessarily in great quantities include mobile phones, blankets/quilts, cosmetics, arms and ammunition, lubricants, mobile phones, items of industrial use, plastics and finished goods, antiques, timber, betel nuts, spices and cooking oil.

Box 1: Air conditioners

In 1994 Pakistan recorded imports of Rs. 30 million in air conditioners. In the same year Afghanistan recorded imports of more than Rs. 1billion worth of air conditioners, while having little electricity and very low domestic demand. It was argued that a large share of the Afghan imports appeared in Pakistan's markets.

The objectives of this paper are to examine the nature of the transit trade that is taking place under the present ATTA; assess the procedure, nature and scope of the unauthorized trade that may be taking place based on facts, available data and its economic and revenue impacts; review the relevant trade policies of the two countries and their contribution to conditions that foster the unauthorized trade taking place; present recommendations on how the issue of unauthorized trade may be addressed, and most importantly, indicate the link of the proposed APTTA in addressing the issue of smuggling.

[8] See for example the article published in The Nation, "Smuggling damaged local tyre industry", November 14, 2009.

CURRENT STRUCTURE OF AFGHAN TRANSIT TRADE

The first step in examining the structure of Afghan transit trade is to identify the amount and type of goods entering into the process. The focus here is entirely on goods intended as Afghan imports. The ATTA established five border points (see figure 1) through which all transit trade is expected to pass:

- Karachi Port
- Port Qasim
- Peshawar-Torkham/Jalalabad
- Chaman-Spin Boldak
- Ghulam Khan-Kelli.

Figure 1: Some of Pakistan's border points

Karachi Port and Port Qasim are the points where imports to Afghanistan may enter Pakistan for duty free transit while the remaining three border points above (and as identified in figure 1) are where these goods may pass from Pakistan into Afghanistan under the Agreement.[9] Detailed data, by 8-digit Harmonized System code, have been provided by the Pakistan Customs Department for Afghan transit trade that enters through Karachi Port and Port Qasim for the two most recent years, (i.e., July 2007 to June 2008 and July 2008 to June 2009). For 2007/08 there were 1,472 different types of goods (8-digit classification) moving under the ATTA, which increased to 2,007 different types of goods in 2008/09. In order to provide a general picture of the general structure of these imports, Table 1 presents these data at a high level of aggregation, corresponding to main HS sections.[10] Less highly aggregated estimates, corresponding to HS Chapters, are presented in Appendix 1.

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[9] It is understood that the great majority of transit trade enters Afghanistan through the Peshawar-Torkham/Jalalabad border point. Data on transit imports from the Afghanistan Customs Department are being sought which would clarify this issue.

[10] The broad HS sections used in this paper correspond to the following HS chapters: Animal and Animal Products, Ch 01-05; Vegetable Products, Ch 06 to 15; Foodstuffs, Ch 16 to 24; Mineral Products, Ch 25 to 27; Chemicals and Allied Industries, Ch 28 to 38; Plastics and Rubbers, Ch 39 and 40; Raw Hides, Skins, Leather, and Furs, Ch 41 to 43; Wood & Wood Products, Ch 44 to 49; Textiles, Ch 50 to 63; Footwear and Headgear, Ch 64 to 67; Stone and Glass, Ch 69 to 71; Metals, Ch 72 to 83; Machinery and Electrical, Ch 84 and 85;

The data indicates a major increase in the total level of transit trade between the two years, from Rs. 56,801 million to Rs. 117,296 million or an increase of 106.5 percent. The reason (or reasons) for this sharp increase are not readily apparent. It does not reflect a significant increase in GDP growth. Although the Afghan economy grew at the robust rate of 16.2 percent in 2007/08, apparently the growth rate for 2008/09 was very much lower, estimated to be 2.3 percent.[11]

Table 2: Afghan Transit Trade through Karachi and Port Qasim: High Level Aggregation *(Millions of Rupees)*

Trade Items	July 2007 – June 2008		July 2008 – June 2009	
	Amount	Percentage	Amount	Percentage
Foodstuffs	10,019	17.64%	12,027	10.25%
Textiles	9,709	17.09%	23,273	19.84%
Machinery and Electrical	7,490	13.19%	17,079	14.56%
Vegetable Products	7,195	12.67%	15,394	13.12%
Transportation	5,390	9.49%	4,351	3.71%
Animal and Animal Products	3,900	6.87%	5,129	4.37%
Chemical and Allied Industries	2,933	5.16%	4,241	3.62%
Plastics and Rubber	2,824	4.97%	5,501	4.69%
Metals	2,364	4.16%	3,911	3.33%
Wood and Wood Products	1,216	2.14%	3,086	2.63%
Mineral Products	1,042	1.83%	2,028	1.73%
Miscellaneous	984	1.73%	3,923	3.34%
Services (Mainly Official Imports)	779	1.37%	15,375	13.11%
Stone and Glass	696	1.22%	1,405	1.20%
Raw Hides, Skins, Leather and Furs	131	0.23%	330	0.28%
Footwear and Headgear	131	0.23%	245	0.21%
TOTAL	**56,801**	**100%**	**117,296**	**100%**

Source: Pakistan Customs Department (Project data)

Total Afghan reported imports grew from USD 3,408 million in 2007/08 (Solar Year 1386) to USD 4,050 million in 2008/09 (SY 1387), or by 18.9 percent, (see Table 4, below). It would appear that most of the far higher growth in imports relative to the far lower GDP growth rate can be attributed to increased imports in three key categories: vegetable products, mineral products and to a lesser degree transportation equipment. These sharp increases are almost certainly, largely a reflection of the significant increases in food and fuel prices that took place globally.

Another possible explanation for the sharp increase in Afghan transit trade could be due to the depreciation of the Pakistani Rupee, which went from an average exchange rate against the dollar of Rs. 63.6 to Rs. 75.0, or by approximately 18 percent during the period.[12] To better assess the real changes in Afghan transit trade, the original estimates were converted to dollars using these exchange rates, (see Table 2).

Transportation, Ch 86 to 89; Miscellaneous, Ch 90 to 97; and 'Services', Ch 98 and 99. Further details can be seen in Appendix 1.

[11] Based on the Afghanistan Central Statistic Office estimates for Solar Year 1386 (i.e., 2007/08) and the most recent estimate for Solar Year 1387 (2008/09). Note that Afghanistan operates on Solar Calendar where the year runs from 21st March to 20th March, while Pakistan operates on a fiscal year from 1 July to 30 June. This approximately three month difference creates difficulties in comparing some data.

12 This is based on average monthly exchange rates reported by the IMF.

Table 3: Afghan Transit Trade through Karachi and Port Qasim: High Level Aggregation *(Millions of US Dollars)*

Trade Items	July 2007 – June 2008		July 2008 – June 2009	
	Amount	Percentage	Amount	Percentage
Foodstuffs	157.54	17.64%	160.29	10.25%
Textiles	152.68	17.09%	310.16	19.84%
Machinery and Electrical	117.78	13.19%	227.61	14.56%
Vegetable Products	113.14	12.67%	205.16	13.12%
Transportation	84.76	9.49%	57.98	3.71%
Animal and Animal Products	61.32	6.87%	68.35	4.37%
Chemical and Allied Industries	46.11	5.16%	56.52	3.62%
Plastics and Rubber	44.40	4.97%	73.31	4.69%
Metals	37.17	4.16%	52.12	3.33%
Wood and Wood Products	19.11	2.14%	41.13	2.63%
Mineral Products	16.38	1.83%	27.03	1.73%
Miscellaneous	15.47	1.73%	52.28	3.34%
Services (Mainly Official Imports)	12.25	1.37%	204.91	13.11%
Stone and Glass	10.94	1.22%	18.73	1.20%
Raw Hides, Skins, Leather and Furs	2.06	0.23%	4.40	0.28%
Footwear and Headgear	2.05	0.23%	3.26	0.21%
TOTAL	**893.17**	**100%**	**1,563.22**	**100%**

Source: Pakistan Customs Department

The nominal and real growth rates, based on Tables 2 and 3, are presented in Table 4. Denominated in dollars, total Afghan transit trade increased from USD 893.17 million to USD 1,563.22 million. (Thus, transit trade amounted to 26.2 percent of total imports in 2007/08 and 38.6 percent in 2008/09.) When measured in real (or dollar) terms, the increase in Afghan transit trade between 2007/08 and 2008/09 is substantially less than in nominal (or Rupee) terms: 75.0 percent as compared with 106.5 percent.

It is worth examining briefly the changing pattern of Afghan transit trade in trying to explain the determinants underlying the sharp increase in total Afghan transit trade. There are seven broad sections where real growth was above average.

- **Services (Mainly Official Imports):** This accounted for 1.37 percent of transit trade in 2007/08, but increased substantially to 13.11 percent the following year. It appears that there was a shift in procedures that results in substantially increased amounts of goods imported by diplomats, embassies or other exempt entities being imported as transit trade. In any case, this is a relatively small category and little impact on to overall increase.

Table 4: Afghan Transit Trade through Karachi and Port Qasim: Nominal and Real Growth Rates 2007/08 to 2008/09 *(Percentages)*

Trade Items	Growth Rate (Nominal)	Growth Rate (Real)
Foodstuffs	20.0%	1.7%
Textiles	139.7%	103.1%

Trade Items	Growth Rate (Nominal)	Growth Rate (Real)
Machinery and Electrical	128.0%	93.2%
Vegetable Products	113.9%	81.3%
Transportation	-19.3%	-31.6%
Animal and Animal Products	31.5%	11.5%
Chemical and Allied Industries	44.6%	22.6%
Plastics and Rubber	94.8%	65.1%
Metals	65.5%	40.2%
Wood and Wood Products	153.9%	115.2%
Mineral Products	94.6%	65.0%
Miscellaneous	298.8%	238.0%
Services (Mainly Official Imports)	1,873.3%	1,572.5%
Stone and Glass	102.0%	71.2%
Raw Hides, Skins, Leather and Furs	151.8%	113.4%
Footwear and Headgear	87.3%	58.8%
TOTAL	**106.5%**	**75.0%**

Source: Tables 2 and 3. See text for details.

- **Miscellaneous:** This area includes optical, photographic, telephonic equipment, and related materials, but accounted for only 1.73 percent (2007/08) and 3.34 percent (2008/09) of total Afghan transit trade. An examination of the detailed data suggests that there were some increases in equipment related to the ongoing investment in the telecom sector, including the implementation of the fiber optic system. None of these are particularly large increases in value terms and as a result contributed relatively little to the overall increase.
- **Wood and Wood Products:** This area includes paper and paperboard and articles of paper pulp. Relatively important imports included toilet and facial tissues, diapers for infants and photocopy paper, et al. The area accounted for only 2.14 percent (2007/08) and 2.63 percent (2008/09) and did not have a significant impact on total transit trade.
- **Hides and Leather:** This is another relatively small area, contributing 2.06 percent (2007/08) and 4.40 percent (2008/09) to total Afghan transit trade. The high growth rate was a result primarily of increased imports of a number of different leather products.
- **Textiles:** This is a major area contributing substantially to Afghan transit trade, 17.09 percent (2007/08) and 19.84 percent (2008/09). The largest single good (HS eight-digit) in both years was synthetic fabric. In 2007/08, HS 5514.2100 polyester fiber, plain weave alone accounted for 8.13 percent of total transit trade. In 2008/09, this good was still significant but its share of the total declined considerably to 1.05 percent. At the same time HS 5512.1900, a similar type of synthetic fabric, accounted for 13.3 percent of total transit trade in 2008/09 where the year before it contributed 2.91 percent of transit trade. It would appear that there may have been a shift in the type of synthetic fabric being imported in high volumes. It is worth noting that synthetic fabric imports through Afghan transit trade as a share of Afghanistan's total textile imports doubled between these two years, (see Tables 6 and 7 below).
- **Machinery and Electrical Equipment:** This area is a major source of transit trade imports in both of the years examined: 13.19 percent (2007/08) and 13.56 percent (2008/09). There are no goods within this group with exceptionally large levels of transit trade imports. Rather, there are substantial amounts for a number of different types of

goods. Amongst the most prevalent goods are transformers and generators. As was the case with textiles, the share of transit trade for this group increased substantially between the two years, (see Tables 6 and 7 below).

- **Vegetable Products:** There are two types of goods that predominate in this area: edible oils and tea. Edible oils contributed 6.74 percent (2007/08) and 6.66 percent (2008/09) to total Afghan transit trade while tea was responsible for 5.16 percent (2007/08) and 5.60 percent (2008/09), (see Appendix Table 1). In contrast to the preceding two areas, transit trade in vegetable products did not contribute substantially to total Afghan imports in either year. In 2007/08 it accounted for 21.7 percent and in 2008/09 24.8 percent.

Based on the data available, it would appear that there are two areas where Afghan transit trade is most likely to find its way to Pakistan's markets, notably synthetic fabric, and various types of machinery and equipment. It has also been argued elsewhere that tea, edible oils and other types of food and vegetable products are subject to substantial levels of smuggling.

Any assessment of the transit trade component should be considered on the basis of the entire structure of imports. A comparable set of estimates for total Afghan imports is presented in Table 5, below. This is based on data published by the Afghanistan Customs Department for the years 1386 (2007/08) and 1387 (2008/09). It should be kept in mind that Afghan and Pakistani agencies report data using different periods and therefore these data may not be strictly comparable. There are several other differences that have been addressed in compiling these data that may still leave, what are expected to be, minor discrepancies. For example, the reporting structure requires some further aggregation to correspond to the presentation of the data from the Pakistan Customs Department presented here.

Table 5: Recorded Afghan Imports *(Millions of Afghanis)*

Description	2007/08 (SY 1386)	2008/09 (SY 1387)	Change	Growth Rate
Animal and Animal Products	5,397.98	4,999.70	(398.28)	-7.38%
Vegetable Products	26,037.97	41,299.52	15,261.55	58.61%
Foodstuffs	12,504.73	11,532.62	(972.11)	-7.77%
Mineral Products	23,736.89	30,879.97	7,143.08	30.09%
Chemical and Allied Industries	6,935.51	8,671.85	1,736.34	25.04%
Plastics and Rubber	11,430.40	10,968.09	(462.31)	-4.04%
Raw Hides, Skins, Leather and Furs	375.31	489.26	113.95	30.36%
Wood and Wood Products	6,541.59	7,299.72	758.13	11.59%
Textiles	18,658.34	19,067.01	408.67	2.19%
Footwear and Headgear	1,850.44	1,993.57	143.13	7.73%
Stone and Glass	2,771.85	3,099.91	328.06	11.84%
Metals	17,279.42	17,382.52	103.10	0.60%
Machinery and Electrical	22,734.98	22,595.69	(139.29)	-0.61%
Transportation	11,633.98	19,323.67	7,689.69	66.10%
Miscellaneous	2,492.92	2,914.09	421.17	16.89%
Not Elsewhere Classified	3.10	0.57	(2.53)	-81.61%
TOTAL	**170,385.41**	**202,517.76**	**32,132.35**	**18.86%**

Source: Afghanistan Customs Department

It should also be kept in mind that these data are based on documented imports and that there are serious concerns regarding the accuracy of the documentation being processed and the substantial amounts of unrecorded trade that is reportedly taking place.

In addition to the high rate of import growth reported, 18.86 percent (mentioned above), perhaps the most noteworthy characteristic of these estimates is the apparent stability in the overall structure of imports for these two years. Relative levels for most groups remained generally close in most areas and where there were significant increases; there are readily apparent reasons (e.g., the increases in food and fuel prices).

Table 6: Relationship between Total Afghan Imports and Transit Trade *(Millions of US Dollars and Percentages)*

Items	Total Afghan Imports	Total Transit Trade	Percentage
	March 21, 2007- March 20, 2008 (1386)	July 2007- June 2008	
Textiles	373.17	152.68	40.9%
Machinery and Electrical	454.70	117.78	25.9%
Vegetable Products	520.76	113.14	21.7%
Services (Mainly Official Imports)	N/A	N/A	N/A
Foodstuffs	250.09	157.54	63.0%
Plastics and Rubber	228.61	44.40	19.4%
Animal and Animal Products	107.96	61.32	56.8%
Transportation	232.68	84.76	36.4%
Chemical and Allied Industries	138.71	46.11	33.2%
Miscellaneous	49.86	15.47	31.0%
Metals	345.59	37.17	10.8%
Wood and Wood Products	130.83	19.11	14.6%
Mineral Products	474.74	16.38	3.5%
Stone and Glass	55.44	10.94	19.7%
Raw Hides, Skins, Leather and Furs	7.51	2.06	27.5%
Footwear and Headgear	37.01	2.05	5.5%
TOTAL	**3,407.71**	**893.17**	**26.2%**

Tables 6 and 7 present estimates for the two years that are generally comparable; including total Afghan imports (from ACD) and total transit trade (from Pakistan Customs Department).[13] There are several points that should be made with regard to these estimates. First, at this aggregate levels the average ratio of goods entering through transit trade and total imports are 26.2 percent (2007/08) and 38.6 percent (2008/09). The maximum ratios including both years are for 'Miscellaneous' 89.7 percent and 'Textiles' 81.3 percent, both in 2008/09. (As indicated previously, the high ratio for Miscellaneous category was probably due to a surge in imports for goods related to ongoing investment in the telecoms industry.)

[13] 'Services' is one area that is clearly inconsistent. It appears that the Afghan data do not include goods imported by diplomats, embassies and other official exempt parties. Therefore, these data have been excluded from these tables until some way of reconciling these differences is found.

Together the estimates presented in these tables suggest that at least for these two years, the relationship between the structure of total imports and the structure of goods entering into the transit trade is relatively stable. (Possible exceptions have been discussed above.)

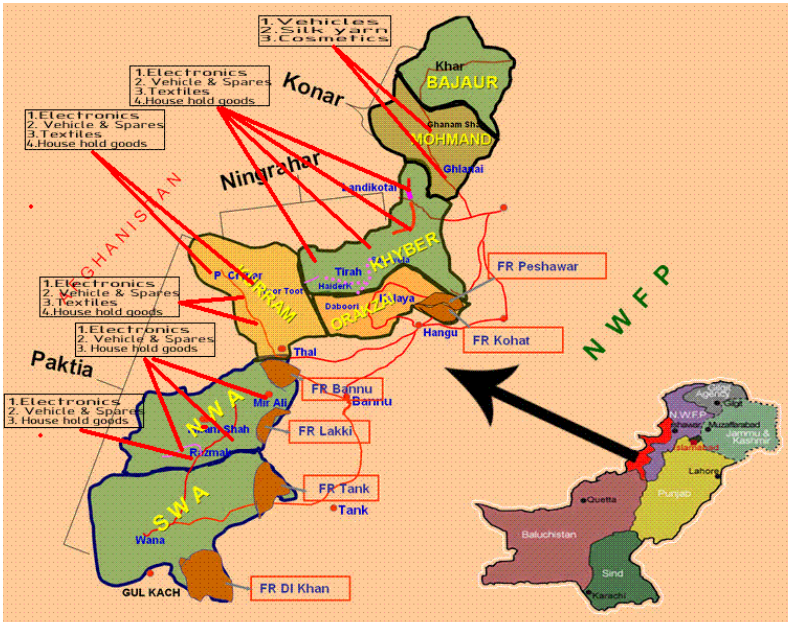
Table 7: Relationship between Total Afghan Imports and Transit Trade ***(Millions of US Dollars and Percentages)***

Real Values (US Dollars)	Total Afghan Imports	Total Transit Trade	Ratio
	March 21, 2008-March 20, 2009 (1387)	July 2008-June 2009	
Textiles	381.34	310.16	81.3
Machinery and Electrical	451.91	227.61	50.4
Vegetable Products	825.99	205.16	24.8
Services (Mainly Official Imports)	N/A	N/A	N/A
Foodstuffs	230.65	160.29	69.5
Plastics and Rubber	219.36	73.31	33.4
Animal and Animal Products	99.99	68.35	68.4
Transportation	386.47	57.98	15.0
Chemical and Allied Industries	173.44	56.52	32.6
Miscellaneous	58.28	52.28	89.7
Metals	347.65	52.12	15.0
Wood and Wood Products	145.99	41.13	28.2
Mineral Products	617.60	27.03	4.4
Stone and Glass	62.00	18.73	30.2
Raw Hides, Skins, Leather and Furs	9.79	4.40	45.0
Footwear and Headgear	39.87	3.26	8.2
TOTAL	**4,050.36**	**1,563.22**	**38.6**

FACTS ABOUT THE UNAUTHORIZED TRADE

During the early days of Pakistan's emergence on the world map the tribal people living in the bordering areas of Afghanistan and Pakistan were allowed to trade without formalities. Informal cross border trade became a way of life and for many the primary source of income. Having become used to this way of life the tribal people continued to trade in this way for many years without considering it a crime. It was considered a legitimate trade with the brotherly neighbours. Similarly, the government has not actively cracked down on such cross border trade primarily because of the lack of alternative sources of income for these people. This source of income in the absence of alternative means has helped to avoid exacerbating the greater problems of crime, drug smuggling and other unsocial activities in the region.

Unauthorized trading of goods has long been carried out throughout the Federally Administered Tribal Areas (FATA). Goods are brought into the tribal areas through dirt tracks and un-metalled roads from across the border. Where tracks are not available and mechanical transport cannot negotiate, animals are used for transportation purposes. Although the security and protection of the region comes under the ambit of the paramilitary forces, there are areas within the region that are inaccessible to all. The Choora Valley in Khyber agency, for example, is a popular route for drug smugglers; however, it is also used for transport of unauthorized goods.



Routes

Along the 1100 km porous border between Afghanistan and Pakistan many routes are used by traders for the exchange of goods. These routes are spread across the tribal belt along the border. The mode of transportation used to carry the goods varies from pickup trucks, trucks, tractors with trolleys to mules and camels depending on the size of the consignment and the route being used. Some of the most popular recognized routes used for the unauthorized trade with 'type of goods' are show in the map above and described in text below:

Nangrahar (Afghanistan) – Landikotal- Khyber Agency (Pakistan tribal region). This is the most common route emanating from Jalalabad and its surrounding areas in Afghanistan and ending in the tribal area of Landikotal in the Khyber Agency of Pakistan. There are several tracks and mud roads through this mountainous and harsh terrain used for transportation of goods. The main tribes operating in these areas are Afridi's and Shinwaris.

Paktia (Afghanistan) –Waziristan (Pakistan tribal region). In the south east of Afghanistan, from Paktia into the tribal region of northern Waziristan in Pakistan is the second most commonly used route for the unauthorized trade. The muddy tracks in this mountainous terrain are used for transport of goods. The two main tribes of Wazir and Mehsud inhabit the bordering area and are responsible for the trade in the area.

Khost (Afghanistan) - Kurram agency (Pakistan tribal region). This is the third most commonly used route for the unauthorized trade. Like the other routes the area around the border is mountainous with vegetation and unpaved paths which are used to transport goods on mules and other animals.

Konar (Afghanistan)-Mohamand agency (Pakistan tribal region). This is the fourth route but with low priority due to the inhospitable terrain on both sides of the border and long distance from the road head making it an expensive choice. Around this area, given the current circumstances, the border between the two countries is manned heavily by the paramilitary and the army making it difficult for such trade.

Another Dimension

Afghan goods have been transiting through Pakistan for many years now. It is widely believed that goods transiting through Pakistan bear no relevance to the consumption in Afghanistan. It is thought that many of these goods are primarily meant for the Pakistani markets to benefit from the tariff differential between the two countries. It is now common knowledge that traders from Pakistan, primarily from the tribal region, are actively involved in the unauthorized trade previously believed to be the purview of Afghan traders. Financiers from Pakistan and Afghanistan as well as abroad also provide funding for such illicit trade. As previously mentioned, due to the circulation of "black" money in the economy many of the financiers attempt to 'launder' their earnings through the sale of such goods in the market.

The procedure

In order for a Pakistani trader to import goods under the ATT agreement for illegal re-export back to Pakistan the following procedure is followed:

1. A Pakistani trader in Peshawar negotiates with an Afghan agent to import goods under transit through Pakistan intended to be illegally re-exported back to Pakistan.

2. With the help of an Afghan agent, the trader obtains an LC (Letter of Credit) from a bank in Afghanistan or (as in most cases) makes an advance payment to import goods from abroad under an Afghanistan registered company.

3. The Afghan agent prepares the requisite documentation to import goods under the provisions of the Afghan Transit Trade Agreement (ATTA) through Pakistan. The fee charged by the agent for his services range between 1 and 1.5 percent of the total invoice value of goods being imported.

4. The trader in Pakistan transfers the advance payment for goods equivalent to the value of invoice through informal channels to the Afghan agent. A receipt is issued for the transaction by the agent that later act as a proof at the point of delivery of goods.

5. The Afghan agent makes the payment to the company exporting the goods through informal channels such as Hundi (money laundering). Upon receipt of payment, the company dispatches the goods to Afghanistan transiting through Pakistan.

6. Goods arrive at Pakistani ports from abroad and under the normal procedure of Afghan transit are transported to one of the borders with Afghanistan for onward delivery.

7. After arrival of goods in Afghanistan, for example at Jalalabad, custom duty according to the applicable tariff is paid and the goods are released as per the normal procedure.

8. The goods are then stored in nearby warehouses for transportation back in to Pakistan. This is done either through Torkham border or any of the other borders crossing point identified in the map above for onward transportation to Pakistan.

9. The trader presents the receipt to the agent importing the goods and arranges for transportation to Pakistan through a reliable carrier.

There are mainly two types of carriers who transport unauthorized goods into Pakistan:

a) *Carries that guarantee the delivery of goods.* These carriers are expensive but ensure safe delivery. The carrier deposits a sum equivalent to the value of goods being transported with the owner of the goods.
b) *Carriers of small cargo.* These carriers are professionals who carry smaller quantities of goods and are mostly new in the market. The basic attraction of these carriers is the lower price of transportation. Smaller traders usually use their services and distribute goods among them to mitigate the risk of detection and seizures.

10. Upon safe delivery of goods the owner refunds the money back to the carrier. In case goods are confiscated by authorities, the owner keeps the deposit and the carrier bears the loss.

11. Upon arrival at the warehouses, goods are marketed by the owner/traders to wholesalers. Every Friday the wholesalers visit the warehouses to see goods, obtain samples, negotiate prices and make purchases. Deals are struck with the owners of goods in bulk and cash payments are made. Once the payments are made the goods are ready to be transported to the wholesalers' outlets within, as well as outside, the tribal region.

From here onwards the goods are also transported to other parts of the country and often seen in 'Bara markets' in Rawalpindi, Lahore and Karachi. These markets, located in the settled areas have recently emerged across the country selling smuggled items. The most common commodities, their prices at source and destination, the typical profits made and the tribes involved in the trade are identified in table 8 below.

Table 8 : Typical un-authorized goods

S.	Description	Total No. of Shops at all Locations	Range of unit price in rupees (all Locations)				Tribes Involved	% of Price benefit for all retail outlets	
			At source in tribal areas		At retail outlets				
			MIN	MAX	MIN	MAX		MIN	MAX
A. Textile (Cloth)									
1.	Silk suites (Chinese- 5 yards)	134	890	3,000	1,250	4,000	Afridi/ Shinwari/Turi/Wazir	50	72
2.	Summer cotton suites(Chinese- 5 yards)	165	900	3,000	1,400 (3 piece suite)	1,600	Afridi/ Shinwari/Turi/Wazir	40	65
3.	Winter suites (Chinese- 5 yards)	165	250	1,200	300	2,000	Afridi/ Shinwari/Turi/Wazir	65	83
B. Electronics									

4.	Electric iron (Phillips - Malaysian)	185	1,000	1,200	2,000	3,500	Afridi/ Shinwari/Turi/Wazir	25	50
5.	Microwave ovens (220/240 volts Phillips- Malaysian)	110	2,500	Rs 3,000	4,000	8,000	Afridi/ Shinwari/Turi/Wazir	50	62
6.	Televisions (56 inch Samsung- South Korean)	145	45,000	48,000	74,000	78,000	Afridi/ Shinwari/Turi/Wazir	55	60
7.	Air conditioners(Haire 220/240volts)	136	18,000	25,000	40,000	65,000	Afridi/ Shinwari/Turi/Wazir	35	45
C. Vehicles, spare parts and tires									
8.	Jeep (Toyota Prado)	140	1,000,000	1,400,000	3,200,000	3,500,000	Afridi/ Shinwari/Turi/Wazir	30	50
9.	Spare parts used (Toyota body)	120	60,000	70,000	120,000	140,000	Afridi/ Shinwari/Turi/Wazir	34	50
10.	Spare parts (used whole engine Toyota 2800cc to 4500cc)	110	45,000	95,000	110,000	120,000	Afridi/ Shinwari/Turi/Wazir	32	41
D. Crockery/Cutlery									
11.	Chinese (stone ware set for 6 people)	165	1,500	16,000	3,500	22,000	Afridi/ Shinwari	32	42
12.	Bone china tea set (6 people)	165	1,200	5,500	3,400	8,000	Afridi/ Shinwari	23	35
13.	Cutlery (Chinese- 12 pieces)	145	850	2,200	1,000	4,000	Afridi/ Shinwari	63	85

In addition to the most popular items given in the table above the following commodities are also smuggled and sold in the markets in the tribal as well as settled areas: (1) blankets/quilts; (2) cosmetics; (3) arms and ammunition; (4) lubricants; (5) mobile phones; (6) items of industrial use; (7) plastics and finished goods; (8) antiques; (9) timber; (10) tea; (11) betel nuts; (12)spices (e.g. large cardamoms, red chilies); and prepared Spices containing various other spices. It is interesting to note that certain items such as cloth and cutlery, in some cases, are actually made in Pakistan (e.g. in Sialkot and Gujranwala) but are sold as smuggled goods with 'Made in Japan' or 'Made in Korea" forged stamps which are in high demand due to superior quality.

It is worth noting that the goods coming through transit via Pakistan are not the only goods that enter Pakistan unlawfully. Other unauthorized commodities are also finding their way through informal routes into Pakistan. These include: (i) cooking oil/ghee manufactured in the only plant in Kabul and smuggled through Torkham/Ladikotal; (ii) Brazilian sugar (it is making its way into the tribal belt of Pakistan although in small quantities - but it is on the rise); (iii) American knives, bayonets and other tools; and (iv) Iranian machine-made synthetic carpets.

THE TRADING/ECONOMIC ENVIRONMENT

One of the key objectives of this study is to examine the possible causes for the unauthorized transit trade that is reportedly taking place. There are essentially two basic factors that determine the economic incentives for smuggling: for a particular good this entails the level of demand, reflected in the price differential and the size of the local market for the good; and the relative costs of legal and illegal smuggling, which reflect the costs associated with seizures, bribes, etc.[14]

When a country imposes import duties or other taxes or trade restrictions on a good, it raises the domestic price relative to the world price (and relative to the domestic prices in other markets with lower tariffs and trade barriers). If the size of the market is sufficient and the costs of illegally moving the goods into the country are sufficiently low, (i.e., below the costs that would be incurred through legal importation) then smuggling activity may take place if the probabilities and penalties associated with detection is sufficiently low. Therefore, it is possible that a major contributing factor to the unauthorized transit trade taking place is the disparities in the trade policies of the two countries. Very broadly, Pakistan has pursued trade policies aimed at providing protection for a number of targeted import substitution industries. Afghanistan, since 2002, has followed a more open trade policy characterized by generally lower import duties.

In this context, it is useful to distinguish between two ways in which unauthorized transit trade might be taking place between Pakistan and Afghanistan, which will be referred to here as,

- 'Type 1' unauthorized trade which amounts to the diversion of goods before they enter Afghanistan; and
- 'Type 2' unauthorized trade which is comprised of goods that physically enter Afghanistan but are then illegally re-exported (smuggled) back into Pakistan.[15]

Pakistan has now ended its reliance on most forms of quantitative restrictions leaving tariffs as the main trade policy instrument.[16] In the medium term, the government is committed to maintaining the liberalization process, reducing the level and disparities in tariff rates. In Pakistan, the average applied tariff in 2007/08 was 14.5 percent.[17] It is high compared to the prevailing rates in all successful exporting countries. There were 14 different ad valorem tariff rate bands, ranging from zero to 90 percent and specific rates of duty on 44 products. In the 2008/09 budget, the government increased duties on 300 non-essential and luxury items from the 15 to 25 percent range to between 30 and 35 percent. These items include cosmetics, many domestic appliances, luxury food items and cigarettes. The government also grants sector-specific duty exemptions,

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[14] There are other reasons for smuggling other than differential prices. There is a lot of money in circulation in the "*black*" economy, which is reportedly used to finance smuggling. Gradually the money is turned "*white*" by sale of such goods in the local markets.

[15] Note that this type of smuggling could very well include goods that did not enter as transit trade, but which may, for example, be imported to Afghanistan from Iran or Central Asia.

[16] The most useful quantitative analysis on Pakistan's trade policies can be found in *Effective Protection of Manufacturing Industries in Pakistan*, (Study 2) for the Ministry of Commerce, Government of Pakistan, by Innovative Development Strategies, pvt Ltd, Islamabad, and *Trade Policies in South Asia*, The World Bank, September 2004 (in three volumes). (Given the changes in the regional trade environment that have taken place, it would be useful for policy makers to update this analysis.)

[17] This information is drawn from a variety of sources, including the *2009 National Trade Estimate Report on Foreign Trade Barriers*, Office of the US Trade Representative.

concessions, and protections under Statutory Regulatory Orders (SROs). (Note further information is needed to assess the potential impacts of SROs in this regard and to produce comparable table and figure for Pakistan's tariff rate structure.)

Pakistan's tariffs reflect a cascading rate structure where in general the tariff rates for final goods are higher than those for raw material and intermediate goods. Based on the tariff rates for 2004/05, the average tariffs for each level of production were:[18]

- Raw materials ____________________10.78 percent;
- Semi-processed goods _______12.54 percent; and
- Fully processed products ___________19.77 percent.

Although the average tariff rate during the last five years has declined from 17.09 percent to 14.5 percent, it would appear that a similar cascading structure continues to be embodied in the current tariff rate structure.

Afghanistan, in contrast, has a lower average tariff rate; the simple average tariff rate in 2008/09 was 5.65 percent.[19] Tariffs fall into 12 bands, although over 93 percent of rates fall into the bands for 2.5 percent, 5 percent and 10 percent (See Table 9, below). The current tariff rate structure represents a significant simplification from as recently as 2003, when there was a highly complicated and differentiated tariff regime with 27 tariff bands, rates varying from zero to 150 percent with an average rate of 43 percent.[20] The Afghan tariff rate structure also cascades, with higher rates on finished goods, lower rates on manufactured inputs and lowest rates on basic raw materials.[21]

Table 9: Afghanistan Tariff Rate Structures

No	Tariff Band	Tariffs Lines in Band
1	0	28
2	1	64
3	2.5	1663
4	3.5	11
5	5	1968
6	8	31
7	10	1078
8	12	5
9	16	170
10	20	6
11	25	10
12	40	5

[18] See the Ministry of Commerce study on effective protection cited above.

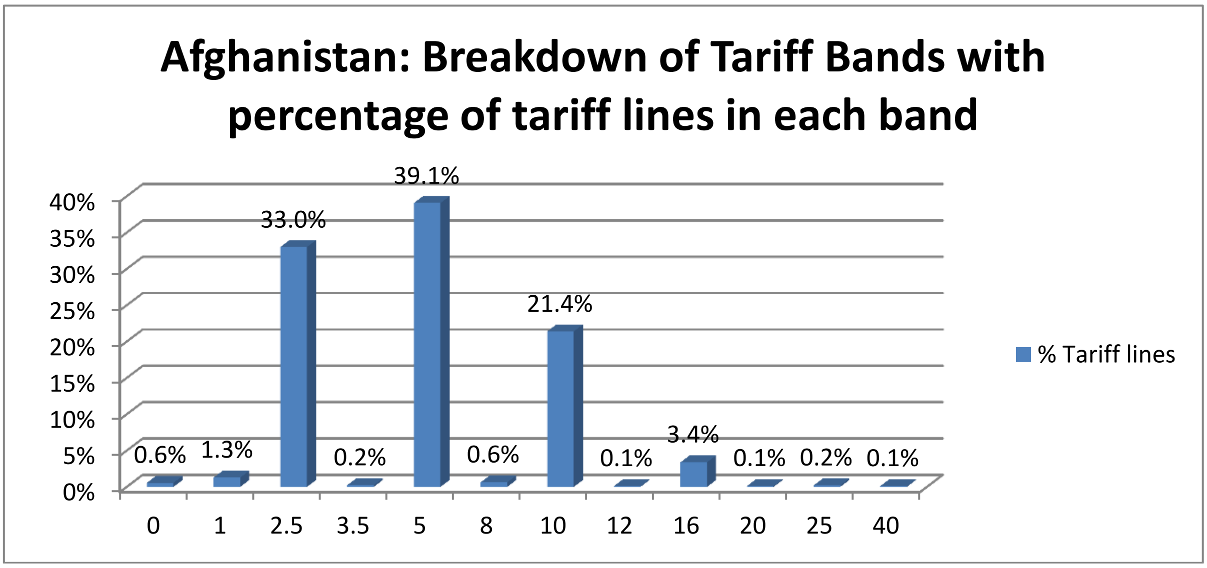
[19] Afghanistan's trade policy is contained in two documents produced by the Ministry of Commerce and Industry, *Trade and Tariff Policy – Afghanistan* and *Trade and Tariff Policy Framework*, May 2008.

[20] Note that because an administered exchange rate was used in calculating tariffs, which was about 10 percent of the prevailing exchange rate, the effective tariff rate was much lower. Now tariffs are based on the current market determined exchange rate published daily by Da Afghanistan Bank (the central bank).

[21] A cascading tariff structure tends to be biased against production activities characterized by high value added (e.g., agriculture) and consequently is biased towards low value added activities (e.g., simple assembly).

No	Tariff Band	Tariffs Lines in Band
		5039

Source: Ministry of Commerce and Industry, Government of Islamic Republic of Afghanistan



Source: Ministry of Commerce and Industry, Government of Islamic Republic of Afghanistan

The most critical question in this context is the difference between the tariff rates for the specific goods entering Pakistan for Afghan transit trade. Using the detailed data for goods admitted at Karachi Port and Port Qasim for transit to Afghanistan reported by the Government of Pakistan (i.e., 8-digit HS code) it has been possible to match the relevant tariff rates for each country. (Note that because the Afghan tariff rate structure is less detailed than Pakistan's rate structure, and because the variation in tariff rates is much less, it was not possible to identify an unambiguous link.) The results for 2008/09 for all goods which contributed 0.25 percent or more to total transit trade for that year are presented in Table 10. (This accounted for more than 70 percent of total transit trade reported for 2008/09.)

There were five tariff lines for different types of edible oils where Pakistan maintains specific duties. Based on the value and quantity data provided, it was possible to estimate an ad valorem duty rate in each case. These estimates were included in Table 10:

1511.9020	Palm oil ____________________	10,800/MT	5.4%
1511.9030	Palm oil____________________	9,050/MT	3.8%
1516.2010	Vegetable fats ______________	10,200/MT	0.9%
1516.2020	Vegetable oil _______________	10,200/MT	7.3%
1517.9000	Margarine __________________	10,800/MT	25.7%

(These estimates of tariff equivalents may be made more robust with additional information to be obtained from Pakistan Customs.)

The principal interest in the estimates presented in Table 10 in this context is the relationships between the two countries' tariff rates. The table has been sorted by the size of the tariff rate differential, with the largest differences at the top. Overall, the (un-weighted) average for Pakistan tariffs for these goods is 17.0 percent; for Afghanistan tariffs the average is 6.0 percent; leading to an average 11.0 percent differential. This no doubt encourages smuggling of goods that legally enter into Afghanistan before being illegally re-exported to Pakistan.

Table 10: Afghanistan and Pakistan Tariff Rate Differential for Transit Goods (2008/09)

HS Code	Description	Share TT	PAK Tariff	AF Tariff	Difference
8703.2321	Components to assemble vehicles	0.27%	100	25	75
3401.1100	Soap (toilette)	0.31%	35	5	30
3401.1900	Soap	0.39%	35	5	30
1905.9000	Bread, biscuits	0.29%	35	10	25
2106.9090	Food prep NEC	2.43%	35	10	25
8516.8090	Electric heaters (other)	0.38%	30	5	25
9403.3000	Furniture	0.31%	35	10	25
1517.9000	Margarine	0.65%	25.7	2.5	23.2
0207.1300	Chicken	0.59%	25	2.5	22.5
0207.3600	Frozen chicken	0.81%	25	2.5	22.5
1701.1100	Cane sugar	0.71%	25	2.5	22.5
4011.1000	Tyres	0.37%	25	2.5	22.5
4012.1100	Used tyres	1.61%	25	2.5	22.5
1701.9910	White sugar	1.34%	25	5	20
1901.9090	Food preparations (eg,malt extract)	1.42%	30	10	20
8537.1090	Electric panels	0.67%	25	5	20
4809.2000	Paper (self-copy)	0.26%	20	2.5	17.5
8502.1120	Electric generators	0.30%	20	2.5	17.5
2710.1951	Lubricating oil	0.74%	25	8	17
2105.0000	Ice cream	0.28%	35	20	15
3924.9000	Tableware	0.50%	25	10	15
4803.0000	Toilette tissue stock	0.45%	20	5	15
4823.9090	Paper (other)	0.34%	25	10	15
9406.0090	Prefab buildings	1.32%	25	10	15
5407.5200	Woven fabrics	1.70%	15	2.5	12.5
5512.1900	Synthetic fabric	13.30%	15	2.5	12.5
5512.2900	Synthetic fabric	0.43%	15	2.5	12.5
5514.1900	Synthetic fabric	0.28%	15	2.5	12.5
5514.2100	Synthetic fabric	1.05%	15	2.5	12.5
8502.1200	Generator sets	1.24%	15	2.5	12.5
8502.1310	Electric generators	0.37%	15	2.5	12.5
3926.9099	Office supplies (other)	0.30%	20	10	10
0902.2000	Tea	0.98%	10	2.5	7.5
0902.4020	Tea	2.19%	10	2.5	7.5
0902.4090	Tea	1.83%	10	2.5	7.5
3004.2000	Medicines (antibiotics)	0.34%	10	2.5	7.5
3004.3900	Medicines (other)	0.33%	10	2.5	7.5
7210.4990	Flat rolled iron	0.26%	10	2.5	7.5
8504.4090	Electric transformers	0.95%	10	2.5	7.5
0902.3000	Tea (black)	0.37%	10	5	5
1701.9100	Sugar w/ flavouring	0.54%	10	5	5
1701.9990	Sugar	0.42%	10	5	5
1516.2020	Vegetable Oil	3.76%	7.3	2.5	4.8
1511.9020	Palm oil	0.38%	5.4	2.5	2.9
4011.2090	Tyres (other)	0.36%	5	2.5	2.5
8417.1090	Furnaces & oven	0.49%	5	2.5	2.5
8428.3100	Machinery for lifting	0.27%	5	2.5	2.5
8479.1000	Machinery	0.25%	5	2.5	2.5
8479.9090	Machinery (other)	1.08%	5	2.5	2.5
1511.9030	Palm oil	1.04%	3.8	2.5	1.3
0407.0090	Eggs	0.54%	5	5	0
7219.9090	Flat rolled stainless steel	0.55%	5	5	0
7612.9010	Aluminium drums	0.27%	10	10	0

HS Code	Description	Share TT	PAK Tariff	AF Tariff	Difference
8609.0000	Containers for transport fluids	1.76%	10	10	0
9901.0000	UN Imports	0.33%	0	0	0
9901.0000	UN Imports	0.25%	0	0	0
9902.0000	Diplomatic goods	11.03%	0	0	0
9902.0000	Diplomatic goods	1.44%	0	0	0
1516.2010	Vegetable fats	0.45%	0.9	2.5	-1.6
0202.3000	Meat (frozen)	0.27%	0	2.5	-2.5
0204.4200	Meat (sheep/goat)	0.74%	0	2.5	-2.5
2201.1010	Mineral waters	0.44%	35	40	-5
2202.9000	Soft drinks	0.44%	35	40	-5
8525.8090	TV transmission equipment	0.26%	5	10	-5
8540.7900	Valves and tubes	0.72%	5	10	-5

Source: Project estimates

Although it is impossible to be precise about how much of a tariff rate differential would be required to make significant unauthorized trade financially attractive (subject to the probability of goods seized and penalties applied), it does appear that the disparities are substantial. The view of Customs officials is evidently that the 12.5 percent tariff rate differential for synthetic fabrics (HS 5512 and 5514) is sufficient to lead to widespread smuggling. (It has been suggested that this view is supported by the very large number of Bara Market's selling smuggled fabrics throughout the country.) It is also argued by Customs that for some goods smuggling is profitable with tariff rate differentials as low as 4 percent.

Consider tariff rate differentials for the types of goods where it is argued that substantial amounts of unauthorized transit trade are taking place:

- Electric heaters ____________25%;
- Tires ____________________________22.5%;
- Electric generators ________________17.5%;
- Synthetic fabrics __________________12.5%;
- Tea ______________________________7.5%.

All of these (except tea) have 'above average' tariff rate differentials, lending weight to the argument that the unauthorized transit trade taking place is being driven at least in part by differences in trade policies.[22] (There are a number of goods where the differential is zero or negative i.e. where the Afghan tariff is higher than that for Pakistan, including mineral waters and soft drinks.)

Undoubtedly tariff rate differentials alone do not fully account for smuggling. The costs of transportation and the probability-weighted costs of interdiction must also be taken into account. Insight into the types of goods that are being smuggled can be drawn from the reports by Customs on the goods that are being seized (see Table 11).

Table 11: Goods Seized by Pakistan Customs in 2007 and 2008 ***(Rupees and Percentages)***

PTC Code	Description of Goods	June 2007	Percentage	June 2008	Percentage
5407.0000	Vehicles U/S 16 (NDP)	2,828,348,726	69.9%	1,129,217,238	52.0%
8703.0000	Vehicles U/S 157	514,371,635	12.7%	334,848,659	15.4%

[22] Keep in mind that the average differential of 11 percent refers to the average of the goods included in Table-8. However, this is not inconsistent with the difference in simple (unweighted) average tariffs: 14.5 percent for Pakistan and 5.6 percent for Afghanistan, yielding a differential of 8.9 percent.

PTC Code	Description of Goods	June 2007	Percentage	June 2008	Percentage
	Misc. Goods	194,349,346	4.8%	213,288,076	9.8%
802.0000	Cloth F/O	131,833,167	3.3%	98,320,893	4.5%
7104.0000	Liquor	65,669,214	1.6%	86,378,907	4.0%
3003.0000	Medicine	62,746,810	1.6%	7,904,441	0.4%
9706.0000	Antiques	30,000,000	0.7%	2,022,800	0.1%
2710.0000	Diesel	29,363,348	0.7%	11,344,856	0.5%
9902.3000	Tea	27,384,058	0.7%	22,286,791	1.0%
9302.0000	Currency (Pak)	26,518,482	0.7%	9,505,040	0.4%
106.0000	Gold/Silver	25,897,827	0.6%	-	0.0%
7113.0000	Petrol	21,854,662	0.5%	3,343,120	0.2%
8708.0000	Tyres & Tubes	17,631,777	0.4%	16,615,353	0.8%
2402.2000	Electronic Goods	17,233,278	0.4%	157,620,125	7.3%
9101.0000	Auto/Spare Parts	15,750,692	0.4%	22,665,267	1.0%
2710.0000	Mobil Oil	9,769,644	0.2%	5,027,278	0.2%
2710.0000	Timber	5,854,500	0.1%	5,866,199	0.3%
6301.0000	Blankets	3,929,620	0.1%	676,802	0.0%
2710.0000	Grease	2,938,328	0.1%	337,680	0.0%
9302.0000	Currency (For US$)	2,552,580	0.1%	25,658,700	1.2%
2402-2000	Cigarettes(Fake/Foreign)	1,949,992	0.0%	4,089,330	0.2%
4011-4013	Food Grains	1,813,156	0.0%	175,000	0.0%
9923.0000	Betel Nuts	1,118,263	0.0%	-	0.0%
	Cooking Oil & Vegetable Ghee	1,094,105	0.0%	5,670,869	0.3%
5701.0000	Carpets	963,350	0.0%	726,800	0.0%
	Toiletries	733,892	0.0%	1,846,523	0.1%
	Dinner Set/Crockery	660,342	0.0%	1,565,172	0.1%
	Arms & Ammunition	648,950	0.0%	1,076,684	0.0%
	Gutka (All Brands/Origin)	551,600	0.0%	740,000	0.0%
8501.0000	Pirated CDs/DVDs	471,270	0.0%	700,200	0.0%
2403.0000	Pan Parag/Zafrani Patti	338,720	0.0%	200,000	0.0%
	Urea	273,250	0.0%	131,000	0.0%
9503.0000	Toys	-	0.0%	472,390	0.0%
	TOTAL	**4,044,614,584**		**2,170,322,193**	

There are a number of points to be drawn from Table 11:[23]

- The totals amount to relatively small proportions of the total Afghan trade for these years: 7.12 percent in 2007 and 1.85 percent for 2008. While Afghan transit trade was increasing substantially, the total amounts of goods seized was declining. The seizures recorded above are by Customs which constitute 90 – 95 percent of total seizures.

[23] It should be noted that these data do not appear to fully correspond to the transit data presented earlier. Further work needs to be done to identify the extent of the discrepancies that may exist. The data available is for Customs Department only. Reportedly this corresponds to about 95 percent (plus) of all goods seized excluding drugs e.g. Heroin, Marijuana etc. Seizures by various agencies including Customs are estimated to be about 5 percent of all the smuggled goods. This will take the volume of smuggling to Rs.80 billion in 2006 – 2007 (USD 1.3 billion) and Rs.40 billion in 2007 – 2008 (USD 700 million)

- These seizures include substantial amounts of illicit goods (illegal in this context), such as liquor, pirated CDs/DVDs, currency (fake and otherwise), gold/silver, antiques, etc, that have no bearing on the Afghan transit trade regime.
- A number of goods where substantial transit trade takes place are reflected in this list, including cloth, tea, tires and electronic goods.
- The largest category of goods, by a substantial margin, is vehicles that were seized. These accounted for 82.6 percent of the total in 2007 and 67.4 percent of the total in 2008. It should be noted that these goods are imported to Afghanistan through Iran from Japan and UAE.

In summary, while Pakistan and Afghanistan maintain broadly similar structures in their trade policies, Pakistan's tariff rates are generally significantly higher, particularly for the types of goods where it is argued that substantial amounts of unauthorized trade are taking place. Pakistan's average tariff rate is 14.5 percent, some two and one-half times the average tariff for Afghanistan (i.e., 5.65 percent). Note, however, that Pakistan's tariff rates do not exceed those for Afghanistan in every case; for goods such as edible fats, meat and soft drinks, the duties in Afghanistan are higher. Nevertheless, for the key goods where it is asserted that there are substantial leakages from the transit trade, it would appear that the incentives to smuggle as measured by the differences in tariff rates are significant, (i.e., electric heaters and generators, tires, synthetic fabrics and tea). The fact that some of these goods are also reported among the types of goods seized by Pakistan Customs, albeit not necessarily in large quantities, is consistent with this view.

More detailed analysis, on a good-by-good basis, would be possible and should be undertaken. For example, consider tea. The Pakistan Tea Association, in a presentation to the Karachi Chamber of Commerce and Industry, argued that the total market for tea in Pakistan is approximately 175 million kilograms per year (i.e., an average of one kilogram per person)[24]. 105 million kg were imported officially, leaving an estimate of 70 million kilograms of tea being smuggled. The data for tea entering the transit trade indicated a total of 91 million kilograms in 2007/08 and 111.9 million kilograms in 2008/09. If the consumption estimate of one kilogram per person is accurate, Afghanistan's population being 28.4 million suggests that somewhere between 62.7 million to 83.5 million kilograms went elsewhere. This is precisely what the Pakistan Tea Association asserted, although it is difficult to determine how much of this calculated surplus found its way to Pakistan's markets. However, it should be stressed that the United Nations Food and Agriculture Organization (FAO) estimated that per capita tea consumption in Pakistan ranged between 0.65 kg and 0.89 kg[25]. If actual consumption were 0.6 kg per capita, slightly below the bottom of the estimated range, then total consumption would have been entirely met by official imports. Having said that, it is a widely known fact that markets in Peshawar and other cities in NWFP are flooded with black Tea (bulk packing) imported in transit to Afghanistan. Secondly, it is often argued that Black Tea consumption in Afghanistan is quite low and they generally prefer Green Tea. This obviously needs further analysis.

[24] See the article in the Daily News cited above.

[25] This covered the years 1994 to 2003. See UN FAO report by the Intergovernmental Group on Tea, July 2005.

RECOMMENDATIONS

The available information presented in this paper is consistent with the view that substantial amounts of unauthorized goods are entering Pakistan (the report accepts the unofficial level of USD 2 billion provided in the earlier USAID paper on The Economic Impact of APTA on Pakistan). Given the time and resource constraints, the report was not able to quantify the volume of authorized trade or its disaggregation into the two forms of unauthorized trade—trade diversion and illegal re-export, although some estimates had suggested that about 70 percent of the unauthorized trade in value terms is the illegal re-exports of Afghanistan into Pakistan.

Most of this unauthorized trade is carried out along the non-formalized border crossing between the two countries. If the APTTA formalizes a number of these border crossings, and Pakistan over time harmonizes tariffs between the two economies in a manner that removes some of the incentives to smuggling, especially of items such as tea and electronic goods, it is likely that a large majority of the currently illegal trade would come through official channels, allowing Pakistan to collect Customs revenues. The earlier USAID paper estimates about USD 135 million of revenue gain for Pakistan from APTTA.

The key immediate issue concerns ways in which the goods entering through Karachi and Port Qasim for transit can be more effectively handled, increasing the prospect that these goods will efficiently arrive at the appropriate border crossing for processing by the Afghanistan Customs Department. The following steps warrant consideration in this regard:

- **Improve procedures** in ways that would reduce both the incentive and the opportunity to smuggle these types of goods into Pakistan and make it easier and more cost effective to maintain control over the movement of goods through the country. For example, further study should be undertaken to examine: border procedures; the role of Customs brokers; pre-arrival information and processing; targeting/selectivity; dwell times; control of exemptions; accountability measures; development of comprehensive IT based information sharing program for Pakistani and Afghan Customs; other government department/agency requirements; legal impediments; etc. With this in mind a 'gap analysis' is currently underway in Pakistan that will determine the current state with respect to Customs procedures and compare this with the desired 'end state' as envisaged in the APTTA. Preliminary findings indicate that there are a number of effective measures that can be undertaken to address deficiencies. A similar assessment of the physical infrastructure and human resource capacity is needed for Customs to carry out its functions effectively needs to be undertaken which will also help in establishing the ground realities and suggest improvements.
- **Strengthen the Bonded Transport and Guarantee System:** There needs to be improvements in the use of bonded carriers and an internationally, regionally or nationally valid guarantee system for transit trade to safeguard revenue in case of inland diversion of transit goods. It would appear, as a preliminary result of the 'gap analysis' that such a system is not in place in Pakistan. Transit trade moves only through the Pakistan Railway or the National Logistic Cell (NLC)[26], both of which are government operated agencies. A Pakistan government agency guarantee for payment of customs duty and taxes owing on diverted Afghan owned trade does not appear to be the most effective system of revenue protection. A Guarantee System should be introduced that will include mechanisms for accepting a mandatory bond/guarantee for Transit from a Customs bonded entity, then subsequently

[26] Afghan commercial transit goods moved exclusively by Pakistan Railway under the Afghan Transit Trade Agreement (ATTA), 1965, and non-commercial Afghan transit goods were moved by NLC. In 2005, in order to facilitate Afghan transit trade, the NLC was authorized to carry Afghan commercial goods as well.

releasing the bond (this bond/guarantee system does not yet exist) only when the goods reach the final destination within Afghanistan. Currently, goods are entered into Afghanistan at the border post, however, they are not cleared until they reach an ASYCUDA Inland Customs Department (ICD), which in most cases will be one of the major economic centers, (i.e., Kabul, Mazar-e-Sharif, Herat, Kandahar and Jalalabad). All of these, except Jalalabad, are some distance from the border. Initial findings of the 'gap analysis' indicate that in order for this system to be effective and reliable, a transit system must be designed wherein reliable, auditable and bonded carriers move the goods into Afghanistan. These goods should travel under a bond that is only released once a verifiable and reliable Customs entry document is processed and communicated back to the point of origin. In light of Afghanistan's current import processing regime, it is difficult to rely on the information exchanged with Afghanistan. Establishing a Customs data exchange system between the two countries will help in reconciliation/verification of such information.

- **Improve entry procedures at Karachi and Port Qasim** in order to ensure more accurate documentation. Under the current Afghan trade transit regime, documentation presented upon arrival of goods moving in-transit through Pakistan to Afghanistan are accorded only the most cursory of examinations by Customs. However, in Afghanistan and Pakistan, it is widely understood that there is a large informal trading sector in which invoices are absent and where use of under-invoicing and mis-description with respect to imported goods is widespread. In response to the concern for the high risk of Afghan in-transit goods being diverted, a more thorough accounting is required to provide the protection of potential revenue leakage. Thus, using risk management techniques, a more thorough verification of supporting documentation in respect to value and description of the goods and the exchange of this information between Customs administrations would be in the interest of both governments. The preliminary findings of the 'gap analysis' suggest that the appropriate methods for addressing these issues are the implementation of a reliable and comprehensive national import/export data collection system that includes information related to Customs value, description of goods and quantities involved, and information exchange process between Afghanistan and Pakistan. Furthermore, this system must be supported by the development of an effective Customs 'post entry' audit capability in both countries and the identification of reliable, auditable carriers which would ultimately help to develop a system of voluntary compliance with respect to these issues. Incentives must be developed and implemented that reward 'good' importers/exporters/carriers with, for example, expedited clearance and the opportunity to profit from the new system (which will mean privatizing certain transit activities currently undertaken by the GoP). This could be started through some public/private partnership Transport Scheme where the private sector would control the operations after Customs have cleared the goods for transit. The public sector should have only a regulatory and supervisory role.
- **Alternative means for directly controlling ATTA imports through a modern risk management system:** An approach through quotas or a negative list has not worked very well since it provides uncontrolled discretionary powers to the authorities. A modern risk management that would be based on the initiatives discussed in the previous paragraph should instead be adopted on ATTA imports in troublesome categories.
- **Better control over ATTA transshipments:** There are four places where containers are de-stuffed and then reloaded on Railway wagons (Covered) and Afghan Trucks. These locations are Amangarh, Peshawar Railway Station, Karachi Port Trust (Transit Shed—for loading in covered railway wagons) and Chaman. It is suspected that most of the Type I smuggling, takes place after this de-stuffing. There is, therefore, a need to probe this further and also to see if this de-stuffing can be avoided and some alternate mechanism adopted.
- **Trade policy reforms:** In the medium to long term, smuggling will continue to take place for as long as there are sufficiently high financial incentives to do so. Borders can be made less porous, but only over time and at high cost. The primary reason for the underlying

incentives for smuggling is the intention by both countries to maintain fundamentally different orientations in their trade policies. (Actually these differences in trade policy orientation extend to other countries in the region as well.) In the medium to long term, the only viable solution to unauthorized transit trade will be to substantially reduce the incentives and the opportunities for smuggling through increased consistency in approaches to trade and through greater regional economic integration. As a first step to this process, Pakistan will need to further rationalize its tariffs and bring it down to a single digit level.

The earlier USAID paper on The Economic Impact of APTTA on Pakistan had clearly indicated the tremendous benefits from APTTA in the Short-Run, and in the Medium to Long-Run that will accrue to the Pakistani economy. These are recapitulated below:

Short-Run Impact

- Foreign Exchange gain of USD 150 to 170 million arising out of the improved efficiency of the cross-border infrastructure between Afghanistan and Pakistan. According to estimates coming from experts in trade facilitation, the transaction costs imposed by inefficient borders range from 10-15 percent of the total value of trade crossing borders. Based on these figures, the transaction costs of Afghanistan-Pakistan cross-border trade (currently around USD 1.2 billion) can be estimated to be the region of USD 150-170 million.
- Customs revenue gain of around USD 135 million with the unauthorized trade estimated to be around USD 2 billion. Most of this trade is carried out along the non-formalized border crossing between the two countries. If the APTTA formalizes a number of these border crossings, and harmonizes tariffs between the two economies in a manner that removes some of the incentives to smuggling, especially of such items such as tea and electronic goods, it is likely that a large majority of the currently illegal trade would come through official channels, allowing Pakistan to collect Customs revenues.
- With the better connectivity between the border regions of Afghanistan and Pakistan, cross-border trade between North West Frontier Province (NWFP), Federally Administered Tribal Areas (FATA) in Pakistan and the 13 major border provinces in Afghanistan is bound to increase. As economic development and increase in consumption follows new and more focused foreign aid and foreign direct investment (FDI) in the border areas, demand from consumer goods, especially from Pakistan's relatively more sophisticated manufacturing and agriculture sector is also expected to take-off. In realistic terms and increase of around USD 130-150 million worth of Pakistani exports (to border regions of Afghanistan) can be expected to materialize within the first couple of years of the agreementi.

Medium to Long-term impact

- A more developed Afghanistan will import much more from Pakistan. If the development goals of renewed reconstruction efforts are met, investment and consumption should rapidly scale up in Afghanistan. Pakistan is a major producer of several items of low-cost manufacturing and agricultural products that will find a ready market in Afghanistan. Linkages between Pashtun- owned businesses are likely to prosper across the border given their close cultural and kinship connections
- Pakistani exports to Central Asian region are less than 1 percent of their total portfolio. An effective APTTA will over the long-run help Pakistan make inroads into this growing market. Given Pakistan human-resource skills and growing maturity in services sectors such as banking, media, education, and construction, it should be well placed to make gains in the export of services to the Central Asian countries

- Both Pakistan and Afghanistan are energy importers. The APTTA will provide the institutional building block for a future energy corridor that links South Asia and Central Asia, addressing the energy security concerns of Afghanistan and Pakistan, as well as enabling both economies to earn substantive transit fees for the gas and oil pipelines that pass overland through their territory
- Pakistan will emerge as the hub of trade and investment for the larger region that connects Middle-East, Central Asia, and South Asia. The regional business networks based in Pakistan will attract significant amount of FDI. Over time, this regional trade, transit and energy corridor can extend to include India to the east and beyond emerging as a new 'silk route' for the 21st century
- Economic development and commercial links, especially in the Afghanistan-Pakistan border region will help in winning the war on terror, as local populations develop a stake in peace and the maintenance of stable borders
- The implementation of the proposed Reconstruction Opportunity Zones (ROZs), the bill for which is before the US Congress, will provide another important vehicle towards the rapid development of the depressed border areas. Success of the ROZs is, to a great extent, predicated upon a functioning APTTA.

This paper corroborates the findings of the earlier USAID report that APTTA will be a win-win for both Pakistan and Afghanistan, and that it will in no way promote or increase unauthorized trade. The importance of the APTTA should be seen in this forward-looking perspective. For Pakistan, the successful implementation of APTTA would provide the opportunity to develop, over the longer run, as a trade and investment hub linking business networks in South, Middle-East, and Central Asia. For Afghanistan, it would provide the external markets that are essential for a small economy to achieve sustainable levels of economic growth.

APPENDIX – I: AFGHAN TRANSIT TRADE THROUGH KARACHI AND PORT QASIM: By HS Section and Chapter (In Pak Rupees)

Description	July 2008-June 2009		July 2007-June 2008	
Animal and Animal Products				
02 MEAT & EDIBLE MEAT OFFAL	3,272,068,757	2.79%	2,853,162,285	5.02%
03 FISH & CRUSTACEANS	23,091,960	0.02%	328,276	0.00%
04 DAIRY, EGGS, HONEY & EDIBLE PRODUCTS	1,828,641,136	1.56%	1,035,746,212	1.82%
05 PRODUCTS OF ANIMAL ORIGIN	4,893,811	0.00%	10,277,007	0.02%
	5,128,695,664	**4.37%**	**3,899,513,780**	**6.87%**
Vegetable Products				
06 LIVE TREES & OTHER PLANTS	1,239,115	0.00%	3,624,826	0.01%
07 EDIBLE VEGETABLES	226,688,787	0.19%	184,119,018	0.32%
08 EDIBLE FRUITS & NUTS, PEEL OF CITRUS/MELONS	175,553,279	0.15%	85,076,443	0.15%
09 COFFEE, TEA, MATE & SPICES	6,567,489,821	5.60%	2,930,907,124	5.16%
10 CEREALS	346,581,419	0.30%	15,071,641	0.03%
11 MILLING INDUSTRY PRODUCTS	206,267,761	0.18%	39,261,244	0.07%
12 OIL SEEDS/MISC. GRAINS/MED. PLANTS/STRAW	62,574,677	0.05%	103,509,957	0.18%
13 LAC, GUMS, RESINS, ETC.	1,004,789	0.00%	2,038,397	0.00%
14 VEGETABLE PLAITING MATERIALS	369,072	0.00%	2,917,538	0.01%
15 ANIMAL OR VEGETABLE FATS, OILS & WAXES	7,806,205,682	6.66%	3,828,629,408	6.74%
	15,393,974,402	**13.12%**	**7,195,155,596**	**12.67%**
Foodstuffs				
16 EDIBLE PREP. OF MEAT, FISH, CRUSTACEANS, ETC	256,570,260	0.22%	144,869,066	0.26%
17 SUGARS & SUGAR CONFECTIONERY	3,782,289,286	3.22%	3,973,919,904	7.00%
18 COCOA & COCOA PREPARATIONS	43,176,947	0.04%	31,811,882	0.06%
19 PREPS. OF CEREALS, FLOUR, STARCH OR MILK	2,089,111,934	1.78%	2,345,123,837	4.13%
20 PREPS OF VEGS, FRUITS, NUTS, ETC.	663,533,342	0.57%	225,543,044	0.40%

Description	July 2008-June 2009		July 2007-June 2008	
21 MISC. EDIBLE PREPARATIONS	3,625,311,252	3.09%	2,303,762,677	4.06%
22 BEVERAGES, SPIRITS & VINEGAR	1,484,333,260	1.27%	966,542,090	1.70%
23 RESIDUES FROM FOOD INDUSTRIES, ANIMAL FEED	4,939,295	0.00%	1,817,344	0.00%
24 TOBACCO & MANUF. TOBACCO SUBSTITUTES	77,724,722	0.07%	25,273,668	0.04%
	12,026,990,298	**10.25%**	**10,018,663,512**	**17.64%**
Mineral Products				
25 SALT, SULPHUR, EARTH & STONE, LIME & CEMENT	79,329,668	0.07%	14,327,923	0.03%
26 ORES SLAG & ASH	21,485,315	0.02%	437,937	0.00%
27 MINERAL FUELS, OILS, WAXES & BITUMINOUS SUB	1,927,256,355	1.64%	1,027,149,686	1.81%
	2,028,071,338	**1.73%**	**1,041,915,546**	**1.83%**
Chemical and Allied Industries				
28 INORGANIC CHEM, ORG/INORG COMPOUNDS OF PRECIOUS METALS, ISOTOPES	124,625,948	0.11%	117,872,376	0.21%
29 ORGANIC CHEMICALS	100,742,598	0.09%	68,317,454	0.12%
30 PHARMACEUTICAL PRODUCTS	1,712,295,109	1.46%	1,121,069,171	1.97%
31 FERTILIZERS	4,477,374	0.00%	1,311,768	0.00%
32 TANNING OR DYEING EXTRACTS, DYES, PIGMENTS, PAINTS & VARNISHES, PUTTY, & INKS	67,543,780	0.06%	18,615,513	0.03%
33 OILS & RESINOIDS, PERFUMERY, COSMETIC OR TOILET PREPARATIONS	675,663,020	0.58%	214,898,417	0.38%
34 SOAPS, WAXES, SCOURING PRODUCTS, CANDLES, MODELING PASTES, DENTAL WAXES	1,278,551,999	1.09%	604,288,409	1.06%
35 ALBUMINOIDAL SUB, STARCHES, GLUES, ENZYMES	28,850,203	0.02%	14,736,836	0.03%
36 EXPLOSIVES, MATCHES, PYROTECHNIC PRODUCTS	21,244,751	0.02%	-	0.00%
37 PHOTOGRAPHIC OR CINEMATOGRAPHIC GOODS	38,267,215	0.03%	24,041,788	0.04%
38 MISCELLANEOUS CHEMICAL PRODUCTS	188,409,199	0.16%	747,488,924	1.32%
	4,240,671,196	**3.62%**	**2,932,640,656**	**5.16%**
Plastics and Rubber				
39 PLASTICS & ARTICLES THEREOF	2,247,330,496	1.92%	1,053,563,097	1.85%

Description	July 2008-June 2009		July 2007-June 2008	
40 RUBBERS & ARTICLES THEREOF	3,253,170,562	2.77%	1,770,207,183	3.12%
	5,500,501,058	**4.69%**	**2,823,770,280**	**4.97%**
Raw Hides, Skins, Leather and Furs				
41 RAW HIDES & SKINS & LEATHER	26,107,287	0.02%	7,033,792	0.01%
42 ARTICLES OF LEATHER, SADDLERY & HARNESS, TRAVEL GOODS, HANDBAGS, ARTICLES OF GUT	302,939,801	0.26%	121,991,510	0.21%
43 FURSKINS & ARTIFICIAL FUR, MANUFACTURES	1,402,096	0.00%	2,209,639	0.00%
	330,449,184	**0.28%**	**131,234,941**	**0.23%**
Wood and Wood Products				
44 WOOD & ARTICLES OF WOOD, WOOD CHARCOAL	229,081,110	0.20%	74,978,577	0.13%
46 MANU. OF STRAW, ESPARTO, OR OTHER PLAITING MATERIALS, BASKETWARE AND WICKERWORK	493,458	0.00%	343,490	0.00%
47 PULP OF WOOD, WASTE & SCRAP OF PAPER	9,883,186	0.01%	708,336	0.00%
48 PAPER & PAPERBOARD, ARTICLES OF PAPER PULP	2,666,711,344	2.27%	1,132,021,265	1.99%
49 PRINTED BOOKS, NEWSPAPERS, PICTURES, MANUSCRIPTS, TYPESCRIPTS & PLANS	179,950,161	0.15%	7,548,932	0.01%
	3,086,119,259	**2.63%**	**1,215,600,600**	**2.14%**
Textiles				
50 SILK, INC. YARNS & WOVEN FABRICS THEREOF	151,408,423	0.13%	432,807,135	0.76%
51 WOOL & FINE OR COARSE ANIMAL HAIR, INC. YARNS & WOVEN FABRICS THEREOF	27,825,372	0.02%	17,730,661	0.03%
52 COTTON, INC. YARNS & WOVEN FABRICS THEREOF	201,412,098	0.17%	29,873,819	0.05%
53 VEG. TEXTILE FIBERS NESOI, YARNS & WOVEN ETC.	937,136	0.00%	9,070,395	0.02%
54 MAN-MADE FILAMENTS, INC. YARNS & WOVEN ETC.	2,744,258,670	2.34%	1,857,924,883	3.27%
55 MAN-MADE STAPLE FIBERS, INC. YARNS ETC.	18,486,606,481	15.76%	6,692,438,092	11.78%
56 WADDING, FELT & NONWOVENS, SPECIAL YARNS, TWINE, CORDAGE, ROPES & CABLES & ARTICLES	70,312,239	0.06%	45,676,044	0.08%
57 CARPETS & OTHER TEXTILE FLOOR COVERINGS	134,222,036	0.11%	25,899,509	0.05%
58 SPECIAL WOVEN FABRICS, TUFTED TEXTILES, LACE	111,889,193	0.10%	11,979,673	0.02%
59 IMPREGNATED, COATED, COVERED, OR LAMINATED TEXTILE	451,523,563	0.38%	116,377,408	0.20%

Description	July 2008-June 2009		July 2007-June 2008	
PROD, TEXTILE PROD FOR INDUSTRIAL USE				
60 KNITTED OR CROCHETED FABRICS	105,260,598	0.09%	3,139,653	0.01%
61 ARTICLES OF APPAREL & CLOTHING ACCESSORIES-KNITTED OR CROCHETED	69,120,425	0.06%	43,361,795	0.08%
62 ARTICLES OF APPAREL & CLOTHING ACCESSORIES-NOT KNITTED OR CROCHETED	93,494,486	0.08%	44,037,141	0.08%
63 MADE-UP TEXTILE ARTICLES NESOI, NEEDLECRAFT SETS, WORN CLOTHING, RAGS	624,375,863	0.53%	379,010,505	0.67%
	23,272,646,583	**19.84%**	**9,709,326,713**	**17.09%**
Footwear and Headgear				
64 FOOTWEAR, GAITERS, & THE LIKE	237,038,585	0.20%	125,522,064	0.22%
65 HEADGEAR & OTHER PARTS	3,743,773	0.00%	-	0.00%
66 UMBRELLAS, SUN UMBRELLAS, WALKING-STICKS, WHIPS, RIDING-CROPS & PARTS	1,374,811	0.00%	629,781	0.00%
67 PREPARED FEATHERS, HUMAN HAIR & ARTICLES THEREOF, ARTIFICIAL FLOWERS	2,451,117	0.00%	4,432,946	0.01%
	244,608,286	**0.21%**	**130,584,791**	**0.23%**
Stone and Glass				
68 ARTICLES OF STONE, PLASTER, CEMENT, ASBESTOS, MICA OR SIMILAR MATERIALS	272,597,554	0.23%	147,687,450	0.26%
69 CERAMIC PRODUCTS	530,687,877	0.45%	227,880,124	0.40%
70 GLASS & GLASSWARE	597,643,526	0.51%	319,438,754	0.56%
71 PEARLS, STONES, PREC. METALS, IMITATION JEWELRY, COINS	4,196,698	0.00%	556,079	0.00%
	1,405,125,655	**1.20%**	**695,562,407**	**1.22%**
Metals				
72 IRON & STEEL	1,507,458,060	1.29%	918,086,508	1.62%
73 ARTICLES OF IRON OR STEEL	1,190,642,911	1.02%	989,614,301	1.74%
74 COPPER & ARTICLES THEREOF	210,447,074	0.18%	67,026,993	0.12%
75 NICKEL & ARTICLES THEREOF	2,446,180	0.00%	1,026,011	0.00%
76 ALUMINUM & ARTICLES THEREOF	519,580,597	0.44%	164,584,389	0.29%

Description	July 2008-June 2009		July 2007-June 2008	
78 LEAD & ARTICLES THEREOF	411,885	0.00%	-	0.00%
79 ZINC & ARTICLES THEREOF	16,250,386	0.01%	2,165,734	0.00%
80 TIN & ARTICLES THEREOF	3,005,469	0.00%	-	0.00%
81 BASE METALS NESOI, CERMETS, ARTICLES ETC.	4,927,083	0.00%	1,117,488	0.00%
82 TOOLS, SPOONS & FORKS OF BASE METAL	242,783,299	0.21%	97,811,929	0.17%
83 MISCELLANEOUS ARTICLES OF BASE METAL	212,814,067	0.18%	122,170,199	0.22%
	3,910,767,011	**3.33%**	**2,363,603,552**	**4.16%**
Machinery and Electrical				
84 BOILERS, MACHINERY & MECHANICAL APPLIANCES, COMPUTERS	6,412,296,438	5.47%	3,399,364,866	5.98%
85 ELECTRICAL MACHINERY & EQUIP. & PARTS, TELECOMMUNICATIONS EQUIP., SOUND RECORDERS, TELEVISION RECORDERS	10,666,480,656	9.09%	4,090,932,354	7.20%
	17,078,777,094	**14.56%**	**7,490,297,220**	**13.19%**
Transportation				
86 RAILWAY OR TRAMWAY LOCOMOTIVES, ROLLING STOCK, TRACK FIXTURES & FITTINGS, SIGNALS	2,060,955,180	1.76%	1,693,592,989	2.98%
87 VEHICLES OTHER THAN RAILWAY OR TRAMWAY ROLLING STOCK	2,279,550,613	1.94%	3,695,859,825	6.51%
88 AIRCRAFT, SPACECRAFT, & PARTS THEREOF	10,003,671	0.01%	689,096	0.00%
	4,350,509,464	**3.71%**	**5,390,141,910**	**9.49%**
Miscellaneous				
90 OPTICAL, PHOTOGRAPHIC, CINEMATOGRAPHIC, MEASURING, CHECKING, PRECISION, MEDICAL OR SURGICAL INSTRUMENTS & ACCESSORIES	731,566,384	0.62%	413,985,610	0.73%
91 CLOCKS & WATCHES & PARTS THEREOF	3,528,804	0.00%	3,921,287	0.01%
92 MUSICAL INSTRUMENTS, PARTS & ACCESSORIES	1,363,359	0.00%	163,605	0.00%
93 ARMS & AMMUNITION, PARTS & ACCESSORIES	1,932,370	0.00%	-	0.00%
94 FURNITURE, BEDDING, CUSHIONS, LAMPS & LIGHTING FITTINGS NESOI, ILLUMINATED SIGNS, NAMEPLATES & THE LIKE,	2,755,200,761	2.35%	406,883,703	0.72%

Description	July 2008-June 2009		July 2007-June 2008	
PREFABRICATED BUILDINGS				
95 TOYS, GAMES & SPORTS EQUIP, PARTS & ACCES.	44,882,965	0.04%	26,766,777	0.05%
96 MISCELLANEOUS MANUFACTURED ARTICLES	382,743,674	0.33%	131,946,634	0.23%
97 WORKS OF ART. COLLECTORS' PIECES, ANTIQUES	1,548,360	0.00%	-	0.00%
	3,922,766,677	**3.34%**	**983,667,616**	**1.73%**
Services				
99 MAINLY OFFICIAL AND DIPLOMATIC COVERED GOODS	15,375,059,324	13.11%	779,142,435	1.37%
TOTAL	**117,295,732,493**	**100.00%**	**56,800,821,555**	**100.00%**

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