



Afghanistan

Opportunities and Challenges for Foreign Investors



**THE VOICE OF
AFGHANISTAN'S
PRIVATE SECTOR**



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Under Supervision of
The Editorial Board

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CEO Message



The business climate in Afghanistan is a complex mix of great opportunity and the most difficult challenges. Outstanding, untapped natural resources, exceptional geographic location, and business friendly legislation sits beside lack of good governance, rampant corruption, high security risks, absence of skilled labor, and dominance of informal arrangements.

Since the fall of the Taliban regime, the Government of Afghanistan has endorsed a series of reforms to improve the business climate; however these reforms are slow to develop, slow to implement, and lack a monitoring and enforcement platform. A measure of the slow pace of reforms is found in the World Bank Ease of Doing Business aggregate indicator. Afghanistan ranked 165th (2010) and 167th (2011) out of 183 countries. In the sub-indicator, Trading Across Borders which is calculated based on import/export document, cost, and time, we ranked last in 2010 and 2011 respectively.

As the leading voice of the private sector, Afghanistan Chamber of Commerce & Industries (ACCI) forcefully advocates for improvement to the business environment.

With the support of its more than 37,000 members as well as assistance from the international community, ACCI focuses its efforts on removing impediments that prevent the Afghan economy from reaching its full potential. We continuously strive to re-invent our approach to attain better results.

In an effort to improve existing business conditions, ACCI and a coalition of eleven other Afghan business associations recently drafted and published the National Business Agenda and handed it over to the Government of Afghanistan. The Agenda identifies laws, regulations and problems in six areas which hinder business activity and investment. The Chamber is developing a system to gauge the progress of implementing policy recommendations that emerge from this National Business Agenda through an active monitoring mechanism.

ACCI is well aware that Afghanistan needs both domestic and foreign investments to expand economic growth and create more employment opportunities. In order to achieve this objective, the Chamber will:

- ▶ Develop the capacity of its people and processes linked to this objective. In recent years, ACCI has strengthened its position as a professional and democratic institution by having a skilled and experienced executive and management team.
- ▶ Push government for faster and broader reforms. The Chamber has a seat on every major government committee established to address business and economic challenges in the different sectors. We will conduct a more effective communications campaign to build support for our reform ideas.
- ▶ Encourage more niche investment subsidies by the government. As well, ACCI will actively publicize and promote safe haven investments by separating it from the more generalized investment narrative that tends to lean toward the negative.

Progress in APTTA Implementation



The Afghanistan and Pakistan Transit Trade Agreement (APTTA) was implemented on Sunday, 12 June 2011 and trucks from both countries crossed the border.

The decision to implement APTTA was made during a visit by President Hamid Karzai to Islamabad on June 10-11.

APTTA was signed in October 2010 but could not be enforced after the two countries failed to sort out differences over bank guarantees for Afghan goods.

Following a series of bilateral talks, a delegation from Pakistan met with Afghan officials and representatives of the private sector on May 7th, to resolve outstanding issues related to the technical requirements to implement APTTA. The visit was fruitful and finally on 2nd June Ghulam Mohammad Elaqi, Deputy Minister of Commerce & Industries and his Pakistani counterpart Mr. Zafar Mahmood signed revisions to APTTA and announced that the Agreement would be implemented in ten days.

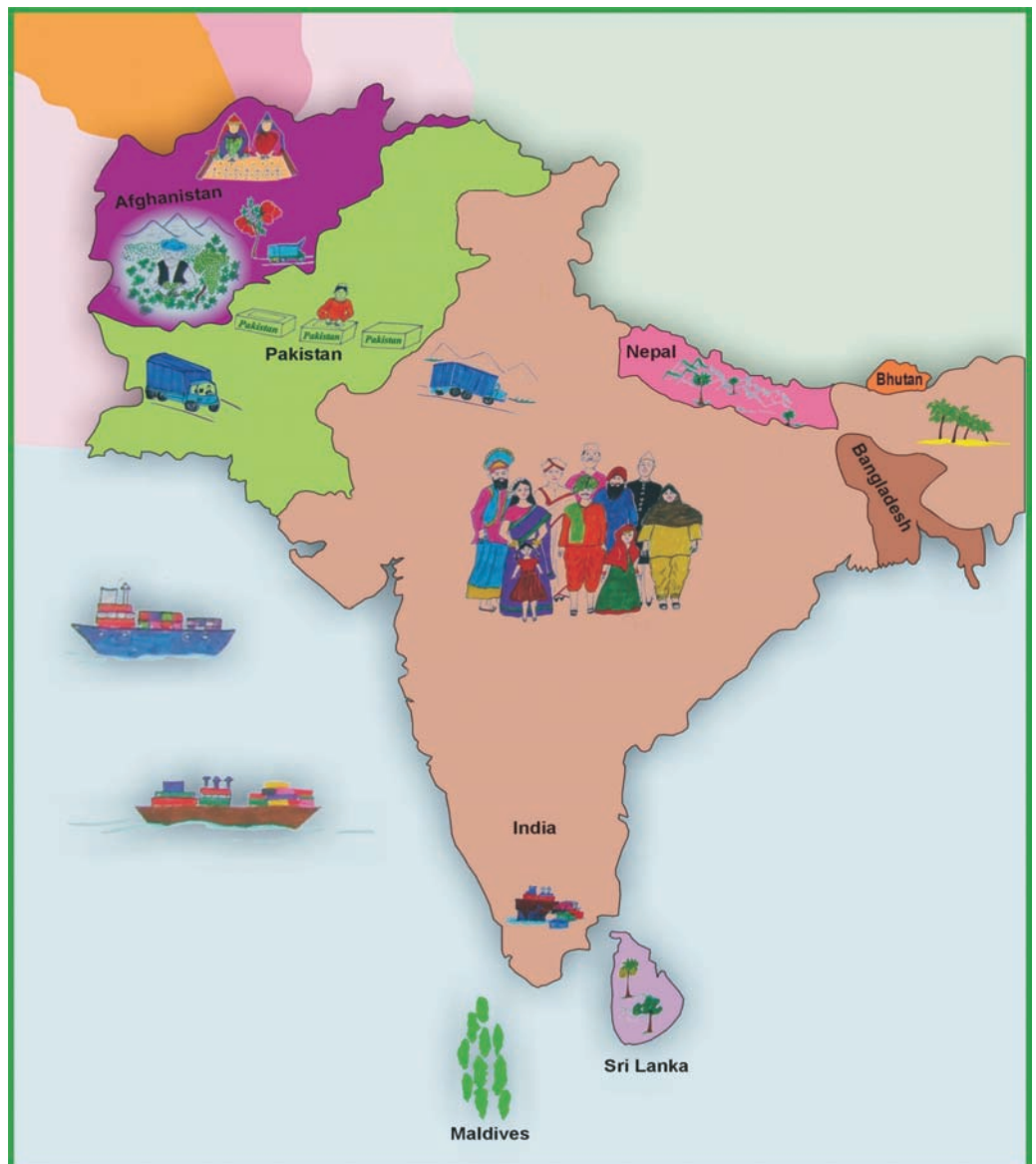
The new agreement replaced the 1965 transit trade agreement, which allows Afghanistan to import goods through Pakistani ports.

Afghan trucks could not cross the border under the old agreement and Afghan goods had to be transported to Pakistani cities in local trucks.

Under the new agreement, Afghan trucks will go directly to Wagah, Karachi and Gwadar ports so that goods can be exported to other countries through Pakistani ports. Afghan trucks can bring goods from Lahore and not from Wagah.

SAFTA to be Entered into Force

South Asian Free Trade Area (SAFTA) agreement, which reduces tariffs to 5% for non-sensitive listed goods in member countries, enters into force on August 7, 2011. The SAARC secretariat has acknowledged that all member states have completed the necessary formalities to ratify the Protocol of Accession for Islamic Republic of Afghanistan.



Trade Statistics: Imports Increased, Exports Decreased

Total trade, and by extension government revenue, increased for the sixth consecutive year. Overall, the value of trade in 1389 increased by 9% compared to the previous year. All of the increase in trade was attributed to imports which rose by 11% while exports decreased by 30%.

The increase in imports was due mainly to demand for vehicles. Vehicles and fuel together account for 35% of import value.

Lack of production, security issues, and export data anomalies are the cause for the steep decline in the export numbers.

The top 3 import nations are Pakistan (16% share), China (15%), and Iran (11%). Vehicles, mineral fuels, iron and steel, electrical machinery, boiler machinery, and cement are the most imported items by value of the commodity. India with a 30% share, Pakistan (22%), and Tajikistan (9%) are the

top export countries for Afghanistan. Agriculture products such as fruits and nuts, raisins, grain, and vegetables remain the Top 4 export commodities

With the impending implementation of the SAFTA agreement, exports are projected to increase due to reduction of tariffs, especially with India and Pakistan where currently import duties applied to Afghan agriculture products are on about average 30%, making these goods less competitive.

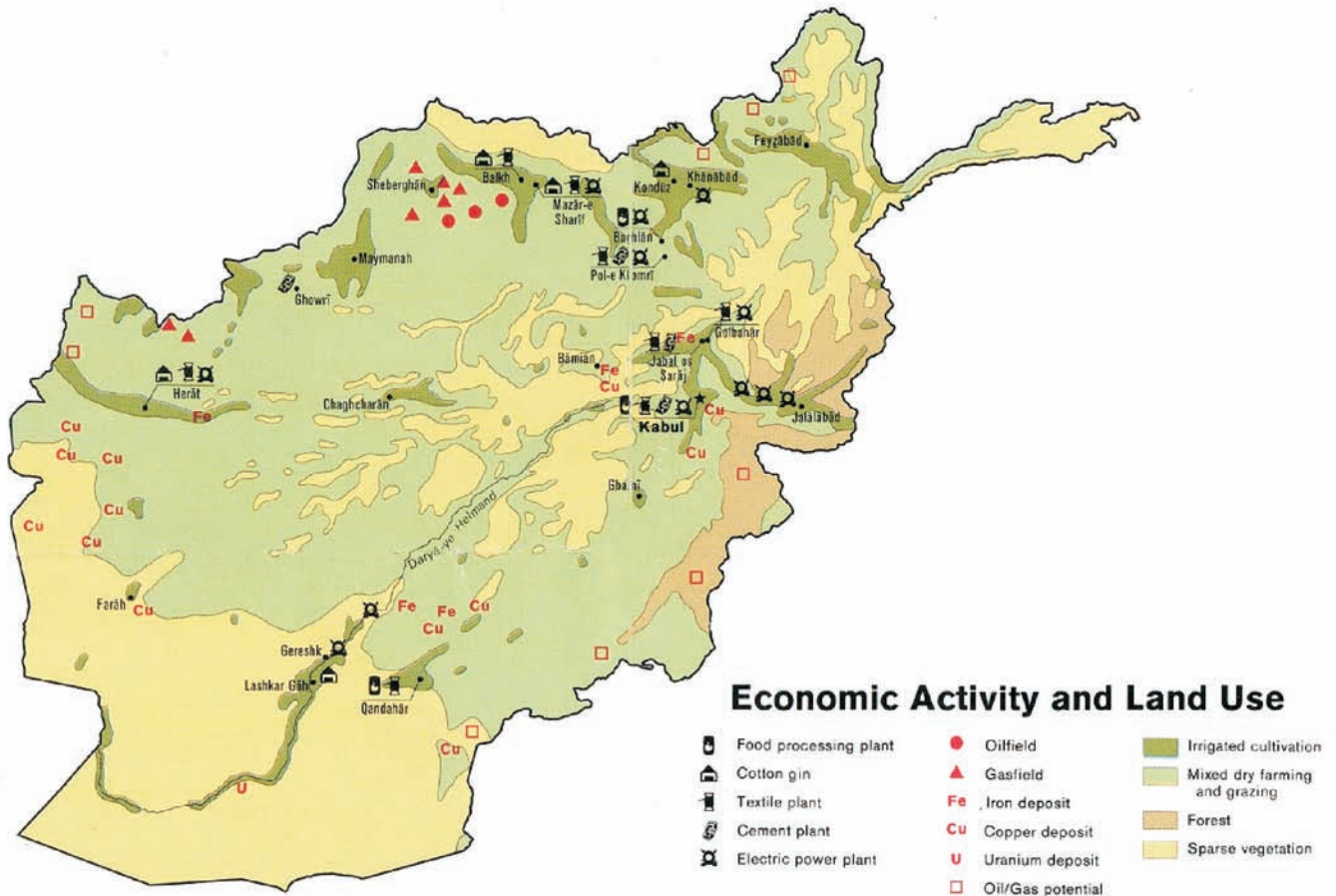
Foreign Trade Statistics, 1389

Overall Trade, 1386 - 1389				
(In Thousand Afs)	1386	1387	1388	1389
Import	147,788,130	202,500,758	287,696,161	320,240,380
Percent Increase/(Decrease)		37%	42%	11%
Export	10,136,071	13,328,371	15,808,519	11,044,394
Percent Increase/(Decrease)		31%	19%	-30%
Trade Turnover	157,924,201	215,829,129	303,504,680	331,438,324
Percent Increase/(Decrease)		37%	41%	9%

Source: Afghan Customs Department, April 2011

Afghanistan

Opportunities and Challenges for Foreign Investors



In a post-conflict environment like Afghanistan attracting foreign investment is central to the private sector development. Investments from outside provide an inflow of foreign capital and funds, in addition to an increase in the transfer of skills, technology, and job opportunities. In the last ten years the Afghan government has taken steps to improve the business environment and attract investment. First, Afghanistan has made the process of registering a business simple and it now ranks 25th in the Doing Business Report 2010 of the World Bank for starting a business. Second, the government strengthened regulatory issues such as tax administration and labor law. But much more remains to be done. The Afghan Chamber of Commerce and Industries interviewed foreign companies and asked them to assess the investment climate. In their view, foreign investment is discouraged by security concerns, weak governance, pervasive corruption, shortage of skilled labour, and the dominance of informal arrangements. This severe criticism is confirmed by international organizations which regularly assess the investment climate in Afghanistan.

Lack of Security

The three-decade long conflicts have kept investors away from Afghanistan. Due to the low security level in the Afghan regions, investment has gone decreasing over the last years - specially the foreign direct investments. The Afghan Business Survey 2009-2010 revealed that even domestic companies see the lack of security as an impediment for growth. For foreign businesses a stable security environment remains a prerequisite for investment.

CIPE Afghan Business Survey 2009-2010: "78 percent of the interviewed companies see the lack of security as the major impediment for investment."

Weak Governance

Although the government simplified the registration of companies, further steps has to be done to improve the business environment. In Afghanistan the weak legal framework and regulatory enforcement create high level of uncertainty for investors. Furthermore, the formal court system suffers from a lack of qualified legal professionals and corruption is reported to be endemic. Consequently, businesses cannot rely on the formal judicial system to resolve disputes and enforce property rights.

Worldbank Governance Indicators 2009: "Regulatory Quality in Afghanistan remains one of the weakest in the world."

Pervasive Corruption

In 2010, Afghanistan ranked 176th out of 178 countries in Transparency International's Corruption Perception Index. While anti-corruption laws exist, and the practice of giving or taking a bribe is illegal, there has been limited enforcement. Foreign businesses identify corruption as one of the biggest obstacles to foreign direct investment and routinely report being asked for a bribe, called sherini or bakshesh. With working-level government salaries not exceeding 300 US-Dollars per month, many officials see small bribes for government services as a necessary means of survival.

**Afghanistan in TI's Corruption Index:
"176th out of 178 countries"**

Shortage of Skilled Labour

Decades of war, a low level of education and lack of training facilities have resulted in a scarcity of skilled technicians, qualified managers and educated professionals in Afghanistan. Foreign companies that establish training programs for their employees should expect significant returns in enhanced productivity, but there is a risk of high turnover as skilled employees chase higher paying opportunities.

**Ranking of Afghanistan in UN's Education Index:
"175th out of 179 countries"**

The Dominance of Informal Arrangements

Much of private sector activity in Afghanistan is carried out in an environment dominated by informal arrangements and practices. The informal economy is relatively free from official regulations because of poor enforcement but is nonetheless subjected to informal regulations that restrict the entry of foreign companies. In a nutshell, while existing firms in the non-formal economy may be growing there are low rates of investment. The informal mechanisms that allow firms to cope with the high levels of uncertainty are not conducive to long-term growth and equity.

"The World Bank estimates that more than 80 per cent of the economic activity is informal."

ETC Power Brings Solar Energy to Afghanistan



Six years ago, four companies from Poland and Germany founded ETC Power in Afghanistan. The company builds photovoltaic and wind power installations and offers alternative solutions to energy generation and hot water treatment. ETC Power employs more than 45 people and is one of the biggest Afghan firms in the field of renewable energies. The company provides buildings with electricity and plans street lighting in major cities.

Interview:

Farzad Alawi, Project Manager ETC Power

Further information: www.etc-power.de

ETC's cooperation partners invested more than one million US-dollars into the foundation of the company. Where does the attraction of the Afghan market lie for your company?

Afghanistan is an interesting market for solar power companies. Ten years after the fall of the Taliban regime, still only 15 percent of the population is connected to the electricity grid. The Afghan government and the international donors therefore increasingly see solar and wind energy as a solution to supply rural areas with electricity. The World Bank has financed the construction of 30.000 solar power panels. Other institutions such as the Asian Development Bank and USAID have also been engaged in long-standing programs for many years. This stable demand has been a strong incentive for ETC's cooperation partners to invest in Afghanistan. Personal links with the country play into it as well. The president of ETC Power, Alishah Ranjbaryan, as well as other partners, were born in Afghanistan and immigrated to Germany during the war. The international engagement after 2001 provided an opportunity for them to return to their home country as entrepreneurs and their German and Polish partner as investors.

How has the company's foundation been accomplished?

The Afghan Investment Support Agency (AISA) is the interlocutor for foreign investors in Afghanistan. AISA offers a "one stop shop" for registration. In the case of ETC Power, we received the documents necessary to launch the joint venture within a week. The costs amounted to less than 1.000 US dollars.

Afghanistan is considered to be a typical example of a fragile state. Transparency International's corruption index ranks the country third to last. What have been your experiences in dealing with other governmental interlocutors?

Unfortunately, the positive experiences we have had with AISA are an exception. In particular, dealing with fiscal and customs authorities has proved to be difficult. In these areas, laws count for little. State officials have the opportunity to take secret bribes at the expense of the private sector. In Afghanistan, it is common, amongst other things, that companies do not receive a tax assessment notice. Thus, fiscal authorities can retroactively levy taxes for the past fiscal years at any time. Under such conditions, it is indispensable to maintain close contacts with the responsible authorities in order to make long-term planning possible. The equal is true for the import of goods. Officially, import tariffs for solar panels are at 17,5 percent, and at up to 12 percent for batteries. But it can happen that tariffs are raised and customs procedures slowed down. In order to facilitate import procedures, ETC Power works together with service providers that ensure imports at normal tariff rates. Our company holds the view that corruption is only a short-term solution to the problem. In

the long term corruption only entails higher costs.

How does the company cope with the issue of security?

ETC Power faces the challenge of operating in the entire country. There are peaceful regions like the western and northern parts of Afghanistan. But the company also installs solar panels in the conflict regions of Helmand and Kandahar. In these regions, armed robberies are a daily occurrence. In the past three years, there have been three incidents, each one of them entailing the theft of solar panels worth 50.000 US dollars. More important than the material damage are the risks to our employees. Until now, we have not had any fatal casualties. However, we have repeatedly had to ransom drivers and technicians who had been kidnapped by the Taliban. In such cases, you cannot expect any support from the police. It is decisive to have contacts to local middlemen.

What kind of measures does ETC Power takes in order to operate in unstable regions?

Security risks in Afghanistan are not covered by any insurance. That is why ETC Power reverts to subcontractors who are familiar with local circumstances. In order to make sure that quality standards are complied with, we organize training sessions in Kabul on a regular basis. Thus, the project managers only have to travel twice to the conflict regions to plan and approve projects.

What is the biggest challenge for ETC Power in the years to come?

An even bigger challenge than corruption and insecurity are low-price competitors from China, India and Malaysia. Since 2005,

solar companies from these countries have established themselves in Afghanistan and push prices down. As a German company, ETC Power focuses on delivering quality. We increasingly have to communicate to our private, public and international clients that sustainable energy solutions come at a cost. To this end, we also plan to work together with the national media.

The international engagement in Afghanistan will be scaled down in the next years. What will be the consequences for ETC Power?

ETC Power has grown continuously during the past years. Currently, the annual turnover amounts to more than 2 million US dollars. In the next years, the company's business environment will change. International donors will curtail their programs in the field of renewable energies. Therefore, ETC Power will have to turn more to the private sector for acquiring orders. We see considerable growth potential in decentralized electricity supply for apartments, administrations, agriculture and businesses.



ACCL International Promotes Sustainable Development in Afghanistan



To ACCL International, making profit is not everything. By taking social responsibility, the Afghan-American construction company wants to make a contribution to Afghanistan's reconstruction. This image helps the company to get ahead in Afghanistan. Since 2003, the company has continuously widened its portfolio. Apart from services in the construction sector, ACCL International offers services in catering, IT and energy supply. The company responds to a particular demand: in an unstable security environment, international as well as national organizations prefer self-sufficient premises.

Interview:

Michael J. Scott, Chief Operating Officer

Further information: www.acclInternational.com



Currently, ACCL International works on eight building contracts with a volume of more than one million US dollars each. How do you acquire orders in Afghanistan?

Our company focuses on open calls for tender launched by the Afghan government and international organizations. The American troops as well as implementation organizations play a special role in this as well. In the tendering procedure, we usually compete with more than ten construction companies. However, ACCL International is one of the few that can offer its services throughout the entire country, including in unstable regions like Helmand and Nangarhar. This is a clear competitive advantage.

ACCL International advertizes with the slogan "Afghans building Afghanistan" and aims at supporting a sustainable reconstruction process. How can these objectives be reconciled with doing business?

In 2003, the current presidents, Habibullah

Peerzada and Sargon Heinrich, founded ACCL International. They followed the US government's call to invest in Afghanistan. To the management, it was clear at the outset that profit would not be the ultimate ambition. With its business operations, ACCL International wants to contribute to the country's reconstruction. Depending on the number of orders, the company employs up to 3,000 staff, thereby supporting up to 12,000 families. Many of our employees are unskilled workers whom we provide with training in technical professions. This is a good example of how companies can promote sustainable development in Afghanistan. Thanks to these training programs, our workers can be better employed within the company. At the same time, they acquire valuable skills and become more attractive for future employers.

What experiences has ACCL International made with Afghan employees?

80 percent of our employees are Afghans. The management pursues a strategy of staff nce of decade-long civil war Afghan employees are not prepared for the

retention and avoiding layoffs. This equally holds in the event of mistakes committed by employees. As a consequence of decade-long civil war Afghan employees are not prepared for the requirements of a modern construction and service company. Especially social skills need strengthening. For this reason, we have established a mentoring program at ACCL International in which international experts advise their Afghan colleagues in their daily work.

In its public relations, ACCL International also capitalizes on its image as a company promoting development. In contrast, the majority of foreign companies try to keep a low public profile in order to avoid being perceived as a target for terrorist attacks. Why does your company pursue this strategy?

ACCL International does not engage in large-scale public relations. But it is important for us to reach specific target groups. Apart from international organizations, these include the Afghan government as well as ministries and provincial administrations. Establishing

provincial administrations. Establishing personal contacts to these actors is essential for companies operating in conflict zones. At the beginning of each project in particular, ACCL International reaches out to the relevant Afghan organizations and highlights the project's value added in terms of job creation and infrastructure. This strategy has served us well. The recognition our company enjoys in Afghanistan does not only prepare a fertile ground for future orders, but also guarantees the security of our employees. Since the foundation of our company, we have not had to suffer casualties. This is remarkable as we are also in charge of high-risk projects at the Afghan-Pakistani border.

What are the security risks your company faces in Afghanistan?

Even though we have not had any casualties until now, this should not obscure the fact that Afghanistan is still a conflict zone. Armed robberies are a daily occurrence in the entire country. Losses are not covered by insurances. Contracts with the US government provide for risk premiums. However, we have to assume financial liability in the event of failure. Therefore, proper risk assessment needs to be integrated as early as possible into the project acquisition phase. Only if general conditions are right, we can work successfully and qualify for follow-up orders.

ACCL International does not only offer services in Afghanistan. The company also distributes construction material. The range of products includes, amongst other things, products of the Knauf Gips KG. What sales potential do German

KG. What sales potential do German products have in Afghanistan?

The construction sector in Afghanistan grows currently at annual double-digit rates. Above all, the housing market is booming. ACCL International benefits a lot from these economic conditions. Last year, the company sold more than 300.000 square meters of drywall. This makes ACCL International the most important distribution partner of Knauf Gips KG. Most of the construction material comes from a regional factory. Nevertheless, import costs are around 30 percent higher than in other markets. This can be explained by the difficult overland transport. Equally, customs disputes between Afghanistan and its neighbors complicate imports. For this reason, it does not take days, but months to import goods.



ACCI Establishes a Monitoring System for the Business Environment

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The public launch of the National Business Agenda (NBA) in late March was the culmination of a coordinated effort between ACCI and Center for International Private Enterprise (CIPE) to better understand the business challenges in the country. Five regional consultative sessions involving 1,300 businessmen and women were held to gather inputs that will guide prospective private sector advocacy efforts.

To link the government's response to the NBA, the Chamber is developing a formal communication and monitoring structure - called the Business Monitoring Cycle - that aligns existing ACCI advisory committees, improves advocacy analysis, and enhances desired outcomes.

Focus groups will be established from existing advisory committees and linked to each of the 7 issue areas found in the NBA. With the aid of existing and newly collected data, these focus groups will draft policy

recommendations for each of these issue areas. A baseline set of indicators will be developed from existing reports, indexes, statistics, and surveys; and serve as the monitoring benchmark.

Thereafter, these policy recommendations will be shared with national-level advisory bodies and non-governmental organizations to inform, gain consensus, and build a coalition of support. Following this, public-private dialogue between ACCI and the government will be held and may take the form of advocacy roundtables, lobbying, and face-to-face interactions, both at the national and provincial level.

Indicators of progress will be derived post-public-private dialogue from defined data sources, and published as the Quarterly NBA Monitor beginning in 2012. Ultimately, the goal is to develop a range of instruments that attests to the business climate of the country, taken at periodic intervals.



EPAA Sees Progress but Challenges Remain



Export Promotion Agency of Afghanistan (EPAA) is an executive agency of Ministry of Commerce and Industry. EPAA was established in September 2006 within the framework of the BMZ/GiZ Sustainable Economic Development Program to enable better communication between the public and private sector and to assist in getting better market access for Afghan product. EPAA focuses its activities on five sectors - carpets, handicrafts, medical plants, fresh and dried fruits; and marbles and gemstones.

Interviewee: Mohammad Fazel Wasit,
Deputy Chief Executive Officer
Further Information: www.epaa.org.af

How would you characterize the link between the private sector and EPAA; what's good and how can it be strengthened?

In general, the link between EPAA and the private sector has been fruitful. EPAA worked with the business community to remove export taxes with the exception of minerals. This was a huge step forward. We resolved the issue of taxation on raisins in Mazar and recently asked the Customs department to bring ASYCUDA to the one-stop-shop facility. Traders come to EPAA because they want us to trouble-shoot problems with the authorities and we intervene on their behalf. One critical deficiency that EPAA needs to quickly

address is the lack of market information for our traders. If we are to gain access to higher-value markets, we must understand its requirements and educate the EPAA audience.

EPAA and ACCI have trade promotion mandates. Is there a clear separation between what EPAA and ACCI does in this regard?

ACCI approaches trade issues from a wider perspective. EPAA's focus is clearly on exports and we have a goal to raise export values to one-third of total trade. This is a challenging goal. In 1389, exports accounted for only 3.3% of total trade value. We have a long way to go to meet this challenge.

challenge.

What are foreign buyers saying about Afghanistan? What's good and what can be improved to stimulate trade?

The positive feedback we are getting from buyers is that the quality and taste of fruits such as apricots is good. We have been praised for our organic products and compared to 2002, packaging has improved but is not yet at the level consumers expect. We do face criticism when we are unable to fill orders from buyers. There was a situation at a Carrefour store in UAE where the store spent resources to put up nice looking signs to promote organic apricots from Afghanistan. Unfortunately, the apricots were nowhere to be found because the order



was not filled. Such situations are not helpful to our reputation.

What do you think APTTA's legacy will be 10 years from now, assuming everything goes smoothly from here on?

It's the diamond road for us and exporters, who benefit from zero export taxes, clearly see opportunity. Once the transit problems are sorted out and there is seamless movement of goods, there will be more capital investment to increase production volume and consequently, exports. I can see a situation where higher value products such as saffron which fetches around USD \$2,200 per kilogram will begin to supplant other lower value agriculture exports. Obviously, we are hopeful that one of the legacies of APTTA ten years from now is a better life for our people. Equally, there is an increased chance of more foreign direct investment.

What advice would you give to Afghan traders who want to sell in the Chinese and Indian markets?

On a daily basis, we export 30 metric tons of dry fruit to India, a country that has the capacity to absorb all of our products. The Indians are concerned with packaging, case in point being asafetida which if not packaged properly emits a horrible stench even while being transported on an airplane. We have just completed a fact-finding mission to open a trade office in both India and UAE. These are big markets for our products. The Chinese have interest in our dry fruit and handicraft but as yet, there is no demand for our fresh fruit. Increasingly, we are exploring our export potential to China. The Kunming Fair from June 6-10, 2011 will feature a lot of our agriculture produce.



Outlook

Second ACCI General Elections

Afghanistan Chamber of Commerce and Industries (ACCI) is preparing for the second ever nationwide business community elections in Afghanistan.

All registered members in 21 provinces will vote for their delegates to the national ACCI High Council in September 2011. All provincial chambers of commerce and industries are currently validating their membership lists and accepting new membership applications. Voter lists will be prepared soon.

Considering the last elections we expect that more than 20,000 members shall cast their votes and elect their delegates for the national High Council of Representatives. The High Council of Representatives will then convene in Kabul and elect new Board of Directors for ACCI.

The key objective of the 2011 ACCI elections is to create a High Council of Representatives and the Board of Directors that is supported by a strong majority of the Afghan business community. The ACCI has established an election schedule for the economically active provinces, as well as procedures for the nomination of candidates and the actual voting. Nomination and elections will be free, fair, and transparent. The event will be a unique opportunity to introduce democratic procedures.

Afghanistan

The Land of Rising Opportunity

Afghanistan is a land of rising economic opportunities for foreign direct investments. Strategically nestled at the confluence of major trade routes, Afghanistan is blessed with untapped natural resources, favorable business regulatory environment and a significant domestic market characterized by expanding consumption from an emerging lower-middle class.

ACCI has recently published a Booklet on investment possibilities in Afghanistan under the title "*Afghanistan - the land of rising opportunities*".

You can download the publication from our website (www.acci.org.af).



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MARKET
ECONOMY



Afghanistan Chamber Of Commerce & Industries

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