*Benchmarking FDI Opportunities*

# Investment Horizons: Afghanistan

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The Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group was established in 1988 to promote the flow of private foreign investment to developing member countries. MIGA offers political risk insurance coverage to eligible investors for qualified investments in developing member countries. MIGA also offers technical assistance programs to develop and implement effective strategies for attracting and retaining foreign direct investment. This hands-on technical assistance focuses on three primary areas: dissemination of information on investment opportunities and business operating conditions in developing member countries through online services; capacity building of the organizations and institutions involved in the promotion of foreign investment; and, investment facilitation activities supporting the efforts of developing countries to identify and attract investment.

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# Investment Horizons: Afghanistan

## An Analysis of Foreign Direct Investment Costs and Conditions in Four Industries

*April 2005*

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# Executive Summary

*Benchmarking in a conflict-affected country like Afghanistan is necessarily fraught with methodological and logistical difficulties, and the results are far more susceptible to change than those in countries that have not recently undergone conflict. In this sense, these findings should be seen as a "snapshot," an initial benchmark on Afghanistan's road to recovery. As such, this publication provides valuable information on current areas of strength and opportunity in Afghanistan. However, most important from the investor's point of view should not so much be the current situation, (which has already significantly improved from recent years), but rather the dynamic movement of the country's economic and security realities, and the future opportunities created for business. As the findings make clear, and as is true across many sectors, investors entering Afghanistan now will benefit from being "first movers" in a virgin market that is highly pro-business.*

## Project Context

The Islamic Republic of Afghanistan and its donor partners are making progress in reconstructing the country's infrastructure, revitalizing the economy, and creating institutions and legal frameworks to support the development of a multi-ethnic state. As part of this effort, the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group, with funding from the German Government's Ministry for Economic Cooperation and Development (BMZ), commissioned the first Afghanistan Enterprise Benchmarking Study to assist the Government of Afghanistan and the Afghan Investment Support Agency (AISA) in their efforts to promote investment. Additionally, as in its other enterprise benchmarking initiatives, MIGA hopes to provide a useful tool for investors in terms of identifying potential investment opportunities.

The specific objectives of the Afghanistan benchmarking study were to: (1) document the current costs and conditions associated with the selected industries, toward determining Afghanistan's overall competitiveness as a location for investors; (2) analyze strengths, weaknesses, opportunities, and threats (SWOT) to identify the prospects and challenges in the four selected sectors; and (3) identify the country's present comparative advantages and make recommendations for improving the sector-specific investment climate and attracting foreign direct investment (FDI) in the coming months and years. It is expected that the results of the study will help to clarify and inform AISA's FDI promotion strategy and marketing efforts.

The study aimed to examine both quantitative and qualitative factors relating to the business environment as they stood at the particular time of the study. For example, firms were asked to report the costs incurred for such items as land and utilities as well as to discuss perceptions of the ease of operating in Afghanistan. As elaborated more fully in Chapter II, the results of the study are based primarily on three sources of data: 32 firm surveys and interviews, local sources such as utility providers and government agencies, and international sources of data. The analysis was further supplemented by a review of relevant literature on Afghanistan's investment climate and meetings with government and other stakeholders.

With input from AISA and MIGA, four sectors were selected for analysis based on an initial sense of their viability for attracting investment. These four sectors are: transport and logistics; food and beverage processing; carpets and textiles; and mining. The findings are divided into general observations that affect all sectors, as well as sector-specific conclusions.

## Summary of Findings

The progress made in Afghanistan since the end of major fighting in 2002 has been marked, especially considering the desperate and damaged state in which the country was left after 23 years of war and isolation. Therefore, a realistic assessment of the Afghan business climate must reflect the dynamic pace of change and progress set against a series of underlying realities. This document aims to reflect both quantifiable factors and the nuances inherent in this sort of transformational, even paradoxical, environment. For example, the country's licit Gross Domestic Product has grown approximately 50 percent in the past two years, and yet basic public services such as water and power are still unreliable. Several multinational corporations have already invested in Afghanistan, but the bulk of the economy remains informal. Therefore, an analysis of prospects for investment reveals challenges and significant opportunities.

The fact that an enterprise benchmarking exercise can be undertaken in Afghanistan at all is remarkable, and a sign of the significant progress that has been made in the economic and security spheres during the past three years. It also reflects the traditionally entrepreneurial spirit of the Afghan people, which remained unbroken through two generations of conflict and is furthered by the Afghan diaspora, now returning to the country. Nonetheless, the situation remains in flux, and therefore, the sample base in the four sectors is not as large or geographically dispersed as one would usually expect would reveal statistically significant variations. While there is no reason to believe that the findings are not representative of the current situation, it is clear that they are subject to limitations imposed by the sample size, variable operating conditions, and the inability to conduct a country-wide survey.

### Cross Sectoral Challenges and Prospects

- **Improving legal framework for investment** – Investors in Afghanistan face an evolving legal regime regarding investment. Many proposed laws intended to improve the country's legal regime and support a modern market economy are in various stages of enactment. For the time being, however, several areas of commercial activity remain poorly regulated or not regulated at all, and the judiciary has limited capacity. This contributes to the country's overall risk perception.

- **Developing tax regime and low tax compliance** – Although the tax regime remains cumbersome and tax compliance is low, this area is targeted for improvement. Officially, hundreds of "nuisance taxes" remain on the books at the Ministry of Finance and other government agencies collect a range of licensing and permit fees and other quasi-tax payments. In general, company awareness of tax policy and law is low. Transitionally, the lack of tax enforcement offers the obvious benefit that many firms pay no taxes other than customs fees. At the same time, larger formal companies complain that the more visible and responsible companies are shouldering a disproportionate share of the corporate tax burden in Afghanistan.

- **Reforms in customs administration** – Customs administration currently lacks consistency and transparency. Investors suggest that individual provinces (some only gradually coming under control of the central government) clear goods and collect various amounts of customs revenue without coordination with the central government. Recent reforms have helped streamline processes, but investors see the need for further improvements.

- **Developing transport infrastructure quality and high transportation costs** – With some notable exceptions, Afghanistan's road network is in poor condition, air freight is still limited and costly, and most goods must be shipped through Pakistan or Iran, adding another layer of costs, delays, and administrative processing. This raises costs for all firms that import or export, and must be an urgent government priority. In that context, opportunities for construction firms, engineering companies, etc., are great.

- **Complex property market** – If the considerable amount of government-held land is appropriately privatized, investors in Afghanistan will have a range of attractive investment location options. While steps are being taken to improve the process, accessing government land currently still seems to be a highly individualized process characterized by many individual government agencies owning, leasing, and selling land in a nontransparent and inconsistent manner. The government owns most land in the country and the private property market works largely on a negotiated basis with prices rising rapidly. The ability of investors to purchase or lease land is frustrated by a highly nontransparent property market. Title disputes are common, procedures for leasing or selling land vary widely, and recourse and judicial settlement are difficult.

- **Improving capacity of the state to provide utility services** – Certain public services such as water, power, and wastewater treatment, are not yet generally available. Indeed, few of the firms interviewed relied on public electricity, waste collection, or wastewater services. Most organizations rely on mobile phones, private wells, and generators for basic utility needs. The government is addressing this, and in turning to the private sector is creating additional investment opportunities.

- **Improving security** – The improving security situation is reducing instability for investors, particularly non-Afghan entrepreneurs. Gradually the entire country is being brought under central government control, but anti-government forces, while significantly weakened, do continue to mount sporadic attacks in major cities. Nonetheless, the outside perception of the security situation remains negative.

- **Strengthening financial markets** – Several international banks and the Central Bank provide conventional financial services to business, but standard financial products such as commercial loans and export financing are not yet available in Afghanistan for domestic investors. As a result, business finance is not fully developed and most loans seem to be informal sector transactions between family and friends.

## Sectoral Conclusions

In general, the strengths across the sectors reflect the economic landscape of a country with a pro-business climate and a range of opportunities for forward-looking investors as Afghanistan regains its position as a hub between Asia, Europe, and the Middle East. The weaknesses, as expressed by investors already operating in the country, are an unvarnished expression of the current reality that still exists after 25 years of war and civil conflict – and is changing every day. But even in the weaknesses, current and potential future investors can see opportunities. To name but one example, the inadequate road network within the country and to neighboring markets represents a prime opportunity for foreign and domestic companies in the engineering and construction fields. This opportunity, in turn, will bring with it upstream and downstream business linkages in equipment leasing, cement and other materials, and related business activity.

## Transport and Logistics

Of the four sectors considered for this study, the transport and logistics sector saw the largest presence of FDI and some unique demand-driven advantages. An analysis of the transport and logistics sector revealed several strengths and weaknesses, including:

### *Strengths*

- **Little or no competition and fertile ground for new ideas** – Because of the difficulties of Afghanistan's recent past, investment levels are still low and new entrants in the sector face limited competition and stable demand for innovative, new, and cost-effective services.

- **Steady demand** – Foreign assistance, government demand, and private sector demand for the equipment and machinery needed to undertake the country's massive reconstruction program should continue for years to come at its current level, thereby creating a stable market for transport and logistics services.

- **High profit margins** – The logistics companies operating in Afghanistan that were interviewed for this study reported that they had begun with a modest initial investment of only a few thousand or tens of thousands of dollars and are making hundreds of thousands or even millions in return. While these margins are expected to fall over time with increased competition, in the interim the transport and logistics sector demonstrates the benefits of "first mover" advantage.

### *Weaknesses*

- **Inconsistent road conditions** – Only about 65 percent of the main circuit of highways comprising the Afghan road network is in good condition, and the main transit road for goods to Pakistan, Afghanistan's most important trading partner, is in disrepair. Furthermore, many companies interviewed expressed dismay that major highways were frequently closed without prior notice for "security purposes" and remained closed for as long as several days.

- **Lack of a seaport** – While many private industry representatives see Afghanistan's lack of a seaport as a major obstacle for industry in the country, some interviewees see the country's landlocked status as a distinct advantage. Afghanistan is dependent on the cooperation of its neighbors who do have seaports, has higher costs of transportation, and cannot promise fixed delivery times to overseas customers.

- **Reforming customs authority** – Although the Afghan customs authority has automated many of its processes, the system is not fully integrated and is limited in its capabilities. Also, there are multiple customs checks (not all of them official) once goods have entered Afghanistan's borders. The current procedure requires that all trucks be cleared at once from a certain bill of lading.

- **Arbitrary rules and regulations in the Afghan countryside** – The central government's authority has been limited in certain regions of the country, but is improving. Local warlords were accustomed to imposing arbitrary taxes and customs charges on overland transport.

- **Undeveloped electric infrastructure and high costs** – Sophisticated logistics services require telecommunications and inventory management systems, and these depend on a reliable electric infrastructure. All the logistics companies interviewed relied on a back-up generator for at least some of their operations, and four of the foreign companies said they either had no municipal power at all or depended 100 percent on their own personal generators. Therefore, electric power costs in Afghanistan are high.

## Food and Beverage Processing

Years of conflict have left Afghanistan's indigenous food processing industry largely devastated and today the country imports most of its processed food. There is considerable potential for import substitution in the sector. The following major strengths and weaknesses were identified in the analysis of the food and beverage processing sector:

### *Strengths*

- **"First Mover" advantages** – As little is currently produced in Afghanistan in the food and beverage industry, companies that establish production or bottling operations are well-poised to reap great benefits as the first domestic suppliers of their products as well as lower transportation costs than their importing competitors.

- **Afghanistan's brand name for traditional products** – Afghanistan has several markets to which it has long exported certain products such as dried fruits and nuts. Restoring production and marketing the country's traditional reputation for quality may confer an advantage to new producers.

- **Proximity to low-cost raw materials** – Afghanistan's arid to semiarid climate and hot summers are particularly good for cultivating a large variety of fruits and vegetables that can be dried, canned, or otherwise processed. Afghanistan also has good surface water availability as compared to the Central Asian Republics and Iran. This means that Afghanistan could develop lower irrigation costs as compared to those countries.

- **Proximity to large markets** – Some of the most populous countries of the world including China, India and Pakistan are in close proximity to Afghanistan and constitute natural buyer markets for Afghanistan's products. Traditional fruit products already have an outstanding reputation in India which could, with some marketing, extend to other food and beverage products.

### *Weaknesses*

- **Transportation and logistics challenges** – Poor roads and arbitrary road closings, lack of a seaport, delays at customs, and the absence of effective transit agreements with neighboring countries all mitigate against the quick, inexpensive transport of perishable food and beverage products abroad and within the country.

- **Lack of quality standards and poor environmental conditions** – There are, as of today, few controls in this traditional industry and there is a general absence of written standards, inspections, price supports, and technical assistance. Current traders lament elevated quantities of dust, sulphur and other toxins in the air and water, a fact which has been confirmed through laboratory tests. Dried fruits may require two to three washings, which can deteriorate their quality. The water used to wash them is sometimes not sanitary. As the sector seeks export markets, quality assurance will become an increasing issue.

- **Unreliable and expensive electric power** – Voltage variations ("brownouts") damage equipment and interrupt production processes, subjecting perishable food and beverage products to spoilage or significantly reducing their shelf-life. Of the seven companies interviewed in this industry, six had no publicly provided power and were incurring generator costs, and the one with power reported frequent brownouts.

- **Need for appropriate equipment and storage facilities** – In the dried fruit and nut sector, most producers have not invested in equipment since the Taliban came to power, meaning that the current equipment is old and obsolete in many cases. Raisin agents see a need for more storage facilities to maintain raisins in a controlled environment. This need will likely also extend to other sectors as they recover from conflict.

- **Limited financing for small and medium-sized enterprises (SMEs)** – Little longer-term financing is currently available for SMEs in Afghanistan. Many of the companies in this industry, especially in the dried fruit industry are SMEs.

## Carpets and Textiles

As one of Afghanistan's traditional economic sectors and with its linkages to rural incomes, much government and private sector attention has been paid to revitalizing the Afghan carpets and textiles sector. An analysis of the carpets and textiles sector reveals some particular strengths and weaknesses:

### *Strengths*

- **Traditional expertise retained** – The carpet industry is one of Afghanistan's traditional products and, despite the war, entrepreneurs in the business suggest that a sufficient supply of the necessary skilled labor remains in the country.

- **International brand retains value** – Although more needs to be done, the Afghan carpets and traditional textiles sector retains a generally favorable international image. Carpets made in Afghanistan are considered a traditional handicraft, reflecting a rich history and a range of quality designs. While production quality is inconsistent, the generally favorable image offers the sector a good basis for improved marketing.

- **Preferential trade access** – Handmade Afghan carpets have been granted preferential duty free access to the important United States and European Union markets. This provides a pricing advantage for Afghan carpets that producers without such access will not enjoy.

- **Non-perishability of product** – Although carpets are sensitive to humidity, they are otherwise very easy to store. This means that output can be stockpiled near to the end customer in overseas markets for a long time. This also confers a transitional advantage in Afghanistan where transport and storage systems are not well suited for exporters of perishable products.

### *Weaknesses*

- **Inability to access affordable land** – Many interviewees in the carpet sector suggest that finding affordable land for warehouses and other facilities is a major concern.

- **Developing supply of raw materials** – Due in part to the devastation of local sources of wool and dyes, most inputs for the carpet industry must be imported through Pakistan. Some firms complained of having difficulty finding regular and affordable supplies of quality dyes, wool, and other inputs. In some cases, importing these raw materials simply adds transport and customs costs, and in other cases the quality of imports is suspect.

- **High transport costs for a heavy product** – In addition to having to pay to import raw materials, carpet traders also reported that almost 100 percent of their output was exported, which increases the basic costs of the business. Carpet makers suggest that shipping large volumes of carpets – a relatively heavy commodity – from Afghanistan via air is not a viable option given the high cost and limited outbound air cargo space, although airfreight costs are beginning to become more competitive. Shipping through Pakistan or Iran adds costs and time.

- **Developing finishing capacity in Afghanistan** – At present, nearly all carpets are shipped as quasi-finished goods to Pakistan for final finishing. Over the past two decades, Afghanistan's finishing infrastructure was either destroyed or outmoded. This not only increases the costs that carpet sellers face, it also constrains the growth of the indigenous industry and creates opportunities for infringements of intellectual property. Carpet vendors indicate that one finishing facility in Mazar-e-Sharif has recently opened, but it is not clear if the factory has the capacity to lure back a significant amount of the finishing business presently being shipped to Peshawar.

## Mining

The minerals sector, which is scarcely functioning in Afghanistan and still largely in public hands, offers great potential in the mid- to long-term. Some of the more significant considerations include:

### *Strengths*

- **Considerable growth potential** – Afghanistan has a wide array of known mineral resources as well as vast areas where the potential is not known. Few of its reserves are being commercialized presently, creating a vacuum that can be filled by private investment.

- **High demand for construction materials** – As a result of the reconstruction boom that Afghanistan is presently undergoing, there is significant local demand for mineral-based construction materials, including paving stones, cement and cement blocks, bricks, gravel, wood, steel, sand, glass, and tile. Presently, even basic materials like cement are imported from Pakistan and Iran, offering great potential for import substitution.

- **Costs associated with transport provide advantage to locally produced materials** – Assuming minerals-based products such as construction materials can be produced at a quality on par with imports, the costs associated with importing such materials confers an advantage to companies that produce locally.

- **Significant unmet demand for energy** – Afghanistan's domestic energy needs remain unmet despite significant deposits of coal. When privatization is complete and the regulatory regime governing private investment is established, demand for locally produced coal is estimated to be steady.

### *Weaknesses*

- **Legal regime in process** – While a draft mining law is awaiting approval by the Cabinet, regulations and administrative procedures are not yet in place to govern private sector involvement in mining. Of particular importance is determining the tax regime facing mining companies. As a result, the Ministry of Mines and Industry has not licensed any minerals exploration, extraction, or processing. Existing mining is either state-sponsored or illegal activity.

- **Incomplete privatization process** – Certain mining resources, including coal for which there is a demonstrated local market, remain in the control of failing state-owned enterprises (SOEs). Reportedly, few of the major mines are operational and those that are have largely reverted to non-mechanized coal mining and production. At the same time, private investment in mining is not yet permissible. The lack of progress on privatization not only keeps certain assets out of private hands, but also sends a generally negative signal to investors about state intrusion in the mining sector.

- **Lack of effective government control over certain mineral-rich areas** – Some of the country's most promising areas for minerals exploration, particularly along the border of Pakistan, remain vulnerable to attack by anti-state actors. This makes investments an uncertain proposition, unless covered by investment insurance.

- **Shortage of skilled mining labor** – Industry experts suggest that Afghanistan lacks a ready supply of skilled technical and managerial workers. Because most of the country's major mining facilities were outfitted with Czech and Soviet machinery, even if individuals working in the sector are familiar with machinery, it is likely to be outmoded. This will increase start-up costs for new investors, as they will need to rely on more expensive foreign labor and factor in costs for lodging and per diems for engineers, machinists, and managers, until local workers can be appropriately trained.

# Chapter I:

# Introduction and Study Objectives

## Introduction

To support the joint assistance efforts of the Multilateral Investment Guarantee Agency (MIGA) and the World Bank in the Islamic Republic of Afghanistan, MIGA commissioned the Afghanistan Enterprise Benchmarking Study as part of the Enterprise Benchmarking Program (EBP). Funded through a grant from the German Government's Ministry for Economic Cooperation and Development (BMZ), the objective of the study is to benchmark the business costs and conditions in Afghanistan from the vantage point of the foreign investor. The study was contracted to a consulting firm, The Services Group, under MIGA's global Enterprise Benchmarking Program. Therefore, this study is consistent with the methodologies and approaches developed for the EBP. The study was conducted in December, 2004, with the facilitation and support of the Afghan Investment Support Agency (AISA).

The Afghanistan benchmarking study involved conducting a total of 32 interviews with companies operating in four selected sectors: transport and logistics; food and beverage processing; carpets and textiles; and mining. These sectors were chosen as a result of input from AISA and MIGA based on an initial sense of these sectors as viable for attracting investment. The interviews were guided by a detailed survey of investor perceptions and costs designed by MIGA under the EBP. The research team conducted surveys with indigenous, Afghan expatriate and foreign investors over a two-week period. As discussed in more detail later, the results highlight the operating costs, constraints, and perceptions of doing business in Afghanistan. The survey analysis is supplemented by observations based on a thorough review of germane literature about the business environment in Afghanistan and numerous interviews with other stakeholders, including individuals working in the donor community and government in Afghanistan.

This publication is organized in five sections. The Executive Summary presents an overview of the findings of the Afghanistan Enterprise Benchmarking Study. Chapter 1 summarizes the project background and objectives. Chapter II explains the EBP methodology and its application in Afghanistan. Chapter III summarizes the results of the survey data and presents an analysis of the strengths, weaknesses, opportunities, and threats – also called a SWOT analysis – of each sector. Endnotes for references to sources noted in the main text appear as Appendix 1. Appendix 2 contains a list of acronyms and abbreviations used in this publication. Appendix 3 provides background on data definitions and resources. Appendix 4 presents tables of findings derived from information obtained through company interviews. Appendix 5 presents tables of findings derived from information collected from local sources. Appendix 6 is the bibliography for the study.

## Project Objectives

The benchmarking study provides valuable data on four sectors with good prospects for attracting investment – transport and logistics, food processing, carpets and textiles, and minerals. The study also provides insights into country competitiveness and investor perceptions that can inform the Afghan Investment Support Agency's strategic planning process and policy advocacy agenda, as well as provide the basic information around which sectoral investment guides can be prepared.

The objectives of the Afghanistan benchmarking program are as follows:

- To compare the competitiveness of costs and conditions associated with the selected industries which could then be used by AISA in the formulation of its foreign direct investment (FDI) strategy and marketing efforts;
- To use SWOT analysis to identify the strengths, weaknesses, opportunities, and threats in the selected industries;
- To identify the country's comparative advantages and make recommendations for improving investment climate and attracting FDI;

The Afghan Investment Support Agency – the principal agent for attracting and facilitating investors – is faced with a challenging task given the post-conflict character of the country and intense global competition for investment. Formally opening in August 2003, AISA is a new and relatively small agency in the early stages of development. In addition to promoting investment, AISA is also tasked with registering investors, creating a "one-stop shop" for investment information and approval, and developing industrial estates. Of the 31 current staff members, only eight work in investment promotion and three in industrial estate development.[1]

Two important tasks facing AISA include advocacy for administrative, regulatory and policy reform that can improve the investment climate and disseminating information to investors about the operating environment and costs. The lack of hard, reliable data comparing economic opportunities and costs in Afghanistan to other countries has proven to be a significant obstacle to marketing the country for investment. To help address this barrier and stimulate FDI in the country, MIGA has programmed the benchmarking exercise in sectors with good potential for attracting investment, including among both foreign and domestic firms. (Specific recommendations prepared for AISA are not included in this publication.)

# Chapter II:

# Methodology

## Purposes of the Benchmarking Program

MIGA's EBP benchmarking methodology is about competitiveness—using an established set of criteria to gauge a country's ability to compete with other sites and locations available to the investor. For the purposes of this exercise, "competitiveness" is defined as a country's or region's relative ability to attract foreign direct investment.

When a company has decided to open a factory, representative office, call center or warehouse, it is faced with the need to evaluate a variety of sites and choose the best one. This often implies a major investment in company resources and the daunting task of obtaining and analyzing a vast body of information. Benchmarking is a tool that companies often use to organize their research and assign value to each bit of information according to their own priorities.

First, the company makes a list of factors that are important to its investment decision. Then, the investor chooses alternative sites (cities, states, regions or countries) to evaluate. Next, the investor gathers information on each factor. This usually involves both primary research in the field and desktop research from secondary sources. Finally, the investor gives each country a score or ranking for the selected factors, analyzes the strengths and weaknesses of each site, and makes a final decision as to where to locate based on the analysis.

Investment promotion agencies (IPAs) are increasingly using a benchmarking approach similar to that of the investor to determine how attractive their countries or regions are from the investor's viewpoint and how their strengths and weaknesses compare to those of other sites.

## Assumptions

MIGA's benchmarking approach begins with a set of assumptions to be tested in the field through empirical data. It assumes, for example, that flexible labor regulations, a steady supply of electric power, abundant labor, and low telecommunications costs make a site more attractive to foreign investors. These assumptions fall under two major categories: costs and quality factors.

**Assumption 1:** Lower costs make an investment site more attractive. The assumption is that when researching a site, all other factors being roughly equal, an investor will prefer lower costs to higher costs. For instance, assuming that the education level and productivity of the work force is similar in two countries, the investor will prefer the country where labor costs are lower.

**Assumption 2:** Higher quality makes an investment site more attractive. Cost factors being equal, the benchmarking approach assumes that higher quality of infrastructure, services, and work force are more attractive to the investor. For example, if the electric power costs in two countries are similar, the investor will prefer the country that experiences fewer power outages.

## The EBP Benchmarking Model

In order to test the initial assumptions, MIGA has developed the EBP benchmarking model. This provides a framework that can be used by IPAs to evaluate their countries or regions in the same way that investors do.

The model attempts to capture the perspective of the investor by administering a detailed survey to investors already functioning in the country in question. The survey obtains information from these investors as to their costs on the ground and the quality of infrastructure and services of that site. It asks them to assign a subjective rating to these factors. The model obtains information from investors on cost and quality factors in the country or countries being studied, as shown in Table 2-1, below.

### Table 2-1: Cost and Quality Factors of the EBP Model

| Cost Factors | Quality Factors |
|---|---|
| Labor costs for managers, professionals, technicians, skilled and unskilled labor | Availability of qualified local personnel |
| Wage burden required by law and customary employer benefits | Language skills of the local labor force |
| Telecommunications costs (land lines, mobile phones, internet connections) | Flexibility of labor regulations |
| Cost of electric power, water, waste water treatment | Annual turnover of personnel |
| Cost of maintaining a back-up generator | Availability of local production inputs and equipment |
| Transportation costs | Efficiency of local customs administration |
| Interest rates available for credit | Quality of transportation services |
| Purchase / lease rates | Quality of telecommunications |
| | Reliability of electric power and water |
| | Quality of life factors |
| | Government incentives |

Furthermore, the model identifies investment motivation factors, that is, the reasons the investor decided to locate in the country or region being benchmarked.

One of the model's greatest strengths is that it allows the researchers using the model to select a group of industries believed to be of importance to the country or region being studied. It then measures the ability of the country or region to compete for foreign direct investment in each of those industries by taking into account the unique requirements of each industry or service sector and evaluating the country or region against those requirements. For example, a textile dyeing factory may require an abundant, low-cost water supply and a large chemical treatment plant, whereas a call center requires an excellent telecommunications infrastructure. If the site being studied has abundant, low-cost water supply but a poor telecommunications infrastructure, the model will reveal that the site is less competitive for attracting a call center than a textile dyeing factory.

In coordination with AISA, the researchers chose four industries believed to be of great current and future importance for Afghanistan: (a) logistics and transport, (b) food and beverage processing, (c) textiles and carpets, and (d) mining. A total of 32 companies operating in these four industries were interviewed for this study.

The EBP methodology has several other important characteristics that make it a valuable approach:

**It measures the country's competitiveness at a specific point in time.** The EBP methodology is based on the concept of capturing a "snapshot" of the investors' perspective for each of several specific sectors. The methodology is most effective when repeated on an annual or semi-annual basis so that it can identify investment trends and reveal areas of declining or increasing competitiveness in a country.

**It selects the primary countries and a group of comparator countries.** The countries which are the focus of the study are chosen. These are the object of in-depth research into the macro, micro, quality and cost characteristics of their business environments. In addition, the researchers choose a group of "comparator" countries. These are usually countries that have achieved a level of success in one or more of the industries being studied or are considered in some way to be direct competition for the primary countries. The comparator countries are not studied in-depth; rather investment factors that are considered key for their ability to compete with the primary countries in selected industries are described and evaluated.

The use of comparator countries allows the researcher to enrich the competitive analysis of key industries across a greater number of countries, but it saves resources in that it does not require that those comparator countries be studied in depth.

For administrative reasons, Afghanistan has been studied without other primary or comparator countries. However, the information obtained in other studies can eventually be incorporated into this one so as to provide a comparative backdrop.

**It depends both on desk research and on field work, secondary sources as well as primary sources of information.** The methodology requires that the analysts research country-specific information in international secondary sources as well as obtain information directly from the investors operating in the country and other local sources of information in the country or countries to be studied.

**It is geographically limited**. Conditions within a single country can vary widely, and choosing five companies from different regions, especially for a country as large and diverse as Afghanistan, may dilute the usefulness of the data. Therefore, the benchmarking methodology is generally limited to a radius of 20km from the capital city. This study was limited to firms with offices in Kabul and its surrounding area except where companies for the chosen sectors were only available outside this region. For example, mining activities are carried out in areas throughout Afghanistan, so the consultants were required to interview company representatives of mining companies with operations outside Kabul.

In addition, the EBP benchmarking methodology can provide direct support to local investment promotion agencies (IPAs) in the following ways:

- It identifies sectors where the country or region has a strong competitive position, relative to its competing sites, and therefore should be promoted;
- It assesses the site's strengths and weaknesses for inward investment in particular sectors;
- It identifies key policy areas that need improvement and should therefore be the focus of the IPA's lobbying efforts;
- It assists an IPA in developing sector-specific key selling messages to attract inward investment; and
- It provides IPAs with specific information that is frequently requested by potential investors.

## Data Gathering

The data used for the benchmarking model is gathered from three types of sources:

**Company interviews:** The bulk of the information is gathered through company interviews using the survey in Appendix A. The survey requests both quantitative and qualitative information and identifies the motivating factors behind the investor's decision to locate at that site. Five to ten companies per industry are interviewed in each country being benchmarked. Foreign investors are usually interviewed, but in the absence of foreign investors, local investors are often surveyed. Preference is given to the leading companies in each industry.

**International sources:** Desktop research is used to gather important data from international sources such as Euromoney's Country Risk Poll, Transparency International's Corruption Perception Index, and macroeconomic statistics found in the World Bank's World Development Indicators.

**Local sources:** Local sources such as tax specialists, real estate agents, construction companies, government ministries and utility providers provide information required by the methodology such as local tax rates, typical rental and land purchase rates, and electric power and water costs. This information is ideally gathered in-country.

All data must meet three criteria: (1) Credibility of the source—all information should be from a respected and reliable international or national source and cross-checked against other sources; (2) Comparability of the data-point across locations; and (3) "Updateability", that is, researchers should be able to return to the source after six months or a year to obtain current information.

For the Afghanistan Enterprise Benchmarking Study, expatriate Afghan investment was considered to be foreign direct investment. Given Afghanistan's post-conflict reality, FDI was not present in certain sectors (e.g., carpets and textiles), and in another sector, the major players were local investors (food processing). At the time of the interviews, only in the transport and logistics sector was there a numerically significant number of foreign investors. This was due in part to the presence of international organizations and the military in need of supplies. Finally, in the mining sector very few duly registered companies are operating, given that the industry is dominated by failing state owned enterprises (SOEs) and indigenous micro-enterprises, so the sample size fell short of the norm.

## The Process

The fieldwork for the Afghanistan benchmarking study was conducted in mid-December 2004, following seven days of preparatory time, document review, and coordination with AISA. Fieldwork was conducted by a team of consultants from The Services Group, Inc., in conjunction with two local consultants, who were engaged to assist in completing the study and in gathering required data in Afghanistan.

The field research yielded the following interviews:

- **Transport and logistics** – Twelve companies including freight forwarders, air, sea, and land transportation companies, small package and document delivery companies, procurement and supply companies, and providers of warehousing and distribution services
- **Food and beverage processing** – Out of the a total of seven companies interviewed, three were dried fruit and nut processors, two distilled water bottlers, one soft drink bottler, and one was a vegetable oil producer
- **Carpets and textiles** – Ten carpet manufacturers/traders
- **Mining** – Of the three operating minerals related companies in Kabul, one was a minerals manufacturer and two were end-users of locally mined materials.

In addition to company interviews, the consultants met with numerous other stakeholders to gather information on the general investment environment, business constraints, and legal and policy issues as well as to collect documents germane to the study.

# Chapter III:

# Results

## Overview of Foreign Investment in Afghanistan

The results presented herein are drawn primarily from the data gathered through the survey interviews with firms operating in Afghanistan in the four sectors examined. As well, secondary sources, including previous World Bank and other studies, and interviews with a wide array of other stakeholders inform the analysis.

### Challenges

The post-Taliban Government of Afghanistan (GoA) and its international partners have made great strides in spearheading reconstruction, jump-starting the economy, resettling three million refugees and internally displaced persons, and developing a policy and regulatory framework to support private investment. Indeed, appreciating the great progress made in Afghanistan in the past three years requires an understanding of the depths of the country's economic, political, and social decline during the war years.

Emerging out of some 23 years of civil strife and isolation, Afghanistan remains one of the poorest countries among the World Bank's membership. By 2002, its infrastructure and productive assets were largely destroyed or degraded through neglect, more than five million Afghans were living as refugees abroad,[2] and a generation had emerged with poor access to education, healthcare, and the other essentials to promise a healthy and productive life. The World Bank estimates that seven million people remain vulnerable to hunger and many ordinary citizens are dependent on humanitarian aid. With rates running as high as 50 percent in Kabul and even higher outside of the capitol, unemployment and underemployment remain major problems in Afghanistan. Gross domestic product (GDP) is estimated at US$4.7 billion, which translates to a GDP per capita of about US$212 per year.[3] The World Bank estimates that non-drug related GDP growth rates, coming from a very low base in 2001, have risen by 45 percent over 2002 and 2003.[4]

With much success, donor assistance has been mobilized to help retrain personnel, restructure institutions, and reform the policy making process, but the government is just reaching the point when it can manage basic state functions like collecting taxes and controlling its borders. This has been accomplished in the context of nearly a quarter century of strife and isolation during which Afghanistan's government largely lost the ability to provide public services. The newly reconstituted government is still characterized by weak institutions, poor personnel performance, and a tendency to revert to outmoded command-and-control style decision making, but internal reforms have set the civil service on the right path toward delivering efficient services.

Given this situation, there is a widespread consensus that private sector-led economic growth is critical to providing Afghanistan with the employment and revenue base to enable the country to function without massive inflows of donor assistance. Wisely, private sector development was recognized as a core goal in

**Table 3-1: Afghanistan at a Glance**

| | |
|---|---|
| GDP (2003) | US$4.7 B |
| GDP per capita | US$212 |
| GDP growth (2003) | 27 % |
| GDP by share: | |
| Agriculture | 52 % |
| Manufacturing | 26 % |
| Services | 22 % |
| Inflation (2003) | 5.2 % |
| Population (2003) | 22.2 M |
| Workforce (2001) | 11.8 M |
| State revenues (2003) | US$200 M |
| State expenditures (2003) | US$550 M |
| Electricity consumption (2001) | 511.4 million kWh |
| Licit exports (2002) | US$98 M |
| Imports (2002) | US$1.007 B |
| Male life expectancy (2003) | 47.67 |
| Female life expectancy (2003) | 46.23 |

*Sources: AISA, U.S. Department of State, "Afghanistan Profile," 2005.*

### The Nature of the Informal Sector in Afghanistan

One factor in Afghanistan's post-conflict transition is the informal nature of much of the economy. As the state's ability to regulate and monitor the private sector collapsed during the war years, Afghans relied on a range of informal activities for their survival. Data on the size and characteristics of the informal sector are hard to gather in any economy, but particularly so in as large and rural a country as Afghanistan. However, informal sector activity can be seen in virtually all sectors of the economy, including agriculture, small-scale mining, and trading. While the Ministry of Commerce and AISA have registered some 8,500 companies since 2002, Ministry of Finance advisors estimate that fewer than 10 percent of companies pay income taxes and only 3,000 firms have received a tax identification number. In Afghanistan the illicit cultivation of poppies for opium and heroin production represents a large share of the informal sector, accounting for 35 percent of national GDP by World Bank estimates.

*(continued on next page)*

the country's 2002 National Development Framework (NDF). In the NDF, the government expressed a clear commitment to developing a competitive export-oriented private sector and to adopting policies and programs that enable the private sector to be the country's engine of growth. While traditional entrepreneurialism is notable among Afghan firms after years of operating in exile or beyond the control of laws and regulations, the Afghan private sector can be characterized as small in scale, largely informal, and unable to compete in the global marketplace. Therefore, a central strategy to facilitate private sector-led growth is to boost formal investment levels in post-conflict Afghanistan, including investment from Afghan expatriates and foreigners. As seen in the columns (beginning at left), the informal nature of Afghanistan's economy poses several development challenges.

## Prospects and Progress

Yet despite the challenges facing private enterprise, business has come back to Afghanistan and the pace of improvements in the investment climate is notable. As GDP growth estimates suggest, the economy is growing rapidly, albeit from a slow pace during the Taliban years. One can observe a steady improvement in the services and goods available, and a few significant multinational corporations (MNCs) have an investment presence in the country. There are currently some hidden and transient advantages to investing in Afghanistan simply because of the failure of the government to collect taxes and charge for public services. For example, few firms pay taxes except for customs duties and most drill their own wells.

The MNCs that have invested in Afghanistan are in the transport and logistics sector (DHL), food processing (Coca Cola), banking (Standard Chartered Bank, National Bank of Pakistan, Habib Bank Ltd., and National Bank of Punjab), tourism (Hyatt Hotels and Serena Hotels), and trade (Toyota Motors and Alcatel Trade International). AISA reports the value of investment at upwards of US$650 million since 2002 from a total of 25 countries. According to AISA, the largest investor country is Turkey, with projects amounting to about US$120 million, followed by Germany, India, and Pakistan. Amounting to an estimated US$180 million, the telecommunications sector has thus far attracted the most investment. [5]

### Table 3-2: Investment Projects in Afghanistan

| Sector | Investment (in US$ M) | Direct Employment |
|---|---|---|
| Construction | $389 | 54,800 |
| Services | $213 | 4,300 |
| Industry | $150 | 21,000 |
| Agro Business | $6.4 | 535 |
| Total | $758.4 | 80,635 |

*Source: AISA.*

The primary target group of potential investors for the country is the Afghan diaspora, which has obvious cultural, family, and historical ties. For the purpose of this study, Afghan diaspora investment is considered FDI. Indeed, many of the

Afghan expatriate entrepreneurs interviewed in this study highlighted the desire to play a role in reconstruction of the country as a primary motivation for investing. Other potential sources of investment are neighboring countries interested in trade and investment opportunities, including India, Iran, Pakistan, Turkey, and Uzbekistan. Finally, investors from other countries may be interested in exploring investment potential particularly if their own governments are involved in the reconstruction and security effort in Afghanistan or if they are interested in the "first mover advantage" of establishing a presence in Afghanistan before significant competition.

The institutional arrangements governing investment have been largely settled with the creation of AISA and the cessation of most of the Ministry of Commerce's (MoC) issuance of business licenses (usually "Trade Licenses"). According to AISA management, approximately 7,000 companies were licensed by the Ministry of Commerce prior to AISA taking over business registration. Since its opening in 2003, 2,000 or more firms have been licensed by AISA, and AISA is responsible for the renewal of the licenses that the MoC previously issued.

## Post-Conflict and Country-Specific Challenges and Conclusions

From the point of view of investment promotion, Afghanistan faces several challenges typical of a post-conflict country. A primary test for AISA and other government agencies involved with promoting the country for investment is in overcoming the international image of the country as a place of poverty and violence. To do this, several underlying issues must be addressed. Among these are completing the physical reconstruction process, shifting from a socialist mode of government, and creating a viable, multi-ethnic state. These three problems are similar to those faced by other post-conflict states like Bosnia and Herzegovina and East Timor.[6] But Afghanistan faces additional challenges due to the length of the war, the country's vast and rural character, the intensity of mine-laying and bombing, insecure rural livelihoods, and continued lapses in security and lack of central government control over certain regions.

The war years produced waves of refugees and internally displaced people, disrupting the chance for a generation to get a good education or acquire modern technical skills. The stress and privation of the war years have reduced the general health of the Afghan people, and today life expectancy remains low (late 40s) by international standards. Warfare, drought, and supply chain failures disrupted the rural agricultural markets that have been the traditional basis for Afghanistan's economy, impoverishing many ordinary citizens. As in many post-conflict countries, Afghanistan is facing a shortage of skilled workers and a surplus of unskilled workers in need of employment.

Physical infrastructure has been largely destroyed and degraded through years of neglect. For the average investor, this translates into such issues as increased costs and delays in shipping and the necessity of purchasing a private generator for power. In many cases, public infrastructure such as roads, bridges, power generation and distribution assets, and schools are in need of extensive rehabilitation. Added to this is the presence of a large amount of unexploded ordinance, which not only extracts a toll on the citizens, but also raises costs and risks associated with certain economic activities. At the same time, investors in infrastructure services will find the opportunities in Afghanistan potentially attractive.

The institutions of government have been reconstituted but much ongoing work needs to be done to modernize the civil service, which was organized around

### The Nature of the Informal Sector in Afghanistan

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While the informal sector tends to be highly responsive and dynamic, informal sector firms tend to operate sub-optimally. Indeed, although the local market has seen vast improvement in the variety and quality of goods and services offered by Afghan companies in the past three years, few indigenous firms are able to compete with international rivals. Typically, an informal sector enterprise makes investments that are short-term and highly opportunistic, allocates scarce resources to evade regulation, and commits only limited capital and time to improve production quality. While informal sector activity can be lucrative, many entrepreneurs experience significant fluctuations in income and tend to be vulnerable to external shocks and predatory government officials. These characterizations are consistent with Afghanistan's informal sector, but other problems are manifest as well. Investors interviewed for the Afghanistan Enterprise Benchmarking Study note that many companies had machinery and other assets destroyed or stolen during the war years. The poor state of transport infrastructure, multiple formal and illegal customs posts, and the absence of a functional commercial bank system raise costs and constrain growth. Although less of an issue for the investors interviewed in Kabul, in some parts of the country warlords and other illegal groups extort companies and trade is vulnerable to banditry and illegal tolls. The war years also represent a loss in human capacity, access to international markets, and management innovation, further undermining the competitiveness of the informal sector in Afghanistan.

*Source: TSG interviews and The World Bank, Afghanistan: State Building, Sustaining Growth, and Reducing Poverty, 2004.*

a command-and-control philosophy where the state was directly involved in running companies and the private sector was constrained. Existing civil servants tend to be of three types. Many who have important institutional memory and practical experience from staying in government throughout the communist and Taliban eras were trained in obsolete management and economic systems, some stemming from the Soviet era, and face challenges adapting to new roles, methods, and concepts that characterize a modern public sector. Younger government staff members, who were educated in the post-Soviet era, while often better educated, lack relevant experience and are essentially learning on the job. Many senior managers are Afghan returnees who bring valuable comparative experience from living abroad and good language and educational backgrounds, but often lack direct practical knowledge of how to operate in Afghanistan today and have no prior government experience. In addition, all government agencies face difficulties in retaining good staff due to low salary levels.[7]

## Cross Sectoral Constraints

It is not surprising, then, that from a competitive point of view Afghanistan faces several challenges in its quest to attract increasing levels of FDI. Although many of the following constraints are improving or will be improved by reforms in process, currently they affect business across all of the sectors studied to one degree or another:

- **Legal framework for investment** – In the aftermath of the collapse of civil society, the legal regime for FDI remains incomplete and in flux. The process for enacting laws has evolved with the development of the government, changing from the issuance of Presidential decrees to a more typical process requiring Cabinet approval and parliamentary ratification. Presently, there is a significant backlog of major pieces of legislation in the process of enactment. A new FDI law has been drafted, but at the time of writing it remains unofficial. Certain industry-specific investment laws, policies, and tax regimes, including those for mining, are not yet complete. A host of other laws of which investors would need to be cognizant are also either incomplete, not in force, archaic, or absent, including those for immigration, social protection, and contract disputes. Most investors suggest that enforcing contracts is virtually impossible in Afghanistan, and the judicial system is regarded as inadequate and vulnerable to corruption. The many legislative changes proposed are anticipated to greatly improve the investment climate in Afghanistan.

- **Tax regime and compliance** – The tax regime remains cumbersome and tax compliance is very low. Officially, hundreds of “nuisance taxes” remain on the books at the Ministry of Finance and other government agencies collect a range of licensing and permit fees and other quasi-tax payments. In general, company awareness of tax policy and law is low. Transitionally, the lack of tax enforcement offers the obvious benefit that many firms pay no taxes other than customs fees. At the same time, larger formal companies complain that the more visible and responsible companies are shouldering a disproportionate share of the corporate tax burden in Afghanistan.

- **Customs administration** – Customs administration is fractured, with individual provinces (some only tacitly under control of the central government) clearing goods and collecting a widely diverging amount of customs duties. Reportedly, importers often pay customs duties more than once, the full amount of customs revenue does not reach the Treasury, and many firms regard customs officials as a major source of rent seeking.

- **Property market** – The ability of investors to purchase or lease land is frustrated by a highly nontransparent property market. Title disputes are common and procedures for leasing or selling land vary widely. The government owns most land in the country and the private property market works largely on a negotiated basis with prices rising rapidly. Accessing government land seems to be a highly individualized process characterized by many individual government agencies owning, leasing, and selling land in a nontransparent and inconsistent manner. While AISA is now administering a new industrial estate, the existing supply of transparently allocated state land does not meet demand. For the time being, foreign investors cannot own land in Afghanistan. Potentially, however, if the considerable amount of government held land is appropriately privatized, investors in Afghanistan will have a range of attractive investment location options.

- **Utility services** – Certain public services, such as water, power, and wastewater treatment, are not yet available. Indeed, few of the firms interviewed relied on public electricity, waste and wastewater services are virtually unheard of, few organizations have landlines, and most companies and individuals draw water from privately drilled, un-metered wells. There is a positive consequence of the collapse of state services, however. Water costs are low compared to most countries where users must pay for water. Given the absence of state landline service, private firms are offering relatively efficient mobile phone services.

- **Security situation** – The improving security situation is reducing instability for investors, particularly non-Afghan entrepreneurs. Gradually all the country is being brought under central government control, but anti-government forces, while significantly weakened, do continue to mount sporadic attacks in major cities.

- **Financial markets** – Several international banks and the Central Bank provide conventional financial services to business, but standard financial products such as commercial loans and export financing are not yet available in Afghanistan. None of the investors interviewed, for example, borrowed from banks and none were aware of any banks that offer commercial loans. As a result, business finance is constrained and most loans seem to be informal sector transactions between family and friends. The traditional and quasi-informal banking system (hawala) also serves the financial needs of many ordinary Afghan businesses.

- **Informal economy** – The World Bank estimates that Afghanistan now produces 87 percent of the word's illegal opium, which, including opium processed into heroin and morphine, contributes roughly one-third of estimated total national income.[8] Such large illegal financial flows, and the violence associated with securing them, create numerous pressures on Afghan society and governance. The opium trade also creates market distortions that arise from laundering drug proceeds, such as inflation in the price of assets like land. Finally, the survival of the drug trade depends on the lack of effective state control over territory and borders, thereby undermining clean, efficient government.

## Interviewee Composition

The Afghan business landscape is unique in that many companies have only begun operating in the last 12-month period. In the food and beverages sector, for example, there are currently no soft drink bottlers operating, and even bottled water was imported until this year when some water bottlers began operating on a small scale. Although the raisin and dried fruit producers have generally been around for anywhere from 30 to 60 years, most ceased to operate until two to three years ago, and many are starting up slowly and have done little more than send samples to prospective clients in Europe, the U.S., and Russia. Many carpet companies fled to Pakistan during the war years and private sector minerals extraction remains technically illegal to date.

Logistics companies are the exception, and many companies in this sector came to Afghanistan in 2002 after much of the major fighting in the country had ceased. They were able to do this because of the low initial investment and great flexibility that they enjoy. Many of the logistics companies began functioning at full throttle while working out of an office in a room in a guest home or small office, and simply linked the end-user with existing airlines and independent truckers as a full-service provider.

There are many carpet and textiles companies operating in Afghanistan, and their size, structure, and range of operations vary widely. In choosing companies to interview, we sought firms that were formally registered, presently exporting, and, according to AISA, among the largest in the sector.

Mining was the most problematic sector because legal mining companies in the target areas are virtually non-existent. The companies that do exist include a salt manufacturer (mostly using salt rock mined in and imported from Pakistan), a construction company with access to quarries and plans to begin producing brick and tile, and a major end-user of gemstones.

In spite of the newness of these operations, these entrepreneurs provided valuable information about the operating environment that future investors will find in Afghanistan. They have already applied for permits, hired construction companies, in many cases imported their raw materials and sent out samples. This provides current information on improvements that have been made to the system and obstacles and constraints that still exist.

Moreover, many of these investors are not new to operating in Afghanistan. The soft drink bottler, for example, shared his perspective both as a businessman who has been importing beverages for years and dealing with customs, the Ministries, and the mother company in the United States, and as a new bottler who has had to overcome obstacles in order to get his bottling facility off the ground. They are therefore intimately familiar with the ins and outs of doing business in Afghanistan from several different perspectives. Carpet traders have a valuable perspective about the operating conditions and quality of inputs and outputs pre- and post-conflict.

## Cost and Quality Conclusions by Industry Sector

### Transport and Logistics

**Definition of the Sector.** The logistics sector in Afghanistan is characterized by a number of sub-sectors that are unique in their focus, facility requirements and regulatory framework. This includes the following:

- Small package and document handling
- Land, sea, and air transport
- Provision of supplies to exempt organizations and warehousing and distribution services
- Freight forwarding, customs clearance, and travel agency services

Most logistics companies in Afghanistan provide only basic services while only a very few provide more sophisticated services such as inventory management and consolidation and deconsolidation.

**Description of the Industry**. The logistics industry is currently driven by two categories of goods: those that are commercial in nature (about 70 percent of the total) and “exempt” goods that are being imported duty-free by the foreign military, non-governmental organizations (NGOs), the United Nations, World Bank, diplomatic entities, the International Security and Stabilization Force, North Atlantic Treaty Organization, and other non-commercial entities. The exempt goods comprise approximately 30 percent of the total.

Air transportation is robust and driven both by commercial and exempt goods. Afghan airlines such as Ariana, Kam Air, and Pamir Air and Iranian Airlines, Mahan Airlines and Kish Airlines, all convey people and cargo in and out of the country. The UN has its own fleet of airplanes and is also active in transporting people and cargo related to donor projects on a non-commercial basis.

Land transport in Afghanistan is hampered by difficult terrain and poor road conditions, although the government is making headway in improving them. The “Main Road” in the southern half of Afghanistan and the “Ring Road” in the northern half form the major network of highways through Afghanistan. Repairs are currently underway in several portions and the Main Road is in better condition than that Ring Road. Of all overland transportation, 60 percent is to or from Pakistan, yet the major road between the two countries (Kabul-Jalalabad-Torkham) is in poor condition. An additional 30 percent of land transportation comes through the Iranian border and a combined 10 percent through Afghanistan’s border with the Central Asian republics to the north.[9]

As Afghanistan is landlocked, it depends on the Pakistani seaports of Karachi and Gwadar and the Iranian ports of Bandar-e ‘Abbas and Chah Bahar for its sea transportation. The transit agreements with Iran and Pakistan are, however, several decades old and basically inoperative.

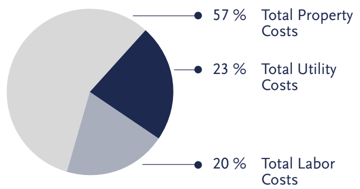
There is no network of railroads currently operating throughout Afghanistan, however a system of railroads begins 10km to the south of the border with Uzbekistan in Hayratan and 10km south of the border with Turkmenistan in Turghondi for transit of goods to and from those two countries by rail.

**SWOT Analysis**. A SWOT analysis is extremely helpful in seeing a potential investment location from the investor’s perspective and for identifying key marketing themes.

For the purposes of this analysis, strengths and weaknesses refer to the advantages and disadvantages inherent to the location (Afghanistan). The government or private industry are often able to control, modify or improve these factors, or at least significantly influence their outcome. Therefore, for example, an “incomplete legal framework for investment” or “low tax compliance” would fall under the category of “weaknesses” because they are currently inherent disadvantages to doing business in Afghanistan, and yet are to a large degree within the area control of the government. “Preferential trade access to key markets” would be a strength because it constitutes an inherent advantage to doing business in Afghanistan for certain industries, and the GoA is able to influence trade through negotiations with its partners. This is also a potential marketing theme, as the GoA can possibly attract more investment by making investors aware of these preferential agreements.

On the other hand, opportunities and threats refer to those external factors that are outside the realm of control of the government or private sector in Afghanistan, and yet must be considered when taking future action because of their potential impact on industry. For example, a growing worldwide market for health and convenience foods presents an opportunity for the processed food and beverage sector of Afghanistan. It is external in that there is little that Afghanistan’s government or private sector can do to influence this worldwide trend, but the trend may greatly impact Afghan industry if companies in this sector are able to supply niche markets

Figure 3-1: Transport and Logistics Company Cost Structure




For this sector, most major operating costs could be captured in three categories to create a representative average cost structure. Property costs, most commonly lease expenses for a building (warehouse) and an office, represent the largest expense category.

in the health and convenience food industry. Finally, growing worldwide security concerns may present a threat to Afghanistan's transport industry in the future if it is not sufficiently equipped to meet these growing security demands.

The following SWOT analysis is based primarily on interviews with twelve companies in the logistics and transport industry in Afghanistan. The interviews produced valuable insights into operating conditions in Afghanistan and sometimes unanticipated results. For example, while some companies viewed Afghanistan's lack of a seaport as a disadvantage because of dependence on neighboring countries and increased delivery times, six indicated that the country's landlocked condition either had no impact whatsoever on their businesses or was actually advantageous as it obligated their client companies to use both their trucking and freight forwarding services to get their product to a port. The latter said that it allowed them to do what they do best—move goods and people across borders—at a premium price. Therefore, Afghanistan's lack of a seaport is listed here as both a weakness and an opportunity.

The following strengths and weaknesses of the Afghan logistics industry emerged from the benchmarking exercise:

**Afghan Transport and Logistics at a Glance**

Railways
Total extension: 24.6 km

Broad gauge: 9.6 km 1.524-m gauge from Gushg (Turkmenistan) to Towraghondi; 15 km 1.524-m gauge from Termiz (Uzbekistan) to Kheyrabad transshipment point on south bank of Amu Darya (2001)

Highways
Total extension: 21,000 km
Paved: 2,793 km
Unpaved: 18,207 km (1999 est.)

Waterways
Total extension: 1,200 km (chiefly Amu Darya which handles vessels up to 500 DWT)

Ocean Seaports
None

Airports
Paved runways: 10
Unpaved runways: 37

*Source: AISA.*

## *Strengths*

**Little or no competition and fertile ground for new ideas** – Because of the difficulties of Afghanistan's recent past, investment levels are still low and companies providing logistics services are entering into the market slowly. It is significant that of the 12 logistics companies interviewed, only one was in existence before 2001. Many logistics and transportation providers will find virgin territory for their services, and companies offering more sophisticated logistics services will find especially fertile ground for new ideas.

**Steady demand** – Foreign assistance in the form of financing and provision of large equipment for improving the infrastructure and machinery of all kinds should continue for years to come at its current level. The volume of transport for commercial goods is almost double that of the donor community and should grow as development levels increase. This means that demand for logistics services should remain stable and even increase in the medium and long term.

**High profit margins** – The logistics companies operating in Afghanistan that were interviewed for this study reported that they had begun with a modest initial investment of only a few thousand or tens of thousands of dollars and are making hundreds of thousands or even millions in return. Many function from a hotel room or single-room office and are moving vast quantities of goods with little overhead. As conditions improve and other transport and logistics companies enter the market, these profit margins will fall. In the medium term, however, they should remain high and give powerful incentive to new entrants into the market.

**Quickly-developing telecommunications infrastructure** – Companies providing services on which logistics activities depend are quickly entering the market. For example, at least three providers of internet links by satellite have just recently begun to offer their services, and more are ready to enter the market. This will enable logistics providers to move into more sophisticated areas in the near future. As competition in telecommunications grows, prices will drop.

**Increased political stability** – Recent successes with the general elections and the promise of continued public sector stability strengthen the foundations of a predictable and well-functioning logistics industry.

### *Weaknesses*

**Poor roads** – Only about 65 percent of the main circuit of highways comprising the Afghan road network is in good condition, and the main transit road for goods to Pakistan, Afghanistan's most important trading partner, is in disrepair.

**Arbitrary road closings** – Many companies interviewed expressed dismay that major highways were frequently closed without prior notice for "security purposes" and remained closed for as long as several days. This makes both planning and timely deliveries difficult and increases transportation costs.

**Unloading and reloading at the borders** – All goods coming into Afghanistan must be offloaded from the trucks or containers that brought them to the border and reloaded onto Afghan trucks. Thus, the importer incurs extra costs of paying workers for the offloading and loading, sending another truck to the border to pick up the goods, and damages resulting in the process which some importers estimate to be as high as 20 percent of total goods.

**Poor condition of trucks** – Most trucks used in overland transport in Afghanistan are used trucks imported from developed countries and are often bought in extremely poor condition. Moreover, there is little maintenance of vehicles and spare parts are often hard to find and expensive. Therefore, trucks often break down en route causing delays and increased transportation costs.

**Lack of a seaport** – Many private industry representatives see Afghanistan's lack of a seaport as a major obstacle for industry in the country. It means that Afghanistan is dependent on the cooperation of its neighbors that do have seaports, has higher costs of transportation, and cannot promise fixed delivery times to overseas customers.

**Difficulties with customs** – Although the Afghan customs authority has automated many of its processes, the system is not integrated and is fairly limited in what it is able to do. Also, there are multiple customs checks (not all of them official) once goods have entered Afghanistan's borders, and the current procedure requires that all trucks be cleared at once from a certain bill of lading. Therefore, if one truck falls behind in a convoy all trucks are held up in customs, and in Kabul they incur a customs charge of US$100 per truck per day after one day of free storage. Products for which there are no established precedents can be detained for weeks or even months before special import permits are obtained.

**Arbitrary rules and regulations in the Afghan countryside** – The central government's authority is limited in certain regions of the country, so local warlords are accustomed to imposing arbitrary taxes and customs charges on overland transport.

**Poor electric infrastructure and high costs** – Sophisticated logistics services require reliable telecommunications and inventory management systems, and these depend on a reliable electric infrastructure. All of the logistics companies interviewed relied on a back-up generator for at least some of their operations, and four of the most important foreign companies said they either had no municipal power at all or depended 100 percent on their own personal generator. Electric power costs in Afghanistan are therefore extremely high.

**Unpredictable costs** – Certain rates that have fixed tariff schedules in most countries—the costs of fixed telephone lines and electric power rates, for example—are all negotiated in Afghanistan between the private company and a government functionary on a case-by-case basis. This leads to arbitrary costs and a lack of predictability. This is especially true for telecommunications, which affects

Illustrative Customs Clearance Challenges

Importers and logistics companies report having difficulties in bringing new products into the country for which there is no established procedure. One third-party logistics (3PL) provider was processing the import from Kazakhstan of steel blocks for a client company. As there was no established agreement with Kazakhstan for this particular product, the shipment remained at the border for a month while a special permit was being obtained from the Ministry of Finance. The client company was required to pay a penalty of US$2500 per day during the month that the shipment had been detained, and informed the 3PL provider that it would have to assume any similar costs in the future.

logistics and transport companies, because quick, reliable communications are crucial to their businesses.

**Difficult access to insurance for shipments** – Companies interviewed informed the researchers that they are not able to obtain insurance for their shipments. This not only constitutes an obstacle to the development of logistics in the country, but is also a major disadvantage to most of Afghan industry.

One View on Being Landlocked

One freight forwarder who has been functioning in Afghanistan for three years said that he sees opportunity for Afghanistan as a "land bridge," rather than as "landlocked."

## *Opportunities*

**Afghanistan's strategic location as a land bridge in the region** – Afghanistan is strategically located between the landlocked countries to the north—Turkmenistan, Uzbekistan, and Tajikistan—and the Iranian and Pakistani seaports to the south, as well as between potentially large trading partners such as Iran and India. Afghanistan is well-poised to become a major transit hub between these strategic locations.

**Lack of a Seaport** – While some companies saw the lack of a seaport as being a major disadvantage, three of the logistics companies said that Afghanistan being landlocked has no impact whatsoever on their business and three others said that it was advantageous to them, because it gave them an opportunity to provide transit services at a premium price. One freight forwarder who has been functioning in Afghanistan for three years said that he simply sees Afghanistan as "a land bridge rather than landlocked".

**The requirement for customs agent certification** – Facilitators and expeditors for getting goods through Afghan customs are commonly used. The new customs code which is expected for issue in 2005 will reportedly require all customs clearance agents to go through a formal, standardized training process and be licensed as customs clearance agents. Companies providing customs clearance services (among others) that were interviewed expressed reluctance to invest the time and money in sending their agents through this training. This opens the door to other companies wishing to provide these services and willing to train and certify customs agents on a large scale.

**Required improvements to the transportation infrastructure** – Afghanistan's transportation infrastructure, especially overland transportation, still bears the scars of years of conflict, and requires significant improvement. While construction is currently underway, the scope of work required will mean vast opportunities for construction companies for many years into the future. This need for the importation of construction materials, machinery, and equipment in turn creates steady demand for transport and logistics companies.

## *Threats*

**Worldwide security considerations** – The security situation worldwide promises to make free-flowing logistics more complicated. Exports from countries such as Afghanistan are likely to receive extra scrutiny, thereby increasing the delay and bureaucracy associated with trade.

**Pressures to modernize** – Worldwide advances in telecommunications, the dependency of the logistics industry on technology and real-time information, and the requirements of customers will put pressure on Afghanistan to modernize its communications and logistics infrastructure. If Afghanistan is not able to do so quickly enough, growth in Afghan logistics may suffer.

**Out-of-date agreements with Pakistan and Iran** – As a landlocked country, Afghanistan depends on the cooperation of its neighbors with seaports. The current transit agreement with Pakistan was adopted in 1965 and specific provisions have eroded to such a degree over the years that they are virtually inoperative. Iran and Afghanistan have signed a Memorandum of Understanding on transit, but many issues remain unresolved, such as the inability of Iranian trucks and containers arriving at Iranian sea ports to enter Afghan territory. Both Iran and Pakistan have a draft of proposed agreements, but neither has been approved nor is there a projected date of approval.

**Growing congestion in ports and inland supply chains** – The recent phenomenon of congested ports worldwide and backups along the supply chain have presented challenges for logistics operators. This may result in increases in overall operating, technology, and administrative costs, and will require a great deal of flexibility from Afghan logistics providers.

## Food and Beverage Processing

**Definition of the Sector.** Currently, the processed food and beverage sector in Afghanistan is limited to a small group of companies producing dried fruits and nuts, bottled water and vegetable oil. Soft drinks which are imported at the present time are soon to be bottled in Afghanistan. Most other food and beverage products for consumption in the local market are imported from abroad.

**Description of the Industry.** Most food and beverage producers in Afghanistan have only recently begun operating. They are either beginning production again after a decades-long hiatus, such as in the dried fruit and nut industry, or they are meeting demand in the market that is currently supplied by import products, such as in the bottled water, soft drink and vegetable oil industry.

The dried fruit industry includes raisins, apricots, mulberries, and plums. Nuts such as almonds and walnuts require skilled primary processing and are therefore included in this category.

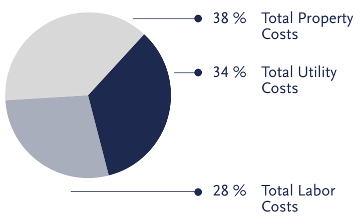
The dried fruit and nut industry in Afghanistan is primarily a cottage industry. For example, raisin traders or exporters work through an agent who is in charge of sourcing the raisins from villages across the country. The raisins are gathered either in facilities close to the villages or are brought directly to Kabul for cleaning. In Kabul there are specialized “cleaning centers” specifically designed for dried fruit. The facilities and equipment are “rented” to the raisin traders who, for a fixed per-kilogram price, bring their own personnel to the centers to run the equipment and use the facilities. Once they have been cleaned, the raisins are brought to market either in Afghanistan or outside the country.

Raisins dominate this industry as the largest economic horticultural crop in Afghanistan, its primary export commodity, and a traditional Afghan industry that accounted for 60 percent of the world raisin market in the 1960s and 1970s. There are 32 raisin processing plants in all of Afghanistan, only eight of which may currently be operable, and among those are some traders who have only sent samples to prospective clients abroad. The main traders and processors are not in Afghanistan, but rather are located overseas.

Afghanistan’s vegetable oil demand was supplied by imports until recently. Now, there are seven vegetable oil processors in Kunduz and one large one in Kabul.

The beverage industry has been slow to develop after 2001, and only two water bottlers have recently opened in Kabul. Until now, the demand for soft drinks has been entirely met through imports, but both Coca-Cola and Pepsi are planning on opening large bottling plants in Afghanistan in 2005.

Figure 3-2: Processed Food and Beverage Company Cost Structure




For this sector, most major operating costs could be captured in three categories to create a representative average cost structure. Transportation costs are excluded due to the firms' current domestic market focus and limited exports at the time of the study. Although most of the surveyed firms in this sector own their own properties, the structure assumes a difficult market for acquiring suitable property, and therefore, property costs reflected here are for the lease expenses of a factory building.

**SWOT Analysis.** Interviews with seven companies in the processed food and beverage industry in Afghanistan—three raisin producers, two water bottlers, a producer of vegetable oil, and one soft drink importer (programmed to begin bottling in 2005)— revealed many unique aspects of the industry. A more advanced industry development had been expected, especially for the dried fruit and nut industry. Raisin "producers" in Afghanistan are actually raisin traders or exporters, and most of them employ an agent who goes from village to village sourcing the raisins. Raisin production itself is virtually a cottage industry performed in private homes and small villages.

The following strengths, weaknesses, opportunities and threats emerged from these interviews:

## *Strengths*

**"First Mover" advantages** – As little is currently produced in Afghanistan in the food and beverage industry, companies that establish production or bottling operations are well-poised to reap great benefits as the first domestic suppliers of their product as well as lower transportation costs than their competing importers.

**Afghanistan's brand name** – Afghanistan has several markets to which it has traditionally exported such as Russia, Pakistan, UK, Canada, and Germany. Even after years of low exports, its dried fruits and nuts still enjoy a reputation for quality. Afghan raisin exporters are banking on the assumption that they can reopen these markets, and indeed they have already begun sending containers of samples to clients in these traditional buyer countries.

**Proximity to low-cost raw materials** – Afghanistan's arid to semiarid climate and hot summers are particularly good for cultivating a large variety of fruits and vegetables that can be dried, canned, or otherwise processed. Afghanistan also has good surface water availability at 2,480 $m^3$ per capita annually as compared to the Central Asian Republics and Iran, which have about 1,430 $m^3$ per capita annually. This means that Afghanistan could develop lower irrigation costs as compared to those countries.[10]

**Proximity to large markets** – Some of the most populous countries of the world including India and Pakistan are in close proximity to Afghanistan and constitute natural buyer markets for Afghanistan's products. Traditional fruit products already have an outstanding reputation in India which could, with some marketing, extend to other food and beverage products.

**Strong international support from the Afghan diaspora** – Afghans worldwide are strategizing on how to invest from their home base abroad, and many have already taken the step of investing. Not only will they invest in the food and beverage industry, but they may also provide a ready-made buyer market for Afghan ethnic food and beverage products overseas.

**Traditional skills in the labor pool** – The dried fruit and nut industry is a traditional industry in Afghanistan, and there is still considerable know-how in the labor pool.

**Large number of returning Afghans** – After the years of conflict, Afghans are returning to the country in large numbers. Although this may mean that the current infrastructure is under some strain to absorb this influx, their skills gained in other countries (how to run a business, how to produce to international standards, etc.) are now returning to Afghanistan and will be utilized in this industry.

## *Weaknesses*

**Transportation and logistics difficulties** – Poor roads and arbitrary road closings, lack of a sea port, delays at customs, local politics in the countryside, and the absence of trade and logistics agreements with neighboring countries all militate against the quick transport of perishable food and beverage products abroad and within the country. The need to unload and reload products from one truck to another at the border lends itself to further delays and damage to the product. Also, only a few companies are currently offering cold transportation services.

**Lack of government standards** – There are few controls in this industry and there is a general absence of written standards, inspections, price supports and technical assistance.

**Environmental conditions** – Current traders lament the large quantities of dust, sulphur and other toxins in the air and water, a fact which has been confirmed through laboratory tests. Dried fruits can require two to three washings which can deteriorate their quality. Even the water used to wash them is sometimes not sanitary.

**No laboratories for testing and inspection** – Until now there have been no laboratories with a capacity for testing and inspection of food and beverage products, much less for issuing an internationally-recognized certificate of inspection (the RAMP program is now funding two laboratories which are to open in 2005 in the Ministry of Commerce Export Institute and in a privately-run laboratory).

**Below-standard practices** – Especially the dried fruit and nut industry is characterized by poor cultivation and harvesting practices, poor transportation, substandard drying processes, lack of both knowledge and inputs, and deficient packaging.

**Unreliable and expensive electric power** – Voltage variations ("brownouts") damage equipment and interrupt production processes subjecting perishable food and beverage products to spoilage or significantly reducing their shelf-life. Of the seven companies interviewed in this industry, six had no public power and were incurring high generator costs, and the one with public power reported that brownouts were constant during the five days of the month when power was available.

**Lack of appropriate storage facilities** – Raisin agents have complained that there are few adequate storage facilities to maintain raisins in a controlled environment.

**Aging equipment** – In the dried fruit and nut sector, most producers have not invested in equipment since the Taliban came to power, meaning that the current equipment is old and obsolete in many cases.

**No financing for small and medium-sized enterprises (SMEs)** – Little financing is currently available for SMEs in Afghanistan, and as many of the companies in this industry, especially the dried fruit industry, fall into this category, they receive little financial help.

**No Letter of Credit (L/C) mechanism** – The financial industry in Afghanistan is currently in its infancy and there is no letter of credit mechanism available. Therefore, all transactions must be done by wire transfer, which is still very risky in the country.

**Reluctance to change traditional practices** – Afghanistan is one of the last grape-growing regions in the world not to adopt the grape trellis as the foundation of its standard production. This coupled with the fact that fresh grapes receive up to three or four times more money for the same weight in raisins discourages raisin production.

Lack of Perishable Export Capacity

The lack of a seaport is a major obstacle to getting perishable food and beverage products fresh to their buyer destinations. A soft drink bottler estimated that it could save 25 percent in total costs if Afghanistan were not landlocked.

## *Opportunities*

**Worldwide growth in the organic food sector** – Organic food, both processed and unprocessed, is one of the fastest-growing sectors in the food and beverage industry worldwide. The market for organic fruits and vegetables has grown 65.5 percent over the past two years, and fast growth is also predicted for the coming years. These organic products can be sold at a premium price. Afghanistan's reliance on traditional methods of agriculture may be an asset as producers seek to identify and develop organic niche products for export.

**Worldwide growth of convenience and pre-packaged foods** – Busy consumer life-styles, especially in industrialized countries, are having a major impact on prepared foods. Marketing focuses on messages such as ease of preparation and new and more convenient packaging. Within the convenience food sector, there are almost limitless possibilities for filling niche markets.

**Worldwide growth of prepared ethnic foods** – A more mobile worldwide population and immigration have led to a worldwide interest in ethnic foods. These foods are increasingly transported across borders in freeze-dried, frozen or vacuum-packaged form. The Afghan diaspora is a natural target of Afghan ethnic food prepared in Afghanistan for export.

**Large and growing local population** – With an estimate 28 million inhabitants, Afghanistan is, in itself, an attractive market for investors, and both it and its neighbors are growing quickly. The fact that most processed food and beverage items are currently imported into Afghanistan to meet local demand means that there is an enormous opportunity in this industry for producing in-country.

**Trade agreement between Afghanistan and India** – In March 2003 these two countries signed a trade agreement in which India granted preferential import duties to Afghan green, black, golden and red raisins (50 percent duty instead of the usual 105 percent MFN duty).

**Growing fruit juice market of Afghanistan** - Currently no juice production is taking place in Afghanistan, and yet this is the largest and fastest growing industry sub-sector for processed food in Afghanistan. Import volumes just for fruit juices stand at about US$20 million a year with an estimated yearly growth of 15 percent.[11] Multiple opportunities at all stages of production exist for Afghan suppliers, including crushing, pressing, pasteurization, filtration, filling, and packaging. The main flavors are mango (35 percent), sour cherry (25 percent) and apple (30 percent) with orange, pomegranate, grape and pear comprising the rest.

**Large world market for dried fruits and nuts** – The market for raisins, pistachios, almonds and walnuts worldwide is large: US$2.2 billion or 1.3 million tons. Afghanistan is currently only providing 2 percent of this worldwide market.

## *Threats*

**Western food industry markets require predictable delivery schedules** – If Afghanistan is to sell consistently to Western markets, it must improve its logistics infrastructure and its own consistency of production to become more reliable. Also, cold storage and transportation are often required in this industry, but only one or two logistics companies in Afghanistan are currently providing this service.

**Competition from China and India** – China is the top producer worldwide of fruits and vegetables with a 15 percent and 43 percent market share respectively, and India is the second producer at 8 percent and 10 percent of the market share.

Prices and port access in both these countries make their products highly competitive. The Afghan food and beverage industry will have to compete directly with the industries of these two countries.

**Large volume supplies in Western markets** – Afghan raisins are typically purchased by agents in smaller quantities from villages and may not be able to deliver the quantities required by Western markets without fundamental changes in the supply chain.

**A saturated raisin market** – The raisin market is saturated worldwide and has remained relatively stagnant for the last few years at about 400,000–450,000 metric tonnes a year.

**Subsidies in competing countries** – Countries such as Iran, which will compete directly with Afghanistan, enjoy substantial subsidies from their governments, especially in the raisin industry.

**More stringent requirements from international markets** – Both current and future EU requirements make sales into the EU of lower-quality, low-priced food and beverage products very difficult. Afghanistan's food and beverage products may not be able to meet these increasingly stringent standards. Even Russia, which is a traditional client market of Afghan products and which had much lower quality standards than the EU, is now tightening its requirements.

## Carpets and Textiles

**Definition of the Sector**. The carpets and textiles sector in Afghanistan is dominated by carpet weaving. While there is some manufacture and sale of other textiles, including items made from cotton, wool, silk, and cashmere this analysis is centered on carpets. Afghanistan produces several types of handmade carpets, including felted wool carpets (namads), flat non-pile fabric woven carpets (kilims), and pile and knotted carpets made from wool, silk, and cotton. Afghan rugs are often identified by the type of design and ethnic or regional origin. Textile production is largely small-scale or, as is the case for cashmere, mostly in unprocessed raw materials.

**Description of the Industry.** The carpets and textiles sector is characterized by numerous dealers or traders that purchase carpets from a network of weavers and sell to the final consumer. When looking at the Afghan carpets and textiles sector, it is important to note that there is a clear distinction between producers (i.e. weavers) and traders who perform a variety of activities related to carpet production and sale. Traditionally, carpet weaving in Afghanistan is considered a means to supplement family income with numerous individuals in a family weaving a carpet for sale. The majority of weavers are women in rural areas.[12] Increasingly, carpet traders will organize these weavers and pay for carpets to be produced under contract according to a design ordered by a specific customer or according to a popular style. Typically, a large carpet will take between six and nine months to weave.

The structures of the firms in the carpet and textiles sector vary. Many companies are family run businesses with numerous relatives working in the business. Full-time employment at the companies interviewed ranged from 5 to 180 persons with reported start-up investment between US$8,333 and US$12 million. Several of the companies interviewed had an overseas office in Pakistan to handle final processing and exports. Some have agents overseas to market Afghan carpets, and others have sales arrangements with established carpet shops abroad. The business is structured such that the highest profit margin is closest to the end customer. Therefore, the value of the Afghan carpet industry could be increased between two and five times if Afghan companies can finish goods in country and sell directly to end consumers rather than going through Pakistani or other intermediaries.

Carpet vendors provide a range of inputs and services to the individuals who do the actual weaving. Many carpet companies provide basic raw materials, such as wool and dyes, and the desired carpet design to individuals who are under contract to produce a rug. Other carpet vendors will provide looms, weaving space, and other assistance to weavers in addition to the raw materials. Still others merely sell finished carpets and work through middlemen to source the rugs.

Today, three types of producer-vendor arrangements are prevalent in Afghanistan. The most popular involves a carpet trader providing the wool, dye, and design to a weaver up front and negotiating a price for the carpet based on size and knot density. Estimates suggest that between 50 to 70 percent of producers work this way and the price paid by the carpet trader to the producer is usually between US$30 to $80 per square meter for the common Chob Rang carpets.[13]

An estimated 20 to 30 percent of producers manufacture carpets on credit with a trader and enter into a profit sharing arrangement. In this system, the trader will provide the raw materials and design, sell the carpet, and then return a portion of the proceeds after sale.

The third type of producer-vendor arrangement is where individual producers are able to finance the purchase of their own raw materials and may develop their own designs. In this scenario, the producers make carpets on their own accord and then sell them to traders who intend to resell the carpets to the end user. The World Bank estimates that between 10 to 20 percent of carpet producers operate as independent producers.

Presently most carpets are purchased from the weaver prior to final washing and dyeing, and the carpet vendor completes this process, usually in Pakistan due to a lack of appropriate facilities in Afghanistan. Hence, the supply chain for Afghan carpets is somewhat complex with a vast network actors involved in producing a carpet.

The quality of data on Afghanistan's carpet sector is questionable. Privately, some carpet traders note that underestimating the value of carpet exports is common to lower their tax burden. Some recent estimates suggest that carpets generated US$209 million in 2001 to 2002, down from US$290 million in 2000 to 2001.[14] Others suggest that 2002 carpet exports were officially valued at US$3.4 million but probably reached US$40 million. These data are compared to a world market for carpets of US$1.5 billion.[15] Afghanistan ranks twenty-first among global carpet exporters behind regional rivals Iran, Pakistan, India, China, and Nepal.

The nature and structure of the companies interviewed also complicate data analysis at the firm level. For example, because the companies interviewed use different methods of paying suppliers and weavers for carpets cost data related to inputs is variable. Similarly, since many of the firms interviewed were family owned companies, formal wage rates paid to management do not fully reflect actual compensation of profit sharing and defrayed costs for such things as the family house and food are considered. Because most actual weaving was done off-site, the utility bills of the carpet traders do not reflect the costs of any power or water used in the actual weaving. (See Figure 3-3.)

Textile production in Afghanistan today is largely a small-scale and low technology activity, but a variety of garments, hats, and other items are made from cashmere, cotton, silk, and wool. As with carpets, a variety of financial arrangements exist for seamstresses and craftspeople that produce textiles. The most significant subsector is cashmere, US$4.3 million of which was exported in 2002, but most of Afghanistan's cashmere exports are in uncombed form for final processing abroad.[16] Cotton production is small and inefficient by world standards.

**SWOT Analysis**. Interviews with ten companies in the carpets and textiles sector have supplemented secondary sources analyzing this important traditional economic activity in Afghanistan. For example, while a few companies and policy-makers suggest that a lack of marketing expertise is a critical constraint many more firms identify problems with finding reasonably priced cargo space out of Afghanistan and a lack of affordable land as priority constraints. As in other sectors, carpet manufacturers expressed a high degree of nationalism in making locating decisions. Indeed, although many of the firms interviewed continued to operate successfully in Pakistan during the recent years of conflict and maintain export and distribution offices there, most of these said that despite the current problems in Afghanistan they were highly motivated to return to their home country.

Based on the firm interviews and secondary source analysis, the following strengths, weaknesses, opportunities, and threats emerged in regard to the carpets and textiles industry:

### *Strengths*

**Traditional expertise retained** – The carpet industry is one of Afghanistan's traditional products and, despite the war, entrepreneurs in the business suggest that a sufficient supply of the necessary skilled labor remains in the country. Its decentralized nature helped carpet and traditional textile manufacturing survive during the civil war, so weaving skills remain strong. Many of the designs used in Afghan carpet making are traditional and localized, and carpet production tends to be a household activity that supplements family income. This production structure has enabled carpet weavers to pass down knowledge of designs and techniques through family groups.

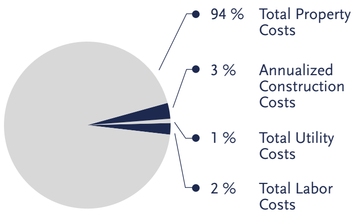
**International brand retains value** – Although more needs to be done, the Afghan carpet and traditional textiles sector retains a generally favorable international image. Carpets are associated with Afghanistan as a traditional handicraft with a rich history and a range of quality designs. While production quality is inconsistent, the generally favorable image offers the sector a good basis for improved marketing.

**Preferential trade access** – Handmade Afghan carpets have been granted preferential duty free access to the important US and EU markets. This provides a pricing advantage for Afghan carpets that producers without such access will not enjoy.

**Low reliance on modern technology** – Particularly in the post-conflict environment where other firms are facing high costs to reestablish plant and machinery, in general carpet manufacture is a low technology industry that is easy to restart at a functional level. Increased technology – notably in finishing – is a constraint but the diffuse and low technology network of carpet producers was one of the reasons why the industry was somewhat resilient during the war and quick to restart after hostilities ceased.

**Low utility costs** – For several reasons, Afghanistan's poor public infrastructure does not as significantly affect investors in the carpet industry as other sectors. The major reason is because carpet manufacture is essentially outsourced to individuals and costs for power, water, and telecommunications are essentially shifted from the carpet sellers to individual families.

Figure 3-3: Carpet and Textile Company Cost Structure




Among the surveyed carpets and textile firms, it was difficult to capture major operating costs because the companies interviewed use different methods of paying suppliers and weavers and their cost data related to inputs is variable. The representative structure shown above reflects the industry's typical outsourced production. Weavers are not considered a payroll expense, and formal wage rates paid to management do not fully reflect actual compensation (including profit sharing and defrayed costs for family housing and food). In addition, utility costs are essentially shifted to the weavers engaged in business from their homes. Consequently, in this structure the costs attributed to property or lease expenses are the overwhelming majority of total costs.

**Non-perishability of product** – Although carpets are sensitive to humidity, they are otherwise very easy to store. This means that output can be stockpiled near to the end customer in overseas markets for a long time.

Prospects for Carpets and Textiles

The Afghan carpet and textile sector represents a sector that may see strong growth. Afghanistan possesses skilled producers, generally positive brand image, and preferential market access. The study revealed many investors in the sector highly motivated to return and reopen businesses.

## *Weaknesses*

**Inability to access affordable land** – Many interviewees from the carpet sector suggest that finding affordable land is a major concern. Several companies said that during the war land and production assets were destroyed or seized and many producers and exporters relocated to neighboring Pakistan. Carpet manufacturers have pursued several options for finding land, including leasing and purchasing from the private sector and leasing land from various government agencies, but there is a widespread consensus that access to affordable space is a significant weakness for the sector.

**Insufficient supply of raw materials** – Due in part to the devastation of local sources of wool and dyes, most inputs for the carpet industry must be imported through Pakistan. The firms interviewed imported an average of 53 percent of their raw materials and 43 percent of their machinery. Some firms complained of having difficulty finding regular and affordable supplies of quality dyes, wool, and other inputs. Afghanistan's cashmere subsector is largely reliant on imported wool from Iran, with only an estimated one-third of demand being met locally.[17] In some cases, importing these raw materials simply adds transport and customs costs, and in other cases the quality of imports is suspect. For example, Afghan carpet makers suggest that the dyes and wool available in Pakistan are not always of sufficient quality. Industry experts note that the overall image of Afghan carpet making has declined in the past 20 years due in part to some makers using lesser quality materials.

**High road transport costs** – In addition to having to pay to import raw materials, the firms also reported that almost 100 percent of their output was exported. The firms interviewed said that on average transport costs accounted for 22 percent of their overall operating costs. Although easy to transport in terms of storage and packing, carpets by nature are heavy.

**High air freight transport costs** – Carpet makers suggest that shipping carpets from Afghanistan via air is not a viable option given the high cost and limited outbound air cargo space. While some carpet exporters note that increasing competition in the airlines industry is gradually lowering costs, today carpet vendors suggest that between 90 to 100 percent of their carpets are exported via Pakistan. Shipping through Pakistan adds costs and time and Afghanistan lacks its own seaport.

**Poor road quality** – Only about 65 percent of the main circuit of highways comprising the Afghan road network is in good condition, and the main transit road for goods to Pakistan is in disrepair. For carpet vendors, this undermines their ability to regularly meet delivery times. The carpet makers interviewed suggest that shipments are delayed an average of 26 percent of the time.

**Poor customs administration** – Although regarded as improving, customs administration is still a burden to carpet vendors. Most complained of delays in clearing imports from between four and seven days. Several noted that an inward shipment can attract customs duties more than once. One carpet vendor suggested that customs officials routinely solicit bribes.

**Lack of finishing capacity in Afghanistan** – There are several factors that account for why carpet manufacturers must pay high transport costs. One major reason is that presently almost all carpets are shipped to Pakistan for final finishing.

Afghanistan's finishing infrastructure was either destroyed or outmoded over the past two decades, compelling most producers to ship quasi-finished goods to Pakistan for final processing. This not only increases the costs that carpet sellers face, it also constrains the growth of the indigenous industry and creates opportunities for infringements of intellectual property. Carpet vendors indicate that one finishing facility in Mazar-e-Sharif has recently opened, but it is not clear if the factory has the capacity to lure back a significant amount of the finishing business presently being shipped to Peshawar.

**Lack of reliable power** – Although the industry is not power intensive, investors in the carpets and textiles sector note that the lack of reliable public power adds another cost of doing business in Afghanistan. Reportedly, the quality of power varies throughout the country, but in general companies must purchase generators and fuel to ensure a reliable source of energy.

### *Opportunities*

**Potential to improve adequate international image Afghanistan carpets** – Afghanistan can help counter some of the concerns of poor quality and renew general interest in Afghan carpets through a successful marketing campaign. Industry experts suggest that despite production problems, Afghan carpets retain a largely favorable image internationally.

**Sympathetic international country and product image** – International sympathy with Afghanistan and its traditional products remain high. Further, traditional textiles and carpets are particularly well positioned to be sold as high end, "authentic" home furnishing items from a country with a rugged and somewhat mysterious image. This favorable response will help Afghan carpet traders market their products abroad.

**Demand for wool is consistent and anticipated to grow** – Presently, local wool and yarn production cannot meet local demand in Afghanistan, creating a ready market for investment. Additionally, the demand for semi-processed types of wool and yarn exists for entrepreneurs who can scour and otherwise process wool.

**Demand for finishing capacity** – As noted previously, most Afghan carpets are washed, trimmed, and otherwise finished in Pakistan, thereby transferring a lot of the value added out of Afghanistan. Many interviewees have expressed their preference to complete the finishing processes in Afghanistan if comparable facilities existed.

**Improved reliance on technology** – Although carpet and textiles manufacturing in Afghanistan has traditionally been a low technology business, the sector could take advantage of modern machinery to increase output and improve quality. For example, increased reliance on the internet would improve marketing and sales. Bringing weavers from their households into factories can extend working hours, improve skills through sharing of technical information and know-how among weavers, and allow for greater monitoring of quality. The use of computer aided drafting (CAD) software can improve the efficiency of creating designs and enable customers to contract with traders for made-to-order carpets.

### *Threats*

**Competition from the Afghan-Pakistani carpet industry** – Arising from the relocation of many carpet manufacturers and exporters to Pakistan during the conflict years, the reconstituted Afghan carpet industry faces effective competition. Not only do many Afghan exporters and some weavers remain in Pakistan, Afghanistan largely relies on Pakistan for final processing and exporting. Several carpet vendors note that presently carpets woven in Afghanistan and shipped to Pakistan for final processing are usually labeled as Pakistani products. This, carpet makers say, improves the image of Pakistani carpets, while undermining the ability of Afghanistan to build a distinct brand image for carpets. High airfreight costs and limited capacity for cargo shipment direct from Afghanistan induce many exporters to export through Pakistan. Additionally, several other countries in the region have well established carpet industries.

**Competition from the international carpet industry** – Since carpet designs are highly portable, Afghan-style carpets can be made anywhere where there are skilled weavers. This leaves the door open for increased competition from countries with lower labor costs and quality standards on the one hand and an established reputation for quality for fine carpets on the other. Iran, the world's leading carpet exporting country, is widely considered to be the leader in producing top quality hand made carpets.

**Need for improving quality** – Carpet makers believe that the international of image of Afghanistan's carpets remains good, but a few noted that some poor output during the past 23 years may have damaged the industry's traditional image for quality. Some carpet vendors suggest that there remains a significant amount of inferior quality Afghan carpets and other textiles (such as silk scarves) on the market internationally.

## Mining

**Definition of the Sector.** The minerals sector examined for this study includes the mining, processing, and end use of stone and mineral resources. Although hydrocarbons are potentially important resources for Afghanistan, they are excluded from this analysis. In Afghanistan there are known deposits of a variety of commercially valuable minerals and metals, including beryllium, coal, chrome, copper, gold, iron, lead, manganese, nickel, salt rock, silver, uranium, and zinc. The country's known precious and semi-precious minerals include alabaster, amethyst, beryl, emerald, jade, lapis lazuli, quartz, ruby, sapphire, and tourmaline. The country also has several types of stone suitable for construction materials, including marble.

**Description of the Industry.** The minerals sector is presently characterized by defunct state-owned enterprises, only a few of which are minimally operating, numerous informal sector mining operations, and a few functioning end-users such as construction materials producers and stone-based handicraft artisans. To date, the Afghan mining policy remains incomplete and private investment in exploration and extraction is not yet legally sanctioned. At the same time, the SOEs that dominated such industries as coal have yet to be privatized and much of the country's known commercial reserves of minerals remain under state control. Among the problems facing privatization in Afghanistan is the lack of reliable financial data to help value SOEs, extreme degradation of physical assets, and ambivalence among Afghan leaders about whether or not to divest the state of some of the best companies. As such, there is no known foreign investment in the Afghan mining sector, although overseas investors have expressed interest in cement manufacturing. As seen in Table 3-3, the government owns several enterprises that are in varying states of disrepair.

Table 3-3: Status of Afghanistan's SOEs in the Minerals Sector

| Company | Asset Description | Likely Action |
|---|---|---|
| Jabal Seraj Cement | Estimated production capacity of 100,000 tonnes/year; operating at 10 percent capacity now due to lack of power; old Czech equipment; in Parwan near Kabul. | Privatization |
| Ghuri Cement | Estimated production capacity of 75,000 tonnes/year; unfinished second plant with theoretical capacity of 300,000 tonnes/year; operating at 50 percent capacity; estimated cost to complete plant 2 is US$15 million; old Czech and Soviet equipment; in Baghlan. | Privatization |
| Construction Materials Production Co. | SOE makes sand and gravel, concrete blocks, metalwork; and furniture. Private ownership already in metalworking. All activities are functioning at some level now. | Privatization |
| North Coal Co. | Four operating mines and two other mines not in its control; producing 40,000 tonnes/year; Czech equipment. | Privatization |
| Engineering Research Co. | Does well-drilling and hydrological surveying; in Kabul. | Privatization |
| Mines Extraction Co. | Metal deposit exploration and exploitation; operational status unclear; in Kabul. | Remain under state control |
| Rukham Marble Co. | Destroyed in civil war; in Kabul. | Liquidation |
| Jangalak Co. | Very limited operations; in Kabul. | Liquidation |

*Source: USAID.*

**SWOT Analysis.** Mining extraction and processing represent important opportunities for Afghanistan. Not only are there significant estimated coal reserves, Afghanistan has commercially significant deposits of copper and other industrial metals. The reconstruction effort has created a boom in demand for construction materials, including cement and cement blocks, bricks, gravel, wood, steel, sand, and glass. Additionally, the country has long mined semi-precious and precious stones and developed handicraft and construction materials industries based on stone products. Yet today, very few private companies are operational and several SOEs in the sector are not yet privatized despite very low levels of productivity.

Based on a limited number of firm interviews and analysis of secondary sources, the following strengths, weaknesses, threats, and opportunities emerged in regard to the mining sector:

### *Strengths*

**High demand for construction materials** – As a result of the reconstruction boom that Afghanistan is presently undergoing, there is significant local demand for mineral-based construction materials, including paving stones, cement and cement blocks, bricks, gravel, wood, steel, sand, and glass, and tile. Presently, even basic materials like cement are imported from Pakistan and Iran, offering great potential for import substitution. Several local companies have already invested in the sector and are expressing significant optimism about being able to find ready customers for a variety of materials.

**Significant unmet demand for energy** – Afghanistan's domestic energy needs remain unmet despite significant deposits of coal. When privatization is complete and the regulatory regime governing private investment is established, it is estimated demand for locally produced coal will be steady.

**Ample unskilled labor suppl**y – While skilled engineering and mining management labor is in short supply in Afghanistan, industry experts suggest that labor among lower skilled workers is plentiful and well priced to support mining.

**Increasing geological clarity of reserves** – Several of the necessary first steps required to enable widespread private investment in mining have been made. Several older studies illustrating where Afghanistan's known and probable mineral deposits are presently being updated with assistance from several international geological and mineral agencies. These studies are being completed in part to assist the country with fast-tracking investment attraction to the sector.

**Costs associated with transport provide advantage to locally produced materials** – Assuming minerals-based products such as construction materials can be produced at a quality on par with imports, the costs associated with importing such materials confers an advantage to companies that produce locally.

**Afghan and donor policies favor local content** – Both the Afghan government and donor community generally prefer to source materials locally where available, thereby helping the local economy. Investors who can create the materials presently being imported locally should have a procurement advantage over companies selling imported minerals-based materials.

### *Weaknesses*

**Incomplete legal regime** – While a draft law is awaiting approval by the Cabinet, regulations and administrative procedures are not in place to govern private sector involvement in mining. Of particular importance is determination of the tax regime facing mining companies. As a result, the Ministry of Mines and Industry has not licensed any minerals exploration, extraction, or processing and what mining is ongoing is either done by the state or illegal.

**Incomplete privatization process** – Certain mining resources, including coal for which there is a demonstrated local market, remain in the control of failing SOEs. Reportedly, few of the major mines are operational and those that are have largely reverted to non-mechanized coal mining and production. At the same time, private investment in mining is not yet permissible. The lack of progress on privatization not only keeps certain assets out of private hands, but also sends a generally negative signal to investors about state intrusion in the mining sector.

**Significant technological degradation of SOEs** – Most of Afghanistan's state owned mining companies have been badly damaged over the past few years. One official in the Ministry of Mines and Industry conceded that the one state owned coal company that was operational had reverted to manual mining. Although Afghanistan's mineral resources offer promise for commercialization, new entrants to the sector will need to import all needed equipment and technology.

**Lack of effective government control over certain mineral-rich areas** – Some of the country's most promising areas for minerals exploration remain in the control of anti-state actors. It is estimated that some of the country's best mineral deposits lie along the border of Pakistan where local leaders remain in power, thereby making investment risky. Until the political situation is resolved, the cost of security can be expected to raise production costs in the minerals sector.

**Poor status of infrastructure** – Perhaps more than other sectors, mining operations are sensitive to the cost and availability of power, water, and transport services. On the whole, Afghanistan's public services are poor to non-existent and although recent improvements in the road network are important signs of progress, more needs to be done. Poor infrastructure and the increased financial cost that this has on mining operations will continue to put the country at a competitive disadvantage.

**Lack of skilled mining labor** – Industry experts suggest that Afghanistan lacks a ready supply of skilled technical and managerial workers. Because most of the country's major mining facilities were outfitted with Czech and Soviet machinery, even if individuals working in the sector are familiar with the machinery, it is likely to be outmoded. This will increase startup costs for new investors, as they will need to rely on more expensive foreign labor and factor in costs for lodging and per diems for engineers, machinists, and managers until local workers can be appropriately trained.

**Lack of institutional capacity to monitor mining sector** – Beyond the obvious security concerns, investment in the mining sector is hampered by the lack of institutional capacity and market-based orientation in the agencies involved. In particular, government lacks the capacity to efficiently issue and monitor exploration licenses, ensure operators meet modern environmental standards, and audit companies' activities and production.

**Unexploded ordinance** – As a former war torn country, Afghanistan faces the additional problem of unexploded ordinance. Afghanistan is one of the world's most heavily land-mined countries and the security precautions required to explore large tracts of land add additional costs for mine developers.

**Lack of locally available finance** – Although informal sector financial markets – including much family lending and the hawala – function in Afghanistan, the formal banking system does not presently offer commercial loans. For capital-intensive industries like mining, the lack of locally available finance may be a concern. This lack of local finance may also disadvantage investors who do not have access to foreign commercial banks.

### *Opportunities*

**Considerable growth potential** – Afghanistan has a great array of known mineral resources as well as vast areas where the potential is not known. World Bank projections suggest that the annual value of Afghanistan's coal, quarries, sand, salt, gemstones, and copper reserves could reach US$253 million up from a current value of US$60 million if reforms are enacted.[18]

**Ability to attract foreign direct investment** – Afghanistan's mineral sector represents a significant opportunity to attract foreign direct investment (FDI). Investment in the sector from abroad would infuse technology, capital, and expertise while creating needed employment. International experience suggests that FDI can also create some beneficial spillovers for a country like Afghanistan and create demand among a network of potential supplier firms.

**Potential for improvement of the local precious and semi-precious stone industry** – Afghanistan has an established handicraft and construction materials industry relying on such stones as lapis lazuli and marble, but significant improvement could be made in quality, output, and marketing. As the processing quality of Afghanistan's mineral resources improves, end users can expect to be able to improve the quality of handicraft and materials outputs.

Minerals Sector Offers Great Potential

Given the wide variety of Afghanistan's known and suspected mineral reserves, including commercial metals, coal and gemstones, the sector offers great potential in the medium to long-term. Also, the pace and development of the sector are largely within the control of the GoA; initial indications suggest that if the appropriate policy and legal regime are instituted, international investor interest will be forthcoming.

### *Threats*

**Degradation of resources by poor informal sector mining** – Despite the lack of legally sanctioned activity in the mining sector, some companies are involved in mining today. In a few cases, companies were granted licenses by the Ministry of Commerce prior to the articulation of the country's draft mining law, and in other cases, mining resources are being processed illegally. In many other cases, small scale mining has continued for years, often with poor regard for environmental concerns and modern, efficient mining techniques. The longer mining activity continues without being effectively regulated, the more threatened the country's mineral reserves become.

## Observations Based on Data Analysis

In addition to the above-mentioned SWOT analyses, the following observations can be made from the data collected by the surveys. (See also Appendix 4: Tables of Findings – Company Interviews.)

### Ownership Structure

Each of the sectors studied for the Afghanistan EBP tends to be dominated either by foreign or local investment. The transport and logistics sector is dominated by foreign (mostly U.S.) and joint venture investment. Food and beverage processing is dominated by local Afghan investment and Afghan investment from overseas (especially in raisins). Carpet and textile companies are owned entirely by local Afghans, although final processing, marketing, and shipping to export markets are largely controlled by companies in Pakistan owned by Pakistanis or Afghans. Mining operations are owned either by local Afghan companies or the Government of Afghanistan.

## Personnel

**Transport and Logistics:** Of the four industries analyzed, transport and logistics offers the highest wages for skilled workers (package processors, inventory management, customs agents) and unskilled workers (drivers, stevedores) due to a combination of factors. Compared to the other sectors, transport and logistics companies are dominated by foreign firms that tend to pay higher wages than local competitors and are well integrated into the global economy, requiring some workers to have better and more modern skills. Workers classified as "professionals and technicians" according to the EBP methodology are scarcely used in the industry, and the firms tend to have more employees in senior management and lower skilled positions. Investors indicated difficulties in finding managers, professionals, and technicians and to a certain extent the language skills they need to do business with their foreign clients. The quality of the local work force's ability to speak English and other languages was rated on average 2.8 out of a best score of 5. Investors in this sector report an average 50-hour work week.

**Food and Beverages:** The food and beverage sector reports the highest wages overall of the four industries and the highest technician and management pay (30 percent higher than logistics, almost four times higher than textiles, and almost six times higher than mining). These companies hire fewer workers categorized by the EBP methodology as professionals and technicians than managers, making these firms both bottom-heavy and top-heavy organizations. Investors indicated difficulties in finding managers, professionals, and technicians. One advantage for this industry is that there is an abundant pool of unskilled and, to a certain extent, skilled labor available. Investors report an average 51-hour work week.

**Carpets and Textiles:** Although most of the work in this sector is actually carried out by a vast team of carpet weavers in villages, they were not included in the employee headcount. The company management and direct employees tend to be comprised of a number of male relatives in the same extended family. While interviewees reported formal wage rates for employees, in some cases they also noted that income from the business went to meeting the basic housing and sustenance needs of family member employees. Investors report an average 54-hour work week.

**Mining:** Mining reported the lowest wages of the four industries studied. In spite of a large pool of skilled labor, some positions such as technicians and machine operators are difficult to fill. Mining investors indicated a better available labor pool at all levels than the other industries. Mining reports the highest wage burden of the sectors (survey average of 45 percent of total firm operating costs accounted for by salaries and benefits). This sector reports the shortest average work week (44-hours per week).

## Employee Salaries and Benefits

Across all sectors there are no state-obligated benefits whatsoever, no social security system, and no retirement funds such as a pension or private retirement account. However, employers are often expected to cover other benefits such as meals at the workplace and transportation allowances, either as a direct cash gift (sometimes lumped into the salary) or through the direct provision of food and transportation organized and provided by the company. The provision of these informal benefits contribute to an investor's wage burden. The percentage of costs associated with labor are the highest for the mining sector where wages are the lowest.

### Expatriate Women Working in Afghanistan

On the whole, most expatriate women working in Afghanistan indicated that with some minor adjustments, they had no difficulties living and working in Afghanistan. However, some expatriate women may find special challenges. According to one employer, the Afghan drivers, deliverymen and other lower-level male employees who tend to have less education and exposure to Western ideas, often show open signs of disgust for the usual Western office attire of their female expatriate employees. Western women almost invariably cover their heads with a scarf when outside. Once inside a building, they may get varying reactions if they uncover their heads. One logistics company told us that a female expatriate employee had resigned because the male Afghan employees were treating her with such contempt.

Managers are often either partners in the firm, own stock in the firm, or are paid in some combination of base salary and profit-sharing.

## Unionization

According to both public and private sources, unions of the kind found in industrialized countries do not exist in Afghanistan. As the private sector evolves, new business interest groups are being formed and old, quasi-state run producer guilds and business chambers are in decline. Several sources described a type of worker discussion group left over from the era of Soviet influence that can be found in some companies, but these consist of nothing more than groups of employees getting together to converse about Marxist theory and worker rights. These groups do not bargain collectively with the employer or organize activities. The status of the legal regime covering unions and work actions is unclear.

Estimates of unemployment and underemployment vary and are high. This corresponds to the finding that annual turnover among firms interviewed in the four sectors is low, ranging from virtually 0 percent in the mining industry to 5.4 percent in the logistics industry.

## Investment and Annual Income

**Transport and Logistics:** With a relatively low investment (US$67,857 was the average investment of the companies interviewed), annual income, even in the first years of operation is high (US$1,018,571 was the average annual income for the companies interviewed).

**Food and Beverages:** Infrastructure for food and beverage processing requires a substantial initial investment (US$5,860,325 average of interviewed companies) but has the potential for attractive first-entrant rewards (US$13,495,072 average yearly income for interviewees).

**Carpets and Textiles:** According to respondents, carpets and textiles companies require a relatively high initial investment (US$2,182,489 was the average of the companies interviewed) and annual income is still low in the industry (US$283,473 average).

**Mining:** The existing mining companies report and average initial investment of US$122,500 and low average annual sales (US$11,000 average).

## Inputs and Equipment

**Transport and Logistics:** Computers and other equipment used in this sector are typically imported from overseas.

**Food and Beverages:** In the raisin and water bottling industries, the grapes and water used in production are of Afghan origin. Packaging and plastic for making the bottles for the distilled water come from overseas, as does the olive oil used to clean the raisins. A vegetable oil producer reports that virtually all of its inputs are imported.

**Carpets and Textiles:** An average of 53 percent of the raw materials for this sector are imported. Wool, cotton, and dyes are sourced predominantly from Afghanistan or Pakistan, although other countries like Iran are sources of raw materials as well. Chemical dyes are sourced from Germany, Korea, Pakistan and other countries. An industry average of 42 percent of equipment is imported from overseas.

**Mining:** Because Afghanistan has no functioning machine industries, mining equipment is imported.

## Transportation of Goods

Across all sectors air travel was seen as the most reliable according to investors, with an average of 74 percent of goods arriving on time and .02 percent loss rate.

Commercial goods tend to be shipped by road, rail and sea transportation, and "duty exempt" goods tend to use air. Exempt goods are not allowed to pass by road through Iran according to the Iranian-Libya Sanction Act (ILSA), and logistically it makes no sense for them to pass through the former Soviet Republics by rail. Rather, they either go through Pakistan's seaports or are flown in.

## Customs

According to survey responses, it takes an average of nine days to clear customs at the border of Afghanistan. All companies indicated that unofficial payments to customs officials and multiple customs checks in the country were the norm.

## Telecommunications

Across all industries only 34 percent of all companies interviewed had a land line and all indicated that the quality was very low. According to surveys, it takes an average of 116 days to get a telephone line installed, and the service did not extend to all sections of the Kabul metropolitan area. Almost all companies gave mobile phone services a better rating than landlines, scoring a 3.5 out a possible best score of 5. Internet usage was uncommon among all firms interviewed, and those that did have service indicated that it took anywhere from a few days to a few weeks to get service. There are currently three companies in Afghanistan offering internet access by satellite.

**Transport and Logistics:** Three out of twelve companies have a land line in this sector. Nine out of twelve have internet access in their offices and, as service providers, predictably used the highest bandwidth (54-512 kbps).

**Food and Beverages:** Two out of seven food and beverage companies reported having a land line. Only one in seven have internet access in their offices.

**Carpets and Textiles:** Half the companies interviewed report having a land line and internet access in their offices.

**Mining:** One company has a land line and internet access.

## Electric Power, Water and Sewage Infrastructure

Across all sectors there was little dependence on the municipal or state electric power infrastructure. All but a few companies had their own generator and almost all depended heavily on it (an average of 312 hours per month). Only two companies had water provided from a government source. The other companies had drilled their own wells and were pumping the water for free, purchasing water from someone else's well, or located near a river or natural source of water. There are currently no wastewater services in Kabul.

**Transport and Logistics:** Eight out of twelve companies in this industry have electric power provided from the government, and these eight companies reported that their government-provided electric power was non-functional an average of 372 hours a month, during which they use a generator.

**Food and Beverages:** Two out of seven companies have electric power, which is non-functional an average of 155 hours a month, during which they use a generator.

**Carpets and Textiles:** Five out of ten companies have electric power, which is non-functional an average of 448 hours a month, during which they use a generator.

**Mining:** Two of the three companies surveyed have electric power, which is non-functional an average of 294 hours a month.

## Living Conditions

Across all sectors personal safety got surprisingly high marks (overall average of 3.3 out of a best score of five) not only among the Afghans interviewed, but also among the expatriates. Costs were considered to be high (average rating of 1.9 out of a best "inexpensive" score of 5) across the board, but more so among Afghans. Other quality of life indicators such as schools, health care and recreation received very low scores. Indeed, much of the country's cultural infrastructure like museums, zoos, parks, gardens, and publicly accessible palaces and monuments were destroyed during the war years.

## Financing

According to the companies surveyed across all sectors, there is currently no private financing for doing business in Afghanistan. Investors from SMEs indicated that they are particularly hard-hit by the lack of financing possibilities. Micro-credit schemes have begun to operate in Afghanistan, but none of the investors surveyed were aware of them. Business financing in Afghanistan tends to be informal.

## Site Factors

Across all sectors, an average of four sites was considered by the surveyed companies before the current site was chosen. Many, especially in the food processing, carpet and mining industries indicated that they had chosen sites based on land they already owned.

Firms in the transport and logistics sector tend to lease their office or warehouse. As the food and beverage industry is dominated by Afghan companies, they tend to locate their plants on their own properties. Carpet and textile firms tend to lease offices, warehouses, and showrooms. Many have offices in Pakistan that focus on marketing and handling exports. The mining companies interviewed all lease office space in Kabul.

## Incentives

Across all industries, very few companies report that incentives are currently offered by the government. Indeed, a fiscal incentives regime is not yet operational in Afghanistan. All "exempt" imports are duty-free, and this exemption is easy to process with a single form and a letter from the importing organization.

While no incentives were reported in the Transport and Logistics Sector, some entrepreneurs in the Food and Beverage Industry reported a five-year tax holiday and others subsidies for purchasing land. Similarly, some firms in the carpets and textiles sector reported that they had received subsidized land from the government and that they have a three to five year corporate income tax holiday (many were unsure about the exact number of years). No incentives were reported among the mining companies. Based on the interviews, it seems apparent that the incentives offered presently lack coherency, consistency, and transparency.

## Motivation for Locating in Afghanistan

Across all industries, 33 percent of the companies surveyed mentioned “a desire to help Afghanistan”, or “patriotism” as at least part of the reason they are currently operating there, and 15 percent said it was the only reason. Many native Afghans said that they had been waiting since they left in the 1970s or 1980s for the political situation to change, and when it did between 2002 and 2003, many quickly returned to explore setting up operations.

**Transport and Logistics:** Only three out of 12 companies said that “cost” was a motivating factor in their investment decisions, and in all cases “cost” was less important than “quality” factors. Transportation costs and real estate costs were most frequently cited as being important. Overwhelmingly, the quality factors outweighed cost factors, and the aspects cited as most important were the general business environment (especially what is perceived as a new political stability and a more manageable bureaucracy) and access to the market (meaning, in most cases, that the logistics companies were there to supply the donor, NGO, and military organizations with supplies).

**Food and Beverages:** Five out of seven companies surveyed said that “cost” was about 50 percent of their reason for locating in Afghanistan. Important “cost” factors were real estate and construction costs. With respect to “quality” factors, the most important were the general business environment (political stability and lower bureaucracy) and access to and size of the market (the size of the local market in the case of the water bottlers and vegetable oil and proximity to cheap raw materials in the case of the dried fruit and nut industry).

**Carpets and Textiles:** Three out of ten interviewed companies indicated that “cost” was about 50 percent of their reason for being in Afghanistan. The importance of “cost” factors was evenly distributed across real estate, construction, water, electric power, telecommunications, wages, transportation costs, and tax rates. There were no outstanding trends in terms of “quality” factors with answers being fairly evenly distributed among general business environment, access to the local market, real estate availability and living conditions.

**Mining:** All indicated that “cost” was not a factor. A single quality factor was cited – access to the local market.

## Afghanistan as a Landlocked Country

There were varying opinions on the subject of Afghanistan being landlocked. Most manufacturing companies were of the opinion that this was purely negative, as it implied higher import and export costs and delays as goods were transferred from seaports to trucks or rail, and were then required to cross borders. When asked to estimate their potential savings if Afghanistan had a seaport, three companies estimated that they would be able to save 25 percent to 40 percent. However, the lack of a seaport creates opportunities for import substituting industries. One large beverage producer actually saw the lack of a seaport as an advantage, because importers of competing products incur higher costs of transportation. Therefore, the beverage producer can sell its locally-produced beverage for a lower price than the importer.

While some logistics companies were of the opinion that Afghanistan's lack of a seaport was a disadvantage because of higher costs, unpredictable delivery times, and problems with customs, others saw it as an advantage as it obligated clients to contract them for multiple services and allowed them to charge higher prices. Still others thought it had no impact whatsoever on their businesses.

### Security Measures

Across all sectors, few investors had any paid bodyguards for themselves or their personnel. There were only two companies that reported any kidnappings. One was a logistics company that reported a truck driver having been kidnapped in the countryside and released a few days later when the ransom was paid. Another company had a family member kidnapped and released after 17 days of direct negotiations with the kidnappers. Finally, the Afghan owner of a third company returned to Afghanistan after many years only to find that his residence had been taken over by the military. After extensive negotiations for which he used a third party—a friend familiar with all the parties involved—and a large payment, he was able to recover his residence.

A common security measure was posting watchmen at factories, offices and residences; one company used attack dogs on the compound at night and another had a sophisticated closed circuit television system which monitored the premises 24 hours a day.

An average of more than US$23,000 was spent annually on extra security measures (in addition to security guards, alarm systems and any routine measures that might be taken in most parts of the world). However, 15 companies out of the 32 interviewed reported no extraordinary expenses for security measures at all.

### Administrative Barriers

Across all sectors a slight majority of the companies (51 percent) indicated that bribes are a major difficulty for them. The average cost per company for bribes per year is a little more than US$35,000. The entities cited most by companies were the customs, police, national government and municipal government officials. Companies indicated that several years ago there were major difficulties in knowing what the correct procedures for registering companies and paying licenses and permits, but that in the last eight months this has become much clearer.

## Local Versus Foreign Investor Perspectives

Predictably, local investors expressed significantly different opinions from those of their foreign counterparts in several areas, such as (a) the availability of qualified personnel, (b) customs (c) living conditions, and (d) security measures.

Local investors consistently rated qualified personnel (managers, professionals, technicians and skilled labor) as more readily available than did foreign investors, in part because the local companies have an existing network of informal contacts that allow them to source quality personnel more readily than foreign companies, which have no such network. It is also likely that indigenous investors are less critical of local workers due to comparatively limited international exposure to other sources of labor. The only exception was for unskilled labor, which was rated by all companies as abundant and available.

Foreign investors indicated that they had fewer problems getting their goods through customs than did local investors. This has a simple explanation: Foreign companies are typically involved in moving exempt goods through customs that by law are given preferential treatment at customs as long as their documentation is complete. Local companies are primarily involved in transportation for commercial activities, which enjoy no such benefits.

Local investors predictably rated all quality of life factors (cost of living, safety, health care, and recreational activities) somewhat higher than foreign investors, as most were accustomed to living in Afghanistan for many years and were naturally inclined to think the best of their country after the years of conflict were over. Foreigners who are accustomed to higher standards of health care in their home countries and a broader range of recreational activities than are currently available in Afghanistan, and are concerned about safety issues gave a much lower rating on quality of life issues than did local investors.

Local investors also generally took fewer safety precautions than foreign investors. Some Afghans indicated that they used family members as bodyguards, paying for their immediate needs (food, shelter, transportation, etc.) rather than paying them a set salary. Foreign investors tended to perceive a higher level of danger, and to take more safety measures. However, even those that had formal safety measures in place and conducted regular safety audits indicated that these measures were imposed by their headquarter offices outside the country rather than requested from within.

The opinion of local and foreign investors did not differ significantly with respect to the quality of the infrastructure in Afghanistan (telecommunications, electric power, water and sewerage), the urgent need for the GoA to provide more incentives to investors, the relative advantages and disadvantages of Afghanistan being land-locked, and the hassle of administrative barriers and informal payments to their operations. Afghan investors from overseas varied widely in their perceptions, and they did not express the same opinion of either foreign or local investors on a consistent basis.

# Appendix 1: Endnotes

1 "AISA Needs Assessment Final Report," MIGA, September 2004, pg. 2.

2 The World Bank, *Afghanistan: State Building, Sustaining Growth, and Reducing Poverty*, 2004, pg. x.

3 AISA. As noted elsewhere, given the size of the informal sector in Afghanistan, including the drug trade, and the lack of fully functioning statistical and other data gathering agencies, data estimates vary widely. For example, the US Department of State estimates GDP at US$4 billion.

4 The World Bank, *Afghanistan: State Building, Sustaining Growth, and Reducing Poverty*, 2004, pg. x.

5 The World Bank, *Afghanistan: State Building, Sustaining Growth, and Reducing Poverty*, 2004, pg. 54.

6 The World Bank, MIGA's Experience in Conflict-Affected Countries: The Case of Bosnia and Herzegovina, 2004, pgs. 3-4.

7 This can be somewhat offset for managers and agencies that successfully undergo the Priority Restructuring and Reform process.

8 Byrd, William and Ward, Christopher, *Drugs and Development in Afghanistan*, 2004, pg. 2.

9 According to estimates from the Afghan Association of Freight Forwarders.

10 UNDP / Altai Consulting, *Market Sector Assessment in Horticulture*, August 2004.

11 UNDP / Altai Consulting, *Market Sector Assessment in Horticulture*, August 2004.

12 The World Bank, *Afghanistan: State Building, Sustaining Growth, and Reducing Poverty*, 2004, pg. 52.

13 Pain, Adam and Ali, Moharram, "Understanding Markets in Afghanistan: A Case Study of Carpets and the Andkhoy Carpet Market, pg. 18.

14 Pain, Adam and Ali, Moharram, "Understanding Markets in Afghanistan: A Case Study of Carpets and the Andkhoy Carpet Market, pg. 10.

15 USAID, "Findings of Industry Research," OTF Group presentation to private sector development roundtable, 2004.

16 USAID, "Findings of Industry Research," OTF Group presentation to private sector development roundtable, 2004.

17 USAID, "Findings of Industry Research," OTF Group presentation to private sector development roundtable, 2004.

18 The World Bank, "Traditional Islamic State of Afghanistan: Mining as a Source of Growth," 2004.

# Appendix 2: Acronyms and Abbreviations

| | |
|---|---|
| AISA | Afghan Investment Support Agency |
| DFID | Department for International Development |
| EBP | Enterprise Benchmarking Program |
| EBS | Enterprise Benchmarking Study |
| FDI | foreign direct investment |
| GOA | Government of Afghanistan |
| GDP | gross domestic product |
| ILSA | Iranian-Libyan Sanctions Act |
| IPA | investment promotion agency |
| Km | Kilometers |
| MoC | Ministry of Commerce |
| L/C | Letter of Credit |
| MOU | Memorandum(a) of Understanding |
| MIGA | Multilateral Investment Guarantee Agency |
| MNC | multinational corporation |
| NDF | National Development Framework |
| RAMP | Rebuilding Agricultural Markets Program |
| SWOT | strengths, weaknesses, opportunities, and threats |
| UN | United Nations |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Program |
| USAID | United States Agency for International Development |

# Appendix 3: Data Definitions and Resources

## Organization of Data

Quantitative and qualitative data were gathered both through desktop research and field work. The individual data points were organized under general headings as follows:

**Desktop Research: Quantitative Data**

| | |
|---|---|
| Investment costs | Sales price of industrial land; sales price of land for hotels; sales price of central city land for office buildings; warehouse, office building and hotel construction cost |
| Property costs | Class A & B office rentals; lease price for industrial site and SFB |
| Utility costs | Electricity; water; waste water treatment; gas; telecommunications, internet |
| International transportation costs | Cost of sea and air transportation |

**Desktop Research: Qualitative Data**

| | |
|---|---|
| General Business Environment | Economic, financial and political stability; doing business; bureaucracy; data transfer and intellectual property rules; corporate taxation |
| Labor conditions | Labor flexibility; working time regulations; social climate |
| Access to inputs and outputs | Proximity to raw materials; export competitiveness; supplier / cluster network; size of domestic market |
| Real estate | Availability of arable areas, vacancy rate for offices and industrial buildings |

**Investor Questionnaire: Quantitative Data**

| | |
|---|---|
| Labor costs | Management; professional; technician; skilled; unskilled; productivity; benefits |
| Investment costs and revenue | Total investment; annual revenue |
| Facility costs | Size of office, warehouse, or production facilities; size of land |
| Safety measure costs | Cost of extra security guards; cost of kidnappings and ransom |
| Administrative barrier costs | Cost of licenses and permits; cost of unofficial payments |

**Investor Questionnaire: Qualitative Data**

| | |
|---|---|
| Labor conditions | presence of labor unions; labor turnover |
| Labor availability | Management; professional; technical; skilled; unskilled; language proficient |
| Infrastructure | Air, train, sea and overland transportation of goods; telecommunications; information technology; electric power; water |
| Real estate | Availability of industrial and agricultural land; availability of industrial buildings and office space |
| Living Environment | Cost of living; safety; quality of international and local schools; health care; recreational activities; housing |
| Access to inputs and outputs | Availability of raw materials, equipment and components |
| Investment Incentives | Exemption of import duties on capital equipment and food and beverages; tax holiday; repatriation of capital; expatriate hiring; VAT and sales tax treatment |

## Definition of Terms

**Sectors**
The logistics and transport industry in Afghanistan includes a wide range of activities. For the purpose of this study, they were grouped under four sub-sector headings as follows:

| | |
|---|---|
| Small package handling | Small package delivery in-country as well as documents, and occasionally larger packages. |
| Land, sea, and air transport | Companies which use their own vehicles, ships or aircraft to transport goods. |
| Supply and warehousing | Any kind of warehousing, distribution or supply services, but especially those related to providing supplies to the military and donor organizations on a tax-exempt basis. |
| Freight forwarder | Providing freight forwarding, customs clearance, and travel agency services by companies which do not have their own vehicles, ships or aircraft. |

The food and beverage industry benchmarked for this exercise was restricted to processed foods and beverages, defined as those having undergone any transformation whatsoever, such as drying, shelling (as with nuts), canning and/or bottling. Merely packaging a product was not considered to be "processing."

**Labor**
Labor costs were determined for different levels of positions that can be generalized over many industries. The following designations were used in the questionnaire:

| | |
|---|---|
| Management | Entry-level manager, mid-level manager, senior manager; excludes expatriate managers |
| Professional | Head accountant, lawyer, consultant |
| Technical | Engineer, accounting clerk, programmer, systems analyst |
| Skilled | Data entry, customer service, assembly line worker with special skills |
| Unskilled | Driver, janitor, chamber maid, entry-level assembly line worker, farmhand |

The term "benefits" refers to any employee contribution above and beyond the regular salary.

**Inputs**

Researchers requested information as to the percentage of raw materials, components, and equipment and/or chemicals required for production that were imported as opposed to sourced from local suppliers. The following definitions were used:

| | |
|---|---|
| Raw materials | Any input that has not yet undergone significant processing, such as raw cotton, timber, sugar, milk, steel ingots |
| Components | Any input that has undergone significant processing or transformation, such as yarn, fabric, precision molded plastic, or engines |
| Equipment/chemicals | All machinery, computers, telephones, fertilizers, beds, table, televisions, packaging and labeling |

With regard to transportation, the researchers differentiated between land transportation within Afghanistan or to an adjacent country ("by land") and land transportation that eventually links with sea transportation ("by sea").

# Appendix 4:

# Tables of Findings – Company Interviews

The tables below reflect the findings from interviews conducted at Afghan companies during the fieldwork of the study. Tables 4-2 through 4-13 present data in each of the four subject sectors: logistics and transport; food and beverage processing; textiles and carpets; and mining. In the logistics and transport sector, data is also broken down by four sub-sectors: small package handling; air, sea and land transport; supply and warehousing; and freight forwarder. The first column in these tables reflects the findings from all firms in the logistics and transport sector, and subsequent columns reflect the individual sub-sector findings.

**Table 4-1: Top Site Selection Factors by Industry**

| Industry | Top Site Selection Factors (in order of importance) |
|---|---|
| Logistics and Transport | Access to customers (both donor and commercial); political stability; level of bureaucratic regulations; desire to contribute to Afghanistan; transportation costs |
| Food and Beverage Processing | Desire to contribute to Afghanistan; access to and size of the local market; access to raw materials (especially water); political stability; cost of real estate; tariff level to access main market |
| Textiles and Carpets | Desire to contribute to Afghanistan; political stability; cost of real estate; cost of living |
| Mining | Desire to contribute to Afghanistan; access to and size of local market; access to raw materials; political stability |

**Table 4-2: Labor Structure – Average Number of Employees**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Total | 86 | 21 | 129 | 64 | 19 | 214 | 180 | 56 |
| Management | 5 | 4 | 7 | 4 | 3 | 6 | 5 | 5 |
| Professional | 1 | 1 | 1 | 1 | 1 | 1 | 8 | 2 |
| Technical | 2 | 1 | 3 | 4 | 2 | 14 | 4 | 3 |
| Skilled | 17 | 12 | 23 | 12 | 8 | 93 | 16 | 9 |
| Unskilled | 61 | 3 | 95 | 43 | 5 | 100 | 147 | 37 |

**Table 4-3: Availability of Qualified Labor**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Management | 1.5 | 1.5 | 1.7 | 1.0 | 2.0 | 2.0 | 2.9 | 4.3 |
| Professional | 1.2 | 2.0 | 1.0 | 1.0 | 1.0 | 2.0 | 3.0 | 3.7 |
| Technical | 1.8 | 5.0 | 2.0 | 2.3 | 1.5 | 2.3 | 3.8 | 3.7 |
| Skilled | 3.0 | 3.7 | 3.8 | 2.2 | 2.7 | 1.6 | 3.8 | 4.3 |
| Unskilled | 4.6 | 5.0 | 5.0 | 4.2 | 5.0 | 5.0 | 5.0 | 5.0 |
| Required Language Skills | English, Dari, Pashtu, Farsi, Urdu, Russian, French, Greek, Chinese | | | | | Dari, Pashtu, English, Farsi | Dari, Pashtu, Urdu, Turkhmen, Uzbek | Dari, Pashtu, Farsi |
| Availability of Language Skills | 2.8 | 3.0 | 3.5 | 1.6 | 2.3 | 4.1 | 4.2 | 5.0 |

RATING BETTER 5 → WORSE 1

(5=Many qualified candidates, 1=Extremely difficult to find)

**Table 4-4: Average Labor Costs**
(Fully-loaded in US$ per annum)

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Management | 6,833 | 3,593 | 7,898 | 5,684 | 6,001 | 8,907 | 3,039 | 960 |
| Professional | 3,495 | 3,293 | 3,596 | 3,593 | 4,801 | 3,615 | 2,058 | 3,581 |
| Technical | 2,470 | 3,623 | 2,181 | 3,612 | 3,600 | 7,148 | 3,196 | 1,719 |
| Skilled | 2,732 | 2,184 | 2,700 | 1,723 | 4,272 | 2,466 | 1,199 | 550 |
| Unskilled | 1,927 | 2,151 | 1,780 | 1,662 | 1,626 | 1,561 | 782 | 328 |

**Table 4-5: Other Labor Factors**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Average Work Week (hours) | 50 | 50 | 49 | 53 | 52 | 51 | 54 | 44 |
| % Annual Turnover | 5.4 | 12 | 2.3 | 6.6 | 3.3 | 1.7 | 3.1 | 0 |
| % Average Wage Burden | 5.9 | 11 | 3.6 | 8.4 | 2.4 | 5.4 | 10.8 | 45 |

**Table 4-6: Investment, Revenue and Facilities (Averages)**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Initial Investment (US$) | $67,857 | $60,000 | $101,250 | $103,750 | $157,500 | $5,860,325 | $2,182,489 | $122,500 |
| Annual Revenue (US$) | $1,018,571 | $250,000 | $795,000 | $1,350,000 | N/A | $13,495,072 | $283,473 | $11,000 |
| Land (ha)[1] | 0.71 | 0.19 | 0.26 | 1.72 | 0.05 | 1.92 | 26.72 | 1.8 |
| Production Floor ($m^2$)[1] | 1,620 | 426 | 2,533 | 425 | 125 | 6,493 | 11,049 | 11,115 |
| Office Space ($m^2$)[1] | 313 | 190 | 493 | 125 | 275 | 1,039 | 610 | 682 |

[1] If the company had multiple sites and an office in Kabul, the size of the Kabul office and one other site, usually the largest, was included.

**Table 4-7: Inputs and Raw Materials**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| % Raw Materials Imported[1] | N/A | N/A | N/A | N/A | N/A | 28 | 53 | 0 |
| % Components Imported[1] | N/A | N/A | N/A | N/A | N/A | 83 | 43 | 33 |
| % Equipment Imported[2] | 61 | 86 | 75 | 54 | 33 | 44 | 42 | 33 |

[1] This only applies to the productive sectors.
[2] Equipment, computers and vehicles used in the logistics sector were all included.

**Table 4-8: Exports**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| % of Product Exported | N/A | N/A | N/A | N/A | N/A | 43.57 | 87 | N/A |
| % By Air | N/A | N/A | N/A | N/A | N/A | 0 | 48 | N/A |
| % By Sea | N/A | N/A | N/A | N/A | N/A | 75 | 13 | N/A |
| % By Land | N/A | N/A | N/A | N/A | N/A | 25 | 77 | N/A |
| Destination Countries | N/A | N/A | N/A | N/A | N/A | Canada, Germany, UK, Switzerland | Pakistan, Switzerland, Dubai, USA | N/A |

**Table 4-9: Transportation Infrastructure**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| **% of goods arriving on schedule** | | | | | | | | |
| By Air | 74 | 92 | 60 | 81 | 78 | N/A | 77 | N/A |
| By Sea | 63 | 55 | 62 | 59 | 77 | 70 | 50 | N/A |
| By Land | 75 | 80 | 82 | 66 | 72 | 50 | 74 | 30 |
| **% of lost goods per annum** | | | | | | | | |
| By Air | 0.3 | 0.5 | 0.5 | 0 | 0.7 | N/A | 0 | N/A |
| By Sea | 0.1 | 0 | 0.3 | 0 | 0.5 | 3 | 0 | N/A |
| By Land | 0.3 | 0 | 0.2 | 0.4 | 1.5 | 0 | 0.12 | 2.5 |
| Days to Clear Customs on Entering (average) | | | 9 | | | 9 | 11 | 1.5 |

**Table 4-10: Telecommunications Infrastructure**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| **Land Line Service** | | | | | | | | |
| % With Land Lines | 25 | 33 | 50 | 20 | 0 | 28 | 50 | 33 |
| Quality Rating | 1 | 1 | 1 | 1 | N/A | 1 | 3.3 | 1 |
| No. Days to Install | 95 | 7 | 138 | 7 | N/A | 197.5 | 118 | 7 |
| **Mobile Phone Service** | | | | | | | | |
| Quality Rating | 2.8 | 2 | 3 | 3 | 2.7 | 3.5 | 3.1 | 4.5 |
| Monthly Bill (US$) | 1,155 | 2,967 | 1,440 | 1,550 | 716 | 582 | 561.11 | 483 |
| **Internet Services** | | | | | | | | |
| Quality Rating | 2.9 | 3.5 | 2.7 | 2.7 | 2.7 | 4 | 3.8 | 2 |
| Monthly Bill (US$) | 7.6 | 4.5 | 3 | 13 | 5 | 2 | 1.25 | N/A |

For all quality ratings above:

| | BETTER | | WORSE |
|---|---|---|---|
| RATING | 5 | → | 1 |

**Table 4-11: Utilities and Infrastructure**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| % with Public Electric Power[1] | 67 | 33 | 83 | 80 | 100 | 29 | 50 | 67 |
| Hours Blackouts / Month | 372 | 44 | 396 | 367 | 450 | 155 | 448 | 294 |
| Hours Energy Fluctuation / Month | 127 | 0 | 30 | 127 | 205 | 100 | 139 | 5 |
| % with Generator | 92 | 67 | 83 | 80 | 100 | 100 | 100 | 67 |
| Hours / Month Generator Used | 426 | 510 | 327 | 478 | 600 | 186 | 231 | 416 |
| Cost per Hour to Run Generator[2] (US$) | 24.70 | 2.30 | 58.50 | 25.00 | 1.66 | 23.91 | 3.52 | 26.5 |
| % with Public Water Supply[3] | 16 | 33 | 33 | 0 | 0 | 0 | 0 | 0 |
| % with Public Waste Water Treatment[4] | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

[1] Because companies had limited electric power from public sources, the information obtained about generator use and costs is often more illustrative.
[2] Differences due to different sizes of generators.
[3] Only a very few companies interviewed had water from a public source; the rest had drilled their own wells from which they were pumping water free of charge.
[4] There is reportedly no wastewater treatment service provided by public entities in the Kabul area. Companies either have a septic tank or are not sure what happens to their wastewater.

**Table 4-12: Land and Buildings**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Number of Sites Considered Before Choosing Present Site | 7.9 | 2.5 | 11 | 2.5 | 12.5 | 2.1 | 2.9 | 2 |
| Availability of Land / Buildings (Rating) | 2.4 | 2.5 | 3 | 2.5 | 2 | 2.8 | 3.2 | 3.7 |
| % Purchasing Site | 25 | 33 | 17 | 20 | 33 | 71 | 20 | 33 |
| Cost per m$^2$ (US$) | Land previously belonging to owners | | | | | 57.33 | 816 | N/A |
| % Leasing Site | 75 | 67 | 83 | 80 | 67 | 29 | 80 | 67 |
| Cost per m$^2$ / Year (US$) | 80.31 | | | | | 77.00 | 7.46 | 15.43 |
| Additional Yearly Payments to Owner[1] | 0 | | | | | 0 | 0 | 0 |

[1] Such as maintenance costs, in addition to rental costs.

Scale for availability of land/buildings:

| | BETTER | | WORSE |
|---|---|---|---|
| RATING | 5 | → | 1 |

**Table 4-13: Living Conditions**

| | Logistics and Transport | | | | | Food and Beverage | Textiles and Carpets | Mining |
|---|---|---|---|---|---|---|---|---|
| | All Firms in Logistics & Transport | Small Package Handling | Air, Sea, Land Transport | Supply & Warehousing | Freight Forwarder | | | |
| Cost of Living | 1.9 | 1.3 | 2.2 | 2.4 | 2.3 | 1.3 | 2.1 | 2.6 |
| Level of Safety | 3.0 | 2.3 | 3.3 | 2.2 | 3.0 | 2.9 | 4.1 | 3.3 |
| International Schools[1] | 1.0 | 1.0 | 1.0 | 1.0 | N/A | 1.0 | N/A | N/A |
| Local Schools | 1.3 | 1.0 | 1.4 | 1.3 | 2.0 | 2.2 | 3.7 | 2.6 |
| Health Care | 1.0 | 1.0 | 1.5 | 1.3 | 2.0 | 1.3 | 1.8 | 2.3 |
| Recreation Activities | 1.1 | 1.3 | 1.3 | 1.2 | 1.3 | 1.6 | 1.4 | 2.0 |
| Housing | 1.9 | 2.3 | 2.5 | 2.0 | 2.3 | 1.3 | 2.9 | 2.6 |

[1] There are two international schools currently open in Afghanistan. Most of the interviewees were not aware of these schools; the local investors interviewed had their children in local schools, and the foreign investors were in Afghanistan without their families.

RATING BETTER 5 → WORSE 1

# Appendix 5: Tables of Findings – Local Information

The tables below reflect the compiled findings from research conducted from published and other sources of information, such as queries of service providers in real estate and freight transportation.

**Table 5-1: Land and Facility Rental and Sales Costs[1]**

| | Sale Price (US$ per $m^2$) | Construction Cost (US$ per $m^2$) | Leasing Rate per annum (US$ per $m^2$) |
|---|---|---|---|
| **Land** | | | |
| Industrial Land | 700 | N/A | N/A |
| Land for Office Building | 1450 | N/A | N/A |
| Land for Hotel | 1450 | N/A | N/A |
| **Buildings** | | | |
| Standard Factory Building | N/A | 287 | 86 |
| Class A Office Building | N/A | 383 | 124 |
| Class B Office Building | N/A | 383 | 82 |
| Hotel | N/A | 473 | N/A |
| Warehouse | N/A | 287 | N/A |

[1] The costs are averages of quoted costs from several real estate agents in Kabul.

**Table 5-2: Official Utility Costs**[1]

| | Cost in US$ |
|---|---|
| **Telecommunications** | |
| Per Minute Local Call | 0.12 |
| Per Minute International Call, Adjacent Country | 0.57 |
| Per Minute International Call, USA | 0.43 |
| Internet Usage Costs | 23.38 |
| Internet Surcharges | 23.38 |
| **Electric Power** | |
| Electric Power Consumption per Kwh | 0.117 |
| Electric Power Demand Costs[2] | 0 |
| **Water** | |
| Water Costs (after well is drilled) | 0 |

[1] Investors on the ground reported that these rates are often negotiated directly with the utility provider, or that the utility provider simply disregards these established rates and negotiates arbitrary rates with the end user.

[2] Where electric power is available, only consumption is charged monthly. No capacity demand is declared, nor is any charged to the user.

**Table 5-3: Transport Costs**[1]

| | | To Rotterdam in US$ | To New York in US$ | To Long Beach in US$ | To Yokohama in US$ | To Singapore in US$ |
|---|---|---|---|---|---|---|
| Sea Freight | 20' Container | 4,250 | 3,900 | 4,350 | 3,350 | 4,100 |
| | | To Amsterdam Schipol (US$) | To New York JFK (US$) | To Los Angeles LAX (US$) | To Tokyo Narita (US$) | To Singapore Changi (US$) |
| Air Freight | General Cargo <45 kg (per kg) | 6.25 | 8.45 | 8.95 | 7.05 | 7.85 |

[1] Quotes are from February 2005.

**Table 5-4: Tax Rates**[1]

| | Land Transfer Tax | Tax on Gross Sales | Tax on Profits | "Sokook" (Tax) on Capital Invested |
|---|---|---|---|---|
| Income Tax Percentages | 1% | 2.5% | 25% | 1% |
| Code Where Found | Art. 34 Income Tax Law & 34-34.4 Income Tax Manual. | Arts. 72-77 Income Tax Manual | Article 3 Income Tax Manual | Gazette #514, 31 Asad 1361 (1982). Art.3, Chap. 2, Band 5 |
| Method of Calculation | Selling price or market value | Gross receipts, regardless of profit, before any deductions | Profit as determined by the corporation's balance sheet | Initial capital invested at the time of incorporation, or later on investing new capital |
| Taxpayer | Individuals, partnerships and families who sell the property | Corporations | Corporations | Corporations |

[1] Many investors on the ground reported that the GoA had not yet begun collecting taxes from them, even though they had been functioning for several years. The 10% VAT is not uniformly collected.

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