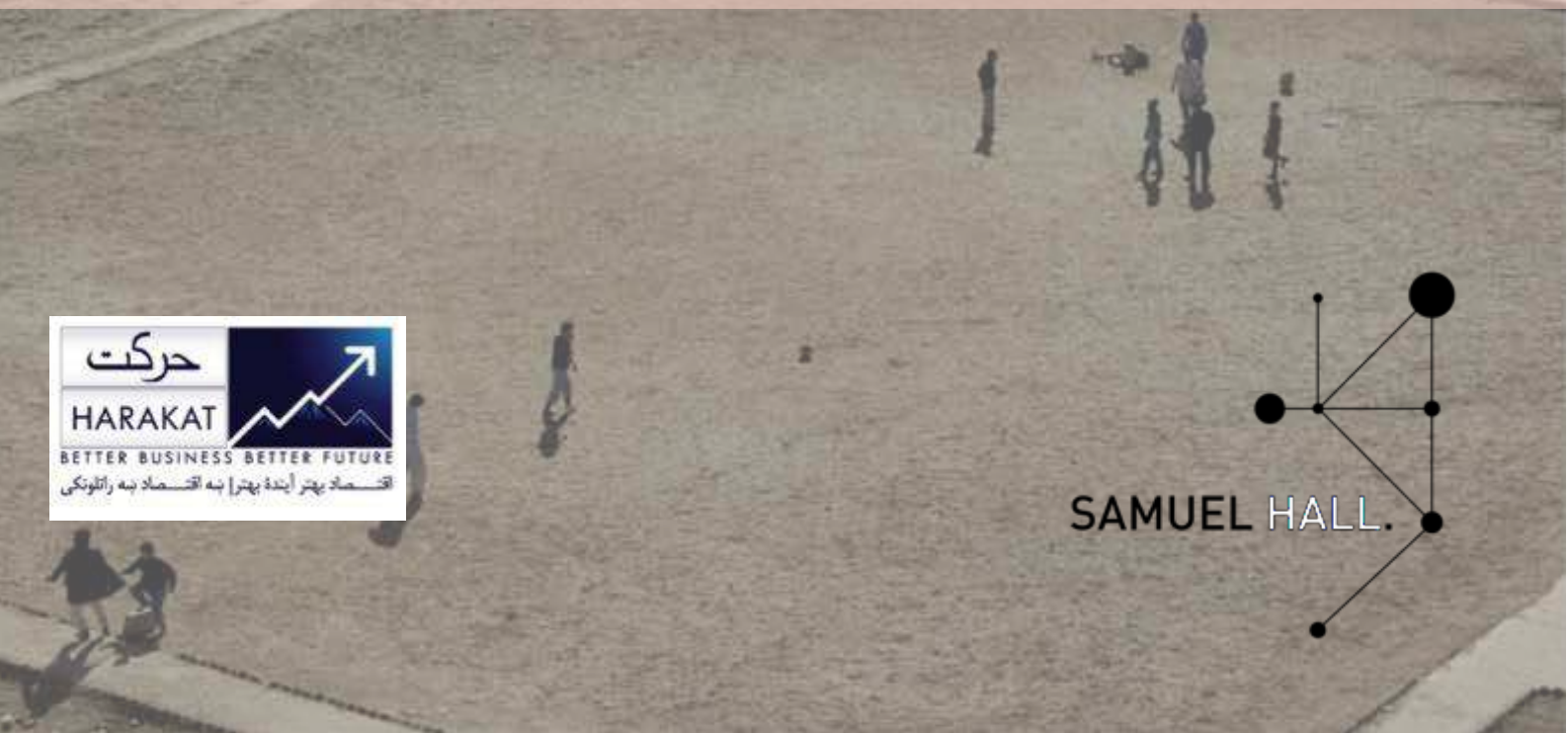




Special Economic Zones in Afghanistan

A new business and economic deal for 2020?



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EXECUTIVE SUMMARY: FROM ODA TO FDI?

"Yesterday I was clever, so I wanted to change the world. Today I am wise, so I am changing myself"

Rumi

Objectives and background

To help the Government of Afghanistan (Ministry of Commerce and Industry) and its partners promote ambitious economic and employment generation schemes in the country, this report investigates the economic context for Special Economic Zones (SEZs) in Afghanistan across seven regions in the country: Kabul, Balkh, Nangarhar, Paktia, Kunduz, Kandahar, and Herat. SEZs are geographical areas within a country, usually cities, which concentrate infrastructure requirements for business; create a hub of suppliers, distributors, and product markets for industry; often enjoy more liberal commercial laws and regulations, lower tariffs than the rest of the country to attract both local and international investors. Such zones can be found in China, India, and Singapore, where they are widely considered successful in their aims.

The Afghan economy faces a reduced GDP growth rate, high levels of unemployment, political instability, and the loss of a key source of demand with the withdrawal of the international community. Afghanistan suffers from weak infrastructure, especially transport and power. These services are integral to the business community, providing the inputs needed for production, and the networks to take products to market. In particular, inadequate electricity supply is often quoted as a serious constraint to growth. By concentrating industry - and

therefore the location for the need for reliable electricity supply - in one place, a SEZ could go some way to alleviating this problem. Likewise, due to high labour costs and low production standards Afghan products cannot compete on international markets, neither regionally, nor further afield. SEZs could help lower the costs of production and improve standards, making Afghan products more internationally competitive.

For Afghanistan, the creation of SEZs would provide a signal to investors that the country is committed to supporting private sector development, and could encourage higher levels of foreign investment - in line with the conclusions of the *London Conference on Afghanistan*, in December 2014.

Key findings

An index was created based only on the responses provided by the respondents of the survey to some critical questions relating to 3 key categories: business environment, infrastructure and business cost. The index was constructed by taking a simple average of the perceptions of the respondents for the following indicators

- Business environment: Security; Tax administration; Trade and labour regulations; Business Registration; National Standards and Starting a business;
- Infrastructure: Electricity; Land and land titles; Water and sewage systems; Site

security; Paved roads onsite and offsite;
Management of the location;

- Cost: Labour Cost; Operating Costs; cost of importing goods and services.

This analysis scores Mazar-e-sharif, Kabul, and Herat as leading options for development of a SEZ, followed by Nangarhar, Kunduz, Paktia, and Kandahar scoring the lowest. While Kunduz and Gardez score well on the numeric indices, the adverse security climate in the region and the lack of industrial development indicated in the regional profiles must be taken into consideration. Such constraints to business development in these areas are significant, and render these locations unsuitable for the location of a SEZ. Overall comparison of the locations thus must take into account the technical as well as soft considerations that have been presented in the regional profiles.

The Afghan government does not have available funds to own and manage a SEZ. However, a fully private SEZ is unlikely to be successful in Afghanistan. The infrastructure requirements are too high to expect the private sector to meet these. Thirty years of socialism have left an expectation of government provision for business services. Moreover, there is a general attitude of mistrust of foreigners. In this regard, the following recommendations should be prioritized:

- **A Public Private Partnership (PPP) is the most secured and sustainable for the creation of SEZs in Afghanistan,** including public (municipalities, governmental agencies) and private actors - with potential funding from international donors or private partners for the initial investment;
- The PPP could include equity-sharing arrangements', where firms are provided

with a long-term lease, but are able to exercise a purchase option after demonstrating a satisfactory level of performance;

- Hence, create a PPP model to be passed into legislation where the private and government responsibilities are clearly articulated with failure standards against both enumerated so that monitoring and evaluation is built into the framework.

SEZs often focus on specific sectors. The subjective assessment shows that in all three locations identified for a potential SEZ, respondents reported the Extractive Industries and Construction as those with the most potential for development. However, **considering the national priorities of the Afghan economy and the existing competitiveness of Afghan products at the regional scale (vs. Pakistani producers), one could argue that SEZs should focus on agribusiness and include the more profitable segments of the value chain (e.g. packaging, marketing, etc.),** as:

- Agriculture, according to World Bank estimates and taking into account a worsening environment, is likely to stay the key job-provider in Afghanistan;
- Afghanistan still suffers from the poor productivity and competitiveness of its agribusiness sector and has a significant margin of improvement in all the segments of the agricultural value chain;
- The other traditional sectors of the Afghan economy have significantly suffered from the reduction of foreign assistance (construction, services, transportation);
- Last, while extractive industries clearly represent a fantastic potential for the Afghan economy, their actual development is still hampered by many caveats and uncertainties. On the longer-term though, the integration of extractive

industries within SEZ should be a priority of any ambitious economic strategy.

Recommendations for stakeholders

The recommendations are divided based on agencies that have the responsibility and capacity to bring change. The overall architecture and responsibility of an ambitious development of SEZs in Afghanistan should naturally be carried out by the Government of Afghanistan - and especially by the Ministry of Commerce and Industry.

Government: In an EZ program, it is often highlighted that the less the government interferes with the private sector activities the better it is. Having said that, the regulatory role of the government of Afghanistan is something that cannot be taken by anyone else. It is especially true in a complex national and regional context:

1. **Create a comprehensive regulatory framework for the general economy:** The time taken to create this legislation is directly proportional to the loss incurred by private enterprises and government.
2. **Create provision for SEZ regime under broader economic policy, with specific development agenda and failure standards with clear time horizon.** During the workshop hosted on May 26, 2015, at the Ministry of Commerce and Industry, governmental officials, international actors and private sector representatives recommended the following roadmap:
 - **Mapping and prioritizing:** The existing taskforce working on the development of SEZs, under the umbrella of the MoCI, should take into account the findings and recommendations of this report and meet with relevant counterparts (ACCI, Harakat, Private Sector, World

Bank, other national and international actors) to identify a roadmap to be submitted to the President of Afghanistan;

- **Piloting and implementing:** Two pilot projects could be designed to test the relevance and potential of SEZs in Afghanistan - based on detailed economic feasibility studies;
 - **Monitoring and learning:** Like any other program SEZs have success and failures that most often can be measured objectively. Defining failure standards with specific time horizons will facilitate regular monitoring of zones and regular review of the policy.
3. **Begin discussion with neighbouring countries and countries with which there are trade agreements to identify opportunity and provision for Afghan SEZs:** Economic zones with their free trading regimes very often have implications for trade in other countries which may even be distortionary: to inform trading partners ex-ante will give an opportunity to bring their concerns on the table so that trade balances can be maintained.
 4. **Promote and support private sector development in SME and primary industry:** The government must continue supporting private businesses outside the economy. Economy wide reforms must continue to generate an input supply and intermediate production base that can assist with production inside potential economic zones.
 5. **Keep discussions open with regional partners for potential "Joint Economic Zones" (with Iran, Pakistan, Tajikistan, etc.):** Commonalities such as shared language, religion and culture would strengthen the bond between nations,

while promoting political stability and economic trade.

Donors: At the onset it must be ensured that the zone programming is in line with strategic orientation of donor interests. With that in mind, donors can

1. **Facilitate advisory and consultation with experts, zone hosting governments and other stakeholders that may contribute to zone programming:** Donors, through their networks must facilitate consultants for the development of zone program for Afghanistan. From their network they can connect and bring in industry experts, policy planners, advisors from economic zone regulatory bodies from other countries, private zone developers under one roof to discuss the way forward for a zone program for Afghanistan.
2. **Create networks with potential investors in other countries:** For the economic zones, the foreign donors can create links with potential investors in a planned zone program. Organizing workshops and conferences with the agenda of seeking the requirements of potential investors will help tailor SEZ strategy towards facilitating these investors from the onset. This may also lead to generating an estimate of FDI and FII interest in the country.
3. **Facilitate comprehensive feasibility studies into creating economic zones in the locations prescribed by the research:** This research narrows down the possibility of having a successful zone program to 3 of the 7 locations surveyed – Kabul, Herat and Mazar-e-sharif (if so inclined, the feasibility study could include Jalalabad as well). The study must include:
 - a. Wide consultative process by key stakeholders to figure out direct and opportunity costs of funds;

- b. A mapping analysis of value chains and supply chains to key locations such as industrial parks and other commercial centres to map linkages;
- c. A key market potential analysis for economic zone in each region.

Harakat: Harakat's role is to provide the Government of Afghanistan with studies, information, and pragmatic suggestions. From the research study, there are 3 separate programs that Harakat will have to work upon to take SEZs forward in Afghanistan:

1. **Consultation Program: Facilitate workshop on the findings of this research to chart way forward for economic zones:** The first thing to do would be to bring in national stakeholders to SEZ policy on a forum to discuss the findings of this research study and confer on the merits of different courses of action that can be taken to create a defensible zone policy for Afghanistan.
2. **Legislation Program: Promote the creation of comprehensive regulatory and institutional frameworks in Afghanistan:** As the consultative program is carrying on, the legislation can be written in parallel so that it can be introduced in parliament as soon as there is consensus amongst the partners. The legislation program will take into account all monetary and operational incentives that could be provided to attract investment in the zones. It will also outlay the institutional structure for the regulation and maintenance of zones.
3. **Infrastructure Program: Promote and support fast track creation of sufficient infrastructure.** This is perhaps the most important program of all. The one that is likely to take the most time and fund commitment. The most critical insufficiency currently is the lack of

infrastructure that is holding back manufacturing investment in Afghanistan.

What is next?

Finally, it is important to note that the potential for the creation and development of SEZs in Afghanistan is real.

Locations: All stakeholders - from the government to donors, from Harakat to private sector actors - should urgently open a dialogue and agree on a pragmatic roadmap to launch the first SEZs in the cities of Kabul, Mazar-e-Sharif, or Herat. Context, sectors and strategies may differ, but as long as there is a pragmatic political will to back up such a necessary economic change, SEZs will succeed in Afghanistan.

Priority Sectors: While this report clearly and carefully recommends a sectoral focus on agribusiness, considering: 1) the still volatile security situation; 2) the uncertainties around the potential and agenda of the development of a promising mining sector, it also acknowledges the remarkable potential of the country in terms of manufacture, textile, construction, transportation, and (more recently) services. But the priority in today's context is probably to develop labour-intensive and fast-income generating schemes along the most promising and traditional sector of the Afghan economy: agriculture.

SEZs' role for today and tomorrow: Turning a poorly efficient and productive agriculture sector into dynamic and sustainable *agribusiness* activities will require significant investments from all Afghan and international actors in relatively new and more profitable segments of the value chains: it is one thing to produce almonds or tomatoes and export them in bulk to neighbouring countries; it is another to

develop more profitable segments of the value chain (transformation, packaging, marketing, sales, etc.). SEZs can strongly contribute to foster this approach by providing: 1) better infrastructures, 2) enabling business environments (land-use, private property rights...), 3) flexible regulatory and fiscal measures, 4) semi-skilled and skilled labourers.

Other Opportunities: Last it should also be noted that despite relatively low scorings for certain areas (Kandahar) or sectors (extractive industries), their untapped potential remains extremely promising and attractive: for instance, security permitting and thanks to its international airport, Kandahar can become a major commercial in Central Asia, between Delhi, Istanbul, and Dubai; likewise, on the longer run, extractive industries represent the most promising socio-economic growth opportunity for Afghanistan. Finally, this report, as mentioned in the recommendations to the government, advocates for the promotion and development of a pragmatic dialogue with other regional partners (e.g. Pakistan, Iran, Tajikistan) to open joint SEZs.

Roadmap: For all these reasons, **this report strongly believes that SEZs should be prioritized - along with other political, economic, and regulatory tools - to shift from economic dependency to autonomy: from Overseas Development Assistance (ODA) to national and Foreign Direct Investments (FDI).**

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ACRONYMS

AISA	Afghanistan Investment Support Agency
CAREC	Central Asian Regional Economic Council
CSO	Central Statistical Organisation
ECO	Economic Cooperation Organisation
EPZ	Export Processing Zones
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GIROA	Government of the Islamic Republic of Afghanistan
IP	Industrial Parks
KII	Key Informant Interviews
MISFA	Microfinance Investment Support Facility for Afghanistan
MoCI	Ministry of Commerce and Industry
MoU(s)	Memorandum (da) of Understanding
NRVA	National Risk and Vulnerability Assessment
ODA	Overseas Development Assistance
PPP	Public-Private Partnership
PSD	Private Sector Development
PSU	Primary Sampling Units
RTA	Regional Trade Agreements
SAARC	South Asian Association for Regional Cooperation
SEZ	Special Economic Zones
SME	Small and Medium Enterprises

1 INTRODUCTION

At the *London Conference on Afghanistan*, in December 2014, the Government of the Islamic Republic of Afghanistan and the International Community committed to “take specific action to increase levels of domestic and foreign private sector investment in Afghanistan to help create and sustain decent jobs, including for women and youth, and improve access to services and markets.”¹ While bearing in mind the big economic Afghan picture, this report specifically looks at promising platforms, which may offer significant economic development and employment creation opportunities: Special Economic Zones (SEZs).

SEZs are geographical areas within a country, usually cities, which concentrate infrastructure requirements for business; create a hub of suppliers, distributors, and product markets for industry; and often enjoy more liberal commercial laws and regulations than the rest of the country. SEZs often offer tax incentives or lower tariffs for companies that locate there. SEZs are usually created with the hope of developing a country’s competitive advantage in a given market and promoting economic growth, often through foreign direct investment (FDI). Such zones can be found in China, India, and Singapore, where they are widely considered successful in their aims. According to the 2008 World Bank report on SEZs: “by some estimates, there are approximately 3,000 zones in 135 countries today, accounting for over 68 million direct jobs and over \$500 billion of direct trade-related value added within zones”.

1.1. PROJECT DESCRIPTION

Afghanistan is one of the poorest countries in the world, with high level of unemployment and a low skills base. Despite gains in economic growth, employment, and education levels since the fall of the Taliban in 2001, the country faces huge challenges for its economic future. The international community has contributed greatly to these gains in recent years, creating demand for Afghan products, and supporting a burgeoning services sector. The 2014 withdrawal of foreign troops and much of the wider development community is forecasted to have a significant negative impact on the Afghan economy.

Investors have traditionally been wary of Afghanistan due to high levels of corruption, on going conflict, difficulty in enforcing contracts, and high capital costs attributable to the country’s mountainous terrain and position as a landlocked country in a political unstable region. Creating SEZs provides a signal to investors that the country is committed to supporting private sector development, and could encourage higher levels of FDI.

The argument for a SEZ in Afghanistan is strong. The country suffers from weak infrastructure, especially transport and power. These services are integral to the business community, providing the inputs needed for production, and the networks to take products to market. In particular, inadequate electricity supply is often quoted as a serious constraint to growth. By concentrating industry – and therefore the location for the need for reliable electricity supply – in one place, a SEZ could go some way to alleviating this problem. Likewise, due to high labour costs and low

¹ See the text of the Conference at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383205/The-London-Conference-on-Afghanistan-Communique.pdf

production standards Afghan products cannot compete on international markets, neither regionally, nor further afield. SEZs could help lower the costs of production and improve standards, making Afghan products more internationally competitive.

On a positive note, Afghanistan offers modern production facilities, easy licensing, and a liberal regulatory authority. Afghanistan's low tax and customs rates, and no minimum requirements in production at the least show intent towards a market driven economy. Firms with a higher appetite for risk² can capitalize on a first mover advantage due to low levels of existing competition. The Government of Islamic Republic of Afghanistan (GIROA) is committed to foster a business-enabling environment. This was reaffirmed at the Tokyo Conference in July 2012 and strengthened at the London Conference in December 2014, with pledges to take steps to achieve World Trade Organization (WTO) accession by 2014 and to improve its World Bank Doing Business rankings³. It is underscored in the Afghan Constitution and the 2005 Private Investment Law (PIL), which prohibits discrimination against foreign investors. The PIL permits investments in nearly all sectors of the economy, except nuclear power, gambling establishments and production of narcotics and intoxicants.

All of the largest donor agencies in Afghanistan fund projects to facilitate private investment in Afghanistan.

1. DFID funded projects such as Supporting Employment and Enterprise Development (US\$ 50 million); the Microfinance Investment Support Program (US\$ 50 million); and Extractives Sector Support Program (US\$14 million)
2. USAID funded projects in credit support to micro, small and medium scale enterprises, developed public-private partnerships worth a US\$130 million. On going projects include Assistance in Building Afghanistan through development enterprises and Afghanistan Workforce Development Program
3. The World Bank has an umbrella project called the 'Afghanistan PSD Support Project' (US\$ 25 million), under which it aims provide land and infrastructure to enterprises, enhance capacity and build support and policy for Private Sector Development (PSD).
4. Other agencies such as the ADB and GIZ are also involved in projects supporting Small and Medium Scale (SME) businesses, attracting investment and making credit available for enterprises in Afghanistan.⁴

These projects have had some successes, and Afghanistan's fledgling private sector is in a much stronger position than it was ten years ago. This report draws from the lessons of past interventions, and highlight how SEZs could streamline current donor activity.

The report does a critical review of past attempted policies and programs at PSD; analyses case studies from SEZ development in other developing foreign countries and presents challenges and lessons learned that would be useful in developing this strategy in Afghanistan. This report investigates the economic context for SEZ in Afghanistan across seven regions in the country. Within in each region, this report builds comprehensive understanding of the opportunities and challenge of locating a SEZ in the area. This report considers the current status of business

² See Afghanistan Investment Support Agency (AISA) website - www.aisa.ororg.af

³ The Tokyo Declaration, "Partnership for self-reliance in Afghanistan: From transition to transformation", July 8, 2012.

⁴ Key Informant Interviews with donors: USAID, DFID, World Bank, ADB, and GIZ.

operating costs, infrastructure availability, business environment, regulatory and licensing capacity, access to capital, and international trade and potential sectors for development among other considerations. This report analyses the impact a SEZ in the area would have on these business concerns.

This report then considers the practicality of creating a SEZ in each of the regions. Some regions may lend themselves to the creation of a SEZ due to their location near borders with key trading partners. Others present challenges in terms of security or relatively poor infrastructure compared with the rest of the country. This report compares the strengths and weaknesses of each region, and selects three areas with potential for development of a SEZ, as agreed with Harakat. The report concludes with recommendations on practical steps to take to set up SEZs such areas, and analysis of the challenges and impacts of doing so.

1.2. RESEARCH METHODOLOGY

In light of the potential benefits of SEZs to increase investment and production, and GIROA's commitment to promoting Private Sector Development (PSD), Harakat-AICFO has commissioned a study to evaluate the feasibility and mechanics of creating SEZs in Afghanistan. Such a study would consider the strengths and weaknesses of locating in one area compared with another; which sectors to support within a SEZ; the potential economic benefits of a SEZ, and a roadmap for implementation.

The project comprised two main stages of research. The first was a desk review of the legislative and regulatory environment for PSD in Afghanistan, and current donor-funded PSD programmes. In the second stage, this report conducted 90 interviews with key stakeholders in the seven regions under study, including:

- a) Government agencies;
- b) Business owners, employers, and commercial investment agencies;
- c) Civil society organisations;
- d) Donors;
- e) Think tanks; and
- f) Sector experts.

This report staggered the research phases so that each stage built upon findings in the previous step. For example, this report first considered the legislative and economic context of PSD in Afghanistan, and current donor and government initiatives. This report used information from the economic analysis to select the seven regions for consideration, and to find appropriate stakeholders for interview in each of these. The research steps are described in the following diagram.

Figure 1.1: Research Methodology



Initial meetings with Harakat-AICFO were useful in developing the research framework. In these meetings this report determined the timeline for each of the stages; the research methodology; and agreed on sample sizes.

Desk Review

Secondary research to uncover Afghanistan's legislative and economic environment for PSD, and current donor and government programmes included analysis of:

1. Programme and strategy documents pertaining to Harakat's PSD initiatives;
2. Publicly available documents on SEZs and Industrial Parks (IPs) in Afghanistan;
3. Studies on market dynamics, urban development, and labour markets;
4. Samuel Hall's past economic assessments, value chain analyses and labour market surveys in Afghanistan; and
5. Policy documents, laws, and regulations covering PSD.

Key Informant Interviews (KIIs)

The research team identified and interviewed relevant stakeholders, as per the list above. Interviews were standardized accordingly to project-specific guidelines. Interviews typically took between 30 minutes and 1 hour.

Quantitative Mapping Survey

A research team comprised of a Project Manager, Research Assistant, 2 Field Supervisors and 12 Interviewers travelled to each of the seven provinces to conduct interviews. Questionnaires were designed to capture quantitative information to map the region on key metrics. Separate questionnaires were used for private sector enterprises and government officials. There was some overlap where questions were relevant for both actors.

Table 1.1 displays the breakdown of interviewees across the seven locations in terms of the type of stakeholders.

Table 1.1: Sample Description

	Large Business Owners	SME Businessmen	Industrial Park Beneficiaries	Government	Total
Kabul	7	92	80	14	193
Herat	5	23	18	9	55
Mazar-e-sharif	2	36	12	10	60
Kandahar	4	37	-	6	47
Jalalabad	7	41	4	5	57
Kunduz	3	36	-	6	45
Gardez	5	34	-	6	45
Total	33	299	114	34	480

Based on data on provincial economic activity collected from the Central Statistical Organization (CSO), Ministry of Commerce and Industry (MoCI), and Afghanistan Investment Support Agency (AISA), this study identified two to four Primary Sampling Units (PSUs) in each region.

Site selection: 7 sites were selected on their merit as the urban commercial centres of Afghanistan 7 administrative zones – Kabul (Central), Herat (West), Mazar-e-sharif (North), Kandahar (South-east), Jalalabad (East), Kunduz (North-east) and Gardez (South-east).⁵ In Kabul, 12 enumerators conducted the survey over three days of fieldwork. Teams comprising of 2 enumerators each was sent to each of the remaining cities the following week.

Identification of private sector respondents: In each location, the respondents divided the city into two survey regions. For cities where there were active industrial parks, one region was the industrial park and the other region was a non-industrial park commercial centre. For cities without industrial parks, it would be two commercial locations. The survey began by identifying a single business in the centre of the region. Subsequently snowball sampling⁶ was used to identify other potential respondents of the survey. This gave enough degree of randomization in the respondents being interviewed for the survey.

For government respondents: the sample identification was a bit more planned. From preliminary review, a list of ministries and departments that are stakeholders to PSD in Afghanistan was drawn up. The enumerators went to the governor’s office in each location with the list and asked for names and contacts of relevant officials within the departments. Subsequently, the enumerators fixed appointments with the officials to carry out interviews in their official locations.

⁵ Gardez and Kandahar were two cities selected in the South-east region because of the large scale and equal potential of both cities to be the upcoming commercial centers of Afghanistan

⁶ A snowball sample is a non-probability sampling technique that is appropriate to use in research when the members of a population are difficult to locate. A snowball sample is one in which the researcher collects data on the few members of the target population he or she can locate, then asks those individuals to provide information needed to locate other members of that population whom they know – “Babbie, E. (2001). *The Practice of Social Research: 9th Edition*. Belmont, CA: Wadsworth Thomson”

Case Studies

This study interviewed managers of industrial parks as stakeholders in a project very similar to SEZs. Such case studies captured perceptions on the following:

- a) The feasibility of such programmes
- b) Policy and regulatory support for PSD programmes
- c) Advantages and disadvantages of SEZs
- d) The potential future for SEZs in Afghanistan

These provide a strong basis for comparison with country case studies on SEZs in India, Bangladesh, and China. This study developed these using publicly available documents, taking into the consideration:

- The policy and regulatory environment;
- The economic and environmental impact of SEZs;
- The structure of SEZs and the services provided;
- The challenges and limitations of SEZs; and
- Best practices and lessons learnt from SEZs.

Validation Workshop at the Ministry of Commerce and Industry in May 2015

Harakat and the Ministry of Commerce and Industry jointly organised the presentation of the findings and recommendations at the Ministry of Commerce and Industry, in Darul Aman road, Kabul. The amicable participation of a vast array of relevant stakeholders and economic actors present in Afghanistan (list provided in annex D) contributed to fine-tune the analyses and recommendations of the report. The presentation took place on May 26th, 2015.

2. BUSINESS ENVIRONMENT & CAPABILITY TO HOST ECONOMIC ZONES

The Afghan government and its international partners have been working to facilitate private sector-led growth in Afghanistan since 2001. The following section answers the questions: how far has this brought Afghanistan and what are the lessons learned from past experiences? Here is presented the current economic position of Afghanistan, describing GDP growth, demand and supply trends, international trade, the state and labour markets. It describes the efforts made towards private sector development by the government and internationally funded programs, and outlines the impact these efforts have had on the economy. This review assessed that the private sector development has had some successes, but there are many lessons to take forward into future interventions in this field.

How the socio-economic review motivates having SEZs in Afghanistan

The economic review overall, by inferring from both national CSO statistics and World Bank forecasts indicate a slow-down in economic activity due to a) political instability; b) drawdown of international presence. In this regard, challenges facing the Afghan economy are towards transitioning the economy from international aid driven demand to domestic demand; large trade deficit and import dependence; and non-inclusive private sector development.

A SEZ program must be designed to address these concerns of the economy. SEZs must focus on reducing import bill by depending on Afghan made input products; SEZs must attract enough private foreign

2.1. SOCIO ECONOMIC REVIEW:

In the last decade Afghanistan's GDP has grown at a remarkable pace averaging 9% of growth over the decade spanning 2003-2013. However, last year, the Gross Domestic Product (GDP) growth rate fell sharply from 11% (2012-13) to 6% (2013-14) on account of slow business activity and reduced private and foreign investment in some sectors. Currently the annual GDP stands at US\$ 8.7 billion more than twice the GDP in 2004. In 2015, the GDP growth rate is likely to reduce owing to the slowdown in business activity due to political uncertainty that was prevalent for the better part of 2014.

The slowdown this year came mostly in construction, manufacturing and services. However, agriculture performed well and grew by 8% on account of favourable weather leading to a good harvest.⁷ The previous year, both services and industry performed well with 16% and 8% annual growth rate, whereas agriculture only grew by 3%. Further development in the future will remain dependent on the performance of the agricultural and services sector. As stated in World Bank's Afghanistan Economic Update, "Growth is projected to remain weak in 2014. A smooth political and security transition would help restore confidence in the economy and enable growth in 2015"⁸.

⁷ It has been argued that donors' massive support to the MAIL has contributed to the growth of the agricultural sector. At this stage, though, there is no robust evidence or evaluation of the impact, for instance, of the NHLP on the development of the agribusiness sector. See Samuel Hall's report on the NHLP

<http://samuelhall.org/REPORTS/Social%20Assessment%20of%20the%20National%20Horticulture%20and%20Livestock%20Project.pdf>.

⁸ World Bank, (2014), "Afghanistan Economic Update - April 2014"

investment to substitute foreign aid driven demand. Finally SEZs must create enough backward linkages into the domestic economy so that benefits trickle down to better socio-economic indicators.

The World Bank estimates that in 2013, trade as a percentage of GDP in Afghanistan increased to the tune of 53% from 45% over the last year⁹. On its own this is not very high as compared to other regions. India - 53%; Pakistan - 32%; Tajikistan - 88%; Turkmenistan (2012) - 118%¹⁰.

The number however merits interest, considering that a large share of GDP is still accounted for by foreign funding. Once that is controlled for, the trade share of *domestic* GDP is isolated, which is considerably higher. In the near future, what will sustain Afghanistan's large trade deficit remains a question.

Table 2.1 provides a breakdown of the contribution to GDP and growth rates of various sectors of the Afghan economy, for the period 2011-2013. The key findings of this table: 1) the agriculture sector is extremely volatile and mainly depends on climatic conditions, as the Afghan agriculture still does not have any real technological safety net to mitigate external factors; 2) in the industry sector, if a strong media political attention has been paid to the mining and quarrying sector, there is still no real impact on the local GDP (from 1.2% to 0.8%).

Table 2.1: Afghanistan's GDP sector share and growth rates. 2011-2013

Sector	2011	2012	2013	2011	2012	2013
	<i>Real Growth (%)</i>			<i>Share of GDP (%)</i>		
Agriculture	4.7	3.2	8.1	27.0	25.4	24.6
Cereals	-22.2	42.8	2.3	8.0	10.6	10.6
Fruits	10.3	8.0	3.2	2.6	2.4	2.1
Livestock	3.0	0.4	-1.7	3.8	3.1	2.9
Others	24.4	-16.2	16.6	12.5	9.3	9.0
Industry	9.8	7.8	4.9	21.6	20.5	19.7
Mining and quarrying	90.0	-1.1	7.0	1.2	0.9	0.8
Manufacturing	3.1	7.3	1.6	13.1	12.0	11.0
Food & beverage	3.1	5.1	1.6	12.6	11.5	10.5
Electricity, gas, and water	-9.4	4.3	0.8	0.1	0.1	0.1
Construction	13.3	8.9	8.0	7.3	7.5	7.8
Services	10.3	16.0	6.3	47.8	50.3	51.8
Wholesale & retail trade	10.8	25.0	0.5	8.0	8.8	8.5
Transport & storage	9.0	28.1	7.4	15.2	18.2	20.0
Communications	11.8	9.0	17.0	4.3	4.1	4.4
Finance & Banking	-44.4	3.8	5.5	1.1	1.0	1.0
	<i>Real Growth Rate (%)</i>			<i>Total (Constant, Billion \$)</i>		
GDP at Market Prices	9	11	6	7.3	8.1	8.7

Source: Central Statistical Organization, Afghanistan (data only available until 2013 at the time of the survey)

The labour market in Afghanistan is characterized by large-scale unemployment (between 8.2% officially and... 30%-40%, according to more realistic estimates)¹¹ and underemployment (16.8% to 40%-50%)¹². Over the last decade the lowest unemployment rate recorded was in 2004 at 8.2%.

⁹ Central Statistical Organization, Statistical Yearbook 2012-13, GIROA

¹⁰ World Bank Indicators

¹¹ Samuel Hall, (2012), "Time to move to sustainable jobs", for the ILO.

¹² NRVA, 2011-12. NRVA unemployment and underemployment figures have often been questioned, as unrealistic. However, it is the only official source, validated by the World Bank and the EU. However, according to most key

Returning refugees to Afghanistan has swollen the labour force supply adding pressure on the local economy. A further report by Samuel Hall for the ILO found that the market has mostly unskilled labour, and still operates mainly through informal networks¹³. While it is claimed that the labour is also cheap, the lack of any salary comparison studies in the region that include Afghanistan make it difficult to assess whether labour costs are competitive enough to attract employers from abroad. Future prospects for the labour market will depend upon the investment it can attract in the economy.

Challenges for Afghanistan economy

Afghanistan’s economic progress fluctuates on account of differing performances of various sectors. This is likely to continue in the next 5-10 years where it will be hard to predict the forecasts for growth and the economy. SEZs can attract investment if they can provide prospects for a more stable business outlook. The following sub-section highlights the main concerns for the Afghan economy.

Economic development driven by international demand from development aid

In a free market economy with no sector prioritization, industries and services have responded to demand from skewed sources, which has resulted in a very superficial industrial and services basis, based on temporary foreign demand. Construction, transport & storage and communications combined account for more than 50% of the total industrial & services base, but are driven mainly by demand from foreign aid and military expenditures. Most of these sources of demand have wrapped up their operations in Afghanistan, and the consequences of their withdrawal have progressively impacted the economy since 2012-13¹⁴. The domestic manufacturing sector is weak, and unable to fulfil demand for goods. This has led to high levels of imports, which has in turn supported a growing trading service sector. The future prospects for domestic demand driving growth remain bleak in the face of international withdrawal.

Figure 2.1 provides details on the share of sectors to industry and services in Afghanistan for the year 2013-2014. For instance, construction contributed to 51% of the total industrial GDP of Afghanistan in 2013-14 and transport and storage contributed 40% of services GDP in the same year.

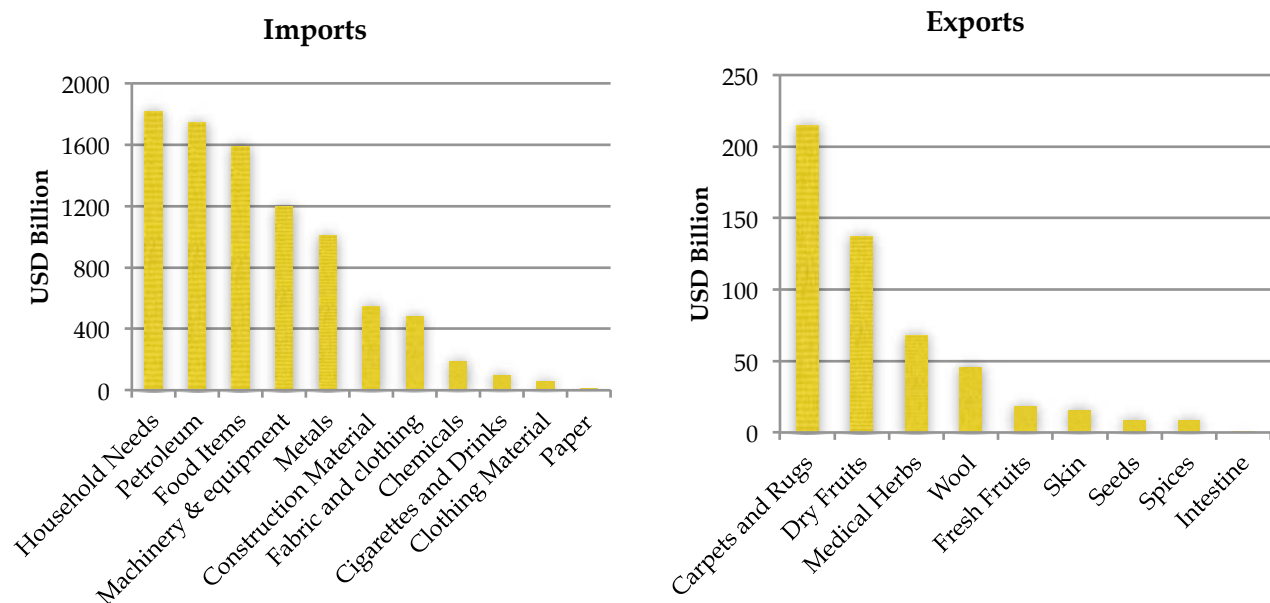
Figure 2.1: Share of sectors in National GDP 2013-14. Source: CSO



Trade deficit shows the gap and opportunity in demand and supply

The opportunity for industrial diversification is visible by comparing the items being imported and exported to and from Afghanistan. Afghanistan exports raw unprocessed items, and imports processed consumption items (see list of items in Figure 2.2). This implies that Afghanistan’s manufacturing capabilities are unable to match demand for processed products. SEZs may be able to alleviate such an issues, by providing an environment for processing industry to thrive, and making Afghan-produced products compete with those which are currently imported. This is of course, one aspect of many others that will be considered in the sections to follow.

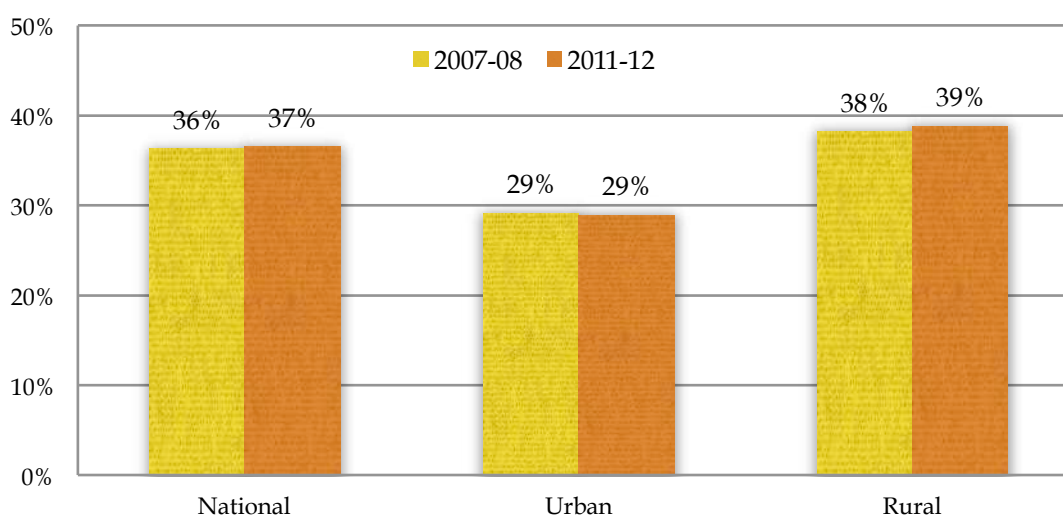
Figure 2.2: List and quantities of top items imported and exported in Afghanistan in 2013. Source: CSO



Socio-economic indicators suggest non-inclusive economic growth

The latest round of the National Risk and Vulnerability Assessment (NRVA, 2011-12) estimated the nationwide poverty rate to be 36%. Furthermore, the survey recorded an increase in the inequality from 29.7 to 31.6 (Gini Coefficient) from the last survey. A look at the poverty headcount figures for urban, (28.9%) and rural, (37.7%) areas also merits a deeper analysis. The important question is whether the private sector’s development is translating to improvements in socio-economic indicators. The failure to reduce the gap between the poverty rates in urban and rural areas over the last five years indicates that the Afghan economic development may not have been as inclusive as wished. Further this merits the question of whether the private sector has created links with SMEs in rural and semi-rural areas, which is an important consideration for allowing private industries to work freely in Afghanistan, i.e. they contribute towards socio-economic benefits to the Afghan populace.

Figure 2.3: Poverty rates in Afghanistan, 2007-08 & 2011-12. Source: NRVA



Lessons of the private sector development reforms efforts for a SEZ policy in Afghanistan

Considerable focus of international development programs and domestic policy intent towards PSD has brought to light challenges in effort to this effect. A weakening investment climate, structural inadequacies in infrastructure and uncertain contextual environment are some of these challenges. Now even the international aid support is reducing.

Past policy initiatives indicate what has worked well and what has not. Firstly, business environment in the remaining economy is a considerable limitation on PSD efforts. Secondly, setting up a regulatory policy ex-ante to the policy itself has worked well in the past, e.g. AISA.

What this shows for the SEZ policy is that a) setting up the SEZ policy must go hand in hand with reforms in the rest of the economy, b) SEZs must be employed under a strong and able institutional structure, c) SEZs must build a strong structural base and d) SEZs must be isolated from contextual issues of the Afghan economy that are not likely to cease in the near future.

2.2. REFORMS TO IMPROVE THE PRIVATE SECTOR IN AFGHANISTAN

Beginning 2010 especially after the Kabul Bank Crisis, most international advice and assistance has been aimed at maintaining macro-economic stability, such as stable interest rates, exchange rates, inflation levels and levels of government debt. This has had an indirect impact on PSD¹⁵ as it created an attractive macro environment for business. In addition, agencies such as DFID, GIZ, USAID and World Bank have established funds and projects to directly support PSD. The projects mostly cover infrastructure projects in power and transport; SME business support; regulatory and licensing reform; and customs reform. The overall target of direct PSD programs has been the promotion and support of SMEs, which dominate the Afghan economy yet operate mainly in the informal market. PSD projects are now in jeopardy, however, as development fund commitments reduce with the approach of the deadline for international withdrawal.

¹⁵ Dowdy, J, & Ermann, A., (2010), "Private Sector Development in Afghanistan: The Doubly Missing Middle", Mckinsey & Company.

The following section reviews some of the past attempts made by stakeholders at private sector reforms in Afghanistan and describes some challenges of the strategy going ahead.

Reviewing past policies

There are lessons to be drawn from past attempts at the development of private sector, all of which bear considerations when devising a strategy for economic zones in Afghanistan. The government supported by foreign donors has implemented all of these policies. Firstly, it is important to note that this report is unable to draw clear conclusions from some of the on going interventions, since their full impact is yet to be determined. Secondly, not all lessons learned from these policies come from failures; some lessons are also successful strategies that can be carried forward.

Table 2.2: Key policy initiatives and reforms for PSD in Afghanistan. Sources: See reference section

Policy/Reform	Automated Systems for Customs Data (ASYCUDA)	Privatization of State Owned Enterprises (SOE)	Industrial Parks	Afghanistan Investment Support Agency: One-Stop-Shop
<i>Year</i>	2001	2006	2004	2003
<i>Reform/Policy Description</i>	Improving and expanding customs facilities and practices to minimize leakage in revenue collection through rationalization of laws, procedures and automated processes.	The divestiture/sale of 65 Afghan State Owner Enterprise (SOE) in a bid to get rid of dysfunctional enterprises and promote private sector development by reducing competition from government subsidized production units.	The government, in partnership with foreign donors, created geographically demarcated zones that offered on-site critical infrastructure like power, storage, paved roads, industrial shells and simple land allocation procedures for businesses to operate.	The Afghanistan Investment Support Agency (AISA) was set up as an autonomous government regulatory body to cover all licensing requirements under one roof. The objective was to cut down the time and number of procedures it takes to start a business in Afghanistan.
<i>Critical Comments</i>	While, the customs reforms brought a marked improvement to be able to raise the revenue 50 million USD to 399 million USD in in just 4 years, it suffered conflicting mandates between ministries administering customs (MoCI, MoF, MoI), which undermined speed and effectiveness of the reform process.	The privatization of SOEs came before any major business environment reform. As such privatizing SOEs was questioned as the enterprises still did not generate activity and most were liquidated.	Industrial Parks are functioning below full capacity, with some land plots still empty. Moreover, many companies have taken land but are not operating. This is not the fault of the Park facilities, but the lack of business prospect in the general economy and corruption	The agency was set up in the absence of a regulatory environment but still worked well and was considered a success. Eventually, AISA created its own regulatory environment. Although more recently, AISA efficiency has been said to be reducing with corruption charges looming over the agency.
<i>Lessons Learned</i>	The institutional framework and capacity (or its lack thereof) between all parties that are stakeholders creates incentives for good/bad management and corruption.	Ad hoc policy incentives are not a substitute to wider economic reforms to generate PSD. Economic incentives must be provided in the context of a supportive business environment. The economic incentives are only as good as the environment they are looking to promote.	An independent management authority for each industrial park created by a committee of its own beneficiary functions well places the interest of beneficiaries above all else and avoids corruption and bureaucracy that comes from government maintenance. Private development and maintenance of zones is more efficient.	In fragile environments, it was a practice that showed that setting up a regulatory authority could precede the creation of a regulatory framework. Recently, however, the agency is showing strained relationship with the government and is itself accused of corruption

In summary past research recognises the importance of local ownership in Afghanistan. Since government is still fragmented, the success of a project depends not only on the central government's intent but also more on the participation of the provincial administrators, i.e. provincial governors. The National Solidarity Program (NSP) which is a country wide program (not PSD but rural development including aspects in small scale rural enterprise development), has been known to successful where the program sort to strengthen local governance rather than challenge it¹⁶. Hence, the industrial park program was successful in being adopted in various provinces because provincial offices had economic development high on the agenda and it came with a huge monetary investment from international aid agencies.

Challenges in PSD

Reduced international sources for PSD funds

It is difficult to estimate the share of PSD investment that has come from different sources, which include foreign business, development aid, diaspora investment and domestic investment. The international community has pledged to assist the economic self-sustenance process with USD 16 billion up to 2015, with further support until 2017¹⁷. Development assistance will reduce over the next 5 years, and create a vacuum of investment. It is unrealistic to expect the private sector to be able to fill this vacuum in the next couple of years. Moreover, as discussed in the Tokyo conference, further pledges for aid are unlikely to be forthcoming, as donors are getting frustrated with the level of corruption and the failure of aid to meet targets.

In the London conference on Afghanistan, held on December 4th, 2014, the Afghan government committed to 'specific reforms to improve the conditions for responsible private sector development'. In this regard, international partners 'acknowledged' the government's commitment towards making business in Afghanistan easier and pledged commitment to aid effectiveness and support as outlined in the Tokyo Mutual Agreement Framework (TMAF): sixteen billion US dollar investment in the country through 2015 and sustained support through 2017 at or near the level of the past decade.¹⁸

Business environment not enough to charm foreign investors

Afghanistan's business environment is gradually making progress towards making economic activity by private investors easier. Reforms in licensing policy coupled with a relatively stable macro-economic environment has made starting a business in Afghanistan easier.

¹⁶ Nagl, J.A., Exum, A.M. & Humanyun, A.A., (2009), "A pathway to Success in Afghanistan: The National Solidarity Program", Policy briefs, Center for New American Security.

¹⁷ Tokyo Declaration, *idem*.

¹⁸ The London Conference on Afghanistan, December 4th, 2014, "Afghanistan and International Community: Commitment to Reforms and Renewed Partnerships"

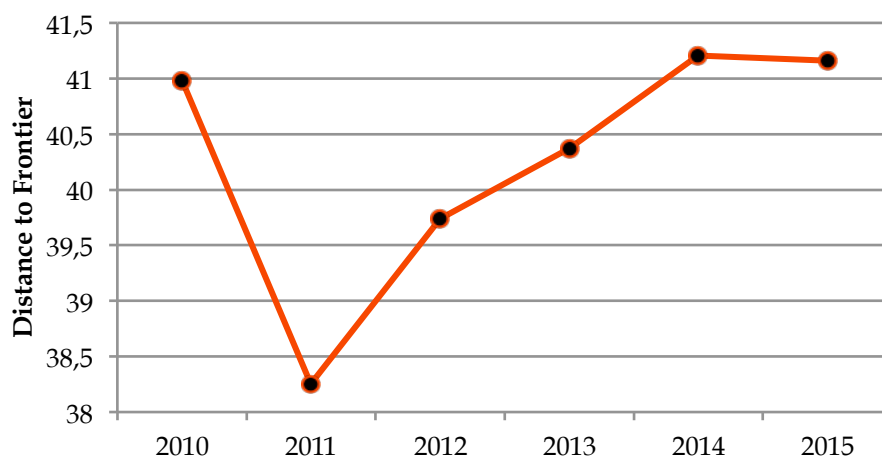
Yet, there are 'structural' and 'contextual' issues that contribute to corrosion of the business atmosphere.

- Structural issues include the lack of credit, power infrastructure, private sector regulatory laws which are still inadequate.
- Contextual issues include conflict, insecurity, and unpredictable political prospects make for a difficult environment to do business¹⁹.

Everything taken together Afghanistan ranked 183 out of a 189 countries in the *ease of doing business* ranking for 2015. This is down one spot from 182 in 2014, making it one of the worst environments to do business in the world. This begs the question whether costs incurred to develop economic zones will justify themselves in the future?

The chart below displays how far Afghanistan's business environment scores, compared with the top-performing country in the world. The distance-to-frontier (DTF) measure gives a percentage of the score of for a country's business environment, compared with the score of the best-performing country. Since this number is under 50 for each year, Afghanistan has less than half the score of the best-performing country in all years. Further, there has been very little improvement over the last 5 years. In relative terms, Afghanistan has slipped down one rank in global positions.

Figure 2.4: Distance to Frontier (DTF)²⁰, 2010-2015. Source: World Bank



¹⁹ World Bank, (2014), *Doing Business 2015: Going Beyond Efficiency*. Washington, DC: World Bank Group.

²⁰ The distance to frontier score shows how far on average an economy is at a point in time from the best performance achieved by any economy on each *Doing Business* indicator since 2005 or the third year in which data for the indicator were collected. The measure is normalized to range between 0 and 100, with 100 representing the frontier

Weakening Investment climate

In the recent study on investment climate conducted by Samuel Hall for Harakat-AICFO²¹, 73% of the total private sector respondents of the survey considered that the investment climate had gotten worse in the last 12 months, a finding that was corroborated by this study. This pessimism stemmed not only from the short term situation arising from the political stalemate in the presidential elections, but on long term considerations such as security, reduction in foreign aid, corruption and poor services and infrastructure. In this regard, the government considers it easier to start a business in the country, than does the business community. Despite all of this, the same survey said that there was overall optimism in the private sector's outlook for investment over the next 5 years, which seems more out of hope for a better future than on the basis of any historical progress. At least, the spirit of entrepreneurship is high, which may signal to investors that Afghanistan is ready to grow.

Table 2.3: Perceived Change in Investment Climate in Kabul vs. Other cities²², last one year

	Kabul	Other Cities
<i>Worse</i>	70%	83%
<i>Same</i>	12%	7%
<i>Improved</i>	18%	10%
Total	100%	100%

Source: Samuel Hall (2014), Perception Study for Harakat

Cross cutting issues that are likely to challenge setting up SEZs

This section indicates that SEZs will have to overcome challenges of unskilled labour market and Regional Trade Agreement restrictions of Afghanistan to be able to implement a successful SEZ strategy. These challenges may not be necessarily internalised into the SEZ framework but constraints to be overcome by the overall strategy.

Underemployment in Afghanistan. Results from ILO labour market assessment

2.3. CROSS CUTTING ISSUES

The section below describes some of the remaining cross cutting issues that will be important consideration in formulating a SEZ policy for Afghanistan.

Labour market prospects

The effect of FDI into Afghanistan on employment levels is unclear. The demand for labour that private investment will create will depend on the kind of investment that is made. On the onset, labour intensive production where many assembly line activities are divisible and done by hand are the best fit for the kind of workmanship Afghanistan can offer. However, this comes hand in hand with demand for skilled labour as well, such as to manage human

²¹ Samuel Hall (2014), "Harakat-AICFO Stakeholder Perception Study", for Harakat-AICFO (forthcoming)

²² Herat, Jalalabad, Mazar-e-sharif and Kandahar

A study on the labour market identified serious issues between private sector demand for labour and the supply provided by NGO-led vocational training and employment programs. Many of the jobs created by these programs are short-term casual jobs, and do not provide skills for long-term employment. The lack of communication between the education sector and the private sector has created a situation where labour training programs are focused more on the number of trained workers, rather than the type of training received, and whether this is appropriate for the needs of the local businesses.

Joint EZ programs: a by-pass to RTA constraints?

Certain RTAs prohibit countries from implementing regulations that may cause disruptions in trade balances. This is mostly true of Bilateral Trade Agreements. Some of the constraints of RTAs can be bypassed by finding regional partners with the aligned or complimentary interests. For instance, the development of the Suzhou Industrial Park in close to Shanghai is a joint venture between the governments of Singapore and China. The park was launched in 1994. By 2008, the industrial park had received foreign and domestic investment of USD 53 billion.

The reason for the success of the zone was the aligned interest of the two governments. The Chinese government at the time was in the process of creating a global, industrial and market economy from a socialist economy. At the same time, Singapore, which had already seen a remarkable 30-year growth sprout, was entering a new phase

resources and finances. The main question is whether Afghanistan's labour market can offer the same cost advantages as were behind the success of many of South Asian Economic Zones. Overtime, the education institutions will also be expected to keep at pace to the evolving labour market demand as production moves from labour intensive to capital intensive production. For the time being, that is a certainly a limitation to the future prospects of business in Afghanistan.

The next section describes in a framework, some past policies that have been implemented for PSD and lessons learned from them.

Regional Trade Agreements (RTAs)

SEZs and RTAs can be highly complimentary to each other. In theory, SEZs promote competitive production, and RTAs help to promote trade and find markets for goods. However, the experience of developing countries in trying to integrate economic zones with RTAs has not been positive. Mostly, countries are concerned that SEZs promote uncompetitive policies on the international stage and for developing countries that creates unfavourable trade balances²³. SEZs, in which industries are given economic incentives as protection, can hurt the competitiveness of similar industries based in other countries in the region. In which case, countries often retaliate by making their own regulatory adjustments, which are not in favour of the trade balance of the original country.

Officials at the Ministry of Finance (MoF) are cautious when it comes to the discussion of regional trade. As one of the officials responded during interview:

"We have to be careful with regional trade agreements. The issue is that if Afghanistan increases or decreases tariff rates, then neighbouring countries also respond by increasing and decreasing if it is not in their interest. Since Afghanistan is still weak in economy, the balance is usually not in our favour".

²³ Koyama, N, "SEZs in the context of regional integration: Creating synergies for trade and investment", in Special Economic Zones, edited by Thomas Farole & Gokhan Akinci

where it was searching for more markets for its growing industrial base. By building a SEZ within China stocked by companies from Singapore, China was able to invite international standard production practices and investment. At the same time, Singaporean firms got introduced to whole new market in China.

The Suzhou industrial park provided not just an economic alignment but also a political alignment towards sustainable economic development of the two countries.

In addition, Afghanistan's permeable customs administration does not elicit confidence in regional trade partners, as Economic Zones can be instruments of tariff jumping. Tariff jumping is when by merely a physical presence on the zone, firms take advantage of free trade regimes to import goods but then goods may be transferred or "leaked" into the customs territory free of charge. Hence, existing firms could merely register themselves while still operating out of domestic customs territory and avoid tax payments. As yet the ASYCUDA has been less than effective in plugging holes on the existing ports of Afghanistan²⁴.

Afghanistan is a member of the Central Asian Regional Economic Council (CAREC), the South Asian Association for Regional Cooperation (SAARC), and the Economic Cooperation Organization (ECO). Further, Afghanistan has more than 30 agreements with other countries in the form of Memorandum of Understanding (MOUs) on trade, commerce, regional cooperation, transit, and transport²⁵. A zone program is likely to have implications for some of these. Afghanistan is strategically located on trade routes between South Asia, Central Asia and the Middle East. There is a future in Afghanistan's regional trade agreements, which is even inscribed in the ANDS. An EZ programme is likely to have implications in negotiations as Afghanistan looks to become more integrated in international trade.

Practical Obstacles in PSD in Afghanistan

Besides the issues discussed above, 90 interviews with stakeholders working in PSD raised a number of practical limitations in PSD efforts. The implementation of a SEZ policy is likely to encounter the same. Note that some of these can be addressed by a SEZ policy. Others are more underlying problems that the general economy will have to address in time.

In the short time period, absence of priority investment areas, gaps in existing laws and their practice, absence of quality control in incoming products, excessive dumping by neighbouring country firms and absence of market assessment data need to be addressed.

In the medium term, Afghanistan will have to correct misallocations in industrial land, mistrust between agencies working in PSD, absence of a national trade policy, underdeveloped supply chains and lack of power and water infrastructure.

²⁴ Parto, S., et.al, (2012), "Afghanistan and Regional Trade: More or Less imports from Central Asia", University of Central Asia Policy Brief.

²⁵ See www.moci.gov.af for more information on Afghanistan's regional trade agreements

In the longer term, security, corruption, absence of comprehensive economic policy, lack of adequate markets and absence of a financial industry are roadblocks to PSD.

Not all is bleak however. Interviews also showed that the Afghan economy has some features that indeed create an environment where SEZs can be considered. Afghan economy shows a **demand for investment**, which might justify implementing a zone policy. There is a need for investment-boosting incentives in the economy following the worsening investment climate; there is entrepreneurial spirit, despite the hurdles; and there seems to be a distinct first-mover advantage. Secondly, Afghanistan has a **high potential for labour abundant and import substituting production**. It offers abundant and cheap labour supply (key to success of other South Asian Zones) and its input export and intermediate and finished goods import imbalance offers the market space for industries to enter and generate profits. Finally, Afghanistan’s **successful licensing regime** through an autonomous investment one-stop-shop has proved fruitful and made investing in Afghanistan easier.

Table 2.4: Practical issues identified in qualitative interviews with practitioners and stakeholders in PSD

	Short Term	Medium Term	Long Term
Institutional	<i>Misallocation of industrial land</i>	<i>Mistrust between agencies</i>	<i>Security Corruption</i>
Regulatory	<i>Gap between laws and practice Absence of quality control</i>	<i>Absence of national trade policy</i>	<i>Comprehensive economic policy</i>
Physical	<i>Absence of market assessment data Excessive dumping and trafficking Absence of priority in investment</i>	<i>Underdeveloped supply chains Lack of power and water</i>	<i>Lack of adequate markets Absence of financial market</i>

2.4. KEY INDICATORS TO CONSIDER FOR A SEZ POLICY

The review of the Afghan economy illustrates some key indicators that the SEZ policy will need to track in order for the policy to be successful

- **Foreign Direct Investment (FDI):** Whether zone regulations and investment are attractive or not will be immediately visible in the amount of the FDI they can attract. One will know whether regulations and policy for the zones are working if they are able to attract investment from abroad and retain it over a long-term period. Thus, SEZs must look to increase and retain investment in the country.
- **GDP and GDP per capita:** SEZs must aim to generate value for the economy. Substantial value will only be created if the SEZs are involved in production of 'down-the-line' supply chain activities and production of finished goods rather than intermediate or raw goods. A study of the effect of SEZs on Chinese economies estimates that zones can increase the level of GDP by as much as 11% to 15%²⁶. If the Afghan zone program can achieve even half of that, they may successfully be justified as a legitimate cost.
- **Import and Exports:** It is important for SEZs to target these indicators so that it may reduce its trade deficit. Ideally, SEZs in Afghanistan would like to reduce the gap between imports and export value in Afghanistan to better its trade imbalance. This has to be done by reducing the import dependence of SEZs by making sure that they depend on domestic production for their input supply.
- **New businesses registered:** An indicator of the magnitude of backward linkage created by zones is the number of new businesses that come up in the vicinity of the zones. An increase in the establishment of new SMEs in the zones periphery, supplying services and goods to zone firms is an indicator of the zone passing its benefits on to the rest of the economy. A successful zoning program in Afghanistan will create a spurt in the number of new businesses registered.
- **Employment multiplier and unemployment rate:** Benefits from SEZs must flow throughout the economy and not just within a zone itself. Successful SEZ have had employment multiplier effects; where besides creating a fixed number of direct jobs in the zone, they led to indirect employment creation in the rest of the economy. Besides, SEZs have also proved successful in creating employment for women. A successful SEZ policy for Afghanistan would mean targeting a high multiplier effect; an effect, which would be seen in a reducing unemployment rate.

²⁶ Alder, S., Shao, L. & Zilibotti, F., (2012), "China's Special Economic Zones: The effect of Economic Reform and Industrial Policy in a Panel of Chinese Cities", Available on <http://ssrn.com/abstract=2369416>

3. ZONING LEGISLATION AND POLICY

The rationale for SEZs is the requirement for a catalytic intervention to drive the economy out of a slump²⁷. This could be seen to be the case in Afghanistan. The Afghan economy faces a reduced GDP growth rate, high levels of unemployment, political instability, and the loss of a key source of demand with the withdrawal international community. In the short term, SEZs can be a means to support wider economic reforms in Afghanistan to improve business climate, generate employment and attract foreign investment²⁸. In the long term, economic zones act as petri dishes for wider economy wide reforms and laboratories to test the effects of new reforms before they are scaled for the entire economy²⁹.

Here the interviews with policy makers and experts in Afghan think tanks, fed into objectives that a potential SEZ firm needs to follow. Specifically, the following objectives were highlighted in discussions with experts about possible objectives that a SEZ policy will look to accomplish

Development of economic zones in the Neighbourhood

Zones in the Middle East and North Africa are free trade zones aimed at enabling trade with the host countries. The impact of these zones remains limited due to their failure to actively develop manufacturing units in these zones, as the zones remained trade oriented (barring some exceptions). The Jebel Ali Free Zone in Dubai developed as a major transport and logistics hub. This is now being scaled up to include specialized zones to host IT and media related services.

In Central Asia, countries coming out of their break-up from the Soviet Union, re-used existing infrastructure (such as old soviet air bases), avoiding the need for huge capital investments. However,

Short term (3-5 years):

- Encourage regional investors to enter market, i.e. Pakistan, Iran and Central Asia
- To change the deficit in terms of trade
- Import substitution
- Re attract domestic and diaspora investment into Afghanistan

Long term (10 years or more):

- Value chain indigenisation
- Promote market economy
- Build local production capacity, improve quality and competitiveness
- Promote labour productivity and skill
- Promote inclusive growth

The development of Industrial Parks (IPs) makes a good basis to start with demarcated and concentrated zone encampments ³⁰ because advantages from the economies of agglomeration

²⁷ FIAS, (2008), "Special Economic Zones: Performance, Lessons Learned and Implications for Zone Development", Washington, DC: World Bank Group

²⁸ Idem

²⁹ See Annex for types of economic zones

³⁰ AISA, (2013), "Industrial Parks in Afghanistan: Growth Challenges and Recommendations", Kabul, Afghanistan

regional trade agreements in preparation for accession to the European Union forced some countries to abandon their zone programs. Such as it is, zone programs are often limited by regional trade agreements.

*Finally, the **Asia and Pacific** have the most to offer Afghanistan in terms of zone experience. Thailand, Malaysia and Taiwan are seen as models of zones that transformed from low to high value added production by diversifying export base. While most zones in the region tried to do that, only these few were successful. The trend in the region has also shifted towards the development of private zones from traditional government-led ones. A number of Asian countries are also embarking on specialized zones in services and manufacturing, based on their comparative advantage in these sectors e.g. India, Thailand, and Malaysia.*

EPZ benefits and the backward linkage phenomenon: The case of Bangladesh and Dominican Republic

Bangladesh's EPZ programme created 90% of the jobs in the garment sector outside the EPZs, because the favourable export climate within the zones helped promote cheap garment exports. This was partly because Bangladesh EPZs restricted forward linkages to protect non-EPZ industries from unfair competition.

To derive socio economic advantages from EPZs, the backward linkages were promoted through exemption in duty and import drawbacks, such that domestic suppliers to EPZ firms

will apply³¹. As mentioned by one of the private sector experts, duplication must be avoided by “carving out a SEZ out of pre-existing capacity”. The challenge will be in linking the zones to the rest of the economy so that benefits may trickle out.

At this stage, it will be prudent to warn that benefits and impacts of zones are vehemently debated. The most succinct answer to the impacts is that positive impact of zones on the economy are linked to a number of factors. Failing that, zones can become isolated regions of commercial activity with nothing to do with the local economy. In some cases, they may even cause negative effects to the countries develop state³². This will be doubly important in Afghanistan as, here, there is a “very strong tendency for new reforms to regress”³³.

Under the objectives identified, the following sections illustrate how zones in Afghanistan may be developed, administered and regulated to ensure success.

3.1. ZONE DEVELOPMENT AND OWNERSHIP

SEZs may be owned and developed by the government, the private sector, or a combination of both, through PPPs. Industrial parks in Afghanistan have tended to take the form of the latter option where GIROA developed the off-site infrastructure as well as factory shells and other amenities and provided the land on a long-term lease basis. Private enterprises financed all internal infrastructures and handle the day-to-day management of the parks through a consortium of industrial park beneficiaries³⁴.

While this development strategy has been utilized to construct industrial zones in various regions of the country, the question of choosing a strategy to

³¹ Agglomeration economies are the benefits that come from firms and people locate near to one another in cities and industrial clusters. (2010), “Agglomeration Economics”, edited by Edward L. Glaeser, The University of Chicago Press

³² See Annex for impact assessment of Economic Zones

³³ A senior lecturer at Kabul University, Department of Economics

³⁴ KII with a member of the management committee of Kabul Industrial Park

were on a level playing field with their international counterparts. However, bureaucratic procedures and understaffed Duty Exemption and Drawback Office (DEDO) created difficulty in receiving these exemptions. Moreover, leaking customs points at the EPZs created more problems for suppliers looking to service EPZ firms.

While Bangladesh offered comparative advantage in labour costs (started out at US\$30 per month, 2.5 times lower than the next cheapest destination at the time), its business environment was a hindrance – ranked 119 out of 183 countries in the index for 2010. EPZ programs helped offset the bad business environment and helped Bangladesh take advantage of its comparative advantage. All in all, Bangladesh's EPZs may be considered a success but could have done better.

Similarly, failure to create backward linkages led to failure of EPZ programs in the Dominican Republic where the country failed to develop capital and intermediate goods manufacture sector outside the EPZs; local producers failed to meet international standards for supply; local manufacturers showed little or no interest to supply to firms in EPZs.

develop SEZs might be useful for planned extensions of these industrial zones. Overall the literature does not comprehensively state that one development strategy is better than other, on account of lack of comprehensive impact assessment. The preliminary inclination, however, is that private zones are generally less costly and more successful in developing countries³⁵.

Private zone development has brought an additional advantage where zones compete not just on prices of subsidized infrastructure provision (rentals for industry shells and infrastructure costs) but also on the range of services they provide. Zones in Afghanistan will be competing with other zones³⁶ in the region for foreign investment. Traditionally zones competed on provision of cheap infrastructure and easy regulations. Private development of zones has allowed zone developers to offset low industrial estate rental margins with developing commercial and residential facilities with higher margins; increase specialization of facilities to target industries and provide greater business support. For instance, industrial parks in Afghanistan are disadvantaged in the sense that they are uniformly developed for general industrial use and nothing else. They do not have the advantage of specialized services that other economic zones in the region can provide.

Table 3.1: Methods for Zone Development

Type	Features
Private Zone Development	<ul style="list-style-type: none"> • Industrial land is leased or sold for development to private developers • Private sector has the responsibility and discretion to construct on-site infrastructure and services • Zone operation may be carried out on the basis of <ul style="list-style-type: none"> ○ Cost Recovery (CR), where revenue receipts for building and operating the zones cover all costs including the capital costs ○ Build Operate Transfer (BOT), where private sector builds and infrastructure project, operates it and eventually transfers the ownership to the government ○ Build Own Operate (BOO), where private sector builds, owns and

³⁵ FIAS, *idem*

³⁶ Specifically, other zones include EPZs in Iran, Bangladesh, Pakistan and India that offer more or less same regional advantages of production.,

	<p><i>operates an infrastructure or some facilities with some degree of support from the government</i></p> <ul style="list-style-type: none"> • Limited regulatory authority to the government to ensure minimum standards • Remaining regulations and options remain with the private developer to decide who will operate within the zone • Off-site infrastructure development remains with the government. In some cases, the private developer may be allowed to construct access roads
Public Zone Development	<ul style="list-style-type: none"> • Zones are owned and developed by the government through public funds • All on-site and off-site infrastructure is developed by government authority • Lands within zones are leased to enterprises, and usually cannot be owned • Infrastructure and land is provided to private enterprises at a subsidized rate • Entire regulations and decision as to who to allow to use the zone is with the government controlling agency
Public-Private Partnership (PPP) <i>International Standards</i>	<ul style="list-style-type: none"> • Government is responsible for financing off-site infrastructure and providing land on the basis of a long-term lease • Private sector is responsible for developing all on-site infrastructure and management of the zone • Private sector provides utilities, and administrative and management services to enterprises in the EZ • Zone regulation remains with the government

Source: FIAS, 2008

Table 3.2: FIAS impact assessment of SEZs: Critics and Proponents

Topic	Critics	Proponents
Foreign Exchange Earnings	Zones host import-dependent activities with low value added	Countries can increase value-added through "equal footing" policies.
Industrial Activity	Zones perpetuate low-skill assembly operations	Many zones have promoted industrial and skill upgrading
Policy Reform	Zones help avoid country wide reforms	Zones are catalysts to broader reforms
FDI	Zones attract the "wrong FDI in low-tech, low-skill and footloose activities	Zones are an effective tool to attract FDI and most industries are not footloose.
Women	Zones segregate women and pay them lower	Zones are an important source of employment for women and higher wages
Labour Rights	Zones suppress basic labour rights	Most zones comply with ILO standards
Working Conditions	Zones permit companies to get away with poor work place health and safety conditions	Better run zones offer much better working standards and conditions than elsewhere
Environment	Zones have lax environmental regulation controls and attract polluting	Well-run zones have better environmental controls and practices

Source: FIAS 2008

Why industrial parks are Afghanistan's best bet for economic zones

Afghanistan's industrial parks offer the best opportunity for EZs as they can be easily scaled up to incorporate zoning. The type of EZ found in contemporary free ports such as Hong Kong, Macau or Dubai is not feasible in Afghanistan because these benefit from access through international ports and high quality infrastructure, neither of which is available in Afghanistan in either the short- or even medium-term.

Industrial parks offer foreign donor funded developed spaces for industrial use that mitigate the capital expenditure required. Given that the capital required to develop land will also have to be shipped into Afghanistan, this already saves a massive cost to prospective investors. Finally, industrial parks precisely offer the commercial infrastructure support that is otherwise missing in the remaining economy. Duplicating efforts to develop that again elsewhere does not make economic sense for a resource strapped country.

AISA, Developer and Regulator, Sub-optimal?

Qualitative interviews suggest that power brokers might have acquired land by political connections at the leasing agency by circumventing the competitive procedure. This sheds light on unregulated regulation bodies and the lack of incentive against corruption. So far this is only mitigated effectively by allowing private sector to develop the zones on their own on a cost recovery or profit basis and leaving only the regulatory role to the regulatory body and not the role of developer. In buying the land sites and

3.2. ZONE ADMINISTRATION AND MANAGEMENT

The industrial parks in Afghanistan are controlled and regulated by the Industrial Park Development Department (IPDD) of AISA, an independent investment promotion authority. Some other parks created under the auspices of the MoCI are in process of transferring management and regulation to AISA. While the Economic High Council has approved this move, there is still some institutional resistance between MoCI and AISA, which has caused significant delay in shifting the industrial parks authority¹. The IPDD is responsible for, *“the development as well as management of new and modern industrial parks. The Department is currently responsible for managing three USAID-funded industrial parks in Kabul, Mazar and Kandahar and overseeing the contraction of two more parks in Jalalabad and Kabul. IPDD is in the process of developing a regulatory and institutional framework and management plan to effectively coordinate the Industrial Parks development”*¹.

In zone development a variety of bodies have evolved to develop, administer, plan and promote economic zones on one hand and regulate them on the other. These include arms of investment promotion agency (such as it is in Afghanistan), autonomous government authorities, specialized ministry departments and zone management boards. International experience has shown that conflict of interest arises in institutional setting when zone regulators are also zone developers. A new practice is to become user responsive where regulating agencies are becoming more corporate by allowing private sector participation at the board level.

3.3. ZONING POLICIES AND INCENTIVES

Besides the provision of physical capital such as superior infrastructure and services, economic zones rely on incentives in terms of monetary and regulatory respites to attract investment by making zones either cheaper or easier (or both) to work in. In the case of Afghanistan what is important to note is that the intended regulatory and fiscal policy economy wide towards private sector development is already quite low (liberal) in requirement. The question is whether incentives offered to producers will be enough by themselves to make zones look more attractive than the rest of the economy.

developing them on their own, it reduces government role in development of the parks and more efficient allocation of industrial space within the zone, as the private developer will offer the zones based on profit motive. In Afghanistan's case, this will require huge resources in restructuring the institutional framework for the industrial parks.

Monetary Incentives

SEZ use a range of monetary incentives. Soft incentives for zones¹ are based on a more liberal licensing regime than what is available in the rest of the economy. These may include lower corporate tax rates, licensing requirements, minimum export requirements, and increased duty-free provisions. Such incentives make SEZ attractive locations to invest in. Further, some countries have also offered subsidized services, infrastructure, and exports.

Table 3.3: Implied costs from creation of a SEZ

	Topic	Under Industrial Park Regime	Under Economic Zone Regime
1	Salaries of government workers in zone authority	AISA is self funded	Incremental cost will be incurred as it will require activity and capacity of the department to be scaled up to manage not just physical but policy aspect of the zones as well
2	Operating expenses of zone authority	Day-to-day management costs are incurred by industrial park beneficiaries	There will be correlated rise to the increment described above as government's management role increase For day-to-day management, no government costs need be incurred
3	Infrastructure development outlays	Funded by foreign donors. No cost to government	Same strategy is currently being carried forward. The cost is in terms of opportunity cost of the development that could be exploited if the remaining development plans were handed over the private sector
4	Import duties and charges lost from duty free goods	No Cost	Incremental costs are difficult to estimate with the lack of data on import and export
5	Taxes forgone from firms relocating from domestic to zone premises	No Cost	Incremental costs are difficult to estimate ex-ante with lack of legitimate data on taxation

Source: FIAS & Author Adaptation

Afghanistan is already an attractive place to invest, in terms of monetary incentives. However, the cost in theory and cost in practice is quite different. The options of offering monetary incentives are available but without enforceability, they are likely to be rendered ineffective. Subsidies also do not seem a big option for Afghanistan since the WTO prohibits subsidies that are harmful to international trade. This includes most subsidies that are contingent on export performances and use of domestic goods³⁷, not to mention that the Afghan government may lack the funds to do so. The only option that Afghanistan has of making economic zones competitive is to reduce actual business cost by enforceability.

Table 3.4: FIAS-prescribed basic policy framework for a SEZ

Policy	Features
Concept of extra-territoriality	<ul style="list-style-type: none"> • Outside domestic customs territory • Eligible for national certificates of origin • Eligible to participate in national trade agreements
Eligibility for benefits	<ul style="list-style-type: none"> • No minimum export requirement • Manufacturers and Services • Foreign and Local firms • Expansion of existing enterprises • Private developers of zones
Foreign and local ownership	<ul style="list-style-type: none"> • No limitations • Equal treatment
Private Zone Development	<ul style="list-style-type: none"> • Clearly defined in legislation • Eligible for full benefits
Sales to domestic market	<ul style="list-style-type: none"> • Liberalized • Provided on a blanket rather than case-by-case basis • Treated as import into domestic market
Purchase from Domestic market	<ul style="list-style-type: none"> • Treated as exports • Exporters eligible for indirect benefits
Labour Policies	<ul style="list-style-type: none"> • Full consistency with ILO labour standards • Specialized dispute settlement mechanism

³⁷ Subsidies and Countervailing Measures (SCM),
http://www.wto.org/english/tratop_e/scm_e/scm_e.htm

The cost of doing business in Afghanistan

In the fiscal regime for private businesses, Afghanistan was ranked 79th of 183 countries. In the economy in general, Afghanistan's average tax rate is calculated 35.8% paid in 20 payments made through a fiscal year. In comparison, the average rate for South Asia is 39.7% in 31 payments made throughout the year. Main corporate taxes include the corporate income tax – 20% of net taxable income of corporates; Business Receipt tax – 2% - 5% of gross business receipts and withheld tax on rental services and personal income¹. Afghanistan's tariff regime for the general economy is also one of the lowest in the region. Most goods fall between the bands of 2.5% - 5% with an average across all goods of 5.6%. Compared to this South Asian countries average tariff rate is 13.5% and low-income countries is 12.7%.¹

The actual cost of import and export however is a different story. The average cost of export and import in US\$ per container is estimated at 5,045 and 5,680 respectively, 60% more than what is charged in other South Asian countries. The time estimated to import and export goods is also estimated to be twice that of South Asia. Overall, the difficulty and expense of importing and exporting goods in and out of Afghanistan ranks it at 184 out of 185 ranked countries. The WB Enterprise Surveys 2014 corroborates that inefficient regulations constrain firm efficiency as they present opportunities for public officials for soliciting bribes and substantially increase the cost of doing business.

Regulatory Incentives

Afghanistan offers one of the most liberal policy incentives for its general economy. In starting a business, Afghanistan is ranked 24 out of a possible 189 countries taking into consideration the time, procedure and cost³⁸. Moreover, official Afghan policy dictates No differentiation between foreign and domestic firms:

- Free repatriation of capital and profits out of the country
- No minimum export requirement
- No limitations on foreign and domestic ownership

The biggest issue Afghanistan deals with at the moment is in settling disputes and protecting investors. Firstly, many laws that would enable business environment are still under development in Afghanistan (the state is still in process of rebuilding regulatory framework). Secondly, the judicial system to redress business grievance is still very slow and corrupt. It can often take up to a year to settle even the smallest business disputes. Even the costs and number of procedures are higher. In other countries where this problem has existed, economic zones have solved this by creating a separate judicial framework and space to solve contract issues (see table 3.3).

Other practices that have proved useful in creating conducive regulatory environment that Afghanistan can incorporate are:

1. Streamlining customs procedures with automated systems to fast track physical transfer
2. Facilitate provision of secondary permits with zone authority rather than individual ministries
3. Default clause authorizing automatic approval if the application has exceeded a fixed time date

³⁸ World Bank, (2014), "Doing Business 2015: Going Beyond Efficiency". Washington, DC: World Bank Group.

3.4. FINAL COMMENTS FOR PRESCRIPTIONS ON ECONOMIC ZONES:

The above section attempts to shed light on the prescriptions in policies that have proven successful in the past for other countries to have special economic zones and how Afghanistan can step towards the same framework. In this regard the prescriptions for Afghanistan are as follows:

1. International practice suggests that **private developed zones are cheaper** and closer to investment demand than government developed zones.
2. Management and regulation of zones can be done through various ways but works best when there is **private sector stake in the agency that regulate/manage**.
3. Incentives are useful only if they are able to **make the zone more attractive in relation to the rest of the economy** and they are able to **make the zones cost competitive internationally**.

Finally, the three functionalities stated above are interdependent, i.e. zone development, management & administration and incentive framework must be in harmony for the zone to succeed. Under legal, regulatory and institutional requirements for SEZs, it will take substantial commitment and political will from the government to implement the structure necessary. The existence of industrial parks has discounted some of the monetary and physical resources that are required for Special economic zones.

The good news is that Afghanistan can in reality have a substantial working zone with at least 20 medium and large-scale firms begin working under deregulated regime in one of its industrial park locations. The bad news is its track record in implementing economic reforms; and there are substantial reforms needed (as described in the previous section) in this matter. The time it takes to build a working SEZ from ground-up quite depends on the technology and the capacity of the host government. In Afghanistan's case, this capacity can be adjudged to be quite weak. Still, it has the base of industrial parks to build upon. With a stable government committed to PSD, Afghanistan can realistically look to frame a policy, pass legislation and build minimum infrastructure within the next 2-3 years.

4. REGIONAL BUSINESS PROFILES

Each location has different features and economic profiles, courtesy their locations, industrial development and comparative advantage, political and institutional development (which also differs a lot between province to province in Afghanistan). The next section describes results from a primary survey conducted in what are considered the 7 main commercial centres of Afghanistan to determine the potential for a city to host a successful zone program. In relation to the geographic importance of economic zone, a private sector development expert stated that:

“There have been minor discussions that economic zones on border regions can be used to improve bilateral relations with countries. While no real research has been done on it yet, the idea is that Afghanistan has the capacity to become a big market of Central Asia and we want to improve infrastructure, railways and want to have some common zones and free zones to improve exchange of commodities with the region”

The capability to host successful SEZs depends on many factors, including the existing industrial base, location, infrastructure development, business sentiment, local labour market and others. Currently, there are uneven levels of economic development between regions because of the uneven exposure they have had to the foreign aid that has poured into Afghanistan. As the capital, Kabul is host to most of the international agencies currently working in Afghanistan and so has experienced significantly higher levels of industrial development than the rest of the country. Herat, Mazar-e-sharif and Jalalabad have traditionally been centres of trade, because of their locations close to Afghanistan’s borders. This has somewhat protected economic activity in these locations from the effects of the on going conflict. Kandahar, Gardez and Kunduz remain the most underdeveloped urban areas due to the relatively high levels of insecurity in these locations.

The success of a SEZ depends on the preparedness of the area for its activities. The contribution of a SEZ to increased local employment will depend on labour market conditions. Its contribution to the local economy will depend on linkage to local markets. How much FDI a SEZ will attract depends on the favourability of its business environment, including regulations, availability of credit, national standards of production, and taxation system. Which industries should be promoted within zones depends on the regional comparative advantage and existing economic profiles.

In the following section, this report describes the socio-economic profiles of the provinces that are host to Afghanistan’s existing commercial centres. This report uses information from a primary survey of private sector and government stakeholders in these commercial centres³⁹. Each profile considers the suitability of the province in terms of location and other factors to host a SEZ.

³⁹ See annex for individual sample profiles from each city.

KABUL Socio-economic Profile

Located in a valley, Kabul city is one of the highest capitals in the world situated at an elevation of ca. 1,800 m. surrounded by the Lowgar and Paghman mountains in the south-east, Qrough mountain in the south-west, Shirdarwaza in the north east, Charikar in the north and the Tangi Gharow mountains in the west.

Population

It has a population of 4.2 million. 54% of the population is currently between the ages of 15-60 with another 1.7 million to enter the labour force in the next 15 years



Education

Male literacy rate is 68.1% and female literacy rate is 34.7%. Consists of more than 9 universities including the prestigious Kabul University, Polytechnic institutes and an accounting school with most modern departments of study



Infrastructure

3 main highways (asphalted) connect Kabul to the rest of the country. In addition, Kabul has the biggest international airport in the country and as security becomes better more airlines are likely to enter airspace



Workforce Stats



Labour Force Participation Employment-to-population
Underemployment Unemployment

Employment



Day Labourer (10%) Salaried worker (48%)
Own account worker (28%) Employer (1%)
Unpaid family worker (14%)

Labour



Agriculture & livestock (17%)
Manufacturing, construction, mining and quarrying (17%)
Services (50%) Public administration (16%)

Source of Income

Credit Services

Microfinance Bank (FMFB), Kabul Bank, Finca, BRAC, CARE, DACCAR, Women for Women, Madeira, CFA, and CHF. Kabul is currently the financial capital of the country and is likely to develop into the main centres of financial services provision



Industrial Park

The Baghrami industrial park is located 7km north of Kabul with a total site area 24 hectare. 11 Hectares is developed and fully operational and the remaining 24 hectares is under planned under phase II. Infrastructure availability includes electric power, clean land titles, site security, water and sewage system, paved roads and professional management. The site is wall perimeter with access control. Potential industries include light manufacturing, plastic fabricators, textiles, pharmaceuticals, food products and beverages



Key Potential Industries

SME industries in agro-processing are a source for tackling food-security problems of the country. Trade, financial services, government, business travel and tourism summarize some of the potential industries. Heavy industries also present a potential but are limited by the lack of access to water. Key industrial crops are Alfalfa and clover

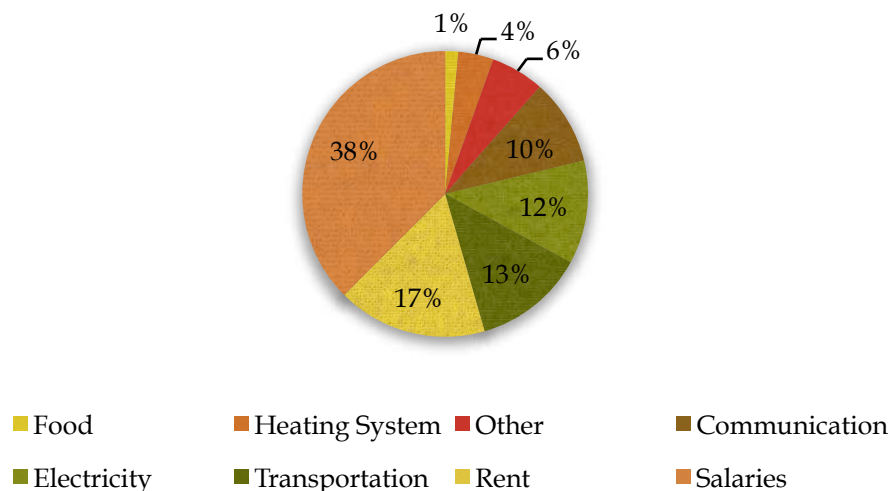
4.1. KABUL

In the following section this report uses information from desk research and 174 interviews to build a picture of the economic context for the development of a SEZ in Kabul. This report focuses on seven key areas of interest. This report then assesses the challenges and opportunities presented by the creation of a SEZ in Kabul, based on findings from our research.

Business operating costs

Employee salaries form the major part (38%) of the operating costs for businesses in Kabul. This is followed by rent, transportation, and electricity, which together account for 42% of costs. Communications costs are significant, comprising 10% of costs for the average business in Kabul.

Figure 4.1: Kabul - Share of costs of production



Electricity costs are higher for companies located in the Industrial Parks outside of Kabul, although this may be simply because these companies use more electricity than their counterparts in the city. For businesses outside the Industrial Parks, the monthly electricity bill could be between 6 to 10 thousand Afs.

The average number of employees in a small company was 12; 34 for a medium-sized company; 502 for a large company. Unskilled workers account for a larger share of workers in larger companies, than in their smaller counterparts. There were 166 women employed for every 1,000 employed men, and these were mostly in management positions.

46% of all workers in the sample were illiterate. 95% of respondents claimed it was easier to find unskilled labour than skilled labour. Compared with other cities surveyed for this report, Kabul appears to have a higher number of employment opportunities because of the presence of more businesses.

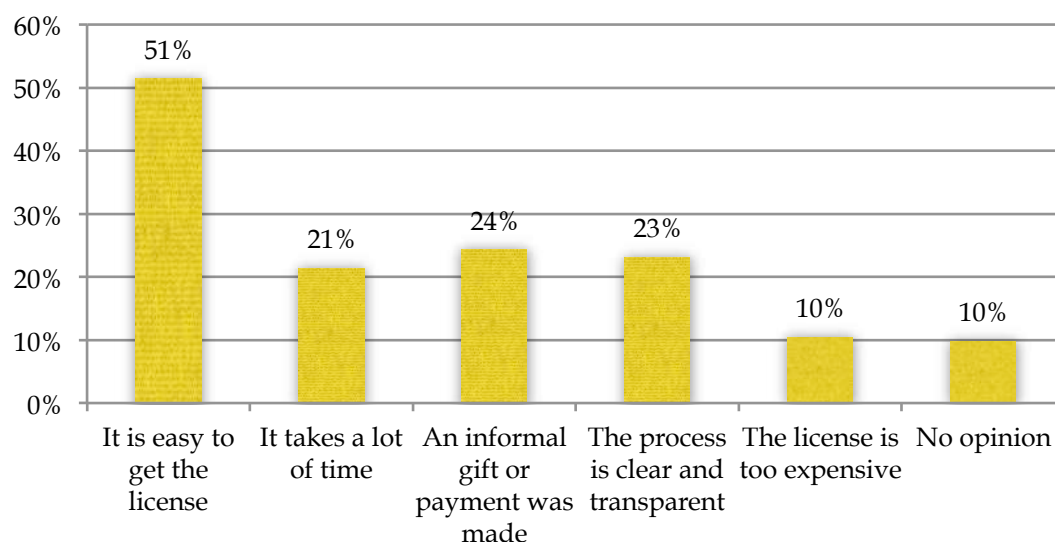
Regulations & national standards

Afghanistan generally enjoys relatively low official regulations for business, but the regulatory system can be complicated. Three separate agencies are responsible for registering businesses in Kabul. The responsible agency depends on the size of the business, and whether it engages in international trade. Registering agencies promise to issue a license in under a week⁴⁰.

62% respondents reported to be registered with AISA; 49% reported to be registered with MoCI; 43% said they were registered with MoF⁴¹. 42% of respondents reported it was easy to register with the authorities. The reported median time to receive a business license was one month. 37% respondents said that they spent less than one day a month dealing with government officials. The regulatory environment in Kabul was not listed as a concern for businesses.

Awareness and implementation of national or international standards in production was very low in Kabul. 60% of respondents said they were not aware of the existence of any national standards. Other companies said they adhered to national production standards, but many could not provide proper names of the standards. On the other hand, 96% of respondents reported to pay taxes. 51% said the taxation system was easy to understand, but it was not widely considered to be efficient, transparent or otherwise business-friendly.

Figure 4.2: Kabul - Opinions on business registration process (Multiple responses possible)



⁴⁰ "Any domestic and foreign firm willing to legally operate in Afghanistan and requires a business license. This license would be issued by Afghanistan Investment Support agency (AISA) and is renewed by the agency on annual basis. Sectorial based companies require an agreement from their relevant ministries such as Health or Transportation sector require an additional agreement from the respective ministries besides the AISA license before starting their operations in the country" – Guidelines for License Issuance, Renewal Charges and Closing, AISA.

⁴¹ As mentioned above, there are licenses required from line ministries like health and mining but MoCI and MoF licenses for tax and trade can be gotten from AISA itself

A SEZ's property as experimental grounds would particularly be relevant in testing new standards as the ANSA builds technical standards. In relation, new standards and accreditations can be tested in SEZ fields before hand.

Access to credit

The banking sector in Kabul is the most developed in the whole of Afghanistan. Despite this, access to credit remains limited. Banks and lending associations do not provide the full range of financial products to encourage investment in businesses. Banks loans are typically expensive and short-term. Most credit comes from informal networks through friends and families.

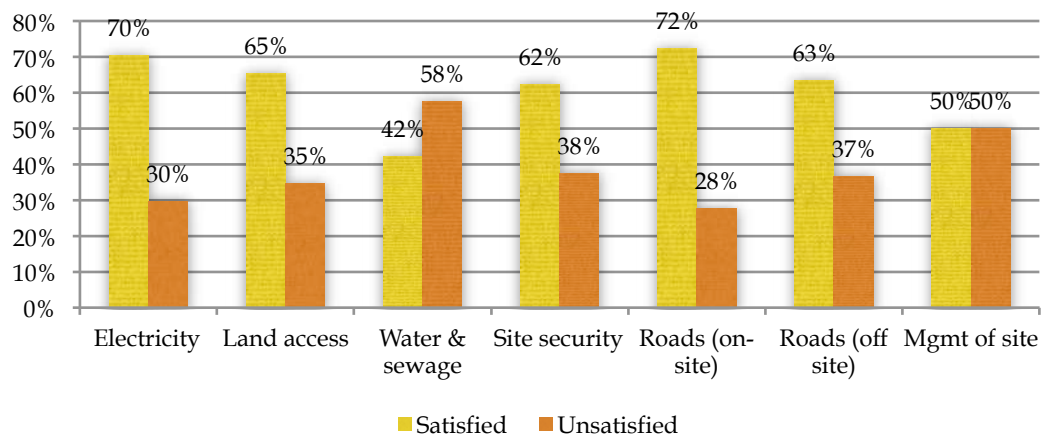
This study found that businesses in Kabul did not have much history with taking credit. Just 25% of the sample had taken credit for investment into their business. Of these, only 18% had taken credit in the form of a bank loan in the last year. 57% of those who had taken credit received it from friends and family and remaining borrowed from shopkeepers.

Infrastructure & Business Environment

Kabul has a publicly provided electricity network, but this is typically only available for an average of 8-12 hours a day. Businesses rely on expensive generators to supplement their electricity provision. The city does not have a reliable network of piped water. Companies must rely on pumping ground water with hand pumps, or similar methods.

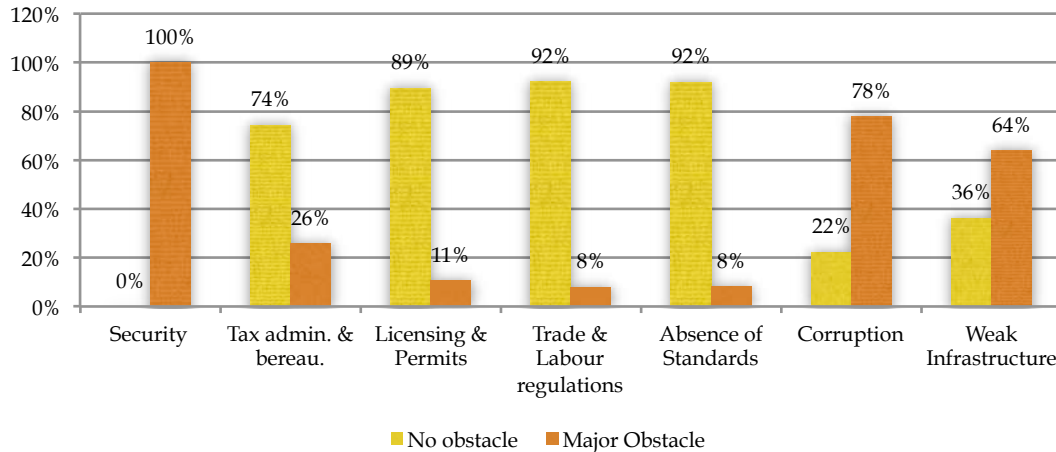
Roads inside and around the commercial location in Kabul are paved and developed. Externally, Kabul is connected by the national ring road with Mazar-e-sharif and in the southeast with Kandahar. Additionally it is connected with Jalalabad and the Torkham international border with the 2-lane Kabul-Jalalabad highway and also with Sherkhan border in Kunduz and Hairatan border in Balkh.

Figure 4.3: Kabul - Satisfaction with the level of infrastructure



Kabul has an international airport with daily flights to Islamabad, Dubai, Istanbul and Delhi. Additional connections are Dushanbe, Ankara and Jeddah. The freight capacity at Kabul airport is currently unknown.

Figure 4.4: Kabul - Obstacles in business



Results from the perception study indicate low satisfaction with the provision of infrastructure in Kabul. 13% of respondents stated that there was no publicly-provided power in their part of town. 59% of business stated that utilities were overpriced in Kabul. Respondents stated access to land, water and sewage, site security and management of locations as their top concerns.

33% respondents said that although their business expanded in the last year, profits did not improve. 24% said that infusion of credit had no impact on their business whatsoever.

In terms of the general business climate, 42% of businesses reported that the investment climate had deteriorated in the last 12 months. 63% reported that the economic reforms in the last decade helped them only to a moderate extent. 53% of respondents reported that it was difficult to start a business.

SEZs can be insulated from external domestic market environment by having a suitable institutional structure. For instance, having an independent regulatory authority that does not depend on the central government’s political influence can mitigate political uncertainty, which was evident in the economy over the last year. Similarly, SEZs firms may be given temporary incentives in times of economic slump to prevent them slowing their production.

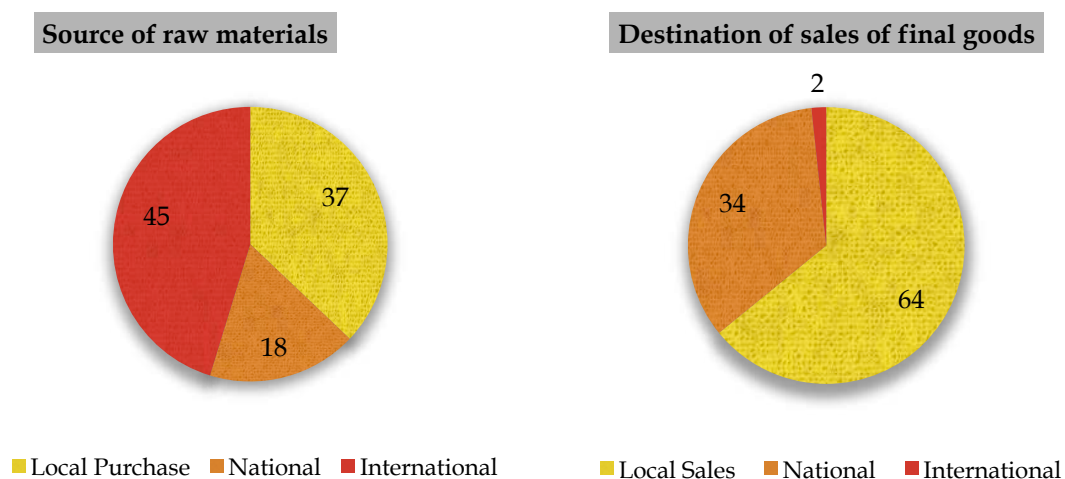
Trade

Potential for international trade from Kabul is strong. The city is well-connected to Pakistan through the border port at Torkham, via Jalalabad. The busy international airport connects Kabul to markets across the rest of the world. Kabul imports many

items as inputs for production, and so has close connections with trading partners. Kabul is situated on the trading route between its regional neighbours, and many products are transferred through the city on their way to final markets. Moreover, since much of the international community in Afghanistan has been resident in Kabul, there is great scope for personal and commercial connections between the international community and local business: results from this research indicates that 86% of sales in Kabul are made to individual retail customers; 65% to groups and companies; 19% to government procurement; and 27% to international and national NGOs. Other clients included the UN and Provincial Reconstruction Teams.

Figure 4.5 clearly shows that while domestic production uses mainly imported raw materials and goods, goods for sale are rarely exported to international markets (2%). Only 13% of responses stated that the materials they needed for production could be adequately sourced in Afghanistan. Imported input materials came mainly from Pakistan, Iran and China. 30% of respondents calculated their import duty to be at least 10%; 67% said that the import duty was too high. Competition from foreign firms did not seem to be as high as that between domestic firms.

Figure 4.5: Kabul - Sources; Sale and purchase of final goods



SEZs such as Export Promotion Zones are exclusively created to build the domestic capacity to increase export. Successful SEZs have also assisted in improving the trade balance of countries and increasing foreign exchange earnings⁴².

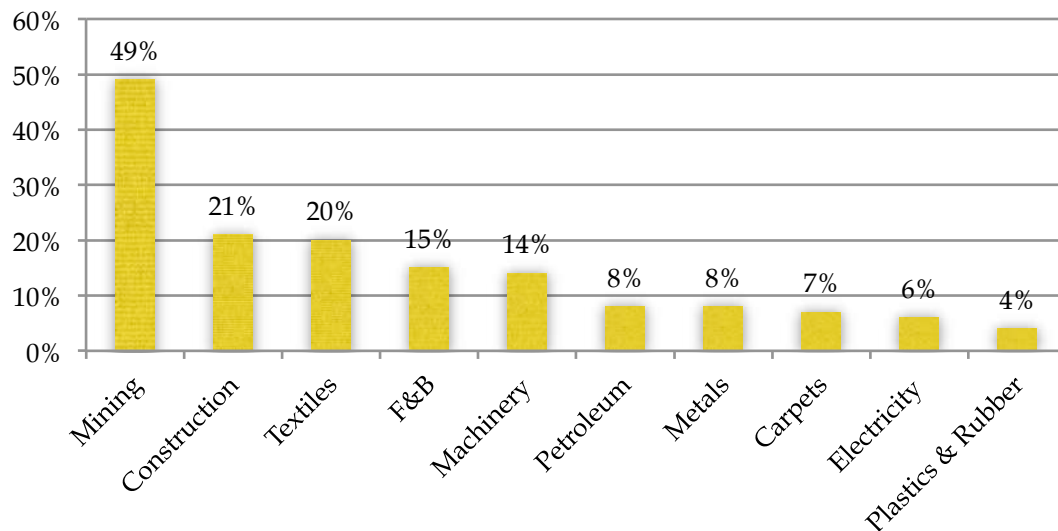
Potential sectors for promotion

Respondents from Kabul favoured the mining industry as likely to have the most potential to generate value, employment and growth (49%). Its favourability far outstretched the preference for any other. Kabul is in close proximity to places with

⁴² "Special Economic Zones" op. cit., p25.

copper and iron deposits⁴³. 130 kms west of Kabul is the Hajigok Iron Ore, one of the biggest in Afghanistan. Aynak copper is a copper mining field located 35 kms South East of Kabul and is likely to bring 400-600 million dollars of revenue annually⁴⁴.

Figure 4.6: Kabul - Sectors nominated as most promising to generate employment, value and growth of income (Multiple Response)



Construction and textiles were the second most favoured industries amongst the respondents in Kabul. Only within Kabul province there are 13 marble reserves identified. While Afghanistan has grown its marble production by 60%, production from Kabul has only grown by 13% in last 5 years⁴⁵. Moreover Kabul, which comes under Afghanistan’s central zone, has estimated US\$ 1.8 billion in business fixed investment⁴⁶. Very little information is available about textile potential besides that Kabul used to be a big producer of cotton textiles out of government mills⁴⁷.

Finally, food & beverages (F&B) and Machinery under light manufacturing were identified as potential industrial opportunities in Kabul.

Critical Assessment on locating a SEZ in the Kabul area

Economic activity in Kabul is weak. The investment climate has deteriorated in the last 12 months due to political uncertainty and insecurity. The unemployment rate is 10%⁴⁸. The local economy needs a boost, which could be provided by the introduction of a SEZ. The decision as to where to locate a business in Kabul is mostly based on the availability of domestic trading opportunities, and ease of operating in that location in terms of regulatory requirements. 16% of business stated

⁴³ World Bank, (2011), “Sustainable Development of Natural Resource Project (SDNP) - II”, www.mom.gov.af

⁴⁴ AISA, (2009), “Main Investment Opportunities in Afghanistan”, p 35, www.aisa.org.af

⁴⁵ AISA, (2012a), “A comprehensive study of Marble Industry in Afghanistan”, www.aisa.org.af

⁴⁶ AISA, (2012b), “Estimating Business Fixed Investment in Afghanistan”, www.aisa.org.af

⁴⁷ AISA, (2013a), “Investment Opportunities in Textile and Clothing Industry of Afghanistan” p vi

⁴⁸ NRVA 2007/8, Provincial profiles

they would prefer to move out of Kabul, as they were unsatisfied with their current location for business. The main constraints to growth were reported to be weak demand, insecurity, corruption, bureaucratic requirements and poor infrastructure.

Private sector respondents, however, seemed unsure as to whether FDI was the answer to the economic problems in the city. Some respondents were genuinely concerned that competition from foreign investment would drive local businesses to bankruptcy. One government official, however, stated “*FDI investment is important to revive economic as domestic investment is not enough*”.

There are other advantages for selecting Kabul as the location for a SEZ. Kabul benefits from comparatively developed infrastructure, including access roads within Kabul as well as those approaching from other provinces. Kabul has a relatively high availability of workers, with comparatively higher skill levels than those found in other parts of the country. Kabul already has two operational Industrial Parks, with an extension planned for one in the near future⁴⁹. Kabul is close to the central government, which opens networks to international markets for companies based in the city. Kabul offers a reasonably well-developed SME base, which, could create linkages with companies in the SEZ, and translate into socio-economic improvements in the surrounding areas.

Creating a SEZ in Kabul, however, could also present significant challenges. The most likely channel to create an EZ would be through existing IPs. The agencies responsible for managing IPs are headquartered in Kabul. There are tensions between these agencies, especially in relation to the current transfer of *Pul-e-charkhi*, Kabul’s biggest IP from the authority of MoCI to that of AISA. Business in Kabul IPs are more vulnerable to negative affects from these inter-agency disputes, than those in IPs in other parts of the country.

The ongoing insurgency creates an atmosphere of mistrust, and the government often checks up on businesses to confirm that activities are legitimate. As the capital city, Kabul faces the biggest threat from the insurgency, and checks on businesses are very common. This can constrain economic activity in general, and would limit the effectiveness of an EZ in the city. One respondent in the Kabul FGD stated:

“On a monthly basis, some people come from National Security Directorate, Health Directorate, Fire Department and so many other unknown departments into our companies and make interruption in our tasks by criticizing on everything. They seek photos from the staff and put us under pressure when any staff has had committed any crimes outside the company. We would be safe against any of the bothering if we are provided with a concise term of conduct, so we hang the paper on the wall and perform the tasks accordingly. Currently, everyone come into our companies from different departments; they seek money for different reasons; some of them want tax and some of the others want money for hygiene.”

⁴⁹ Pul-e-charkhi and Baghrami Industrial Parks

Kabul has a well-developed SME sector, which could take advantage an EZ in the **short-term**. Business development and supporting services can connect businesses in an EZ with existing SMEs for increased economic benefits. In the **long term**, there may be opportunity to grow one or two heavy industries, to support expected growth in mining activity in the Kabul area.

Table 4.1: Preliminary feasibility and SWOT analysis of EZ project in Kabul area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	Well-connected by Kabul international airport; Well-developed (and improved) road networks to the rest of the country; Relative proximity to the Pakistan border at Torkham.
	Access to input supply (Backward Linkages)	Access to local input market is limited due to the non-developed supply chains and rudimentary, non-commercial agricultural services; Inputs are mainly sourced from Pakistan; Products are exported to Pakistan.
	Access to markets (Forward Linkages)	Most headquarters (national and international private sector) and governmental agencies are based in Kabul; A lot of potential to tap into (commercial and trade exports through regional flights to Dubai and Pakistan).
Infrastructure		Industrial parks are the best bet for accessing high quality infrastructure for production in Kabul; Off site infrastructure in electricity, water supply, land access and management of commercial site is unsatisfactory;
Labour		Largest supply of cheap and semi-skilled and unskilled labour; presence of largest number of educational institutions to train future labour force contributions;
Business environment	Enablers	Trade and labour regulation; Licensing and permits; agreements with neighbouring transit countries (mainly Pakistan)
	Disablers	Tax system and bureaucracy; security; Absence of standards; lack of credit

Strengths	Weaknesses	Opportunities	Threats
<ul style="list-style-type: none"> Existing (2) and future (1) Industrial Parks Direct access to national markets Large labour supply Well developed communication Access to countries through international ports 	<ul style="list-style-type: none"> Corruption at custom locations Corruption in government procedures Lack of credit disbursement Absence of standards Benefits to women unlikely Weak offsite infrastructure 	<ul style="list-style-type: none"> Opportunity in light manufacturing sector Opportunity in business development services Added phase to industrial park development Development of the already existing IPs and transformation into SEZs? 	<ul style="list-style-type: none"> Region under threat of on-going conflict Labour cost competitiveness threatened by regional rates Dumping ground for industries in Pakistan Competition from industries across the border

HERAT Socio-economic Profile

Herat province is located in the western part of the country, and borders with Iran (Islam Qala Crossing) and Turkmenistan (Torghundi Crossing). It has internal borders with Badghis province in the North, Ghor in the East and Farah in the South

Population

Total provincial population estimated to be 1.8 million; 48% of the population is between the ages of 15-60 with another 0.9 million to enter the labour force in the next 15 years.



Education

There are 7 universities in Herat of varying quality. Out of these only Herat university is the state owned university that exists. Courses on economics, engineering, psychology, medical, law and political science can be found



Infrastructure

There is one hydraulic power station operating in the province. 90% of the province is covered with roads, with 56% all weather roads connecting to major ports of trade. Communication services are provided by Roshan, Areeba, AWCC, Etesalat and Afghan telecom. Herat also has a small international airport

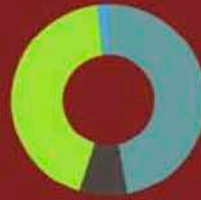


Workforce Stats



Labour Force Participation (47%)
Employment-to-population (21%)
Underemployment (10%)
Unemployment (22%)

Employment



Day Labourer (47%)
Salaried worker (8%)
Own account worker (43%)
Unpaid family worker (2%)

Labour



Agriculture & livestock (38%)
Trade and Services (21%)
Manufacturing (4%)
Other (39%)

Source of Income

Credit Services

Implementing partners of MISFA present are BRAC and FMFB providing microfinance loans. Additionally, few branches of commercial banks such as Kabul Bank may be found in the city



Industrial Park

Herat industrial park is located opposite the Herat International Airport. 3 phases with 760ha active for industrial use and a planned IV phase extending the park by 300ha. Potential industries include textiles and mining, with light manufacturing, agro-production and stone cutting



Key Potential Industries

The major industrial crops grown are cotton, tobacco and Sesame. The SME industry is well developed particularly in handicrafts, rugs and carpets and Silk. Mining, Saffron, Agro and food processing and import and export are major opportunities that can be developed

4.2. HERAT

In the following section this report uses information from desk research and 49 interviews to build a picture of the economic context for the development of a SEZ in Herat. This report focuses on seven key areas of interest. This report then assesses the challenges and opportunities presented by the creation of a SEZ in Herat, based on findings from our research.

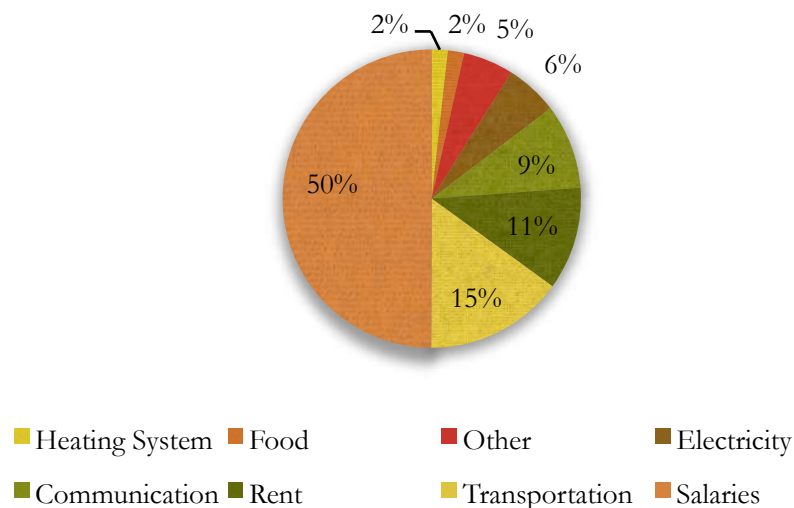
Business operating costs

Businesses in Herat enjoy access to a large pool of unskilled workers from the neighbouring districts and provinces.

Our primary research indicated that small companies employ an average of 9 workers; this is 42 for medium-sized companies, and 266 for large companies. Small companies employ a higher share of skilled workers (60%) than their medium (23%) and large-scale (30%) counterparts. More than half of the labour force in Herat is female, with 563 women employed for 1000 men. This is a higher female-male ratio than in any other city in Afghanistan. The workforce has the lowest illiteracy rate in Afghanistan, at 28%. 72% of respondents said it was easy to find skilled labour. 95% of respondents report that unskilled labour is easily available.

Employment costs form the largest share of operating costs for businesses in Herat (50%). This is followed by transportation (15%), rent (11%) and communications costs (9%). Electricity costs in Herat account for only 6% of business operating costs, which is the lowest share in the country.

Figure 4.7: Herat - Share of costs of production

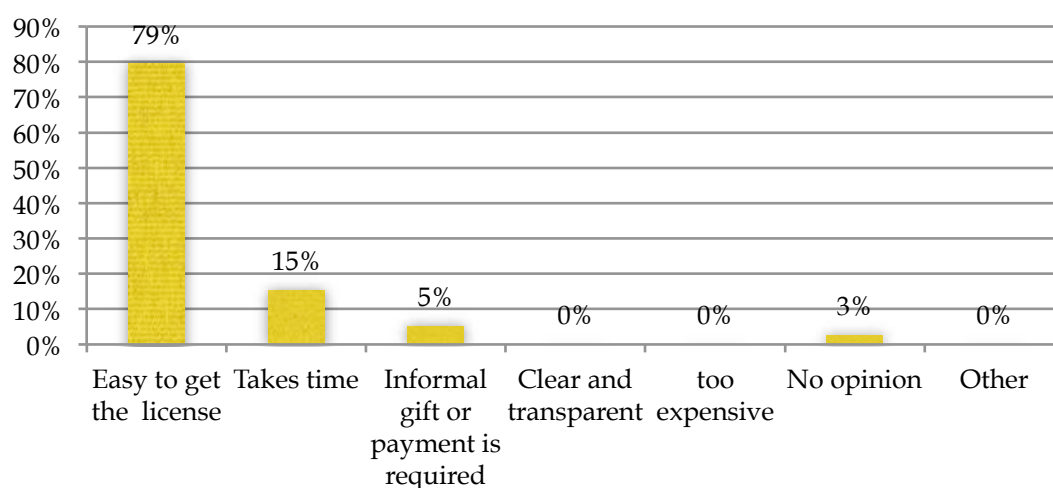


Regulations and national standards

Herat enjoys the same relatively low regulatory controls on business operations, as the rest of Afghanistan. AISA, MoCI, and ACCI have significant regional offices in the city, highlighting the importance of Herat to Afghanistan's economy.

70% of companies reported to be registered with either AISA or MoCI. 75% gave positive feedback on the registration process, but 56% had some negative experience. It is unclear which agency provided the better experience. Easier transportation of goods and access to the government promotion were listed as the benefits of registration. 61% of businesses reported to be ACCI members. The median time to receive a business license was one month. The average time spent in dealing with government officials was less than 2 days a month.

Figure 4.8: Herat - Opinions on business registration process



50% of the managers in the surveyed companies confessed they did not know there existed national standards. Of the remaining 50%, 41% said they adhered to international standards of production. 93% respondents reported pay taxes to the government. The biggest complaint against taxation in Herat was that rates were unfriendly to business, and the system was inefficient.

Access to credit

Whilst Herat is a commercial capital in Afghanistan, the supporting financial system remains weak. In Herat there are at least 8 financial institutions that are offering financial services like credit and overdraft facilities of the 16 registered financial institutions operating in Afghanistan⁵⁰.

Of the 46 businesses surveyed in Herat, only 15% had taken a business loan in the past year. Of these, only two had gone to the bank for their loan; other lines of credit

⁵⁰ 8 financial institutions in Herat participated in the Herat A2F business to bank roundtable held in Herat on March 16/17, 2014. <http://www.aba.org.af>

came through informal channels. Loans did not generate improved profits for four of the seven companies who had taken a loan. Loans were taken from mostly from friends, family other shopkeepers; only 1 person took a loan from the bank.

The fact that few businesses took out a loan could be indicative of a lack of access to credit assuming that some businesses require fund for investments.

Infrastructure and business environment

Herat has a better public supply of water and electricity than most other cities in Afghanistan. 73% of survey respondents said that they received city power for 24 hours a day; 72% said they had access to piped water. The supply does not meet demand, however, as business owners (and managers) said they needed more water for their operations. A further concern was security for sites of production and sales. 61% of respondents reported that the cost of utilities was very high. Despite this, 89% of respondents said they would prefer to remain in the city. This seemed to be mainly due to the condition of the local markets for their products, since 98% of respondents stated these were sufficient for their business.

Figure 4.9: Herat - Satisfaction with the level of infrastructure

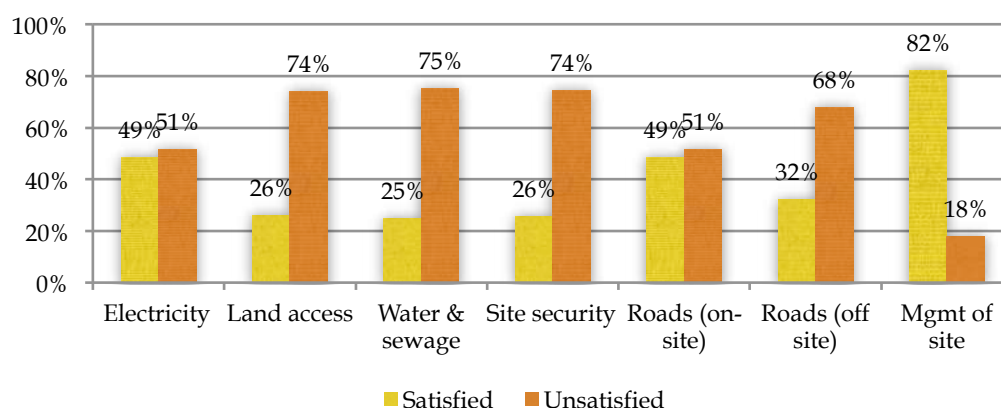
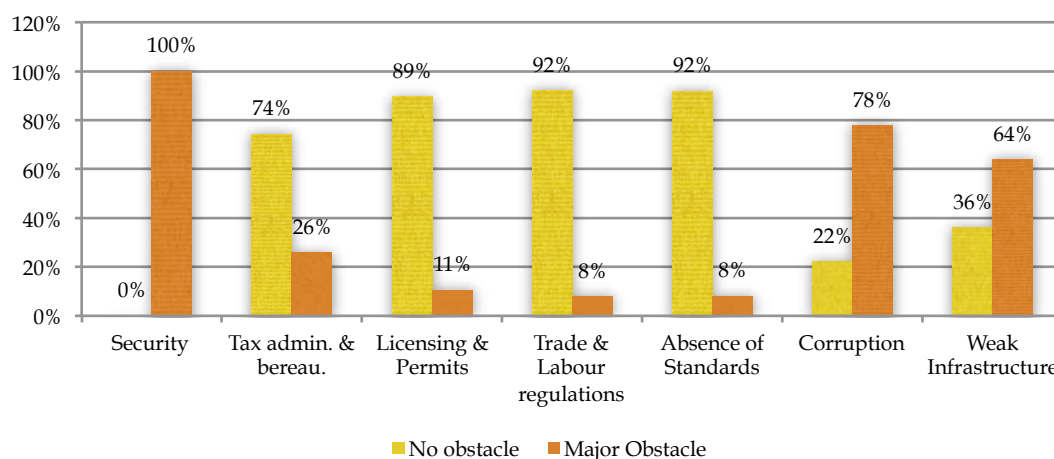


Figure 4.10: Herat - Obstacles in business



Low security for their personnel, and for goods in transit were the main concerns for businessmen in Herat. Corruption was also stated to be a problem. 48% stated it was difficult to start a business in Herat. 65% of the respondents were negatively affected by the deteriorating investment climate of the past 12 months. 18% of the business made a loss during this period. Private sector reforms of the last decade seemed to have helped 63% of the businesses surveyed, but only to a small extent.

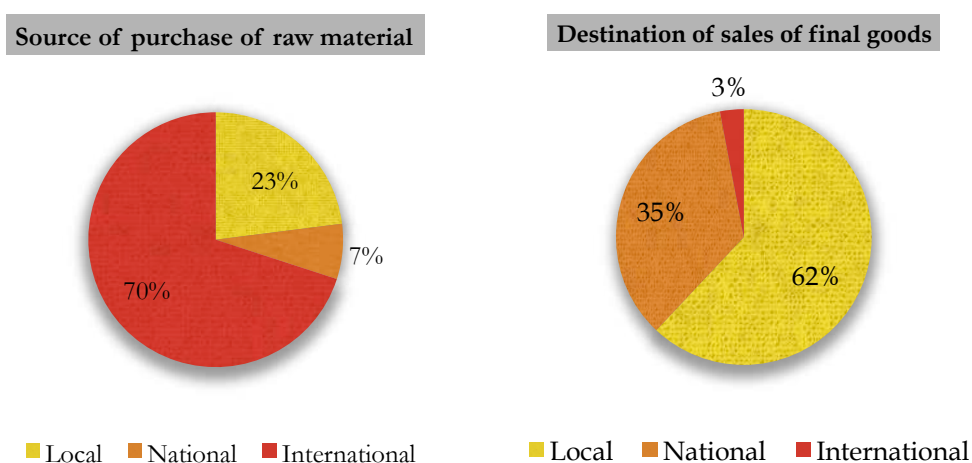
Trade

Herat is very close to the Afghanistan's borders with Iran and Turkmenistan, and has historical trade ties with these countries. 70% of imported materials for use in production enter Afghanistan at Herat. Iran, China, Pakistan and Turkey are the main countries of origin for these inputs. Reported import duty ranged between 2.5-5%, which is in the range of the national average for importing goods. However, 79% of respondents considered the duty to be excessive.

Imports for raw materials are high. 85% of respondents said that the goods they require for production are not available locally. 33% of the sample said they sold their product in Herat city; 43% said they sell throughout the province; 20% said they sell nationally; only 4% said they exported to foreign markets. Since Herat imports a lot of its raw materials for production, but does not export much of its final products, a lot of foreign currency leaves the country here.

Herat's customer base has changed in the last 5 years due to the withdrawal of much of the international community. NGO customers used to account for 20% of sales, but this figure is now only 2%; demand from PRTs was 17% of sales, and now is 0%..

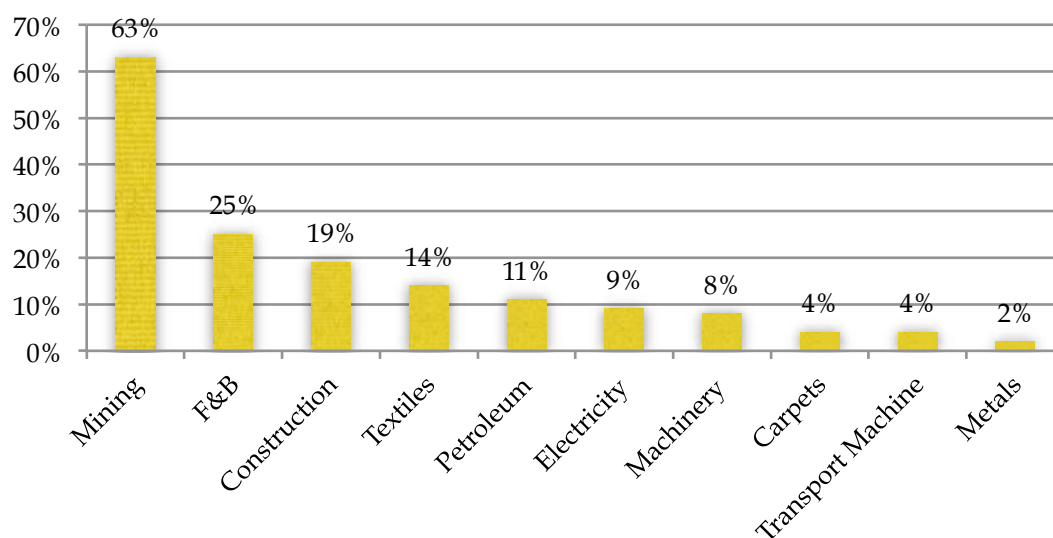
Figure 4.11: Herat - Sources; Sale and purchase of final goods



Potential Sectors for Promotion

Respondents from Herat projected the mining industry as the most lucrative in the region (60%). The World Bank's SDNP-II project estimates nearly 7 iron ore deposits and at least 4 copper deposits in the immediate vicinity of Herat city. Furthermore, a survey showed that there are oil and natural gas resources in Herat to be exploited⁵¹.

Figure 4.12: Herat - Sectors nominated as most promising to generate employment, value and growth of income



25% respondents favoured the F&B industry to be the second most lucrative in Herat. 850 *Jerib* (80% of Afghan saffron production) of plantation in Herat is under saffron production. However, merely 2 major companies are controlling saffron production from Herat and there is an opportunity both in saffron derivatives and processing as well as packaging and storing⁵².

19% respondents said the construction was also favoured as a growing sector and 14% indicated textiles. Under the latter, Herat produces raw cashmere. Currently there is a potential to triple the amount of cashmere production in Afghanistan to 1000 tones⁵³. Herat also offers substantial opportunity in construction of hotels in the city.

Other favoured industries of Herat include petroleum, electricity, machinery and carpets production. AISA's study estimates US\$ 0.2 billion in fixed capital business in the western region of Afghanistan. Herat receives US\$ 61 million in development aid, very little of which was spent towards industrial development.

⁵¹ AISA, (2009), op.cit, p36

⁵² AISA, (2013b), "A Comprehensive Study of Afghan Saffron", www.aisa.org.af

⁵³ AISA (2009), op.cit, p 24

Critical assessment on location of SEZ in the Herat area

The business community in Herat faces challenges to growth. Herat has felt the impact of the uncertainty created by the 2014 presidential election and transfer of security to Afghan forces more deeply than other areas of the country. Corruption within government departments, although not a primary concern, is still an issue within Herat's business community.

The distribution of land is still a significant roadblock to economic development. Industrial parks have been allocated dedicated land, but may not be enough. Further, the procedure for allocation is confusing. As noted by one respondent: *"(The) bureau of land has the responsibility to distribute lands, but sometimes in some cases the municipality is distributing the lands as well."*

Businesses continue to face the threat of kidnapping and theft. This was a real concern for one respondent, who states:

"I can tell you which companies are operating in the industrial park but I cannot give the names and contacts of the officials working there. Kidnappings of businessmen occurs frequently and hence we do not share contact details."

On a positive note, the recent introduction of AISA's regional office in Herat has made registration and licensing much easier. This in turn has facilitated the transit of goods, by reducing time at checkpoints, for example. Herat has a strong business community due to its long history as Afghanistan's trading centre with the West.

In some sense Herat has already started to develop a SEZ. One key informant stated: *"In the highway of Herat-Turgundi in Dasht-e-Hawz area, we have established a town for petroleum, gas and refinery installation, there is a one refinery active and one refinery that will begin shortly"*. Local manufacturers have worked independently to take advantage of the benefits of locating their operations close to refineries, such as reduced costs and better networks to market. Herat also has an Industrial Park funded by foreign donors⁵⁴, with an extension currently under plan.

⁵⁴ Industrial Park Report

Table 4.2: Preliminary feasibility and SWOT analysis of EZ project in Herat area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	The national ring road connects Herat with Mazar-e-sharif in the North and Kandahar in the south Herat has access to 2 in-land ports Herat has a small international airport
	Access to input supply (Backward Linkages)	Access to local input market is limited Supply chains are weak Agriculture is rudimentary and non-commercial
	Access to markets (Forward Linkages)	Good networks to domestic markets via the national ring road Good access to international markets through border ports with Iran and Turkmenistan
Infrastructure		Industrial parks offer the best place for infrastructure. The rest of the city struggles with weak water and power supply. Access to land, sewage facilities and on-site security on site are problematic
Labour		Good supply of unskilled labour, suitable for low tech production; Skill level of the labour force does not match the demand from business Some available training centres, but education still weak High female participation in the labour force
Business environment	Enablers	Low trade and labour regulation, including low requirements for licensing and permits. Low administrative burden on taxes;
	Disablers	Poor security situation; Lack of standards; Corruption; Poor access to credit

<u>Strengths</u>	<u>Weaknesses</u>	<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> • Existing Industrial Park • Access to international airport • Direct access to national markets • Large labour supply • Well developed communication • More likely benefits to women • Access through international ports 	<ul style="list-style-type: none"> • Weak infrastructure outside IPs • Lack of credit supply and financial services • Corruption in government • Lack of higher education services 	<ul style="list-style-type: none"> • Opportunity in manufacturing sector • Opportunity in consumer services • Opportunities in business development services • Opportunities in education services • Added phase to industrial park development 	<ul style="list-style-type: none"> • Region under threat of on-going conflict • Labour cost competitiveness threatened by regional rates • Added pressure on power and water infrastructure capacity • Dumping ground for industries in Iran

BALKH Socio-economic Profile

Balkh is situated in the northern part of Afghanistan with borders to Uzbekistan and Tajikistan. It is adjacent to Kunduz in the East, Samangan in the south-east, Sar-e-pul and Jawzjan in the west. The commercial centre of the province is Mazar-e-sharif.

Population

Total provincial population estimated to be 1.2 million, 53% of the population is between the ages of 15-60 with another 0.5 million to enter the labour force in the next 15 years.



Education

Male literacy rate is 49.4% and female literacy rate is 26.8%. The University of Balkh has faculties of Medicine, Engineering, Law, Literature, Economics, Agriculture, Religious Law, and Education.



Infrastructure

95% of the urban areas in Balkh have access to electricity with majority relying on public distribution. 38% of roads in the province are able to take car traffic in all seasons, and 34% are able to take car traffic in some seasons. The urban commercial center Mazar has most of the main providers of Tele-communication available in Afghanistan.



Workforce Stats



Labour Force Participation 75%
Employment-to-population 53%
Underemployment 15%
Unemployment 17%

Employment



Day Labourer (14%)
Salaried worker (20%)
Own account worker (58%)
Employer (8%)
Unpaid family worker (2%)

Labour



Agriculture & Livestock (42%)
Trade and Services (34%)
Manufacturing (12%)
Other (12%)

Source of Income

Credit Services

Financial products and services are offered by the First Microfinance Bank (FMFB), ARMP, Kabul Bank, BRAC, WOCCU, Women for Women, and Madeira.



Industrial Park

The Gorimar Industrial Park is located 22 km east of downtown Mazar-e-sharif. Overall area covered by the park is 25 ha. An extension of 22 km of power transmission line is an ongoing project to supply the IP with electricity. The industrial park has a planned extension of 60ha. Most suitable for light manufacturing in plastics, chemicals and food processing.



Key Potential Industries

The major industrial crops grown are cotton, tobacco and Olives. The SME industry is well developed in providing Qoraqi skin, Handicrafts and rugs and carpets. In the urban region there is potential for the development of services such as tourism, education, trade, health and financial services. In Manufacturing there is potential in Mining, textiles and agro-based products.

4.3. BALKH

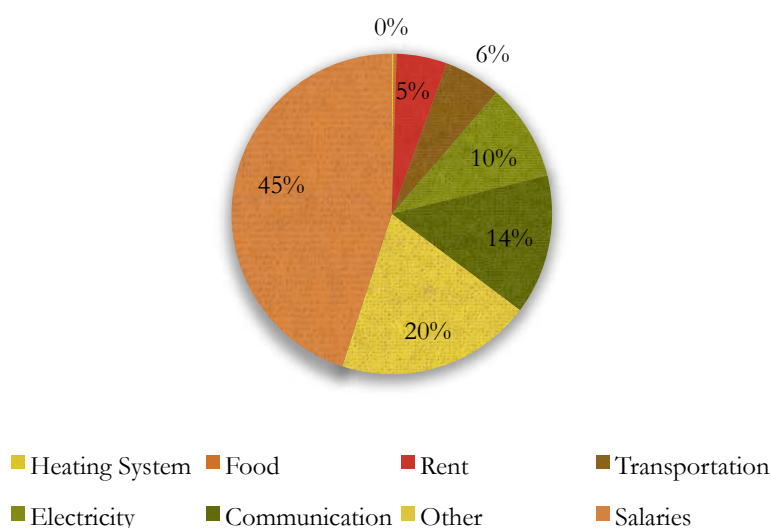
In the following section this report uses information from desk research and 50 interviews to build a picture of the economic context for the development of a SEZ in Balkh. This report focuses on seven key areas of interest. This report then assesses the challenges and opportunities presented by the creation of a SEZ in Balkh, based on findings from our research.

Business operating costs

Mazar-e-sharif is an industrial centre with many small and medium enterprises, and a few large-scale operations. As with the other cities considered so far in this report, employee salaries form the largest share of business operating costs (45%). This was followed by 'other' costs (20%), which included business overheads, and input purchases. Communications costs are a significant operating cost in Mazar-e-sharif, accounting for 14%, compared with 10% in Kabul. Electricity costs formed 10% of the average business operating costs.

Small companies employ an average of 10 workers; medium sized companies employ an average of 39 workers; and large companies employ an average of 365 workers. The ratio of skilled-unskilled workers reduces as the size of the company grows, with many more unskilled workers being managed by fewer skilled workers. Compared with other cities, workers in Mazar-e-sharif are more literate (44%). 13% of workers had attended high school; 16% were reported to be graduates. All respondents agreed it was easy to find unskilled labour. 78% said it was easy to find skilled labour. There were 14 female workers for every 1000 male workers.

Figure 4.13: Mazar - Share of costs of production

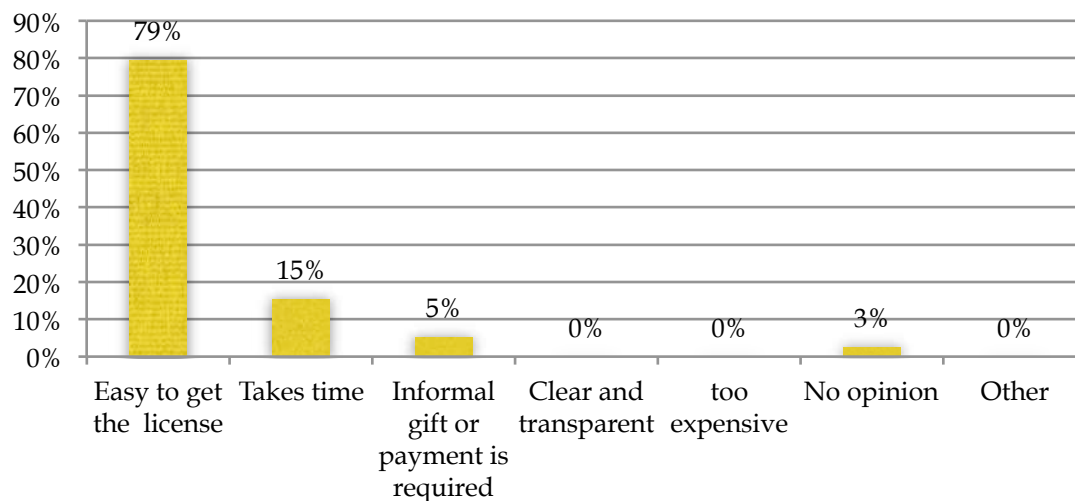


Regulations and national standards

The presence of governmental agencies responsible for registering and regulating businesses is weak in Mazar-e-sharif. This has fed through to a low share of business being registered with the relevant authorities. When asked whether they were registered with formal authorities, 56% of surveyed companies reported being registered with AISA, and 48% with MoCI, while only 22% of respondents said they were members of the ACCI. More concerning: 56% of respondents said they were unclear about the registration process.

88% reported that transfer of goods was much easier after they had received registration documents. It was also easier to employ foreign workers if production was authorized by the government. 67% of respondents stated that licenses were received within a month of application. Business reported to spend less than one day per month dealing with government officials.

Figure 4.14: Mazar - Opinions on business registration process



Only 1 in 5 managers knew national standards of production to exist. 96% of respondents reported to pay taxes, and, more interestingly, 50% agreed that the tax system was transparent, efficient and easily understood. This represents a higher level of agreement with the tax system than in any other city.

Access to credit

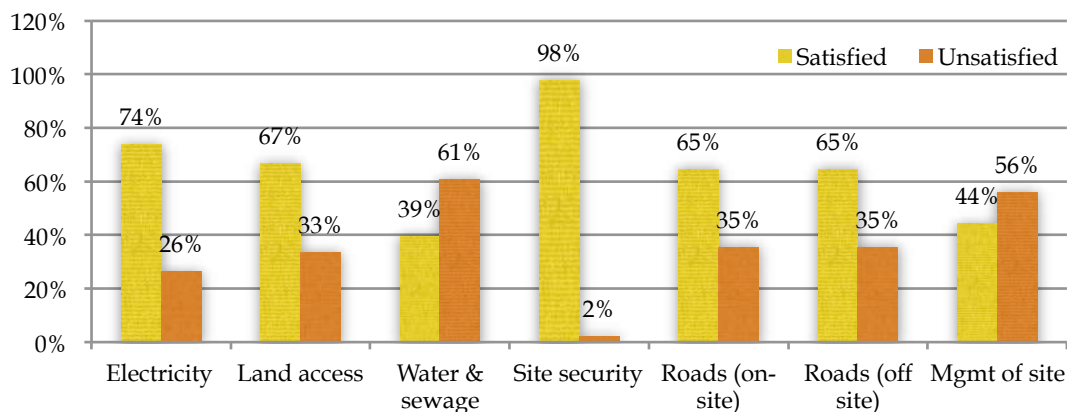
There are very few formal lending institutions present in Mazar-e-sharif. Although every major Afghan banking institution has a presence in the city, they are not well-known among potential beneficiaries.

The market for credit was weak, with low levels of supply and demand. Only 5 of the 50 surveyed companies had borrowed money in the last year. Of these, only 2 of had received their loans from banks. All business that had borrowed money, reported to have converted their investment into higher levels of profit.

Infrastructure and business environment

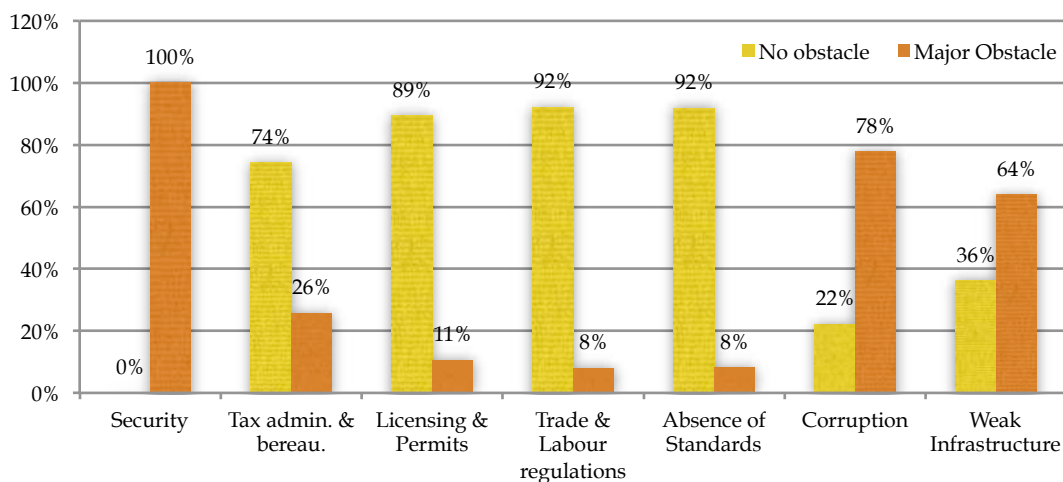
Availability of power and water within Mazar is moderate. The main constraints to business development were stated as weak infrastructure and corruption. In certain parts city power was reportedly available for 24 hours. 14% of the sample, however said they received no publicly provided electricity at all. Only 18% of respondents reported to have access to piped water. 52% of respondents used hand pumps to access water; 22% used water tanks. Businesses enjoyed better on-site site security than that found in other Afghan cities. 52% said they would consider moving business out of Mazar because they were unsatisfied with the provision of infrastructure. 68% people thought that the cost of operations in Mazar would be close to the national average.

Figure 4.15: Mazar - Satisfaction with the level of infrastructure



The prevalent opinion was that it was easy to start a business here. This was made easier by the fact that 66% considered business registration to be easy in the city. 86% respondents felt that the national investment crisis had worsened business opportunities in the last year. 68% of sampled businesses reportedly made a loss in this period. Respondents stated that the economic reforms of the past decade seemed to have made little impact to growth in the city.

Figure 4.16: Mazar - Obstacles in business



While many said that the extended election process had reduced economic activity in the last 12 months, they also stated an improvement in the economic situation compared with five years ago. This was mainly attributed to the perception of an improved security environment Mazar, allowing for more dynamic commercial and economic exchanges. The unemployment problem in Mazar is not as severe as some other regions in Afghanistan, such as Kabul or Jalalabad.

Trade

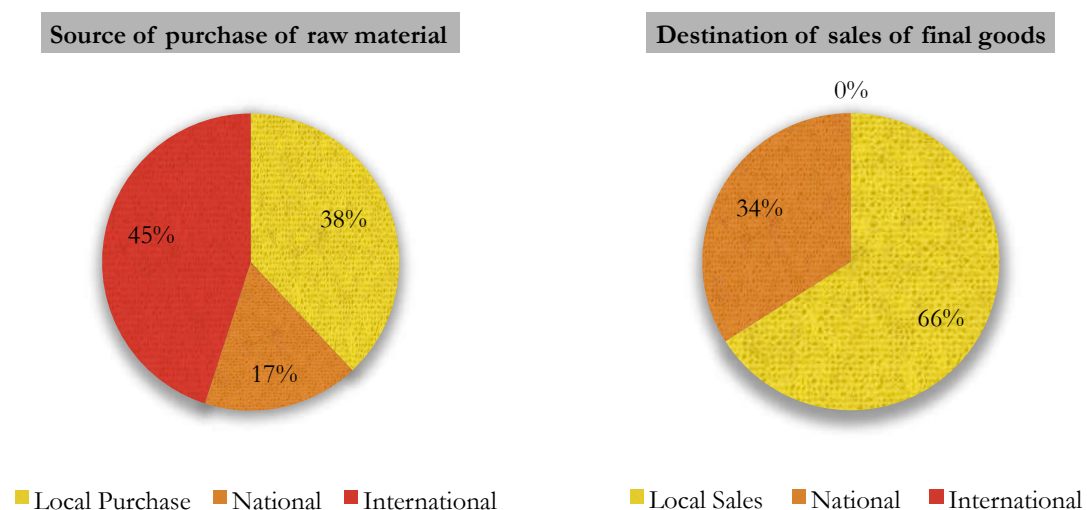
Mazar-e-sharif has good opportunities for trade through inland border ports with Central Asian countries. A high volume of imports currently enters the country through the Hairatan border crossing with Uzbekistan.

45% of respondents required imported inputs to production, mainly sourced from China, Pakistan, and Iran. 38% of respondents reported to be able to find input requirements in the province; 17% said they found these within Afghanistan. 52% of those who imported their inputs considered the import duty to be reasonable, at 5-10%.

66% of business sold their goods in local markets within Mazar-e-sharif. 34% sold to domestic markets throughout Afghanistan. None of the businesses surveyed exported their products. Customers were primarily individuals or private companies. The share of business customers reduced from 70% to 61% in the last five years.

Competition for local production is mainly from other domestic providers, and not from imports. 60% of respondents said they faced very little competition from foreign-made goods. 50% stated they faced moderate competition from domestic producers.

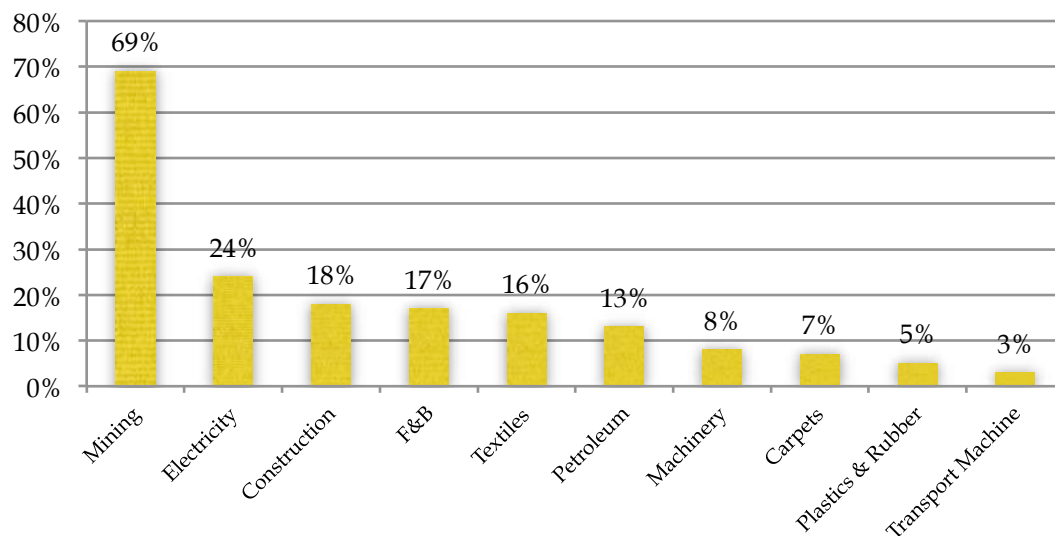
Figure 4.17: Mazar - Sources; Sale and purchase of final goods



Potential sectors for promotion

In Mazar, 69% of the people favour mining as the industry likely to generate the most amounts of value, employment and growth in the next 5 years in Mazar-e-sharif. However, there is not as much mineral resources close to Mazar as there are opportunities in petroleum extraction and refining. Afghanistan has 8 sites identified as potential or existing oil fields with one in the same Balkh province and 7 in close proximity⁵⁵.

Figure 4.18: Mazar - Sectors nominated as most promising to generate employment, value and growth of income



24% respondents identified opportunity in electricity production and distribution while another 18% in construction. However, further regional information about these sectors is unavailable. The only information forthcoming is that there are public planned projects to invest into business sites and power infrastructure (Mazar-e-sharif power plant) to supply the industrial parks. Further there is 1 marble reserve in Balkh province⁵⁶.

Under the F&B industry, almond production and processing taking place from Mazar is still manual and informal and there is an opportunity here to develop⁵⁷. In textiles, Mazar, before the war was known for production and distribution of cotton and there is a US\$ 2 million investment opportunity to operationalize the Balkh Cotton Textile Enterprise, under a public-private partnership model⁵⁸.

⁵⁵ World Bank SDNP-II

⁵⁶ AISA, (2012), op. cit., p 8

⁵⁷ AISA, (2009), op. cit., p 11

⁵⁸ AISA, (2013a), op. cit., p 3

US\$ 80 million in development aid (till date) that has flown into Balkh has mostly been spent in the transport sector, while the remaining has gone to non-industrial sectors like agriculture, education and health⁵⁹.

Mazar-e-sharif presents opportunities for tourism, education and financial services. Mazar is commercially well developed, compared with other cities in Afghanistan, and so presents an opportunity for the growth of a service sector. Lastly, in a near future, mining and quarrying activities *could* provide channels to grow heavy industry in the region; however, at this stage, there are still many uncertainties with regards to the: 1) sustainability and commitment of local and foreign investments; 2) issues of technical feasibility; 3) political changes post-2014 (with a new Minister of Mines, who publicly denounced the opacity and illegality of the contracts signed with international firms); 4) the security situation (criminal activity + insurgency).

Critical assessment on the location of a SEZ in the Mazar-e-sharif area

Some local businesses were optimistic about the effects of creating a SEZ in the Mazar-e-sharif area. One interview stated such an initiative could *“facilitate job opportunities for Afghans”*.

An SME business owner in Mazar with 75 employees gave insight into how supply chains could be fostered in the area. *“We produce tomato paste. Since setting up, our network for inputs has grown from 300 to 1000 farmers, by distributing tomato seeds and micro loans for farmers tomato seeds and micro loans.”* Such a strategy could be used by a prospective SEZ in Mazar, to ensure the local areas receive the maximum benefit from production.

The business environment in Mazar is a strength. One respondent went as far to say: *“The governor’s office assists in extending electricity lines, the AISA is honest and did not trouble us for the license and the MoF is efficient and transparent in its collection of taxes”*.

One challenge to business operations in Mazar is the problem of contraband. Illegal trade is facilitated by an unregulated and corrupt customs channel. Domestic producers said that that it undermined the value of Afghan products. The acting General Manager in an SME said, *“I want the government to pass a law to charge penalty of contraband in order to increase the value of home (Afghanistan) production.”*

There is an existing IP in Mazar-e-sharif, with a planned extension⁶⁰. The extension includes plans for a dedicated electricity transmission line. Foreign donors have committed funds to developing the land with industrial shells, water, sewage systems, and paved roads. This IP offers an opportunity for the creation of a SEZ in the area.

⁵⁹ CSO, GIROA

⁶⁰ Industrial Park Report

Table 4.3: Preliminary feasibility and SWOT analysis of EZ project in Mazar area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	The national ring road connects Mazar-e-sharif to Herat and Kabul; The are border ports with Uzbekistan and Tajikistan; There is an airport
	Access to input supply (Backward Linkages)	Access to local input market is limited Supply chains are weak Agriculture is rudimentary and non-commercial
	Access to markets (Forward Linkages)	Good networks to domestic markets via the national ring road Good access to international markets through border ports with Uzbekistan and Tajikistan
Infrastructure		Industrial parks offer the best place for infrastructure, although this is also good off-site An international railway that passes through the city is in planning stages
Labour		Good supply of unskilled labour, third most populated city in the country Some available training centres, but education still weak
Business environment	Enablers	Low trade and labour regulation, including low requirements for licensing and permits. Low administrative burden on taxes; Relatively better security compared with other Afghan cities
	Disablers	Low standards for production Poor access to credit

<u>Strengths</u>	<u>Weaknesses</u>	<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> Existing Industrial Park Likely benefits to women Access to domestic airport Direct access to national markets Large labour supply Well developed communication Access to countries through international ports 	<ul style="list-style-type: none"> Corruption at custom locations with leakage of contraband and bribery inflating cost Lack of credit disbursement Export industry is underdeveloped with most of the trade flowing one way inwards. 	<ul style="list-style-type: none"> Opportunity in manufacturing sector Opportunity in business development services Added phase to industrial park development On going development of international rail network 	<ul style="list-style-type: none"> Region under threat of on-going conflict Labour cost competitiveness threatened by regional rates Added pressure on power and water infrastructure capacity Dumping ground for industries in Iran

KANDAHAR Socio-economic Profile

Kandahar province is located in the southern region of the country and has borders with Zabul in the East, Urozgan in the North, Kandahar in the West and an international border with the Balochistan province of Pakistan in the south

Population

Total provincial population estimated to be 1 million; 44% of the population is between the ages of 15-60 with another 0.6 million to enter the labour force in the next 15 years



Education

Male literacy rate is 30% and female literacy rate is 3.4%. The University of Kandahar has four faculties including medicine, engineering, agriculture and training and education. In 2011 there were 1200 students enrolled at the university



Infrastructure

85% of the urban areas in Kandahar have access to electricity. 76.8% of roads in the province are able to take car traffic in all seasons. Telecommunication services are still under-developed with Roshan and Afghan telecom 2 of the few service providers active in the province. It also has a limited capacity domestic airport



Workforce Stats



Labour Force Participation (84%)
Employment-to-population (18%)
Underemployment (12%)
Unemployment (8%)

Employment



Day Labourer (6%)
Salaried worker (6%)
Own account worker (84%)
Employer (2%)
Unpaid family worker (2%)

Labour



Agriculture & livestock (28%)
Trade and Services (29%)
Manufacturing (2%)
Other (41%)

Source of Income

Credit Services

There are almost no credit institutions apart from AIB and Kabul Bank exists in the province that can provide finance and loans; AIB and Kabul bank loan are not very much welcomed by the people due to the fact that interest is not allowed in Islamic and Sharia laws



Industrial Park

The Sharandam industrial park is located 10 km east of Kandahar city, on the main road to Kandahar airfield. The industrial park covers 15 ha of an estimated 400ha of allocated industrial land. The industrial park has a plan extension of 400ha once approved by the high Economic Council. Potential industries are plastic, oil, marble, food and ice production



Key Potential Industries

The major industrial crops grown are tobacco and sugar extracts. The SME industry is under-developed mostly engaged in Qaraqul skin and sugar derivatives. There is potential for development of fisheries with the availability of irrigation system in the province. Mining and agro-based products are potential manufacturing industries that can be developed

4.4. KANDAHAR

In the following section this report uses information from desk research and 41 interviews to build a picture of the economic context for the development of a SEZ in Kandahar. This report focuses on seven key areas of interest. This report then assesses the challenges and opportunities presented by the creation of a SEZ in Kandahar, based on findings from our research.

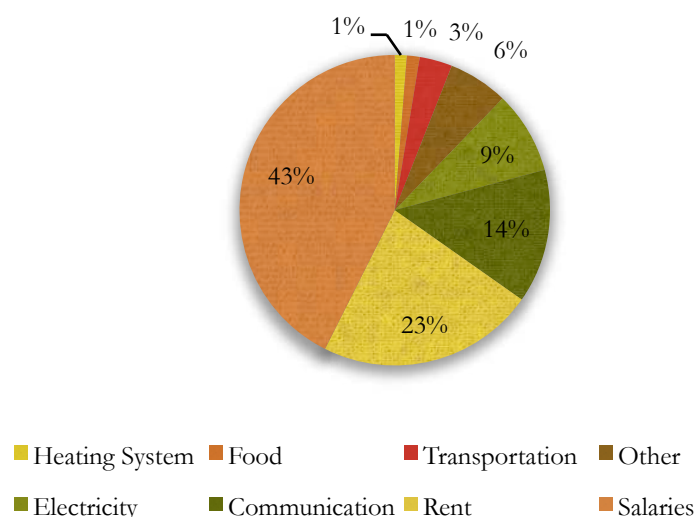
Business operating costs

As with all other cities considered so far, employee salaries form the largest share of operating costs for businesses in Kandahar (43%) This was followed by rent (23%). This is a significant share in comparison to Herat, where rent accounts for only 11% of business operating costs.

Small companies employ an average of 18 workers; medium-sized companies employ an average of 36 workers; and large companies employ an average of 113 workers. In Kandahar, the larger the company, the larger the share of skilled workers. This seems to buck the national trend, where larger companies are characterised by large numbers of unskilled workers managed by a few skilled workers.

10% of the workforce had education to a graduate or post-graduate level. 43% was illiterate. 71% of respondents considered it easy to find skilled labour. 98% said it was easy to find unskilled labour in Kandahar. Companies reported no women to be working in their companies.

Figure 4.19: Kandahar - Share of costs of production



Regulations and national standards:

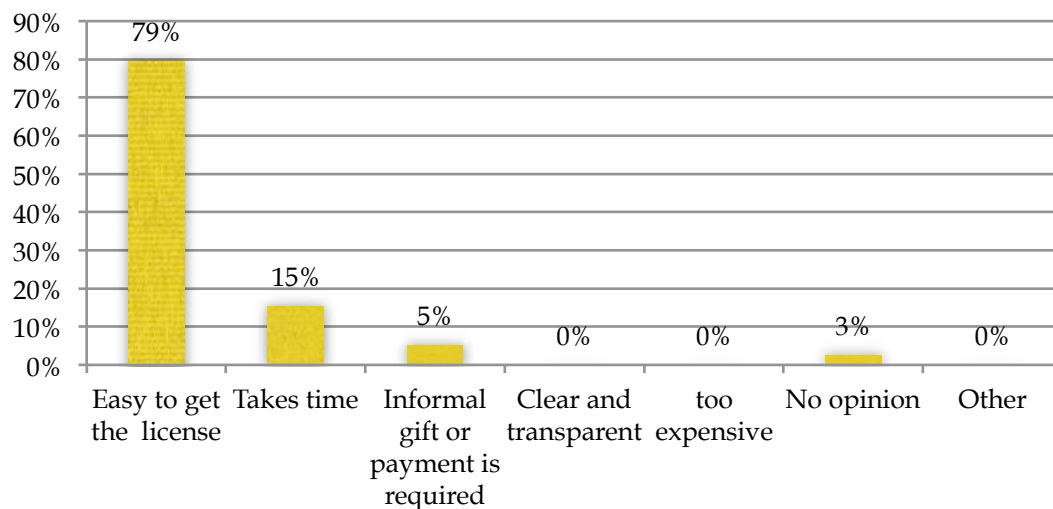
85% of respondents reported to be registered with AISA. 54% said they were registered with the provincial department of the MoF; 48% stated they are registered

with MoCI. Registering business reportedly made the transfer of goods from one place to another much easier. Kandahar business owners also stated that registration made it cheaper to do business in the long run.

59% of businesses in Kandahar reported to spend three to five days per month dealing with government officials, compared with an average time of two days in Herat. 80% of respondents stated it took more than 30 days to receive their business license; this figure was 50% in other cities.

90% of the respondents in Kandahar were unaware of the existence of national standards. This is in spite of comparatively high government involvement in daily business activity.

Figure 4.20: Kandahar - Opinions on business registration process



Access to credit

Only 7% of the surveyed companies had taken credit in the last twelve months, with credit coming mostly from social networks of friends and family. Presence of commercial lending institutions in the formal sector is weak. Instead credit in Kandahar is being made available through international development aid from ADB as part of their rural business support program. The Micro Finance Investment Support Facility for Afghanistan’s (MISFA) SME support program has a small presence through local partners in Kandahar.

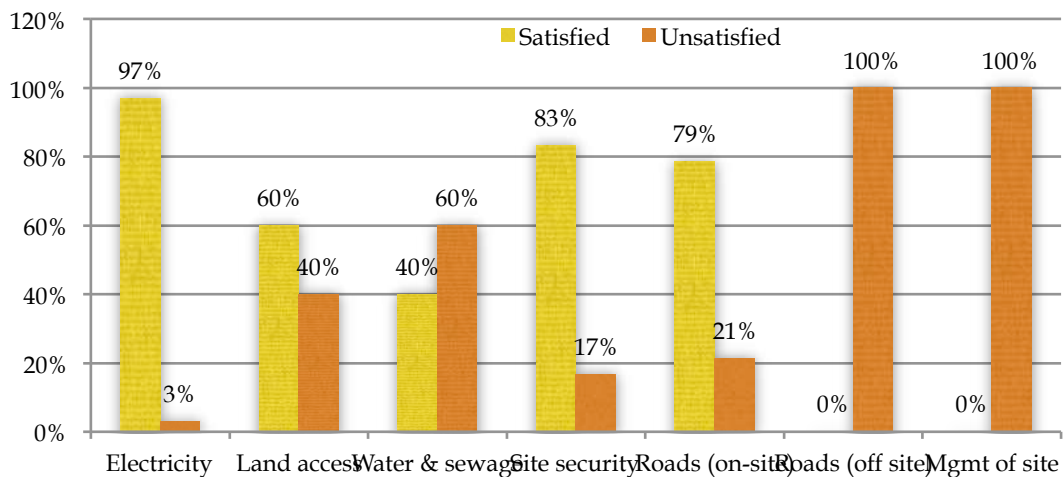
Infrastructure and business environment

In terms of the general business environment, 95% businesses in Kandahar said that the investment climate had deteriorated over the past 12 months. Local businesses have suffered losses. The unemployment rate for Kandahar is 9%.

In recent years, Kandahar has undergone extensive urban development. The road network within the city is well developed, but there are few good roads connecting the capital of the province to the districts.

The Kandahar business community does not rely on publicly provided power, which is generally available for five to seven hours per day. Instead, many local residents use solar panels to generate electricity. No respondent claimed to have access to piped water.

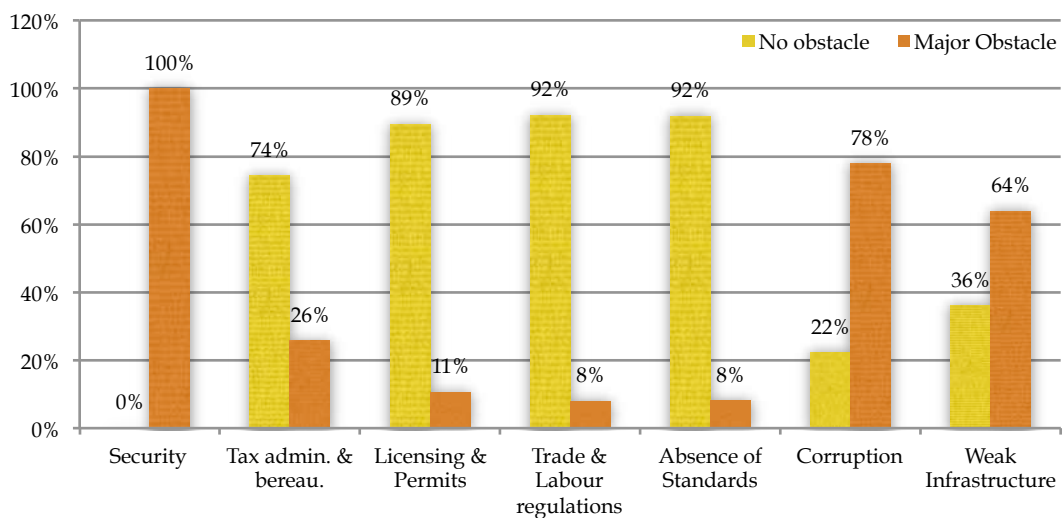
Figure 4.21: Kandahar - Satisfaction with the level of infrastructure



Kandahar is an insecure location. Poor off-site security was a real concern for the business owners. Every interviewee scored security provision with a zero.

95% of respondents thought operating costs for business were higher in Kandahar than in other parts of the country. 29% respondents said they would consider moving out of the current location, for various reasons, including expense.

Figure 4.22: Kandahar - Obstacles in business



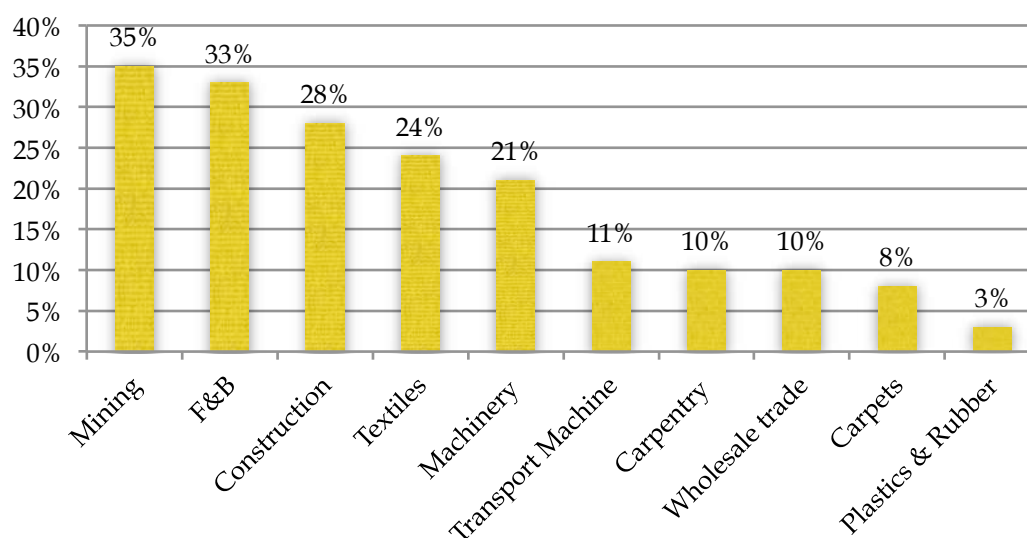
88% of respondents in Kandahar said they did not have local access to adequate markets. 20% of respondents complained of inadequate transport and logistics facilities.

The tax administration and bureaucracy was reported to be an obstacle to conducting business. 51% considered it to be difficult to start a business. 95% said the business climate in the last 12 months had deteriorated. 68% reportedly made a loss during the same period. 88% people said that the economic reforms of the past decade had brought significant growth and helped businesses to a great extent.

Potential sectors for promotion

In Kandahar the mining and F&B industry are favoured as the top industries to generate employment, value and growth in the region. Kandahar’s main proximity is to regions with identified gold reserves (south central belt containing 10-12 gold reserves) and a few iron and copper locations sites. AISA’s website also claims investment opportunity in limestone⁶¹.

Figure 4.23: Kandahar - Sectors nominated as most promising to generate employment, value and growth of income



Construction was the third most preferred industry in Kandahar to generate wealth. With regards to this industry, AISA’s website describes potential to generate cement with an estimated demand of 3 million ton and opportunities for export to Central Asia and Pakistan⁶².

Other industries favoured to succeed were textiles (24%), machinery (transport 11% and other 21%) and carpentry (10%). Kandahar’s industries have barely seen any development assistance (a mere US\$ 4.8 million)⁶³ coming forth in 2013.

⁶¹ <http://www.aisa.org.af/investmentopp/Mining.pdf>

⁶² AISA, (2009), op. cit., p 33

⁶³ CSO, GIROA

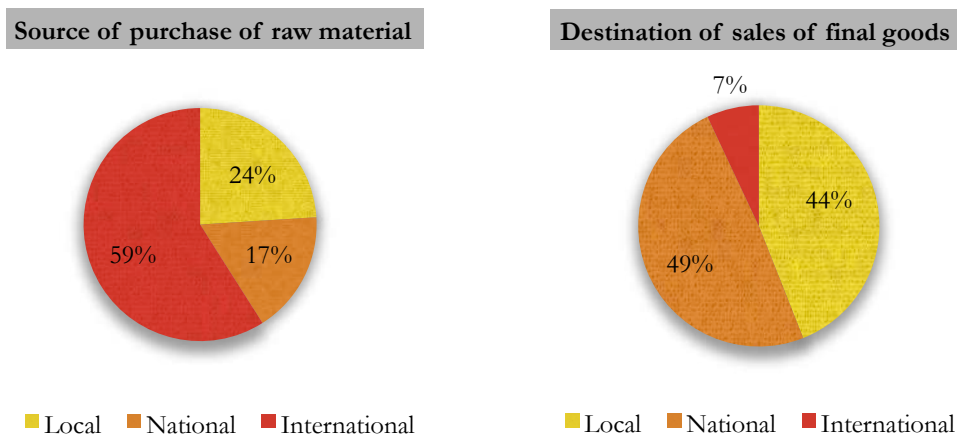
Trade

Companies in Kandahar were heavily dependent on imports for their raw materials. 96% of the respondents said that the inputs they required are not available in Afghanistan. 58% reported that they import their inputs directly from across the border in China, Iran, Pakistan and Turkey. The import duty paid on goods was reported to be 10% or higher; 65% of respondents said this was high, despite averages in other cities being 5-10%. Corruption at customs and ports increases the costs of importing.

Only 3 of the 43 surveyed companies reported to export their goods outside of Afghanistan. 49% of the final products left the city, and were sold nationally. This could be indicative of the local economy not being able to provide enough opportunity for producers. As in other cities, demand from NGO customers has reduced in the last 12 months, with the drawdown of the international community with businesses instead looking to individuals and businesses to make up for the lost demand.

Business owners claim their products face high levels of competition from both domestic and international sources. 59% said they faced competition from imports, and 85% said competition came from domestic companies.

Figure 4.24: Kandahar - Sources; Sale and purchase of final goods



Critical assessment on the location of a SEZ in the Kandahar area

Respondents at focus groups and all government stakeholders thought foreign investment would help the local economy. Kandahar has traditionally been inhospitable to foreign investment, however. Kandahar presents significant problems to the creation of a SEZ in the area. Interviews suggest theft, kidnappings, and extortion are common. Security for economic units is weak. The business

environment is therefore volatile, with security and corruption threatening production.

Setting up a SEZ in the area would require substantial infrastructure investments. There is an IP that could serve as the basis for a SEZ, but this would only deal with the problem of on-site infrastructure. Access roads to the area are poor, and improvements would require large capital investments. For example, the roads connecting Kandahar with Herat and Kabul are reported to disappear to dirt tracks upon leaving the city boundary.

Considering that access and security are the two main obstacles to the development of a dynamic economic activity in Kandahar – potentially supported by a SEZ – the review team considers that the most promising, albeit unlikely at this stage, opportunity for Kandahar would be the transformation of the international airport into a proper hub. Mazar airport is called *international*, as there is one flight a day that goes to Teheran. By contrast, Kandahar airport has the traffic and the potential of a real international hub: over the past ten years, there have been massive technical and logistical improvements, mostly for military purposes. Kandahar could become a unique international hub, linking East-Asia, Central-Asia, and the Middle-East, and allowing Afghan companies to export their agricultural productions, manufacture in the entire world.” Such an optimistic view is not realistic at the moment but could totally reshape the strategic role and economic significance of the province of Kandahar in the next 20 years – should the security situation drastically improves.

Table 4.4: Preliminary feasibility and SWOT analysis of EZ project in Kandahar area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	International border with Pakistan; Insecure access road to Kabul International airport High degree of conflict in surrounding rural areas
	Access to input supply (Backward Linkages)	Access to local input market is limited Supply chains are weak Agriculture is rudimentary and non-commercial
	Access to markets (Forward Linkages)	Located on the domestic trade route with Herat and Kabul; Border with Pakistan
Infrastructure		Industrial parks offer the best opportunity to find infrastructure in the area; Fairly well-developed public utilities Poor commercial infrastructure
Labour		Primarily unskilled, illiterate labour force University of Kandahar is the only higher learning institutions, and offers a limited range of subjects
Business environment	Enablers	Low trade and labour regulation;
	Disablers	Absence of standards; Poor access to credit; Insecure area High burden on registration and licensing, tax administration and bureaucracy;

<u>Strengths</u>	<u>Weaknesses</u>	<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> • Existing Industrial Park • Access to domestic airport • Basic access to national markets 	<ul style="list-style-type: none"> • Lack of physical infrastructure development • Corruption in government – political favoritism and bribery • Lack of credit disbursement and financial services • No benefits to women likely • Lack of road access beyond Kandahar city 	<ul style="list-style-type: none"> • Opportunity in manufacturing sector • Added phase to industrial park development 	<ul style="list-style-type: none"> • Region under threat of on-going conflict • Extortions and theft against businesses • Labour cost competitiveness threatened by regional rates • Heavy competition from firms in Pakistan which have roughly the same comparative advantages

NANGARHAR Socio-economic Profile

Located in eastern Afghanistan, the province of Nangarhar shares a border with Pakistan's NWFP province. Nangarhar's capital city of Jalalabad lies on an ancient trade route leading from Kabul via the Kyber Pass to Peshawar and the Indian subcontinent

Population

Total provincial population estimated to be 1.7 million; 43% of the population is between the ages of 15-60 with another 0.9 million to enter the labour force in the next 15 years



Education

Male literacy rate is 45% and female literacy rate is 9.3%. The University of Nangarhar and Jalalabad university have faculties in Medicine, Engineering, Agriculture, Law, Economics, Religious Law, Literature, Veterinary Science, and Training and Education. There is also a mechanics vocational training



Infrastructure

83% of the urban areas in Nangarhar have access to electricity. 54% of roads in the province are able to take car traffic in all seasons. In telecom, ROSHAN, Areeba and AWCC, DIGITAL are the main service providers. All the main access routes in the province are covered by mobile phone networks



Workforce Stats



Labour Force Participation (blue), Employment-to-population (grey), Underemployment (green), Unemployment (orange)

Employment



Day Labourer (38%), Salaried worker (13%), Own account worker (46%), Employer (2%), Unpaid family worker (2%)

Labour



Agriculture & livestock (48%), Trade and Services (31%), Manufacturing (1%), Other (20%)

Source of Income

Credit Services

Informal credit is mainly working where in time of need, money is borrowed from close relatives and other resourceful people. The microfinance program of MRRD is mainly implemented in the province by BRAC, FINCA and MADERA



Industrial Park

The major industrial crops grown are cotton and sugar. The SME industry is well developed in handicrafts and sugar derivatives. Fish farming is already developed but needs to increase to meet the demand. Wood and timber, agro-processing, energy and stone work present some further opportunities for development



Key Potential Industries

The Hesar-e-shahi industrial park is located 22 km south-east of Jalalabad city, on the Jalalabad-Torkham highway. The industrial park covers 207 ha of industrial land. Planned projects include a 24km asphalt road and 110kv power transmission line. Phase II of the industrial park covers 81ha of land and is partially developed

4.5. NANGARHAR

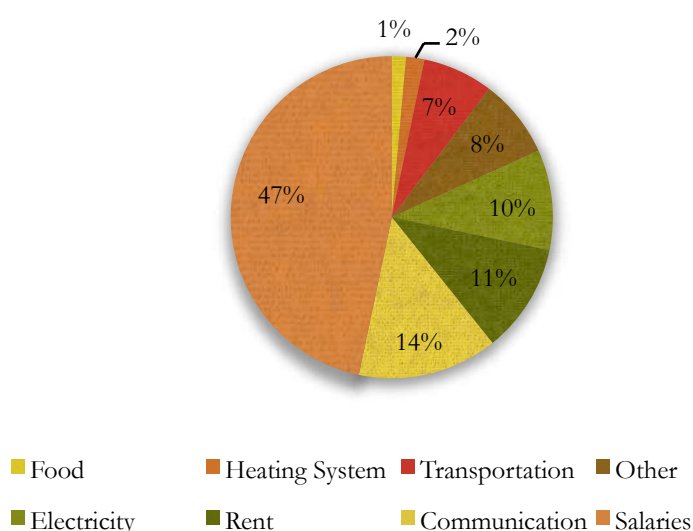
In the following section this report uses information from desk research and interviews conducted in the province of Nangarhar to draw a picture of the economic context for the development of a potential SEZ. This section assesses the challenges and opportunities presented by the creation of a SEZ in Nangarhar, based on findings from our research.

Business operating costs

The composition of labour employment in terms of skills was different from what was observed in other cities. In small and medium scale companies there were on average 8 and 49 employees respectively out of which an average 64% and 68% respectively were unskilled labour. However, Jalalabad also suffers from the lack of females in the workforce as does the rest of southern Afghanistan. From the surveyed companies, Jalalabad reported only 2 women employed per a 1000 male workers. The currently employed workforce was characterized by high level illiteracy and lack of formal education. On top, 48% respondents indicated that it was difficult finding skilled employees for their workplace. Almost all however agreed that it was easier coming across unskilled labour.

The cost of running a business in Jalalabad was inflated by the salary payment of its workers. The average across all businesses indicated 46% of the proceeds went towards salary payments, 17% towards transport, 10% towards communication and 9% each towards rent and electricity for the workplace.

Figure 4.25: Jalalabad - Share of costs of production



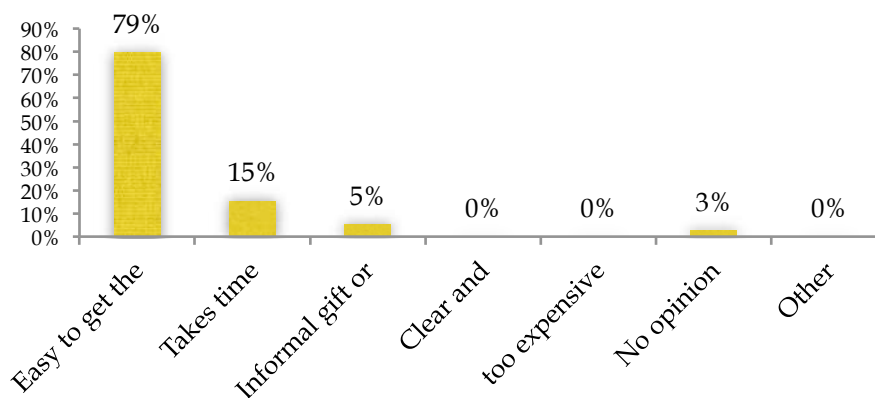
Regulations & National Standards:

The regulatory environment in Jalalabad, while not the worst, could not be described as business friendly. Firstly, only 52% business reported to be registered with AISA

while 50% responded to being registered with the provincial departments of the MoF and 31% with the MoCI: additional phone interviews with respondents who had reported being registered with the MoF suggest that there is a confusion about what registration is for many respondents: being registered with the MoF is a requirement to pay income taxes in Afghanistan but while it is a necessary requirement to legally operate as a company, it is not a commercial registration (like those with MoCI or AISA, for instance). In other words, the relatively low percentage of respondents who reported being “registered” with MoF should be taken with a pinch of salt, as it only shows that a significant proportion of the companies that did not report being registered with MoF consider this registration as a given: *“I did not mention this registration because it is obvious. You cannot have a company without the MoF knowing about it. However you can sometimes operate with a certificate from the Municipality, regardless of AISA or MoCI’s registrations”* (Businessman, IT and communications, Nangarhar).

Secondly, government interference in day to day activity was reportedly high (42% said more than 3 days a month). Only 38% agreed that it was easy to get a license in Jalalabad. 8% reported that the license was obtained by making an informal payment. The main advantages that were listed about being a registered company in Jalalabad was the easier access to transfer goods, cost reducing effect in the long run and opportunity to participate in government’s promotion campaign for businesses. 19% also indicated that registration may often lead to provision of government allocated land.

Figure 4.26: Jalalabad - Opinions on business registration process



Consequently 54% of the survey respondents were unaware of the existence of national standards, which meant that production regulation of the private sector was not well covered. As such, there were some companies that reported following standards of Pakistan, Iran and Turkey based on the country of dealing or production methods used. A few mentioned that they follow the ISO standards in the production activity but this is on own account and not on account of enforcement. Private sector opinion about the tax system was more towards the negative spectrum rather than the positive. This compared equally about the opinions of businessmen across the rest of Afghanistan.

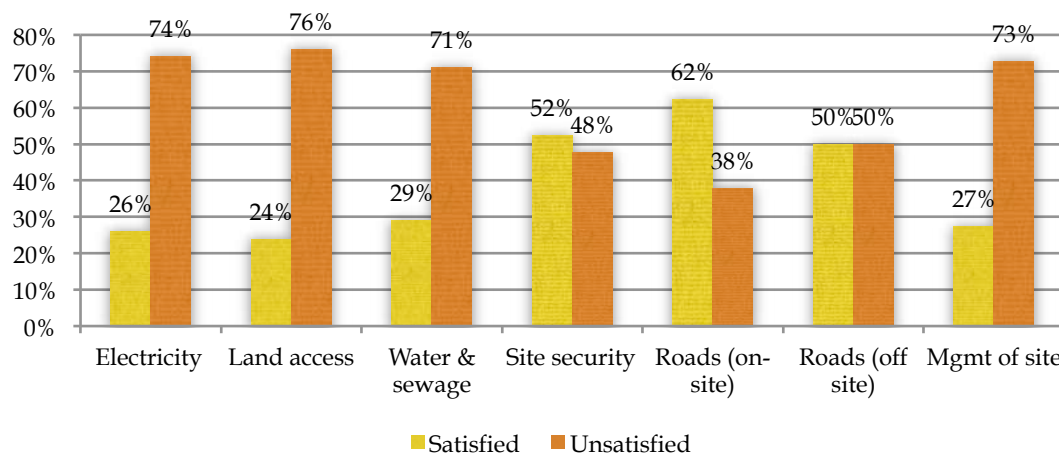
Access to Credit

Respondents in Jalalabad had been more adventurous in borrowing than other cities indicated. 42% companies had borrowed money over the past year but the issues was that more than half of the companies had borrowed from friends and family rather than formal channels of credit which severely restricts the amount of business credit that one had access too. The deteriorating economic conditions of the last year contributed to a quarter of the borrowers unable to improve their profits even with infusion of this credit.

Infrastructure & Business Environment

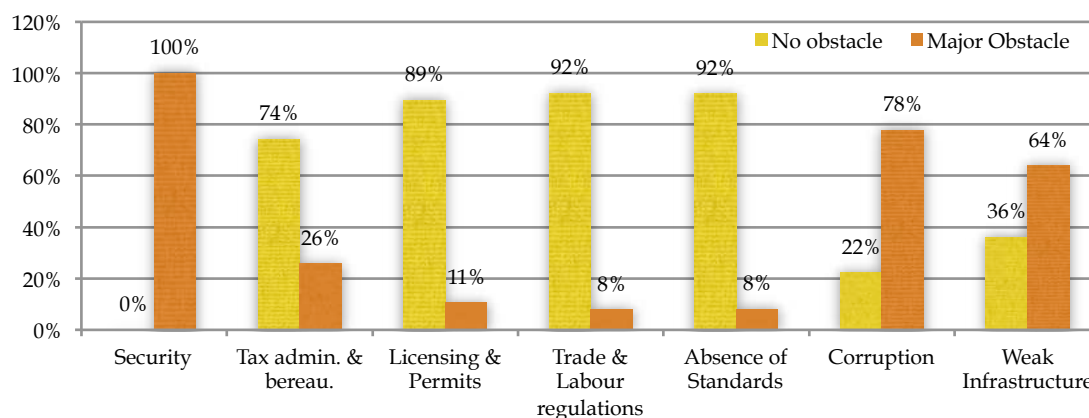
Electricity/power was the most major issue for Jalalabad with severe shortages and power cuts. 73% people indicated that they had city power only for 5-7 hours a day which makes any machine-based production activity highly unlikely to sustain itself. No one reported access to piped water. Consequently, dissatisfaction reported by respondents was high. In addition there are in-adequately paved roads, and non-existent water and sewage systems. Finally site security was the biggest concern for the business owners. 95% said that the operating costs for business were higher here than elsewhere. Consequently 29% respondents said they would consider moving out of the current location.

Figure 4.27: Jalalabad - Satisfaction with the level of infrastructure



Correspondingly the overall business environment in Jalalabad was not encouraging for development of any kind of economic zone. 88% people said they did not have access to markets from here and 20% respondents complained of inadequate transport and logistics provision. No one considered rating the security here more than 0 on a 5-point scale. In addition the tax administration and bureaucracy was a big obstacle to conduct business. 88% people said that the economic reforms of the past decade had brought significant growth and helped businesses to a great extent. Now however, 51% considered starting a business here as difficult rather than easy. 95% said the business climate in the last 12 months had deteriorated and 68% reportedly made a loss during the same period.

Figure 4.28: Jalalabad - Obstacles in business

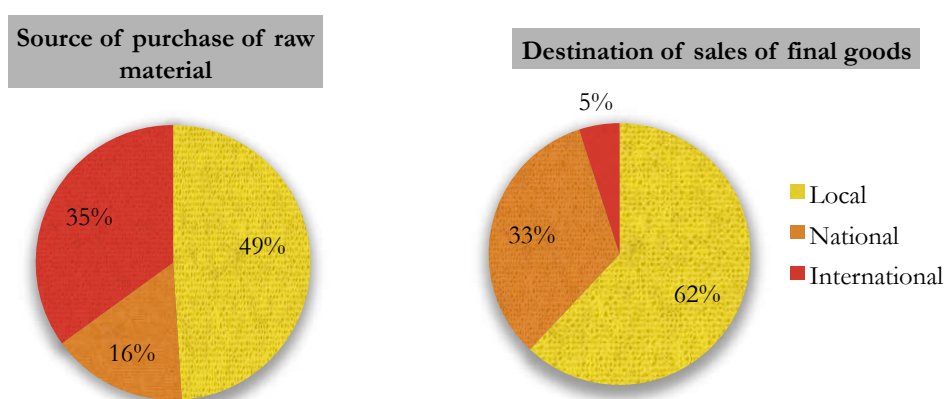


Trade

Respondents indicated that for their particular businesses it was difficult finding inputs within Afghanistan. It was the opinion of 61% respondents that the inputs were either not available at all or were very scarcely available. This meant that 36% respondents said that they directly imported from outside the country. Another 49% bought the goods locally, although presumably these were also imported goods merely sold by domestic importers. Import duty averaged between 2.5 to 5% which was still considered high by most since the quantity of imports was high, cumulative custom duty paid by traders in Jalalabad must be on the higher side. 62% of the final goods were locally sold indicating a large local market. 5% of the final goods sold were sold to customer across border.

Respondents in Jalalabad were contrarily unaware of the foreign competition and could not decisively say how much of their competition came from foreign producers. 62% however said that their goods face competition from other goods produced within by other domestic companies such as themselves. In the customer composition, between 5 years ago and now, sales to individual retail customers has reduced by 6%, to private institutional buyers by 9% and a marginal decrease in the supply to international actors.

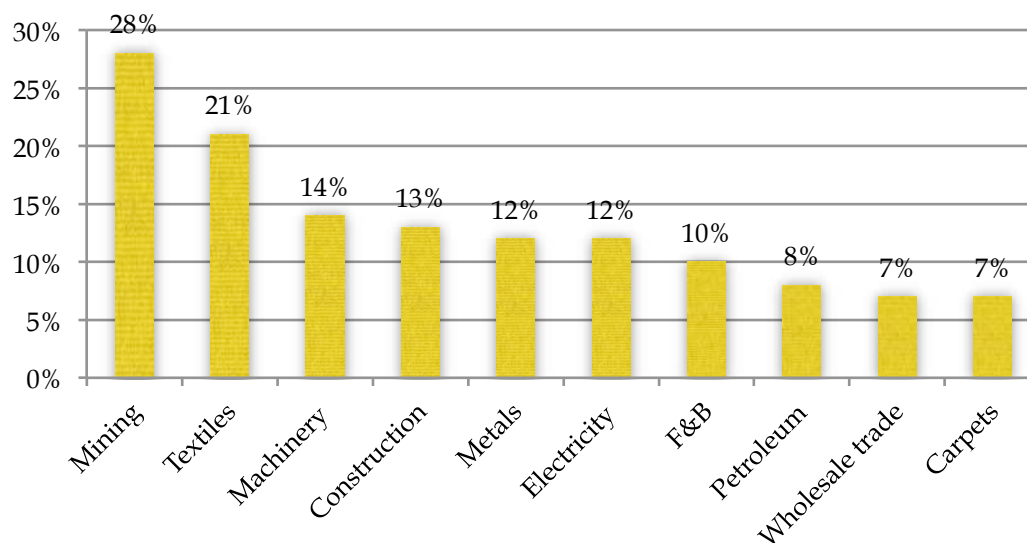
Figure 4.29: Jalalabad - Sources; Sale and purchase of final goods



Potential sectors for promotion

28% respondents from Jalalabad favoured the mining and extractives industries with the most potential to generate employment and value for the region. Jalalabad is in close proximity to copper and iron fields towards the west and an emerald site in the east. Finally there are chromite deposits within Nangarhar province⁶⁴.

Figure 4.30: Jalalabad - Sectors nominated as most promising to generate employment, value and growth of income



21% respondents indicated that there also might be substantial potential in the textile industry of Jalalabad. Cotton weaving and production of fabrics, hats, scarves, shawls and local garments are produced across various districts in the neighbourhood. Most of the manufacturing units are small-scale and labour intensive⁶⁵.

There is little published information to be found about the machinery-manufacturing sector in the region but there are 5 marble and 2 granite reserves in the province that can support a thriving construction sector in the province⁶⁶.

Finally, Jalalabad has almost 2000 hectares of land under olive plantation in its access. It is currently producing olives from 20 hectares with another 1400 hectares under on-going rehabilitation⁶⁷.

⁶⁴ World Bank SDNP-II

⁶⁵ AISA, (2013a), op. cit., p 1

⁶⁶ AISA (2012a), op. cit., p 8

⁶⁷ AISA (2009), op. cit., p 21

Critical Assessment

In Jalalabad, participants of the focus group identified a problem of currency exchange and multiple currencies that was causing issues as the exchange rate fluctuated and prices of the goods changed often. Participants noted that:

“Pakistani Rupee (PKR) and Dollar usage should be blocked at the stores, and that could be possible if the government established exchange markets at every four gates of all the provinces of Afghanistan and those who have PKR should exchange with Afghani currency to avoid the reduction price of Afghani against other currencies. We want the government to establish a special committee for blocking of PKR usage in Afghanistan so that we come out of these problems.”

This is an interesting finding, as economic zones both impact and get impacted by foreign exchange distortions. An unstable foreign exchange situation is a recipe for disaster when inviting foreign firms who will have import bills of 60-70% of the total purchases.

In the Focus group discussion with SME owners from the private sector, they said that the nature of corruption was such that it was difficult to deal with government officials on their own. As a result they have to hire middlemen who carry out registration, business renewals and get permissions. This is often more costly but less time consuming. Otherwise, they would end up spending a lot more time dealing with the government procedures and less time focusing on the business itself.

A first phase of industrial power is ready and operational with a second phase in planning⁶⁸. The extension comes with a dedicated transmission line and asphalt road connecting the IP to the main city. Additionally, business licensing and regulation, trade and labour regulations provided some support to the business in Jalalabad. The infrastructure however was weak requiring significant capital investment to develop power capacity. People complained of corruption in government procedures.

⁶⁸ Industrial Park Report

Table 4.5: Preliminary feasibility and SWOT analysis of EZ project in Jalalabad area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	Closest airport in Kabul international airport connected by the Kabul-Jalalabad highway (double lane, mostly undivided) Proximity to Torkham Pakistan border crossing means access to international port
	Access to input supply (Backward Linkages)	Access to local input market is limited due to the non-developed supply chains and rudimentary, non-commercial agricultural services; Domestic Input supply is mostly substituted by inputs from Pakistan; Input production flows into Pakistan rather than domestic enterprises
	Access to markets (Forward Linkages)	Technically Jalalabad would have the same access to domestic markets as does Kabul with an added travel time; Proximity to Kabul is its best advantage; International markets are only accessed through ports at Torkham and Kabul international airport.
Infrastructure		Industrial parks are the best bet for accessing high quality infrastructure for production in Jalalabad Off site infrastructure in electricity, water supply, land access and management of commercial site is unsatisfactory
Labour		Jalalabad has a high share of semi-skilled and skilled labour trained mostly in Pakistan. Majority are still unskilled labour and higher education services offer some chance of developing skill base
Business environment	Enablers	Trade and labour regulation; Licensing and permits
	Disablers	Tax system and bureaucracy; security; Absence of standards; lack of credit

<u>Strengths</u>	<u>Weaknesses</u>	<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> Existing Industrial Park Direct access to national markets Large labour supply Well developed communication Access to countries through international ports 	<ul style="list-style-type: none"> Corruption at custom locations Corruption in government procedures Lack of credit disbursement Absence of standards Benefits to women unlikely Weak offsite infrastructure 	<ul style="list-style-type: none"> Opportunity in light manufacturing sector Opportunity in business development services Added phase to industrial park development 	<ul style="list-style-type: none"> Region under threat of on-going conflict Labour cost competitiveness threatened by regional rates Dumping ground for industries in Pakistan Competition from industries across the border

KUNDUZ Socio-economic Profile

Kunduz province is located north of Kabul and borders with Tajikistan. The province also borders with Baghlan, Takhar, Balkh and Samangan provinces

Population

Total provincial population estimated to be 0.9 million, 48% of the population is between the ages of 15-60 with another 0.5 million to enter the labour force in the next 15 years



Education

Male literacy rate is 25.1% and female literacy rate is 8.9%. The Higher Education Institute of Kunduz has faculties of Social Sciences, Science and Training and Education. There is also an agricultural vocational school and a girl's commerce school in Kunduz



Infrastructure

84% of the urban areas in Kunduz have access to electricity. 68% of roads in the province are able to take car traffic in all seasons. Roshan, AWCC, AREEBA, DIGITAL Afghan Telecom are main service providers though unevenly distributed around the province.



Workforce Stats



Labour Force Participation (85%)
Employment-to-population (15%)
Unemployment (0%)
Not-gainfully employed (0%)

Employment



Day Labourer (28%)
Salaried worker (13%)
Own account worker (57%)
Employer (1%)
Unpaid family worker (1%)

Labour



Agriculture & livestock (86%)
Trade and Services (28%)
Manufacturing (8%)
Other (0%)

Source of Income

Credit Services

Informal lending through friends and family is the most common way of credit distribution. Information on formal credit institutions is missing. MISFA's implementing partner in the area is FMFB



Industrial Park

There is no industrial area planned for Kunduz



Key Potential Industries

The major industrial crops grown are cotton and sesame. The SME industry is under-developed textiles, rugs, carpets and jewellery. Listings for potential manufacturing industries that can thrive are difficult to find. However, Kunduz is on a major international trade route and thus presents huge opportunity for import and exports

4.6. KUNDUZ

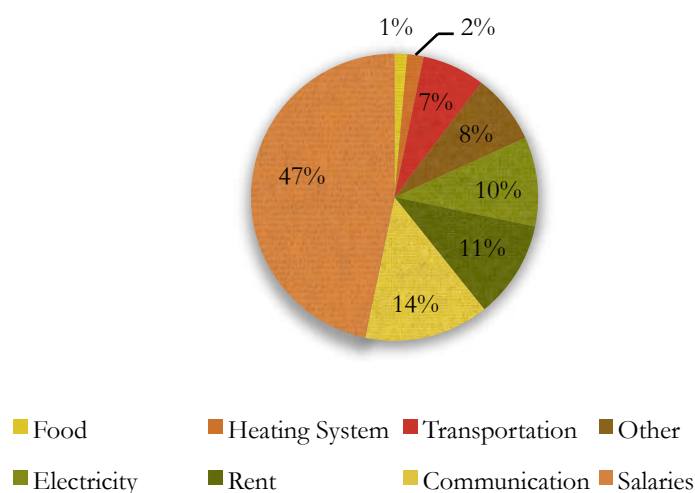
In the following section this report uses information from desk research and interviews conducted in the province of Kunduz to draw a picture of the economic context for the development of a potential SEZ. This section assesses the challenges and opportunities presented by the creation of a SEZ in Kunduz, based on findings from our research.

Business operating costs

Firstly, it was extremely difficult identifying business in Kunduz for survey. Kunduz is characterized by small import houses and businesses rather than any consequential production units. Though undoubtedly, present, medium scale enterprises were not surveyed indicating that Kunduz is largely characterized by smaller scale businesses. From the recorded workforce in the companies surveyed here, 51% in small-scale and only 5% in the large-scale companies were skilled workers. Besides, only 66 women per 1000 male workers were recorded in the city. 90% businesses characterized abundance of required skilled labour and 100% indicated it was easy finding unskilled labour in Kunduz. Moreover, 39% of the workforce currently employed was reportedly illiterate.

A relatively abundant labour supply then, translated to 47% of the total costs of businesses in the reported categories towards payment of salaries. Other major cost costs included communications, rent and electricity. As noticeable in primarily trading oriented cities, cost of business communications has been higher.

Figure 4.31: Kunduz - Share of costs of production



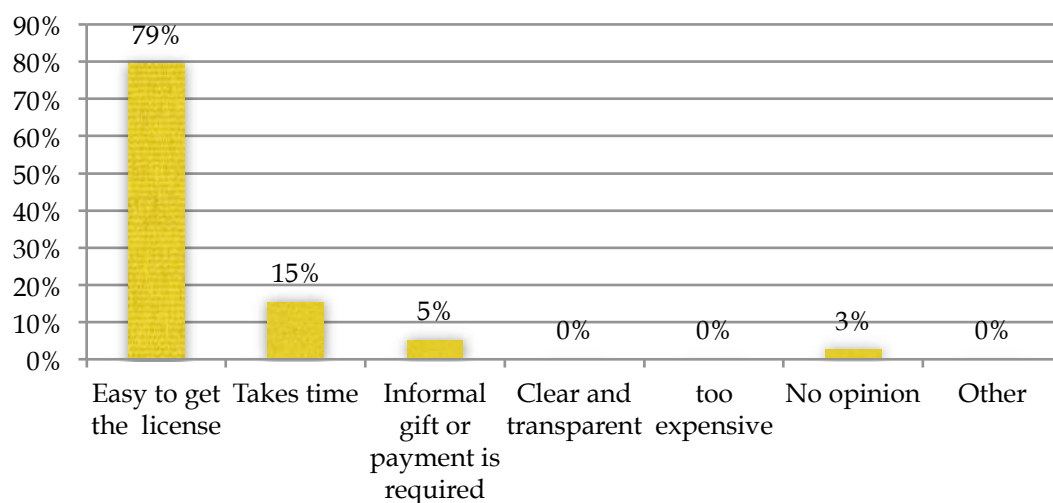
Regulations & National Standards:

Very few businesses were registered in Kunduz indicating sparse presence of any registration agencies here. Only 33% were registered with AISA and 21% each with MoF and MoCI provincial departments. The transfer of goods was most easily done

if businesses were registered in Kunduz. Regulatory presence of the government was correspondingly less with 87% people indicating government interaction for less than 1 day in a month.

Neither the tax system nor the national standards had much credibility. 62% people said they were unaware of the existence of national standards in the country. There was high amount of over reporting in the number of businesses who said they paid their taxes to the government. Independent of the experience that businesses might have had with the tax system, the general perception about it was that it was difficult to understand (59%) and rates were un-friendly to run businesses (56%). More than half also considered the tax system to be non-transparent (51%) and inefficient (51%).

Figure 4.32: Kunduz - Opinions on business registration process



Access to Credit

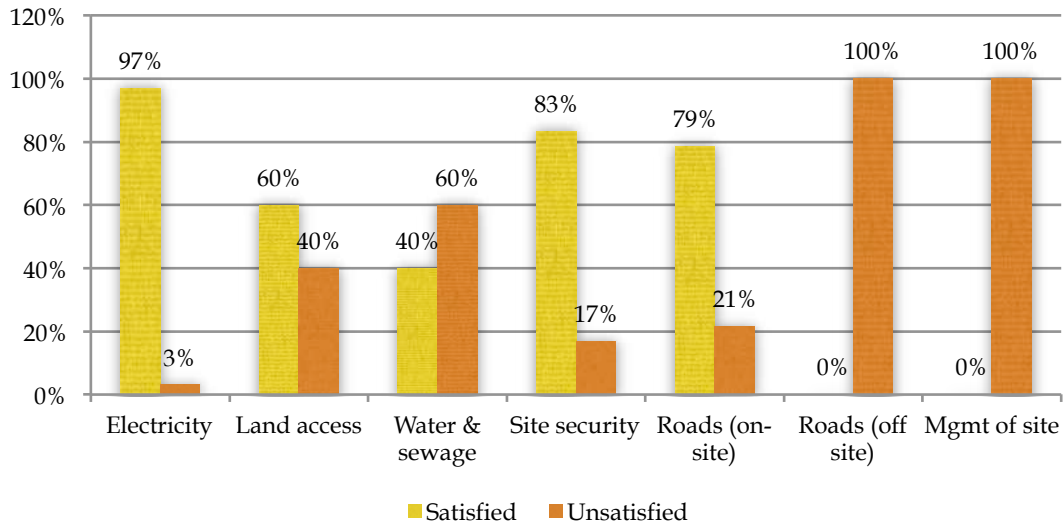
The testament to the fact that Kunduz was a trading city also comes from the fact that 49% respondents said they had taken on credit in the last one-year. This is because, trading in Afghanistan very often happens by taking on credit. However, formal lending was completely absent. The share of credit taking companies in Kunduz is significantly higher than what has been seen in any other city over the last one year. Half of these businesses borrowed from their social network and the other half borrowed money from shopkeepers (shopkeepers are the main creditors in the informal economy in Afghanistan). While 84% of the businesses said they expanded the scope of their operations, only 16% said it had resulted in more profit for their business.

Infrastructure & Business Environment

The nature of non-producing economic environment of Kunduz meant that activities were not heavily power dependent. City power in Kunduz was available for 8-12 hours a day in most locations. Piped water was available for 44% of the respondents and most of the rest managed with hand pumps. Physical connectivity is important

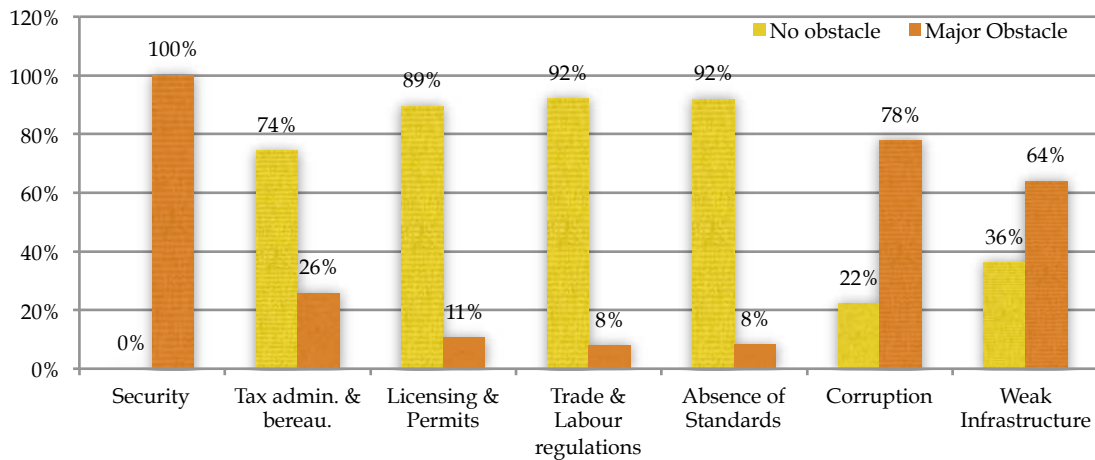
to traders to transport goods, and as such the infrastructure dissatisfaction came from absence of paved roads around Kunduz city except the one to and from the international border, which limited their access to markets for buyers and suppliers. 72% people said that being in Kunduz was convenient for domestic trading and 23% said it had easier regulatory environment.

Figure 4.33: Kunduz - Satisfaction with the level of infrastructure



The business environment in Kunduz was limited by security problems and the lack of opportunity to access markets. Finally corruption highly discouraged the business environment in Kunduz. As a result 62% said it was with some difficulty that one could start a business here. All respondents said that they considered the last 12 months to be bad for investment. During the same time as many as 51% businesses made a loss. Only 10% churned a profit.

Figure 4.34: Kunduz - Obstacles in business

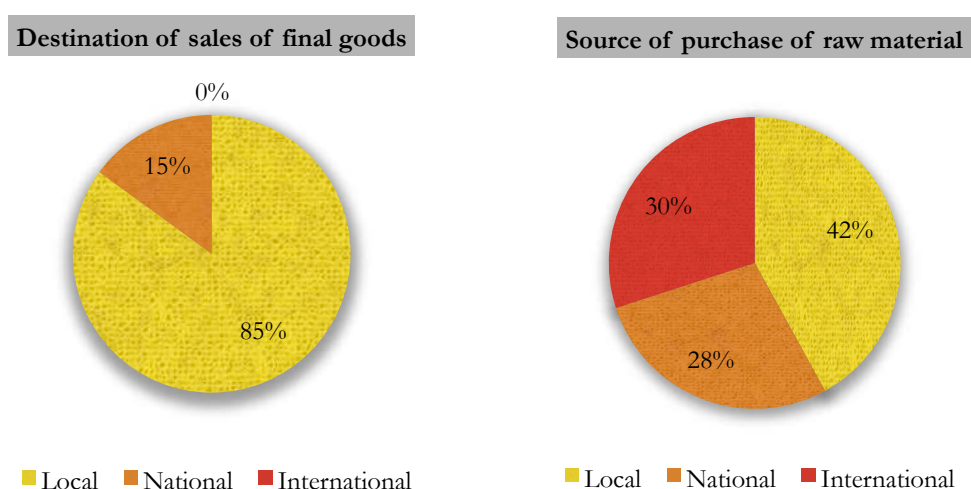


Trade

Kunduz, as mentioned previously, is mostly characterized by a trading economy. The trade, whether in inputs/raw materials for production or in final goods for wholesale or retail trade is skewed towards imports rather than exports. 30% companies said they acquire/purchase raw material directly from international sources. 42% got it from local purchases and 28% from sources based in the rest of the country. Pakistan, Iran and Tajikistan were the main trading partners. Kunduz hosts the Shir Khan Border in-land border crossing with Tajikistan, a gate to central Asian markets. The import duty paid at customs was indicated between 2.5 to 10%, which is what the official document also suggests. The same inputs were scarcely available in Kunduz. Finally, 85% of the final goods were traded locally in the city and just the remaining 15% were sold nationally. No one recorded in the sample sold their goods outside.

The producers/traders interviewed in Kunduz, said their goods were likely to face more competition from domestic made goods rather than foreign goods. Presently, 87% businesses said their customers were individuals, 41% said they sold to other private companies, 41% businesses said they sold to NGOs and 18% sold to government institutions.

Figure 4.35: Kunduz - Sources; Sale and purchase of final goods



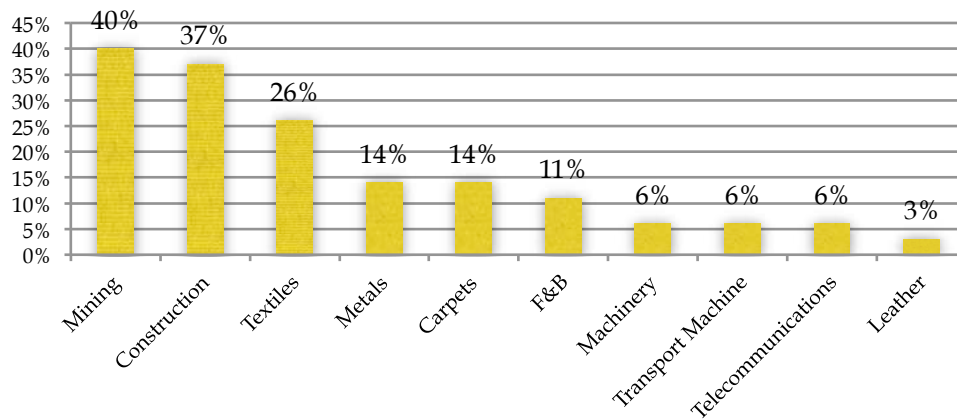
Potential sectors for promotion

From the primary survey, mining (40%), construction (37%) and textiles (26%) are regarded as industries that can generate employment and value in Kunduz. Under mining, Kunduz is located in the middle of two identified oil reserves. Additionally, it is the closest commercial centre to gold reserves identified across the province of Badakshan⁶⁹. Despite an extensive search, there was very little information available

⁶⁹ World Bank SDNP-II

about the Kunduz's industrial profile and development. Hence, it was difficult to derive any robust conclusions about its industrial base and future prospects in any other sectors.

Figure 4.36: Kunduz - Sectors nominated as most promising to generate employment, value and growth of income



Critical Assessment

Government interference in private activity was discovered when a participant of the FGD revealed that certain traders were favoured to import goods and products at cheaper costs while others had to pay bribes at custom points. Smaller traders blamed the free market regime the government had implemented saying that with government patriarchy and free market regulations smaller traders were being destroyed. As a trader puts it

“Some traders have established Mafia state and strong relationship with the governmental agencies as they have state support for ever. They are supplying their goods in market in a low price, which causes prices to fall. We don’t agree with the free enterprise system and we would like regulation against such practices.”

On a relative scale less, business in Kunduz were less dependent on manufacturing or service activities except for trading. With regards to trade and import, there had been a relatively lesser fall in investment climate. Having said that the respondents from Kunduz preferred that private investment be made towards productive activities so that Afghanistan can substitute some of its import requirements.

Kunduz on the on-set presented little existing infrastructure. Absence of an industrial park and trade dependent economy has neither developed nor created a need for the development of commercial infrastructure. Business environment was mainly restricted by the lack of security. Overall the lack of infrastructure is likely to offset any interest by foreign investors that can be created by offering free trade incentives and such.

Table 4.6: Preliminary feasibility and SWOT analysis of SEZ project in Kunduz area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	The access to Kunduz, is through a domestic and minimalistic airport currently only serviced by two domestic airlines. Kunduz is however linked by the highways with Mazar to the west and Kabul to the south
	Access to input supply (Backward Linkages)	Kunduz is primarily located between large scale agricultural areas but supply chain development is low; It suffers from the same subsistence type agriculture unsuitable to supply to manufacturing firms
	Access to markets (Forward Linkages)	The connectivity to domestic markets is good; Kabul and Mazar are both service by Kunduz, through inland transport network
Infrastructure		Commercial scale infrastructure development is absent; Electricity and water supply for production is less as are availability of paved roads outside of the city except for highways connections
Labour		Only the 5 th largest city Kunduz had little to offer in terms of quantity and quality of labour. Labour is primarily unskilled with very little in terms of education institutes operating in the city
Business environment	Enablers	Tax administration and bureaucracy; Trade and labour regulation; Licensing and permits
	Disablers	Security; Absence of standards; lack of credit

<u>Strengths</u>	<u>Weaknesses</u>	<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> • Existing trade networks • Direct access to national markets • Access to countries through international ports 	<ul style="list-style-type: none"> • Corruption at custom locations • Corruption in government procedures • Lack of credit disbursement • Absence of standards • Benefits to women unlikely • Weak infrastructure 	<ul style="list-style-type: none"> • Trade related services • Transport and logistics 	<ul style="list-style-type: none"> • Region under threat of on-going conflict • Import competition

PAKTIA Socio-economic Profile

Paktia province is located in the South-eastern region of Afghanistan with a small international border with Pakistan towards the east. Its capital is Gardez, and it is surrounded by Khost and Paktika, to the south, Ghazni to the west and Logar in the north

Population

Total provincial population estimated to be 0.5 million; 50% of the population is between the ages of 15-60 with another 0.2 million to enter the labour force in the next 15 years



Education

Male literacy rate is 43% and female literacy rate is 5.8%. A university have recently been established in the center of Paktia Province



Infrastructure

Only, 16% of the province is recorded to have electricity. 64.2% of roads in the province able to take car traffic in all seasons. Roshan was the only service provider noted in the area



Workforce Stats



Labour Force Participation Employment-to-population
Underemployment Unemployment

Employment



Day Labourer (18%) Salaried worker (18%)
Own account worker (58%) Employer (8%)
Unpaid family worker (2%)

Labour



Agriculture & livestock (59%) Trade and Services (19%)
Manufacturing (2%) Other (20%)

Source of Income

Credit Services

There is no any official credit program. Informal lending is the only source to credit noted in the area



Industrial Park

There is no industrial area planned for Paktia



Key Potential Industries

The major industrial crops grown are tobacco, seaserme and cotton. The major natural resources of this province are forest and gas. Wood and timber production are the main industrial strengths of the province but have to fight illegal forestation and land ownership uncertainties

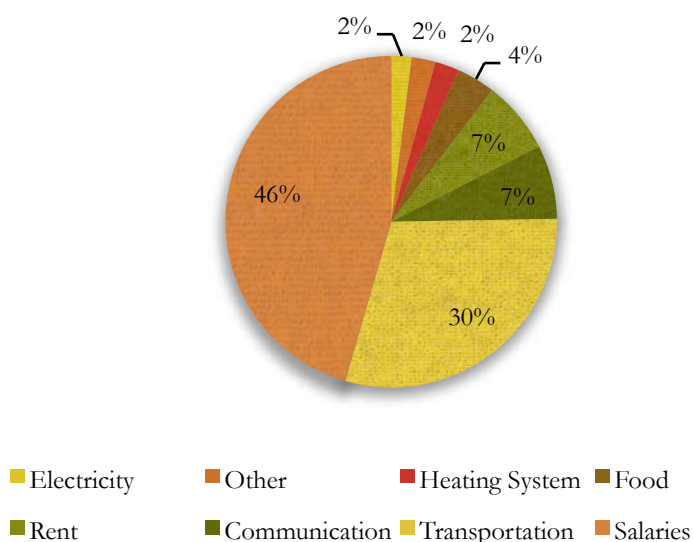
4.7. PAKTIA

In the following section this report uses information from desk research and 39 interviews to build a picture of the economic context for the development of a SEZ in Paktia. This report focuses on seven key areas of interest. This report then assesses the challenges and opportunities presented by the creation of a SEZ in Gardez, based on findings from our research.

Business operating costs

Employee salaries and transportation costs together account for 76% of the operating costs for business in Gardez. Communication and rent both account for 7% of the operating cost each. The electricity cost incurred in Gardez was even less than cost for food and heating system.

Figure 4.37: Gardez - Share of costs of production



The average number of employees in a small company was 7; 77 for a medium-sized company; 142 for a large company. Unskilled workers account for a larger share of workers in larger companies (78%), than in their smaller counterparts. There were 53 women employed for every 1,000 employed men mostly in assistance form to the main employer of some kind.

Employers claimed that nearly 35% of the workers in Gardez were literate and another 35% of were literate. The share of literate workers in the workforce was large; the only other city, which reported a larger share of literate workers was Mazar-e-sharif.

Regulations & national standards

In Gardez, most businesses operated out of the informal market. 13%, more than another location, businesses said that they were unregistered while 41% said were registered with the municipality. Only 21% said they were registered with AISA and 13% with MoCI.

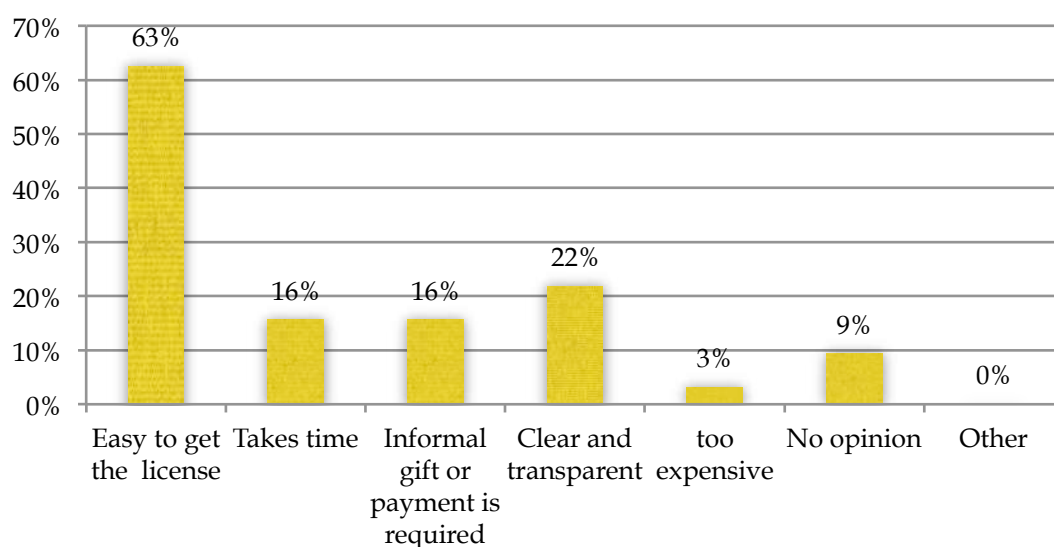
51% of respondents reported it was easy to register with the authorities. However, since very few businesses were actually registered with AISA, it is difficult to ascertain the difficulty in

registering through the correct process. The main advantage of registering with the government was that they could get space (land or building) to work from.

The reported median time to receive a business license was one month. The share of respondents who indicated the interference of the government in month of business activity was less than 1 days was 8%; 1 to 2 days was 15% and more than 3 days was 42%. This is similar to the levels recorded in Jalalabad and Kandahar.

More than half the people in Gardez said they were not aware of the existence of any kind of national standard. Even though 46% people said they knew national standards existed, no one could correctly name any of the standards for products that are applicable to Afghanistan. In Gardez 13% businesses said that they did not pay taxes. Majority (more than half considered) the tax system to be easy to understand, efficient and transparent.

Figure 4.38: Gardez - Opinions on business registration process



Access to credit

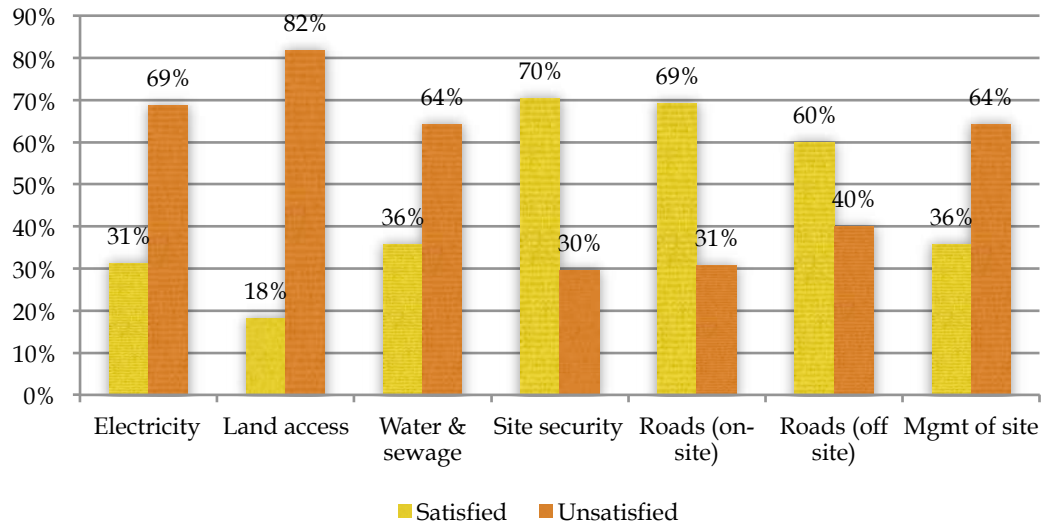
In Gardez, 69% of the respondent companies said they had not borrowed money in the last year. This was in part due to the lack of availability of credit and lack of demand for credit due to low investor sentiment. None of the respondent borrowed from a financial institutions and most relied on family and friends, shopkeepers and local land-owners to get credit. Only 1 branch of the Kabul Bank was noticed in the town. However three quarters of the respondents who had borrowed said that it served them well in their business.

Infrastructure & Business Environment

The availability of city power through gridlines was abysmal in Gardez, 49% respondents saying they did not have city power at all and 33% saying they got it for 8 hours a day. Generators sustained the little power that was used. Not a single person reported having access to piped water in the city. 95% said they relied on hand pumps.

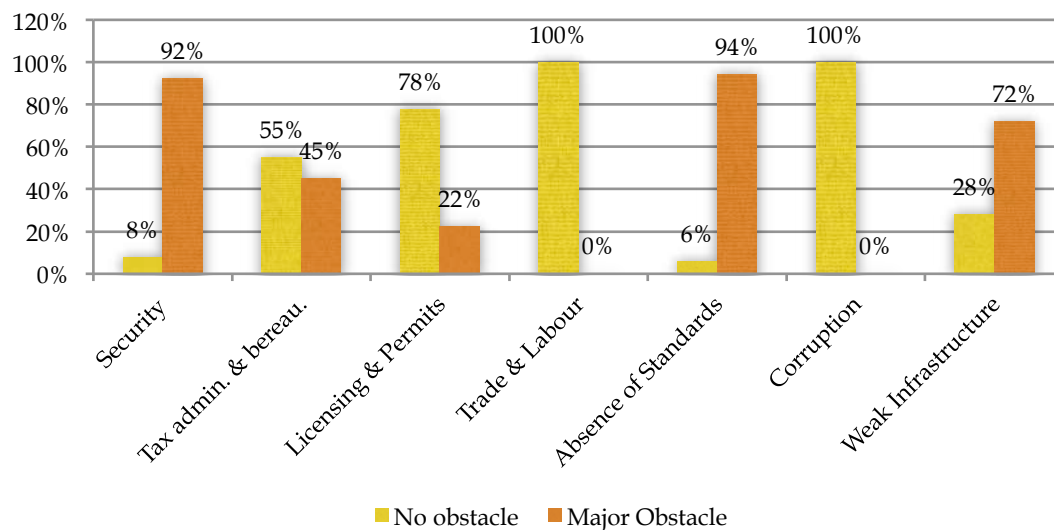
The connectivity to Gardez is also not great. There is one road that connects Kabul to Gardez. However a new agency reported increasing theft on that highway. Gardez has a small airport mostly serving international aid transport. Currently number of commercial flights to Gardez are unknown.

Figure 4.39: Gardez - Satisfaction with the level of infrastructure



As can be seen from the graph above there is large discontent in the access to basic infrastructure such as electricity, land and water, which puts the infrastructure conditions in Gardez at the lowest amongst all the cities surveyed.

Figure 4.4: Gardez - Obstacles in business



Biggest obstacle to business in Gardez was the lack of security. The conflict in the neighbouring regions and in Gardez was not allowing any investment to flow through. And that is also the reason why infrastructure had not developed.

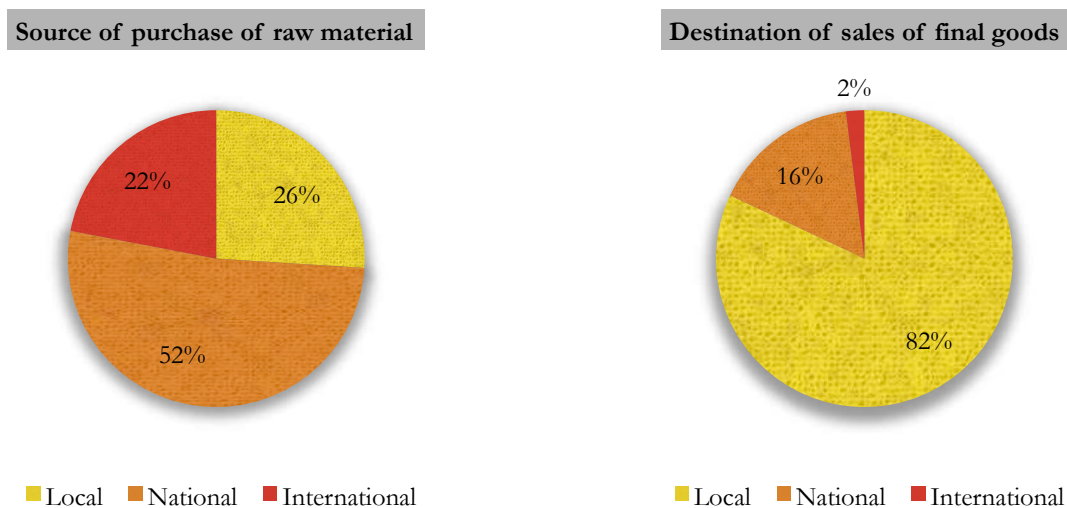
48% respondents reported that it was difficult to start a business in Gardez whereas only 16% said it was easy. 48% also said that registering a business in Gardez was difficult where as 21% said that it was easy. 64% respondents said that the investment climate in Gardez had gotten worse in the last 1 year. Consequently 59% people said that they either just broke even or made a loss on their business over the last 12 months. Over a larger time scale however, 90% people said that economic reforms in the past decade had helped improve business from at least a small to a large extent.

Trade

38% people indicated that their markets customers were within Gardez city; 46% said they were in the same province; 10% said they were in the same country and only 3% sold their products nationally.

5 years ago, 89% of the surveyed businesses said they supplied to individuals whereas only 39% supplied to other businesses indicating a more retail consumer market than business-to-business selling. The share of sales to other private companies presently has fallen to 16% indicating a further reduction in business. Sales to NGOs and international organisations have fallen from 11% to 5% in the last 5 years. Sales to PRTs have nearly stopped.

Figure 4.40: Gardez - Sources; Sale and purchase of final goods



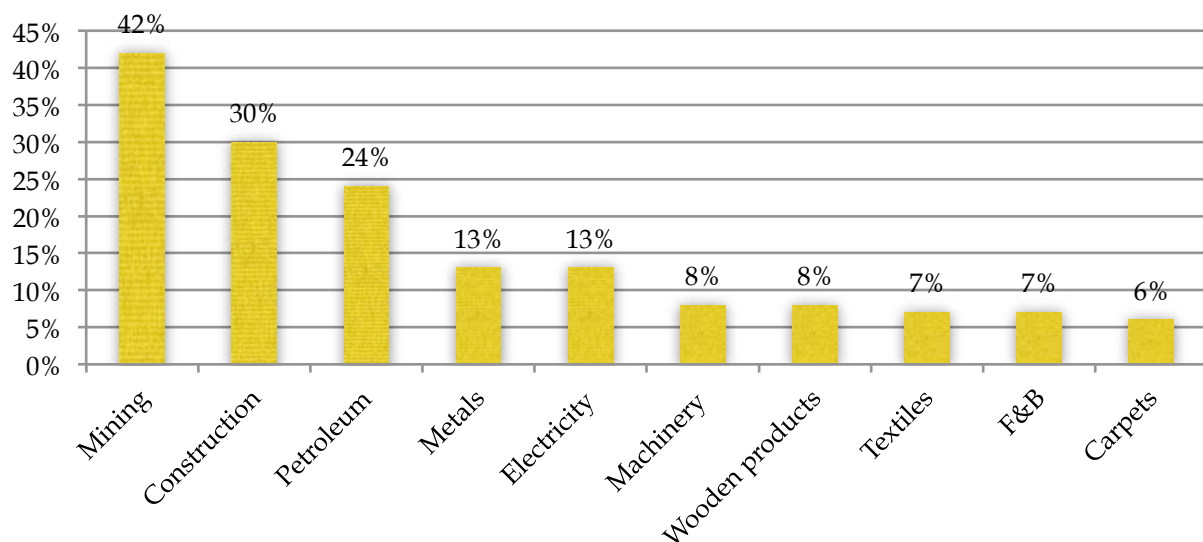
The charts above indicate 22% of the input purchase came from international sources - imports. Where as only 2% of the final goods produced were exported outside the country. While 33% said that they did not know what the import duty was, 67% said that the import duty was between 2.5% to 10%. 40% people thought that this was very high for their businesses.

53% businesses surveyed said that the inputs they needed were available in Afghanistan indicating that companies operated from utilizing domestic produce.

Potential sectors for promotion

Mining (42%), construction (30%) and petroleum (24%) were the most selected industries by the respondents to generate employment and value in the region. However, with the scarce information available, there is hardly any potential noticeable. Gardez the capital is close to at most 1 copper field that could support some manufacturing. Petroleum however was an odd choice for Gardez given there were no oil fields or substantial trading taking place in the region.

Figure 4.41: Gardez - Sectors nominated as most promising to generate employment, value and growth of income



Critical Assessment on locating a SEZ in the Gardez area

Gardez economy is weak and still highly rudimentary. Most important of all, there are fundamental difficulties in doing business namely, the insecurity and the weak infrastructure. At a second tier there is an absence of credit services and absence of any regulatory authority in Gardez to regulate or promote investment. A government official who worked in the commerce department of the provincial office said, “Paktia (Gardez) has lost investment from its own local people to other countries due to its weak infrastructure and security”.

The lack of adequate connectivity to the province with the rest of the country also adds a hindrance to development. As another government agent puts it, “Gardez may become a site for a special economic zones if setting up transit routes and collaborations with other businesses in the country can be made a priority for development”. This does not seem to going well as a news agency in 2013 reported the number of thefts on the Kabul-Gardez highway have been on the rise.

The only redeeming quality of Gardez is the proximity to the Pakistan border that has an official transit route. 3 of 6 surveyed government agents pointed at the transit route saying that that is the biggest strength of Gardez to develop as an economy. However, that hardly seems enough to cover for its other deficiencies.

Table 4.7: Preliminary feasibility and SWOT analysis of SEZ project in Gardez area

Criteria	Sub-criteria	Critical Assessment
Location	General Access	<p>Gardez is connected to Kabul by a 103 kms long highway with travel time between 2-3 hours.</p> <p>Status if highway deemed unsafe due to insurgent activity and thefts</p> <p>There is an airport but capacity of the airport in terms of passenger and freight transport is unknown</p>
	Access to input supply (Backward Linkages)	<p>Businesses in Gardez seem to rely more on domestic input production than most cities;</p> <p>However nature and type of this connectivity is unknown and hence indeterminate</p>
	Access to markets (Forward Linkages)	<p>There is hardly any connectivity to the major domestic markets;</p> <p>Gardez shares a border with Pakistan with an official transit route that can access international market</p>
Infrastructure		Basic infrastructure such as electricity and water (even for non-commercial use) is absent;
Labour		<p>There is not very abundant labour present in the city as it is the smallest city in all the 7 that were surveyed</p> <p>Labour is primarily unskilled with very little in terms of education institutes operating in the city</p>
Business environment	Enablers	Trade and labour regulation; Licensing and permits
	Disablers	Security; Absence of standards; lack of credit; lack of infrastructure

<u>Strengths</u>	<u>Weaknesses</u>	<u>Opportunities</u>	<u>Threats</u>
<ul style="list-style-type: none"> • Access to an international transit port 	<ul style="list-style-type: none"> • Absence of credit institutions • Lack of infrastructure • Lack of physical connectivity • Benefits to women unlikely 	<ul style="list-style-type: none"> • Trade related services • Transport and logistics 	<ul style="list-style-type: none"> • Region under threat of on-going conflict

5. RECOMMENDATIONS

Previous analysis has identified the options for location of a SEZ as Kabul, Mazar-e-sharif, and Herat. In this section, this report provides recommendations on the potential shape of a SEZ in each of location.

5.1. CHOOSING A LOCATION FOR SEZ

The previous section of this report provides an economic analysis of each region of Afghanistan, covering:

- Business operating costs;
- Regulations and national standards;
- Access to credit;
- Infrastructure and the business environment;
- Trade; and
- Sector analysis; and
- Critical assessment of location ad SEZ in the area.

In this section, this report compares the options for the location of a SEZ in Afghanistan, taking these areas of interest into consideration.

Table 5.1: Ability to host SEZ, Regional Scores (1-10)

Categories	Kabul	Herat	Balkh	Kandah	Nangar.	Kunduz	Paktia
Business Operating Costs	3	6	4	2	4	7	5
Regulations and National Standards	4	5	7	2	3	4	6
Access to credit	6	4	4	1	4	2	0
Infrastructure and Business Environment	8	7	7	5	5	5	4
Trade	6	4	5	5	7	6	7
Location	8	7	7	4	5	5	1
Sector Potential	7	7	7	2	6	1	1
Critical assessment for location of a SEZ	7	7	8	2	4	2	2
Average	6.1	5.8	6.1	2.8	4.8	4.2	3.3

This report has summarized the analysis from the regional profiles in Table 5.1 above. Each region was rated on a score of one to ten based on the responses given by quantitative respondents and put within context of all the qualitative data available from the field. In all the

categories 1 represents the worst of the category and 10 represents the best. This report took an average of the scores to obtain a figure for overall comparison.

This represents a subjective assessment of the information from the qualitative interviews, field observations and secondary information. The information here is nuanced and complements information derived from responses of the various participants of the survey.

This analysis scores Kabul and Mazar-e-sharif as leading options for development of a SEZ, followed by Herat. Kandahar and Gardez score the lowest.

The final analysis focuses on three key criteria for the location of a SEZ in Afghanistan: business environment, infrastructure and business cost. An index was created based only on the responses provided by the respondents of the survey to some critical questions relating to the 3 categories. The responses to these questions have been illustrated in table A.5. The index for each of the 3 categories was constructed by taking a simple average of the perceptions of the respondents for the following indicators

- Business environment: Security; Tax administration; Trade and labour regulations; Business Registration; National Standards and Starting a business
- Infrastructure: Electricity; Land and land titles; Water and sewage systems; Site security; Paved roads onsite and offsite; Management of the locations
- Cost: Labour Cost; Operating Costs; cost of importing

Under the cost head, the analysis required running a regression to isolate and aptly describe costs. Box 4.1 describes the regression analysis in more detail.

In the graphs, the 'x-axis' reports the index for business environment, the 'y-axis' reports the index for infrastructure and the diameter of the bubble (representing the locations) describes the index for cost of business.

From this, Mazar-e-sharif, Herat, and Kabul scored the highest in terms of infrastructure and environment i.e. the bubble for these regions is furthest out in the direction of the top-right corner of the graph. However, the cost of business in Kunduz was substantially larger. Similarly companies located in IPs reported having better access to infrastructure at a reduced cost than those outside; however, companies outside of IPs reported having a better business environment.

While Kunduz and Gardez score well on the numeric indices, the adverse security climate in the region and the lack of industrial development⁷⁰ indicated in the regional profiles must be taken into consideration. Such constraints to business development in these areas are significant, and render these locations unsuitable for the location of a SEZ. As such the next best options are promoted over these locations. Herat is already a commercial town, is well connected, has existing industrial parks and industries and offers a more stable environment to do business is the natural next choice to locate a SEZ. Overall comparison of the locations thus must take into

⁷⁰ The lack of industrial development is considered for more weightage because, the responses for perceptions on business environment and infrastructure depend upon the relative demand for these components. For instance a more industrially developed region will have higher requirement of a better business environment and infrastructure than a primarily agricultural region. In this sense the answers become subjective and have to be scaled in different regions to be considered.

account the technical as well as soft considerations that have been presented in the regional profiles.

Together, the comparative analysis suggests Kabul, Mazar-e-sharif, and Herat as the most suitable locations for the development of a SEZ in Afghanistan. While not surprising, this analysis has the advantage of being corroborated by both subjective (perception survey) and more objective (official data, observations, desk review, site-assessments) sources.

Regression to estimate labour cost and operating cost

To get the correct picture of labour cost, this report needs to estimate how much would a company need to pay to hire the labour in different locations around Afghanistan. For instance, to hire a daily labour in Kabul might be more expensive than hiring the same labour in Kandahar assuming that the cost of living for that labourer in Kabul is higher. Assuming that the salary consists of a basic cost of living expense 'labour cost' plus a 'premium' for the skill of the labour, this labour cost is the same for skilled and unskilled labour (since the cost of living for anyone is the same in any one city). How to remove this premium from the given responses of salary costs?

A regression estimates the additional salary expense that was incurred from hiring a skilled and unskilled worker. By removing this additional salary estimate from the original salary cost reported by each surveyed company, the residual only consists of the average wage per employee that comes with living in that particular city, i.e. the 'labour cost'.

$$\text{Monthly Salary (reported)} = \text{Labour Cost} + \text{Skill Premium}$$

$$\text{Estimated skill premium for skilled workers} = 1,986 \text{ Afs; unskilled workers} = 478 \text{ Afs}$$

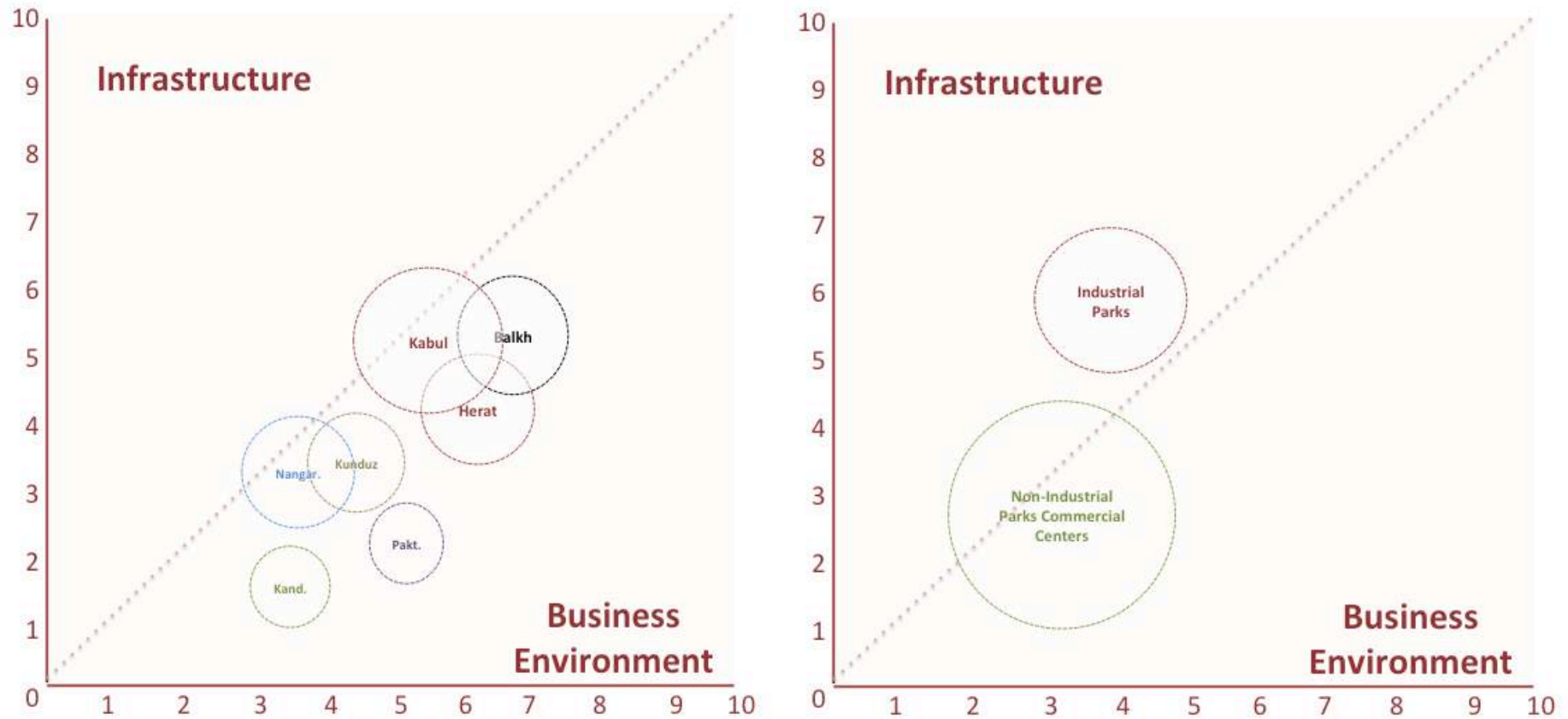
Similarly, firms reported a total operating cost for all their operations carried out in the city. However, these operating costs depend on the scale of the company. It was assumed that the operating cost consists of a minimum cost of operation that comes from locating in a city and an additional expense from operating at different scales. For operation cost a similar regression was run so that the effect of the 'scale' (indicated by the number of people it employs) of the company on the operating cost could be determined. By subtracting this, we were left with the minimum cost of operation for each company in the region it was located in.

$$\text{Monthly operating Cost (reported)} = \text{Operating Cost} + \text{Scale Increment}$$

$$\text{Estimated scale increment for Small scale} = 126,006 \text{ Afs; Medium Scale} = 161,323 \text{ Afs; Large scale} = 766,368 \text{ Afs}$$

After estimating the labour and operating costs for each company, the regional average was estimated by taking a simple mean of the costs across all companies. Similarly a national average of the costs was also estimated. To facilitate a national comparison between the regions, the index was determined by the number of companies in each region whose operating costs are lower than the national average.

Figure 5.1: Visual mapping of quantitative indices



Note:-The 'x-axis' reports the index for business environment, the 'y-axis' reports the index for infrastructure and the diameter of the bubble (representing the locations) describes the index for cost of business.

5.2. ROADMAP FOR THE DEVELOPMENT OF A SEZ

This section considers which type of SEZ best fits the Afghan context, and describes critical success factors. The section also describes the sectors that should be considered under each potential location. Further, the potential economics impacts of a SEZ in the local area, and how best to harness these are described part of the analysis. This report considers the infrastructure requirements and key challenges to developing a SEZ in each location. Finally, this report concludes with a table summarising our analysis.

The form of a SEZ in Afghanistan

The Afghan government does not have available funds to own and manage a SEZ. However, a fully private SEZ is unlikely to be successful in Afghanistan. The infrastructure requirements are too high to expect the private sector to meet these. Thirty years of socialism have left an expectation of government provision for business services. There is a general attitude of mistrust of foreigners.

Recommendation

- A PPP is the recommended option for the creation of a SEZ in Afghanistan
- The PPP could include equity-sharing arrangements⁷¹, where firms are provided with a long-term lease, but are able to exercise a purchase option after demonstrating a satisfactory level of performance.
- Hence, create a PPP model to be passed into legislation where the private and government responsibilities are clearly articulated with failure standards against both enumerated so that monitoring and evaluation is built into the framework. Section 3 in this report lays down the considerations for creating such legislation.
- Build upon existing IPs to leverage infrastructure services for a SEZ

SEZs in the Afghan context: cross-cutting critical success factors

Whereas traditional thinking on SEZ highlights the importance of fiscal incentives, recent research by the Foreign Investment Advisory Service (FIAS)⁷¹ suggests that the reliability of supporting infrastructure is a more important concern for investors. The policy and incentive framework, location, and management of a SEZ are also critical success factors.

Common reasons for failure have been identified as:

- Poor site locations, entailing heavy capital expenditures
- Uncompetitive policies – reliance on tax holidays, rigid performance requirements, poor labor policies and practices
- Poor zone development practices – inappropriately designed or over-designed facilities, inadequate maintenance and promotion practices
- Subsidized rent and other services
- Cumbersome procedures and controls
- Inadequate administrative structures or too many bodies involved in zone administration

⁷¹ “Special Economic Zones” (2013), op. cit

- Weak coordination between private developers and governments in infrastructure provision⁷².

Sectors

SEZs often focus on specific sectors. The decision as to which sector for focus will depend on the location. The sectors for promotion in Kabul will not be suitable for Herat, for example. In all three locations identified for a potential SEZ, respondents to our survey reported the Mining and Construction sectors as those with the most potential for development. The third sector in the top three most popular responses was Textiles in Kabul, Food and Beverages in Herat, and Electricity in Mazar-e-sharif⁷³. This last mention may suggest that respondents do not always understand the role played by SEZs, as Afghanistan imports its electricity and only marginally produces hydropower and solar energy for domestic purposes. Moreover, these subjective prioritizations are not necessarily relevant, as the development and growth of a special economic zone in Afghanistan could also differ from those of other countries. SEZs may not be sector-driven but more dependent on a diversified local reality – including agribusiness, extractive industries, construction, manufacture, and services. However, considering the national priorities of the Afghan economy and the existing competitiveness of Afghan products at the regional scale (vs. Pakistani producers), one could argue that SEZs should focus on *agribusiness* and include the more profitable segments of the value chain (e.g. packaging, marketing, etc.), as:

- Agriculture, according to World Bank estimates and taking into account a worsening environment, is likely to stay the key job-provider in Afghanistan;⁷⁴
- Afghanistan still suffers from the poor productivity and competitiveness of its agribusiness sector and has a significant margin of improvement in all the segments of the agricultural value chain;⁷⁵
- The other traditional sectors of the Afghan economy have significantly suffered from the reduction of foreign assistance (construction, services, transportation);⁷⁶
- Last, while extractive industries clearly represent a fantastic potential for the Afghan economy, their actual development is still hampered by many caveats and uncertainties. On the longer-term though, the integration of extractive industries within SEZ should be a priority of any ambitious economic strategy.⁷⁷

⁷² Special economic Zones performance, lessons learned, and implications for Zone development, April 2008, FIAS.

⁷³ For more information, please refer to Sector Potential for Promotion under the regional profile sections.

⁷⁴ The World Bank, Afghanistan Economic Update, April 2014.

<http://documents.worldbank.org/curated/en/2014/04/19425195/afghanistan-economic-update>

⁷⁵ Idem.

⁷⁶ Idem.

⁷⁷ Samuel Hall Consulting, (2014), *A Community Perception Survey of Mining in Afghanistan*, Commissioned by the World Bank.

Economic Impacts

This report has identified five economic impacts of the creation of a SEZ in Afghanistan.

1. Skills upgrading

Afghanistan's workforce remains largely unskilled, despite significant improvements in education indicators over the last ten years.

Data from the WB Enterprise Survey (2014) indicates that more than 40% of the workforce is unskilled in each of the three regions this report considers for location of a SEZ. Access to adequately skilled labour is considered to be a major constraint for roughly 50% of the firms in Kabul and Mazar; this figure is 90% for firms in Herat.

Creation of a SEZ can have positive impacts on the skills levels of the local labour force. Local businesses demand workers with skills for their relevant industry, and invest in the appropriate training for their staff. In some instances, however, foreign investors in a SEZ will import labour from their home country, reducing the opportunity for training of local workers.

Recommendation:

- ✚ Limit the ability of firms located in the SEZ to use foreign labourers.
- ✚ Support sectors that do not require skilled workers in the initial stages, i.e., invite and promote FDI in low skill manufacturing sectors.
- ✚ Partner with educational institutions to support degree and diploma educational courses in human resource management, engineering, finance and accounting, language and vocational skills like carpentry, metal work, mining etc. This will help fuel future demand for skilled labour as manufacturing levels progress.

2. Export promotion

The Afghan economy is heavily dependent on imports. Importantly, Afghanistan imports many of its raw materials for use in local manufacturing activities. Afghan products are not exported. Roughly 6% of Afghan sales are exports⁷⁸. This is less than half the figure from comparator countries (WB Enterprise Survey 2014). The balance of trade is therefore poor. A SEZ could improve this situation, through the encouragement of FDI. Foreign investors have important networks to international markets, and will be able to sell Afghan products abroad.

Each of the three locations this report has highlighted in our analysis is well-connected to international markets. Our primary research indicated corruption to be a major concern for cross-border trade, however. If Afghanistan wants to be a serious player in international markets, it must become more effective in monitoring and regulating activity at the borders.

⁷⁸ Either indirect or direct. The comparison with direct exports only is worse: 3% in Afghanistan, against almost 8% in comparator countries.

Recommendation:

- ✚ Secure borders near the SEZ
- ✚ Improve customs procedures at ports near the SEZ by automating processes at customs locations and setting minimum time and cost criteria standards. Minimum time and cost criteria standards means that if goods are stuck on borders for a minimum time period, they are eligible for automatic clearance.

3. Employment generation

Businesses in SEZs require workers for their operations, however certain sectors are more labour-intensive than others. A successful SEZ could employ a large number of workers. This will depend on the type of industries located in the SEZ.

Recommendation

- ✚ Support labour-intensive sectors

4. Economic spill-overs

Poverty in Afghanistan is widespread. The poverty rate is 36%, and has not increased since 2008 (WB Country Snapshot). Although some provinces are richer than others, and poverty is most prevalent in rural areas, broad-based economic growth is required to lift the majority of the population out of poverty. Inequality has increased in this period. The Afghan population has not equally shared the economic improvements of the last decade.

A SEZ should disperse its benefits as widely as possible. This can either be through creating backward linkages to national input providers, or by serving as an example for reforms in other parts of the country.

Recommendation

- ✚ Require businesses in the SEZ to source their inputs locally.

5. Female employment generation

Female participation in Afghanistan's labour force is low. Roughly 20% of full-time workers in Herat and Kabul are female according to 2014 WB data (Enterprise Survey). This figure is only 5% for Mazar-e-sharif.

SEZs have traditionally been successful in encouraging female participation. Female workers account for 60-70% of employee in all zones worldwide. This may be due to the fact that the types of industries that employ female workers are often located in SEZs e.g. garment manufacturing.

Recommendation

- ✚ Encourage industries focused on simple assembly lines

Challenges and infrastructure requirements

The WB Enterprise Survey collects data on the biggest obstacle to doing business and infrastructure concerns. Political instability is considered to be the biggest obstacle to business in Herat and Kabul (WB Enterprise Survey). In Mazar-e-sharif, this is Access to Land.

Afghanistan has one of the world's lowest rates of electricity use. Less than one quarter of the population is estimated to be connected to the grid. 92% of firms in Herat reported lack of electricity to be a major constraint to doing business. Kabul business reported more than 80% of their electricity comes from a generator; 96% of business in Kabul owned a generator.

This report has summarised these considerations for Kabul, Herat and Mazar-e-sharif in Table 5.1.

Table 5.2: Impact Module with SEZs for Kabul, Herat and Mazar-e-sharif

Location	Sectors	Infrastructure requirements*	Key challenges	Opportunity for Impact				
				Skills upgrading	Export promotion	Employ generation	Economic spill overs	Female employment
Kabul	Agribusiness Mining Construction Textiles	Electricity	Access to land; Political instability; Corruption	Medium	High	Medium / High	Low/ Medium	Medium
Mazar-e-sharif	Agribusiness Mining / Petroleum Electricity Construction	Electricity; Physical access to other markets	Access to land; Access to finance; Political instability	Medium	High	Medium	High	Medium
Herat	Agribusiness Mining Food & Beverages Construction	Electricity; Roads (exports)	Access to land; Access to finance; Political instability	High	High	Medium	Medium	Low

Kabul:

- ✚ Connect the Bagrami and Pul-e-Charkhi industrial park to consistent commercial electricity supply, providing high capacity transformers and distribution network. The program should target to minimize the cost through subsidies or financing.
- ✚ Improve access to and from industrial parks with direct connections to Torkham international port and Kabul international airport.

Mazar-e-sharif

- ✚ Connect the Mazar industrial park to consistent commercial electricity supply, providing high capacity transformers and distribution network. The program must target to minimize cost of electricity.
- ✚ Improve access to Shir Khan, Hairatan and Aqina international customs crossing and Mazar-e-sharif international airport with direct access routes
- ✚ Connect the industrial park with the Northern Afghanistan Railway Network with rail connection coming out of the industrial park so that freight transport by rail can be facilitated.

- ✦ Connect the Herat industrial park to consistent commercial electricity supply, providing high capacity transformers and distribution network. The program should target to minimize the cost through subsidies or financing.
- ✦ Improve access to and from industrial parks with direct connections to Islam Qala and Towraghondi international port and Herat international airport.

5.3. GENERAL RECOMMENDATIONS FOR STAKEHOLDERS

The following section outlines recommendations according to the findings of this report that the actors might adopt. The recommendations are divided based on agencies that have the responsibility and capacity to bring change. At the onset, the first thing would be to start a dialogue between stakeholders to float the idea of having a separate economic zone regime within the larger regulatory framework. At this point, a lot of recommendations are still to do with stabilizing the general economic environment in the regulatory and institutional sense that will create the framework for having a more driven zone regime legislation.

Government:

In an EZ program, this report has mentioned that it is always better that the less the government interferes with the private sector activities the better it is. Having said that, the regulatory role of the government is something that cannot be taken by anyone else. In this regard, the recommendations for the government are a complimentary effort towards making them a robust regulatory authority.

1. **Create a comprehensive regulatory framework for the general economy:** This is already a work in progress, but if the government would like to expedite development procedure, then focusing on creating a robust and encompassing regulatory framework for private sector activities in the general economy is a necessity. One reason for corruption is the absence of a comprehensive legislation, which means the current laws are open to misinterpretation. This gives government officials opportunities to exploit. The time taken to create this legislation is directly proportional to the loss incurred by private enterprises and government.
2. **Create provision for SEZ regime under broader economic policy, with specific development agenda and failure standards with clear time horizon.** During the workshop hosted on May 26, 2015, at the Ministry of Commerce and Industry,⁷⁹ governmental officials, international actors and private sector representatives unanimously recommended the following:

⁷⁹ <http://moci.gov.af/en/news/conference-held-on-the-key-findings-and-recommendations-of-special-economic-zone-pre-feasibilitymay262015>

- **Mapping and prioritizing:** The existing taskforce working on the development of SEZs, under the umbrella of the MoCI,⁸⁰ should take into account the findings and recommendations of this report and meet with relevant counterparts (ACCI, Harakat, Private Sector, World Bank, other national and international actors) to identify a roadmap to be submitted to the President of Afghanistan;
 - **Piloting and implementing:** Two pilot projects could be designed to test the relevance and potential of SEZs in Afghanistan – based on detailed economic feasibility studies;
 - **Monitoring and learning:** Like any other program SEZs have success and failures that most often can be measured objectively. Defining failure standards with specific time horizons will facilitate regular monitoring of zones and regular review of the policy.
3. **Begin discussion with neighbouring countries and countries with which there are trade agreements to identify opportunity and provision for Afghan SEZs:** Economic zones with their free trading regimes very often have implications for trade in other countries which may even be distortionary. As such an isolated zone program without consultation can be misinterpreted as a hostile move by foreign government. Thus, to inform trading partners ex-ante will give an opportunity to bring their concerns on the table so that trade balances can be maintained. Secondly, SEZ programs can also partner with zones in other countries for vertical specialization depending upon comparative advantage.
 4. **Promote and support private sector development in SME and primary industry:** The government must continue supporting private businesses outside the economy. Economy wide reforms must continue to generate an input supply and intermediate production base that can assist with production inside potential economic zones.
 5. **Keep discussions open with regional partners for potential “Joint Economic Zones” (with Iran, Pakistan, Tajikistan, etc.):** Commonalities such as shared language, religion and culture would strengthen the bond between nations, while promoting political stability and economic trade. As many private sector partners we met during the field visits, this report advocates for the promotion and development of a pragmatic dialogue with other regional partners (e.g. Pakistan, Iran, Tajikistan) to open joint SEZs. On the medium- and long-run, this is probably the sense of political and economic history in the region.

Donors:

At the onset it must be ensured that the zone programming is in line with strategic orientation of donor interests. With that in mind, donors can:

1. **Facilitate advisory and consultation with experts, zone hosting governments and other stakeholders that may contribute to zone programming:** The donors, through their networks must facilitate consultants for the development of zone program for

⁸⁰ And in collaboration with relevant stakeholders (MoE, ACCI, AISA, Harakat, The World Bank and other donors, private sector associations, and other Afghan social, economic and business leaders).

Afghanistan. From their network they can connect and bring in industry experts, policy planners, advisors from economic zone regulatory bodies from other countries, private zone developers under one roof to discuss the way forward for a zone program for Afghanistan. The findings of this research will create a good basis to start discussions as it points to some important questions for decision makers. One to two of such consultative processes may guide the strategic orientation for supporting such a program.

2. **Create networks with potential investors in other countries:** For the economic zones, the foreign donors can create links with potential investors in a planned zone program. This can happen even in the planning and feasibility stage. Organizing workshops and conferences with the agenda of seeking the requirements of potential investors will help tailor SEZ strategy towards facilitating these investors from the onset. This will also tell the donors about the interest in such a policy from potential beneficiaries. This may also lead to generating an estimate of FDI and FII interest in the country.
3. **Facilitate comprehensive feasibility study into creating economic zones in the locations prescribed by the research:** This research narrows down the possibility of having a successful zone program to 3 of the 7 locations surveyed – Kabul, Herat and Mazar-e-sharif (if so inclined, the feasibility study could include Jalalabad as well). The study must include:
 - a. Wide consultative process by key stakeholders to figure out direct and opportunity costs of funds;
 - b. A mapping analysis of value chains and supply chains to key locations such as industrial parks and other commercial centres to map linkages;
 - c. A key market potential analysis for economic zone in each region

Harakat:

From the research study, there are 3 separate programs that Harakat will have to work upon to take SEZs forward in Afghanistan – the consultation program, legislation program and infrastructure program.

1. **Consultation Program: Facilitate workshop on the findings of this research to chart way forward for economic zones:** The first thing to do would be to bring in national stakeholders to SEZ policy on a forum to discuss the findings of this research study and confer on the merits of different courses of action that can be taken to create a defensible zone policy for Afghanistan. A workshop in this regard would help the research incorporate considerations of various actors from the beginning. The objective of this program is to get consensus on the SEZ policy so that commitments in implementation can be garnered. Some actors that would be critical in such a consultative process are
 - a. Representative from the MoCI and MoF from the Afghan government;
 - b. ACCI and Harakat Representatives as promoters of private sector in Afghanistan;
 - c. Representative from PSD departments of donors such as DfID, USAID, GIZ, World Bank and ADB;

- d. At least one private sector representative from industrial organization from each of the 6 priority sectors, i.e., agriculture, construction, energy, extractive industries, carpets-handicrafts and agro-producing manufacturing industries.

2. **Legislation Program: Promote expediting the creation of comprehensive regulatory and institutional framework in Afghanistan:** In line with its objectives, Harakat must constructively help the government to expedite the process of creating a PPP regulatory framework for SEZs. As the consultative program is carrying on, the legislation can be written in parallel so that it can be introduced in parliament as soon as there is consensus amongst the partners. The legislation program will take into account all monetary and operational incentives that could be provided to attract investment in the zones. It will also outlay the institutional structure for the regulation and maintenance of zones. This includes

- a. Facilitating consultants and experts to write legislation;
- b. Hold training sessions for parliamentarians on these legislations and economic development strategy of Afghanistan;
- c. Coordinate between AISA and government, and facilitate the process of harmonising licensing and regulatory authority between the MoCI and AISA as per the resolution passed by HEC;
- d. Help in creating a facility for legal recourse for contract enforcement in the private deals and businesses;
- e. Wide dissemination of information about the regulatory and institutional framework to existing and potential investors.

3. **Infrastructure Program: Promote and support fast track creation of sufficient infrastructure.** This is perhaps the most important programs of all. The one that is likely to take the most time and fund commitment. The most critical insufficiency currently is the lack of infrastructure that is holding back manufacturing investment in Afghanistan. Thus, Harakat must focus on 2-3 key areas to improve infrastructure

- a. As mentioned above, provide sufficient and round-the-clock commercial electricity supply and try to minimize the cost as much as possible;
- b. Support the physical access to industrial parks through road construction projects;
- c. Build capacity of the customs locations by introducing technology and trained staff to man customs location and expedite transfer process of freight.

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ANNEX A: ADDITIONAL TERMS, CONCEPTS AND TABLES

Definitions and Concepts for SEZ (Source: FIAS)

The study will focus on a modern generic term of “*Special Economic Zone*”, a generic term that encompasses all variations to the concept and its evolution. The definition of SEZs, consist of the following 4 essential parameters¹:

- *Geographically delimited area*: This refers to the location of the firms (may or may not be fenced-in) or the production units upon the consideration that the geographical area is most suitable to facilitate internal and external trade (like major ports), is well connected to the rest of the economy for input and output movement, has concentrated infrastructure supply so that economies of scale may apply as also to reduce cost of supply services over a wide area.
- *Single management/administration*: The management of the economic zones is a separate body; may be private, government or autonomous government body; with its own resources to ensure smooth delivery of services to the firms and also to make sure that the SEZ is fulfilling its economic objectives.
- *Eligibility for benefits*: This refers to a set of regulations that would qualify a firm to set up operations within the boundaries of the SEZ. This is simply because under the economic regulations, Economic Zones have some objective as such, some production units/sectors/industries/firms are more important to fulfil those objectives than others.
- *Separate customs area and streamlined procedures*: This is the set of regulations and procedures (or the lack of them) that govern production and operation of firms so that they are attracted to come and carry out their operations in the SEZ. This is not limited to customs or tax breaks only, and may include targeted incentives such as subsidies to attract firms.

Under the purview of this definition, the FIAS¹ classifies types of economic zones in the following broad 5 types:

1. **Free Trade Zones**: Geographically demarcated (fenced-in) areas offering duty free entry and exit of products. The zones come with warehousing, storage and distribution facilities for trade and trans shipment purposes and are ideally located in the ports of entry in a country.
2. **Export Processing Zones**: Zones offering special incentives to industries that are particularly export oriented with regards to the country. There are zones that exclusively host export industries or zones could have a sub-zone having special privileges for industries of the zone that export goods outside.
3. **Freeports**: These zones include all kinds of economic activities from tourism to retail sales. Broader geographical coverage also means that are often residential facilities on the zones. Freeports use a broader set of liberal economic policies to attract investment.
4. **Enterprise Zones**: These zones again look at specialized industrial sectors of production, very often to revitalize urban or rural areas in slump through tax breaks and financial incentives.
5. **Single Factory Zones**: As the name suggest, such zone schemes provide incentives to individual enterprises in the manufacturing sector, one that has linkages with the domestic economy so that ancillary activities along with manufacturing can also develop.

Table A 1: Afghan definition of scale of companies

Enterprises	Number of Employees	Manufacturing Sector (Investment in Plant and Machinery)	Services (Investment in Equipment)
Micro	<5	< 2.5 million	AFN 1 million
Small	5-19	2.5 – 5 million	1 – 2 million
Medium	20-99	5 – 10 million	2 – 5 million
Large	More than 100	> 10 million	> 5 million

MSMEs definition in Afghanistan by World Bank Financial and Private Sector Development. <http://moci.gov.af/en/page/6024>

Table A 2: Share of trade, merchandise, export and import as part of GDP

Country	Trade (%)	Merchandise (%)	Export (%)	Import (%)
<i>Afghanistan</i>	53	31.9*	6	47
<i>India</i>	53	42.1*	25	28
<i>Pakistan</i>	32	30.6*	13	19
<i>Iran</i>	NA	30.2*	NA	NA
<i>Tajikistan</i>	88	67.3*	19	68
<i>Turkmenistan</i>	118*	73.1*	73*	32
<i>Kyrgyzstan</i>	146*	110*	48*	98*

Source: World Bank

Table A 3: Important terms and definitions used in the report

Term	Definition	Source
Comparative Advantage	The ability to produce a good at lower cost, relative to other goods, compared to another country. In a Ricardian model, comparison is of unit labour requirements; more generally it is of relative autarky prices. With perfect competition and undistorted markets, countries tend to export goods in which they have comparative advantage.	Deardoff's Glossary of International Economics
Control of Corruption	The extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests	World Bank
Dynamic Economic Benefits	Economic benefits being derived in the long term through the use of economic zones as instruments of trade and investment policy	Farole, 2010
Enterprise	An enterprise is an institutional unit as a producer of goods and services. It has the autonomy in decision-making and allocating resources. It may be engaged in one or more economic activities i.e. productive activities. It can be a corporate or a unincorporated enterprise.	IBES Final Survey Report
Enterprise Zones	Intended to revitalize distressed urban or rural areas through the provision of tax incentives and financial grants. Most zones are in developed countries, for example the United States, France, and the United Kingdom, although South Africa is developing a similar mechanism.	FIAS, 2013
Establishment	Establishment is an enterprise or part of the enterprise located in a single location and normally a single economic activity is carried out in the establishment. It is to be noted that in majority of the cases and particularly for the smaller or medium-sized units, enterprise and establishment becomes identical.	IBES Final Survey Report
Export Promotion	A strategy for economic development that stresses expanding exports, often through policies to assist them such as export subsidies. The rationale is to exploit a country's comparative advantage, especially in the common circumstance where an over-valued currency would otherwise create bias against exports.	Deardoff's Glossary of International Economics

Import Substitution	A strategy for economic development that replaces imports with domestic production. It may be motivated by the infant industry argument, or simply by the desire to mimic the industrial structure of advanced countries.	Deardoff's Glossary of International Economics
Public Private Partnership (PPP)	PPP refers to arrangements, typically medium to long term, between the public and private sectors whereby some of the services that fall under the responsibilities of the public sector are provided by the private sector, with clear agreement on shared objectives for delivery of public infrastructure and/or public services. PPPs typically do not include service contracts or turnkey construction contracts, which are categorized as public procurement projects, or the privatization of utilities where there is a limited on going role for the public sector.	World Bank
Regulatory Quality	The ability of the government to formulate and implement sound policies and regulations that, permit and promote private sector development.	World Bank
Rule of Law	The extent to which agents have confidence in and abide by the rules of society, and in particular of contract enforcement, the policy, and the courts, as well as the likelihood of crime and violence.	World Bank
Static Economic Benefits	Economic benefits being derived in the short term through the use of economic zones as instruments of trade and investment policy	Farole, 2010

Table A 4: Log frame for indicators used in the scoring and zone mapping exercise

Economy	Ease of doing business ranking	Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting minority investments	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Sri Lanka	99	4	2	3	5	3	4	7	1	5	1
Nepal	108	4	3	2	1	5	5	4	7	3	3
Maldives	116	2	1	4	6	5	7	5	4	2	4
Bhutan	125	3	5	1	2	2	6	3	6	1	8
Pakistan*	128	7	4	7	3	7	2	8	2	4	2
India*	142	8	7	5	4	1	1	6	3	7	5
Bangladesh	173	6	6	8	8	7	3	2	5	8	6
Afghanistan	183	1	8	6	7	3	8	1	8	6	7
*Sub-national Source: www.doingbusiness.org											

Table A 5: Log frame for indicators used in the scoring and zone mapping exercise

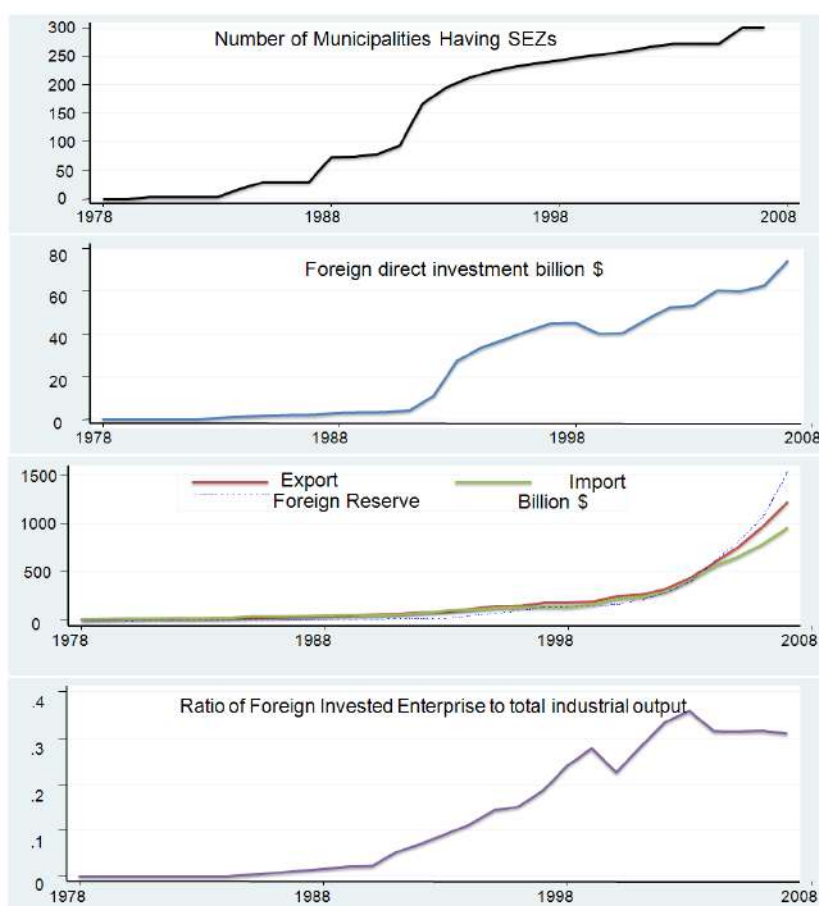
Indicator	Definition	Q #	Kabul	Herat	Mazar	Kandahar	Jalalabad	Kunduz	Gardez
Labour Cost	% of companies below national mean	Q14	82%	72%	64%	54%	71%	92%	74%
Operating cost	% of companies below national mean	Q14	74%	67%	74%	56%	71%	97%	87%
Import	< 10% import cost	Q33	28%	59%	42%	22%	38%	23%	26%
Tax administration	No/minor obstacle	Q56	28%	48%	56%	5%	31%	47%	41%
Trade & labour regulations	No/minor obstacle	Q56	69%	67%	84%	39%	65%	50%	85%
National Std.	No/minor obstacle	Q56	65%	65%	84%	80%	62%	57%	74%
Business registration	Easy/Very easy	Q57	20%	26%	42%	5%	17%	15%	15%
Starting a business	Easy/Very easy	Q58	41%	50%	66%	98%	56%	67%	21%
Security	No/minor obstacle	Q56	22%	15%	60%	2%	4%	0%	8%
Electricity	Satisfied/Very satisfied	Q51	61%	57%	62%	2%	25%	62%	26%
Land and Land titles	Satisfied/Very satisfied	Q51	51%	45%	52%	32%	21%	54%	15%
Water & Sewage	Satisfied/Very satisfied	Q51	32%	32%	30%	2%	25%	36%	26%
Access to formal credit	% of people accessed credit	Q45	5%	4%	4%	2%	4%	3%	0%
Site Security	Satisfied/Very satisfied	Q51	55%	20%	88%	17%	44%	67%	49%
Paved roads on site	Satisfied/Very satisfied	Q51	63%	37%	40%	5%	54%	56%	46%
Paved roads off site	Satisfied/Very satisfied	Q51	49%	22%	40%	2%	40%	0%	23%
Mgmt of location	Satisfied/Very satisfied	Q51	36%	50%	30%	32%	12%	0%	13%
Imports	% of people importing goods	Q 31	4%	9%	0%	10%	12%	0%	5%

ANNEX B: THE SEZ EXPERIMENT IN CHINA (1980-2010)

The Chinese experiment with the SEZs is by far the most successful example worldwide.

Presence and impact of SEZs in China: A study of the effect of SEZs on Chinese economies estimates that zones can increase the level of GDP by as much as 11% to 15%⁸¹. The ratio of municipalities with SEZs starts from 0% in 1978, to 9% in 1985, 24% in 1990, 69% in 1995 and 92% in 2007. This SEZ experiment has transformed China into one of the largest FDI recipients, exporters and foreign exchange reserve holders in the world. Attracted by the country's investment opportunities and by its sheer size and growing domestic market, China received about 20% of all FDI to developing countries between 2000 and 2010 and over \$124 billion in 2010 (best year ever). In terms of share of GDP and investment, however, FDI accounted only for some 2.5% of GDP on average between 2006 and 2009. While this may appear to be low it also suggests that while FDIs have contributed to drive the initial phase of the modern economic development of China, they now play a *relatively* more minor role. It also confirms that SEZs have fully played their role: *"Together, these contributions have supported China in maintaining a record-high 10% growth rate during most of the 1980-2010 period"*.⁸²

Figure 1: SEZs, FDI and Trade Outcome

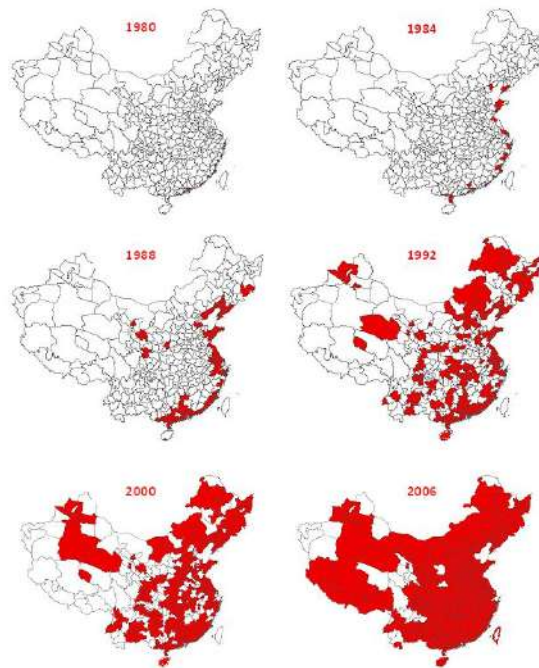


⁸¹ Alder, S., Shao, L. & Zilibotti, F., (2012), "China's Special Economic Zones: The effect of Economic Reform and Industrial Policy in a Panel of Chinese Cities".

⁸² The World Bank, Foreign Direct Investment – the China story, July 2010.

History and principles: From 1979, China has gradually created SEZs in its municipalities with property rights protection, tax breaks and a preferential land policy specifically for foreign investors. In August 1980 the People Congress passed the first legal rule on the SEZs: the Regulation for Guangdong SEZs. The government made clear the targets of Special Economic Zones described by 4 principles: "*Construction primarily relies on attracting and utilizing foreign capital; Primary economic forms are sino-foreign joint ventures and partnerships as well as wholly foreign-owned enterprises; Products are primarily export-oriented; Economic activities are primarily driven by market forces*".

Figure 2: Geographic evolution of Special Economic Zone Experiment⁸³



Policy measures for investors: The law of SEZs explicitly provides the following policy packages for foreign investors:

- Private Property Rights Protection: the SEZs encourage foreign citizens and overseas Chinese to open factories and set up enterprises and other establishments with their own investment or in joint ventures with Chinese. The SEZs guarantee to protect their assets, accruing profits and other rights in accordance with the law.
- Tax incentives: foreign investors can enjoy a reduced rate (15-24%) of corporate income tax compared to 33% paid by domestic firms. They bear virtually zero custom duties and can enjoy duty free allowances for production materials. There are income tax exemptions for foreigners working in SEZs as well;

⁸³ Jin Wang (2009), "*The Economic Impact of Special Economic Zones: Evidence from Chinese Municipalities*", Job Market Paper, London School of Economics.

- Land use policy: Under Chinese law, all land is under state ownership. Foreign investors may lawfully obtain the rights for land development, use and business: 1) invest in projects encouraged by the State for an operation term of more than 15 years; 2) The land use right is guaranteed for projects that have a total investment of US \$10 million, or that are technologically advanced and have a major influence on the local economic development despite total investment being below US\$10 million.
- Liberal economic and labour laws: there are limited restrictions on foreign ownership. Foreign invested forms have the power to hire and fire their employees.

Strategic measures for investors: The SEZ policy was based on the following strategic guidelines:

- Infrastructures first: The SEZ creation was also accompanied by laying down of extensive infrastructure – transportation, telecommunications, power supply and water supply – to help deploy FDIs in the creation of manufacturing units, and concentrate on enhancing their production.
- Alignment on development priorities: SEZs are strategically located to benefit from locational advantages (e.g., nearness to ports). During the initial phase, most SEZs were strategically located close to the boundary of Hong Kong, a commercial and financial hub. This resulted in large amount of foreign investment inflows from the nearby region into China.
- Critical size: Most of the zones are large in size with the areas ranging from 60-300 sq. km. The large size appears to be quite critical for a variety of reasons – economies of scale, achieving diverse activity mix, social infrastructure and attractiveness to private investors.
- High return-on-investment activities: The targeted activities in the zone are activities like high-tech, R&D, trading and light manufacturing, all of which are semiskilled to skilled jobs;

Lessons learned for Afghan SEZs?

- Coordinating reforms with the SEZ agenda! As the economic reforms in China did not happen along with other major structural reforms (financial system in particular), it strongly raised the costs of doing business;
- Watching the trade deficit and risk of financial bankruptcy! The laying down of infrastructure and construction of large buildings, bridges and roads by the government might result in high debt levels at both central and provincial scales, potentially increasing the trade deficit and risk of bankruptcy of a fragile state like Afghanistan.
- Promoting a balanced and inclusive development! The geographic concentration of the FDI was also a matter of concern in China, as it clearly widened the gap between the coast and the rest of the country.
- Controlling inflation and ensuring tax policies! The creation and expansion of SEZs throughout Afghanistan without implementing appropriate measures to control inflation and to ensure equitable tax policies might lead to social and economic chaos;
- Political will as a cornerstone! The future of SEZs depends critically on the support of political leadership, which may take a turn in case of its changes and any public disruptions.

ANNEX C: WORKSHOP AT THE MOCI - 26 MAY 2015

In light of the potential benefits of EZs to increase investment and production and the government's commitment to promote Private Sector Development (PSD), Harakat-AICFO commissioned a comprehensive study to evaluate feasibility, mechanics and support for EZs in Afghanistan. The study is meant to look at likelihood that an EZ can bring forth benefits sought by the economy. EZs, capitalizing on Afghanistan's key sectors like agriculture, mining, textiles and exports in key locations could be a simple and straightforward answer to all of Afghanistan's challenges. EZs will look to provide better investment climate than what is available nation-wide to prospective entrepreneurs and businessmen.

As a follow-up to the research process, there was an interest between stakeholders of this project to have a formal dissemination strategy for the final report so that the findings of the report can be circulated between key stakeholders to Afghanistan's economic development strategy.

A workshop was kindly hosted by the Ministry of Commerce and Industry (MoCI) and organized jointly by the Ministry of Commerce and Industry, Harakat-AIFCO, and *Samuel Hall*. Relevant stakeholders in Afghanistan's economic development were invited to discuss the findings of the report.

Workshop agenda:

- a) Distribution of copies of the full/summary report
- b) Introductory remarks by CEO of Harakat, Mr. Naseem Akbar
- c) Remarks by Senior Government Representatives from MoCI and ACCI
- d) Presentation of the findings of the report by *Samuel Hall*
- e) Round table/Group Discussion Sessions on pre-decided topics relating to the findings
- f) Presentation of the results from the discussion
- g) Concluding remarks by selected dignitary MoCI and Harakat

Key points:

- **Organisation:** The workshop was kindly hosted by the MoCI - list of participants in the table below. The Harakat team was thankful to the MoCI (Deputy Minister and advisors) for setting up the workshop and inviting such high-ranking stakeholders - from government officials, international community representatives, (The World Bank, UN, AREU), local NGOs, and the Afghan private sector, etc.
- **Methodology:** The MoCI highlighted that, due to time and resource limitations, the conclusions and recommendations of this pre-feasibility study should sometimes be nuanced, as "only" 400 stakeholders had been interviewed during the research process; the research team fully agreed, while insisting on the specific nature of the quantitative part of the assignment - based on semi-structured interviews with relevant private and public sector respondents and not on random sampling of Afghan households. In this regard, while not fully statistically representative, this study provides a comprehensive and rigorous *indicative* image of the business sector in the country.
- **Analytical framework:** The World Bank recommended that this study dig more into the lessons learned from other countries as well as other relevant economic studies conducted

in the country. Should specific feasibility studies be developed in the future, the review team agreed that benchmarks and comparative assessments should be prioritized.

- **Policy level:** The MoCI, the World Bank, and the ACCI all insisted on the fact that an ambitious SEZ policy for Afghanistan should be participatory and led by the MoCI. The MoCI showed a strong interest in hosting and leading future working groups on SEZs.
- **Next steps:** The MoCI, the World Bank, Harakat, the ACCI, and private sector representatives all agreed on the opportunity of developing:
 - A working group, led by the MoCI and associating all stakeholders;
 - A strategic paper on SEZs detailing the rationale behind and roadmap for a *SEZ strategy for Afghanistan (2015-2024)*;
 - The submission of the *SEZ strategy for Afghanistan (2015-2024)* to the Office of the President - Islamic Republic Of Afghanistan.

List of participants:

NO	Name	Position/ Title	Sector	Organization
1	Ahmadjawid Wafa	Economic Director	Government	Presidential Office
2	Rahim Saeedi	Director PSD	Government	Ministry of Commerce and Industries
3	Atiq Nasrat	CEO	Government	ACCI
4	Yunus Nigah	Research Director	Government	ACCI
5	Sulaiman Akbari	Economist	Donor	The World Bank
6	Choonaa Echavez	Head of Research	Research Agency	AREU
7	Faraidoon Shariq	Project Director	Research Agency	AREU
8	Rahman Gol	Country Economist	Donor	Asia Development Bank (ADB)
9	Rafi Amiri	President	Private Sector	Harirod Construction
10	Bashirullah Khpolwan	AITF Consultant	Donor	Asian Development Bank (ADB)
11	Naeem Yasin	CEO	Private Sector	Afghanistan Builders Association
12	Sakhi Payman	CEO	Private Sector	Payman Ice Cream
13	Abdul Ghafoor	CEO	Private Sector	Kabul Packaging
14	Abbas Ahin	CEO	Private Sector	AAFFCO - Transportation
15	Haji Gharcheen	CEO	Private Sector	Ahmadyaar Group
16	Haji Bahadoor	CEO	Private Sector	National Petroleum (Energy Fuel)
17	Hadi Farzam	Head of the NCA	Private Sector	National Carpet Association
18	Sarajuddin Kamali	Head of Association	Private Sector	Afghanistan Marble Association
19	Nasim Dost	CEO	Private Sector	Dost Mining (Now Called Afghan Pearl)
20	Mustafa Sidiq	CEO	Private Sector	Omid Bahar
21	Shirbaz Kaminzada	CEO	Private Sector	Baheer Printing
22	Azarakhsh Hafizi	Head of Department	Government	ACCi / Fuel Importers

23	Khanrasul Qaraloq	Director Registration	Government	Ministry of Commerce and Industries
24	Ahmadshah Arian	Vice President	Association	AIIESEC Afghanistan
25	Haroun Mir	CEO	Association	BINA (Business Integrity Network Afghanistan)
26	Zabih Barmak	Communications specialist	Association	BINA (Business Integrity Network Afghanistan)
27	Rahin Jawid	Co-founder	Association	Afghan Business directory
28	Alhaj Mohammad Ismael Mollazada	BIA President	Government	ACCI
29	Obaidullah Baha	Officer (Licensing)	Government	AISA
30	Nasishah Alemi	CEO	Private Sector	Etemad Group / Transportation
31	Yusuf Mehrabi	Representative	Private Sector	Infrontier LTD / Investment
32	Abdulqadir Bahman	Deputy CEO	Government	ACCI
33	Shafiqahmad Ahmadi	Regional Manager (Herat)	Government	AISA
34	Firuzudin Qiami	Advisor	Government	Da Afghanistan Bank
35	Asadullah Safari	Consultant	Government	Da Afghanistan Bank
36	Abdulrahim Noorzad	Deputy Head Commercial Banking	Private Sector	FMFB
37	Ziauddin Haidari	Manager	Private Sector	FMFB
38	Firuzudin Qiami	Advisor	Government	Da Afghanistan Bank
39	Asadullah Safari	Consultant	Government	Da Afghanistan Bank
40	Engineer Motasel Komaki	Advisor and Expert	Government	Ministry of Commerce and Industries / ACCI
41	Abdulrahim saeedi	General Director / PSD	Government	Ministry of Commerce and Industries / ACCI
42	Nabi Sorosh	Monitoring Manager (ANDS)	Government	Ministry of Economy
43	Hervé Nicolle	Director and Founder	Research Agency	Samuel Hall Consulting
44	Naeem Meer	Country Representative	Research Agency	Samuel Hall Consulting
45	Lailoma Naeemi	Journalist and Manager	Government	Ministry of Commerce and Industries
46	Baktash Musawer	Project Manager	Association	Harakat
47	Sadaf Dashti	Project Director	Association	Harakat
48	Imad Ahmad Haroon	Director of M&E	Association	Harakat
49	Haroon Wafa	Project Manager	Association	Harakat
50	Hassan Nasrullah Sahibzada	Senior Project Manager	Association	Harakat
51	Hamid Rahimi	Technical Advisor	Government	Ministry of Commerce and Industries
52	Ahmad Waiss Taraki	Technical Advisor	Government	Ministry of Commerce and Industries
53	Waheed Abdullah	CEO	Private Sector	Jehoon Printing
54	Mariam Yousufy	CEO	Private Sector	Director of mariam group of company

55	Muhibullah Hafiz	Country Representative	Private Sector	Tarsian and blinkley
56	Naeem Yasin	CEO	Private Sector	Afghan builders association (ABA)
57	Ahmad Jawid Hamidzada	Director	Association	AAIDO (Almonds)
58	Ahmad Zubair	CEO	Private Sector	Jehoon Printing

ANNEX D: SAMPLE DESCRIPTION OF PRIVATE SECTOR SURVEY

A research team comprised of a Project Manager, Research Assistant, 2 Field Supervisors and 12 Interviewers travelled to each of the seven provinces to conduct interviews. Questionnaires were designed to capture quantitative information to map the region on key metrics.

Based on data on provincial economic activity collected from the Central Statistical Organization (CSO), Ministry of Commerce and Industry (MoCI), and Afghanistan Investment Support Agency (AISA), this report identified two to four Primary Sampling Units (PSUs) in each region.

Site selection: 7 sites were selected on their merit as the urban commercial centres of Afghanistan 7 administrative zones – Kabul (Central), Herat (West), Mazar-e-sharif (North-west), Kandahar (South-east), Jalalabad (East), Kunduz (North-east) and Gardez (South-east).⁸⁴ In Kabul, 12 enumerators conducted the survey over three days of fieldwork. Teams comprising of 2 enumerators each was sent to each of the remaining cities the following week.

Identification of private sector respondents: In each location, the respondents divided the city into two survey regions. For cities where there were active industrial parks, one region was the industrial park and the other region was a non-industrial park commercial centre. For cities without industrial parks, it would be two commercial locations. The survey began by identifying a single business in the centre of the region. Subsequently snowball sampling⁸⁵ was used to identify other potential respondents of the survey. This gave enough degree of randomization in the respondents being interviewed for the survey.

⁸⁴ Gardez and Kandahar were two cities selected in the South-east region because of the large scale and equal potential of both cities to be the upcoming commercial centers of Afghanistan

⁸⁵ A snowball sample is a non-probability sampling technique that is appropriate to use in research when the members of a population are difficult to locate. A snowball sample is one in which the researcher collects data on the few members of the target population he or she can locate, then asks those individuals to provide information needed to locate other members of that population whom they know – “Babbie, E. (2001). *The Practice of Social Research: 9th Edition*. Belmont, CA: Wadsworth Thomson”

KABUL

179 Respondents



Respondent Profile



Small Scale (69%) Medium Scale (22%) Large Scale (9%)
Share of sampled companies by no. of workers employed

Age Bands

The sample respondents were between the ages of 17 and 75, with the average age of 37 and a standard deviation of 11 years.

Education

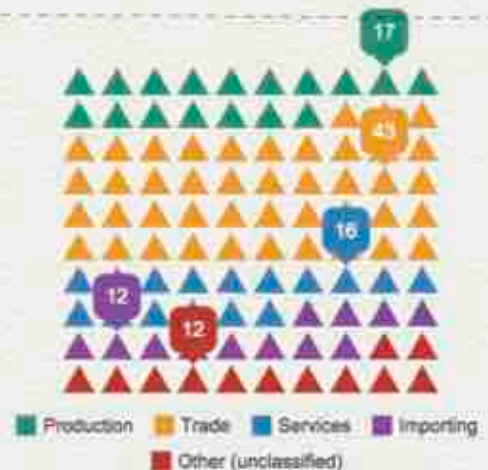
33% of the respondents had graduated from high school, 28% going on to get college diplomas and degrees, 9% were illiterate.

Experience

The sample respondents represented an average of 6 years and 9 months worth of experience in their respective positions.



Skilled Workers (22%) Unskilled Workers (78%)
Share of skilled and unskilled employees of the respondent companies



Production Trade Services Importing Other (unclassified)
Share of sampled companies by production sector

46 Respondents



Respondent Profile



Small Scale (61%) Medium Scale (17%) Large Scale (22%)

Share of sampled companies by no. of workers employed

Age Bands

The sample respondents were between the ages of 23 and 60, with the average age of 37 and a standard deviation of 10 years.

Education

48% of the respondents had graduated from high school, 35% going went on to get college diplomas and degrees, 0% were illiterate.

Experience

The sample respondents represented an average of 7 years worth of experience in their respective positions.



Skilled Workers (31%) Unskilled Workers (69%)

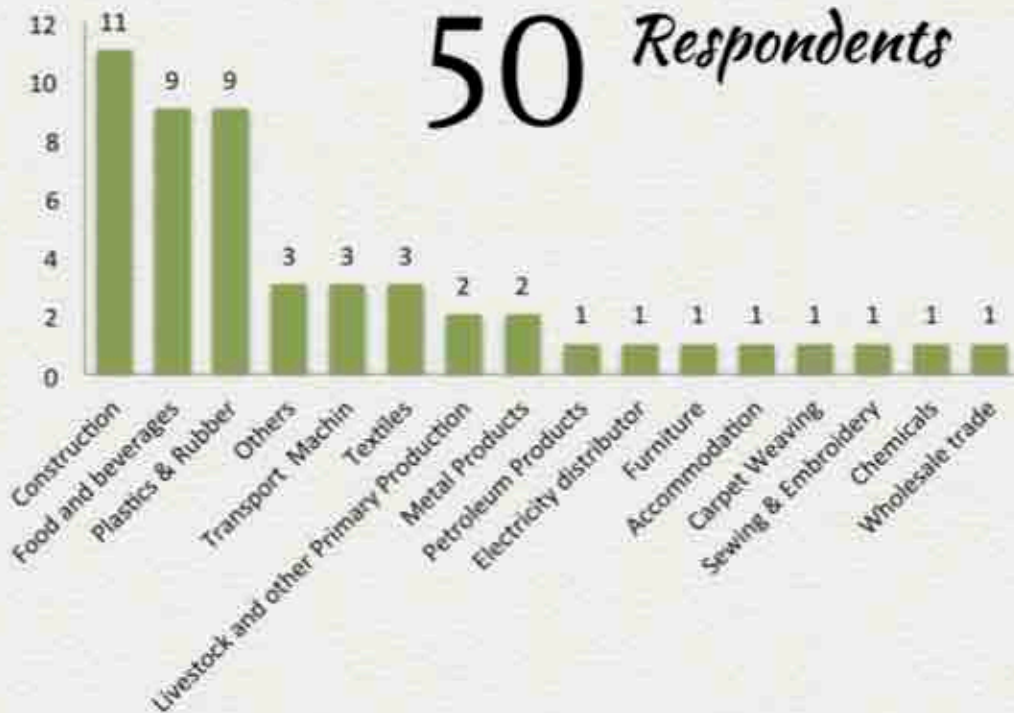
Share of skilled and unskilled employees of the respondent companies



Production Trade Services Importing Other (unclassified)

Share of sampled companies by production sector

MAZAR-E-SHARIF



Respondent Profile



Small Scale (72%) Medium Scale (6%) Large Scale (22%)
Share of sampled companies by no. of workers employed

Age Bands

The sample respondents were between the ages of 19 and 62, with the average age of 37 and a standard deviation of 11 years.

Education

44% of the respondents had graduated from high school, 36% going went on to get college diplomas and degrees, 4% were illiterate.

Experience

The sample respondents represented an average of 7 years and 11 months worth of experience in their respective positions.



Skilled Workers (29%) Unskilled Workers (71%)
Share of skilled and unskilled employees of the respondent companies

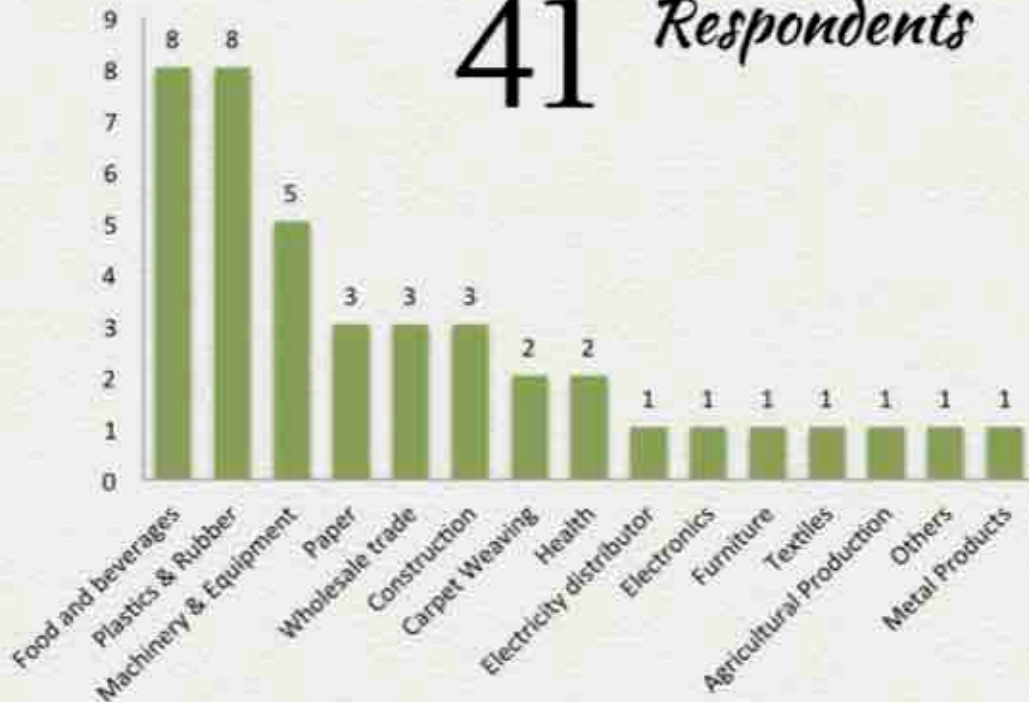


Production Trade Services Importing
Other (unclassified)

Share of sampled companies by production sector

KANDAHAR

41 Respondents



Respondent Profile



■ Small Scale (51%) ■ Medium Scale (34%)
■ Large Scale (15%)

Share of sampled companies by no. of workers employed

Age Bands

The sample respondents were between the ages of 21 and 60, with the average age of 36 and a standard deviation of 8 years.

Education

44% of the respondents had graduated from high school, 5% going went on to get college diplomas and degrees, 2% were illiterate.

Experience

The sample respondents represented an average of 9 years and 1 months worth of experience in their respective positions.



■ Skilled Workers (32%) ■ Unskilled Workers (68%)

Share of skilled and unskilled employees of the respondent companies

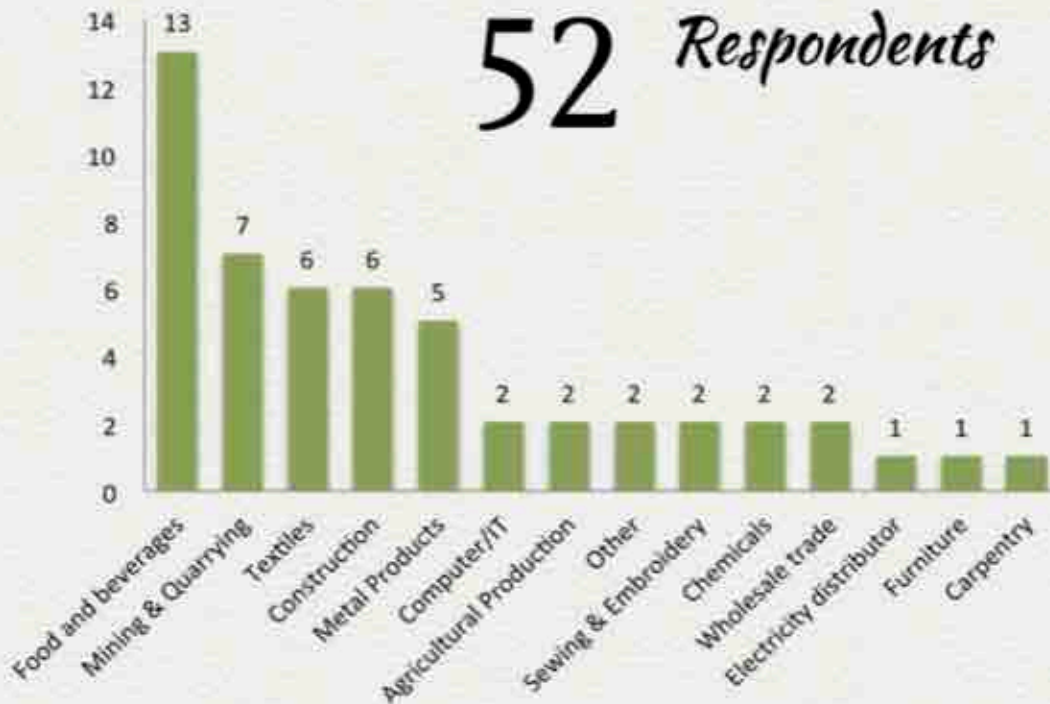


■ Production ■ Trade ■ Services ■ Importing
■ Other (unclassified)

Share of sampled companies by production sector

JALALABAD

52 Respondents



Respondent Profile



Small Scale (64%) Medium Scale (17%) Large Scale (19%)

Share of sampled companies by no. of workers employed

Age Bands

The sample respondents were between the ages of 20 and 75, with the average age of 38 and a standard deviation of 12 years.

Education

52% of the respondents had graduated from high school, 21% going went on to get college diplomas and degrees, 13% were illiterate.

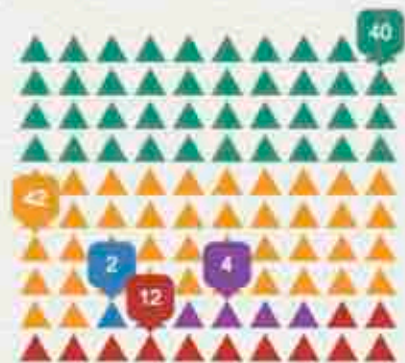
Experience

The sample respondents represented an average of 11 years and 11 months worth of experience in their respective positions.



Skilled Workers (71%) Unskilled Workers (29%)

Share of skilled and unskilled employees of the respondent companies



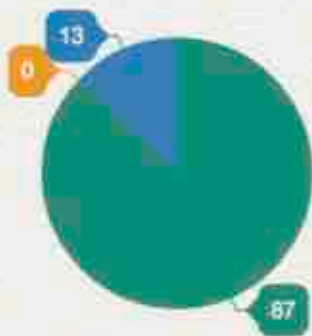
Production Trade Services Importing Other (unclassified)

Share of sampled companies by production sector

39 Respondents



Respondent Profile



Small Scale (87%) Medium Scale (0%) Large Scale (13%)
Share of sampled companies by no. of workers employed

Age Bands

The sample respondents were between the ages of 18 and 65, with the average age of 36 and a standard deviation of 12 years.

Education

41% of the respondents had graduated from high school, 28% went on to get college diplomas and degrees, 3% were illiterate.

Experience

The sample respondents represented an average of 9 years and 10 months worth of experience in their respective positions.



Skilled Workers (13%) Unskilled Workers (87%)
Share of skilled and unskilled employees of the respondent companies



Production Trade Services Importing
Other (unclassified)

Share of sampled companies by production sector

39 Respondents



Respondent Profile

Age Bands

The sample respondents were between the ages of 20 and 64, with the average age of 34 and a standard deviation of 11 years.

Education

49% of the respondents had graduated from high school, 13% going went on to get college diplomas and degrees, 13% were illiterate.

Experience

The sample respondents represented an average of 9 years and 4 months worth of experience in their respective positions.



Small Scale (84%) Medium Scale (3%) Large Scale (13%)

Share of sampled companies by no. of workers employed



Skilled Workers (22%) Unskilled Workers (78%)

Share of skilled and unskilled employees of the respondent companies



Production Trade Services Importing Other (unclassified)

Share of sampled companies by production sector

Samuel Hall is a research and consulting company based in Asia (Kabul, Afghanistan) and East Africa (Nairobi, Kenya). We specialise in socio-economic surveys, private and public sector studies, and impact assessments for non-governmental and international organisations. Our teams of field practitioners, academic experts and local interviewers have years of experience leading research in Central Asia and East Africa. This has enabled us to acquire a firm grasp of the political and socio-cultural context in the country; design data collection methods and statistical analyses for monitoring, evaluating, and planning sustainable programmes; and to apply cross-disciplinary knowledge in providing integrated solutions for efficient and effective interventions. To find out more, visit samuelhall.org.

