Case Studies Series

UNDERSTANDING MARKETS IN AFGHANISTAN: A case study of the market in construction materials

This publication is being made available in working draft form. The paper is being released as a resource to benefit policymakers and researchers working in Afghanistan and is not a final publication. As such, it has not been edited by AREU or the World Bank for clarity.

by Sarah Lister and Zainiddin Karaev

Understanding markets in Afghanistan: a case study of the markets in construction materials

Sarah Lister and Zainiddin Karaev
Afghanistan Research and Evaluation Unit

June 2004

Contents

List of figures and boxes

Abbreviations

AREU	Afghanistan Research and Evaluation Unit
CPI	Consumer price index
CSO	Central Statistics Office
DoT	Department of Transportation (provincial arm of MoT)
FATA	Federally Administered Tribal Areas, Pakistan
MoC	Ministry of Commerce
MoF	Ministry of Finance
MoT	Ministry of Transport
NWFP	North West Frontier Province, Pakistan
TISA	Transitional Islamic Government of Afghanistan

Photographs by Zainiddin Karaev and Sarah Lister.

1. Introduction

This study is one of three case studies funded by the World Bank and conducted in March – April 2004 under the Political Economy and Markets Programme of the Afghanistan Research and Evaluation Unit (AREU).[1] The case studies cover three activities important to the Afghan economy: raisins, carpets, and construction materials. The aim of the studies is to enhance understanding of the role of markets in affecting the prospects for growth, and the distribution of the benefits of growth, in Afghanistan. They explore the structures and functioning of markets in Afghanistan and thereby assist in the formulation of government policies aimed at enhancing broad-based growth and poverty reduction in a market environment. The studies are designed to stand alone, but should be read together to gain a fuller picture of markets and the political economy of Afghanistan. A short synthesis paper provides information and discussion relevant to all three studies, as well as preliminary analysis of the salient points emerging from the three studies.

Stimulated by donor-funded reconstruction projects, private business and residential contracts as well as military projects, the construction market in Afghanistan is booming. Demand for construction materials is soaring. Materials of different quality, origin and price can be found in different marketplaces across the cities of Afghanistan. At first glance, it appears that this sharp rise in demand has also brought an increasing number of traders and trading companies into the market. This study explores the markets in construction materials. Where do materials come from? How do they reach their destination? What is happening to prices and distribution? However, it also tries to understand who is benefiting from these booming markets: who can participate, who cannot, and how are they excluded?

The study was conducted in March and April 2004. Researchers conducted interviews with importers, wholesalers and retailers of construction materials, as well as with different sized building contractors, international agencies, and relevant government bodies. Research was conducted in Kabul, Mazar-e-Sharif and Hairaton, Jalalabad and Peshawar and along the Jalalabad-Peshawar highway. A number of data collection problems were encountered, linked both to the nature of the construction business, and general suspicion related to information-gathering on commercial activities. Moreover, in a limited study such as this, it was difficult to investigate in detail the procurement and use of materials by either the military, foreign contractors, or very large Afghan companies. Although there is some information on this, this study therefore concentrates on materials used by medium and small Afghan contractors. It also does not look at types of construction very common in rural areas which use mainly mud brick and minimum inputs from outside the immediate vicinity.

[1] These three studies were produced by an AREU research team consisting of: Mohammad Moharram Ali (consultant),Tom Brown (consultant), Zainiddin Karaev (Research Intern, AREU) Jamal Khan (consultant), Sarah Lister, (Team Leader -consultant), Adam Pain (consultant). This construction study draws heavily on research conducted by Jamal Khan.
Additional data collection was also conducted by: Asif Karimi (Researcher, AREU), Aimal Ahmadzai (Researcher, AREU), Rafi Tokhi (Deputy Director, Finance, AREU)
For further details on the studies contact Sarah Lister: sarah@areu.org.pk

This report first sets the scene, providing background information on the construction business in Afghanistan. It then provides detailed information on a number of materials, their sources and distribution. The following two sections discuss issues related to the market and government involvement in the construction sector. The report concludes with a discussion of potential entry points for intervention.

2. The construction sector in Afghanistan

The focus of this study is not on the construction business as a whole but, more specifically, on markets in building materials. However it is important to understand changes in the broader construction business and the contracting environment. It is impossible to quantify the current boom, but it consists of four major types of construction:

- major military-related projects, currently the Baghram airbase and the NATO premises at Darul-a-man
- government reconstruction projects, including a few very large ones, such as the recently completed Kabul-Kandahar road.
- the growth in private and business construction, the so-called ‘narco-villas’ and large shopping malls.
- smaller scale development of retail and residential premises.

Box 1. Some construction contracts funded by the US Government in Afghanistan

Contrack International was tasked in January 2003 with designing and constructing military facilities and other infrastructure projects. The one-year contract was worth a minimum of $5 million and a maximum of $100 million, but it can be extended for four years for a total of $500 million.

Louis Berger. Media reports say the company has a $300 million contract to oversee postwar reconstruction in Afghanistan, this includes road and school-building. Their biggest contract is the Kabul-Kandahar highway reconstruction. USAID provided US$ 270million, or $640k per km. However, some sources say that security concerns (the contractor hired 1100 armed guards) caused an increase above that in the actual cost. Berger subcontracted to an Afghan-American, 3 Turkish and 1 Indian construction companies.

Perini Corporation. In a news release, the company said it would earn up to $25 million for the contract to design/build facilities to support the First Brigade of the Afghan National Army.

Sources: the Center for Public Integrity. http://www.publicintegrity.org and USAID.

Although the third and fourth categories of building are the most visible when driving around the major cities in Afghanistan, construction in the first two categories (especially the military but also major government projects, such as road projects), actually dwarfs the private construction activities in value, by many orders of magnitude. It is very difficult to gain accurate figures on the size of these contracts, but box 1 gives some examples of recent contracts awarded.

These very large donor-funded and military contracts not only dominate the market in terms of size, but also affect the way the contracting business operates in Afghanistan.

Five related trends in the construction business are particularly important:

i) The most significant trend is the **overall reduction of the number of players** in the construction business, which is fuelled primarily by concerns about security. Thus contracts awarded by international contractors to sub-contractors are getting fewer in number, but larger in value and covering a wider range of services and activities.

ii) The second trend relates to the **types of companies which are primarily benefiting from these contracts**. There are two groups. The first group is those Afghan companies with very strong political connections, usually to one of several members of Cabinet.

The second group benefiting is non-Afghan companies, particularly Turkish, Iranian, Chinese and Pakistani. There are a number of reasons that medium-sized Afghan companies are being excluded, from even quite small (e.g. US$200k) contracts. These include their lack of:

- technical skill and experience
- sufficient plant, or the ability to purchase such plant through credit
- 'bonds' or other forms or recognized security
- pre-existing relationships with the foreign contractors, unlike many of the non-Afghan companies

Of course, this is an increasingly exclusionary situation. As a few companies continue to benefit, they are able to grow and further exclude others from the market.

iii) A third trend which is much discussed, but difficult to substantiate, is the perceived **increase in corruption** related to the award of contracts, at most levels of the contracting-subcontracting 'chain'. As the contracts become larger and more exclusive, with fewer opportunities to benefit, so the 'kickbacks' have also become larger. There are certainly allegations of very large sums of money changing hands, including sums paid to the international and national staff of international businesses and agencies.

iv) Related to this, the fourth trend is **an increase in the overall 'militarization' of the construction business**. As concerns about security lead to increasing levels of armed protection for those involved in construction, so the enforcement of formal and informal agreements is accompanied by the (perhaps often implicit) threat of armed force.

v) A fifth trend is the **very low levels of scrutiny, both financial and technical, of the implementation of contracts**. This not only increases the financial payback for those who conduct sub-standard work, but it also allows the use of poor quality or illicitly procured materials, with little fear of redress.

All of the above factors are causing disquiet among some involved in the construction business, from international staff to Afghan contracting companies, as well as those concerned with broader economic governance and political economy issues. It is of course impossible to verify most of the claims of corruption made during the course of this research, and some may be motivated by jealousy from companies unsuccessful in winning contracts. However, what is certainly true is that, although it is recognized that all over the world construction is a 'dirty' business, there is a perception of a 'step-change' that has taken place in Afghanistan and widespread and deep-seated concern about the way that business is being conducted. It is common to hear reference to a 'construction mafia' who are closely, and quite openly, tied to Cabinet ministers and warlords.

It is also worth noting that not all of the boom in construction is demand-related, but is also tied into the broader political economy of the region, as well as international developments. After the terrorist attacks in the United States on September 2001, and the ensuing 'war on terror', there have been increasing controls on the movement of money, and ongoing investigations into the source and uses of funds from the region. Many Afghans and Pakistanis who have earned their income through illegal sources (including re-export of transit goods and opium) and had invested their money in the Gulf States, Europe and USA feared that an investigation into the sources of their money might be damaging, or that their assets might be frozen. This resulted in a sharp increase in remittances in 2002/2003.[2] In Pakistan this inflow of large amounts has lifted the Pakistani stock market, increased government foreign exchange reserves, as well as precipitated a construction boom. In Afghanistan, it has funded the growth of luxury houses as well as large commercial plazas. These are mostly being built by seasoned traders as well as commanders who consider these investments both a sound investment, and a symbol of their status and prestige.

3. Construction materials and their supply

"You can fill a truck with bricks or for that matter anything else and bribe your way from Peshawar to Jalalabad without any documentation" Jalalabad trader (interview, April 2004)

The main products in high demand, and considered in this study, are: cement and cement block; wood; steel and steel products; bricks; aggregate and sand; plumbing products and sanitary fixtures; and glass.

There is very little manufacturing capacity in Afghanistan – most cement and wood, and all steel, sanitary fixtures and other manufactured goods are imported. The main sources of import of construction materials are Pakistan, Iran, Russia and to a lesser degree UAE and China. Pakistan and Iran have road networks connected with Afghanistan, while railway and air freight are used for import from Russia, and UAE and China respectively.

Although processes vary by product, there are three basic patterns of import:
i) large contractors import materials for their own use.
ii) import/export companies buy from manufacturers, sell to wholesalers, who sell to retailers and large consumers.
iii) manufacturers export directly, and sell to Afghan wholesalers. This is unusual, and mostly occurs with bricks exported from Pakistan.

[2] Source: Statistics Department, State Bank of Pakistan

3.1 Cement

There is at least one working Afghan cement plant at Puli Khumri. This is operated by the Ministry of Mines and Industry. However, its production is not sufficient to meet domestic demand, and Afghan cement can frequently not be found in the market in any city.[3]
Instead the market is dominated by Pakistani cement.[4] Cement factories located in Northern Punjab and North West Frontier Province (NWFP) export to Afghanistan, mostly along the Peshawar-Jalalabad highway. Some exports (about 17%) also take place from the southern provinces of Balouchistan and Sind through the Chaman-Spin Boldak border. [5]

Figure 1 shows the cement exports to Afghanistan from Jan-April 2004 from NWFP and Northern Punjab. Local estimates suggest that total recorded cement exports from Pakistan to Afghanistan in 2004 will be 1.2-1.5 million tons.

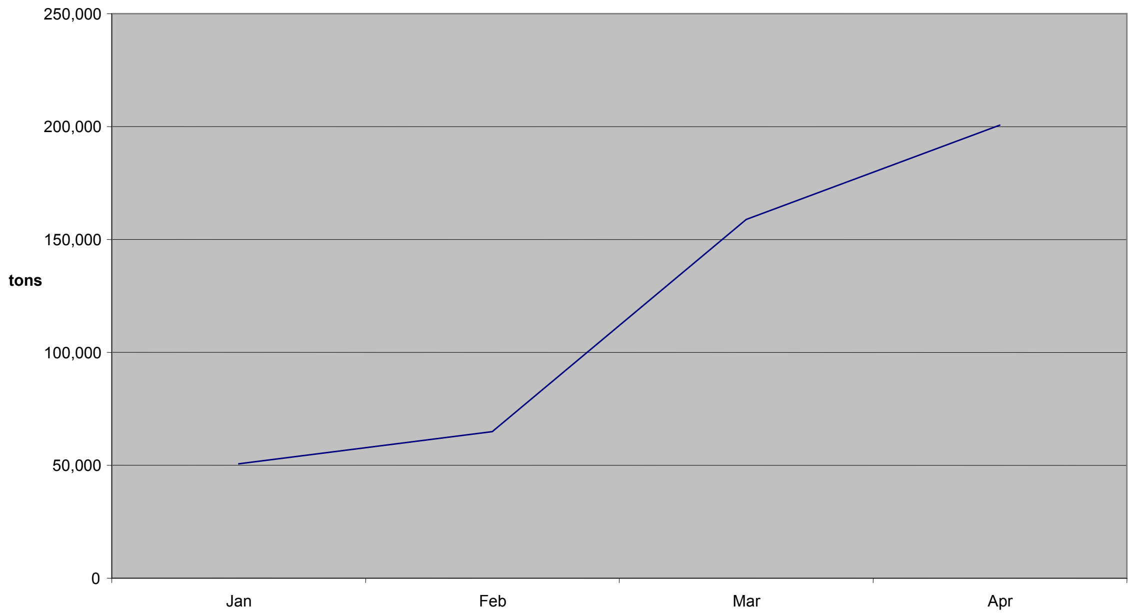
Figure 1: Export of cement from Pakistan to Afghanistan in January-April 2004

	Unit name	Annual production capacity	Exports to Afghanistan				Total
			Jan	Feb	Mar	Apr [6]	
1	Askari (wah)	945,000	5,055	2,360	960	0[7]	8,375
2	Askari (NP)	1,260,000	1,500	6,360	5,320	9,675	22,855
3	Bestway	1,039,500	11,205	17,765	39,815	46,182	114,967
4	Cherat	787,500	6,768	10,160	24,920	37,814	79,662
5	DG Khan	1,732,500	8,656	7,272	27,269	41,972	85,169
6	Fauiji	945,000	3,160	6,880	16,560	13,950	40,550
7	Fecto	630,000	560	880	5,480	788	7,708
8	Kohat	567,000	10,372	8,925	14,845	10,000	44,142
9	Lucky	1,320,000	3,375	4,299	23,696	38,925	70,295
12	Pioneer	630,000	0	0	0	1,407	1,407
	Total	**13,048,550**	**50,651**	**64,901**	**158,865**	**200,713**	**475,130**

Figure 2 depicts the increase in volume of recorded exports to Afghanistan.

[3] There have however been overtures from American companies who are considering significant investment in the Afghan cement industry.
[4] Source for Pakistan-Afghanistan cement data: Jamal Khan research.
[5] Source: http://www.paknews.com/flash.php?id=25&date1=2003-09-17
[6] Data collected until April 20th only. Figures adjusted to show export for whole month, assuming equal export throughout the month. Additionally Kohat April figure has been estimated as no April figure available at time of data collection.
[7] Closed for plant maintenance

Figure 2: Recorded volume of cement exported from Pakistan to Afghanistan (Jan-Apr 2004)



However to understand both these figures and the market in cement in Afghanistan, it is important to understand the tax differentials between Pakistan and Afghanistan, and appreciate that the Pakistani cement business operates as a cartel. In Pakistan, there are 24 cement units, 4 in the public sector and 20 in the private sector, with a total installed annual capacity of 17.7 million tons. Until recently, production capacity was much higher than demand, so the All Pakistan Cement Manufacturers Association (APCMA) fixes quotas for each producer in order to stabilise prices. The price of Pakistani cement is usually the same or lower in Afghanistan than in Pakistan, because sales and other taxes adding up to 35% on goods for the domestic market are waived on goods for export. [8] (For example, imported Pakistani cement costs $3.25-4.00 in Jalalabad market, depending on brand, but $3.76-4.86 in Peshawar). So, it is profitable for manufacturers to export their cement and then smuggle it back in. However, due to the cost and difficulty of transport for such a heavy item, in practice what usually happens is that more cement is recorded as exported than actually leaves the country (see box 2), and the difference is sold at an increased profit in Pakistan. Additionally cement for export is also produced ‘off the record’ (for example, by running the machinery on Sundays or all night), and this is considered outside the APCMA quota system. This may, for example, also explain how one manufacturer, Bestway, appears to have produced in the first four months of 2004 a volume of goods for export in excess of its annual production capacity.

Given this situation, it is not clear how much of the recorded volume of export actually reaches Afghanistan. Official statistics for cement import do show a marked rise over the period 1998-2002 (see figure 3 below), however figures for 2003 are not yet available and it is not clear how accurate these figures are anyway. For example, the total recorded import for

[8] The News ‘Study calls for subsidy to cement makers’, Dec 23 2003, www.jang.com.pk/thenews/dec2003-daily/23-12-2003/business/b6.htm

the whole of 2002, is less than a third of the total recorded import from Pakistan for one month, April 2004

Box 2: The Pakistan-Afghanistan-Pakistan cement business

To export from Pakistan to Afghanistan, an export company places an order with a manufacturer, paying both the agreed price and a security deposit. In Afghanistan the exporter takes his consignment to the nearest Pakistani consulate (Jalalabad for most exports) and has it checked, after which his export documents are stamped. On his return to Pakistan, he shows stamped documents to the manufacturers and his security deposit is returned. This procedure aims to prevent exporters from selling non taxed export cement in Pakistani markets.

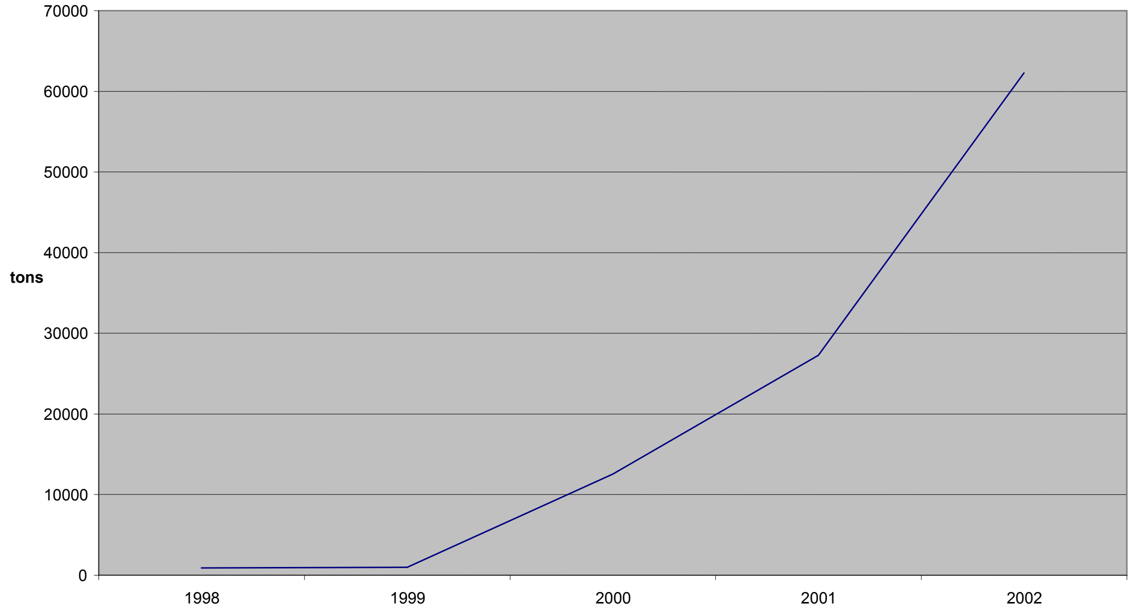
However, there are various ways of getting round this procedure. Some very well connected people just verify their export documents from the consulate without actually delivering anything, however this is unusually blatant. Others load their trucks with 300 bags of cement on top, and 500 bags of sand below. The 500 bags of cement which are substituted by the sand are sold in the Pakistani market (without paying the appropriate domestic taxes). However, filling cement bags with sand is not a simple procedure. Exporters have to arrange untorn bags from the manufacturer. Then these bags go all the way from Peshawar to Jalalabad under the eyes of numerous agencies all of whom are kept happy by bribes. Then the Pakistani consulate in Jalalabad makes the final inspection. Every stage of the process requires good contacts and appropriate bribery.

Nevertheless, it is an extremely profitable business. A ‘normal’ exporter sending a 40 ton truck to Afghanistan carrying 800 bags of 50 kg cement might only make $250 profit in total, after all necessary bribes and freight costs. However, taxes on a ton of cement for domestic sale are $24 per ton (35% of the total cost to the wholesaler). If an exporter is able to keep most of this sum as profit on 500 of the 800 bags on a 40 ton truck (by substituting them on the truck with sand-filled bags), then he can make $1000 extra profit per truck.

Over 150 cement trucks cross daily from Peshawar to Jalalabad, even if only 30 trucks are partially filled with sand bags these 30 trucks can generate as much profit for the exporters as all the other trucks combined.

Cement is imported both by individuals and export companies agencies which use the brand name of the manufacturers, but are independent from them. Exporters must belong to a regional Chamber of Commerce in Pakistan, for which Pakistani citizenship is required, so Afghans without a Pakistani partner cannot officially export. Cement exporters are mostly seasoned traders who have a good understanding of the Peshawar-Jalalabad highway and good relationships with the authorities on both sides. In fact, import of Pakistani cement to Afghanistan is increasingly controlled by a few trading companies, including a business run by a large Dubai-based businessman. The Government of Pakistan, as well as the military, are also involved in the cement export to Afghanistan, both through exercising ownership or influence over parts of the cement business in Pakistan, and because of military control of supply routes from Pakistan to Afghanistan through the national logistics cell of the Pakistani army. Cement importers will also often be linked closely with, or perhaps even own, a wholesale/retail outlet in Jalalabad. So the percentage of profit attributed in figures 4 and 5 (below) to the wholesaler/retailer will often, in reality, go in whole or in part to the importer.

Figure 3: Recorded imports of cement 1998-2002



Source: CSO, Afghanistan Statistical Yearbook (2003), table 12.4

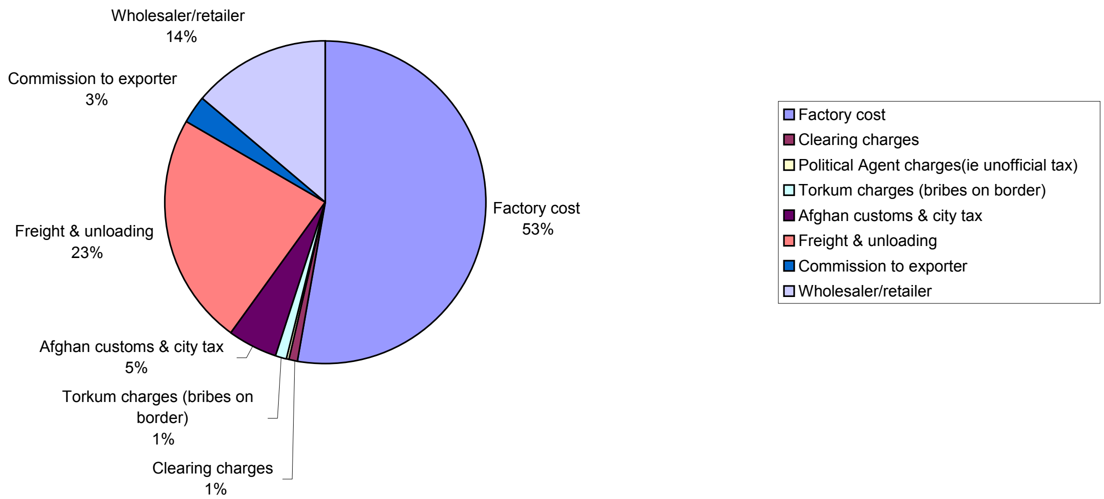
Figures 4 and 5 provide a breakdown of the costs of imported Pakistani cement in Jalalabad

Figure 4: "Lucky" cement - Jalalabad retail price breakdown

	Per vehicle 40 tons $	Per 50kg $	Per ton $
Ex factory	1640.00	2.05	41.00
Clearing charges	20.69	0.03	0.52
Political Agent charges(i.e. unofficial tax)	13.79	0.02	0.34
Torkum charges (bribes on border)	31.03	0.04	0.78
Gumrak (Afghan Customs)	17.24	0.02	0.43
Shaherwali (Afghan city tax)	137.93	0.17	3.45
Unloading charges	17.24	0.02	0.43
Freight	706.90	0.88	17.67
Profit to export agent	86.21	0.11	2.16
Wholesale price in Jalalabad	2671.03	3.34	66.78
Retail price in Jalalabad	**3100.00**	**3.88**	**77.50**

(Source: exporters and Jalalabad retailers)

Figure 5 Breakdown of retail price in Jalalabad of Lucky cement



Cement is also imported from Uzbekistan, Turkmenistan and Iran. Iranian cement used to pose more of a challenge to Pakistani cement, because of cheaper fuel costs in Iran. Not only was Iranian cement cheaper in Afghanistan, it was also smuggled into Pakistan and was sold there about 30% more cheaply than locally produced cement. However, Pakistani cement has managed to dominate the market in Afghanistan through manipulation of the price.[9] When the cement industry in Pakistan hit a crisis point of low demand about two years ago, Pakistani cement flooded the Afghan market at very low prices. Manufacturers argued that this was due to increased production lowering unit costs, coupled with lower fuel costs as many factories switched to more efficient coal-fired systems, from oil and gas fired systems. However, there was undoubtedly collusion among the cartel members, and some form of tacit understanding with the Pakistani government. Contractors in Afghanistan consistently claim that prices have since been pushed up steadily, now that Pakistani cement has established market dominance. The price data from CSO for the last 17 months does not support that claim, but the researchers heard it consistently from across a broad spectrum of those involved in the building business.

Cement is also increasingly used in the making of cement blocks, which is a new product in Afghanistan. This technology has come from Iran with returnees who have brought the skill and equipment with them and established small enterprises in Afghanistan. There are different sizes and qualities available, but many expressed concern about the strength of the blocks being used, with fears that the correct percentage of cement and sand is not being

[9] Additionally, contractors using USAID money are not allowed to use Iranian products.

used. ISAF tests the strength of the blocks it uses, and is also establishing a block-making enterprise in Kabul.

3.2 Wood

Some of the large demand for wood in Afghanistan is met by domestic production[10], but most wood is imported from either Pakistan or Russia. However, overall quality tends to be poor, because it has not been dried properly, and facilities do not exist in Afghanistan for the artificial drying of wood. There is a lot of misinformation about wood in the markets. Most purchasers are unable to identify correctly the source of wood or judge its quality, so there is much potential for purchasers to be cheated. The biggest markets for wood are in Kabul, Mazar-e-Sharif and Kandahar.

Box 3: A trader in Kabul wood market

The wood market occupies a huge space divided into more than 50 stalls of different size, ranging from $10m^2$ to $100m^2$. In the entrance to the market there are carpentry shops which produce windows and doors as well as sell timber.

Towards the middle of the market are the wood stalls. There a wood trader was busy re-arranging piles of wood in his stall. Wood of different sizes and use is piled up in his shop. He sells wood for fuel as well as for construction purposes.

Three types of Afghan wood from domestic types of trees are available in this shop. In particular, he sells Afghan wood produced in Wardak, about 70kms west of Kabul. Wardak residents own pieces of land in forests where they grow trees. After 10-12 years, they sell their trees to traders. It is the responsibility of the trader to organize tree logging and transportation from the forests to the markets. Traders employ local residents to help with cutting and loading, as well as transportation and unloading in the markets.

In both Afghanistan and Pakistan, production is characterized by illegal tree logging. In Afghanistan, the quality of wood is generally very good so there is high demand, but there is no licensing system or adequate regulation, although there are some examples of local shura-based initiatives to regulate forest use.[11] Large scale logging takes place primarily in the east, in Kunar and Nuristan, also further south in Khost. Wood is mostly smuggled to Pakistan by floating it down the River Kunar. The business is controlled by local warlords, for whom it is a major source of income, together with opium smuggling. Some of this wood is then re-exported to Afghanistan, branded as Pakistani wood to facilitate the export from Pakistan. It is difficult to estimate what proportion of wood from Pakistan is re-export of smuggled wood from Afghanistan.

[10] For a description of a localized wood economy in Laghman see Kerr Wilson, A. and Pain, A. (2003) *Three Villages in Alingar, Laghman: A Case Study in Rural Livelihoods* Kabul: AREU.
[11] Ibid, p 22

The export of Pakistani wood to Afghanistan is also restricted. Nonetheless, much Pakistani poplar wood is exported because it is cheap and is used for low quality construction. Most of this export is smuggling along the Ali Masjid Tirah Bazar Road.[12] Figure 6 provides the cost breakdown of poplar import from Peshawar to Jalalabad.

Figure 6: Cost breakdown for a unit (15ft x 15ins) of poplar smuggled from Peshawar to Jalalabad

	Truck (600 units)	Unit cost (R$)	Unit cost ($)
Poplar price in Peshawar	78000	130	2.25
Bribes	80000	133	2.31
Freight	20000	33	0.58
Poplar cost at arrival in Jalalabad	178000	296	5.13
Retail price in Jalalabad			6.50

Source: Jamal Khan research

Much of the wood in the market is imported from Russia, with large quantities coming from Siberia. Russian wood is of higher quality than Pakistani and therefore demand and prices for it are higher. While trade in Afghan and Pakistani wood is primarily done by individuals and small traders (see box 3 above), Russian wood is imported almost exclusively by large trading companies.

Kabul wood market

3.3 Steel and steel products

Steel bars (rebar) and steel products (such as I-beam and C-channel) are also imported almost entirely from Pakistan and Russia. However, Chinese materials have recently begun to enter the market, imported mainly through Pakistan.

[12] There are two main Pakistan/Afghanistan crossings along the Peshawar-Jalalabad route. The most widely used is the Peshawar-Torkum-Jalalabad road. The second border crossing is Peshawar-Alimasjid Tirah Bazar- Jalalabad. A detour is taken off the Peshawar-Torkhum road near Ali Masjid into the difficult terrain of the Tirah valley. This route is mostly used for smuggling timber and animals from Pakistan, and a variety of goods including opium from Afghanistan.

Quality is a serious issue in the steel trade and preference is almost always given to Russian materials. The price difference between Russian and other steel is significant and can reach as high as fifty percent more. Due to its location close to the northern border, Mazar-e-Sharif has the biggest market for Russian steel with the lowest price in Afghanistan. High transportation costs within the country because of its weight affect the steel price in other cities. For instance, the price for Russian steel in Kabul may ten percent more than the price in Mazar-e-Sharif. For this reason, large contractors, particularly those with their own trucks, may on occasion transport steel from Mazar to other parts of the country.

Pakistani steel is primarily manufactured in the Punjab region. This means there is a longer paper-trail and the involvement of more agencies in its transportation for export. For this reason, as well as the difficulty of transporting it due to its weight, it is the Pakistani product least likely to be smuggled into Afghanistan.

The price of steel has risen particularly sharply in the period Feb-April 2004. This is partially the result of the rise in world steel prices, caused by the demand for steel to feed the Chinese construction boom. Last year the worldwide cost of raw materials rose by 22%. However, due to long-term contracts between the suppliers of raw materials and manufacturers, world prices have risen only about 10%.[13] However, prices in Afghanistan have seen much higher rises, up to 40% in three weeks in March and April. This research did reveal some suggestion of monopolistic buying practices in Russia which might be over-inflating the prices, but it was impossible to verify this. The issues of prices is discussed in further detail below, section 4.1.

3.4 Bricks

There is a basic distinction between baked and unbaked bricks in the market. *Bhatas* (traditional manufacturing units for baked bricks) usually consist of a furnace fired by sawdust, wood and old tyres. They are usually built near the premises from where the soil is extracted. Sometimes other systems are used - for example, in Shibergan the natural gas in the area is used to fire bricks in large hollow chambers in the ground.

All mud bricks are made in Afghanistan and sold in local markets. Only baked bricks are imported from Pakistan, but some are also produced in Afghanistan. Indeed, in the last year there has been a significant shift in manufacturing capacity for baked bricks from Pakistan to Afghanistan. *Bhatas* have been started in Afghanistan, to save on freight and custom charges. However many of them are still owned and operated by Pakistanis who previously either manufactured in Pakistan and/or exported from there. These individuals had good relationships with businessmen in Afghanistan and the links necessary to secure suitable land. In Pakistan, a few families dominate this business which often involves underpaid workers (usually Afghans), poor conditions and resulting ill-health for workers, and the bribing of officials.[14] There is no reason to think conditions in the Afghan industry are any better.

[13] BBC News Online, "Material Costs 'hit steel firms', Mon 2 Feb 2004: http://news.bbc.co.uk/1/hi/business/3452043.stm

[14] Contract labourers, who are mostly Afghan refugees, in Pakistan are paid $2 per 1000 bricks to fill the moulds with the raw material and place them in the oven. Many workers are caught in a form of bonded slavery, working to pay off debts. Source: Jamal Khan and BBC News online 27 Feb 2004. http//news.bbc.co.uk/1/hi/world/south_asia/3490926.stm

Box 4. An Afghan brick factory

The brick factory near Khai Khona, on the Shomali Road leading out of Kabul, was established two years ago. There are eleven other such factories in the vicinity. This one is owned by a local commander, and it would be interesting to investigate the legality of his claim over the land from which the clay is extracted and where the kiln is operating.

This factory currently employs 40 men, who earn 150 Afs per day and mostly live on site. Many of them are returnees from Pakistan. Indeed, some who used to work in the brick factories in Peshawar have returned in the last month because there is now more work in Afghanistan.

All the bricks produced are used to supply local building projects – there is a large residential project about 500m away.

Despite the growing capacity in Afghanistan, Pakistani bricks are still exported to Afghanistan, even though they are more expensive:

> *Prices of locally manufactured bricks are about $30-32 per 1000 bricks in Jalalabad, while Pakistani bricks are costly, but still people like to export bricks from Peshawar at a price of $40-42 per thousand bricks. The soil texture of our bricks is such that the bricks are a good quality and desirable." (interview with owner of Peshawar manufacturing unit, April 2004).*

Pakistani bricks are usually bought for wealthy individuals or government contracts.

Most large users of bricks buy directly from the manufacturers, although there are also areas outside major cities where bricks from a number of manufacturers are sold by the truckload.

3.5 Aggregate and sand

Different grades of aggregate and sand are all extracted and sold locally, although some areas are more endowed than others. For example, aggregate has to travel large distances to reach construction projects in Kunduz.

There are a number of concerns about the quality of aggregate being used in construction projects. For example, a lot of river gravel is currently being used but it is not clear whether this is being treated in the correct fashion. Similarly, if crushing machines are not maintained properly they create a lot of flaky material which undermines the strength of the crushed aggregate.

There is virtually no regulation of the extraction and sale of aggregate and sand. It is those who can enforce ownership claims on the land from which aggregate is being extracted who are currently benefiting from the surging demand, as well as those who are living close to large building projects. In the context of the complex problems around land ownership in Afghanistan, this means those with political, financial and military power.[15]

3.6 Other manufactured goods

Unlike wood and steel, sources of import of these products, such as sanitary and plumbing products, vary and so do the prices. Materials are imported from as far as Germany. Most arrive from Pakistan and Iran, with Pakistani goods the cheapest, and usually considered the poorest quality. Many of these goods are manufactured in NWFP. Recently some limited Afghan capacity has been established, for example, small enterprises have started to produce tiles.

The demand for glass is increasing significantly in Afghanistan, due to the current popular style of major buildings in large cities. Glass comes from Uzbekistan, Russia, Iran, Belgium, Pakistan, China and Kyrgyzstan. Import of Chinese glass has particularly increased in recent months. The quality of glass is of great concern to traders, who complain about Uzbek glass, which they say is not produced at the correct heat.[16] Tinted and patterned glass is currently very popular.

Box 5: Construction materials in Mazar-e-Sharif

Mazar-e- Sharif is the economic hub of Balkh province. The province borders Uzbekistan, which connects Afghanistan with the main import routes from Russia and other former Soviet countries. The city of Mazar is located 90 kms south of Hairatan port on the Afghan-Uzbek border. As such it is the main commercial center in the north and both a primary market and distribution point for construction materials imported from Russia. The regional customs office is located in Mazar. Tens of trucks with imported wood and steel are always parked in the compound of the customs office waiting for paperwork to be completed and duties to be paid before they move on. Drivers usually spend 1-2 days there.

The ‘bazaars’ in construction materials are booming. There are four big markets in the city as well as numerous small shops in the central part of the city. There is some price difference between goods in Mazar and those in other cities. Usually materials imported from Russia are cheaper here than in Kabul or any other city in Afghanistan. Smuggled goods from Pakistan, such as plywood, also reach the markets of Mazar.

Mazar-e-Sharif is also home to many large importing companies. Barakat Construction is among the largest. It has been trading for 45 years and mostly imports steel and wood from Russia and exports raisins to Moscow.

[15] Wily, Liz Alden (2003) “Land Rights in Crisis: Restoring Tenure Security in Afghanistan” Kabul: AREU
[16] USAID & Pragma (2003) “Afghanistan Market Research Trip Report: Finding New Opportunities” Enterprise Development Project in Central Asia.

4. Market issues

4.1 Prices

Without exception, actors all along the supply chain report recent large increases in prices of materials, which started in February or March of this year. For example, in Mazar, steel and steel products reportedly rose 39% in 20 days during March-April. Wood prices have also seen sharp increases, with other products also rising, but less sharply. These prices are explained by a number of factors:

- the end of winter, which has precipitated a sharp increase in demand as construction restarts
- worldwide rise in prices, particularly fuelled by the Chinese construction boom, especially for steel (see above)
- a change in the import tariff system in Afghanistan, introduced at the start of the Afghan new year.

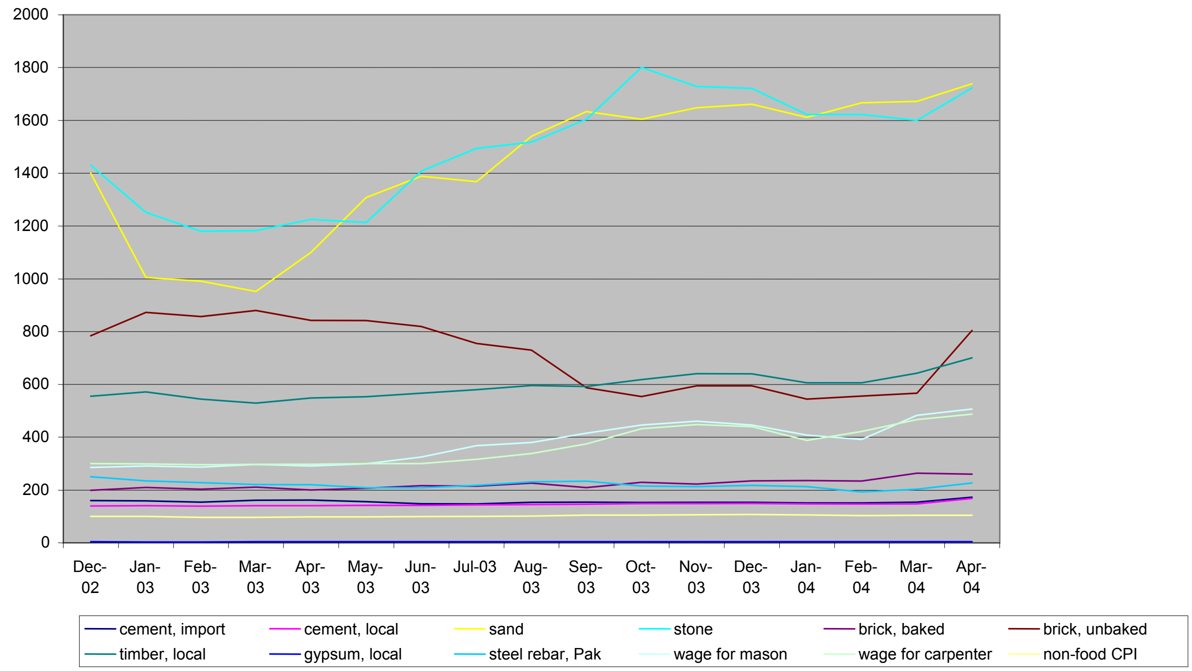
The recent change in tariff system has undoubtedly produced an increase in taxes paid by those traders who import legally and are eligible for import duties (goods imported for government or humanitarian projects are exempt). The introduction of an international standard tariff system has seen a simplification of the regime. Under the old system, there were 25 customs import tariff bands with rates ranging from 7 percent to 150 percent, allocated across 888 items, with an unweighted average tariff rate of 43.3 percent. Under the new customs code, customs duties are in four bands (2.5%, 5%, 10% and 20%). Customs duties for most construction materials are either 2.5 or 5 percent.

However, the effective tariff rate for importers is now higher because a uniform floating exchange rate is now used to obtain the taxable value of imports, rather than the undervalued exchange rate previously employed.[17] Nevertheless, the price rises are much higher than those that can be explained by the tariff reform. However, the general lack of information about the tariff reform (the revised code, for example, was not at the time of this research available from anywhere other than the MoF in Kabul) means that there is great confusion about the actual changes effected. It appears that importers have used the reform to pass on price rises to their purchasers much greater than those actually caused by the reform, and to blame them on the government.

It is worth noting that the reported rises in prices are not reflected in the price-tracking conducted by the Central Statistics Office (CSO) as part of their consumer price index (CPI) tracking exercise (see figure 7 below) . Their price collection for the past 17 months shows in general a moderate rise in prices, with the sharpest fluctuations in the prices of stone, sand and unbaked bricks. While construction materials do show a sharper rise than the overall non-food CPI (included below for comparison), these figures do not reflect the story which is told by retailers, wholesalers and contractors in the construction business, suggesting a problem with the data used by CSO.

[17] Under the old system 10 different exchange rates were by various public institutions for customs valuation: Chamber of Commerce at Af3.5/$; Herat Customs at Af2/$; Kabul Customs at Af4.5/$; and Kandahar Customs at Af2.5/$. Source: Fujimora Manabu (2004) " The Post-Conflict Afghan Economy, Asia Development Bank".

Figure 7: Prices of construction materials



Source: Central Statistics Office, Consumer Price Index (CPI), Oct 2003 and May 2004[18]

Nationally integrated markets

Figure 8 below shows the prices of commonly used materials during April 2004 in 4 Afghan cities and Peshawar. Despite problems in the data collection[19], the figures tell a story reasonably consistent with what is known about the markets and the origin of imports. In general, Pakistani products are cheaper in Jalalabad (and Peshawar). Goods from Russia are cheaper in Mazar. However, there do not appear to be consistently and large price differentials between cities, which suggests that markets are reasonably integrated nationally. The only goods that are not bought locally by contractors (apart from very large contractors who import for themselves) are steel and wood. However, the purchase of goods from other cities by contractors to make cost savings occurs infrequently, and only by contractors who own their own trucks.

[18] Actual prices as given in the CPI have been changed for a number of goods to allow for easier display of data, this does not affect overall trends in prices, merely the quantities of goods for which prices are provided. Timber & bricks have been reduced by a factor of 10, steel has been increased by a factor of 10.

[19] In all cities except Herat, three quotes were obtained from suppliers, and a mean was calculated. In Herat figures used are those provided to returnees by UNHCR/WFP. Data was not collected on the same day in each city (during a period of rapid price inflation especially for steel and wood), however the figures do not suggest that this was a significant influence (order of data collection: Kabul, Mazar, Peshawar, Jalalabad). More significantly, the data was not collected by the same surveyors, so in some cases exact products may not be compared. Due to deterioration in security in the area, planned data collection along the Quetta-Kandahar route in May did not take place.

Figure 8 Provincial prices for construction materials in Afghanistan

Item	Kabul	Mazar	Herat	Jalalabad	Peshawar	Notes
Pakistani white toilet	1400	1968	X	1392	1392	
Plastic pipe 4ins/6m	425	433	X	557	480	In Jalalabad & Peshawar from Pakistan. Elsewhere from Iran
Plywood 120x140 12mm	550	626	X	576	293	Price given for 8mm in Jalalabad and Peshawar. Transportation cost is Afs38/sheet, so very significant mark-up
Wooden bars local - qury (20)	13250	11600	X	22080	n/a	In Jalalabad good quality wood. This is also smuggled to Peshawar.
Wooden bars import - qury (20)	6750	9310	X	6000	2160	In Mazar, Russian. Elsewhere smuggled Pakistani.
Steel rebar 8mm/kg - Russian	36	34	20	31	24	
U-channel Russian - 12m	5100	6240	X	6031	6031	
I-beam - 12m	5100	4576	X	4255	X	
Red baked bricks -local - best quality/1000 pieces	2900	2032	1680	1560	1968	
Coarse aggregate/truck	1650	3072	1392	X	n/a	sold by truck - may not be same size of truck
Crushed aggregate/truck	2000	n/a	X	X	n/a	
Sand/truck	1900	1984	X	X	n/a	
Cement/50kg bag	183	177	206	193	220	In Kabul & Jalalabad Cherat cement(Pak), in Mazar Russian

Note:
All Prices in Afs.
Exchange rate: US$1=48Afs
n/a – goods not available
x – price not collected

Prices are, however, sensitive to security concerns as transport costs are affected. Prices can fluctuate significantly as truckers demand higher compensation, and consumers are often fooled by traders who inflate prices artificially and blame it on security concerns. The more chaotic the situation the traders can portray, the higher they can charge and the customer often has limited information, and few choices about the price he pays.

4.2 Credit

As in all sectors of the Afghan economy, there is generally very little credit available in the construction sector. Contractors with established relationships with suppliers may be able to delay payment for 1-2 months at no extra cost. Or, for example, a contractor may take bricks on credit and pay back in installments. Access to credit is also related to social ties. A trader in Mazar-e-Sharif said he recently received a short-term credit from his fellow traders in the same market, whom he has known for many years, and his father used to enjoy close connections with their fathers.

However, there is little possibility of gaining the large scale credit necessary to buy plant. In the 1980s, a number of medium-size contractors were granted 25 year low interest loans by the Soviets and were able to establish themselves in business that way, although they were then forced to pay the remainder of the loan in a lump sum to the Taliban. However, there are no such arrangements in place today. Some large companies may have arrangements with regional warlords from whom they can obtain credit – this also enables the warlords to launder money from illicit activities.

The lack of credit further enhances the dominance of large businesses, or those with the links to wealthy elite, who are able to finance the expansion which allows them to bid for large contracts.

4.3 The transport sector

Markets in construction materials are linked closely to and affected by the transport sector. Given the weight of most construction materials, freight costs are a relatively large percentage of final cost. As discussed above, fluctuations in the prices of materials are often caused by changes in freight costs due to security concerns. Prices can also be affected by poor weather, road conditions and a shortage of trucks.

As in Pakistan and India, the road transport industry in Afghanistan operates in an informal environment. The industry is based on traditional means of ownership and collateral financing, as well as regulations that go back to 1967. Regulation is largely through social norms. The industry has little or no participation in international transport systems, or the international demand for transport within and through Afghanistan. International freight forwarding operations are facilitated by informal border transit payments (see below).[20]

The Ministry of Transport (MoT) oversees the transport sector. Its policy dictates that the private sector can set prices independently, but that it sets the rate for government contractors hauling government goods. That rate is 0.6 Afs per mt per km for paved roads,

[20] World Bank (Nov 2003) "Technical Annex for a proposed…Emergency Customs Modernization and Trade Facilitation Project)"

and 2 Afs per mt per km for unpaved roads.[21] However, in some provinces the MoT intervenes directly, both setting prices and collecting taxes for a variety of 'services'.

Box 6: Rent-seeking in the transport sector

i) Department of Transportation (DoT) in Herat
In Herat the DoT ensures the delivery of goods anywhere in Afghanistan and is responsible for security of shipments. It has established commissions, which are essentially working groups of transporters, traders and DoT officials. These commissions set the trucking rates for all companies operating out of Herat, based on product categories and shipment route. All transport companies must follow these rates. Traders cannot work directly with transport companies but must go through the DoT, where the commissions effectively function as freight agents. To backhaul goods from Herat, a transport company from another region of Afghanistan must obtain permission and work through the DoT in Herat. No companies from outside the country can transport in this province.

The system is out of line with national policy, but it offers security and order. Many truckers actually prefer to work in Herat, as they have fewer problems with security of shipments there than in other provinces.

ii) the DoT in Balkh
Herat is an extreme example of intervention. However, even in provinces where there is less intervention some control and rent seeking often occurs, all increasing the freight costs for traders.

In Balkh province, just outside the town of Hairaton, a department of the MoT manages a truck park. Any private trucks which wish to service the port but do not have a pre-arranged contract have to register here. Trucks (mostly driver-owned) have to be physically parked in the compound of this office while they wait for business. The office manages a list of trucks on the line, and rents them out according to this line to traders who request transport. Truck drivers may have to wait 15-20 days for work. The DoT charges 1.68 Afs per kilometer (85 kms to Mazar) to the drivers who use this 'service'.

Other trucks which service the port on private contract also have to 'register' with this office. It was not entirely clear whether there is a fee connected with this 'registration'.

Sources: Herat: USAID & Pragma (2003) ibid. Balkh: research interviews

4.4 The actors in the construction business

Any company or individual trader may engage in the construction business. For this they are required to obtain a trade licence, individual tax number and pay certain taxes (see below). As such barriers to entry do not exist, at least theoretically. In practice, the markets are difficult to enter, and even more difficult to trade in profitably.

Market dominance by the big players

Despite the appearance of a multiplicity of actors, the markets in construction materials are dominated by relatively few players. In particular, the import business is dominated by a small number of large trading companies with a comparatively large capital base. These

[21] USAID & Pragma (2003) op cit.

companies have offices outside Afghanistan, primarily in Dubai, Moscow, Tashkent and even in the USA. They usually also have strong links in Pakistan. Access to information and networks both inside and outside Afghanistan enables these companies to import the construction materials that are in high demand in the county and reap substantial benefit. It also enables them to dominate the market and manipulate prices. Some of these companies specialize in the import of specific construction materials, such as steel and wood from Russia, and plumbing and sanitary goods from Iran and Pakistan. However, the majority of them engage in general trade and they import commodities that are of higher demand than others, switching from one commodity to another.

To understand how some businesses have come to dominate in Afghanistan today it is necessary to understand the history of trade in Afghanistan and how it is linked to relationships with neighbouring countries. A brief history is provided in Annex A. For more detail, a number of useful texts are available. [22] The relationship with Pakistan has, and remains, particularly critical. For most of the last three decades, all Afghan traders (apart from some gem traders), including transit trade smugglers, carpet manufacturers, arms and timber smugglers have relied on Pakistani markets, roads and financial institutions.

It is the same group of traders, formed over the decades from the 1970s and who have close links and networks in Pakistan, who continue to dominate the markets in Afghanistan. Even those who may now be based elsewhere, such as in Dubai, usually have their business origins in the trade between Pakistan and Afghanistan. Although other Afghans are now returning from the West, the business class is dominated by the old players, and the returnees have neither the capital nor the networks or established relationships to compete with them. Many of the returnees are reluctant to risk the capital they have, recognizing that it is only this dominant class which can benefit in the current environment (interview with prominent Kabul businessman).

Through understanding the history one can understand how this group is able to maintain control of markets and squeeze out challengers:

- they have a working relationship with those who **control the road from Jalalabad to Peshawar** which has developed over several decades. This enables them not only to make shipments with relative ease, and without excessive bribes which put at risk the profitability of their ventures, but also to increase their profit margins through various methods (for example, see box 3 on cement smuggling).

- their businesses are large enough, and they have **sufficient capital** through illicit means, to buy in large quantities, usually in cash.

- There are **quite high levels of vertical integration** at the top end of the market. Large contractors will operate their own transport and import their own goods. In

[22] Useful publications include Rubin (1995) “The Fragmentation of Afghanistan: State Formation and Collapse in the International System” Oxford University Press: Oxford; and Rubin, B. (1999). The Political Economy of War and Peace in Afghanistan. Meeting of the Afghan Support Group, Stockholm, Sweden, and Schetter, C. (2001). The 'Bazaar Economy' of Afghanistan: a comprehensive approach. in C. Noelle-Karimi, C. Schetter and R. Schlagintweit (eds) Afghanistan - A Country without a State? Frankfurt, IKO Verlag. The analysis here and in Annex A draws on these texts, as well as the research conducted by Jamal Khan.

the case of cement importers they will also have close links to wholesale and retail businesses.

- They are fully hedged by having at least a token **representation in all profitable ventures**, so that any big profit-making opportunity is not wasted. Therefore many opium traders hedge their businesses by investing in other sectors, such as transport, real estate and transit trade, while many traders trade a little opium to ensure they do not miss out on opportunities.

Similar principles apply to trading through countries other than Pakistan. The ability to trade successfully is dependent on longstanding relationships both inside and outside the country. There are few totally new entrants, although there has been some shifting of relative market position, especially among the big trading companies in the North, since some companies which were mainly trading outside Afghanistan have returned since the fall of the Taliban. However these companies always have been and remain extremely well-connected. Those companies who are importing from Russia and the former Soviet Union have partner companies in those countries, often owned by a family member, as well as powerful contacts there.

Inside Afghanistan, almost all large trading companies have some sort of connection with regional warlords. These connections provide them with security both of themselves and their goods, as well as often exemption from border taxes. In the past, operating outside warlord control was virtually impossible, since they controlled the borders and imposed customs duties at their own discretion. Traders were also able to secure credit from the warlords, who in turn laundered their money accumulated from the drug trade and other activities. This 'coping strategy' has developed into a permanent patron-client relationship. Little evidence exists to show disengagement of these companies from this type of relationship.

Box 6: Afghan Traders in Russia

There are many Afghan traders in Russia, especially in Moscow. Retail markets in Moscow are full of Afghan traders, who dominate the markets in some items such as umbrellas, shoes and household cleaning items. A small number of Afghans are involved in large-scale import or export activities.

There is no 'Afghan' company in Russia; there are Russian companies with capital from Afghan traders. The Russian public and authorities, especially the police, are very hostile towards Afghans, extorting bribes often on a daily basis.

Trade patterns among the Afghan trading community in Russia are ethnically determined: Hazaras are mostly involved in retail trade and mostly concentrated in Moscow; Tajiks and Pashtuns are more involved in large-scale trading and export-import operations. Little trust exists between Hazaras and members of other ethnic groups.

Afghan companies involved in construction materials are not usually based in Moscow. Instead they are in Barnaul or Novosibirsk, in western Siberia, where the resources (wood and iron) are concentrated. Such companies have seen a boom in business recently.

Source: Afghan Hazara trader in Moscow, interview April 2004

Small and medium suppliers

As with many markets in Afghanistan, the distinction between wholesale and retail is blurred. Many medium-sized suppliers will supply both retail shops and building contractors.

Most small and medium-sized suppliers are located in the specialized marketplaces for different types of material which can be found in all the big cities. Usually there is more than one market for each of these product categories. Markets for bulky products such as steel and wood as well as brick are located in the open spaces in the outskirts of the cities. Other products are sold in the numerous small shops and markets that are mostly concentrated in central parts of the cities.

Materials for sale in Kabul

Box 7: A cement seller in Kabul

This man sells in a middle-sized market located just off the main Shomali road (see photo above). There are around 20 containers on each side of the road and the occupants are busy selling bricks, grouting and cement. The trader is a middle-aged man who was sitting with a cup of tea by his container waiting for a customer. He sells mostly cement and bricks and only a few bags of grouting.

He buys cement from a large wholesaler in the city. The wholesaler imports cement from Pakistan and is believed to supply all of the cement stock in this market. He delivers cement to this market by his company's trucks.

The trader has an interesting arrangement for the rent of his stall: a representative from the city municipality visited this market about 3-4 months ago and told all traders to visit his office and obtain a document which would grant them the legal status of trader in this market. According to this representative, every trader had to pay a monthly rental fee of 530 Afs. When the trader visited the office he was asked to give 2000 Afs as a bribe to receive the document. The document costs only 24 Afs. He refused to pay and left the office. Later another representative from the municipality came around and offered his 'service' in the form of a smaller monthly payment. Now he pays this man 200 Afs every month and continues his trade without the municipality's document.

Traders within one market sometimes seem to act more collaboratively than competitively – they usually receive their goods from the same supplier (who may also be trading in that market). Sometimes they provide a safety net for each other – with regular payments to a common fund which can be taken as a loan by any of them who runs into difficulties.

Entry into the construction business is easier at the lower levels of the commodity chain, but barriers still remain, and there are surprisingly few completely new players. Even the many retail shops that are springing-up in the major cities mainly represent the revival of longstanding businesses that have been in the family for several generations, and have perhaps been kept functioning at very low levels during the 1990s. The new players in the retail and wholesale markets usually have political connections or other links which have enabled them to establish their businesses, and they are resented by the existing businessmen.

The lack of credit, and the vertical integration of the top end of the business means that it is very difficult for small and medium-sized businesses to expand, and virtually impossible in the current environment for them to challenge the big players.

Relationships between actors

"You can't even buy vegetables at the right price without proper contacts here" (Peshawar trader, interview April 2004)

Relationships between different parts of the 'commodity chain', between suppliers and contractors, and between businessmen and political power-holders are extremely complex, and do not lend themselves either to simplification or to swift investigation by outsiders. What is certain is that it is on the basis of networks and personalized clientalist relationships that business is conducted.

These relationships are based on a complex mix of factors, including family relations, ethnicity, shared history and shared ideology. They are not, as is sometimes asserted in the Afghan context, simply based on family. Indeed, recent ethnographic research into trading networks among the Hazara suggests that many businessmen deliberately diversify their business relationships away from immediate blood relations, recognizing the difficulties of extrication if business deals go sour.[23] Nonetheless, ethnicity is an important issue, with certain trades dominated by certain ethnic groups. In the North, the construction industry is dominated by Uzbeks. In Kabul, there is a new group of Panjsheri building contractors whose businesses are growing rapidly because of their strong political connections. Throughout most of the country, transport systems are controlled and operated by Pashtuns.

The cultivation of relationships with power-holders is considered particularly critical for the success of business. As discussed above, such relationships buy security, tax exemption and may even secure credit for big businessmen. For smaller players, such relationships ensure a measure of both physical protection for their assets and freedom from harassment, as well as powerful allies to call on in the resolution of disputes. Such relationships are often cultivated over long periods, and an important part of this is the giving of gifts. Gold, cars and

[23] Alessandro Monsutti, "Beyond refugee and migrant figures: the role of transnational social and economic strategies among Hazaras", seminar 26 April 2004, AREU, Kabul.

communications equipment are particularly common. Clients may also attend the family celebrations of power-holders, and over time, they may even develop family relations with their patrons through, for example, the marriage of their relations. At this point, they may themselves become cultivated by others (perhaps even bigger businessmen) who want to use their links to enhance their own relationships with the patron.

5. Government regulation

Three potential sets of government regulations affect participants in the construction business: administrative and tax issues related to trading; import procedures; and quality control issues.

5.1 Administrative and tax issues related to trading

This study certainly confirmed this recent observation on the problems to traders of current enforcement of administrative procedures:

> *Many transactions, such as obtaining trade and investment licenses, or clearing exports and imports, are subject to procedures that are onerous, duplicative, often vaguely defined and not applied uniformly. This generates unpredictability and increases the scope for discretion and corruption. Simple transactions may involve interactions with multiple agencies, including repeated dealings with the same agency. Small and medium enterprises, which typically lack connections and the resources to hire professionals and facilitators, usually bear a disproportionate burden emanating from administrative barriers.*[24]

However, government regulation of all trade, as well as the tax regime in the country, is currently undergoing significant reform, with an attempt to simplify and enforce regulations, as well as reform the government agencies responsible.[25] It is recognized that this process will take time. However, there is certainly currently considerable confusion among traders about the regulations in force and the requirements on traders imposed by the central government. It is also not easy for traders to obtain information on reforms.

It is clear that there remain both bureaucratic impediments to trading, and large numbers of 'informal' payments that are made to local power-holders. The researchers for this study heard many variations on the types and amounts of taxes that had to be paid, reflecting both the lack of information available to traders and the uninstitutionalised and informal nature of business regulation. As correctly identified in the quote above, this burden falls disproportionately on small and medium enterprises.

All trading companies with a capital base of over 3500 Afs must obtain a trade licence issued by the Ministry of Commerce (MoC). The process of obtaining a license used to be a complicated, cumbersome and time-consuming process, requiring the collection of 58 signatures. The MoC has revised the process, reducing the number of signatures to seven and

[24] TISA and International Agencies (Jan 2004) "Securing Afghanistan's Future: Accomplishments and the Strategic Path Forward" Trade and Investment and the Public Sector: Technical Annex p 13
[25] Details of planned reforms can be found in TISA and International Agencies ibid and World Bank (Nov 2003) op cit.

the whole process to one day. However, this is a new system introduced in Kabul only in April 2004. It will be rolled out in the provinces in phases.

All companies must also register with the Ministry of Finance (MOF) to obtain their Tax Identification Number (TIN). This is also a new process introduced only in mid April 2004. Provincial departments of finance, or *mustoufiat*, are in the process of registering all companies and developing a new database.

One of the peculiarities of the regulative environment as it affects the construction sector in Afghanistan is that registration as an NGO results in a lower tax burden than registration as a company and requires less capital. This is the reason there are so many 'local NGOs' contracted by international agencies to do construction work. Many such organizations may only do building work, although their charters usually mandate them to do a range of other humanitarian and development related work.

5.2 Import procedures

As discussed above (section 4.1 prices), import tariffs have also been changed recently bringing them in line with international customs standards. The system of import registration has also been reformed. Previously a complex system existed whereby trading companies had to register their import contracts with the MoC and the Chamber of Commerce and pay 2.5 per cent tax on the contract value. This was in addition to other taxes, such as sales and income taxes, which were payable to the Ministry of Finance. Recently this contract tax has been reduced to a uniform level of 0.15 percent.

The operation of customs is also changing. Problems identified elsewhere were confirmed during the research for this study. These include:

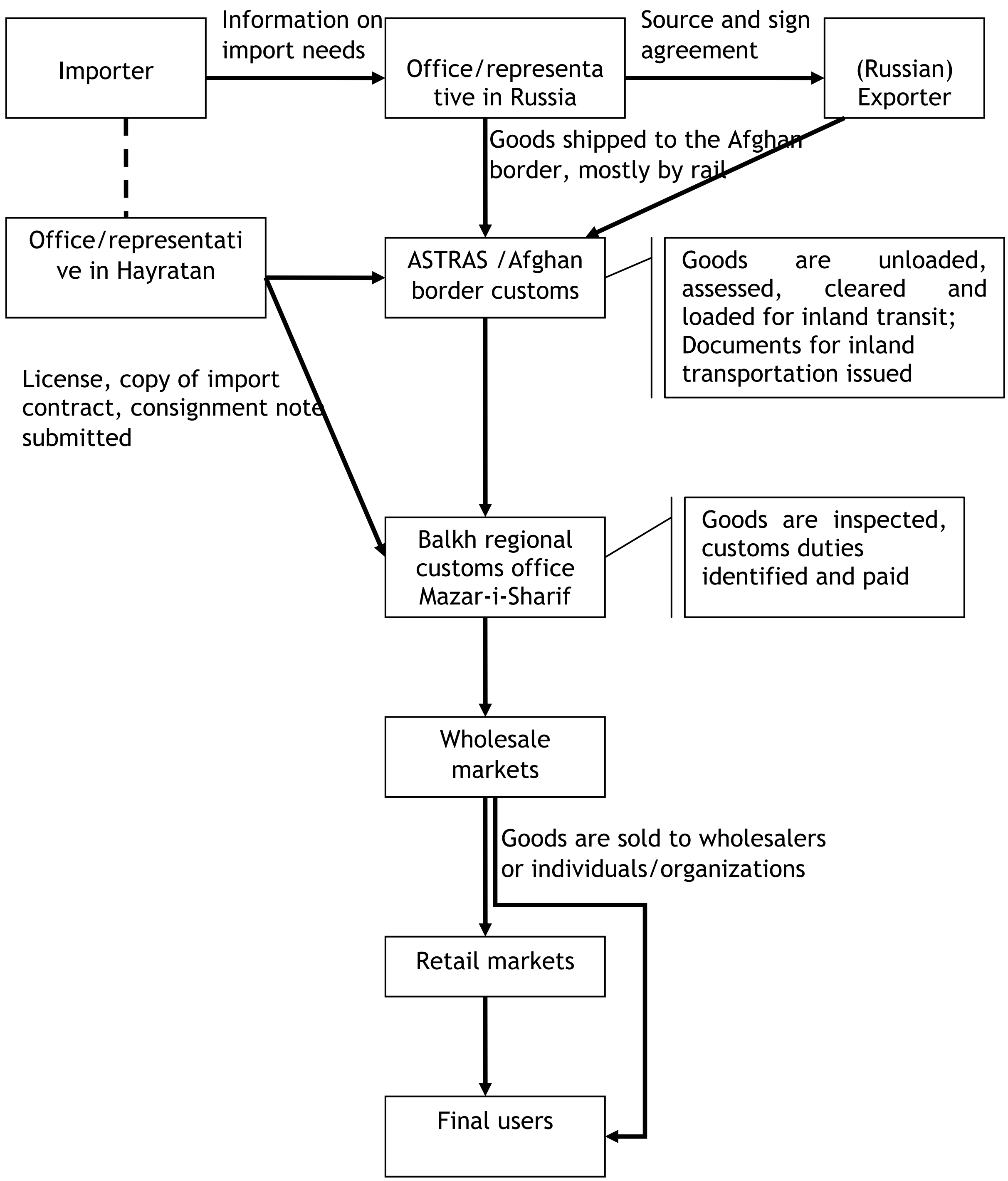
- limited inward transit and related extensive transshipments;
- insufficient control over goods, vehicles, and passengers;
- poor space management;
- inter-agency overlap;
- excessive clearance procedures and associated documentation; and
- extensive handling of goods with possibly excessive examination. [26]

However, there undoubtedly are changes taking place, both in terms of simplification of processes, and increased revenue for the government. For example, the valuation system for imported commodities has changed. Previously, trading companies had to pay commission to the local Chamber of Commerce for valuation of imported commodities. Now this service is offered by the customs office free of charge.

Informants for this study also reported a significant increase in the amount of revenues being remitted to the centre. Now all tariffs paid into the customs account, certainly on the Northern borders, is remitted to the MoF in Kabul. The question, of course, remains how many payments for the release of goods are not paid into this account. Certainly informants suggested that income from the Aqina entry point (the border with Turkmenistan in Jawzjan province) is still going to the controlling warlord's pocket, with a small amount put into the bank on occasions to show that he is cooperative and supportive of the proposed reform system.

[26] World Bank 2003. ibid. Attachment 3.

Figure 9: The route for imported construction materials from Russia to Afghanistan through Hayratan border crossing point



Box 8: Torkhum customs

It is estimated that 70% of all imports to Afghanistan come through Torkhum. However, the scene there is chaotic.

The big gate connecting the two countries is open at dawn. Truckers trying to avoid the morning rushhour usually go to Afghanistan in the early morning. Trucks from Pakistan are parked at the huge customs parking lot. A batch of 10-12 trucks is cleared by customs at a time. After completing procedures in customs, these trucks proceed to the gate where an unarmed *khasadar,* or paramilitary soldier, climbs onto it and randomly checks it. An exchange of a few words with the driver and a 'fistful handshake' (bribe money) usually clears the truck to go to the other side.

In Afghanistan the process is equally cursory. In fact it is not always easy to tell which side is which, or which country the un-uniformed officials are from. They certainly cross over from side to side frequently and undoubtedly collude with each other over bribe money. Moreover, paying at the gate is not enough for truck drivers, there are several other checkposts on both sides of the border.

Some of the people crossing by foot into Pakistan also have to pay bribes especially if they are unwilling to pick a fight with the guards. Most Afghans coming into Pakistan are without passports, some who do have a passport and a valid visa go to the passport office to get their passport stamped. Others just walk past it.

Rough estimates put the daily bribe money paid at the border to be around US$70,000 on just the Pakistani side. At the end of each day this is split between different officials and local power-holders according to a pre-determined percentage. However, lower officials try to cheat the bribe system by under-reporting the number of trucks, and keeping a higher percentage for themselves.

Truckers estimate that clearance takes up to 3 days (2 days is considered normal) and the documentation charges are about $165/container.

Source: Jamal Khan research, World Bank 2003 op cit.

5.3 Quality control

At the moment, there are no quality regulations for any aspect of the construction industry. This is recognized as a problem - low quality materials are used in sub-standard construction by unqualified people operating in an unsafe working environment. As discussed above, the level of supervision by contracting agencies is generally inadequate. Some of the resulting buildings are likely to be hazardous, especially since Afghanistan is prone to earthquakes. Additionally the quality of road building in the country is considered by some to be poor.

The MoC is currently establishing a Department of Standards and Metrology. Construction will be one of the sectors within the remit of this department.

6. Ways forward?

This study has discussed processes relating to the production, import and trading of construction materials in the context of the changes in the construction sector. The construction sector is booming in Afghanistan, and is likely to continue to do so in the medium-term. This undoubtedly represents an opportunity for growth which could benefit a wide group of people. This section briefly considers three areas where interventions to assist a raising of standards and a broadening of the distribution of benefits could be targeted: ensuring high quality work; facilitating development of the sector; and tackling broader political economy issues as they relate to the construction sector.

Ensuring high quality work

Standards in construction in Afghanistan are undoubtedly a serious cause for concern, and need urgent attention. The quality of materials used is a part of this issue. A three-fold approach is needed to tackle this:

- Government regulation. As discussed above, the MoC's Department of Standards and Metrology is being established. The quality of construction materials should be explicitly included within its remit, and sufficient capacity installed to enable appropriate testing and enforcement. Additionally, the environmental impact of the extraction and production of construction materials must be reviewed. This will include the establishment of logging control, regulation of the extraction of aggregate and sand, as well as a consideration of environmental health issues, especially in the brick industry.
- Self-regulation by the construction industry. The Afghan Chamber of Commerce (AICC) is planning to establish an association of Afghan builders. It hopes to establish performance standards and accreditation. The appropriate use of good quality materials must be included within the standards established.
- Improved monitoring and evaluation by donors. The above two initiatives are likely to need some time to establish themselves and begin to function effectively. In the interim, it is essential that there is improved monitoring and evaluation of the quality of work by donor agencies, and their contractors.

Facilitating development of the sector

The trading and import processes described in this report clearly have many implications for the development of the private sector in Afghanistan. These include:

- high transaction costs, which disproportionately affect medium and small enterprises.
- reinforcement of the power base of those who either control customs and associated transport routes, or the issuing of suitable documentation. This is not only because of the financial benefit received by these power-holders, but also the result of the strengthening of existing patron-client relations.
- reinforcement of the non-competitive nature of the markets.

The non-competitive nature of markets in Afghanistan is discussed more generally in the synthesis note which accompanies these case studies. In the context of the construction sector, possible interventions include:

- improved access to credit through formal institutions to enable medium-sized businesses to 'scale-up' and bid on larger contracts, without indebtedness to commanders and others who gain their capital through illicit means.
- continued reform of trade regulations and customs processes, ensuring that adequate information about these reforms is disseminated widely to minimise the potential for exploitation.
- continued negotiation with neighbouring countries to improve cross-border trade procedures.
- support to the establishment of trader associations, ensuring that they are membership-based and operate in a relatively democratic manner.

Political economy issues

Other issues related to the control of the market require broader political will and a change in the overall political economy of Afghanistan. In the context of the construction sector, initial steps might include:

- improved transparency in the awarding of major construction contracts, including disclosure requirements and tighter control when clear conflicts of interest emerge, particularly in the awarding of contracts to the family of cabinet ministers, and other powerful individuals.
- improved monitoring and accountability in the implementing of government and foreign-funded construction contracts, including review of material costs and wage levels.
- a review of the numerous exemptions from export restrictions issued by certain government bodies on consignments of wood, as well as appropriate legislation on extraction of materials.
- reduction in the inappropriate influence of major business in the MoC, by ensuring appropriate space between senior politicians and officials and big businessmen.
- support to the establishment of membership-based, democratically run chambers of commerce throughout the country which can provide a legitimate private sector lobby group.

Annex A. Trading between Afghanistan and Pakistan

Trading has always taken place along the routes between Afghanistan and Pakistan, but it expanded significantly from the 1960s with the establishment of transit markets in Pakistan, and then still further once money from the smuggling of hashish and opium entered these businesses in the 1970s. From the 1980s, under both the Mujahidin and the Taliban, the smuggling of timber, antiques, arms and opium multiplied. The existing network of transit traders between the two countries, particularly those operating from Jalalabad to Peshawar, was used for all these illicit activities.

This expansion of business created a new and larger elite group of Afghans, which replaced the old landed elite. Most of these businessmen were, in the late 1980s and 1990s, physically located in Pakistan which not only gave them access to Pakistani markets, but also allowed them to form good relationships at both the public and private level in Pakistan. Although much of the business in NWFP and FATA operates outside the law of Pakistan, links are maintained between these businesses and government agencies. For many decades, the traders in this region have had working relationships with agencies of the Pakistani government, and large bribes are paid at every level. Government also maintains its control in these areas by acting against those traders who do not, at least publicly, espouse pro-government policies. From the government of Pakistan's perspective, it suits them to have Afghan businessmen dependent on them for the protection of their business, and to build in an economic element to their policy of 'strategic depth' in Afghanistan. Thus from the 1980s, Pakistani agencies not only decided which Afghan Mujahidin faction should get the greatest share of assistance sent by Western or Gulf states, but they also decided what kind of individuals would be allowed to do business with or through Pakistan. This was based on both the political and the ideological/religious alignment of the traders.

However, the traders were linked not only to the Pakistani establishment to facilitate their business in Pakistan, but also increasingly to Pakistani-armed commanders in Afghanistan. Throughout the 1990s, as the influence of commanders in the South and East of the country grew, many traders asked for their protection. Additionally many commanders started trading because they controlled the roads. Under the Taliban, the traders continued to operate, benefiting from the relative security in the country, and striking their own deals with the Taliban.

It is this same group of traders, formed over the decades from the 1970s and who have close links and networks in Pakistan, who continue to dominate the markets in Afghanistan.

References

Fujimora Manabu (2004) " The Post-Conflict Afghan Economy" Kabul: Asia Development Bank

Rubin, B. (1995) "The Fragmentation of Afghanistan: State Formation and Collapse in the International System" Oxford University Press: Oxford;

Rubin, B. (1999). "The Political Economy of War and Peace in Afghanistan", paper presented at the Afghanistan Support Group meeting, Stockholm, Sweden, 21 June 1999

Schetter, C. (2001). The 'Bazaar Economy' of Afghanistan: a comprehensive approach. in C. Noelle-Karimi, C. Schetter and R. Schlagintweit (eds) Afghanistan - A Country without a State? Frankfurt, IKO Verlag.

TISA and International Agencies (Jan 2004) "Securing Afghanistan's Future: Accomplishments and the Strategic Path Forward" Trade and Investment and the Public Sector

USAID & Pragma (2003) "Afghanistan Market Research Trip Report: Finding New Opportunities" Enterprise Development Project in Central Asia.

Wily, Liz Alden (2003) "Land Rights in Crisis: Restoring Tenure Security in Afghanistan" Kabul: AREU

World Bank (Nov 2003) "Technical Annex for a proposed…Emergency Customs Modernization and Trade Facilitation Project" Kabul.