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PERSPECTIVE: INTERSECTION OF AFGHAN TRANSIT TRADE WITH LAW AND POLICY

MUHAMMAD SHAHZEB USMAN



Executive Summary

Smuggling under the guise of Afghan Transit Trade is a major issue for Pakistan. For this purpose, Pakistan is imposing stringent conditions which include a bank guarantee from Afghan traders. The brief shall provide a perspective from international law as well as from a policy angle in relation to the reasons for this smuggling. It shall explore the intersection of local tariff and tax decisions with smuggling. Moreover, it shall also discuss international legal obligations on Pakistan in relation to Afghan Transit Trade. The issue of counter – productivity shall also be discussed which occurs when the conditions of Afghan Transit Trade are very hard. Lastly, the brief shall provide following policy recommendations:

- Increase in advocacy that Pakistan is generally compliant with international law obligations in relation to the Afghan Transit Trade.
- Imposition of less stringent policy measures in the long run to reduce any counter – productive effects of increased smuggling. Less stringent measures must be complemented with effective border management system and 'TIR' level of custom standards and processes even if there is no legal obligation.
- Avoiding any proposal of tariff harmonization with Afghanistan.

About the Author

Muhammad Shahzeb Usman completed his Bachelor of Laws (BA-LL.B.) from the Lahore University of Management Sciences (LUMS) in 2021. He graduated with the degree of Master of Laws (LL.M.) in 2022 from the University of Nottingham, United Kingdom where he studied as the Developing Solutions Scholar. In 2019, he completed the International Course on Global Refugee Crisis on Merit Scholarship at Koc University, Istanbul, Turkey. In 2018, he also completed an International Course on Politics in South – East Asia at UNMC, Kuala Lumpur, Malaysia. He is currently working as a Legal Researcher in the Department of International Law at the Islamabad Policy Research Institute (IPRI). His areas of interest include analysing the impact of International Financial Institutions (IFIs) from TWAIL perspective, International Human Rights Laws, Economic Rights, Labour Laws, Tax Laws, Competition Laws, and Refugee Laws.

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Transit Policy and the Harm

Afghan Transit Trade (ATT) is a major policy issue which is a source of considerable discussion in Pakistan. ATT primarily refers to the use of the territory of Pakistan and the ports of Pakistan to act as a facilitator for the exports from Afghanistan and imports to Afghanistan.¹ In 2023, the Government of Pakistan decided that considerable policy changes shall occur in relation to ATT. The Government of Pakistan imposed a complete ban on certain goods which were unessential to Afghanistan; imposed 10% fees on some imports, and a condition of bank guarantee was imposed which can only be en-cashed once the goods do not reach the destination in Kabul. The decision was imposed as Pakistan tracked an increase in the fabrics and cooking oil in the imports to Afghanistan which could not be reasonably justified considering the demands in Afghanistan.² Much of the \$2.8 billion increase of imports to Afghanistan under the ATT was due to the stoppage of imports to Pakistan due to the balance of payment crisis in the country.³ Most of these goods are then smuggled back to Pakistan or diverted within Pakistan during the journey never reaching Afghanistan. The smuggling of goods from Afghanistan to Pakistan hurts the Pakistani economy for two reasons. First, Pakistani exchequer loses a source of revenue in the form of legal trade tariffs and duties. Second, presence of smuggled goods in market disincentives the businessmen who indulge in legal trade.⁴

Transit Policy and Potential of Counter – Productivity

One of the main issues with the current policy is in relation to the financial guarantee systems. These guarantees are issued to safeguard the concerns of the Government of Pakistan that a large source of revenue shall be lost due to unauthorized usages and leakage of goods in transit. Initially, Afghanistan - Pakistan Transit Trade Agreement (APTTA) dictated that a financial guarantee needs to be provided in the form of insurances. The provision of insurance guarantees allowed various insurance

¹ 'UNCTAD-supported Afghanistan-Pakistan transit trade agreement to take effect on 14 February', *UNCTAD* (Geneva, 4th February 2011) Information Note, UNCTAD/PRESS/IN/2011/004

² Shahbaz Rana, 'Govt tightens transit trade import regime' *Express Tribune* (Lahore, October 4th, 2023)

³ Shahbaz Rana, 'Transit Trade widely misused' *Express Tribune* (Lahore, October 4th, 2023)

⁴ Dr. Muhammad Zubair Khan, 'Enhancing Trade and Regional Cooperation between Afghanistan and Pakistan' (Asia Foundation, March 2016) 16

companies to provide the guarantees at a much lower rate as the rates of insurance dropped from 2.5% to 0.5%.⁵ However, despite the growth in the number of companies, various insurance companies refused to provide guarantees for Afghan trucks causing uncertainty after 2010 and the Afghan traders complained about the high cost of rates on insurance guarantees.⁶ Now the government requires a bank guarantee which covers duty and taxes involved in relation to the vehicle and goods as well as a processing fees on certain items.⁷ The government also requires that the bank guarantee to be around 100% of the assessed value.⁸ However, it must be noted that while the insurance guarantees might be subject to more delay, bank guarantees also might increase the hindrances in importing goods for the Afghan traders to a point where they might resort to smuggling as a last destination.⁹ It is not to say that government should not take measures to stop smuggling. However, a right balance needs to be achieved which ensures that bank guarantees and other fees are not cumulatively so high that they result in no import of the goods for the Afghan traders or have very less incentive for the Afghan traders. It is also to be noted that a considerable number of people are inherently linked with Afghan transit trade within Pakistan. If there are no imports for Afghanistan, there is no work for the people associated with transit trade. If the transit trade is increased between Afghanistan and Pakistan, the subsidiary employment increases. There is a possibility that such stringent policies result in even more smuggling if shared border management remains weak.¹⁰ In this regard, the importance of integrated systems is important as a system which creates inter – link between NADRA, FBR and other government departments at all levels on Pakistan's Western Border.¹¹ Thus, it must be a Comprehensive Border Management Framework (CBMF) that includes all elements from socio – cultural issues to intelligence cooperation to diplomatic engagement which integrates data from Ministry of Foreign Affairs, Ministry of Commerce, Ministry of Interior and Ministry of Defence.¹² Moreover, increase in the cost of transit trade and providing an

⁵ USAID, 'USAID Trade Project', (Final Report, September 2014) 41

⁶ Irshad Ansari, 'Transit Trade: Insurance firms refuse to provide guarantees', *Express Tribune* (Lahore, July 1st 2011)

⁷ Sohail Sarfraz, 'Customs agents, transporters: FBR seeks bank guarantees for Afghan Transit Trade' *Business Recorder* (Lahore, October 4th, 2023)

⁸ Sohail Sarfraz, 'Afghan transit commercial goods: FBR slaps 10pc processing fee on 5 categories' *Business Recorder* (Lahore, October 4th, 2023)

⁹ Dr. Waqar Ahmed, 'Pakistan's transit trade dilemma: Balancing Security and Economic Relations' *ArabNews* (Islamabad, October 14th, 2023)

¹⁰ Ibid.

¹¹ Rauf, Dr. Sarwat, and Shakeel Ahmad. 2019. "PAK AFGHAN BORDER MANAGEMENT: DEVELOPMENTS AND CONTROVERSIES". *Journal of Contemporary Studies* 8 (1):35-51. <https://jcs.ndu.edu.pk/site/article/view/29>

¹² Hassan Ahmed Siddiqui, 'Comprehensive Border Management Framework for Pak – Afghan Border' *Stratheaia* (Islamabad, October 9th, 2023)

excessive power to officials can cause shift of trade to Iran although Pakistan provides considerably shorter way for Afghan trades.¹³ In summation, an excessively high cost of transit trade can cause a significant impact on increasing the chances of smuggling as well as loss of employment for a number of Pakistanis.

Customs and Transit Policy

There is a significant debate about the customs policy in relation to the transit trade. Under the current regime, there are considerable stringent measures on the Afghan traders as Article 21 of APTTA allows 5 percent of containers arriving at the port to be randomly selected. In addition, Afghan traders also complain about demurrage charges and extortion fees as the delay in clearance of documentation at the Pakistan Customs cause excessive demurrage charges to Afghan traders. Delay in receiving traders also results in unfair charges on the traders as the fine on the trader increases with time from the trading firm.¹⁴ However, international law is also relevant here as such practices can create a lack of goodwill in Afghanistan for Pakistan. As a result, Afghanistan can cause considerable problems for Pakistan on their compliance with the Customs Convention on the International Transport of Good (TIR Convention) in relation to the transit trade of Pakistan to Central Asian Republics (CAR). TIR Convention provides certain insights into the best practices, and Pakistan ratified it in 2016.¹⁵ It requires vehicles to be sealed throughout the transport with a secure sealing at the custom office of departure. Such standardized procedures result in no need of indulging in the normal transit procedures and reduces any chances of inaccurate procedures as it is governed by only a single transit document. It also reduces the requirement to furnish unnecessary guarantees. For this process to be implemented, there is a need that goods travel in a secure and sealed vehicles and the taxes as well as duties are secured through an international guarantee via a local guarantee association. A standardized customs procedure operate which is internationally recognized including provision of TIR Carnet.¹⁶ However, despite these procedures, it still provides the custom officials a right to inspect the goods under custom seal and

¹³ Abdul Qahar Hotak, 'The Impact of Mutual Benefits of Pak – Afghan Transit Trade' (2021) 9:3 AJEF 1, 19-20

¹⁴ Shoaib A Rahim, 'Afghanistan – Pakistan Transit Trade' (Vivekananda International Foundation, October 2017) 19

¹⁵ Mubarak Zeb Khan, 'First Shipment under TIR Convention for Uzbekistan Leaks' Dawn (Karachi, May 1, 2021)

¹⁶ Ibid (n.4), 18,19

to comply with their own national laws.¹⁷ Afghanistan has signed TIR Convention to seamlessly entertain transit trade to Central Asian states.¹⁸ In summation, if Pakistan continues to impose hard conditions on Afghanistan, Afghanistan shall also be naturally less compliant and harsher in their facilitation of transit trade even if the country has signed TIR Convention.

Relationship with the Local Policies

Smuggling of goods from Afghanistan through transit trade is inherently tied with the policies drafted in the local taxation and import related tariff system. Pakistan has higher tariffs as compared to Afghanistan which has generally a lower tariff system. Therefore, the tariff system provided an incentive to smuggle goods from Afghanistan to Pakistan. For instance, LCD TVs are high value products which are easily differentiated. On the other hand, tea is low value and is considered homogeneous. In relation to LCDs, the natural incentive shall always be to smuggle it from Afghanistan considering the corresponding tax rates and tariffs in Afghanistan. The informal traders shall provide a substantial discount on the LCDs and that shall make informal traders competitive as compared to formal traders. Even a substantial decrease in taxes and tariffs shall not make the price of LCDs much competitive in comparison to informal traders. Similarly, in the sale of even tea in which the profits in informal trade are less, an even more decrease in sales tax shall be required to make the informal trade less competitive.¹⁹ In light of this analysis, the tariff structure for items prone to smuggling is one of the reasons for smuggling in ATT. Thus, there is an argument that it needs to be regulated in such a manner, that it creates very less incentive for smuggling in terms of profitability. This can be a short term measure to reduce the incentive for smuggling until the border management system completely curb the menace of smuggling.

An argument also exists that sought to harmonize trade tariffs between both countries to curb smuggling. It is simply unpractical due to the vast differences between the economies of both the countries. Pakistan is a huge economy with a protectionist approach adopted towards some local industries to protect the industrial base of the

¹⁷ 'Benefits of the TIR Convention for the Implementation of the BBIN Motor Vehicles Agreement' (Cuts International, August 2017), 51

¹⁸ 'Issuance of Carnet TIR', ACCI < <https://accj.org.af/en/services/issuance-of-carnet-tir.html> > accessed 22th November 2023

¹⁹ Adil Khan Miankhel, 'Channeling Afghanistan to Pakistan Informal Trade Into Formal Channels' (EABER, 27 June 2015) 24, 25

economy. On the other hand, Afghanistan has a small tax base and has no industrial outlook as to significantly adopt a very protectionist approach. Therefore, there shall always be huge difference in tariffs between the two countries on certain items especially in relation to which Pakistan considers protectionism as vital.²⁰

International Legal Obligations and the Transit Policy

International Law generally supports Pakistani stance on the ATT. However, that comes with certain caveats. World Trade Organization's Trade Facilitation Agreement in Article 11 clearly provides that countries must ensure movement of traffic which eliminates all unnecessary restraints. Moreover, the government must also only impose fees or charges which are only administrative in nature. If a guarantee is required, Article 11 clearly requires that it only serves to fulfil the requirements it needs to discharge. Similarly, in relation to the provision of access to landlocked states, the United Nations Convention of the Law of the Sea (UNCLOS) in Article 69 states that there needs to be an access of sea to the landlocked states such as Afghanistan. Pakistan has ratified UNCLOS but Afghanistan is only a signatory to UNCLOS.²¹ Therefore, there is currently no chance that Afghanistan can submit a dispute in the International Tribunal for the Law of Sea. Furthermore, Article 127(1) and Article 130 of UNCLOS requires that there are no custom duties or taxes on the landlocked states for providing access to sea and that difficulties of technical nature needs to be ameliorated.²² Article 2 of the Convention on Transit Trade of Land-Locked States (CTTLLS) further provides that states must take measures for regulating and facilitating traffic in transit in a mutually acceptable way. Article 3 and 4 of CTTLLS also states that custom duties shall not be applicable but administrative expenses can be levied as well charges which are facilitation in nature in a reasonable manner. Moreover, Article 5 of CTTLLS stipulates that the customs shall be free, uninterrupted and continuous with simplified documentation and methods. However, the government has full right to prohibit goods on the grounds of security under section 11. The obligation of transit is further expressed in Article 5 of General

²⁰ Ibid (n,4), 17-18

²¹ 'Chapter 11: Freedom of Transit' *UNCTAD (Geneva) Technical Note* < https://unctad.org/system/files/non-official-document/wto-technical-note_ch11a11_en.pdf > accessed 22th November 2023

²² 'Afghansitan rights of access and transit under International Law' *South Asia Monitor* (July 1, 2023) <https://www.southasiamonitor.org/reprints/afghanistans-right-access-and-transit-under-international-law> accessed 22th November 2023

Agreement on Tariffs and Trade (GATT) as well as the philosophy is encapsulated in various UN resolutions. For instance, Article 55 of the UN promotes economic progress and finding solutions to economic problems. The UN General Assembly 1028 (XI) 10 further reiterated the concept of economic development in terms of rising challenges to expand international trade.²³

In light of these international law obligations, it is reasonable to assume that Pakistan has generally complied with the international law on transit trade in Afghanistan. Pakistan has provided a right of way and only imposed monetary obligations which were in the form of processing fee. Pakistan has also never imposed any kind of taxes on the goods imported to Afghanistan or exported from Afghanistan. However, Pakistan does need to make the process easy for Afghan traders and remove difficulties for them.

Recommendations

1. Pakistan needs to increase the advocacy and research to make the country compliant with international law obligations especially from a trade and economic perspective in relation to making the trade process easy for Afghan traders. However, Pakistan also needs to strengthen the advocacy voices that state is largely compliant to the international law obligations in terms of transit trade with Afghanistan. Pakistan needs to generate a discourse in academia and media that the country is compliant with UNCLOS, CTLLS and GATT as Pakistan has never hindered access of sea to Afghanistan from Pakistan. Moreover, the key areas of advocacy should be that Pakistan has never imposed custom duties or taxes and also has not charged any unnecessary fees in relation to ATT. Pakistan needs to advocate that the country has also not deliberately attempted to hinder the application of international legal obligations in order to make the trade process cumbersome for Afghan traders.
2. Pakistan needs to view the issue of Afghan Transit Trade in a very holistic and deep – rooted way. It is not only a matter of preventing smuggling and leakage of goods. It can have implications on long-term geostrategic objectives as well as on employment generation in both countries which is inherently in a

²³ Ibid (n.14), 9

symbiotic relation with the security situation in the milieus of both countries. Therefore, to keep our options open for transit trade with Central Asian states, it is vital that Afghanistan is not invoked to cause hindrance in our own transit trade.

3. Pakistan needs to develop a framework for Afghan traders which does not restrict their ability to import or export goods through Pakistan in the long run. For the time being, it is important to take stringent measures but the focus should be to develop a model similar to 'TIR level' of customs arrangement in the long run. For this purpose, a joint coordination between both countries on custom capacity building and sophistication of custom processes shall be essential.
4. Moreover, an intelligent border management system would also be a linchpin for the stabilization of a long term transit relation with Kabul. Both of these measures are the key for achieving the right balance as to protect the interests of both Pakistan and Afghanistan on all fronts.
5. Pakistan should not take measures such as tariff harmonization with Afghanistan as the structure of economy of both countries is inherently dissimilar. However, Pakistan can take targeted short – term measures in relation to tax and tariff for some products assuming there is no other caveat.