



Investing in Afghanistan

Business opportunities in the carpet industry

The tradition of Afghan carpets goes back for centuries. The richness and variety of designs reflect the cultural diversity of our country. The skill of our weavers is unrivalled in the world and make our carpets unique. Rightfully, our weavers take great pride in being part of this living heritage of our country. Commercially, the carpet industry is a cornerstone of our economy. It is our leading export sector, it represents an important source of income for the rural population, and it provides jobs to many returning refugees.

However old the roots of the carpet industry, it has a great future ahead. Today's globalised world, with the associated modern information technology, offers tremendous opportunities for the industry. The once remote place of Afghanistan is now well connected to the international markets. This allows to react much faster to changes in tastes and demands of the international customers. The combination of our heritage and weaving skills with these new opportunities makes for a bright outlook for the carpet industry.

The Afghan people are hard-working and possess a spirit of entrepreneurship and resilience. Around the country we witness our people rebuilding their homes, villages, and cities. Everybody joining these efforts is welcomed with open arms by our people. Take advantage of the opportunities. We are happy to help all investors wherever we can. The time for business in carpets is now.

Why Afghanistan? Why now?

Afghanistan is an exciting place for new business. With three years into the reconstruction process the signs of better times are visible around the country. The economy has been growing at an average rate of around 20% per annum over the last three years and growth is forecasted to remain strong over the next decade. All macroeconomic indicators underline the positive development that can be experienced around the country. The government's finances are in balance and inflation has been close to zero since the introduction of the new Afghani currency in early 2003. Many individual success stories of thriving businesses reflect the overall positive development of the country. Political stability has substantially increased over these last years. The presidential elections have been a great success and the victory of President Hamid Karzai demonstrates the strong support for the government and its policy. The international community has guaranteed continued large-scale support for the country.

The government has shown its commitment to promote the development of Afghanistan's private sector. It has successfully introduced a sound business-friendly legal framework. The policy measures include clear and attractive investment, banking and taxation legislation. Parts of this legislation is currently updated to meet even better the needs of investors and to further facilitate the interaction between the government and the private sector. The government has actively negotiated a number of preferential trade agreements with neighbouring countries and receives important preferential market access to important overseas markets. The customs organisation and the tariff system have been drastically simplified, including a substantial reduction of tariffs. Public administration is being modernized and many procedures have been streamlined to reduce bureaucratic procedures. In all its actions the government has shown a hands-on approach to support businesses willing to invest.

The infrastructure around the country has been substantially improved. Two mobile telecommunication networks cover all major and many smaller cities as well as many of the main roads. Similarly, several internet providers are offering their services in Afghanistan. As a recent example, US based Group Sat just decided to invest US\$ 36 million into broadband services for Afghanistan. Along with many other projects, the Kabul-Kandahar road has been completed. Travel times between many cities have been drastically shortened. The number of international flights to Kabul is steadily increasing and air freight rates are falling. Additionally, President Hamid Karzai has issued a decree ordering ARIANA to transport Afghan carpets at cost price. The system of power generation and distribution is rebuilt with strong international support. Given the international pledges for further support, the country will continue to invest heavily in the infrastructure for production and trade. Our neighbouring countries, Iran and Pakistan are also both investing heavily in transit infrastructure that will improve connections between Afghanistan and the overseas markets.

International support for the country remains strong. Many international governments have made it clear that they will be supporting the reconstruction process not only with their military peacekeeping operations but also with continued economic assistance. Refugees continue to return from neighbouring countries, and many of them possess important skills in carpet weaving and production.

The improved conditions for private activities and the numerous profitable opportunities are reflected in the substantial increase in private investments. Besides this general positive

development the carpet industry is in a especially promising situation. The time is right for further investment in the carpet industry.

The Afghan carpet industry

The Afghan carpet industry has a long tradition and it has been the country's most important export sector over the last years. Carpet production is concentrated in several regions, where the production is dominated by home production. An increasing number of carpet factories has also been established in urban centres over the last years. The competitiveness of the Afghan carpet industry is largely determined by the skills of the Afghan weavers to produce high quality carpets. This quality has allowed Afghan carpet makers to compete against foreign rivals that did not face the challenges of a post-war economy. With this handicap being steadily reduced, the perspective of the industry looks bright.

The importance of the carpet sector is well understood by the government, NGOs and international actors, particularly since it is an important source of income for the rural population, particularly for women, and has a large potential for employment creation and poverty alleviation. Government's policy and international support are increasingly directed to the benefit of the industry.

Transportation of carpets is either done via land and ship or via air. Air transportation is an option for high quality carpets. The growing number of air freight companies serving Kabul and the associated falling freight rates make this an increasingly attractive alternative. Air transport also allows to bypass intermediate traders in neighbouring countries. As transportation is faster less capital is tied up in the transaction. It will become even more attractive as customs procedures are speeded up. In support of the Afghan carpet industry, president Hamid Karzai has issued a decree that ARIANA transports Afghan carpets at cost price.

A particular challenge, but also a great business opportunity, is the access to the overseas markets. Most of the Afghan production for the overseas markets is transported to Pakistan for washing, trimming, and finishing, and re-exported from there to the overseas markets. Few appropriate post weaving processing facilities exist in Afghanistan, which is a primary source of dependency on the export route via Pakistan. The added value of these production stages is generated in Pakistan, although these activities could well be carried out within Afghanistan. Pakistani traders receive commission payments, and this structure implies dependency on a few international traders operating from Pakistan. Their control over re-exports gives them substantial market power to the disadvantage of Afghan traders and producers. Huge parts of the potential Afghan revenue is lost to the intermediate foreign traders.

The large potential of Afghan carpets

The Afghan carpet industry has a great potential and investment is very profitable. Here are some of the reasons:

Reducing the trading power of foreign traders

Establishing those parts of the carpet production chain which are now mainly carried out outside the country entails great business opportunities. Afghanistan meets all the conditions

necessary to carry out these activities within the country. Large profits can be diverted to investors in Afghanistan if they strategically invest in those production facilities that cause the dependency on the intermediate traders in Pakistan. The re-establishment of the entire production chain within Afghanistan allows more direct trade with the overseas markets. Investors can cash in on the substantial gains originating from the trade to the overseas markets.

Increased competition in Afghanistan

The high mark-ups observed in the carpet business point at the large profit opportunities for investors. The improvement of the trading infrastructure, modern telecommunication, and the increasing availability of credit make it much easier for new entrants and for smaller businesses to invest and to expand. Large existing businesses need to invest in order to defend their leading positions. This increased competition will make the Afghan carpet industry more competitive vis-à-vis the main international competitors.

Product differentiation strategy and unique branding

Afghan high quality carpets offer great opportunities to position them in the international market. The great skills of the Afghan weavers, the existing traditions and the richness and uniqueness in designs, and the mystery that surrounds Afghanistan as a remote place, provide a solid base for a marketing and product differentiation strategy for Afghan carpets. Enacting such a branding strategy will allow the Afghan producers to command an additional price premium for their products.

Niche markets

Given the high potential of Afghan carpets in the high quality segment, niche products have a particular potential. Weaving on demand, where the final customer, using modern information technology, orders a carpet that is then customized according to his specified preferences is one example. Prayer rugs are another example of such potential niche markets.

Improvements in quality

The current structure of the trade that depends on import of important inputs such as wool and yarn and on export for washing, trimming, and finishing are a challenge to the production of high quality carpets. Investment in the entire production chain allows improved quality management.

Modern information technology

The use of modern information technology allows producers to instantly react to changes in tastes in the overseas markets. This is a particular opportunity for producers located in a once isolated location like Afghanistan. It eliminates the disadvantage vis-à-vis other producers that were located closer to customers. Moreover it provides a new marketing tool for addressing potential customers directly and to brand the uniqueness

Market access

Afghan hand-made carpets enjoy preferential access to important overseas markets. No customs duty is levied on their import into the United States nor into the European Union.

Relocation of the exile carpet industry

The Afghan exile carpet industry in Pakistan has concentrated a very valuable stock of knowledge and skills, the contacts, and the capital. The Afghan government is increasingly recognizing this potential and AISA is particularly aware of the needs of this group. Further relocation of the exile weavers and traders will have a substantial positive impact on the industry.

Industrial land made available

In the past, the lack of appropriate land has been a main bottleneck for the industry's development. Production often takes place under severe space constraints. Various production stages are often inefficiently scattered around to many small premises because production sites of appropriate size were not available. Now, with the initiation of the industrial parks program, appropriate land for the expansion of carpet businesses is available. This will increase the efficiency of production and the quality of the products.

Opportunities in the carpet industry

Given the large potential in the Afghan carpet industry many concrete profitable investment opportunities exist.

Wool scouring and spinning

Quality carpets require quality wool and yarn. Some producers of quality carpets try to exclusively use local wool, but the supply of local wool is insufficient to meet demand. With the number of livestock increasing again, investment in more wool scouring facilities are necessary.

Spinning of high quality yarn, either from local or imported wool, offers substantial opportunities and is not dependent on an increasing local sheep population. As demand for high quality carpets is increasing, the demand for hand spun wool will be increasing.

Carpet factories

A number of carpet factories have already been established over the last years in Afghanistan. These factories have various advantages over traditional home production. Completion time is drastically reduced, since electricity makes longer working hours feasible. Permanent monitoring increases the quality of the product and information and skills are being exchanged between workers. Similar arguments apply to spinning factories where the yarn is being spun by hand.

Post weaving facilities: washing, trimming, finishing

Currently, washing, trimming, and finishing facilities hardly exist in Afghanistan. This lack is a major bottleneck for the development of direct access to the overseas markets. They are a central cause for the dominant market position of Pakistan-based middlemen. The establishment of such activities is not only profitable as a business itself. More important, it

breaks this dominance of foreign intermediate traders. This diverts profits from trading in carpets to Afghan businesses. Such facilities can also sell their services to other traders, generating an additional source of revenue for investors.

Investment in carpet trading

The fact that Afghan carpet traders have been widely excluded from directly exporting to the overseas markets has diminished their contacts and knowledge of these markets. Given the particular potential of Afghan carpets this underlines the opportunities that exist for people that possess this international market knowledge. For such actors substantial business opportunities exists by engaging in trading activities, as they can cut into the profits of the few established, often foreign-based traders.

More efficient production using modern information technology

Currently, most designs are sketched and plotted by hand. Investment in computer aided design (CAD) technology and associated training has substantial potential for efficiency gains. This also facilitates the interaction with overseas customers who can interact in the production process.

A short guide to investing in Afghanistan

AISA - The Afghan Investment Support Agency

AISA was set up by the Afghan government in October 2003 as an independent institution to serve as a one stop agency for investors. Since then, it has helped and registered thousands of domestic businesses and over 300 international businesses starting operations in Afghanistan. The formal procedures are straightforward and AISA registration typically does not exceed 2 weeks, with the majority of cases registered within 4 days. AISA acts as an independent agency, decides fully autonomously, and lobbies policy makers for business friendly policies.

Its staff is well educated and especially trained to assist investors with all potential problems these may face. The Industrial Parks Development Authority (IPDA) has been established under AISA in order to bundle assistance to businesses in a single competent agency. AISA is in the position to offer a large variety of services tailored specifically to individual investors' needs.

How AISA helps investors:

- Provision of information on key business sectors and investment opportunities.
- Advice on property and land solutions including details on the availability of slots in the various industrial parks.
- Advice on legal provisions regarding investment, tax, labor, insurance and environmental and social standards.
- Advice on local banking and credit institutions.
- Advice on donor-led support programs for investors.
- Assistance in customs clearance of investment related capital goods.
- Sponsoring of investment conferences, symposiums, and round tables.
- Assistance in setting up business in Afghanistan
- Securing all necessary permits, licenses and clearance, including a simple fast-track registration procedure.
- Announcement of investment opportunities, including privatisations of state owned enterprises.
- Directly issue investment licences for investments up to US\$ 1.5 millions.
- Help with the preparation of High Commission for Investment approval (necessary for investments exceeding US\$ 3 millions).

The industrial parks program (IPDA)

To promote private sector business activities, Afghanistan has started an ambitious industrial parks program with international support. Three parks are currently developed and further 6 have been projected. Within the parks, slots for business development of various sizes are available. The amenities of the industrial parks include the quick availability of a clear land title, the provision of power and water, and 24 hour security. This helps investors to avoid delays related to site acquisition, title disputes, zoning and permitting, and to benefit from the high quality and reliability of the parks' infrastructure. The industrial parks also generate substantial interaction between firms and businesses are benefiting substantially from such interaction.

Industrial parks

Current projects include

Bagrami Industrial Park, a 24 hectare (52.8 acres) park located 7 km east of central Kabul;
Mazar Industrial Park, a 26 hectare (57.2 acres) park located 7 km north of *Mazar-e-Sharif*;
Kandahar Industrial Park, a 15 hectare (33 acres) park located 10 km east of *Kandahar*.

A second phase is also underway, which includes Industrial Parks in

Kamari, a 120 hectares park located 13 km from central Kabul;
Sinjet Dara Industrial Park, a 120 hectare park located 7 km south of Charikar;
Deh Sabz Industrial Park, a 750 hectare park located 5 km north of Kabul Airport.

For further projects and progress on the various parks, please contact the AISA/IPDA staff.

illustration: map with location or picture of Bagrami park and or location of IP across Afg

The first public offering of slots at the Bagrami site near Kabul has been met with strong demand from the national and international business community. Slots are offered at competitive prices calculated on the basis of land prices plus the development and infrastructure costs. The allocation of slots in the new parks is typically done in a three stage procedure. This consists of

- the expression of interest stage,
- application and investor selection stage,
- lease and sales negotiations.

All industrial parks are open to the carpet industry. The carpet industry's needs have been especially taken into account in the development of Bagrami park and similar attention will be given to the industry's needs in the development of the other industrial parks. For further information regarding the industrial parks program please consult the AISA/IPDA web pages or consult directly the AISA/IPDA staff.

Regulatory framework and taxation in Afghanistan

Private sector development has been a corner stone of the national development program of the Afghan government. It is recognised that only private investments and private business activities can be the driving forces of development. The government has adopted a business friendly approach. The tax and investment laws together comprise an attractive package for investors.

The central features of the tax law currently being approved are a 20 % flat tax rate on corporate income, unlimited loss carry forward and provisions for accelerated depreciation. For imports, Afghanistan has introduced a simplified tariff scheme with rates ranging from 2.5% to 16%. A tariff of 4% is levied on the import of capital goods. Regarding exports, Afghanistan enjoys full duty free access to the EU under the "everything but arms program" for least developed countries. It also enjoys preferential treatment under the preferential trade systems of all other major industrialized countries. Afghanistan has been granted observer status at the WTO and all trade related regulations are already enacted with the perspective of

future full WTO accession. Official business registration has been made very easy, with fast track registration through AISA.

Security

Over the last three years, the country has seen a strengthening of the central government's role with a substantial increase in security. All major cities are very secure areas. Crime rates within the cities are very low by international standards. Security concerns remain with respect to various remote areas of the country, particularly in the South-East of the country. In a recent business survey carried out by the Worldbank security concerns were ranked 19th in a suggestive list of 20 challenges faced by businesses operating in Afghanistan.

Human resources

The Afghan people are hard-working and are eager to rebuild their country. Their energy and resilience are now directed towards improving their lives. The spread of peace, security and prosperity is highly valued, and people are looking optimistically ahead. The workforce consists of a large number of young people, which are willing to learn and to adjust to a rapidly changing environment. Further labour supply from returning refugees will keep wages low. Many of the returning refugees from Pakistan possess high skills in carpet weaving and production.

Finance and credit

A number of commercial banks have started their operations in the country. While all of them offer payments transfer services some have also started providing credit to businesses. For small and medium sized businesses, under an internationally financed program, credit up to US\$ 50,000 is provided by the First Micro Finance Bank. Other banks will be included in the program soon.

MIGA and other investment insurance schemes

Afghanistan is a member of the international investment insurance scheme MIGA. MIGA provides investment guarantees against certain non-commercial risks (i.e., political risk insurance) to eligible foreign investors for qualified investments in developing member countries. MIGA's coverage is against the following risks:

- Transfer Restrictions.
- Expropriation.
- Breach of Contract.
- War and Civil Disturbance.

AISA staff is trained to advise investors on the MIGA program.

Besides this multinational scheme, agreements for the inclusion of Afghanistan in export and investment guarantee schemes of various industrial countries are being negotiated. Such an agreement has just been signed with Germany in December 2004.

Contact and further information

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