Sources of Tension in Afghanistan and Pakistan: A Regional Perspective

Perspectives from the Region in 2013 & 2014:

7. Formal & Non-Formal Economies in Afghanistan & Pakistan: THE VIEW FROM THE GULF

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FORMAL & NON-FORMAL ECONOMIES IN AFGHANISTAN AND PAKISTAN: THE VIEW FROM THE GULF

Under CIDOB's "Sources of Tension in Afghanistan and Pakistan: Regional Perspectives (STAP RP)" policy research project on the regional powers and their interests, this series is a product of field research visits to a number of the key regional powers identified in the 2012 Mapping Document http://www.cidobafpakproject.com/ by the STAP RP project team.

Understanding the perspectives of the five main regional powers (India, Iran, China, Russia and Saudi Arabia) with an interest in outcomes in Afghanistan and Pakistan is a critical element in relation to this volatile region, which is currently in a state of flux. Identification of opportunities for dialogue, peace building, improved bilateral relationships and the development of regional organisations as mechanisms for dialogue, as well as examining how the regional powers see Afghanistan and Pakistan from a broader geopolitical and foreign policy perspective are key elements in enhancing this understanding.

This report is a product of a Round Table Discussion in Doha, Qatar on October 21 2014, which was co-hosted with the Gulf Studies Program, Qatar University.

The collaboration with, and contributions by, the Gulf Studies Program in this event are gratefully acknowledged. The report is jointly authored by Emma Hooper and Gabriel Reyes Leguen.

While many experts contributed to the findings presented, the final responsibility for the content is that of CIDOB alone.

Introduction

As part of the focus of the STAP RP in 2014 on peripheral actors and activities that might play a more central role given changes in the region, including the draw-down of western troops in Afghanistan and a new government there, a one day round table discussion was held in Doha, Qatar, hosted by the Gulf Studies Program of Qatar University and CIDOB, to explore the nature of flows of funds from Afghanistan and Pakistan, from both formal and non-formal economies, and how these impact the Gulf region, in particular Dubai.

The Flow of Capital between Afghanistan and Pakistan from Formal & Non-Formal Economies

The Historical Perspective

The main flows of capital to Afghanistan and Pakistan during the 1970´s were in fact from, not to, the Gulf, and were largely within the framework of foreign aid. This increased dramatically during the 1980s, particularly in the form of flows of funds to the Afghan Taliban and other non-state actors: (the Taliban were recognised by the UAE, Saudi Arabia and Libya at the time). These funds made a significant contribution to the economy in Afghanistan, as well as the financing of Islamic schools/ *madrassas* in both the latter and in Pakistan. The Saudi role in mediation in the 1990s significantly assisted the economies of both countries. Incoming UAE assistance to Pakistan saw the attention paid to different groups within Pakistan, and the overall formal flow of capital to the latter from the UAE has historically been large.

Trade Flows from Afghanistan

Afghanistan´s GDP growth, attributed to the financial flows based on international assistance, is likely to drop considerably as the international presence there withdraws. Managing the country´s macro-economic stability and cash flow, rather than GDP growth in the immediate future, has been acknowledged as the main challenge. If this effort fails, it is considered that there will be an upsurge in instability in the country. Projections indicate that by 2020 Afghanistan will need to import US$ 3 billion in formal goods, but cash in hand will be required to pay for them, and the question arises of where it may come from. Afghanistan does not trade far from the region and its interactions are limited to the neighbouring economies. In consequence, solutions in Afghanistan will have to emerge from the region itself.

Afghanistan-Pakistan Trade

Some 70% of Afghanistan´s trade is concentrated in a few commodities. Bilateral trade between Afghanistan and Pakistan amounted to approximately US$ 2.5 billion in 2012/13 (World Bank sources), but was also heavily dependent on the presence of foregin troops in the former. Cross-border trade across the Chaman and Torkham border posts is critical.

Because there is no physical border, informal markets thrive, but no model mechanisms or supporting authorising structures exist that might capture and formalise these trade flows in national accounting. The (mostly formal) Afghan transit trade via Torkham is focused on commercial trades between the two countries; the Afghanistan transit trade; NATO transit; donor supplies; informal (non-opium) trade including smuggling (electronics, car parts, semi-precious stones, carpet, livestock, foodstuffs). Informal trade reportedly accounts annually for US$ 1.5 billion, with smuggling accounting for US$1 billion. However, the volume of both commercial and transit trade are likely to drop considerably post-troop withdrawals.

The Challenges of Informality

Whilst a natural trade corridor exists between the two countries, there is no actual economic connectivity between the two in formal terms. Inefficient border management, strong tribal mechanism, illiteracy and fear of form-filling, as well as flawed economic policies on the transit trade (including reverse smuggling due to duty differentials as high as 30—40%) are all contributing factors impeding economic connectivity.

None the less, the potential rewards are considerable: Afghanistan provides a land link to Central Asia; Pakistan provides access to the sea and the west China corridor via the port of Gwador, and – geopolitical relations permitting – to north west India as well. Opportunities therefore certainly exist, but the question arises of what would trigger the respective sets of authorities to look at the border posts as centres of trade and commerce (vs of conflict), from the economic perspective. There is a need to change the vision of the region, from a geographic approach based on physical borders (often viewed with suspicion), to a broader economic view of the region as the space for interconnectivity of twelve different markets. This potential change offers huge opportunities to Gulf-based investors, through good connectivity to twelve potential markets. Prior to 9/11, connectivity was restricted, and Afghanistan was emerging from 40 years of conflict. The trade focus was historically local, illegal, and neighbouring countries restricted both cross-border and transit trade. Currently, security trumps other considerations when addressing border management, due to the activities of non-state actors including militant groups. Consequently, unless legal incentives are offered to integrate non-formal activities into the formal economy, these opportunities will by-pass the system: (it was also noted that not all informal flows of trade are illegal). The realisation of what Afghanistan´s commercial sector can offer is relatively recent (2007-8), and valuable time has been lost in establishing a model economic environment for the transit trade. There is consequently a need to build parallel structures, so that those engaged in informal markets have alternatives. The Afghanistan Transit Trade Agreement of 1965 was renegotiated in 2010, but became caught up in (resolvable) issues, such as the time taken to negotiate transit trade fees which was highly politicised. This was recently resolved by the new president of Afghanistan, Ashraf Ghani.

The main source of illegal flows of funds out of Afghanistan and Pakistan are value transfers via *hawala* or *hundi* mechanisms, under which money is moved via regional finance centres, often third-country (such as China, Japan, South Africa) by means of asset transfers. The average transaction cost from *hawala* and *hundi* has gone down from approximately US$ 1 million/year in the 1980s and 90s, to about $ 20,000 at present, due to the effectiveness of anti-money laundering regulations. None the less, profit margins are considerable, and are usually invested in production or shared via remittances.

The Potential of Greater Regional Economic Connectivity

The challenge for the international community and the Gulf is whether Afghanistan can be viewed as a transit hub and an investment destination. In this regard, the World Bank, among others, is supporting the view that infrastructure and the energy trade will open up regional markets and Afghanistan´s connectivity. However, in the view of one analyst, the drivers of regional cooperation will have to come from the region, not multilateral or external organisations, due to a deficit of trust. Amongst these drivers the following were highlighted: a continuing shift in the world's economic centres; greater regional interdependence; competition for energy/water resources; the establishment of Afghanistan as a reliable trading partner and a safe transit country; and most importantly, international and regional support for physical, regulatory and financial infrastructure.

Existing mechanisms such as the recently-signed CASA 1000 agreement between Kirghizstan, Tajikistan, Afghanistan and Pakistan, as well as other projects still on the drawing board such as the TAPI, the IPI pipelines and power transmission projects such as the India-Pakistan; TUPAP (connecting the power systems of Turkmenistan-Uzbekistan-Tajikistan-Afghanistan-Pakistan); Iran-Pakistan; Nepal-India, all have the potential to be transformational in terms of looking at the economies of the region in a different way. Without such a new perspective on doing business and leaving aside rivalries and mistrust, stability in Afghanistan – but also in Pakistan – will be in doubt and an increase in informal markets, including illegal cash flows (which are large but by nature unverifiable) is likely. In the view of one of the participants, "*as long as practical measures using 21st century risk management tools and technology to restore trust, and thereby connectivity, are not used, the Afghan corridor will remain a myth*". If one or two of the above-mentioned projects manages to crystallise in the coming twenty years, the region might be able to move forward.

Illegal & Informal Economies in Afghanistan

Informal economies in Afghanistan present both costs and opportunities. Illegal informal economies are widespread there. It was noted that Afghanistan was cited as the most corrupt country worldwide for two years running by Transparency International. Afghanistan's vital sectors are customs, aid, banking and finance, natural resources – the pillars of a successful Afghan economy being relied on for future economic growth and development in the country, but which ironically are also the pillars of the principal illegal economies as well. Negative factors include corruption, the diversion of funds, weak financial systems, narcotics, and the subversion of money from natural resources being diverted towards armed groups and non state actors.

On the cost side, illegal economies create local-level grievances. They also fund armed groups and are drivers of conflict, as well as undermining the legitimacy of government and the effectiveness of both the latter and the armed forces as well as the effectiveness of use of revenues and budget, taxes, customs and the economy as a whole. "*Lack of justice and rule of law, of which informal economies are a part, are a greater threat to Afghanistan than insurgenc*y" as one participant pointed out. Thus, the link with insecurity is direct, and considerable. None the less, this recognition is not reflected in current policy responses. Reportedly, according to USAID, the revenue from customs dues (which account for 44-48% of total domestic revenue; that is $698 million – $1.1 billion/year) could be doubled if corruption was significantly reduced. On the other hand, aid contracting has links to insurgents through misuse of funds whereby convoy protection payments actually contribute to warlords´ protection rackets, and rent sought by the Taliban from extortion on licit and illicit agencies inadvertently create a direct financial pipeline from Washington DC to the Taliban (see the $2.16 billion Host Nation Trucking Agreement). Other examples of corruption scandals undermining the Afghanistan's economy and governance include the Kabul Bank scandal ($935 million fraudulently lent; $861 million benefited 11 individuals) which almost led to the collapse of the entire afghan economy and put at risk the physical security of Afghanistan, as almost all ANSF salaries were paid through the Kabul Bank; and the former Shaheen money exchange system (*hawala*) which collaborated with the Kabul Bank to make transfers. In other words, present illegal flows of funds have huge (legal) financial potential, if they can be fully exploited and captured: there are approximately US$ 1 trillion in estimated mineral reserves in Afghanistan, and Ashraf Ghani has reportedly referred to Afghanistan as the *"South Africa of lithium"*, referring to its huge potential in that subsector.

But, there is also huge potential for harm.

There are reportedly some 1400 illegal mines controlled by warlords and non-state actors. The largest revenue source for the Taliban in Helmand is marble mining (the 2nd largest revenue source in the region after opium according to a UN 2014 report). The chromite trade enriches local Afghan police commanders with poor human rights records. Unconfirmed reports link the timber trade with the Haqqani network and other militant networks. Even in the formal economy, the mining sector (Mes Aynak, Hajigak, Qara Zaghan, Amu Darya) has problems, allegedly suffering from corruption. The Afghan Local Police (ALP) in Kunar is reportedly involved in chromite smuggling (shipped through main Haqqani network-controlled areas in Pakistan) and in Badakhshan, cuts from the lapis lazuli trade reportedly go to Commander Malek, the former chief of the District Police, according to Global Witness. This results in competition within armed groups for access to funds from natural resources and international repercussions: ALP commanders in East Africa, in collaboration with the Taliban, are reportedly engaged in smuggling to Pakistan.

The lapis lazuli and precious stones market is another example. Stones go to Pakistan via the Namak Mandi (Salt Market) in Peshawar and from there, travel on to the Gulf, to China and India. Little benefits stay behind with the poor who are involved in their extraction – another problem of the informal economy.

The overall results of this set of circumstances are budget losses, an under-developed natural resources sector with low investment, low employment, whose value does not stay in Afghanistan and which funds armed groups. Resentment is created among the local population, funds flow directly to the Taliban, and in turn, drives conflict.

Links to the Gulf

There are major flows of funds from Afghanistan to the Gulf, and specifically to Dubai for the most part. Whilst the UAE is a high-risk area for money laundering, some reforms are in process that may help limit flows of illegal funds. None the less, real estate bought with Afghan assets accounts is considerable: some $50 million worth was bought in Dubai by investors in the Kabul Bank.

The Gulf´s links with Afghanistan are a mixture of the legal and the illegal. It is easy to say that more could be done, but less easy to address the "how": illegal flows occur on a large scale; entrenched local interests are involved; enforcement is poor; and at the policy level, action is weak. On the positive side, there are a number of obvious measures that could be taken in Afghanistan itself: ensuring transparency, through the publication of controls, data, payments to government, conflict prevention measures with local communities. Political support for accountability, introduction of a regulatory framework, due diligence on the supply chain, security sector reform as part of the wider issue of the rule of law and legitimacy, are among them. A participant concluded that the implementation of greater transparency on the ground was possible, though difficult, and some successes have been witnesses such as the exclusion of certain generals from the Ministry of Interior). The challenge for the incoming president will involve a balancing act between the political and the economic, and will be complicated by the role of the Taliban movement, which has "statist" entitled thinking but perhaps more importantly is the most effective organisation that most parts of Afghanistan experienced in governance terms, including for enforcement of contracts. The parallel economy, if it were to become merged with the formal economy, offers considerable opportunities that make it worth "pushing the envelope" more on finding ways to capture it.

The Impact of Illegal Economies from Afghanistan, Pakistan and Central Asia on the Gulf

(i) Paper Trades in Cities in Pakistan

Sharing the preliminary outputs of upcoming research on informal economies out of Peshawar and Quetta, in Pakistan, a participant described the phenomenon of the unexplained demand for high-denomination currency notes in those cities, despite the overall level of lending in the two provinces (Khyber Pakhtunkhwa – KP – and Balochistan, respectively) being low. The cash operations of banks in the two cities are unusually high, and cash is used in settling a large volume of informal transactions. On line transactions are growing in number, but so is paper trading (via cheques and pay orders). Although the majority of financial clearing houses for paper trading are located in Sindh and the Punjab, there is one each in both KP and Balochistan which clear a lot of cash, and have low on line transaction levels.

By examining monthly data from 1999 to 2013, the upcoming study shows a steep increase in financial flows through clearing houses in the two provinces (from 200bn rupees to a trillion rupees) with a steep rise from 2005 onwards. The analysis also showed greatly increased volatility (particularly from 2010), with amounts being cleared varying considerably and rapidly from month to month. Examining the trends in comparison to other clearing houses outside Karachi and Lahore as comparators, the study´s indicative findings note that this is not a trade where "all boats rise" – rather, a particular type of economic transformation is occurring in cities experiencing high levels of paper settlements. For example, Faisalabad in the Punjab has the largest year-round yarn market in Asia and certainly within Pakistan. Settlement is always by cheque. Similarly, Multan, a large centre for the wheat trade in Southern Punjab also settles by cheque and there are a lot of fixed transactions in both. Surprisingly, both Peshawar and Quetta are both – unaccountably – in the same league as Faisalabad and Multan in terms of volume of paper settlements. The question therefore arises of where are the trades coming from and who to.

The upward tend demonstrated in Quetta and Peshawar´s share of the total (sometimes peaking above 8%) indicates large amounts of money passing through clearing houses, implying that something big has been stirring, using cheques. The culture of using cheques is well-established across Pakistan, but it is not the prevailing culture in Quetta, which historically uses cash for transactions, and the amounts under study are large. The velocities, amounts and numbers of cheques presented produce a per-cheque average of 400 000 -500 000 Pk Rs (approximately US$ 3886 – 4850), with a trend towards rising amounts. Both Quetta and Peshawar have connections to the economy across the border in Afghanistan an regional hubs connect the latter to the Pakistan economy, including the transit trade. The majority of the transit trade from Afghanistan passes through Peshawar and to a lesser extent, through Quetta. However, the disparity in percentages and banking velocity cannot be explained by the Afghan Transit Trade Agreement alone. "Indigenous" transactions out of the two cities occur with no corresponding rise in deposits in the two cities. In other words, this implies a connection with accounts outside Quetta and Peshawar, but which are being cleared in the latter two cities. According to the preliminary conclusions of the study, the only explanation that fits, is linked to the Afghan transit trade, and illegal activities surrounding it.

(ii) Islamic Charities

Funding for Al Qa´eda-affilitated militant groups has been identified as coming from three main sources: legitimate business, wealthy benefactors, and criminal activities. Charitable organisations have particular characteristics which may lend themselves to cooption (wittingly or unwittingly) for militant funding: they enjoy public confidence, have access to significant cash resources, have a transnational presence in many cases, and in some countries, undergo little or no regulation, including background cheques on employees. Al Qa´eda reportedly has used a strategy of infiltration of employees into charities in order to divert legitimate donations to illegitimate uses, and have in some cases created their own network of charities as a cover to obtain direct funding.

The discussions in Doha were limited to Sunni charities, based on research by one participant and open source publications.

In Pakistan, charity has reportedly been used as a front for the Lashkar e Tayyeba, and the Jamaat ul Daawa. Following the 2005 earthquake, even international charities cooperated with the JuD because it had access and outreach to remote areas where aid needed to be delivered, had an extensive network of ambulances, and due to the humanitarian vacuum on welfare and health needs in the country, has been unable to be closed down, in the view of one participant. Its links with subversive armed groups are well documented.

However in other regions, one view was put forward that the extent of the subversion of Islamic charities to fund non-state actors has been "exaggerated", and is linked to a formerly lax US charity law which was appropriated to promote the strategic aims in the region in the 1980s. In this view, the flow of funds from the Gulf and the extent of the abuse of Islamic charities on terror financing has been exaggerated, with a few exceptions such as the Al Wafa´a organisation based in Kuwait, which reportedly had proven links to Al Qa´eda. From 2011, a cloud of suspicion on a number of charities led to their being blacklisted (with no process of defence or appeal). This was seen as exacerbating the humanitarian vacuum currently being experienced in Iraq and Syria.

Charities are inherently trust-based, hence there is a need for their protection from abuse and misunderstanding – the example was quoted of the Revival of Islamic heritage Organisation in Kuwait being named as a terrorist organisation because of its activities. Another example was Palestine, where local charities in the West Bank and Gaza had been accused of supporting terrorism. Whilst the charity sector in the Gulf is stagnating, in consequence, in the west, it is a flourishing sector. None the less, the sector requires international level attention to its regulation and monitoring, to address what was seen as the "*wilful unawareness that is not paying attention to humanitarian aid, due to perceptions of terrorist linkages*".

Discussion centred on whether the weakness of Gulf charities is a technical one, or a political controversy, with a Gulf-based participant noting that charities in the Gulf are not monitored; that there needs to be an improved understanding of sources of financing, though in fact the majority of funds come from governments and political elites in the Gulf, not individuals (though individual donations have been reported as a significant source of funding for non-state activities, wittingly or unwittingly, through both financing proxy *jihad*, "boutique" *jihad* fundraising evenings in the houses of businessmen and academics in Saudi Arabia, Kuwait and the UAE[1]). Such monitoring should, in the view of one participant, include monitoring of funds going to Afghanistan and Pakistan in particular. It was noted that whilst there are multiple ways of collecting funds, including soliciting door to door in countries throughout the

1. See for example Holy Money, a study of jihadi finance by Five Dimensions Consultants

Gulf, most require proper permission to do so. Monitoring should also focus on the donors.

A participant also noted that there is a change in perception that, over time, "support to freedom fighters" has become "support to terrorists", which has impacted on charities which did not pick up on that conceptual change. Interpretations of giving *zakat* (one form of charity) for defensive activities as well as pure charity have resulted in discrimination against Islamic charities, and require an airing of the issues in an impartial forum, to be adequately addressed. Another participant noted that both Pakistan and Afghanistan start from a low institutional base: Pakistan is struggling for institutional space, and Afghanistan´s situation is even worse, in terms of humanitarian and service delivery to the poor, and the mechanisms required to achieve this. The efficacy of sanctions was questioned in terms of its impact on charities, and whilst it may be possible to regulate more effectively in the Gulf, it is less so in Pakistan, for example, though in the former, mediation would definitely be required due to both suspicions on the part of Gulf charities regarding the motives of western intelligence agencies.

Regarding the Taliban, a participant commented that they have ready access to money, are able to move it around, and that their commitment has in fact outlived that of the Great Powers in relation to Afghanistan. They are adept at using both multiple identities and proxies, and the impact of sanctions on charities on their funding has therefore been very limited. Sanctions have been restricted to the state level though the order of magnitude of state charity was noted as being extremely large (the example was cited of Saudi Arabia having given $1.5 billion in charity in 2014), with a concomitant lack of transparency. It was concluded that there needs to be an indigenous demand for regulation, rather than this being imposed by the West.

Licit Activities, Illicit Proceeds: A Grey Area

The Economic & Cultural Space – the Role of the Gulf

Using the metaphor of an imagined landscape of *jihadi* areas of application, a participant used case study examples to encapsulate how the Gulf interacts with *jihadi* financial portfolio management.

When the Taliban were in power in Afghanistan, links to the Gulf were seen as a way to make money. Armed crime crossed borders: a corrupt policeman in Dubai provided protection to a TTP commander in Orakzai; bank robberies in Dubai funded Taliban activities in Afghanistan; threats to the relatives of a target in the tribal FATA area of Pakistan resulted in payments under pressure being used for non-state activities; and pressure cookers purchased in Lahore were used for improvised explosions. The common point is that of invisibility: someone flies to the Gulf from Karachi, collects a considerable amount of money, which then finds its way to the economic committee of the Taliban.

In an examination of "God vs Mammon" in relation to what the Afghan Taliban really stand for, and how to deal with an organisation whose aims are to eradicate western influences from Afghanistan and to re-establish a *shari´a* system, the following points were made:

i. The Taliban´s religious motivations are rooted in the Deobandi historical tradition of Islam (the "*South Asian brand of anti-imperialist Islamist thought*", as one participant put it).
ii. The Taliban are anti-crime, and pro-justice, yet simultaneously for the last ten or more years have sustained an armed insurgency fed by crime, with few licit means of funding available. Hence the need to manage a financial portfolio to fund Taliban activities.
iii. A formal economic committee manages Taliban economic activities including fund raising, however it tends to avoid the blatant tarnishing of its pro-justice stance.
iv. The identity of the Taliban is complex, built around three components of being Pashtun, but also Afghan, and also clerics. In terms of where they operate, a key concept is that of an accessible economic and cultural space. – that is, one accessible to people with these three shared elements of identity.

Where, therefore, can the Taliban go to do the business required to achieve their aims? They require supporting activities, including fund raising, management, in places where the Pashtun diaspora is situated, and which can be travelled to easily. This economic and cultural space which the Taliban regard as their own, and which transcends national boundaries, can be traced across Pakistan where there are concentrations of Pashtun populations (Quetta, Karachi, Peshawar). Beyond Pakistan, the Gulf becomes a part of this economic and cultural space due to the large number of Pashtuns living and working there, in which the Taliban feel comfortable operating, including because of kin networks, facilitation in operating – including obtaining visas, *iqama* (residence permits), shelter – and support from members of indigenous elites, in one form or another, from food to funds. In other words, the Gulf is solidly part of the economic and cultural space within which the Taliban operate. This trajectory is high, and still rising. A participant professionally involved in interviews with Taliban noted that references to dealings with the Gulf featured high in discussions and indicated "intense" interaction, showing that the Gulf remains an important hub in this regard.

Whilst the Taliban are reportedly transparent on expenditures, they appear to be far less so in relation to revenues, despite operating within an informal domain.[2] Its internal responsibilities are assigned in terms of who spends what, on what. None the less, the levels of awareness on sources and movements of revenue are reportedly much more opaque – not least in order to stay ahead of the financial regulators – but there is still a lot of ambiguity. Anecdotal accounts refer to people coming back from the Gulf with money, but little is known about its sources. It would appear that part of the Taliban´s revenue portfolio is located in the Gulf; that this is an important – but probably not a majority – source. The view of the Gulf from this perspective, is that of a non-mandated safe haven for the Taliban. This is in marked contrast with Pakistan, which the Taliban still see as having a formal "mandated" relationship with them. Furthermore, the Gulf is one of the few places that the Taliban can travel to (albeit on false documents, reportedly, but with genuine visas), and where they can meet people whilst presenting an image of

2. As an example of organisational skills, apparently they even use organigrams.

respectability. So long as the Gulf can be maintained as a "safe haven", organised crime will remain an exception. In this regard, the recent arrest and deportation of two of the Haqqani network from the Gulf in mid October 2014 caused ripples of anxiety.

In conclusion, the Gulf is regarded as "friendly territory" (in terms of carrying out a *jihad* against the West). Some see the Gulf as using the Taliban as proxies for their own anti-western feelings, and therefore "fraternal" territory. The ability to travel to the Gulf is absolutely critical by the Taliban and nothing will be done to jeopardise this, in the view of one participant. This translates into caution: no link ups with the Mafia, no attention-seeking operations. Infringement of currency regulations is one thing, but beyond that, the intention is to stay within the law, not to antagonise the local authorities; and play on the inherent sympathies of those in the Gulf that share their aims.

Spheres of Influence

The borders of Afghanistan include the Durand Line, which results in two thirds of the Pashtun population being located in Pakistan. There are also considerable diasporas of Pashtuns in the Gulf and in London. Other non-Pashtun nationalities such as the Baloch are also important in relation to illicit trade, including in heroin going to Iran and Central Asia. The role of cocaine in the *de facto* economy in Afghanistan is said to be three times that of Colombia at its height there (representing some 45% of the cash economy of Afghanistan). All Afghanistan´s borders until recently delineated spheres of influence, some overlapping.

One feature is the permeable, indistinct nature of the border itself. The Powindah and Kuchi nomadic groups cross borders as groups of transhumants, by right, but also for trade. Arms enter Afghanistan via the Gulf or Kuwait through Balochistan. The heroin trade impacts severely on the UK, Europe, and Russia, as well as on Afghanistan itself, but not on the US. The majority of heroin production is now in the southern areas of Afghanistan under Taliban control, resulting in "*the intertwining of the Taliban and organised crime*", according to one participant. In Pakistan the TTP are linked with the land mafia and with criminality. Opium has been exploited in all Afghanistan´s conflicts, with warlords taxing heroin "*because it is there*". The reported value of heroin exported from Afghanistan is some $4-5 billion/year, comparable to the annual US aid budget provided to the Afghan national security forces. The annual budget of the Taliban is reported to be less than one tenth of that amount, and they have significant other sources of revenue as well. In other words, the Taliban are not the main beneficiaries of the heroin trade – reportedly, these include the warlords, the Afghan National Army and others. Who gets what out of the heroin trade is a consequence of a consensus on the division of the spoils made earlier in the process. It is noteworthy that a very low proportion of the Afghan national budget comes from taxes and revenues. In consequence, illegal sources of revenue will not be abandoned until the conflict ends, in the view of a participant. Indeed, this year, there is talk of record levels of heroin production which the state remains too weak to address, too week to legalise and purchase itself (as was done in Turkey and Thailand) to address enforcement.

A source of income for the Taliban in the past in Afghanistan was taxing the NATO convoys coming in from Pakistan in areas controlled by the TTP. It is not coincidental that with the decline in NATO movements, the heroin trade is increasing and the drug war continues. This is seen as unlikely to change whilst the conflict continues. One participant commented that it is in fact the Taliban who are the only force capable of controlling heroin production, as they successfully did in 2000/2001. Anecdotal reports indicate that they would be willing to do so again, but only as part of a peace settlement that brought both international recognition and funds from the international community; or following a Taliban victory in Afghanistan.

Discussion focused on the extent of Taliban autonomy in the south of the country due to the heroin trade, and the comment was made that should US interest in Afghanistan decline and there was no concern in the US about heroin (since Europe and Russia are the main geographical areas of impact), there would be a need to examine what would be required to build an alternative economic model for Afghanistan to identify whether mineral resources could take the place of heroin in the medium term. The survival of the Afghan state almost certainly depends on minerals, but the problem remains of their development and extraction under near-civil war conditions; and that time would be required to change this. The example of China behaving very cautiously in this regard despite having signed contracts for mineral extraction, was cited. Furthermore, largescale mineral extraction was considered unlikely to bring direct benefits to the local level, in contrast with the heroin trade, which does. The international community needs to still support the Afghan state, without which it will face collapse. The comment was also made that the Taliban are today against Islamic State (IS or Daesh), but that could change, though at present there still appears to be an ongoing dispute between Daesh and the Taliban. The Taliban have maintained a level of cohesiveness that is almost unique in Pashtun history, including the maintenance of a central level of control over revenues, that gives an incentive to far-off Taliban to recognise the authority of the centre.

The Drug Economy in Afghanistan and Likely Post-2014 Impacts on Pakistan: Implications for the Gulf

The key findings of the STAP RP paper on the impact of the post-2014 drug economy out of Afghanistan and its impact on Pakistan were presented by the paper´s author.[3] It was noted that the drug economy is by definition a business about which there is little understanding, due to its undocumented nature.

According to the World Economic Forum, the estimated value of the global market of opium and heroin amounted to US$ 60bn in 2011: (the equivalent of a third of Pakistan's GDP), whilst the Financial Action Task Force (FATF) gives a figure of $80bn for the same period. Despite the difficulty of breaking down an exact figure, the phenomenon is of great magnitude. The specifics about the drug industry and its inner workings were discussed and presented during the meeting. Afghanistan is the largest opium producer in the world: (370 tons in 2012 which represent 72% of the total output), whilst Pakistan remains essentially a transit country (with a production of 0,9 tons in 2012) – a trend that

3. See http://www.cidob.org/en/publications/stap_rp/policy_research_papers, Safiya Aftab 02/2014

is unlikely to change in the near future. The production of cannabis resin in Afghanistan is significantly lower than that of opium (1300 tons) but its impact in the economy remains high. As for heroin (and it was noted that not all opium is turned into heroin), this is largely produced in Afghanistan, but only 5% of the total output is consumed in Afghanistan and Pakistan. Despite the small percentage, consumption of heroin still has a serious impact on the local populations of both countries, although far less than in Western Europe, South East Asia and increasingly in China. The street value of heroin varies from $20/gr in Pakistan to $100/gr in Western Europe to $400/gr in Australia (where it is a relatively new phenomenon). It was noted that the high value of the drug and the profits generated by the trade are at the heart of the current problem, as they constitute a massive incentive for producers and traders alike.

The importance of Pakistan in the trade of Afghanistan-produced drugs has decreased in the past years, as heroin and other drugs are increasingly transiting through alternative northern routes to Central Asia and Russia. Still, according to conservative estimates, 40% of the Afghan heroin transits through Pakistan (representing some $150bn in 2012 alone), of which 20tns are consumed, 10tns ceased and the remaining 120tns transit the country. This represents a very large amount of money with a great impact for the Pakistani economy: (based on the most conservative street value of $20/gr, the estimated value of the drug transiting Pakistan would be $1,5bn – the equivalent of one month legal imports in Pakistan – whilst the highest estimates put the total figure at $8bn – which represents 40% of Pakistan's imports). These are extremely large amounts of illegal money, although it was noted that Pakistan, unlike Afghanistan, is not yet a narco-economy. This should raise concerns amongst policy makers, yet there is a relative silence in the country about the issue (which furthermore is the subject of little research), in contrast with the alarm raised during the 1980s, when Pakistan witnessed a sharp increase in drug consumption.

Proceeds of the drug trade filter into the real estate market, as well as consumer durables markets, which in turn have an impact on policy and legislation (through funds made available to civil servants and legislators, although hard proof of this is very difficult to come by). The impact on the economy of ordinary Afghans and Pakistanis (let alone the main drug lords) is considerable: according to recent studies, Afghan farmers earn $1.4bn a year derived from the production of opium, whilst in Pakistan, were production is much smaller, drug trade provides regular low income for a large number of families, who can get up to Pk Rs 13.000 a month (the equivalent of a monthly basic income for regions like FATA and KP) simply for storing the drug until it is picked up by the dealers. Compensation of cost grows along the supply chain, with a whole economy built around it, from transporters to packers and handlers. Overall, the economic opportunities of this trade are significant even for those who are less benefited and the deterrents are very small (with very few convictions for those caught)

The biggest channel for drug money in Pakistan remains real estate, especially due to the nature of the market, which only requires a National ID card as proof of identity and no proof of tax payments. The fact that the market lends itself to cash payments, which in turn allows for money laundering, only makes real estate more attractive to channel proceeds from the drug trade. This could explain the overestimated value of properties – 15-18% – in major cities in Pakistan and the fact that real estate prices do not respond to economic fundamentals: (there are periods of stagnation and periods of very high growth, not necessarily linked to high GDP growth). It was stressed that all these are indicators of a large informal economy that could very well be connected to the drug economy. In addition, it was noted that, although hard proof is scarce, the drug economy has a significant impact on corruption and politics, and that drug networks and lobbies have a certain capacity to influence policy and law making which in turn have an effect on governance.

All these factors have a negative impact on the authority of the state which is the result of a number of factors: a combination of weak economy, internal security issues and an unstable political climate which make Pakistan vulnerable to activities of organized crime and the infusion of large amounts of illicit money into the licit economy. The vulnerability of the State and law enforcement institutions in Pakistan has been exacerbated by the existence of a considerable drug economy and networks affiliated to it. Foreign relations with neighbouring countries have also suffered from this phenomenon, as countries like China and Russia are increasingly concerned about the impact of the drug trade in their societies (an issue which together with the links to terrorism, has been raised within the framework of bilateral talks).

As for the immediate future, poppy production in Afghanistan is unlikely to decrease post 2014: (in fact the cultivated surface is growing). On the other hand, Pakistan's position of destination and transit country is likely to remain unchanged due to the limited capacity of law enforcement agencies to tackle the threat. There is even a risk of destabilization of the country as criminal and militant networks take advantage of these circumstances. It was stressed that "business as usual" in Afghanistan may not mean business as usual in Pakistan, as the situation might worsen as a result of the increasing political instability (currently evolving from a low base instability to a potentially more dangerous situation). The injection of a new – and growing – element of instability such as that of the drug economy could therefore further deteriorate the situation in Pakistan.

It was also pointed out that the Pakistani Taliban both profit from, and are engage in, the drug trade. According to the UNODC monitoring team on Al Qaeda, drugs represent a limited source of income; and finance professionals are either complicit in, or unaware that they are managing drug-revenue assets. The Russian government is working in cooperation with UNODC.

Afghan opiates have multiple markets, and are not run by a single cartel, though there is significant control exerted by specific groups. Some 50-90% of transactions in Afghanistan are via value transfers or in cash. The majority of illicit funds are moved through, or stored in financial centres, with the UAE being a centre particularly open to abuse. Virtual currencies are also used for drug-related transactions. While financial flows from opium, heroin, and cannabis link both Afghanistan and Pakistan, there is little hard evidence in terms of links between Gulf real estate transactions and the drug economy. Many purchases are reportedly made through ghost transactions using local intermediaries who are wealthy enough not to need the money from a genuine purchase, powerful (hence well-protected), and sympathetic to the ideologies of those making the transaction. Drugs tend to enter the Gulf often via Oman out of Balochistan, since the long Omani coastline is hard to police.

Suggested ways forward to address the drug trade include enhanced international cooperation on exchange of information (both state and private sector); asset freezes; regulation of financial centres in the UAE in particular: (here, it was noted that Qatar has signed the Vienna Convention on drugs). New methodologies and new frameworks to map the business model of the drug economy are required.

List of Participants

Safiya Aftab
Independent analyst (Pakistan) and author of STAP RP paper

Khaled al Mezaini
Qatar University

Abdullah Baabood
Director, Gulf Studies Centre, Qatar University

Zahra Babar
Georgetown University

Kristie Barrow
ISAF Afghanistan

Jonathan Benthall
Expert on Islamic charities

Stephen Carter
Global Witness

Malaiz Daud
Member of STAP RP Project Team, Associate Researcher, CIDOB

Emma Hooper
STAP RP Project Director, Senior Researcher Associate, CIDOB

Khurram Husain
Former Woodrow Wilson Pakistan scholar, financial journalist and researcher

Mehran Kamrava
Georgetown University

Anatol Lieven
Kings College London & Georgetown University Qatar

Gabriel Reyes Leguen
Member of STAP RP Project Team, Associate Researcher, CIDOB

Michael Semple
Afghanistan expert, member of STAP RP regional network of experts

Haroon Sharif
World Bank

Eduard Soler i Lecha
Research Coordinator, CIDOB

Roberto Toscano
Member of STAP RP Project Team, Senior Research Associate, CIDOB

Luciano Zaccara
Research Coordinator, Gulf Studies Program Qatar University

Hafizullah Zulmay
Independent Consultant

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