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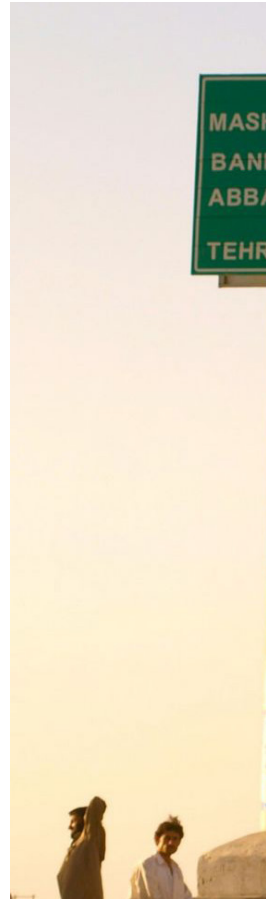
# Afghanistan Reconnected: Opportunities from an Opening Iran



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The EastWest Institute (EWI), in partnership with the Tehran-based Institute for Political and International Studies (IPIS) and with the support of the German Federal Foreign Office, convened a dialogue in Tehran in December 2016 as part of EWI's "Afghanistan Reconnected Process," a multi-year program aimed at contributing to Afghanistan's future stability by encouraging regional cooperation.

A truck pauses at the Afghan-Iranian border in Zaranj, the administrative capital of Afghanistan's Nimroz Province.



The Tehran dialogue extended to both policy makers and the business community to gain a deeper understanding of the challenges and opportunities facing Iran as an essential neighbor of Afghanistan. Jointly chaired by IPIS President and Vice Foreign Minister, Dr. Sajjadpour, and EWI Vice President for Regional Security, Ambassador Martin Fleischer, the dialogue aimed to deliver relevant policy recommendations that have a reasonable prospect of implementation. Specifically, discussions focused on identifying obstacles to trade, transit and energy cooperation between the two countries, and proposing viable solutions to these obstacles. The present briefing, jointly issued by EWI and IPIS, is intended to highlight the findings of the dialogue and the resulting recommendations.

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## I. Executive Summary

Iran's re-entry into the global fold presents a number of unprecedented opportunities, positioning the country to contribute considerably to the development of neighboring Afghanistan in the coming years. Afghan President Ashraf Ghani's strategy of fostering regional economic cooperation as the linchpin for long-term growth and stability in Afghanistan will encourage and even necessitate Iranian participation. As a vital neighbor emerging from global isolation, Iran can serve as a critical partner in this long-term plan, and also in the efforts of the international community.

Tremendous opportunity exists to increase trade and economic cooperation between Iran and Afghanistan. Sharing a 936KM border with trading routes through



Herat in Afghanistan's north, water sharing agreements on the Helmand River, and mutual opportunities for resource development, Iran is well-positioned as an integral member of Afghanistan's regional development sphere. The India-supported construction of Iran's Chabahar port represents an important step toward taking advantage of Iran's access to deep water points. Opportunities also arise in addressing the massive trade imbalance between the two countries. At the end of the Iranian calendar year in March 2016, Afghanistan exported less than \$26 million in non-oil trade to Iran, while importing only \$2.5 billion from its neighbor in return.

Iran stands ready to increase its role in Afghanistan, but there are clear obstacles to maximizing the potential of the Iranian/Afghan relationship: namely, poor connectivity and infrastructure, a deteriorating security

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situation, endemic corruption in Afghanistan, an absence of contacts and networks between Iranian and Afghan business people operating in either country, unfavorable visa policies and tariffs, and a lack of trust in the Afghan market.

Cooperation between Iran and Afghanistan to create a more secure environment is vital to long term economic growth in both countries. Iranian influence both in western Afghanistan and in a broader regional context can serve to improve security, assist Afghan governance improvements, and implement long term regional economic plans grounded in trusted agreements. A genuine partnership between Afghanistan and Iran, as well as strengthened regional and international efforts toward cooperation, will be crucial for future prosperity in the coming decades.



## II. Iran's View on Afghanistan

Iran and Afghanistan traditionally enjoy a good and close relationship which is based on cultural commonalities and people-to-people bonds, with Iran hosting 3 million Afghan refugees over the past 35 years. The country's primary goal as regards Afghanistan is countering terrorism and instability. Tehran favors an Afghanistan free of outside forces, in part because it feels that their presence allows the Taliban and other groups to frame their militancy as an insurgency against foreign occupation. At the same time, Iran recognizes pragmatically that the departure of foreign troops cannot happen overnight. Regarding the emergence of the Islamic State (IS) in Afghanistan, Iran feels its warnings to both Kabul and Western countries concerning IS operations were largely overlooked and that the scale of the group's operations in the country is underestimated. IS is not only recruiting and carrying out operations in Afghanistan, but is even running radio stations and schools, creating additional strain on the already overstretched Afghan army and police forces.

Other concerns for Iran include Saudi Arabia's rapidly-increasing interests in Afghanistan, which it fears could be a carrier of religious ideology akin to the period following the withdrawal of Soviet forces in 1989. Iran considers these developments similar to Saudi Arabia's presence in Pakistan, where activities such as the construction of mosques have paved the way for the spread of extremist readings of Islam. Afghanistan's ever-expanding narcotics industry is another major concern as it funds and fuels terrorism. Combatting the illicit movement of narcotics through Iran—which is often used by traffickers as a conduit to Europe—has been costly for Tehran, and policymakers wish

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to deepen European collaboration in future efforts.

Iran's basic strategy in Afghanistan is to promote the interdependency between security and development, with policy makers in Tehran willing and waiting to collaborate with other stakeholders in working towards this goal. In this regard, Iran's cultural similarities with its close neighbor and its influence on different groups and ethnicities could be of great benefit in efforts towards national reconciliation, albeit in appropriate formats that engage all relevant national authorities. However, while the involvement of neighbors and the international community is a vital element, Iran maintains that Afghanistan's National Unity Government --which Iran continues to support -- must take the lead and draft a comprehensive strategy for the peace process. Iran maintains that excluding influential actors from regional equations will undermine all securitization and development initiatives and therefore advocates for the incorporation of other local states to play a central role in stabilizing Afghanistan.

## III. Trade & Transit

### Infrastructure

Despite their immediate adjacency, a lack of existing infrastructure limits economic connectivity between Iran and Afghanistan. Afghanistan's position as a regional hub and Iran's extensive abilities and drive to open itself up economically present an ideal opportunity for mutual benefit. Currently, construction is underway on a railway link between Afghanistan's Herat and Iran's Khaf provinces<sup>1</sup>. More critically, the development of the Chabahar port in Iran will bring with it the

<sup>1</sup> Khaama Press, "Afghanistan-Iran railway construction kicks off near Herat". 8 September 2016.

potential for increased connectivity for both countries, in terms of land-sea connection to India and other markets, as well as broader railway connectivity. For Afghanistan, this project will make Iran a viable alternative to Afghanistan's existing transit routes to India via Pakistan. For Iran, easier and larger-scale access to both the lucrative Indian and Afghan markets will be of obvious benefit. Attracting new investment—including from countries outside the region such as Japan, which has expressed an interest-- and increasing traffic to the Chabahar port should be a priority for the Iranian, Indian, and Afghan governments. This could be achieved by encouraging the development of large-scale projects such as mineral conversion as well as rail and road infrastructure.

Prioritizing the development of infrastructure surrounding Chabahar to connect Afghanistan to the port is also of paramount necessity. India's state-owned IRCON has already agreed to construct a 500km railway link between the port and Zahedan on the Afghan border as part of the transit corridor to Afghanistan. The implementation of this plan should be encouraged and further investment in the port should be pursued. In addition, plans are underway for further rail connections through Zaranj on the Iranian –Afghan border. However, this route will pass through unstable areas with heavy Taliban activity.

The primary obstacle to realizing these large infrastructure projects is securing the routes along the Ring Road through Taliban territory between Helmand and Kabul. More connections between Chabahar and the Iranian rail and roadway systems should be pursued, while existing road infrastructure should be improved and enhanced. Connections between Iranian and neighboring transportation systems should be

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Only 72 km to the east of Chabahar, across the border into Pakistan, the Chinese-administered port of Gwadar is being developed as part of the China-Pakistan Economic Corridor (CPEC), for which it will serve as the main terminus. Gwadar is strategically located on the shores of the Arabian Sea, at the mouth of Persian Gulf, and at the confluence of a number of sea routes, with the potential to serve 3 commercially-important regions: the oil-rich Middle East, resource-full Central Asia, and densely populated South Asia. Many observers fear the Chabahar port may threaten the regional significance of Gwadar; however, these concerns are misplaced for a number of reasons. Gwadar's strategic location and its connections to Chinese markets through access to the 'One Belt, One Road' (OBOR) projects will ensure the port's continued position as a lucrative economic hub both on its own and as part of a corridor connected to Iran. Recognizing this, Iran stands ready to build a road link between the two ports, allowing them to become mutually-supportive. Both ports can then be leveraged to the advantage of Iran and the continued benefit of Afghanistan through this connection, thus providing access to China via Gwadar. The short distance between them will also allow Gwadar to handle any spillover cargo from Chabahar, particularly as Afghanistan's mineral wealth is tapped and exported in the large quantities projected. Both ports therefore can and should be viewed as complementary, and Iran and Afghanistan should further work with Pakistan and China to explore other avenues by which connectivity with and inclusion in the CPEC and OBOR projects could bring economic benefits.



A group of Afghan migrant workers enter Afghan territory after leaving Iran at the Islam Qala border in Herat province.

### Political and Administrative Cooperation

The development of infrastructure in support of trade and transit growth is limited by political and bureaucratic restrictions on travel and trade between the two countries. A favorable visa regime for traders, transport operators, and business people between Iran and Afghanistan is necessary. The Afghan government should streamline the visa process for Iranians looking to do business in Afghanistan, and the Iranian authorities should explore ways of facilitating Afghans seeking visas to Iran. Both sides should enhance efforts to issue visa-free transit permits similar to the Rahdari issued by agencies on the Afghanistan-Pakistan border, which aim to prevent delays in transport operations and traders' movements.

Enforced agreements - both bilateral and regional - are needed to facilitate increased trade. Presently, over 100 bilateral trade agreements and Memorandums of Understanding

exist between Iran and Afghanistan (including a bilateral preferential trade agreement that has yet to be finalized) but are yet to be implemented. It was suggested during EWI's delegation discussions with the Iranian Chamber of Commerce that an agreement along the lines of the Afghanistan-Pakistan Transit Trade Agreement (APTTA) could be beneficial, and that a trilateral agreement regarding Chabahar, involving Iran, Afghanistan, and Pakistan could be welcomed if explored. Both countries should commit to drafting and implementing new and existing trade agreements. Afghanistan should incentivize and facilitate Iranian investment in natural resources and extractives by improving Iranian access to tenders for mining and infrastructure projects.

Excessive and non-preferential tariffs currently imposed between Iran and Afghanistan hinder further bilateral trade. Iran should reduce the number of tariffs imposed on Afghan businesspeople exporting to Iran, and Afghanistan should likewise impose

the same preferential tariffs for Iran that it does for Pakistan.

### Security and Business Connectivity

It is important to actively encourage trade by fostering people-to-people contact. At present, the Iran-Afghanistan Joint Chamber of Commerce exists only in Iran, and its Afghan representation is primarily Iranian-based businessmen of Afghan origin. Therefore, the business conducted between Iranian and Afghan traders is typically not conducted in-country, leading to the outflow of capital and a lack of investment in Afghanistan proper. The establishment of an Iran-Afghanistan Joint Chamber of Commerce representation in Kabul would help Iranian businessmen facilitate business ties and conduct trade within Afghanistan.

Banking connections between the two countries are also underdeveloped. Due to the longstanding economic sanctions on Iran, the Iranian



banking system has remained paralyzed, effectively handicapping its entrepreneurs looking to enter international trade, while the Afghan banking sector remains hobbled by excessive regulation and a lack of access to collateral for ordinary citizens. Financial sector reforms in both Afghanistan and Iran must be prioritized, and banking cooperation between the two countries, including between specific banks, should be pursued by both countries' governments and the financial sectors.

A lack of popular and foreign trust in the Afghan government and market due to endemic corruption hampers both trade and security in the country. Though anti-corruption efforts have improved government efficiency and effectiveness, there remains a well-justified perception that the government cannot guarantee the safety of traders and investments. The Taliban and other groups exploit this lack of trust and use it to expand their influence and control in southern and rural areas. Reports of violence against Iranian truck drivers in the country reinforce this perception, and Iranians and other foreign traders are reluctant to travel or trade in an environment that is unsafe both physically and economically. The Afghan government should facilitate financial security for Iranian investment by enforcing existing tax and finance laws and passing new laws that guarantee the security of foreign investments. Addressing corruption will dramatically improve the national security environment for all investors as well as individual workers. Furthermore, possible avenues for intelligence sharing between Afghanistan and Iran should be explored in order to develop joint counter-narcotics and law enforcement efforts.

The fragile and deteriorating security situation in Afghanistan presents a

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substantial hurdle to Iranian economic investment and participation. Security for any new transit corridors will be of vital importance, in particular the security of the Afghan Ring Road, as connectivity between Afghanistan and Chabahar will rely on this route. However, the current security situation is not merely an Afghan problem. In addition to the Taliban, extremist groups from around the region and beyond-- including the Islamic State-- operate in Afghanistan and jeopardize not just the country's security and economic development, but the stability and growth of the entire region. A common approach to countering terrorism, possibly leading to specific legal frameworks for regional cooperation and potential intelligence sharing, is critically important and urgently required.

#### IV. Energy

Cooperation and development in the energy sector stands to be a key prerequisite to stability for Afghanistan and its neighbors, including Iran. Centrally located amongst major hydrocarbon producers (Iran and Turkmenistan) and major hydroelectricity producers (Kyrgyzstan and Tajikistan), Afghanistan is well situated to play a key role in multilateral economic initiatives. Currently, however, Afghanistan's vast potential as a transit country for gas from Central Asia is severely underestimated. In this particular context, Iran, with its gigantic oil and gas reserves (according to BP estimates, the 2nd largest gas and 5th largest oil reserves, respectively) offers a natural source of supplies for Afghanistan's nascent energy sector. Despite this opportunity, the unfortunate reality on the ground is that a complex mix of political mistrust and historical disputes, a lack of infrastructure and connectivity, and significant security concerns hamper potentially beneficial energy cooperation

between the two countries, leaving bilateral energy cooperation underdeveloped.

Although Iran is one of Afghanistan's largest trading partners, exporting over \$3 billion of goods and services (which accounts for 40% of the latter's total imports), energy is not a dominant component of Iranian exports to Afghanistan. This is largely because Iran has to compete with other suppliers such as Belarus, Pakistan, Russia, Tajikistan, Turkmenistan, and Uzbekistan to gain a market share. For instance, in 2014, petroleum-based products accounted for less than 10 per cent (\$0.221 billion out of \$2.4 billion) of Iranian exports to Afghanistan. Current official exports of Iranian industrial equipment to Afghanistan are also relatively miniscule, accounting for only \$3.8 million from March 20-September 21, 2016.

**Electricity:** In 2015, over 78% of electricity consumed in Afghanistan was imported from neighboring countries via transmission lines with a total capacity of 1000 MW. Power grid connections with Iran represented only 164 MW out of 1000 MW- a number well below transmission capacity considering Tajikistan accounted for 433 MW and Uzbekistan 326 MW. From April 2014 – March 2015, Iran was only the third biggest electricity supplier to Afghanistan (888.7 GWh), after Uzbekistan (1425.6 GWh) and Tajikistan (1102.7 GWh). Furthermore, a 400 MW gas power plant, set to be operational next year, is being built in Turkmenistan to export electricity to Afghanistan.

Currently, Afghanistan has one of the lowest rates of electricity usage worldwide. Per capita electricity consumption is just 176 KWh. In comparison, Indian per capita consumption is 1075 KWh, only a third of the global average, but still 600%

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higher than Afghanistan. A 400% increase in electricity consumption will be required for Afghanistan to implement its economic and social modernization plans. New sources of electricity will have to be found both inside the country and in the neighboring states. Iran's rapidly expanding gas-based power generation may therefore become an important source of energy supplies to Afghanistan.

**Petroleum:** Iran's presence in the Afghan petroleum market is more significant than its electricity supply, but remains underrepresented. Afghanistan does not have a domestic refining capacity and imports around 3.6 million tons of petroleum products per year for domestic consumption. Though it aims to import up to 1.2 million tons of petroleum per year from Iran, current numbers are far off target, consisting of approximately 200,000 tons of diesel, 200,000 tons of LPG, and similar volumes of petrol. Afghanistan's per capita consumption of petroleum is 92% lower than Iran's. However, this gulf is a consequence of supply rather than demand issues as underdevelopment, lack of industry, and general absence of basic transport infrastructure (such as safe roads) hinder Afghanistan's ability to import more petroleum-based goods. Addressing these logistical issues will increase consumption leading to fresh opportunities for Afghanistan's exporting neighbors (Iran and Turkmenistan). Increased production and export capacity – Iran's oil production is expected to reach 5.4 million bpd in 2022, with oil exports going up to 3.1- 3.2 million b/d – will therefore enable the necessary volumes of oil and refined products for export to address this shortfall in Afghanistan's petroleum consumption.

While Iranian petroleum exports are quite important in the context of Afghanistan's energy market,





Iranian gas network (Source: The Energy Consulting Group)

other countries are also actively trying to extend their market share in Afghanistan. In November 2016, Turkmenistan opened an 88-km railway link to Afghanistan in order to increase exports of petroleum products to this country and constructed a petroleum terminal with an annual capacity of 540,000 tons. Turkmenistan does not publish any data on physical volumes of oil exports, but its petroleum deliveries to Afghanistan might be of equal importance to Iran's shipments.

Investment: Iranian companies are also less visible than their regional competitors in terms of direct investment in the Afghan energy sector. From March 2016 – January 2017, Afghanistan attracted over \$800 million in foreign and domestic investments for its energy sector. Among other foreign investors, most

prominent deals in the electricity sector were signed by Turkish and Indian companies. Furthermore, according to officials from the Afghan Ministry of Energy and Water, Kazakh investors were willing to commit \$1.2 billion to a 450 MW hydropower project on the Kocha River in Takhar province.

Problems and Solutions: Energy is a prerequisite for economic and social development, which in turn will foster a more positive political, economic and security landscape. Economic growth is premised on reliable access to affordable energy sources, while a deficit in access to power and energy may contribute to reducing GDP growth. Moreover, energy projects and infrastructure create spillover effects, increasing energy consumption and opening new avenues for economic growth. In the case of Afghanistan,

industrialization is necessary for the socio-economic recovery of the country. Mining together with industry could help to increase GDP growth in the country. Industrial development will create employment that would lead to waning support for terrorism in Afghanistan.

This potential for energy cooperation between Afghanistan and Iran has not yet been fully realized due to multiple bureaucratic hurdles, a distinct absence of regulation, infrastructure bottlenecks, and the ongoing security situation in Afghanistan. The Afghan energy market remains obfuscated by a lack of access, regulation, and proper forms of standardization. However, regional dynamics in the energy market offer numerous opportunities for Iranian companies. Both the Afghan and Iranian governments must undertake measures to address these impediments and maximize mutual benefits by streamlining current administrative procedures hindering bilateral energy cooperation and developing a joint regulatory framework. Iran should explore avenues to increase its share in the Afghan energy market as it seeks to extend its economic presence. Simultaneously, Afghanistan should

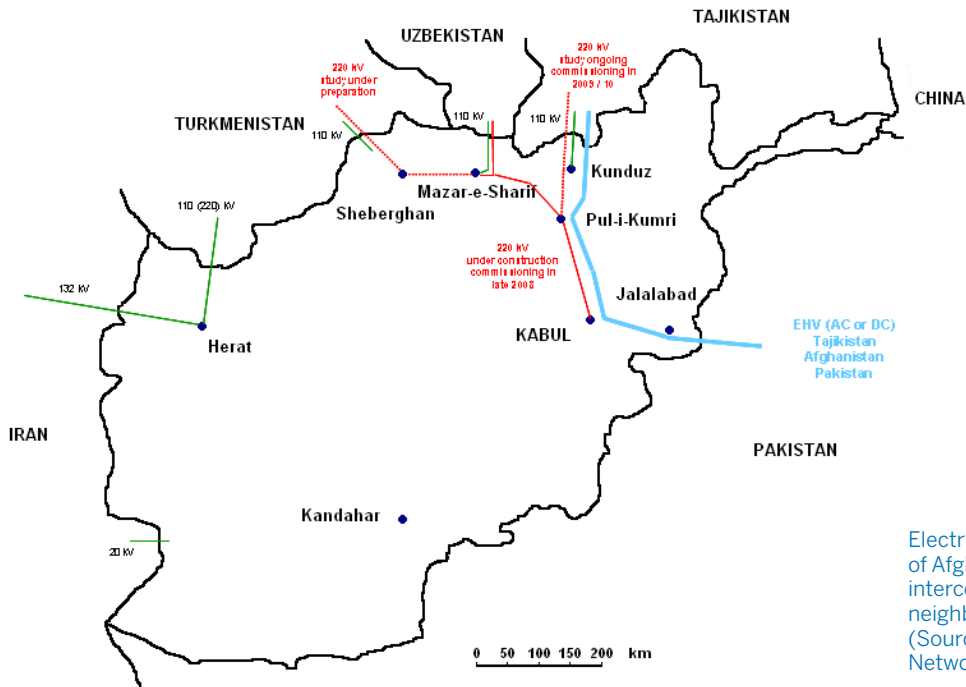
Further infrastructure connection between the two countries, such as the planned trans-border pipeline between Iran's South Khorasan and Afghanistan's Herat provinces, should be supported and encouraged by both governments as well as other regional and international actors.

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Finally, no solid cooperation can be achieved without access to and connectivity between infrastructure projects, without which solid investment plans are not foreseeable. The creation of infrastructure increases interconnectivity, which in turn will serve as the basis for regional infrastructure projects and improve stability and prosperity in Southwest Asia. Investments will follow roads, pipelines, ports and electricity lines. Infrastructure projects are therefore in the interest of Afghanistan, Iran and all regional actors. In July 2016, Iran approached Afghanistan regarding the construction of a trans-border pipeline to increase petroleum exports. This particular undertaking and others like it are important beyond bilateral Afghanistan – Iran relations. Further infrastructure connection between the two countries, such as the planned trans-border pipeline between Iran's South Khorasan and Afghanistan's Herat provinces, should be supported and encouraged by both governments as well as other regional and

Iran's cross-border trade in electricity with neighboring countries  
(Source: Iran Grid Management Co.)





Electricity network of Afghanistan and interconnectors with neighboring countries (Source: Global Energy Network Institute)

international actors. Strong political backing for the pipeline will bolster other regional developments like Iran's Birjand oil tank farm in South Khorasan, which is set to have a capacity of 100 thousand barrels.

## V. Conclusion and Outlook

After 15 years of international engagement in Afghanistan, huge sacrifices have led to some successes but also to major setbacks. In this context, a burgeoning “Afghanistan fatigue” on the part of both regional actors and the international community is understandable. Yet, the bitter truth remains that Afghanistan, its neighbors, and the international community must maintain or even strengthen their efforts to stabilize and develop the country, or risk see it revert back to the chaos that preceded U.S. intervention, with the possible consequence of increased migrants flows, narcotic production and regional instability.

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pursue and cement greater economic development, Afghanistan should focus on revitalizing its traditional role as a nexus for trade and transit – a hub for the smooth movement of goods, of people, and of energy, and looking to the future, potentially of digital data. The Iran-Afghanistan-India tripartite agreement on the Chabahar port is a milestone in this regard, but other neighbors, notably Pakistan and China, need to be engaged too.

With this in mind, EWl is holding its next dialogue in China, in order to explore how China's historic “One Belt, One Road” initiative (and the China-Pakistan Economic Corridor as part of that) can bring benefits to Afghanistan and the region. As a subsequent program phase, EWl will help the Afghan government convoke a high-level track 1.5 dialogue with neighboring countries in Autumn 2017, aiming to forge a joint vision of regional economic cooperation in an environment of diverging political positions. Considering the crucial role of Iran stressed in the present paper, IPIS will be a key participant in both dialogues.



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