



MINISTRY of AGRICULTURE,
IRRIGATION and LIVESTOCK

ADB Rural Business Support Program (RBSP) Afghanistan
Prefeasibility Study of Balkh Carpet Value Chain
May 2008

Report	Prefeasibility Study May 2008
Program	Rural Business Support Program
Project Funder	Asian Development Bank funded by Japanese Fund for Poverty Reduction
Program Officer	Ms. Donneth Walton Senior Rural Development Specialist Central and West Asia Department Asia Development Bank
Contract	TA-9100 AFG
Contract Period	November 10,2007 to November 30,2010
Contract Amount	\$5,644,000 Consulting Budget \$12,356,000 Implementation Budget
Executing Agency	Ministry of Finance, Islamic Republic of Afghanistan
Implementing Agency	Ministry of Agriculture, Irrigation and Livestock
Consulting Organization	Roots of Peace
Report Authors	Kenneth Neils, PhD (Program Director), Roots of Peace, Vickie Sigman, Extension Specialist, Roots of Peace Larry Hendricks, Credit Specialist, Roots of Peace Alem Alemi, Deputy Team Leader, Roots of Peace
Abstract	This report is a prefeasibility study of the carpet value chain in Balkh Province of Afghanistan. The study focuses on the ability to positively impact the overall carpet value chain with specific interventions.

This publication was produced for review by the Asia Development Bank. It was prepared by Roots of Peace. The author's views expressed in this publication do not necessarily reflect the views of ADB.



This Prefeasibility Study was produced by Roots of Peace under the ADB-funded Rural Business Support Project (JFPR 9100-AFG). It was written by Dr. Kenneth Neils, Acting Team Leader of the Rural Business Support Project, with assistance from RBSP Staff, including, Mr. Alemi Alem (Deputy Team Leader), Dr. Vickie Sigman (Extension Specialist), and Mr. Larry Hendricks (Credit Specialist). The Study was formatted by Gary Kuhn of Roots of Peace. For more information, contact Roots of Peace at info@rootsofpeace.org or +1 415 455 8008.

Roots of Peace is a humanitarian, not-for-profit organization based in California, USA. Roots of Peace, established in 1997, focuses on post-conflict countries to eradicate remnants of war and to re-establish and promote economic livelihoods and social programs. Roots of Peace is funded by public and private sources.

CURRENCY EQUIVALENTS

(as of 30 January 2008)

Currency Unit	–	Afghani (Afs), Rupee (Rs)
Afs1.00	=	\$.05
\$1.00	=	50Afs
\$1.00	=	62Rs

ABBREVIATIONS

ADB	Asian Development Bank
AKDN	Aga Khan Development Network
AISA	Afghanistan Investment Support Agency
AREDP	Afghanistan Rural Enterprise Development Program
ARMP	Afghanistan Rural Microcredit Program
ASAP	Accelerating Sustainable Agriculture Program
ASMED	Afghanistan Small and Medium Enterprise Development
AWBF	Afghan Women's Business Association
DAIL	Department of Agriculture, Irrigation, and Livestock
HLP	Horticulture and Livestock Program
MAIL	Ministry of Agriculture, Irrigation, and Livestock
MFI	Microfinance Institution
MISFA	Microfinance Investment Support Facility for Afghanistan
M&E	Monitoring and Evaluation
MRRD	Ministry for Rural Rehabilitation and Development
NGO	Non-Government Organization
PFI	Participating Financial Institutions
PHDP	Perennial Horticulture Development Project
RBSP	Rural Business Support Project
ROP	Roots of Peace
SSPSRL	Support to Strategic Planning for Sustainable Rural Livelihoods
TOT	Training of Trainers
USAID	United States Agency for International Development

WEIGHTS AND MEASURES

kg	Kilogram or kilograms
ser	7 kilograms

NOTE

- (i) In this report, "\$" refers to US dollars, "Afs" refers to Afghanis, the currency of Afghanistan and "Rs" refers to Rupees, the currency of Pakistan.

CONTENTS

1. EXECUTIVE SUMMARY	5
2. INTRODUCTION	6
3. VALUE CHAIN DESCRIPTION	7
4. MARKET ASSESSMENT	9
4.1. Demand and Supply	9
4.2. Production Costs	11
4.3. Processing Costs.....	12
4.4. Marketing Costs.....	12
4.5. Price Trends	12
4.6. Prices and Value Added Along the Value Chain	12
4.7. Estimated Increase in Revenue.....	14
5. KEY CONSTRAINTS/GAPS	16
5.1. Raw Wool	16
5.2. Wool Scouring	16
5.3. Spinning.....	16
5.4. Dying	16
5.5. Design	16
5.6. Weaving.....	17
5.7. Finishing: Cut and Wash	17
5.8. Marketing.....	17
5.9. Organization	17
5.10. Credit	18
5.11. Subsidies	18
6. OPPORTUNITIES	19
7. OTHER DONOR PROJECTS.....	21
7.1. Carpet Sector Development: National Level	21
7.2. Training/Capacity Development	22
7.3. Existing Institutional Capacity	23
7.4. Existing Groups/Associations	23
8. CREDIT MAP: BALKH CARPET	24
9. PROPOSED INTERVENTIONS	27
9.1. Description.....	27
9.2. Strategic links to existing programs.....	28
9.3. Stakeholders Interest in Value Chain Improvement	28
10. INDICATIVE NUMBER OF POTENTIAL BENEFICIARIES	29
11. RECOMMENDATIONS	30
11.1. Feasibility	30
11.2. Cost Effectiveness	30
11.3. Risk Manageability	30
11.4. Financial Viability	31
11.5. Environmental Issues.....	31
ANNEX 1: VALUE CHAIN FOR BALKH CARPET	32
ANNEX 2: CREDIT MAP: BALKH CARPET	33

1. EXECUTIVE SUMMARY

One of the principal provinces in Afghanistan where carpets are made is Balkh province. Balkh has a long and rich history of carpet weaving. Approximately one-fourth of all villages in Balkh weave carpets.¹ There are over 1.7 million square meters of carpets produced in Balkh and the northwest provinces. There are over 100,000 families in this region involved in producing carpets. Although the Afghan hand-made carpets are the prize export of Afghanistan, much of the value added is lost to Pakistan.

Pakistan receives an estimated 80% to 95% of Afghan carpets, including a similar percentage from Balkh. Carpets are then finished and re-exported as Pakistani carpets. Pakistan brands Afghan carpets and exports onwards, primarily to Europe and the USA. The great majority of Afghan hand-made carpets go through Pakistan due: (i) to the lack of sufficient cut and wash facilities in Afghanistan, (ii) to the long-term relationships Pakistanis have established with their Afghan partners and with their international trading partners, (iii) to limited trading relationships between Afghans and international partners, (iv) to relatively low cost of shipping from Afghanistan to Pakistan versus high cost of shipping from Afghanistan to international markets, and (v) Pakistan's advantage in that the Pakistan Government subsidizes Pakistan's carpet industry.

The Afghan carpet industry has an opportunity, if it gets better organized, to capture more of the value of its prized carpets by adding value to the wool that is used for its carpets and by establishing its own proper cut and wash facilities and direct marketing capability. Afghan traders are quite opportunistic when they are buying wool in Pakistan or in Iran. The wool traders are not necessarily looking for the same wool that would give the weaver the "best bang for the buck". Afghan wool cleaners, spinners, dyers, and weavers all have a stake in the carpet industry. They require high-quality inputs. Overall, the wool and carpet value chain in Afghanistan requires the quality and the demand-driven incentives to be captured by the Afghan producers. The feasibility of cut and wash facilities has been investigated and the results indicate a very high return. The direct marketing of carpets branded by Afghan exporters also has tremendous potential as long as the shipping costs can be managed.

In addition, the weavers of Balkh need a chance to access their own inputs independently, own their own looms, learn about the designs in most demand, establish cut and wash facilities, and send their carpets through Afghan exporters with direct linkages to lucrative markets. These value-added activities are feasible and if implemented could lead to very significant increases in income to stakeholders working within the value chain in Balkh.

¹ Ministry of Rural Rehabilitation and Development (MRRD). 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities*. Kabul: MRRD.

2. INTRODUCTION

Afghanistan has had a long tradition in, and is one of few countries, producing hand-woven carpets made from wool, cotton, and/or silk. Prior to the 1990's, Afghanistan was a very important player in the global carpet market. Over the period 1990 – 2002, due to the war and civil strife, Afghanistan was not able to export regionally nor internationally and lost its share of the market, largely to Pakistan. The revival of the carpet industry in Afghanistan began in 2002. The Afghanistan Carpet Exporters Guild estimates there are over one million Afghans working in the production of carpets with additional millions involved in supporting activities such as wool production, cut and wash operations, and design development¹. While figures vary widely, information from the Ministry of Commerce, International Trade Department, based on CSO data indicate Afghanistan annually exported, through formal market channels, an average of \$176 million worth of carpets over the period 2003-2006. Of this, annual exports estimated at \$164 million went to Pakistan through formal market channels. This official estimate underestimates the actual carpet exports. If the informal trade of carpets is included, it has been estimated that Afghanistan produces annually about 6.6 million square meters of hand-made carpets, most of which are exported.² The value of 6.6 million square meters of carpets is at least twice the official data.

The carpets in Afghanistan are globally acknowledged as one of Afghanistan's most viable and visible products and have become a major development focus for both Afghanistan's government and private sector support organizations.³ One of the major producing areas of carpets is Balkh. Balkh has a long and rich history of carpet weaving. Approximately one-fourth of all villages in Balkh weave carpets.⁴ There are over 1.7 million square meters of carpets produced in Balkh and the northwest provinces. There are over 100,000 families in this region involved in producing carpets. The average weaver in Afghanistan produces about 18 square meters of carpet per year. The weaving is done mostly by women in their homes. Because so many women are involved in weaving, the economic impact of the income these women bring to their households is strongly felt.

This document presents information collected from field trips in Balkh province, from donor project documents, and from discussions with various Kabul-based stakeholders. The schematic presented in ANNEX 1 provides a summary of the findings of the field work leading to the development of this study. At the top of the schematic is a brief outline of the value chain. The horizontal sections below the outlined value chain set out the constraints/gaps, opportunities for value chain improvement and suggested strategic interventions for the RBSP program. The remainder of this study provides the information and prefeasibility analysis of interventions in the carpet value chain.

² Landell Mills, Ltd. 2007. *Preparing the Commercial Agricultural Development Project, Main Report, Phase 2*. Asian Development Bank Project.

³ McCord, M. May 2007. *An Analysis of Business Opportunities within Afghanistan's Carpet Sector*. Kabul.

⁴ Ministry of Rural Rehabilitation and Development (MRRD). 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities*. Kabul: MRRD.

3. VALUE CHAIN DESCRIPTION

There are many steps in the carpet value chain. The initial steps involve obtaining the proper quality and volume of wool, including:

purchasing the wool - the quality and source of raw wool needs to be considered and is contingent on the breed of sheep and availability, respectively. Some of the best wool for carpets comes from Afghanistan's Ghazni sheep. The wool is highly-prized for its texture, long length of fibers, and for its high proportion of white wool. Other wool of various quality types originates from the Middle East and is imported from Pakistan or Iran.

washing the wool - Raw wool requires proper washing, that is, scouring. Wool scouring uses hot water with detergent to remove the oil and non-wool contaminants.

carding/combing (following the drying, of the wool) by brushing the wool fibers with wire teeth to align the fibers.

spinning the wool into yarn by hand, by use of spinning wheels, or by machine. Even though hand-spun yarn, which includes yarn spun on hand-spinning wheels, has an uneven structure, this look is frequently desired for high-quality carpets.

dyeing the wool, an intricate process requiring extensive knowledge and experience (controlling temperature and pH) of dyes and colors. Both chemical and natural dyes are used.

Most carpet weavers obtain their wool and other inputs from carpet traders and, therefore, are not involved in the above steps. The traders also provide carpet designs to the weavers. The traditional designs, as well as the contemporary designs, reflect buyer preference, and are graphed, showing both color and pattern. Graphing is done by hand in Pakistan and Afghanistan by master graphers. Afghanistan is famous for its traditional Turkmen design, woven mainly in Northern Afghanistan, including Balkh. Traditional Turkmen design is made-up of geometric patterns on a dark red or burgundy base. The more recent "Chob Rang" carpets are woven with natural dyes, typically having floral designs in pastel colors. Afghan Kazak carpets are based on traditional Caucasian designs and woven with good quality wool yarns, much of which has been dyed using natural vegetable dyes.

Carpet weavers may have their own loom or they may receive their loom from the carpet trader. Depending on the size of the loom, up to five people can work together on a single carpet. Wooden or steel, horizontal or vertical, looms ranging in size from 2 to 25 meters square. An expert weaver can produce around two square meters of carpet per month, although this varies with the density of knots required in the design and with the experience of the weaver. There are three major standard densities, measured as number of knots per 10 cm squared. These are: 35 x 35, 40 x 40, and 50 x 50. The higher the density, the higher the quality and price of the carpet.

The cut and wash process following weaving cleans the carpet, restores the original shine of the wool, and brings out the carpet's sheen and luster. There are three types of washing that produce carpets of different degrees and luster. These are:

Antique wash gives an old look to the carpet

Tea wash gives a shiny look
Simple wash gives an original color look

After the carpet is dried the carpet's surface is cut (clipped or shaved) to a uniform level.

Marketing is accomplished largely by traders who have contracted weavers to weave and who then sell the carpets, primarily to Pakistan. Contract weaving is very widespread in Afghanistan. Traders contract weavers, providing them with the loom, yarn, and design, and pay them a per meter wage ranging from \$31 - \$50 depending on intricacy of design, knot density, quality, and size of carpet. Some weavers are paid up to \$79 per meter for unusually high knot density carpets, but this is very infrequent. Merchants themselves typically have contracts with Pakistan buyers, who are directly linked to end buyers in international markets. Some weavers independently sell their carpets in local markets.

4. MARKET ASSESSMENT

4.1. Demand and Supply

4.1.1. Demand

By Product Type

This report focuses on handmade knotted carpets. Demand for the carpets is dictated by make (wool, cotton, and/or silk), design, wash type, quality in terms of number of knots per square inch, etc. The European market prefers carpets that are finished using the Simple Wash technique, whereas the American market prefers carpets that have been Tea Washed. The Antique wash has a niche in both markets. The OTF study referenced in this study has a detailed description of the demand for hand-made carpets.

By Geographical Location

Local and Provincial

Mazar is a key location for carpet trading, networks, and services with estimates indicating 90% of carpets produced in Balkh transfer through Mazar to Pakistan.

National

Relative to domestic demand, there is limited domestic demand for carpets at the national-level in Afghanistan. Reports are that around 8% of Afghan carpets are purchased in Afghanistan⁵.

Regional and International

Although not a direct demand, Pakistan receives an estimated 80% to 95% of Afghan carpets. Carpets are then finished and re-exported as Pakistani carpets. Pakistan brands Afghan carpets and exports onwards, primarily to Europe and the USA. This is due: (i) to the lack of sufficient cut and wash facilities in Afghanistan, (ii) to the long-term relationships Pakistanis have established with their Afghan partners and with their international trading partners, (iii) to limited trading relationships between Afghans and international partners, (iv) to relatively low cost of shipping from Afghanistan to Pakistan versus high cost of shipping from Afghanistan to international markets, and (v) Pakistan's advantage in that the Pakistan Government subsidizes Pakistan's carpet industry.

Reports state there are over \$1.4 billion in carpet sales on the world market each year.⁶ Around 70% of global demand for carpets is from five countries: United Arab Emirates, Italy, Germany, USA, and UK⁷. The USA and Germany purchased \$531 million and \$300 million worth of carpet in 2004. The US demand grows slightly annually, while the German demand has fallen rapidly over the period 1998 – 2004.

⁵ OTF Group. 2006. *Afghanistan Competitiveness Project Key Documents Library: Volume 2*. Kabul.

⁶ McCord, M. May 2007. *An Analysis of Business Opportunities within Afghanistan's Carpet Sector*. Kabul.

⁷ OTF Group. 2006. *Afghanistan Competitiveness Project Key Documents Library: Volume 2*. Kabul

For Close Substitutes

Machine-made carpets—from Iran, China, and India—are increasingly becoming more attractive to international buyers. The method of production is reportedly now less important than the way the product is styled and colored.

4.1.2. Supply

By Product Type

This study focuses on handmade knotted carpets. The supply of carpets is limited by the time that the weavers have to devote to hand-making the carpets. Some experienced weavers would weave more carpets if they had different-sized better looms. New potential weavers would weave, if they could learn more about good weaving techniques and could afford the loom.

Two other types of floor coverings are produced in Afghanistan—felted wool carpets (namads/lamsai) and flat woven carpets (kilims). However, these represent a small percentage, about five percent, of all floor coverings produced in Afghanistan⁸. Most are used in the homes of the weavers who produce them. Rarely are they exported.

By Geographical Location

Local and Provincial

Discussion with officials in Balkh and in several districts in Balkh confirms that Dawlat Abad is the district most well-known for weaving and has the highest number of weavers. Weaving is less widespread in Dehdadi and Nahri Shahi, although its importance is increasing. The Ministry of Rural Rehabilitation and Development (MRRD) National Area-Based Development Program has been instrumental in assisting districts develop their district development plan. District Development Plans for Dawlat Abad, Dehdadi, and Nahri Shahi each mention the positive impact of carpet weaving activities in their district on the economy of the district. Most carpets produced in Balkh are shipped to Pakistan via Mazar. While there is information on amount of carpet shipped to Pakistan from Mazar, this information is not disaggregated by district. Thus, district-level information is currently unavailable.

It is widely-held that Balkh is one of Afghanistan's most important provinces for carpet production. Estimates are that 1,700,000 square meters of carpet were exported from Mazar to Pakistan in 2005 through formal market channels.⁹

National

The Export Promotion Agency of Afghanistan suggests annual production to be in the area of two million carpets with an average size of 3.2 meters square. This results in an annual estimate of around 6.4 million square meters of carpet. Adjusting this figure

⁸ OTF Group. 2006. *Afghanistan Competitiveness Project Key Documents Library: Volume 2*. Kabul.

⁹ Landell Mills, Ltd. 2006. *Preparing the Commercial Agriculture Development Project: Phase 1 Report*. Kabul.

based on more recent data from Mazar, Herat, Kabul, and Andkhoy, results in an annual estimate of 6.6 million square meters.¹⁰

Regional

Iran is the largest supplier of carpets, followed by Pakistan and Afghanistan. Table 1 shows top suppliers based on value of exports. While Afghanistan appears third, Afghanistan supplies significantly more carpet than the table suggests because much of its production is under-reported while being exported to Pakistan where it is re-exported as Pakistani.

Table 1. International Carpet Market: Top Suppliers

Country	Carpet Exports (Millions \$)
Iran	391
Pakistan	246
Afghanistan	149
India	148
China	121
Nepal	100

Source: OTF Group. 2006. Afghanistan Competitiveness Project
(Key Documents Library: Volume 2. Kabul)

Of Close Substitutes

Afghan handmade carpets compete with machine-made carpets from Iran, China, and India. The supply of machine-made carpets continues to grow and as mentioned above, reports indicate the method of production is less important than how the carpet is styled and colored.

4.2. Production Costs

The margins represented in the value chain for carpets exported from Balkh to Pakistan and then on to the European market are given in the following table:

Table 2. Carpet Value Chain

Activity	Margin (Rs)	Margin (\$)
Raw wool	999	16.30
Dying	245	4.00
Weaving	2759	45.01
Transport to W/S market	150	2.45
Wholesale price	2495	40.70
Transport to Peshawar	92	1.50
Cut and wash	300	4.89
repairs	104	1.70
Wholesale Peshawar	1033	16.85
Transport to Europe	61	1.00
Wholesale Europe	1778	29.00
Retail EUROPE	1839	30.00

Source: Landell Mills, Ltd. 2006. *Preparing the Commercial Agriculture Development Project (Phase 1 Report)*. Kabul)

¹⁰ Landell Mills, Ltd. 2006. *Preparing the Commercial Agriculture Development Project: Phase 1 Report*. Kabul.

The graph of the margins within the value chain for carpets is given in Figure 1 below.

4.3. Processing Costs

Cut and wash processing costs are estimated at \$8.00 per square meter in Pakistan. There are cut and wash facilities in Kabul, Mazar, and Herat. The quality of these varies, but is generally low. One service near the silo in Mazar, run by the Naim Company, reportedly offers high quality services, although at higher prices than its local competitors.¹¹ There are indications that cut and wash in Afghanistan ranges from \$4 - \$7 USD per square meter.

4.4. Marketing Costs

Transport from Kabul to Pakistan and onwards to international destinations is one marketing cost. Costs from Kabul to Pakistan are between \$6.50 and \$7.00. Costs of transport from Pakistan to UK are much lower, estimated at around \$3.00. This is largely because the former is by truck/road and the latter by container/sea. Afghanistan exporters would have an advantage shipping to the US in that carpets may be shipped to the USA duty free. Considerable investment is required to develop and expand markets and advertise products internationally. Currently, marketing costs are covered largely by the Pakistani traders, but there are reports that the Pakistan Government subsidizes the container shipments of its carpets.

4.5. Price Trends

International prices for carpets generally follow the growth and inflation rates of the major international economies. Over the period 2002-2004, the carpet market in the US and Germany grew by about 3% and 7%, respectively. In general, international prices for carpets steadily grew with the low inflation rates in these countries.

More specifically, the trends in market prices have followed the quality, styles, and colors demanded by the international market. The best growth in carpets accompanied by higher prices has been in the soft contemporary designs. The market for high quality, traditional carpets is not growing, but slowly losing out to the contemporary style. The market for Chob Rang carpets has become less popular, with a sales decline of 25% having taken place in recent years.¹²

4.6. Prices and Value Added Along the Value Chain

The price of wool varies - Carpets for the local market at the bottom end of the market use Iranian wool costing about US\$1.00 per kilo. The finished carpet sells for about \$25/ m². On the high end, 'Belgique' wool, imported machine spun wool, retails for US\$6.00 to US\$7.00 per kilo. The finished carpet sells for \$about as much as \$150/ m². Part of the difference in the costs is from the price of the wool and the other is from the knot density, which is higher with the imported wool, as the wool is finer and the knot density is 55 x 60 per 10 cm.

¹¹ MRRD. 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities*. Kabul: MRRD.

¹²OTF Group. 2006. *Afghanistan Competitiveness Project Key Documents Library: Volume 2*. Kabul

Besides the prices of the inputs, the prices of carpets are dictated by the number of knots per 10 cm and by the type of wool. The price paid to the weaver, minus input costs is given in Table 3.

Table 3. Cost Structure and Percentage of Carpets Woven

Item	30-35 double knots per 10 cm (Iranian wool)	35-50 double knots per 10 cm (Iranian wool)	50-60 dbl knots per 10 cm (Belgium wool)
	US\$	US\$	US\$
Cost per m ²	25-30	40-50	100-120
Percent of total carpets woven	25 percent	40 percent	35 percent

Note: Carpet prices are also lower by 10% or more for carpets that have flaws.

Most carpets are exported from Afghanistan after they have been woven and before they are cut and washed. Most Afghan carpets are cut and washed in Pakistan and then marketed to international markets. The prices for the different quality of carpets in the US are given in Table 4.

Table 4. Price Structure for Different Grades of Carpets in US\$¹³

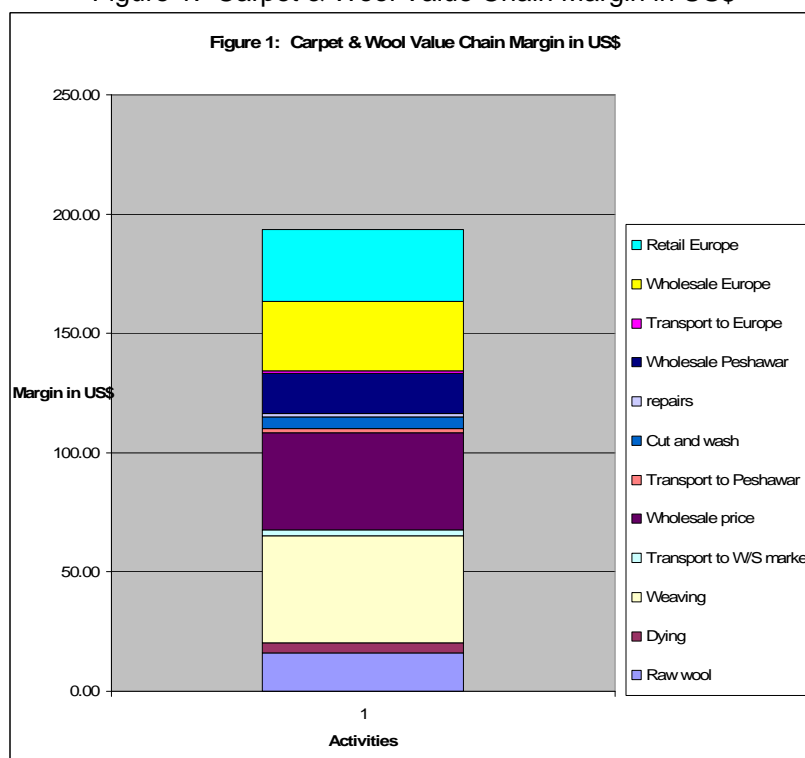
Knot Density	Best	Good	Bad
35x40	90	85	74
40x40	107	98	79
50x50	131	115	82

Note: Where Best represents the top style, excellent quality, and preferred color; Good represents less popular style, good quality, and average color; Bad represents relatively unpopular, fair quality, and poor mix of colors.

¹³ Landell Mills, Ltd. 2007. *Preparing the Commercial Agricultural Development Project, Main Report, Phase 2*. Asian Development Bank Project.

The graph of the margins within the carpet value chain is given in Figure 1.

Figure 1: Carpet & Wool Value Chain Margin in US\$



4.7. Estimated Increase in Revenue

The project will provide technical assistance and training (in accessing quality inputs, in developing demand-driven designs, in correcting all flaws in weaving) to about 600 weaving households over the two year period. The trained weavers will receive \$5/sq.m. more for their carpets because the carpets do not have flaws, the design is more preferred, and the inputs are of higher quality. Assuming three weavers per household with an average production of 18 square meters per weaver, the estimated increase in revenue is \$162,000.

Many weavers do not own their own looms; instead they pay the traders who rent them looms for \$4/sq.m. of carpet. Through the support of the Project, two hundred weavers will purchase steel looms on credit. The average weaver household produces 54 sq. m. of carpet per year. The estimated increase in revenue for the 200 weavers is \$43,200.

Many people who spin wool including many weavers in the Balkh districts are hand spinning 0.2 kg of wool per day and receiving \$0.63 kg/day. The Project will assist 200 spinners who are interested in spinning wheels in purchasing and using spinning wheels to increase their spinning to 1.2 kg/day. The increase in rate of spinning is 0.9 kg/day. If the 200 spinners use the spinning wheels for 300 days/year, the estimated increase in their revenue is \$43,020.

The Project will assist two investors in establishing two cut and wash facilities in Balkh province each with a capacity for cutting and washing at least 90,000 sq.m. of carpets

per annum. Instead of the Balkh carpets being sent to Pakistan for cut and wash, it is estimated that approximately 180,000 sq meters will be cut and washed per annum. The estimated increase in revenue at \$5.50/sq.m. is \$990,000.

Once the carpets are cut and washed, the Project will assist the carpet exporters in exporting the 180,000 sq.m. of carpets directly to international markets bypassing Pakistan. By eliminating Pakistan from the value chain, the Pakistan exporters will save at least \$16 of gross revenue. The estimated increase in revenue from marketing the 180,000 sq.m. is about 2,880,000.

The total estimated revenue from the Project interventions is \$4,046,130.

5. KEY CONSTRAINTS/GAPS

While Pakistan represents a prime constraint to the improvement of Afghanistan's position in the global value chain, Pakistan also provides inputs and services currently in short supply in Afghanistan. This is the foremost challenge facing the Afghan carpet industry. Other specific constraints and gaps in the value chain are discussed below.

5.1. Raw Wool

Local Ghazni wool, considered of very high quality, accounts for about 15% of wool used in Afghanistan.¹⁴ Because demand is greater than supply, Afghanistan imports raw wool, primarily from Pakistan.

5.2. Wool Scouring

A growing concern for the environment has led to increased demands on the scouring process. Improved technologies are available to address environmental concerns related to wool scouring. However, in Afghanistan wool is scoured using traditional processes. There are currently no improved facilities for wool scouring in Afghanistan. Few merchants have adequate space for drying and storing wool.

5.3. Spinning

Wool is traditionally hand-spun in Afghanistan. There are few small wooden spinning-wheels in Afghanistan and most weavers have reportedly never used spinning-wheels. Much of the yarn used in Afghanistan is imported, already spun, from either Pakistan or Iran although Mazar has one private yarn producing company. The company has been in operation for the past three years and imports wool from Iran, Uzbekistan, and Pakistan.

5.4. Dying

There are a number of small-scale facilities in Afghanistan where yarn is dyed using natural dyes. However, there are few in Balkh. Dying is becoming a lost art and materials required for natural dyes are becoming more difficult to source. There are no medium or large-scale factories in Afghanistan dying wool using natural dyes. There are large-scale factories in Pakistan where chemical dyes are used to produce large quantities of dyed yarn. Afghanistan imports much of its dyed yarn from Pakistan and Iran.

5.5. Design

Reports are that the time required to hand copy designs is a constraint in the carpet weaving process. As well, designs come to Afghan weavers via Pakistan, again tying Afghan traders and weavers to Pakistani merchants. There is a lack of design expertise within Afghanistan making it difficult for Afghanistan to respond to changes in international market preference and demand.

¹⁴ MRRD. 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities*. Kabul: MRRD

5.6. Weaving

Contract weavers often have no alternative to accepting conditions dictated by those with whom they contract and may have less incentive than required to produce high-quality carpet. Reports are that weavers who have their own looms are paid around \$4.00 more per square meter for their work than weavers who are provided looms by their contractor. As well, there are indications weavers who purchase their own inputs can make more money, but this assumes they can sell their carpet at good price and few weavers are directly linked to good markets. Quality is an important issue for weavers and traders alike. Weavers who produce poor quality carpets receive less money (2000 Afs/sq meter) than those who produce high quality carpets (3500 Afs/sq meter). Weavers lack negotiating capacity and organization to advocate for better wages, working conditions, and/or initiate direct marketing. Although Balkh has a tradition of producing high quality carpet, the handmade carpet industry is very competitive, with market shares contingent on production of high quality products.

5.7. Finishing: Cut and Wash

Reports suggest 10% to 20% of Afghan carpets are finished in Afghanistan with the large majority transported to Pakistan for finishing.¹⁵ There are a few cut and wash facilities in Mazar, Herat, and in Kabul. In Mazar, there are a total of ten facilities. These provide finishing services for Afghan customers and the quality of these operations, with a few exceptions, is low¹⁶. Out of the ten, one is considered to be competitive, providing high quality finishing services, although at a higher cost than the other operations. Pakistan's weather is a comparative advantage in cut and wash compared to most carpet making locations in Afghanistan. It is difficult to dry carpets in cold weather, a condition in the central and northern parts of Afghanistan which exists anywhere from four to six months of the year. Few Afghans have the technical skills and expertise required to add value via cut and wash processes. Chemicals required for cut and wash are imported from Pakistan and have a short shelf-life, thus increasing the cost of cut and wash operations in Afghanistan. There is little work being done on identifying better sources of chemical or better chemicals for the cut and wash process.

5.8. Marketing

As earlier mentioned, the handmade carpet industry is highly competitive. Cutting-edge marketing skills, linkages, and technologies are needed to enable Afghan merchants to successfully compete. Few Afghan traders are linked to international markets. Few are able to direct market over the internet. Most are tied to buyers in Pakistan. There is an almost complete lack of branding of Afghan carpets as most are exported as a Pakistani product.

5.9. Organization

There are two large trader organizations operating in Balkh. While they represent large numbers of traders and weavers, as further detailed below, their professional organizational and business skills are weak and they lack the expertise required to

¹⁵ MRRD. 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities*. Kabul: MRRD. And McCord, M. May 2007. *An Analysis of Business Opportunities within Afghanistan's Carpet Sector*. Kabul.

¹⁶ Ministry of Rural Rehabilitation and Development (MRRD). 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities*. Kabul: MRRD.

trade effectively in the international market. There are indications there are weaver groups in Balkh, concerned primarily with weaver-related issues. However, most are reportedly small and few are well-organized.

5.10. Credit

Traders report constraints in their cash flow to keep contract weavers working. Weavers may need credit to purchase new looms and/or other inputs. All advise they lack access to credit. This is not only a function of credit availability, but of their ability or credit worthiness to obtain credit and their concerns over what they consider high interest rates as well as their concerns about loan repayment.

5.11. Subsidies

The Pakistani government subsidizes its carpet industry. For example, the Union President maintains the Pakistani Government provides a bonus to its traders of \$5,000. for every 40 foot container of carpets shipped out of Pakistan. Afghan merchants believe these types of subsidies put them at a distinct disadvantage and they frequently request some type of government assistance.

6. OPPORTUNITIES

The Afghan Investment Support Agency (AISA) is a one-stop shop supporting investors. They have studied investment opportunities in the carpet industry advising:

“Wide opportunity exists for investors to add value to their products by controlling the highly profitable activities closest to the end customer. It is estimated that the value of Afghanistan’s entire carpet industry would increase between two and five times if companies finished goods in country and sold directly to overseas markets, rather than exporting through intermediaries. Handling all aspects of production within Afghanistan would allow for enhanced quality and a revitalized, “Made in Afghanistan” brand of carpets marketed for export worldwide. Along the supply chain, investment opportunities include: wool production, dye manufacture, carpet finishing, international marketing services, and transport and logistics.”¹⁷

The Afghanistan Small and Medium Enterprise Development (ASMED) project conducted a review of the carpet sector and identified investment opportunities in the sector.¹⁸ The table below draws on ASMED data, sources already referenced, and field work conducted for this study.

Table 5. Constraints/Gaps and Opportunities in the Carpet Value Chain

Constraint/Gap	Opportunity
<ul style="list-style-type: none"> Limited supply of high-quality Afghan raw wool 	<ul style="list-style-type: none"> Increase flock size Grade and brand Afghan wool
<ul style="list-style-type: none"> Lack of improved scouring facilities 	<ul style="list-style-type: none"> Facilitate establishment of facilities utilizing improved technologies for washing/drying/storing wool
<ul style="list-style-type: none"> Spun yarn imported from Pakistan 	<ul style="list-style-type: none"> Increase quantity of hand-spun wool in Afghanistan by introducing and testing spinning wheels¹⁹
<ul style="list-style-type: none"> Expertise to use and to source natural dyes is limited Dyed yarn imported from Pakistan 	<ul style="list-style-type: none"> Institute an apprenticeship program to expand the number of people with expertise in using, sourcing, and marketing natural dyes Facilitate establishment of a medium-size facility to produce naturally-dyed hand-spun yarn
<ul style="list-style-type: none"> Traditional techniques for design development and copy are inefficient Lack of Afghan design capacity decreases opportunity to respond to changing international design preferences 	<ul style="list-style-type: none"> Explore feasibility of Computer Assisted Design technologies to speed-up design drawing and copying process Provide opportunities for several artisans to further develop their design expertise through regionally-based training Develop Afghanistan-based design services to collect market information about designs and colors for Afghan

¹⁷ Available: http://www.trade.gov/static/afghanistan_carpetstextiles.pdf

¹⁸ ASMED. September 2007. *Presentation: Investment Opportunities in Afghan Carpet Sector*. Kabul.

¹⁹The Indigo Carpet Association, based in Kabul, produces and promotes hand woven carpets using hand-spun wool and natural dyes. The Association has experience with spinning wheels, having provided spinning wheels to women with whom they work in Herat. These women were able to increase their production of spun wool by 400%, thereby significantly increasing their incomes. USAID. January 2008. *Accelerating Sustainable Agriculture Program: Annual Report 1, November 22, 2006 – December 31, 2007*. Kabul

Constraint/Gap	Opportunity
	merchants/weavers
<ul style="list-style-type: none"> Limited attention to weaver-related issues 	<ul style="list-style-type: none"> Boost motivation for weavers to produce high-quality carpet by facilitating loom ownership, providing targeted training to improve weaving skills, facilitating weaver access to higher-quality inputs, and initiating an association-based quality improvement and control program
<ul style="list-style-type: none"> Limited number of high-quality cut and wash facilities in Afghanistan; in Balkh the capacity of the existing cut and wash facilities is about 5000 sq.m. per month; Most carpets sent to Pakistan for finishing 	<ul style="list-style-type: none"> Facilitate establishment of medium to large-scale facility providing fee-based quality finishing including labeling services to production units, traders, and associations The potential demand for cut and wash facilities in Balkh beyond the 5000 sq.m. capacity that exists is estimated at 55,000 sq m per month²⁰.
<ul style="list-style-type: none"> Afghan merchants linked primarily to Pakistan, not directly to international markets Afghan merchants unable to effectively advocate with Government 	<ul style="list-style-type: none"> Assist merchants to initiate/improve direct marketing activities including website development, linkages to international web-based marketing, inventory management, branding, sea and air shipping, and customs clearance procedures Strengthen merchant capacity to articulate market issues and concerns to related national agencies and government Facilitate Afghan participation in international trade shows
<ul style="list-style-type: none"> Limited capacity of existing trader unions/associations Few or weak weaver groups/associations 	<ul style="list-style-type: none"> Assist existing, organize new associations to strengthen trader/weaver capacity to produce, negotiate, and market Develop groups/associations to empower weavers to advocate for better wages, working conditions, and/or to initiate direct marketing
<ul style="list-style-type: none"> Lack of capital 	<ul style="list-style-type: none"> Broker linkages among weavers/merchants and credit suppliers

²⁰ MRRD. 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities. Subsector Analysis and Business Plan Development/ North and Northeast/Economic Viability and Technical Feasibility.*

7. OTHER DONOR PROJECTS

7.1. Carpet Sector Development: National Level

There are three major projects addressing development of the carpet sector at the national-level. These are the Afghanistan Competitiveness Project, completed in 2006; the Afghanistan Rural Enterprise Development Program (AREDP) planned to begin implementation in 2008; and the Afghanistan Small and Medium Enterprise Development (ASMED) project currently in operation.

The Afghanistan Competitiveness Project, funded by USAID and carried-out by the OTF Group, began in 2004 and was completed in 2006. The project helped develop a national-level strategy for growth of the carpet sector, provided institutional support to the development of the Afghanistan Carpet Committee in the Ministry of Commerce, and supported an outreach effort to address general competitiveness issues.²¹ The project was very instrumental in establishing the national framework within which Afghanistan's carpet industry is currently operating.

The Ministry of Rural Rehabilitation and Development (MRRD) is in the process of developing the AREDP which is to be funded by a group of donors. This is a large-scale national program, designed for a 10-year period with a funding base of \$568 million, to facilitate enterprise development in rural communities, to support policy-based lending to communities and enterprises, and to provide a range of business services to enterprises.²² This national program will reach communities and operate at the community-level. AREDP will focus on products in strategic sub-sectors, among these will be carpets. AREDP intends to develop and test its project methodology through pilot-project efforts, some of which are currently in operation. Details of AREDP activities in the carpet-sector have yet to be determined. Plans are that AREDP will begin implementation in 2008, likely in the fourth quarter. As AREDP begins implementation, RBSP must ensure there is close collaboration between the two projects.

Afghanistan Small and Medium Enterprise Development project (ASMED), a USAID funded project, is an important actor in the carpet value chain, as well as in other value chains in Afghanistan. ASMED focuses on five main economic development activities including: marketing, business service provider development, business association development, public-private sector alliance creation, and private sector workforce capacity development. ASMED has sponsored delegations to international trade fairs and sponsored the first ever Afghanistan International Carpet Fair held in Kabul in 2007. The project assists in the development of national-level business associations such as the Afghan Carpet Exporters Guild, the Kabul Carpet Association, and the Export Promotion Agency of Afghanistan. ASMED is interested in a strategic alliance with RBSP in Mazar to support the development of small and medium enterprises related to the carpet sector there. The concept is one of a joint venture whereby the two projects pool resources to facilitate the development of enterprises which will support the carpet

²¹ Available: http://www.trade.gov/static/afghanistan_carpetsummary.pdf

²² MRRD. No Date. *Draft Program Document. Afghanistan Rural Enterprise Development Program.* Kabul.

sector. ASMED is particularly interested in collaboration related to cut and wash operations. ASMED advises they are currently working with investors interested in establishing finishing facilities in Mazar.

As well as these carpet-focused project activities, the ASAP project has a website, AgNet, developed to assist Afghanistan merchants in marketing internationally. The Project will have access to this website.

7.2. Training/Capacity Development

7.2.1. National-Level

Several Ministry of Agriculture, Irrigation, and Livestock (MAIL) associated training and capacity development programs potentially relevant to RBSP activities operate at the national-level. These are Horticulture and Livestock Program (HLP), Perennial Horticulture Development Project (PHDP), and Support to Strategic Planning for Sustainable Rural Livelihoods (SSPSRL). None have plans to intervene specifically in the carpet sector. However, each has relevance to RBSP training and capacity development as is further explained below.

Both HLP and PHDP advise they have plans to help develop farmer organizations in the districts in which they will be working. Their efforts will focus on utilizing organizations as the mechanisms for delivery of technical training. Should their organization development training be more general in nature, then RBSP is invited to collaborate with them.

SSPSRL has been instrumental in developing a core group of trainers who are currently assigned to different departments within MAIL. The Capacity Development Unit, a planned unit in MAIL's newly-established Human Resources Department, is expected to be the ultimate home-base for these trainers. SSPSRL has initiated a long-term capacity development effort whereby DAIL lead trainers are trained in training of trainers (TOT) in each province. Following TOT training, lead trainers are trained in General Management and Project Management. Two lead trainers have been trained in Bamyan. These trainers are an important resource for RBSP and their involvement in Project supported training should be obtained whenever possible. MAIL has advised SSPSRL they would like two provincial-level M&E staff to be trained. Staff have yet to be posted to the field, but plans are to do so. SSPSRL does not currently have plans to provide M&E training. This is an area where RBSP can assist MAIL and collaborate with SSPSRL by ensuring MAIL staff are included in Project M&E training and M&E implementation.

7.2.2. Balkh: Provincial and District-Level

The foremost player in carpet in Balkh is ASMED. Balkh is one of five regional centers where ASMED projects are implemented. As noted above, ASMED is engaged in marketing, business service provider development, business association development, public-private sector alliance creation, and private sector workforce capacity development. All these developmental activities will reportedly be carried-out in Balkh and will focus, among others, on the carpet sector.

Community Development Councils, supported through the MRRD National Solidarity Program, have been involved with carpet weaving in some districts in Balkh. This has usually been accomplished by the Council's women's shura. The Council purchases looms and/or inputs and provides training to weavers, primarily women. Carpets are sold in local markets, usually in Mazar.

The development community in Balkh is large and active. However, current information suggests there are no other NGOs/organizations engaged directly in carpet sector development in Balkh.

7.3. Existing Institutional Capacity

Neither MAIL nor its Department at the provincial-level has staff trained in weaving. Most women in MAIL and in its provincial-departments are employed in the Department of Home Economics. Building the capacity of women in this department to work with women weavers is an option which merits consideration.

7.4. Existing Groups/Associations

The Carpet Producers and Exporters Union is allegedly the largest organization of traders representing traders from the North. Along with others, there are about 360 Mazar-based traders in the Union. Established in 1967, the Union is registered with the Ministry of Commerce. Union headquarters are in Kabul with satellite offices in Mazar, Jalalabad, and Herat. The President of the Union advises trader members have established working relationships with large numbers of weavers with some traders having 1,500 – 2,000 working looms.

The second largest trader organization is the Afghan Hand Knotted Carpets Manufacturers Export's Development Association. This Association is headquarters in Aqcha in Jawzjan Province. The Association represents 66 traders and 100,000 weavers. The large majority of association activities are in northern areas, other than Mazar, although they reportedly work with some weavers in Mazar.

There are few, if any, associations organized to specifically address weaver concerns. Some weavers in Dawlat Abad have been organized via Community Development Councils but these are very few and they lack organizational and business skills.

8. CREDIT MAP: BALKH CARPET²³

The MISFA microfinance organizations working in the province Project provinces have been surveyed to obtain information on their loan products (Tables 6-7). Note that Banke Millie also has a loan product and is operating in Balkh. Because the processors and marketers will be seeking loans from organizations providing loans large than MFIs the SME/commercial banks and NBFIs were surveyed to determine their minimum equity. The minimum equity is critical information as these potential clients may require an equity transfer. To justify the equity transfer it is necessary to know the minimum equity required by these organizations.

The MFI reports through MISFA will let the Project know exactly how many Project clients the MFIs provide loans. Based on discussions with MISFA the Project will be able to request and obtain specific information about the number and size of loans in its value chains. This will be an added requirement on the MFIs and a condition of the MISFA contract. The extent of any additional detail may be problematic when negotiating with MISFA²⁴. Note that since the Project will have no relationship with Banke Millie or any other financial institution outside MISFA or for loans above the MISFA MFI limit no report on their participation in the Project will be available.

²³ Where possible the numbers provided by the MFI were checked against those reported to MISFA. Where different the MISFA numbers were used.

²⁴ MISFA has had a bad experience with ADB in the past in terms of delays and people changing their minds. This will not give the Project much room to make demands.

Table 6. MISFA Loan Status

District No	District	Active Clients (total)	Active Borrowers (total)	Loans Disbursed (number)	Loans Disbursed (\$)	Loans Outstanding (\$)
1	City Districts	29,351	23,389	76,382	36,048,132	9,913,288
2	Balkh	4,957	4,084	19,281	5,362,233	1,106,255
3	Nahrishahi	3,675	2,802	8,184	2,623,617	786,862
4	Dawlat Abad	1,089	935	6,139	1,038,226	273,589
5	Shulgara	1,781	1,416	3,205	2,057,536	701,913
6	Khulm	1,501	1,111	5,123	1,031,146	234,781
7	Shortapa	-	-	-	-	-
8	Charbolak	7	1	7	4,000	416
9	Chemtal	22	2	7	4,300	1,172
10	Kaldar	-	-	-	-	-
11	Dehdadi	6,090	4,720	21,003	5,850,750	1,338,266
12	Marmal	3,313	3,137	8,968	2,542,371	800,546
13	Kushenda	2	-	1	500	-
14	Chargumbad	15	-	4	2,100	-
15	Zari	-	-	-	-	-
	Total	51,803	41,597	148,304	56,564,912	15,157,088

Source: MISFA Consolidated as of March, 08

At the association formation stage all microfinance financial institutions will be invited to introduce themselves and their products to the producers. It will then be up to the MFIs and the producers to connect and access credit.

Table 7. MFIs in the Districts

Microfinance	MISFA							Banke Millie
	ARMP	BRAC	FINCA	FMFB MF	FMFB SME	OXUS	WOCCU	
MFIs Operating in Area								
Dawlat Abad District	X	X						X
Nahrishahi District	X	X					X	X
Types of Lending								
Group	X	X	X	X		X		
Individual	X	X	X	X	X	X	X	X
Terms								
Months	4-24	6-12	5-12	4-12	6-36	6-18	6-12	12
Interest ²⁵	15.6 F	17.5 F	24 F	15 F	15 F	18 F	24 D	12 D
Payment Frequency	Monthly	Weekly	Biweekly	Monthly	Monthly	Biweekly/Monthly	Monthly	Monthly
Loan Sizes								
1 st Loan Max.	\$500	\$20	\$160	\$200	\$30,000	\$100	\$500	\$5,000
Number of Clients								
	3,890	20,738	6,511	6,522	49	2,643	1,275	N/A
Repayment Rate								
	59.6%	96.7%	65%	100%	100%	74.15%	99.35%	N/A

SME/Commercial Banks and NBFIs	AIB	AFC	ARFC	Azizi	BRAC Bank	Millie	Nat'l Bank Pakistan	Kabul	Pashtany
Minimum equity required	debt service ratio	20%	50%	30%	25%	66%	N/A	50%	70%

Note: See Annex 2 for details.

²⁵ F = Flat, D = Declining

9. PROPOSED INTERVENTIONS

The Project will operate in Dawlat Abad, Dehdadi, and Nahri Shahi districts with a population of 79,638, 66,009, and 38,791, respectively. Dawlat Abad has the most weavers of all Balkh districts and is the major carpet producing district in Balkh. Weaving is less widespread in Dehdadi and Nahri Shahi, although its importance is increasing. Many newly-settled Afghans in Nahri Shahi have been trained in carpet weaving. The Governor of Balkh has allocated land for a carpet weaving village in Nahri Shahi. Reports are infrastructure—housing, power, and water—are beginning to be developed. Dawlat Abad and Dehdadi also have a significant number of sheep, adding to the availability of raw wool. Road access to these locations is good. Electric power is most available in Dehdadi district where the fertilizer plant is located. Water is abundant in Dehdadi, much less so in Dawlat Abad and Nahri Shahi.

9.1. Description

9.1.1. Production

The Project will assist weavers to access high-quality carpet inputs such as looms, yarn, and designs. Via the Project, weavers will learn about and test-out new spinning wheels to increase their spinning productivity. Through an extension program, the Project will increase weaver capacity in various wool value-added activities, emphasizing improved dyeing and marketing of dyed and spun wool. To create a core of advanced weavers, selected weavers will be trained in carpet weaving Best Practices. A critical component of the extension program will be quality-improvement whereby trained Project and MAIL extension staff will technically backstop the weaving process and assist weavers to improve the quality of their carpets.

9.1.2. Processing

To establish the feasibility of wool scouring operations, the Project will support a feasibility study of wool scouring (washing/drying/storing) and will support a wool scouring facility environmental impact assessment. If feasible and if any negative environmental impacts can be appropriately mitigated, the Project will assist investors in establishing facilities in appropriate and strategic locations.

To facilitate the establishment of a cut and wash facility, the Project will support an environmental impact assessment of such facility. If negative environmental impacts can be appropriately mitigated, the Project will assist investors in establishing a cut and wash facility in an appropriate and strategic location.

For both the scouring and finishing facilities, the Project will train facility staff to operate and maintain facilities. Training will consider environmental issues as well as Best Practices.

9.1.3. Marketing

The Project will work closely with existing trader unions and associations to build their organizational and business capacity. As may be needed, the Project will assist in developing additional marketing groups. Carpet traders will be trained in various

procedures to improve their value-added activities and volume of sales. Procedures will include, for example, inventory management, branding, customs clearance, and marketing by air and sea. E-commerce direct marketing will be emphasized. Traders will be assisted to develop websites and they will be linked to international markets via AgNet. In collaboration with ASMED, the Project will support Balkh traders to attend national trade fairs. The Project will help Balkh traders learn how to engage Government in constructive dialogue and how to articulate their positions and concerns to Government.

9.1.4. Association Development

The strengthening of existing and the organization development of new weaver and trader associations will be a priority of the Project. By the end of the Project, Associations will be self-sustaining.

9.1.5. Staff Capacity Development

To implement the Project successfully, training will be provided for various Project staff in selected aspects of the carpet value chain, primarily wool dyeing and spinning and carpet weaving and marketing. To the extent possible, Project staff trained for this value chain will be women as they can work with women weavers more readily than can men. The Project will train DAIL female staff to participate in the Project on a part-time basis. This will help build capacity in the industry in general and in DAIL in specific.

9.2. Strategic links to existing programs

Consideration should be given to MAIL's participation on the Afghanistan Carpet Committee. As AREDP becomes operational, the strategic linkages between the projects will need to be further discussed and detailed. AREDP proposes to integrate business development services across all its activities. This is an area where RBSP clients may well benefit and offers one specific area for strategic linkages. RBSP will further explore the concept of joint venture with ASMED to facilitate the development of wool scouring and/or cut and wash facilities in Mazar. The AgNet website, developed by ASAP, will be available for use by RBSP clients.

9.3. Stakeholders Interest in Value Chain Improvement

The Carpet Producers and Exporters Union is ready to collaborate with RBSP. Within this group are merchants who are eager to build their businesses and learn more about international markets. All weavers contacted were interested in Project participation. They asked many questions regarding the conditions of participation and were advised this information would be forthcoming as such decisions are finalized.

Several of the carpet traders in Balkh advise they are interested in establishing better facilities for wool scouring, spinning, dyeing, and storing in Balkh. Merchants in the province have also indicated interested in establishing cut and wash facilities in Balkh. .

10. INDICATIVE NUMBER OF POTENTIAL BENEFICIARIES

There are an estimated 26,350 families in the three target districts. The Project plans to involve around 600 of these families in a quality-improvement focused extension program carried-out largely by female extension workers. On a more intensive level for fewer weavers, the Project intends to support 200 weavers' access to high-quality inputs (looms, spinning wheels, designs); improve 200 weavers' skills in various value-added activities (cleaning, dyeing, spinning); and train 300 weavers in Best Practices in order to improve weaving quality. To further support weavers, the Project plans to promote the organization of ten carpet weaver associations, involving up to 1,000 weavers and to assist existing carpet marketing associations to develop more effective associations, involving up to 100 traders and weavers.

The Project plans to work with eight groups of investors to facilitate the development, if feasible, of a wool scouring facility, of five drying and storage warehouses, and two cut and wash facilities. The number of direct beneficiaries will be dependent on the number of investors in each group. These activities will impact a far larger number of beneficiaries as secondary beneficiaries will be traders and weavers not only in Balkh Province but in the north in general. The Project expects to work intensively with existing trader associations and specifically with twenty traders to improve their capacity to direct market as well as negotiate effectively with Pakistani buyers.

11. RECOMMENDATIONS

11.1. Feasibility

Those weavers who purchase a steel loom for \$300 will need to service their loom loan at 25%. Within two years the weavers are able to pay off and outright own the loom.

The investors, who the Project will help establish two cut and wash facilities for \$105,000 each, are each projected to cut and wash 90,000 sq.m. per annum. The cost of cutting and washing 90,000 sq.m. is projected to be \$4/sq.m. of carpet for labor, electricity, and chemicals, water, and various consumables.²⁶ The capital investment includes land, building, drainage, equipment, washing material, cutting machine, power stabilizer, etc. A loan on \$70,000 will cost the investor 25%. At a cut and wash price of \$4.89/sq.m.²⁷, and operating and interest costs of \$4/sq.m. and \$0.194/sq.m., resp., the return on investment is 179%.

11.2. Cost Effectiveness

The Project's investment cost includes equity transfer or a loan guaranty of about \$58,500 for inputs including looms, \$67,250 for wool cleaning, scouring, wool spinning and dyeing, wool drying and storage, \$100,000 for wool scouring equipment and building, \$50,000 for two carpet cut and wash facilities, \$25,000 for carpet inventory and packing house, \$25,000 for branding and advertising. Total for investment is \$377,250.

The estimated increase in revenue from the Project interventions in the carpet value chain is \$4,046,130.

11.3. Risk Manageability

Table 8. Risks and Risks Management

Risks	How Managed
Weavers access their wool and other inputs independently	The Project will assist those weavers in accessing quality inputs and linking the weavers with cut and wash and exporters that market branded Afghan carpets directly to the international buyers
Availability of water for cut and wash	Water wells may need to be drilled by cut and wash operators
Willingness of carpet traders to keep the carpets in Balkh for cutting and washing and marketing versus exporting to Peshawar with existing arrangement	The Project will identify international buyers willing to buy direct from Balkh and assist the cut and wash investors and carpet exporters access necessary inputs and efficient and cost effective international shipping arrangements from Balkh

²⁶ MRRD. 2007. *Feasibility Study for Carpet Subsector Plan: Operationalizing Cut and Wash Facilities. Subsector Analysis and Business Plan Development/ North and Northeast/Economic Viability and Technical Feasibility.*

²⁷ Landell Mills, Ltd. 2007. *Preparing the Commercial Agricultural Development Project, Main Report, Phase 2.* Asian Development Bank Project.

11.4. Financial Viability

The various value added activities in the wool portion of the carpet value chain are not high return activities. However, spinning wool by use of spinning wheels rather than by hand can provide women an opportunity to increase their incomes. Also, helping weavers buy their own looms gives them a chance to build equity in their trade and become more independent and able to buy their own inputs and sell their carpets through the Project assisted, local marketing agents with direct marketing opportunities.

A study is needed to determine the feasibility of wool scouring.

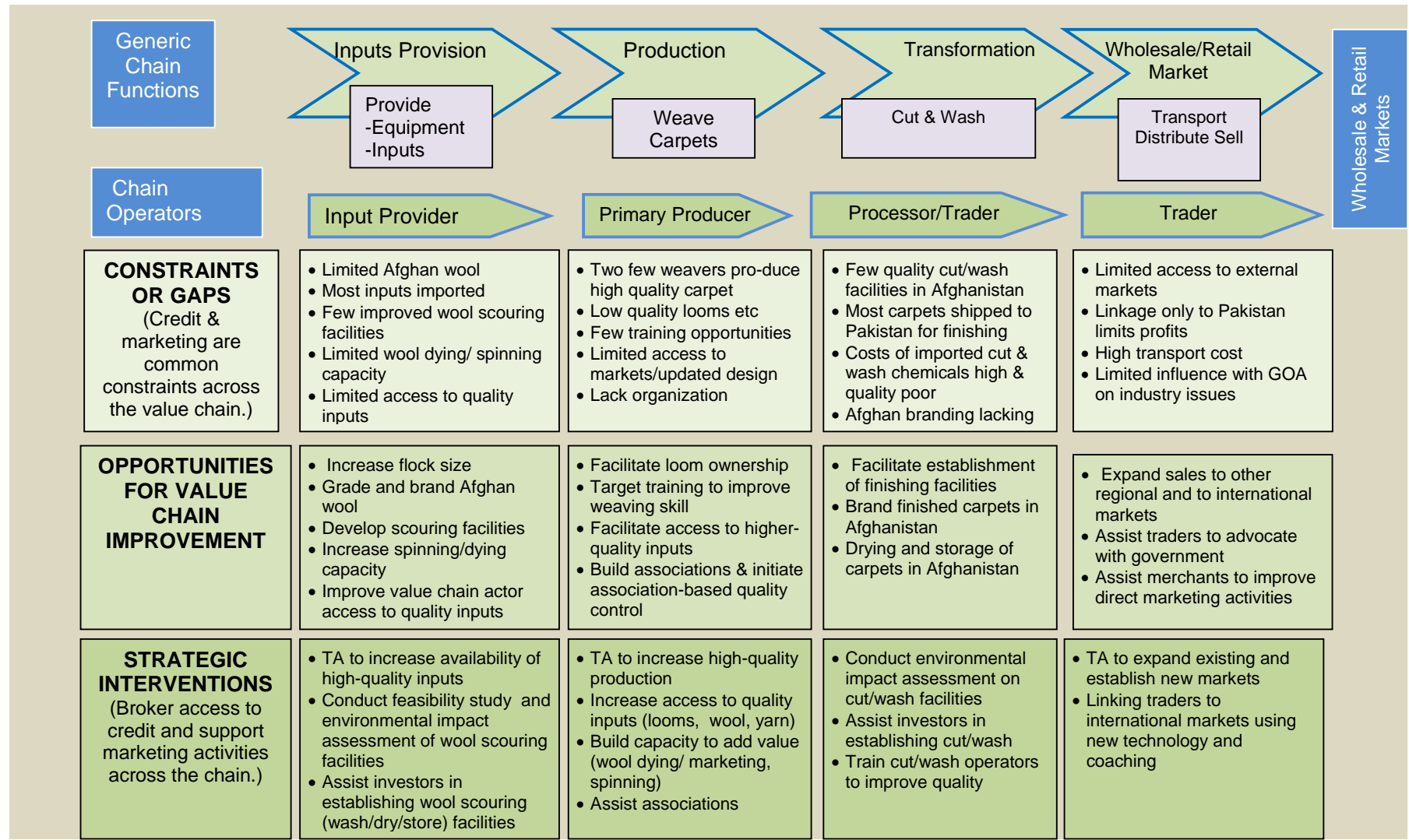
The return on investing in cut and wash facilities is high, assuming the difficulties in drying the carpets does not present a problem in the winter.

The marketing of carpets direct from Balkh to the international buyer is more expensive than the shipping cost from Peshawar to the international buyer. However, the extra costs incurred by Afghans in shipping containers of Afghan products through the Karachi port are likely to drop as trade barriers are pulled down as Pakistan comes under mounting pressure from the international community. Afghan carpets can enter the US without import duties, making Afghan carpets more competitive.

11.5. Environmental Issues

The feasibility for wool scouring will be accompanied with an environmental impact assessment. Similarly, an environmental impact assessment will be conducted before the Project supports the establishment of any cut and wash facilities. In both cases, mitigation measures will be needed to be put in place along with the investments.

ANNEX 1: VALUE CHAIN FOR BALKH CARPET



ANNEX 2: CREDIT MAP: BALKH CARPET²⁸

Financial Institution: ARMP (Afghanistan Rural Microcredit Program)

Provincial level:

of clients: 3,890 - \$2,360,674 outstanding

of clients in target districts

Dawlat Abad: 443 as of March 2008

Nahrishahi: 776 as of March 2008

Repayment rate:

Overall: 59.6%

Average Loan size: about \$670

Type of Lending: Groups of 4-8 people 15%, Individuals 85%

Group Loan Guarantee: Group

Individual Loan Guarantee: Personal guarantee, 3rd party guarantee, reference from Shura with promise to help in recovery.

Collateral: title deed or property: house or shop

Loan size (cycles):

First: \$500 maximum

Second +: up to \$3000

Loan Product Terms:

	Business Loans	Agriculture	Animal Husbandry
Minimum equity	50%	50%	50%
Grace period	1 Month	4-12 Months	4-8 Months
Term	4-12 Months	6-24 Months	6-24 Months
Interest rate: Flat	1.3%	1.3%	1.3%
Payments	Monthly	Monthly	Monthly
# of clients	617	152	3,111
Value outstanding	\$350,756	\$131,000	\$1,866,871

* Previously had housing loans but cancelled, 10 loans remain outstanding with a value \$12,048.

Other information:

Loan officers come from district in which they work

Financial Institution: BRAC

Provincial level:

of clients: 25,340 - \$3,907,053 outstanding

of clients in target districts

Dawlat Abad: 643 as of March 2008

Nahrishahi: 2,819 as of March 2008

Repayment rate:

Overall: 96.7%

Average Loan size: about \$188

²⁸ Where possible the numbers provided by the MFI were checked against those reported to MISFA. Where different the MISFA numbers were used.

Type of Lending: Individuals with group guarantee (15-35 with subgroups of 5) and individuals

Individual Loan Guarantee:

Collateral: In some cases land title, shop, license

SME loans require a guarantor

Loan size (cycles):

	Poverty Alleviation	Agriculture	SME
First:	\$20	\$300	\$1,000 maximum
Increments	\$1-200	\$1-200	\$variable
Maximum	Urban \$600 Rural \$500	\$1,000	\$10,000

Loan Product Terms:

	Poverty Alleviation	Agriculture: Crops, Livestock	SME
Minimum equity	5%	24%	
Grace period	0	0	0
Term			
1 st	6 Months	6 Months	1 year
2 nd	9 Months		
Admin: Flat	17.5%	17.5%	17.5%
Payment	47 over 1 year	47 over 1 year	Monthly
# of clients	N/A	N/A	N/A
Value outstanding	N/A	N/A	N/A

Other information:

Branch office organizes 2 village groups of 15-35 members in each village. One group is for poverty alleviation loans and the other for agriculture loans. Each group is broken down into small groups of 5. The group acts as the initial credit committee – two sign as witness to loan contracts. Each small group has a leader. These people manage the small group and make up the management of the village organization.

When a person joins they must commit to save a specified amount weekly. 6% interest is paid on the savings. 5% of the loan size must be in savings. Up to 15% of savings may be withdrawn for emergency purposes.

The agriculture extension side of BRAC provides training to crop and livestock borrowers.

Financial Institution: FINCA

Provincial level:

of clients: 6,511 - \$ 652,950 outstanding

of clients in target districts

Dawlat Abad: 0 as of March 2008 Closed operations had 157 clients

Nahrishahi: 0 as of March 2008 Closed operations had 665 clients

Repayment rate:

Overall: 56.3%

Average Loan size: about \$161

Type of Lending: Groups of 10-40 (women's group), 3-10 (market group), and Individuals

Group Loan Guarantee:

Group

Before borrowing group members must save 2% of the future loan. This amount is used by the group as insurance against a member's default.

Pledge of moveable and immoveable assets

Community leader reference letter.

Individual Loan Guarantee: Can qualify only after two successful cycles in group and reference of neighborhood or village Shura.

Collateral: 120% of loan and can include consumer items and title deed or property: house or shop

Loan size (cycles):

Women's Group	Market Group	Business
First: \$160	\$400	\$1,200 maximum
Second: \$300	\$700	\$800-5,000
Third: \$500	\$1,000	
Fourth: \$800		
Average Loan size: about \$300		

Loan Product Terms:

	Women's Group	Market Group	Individual Business
Minimum equity	70% of inventory	70% of inventory	N/A
Grace period	0	0	0
Term			
1 st	6-9 Months	5 Months	6-9 Months
2 nd	6-12 Months	6-10 Months	6-12 Month
3 rd	6-12 Months		Up to 18 Months
Markup: Flat	2-3%	3%-5 Months 2.33%- 6 Mo's 2%- 8 Months 2%-10 Mo's	2%
Payment			Biweekly
1 st	Biweekly	Biweekly	
2 nd	Monthly	Monthly	
# of clients	N/A	N/A	N/A
Value outstanding	N/A	N/A	N/A

Other information:

Primary market is urban.

Use Sharia compliant Muragahah loan methodology.

Markup on delinquent loans cannot be compounded.

Administration costs are included in markup.

For client performance, FINCA has a three tier rating system.

FINCA buys the produce and sells to the client at cost plus markup.

Looking at SME and housing renovation loans and may start in 4th Qtr 2008 or early 2009.

Financial Institution: FMFB (First Microfinance Bank)

Provincial level:

of clients: 9,937 - \$7,165,335 outstanding

of clients in target districts: N/A works in urban areas only

Average Microfinance loan: \$251

Average SME loan: \$ 15,492

Repayment rate:

Overall: approximately 00%

Type of Lending: Microfinance: group and individuals SME: Individual

Loan size (cycles):

	Microfinance	SME
First:	\$200-1500	\$3,000-30,000
Maximum	\$5,000	\$50,000

Loan Product Terms:

	Microfinance	SME
Minimum equity	5%	
Grace period	0	0
Term	4-12 Months	6-36 Months
Interest	15% Flat	15% Flat short term 20.4% Declining medium term
Payment	Monthly	Monthly
# of clients	6,522	49
Value outstanding	\$6,462,479	\$759,138

Other information:

Most of the microfinance loans are to retailers and for handicrafts. Other areas are services and transportation.

Most SME loans are traders as well as manufacturing and services.

Financial Institution: OXUS (Sponsored by ACTED)

Provincial level:

of clients: 2,643 - \$460,270 outstanding

of clients in target districts

Dawlat Abad: 0 as of March 2008

Nahrishahi: 0 as of March 2008

Repayment rate:

Overall: approximately 74.15%

Average Loan size: about \$192

Type of Lending: Individuals with group guarantee and individuals

Individual Loan Guarantee:

Collateral: In some cases land title, shop plus two personal guarantors who are local leaders

Loan size (cycles):

	Group	Individual
First:	\$100	\$50
Up to 20 cycles	\$600	\$500

Loan Product Terms:

	Group	Individual
Minimum equity	50%	50%
Grace period	1 month	0
Term	6 Months	12-18 Months
Admin: Flat	18%	18%
Payment	biweekly	Monthly
# of clients	3,100	300
Value outstanding	\$410,000	\$240,000

Clients by activity: Agriculture 66, livestock 54, handicraft and manufacturing 72, trade and services 2448.

Other information:

Group loans are made up of groups of 5. The group receives the loan with allocations to each individual.

Have two branches in Mazar. One is being restructured due to corruption.

Although primarily in the city some groups on the fringe. Agriculture activities are encouraged

Financial Institution: WOCCU (Islamic Investment and Finance Cooperatives)

Provincial level:

of clients: 3,482 - \$610,804 outstanding

of clients in target districts

Dawlat Abad: 0 as of March 2008

Nahrishahi: 10 as of March 2008

Repayment rate:

Overall: approximately 99.35%

Average Loan size: about \$484

Type of Lending: Individuals

Individual Loan Guarantee: Character reference Shura, mullah, trade union or mayor, cash flow analysis.

Collateral: In some cases land title

Loan size (cycles):

All loan products are the same except government employees' loan has a maximum of 35% of annual salary

First: \$500 maximum

Open there after to 20% of the loan portfolio but usually not over \$3,000. Normal maximum is \$1000

Loan Product Terms:

	Business: Trade, Service, Manufacturing	Agriculture: Crops, Livestock	Government employees salary loan
Minimum equity is called pledge savings	24%	24%	
Grace period	0	0	0
Term 1 st 2 nd	6 Months 9 Months	6 Months	1 year
Admin: Declining	2%	2%	2%
Payment	Monthly	Monthly	Monthly

# of clients	1632	733	0
Value outstanding	\$1,079,175	\$589,280	0

Other information:

Membership is 100 Afs (\$2)

Share capital to get a loan is 1,000 Afs (\$20)

Use Sharia compliant Muragahah loan methodology.

Markup on delinquent loans cannot be compounded.

Administration costs are included in markup.

WOCCU buys the produce and sells to the client at cost plus administration costs.

Loans above \$1,000 require WOCCU to be at the credit committee meeting.

All savings are referred to as either active share savings or term share savings.

As part of the ARIES project the first year and a half of operating costs are paid by the project. Thereafter the credit union must be sustainable and cover all of its operating costs.

For the present time profit is put back into primary capital.

All cost of capital (8%), operating expenses (10%) and profit (4%) are included in operating costs.

Interest on savings is 7.5-8%

Staff turnover is low except for Balkh.

SME/Commercial Banks and NBFIs

Financial Institution: BRAC Bank

Provincial level: Unit Office with full branch planed for 2008

of clients: 77 - \$526,000 outstanding

of clients in target districts

Dawlat Abad: 0 as of January 2008

Nahrishahi: 0 as of January 2008

Repayment rate:

Overall: 82%

Province: 100%

Type of Lending: Enterprises

Enterprise Loan Guarantee: 3rd party guarantee from 3-5 people.

Collateral: title deed or property: house or shop preferably registered but will accept unregistered

Loan size:

\$10 – 30,000 Development Loan

\$4 – 10,000 Double Deposit Loan

\$4 – 30,000 Medical (licensed hospitals, clinics and pharmacies)

\$4 - 10,000 SME

Loan Product Terms:

	Development	Double Deposits	Medical	SME
Minimum equity	25% of inventory	25% of inventory	25% of inventory	25% of inventory
Grace period	0	0	0	0
Term	3-12 Months	3-12 Months	3-12 Months	3-12 Months
Interest rate: Flat	20%	20%	20%	20%
Payments	Monthly	Monthly	Monthly	Monthly
# of clients	N/A	N/A	N/A	N/A
Value outstanding	N/A	N/A	N/A	N/A

Other information:

BRAC Bank is strictly urban

Forced savings of 1,000 Afs per 2,000 Afs borrowed per month.

Service charge of 1%

Centralized credit approval. In unit offices client must open an account in Kabul Bank which is used for disbursement and repayment. The client signs standing order for up to 12 months to transfer payments to BRAC Bank.

Afghanistan International Bank (AIB)

AIB's SME loans range from \$30-300,000²⁹. They do not normally lend to start ups. 3% of the loan portfolio is in agriculture. AIB does not have a minimum equity requirement. They use the debt/servicing ratio of the cash flow.

Afghanistan Finance Company (AFC)

Minimum equity on leases is 20%

Afghanistan Rural Finance Center (ARFC)

Minimum equity: 50% of total project

Azizi Bank

Minimum equity: 25% is the minimum but 30% is the actual minimum. Azizi does very little lending outside of Kabul.

Banke Millie

In 2006 Banke Millie, in cooperation with MAIL, lent approximately \$2 million to cooperatives for fertilizer. Apparently there were 2-3 cases of cooperatives being formed to obtain the financing. Many of the farmers treated the loans as grants and the repayment rate, although not disclosed, was very bad. The bank is reluctant to lend for agriculture without some sort of a 50/50 cost sharing. Banke Millie has four loan products: agriculture, construction, industry and microfinance. The loan description is as follows. Agriculture loans have two types – microfinance (\$100-5000), and larger loans (\$5000 and above) backed by strong collateral or personal guarantees. Both types of loans have a 1 year term with 12% interest. Construction loans also have two types – microfinance (up to \$10,000) and larger loans \$10,000 and above). Both loans have a 1-

²⁹ DAB requires audited financial statements for any company to whom a bank lends \$250,000 or more.

5 year term and the interest rate ranges from 12-15%. Industrial loans start at \$10,000 and go upward. The term is 1-3 years and the interest rate is 12-15%. Microfinance loans range from \$100-5000. They have a 1 year term with interest rate of 12%. Banke Millie would not or could not provide the percentage of their loan portfolio made up by these products. Banke Millie is opening 6 new branches, planning on entering the leasing market and developing a Sharia compliant loan product because they believe that it will attract deposits.

Kabul Bank

Kabul Bank has a centralized lending system. A majority of their loans are overdrafts for working capital and trade finance. When they do make term loans the minimum equity is 30-50% with a 12 month term. The interest rate is 12-18% with the majority at 15%. To obtain a loan the client must have an account with the bank for a minimum of 6 months. Most loans are in the \$20-30,000 range.

National Bank of Pakistan

The National Bank of Pakistan has a \$20 million loan portfolio and lends at 12%. They would not provide a minimum equity number. The bank wants a soft loan of approximately 8% from ADB of which they would keep 1-2% interest and repay ADB. Alternatively the bank would like ADB to provide them with a loan guarantee mechanism. The bank does mostly working capital loans and only a few term loans. The term loans that they do provide are for 1 year because they do not have any long term deposits to match their lending.

Pashtany Bank

The Export Promotion Bank was merged into Pashtany Bank in August 2007. Pashtany Bank dropped the "Tejaraty" (Trade) from its name to become a full service bank. Pashtany Bank currently only lends for trade and construction. It has a proposal going to its board that it also lend into the agriculture sector. Term loans are for 1 year. Trade loans require as collateral fixed assets with documents registered with the Ministry of Justice. Collateral for trade loans must be 50-80% of the loan. Construction, agriculture and industrial loans will have a 1-3 year term with the minimum equity 50-70% and a 12% interest rate.