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“Most of Afghanistan’s mineral deposits are located in the southern and eastern regions of Afghanistan where the insurgency is the strongest. Both mining and security prospects could be jeopardized if communities become aggrieved and disaffected.”

Improving High-Value Resource Contracting in Afghanistan

Summary

- Afghanistan’s vast mineral wealth could contribute to state-building and sustainable development if mining contracts are fair, transparent and effectively monitored. Prudent management of mineral resources could trigger and sustain equitable economic growth and lay the foundation for lasting peace.
- Lessons from the award of exploration rights for the Aynak copper mines in 2008 point to gaps in Afghanistan’s contracting processes. Positive developments in Afghanistan’s finance and health sectors could be instructive.
- Improving contracting procedures, regulations and practices in Afghanistan’s mining sector could reduce the likelihood of conflict and improve prospects for sustainable economic development. This would reduce aid dependency, create a framework for enhanced transparency and accountability, improve the quality of investment inflows and help build communities that are stable and secure.
- In the coming months, Afghanistan could consider eliminating tied aid from resource contracts; using the Extractive Industries Transparency Initiative as a mechanism to improve transparency; augmenting local capacity with experienced experts to enhance processes for the award and monitoring, and prioritizing community involvement at all stages.
- Weak contracting processes in Afghanistan’s mining sector could become a conflict driver. It could fuel inequalities via corruption, exacerbate community tensions via land tenure issues and environmental damage, and undermine stability and security by rewarding potential spoilers.

Background

Afghanistan’s vast mineral wealth could contribute to state-building and sustainable development if resource contracts are fair, transparent and effectively monitored. The suggested value of known deposits—including copper, gold, iron ore, lithium and marble—could exceed \$1 trillion, according to recent estimates. The potential contributions to government revenue, job creation, technology transfers and related infrastructure could make the mining sector the “backbone of the Afghan economy,” according to Jalil Jumriany, an adviser to the Afghan Ministry of Mines.¹ The controversial award of the Aynak copper mines to the Metallurgical Corporation of China (MCC) in 2008 exposed some of the weaknesses in preparing, executing and monitoring extractive industry contracts in Afghanistan. Contracting in Afghanistan’s mining sector lags other sectors, like finance

and health, in which progress has been made in improving transparency and enforcing accountability.² Lessons from these sectors could benefit contracting in the mining sector.

Afghanistan's Minerals

Afghanistan's vast mineral deposits are no recent discovery. In 1957, the Soviet Union signed a technical assistance agreement with Afghanistan to explore the country's mineral wealth, and in the mid-1980s, it provided assistance to develop these resources, which included substantial deposits of high-grade iron ore in Bamiyan province and copper in Logar province.³ More recently, American geologists also found lithium to be among the most promising reserves that could make Afghanistan the "Saudi Arabia of lithium."⁴

Afghanistan's mining sector has the capacity to be a veritable engine of growth that could move the country away from aid dependence and put it on a path toward self-sustained economic development. However, for this to materialize, Afghanistan's contracting processes and practices must improve.

Lessons from the Aynak Process

The Aynak copper deposit in the Logar province, located in eastern Afghanistan, is considered world class and one of the largest unexploited copper deposits in the world. Russian development drilling indicated a resource of at least 230 million tons of material with copper content averaging 2.3 percent.⁵ In 2008, Afghanistan's national budget was \$650 million, and international experts estimated that royalties from the Aynak mine alone could add more than \$200 million to the Afghan national budget each year. Additionally, an estimated 30,000 new jobs could be created, and a 400-megawatt power plant could be constructed, along with infrastructure development in surrounding areas to facilitate transportation of workers and materials.

The scale of the international tender process was unprecedented in Afghanistan. The government had neither the capacity nor the institutional or regulatory framework to oversee the process effectively. Added to this was the seemingly pervasive nature of corruption in public and private life. The Afghan government and the World Bank attempted to address these problems by creating an Evaluation Committee to appoint an independent body, or a Transaction Adviser, to oversee the tender process. The U.S.-based Gustavson Associates was selected to serve as the Transaction Adviser.

While some observers, like the World Bank, believe the Aynak tender process met international standards in spite of a few shortcomings, others view it as inherently flawed. They argue that the failings have reinforced a culture of corruption and impunity, which could constitute a reputational risk for Afghanistan. They describe the process as opaque, with too much discretionary authority vested in government officials. It must, however, be noted that open-source evidence of malfeasance is difficult to find.⁶ Another issue raised by critics is that the bidding process and documentation were not standardized. The winning bid apparently contained substantial amounts of development assistance and sovereign guarantees. Issues related to the contracting process, contract execution and the monitoring of contractual obligations are detailed below.

Improving the Contracting Processes

Strengthen the institutional framework: Although the Afghan government received significant technical assistance for the Aynak process, decision-making was highly centralized and opaque. Subsequent efforts to enhance transparency and publish tender details must be reinforced and

institutionalized at both national and provincial levels. Publicizing clear procedures and regulations for all investors would help reduce uncertainty. In the short term, devolving some authority for a more open tender process could be part of a comprehensive strategy for institutional strengthening.

Address corruption: A weak regulatory framework and limited oversight reduced transparency during the Aynak tender process. This opaqueness undermined trust and led to allegations of wrongdoing.⁷ In his capacity as chairman of the Evaluation Committee, the minister of mines is believed to have restricted information flows and prevented the publication of the terms of the various bids, as required by international practice. Furthermore, inter-ministerial review meetings were held behind closed doors, and deliberations and decisions were off-the-record.

Level the playing field: Inadequate standardization in the Aynak bidding process gave some investors an unfair advantage over others. The MCC bid included development projects which many observers believe could be part of Chinese foreign assistance packages. This boosted the MCC bid significantly; they outbid the second place bidder by almost \$1 billion.⁸ On the other hand, bids from other investors did not reflect development assistance from their host countries. Furthermore, the relative benefits of training facilities offered by some bids versus health facilities offered by others were difficult to quantify. Developing a set of standardized (and enforceable) parameters for potential investors could help level the playing field.

Execution of Extractive Contracts

Building institutional capacity: Afghanistan's Minerals Law requires that the Afghan government conduct due diligence of the bidders. Unfortunately, Afghanistan's key oversight bodies do not have the capacity to oversee the execution of a wide range of mining, financial, economic, social, labor, economic and environmental obligations relating to the Aynak contract. Taking steps to augment capacity via technical assistance in the short term, while developing a cadre of qualified and motivated Afghans over the longer term could help address this gap. Finding the right international experts for these challenging technical assistance slots would be difficult, primarily because most subject matter experts lack vital contextual knowledge (as illustrated by the Aynak process).

Land compensation: Land compensation is another issue that comes into play during the execution of the contract. According to Lorenzo Delesgues of Integrity Watch Afghanistan (IWA), the government of Afghanistan left many details regarding land compensation in the Aynak copper deal to the MCC, which has little incentive to properly address social and land tenure issues in this part of the country.⁹ IWA's social surveys reveal simmering tensions in mining communities related to land compensation issues. Most of Afghanistan's mineral deposits are located in the southern and eastern regions of Afghanistan where the insurgency is the strongest. Both mining and security prospects could be jeopardized if communities become aggrieved and disaffected.

Monitoring Resource Contracts

Revenue transparency: There has been some progress in addressing revenue transparency in Afghanistan. The country registered its candidacy for Extractive Industries Transparency Initiative (EITI) compliance in February 2010. In doing so, Afghanistan is committed to abiding by the internationally-agreed EITI standards for revenue reporting and transparency. The required institutional reforms are expected to be in place within two years. Afghanistan could demonstrate its avowed commitment to eradicating corruption by requiring all mining companies to also make their data public. Furthermore, transparency measures adopted at the national level should be mirrored at provincial and community levels.

Overseeing contractual obligations: In addition to financial obligations, monitoring mechanisms could be developed to ensure that investors meet all their contractual obligations, particularly those relating to the use of domestic labor and services, and environmental protection. Routine assessments by a designated, third party ombudsman should be publicized. Programs could also be introduced to upgrade skills in the labor market and facilitate the development of a service sector that could support the mining industry.

Minimizing adverse social impacts: Monitoring the social impact of mining will help alleviate tensions between local communities and the national government. Evidence suggests that community level monitoring and reporting are especially effective. This is particularly true in Afghanistan, where the National Solidarity Program (NSP) has proven to be quite successful.¹⁰ Local leaders should be engaged from the start of the tender process. This engagement should continue in various aspects of monitoring and evaluation throughout the life of the mine. This would improve effectiveness, promote community buy-in and limit social tensions.

Protecting the environment: Under the Environment Law of Afghanistan, it is mandatory for mining companies to acquire permits from the National Environment Protection Agency (NEPA) before commencing operations.¹¹ Nonetheless, in the Aynak copper deal, the MCC began operations before the under-resourced NEPA began monitoring the environmental impact of the operations. There are still no baseline studies, or publically available vulnerability assessments, or environmental impact assessments.

Recommendations

Improving contracting procedures, regulations and practices in Afghanistan's mining sector could reduce the likelihood of conflict and improve prospects for sustainable economic development. In order to accomplish this, the Afghan government, the Afghan people and Afghanistan's international partners could consider the following recommendations:

- 1. Take immediate steps to level the playing field:** All stakeholders should support initiatives to standardize the bidding process so that all bids are evaluated on the same terms. Every effort must be made to avoid tied aid, while allowing firms some flexibility to support and strengthen mining bids.
- 2. Take credible steps to improve transparency and reduce corruption:** Ongoing multi-stakeholder initiatives, such as the EITI, should receive sustained political and financial support. The Afghanistan government should be held to its commitments. Initiatives like the EITI help depoliticize issues like corruption and waste.
- 3. Prevent resource exploration from outpacing capacity and infrastructure:** Concerted international support for knowledgeable and competent advisers could be a short-term response to the problem of lack of capacity. Programs to train and retain Afghan professionals should be prioritized.
- 4. Support initiatives that promote community sensitization and participation:** International partners should increase their financial and political support for NSP, which could be expanded to resource rich provinces, and include forums in which populations affected by extractive projects could voice their grievances as well as their recommendations.
- 5. Prioritize initiatives that enhance sustainable administrative transparency:** By improving the company registration process, increasing the use of electronic banking, and building the capacity of Afghan media to understand and report on illegitimate business transactions, the Afghan public and business communities will be better able to identify corruption and counter it in their own self-interests.

ABOUT THIS BRIEF

The United States Institute of Peace hosted a panel discussion on "High-Value Resource Contracts, Conflict, and Peace in Afghanistan" in Washington, D.C. on July 14, 2010 to examine contracting challenges in Afghanistan's mining sector and to propose a set of remedial measures. The panelists were: Scott Worden, senior rule of law adviser at the U.S. Institute of Peace; Graciana del Castillo, senior research scholar at Columbia University and author of "Rebuilding War-Torn States"; and James Yeager, former adviser to Afghanistan's Ministry of Mines and author of "The Aynak Copper Tender: Implications for Afghanistan and the West." Raymond Gilpin, associate vice president of USIP's Sustainable Economies program, moderated the event. This report does not necessarily represent the views of the panelists or USIP.

Endnotes

1. James Risen. "U.S. Identifies Vast Mineral Riches in Afghanistan." *The New York Times*, June 13, 2010. This article suggests a guesstimated value. More precise valuation will only be possible after the resources are developed.
2. According to the World Bank's 2010 Public Expenditure Review, Afghanistan's Public Financial Management system has undergone a structural transformation, especially at the Ministry of Finance. This is confirmed by a significant improvement in the Public Expenditure and Financial Accountability (PEFA) indicators. See: World Bank, "Afghanistan: Public Expenditure Review 2010," Report No. 53892-AF (April 2010). Improvements in contracting in Afghanistan's health sector are documented in: Michael McDowell. "A Tale of Two Countries: Contracting for Health Services in Afghanistan and Congo (DRC)." *The World Bank* (February 2010).
3. Richard F. Nyrop and Donald M. Seekins. "Afghanistan Country Study." *Foreign Area Studies*, The American University: January 1986.
4. Paul Fitzgerald. "Afghanistan: The Saudi Arabia of Lithium?" *OpEd News*. 23 June 2010. <http://www.opednews.com/articles/Afghanistan-the-Saudi-Ara-by-Paul-Fitzgerald-100622-167.html> (accessed 05 August 2010)
5. Minerals in Afghanistan: The Aynak Copper Deposit. Report prepared by the Ministry of Mines and Industry, Kabul, Afghanistan. http://www.bgs.ac.uk/afghanminerals/docs/aynak_a4.pdf (accessed 05 August 2010)
6. Substantiating high-level corruption in Afghanistan is difficult and the weak judicial system does not help. However, the subsequent removal of the then minister of mines was viewed by many as vindication of their claims.
7. Joshua Partlow. "Afghan Minister Accused of Taking Bribe." *The Washington Post*, November 18, 2009.
8. James R. Yeager. "The Aynak Copper Tender: Implications for Afghanistan and the West." *Skyline Laboratory and Assayers*, 2009.
9. Lorenzo Delesgues et al. "Community Monitoring Mechanisms for Responsible Mining in Afghanistan." *USIP Special Report*, September/October 2010.
10. Afghanistan's National Solidarity Programme (NSP) was created in 2003 by the Ministry of Rural Rehabilitation and Development to develop the ability of Afghan communities to identify, plan, manage and monitor their own development projects. See: <http://www.nspafghanistan.org/> (accessed 05 August 2010)
11. Islamic Republic of Afghanistan Environment Act, Article 89.



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