



POLICY BRIEF

AVOIDING THE RESOURCE CURSE: EXTRACTIVES, CORRUPTION, AND CONFLICT IN AFGHANISTAN

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Extractive resources are one of the few major potential sources of new development and government revenue in Afghanistan, and hopes for economic growth implicitly rely on the sector. But without urgent action, it is likely these resources will instead do great harm, driving corruption and conflict on a national scale.

As President Ashraf Ghani has noted, the country is at enormous risk of falling victim to a ‘resource curse’. Indeed, in many respects it already has: minerals are the second largest source of Taliban funding, and mining is driving instability from Badakhshan to Helmand.

There are practical, realistic and effective reforms that could do much to reduce this clear and present danger – but many have yet to be put in place. President Ghani has made notable and encouraging commitments to reform, but many have yet to be implemented, and donors have generally failed to make the issue a priority. While there are no silver bullets, just a half-dozen key measures could greatly increase the cost of abuses (see list on p 5). There is still hope that the threat hanging over Afghanistan can be avoided, and that its natural riches can fulfill their promise, but only if there is the will and energy to act decisively.

A TREASURE OR A POISON?

Much hope has been invested in Afghanistan’s extractive industries as a potential source of revenue and development. Indeed, IMF projections for an increase in Afghan GDP rely on the sector expanding.¹ Managed responsibly and transparently, the sector can help fund the Afghan budget, increase independence from foreign aid, spur economic growth, and directly

contribute to building roads, railways and other infrastructure. With foreign assistance decreasing and conflict intensifying, extractives are critical to the future of the country.

But the reality is that extractives are instead a major driver of corruption and conflict around Afghanistan, fund armed groups and the insurgency, and provide minimal revenue to the government. Minerals are being fought over from Herat to Helmand, empowering warlords and alienating communities from the government.² Badakhshan is a particularly powerful example: illegal lapis mining provided tens of millions of dollars to armed groups in 2014, according to rough estimates, and as of May 2016, more than 50% of the mine revenues were going to the Taliban.³ (Lapis production has likely declined significantly since then, but illegal mining continues.) Overall, mining is the Taliban’s second largest source of funding,⁴ and there is evidence that it is of special strategic interest to the Islamic State.⁵

Meanwhile, the Afghan government declared revenues from the whole extractive sector of just \$20m in 2013 – around 1% of total revenues.⁶ Other and more recent estimates put revenues at around \$36m-\$40m, but even so, this means the government’s declared revenue from mining, oil and gas was only a few times greater than the revenue illegal armed groups made from lapis mining in one area of Badakhshan.⁷ Overall, the rough estimate is that \$300m a year in revenue is lost to illegal mining – possibly a conservative figure.⁸

There are extensive reports of mining contracts being exploited by local strongmen or awarded through political influence. Even major contracts like the Mes Aynak copper project, the largest commercial contract

in Afghan history, have been controversial, and so far produced little of the benefits they promised.⁹

Finally, abuses around extractive resources disproportionately harm women in Afghanistan. They directly drive conflict, and fund armed groups and political actors who often undermine the position of women and directly abuse them. They divert the revenues which might fund social investments like education, infrastructure and health, which are disproportionately important to the position of women, to the private pockets of political actors and armed groups. And extractives create direct social and environmental impacts which disproportionately affect women, such as water pollution, out-migration of men, and increased criminality.¹⁰

Afghanistan's extractive resources are desperately needed if the country is to become more prosperous and self-sufficient. Yet at present they are not only failing to fulfill their promise, but instead are a major driver of instability and poverty in the whole country. In face of this threat, there has been a failure to fully recognize the threat and systematically put in place the measures that might help to counter it.

EXISTING COMMITMENTS

Afghanistan has made repeated commitments in international fora to meet and exceed international best practices for the sector, including becoming fully compliant in the Extractive Industry Transparency Initiative (EITI).¹¹ The 2012 Tokyo conference set out a commitment to develop a Framework to govern natural resources "through an accountable, efficient and transparent mechanism which builds upon and surpasses international best practices."¹² The Afghan government also committed at the 2014 London Conference on Afghanistan to "putting in place the strongest possible available measures, based on international best practice, to counter the threat of conflict and corruption around the extractive industries."¹³ Other commitments were made at a May 2016 anti-corruption conference in Kabul.¹⁴

At the London Anti-Corruption Summit in May 2016, the government committed to several substantive governance reforms relevant to extractives, including a public register of beneficial ownership.¹⁵ At the October 2016 Brussels conference, the government committed to presenting amendments to the mining law, including key elements of best practice such as

contract publication as condition of validity. Their 2017 Anti-Corruption Strategy contained full or draft commitments to a single transparent extractives account, contract publication as a condition of validity, and other measures. Transparency is the first principle set out in the government's Mining Sector Road Map.¹⁶

These commitments are welcome, and deserve support: they indicate genuine will for reform from within the Afghan government. Indeed, the government has begun to put some of these commitments into action, such as publishing the Mes Aynak copper contract and other documents.

Nonetheless, there are a number of basic safeguards, including some routine elements of international best practice, which have yet to be implemented, or in some cases even committed to. Critically, most of these do not require substantial additional administrative capacity or investment. The current Mining Law in particular has important gaps: it is under review, but it is still unclear what reforms will be included.

OPPORTUNITIES FOR CHANGE

There are many possible reforms to the sector based on international best practice, adapted to Afghan conditions. Their specific form is important: for example, a requiring contract publication would likely be ineffective alone, but very powerful if it was made a condition of contract validity. See our website for more details, but the most important measures include:

Require publication of production and payment data, backed by a mandatory single transparent sub-account for all natural resource payments

This is a key tool that makes illegal extraction and loss of revenue much more visible – allowing politicians, media and civil society to bring effective pressure to bear. The law should be amended to require that the Ministry of Mines and Petroleum (MoMP) and extractive companies disclose payment and production figures – including the amount and quality of material that is mined, and all payments between companies and the government, broken down to project level to allow it to be traced to specific mines.

But critically, this needs to be backed up by a strong mechanism for implementation. The government should establish a single, transparent and public account for all natural resource payments to and from

companies or individuals – including license payments, royalties, bonuses and profits from State Owned Enterprises (SOEs). This is in line with established precedents like the widely-praised South Sudan Petroleum Revenue Management Act.¹⁷ A legal requirement for payments to be made to this account in order to be accepted would ensure absolute clarity about revenues, while making minimal demands on administrative capacity.

One concern is to avoid undermining the primacy of the government's Treasury Single Account (TSA), which could open up opportunities for corruption. That can be addressed by using a sub-account of the main TSA.¹⁸ Further details are available in a separate briefing.

Make contract publication a condition for validity

Contract publication is vital to transparency and accountability. A 2012 presidential decree mandated publication of mining contracts, and hundreds more were published in late 2017 – but these are one-off measures. At least one contract linked to possible abuses has not been published.¹⁹ A much stronger mechanism would be to change Afghan law to stipulate that contracts only become valid after they are made public. This would be an almost foolproof safeguard, creating a strong incentive for publication, and making clear that contracts that were not public were illegal. Indeed, the measure should be applied across state procurement (with tightly defined exceptions for the most sensitive security-related contracts).

Publish beneficial ownership

Much extractive sector corruption in Afghanistan – as elsewhere – involves well-connected figures using illegitimate influence to secretly control contracts, often through third parties. The current Mining Law excludes some senior officials from direct or indirect benefit from a mining license, but those not listed notably include Members of Parliament and members of the security forces.²⁰ For this reason the law should require companies to publish their ultimate beneficial ownership (that is, the real individuals who exercise significant control or gain significant benefit from a concession).

Beneficial ownership publication is required under the EITI, and many countries are in the process of implementing it.²¹ In May 2016 the Afghan government

committed to a public register of beneficial ownership – an important and welcome step. But as the government itself acknowledges, implementation will be challenging. For the reform to be fully effective, Afghan law should be amended to require that companies applying for government contracts (including extractive sector licenses) publish beneficial ownership information; to set out clear penalties for hidden ownership; and to publicly define who is forbidden from beneficial ownership, including a wider named group of Politically Exposed Persons (PEPs). The government could collect and publish beneficial ownership data as part of the licensing of enterprises – a straight-forward means of collecting details without incurring major new costs or bureaucracy.

Require audits for medium and large companies

A further critical support would be to require medium and large-scale extractive companies and all SOEs to publish audits of their accounts at least annually, independently carried out to international standards. This is a basic requirement for listed companies in many parts of the world, but not so far in Afghanistan.

Strengthen bidding processes

The government has made progress in reforming procurement, but more could be done. In particular, they could amend Afghan law to further entrench transparent and fair contracting processes – including for example requiring publication of the substance of losing bids, public criteria for eligibility, legal penalties for preferential treatment and incorporation of the principles of Open Contracting.²² At the May 2016 anti-corruption summit Afghanistan committed to initial work on Open Contracting. Ideally this should extend to allowing public scrutiny of medium and large contracts before finalisation. These standards should be applied across government procurement, but especially to natural resource contracts.

Protect against common sources of revenue loss

Afghan law should include strong protections against the most common sources of revenue loss visible in other resource-rich countries. For example, transfer pricing and the manipulation of debt to equity ratios are commonly used to reduce tax liability. While the current Mining Regulations include some protections, the Mining Law has almost nothing – an oversight which puts it at odds with best practice.

Move to a license system – and use model contracts

Moving to a license rather than contract-based system would entrench key terms and protections for contracts in the law, greatly reducing opportunities for corruption. In the interim though, model contracts can help entrench best practice. The government should commit to using strong model contracts, incorporating international best practice against corruption and conflict, as the basis for contract negotiations. To ensure they are effective and legitimate, they should be openly developed in consultation with civil society, business and other stakeholders. This would also reduce the risk that contracts may be challenged later, and increase the public legitimacy of extractive deals.

Enable community monitoring and benefit

Community monitoring has had good results when applied to aid projects. It strengthens oversight and reduces corruption and conflicts, while making minimal demands on government capacity. It can also particular help give women a greater voice. IWA has already run a pilot community monitoring program for extractives: the Afghan government should now take the lead to roll the practice out across the sector.

A key part of this is to ensure communities have some incentive to support legal extraction and to fight corruption. To do this, the Afghan government should consider providing local communities with a specific, small percentage of the legal revenue the government receives from a mine, something which could be integrated within the existing requirement under the Mining Law that 5% of mining revenues be returned to local government. This amount should be spent on projects that directly benefit the communities around the mining site. One way to ensure this happens, and to minimize additional costs and bureaucracy, would be to add the funds to the budgets of the local Community Development Councils (though additional safeguards against misuse might be needed).

This provision should be in addition to (not in place of) other community benefits provided through Community Development Agreements or other means. It should also be complemented by measures for community ownership of mining contracts, and for the legalization of artisanal mining – although both these require careful safeguards.

The Mining Law has some provisions for communities, but company obligations on service delivery and recruitment of local people (and not just Afghan citizens) should be clarified and strengthened. The government should also commit to including in the law a requirement for a dispute resolution process that is effective, timely, impartial, and accessible to all, and should strengthen requirements to consult communities before and during extractive projects.

Require supply chain due diligence

In conflict-affected areas with minimal government presence, supply chain due transparency can help restrict illegal extraction. The government and the major importing countries for Afghan minerals, oil and gas should commit to requiring that companies carry out risk assessment and due diligence on their supply chains, at a minimum to the standard set out in the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict Affected High Risk Areas, to ensure they do not fuel additional corruption or support armed groups.

Address the lack of capacity

The management and oversight capacity of the MoMP is limited, to the point that it is frequently unable to provide basic information on contracts, revenues and production, and is unable to provide adequate regulation or strategic direction. Both the government and donors have so far failed to address this, despite substantial expenditure. Flawed approaches to building capacity at the Ministry have failed to fill the gaps in its staff, but especially in its systems, oversight, and information management. The problem is especially serious at provincial level, where local offices have few financial and technical resources. Even at the central level the contributions of some major enterprises are unclear.²³ This basic issue deeply undermines efforts against corruption and tax evasion, and arguably makes it impossible for the government to responsibly oversee the sector.

Coherent, coordinated strategy and benchmarks

In terms of strategy, three things are needed if reform is to be effective. First is a coherent overall strategic approach, which explicitly recognizes that weak governance is currently the most important threat to the sector, and seeks to address that threat systematically. Expanding mining is a legitimate aim,

but the end goal is not to dig minerals out of the ground but rather to create a benefit for the Afghan people. Transparency, oversight and accountability are not obstacles to fulfilling the potential of the sector, they are an essential foundation for it.

Secondly, there needs to be better coordination among donors and government, so that the different elements of reform needed are systematically addressed. There have been some efforts on this front, but they have largely been ineffective. The government has yet to produce an overall strategic plan (in the form of the Extractive Industries Development Framework) that might guide government and donors, and donors have been very weak at coordinating their support.

Finally, there needs to be a focused, realistic and effective set of asks and mutual accountability for the Afghan government and donors. At a minimum, this should include an expectation that the government will be able to keep track of contracts, produce clear accounts for payments, provide effective inspection and oversight, and create and enforce clear, simple processes for major functions which increase automation and reduce the potential for abuse. An expectation that extractive revenues will increase could also be included. Donors for their part should be expected to provide coordinated and effective support. An 'compact for the mining sector' should be agreed to set out this common roadmap of reforms and commitments.

Prioritise security in extractive areas

Resources-rich areas are particularly prone to conflict, and security forces there are often tied to corruption and other abuses. The government and its allies face many demands on their capacity, but should commit to making the security of extractive areas a substantially greater priority than is currently the case.

But security forces in extractive areas are often a source of abuses in their own right – Badakhshan again being a key example.²⁴ The Afghan government should require that forces in these areas operate according to a higher standard of accountability and oversight. At a minimum this should incorporate the Voluntary Principles on Security and Human Rights, and requirements for consultation with local communities. Existing Mining Police units should be reviewed and

reformed to prevent the coming under control of political actors, as in Badakhshan.

SEIZING THE BRUSSELS MOMENT

There is a unique opportunity for reform since October 2016 through the implementation of the Brussels conference benchmark on extractives, in which the government committed to put in place governance reforms such as the publication of contracts as a condition of validity. The first focus of the government and donors should be implementing this commitment as strongly as possible.

A limited set of amendments to the law has the potential to have a major impact if they are drafted correctly. **The most important priorities include:**

- *Publication of project-level payment and production data, backed up by a single, transparent sub-account for all extractive payments, as a condition of receipt*
- *A public register of beneficial ownership of extractive companies, to be used as a condition of holding or applying for a contract*
- *A requirement for the publication of contracts as a condition of their validity*
- *Increase transparency in allocation of extractive contracts, including use of model contracts*
- *Published audits at least annually of medium and large scale extractive companies and SOEs*
- *Language to enable community monitoring of mining, and a community interest in its proceeds*
- *Provision for local (and not just Afghan) employment in mining projects*

Detailed suggestions for these amendments have been made by a coalition of Afghan and international civil society organisations (see websites below).

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ENDNOTES

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³ 'War in the treasury of the people', Global Witness, June 2016, pp 6-9 <https://www.globalwitness.org/en/campaigns/afghanistan/war-treasury-people-afghanistan-lapis-lazuli-and-battle-mineral-wealth/>

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⁵ 'War in the treasury of the people', pp 22-23

⁶ The government declared revenues from the extractive sector in 2013 of Afs 1.25bn, according to the latest report of the Afghanistan Extractive Industries Transparency Initiative – about \$20m at the time. That figure includes oil and gas as well as mining, and covers custom receipts, and covers revenue received by the Ministry of Finance as well as the Ministry of Mines and Petroleum. However it includes some but not all revenue from State Owned Enterprises, and another estimate in the same report puts the figure at around Afs 2bn. 'Inception Report and Fourth Conciliation Report', Afghanistan Extractive Industries Transparency Initiative, February 6, 2016, pp 6, 9

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⁷ The February 2016 EITI reconciliation report states that the Afghan government declared revenues from the extractive sector of Afs 1.25bn (\$22m) for 2013 (1392 in the Afghan calendar). That figure excludes some revenues from State-Owned Enterprises (SOEs). However, the same report also said that government and companies taking part in the EITI process had reported total extractive sector revenue for 1392 of a little over Afs 2bn (\$36m). The difference may

well be accounted for by the excluded SOE revenues, although this is not entirely clear. If we take the higher figure, lapis revenues to armed groups of up to \$20m would be a sum equivalent to around 55% of the government's total extractive sector revenues of \$36m. (If we took the lower figure, of course, it would be almost the same as total extractive revenues). In an email in April 2016, the then Minister of Mines Dr. Daud Saba stated that total revenues for 2014 were also about Afs 2bn, and those for 2015 were around \$35m-\$40m (a similar level). It was not possible to check the source of his figures, and it is possible that he was referring to the previous years (i.e. 2013-2014 and 2014-2015). 'Inception Report and Fourth Conciliation Report', Afghanistan Extractive Industries Transparency Initiative, February 6, 2016, pp 6, 9, 44, 59, 60, 85

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¹⁵ “Anti-Corruption Summit – London 2016: Islamic Republic of Afghanistan Country Statement”, Government of the United Kingdom, May 12, 2016
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/522697/Afghanistan.pdf

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¹⁷ Petroleum Revenue Management Bill, pp 8-9; 21-22
<http://www.eisourcebook.org/cms/February%202016/South%20Sudan,%20draft%20Petroleum%20Revenue%20Management%20Bill%202012.pdf> (While the text of the Act appears to be only available offline, the final version is not thought to have any material differences from the 2012 Bill).

¹⁸ The Afghan Customs Department (ACD) has 17 Inland Customs Depots and 11 Border Control Points in operation across the country.
<http://customs.mof.gov.af/en/page/1027>. Custom duties are collected through DA Afghanistan Bank branches established at these points. Traders pay their custom duties to intermediary accounts (all based in DA Afghanistan Bank) dedicated to collect custom revenue. These accounts eventually clear into Central treasury as Afghanistan constitution has commanded. Following electronic notification of a trader’s payment, the Da Afghanistan Bank branch at each customs office issues a payment

confirmation for each transaction and submits it to the customs office. Customs then issues an order to release the goods.

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