



## POLICY BRIEF

# THE BRUSSELS CONFERENCE AND EXTRACTIVES IN AFGHANISTAN: AVOIDING THE RESOURCE CURSE

Updated: August 2016

Natural resource exploitation has the potential to be a major source of development, economic growth, and government revenue for Afghanistan, but there is very serious risk that it will instead drive corruption and conflict on a national scale. The Afghan government and its international partners can both do much to decide which of these paths Afghanistan takes. The October 2016 Brussels summit in particular is a vital opportunity for the government and donors to set out a roadmap of practical, realistic and effective reforms, and to demonstrate their resolve to tackle this major threat. While President Ghani has made clear he sees reform as a priority, and has made some notable initial commitments, the comprehensive framework for the sector promised at the Tokyo summit in 2012 is not yet in place, and some basic transparency and oversight reforms have yet to be implemented.

## 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.<sup>1</sup> 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 the country, fund armed groups and the insurgency, and provide

minimal revenue. Minerals are being fought over from Herat to Helmand, empowering warlords and alienating communities from the government.<sup>2</sup> Badakhshan is a particularly powerful example: illegal lapis mining provided an estimated \$20m to armed groups in 2014, and as of May 2016, more than 50% of the mine revenues were going to the Taliban.<sup>3</sup> Overall, mining is the Taliban's second largest source of funding,<sup>4</sup> while the Afghan government declared revenues from the whole extractive sector of just \$20m in 2013 – just 1% of total revenues.<sup>5</sup> In other words, the government's declared revenue from mining, oil and gas is of roughly the same order as the revenue that illegal armed groups make from lapis mining in one small area of Badakhshan.

There are also extensive reports of 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 Afghanistan's history, have been controversial, and so far produced little of the benefits they promised.<sup>6</sup> Without better governance, the extractive sector will not only fail to fulfill its promise, but it will continue to be a major driver of instability and poverty for the whole country.

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).<sup>7</sup> The 2012 Tokyo conference set out a commitment to develop "an Extractive Industries Development Framework that governs Afghanistan's natural wealth through an accountable, efficient and

transparent mechanism which builds upon and surpasses international best practices.”<sup>8</sup> 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.”<sup>9</sup> Most importantly, at the London Anti-Corruption Summit in May 2016, the government committed to a range of substantive reforms, including a public register of beneficial ownership.<sup>10</sup>

These commitments are very welcome, and fully deserve support: they indicate genuine will for reform from within the Afghan government. However, despite this, there are nonetheless a number of basic safeguards, including some routine elements of international best practice, which have yet to be implemented, or in many 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: while it is under review, it is unclear what reforms will be included in that process.

## AN OPPORTUNITY FOR CHANGE

The 2016 inter-ministerial conference in Brussels is the critical forum to establish the mutual obligations of the Afghan government and its international partners for the next few years: it is vital that the Afghan government and its international partners make extractives a significant item on the summit agenda. But it is also critical that the meeting does not simply reiterate well-worn aspirations: to be effective, it must set out specific measures the Afghan government and its partners will carry out within reasonable timeframes to give practical expression to their mutual promises. We suggest that these include:

### **Require publication of production and payment data**

This is a key tool that makes illegal extraction, tax avoidance and theft of revenues much more visible – allowing politicians, media and civil society to bring effective pressure to bear. The law should be amended to require the Ministry of Mines and Petroleum (MoMP) and extractive companies to 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.

### **Create a single, transparent account for all natural resource payments**

Confusion and complexity over payments greatly undermines efforts to prevent corruption and tax abuses. 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, and bonuses. If by law relevant payments had to be made to this account in order to be accepted, this would ensure absolute clarity about extractive revenues, while making minimal demands on administrative capacity.

### **Make contract publication a condition for validity**

Contract publication is vital to transparency and accountability. A 2012 presidential decree mandated publication of extractive sector contracts, and 300 were made public – but implementation has since been inconsistent and a significant number of contracts have not been published, including contracts linked to possible abuses.<sup>11</sup> A much stronger mechanism would be to change Afghan law to stipulate that government 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, this measure should be applied across state procurement (with tightly defined exceptions for the most sensitive security-related contracts).

### **Publish beneficial ownership**

Much of the corruption in Afghanistan’s extractive sector – as elsewhere in the world – involves well-connected figures using illegitimate influence to secure control of contracts, often secretly through third parties. The current Mining Law excludes some senior officials from direct or indirect benefit from a mining license, but those not on the list notably include Members of Parliament and members of the security forces.<sup>12</sup> For this reason a key measure is to 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.<sup>13</sup> In May 2016 the Afghan government in fact committed to a public register of beneficial ownership – an important and welcome step which deserves full support. But as the government itself acknowledges, implementation will be a substantial challenge. 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 defining 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 on the identity of the real owners without incurring major new costs or bureaucracy.

### **Strengthen bidding processes**

The government has made some real progress in reforming procurement, but more could be done. In particular, they could amend Afghan law to require transparent, open and fair bidding and contracting processes – including for example publication of the substance of losing bids, public criteria for eligibility, legal penalties for preferential treatment and incorporation of the principles of Open Contracting.<sup>14</sup> At the May 2016 London anti-corruption summit Afghanistan committed to initial work on Open Contracting. 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 minor protection against these, the Mining Law has almost

nothing – an oversight which puts it at odds with best practice. The law should be amended to correct this.

### **Use model contracts**

Use of model contracts helps entrench best practice as matter of routine. The government should commit to use model contracts, incorporating international best practice on measures against corruption and conflict, as the initial 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 natural resource deals.

### **Address the lack of oversight 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 build capacity at the Ministry have failed to fill the gaps in its staff, systems and information management. The problem is especially serious at provincial level, where local offices have few financial and technical resources. Payments to provincial government offices are not always recorded in Kabul, though even at the central level the contributions of some major enterprises are unclear.<sup>15</sup>

This basic issue deeply undermines efforts against corruption and tax evasion, and arguably makes it impossible for the government to responsibly oversee the extractive sector. It should be relatively easy to resolve with adequate political will and technical support. One further useful support could be to require medium and large-scale extractive companies and SOEs to publish annual audits of their accounts, independently carried out to international standards – a basic requirement for listed companies in many parts of the world, but not so far in Afghanistan.

### **Enable community monitoring**

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. 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, which requires that 5% of mining revenues be returned to local government. This amount should be spent on projects that directly benefit the communities living around the mining site. One way to ensure this happens, and to minimize additional administrative cost 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. The Mining Law has some provisions for communities, but company obligations on service delivery and the recruitment of the local people 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.

### **Prioritise security in extractive areas**

Areas with extractive resources 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 integrating the security of extractive areas into security planning and strategy, as 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.<sup>16</sup> 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 is the case in Badakhshan.

## **A BENCHMARK FOR BRUSSELS**

These measures form a basic road-map for mitigating the risk from the resource curse in Afghanistan. This road map can be incorporated into the Brussels commitments through a single short section. One suggested wording is as follows:

*In the interests of strengthening stability, fostering development, and increasing state revenue, the Afghan government re-affirms its commitment to put in place effective measures to counter the threat of conflict and corruption linked to the extractives sector.*

### **To achieve this, the Afghan government commits to:**

- *By June 2018, amend Afghan law to require publication of project-level extractive sector payment and production figures; to require publication of natural resource and other contracts as a condition for their validity; to establish a public register of beneficial ownership; and to establish a single, transparent account, to be used for all natural resource revenues and payments as a condition of their receipt. Pending the adoption of these measures, the government*

*will use existing powers to achieve the same results as far as possible.*

- *By January 2017, publish, and regularly update, a full database of extractive sector contracts, their output, and the state revenue generated under each contract.*
- *By the end of 2017, on the basis of these reforms, achieve validation under the Extractive Industries Transparency Initiative.*
- *By October 2017, provide for community monitoring of extractive activities, linked to a mandate for affected communities to receive an appropriate percentage of legal revenues or profits from extraction.*

***Afghanistan's international partners commit to:***

- *Provide material and technical support for these reforms as they are implemented, with a particular focus on increasing oversight and management capacity at the MoMP.*

- *Provide substantive support to Afghan actions to increase security and strengthen rule of law in extractive areas.*
- *Support the development of the Afghan extractive sector within a framework of rule of law, including by providing support to overcome infrastructure barriers to sustainable extraction and to the Afghanistan Resource Corridors Project (ARCP).*

If it is to be at all meaningful, the Brussels conference must move beyond the pattern of earlier summits, which have set broad goals but with a narrow focus on the EITI as an indicator of progress. The EITI is critical, but Brussels must set out the specific reforms that will give practical form to the commitment to put in place “the strongest possible available measures” against threat of conflict and corruption around extractives. Four years after the Tokyo conference, the people of Afghanistan, and of its international partners, deserve nothing less.

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