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POLICY BRIEF

SMAF AND THE EXTRACTIVE INDUSTRIES IN AFGHANISTAN

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Natural resource exploitation has the potential to be a major source of economic development and government revenue for Afghanistan, but there is a grave danger that it will instead drive corruption and conflict on a national scale. The Self-reliance through Mutual Accountability Framework (SMAF) Process can play a major role in deciding which path Afghanistan takes. While President Ghani has said he sees reform as a priority, the comprehensive framework for the sector promised at previous summits going back to Tokyo has yet to be put in place. The Brussels summit is a vital opportunity for the government and donors to set out a roadmap of practical, realistic and effective measures, focusing resources and providing a clear demonstration of resolve to tackle this major threat.

A TREASURE OR A POISON?

Afghanistan's extractive industries are almost unique as a potential source of economic growth, revenue, and the development of the country for the benefit of all Afghans. Managed responsibly and transparently, the sector can help fund the Afghan budget, increase Afghanistan's independence from foreign aid, create thousands of long term jobs for a growing number of unemployed youth, and directly contribute to building roads, railways and other infrastructure. With decreasing foreign assistance and ongoing conflict, extractives are critical to the very future of the country.

But the reality is that extractives are instead a major driver of corruption and conflict around the country, funding armed groups and the insurgency, at the expense of the government budget. Minerals are

being fought over from Badakhshan to Helmand, empowering warlords and alienating communities from the government.¹ Mining is the second largest source of funding for the Taliban,² while providing less than \$20m to the Afghan treasury in 2013 – just 1% of total revenues.³ There are extensive reports of contracts being exploited by local strongmen or awarded through political influence, and of mining funding abusive militias and local strongmen. Even major contracts like the Mes Aynak copper project, the largest commercial contract in Afghanistan's history, have been full of controversy, and so far produced little of the promised benefits.⁴ Without better governance, mining 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 commitments in a variety of international fora to meet and exceed international best practices, including becoming fully compliant in the Extractive Industry Transparency Initiative (EITI).⁵ It committed at the 2014 London Conferences 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."⁶

These commitments are very welcome, but despite some positive efforts, there are many basic safeguards, including some increasingly routine elements of international best practice, which have yet to be put in place. Most of these do not require substantial additional administrative capacity or investment. The current Mining Law especially has important gaps, though the government is in the process of reviewing the law.

AN OPPORTUNITY FOR CHANGE

As the primary forum for setting out the mutual obligations of the Afghan government and its international partners, the SMAF process can play a key role in addressing this issue. Extractives should be a priority on the agenda for the 2016 inter-ministerial conference in Brussels. But it is also critical that the meeting should not just reiterate general goals which are already well established, but instead set out commitments on the specific measures the Afghan government and its partners will carry out within reasonable timeframes to give practical expression to their promises. We suggest that these include:

Require publication of project-level production and payment data

This is a key tool that makes illegal mining, tax avoidance and theft of revenues much more visible. The law should be amended to require the Ministry of Mines 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.

Make contract publication a condition for validity

Contract publication is vital to transparency and accountability. A 2012 presidential decree already mandated contract publication, and 300 contracts were made public – but implementation has since been inconsistent and a significant number of contracts have still not been published.⁷ As much stronger mechanism exists: the Mining Law should be changed to stipulate that natural resource contracts become valid only after they are made public. This would be an almost foolproof safeguard – indeed it should be applied across government procurement.

Publish beneficial ownership

Much of the corruption in Afghan mining – as elsewhere in the world – involves well-connected figures using illegitimate influence to secure control of mining 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 on the list notably include Members of

Parliament and members of the security forces.⁸ 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, by whatever means). The Mining Law should be amended to require that companies applying for or owning mining licenses publish this 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).

Beneficial ownership publication is strongly encouraged under the EITI, and many countries are in the process of implementing it.⁹ In Afghanistan, the Afghanistan Investment Support Agency (AISA) could collect and publish beneficial ownership data as part of their licensing duties as a straight-forward means of collecting details on the identity of the real owners and shareholders without incurring major new costs or bureaucracy.

Strengthen requirements for a transparent and fair bidding process

The government has made some progress in reforming procurement, but more could be done. It could for example commit to amending the 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. These standards should be applied across government procurement, but especially to natural resource contracts.

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.

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 by these groups later, and increase the public legitimacy of natural resource deals.

Address the lack of oversight capacity

The data management and oversight capacity of the Ministry of Mines is limited, to the point that it is frequently unable to provide basic information on contracts, revenues and production. Payments to provincial government offices are not always recorded in Kabul, and the contributions of major enterprises like the Afghan Emerald Company are unclear. This basic issue deeply undermines efforts against corruption and tax evasion, and arguably makes it impossible for the government to responsibly oversee the mining sector. It should be relatively easy to resolve, but government and donor efforts have so far failed to address the issue despite substantial expenditure. Apart from need for political will and technical support, a useful support to this could be to require mining 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.

Enable community monitoring and dispute resolution

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 mining 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 mining projects.

Require supply chain due diligence

In conflict-affected areas with minimal government presence, supply chain due transparency can help restrict illegal mining. The government and donors should commit to requiring that companies carry out responsible 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 security in mining areas

Mining areas are particularly prone to conflict, and security forces there are often tied to corruption and other abuses. The government should commit to requiring that security forces at mine sites 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. Mining Police units should be reviewed

and reformed to prevent the coming under control of political actors.

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 SMAF commitments through a single short section. A suggested wording is as follows:

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

To achieve this, the Afghan government commits to:

- Amend Afghan law to:
 - Require publication of project-level payment and production figures from extractive companies and government and publication of the beneficial ownership of extractive companies
 - Require publication of natural resource contracts as a condition for their validity
 - Establish a single, transparent account for natural resource revenues and payments
 - Mandate use of publicly-developed model contracts as the initial basis for contract negotiations
 - Strengthen protections for local communities in areas affected by extractives contracts, with a requirement for effective, independent and accessible mechanisms for consultation and dispute resolution, and clearer requirements for employment of local inhabitants
 - Provide for community monitoring of mining, linked to a mandate for mining communities to

receive a small percentage of legal revenues from extraction

- *Require more transparent bidding and contracting processes, in accordance with Open Contracting principles, for the extractive sector and across government;*
- *Strengthen oversight information management practices and capacity at the Ministry of Mines, and require independent audits of company accounts for large -scale projects*
- *Strengthen safeguards against abuses by armed groups or by security forces at mining sites*
- *Achieve validation under the Extractive Industries Transparency Initiative (EITI)*

Afghanistan's international partners commit to:

- *Provide material and technical support for these reforms, with a particular focus on increasing oversight and management capacity at the Ministry of Mines.*
- *Support Afghan actions to increase security and strengthen rule of law in mining areas*
- *Ensure supply chain transparency and due diligence for imports of minerals, gas and oil from Afghanistan, and accountability from extractive sector companies operating in Afghanistan over which they have jurisdiction.*

If it is to be at all meaningful, the SMAF process must move beyond broad goals and a singular focus on the EITI, important though that mechanism is, to set out commitments on the specific measures that will be taken to put in place “the strongest available protections against corruption and conflict.” Four years after the Tokyo conference, the people of Afghanistan, and of its international partners, deserve nothing less.

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ENDNOTES

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