

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

**Report No.:75416**

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<b>Project Name</b>	Sustainable Development of Natural Resources Project 2
<b>Region</b>	South Asia
<b>Sector</b>	Oil, Gas and Mining
<b>Project ID</b>	P118925
<b>Borrower(s)</b>	Islamic Republic of Afghanistan
<b>Implementing Agency</b>	Ministry of Mines
<b>Environment Category</b>	<input type="checkbox"/> A <input checked="" type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
<b>Date PID Prepared</b>	February 25, 2011
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## 1. Country and Sector Background

Afghanistan faces a broad set of development challenges as the country seeks to emerge after thirty years of conflict, while at the same time still facing immediate and significant security challenges. Afghanistan is one of the most aid-dependent countries in the world, and donor funding will remain crucial to support the Government in covering its operating balance, strengthening the macro economy, reestablishing institutional capabilities, developing infrastructure, finding foreign and domestic sources of private sector investment, and taking other measures to enable the country to eventually achieve fiscal sustainability.

In the past three years, the Government has made progress in stabilizing and rebuilding the economy. Growth is expected to slow to about 3-5 percent in 2010. Through sound monetary policy, the Central Bank contained inflation and reduced non-food inflation in 2009-10 to around 3 percent, from 9 percent the previous year. While institutional capacity is still very slim, donor support has led to capacity building in most ministries. However, there is still much work to be done to build well-functioning government capacity. Infrastructure development remains a major challenge, as does attracting new sources of private sector growth and exports—although potential has been identified in small and medium enterprises, especially those linked to the extractive industries sector.

With regard to the mineral sector, Afghanistan is reported to have a significant mineral endowment (upwards of USD 1 trillion), but much of that wealth is locked in the ground pending development of supporting infrastructure that will link mines to global markets. Both the Aynak copper resource and the Hajigak iron ore resource are some of the largest deposits being offered under competitive tender in the region. Not surprisingly, those assets are stimulating much discussion around their ability to act as anchor tenants to support development of large-scale infrastructure. In addition, Afghanistan has extensive natural gas, limestone, and other mineral resources, as well as significant gold and gemstone deposits.

The most significant development in the Afghanistan mineral sector has been the Government's successful tender of the Aynak copper deposit, with World Bank technical assistance (SDNRP).

Successful conclusion of the main agreement has resulted in a payment of US\$80.8 million to the Government, as the first tranche against a total signature bonus of US\$808 million premium for the right to develop the deposit. The agreement also includes a sliding scale of royalties. Due to the success of the Aynak tender, the Government has begun the tender process for the Hajigak iron ore deposit, the largest in Asia being offered at this time, as well as three petroleum blocks. In addition, on March 16, 2009 the Government endorsed the principles of the Extractive Industries Transparency Initiative (EITI), signaling its commitment to transparent and accountable sector governance. Emerging new geological data has served to increase understanding of the potential for oil, gas and minerals production. The Government of Afghanistan has requested the World Bank's continued support in strengthening its sector and macroeconomic governance framework to ensure that this transformation has a positive outcome.

## **2. Objectives**

Under the SDNRP 2 Technical Assistance Project, the World Bank would continue sector support through **(a)** strengthening regulatory requirements along the entire EI Value Chain; **(b)** improving the Government's access to geological information, to support competitive and transparent tender processes for development of the country's mineral deposits, and enable informed long-range economic planning; **(c)** supporting the developments of alternative livelihoods through sustainable development and promotion of ASM mining; **(d)** improving the capacity of the Ministry of Mines and other relevant institutions to monitor contractual compliance with reporting obligations, payment of taxes and royalties, and social, environmental, and cultural safeguards; **(e)** supporting the Government's efforts to become fully compliant with EITI.

The proposed grant would finance a wide range of technical assistance the costs associated with gaps in effective sector governance, which come at a critical time when (a) the number of small-to-medium operations is expanding within quarry and dimension stone industries, all of which impart significant environmental damage, and (b) a number of large scale mineral projects will start operating in Afghanistan, which if properly administered through the development of natural resource corridors could create significant potential benefits for the country. The enabling environment for good sector development will emerge from instituting good governance practices and building capable sector institutions having the absorptive capacity for transparent, non-discretionary administration. The proposed support will help respond to the situation by strengthening capacities throughout all regulatory requirements along the mineral value chain, including the provision of better geological information to the Government to enable preparations for competitive and transparent tender processes (including the Hajigak deposit), increasing the capacities of the relevant institutions to better monitor the contractual compliance with special emphasis on social, environmental and cultural safeguards, improving transparency and accountability by supporting EITI implementation, and collaborating with the Government in assessing potential resource corridors and identifying concurrent actions to be taken through parallel World Bank and other donor assistance in related disciplines (i.e. vocation training, infrastructure development, community participation etc). The outcome of these activities would ultimately be a higher share of benefits derived from mineral operations, which are governed by capable institutions to ensure sound environmental, social and cultural compliance.

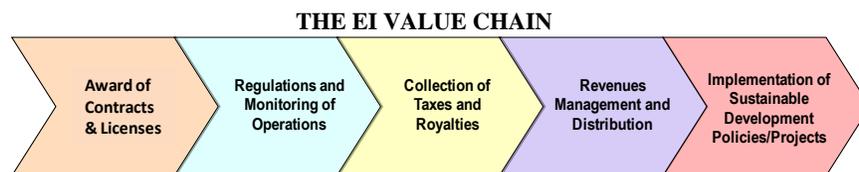
### 3. Rationale for Bank Involvement

The project would continue the technical assistance that began under SDNRP1 (2006-2013) to support the Government's efforts to create a sound policy and institutional framework for the extractive industries (EI) sector. These activities helped the Government to make significant progress in preparing the EI sector to overcome its key constraints to development, enabling the sector to become the country's leading driver of formal sector employment, fiscal revenue generation, foreign exchange earnings, technical capacity building, economic diversification, social development, innovation, and technology transfer.

However, the continuation of effective tenders will put more pressure on the Government's ability to regulate the sector in an efficient way, and while reform processes do show signs of success, the efforts must continue in the future. The design of SDNRP2 is fully aligned with the Government's master plan for the EI sector, which focuses on diversified economic development, accompanied by social and community development, along the infrastructure corridors that are now being planned to facilitate mining operations. Moreover, SDNRP2 is precisely the kind of innovative, selective, policy knowledge-driven project that the Development Committee envisions for the coming years.<sup>1</sup> It mainstreams anti-corruption, risk management, participation, and environmental and social concerns. It provides economic opportunities for women. Its interventions are selective, based on the Bank's comparative advantages, and their impacts will be amplified through two important channels: (a) the hundreds of millions of dollars in FDI flows into Afghanistan's economy; and (b) the horizontal and vertical linkages with the activities of other donors, all of which are laid out in the sector master plan.

### 4. Description

The project components are aligned with the five stages of the World Bank's Extractive Industries (EI) Value Chain, to define an integrated set of feasible interventions to transform mineral resource potential into sustainable development outcomes. Stages 3 and 4 of the Value Chain have been merged under Component 3. There is an additional project component, Component 5, which is not part of the EI Value Chain, as it encompasses project implementation support and administrative functions.



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<sup>1</sup> *New World, New World Bank Group: (I) Post-Crisis Directions*, background paper for Development Committee meeting, April 20, 2010.

### **Component 1. Award of Contracts and Licenses**

This component will support the preparation and management of competitive and transparent tender processes for extraction and development of the country's mineral resources, by strengthening the Government's policy and planning capabilities and developing the geological information needed for informed decision-making and the preparation of additional resource auctions. It will further assist in supporting infrastructure planning options to render large-scale operations feasible.

### **Component 2. Regulation and Monitoring of Operations**

This component will increase the capacity of the Ministry of Mines and other relevant institutions to monitor contractors' compliance with national laws and sector regulations, including through field verification visits to ensure the transparent and efficient reporting and collection of EI revenues. This component will also build capacity to monitor compliance with the World Bank Group's environmental and social safeguards, including the preservation of physical cultural resources.

### **Component 3. Revenue Collection and Management**

This component will strengthen the fiscal and regulatory instruments, and will provide policy options to the Ministry of Finance and Ministry of Mines regarding stabilization of the EI revenue stream to enable long-term fiscal planning.

### **Component 4. Supporting alternative livelihoods through sustainable ASM and mining communities**

This component will help to promote alternative livelihoods through improving the sustainability of small and medium scale mining enterprises, with an emphasis on women employment, gemstone, decorative stones and jewelry craft, including improving market access. It will also work with communities and women in the Logar valley to promote local production of artifacts.

### **Component 5. Project Implementation/Embedded Technical Expertise**

This component will continue funding for the existing Project Management Unit (PMU), which has been overseeing day-to-day implementation of SDNRP1. It will also strengthen capacity at the Ministry of Mines and the National Extractive Industry Excellence Program (NEIEP) to (a) assess the progress of mining operations; (b) maintain comprehensive and current site data pertaining to mining licenses; (c) ensure compliance with Grant Agreement provisions governing procurement and project financial management; and (d) ensure compliance with environmental and social regulations. The embedded technical expertise in this component will be the project's main mechanism for knowledge transfer.

## 5. Financing

IDA: USD 52 million

Total Project Cost: **USD 52 million**

## 6. Implementation

Activities under this proposed project would be carried out using the existing implementation arrangements for the on-going Technical Assistance Project (SDNRP). The Ministry of Mines would continue to have the overall responsibility for project implementation. Under this project, a Project Management Unit (PMU) has been established to oversee day-to-day implementation of the project.

## 7. Sustainability

Regarding this TA project, sustainability will relate to the capacity of the respective agencies to manage the mineral sector in a sustainable way, including economic, environmental and social performance measures. Several of the project's key development indicators have been established to enable Bank management and stakeholders to track the achievements of the project in this matter, including indicators for tracking economic efficiency of the mining sector, effectiveness of oversight and enforcement agencies and mechanisms, environmental, social and health standards, as well as for the protection and presentation of national antiquities in the Logar valley.

## 8. Lessons Learned from Past Operations in the Country/Sector

(a) *Coordination between agencies not always effective*

While progress has been made in clarifying the roles and responsibilities for instance between MoM and NEPA, proper coordination will need to be ensured, and will also include other relevant ministries such as MAIL and MRRD

(b) *Need for effective communication*

While there is increased global interest in the Afghan mining sector, there were as yet deficiencies in supplying the appropriate information and thus countering incorrect statements. An effective communication strategy is being developed, and care will be taken that this is properly applied throughout the project

(c) *Alignment of Government's resettlement action plan*

While the Government has an initial RAP in place for Aynak, it will need to be further aligned with World Bank guidelines vis a vis representative community consultation. Thereafter, it a general RAP template will be required for application elsewhere within the sector and across the broader development agenda.

*(d) Experience with mineral auctions*

The Aynak tender was the first international, transparent and competitive bid process to take place in the country, and has provided the Bank team with important insights around transaction preparations, bid documentation and evaluation and contract publication. These lessons will be taken into account during future support for auctions.

*(e) Importance of geological information*

The key role for better quality geo information has become clear, reinforced through the successful Aynak tender.

*(f) Need to strengthen financial management systems of the project*

The financial management performance should be improved by undertaking internal audits, completing external audits on a timely basis, responding to audit findings, and by strengthening internal control systems. Additional FM staff have been hired in the PMU towards this goal.

*(g) Making security arrangements more efficient*

This would largely be ensured via the increased hiring of firms which will be responsible for their own security arrangements.

**9. Safeguard Policies (including public consultation)**

<b>Safeguard Policies Triggered by the Project</b>	<b>Yes</b>	<b>No</b>	<b>OP/BP 4.00</b>
<a href="#">Environmental Assessment (OP/BP 4.01)</a>	X		
Natural Habitats ( <a href="#">OP/BP 4.04</a> )		X	
Pest Management ( <a href="#">OP 4.09</a> )			N/A
Physical Cultural Resources (OP/BP 4.11)	X		
Involuntary Resettlement ( <a href="#">OP/BP 4.12</a> )	X		
Indigenous Peoples ( <a href="#">OP/BP 4.10</a> )			N/A
Forests ( <a href="#">OP/BP 4.36</a> )			N/A
Safety of Dams ( <a href="#">OP/BP 4.37</a> )			N/A
Projects in Disputed Areas ( <a href="#">OP/BP 7.60</a> )*		X	N/A
Projects on International Waterways ( <a href="#">OP/BP 7.50</a> )		X	N/A

\* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas

## **10. List of Factual Technical Documents**

### **11. World Bank Contact point**

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