Afghanistan: Mining as a Source of Growth

Afghanistan’s rich mineral resources offer significant potential for development, but severe constraints hinder private investment in the sector. This ESW highlighted the need for an enabling legislative and regulatory framework and for accurate geologic and mining information. Follow-on technical assistance has contributed to an improved enabling environment and to minerals development through private investment. For instance, the government has already awarded the tender of the Aynak copper reserves to a Chinese firm. The project, valued at over $2 billion, is the largest international investment in Afghanistan to date and is expected to contribute significantly to the Afghanistan economy through tax revenues, infrastructure development, and generation of employment.

1. Challenge

Although Afghanistan has excellent geologic potential, the mining and hydrocarbons sectors remain undeveloped and the country’s mineral resources are underexplored. Years of conflict devastated production facilities and basic infrastructure, and minerals output fell sharply. Isolation from the international mining industry further hindered development of the sector. The Afghan government that took office in January 2002 did not have funds to invest in minerals development, and such investment could not be justified in any case given other urgent priorities and the risks inherent in mining. It was necessary to attract private investment. However, inadequate mining legislation and negative investor perceptions made it difficult to mobilize large-scale private sector investment for minerals exploration and development on an industrial scale. Reliable statistics on the existing mining production, primarily small-scale quarrying and gemstone mining, was virtually nonexistent. Moreover, the central government did not receive any royalties or taxes on this exploitation of nonrenewable resources.

Soon after the new government assumed its functions, World Bank specialists conducted a mission to determine how the Bank might best assist with the reconstruction and development of the country. In discussions with government officials, the mission determined that the minerals and hydrocarbons sectors offer promise for development. Recognizing the huge needs of the country and the particular conditions present in conflict states, the Bank conducted an ESW in 2004 to examine the mining sector as a potential source of growth for the Afghanistan economy.

2. Findings and Dissemination

The ESW determined that minerals development could help jump-start the Afghan economy. It estimated that over a five-year time horizon, that is, by 2008, some $250 million in annual production value could be generated from the
sector. To achieve this, however, severe constraints would have to be overcome.

The lack of appropriate legislation, regulations, and fiscal measures for the mining sector was a key obstacle to private sector investment in minerals exploration and development. Moreover, the institutional structure did not reflect the role of the state as a regulator, focusing instead on its role as an operator of mines. Several key offices—such as an office to administer mineral titles and audit production—did not exist. The ESW proposed the adoption of a legislative and regulatory framework consistent with international standards that would provide the basis for transparent allocation of mining titles to private entities. It also called for an internationally competitive fiscal and taxation package that would impose a reasonable fiscal burden on enterprise while ensuring that the government receives tax benefits commensurate with the value of its mineral resources. The ESW recommended strengthening government oversight institutions to distinguish clearly between the government’s functions as regulator and its functions as owner/operator of state mining enterprises. Improving the regulatory and fiscal regime would help attract new investment, and strengthening government institutions would improve monitoring of existing production.

Many of the mining operations were under the control of warlords and various factions. No data were available on their operations, and none could be conveniently or safely collected. The facilities of the Afghanistan Geological Survey, which used to have an excellent library and database, had been completely destroyed. The ESW emphasized the need to address information gaps by updating and strengthening basic geologic and mining information through mapping and surveys. This information could be used to promote private investment for exploration and mine development, along with sustainable social and economic development.

3. Subsequent Role for the Bank

As a result of the ESW, the Bank provided assistance to the government through a $30 million technical assistance grant approved in 2006 and presently under implementation. The TA aims to support the development of mining regulations, strengthen government supervisory services, support tender operations for mineral prospective areas, and support the government in significant transactions with private investors. The Bank is also helping the government improve its geologic database.

4. Key Results

The ESW has contributed to early results in several areas:

*Improved enabling environment.* A new mining law was passed in 2005, and regulations are being developed to provide a legal framework for minerals exploration and mining and to encourage investment in the sector. The regulations aim to help the government transition from the "command and control" thinking of the past to an emphasis on its function as a regulator. The law provides for a licensing system that allows private sector companies to obtain mine titles for exploration. It establishes the key government institutions that will supervise the sector and provides for stability of tenure for holders of mineral rights. The law also provides for the government to tender certain mineral deposits for which it has ample geologic data.

*Mineral development through private sector investment.* The TA project has supported the tender of the huge copper deposit at Aynak, which the ESW identified as one of the principal mineral assets for development. Aynak is one of the largest copper deposits in the world, with in situ reserves worth an estimated $54 billion (at $3.50/lb.). The project tender, awarded to a Chinese firm in May 2008, is valued at over $2 billion and is the largest international investment in Afghanistan to date. The Aynak development will contribute significantly to the Afghanistan economy through tax revenues and employment opportunities for more than 6,000 people. It will also have substantial spin-off effects. For instance, the coal-fired generators at the mine are expected to generate 400 megawatts of electricity: 200 megawatts to operate the project and the remaining 200 megawatts to distribute to consumers. Significant amounts of electricity will be supplied to Kabul, located 50 kilometers from the deposit.

*Strengthened geologic database.* In response to the ESW’s emphasis on the critical role of accurate information, the government is taking steps to update and strengthen basic geologic and mining data. The compilation of maps using existing and Soviet data is a significant step forward in providing potential investors the geoscientific information they need to make decisions.
5. Lessons Learned

The Afghanistan experience, while still preliminary, suggests the value of encouraging nontraditional investors in countries affected by or emerging from conflict. Mainline international mining companies have somewhat negative perceptions of Afghanistan, principally because of the security situation. Effective and safe mine development requires the central government to exert effective control over the mining areas; in the absence of such control, it will be difficult to attract significant involvement from large Western firms. However, there are numerous smaller firms with less aversion to risk. In addition, Chinese companies are actively searching for new sources of minerals. These nontraditional players in the minerals sector may offer the best possibilities in the near term for Afghanistan to mobilize private sector investment. However, the government will be challenged to put into place effective monitoring mechanisms to ensure that these companies comply with their contractual obligations.

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