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**TECHNICAL ANNEX  
FOR A PROPOSED GRANT OF  
SDR 20.6 MILLION  
(US\$30 MILLION EQUIVALENT)  
TO  
THE ISLAMIC REPUBLIC OF AFGHANISTAN  
FOR A  
SUSTAINABLE DEVELOPMENT OF NATURAL RESOURCES PROJECT**

**May 16, 2006**

**Oil, Gas and Mining Policy Division  
Oil, Gas, Mining & Chemicals Department  
Afghanistan, Bhutan and Maldives Country Unit  
South Asia Regional Office**

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### CURRENCY EQUIVALENT

(as of April 2006)

Currency Unit: Afghani

US\$1.00 = 49.89

### GOVERNMENT FISCAL YEAR

March 21 - March 20

### ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank	MoF	Ministry of Finance
AGS	Afghanistan Geological Survey	NEPA	National Environment Protection Agency
ANDS	Afghanistan National Development Strategy	PACB	Public Administration Capacity Building
ARDS	Afghanistan Reconstruction and Development Services	PFEM	Public Finance and Expenditure Management
BGS	British Geological Survey	PFM	Public Financial Management
DA	Designated Account	PMU	Program Management Unit
EITI	Extractive Industries Transparency Initiative	PRR	Priority Restructuring and Reform
FM	Financial management	PRSP	Poverty Reduction Strategy Paper
FMS	Financial management system	SDU	Special Disbursement Unit
IDA	International Development Association	SOEs	State-owned enterprises
I-ANDS	Interim Afghanistan National Development Strategy	TSS	Transition Support Strategy
ISN	Interim Strategy Note	USAID	US Agency for International Development
MDGs	Millennium Development Goals	USGS	US Geological Survey
MEW	Ministry of Energy and Water	USTDA	US Trade and Development Agency
MoM	Ministry of Mines		

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**AFGHANISTAN  
SUSTAINABLE DEVELOPMENT OF NATURAL RESOURCES PROJECT  
TECHNICAL ANNEX**

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## SECTION A—BACKGROUND AND STRATEGY

### Background: The Minerals Sector

1. Mining and hydrocarbons development in Afghanistan is an engine of economic growth; and essential to reconstruction and development. Despite having abundant natural resources, a vibrant minerals sector has eluded Afghanistan. Years of neglect have stripped the Ministry of Mines (MoM) its institutional capacity to manage and the ministry is struggling to meet new challenges. The barriers facing MoM have been summarized in the International Development Association (IDA) document *Mining as a Source of Growth* (2004).<sup>1</sup> This study concludes that institutions responsible for mineral resources are not appropriately organized, staffed and equipped to grow the sector. The ministry has several state-owned enterprises, and this organizational structure does not reflect MoM's new role as mineral sector regulator rather than owner and operator of mining enterprises. Stimulating new investment into the mining sector will, therefore, require a concerted effort towards institutional strengthening and capacity building.

2. The study, *Mining as a Source of Growth*, estimated that the gross annual market value of solid minerals produced could increase from the estimated US\$60 million currently to US\$253 million per annum by 2008 (four-five year time horizon). A longer term growth scenario—ten to twelve years into future—could see the development of very large iron ore deposits, industrial scale coal mines for power generation, gas-to-power development, and one or two gold mines and other industrial minerals production facilities. More recent projections, based on the significantly higher commodity prices of recent years, estimate that total minerals production could reach US\$ 600–800 million by 2015. Such growth scenarios would imply significant economic benefits in terms of value added, royalties and taxes to the government, export earnings, new jobs, and substantial community development spin-offs. Government revenues by 2015 could reach US\$ 100–150 million. The Government acknowledges that mining sector development cannot be spearheaded by public sector investments but rather will require substantial new private sector investment. This, in turn, requires that the Government establish conditions and an enabling environment to attract and retain investment by private local and international companies. Also, the government must ensure that public institutions are strengthened and that sufficient capacity within them exists to administer the laws and regulations in a transparent manner.

3. The Afghanistan mineral sector is described according to five major commodity groups (i) hydrocarbons, (ii) solid fossil fuels (principally coal), (iii) base and ferrous metals, (iv) construction materials (principally crushed stone and cement), and (v) dimensional stone and gemstones. These industries were much more productive in the 1970s and 1980s than they are today. Existing mineral production is now limited to small coal operations in Baghlan and Bamyan provinces, limestone for two operating cement plants, construction materials (sand, gravel, crushed rock) nationwide, and gemstones and dimensional stone from artisanal operations. There has been limited production of oil in Sar-i-Pol but this has been shut in.

4. Today, all hydrocarbon activities and large-scale mining are controlled by the government, whereas smaller-scale mining of construction is unregulated and occurs within the informal sector. Overall, the conditions of hydrocarbon and large-scale coal mining activities are not conducive to private sector participation, although, as essential materials, their production must be sustained. Current production falls far short of the sector's potential, and although still operating, all existing operations suffer from chronic neglect, damage from war, and severe under-funding. The resource base could support substantially larger operations and there are identified deposits that have not been exploited; most notably Aynak copper and Hajigak iron ore deposits.

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<sup>1</sup> Transitional Islamic State of Afghanistan: Mining as a Source of Growth, Report No. 28231-AF, March 2004, The World Bank

## Background: The Ministry of Mines

5. Historically, the Ministry of Mines and Industries<sup>2</sup>, now renamed the Ministry of Mines, has operated as a vertically integrated extractive industry conglomerate with enterprises reporting to the center, but operating autonomously in terms of budget planning and revenues management. In January 2005, the Government was reorganized, and MoM's portfolio was expanded to include light industry. For the past several decades MoM has been centered on extractive industries and associated heavy industries: (a) mining of minerals and construction materials, (b) petroleum exploration and production, and (c) the operation of downstream industries that utilize extractive industry outputs. With the addition of the light industries wing in early 2005, MoM added a cluster of 10 textile-based enterprises. The ministry was restructured in March 2006, and light industries were transferred out of what was at the time Ministry of Mines and Industries. After the last restructuring, approximately 4,000 employees work for MoM and its various state-owned enterprises.

6. As a regulatory agency, MoM will need to provide a transparent and efficient regulatory environment that enables private-sector led investment and facilitates sustained economic growth and revenues to the government. Key actions required of MoM in achieving this objective will target:

- improved fiscal and regulatory regimes through new policies, laws and tax provisions based on international best practices;
- building new institutions of government to effectively regulate and enforce the hydrocarbon and mining laws
- building technical capacity in the administration and regulation of hydrocarbon and mining laws and ensure institutional efficiencies;
- assisting other ministries in infrastructure and land-use decision making by providing more complete assessments of mineral resource potential;
- undertaking sector promotion for sustained long-term growth based on private sector investment
- moving existing enterprises to market- and private-finance based principles—MOM will lead this transition from government-owned and controlled to private-sector run in mining, hydrocarbons, and associated industry.

7. During project preparation, a preliminary evaluation of MoM's functions and structure was conducted. This evaluation identified major structural issues that were not being resolved by other government reform initiatives, such as the Priority Restructuring and Reform (PRR) process, on which MoM made very little headway. The evaluation concluded that MoM is currently structured as a Soviet-styled production ministry—a mass of semi-commercial activities and mixed semi-regulatory activities. There is no clear distinction between the role of regulator and business operator with the inevitable result that the MoM has conflicting objectives and compromised outcomes, particularly in terms of the trade-offs between social and environmental sustainability and commercial objectives.

8. Making the transition of MoM from owner/operator of enterprises into the regulatory role will require several key actions, some of which have already been taken or are underway. Other actions will be supported by the proposed project.

- *Creating a Modern Legal and Regulatory Framework.* The MoM has worked with other key ministries to draft and pass Minerals (July 2005) and Hydrocarbon (December 2005) Laws. Both laws reflect international standards of quality, apply to all investors local and foreign, and provide the basis for transparent allocation of mineral and hydrocarbon rights to private entities. The project will

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<sup>2</sup> The Ministry of Mines and Industries was renamed in April 2006 the Ministry of Mines. This name may be subject to further change as some heavy mineral-related industries (i.e. cement) may remain within MoM.

support engaging legal experts to help the government draft mining regulations and a model investment contract. A model contract for exploration and production sharing has been drafted, which could form a basis for negotiation of new production.

- *Improving sector governance and transparency.* The government is adopting a number of initiatives to enhance governance and transparency in the mining sector. These initiatives, supported by the project, are aimed at ensuring that the mining titles and contracts are issued in a competitive and transparent manner and that the fundamental terms and conditions of the deal is “fair” by comparison to international best practices.
- *Adopting an Internationally Competitive Fiscal and Mining Taxation Package.* The 2005 Amendment to the Income Tax has specific provisions for extractive industry investors. It also authorizes the Minister of Finance to income tax stability subject to certain conditions.
- *Building Capacity and Strengthening Supervisory Institutions.* A key issue, given the existing staff profiles and functional responsibilities in MoM, is to build capacity and competencies required for the new role of regulator and administrator of the sector. This involves not only the creation of new units and departments within MoM such as a cadastre office and a unit for mines inspection, among others, but also augmenting the technical capacities of MoM staff. Because of the political turbulence of the past years little training has taken place for MoM staff and exposure to international best practices is extremely limited. As well, the ministry has not attracted new staff so the staff age profile is advanced. Finally, staff are used to the owner/operator role and have little understanding of regulatory functions. Thus, a major effort is required to build capacity in all key functions within MoM.
- *Enhancing the Capacity of Government Institutions to Attract Sector Participation in the Development Thereof.* The government needs a program of investment promotion which involves, amongst others, public outreach, establishing an investor-friendly climate, and negotiating contracts quickly and expeditiously in a transparent manner.
- *Improving Knowledge of Afghan Geoscience.* Increasing geo-scientific knowledge in key areas through systematic data collection, compilation, and maintenance of a well-organized data base can help attract new investment and help develop the sector.
- *Inventory and Strategic Plan for Minerals-Based State-Owned Enterprises.* The principal state-owned enterprises (SOEs) and departments carrying out commercial activities have been identified and described as part of ongoing work in the SOE Department of the Ministry of Finance (MoF). The enterprises and departments include the Mines Extraction Company, North Coal Enterprise, State Gas Enterprise, Jabal Seraj and Ghori Cement Enterprises, Kud Bergh Fertilizer and Power Enterprise, Hydrology Engineering Research Service Enterprise, Afghan Geological Survey, Department of Oil and Gas, and the Oil and Gas Exploration Department. There are also two non-operating enterprises: Technical Services Enterprise and Rukhaman Marble Enterprise. Important or large enterprises and departments within MoM are described in Appendix 1

## **Sector Strategy**

9. Previously, the former Ministry of Mines and Industries produced two key documents, (1) “The Strategy for the Mineral Resources Sector, Afghanistan,” (April 2005) and (2) a Letter of Sector Development Policy (February 2006). This letter of sector development policy is appended to this technical annex. Both documents define the guiding principles and commitments of the ministry to good sector governance. MoM is further

guided by the “Afghanistan Investment Climate Assessment Report”<sup>3</sup>—in that good governance via a sound legal framework, judicial and regulatory enforcement, and functioning government has been cited as essential to attract private investment into Afghanistan. Overall, MoM states the current state of the industry is not indicative of the underlying mineral wealth, and properly governed, the minerals sector should be a source of economic growth and a key instrument in fighting poverty. Thus, MoM is challenged to facilitate positive economic impacts by creating good governance through institutional strengthening and capacity building, and establishing conditions and an enabling environment to attract and retain private investments.

10. Mineral sector strategy has been developed in response to higher-level considerations relating to long term growth. On January 22, 2006, the cabinet formally approved the Interim Afghanistan National Development Strategy (I-ANDS). This five-year strategy follows the National Development Framework prepared in 2002 and the Securing Afghanistan Future (SAF) exercise prepared in 2004, and aims to transform the economy to enable the private sector to be the engine of growth and empower the poor to participate fully in that growth. I-ANDS is a five-year strategic plan consisting of three pillars—(1) security, (2) governance, rule of law, and human rights, and (3) economic and social development. These pillars are indispensable to realizing the Government’s vision of consolidating peace and stability through just, democratic processes and institutions, reducing poverty, and achieving prosperity through broad-based and equitable economic growth. The three pillars are built into sectoral programs, and an appropriate emphasis is placed on enhancing infrastructure and development of natural resources. I-ANDS sets high-level goals and underpins the basis for the Afghanistan Compact, a commitment made by the Government of Afghanistan and the international community during a conference in London on January 31, 2006. The Afghanistan Compact is a five-year blueprint for reconstruction based upon detailed outcomes, benchmarks, and timelines for delivery in security, governance and human rights, and social and economic development. For mining and natural resources, the Compact’s benchmarks are (1) creation of an enabling regulatory environment for profitable extraction of mineral and natural resources by end-2006, and (2) improved investment environment and infrastructure to attract domestic and foreign direct investment to mining and natural resources by end-2010.

11. The goal of the Natural Resources and Mining component within I-ANDS is to “... establish Afghanistan as a globally competitive and attractive destination for investment in industries, mineral and hydrocarbon exploration, development and mining in a manner that protects these resources and their benefits for future Afghan generations.”<sup>4</sup> Measurable Benchmarks include (a) creating an enabling regulatory environment by end-2006, (b) enhancing the investment and infrastructural environment in order to attract domestic and foreign direct investment in mining and natural resources, and (c) increasing government revenue through minerals production. The I-ANDS further states that MoM will lead on the development and protection of Afghanistan’s mineral, oil and gas reserves, and will establish the necessary regulatory environment for attracting private investment, negotiation of contracts, and ensuring that resources are extracted in a sustainable way that maximizes revenues and protects the environment. MoM will coordinate with the National Environmental Protection Agency (NEPA) to ensure that development of mineral resources is conducted in accordance with sound environmental practices.

12. To date, donor coordination has been *ad hoc* in that the former Ministry of Mines and Industries lacked the capacity in the earliest years (2002–2004) to define long-term sector strategies and guiding policies. Without a minister for much of this period, management of the day-to-day operations of MoM became fragmented. Furthermore, without a Program

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<sup>3</sup> The Investment Climate in Afghanistan: Exploiting Opportunities in an Uncertain Environment, The World Bank, December 2005.

<sup>4</sup> Interim Afghan National Development Strategy (I-ANDS), Volume II – Consolidated Program Summaries, 2.1.5 Natural Resources And Mining Program, Policy Overview.

Management Unit (PMU) or other central coordinating unit, donors were without a common framework in which they could respond to the many needs of the sector (see Section E: Institutional Arrangements). Despite these handicaps, senior managers at MoM managed to attract and support an overall suite of interventions that addressed many key issues. Donors active in the sector include the Department for International Development (DfID)–British Geological Survey (BGS), Asian Development Bank (ADB), US Geological Survey (USGS), and US Trade and Development Agency (TDA). An accounting of donor activities within the sector are presented in Appendix 3.

## SECTION B—IDA RESPONSE AND STRATEGY

1. The World Bank's Board of Executive Directors approved a Transitional Strategy Support (TSS) for Afghanistan in March 2003 and an Interim Strategy Note (ISN) on May 25, 2006. The ISN is anticipated to guide IDA's engagement over a two-year period. By 2008, the government plans to have developed its full Poverty Reduction Strategy Paper (PRSP), paving the way for preparation of a Country Assistance Strategy. The pillars of the ISN are:

- Building the capacity of the state and its accountability to its citizens to ensure the provision of services that are affordable, accessible and of adequate quality
- Promoting growth of the rural economy and improving rural livelihoods
- Supporting growth of a formal, modern, and competitive private sector.

2. The ISN identifies public administration and corruption as two key areas emerging as challenges. It specifically mentions that good governance is essential to avoid the misallocation of national resources that could lead to increased poverty, corruption, and renewed conflict, the so-called paradox of plenty. Afghanistan has an opportunity to put in place systems to reap the benefits of its natural resources for the nation as a whole. However, the ISN points to the need for a concerted approach to prevent corruption by strengthening institutions and implementing competitive, transparent processes that encourage quality investors who can sustain sector growth before the country can reap the benefits of its mineral resources. The proposed Sustainable Development of Natural Resources Project will support activities that are designed to improve the governance of the minerals sector, enable sector growth through private sector participation, and help the Ministry of Mines (MoM) separate the policy and regulatory roles from operational and commercial functions.

### International Development Association (IDA) Activities

3. The IDA has been working with MoM since 2002. The activities undertaken with participation of the IDA include:

- Technical assistance in the minerals sector for policy development and reforms
- Assistance for preparing sector legislation, sector-specific tax amendments, and a model contract for hydrocarbons
- Compilation and analysis of existing geoscience data
- Assessment of the sector potential and institutional shortcomings with a view to making recommendations for future actions for sector growth
- Assistance for developing an integrated energy strategy.

4. A large volume of data on hydrocarbons has been compiled and analyzed by Gustavson Associates under the IDA's Emergency Infrastructure Reconstruction Project. The data were used to produce a high-confidence, short-term gas production forecast as well as assess long-term hydrocarbon development and production potential. For solid minerals, IDA gathered and analyzed available data, and the findings are summarized in "Mining as a Source of Growth" (2004).

5. IDA conducted two large studies to assess the sector potential and institutional shortcomings to achieve the potential, one in mining and the other in hydrocarbons. *Mining as a Source of Growth* estimated the current and future production of different minerals, their values, and their potential contribution to economic development; identified obstacles to sector growth and attracting private capital; suggested a strategic path for sector growth; described the needed reforms to the legal, fiscal, and institutional regimes; and recommended specific action steps for the next two years. "Evaluation of Investment Options for the Development of Oil and Gas Infrastructure in Afghanistan" (2005)—funded by the US Trade and Development Agency (USTDA) and managed by IDA—examined immediate, medium-term, and long-term oil and gas potential; conducted a study on demand for natural gas in Kabul; evaluated alternative strategies for the (existing) fertilizer plant, (existing) gas processing plants, a small refinery, and a pipeline from Sherbergan to Kabul; conducted an

institutional review of MoM coupled with some training activities, and recommended an investment program. For natural gas, low prices and a lack of history of prompt payment by consumers were identified as serious obstacles to gas market development. The IDA held a workshop on gas pricing principles with MoM and other interested ministries in July 2005.

6. Recognizing that appropriate sector and tax laws need to be in place before any investment can be contemplated, the IDA assisted MoM in drafting mining and upstream hydrocarbons laws, and worked closely with MoF and MoM in drafting special tax provisions for extractive industries. The Cabinet approved the Minerals Law of Afghanistan in July 2005, and the Hydrocarbons Law in December 2005. The Income Tax Law of 2005 has a chapter spelling out taxation rules for qualifying extractive industry taxpayers. The provisions include ring-fencing rules, accelerated depreciation, treatment of pre-production expenses and the business receipt tax, recognition of deduction for contributions to a fund for environmental and social obligations, and loss carry-forward and tax stability agreements. IDA also helped examine different fiscal options for hydrocarbons and helped draft a model production sharing agreement. Workshops were held to explain to MoM staff key elements of internationally acceptable laws, regulations, contracts, and tax regimes.

7. The sub-sector studies and assessments are useful and necessary, but they do not capture the inter-related nature of energy sector developmental issues and, consequently, the trade-offs that may be entailed in the strategic decision-making process. In response to the government's request to assist in elaborating a strategy for the development of the country's energy sector with particular reference to priority policy reforms and associated investments over the short to medium term, IDA also prepared and presented an energy strategy note in February 2005, pulling together policy issues for electricity, hydrocarbons, and coal.

#### **Coordination with Other Donor Activities**

13. The Asian Development Bank (ADB), the British Geological Survey (BGS), and various agencies within the U.S. government—USTDA, US Agency for International Development (USAID), and US Geological Survey (USGS)—are playing a major role in assisting MoM in the minerals sector. IDA has worked closely with BGS which has carried out mineral data compilation, assessments, and digitization; institutional strengthening of the Afghanistan Geological Survey (AGS); and investment promotion. BGS activities are funded until 2007. The components of this proposed project were discussed in detail with BGS to ensure that the activities of the two institutions complement one another and ensure long-term sustainability.

14. ADB is focused primarily on natural gas. It has several technical assistance programs for capacity building and regulatory reform in the gas sector. Under its Emergency Infrastructure Rehabilitation and Reconstruction Project, it will be rehabilitating a natural gas pipeline and several producing wells. ADB is preparing a stand-alone natural gas project in the amount of about US\$50 million to go to its Board in 2007, with a planned US\$100 million private sector guarantee to further support rehabilitation of gas-producing wells and pipelines. To complement the activities of ADB, the proposed project will focus primarily on solid minerals, with support for policy issues in the oil sector. The PMU under this project is envisaged to be for the entire ministry.

15. In addition to funding "Evaluation of Investment Options for the Development of Oil and Gas Infrastructure in Afghanistan," USTDA is currently assisting MoM in conducting a cement industry study. It has recently completed analysis of existing data for oil and gas prospects in the north. In the south, USGS is carrying out an airborne geophysical survey using funds provided by the Government of Afghanistan. USAID recently completed a feasibility study for a power plant using natural gas, and is working with ADB and MoM to clarify the logistics and funding sources for producing gas for the power plant.

16. This proposed project complements other donors' activities by focusing on overall regulatory and policy-making functions of MoM, helping MoM to separate its commercial activities from its regulatory and policy role, and strengthening the institutional framework for mineral sector development through establishing and putting into operation a number of units needed to regulate mineral production.

## SECTION C—DETAILED PROJECT DESCRIPTION

1. The objective of this project is to assist the MoM in improving its capacity to effectively regulate Afghanistan’s mineral and hydrocarbon resources sector in a transparent manner and foster private sector development. It is designed to support MoM in developing and implementing a plan for MoM’s transition from being a producer of minerals and other commodities to a policy-maker and regulator. Among the benefits to Afghanistan of development of its mineral resources will be tax revenues, employment, rural development, and economic spin-offs. The project will help

- (1) Improve internal efficiencies of ministry departments by strengthening capacity and streamlining processes within the Administration Department
- (2) Develop regulatory capacity by establishing and putting into operation three new departments—Inspectorate, Cadastre, and Environmental and Social Protection
- (3) Develop mineral resources by supporting the activities of the Sector Policy Unit and the following three departments—Afghanistan Geological Survey, Mines and Hydrocarbons, and Industrial Enterprises.
- (4) Enhancing sector governance through upfront technical assistance: establishment of an International Advisory Council and the endorsement and implementation of the Extractive Industries Transparency Initiative (EITI)

2. According to OP8.50 (Emergency Recovery Assistance) under which this grant falls, emergency recovery projects are normally fully implemented in two to three years. Given the extremely thin institutional capacity at MoM, however, it is proposed that this project be implemented over five years.

3. The project will establish a Program Management Unit (PMU) to supervise day-to-day implementation of the project and coordinate with other donor projects. The PMU will also have procurement and financial management specialists and an advisor for EITI and the International Advisory Council. The project components and their corresponding costs are summarized in Table C-1.

**Table C-1 Project Component Cost (in US\$ million)**

Component	Activities	US\$
<b>Program Management Unit</b>	Coordination of the external budget, assist coordination of the internal budget, project procurement, and accounting	3,400,000
<b>Component 1: Improving Internal Efficiencies</b>	Strengthen the Administration Department	1,300,000
<b>Component 2: Developing Regulatory capacity</b>	Render operational a Mining and Hydrocarbons Title Registry and Cadastre Department Render operational a Mining and Hydrocarbons Inspectorate Department Render operational a Social and Environmental Protection Department	9,000,000
<b>Component 3: Developing Mineral Resources</b>	Formulate sector policy and prepare and promulgate legislation, guidelines, and standards specific to mining and hydrocarbons Strengthen geological knowledge through data collection, geologic mapping, and mineral district studies Raise investment awareness and promote the sector Conduct assessment of SOEs and design sub-sector strategies	10,000,000
<b>Component 4: Enhancing Sector Governance</b>	Improve transparency, competition, and fairness through third-party opinions on transactions provided by an International Advisory Council Full publication and verification of company payments and government	1,350,000

Component	Activities	US\$
	revenues in extractive industries by implementing the EITI	
Other	Workshops, training, vehicles, works, equipment, furniture	4,500,000
	Incremental operating costs – vehicles and equipment	450,000
<b>Total</b>		30,000,000

### Component 1: Improving Internal Efficiencies

4. Activities in this component will strengthen capacity and streamline processes within the Administration Department of MoM covering: budget and planning, financial management, human resources, information technology, and asset management. The project will assist MoM in having an operating information technology and financial management system.

5. Financial management, including budgeting, is a weakness of MoM at present, which is true for most of the other ministries. This project will define a strategy for development of a Finance and Accounts Unit including staffing, budget, and skills requirements; define systems for performing accounting, financial management and internal audit functions; and provide technical support to the budgetary process.

### Component 2: Developing Regulatory Capacity

6. This component will develop MoM's regulatory capacity and put into operation three new essential departments: (1) Mining and Hydrocarbons Inspectorate, which will house a Small-Scale Mining and Extension Services Unit, (2) Mining and Hydrocarbons Title Registry and Cadastre, and (3) Environmental and Social Protection Department, under which falls a Liaison Unit, linking MoM to the National Environmental Protection Agency (NEPA).

7. A Mining Licensing Board will review the activities of the three departments with respect to the rights of investors to operate in the sector. The Board will consist of three MoM department heads and two external advisors. It will check conformity of award, renewal, cancellation or termination, and surrender of licenses, titles, and contracts with applicable procedures and make recommendations to the Minister accordingly. For all applications for mining titles and hydrocarbon contracts, the Board will check the financial and technical competencies of the applicant and the compliance of the proposed work program to established guidelines.

8. The project will prepare operational guidelines and operationalize a Mining and Hydrocarbons Inspectorate. The Mining and Hydrocarbons Inspectorate will begin the process of formalizing the many operating mines currently not licensed and not paying royalties; inspect extractive industry operations to monitor compliance with occupational health, safety, and work-procedural regulations as well as terms of contracts where applicable; and enforce other sector-specific laws and regulations. The Inspectorate will also supervise compilation and publication of statistics and information about the production and sale of minerals and hydrocarbons. The Small-Scale Mining and Extension Services Unit under the Inspectorate will provide technical support and guidance to small-scale miners and assist in the formalization of the many operations currently not paying royalties.

9. Mining and Hydrocarbons Title Registry and Cadastre will house a Licensing Unit and a Production and Royalty Audit Unit. The Licensing Unit will process and register various applications from investors and license holders; issue mineral rights in the form of licenses, authorizations, and contracts; ensure compliance therewith; and maintain a register of industry activity. The Production and Royalty Audit Unit will verify annual mineral and hydrocarbon production; assess royalties based on the quantities and qualities of the minerals

and hydrocarbons produced in accordance with the minerals and hydrocarbons legislation; and ensure payment thereof to the central Treasury. Given the lack of capacity and experience with these modern cadastre and inspection functions, the project will deploy significant technical assistance to these units throughout the duration of the project.

10. One of the principal aims of the project is to create appropriate environmental and social management units within MoM, as required by the Minerals and Hydrocarbons Laws, and to train ministry staff to monitor and supervise the environmental performance of the sector. The Environmental and Social Protection Department will develop an environmental/social policy framework for future sector development; establish and assist NEPA in enforcing sector-specific environmental guidelines and procedures; monitor compliance therewith by private companies; and evaluate, jointly with NEPA, environmental impact assessments, environmental management plans, and abandonment plans as may be required under the legislation. A key function of this department is liaison with NEPA on broader oversight of environmental issues across sectors. Throughout the technical assistance process particular emphasis will be given to training and the development of internal capacity within MoM to carry out these tasks independently.

### **Component 3: Developing Mineral Resources**

11. Promoting the development of mineral resources is the largest component in the project. This component will support activities in the Sector Policy Unit and in the Afghanistan Geological Survey, Mines and Hydrocarbons Department, and Industrial Enterprises Department.

12. The Sector Policy Unit will formulate extractive industries policy and undertake market analysis by way of analyzing supply and demand. It will also prepare sector laws, regulations, and guidelines with input from other departments and units.

13. The Afghan Geological Survey will receive technical support for mapping of prospective mineral regions and mineral resource assessments to encourage new private sector exploration investment. The project will also support the development of a geographic information system for internet-based distribution of information and a public information center. This builds upon the work carried out by the British Geological Survey (BGS) and U.S. Geological Survey in building capacity within the department. AFG will house a Business Development Unit to design short-term resource development strategies and serve as the interface to the private sector on basic information, MoM activities as defined by sector laws and regulations, and tender of resource properties. The Business Development Unit will promote investment by participating in industry trade shows and conferences and preparing promotional materials.

14. The Department of Mines and Hydrocarbons Development and the Department of Industrial Enterprises will be assessed in terms of assets, operations, financial positions, future business prospects, and human resources. Based on the initial assessment, sub-sector strategies for the state-owned enterprises (SOEs) operating under these departments will be developed.

### **Component 4: Enhancing Sector Governance**

15. The government, through the project, will devise and implement a number of measures to ensure competition, transparency, and adherence to international best practices in respect of authorizing new investments in the sector. The approach to governance in this project is described in greater detail in Appendix 4. Within MoM, the project will provide significant advisory technical assistance, create the Mining Licensing Board, and confer operations of the mining cadastre to a qualified private firm. Associated policy work will focus on management of revenues and sharing of benefits. In addition, the project will help

establish and support an International Advisory Council and promote the implementation of the Extractive Industries Transparency Initiative (EITI).

16. The International Advisory Council will consist of a number of experts widely recognized in their respective fields for their knowledge of the sector and emerging trends in governance and transparency in the mining and hydrocarbons sectors. The Council will review procedures for awarding licenses and contracts for all major transactions as well as the negotiated licenses and contracts themselves, and provide a second opinion on the conformity of each transaction with international best practice and the “fairness” of the deal. The Council will also conduct an annual audit of cadastre functions. The Council will report to the Minister of Mines who will present the Council’s findings to the Inter-Ministerial Committee established by the Mining and Hydrocarbons Laws and the management committee of the Afghanistan Reconstruction Trust Fund.

17. The EITI supports improved governance in extractive industries through the full publication and verification of company payments and government revenues from oil, gas, and mining. The government, as part of negotiations for the project, has indicated its intentions to endorse the principles of the EITI. The project will help establish a multi-stakeholder EITI committee, which will agree upon basic EITI procedures and develop a work plan. The committee will draw members from the government, extractive industries, and civil society. The committee will design a reporting template and engage the public in dissemination and discussion of the audit findings.

18. All components are described more specifically in Table C-2.

#### **Likely Risks and Mitigation Measures**

19. The risks to achieving the sector goals are high and can be split into those that cannot be mitigated (political, security) and those that can. A deterioration of the security situation or a reversal in the political process will limit the ability of the Government to implement the reform program. Project risks include the following:

8. *Deteriorating security* in the country is a major risk factor that may discourage foreign consultants to participate in the project and make it difficult to carry out activities outside of Kabul. Despite efforts to improve security by both the Government and the international community, the IDA Interim Strategy Note reports a deteriorating security situation in which insurgents represent a greater threat to the expansion of government authority than in any point in time since late 2001<sup>5</sup>. The project cannot mitigate this risk. To this end, most of the technical assistance will take place in Kabul and extensive travel around the country is not required to implement the project. Furthermore, it will be the responsibility of MoM to exert hegemony over mineral resources.

9. *Reversal of the vision and policy framework outlined in I-ANDS* may affect MoM’s restructuring plans and formulation and implementation of a long-term strategy for its SOEs. This risk, which is outside MoM’s control, does not appear to be significant at the moment, given the consultations that took place during the preparation of I-ANDS, but the level of involvement by the new Parliament is yet to be tested.

10. *Possibility for political interference (“rent seeking”) and corruption*, given the large revenue potential from Afghanistan’s mineral resources, is also a risk. Afghanistan has adopted good governance practices in its recently approved legislation, but the ability of the government to strictly adhere to and monitor compliance will be a challenge, especially given the very weak judicial system. Transparency clauses are found in the Mining and Hydrocarbons Laws, and compliance with these provisions will be monitored in the monitoring framework.

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<sup>5</sup> Interim Strategy Note for Islamic Republic of Afghanistan for the period FY07-08, World Bank Afghanistan Country Unit, March 21, 2006.

11. *Weak implementation capacity* of the executing agency to implement the project is a major risk. The Program Management Unit, which will be established under this project with support from other donors, is designed to mitigate this risk by hiring international and local consultants with requisite expertise who will train and work closely with MoM counterparts. These will include those responsible for procurement and financial management. The core consultants for this purpose came on stream in April 2006 and would help mitigate this risk. It might be difficult to find an adequate number of suitable local counterparts, especially for newly created units. Outsourcing of some of the activities in the early years of the project may need to be considered.

12. *Non-Transparent transactions* are a key investor risk. The private sector may be unwilling to invest in the minerals sector owing to a general risk aversion to conducting business in a post-conflict setting, concern about the readiness of regulatory institutions, or concern about discretionary actions by the ministry in a non-transparent fashion. To bolster investor interest and confidence, the government will want to foster stability and security through implementation of transparent, non-discriminatory/non-discretionary actions based on competitive business processes. The risk of non-transparent processes within the sector will be partially addressed through capacity building within the project, but remains a responsibility of the MOM.

13. *Lack of established mechanisms for inter-ministerial coordination* needs to be addressed, as a number of measures contemplated in the project rely critically on coordination with other ministries, particularly the Ministry of Finance, Ministry of Justice, and the Ministry of Energy and Water. Strengthening inter-ministerial coordination is an important focus of this project.

**Table C-2: Detailed Description of Project Components**

<b>Program Management Unit</b>	
<p><i>Description.</i> Oversee day-to-day management of this project and coordinate with other donor projects, support to the International Advisory Council and the EITI process</p>	<p><i>Project Activities.</i> (i) Project management; (ii) coordination between this project and other donor activities; (iii) execution of procurement and financial management activities; (iv) training of procurement and financial management specialists within MoM; (v) support to the International Advisory Council and the EITI process</p>
<p><b>Component 1: Improving Internal Efficiencies</b></p>	<p><b>Administration Department</b></p>
<p><i>Description.</i> Strengthening of the Administration Department</p>	<p><i>Project Activities.</i> (i) Assessment of skills requirements and staffing of the Budget and Planning, Finance and Accounts, Human Resources, Information Services, and Asset Management Units; (ii) defining administrative systems for performing internal audit functions and improving MoM financial efficiencies using market-based budget and accounting practices, (iii) enabling MoM to prepare an annual budget that reflects the priorities of developing regulatory capacity and mineral resources and submit the budget to MoF in a timely fashion; (iv) developing managerial linkages to other departments/units of MoM and to MoF, specifically relating to expenditure reconciliation between MoM and MoF; (v) development of a staffing requirement plan and ministry-wide assessment of skills and assets, and market-based human resources functions; (vi) development of an operating information technology system; and (vii) sound management and accurate registry of the ministry's physical assets</p>

<b>Component 2: Developing Regulatory Capacity</b>	<b>Mining Licensing Board</b>	
	<b>Description.</b> Review of the activities of the Mining Inspectorate, Cadastre, and Social and Environmental Protection with respect to the rights of investors to operate in the sector	<b>Project Activities.</b> (i) Establishment of the Board consisting of three MoM department heads and two external advisors; (ii) checking conformity with applicable application, renewal, cancellation/termination, and surrender procedures for licenses, titles, permits, and contracts; and (iii) making recommendations to the Minister based on these objective criteria.
	<b>Mining Inspectorate Department</b>	
	<b>Description.</b> Establishing and implementing a system for effective inspection of mining and hydrocarbon operations	<b>Project Activities.</b> (i) Inspection of mining and hydrocarbon operations to ensure compliance on the ground of exploitation companies with applicable regulations and investment obligations; (ii) training of MoM staff to carry out effective inspection; (iii) annual reporting of production in a government databank for public dissemination; and (iv) maintaining a register of industry activity
<b>Mining and Hydrocarbons Cadastre Department</b>		
<b>Description.</b> Putting into operation the Cadastre Department	<b>Project Activities.</b> (i) Developing and implementing a properly functioning mine title and registration system; (ii) developing and implementing precise procedures and guidelines for the issuance and maintenance of titles, permits, licenses, and contracts; (iii) accepting and evaluating license, mining title, permit, and contract applications; (iv) issuing licenses and mining titles; (v) organizing a tender process for awarding large contracts; (vi) technical evaluation of bids; (vii) issuing renewal, cancellation, and termination notices in conformity with prescribed procedures; (viii) receiving, evaluating, and accepting or rejecting surrender notices; and (ix) training of MoM staff to	

		undertake cadastre functions.
	<b>Social and Environmental Protection Department</b>	
	<b>Description.</b> Putting into operation the Social and Environmental Protection Department	<b>Project Activities.</b> (i) Preparation of regulations, guidelines, and standards for social and environmental protection in mining and hydrocarbons; (ii) working with NEPA to monitor compliance with the social and environmental protection measures in both the Environmental Act and sector regulations, guidelines, and standards; and (iii) technical evaluation of environmental management plan, abandonment plan, and environmental impact assessment
	<b>Sector Policy Unit</b>	
	<b>Description.</b> Policy formulation and establishment of a fair and transparent regulatory framework	<b>Project Activities.</b> (i) Establishing a Policy Unit; (ii) extensive capacity building in policy formulation; (iii) development of policies and implementation strategies; and (iv) drafting of laws, regulations, standards, and guidelines
	<b>Afghanistan Geological Survey</b>	
	<b>Description.</b> Data analysis, consolidation, and dissemination, and sector promotion	<b>Project Activities.</b> (i) Creating a public information center for the sale and dissemination of MoM and AGS reports and geoscience products; (ii) geological mapping, data collection, and in-field mineral district studies; (iii) data analysis training; (iv) geographic information system database construction; (v) formation of the Private Sector Promotion and Development Unit; and (vi) participation in international sector promotion events
<b>Component 3: Developing Mineral Resources</b>		

	<b>Departments of Mines &amp; Hydrocarbons Development and Industrial Enterprises</b>	
	<p><b>Description.</b> Strategic sector studies for MoM to develop sub-sector strategies, gross assessment of SOE activities, and contribution toward an emerging policy on SOEs in general</p>	<p><b>Project Activities.</b> (i) Undertaking a strategic assessment of the various sub-sectors in which MoM's SOEs operate; (ii) scoping analysis of current activities and business structures; (iii) assessment of underlying resources associated with each enterprise; (iv) development of guiding notes regarding opportunities for various SOEs; (v) coordination with Asian Development Bank activities on the Afghan Gas Enterprise, cement enterprises, and the fertilizer/power plant; and (vi) contribution toward an emerging policy on SOEs.</p>
<b>Component 4: Enhancing Sector Governance</b>	<b>International Advisory Council</b>	
	<p><b>Description.</b> Improved transparency, competition, and fairness through third-party opinion on transactions</p>	<p><b>Project Activities.</b> (i) Preparation of terms of reference and procedures for the Council; (ii) formation of the Council; (iii) Council reports on transactions and on annual audits of cadastre functions given to the Minister of Mines and the management committee of the Afghanistan Reconstruction Trust Fund</p>
	<b>Extractive Industries Transparency Initiative</b>	
	<p><b>Description.</b> Full publication and verification of company payments and government revenues in extractive industries</p>	<p><b>Project Activities.</b> (i) Statement by the government endorsing the principles of the EITI and committing itself to its implementation; (ii) identification of stakeholders; (iii) formation of the multi-stake holder committee; (iv) designing of the reporting template; (v) audits of payments made and received; (vi) public dissemination and discussion of EITI audit reports</p>

**SECTION D—STUDIES AND TECHNICAL ASSISTANCE**

Studies and technical assistance (TA) required for short-term recovery, reduction of loss in case of a future disaster, or development of a disaster mitigation strategy.

Not applicable.

## SECTION E—INSTITUTIONAL ARRANGEMENTS AND PROJECT IMPLEMENTATION

### **Institutional Arrangements**

1. The Ministry of Mines (MoM) will have overall responsibility for project implementation. It is recognized that MoM has a weak implementation capacity and lacks qualified personnel as a result of the twenty-five years of conflict when a number of trained people left the country and the majority did not have access to higher education. Many of the staff are close to retirement, and have had virtually no exposure to policy formulation, sector regulation, recent developments in international industry practice (technological advances; health, safety, and environmental standards; regulatory, fiscal, and contractual regimes), modern methods of management, contract negotiation, and supervision of private investors.

2. As a result of these constraints, MoM will retain the services of several consultant firms as well as individual local and international consultants to provide teams of technical staff. The project will be implemented over a five-year period from July 2006 to July 2011. In order to build capacity, a “train the trainer approach” will be employed, with initial international staff undertaking much of the initial capacity building/institutional strengthening, but progressively transferring to national staff who, once trained, will lead in later years. The ability of MoM line staff to be trained and to progressively take over project implementation is critical to the sustainability of the project. A broad sketch of the organizational structure under the project is given in

3. Figure E-1.

4. Under this project, a Program Management Unit (PMU) will be created to oversee the day-to-day implementation of the project and ensure compliance with provisions in the Grant Agreement which govern procurement, financial and project management. Other donor-funded programs within the Ministry would also come under the general umbrella of the PMU in time.

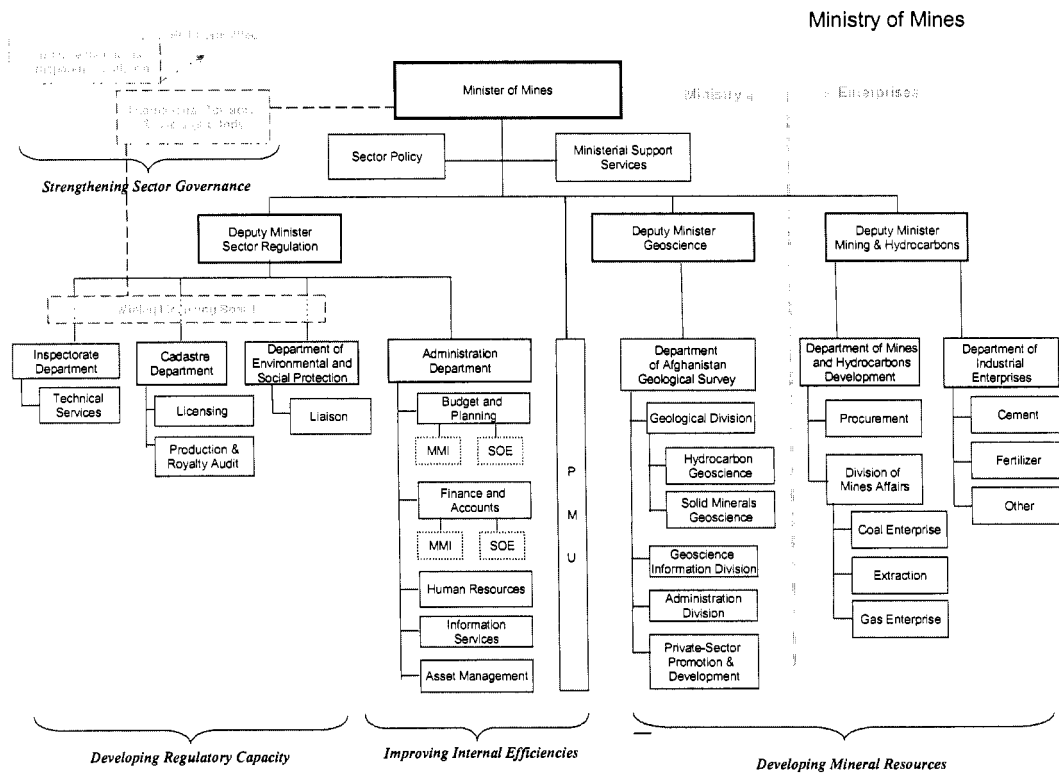
5. The ministry has an immediate need for a functioning inspectorate and cadastre. For this reason, it was agreed during the negotiation that two departments would be staffed with international inspection and cadastre specialists and that these functions would commence immediately, initially undertaken entirely by the international specialists. Training will be provided to the ministry staff in parallel to ensure that, by the end of the project, ministry staff will be able to perform the inspection and cadastre functions entirely on their own.

6. Two project elements will interact closely with entities outside of MoM. The International Advisory Council provides its findings and reports via the Minister of Mines to the Inter-Ministerial Committee established by the Mining and Hydrocarbons Laws and to the donor community through the management committee of the Afghanistan Reconstruction Trust Fund. The principal counterpart for the EITI multi-stakeholder committee is the Ministry of Finance.

### **Procurement Arrangements**

7. Procurement arrangements are described in Appendix 5. The procurement of goods and services financed by IDA will be carried out in accordance with the appropriate World Bank guidelines. A procurement/financial management specialist has been hired by MoM under the Project Preparation Facility (PPF) to assist the ministry in preparing procurement packages. A procurement team will be established for the project, led by an international procurement specialist initially. Prior review threshold and methods of procurement are summarized in Appendix 5.

**Figure E-1 Conceptual Framework for Personnel and Units under the Project**



### Financial Management, Disbursement, and Audit

8. Financial management (FM) arrangements are described in Appendix 6. The procurement/ financial management specialist hired under the PPF will assist MoM in confirming interim unaudited financial reports formats and developing a financial management manual and a project implementation manual.

9. Quarterly unaudited interim financial statements will be used for project monitoring and supervision. The financial statements will be produced based on records kept on Excel spreadsheets or some other simple database. For disbursement, a single designated account will be opened at Da Afghanistan Bank or in a local commercial bank.

10. MoF-Special Disbursement Unit (SDU) will verify that the project FM system at MoM correctly handles preparation of payment applications, expenditure reconciliation, recording of expenditures, and obtaining and processing cash advances from SDU.

### Environmental and Social Safeguards

11. This project focuses on the provision of technical assistance and capacity building to MoM. The project will implement the tasks related to environmental and social safeguards with reference to the National Environmental Action Plan in cooperation with the National Environmental Protection Agency (NEPA).

12. The project will not involve direct IDA investments in specific mineral assets or the preparation of pre-feasibility, feasibility, or engineering studies. The nature of advisory services to be provided to MoM is to enhance the capacity of MoM to evaluate and facilitate mineral and hydrocarbon investment in a manner that is consistent with international best practice in terms of technical, environmental and social standards.

13. It is recognized that there are currently a number of potential investors covering a range of mineral and hydrocarbon commodities that are waiting for the formalization of the regulatory framework in order to take advantage of opportunities to invest in the sector. This could result, during the implementation of the project, in the need for advice on specific mineral-based transactions to be provided to MoM. These transactions will be used by the technical assistance project as case studies to develop the required internal capacity to facilitate mineral investment. In such cases the project will ensure that full environmental impact assessments be prepared by the investor consistent with the requirements of MoM and NEPA. The transaction case studies will thus provide opportunities to train MoM staff in the application of the relevant safeguard policies and environmental and social assessment procedures.

14. Work is also required to prepare strategic assessments and evaluations of existing SOEs. This work will be in the nature of strategic technical and policy assessments as well as training of MoM staff in technical, environmental and social assessment evaluations.

## SECTION F—FINANCIAL AND ECONOMIC JUSTIFICATION

1. The World Bank Group's work over the past 20 years with many countries on mining sector reform agendas helps to address two common questions: (1) Is there a good economic justification for using public funds to pay for expensive technical assistance to improve the enabling environment and thereby to help attract new investment?

(2) How much could the government benefit from extractive industries in the medium and longer terms if new investment were to be generated? These questions relate to the direct consequences that use of public funds may have to generate income and other benefits streams for the country. Equally important are the results which may be achieved in terms of preventing fraud and other negative impacts of the sector if public funds are not used for the purposes of strengthening government oversight of the sector.

2. The World Bank Group's programs in developing countries that aim to improve the ability of the government to attract private sector investment and to monitor and regulate it in an effective manner provide strong evidence that funding technical assistance is beneficial to directly stimulate revenues for the government as well as to prevent abuse and fraud. Table F-1 shows the "before" and "after" results of the reform programs in terms of increased exploration investment, production, and exports.

**Table F-1 Mining Reform "Before" and "After": Results in Selected Countries**

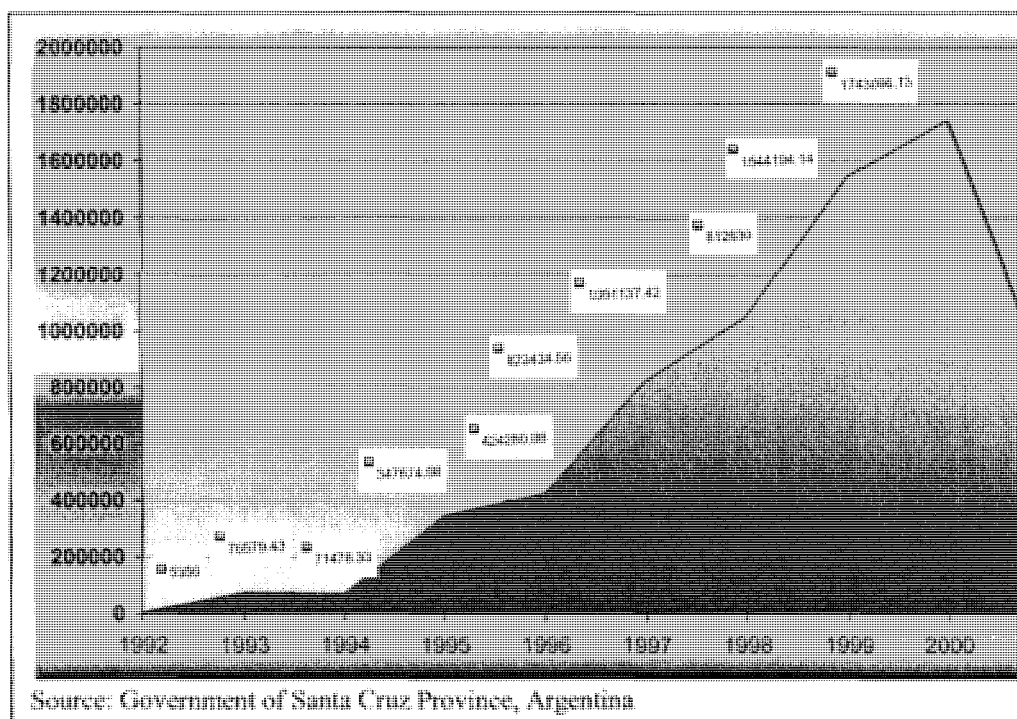
Country	Exploration Value US\$ Million		Production Value US\$ Million		Exports Value US\$ Million	
	Before	After	Before	After	Before	After
Argentina	<3	150	340	1,310	70	700
Chile	15	250	2,400	7,500	2,300	6,900
Peru	10	200	2,000	3,900	1,900	3,600
Tanzania	<1	35	53	350	53	350
Ghana	<1	N.A.	125	700	125	650
Mali	<1	30	<1	242	<1	230

3. Specifically, the mining sector reform programs provide extensive technical assistance to re-write the basic sector legislation and regulations; liberalize the fiscal regime while, at the same time, tighten up on tax compliance; strengthen public sector oversight institutions including cadastre management and mines inspectorate; improve environmental review and controls on projects; improve and enhance the geo-science database; and provide extensive training and capacity building in key functions. The results of these programs has been demonstrably positive: in almost every instance key indicators such as exploration expenditure, production value, export earnings, tax receipts, and value added from the sector have increased substantial from the levels before the reforms.

4. The case of Argentina is indicative of the results that can be achieved. In 1991, the new government announced an ambitious program of macro economic and sector reforms to reduce the presence of the state in all sectors of the economy. The government, with technical assistance provided by two successive Bank projects in the total amount of US\$70 million, initiated work to reform the mining legislation, improve the tax regime, strengthen government oversight institutions at the federal and provincial levels, put into place a modern computerized mine title and registry system, up-grade the geological information systems to international standards, and undertake other reforms. Argentina mineral production has increased from US\$341 million to US\$1,310 million; annual expenditures in exploration are over US\$150 million and in capital expenditures US\$350 million. Finally, exports of minerals have increased ten-fold from US\$78 million to US\$700 million. In 2001, by value, minerals exports earnings surpassed those of beef. The exploration and production booms have

continued: in 2005, Argentina had three “mega” mining projects which will produce very substantial revenues to the government and benefits streams for the nation.

**Figure F-1 Surface Rents and Tax Receipts, Santa Cruz Province, Argentina, 1992-2000 (Amounts in US\$ per Year)**



5. Fiscal receipts in Argentina have also increased by substantial amounts. In Santa Cruz province, for instance, after the introduction of a modern mining title registry and cadastre system, made possible through the technical assistance provided under the Bank’s project, receipts of surface rents, fees, and some royalties increased from US\$53,000 in 1992 to US\$1.7 million in 2000 (the latest year of full data availability) in this example.

6. The excellent results obtained in Argentina could be repeated in Afghanistan if the enabling environment for new investment is improved and proper title registry, tax collection and monitoring procedures are put into place. The Bank estimates that over US\$500,000 annually could be generated in surface rents and fees if technical assistance is used to put into place a functional cadastre registry. Furthermore, strengthening the ability of the government to assess and collect taxes and royalties from existing mining and quarry operations could generate US\$10–20 million annually within three years. As new mining operations come on stream, and in particular the Aynak copper project, the potential for new revenue to the Government increases even further. Assuming a five year exploration and development profile for the Aynak project and a capital depreciation period of five years, it is anticipated that direct revenues from the sector could increase to US\$100–120 million annually by 2015. The potential for commercialization and expansion of existing coal operations, and the potential for new gold mining projects could add to this total with possible annual receipts of up to US\$150 million by 2015. In addition to the direct revenues from mining operations there are substantial indirect revenues from wages tax, import duties and excise taxes, as well as taxes on profits of suppliers and support industries.

7. Also of significance in terms of investment and revenue is the amount spent by exploration companies in their attempts to identify and develop new mineral deposits. A functioning cadastre will facilitate new exploration through the granting of secure licenses to explore. This will allow for expenditure on new drilling activity and related field support

logistics, analytical laboratories, and payments of wages and taxes which will contribute directly to regional economies in mineral rich provinces. It is anticipated that exploration expenditures by mining companies could reach US\$10–20 million per year within five years.

## SECTION G—ACTION PLAN

1. This section tabulates and summarizes the principal agreements reached during negotiations, and the key implementation activities and indicators that are to serve as monitoring devices for the borrower and IDA.

**Table G-1 Afghanistan: Sustainable Development of Natural Resources Project Results Framework**

Project Development Objective	Definition	Outcome Indicators
Enhance the governance of the mineral and hydrocarbon resources sector	Transparency, competition, and fairness of mineral and hydrocarbon development agreements	Effective review by the Ministry with advice from the International Advisory Council
Effectively regulate the sector in a transparent manner	Strict adherence to the dispositions of the Minerals Law and Hydrocarbons Laws and associated regulations in the issuance of mining titles, licenses, and contracts, and compliance of the contractors with their contractual obligations	Issuance of mining titles within the timeframe defined in the Minerals Law
		All new hydrocarbon exploration, development, and production resulting from competitive tender
Foster private sector development	Ability to attract new investments	Two new medium-size mines under development by 2010
		Two hydrocarbon licensing rounds by 2011

2. Table G-2 lists, against each identified activity, which entity (government, consultant, donor, other) is responsible for the task, and the expected benchmark outputs according to the implementation dates specified.

**Table G-2 Project Implementation and Performance Indicators**

Project implementation objectives	Specific elements	Outputs	Output indicators	Baseline Target	Target completion in each project year (cumulative)					Data collection and reporting		
					PY 1	PY 2	PY 3	PY 4	PY 5	Frequency and reports	Collection instruments	Responsibility
<b>Improving internal efficiencies</b>	Strengthen budget formulation capacity	MoM budget	Budget submission to MoF in a timely manner	Budget does not reflect MoM priorities Budget reflecting the priorities of developing regulatory capacity and mineral resources submitted to and approved by MoF	50 %	100 %	100 %	100 %	100 %	Annual budget	Annual budget submission to MoF	MoM
<b>Developing regulatory capacity</b>	Establish three new regulatory departments	Operating cadastre, Inspectorate, and Environmental and Social Protection Departments	Licenses, titles, and contracts are issued in accordance with regulations and guidelines	No licenses, titles and contracts Exploration licenses Quarry authorizations Exploitation licenses Hydrocarbon licensing rounds	0	5	12	22	37	PMU quarterly monitoring and evaluation reports	Minutes of Mining Licensing Board meetings	MoM/ Mining Licensing Board
					0	10	35	110	210			
					0	3	6	9	12			
					0	1	0	2	2			

Project implementation objectives	Specific elements	Outputs	Output indicators	Baseline Target	Target completion in each project year (cumulative)					Data collection and reporting		
					PY 1	PY 2	PY 3	PY 4	PY 5	Frequency and reports	Collection instruments	Responsibility
<b>Developing mineral resources</b>	Strengthen geological knowledge	Collection and dissemination of geoscience information	In-field mineral district studies	No studies A minimum of one study a year	0	1	2	3	4	Annual study reports	Study reports and maps	AGS/MoM/consultants
	Promote private-sector investment in mining and hydrocarbons	Participation in international promotion events	Expressions of interest by private companies	No active promotion At least one promotional event a year	1	2	3	4	5	Annual report, and as events occur	Publicity material, event and annual reports	MoM/consultants
<b>Enhancing sector governance</b>	Put into operation International Advisory Council	Improved transparency, competition, and fairness	Reports on transactions	No reports on transactions Reports on all major transactions	60 %	100 %	100 %	100 %	100 %	As needed	Fairness reports	International Advisory Panel
	Adopt and implement EITI	Audit mechanisms and reporting in place	Audits being conducted and results published	No reporting and auditing of payments paid and received Regular auditing and reporting of payments paid and received	10 %	30 %	50 %	80 %	100 %	Annual publication of audit reports	Annual EITI audit reports	EITI audit committee/ MoF/MoM

## APPENDIX 1: EXTRACTIVE INDUSTRY STATE-OWNED ENTERPRISES IN THE MINISTRY OF MINES

Important state-owned enterprises and departments in extractive industries under the Ministry of Mines are described below.<sup>6</sup>

- **Mines Extraction Company** The Law of Mines gives this company exclusive rights to all mineral and metal deposits other than coal and hydrocarbons. It enters into contracts with private firms for extraction of minerals and metals. Revenues and expenditures appear to be neither recorded nor reported.
- **North Coal Enterprise** This enterprise suffers from long-standing neglect of the mines, lack of development capital and maintenance budget, and effects of poor past mining practices. From an annual production of 250,000 tonnes as recently as 15 years ago, annual production is now down to 30,000 tonnes. The enterprise also purchases for distribution an additional 60,000 tonnes of coal per year from artisanal production. Capital investment of US\$5 million is needed immediately (and being provided as emergency assistance by MoF) with an additional US\$4 million over the next three years to return production to 190,000 tonnes per year (tpy). Annual coal demand for cement alone could easily reach 200,000 tonnes in the not too distant future.
- **State Gas Enterprise** From the daily peak production of 11 million cubic meters (m<sup>3</sup>) in 1978–79, the State Gas Enterprise is currently producing 0.5 million m<sup>3</sup> per day. Infrastructure for local production of gas, treatment, and transport is non-existent or functioning inefficiently.
- **Cement Enterprises** Ghori (1&2), Herat, and Jabal Seraj are the four operating cement enterprises. Among them, only Ghori 1 is producing at a reasonable level (50 percent of capacity). Coal and electricity shortages are the main constraints on production. All four enterprises use technology that is obsolete and much less efficient than modern processes.
- **Kud Bergh Fertilizer and Power Plant** This plant uses inefficient and obsolete technology and suffers from high operating cost, extensive cannibalization of equipment and machinery, and a lack of ready available spare parts. It is not a viable entity and even full rehabilitation is not expected to make this plant economic. This plant has not been paying regularly for gas, the primary feedstock.
- **Afghan Geological Survey (AFG)** AFG has been receiving assistance from the British Geological Survey (BGS) and the U.S. Geological Survey (USGS). There was significant geological mapping of the country between 1967 and 1971 by Italian, German, Soviet, and Afghan geologists. Soviet and Afghan geologists have also in the past completed mineral evaluation studies on 110 deposits.
- **Department of Oil and Gas** Created in 2003, this department is responsible for the State Gas Enterprise and the Oil and Gas Exploration Department.
- **Oil and Gas Exploration Department** This department has 1,800 employees with no specific tasks. There has been no funding for field services for about six years.

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<sup>6</sup> Modified from Afghanistan: Managing Public Finances for Development, The World Bank, December 2005.

## APPENDIX 2: LETTER OF SECTOR DEVELOPMENT POLICY

*(in this appendix the term “MMI” and “Ministry of Mines and Industries” refers to the now renamed “MoM” and “Ministry of Mines”)*



*Islamic Republic of Afghanistan*

### AFGHANISTAN’S MINERALS SECTOR: LETTER OF SECTOR DEVELOPMENT POLICY

Afghanistan Ministry of Mines and Industries  
Revised February 27, 2006

The goal of the Ministry of Mines and Industries is “...to provide a transparent and efficient regulatory environment for Afghanistan’s mineral, oil, gas, and industrial development that enables private-sector led investments, facilitates sustained economic growth, and increases revenues to the government.”<sup>7</sup>

The Afghanistan mineral sector consists of five major commodity groups: (i) hydrocarbons (principally gas), (ii) solid fossil fuels (principally coal), (iii) base, ferrous and precious metals, (iv) construction materials (principally crushed stone and cement), and (v) dimensional stone and gemstones. These industries were much more productive in the 1970s and 1980s than they are today. The civil wars of the 1980s and 1990s severely crippled production and exploration. Existing mineral production is now limited to some natural gas production in Sherbergan, small coal operations in Baghlan and Bamyan provinces, limestone for two operating cement plants, construction materials (sand, gravel, crushed rock) nationwide, and gemstones and dimensional stone from artisanal operations.

Even though development of a vibrant minerals sector has so far eluded Afghanistan, the resource base and undeveloped potential is substantial. Development of industrial mining could substantially increase government revenues and export earnings as well as create new job opportunities and downstream industries. Also, supply of essential commodities such as coal and industrial materials to local industries is critical. Attracting new investment to the sector is thus an essential element to help reduce poverty.

For the past several decades the Ministry of Mines and Industries (MMI), the government institution responsible for the mining sector, has been centered on extractive industries and associated heavy industries: (a) mining of minerals and construction materials, (b) petroleum exploration and production, and (c) the operation of downstream industries that utilize extractive industry outputs. Historically, MMI has operated as a vertically integrated extractive industry conglomerate with enterprises reporting to the center, but operating autonomously in terms of budget planning and revenues management. However, the government has made the strategic policy decision that MMI should transform itself into a regulatory body to facilitate private sector investment rather than own and operate mines, industries, or other state-owned enterprises. The obstacles facing MMI to make this transition have been summarized in the IDA document “Mining As A Source of Growth” (2004). The study concluded that MMI is not appropriately organized, staffed, and equipped to regulate the sector and stimulate new investment. With the addition of the light industries wing in early 2005, MMI added a cluster of 10 textile-based enterprises. At this time approximately

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<sup>7</sup> The Ministry of Mines and Industries (MMI) has since been renamed the Ministry of Mines (MoM).

12,000 employees work for the Ministry and its various state-owned enterprises (SOEs), including about 7,000 employees who work with the oil, gas, and minerals sectors. This organizational structure does not reflect MMI's pending role as mineral sector regulator, and concerted institutional strengthening and capacity building is needed. Moreover, due to the political turbulence of the past 30 years, MMI has lost much of its institutional capacity to supervise the sector. MMI will have to be significantly strengthened to meet the new challenges of developing the country's mineral wealth.

To this end, MoM acknowledges that (a) future resource development must be guided by good governance policies, and (b) institutional strengthening and capacity building is needed to ensure that the sector meets national objectives and benefits the people of Afghanistan. This letter builds on MMI's current Strategy for the Mineral Resources Sector of Afghanistan (April 28, 2005, Revised January 29, 2006).

### **Good Governance Policies**

Within the Interim Afghanistan National Development Strategy (I-ANDS), a) security; b) governance, rule of law, and human rights, and c) economic and social development, are deemed essential to consolidating peace and stability, reducing poverty, and achieving prosperity through broad-based and equitable economic growth. Under the economic and social development pillar, the government commits to a five-year strategic benchmark to create an enabling regulatory environment and improved infrastructure for profitable extraction of Afghanistan's mineral and natural resources.

The MMI acknowledges that development of mineral resources will require investments in excess of government abilities and thus seeks to establish conditions and an enabling environment to attract and retain investment by both private local and international groups. As a first step, the ministry has undertaken preparation and passage of (i) the Minerals Law (July 2005) and (ii) the Hydrocarbons (Exploration and Production) Law (December 2005). To make these laws operational, MMI must now build institutional capacity to address institutional barriers and increase administrative efficiency.

To do so, MMI is developing a national minerals policy that reflects the strategic orientations of overall government policy as well as recognizing the complexities of issues and challenges facing the hydrocarbons and mineral industries. This policy includes the following main elements.

#### ***Good Governance of Afghanistan's Mineral Resources.*** MMI will:

1. be guided by principles of sustainability to define a national minerals development policy;
2. exert central government sovereignty over mineral resources located throughout the national territory;
3. stimulate and mobilize local and international private investment in minerals exploration and development;
4. increase tax revenues to the central government from minerals production and ensure adequate disclosure thereof;
5. strengthen government supervisory institutions to distinguish clearly between the roles and responsibilities of the regulator and SOEs;
6. promote the transition of state-owned mineral resource enterprises to operate on a commercial basis;
7. promote scientific and geological investigation into the nature and extent of Afghanistan's mineral resources and to make such information available to the public and potential investors.

***Ensuring that Afghans Benefit from Production of Resources.*** MMI will

1. seek to ensure that communities benefit from extractive industries and, where possible, link local economic development (small to medium enterprises) to the project;
2. seek to ascertain broad support of affected communities through informed consultation and capacity building at the local level;

***Addressing Environmental and Social Issues.*** MMI will:

1. ensure, in cooperation with the National Environment Protection Agency, that mining operations are conducted in an environmentally and socially sustainable manner through the enforcement of legislation and creation of an Environmental Protection Department, and that operators conduct proper environmental impact assessments and develop and implement environmental management plans;
2. ensure adequate frameworks and capacity to implement mine closure/well rehabilitation and financial surety on project to do so;
3. undertake a rolling update of technical guidelines using accepted best practices.
4. begin to regularize small scale mining and provide for adequate institutional and technical support of these activities;
5. apply internationally accepted policies to safeguard social protection associated with mineral production; and
6. seek to implement globally recognized voluntary principles on the use of security forces.

***Coordination between MMI, Other Government Ministries, and Donors.*** MMI will

1. coordinate donor programs and work with other government ministries in a manner consistent with the ministry's policies and the broader objectives of the government;
2. develop a program management unit (PMU) for this purpose.

## **Institutional Strengthening and Capacity Building**

As detailed in I-ANDS, the Government of Afghanistan is putting into place a private-sector led economic development model, with the Government divesting itself of ownership of the means of production, and instead carrying out policy making and regulatory functions. Based on this model, the roles and responsibilities of MMI will fall into the following three main areas:

- ***Setting Sector Policy.*** MMI will set and implement policies for the mining, hydrocarbon, and the industrial sectors. MMI will take the lead in formulating policies and drafting laws, regulations, standards, and model contracts.
- ***Regulating natural resource production and industrial activities.*** MMI will take the lead in (i) negotiating and issuing licenses and contracts, and (ii) ensuring compliance with laws, regulations, licenses, contracts, and standards. Working closely with other ministries, MMI will also engage in economic regulation where there is a natural monopoly or little effective competition. Regulation requires that MMI be able to measure or verify production; calculate royalties, fees, and the Government's petroleum production share; and inspect and make the necessary measurements to check compliance with health, safety, and environmental standards.
- ***Moving to market- and private-finance based sectors.*** At present most activities in individual sectors are financed and managed by the Government. MMI is therefore both a regulator and an operator. In due course, the Government of Afghanistan plans to privatize or liquidate most SOEs. MMI will maintain an up-to-date database on natural resources and production, provide vital data and information (such as production, sale, exports, imports, prices paid) to private sector participants and promote the sectors to potential investors. Together with the Ministry of Finance (MoF), MMI will lead this transition from government-owned and controlled operations to private-sector run operations in mining, hydrocarbons, and industry.

The transformation of MMI to this regulatory role will require a number of actions. These include:

- ***Creating a Modern Legal and Regulatory Framework.*** The MMI has prepared new Minerals and Hydrocarbon (Exploration and Production) Laws, and both laws have now been passed by the Cabinet. They reflect international standards, apply to all investors local and foreign, and provide the basis for transparent allocation of mineral and hydrocarbon rights to private entities. Terms of reference have now been prepared to engage legal experts to help the Government draft mining regulations and a model contract.
- ***Implementing an Internationally Competitive Fiscal and Mining Taxation Package.*** The Income Tax Law of 2005 provides internationally competitive fiscal terms for qualified extractive industry taxpayers. These provisions cover depreciation, amortization, loss carried forward, and stability.
- ***Building Strategic Planning and Technical Capacity.*** As an organization, MMI traditionally has had limited experience in formulating sector strategies and policies for private sector growth, or in interacting with the public. MMI is organized differently from most Afghan ministries, because it has had limited direct contact with the public. Instead, its services were directed to the Government and to support of its SOEs. Today, formulating strategies for the new MMI will require a better understanding of factors that make sectors economic and efficient. It will also be important to understand the optimal sectoral structures and appropriate legal and contractual frameworks. Strategic planning also requires knowing how best to handle SOEs. The IDA and the Asian Development Bank are both working to build strategic planning and sectoral capacity within MMI. Further, the British Geological Survey and the US Geological Survey have important programs targeted towards professional development within MMI, principally within Afghan Geological Survey.
- ***SOE Reform.*** The Ministry of Finance is responsible for overseeing SOE reform. Its SOE department has already developed an approach to SOE reform and a preliminary classification of SOEs. By recent Cabinet decision, privatization decisions now require joint actions by both a line ministry and MoF. The MMI is working with MoF on these issues to ensure that strategic considerations - such as the need to retain production of certain essential commodities in the short term given the lack of private sector investment and technical sectoral expertise - are fully taken into account in the privatization strategy and its implementation.
- ***Regularizing the Informal Sector.*** This is needed to effectively regulate informal operations and to enforce legal, environmental, and social compliance.

To achieve the above goals, MMI needs extensive capacity building and institutional strengthening.

- Emphasis will be placed on professional development of personnel through training and exposure to best international practices in the mineral industries.
- Administrative units/departments will be given clear and consistent mandates and procedures will be established to enhance communication and coordination between them.
- Regional offices will be strengthened in order to reinforce links between the center and the outlying areas.
- Emphasis will be placed on transparency and good governance and specific procedures will be established in this respect.
- Establish and, if necessary re-organize, departments to handle policy and administration, cadastre services, mines inspection, health and safety issues, environmental matters, commodity certification and quality control, and geological

survey and laboratory services. Develop programs for promotion of the mining sector to local and foreign investors.

- Competitively tender mineral deposits internationally for which the government has detailed and complete geological information.
- Develop and implement plans for the rehabilitation and eventual liquidation/commercialization/privatization of SOEs.
- Establish a department to support small scale mining.

### **From Policy to Action**

MMI seeks to build minerals sector governance to stimulate economic and social development, bring stability to rural areas, fight poverty, and bring prosperity through broad-based and equitable economic growth. Strategic investments are needed through a coordinated multi-donor assistance program across several years. MMI invites the international community, donors, bilateral agencies, and civil society to take a stake in the process and ensure that the nation moves forward building upon a strong minerals sector. This letter is our commitment to actions that will sustain the government and the people for years to come.

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Eng. Mir Mohammed Ashan Sediq  
Minister of Mines and Industries  
Government of Afghanistan  
February 27, 2006

**APPENDIX 3: MOM OVERALL DONOR ASSISTANCE TO THE MINERAL SECTOR IN AFGHANISTAN<sup>8</sup>**

<i>Objective/Rationale</i>	<i>Activity</i>	<i>Outputs</i>	<i>Roles &amp; Responsibilities</i>
<b>Establish central government control</b> over natural resources, which is essential for ensuring their rational exploitation	Prepare and pass mining and hydrocarbon legislation	Minerals Law, Hydrocarbons Law, model production sharing contract	WB technical assistance/US AID Rule of Law Project/US Embassy
	Establish mine title and licensing system; reinforce inspection functions of MoM	Creation of mine cadastre office and mines inspectorate in MoM	BGS 2003–2006 and strengthening through capacity building WB Nat. Res. Project beginning July 2006
<b>Reinforce ability of government</b> to set sector policy, prepare and enforce legislation, stimulate new investment, and monitor developments in the sector	Prepare and pass fiscal regime for natural resources	Fiscal provisions for extractive industries in the Income Tax Law	IMF, Adam Smith Institute, US AID, WB technical assistance to MoF
	Establish a gas regulatory framework	Strengthened regulatory framework	ADB: Support for establishing a gas regulatory framework
	Capacity building and institutional strengthening	Sector-wide capacity building and institutional strengthening, including creation of key administrative units and reorganization	ADB: Institutional strengthening of the gas sector WB Nat. Res. Project beginning July 2006 BGS and USGS training programs within AGS
	Priority Reform and Restructuring (PRR)	PRR pilot program	BGS Pilot Reform within AGS

<sup>8</sup> Taken from Ministry of Mines and Industries, Strategy for the Mineral Resources Sector, Afghanistan April 28, 2005, Revised January 29, 2006

<i>Objective/Rationale</i>	<i>Activity</i>	<i>Outputs</i>	<i>Roles &amp; Responsibilities</i>
	Prepare and pass a National Minerals Development Policy	A national policy guided by the principles of sustainable development and best industry practice	WB Nat. Res. Project beginning July 2006, guided by I-ANDS, MoM goals, and the outcome of the WB's Extractive Industry Review
<b>Stimulate investment</b> in the minerals sector by private local and international investors for large and small operations, existing or new deposits, and rehabilitation of certain operations	Tender of Aynak copper; private investment	Mineral tender process and associated learning, investment into Aynak bankable feasibility and, subject to a production decision, investment of US\$100-250 million	TAFSU May–October 2006
	TAP Pipeline	TAP Feasibility Study Multi-government coordination	ADB: Feasibility study for TAP, completed in 2005, facilitation of Steering Committee meetings
	Rehabilitation of gas-producing wells and repair gas pipelines, US\$24 million	Several wells and a pipeline rehabilitated	ADB: Emergency Infrastructure Rehabilitation and Reconstruction Project
	Rehabilitation of existing coal operations	Equipment needs definition Procure and install equipment for rehabilitation	MoM, engineering analysis completed October 2004 Procurement completed January 2006;
	Initial National Mineral Resource Assessment, compilation, geophysical / geochemical surveys, cartographic work	Airborne geophysical survey of key mineral resource areas	USGS (unpublished) 2005–2006

<i>Objective/Rationale</i>	<i>Activity</i>	<i>Outputs</i>	<i>Roles &amp; Responsibilities</i>
	Development of coal for thermal industries and space heating	Assessment of Dar-e-suf and other selected resource areas Action plan to attract investment and/or organization of local producers	Preliminary resource estimation, WB Nat. Res. Project beginning July 2006
	Cement, construction and quarry materials	Assess current cement operations and develop a sub-sector action plan	TDA Cement Study October 2005–February 2006
	Gemstones and small scale mining	Establish an action plan for licensing; provide extension services through MoM; create gemstone exchange in Afghanistan	Action plan, WB Nat. Res. Project beginning July 2006
<b>Increase geo-scientific knowledge in key areas to attract new investment</b>	Prioritize key mineral resource areas	Analysis of gas fields	ADB: Sofregaz and Energy Markets for ADB, June 2004, “Energy Sector Review and Gas Development Master Plan” USTDA/WB: Hill International, March 2005, “Evaluation of Investment Options for the Development of Oil and Gas Infrastructure in Afghanistan”
	Reconnaissance mapping and sampling	Select areas for rapid private sector promotion (e.g., Aynak copper belt)	WB Nat. Res. Project beginning July 2006
	Investment promotion campaign	Brochures, technical sessions, investment	ADB: Gustavson Associates for the Government of Afghanistan, July 2005,

<i>Objective/Rationale</i>	<i>Activity</i>	<i>Outputs</i>	<i>Roles &amp; Responsibilities</i>
	Assessment and development plan for Hajigak iron ore Reinforce AGS	Action plan Logistical and other support to AGS to build mapping capacity	“Promotion of Oil and Gas Producing Areas to the Private Sector” BGS March 2005 / 2006 – World Mines Ministers Forum and Prospectors and Developers Association Annual Meeting Unfunded BGS 2004 – 2007
<b>Increase tax revenues to government</b>	Strengthen inspectorate and production audit capacity	Development of tax assessment policies and procedures, increased inspections of existing operations	WB Nat. Res. Project beginning July 2006
<b>Create jobs and new spin-off industries for locals</b>	Work with producers and communities on development plans	Community development plans New direct and indirect jobs	WB Nat. Res. Project beginning July 2006
<b>Extractive Industries / State-Owned Enterprises</b>	Prepare inventory and strategic plan, part of which will be to assess full value of mining assets	Asset value of plant and equipment, underlying resources, markets, competitive advantages, transportation, etc. A strategy for either immediate privatization, liquidation, or retention by MoM followed by	WB Nat. Res. Project beginning July 2006 WB Nat. Res. Project beginning July 2006

<i>Objective/Rationale</i>	<i>Activity</i>	<i>Outputs</i>	<i>Roles &amp; Responsibilities</i>
		<p>commercialization and eventual privatization, and business plans for select operations</p> <p>Solicit expressions of interest through international tender, working with MoF SOE Privatization Department</p>	<p>Unfunded</p>
<p><b>Improve environmental and social performance</b> of minerals sector</p>	<p>Establish regulations and standards</p> <p>Mine / well closure and rehabilitation (where applicable)</p> <p>Enhance MoM capabilities including laboratory</p> <p>Rehabilitation of the AGS building</p>	<p>MoM Environmental regulations and procedures</p> <p>Mine / Well closure</p> <p>Improved capacity to monitor sector performance</p> <p>Rehabilitated space for AGS</p>	<p>WB Nat. Res. Project beginning July 2006 (possibly in conjunction with WB Environmental Project)</p> <p>Unfunded</p> <p>Partially funded by WB Nat. Res. Project beginning July 2006 US Embassy</p>
<p><b>Rehabilitation of Physical Assets</b> including MOM's facilities and equipment</p>			

## APPENDIX 4: GOVERNANCE AND TRANSPARENCY IN THE NATURAL RESOURCES SECTOR

1. The Afghan mineral sector offers a source of economic growth, employment, and export earnings. Worldwide experience shows, however, that resource-rich countries have grown more slowly than resource-poor countries since the 1970s, and in the 1990s the average per capita gross domestic product of resource-poor countries surpassed that of resource-rich countries. This phenomenon has come to be known as the “resource curse.” Good governance is essential to avoid misallocation of national resources that could lead to increased poverty, corruption, and conflict.

2. To avoid unwanted outcomes, the government has prepared a policy letter to direct orderly private-sector-led development of national resources based on transparent, competitive processes. The private sector is responding by expressing early interest in an array of mineral resources, including the initial competitive tender of the Aynak copper deposit and possibly exploration of certain oil blocs. However, there is a danger that some investors could seek to circumvent such good governance processes for both solid minerals and hydrocarbons by exploiting capacity deficiencies in order to secure resources exclusivity through non-competitive, non-transparent and possibly corrupt means.

3. The government, through the project, will devise and implement a number of measures to ensure competition, transparency, and adherence to international best practices in respect of authorizing new investments in the sector. It is important to recognize that this multi-layered approach puts into place transparency procedures at each key decision point in terms of (a) upstream issuance of mine title and/or authorization of investment agreements; and (b) downstream management of benefit streams through sound sector policy. As such, it will provide the government and the international donor community with some comfort that the bitter experience of the resource curse in other countries will not be repeated in Afghanistan.

4. The fundamental starting points to ensure good governance in the sector have already been established. The Minerals Law was gazetted by the government in 2005, providing for international standards to be applied to the investments in the sector. The Hydrocarbons (Petroleum and Gas) Law was approved by the Cabinet in December 2005. Regulations, administrative procedures, and guidelines will be prepared in the initial months of the project. This legislative framework for minerals and hydrocarbons will provide the basis for additional governance and transparency measures to be implemented as follows.

- ***Sector Policy Advisors.*** In both sub-sectors, the project will fund sector policy advisors to the MoM. The advisors will provide, among other functions, advice to the MoM on international best practices concerning competitive bidding, governance and transparency measures, and management of benefits streams which are generally used in the minerals and hydrocarbons sectors.
- ***Technical assistance in cadastre management and mines inspection.*** The keystone of good governance in the sector is a properly functioning mine title and registration system together with precise procedures and guidelines for the issuance and maintenance of titles (cadastre system). At present, MoM has no experience with modern and sophisticated cadastre systems. Similarly, an effective mines inspection function is essential to ensure compliance on the ground of exploitation companies with applicable regulations and investment obligations. Because MoM lacks experience and capacity in both the cadastre and mines inspection functions, the project will fund significant technical assistance early on in the project to establish such systems within MoM. While a great deal of effort will be made to train and build capacity of MoM staff, it is recognized that this will take some time. Accordingly, a single large consultancy contract will be awarded for the duration of the project to an

international firm having expertise in cadastre management and mines inspection. The terms of reference for the consultant will provide for direct day-to-day management of these functions in accordance with internationally accepted procedures and guidelines. The terms of reference will also provide for training, capacity building and knowledge transfer for MoM staff, with precise performance indicators to assess how well this has been accomplished.

- ***Mining Licensing Board.*** Review of the cadastre, inspection, and environmental and social safeguard functions related to the rights of investors to operate in the sector will be provided by a Mining Licensing Board. Similar to the practice in many countries, the Board will be composed of three senior department heads within MoM supplemented by two representatives of the consultancy firm responsible for management of the cadastre and mines inspectorate. The purpose of the Board will be to certify the compliance of mine title, hydrocarbon license, and contract applications with the regulations in force, specifically the conformity with applicable application procedures, the financial and technical competencies of the applicant, and the compliance of the proposed work program to established guidelines. The Board will also review each renewal, cancellation, termination, and surrender case to ensure that due procedures were followed. It will make recommendations to the Minister by consensus decision based on these objective criteria. The Minister may not reject the recommendations of the Board except for material breaches.
- ***International Advisory Council.*** Under the project, an advisory council will be established, composed of eminent international experts in mining and hydrocarbons investments. The Minerals and Hydrocarbons Laws provide for contracts be approved by an Inter-Ministerial Committee upon proposition of the Minister for Mines and Industries. The purpose of the International Advisory Council will be to render an opinion in respect of: 1) the procedures and processes used to negotiate such agreements and contracts and, 2) the “fairness” of the terms and conditions of such agreements and contracts. The Council will issue its opinions directly to the Minister of Mines with copy to the management committee of the Afghanistan Reconstruction Trust Fund. This will reassure the donor community that the government is granting rights to develop the nation’s natural resources in a transparent manner as well as provide comfort that this development will be “fair” and consistent with best practice. The Council will also conduct an annual audit of cadastre functions and report to the same two bodies.
- ***Extractive Industries Transparency Initiative.*** During negotiations it was agreed that the Ministry of Finance would publish its endorsement of the principles of the Extractive Industries Transparency Initiative (EITI). During the course of the project the government will implement the EITI with financial and technical assistance provided by the project and the EITI trust funds. The EITI is under implementation with the support of a number of governments (United Kingdom, Norway) and the World Bank Group. The EITI is a process by which the government, private sector companies operating in the extractive industries, and civil society groups discuss in a structured fashion how to enhance reporting and disclosure of revenues and benefits streams from extractive activities. The ultimate objective of the EITI is to prepare a template which will report on a regular basis the revenues paid by companies and received by the government. The fundamental principles of the EITI are available at: [www.eitransparency.org](http://www.eitransparency.org).

## **APPENDIX 5: PROCUREMENT ARRANGEMENTS**

### **Country Context**

IDA has gained substantial experience and understanding of the procurement environment in Afghanistan through its involvement in the interim procurement arrangements put in place through the Emergency Public Administration Project as well as with the institutions with current responsibility for those and the subsequent arrangements, namely Afghanistan Reconstruction and Development Services (ARDS). As part of the broader review of Afghanistan's Public Finance Management (PFM) system, IDA carried out an assessment of the procurement environment in the country based on the baseline and performance indicators developed by a group of institutions led by the World Bank and the OECD Development Assistance Committee.

The first key issue identified through the procurement assessment was the need for ownership and a champion in the Government for reform, deepening of capacity, ensuring integrity in the operation of procurement systems, and promoting sound procurement among ministries.

A new Procurement Law was adopted in November 2005 which radically transformed the legal and regulatory framework. While the law provides a very modern legal system for procurement, it may be difficult to implement in the current context. It relies, for example, on the establishment of a procurement policy unit to ensure implementation through the creation of secondary legislation, standard bidding documents, provision of advice, and creation of the necessary information systems for advertising and data collection. It further relies on the development of an independent complaints review mechanism to ensure enforcement. Neither is yet in place.

In the absence of adequate capacity to manage procurement activities effectively, a central procurement facilitation service has been established. IDA and the Government has agreed on a program for country-wide procurement reform and capacity building, leading to the transition from centralized to decentralized procurement services. The IDA-funded Public Administration Capacity Building (PACB) project is the primary instrument for implementing the program to strengthen capacity of the line ministries to manage public procurement in an effective, transparent, and accountable manner. However, the implementation of the procurement capacity building strategy has not made any significant progress yet due to a lack of coordination and delays in decision making within the Government. The radical changes to the procurement environment brought about by the new Law also require the urgent implementation of a comprehensive capacity development program. The implementation of the procurement reform component of the PACB project should be considered with due priority to ensure that fiduciary standards are further enhanced and that capacity is developed in the Government to maintain these standards.

### **Part A General**

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004, "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Financing Agreement. The general description of various items under different expenditure categories are described below. For each contract to be financed by the Grant, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame are agreed between the Grant Recipient and the IDA project team in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

**Procurement of Works:** Works procured under this project, would include office renovation. The procurement will be done using the World Bank Group's Standard Bidding Documents

(SBD) for all ICB and National SBD agreed with (or satisfactory to) IDA for all NCB. Other procurement method will be shopping and direct contracting. Threshold for NCB works will be US\$500,000 and for shopping will be US\$100,000 per contract.

**Procurement of Goods:** Goods procured under this project would include: (1) vehicles, (2) office equipment and software, (3) publications, (4) scientific/engineering equipment, (5) consumables for operating equipment, vehicles, office equipment, etc. The procurement will be done using World Bank Group's SBD for all ICB and National SBD agreed with (or satisfactory to) IDA for all NCB. Other procurement method will be shopping. Threshold for NCB goods will be US\$200,000 and for shopping will be US\$100,000 per contract.

**Selection of Consultants: Consultancy Service procured under this project would include:** (1) 14 individual consultants hired for the Project Management Unit; (2) consultant contract for legal, Cadastre, and Inspectorate; (3) consultant contract for small-scale mining and extension services; (4) consultants contract for environmental and social protection; (5) consultant contract for the Sector Policy and Private-Sector Promotion and Development Unit; (6) consultant contract for the Afghanistan Geological Survey; (7) consultant contract for strategic sector studies; and (8) consultant contract for auditors. The selection methods for selection of consultants will include QCBS, QBS, and individual consultant. Threshold for CQS procedure will be US\$200,000 per contract.

Short lists of consultants for services estimated to cost less than US\$50,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

**Operational Costs** which would be financed by the project would be procured using the implementing agency's administrative procedures which were reviewed and found acceptable to IDA.

#### **Part B Assessment of the agency's capacity to implement procurement**

Procurement activities will be carried out by the PMU under the Ministry of Mines. The procurement in MoM will initially be led by an international consultant and progressively transferred to local staff. An assessment of the capacity of the ministry and the implementing agency (Project Office) to implement the procurement actions under the project was carried out in February 2006 by D. Kumar, Procurement Specialist, and Rahimullah Wardak, Procurement Analyst. The assessment reviewed the organizational structure and capacity of the MoM, largely because the PMU will be established as part of the project itself. The PMU will be responsible for day-to-day project management including procurement, financial management, progress and financial reporting, staff appointment and management, and project monitoring and evaluation.

The Ministry currently procures items such as vehicles, generators, pumps, helmets, bearings, ventilators, chemicals and drugs and weigh bridges using their own resources. They handle about 20 to 30 procurement cases every year. The Deputy Ministers has delegated the authority to approve procurements valued up to AF250,000 (approximately US\$ 5,000) and the Minister of Mines has delegated the authority to approve procurements valued up to AF3,000,000 (US\$60,000). For procurements of complex nature and larger procurements, they seek assistance from the Afghanistan Reconstruction and Development Services Procurement Unit (ARDS-PU) which handles the procurement on the Ministry's behalf. At present, ARDS-PU is handling procurement of 147 items of mining equipment, valued at about US\$ 4.7 million, financed by ADB. One official has attended a 15-day course on ADB's procurement procedures and another official has taken a part-time course on World Bank procedures.

The Ministry has no experience in World Bank procurement procedures. The procurement capacity within the Ministry for the project under consideration is weak and the procurement

risk is considered high. However, there is potential to develop capacity of the Ministry officials through on-the-job training and guidance from ARDS-PU. It is necessary to have a capable and experienced Individual Procurement Consultant familiar with World Bank procedures in the Ministry for the first 12 months, extended subsequently based on need. The Consultant will handle the procurement work and provide on-the-job training to the staff of the Ministry. The following action plan has been agreed with the Ministry to mitigate the risk:

Sl. No.	Action Plan	Target	Responsibility
1	Selection of an individual Procurement Consultant to work in the Ministry for the first 12 months of the project	June 30, 2006	MoM with the help of ARDS-PU.
2	On the job training to the staff of the Ministry by the Procurement Consultant	Within 6 to 8 months of the start of the project	Procurement Consultant
3	Assistance from ARDS-PU	As and when required	MOM

The overall procurement risk with the above measures is high.

### Part C Procurement Plan

The Grant Recipient, at appraisal, developed a Procurement Plan for project implementation which provides the basis for the procurement methods. This plan has been agreed between the Grant Recipient and the Project Team on May 4, 2006 and is available at the offices of the IDA in Kabul. It will also be available in the Project's database and on the World Bank's external website. The Procurement Plan will be updated in agreement with the Project Team annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

### Part D Frequency of Procurement Supervision

In addition to the prior review supervision to be carried out from World Bank offices, the capacity assessment of the Implementing Agency has recommended two supervisions missions per year to visit the field to carry out post review of procurement actions.

#### Attachment 1

#### Details of the Procurement Arrangement involving International Competition.

##### A Goods and Works and Non-Consulting Services

(a) List of contract Packages which will be procured following ICB and Direct contracting:

1	2	3	4	5	6	7	8	9
Ref. No.	Contract (Description)	Estimated Cost	Procurement Method	P-Q	Domestic Preference (yes/no)	Review by IDA (Prior / Post)	Expected Bid-Opening Date	Comments
1	Vehicles	400,000	ICB	No	No	Prior	Jul 08	

(b) ICB Contracts for works estimated to cost above US\$500,000 equivalent per contract, for goods above US\$200,000 equivalent per contract and all Direct contracting will be subject to prior review by IDA.

## B Consulting Services.

(a) List of Consulting Assignments with short-list of international firms.

1	2	3	4	5	6	7
Ref. No.	Description of Assignment	Estimated Cost	Selection Method	Review by IDA (Prior / Post)	Expected Proposal Submission Date	Comments
Contract 1	<b><i>Mining &amp; Hydrocarbon Regulations</i></b> <ul style="list-style-type: none"> <li>• draft Mining &amp; Hydrocarbon regulations and amendments</li> </ul>	\$9,000,000	QCBS	Prior	August 30, 2006	
	<b><i>Hydrocarbon / Mining Cadastre</i></b> <ul style="list-style-type: none"> <li>• Diagnostic &amp; design</li> <li>• Cadastre implementation including budget requirements, skills, operational manual, and job descriptions</li> </ul>					
	<b><i>Hydrocarbon / Mining Inspectorate</i></b> <ul style="list-style-type: none"> <li>• Diagnostic &amp; design</li> <li>• Draft Health &amp; Safety regulations</li> <li>• Inspectorate implementation including budget requirements, skills, operational manual, and job descriptions</li> </ul>					
Contract 2	<b><i>Small Scale Mining / Extension Service Unit (ASM)</i></b> <ul style="list-style-type: none"> <li>• Define a strategy, structure, and budget for creation of minerals section</li> <li>• Create/implement new Minerals Section</li> </ul>	\$385,000	QCBS	Prior	Feb 30 2007	
Contract 3	<b><i>Environmental / Social Protection</i></b> <ul style="list-style-type: none"> <li>• Define a strategy, structure, and budget for creation of minerals section</li> <li>• Draft environmental / social administrative guidelines</li> <li>• Create/implement Environmental/Social Protection Department</li> </ul>	\$385,000	QCBS	Prior	Sept 30, 2006	
Contract 4	<b><i>Improving Internal Efficiencies</i></b> <ul style="list-style-type: none"> <li>• Scoping functional review and staffing assessment / plans for all MoM</li> <li>• Assess Budget and Planning, Finance and Accounting, Human Resources, Information Technology capacities and define a strategy for administrative reform</li> <li>• Define structure and budget requirements, including job descriptions</li> <li>• Reform units</li> <li>• Implement new administrative/financial management / HR, and IT systems</li> </ul>	\$1,300,000	QCBS	Prior	Oct 30, 2006	
Contract 5	<b><i>Sector Policy</i></b> <ul style="list-style-type: none"> <li>• Assess needs for a national sector policy</li> <li>• Draft national sector policy and assist MoM in passage / implementation</li> </ul> <b><i>Private Sector Promotion and Development Office</i></b> <ul style="list-style-type: none"> <li>• Define a strategy, structure, and budget for creation of a private sector promotion and business development office</li> <li>• Create / implement new office and promotion plan</li> </ul>	\$495,000	QCBS	Prior	Dec 21, 2006	

Contract 6	<b><i>Afghan Geologic Survey</i></b> <ul style="list-style-type: none"> <li>• Technical assistance to restore mineral collection</li> <li>• Establish public information center</li> <li>• Training in GIS and electronic data mapping systems</li> <li>• Capacity building in geologic mapping, mineral resource assessment, district studies</li> </ul>	\$1,848,000	QCBS	Prior	April 30, 2007	
Contract 7	<b><i>Conduct strategic sector studies</i></b> <ul style="list-style-type: none"> <li>• Develop sub-sector strategies and develop an understanding of comparative advantages, at a regional level, for SOEs</li> <li>• Conduct an inventory of extractive industry SOEs, including current activities and estimates of underlying resources</li> </ul>	\$1,358,000	QCBS	Prior	March 30, 2007	
Contract 8	<b><i>Auditors</i></b>	\$200,000	LCS	Prior	July 1, 2006	

(b) Consultancy services estimated to cost above US\$ 200,000 or equivalents per contract and all Single Source selection of consultants (firms) and individual for assignments will be subject to prior review by the IDA.

(c) **Short lists composed entirely of national consultants:** Short lists of consultants for services estimated to cost less than US\$50,000 equivalent per contract, may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

## Procurement Plan

### A General

#### A1 Project information:

Country Afghanistan  
 Borrower Islamic Republic of Afghanistan  
 Project Name Sustainable Development of Natural Resources Project  
 Loan/Credit No.  
 Project Implementing Agency (PIA): Ministry of Mines

**A2 IDA's approval Date of the procurement Plan: April 2006**

**A3 Date of General Procurement Notice: TBD**

**A4 Period covered by this procurement plan: 2 years**

### B Goods and Works and non-consulting services.

**B1 Prior Review Threshold:** Procurement Decisions subject to Prior Review by IDA as stated in Appendix 1 to the Guidelines for Procurement:

	Procurement Method	Prior Review Threshold (\$)	Comments
1.	Goods	200,000 Equivalent or more	
2.	Works	500,000 Equivalent or more	
3.	Direct contracting (goods and works)	All	

**B2 Reference to (if any) Project Operational/Procurement Manual: NONE.**

**B3 Any Other Special Procurement Arrangements:** [including advance procurement and retroactive financing, if applicable]: NONE.

**B4 Procurement Packages with Methods and Time Schedule**

[List the Packages which require IDA's prior review first and then the other packages]

1	2	3	4	5	6	7	8	9
Ref. No.	Contract (Description)	Estimated Cost (US\$)	Procurement Method	Pre-qualification (yes/no)	Domestic Preference (yes/no)	Review by IDA (Prior / Post)	Expected Bid-Opening Date	Comments
1	Vehicles	200,000	NCB	No	No	Prior	Nov 06	
2	Vehicles	200,000	NCB	No	No	Prior	Apr 07	
3	Vehicles	400,000	ICB	No	No	Prior	Jul 08	
4	Office renovation	250,000	NCB	No	No	Post	Nov 06	
5	Inspection equipment	100,000	Shopping	No	No	Prior	Jun 07	
6	Geological equipment	100,000	Shopping	No	No	Prior	Jun 07	
7	Office equipment	150,000	NCB, shopping	No	No	Post	Throughout project	Multiple packages
8	Software, and publications [value for NCB goods shall be below \$200,000 per contract, and that for shopping shall be below \$100,000 per contract]	1,140,000	NCB, shopping	No	No	Post	Throughout project	Multiple packages. Publications include both publication by MoM of digital and printed materials for distribution to potential investors and purchase of books and journals in fiscal and technical areas.

**C Selection of Consultants**

**C1 Prior Review Threshold:** Selection decisions subject to Prior Review by IDA as stated in Appendix 1 to the Guidelines Selection and Employment of Consultants:

	Selection Method	Prior Review Threshold (US\$)	Comments
1.	Competitive Methods (Firms)	More than 200,000 Equivalent	
2.	Individual Consultant	More than 50,000 Equivalent	
3.	Single Source (Firms)	All	
4.	Single Source (Individual)	All	

**C2 Short list comprising entirely of national consultants:** Short list of consultants for services, estimated to cost less than US\$50,000 equivalent per contract, may comprise

entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

**C3 Any Other Special Selection Arrangements:** [including advance procurement and retroactive financing, if applicable]

**C4 Consultancy Assignments with Selection Methods and Time Schedule**

1	2	3	4	5	6	7
Ref. No.	Description of Assignment	Estimated Cost (US\$)	Selection Method	Review by IDA Prior / Post)	Expected Proposals Submission	Comments
Contract	<b>Mining &amp; Hydrocarbon Regulations</b> <ul style="list-style-type: none"> <li>• draft Mining &amp; Hydrocarbon regulations and amendments</li> </ul>	\$9,000,000	QCBS	Prior		
	<b>Hydrocarbon / Mining Cadastre</b> <ul style="list-style-type: none"> <li>• Diagnostic &amp; design</li> <li>• Cadastre implementation including budget requirements, skills, operational manual, and job descriptions</li> </ul>					
	<b>Hydrocarbon / Mining Inspectorate</b> <ul style="list-style-type: none"> <li>• Diagnostic &amp; design</li> <li>• Draft Health &amp; Safety regulations</li> <li>• Inspectorate implementation including budget requirements, skills, operational manual, and job descriptions</li> </ul>					
Contract 2	<b>Small Scale Mining / Extension Service Unit (ASM)</b> <ul style="list-style-type: none"> <li>• Define a strategy, structure, and budget for creation of minerals section</li> <li>• Create/implement new Minerals Section</li> </ul>	\$385,000	QCBS	Prior	Feb 30 2007	
Contract 3	<b>Environmental / Social Protection</b> <ul style="list-style-type: none"> <li>• Define a strategy, structure, and budget for creation of minerals section</li> <li>• Draft environmental / social administrative guidelines</li> <li>• Create/implement Environmental/Social Protection Department</li> </ul>	\$385,000	QCBS	Prior	Sept 30, 2006	
Contract	<b>Improving Internal</b>	\$1,300,000	QCBS	Prior	Oct 30, 2006	

1	2	3	4	5	6	7
Ref. No.	Description of Assignment	Estimated Cost (US\$)	Selection Method	Review by IDA (Prior / Post)	Expected Proposals Submission Date	Comments
4	<p><b>Efficiencies</b></p> <ul style="list-style-type: none"> <li>• Scoping functional review and staffing assessment / plans for all MoM</li> <li>• Assess Budget and Planning, Finance and Accounting, Human Resources, Information Technology capacities and define a strategy for administrative reform</li> <li>• Define structure and budget requirements, including job descriptions</li> <li>• Reform units</li> <li>• Implement new administrative/financial management / HR, and IT systems</li> </ul>					
Contract 5	<p><b>Sector Policy</b></p> <ul style="list-style-type: none"> <li>• Assess needs for a national sector policy</li> <li>• Draft national sector policy and assist MoM in passage / implementation</li> </ul> <p><b>Private Sector Promotion and Development Office</b></p> <ul style="list-style-type: none"> <li>• Define a strategy, structure, and budget for creation of a private sector promotion and business development office</li> <li>• Create / implement new office and promotion plan</li> </ul>	\$495,000	QCBS	Prior	Dec 21, 2006	
Contract 6	<p><b>Senior Industry Advisors</b></p> <ul style="list-style-type: none"> <li>• Provide advice on MoM investor discussions</li> </ul>	\$972,000	QCBS	Prior	June 30, 2006	
Contract 7	<p><b>Afghan Geologic Survey</b></p> <ul style="list-style-type: none"> <li>• Technical assistance to restore mineral collection</li> <li>• Establish public information center</li> <li>• Training in GIS and electronic data mapping systems</li> <li>• Capacity building in geologic mapping, mineral resource assessment, district studies</li> </ul>	1,848,000	QCBS	Prior	April 30, 2007	

1	2	3	4	5	6	7
Ref. No.	Description of Assignment	Estimated Cost (US\$)	Selection Method	Review by IDA (Prior / Post)	Expected Proposals Submission Date	Comments
Contract 8	<b>Conduct strategic sectoral studies</b> <ul style="list-style-type: none"> <li>Develop sub-sector strategies and develop an understanding of comparative advantages, at a regional level, for SOEs</li> <li>Conduct an inventory of extractive industry SOEs, including current activities and estimates of underlying resources</li> </ul>	\$1,358,000	QCBS	Prior	March 30, 2007	
Contract 9	<b>Auditors</b>	\$200,000	LCS	Prior	July 1, 2006	
10	Interim Project Preparation Specialist	\$99,500	IC	Prior	Jan 2006	Hired under PPF
11	Interim Procurement Specialist	136,000	IC	Prior	Jan 2006	Hired under PPF
12	Interim Environmental/Social Specialist	70,000	IC	Prior	Jan 2006	Hired under PPF
13	International Director PMU (4 years)	\$810,000	IC	Prior	July 2006	
14	Local Director PMU (5 years)	\$150,000	IC	Prior	Oct 2006	
15	Procurement Specialist (4 years)	\$570,000	IC	Prior	Jan 2007	
16	Accounting / Financial Management Specialist (3 years)	\$427,500	IC	Prior	July 2006	
17	EITI / Advisory Board Secretariat (2 years)	\$345,000	IC	Prior	Dec 2006	
18	Local Staff PMU Management (4 years)	\$320,000	IC	Prior	Jan 2007	
19	Interpreter (2 years)	20,000	IC	Post	Sept 2006	
20	Interpreter (2 years)	20,000	IC	Post	Dec 2006	
21	Translator (for documents, 2 years)	40,000	IC	Post	Oct 2006	
22	Translator (for documents, 2 years)	40,000	IC	Post	June 2007	

#### D Implementing Agency Capacity Building Activities with Time Schedule

**D1** In this section the agreed Capacity Building Activities (some items could be from CPAR recommendation) are listed with time schedule. NOT APPLICABLE.

No.	Expected outcome /Activity Description	Estimated Cost	Estimated Duration	Start Date

## **D2 Agreed Procedures for National Competitive Bidding**

In order to ensure economy, efficiency, transparency and broad consistency with the provisions of Section I of the Procurement Guidelines, the following criteria shall be followed in procurement under National Competitive Bidding procedures:

- (i) Standard bidding documents approved by the World Bank Group shall be used.
- (ii) Invitations to bid shall be advertised in at least one (1) widely circulated national daily newspaper and bidding documents shall be made available to prospective bidders, at least twenty eight (28) days prior to the deadline for the submission of bids.
- (iii) Bids shall not be invited on the basis of percentage premium or discount over the estimated cost.
- (iv) Bidding documents shall be made available, by mail or in person, to all who are willing to pay the required fee.
- (v) Foreign bidders shall not be precluded from bidding.
- (vi) Qualification criteria (in case pre-qualifications were not carried out) shall be stated on the bidding documents, and if a registration process is required, a foreign firm determined to be the lowest evaluated bidder shall be given reasonable opportunity of registering, without any hindrance.
- (vii) Bidders may deliver bids, at their option, either in person or by courier service or by mail.
- (viii) All bidders shall provide bid security as indicated in the bidding documents. A bidder's bid security shall apply only to a specific bid.
- (ix) Bids shall be opened in public in one place preferably immediately, but no later than one hour, after the deadline for submission of bids.
- (x) Evaluation of bids shall be made in strict adherence to the criteria disclosed in the bidding documents, in a format, and within the specified period, agreed with the Association.
- (xi) Bids shall not be rejected merely on the basis of a comparison with an official estimate without the prior concurrence of the IDA.
- (xii) Split award or lottery in award of contracts shall not be carried out. When two (2) or more bidders quote the same price, an investigation shall be made to determine any evidence of collusion, following which: (A) if collusion is determined, the parties involved shall be disqualified and the award shall then be made to the next lowest evaluated and qualified bidder; and (B) if no evidence of collusion can be confirmed, then fresh bids shall be invited after receiving the concurrence of the IDA;
- (xiii) Contracts shall be awarded to the lowest evaluated bidders within the initial period of bid validity so that extensions are not necessary. Extension of bid validity may be sought only under exceptional circumstances.
- (xiv) Extension of bid validity shall not be allowed without the prior concurrence of the IDA (A) for the first request for extension if it is longer than eight (8) weeks, and (B) for all subsequent requests for extensions irrespective of the period.

- (xv) Negotiations shall not be allowed with the lowest evaluated or any other bidders.
- (xvi) Re-bidding shall not be carried out without the IDA's prior concurrence; and
- (xvii) All contractors or suppliers shall provide performance security as indicated in the contract documents. A contractor's or a supplier's performance security shall apply to a specific contract under which it was furnished.

## **APPENDIX 6: FINANCIAL MANAGEMENT ANNEX OF SUSTAINABLE DEVELOPMENT OF NATURAL RESOURCES PROJECT**

### **Country Issues**

IDA has gained substantial experience and understanding of the financial management (FM) environment in Afghanistan through the large number of projects under implementation over the past four years. The Public Administration Capacity Building (PACB) project is the primary instrument to continue and enhance the fiduciary measures put in place during the past years to ensure transparency and accountability for the funding provided by IDA and other donors.

A PFM performance rating system using 28 high-level indicators developed by the Public Expenditure and Financial Accountability (PEFA) multi-agency partnership program was applied in Afghanistan in June 2005. The system is structured around six core dimensions of PFM performance (budget credibility; comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting, recording, and reporting; and external scrutiny and audit). This has been accomplished with very high levels of support from international firms. This assistance will continue to be needed in the medium term if these ratings are to be maintained. There is also much room for improvement.

In spite of undeniable gains made in reconstruction since the end of 2001, the challenges facing Afghanistan remain immense, not least because of the tenuous security situation in the region and continued prevalence of a large illegal and illicit economy. The policy framework benchmarks have not yet been costed and various priorities are funded through the annual budgeting process. The rising costs of the security sector constitute a major constraint on attainment of fiscal sustainability. The National Assembly will play an increasingly active role with regard to executive oversight. The national strategy has created high expectations of the executive which could prove to be quite difficult to meet.

The public sector, in spite of considerable efforts to reform its core functions, remains extremely weak outside of Kabul. The lack of qualified staff in the civil service and the absence of qualified counterparts in the government after 30 years of war and conflicts is a binding constraint. Delays in reforming the pay structure and grading of civil servants have severely crippled the public administration of the country. Domestic revenues lag behind expenditures by a factor of ten to one. Large-scale corruption could emerge to undermine the government's efforts to enhance aid flows through national accounts. Capacities to track expenditures and monitor expenditure outcomes have improved, but they need rapid and substantial strengthening if progress toward the attainment of national development targets is to be monitored. Currently, 75 percent of external revenues bypass government appropriation systems.

An IDA project is currently financing a Financial Management Advisor to assist the Ministry of Finance, an Audit Advisor to assist the Control and Audit Office, and a Procurement Advisor to assist in Procurement-related activities. Also an Internal Audit function is being developed with IDA financing. USAID, and earlier the Indian Aid Assistance Programme, are also financing a team of consultants and advisors to assist the Da Afghanistan Bank in local as well as foreign currency operations. The activities carried out under the existing Public Administration projects have helped the Government to ensure that appropriate fiduciary standards are maintained for public expenditures, including those supported by IDA and the donor community.

Progress has been slower than expected in shifting from operations support provided by the Advisors to capacity development and knowledge transfer to the civil servants. Given this situation, the use of the Advisors is expected to continue to be required for the medium term. Challenges still remain in attaining the agreed-upon fiduciary standards and also to further enhance them. In the interim, the regulatory environment in Afghanistan has advanced significantly. Unfortunately, even the mastery of basic skills in the early environment does not fully qualify the civil servants to work effectively in the new emerging environment.

Country systems that are in place for externally-aided projects will be used for all financial management matters of the project.

### **Risk Assessment and Mitigation**

The table below identifies the key risks that the project may face and indicates how these risks are to be addressed.

<i><b>Risk</b></i>	<i><b>Risk Rating</b></i>	<i><b>Risk Mitigation Measures</b></i>	
<b>Inherent Risk</b>			Residual risk
Country Inherent Risk	M	Source - PFM study	M
Project Financial Management Risk	H	Ensure reasonableness of advance in the designated account; maximize direct payments to consultants; all procurement through Procurement Advisor. Oversight by SDU with the support of FM Advisor to ensure timely acquittal of cash advances under the project.	M
Perceived Corruption	H	Government commitment, internal controls and new internal audit unit will all help reduce the high level of perceived corruption.	S
<i>Overall Inherent Risk</i>	S		S
<b>Control Risk</b>			
1. Weak Implementing Entity	H	Extremely weak FM capacity in MoM will be supported by a qualified FM consultants' team hired under PPF to assess FM capacity and develop strategy for improvements. A financial management system (FMS) will be in place in the PMU before IDA disbursements.	S
2. Funds Flow	M	Follows flow established in previous projects.	M
3. Budgeting	S	FMS and Head of Development Budget will be responsible for this function.	M
4. Accounting Policies and Procedures	M	Will follow international standards with support from FM Advisor.	M
5. Internal Audit	S	Internal audit department will review project internal control systems.	S

6. External Audit	S	Will be audited by CAO with support from Audit Advisor.	M
7. Reporting and Monitoring	S	Strengthening the Special Disbursement Unit (SDU) is a priority under the new FM Advisor contract, to provide information that will comply with agreed format of interim unaudited financial reports.	S
<b>Overall Control Risk</b>	S		S
<b>Detection Risk</b>	L	Accounting/Recording/oversight by SDU – MOF of all advances/M-16 supported by FM Advisor.	L
<i>Risk rating: H=high risk; S=substantial risk; M=modest risk; L-low risk</i>			

## Strengths and Weaknesses

### Strengths

The main strength is the Government's commitment to the PACB project's approach to ensure that capacity is in place to strengthen accountability and transparency in its operations. PACB helps to strengthen the financial management in Treasury operations, internal audit, public procurement, and external audit under the Auditor General. This helps to provide assurance to IDA and other donors that the current measures designed to ensure appropriate utilization of funds will not be circumvented.

A PMU will be established to implement the project, with staffing to include a FM Specialist. MoM has initiated reforms of the ministry's administrative and financial functions. A Project Preparation Facility (PPF) has been approved which includes provision to put in place a team of four consultants (1 international consultant and 3 local consultants) to assess MoM's financial management requirements and develop a strategy for improvement. Administration Department staff will be provided on-the-job training to process expenditures under the project in order to mainstream project financial management within MoM.

### Weaknesses

The main weakness in this project, as in many others in Afghanistan, is the ability to attract suitably qualified and experienced counterpart staff. A lack of capacity in the civil service has led to continued reliance on international firms to perform core government functions.

MoM has not yet been involved in the management of foreign grants thus the ministry's systems and staff lack the capacity to deal effectively with donor agencies. However, to address this weakness, MoM staff will be involved at multiple levels in financial management of the project working closely with the FM consultants under PPF and with the FMS in the PMU.

### Implementing Entity

MoM is the implementing agency for this project. FM capacity in MoM is extremely weak. It is envisioned that capacity will be built first by way of hiring a team of consultants to assess FM capacity and to prepare strategy for improvement. Second, an FMS will be in place before the IDA project starts disbursements. Third, local counterpart staff will be recruited. Training will be imparted to existing MoM staff in the Planning and Finance units of the Administration Department for effective implementation of the project. In addition to the Director of Planning and Policy, the Vice President and Head of Development Budget within

the Planning and Policy unit will work closely with the FM Specialist to facilitate day-to-day FM operations of the project, preparation of M-16 forms, and overall contract management.

### **Budgeting**

Because there is limited capacity in managing external budget within MoM, the FM team will be responsible for ensuring that project expenditures envisaged to be expended in a fiscal year are captured in the Governmental Development budget of that fiscal year. It is to be ensured that the project is included in the budget decree. However, in case it has not been included, MoM must obtain approval from the presidential office to be attached to D1 forms at the time of requesting annual allotments for contracts under development project to avoid delays when payments are processed.

### **Funds Flow**

The standard mechanism of flow of funds employed in the other investment projects in Afghanistan will be followed. Project funds will be deposited in a single Designated Account (DA) to be opened and maintained at the Da Afghanistan Bank (DAB) or in a local commercial bank. Capacity in terms of delivery of service and charges for the services will have to be assessed by the Government (MOF) and arrangements formalized before moving from the existing practice of placing this account in Da Afghanistan Bank (DAB). The DA, in keeping with current practices for other projects in Afghanistan, will be operated by the Special Disbursement Unit (SDU) in the Treasury Department of Ministry of Finance. Requests for payments out of DA funds will be made to the SDU by MoM and authorized by officials of MoM.

In addition to payments out of DA funds, MoM may also request the SDU to make direct payments to third parties or request that that IDA issue special commitments for contracts covered by letters of credit. Such requests will follow the World Bank Group procedures.

### **Retroactive Financing**

No retroactive financing is envisaged for this project.

**Project Preparation Facility.** An advance in the amount not exceeding US\$1,550,000 has been provided to the Recipient for the preparation of the project. The amount of the Advance withdrawn, and the service charge incurred to the date of repayment, shall be refinanced out of the Grant as soon as the Financing Agreement shall have become effective.

### **Accounting Policies and Procedures.**

Under the PPF, the FM consultant team will develop FM procedures including accounting policies and systems to be in place for effective project implementation. The Financial Management Specialist within the PMU will facilitate implementation of suggestions by the team along with the local counterparts in MoM. The FMS will also: i) supervise preparation of supporting documents for expenditures, and payment orders (Form M16), ii) obtain approval for M-16 forms by the Minister/Deputy Minister depending on the payment amount, and iii) submit these forms to the Treasury Department in MOF which in turn will issue a check payable to the cash trustee by DAB after verification of supporting documents and approvals on the form.

Currently, all records of payments are maintained manually in files. It will be FMS' responsibility to establish accounting and reporting systems in the Planning unit and train existing staff with the support of local counterpart to maintain financial data for the project. **A Financial Management Manual outlining guidelines and procedures for project financial management will be developed by the FMS and the local staff at MoM.**

The FMS will establish project financial management in accordance with standard Afghan government policies and procedures, including use of the Chart of Accounts developed by the Financial Management Advisor to record project expenditures. The use of these procedures will enable adequate recording and reporting of the project expenditures. Overall project accounts will be maintained centrally in SDU which will be ultimately responsible for accounting for all expenditures and receipts in the Government's accounting system. Reconciliation of project expenditure with MoF records will be carried out by Finance along with Planning. This will be supported by the FMS who will ensure that monthly and yearly reconciliation for project expenditures are carried out by MoM with Treasury-MOF.

The Financial Management Specialist and the local counterpart staff in Planning will be responsible for coordinating FM activities of the project with the SDU. Project accounts will be consolidated centrally in the Ministry of Finance, through the Special Disbursement Unit in the Treasury supported by Financial Management Advisor. Consolidated Project Financial Statements will be prepared for all sources and uses of project funds.

### **Internal Audit**

The project financial management systems will be subject to review by the newly established internal audit directorate of the MOF, according to programs to be determined by the Director of Internal Audit. A risk-based approach will be applied to review project internal controls and systems.

### **External Audit**

The accounts of the project will be audited by the Auditor General, with the support of the Audit Advisor with terms of reference satisfactory to the Association. The audit of the project accounts will include an assessment of the: (a) adequacy of the accounting and internal control systems; (b) ability to maintain adequate documentation for transactions; and (c) eligibility of incurred expenditures for Association financing. The audited annual project financial statements will be submitted within 6 months of the close of fiscal year. All agencies involved in implementation and holding records of expenditures would need to retain these records as per the IDA retention policy.

The following audit reports will be monitored in the Audit Reports Compliance System (ARCS):

<b>Responsible Agency</b>	<b>Audit</b>	<b>Auditors</b>	<b>Date</b>
MOF, supported by Special Disbursement Unit	SOE, Project Accounts and Designated Account	Auditor General	Sep 22

### **Reporting and Monitoring**

Interim unaudited financial reports will be used for project monitoring and supervision. Based on the FM arrangements of this project interim unaudited financial reports will be prepared by the FMS with the help of local counterparts in Planning. These reports will be produced based on records kept on Excel spread sheets or a simple data base.

Quarterly interim unaudited financial reports will be produced showing: (i) sources and uses of funds by disbursement category and project component; (ii) physical progress; and (iii) status of procurement activities. The Ministry of Mines will forward the relevant details to DBER for consolidation, if any, with a copy to IDA within 45 days of the end of the quarter. The government and IDA have already agreed on a *pro forma* format for all IDA projects, and the same format will be applicable for this project.

Annual project accounts will be consolidated centrally in the Ministry of Finance; in particular, the Treasury Department, supported by the Financial Management Advisor, and

consolidated project financial statements will be prepared for all sources and uses of project funds.

### Disbursement Arrangements

**Table A6-1 Allocation of Grant Proceeds**

Expenditure Category	Amount	Financing Percentage
Consultancy services, goods, works, training, and operating costs	US\$28,450,000 SDR 19,500,000	100
Refund of project preparation advance	US\$1,550,000 SDR 1,100,000	Amount payable pursuant to Section 2.07 of the General Conditions
<b>Total</b>	<b>\$30,000,000</b>	<b>100</b>

Table A6-1 shows the allocation of IDA proceeds. The table includes only 2 categories: (1) A single category for "consultancy services, goods, works, training and operating costs"<sup>9</sup> and (2) Refund of the PPF. The single category has been selected to facilitate preparation of disbursement applications and record-keeping. The project will be disbursed over a period of 4 years. The closing date of the project will be July 31, 2011, with a final disbursement deadline four months after the closing date. During this additional 4-month period, project-related expenditures incurred prior to the closing date are eligible for disbursement. Disbursement estimates of the IDA proceeds over the five year project are presented in Table B3 in Schedule B.

Disbursements procedures set out in the World Bank Group's "Disbursement Handbook for World Bank Borrowers" (October 2005) are applicable to this project.

#### Designated Account

The single designated account (DA) will be opened at Da Afghanistan Bank or in a local commercial bank in US dollars for a maximum amount of US\$2.5 million representing 3 months of estimated expenditures. The SDU in MoF will manage advances to this account and submit expenditure reporting on a monthly basis.

As authorized by Treasury and only where no other mechanism can be arranged and for amounts of less than US\$5000, cash advances may be taken from the DA and held and managed by MoM. This agency's controls as related to holding and accounting for cash, properly recording expenditures, and preparing statements of expenditures, will need to be satisfactorily assessed before the Ministry of Finance will release any cash advances to MoM. New cash advances will be made only when all other prior cash advances have been justified through submission of statements of expenditures to the SDU.

Expenditure reporting on payments made through the DA will be replenished on a monthly basis. Requests for advances may be made as often as needed.

#### Direct Payments

<sup>9</sup> "Operating Costs" means the Project-related incremental expenses incurred on account of Project implementation support and management including the rental of office space; the operation, maintenance, rental and insurance of vehicles; fuel; communications supplies and charges; advertisements; books and periodicals; office administration and maintenance costs; bank transaction charges; utility charges; domestic travel and per diem but excluding salaries of officials and staff of the Recipient's civil service.

Direct payments from IDA to vendors will be made for amounts exceeding 20% (US\$500,000) of the advance in the DA. All such payments require records (*e.g.*, invoices, fee statements, consultants' statement of reimbursable expenses, and other records) that may be identified by IDA as necessary to support disbursement.

**Preparation of Withdrawal Applications**

The SDU will review quality of withdrawal applications and ensure conformity to Treasury procedures, and then obtain required signatures. Selected MoM finance staff will become registered users of Client Connection and take an active role in managing disbursements.

**Summary Reports**

Summary reports in the form of Statements of Expenditure will be used for expenditures on contracts that are less than US\$20,000.

**Records**

All expenditures on contracts above US\$20,000 will require submission of records.

**Action Plan**

<b>Action</b>	<b>Responsible Person</b>	<b>Target Date</b>
Appoint Financial Management Specialist in the PMU	MoM	Before disbursements
FM consultant team in place	MoM	After PPF effectiveness
Develop FM manual and system	FMS-MoM	Before disbursements

**Financial Management Covenants**

- IRA shall submit audit financial statements within six months of the end of each fiscal year. The audit report will cover the project financial statements, the project DA and statements of expenditures, in accordance with terms of reference to be agreed with IDA.
- Interim unaudited financial reports will be submitted on a quarterly basis.

**Supervision Plan**

IRA shall submit audit financial statements within six months of the end of each fiscal year. The audit report will cover the project financial statements, the project DA and Statements of Expenditures, in accordance with terms of reference to be agreed with IDA. Interim unaudited financial reports will be submitted on a quarterly basis.

**Supervision Plan**

During project implementation, IDA will supervise the project's financial management arrangements. The team will review (i) the project's quarterly interim unaudited financial reports as well as the project's annual audited financial statements and auditor's management letter; (ii) project's financial management and disbursement arrangements (including a review of a sample of Statements of Expenditures and movements on the Designated Account) to ensure compliance with IDA's minimum requirements and the FM Manual; and (iii) status of FM reforms in MoM under component 1 of the project.

**Conclusion**

The FM arrangements, including the systems, processes, procedures, internal controls, and staffing are adequate to support this project, subject to implementation of the items listed in the action plan.

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