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Reviving Commercial Development of Afghanistan's Aynak Copper Resource

Summary

- Rampant looting of Afghanistan's medium-sized and smaller mineral resources is ongoing, but the major Aynak copper deposit languishes, having made only negligible progress toward commercial exploitation since the contract was signed in 2008.
- The main problem is that the Chinese consortium awarded the contract made unrealistic promises that would be impossible or highly unprofitable to fulfill, resulting in a need to renegotiate contract terms in its favor, which the Afghan government has been reluctant to go along with.
- Several options to break out of the current impasse are viable: the two sides enter into sincere, results-oriented renegotiation of the contract and move forward expeditiously with implementation; the current contract is abrogated on a no-fault basis by both sides and Aynak is retendered for international competition; or the existing contract is by mutual agreement taken over, renegotiated, and implemented by another experienced international mining company able and willing to operate in the current security environment.
- Reviving Aynak's development would send a powerful signal of beneficial exploitation of Afghanistan's mineral resources, potentially also catalyzing broader development of extractives in the future.

"The lack of realism of the original contract terms, the company's consequent desire to renegotiate the contract in its favor, and the Afghan government's reluctance to do so appear to be at the core of the current impasse over Aynak."

Introduction

Afghanistan is well endowed with mineral resources, roughly estimated to be worth around $1 trillion, including copper, gold, iron, coal, chromium, lead, zinc, lithium, marble, precious and semiprecious stones, sulfur, talc, natural gas, petroleum, and others. Mining could contribute to government revenue, infrastructure development, and provide a demonstration effect to build confidence, stimulate other investments, and potentially help generate a peace dividend over the medium term (if there is progress toward ending Afghanistan's decades-long conflict).

However, numerous medium-sized and smaller resources are being rampantly looted and little is paid to the Afghan state—to which underground resources belong according to Afghanistan's constitution—in taxes and royalties.[1] This ongoing extraction, mostly under mining contracts issued by the Ministry of Mines and Petroleum (MoMP), strengthens and entrenches various powerholders, corrupts the government and undermines governance, provides funds to the Taliban and reportedly the self-proclaimed Islamic State, and fuels local conflicts and the wider insurgency.

In striking contrast, large mega-resources remain in limbo, most notably the Aynak copper deposit in Logar Province, some forty kilometers (roughly twenty-five miles) from Kabul. One of the largest unexploited copper resources in the world—an estimated total size of around 450 million metric tons of ore and a total value upward of $50 billion[2]—Aynak was Afghanistan's first major resource to go through international tendering. After a lengthy process supported by international technical assistance, the Afghan government awarded the Aynak contract to a consortium of the state-owned Metallurgical Corporation of China (MCC) and Jiangxi Copper Corporation in 2008.[3] However, beyond some related agreements and initial steps, no progress has been made toward commercial extraction.

What Went Wrong?

Multiple factors contributed to the failure to move forward. The contract was quite favorable to the Afghan government and included unrealistic commitments by the company (MCC/Jiangxi Copper consortium):

- Pay the Afghan government a premium of $808 million, 10 percent on contract effectiveness, 20 percent on approval of the feasibility study, and the remainder upon commencement of commercial production.
- Pay a 19.5 percent royalty rate, reportedly double the worldwide average, whenever the London Metal Exchange price for copper is above $2 per pound.[4]
- Construct, "at MCC's sole expense, a railway associated with the Project" to extend across Afghanistan from the Torkham border with Pakistan to the Khairatan border with Uzbekistan, along with a spur to Aynak.[5]
- Construct, "at MCC's sole expense, one, four hundred (400) megawatt capacity coal fired power plant to supply electrical power to the Project and to Kabul."

These commitments may well have enabled the company to win the bidding competition, but fulfilling them would have been unprofitable or even impossible. Not surprisingly, the company has tried repeatedly to renegotiate the contract, which inevitably would have resulted in better terms for it and less favorable to the Afghan government. Indeed, the contract's provision for renegotiating the financial terms every five years may have been seen by the company to provide a way out of its unrealistic promises. Renegotiating the contract, however, would likely have exposed the government to criticism and political backlash, so it has refused to do so, resulting in the current impasse.

Security became another obstacle. A decade ago, the mining site and Logar Province were seen as secure, particularly given the proximity to Kabul. The security situation has since deteriorated markedly, and this has been seen as problematic by the company, which apparently is rather risk averse—in contrast to the risk tolerance exhibited by experienced international mining companies in other insecure countries.

Moreover, the company was not experienced in copper mining outside China, but rather in smelting and refining. Its core competency and expertise were not particularly well suited for a large, integrated copper mining endeavor such as Aynak.

The commodity boom ended soon after the contract was signed. Copper prices collapsed and remained low during the global recession, making the contract much less lucrative in the short run. This weakened stakeholders' enthusiasm for moving ahead quickly and further underlined the need for the contract to be renegotiated on terms more favorable to the company—but even more unfavorable to the government due to the low international copper price.

Finally, important Buddhist archaeological remains are located at the mining site, raising issues of how to safeguard this cultural heritage. Considerable work has been done in mapping the site and engaging in conservation, but as time passed the urgency to come up with, let alone implement, a reasonable solution seems to have dissipated. This may have become a further excuse for inaction.[6]

The lack of realism of the original contract terms, the company's consequent desire to renegotiate the contract in its favor, and the Afghan government's reluctance to do so appear to be at the core of the current impasse over Aynak. Other problems, though genuine, may have become to a large extent excuses masking the key problem over contract terms.

Recent Developments

Although the Afghan government apparently remains reluctant to renegotiate the Aynak contract, significant developments have occurred on the Chinese side. MCC was absorbed in the Chinese state-owned conglomerate China MinMetals Corporation (CMC) in December 2015 as part of a broader consolidation of Chinese state-owned enterprises.[7] Aynak is mentioned along with the Las Bambas Copper Mine (in Peru) as among CMC's major assets.[8]

CMC, unlike MCC, does have access to international mining expertise and experience. Its subsidiary Minerals and Metals Group (MMG) was formed when CMC acquired the majority of the assets of OZ Minerals Ltd, an experienced Australian mining company, in 2009. In 2012 MMG acquired Anvil Mining, a Canadian copper company with operations in the Democratic Republic of Congo.[9]

Moreover, global prospects for copper are now looking better. Demand is likely to boom because copper is a "green metal" with numerous environment-friendly uses.[10] The future would therefore appear bright for Aynak if it is at long last developed for commercial extraction.

Ways Forward

The impasse can be broken in one of several viable, consensual ways. The first is that both sides enter into sincere, results-oriented renegotiation of the contract, and then move forward expeditiously toward commercial extraction. As stated in the contract, "In undertaking such review, the Parties shall bargain in good faith with a view toward providing a fair and equitable division of profits in light of the economic factors prevailing at the time of the review." This would require the Afghan government's willingness to discuss more realistic terms (that is, more favorable to the company), and the company's willingness to engage in mining investments and operations in the current security context. In return for getting out of unrealistic commitments such as the railway, the company may be called upon to provide better than normal financial terms (even if not as generous as in the original contract) with regard to bonus, royalty rate, and so on. Arrangements to deal with the archaeological site in an effective and timely manner also would need to be decided.

A second option is that the current contract is abrogated on a no-fault basis by mutual agreement (without penalties), and Aynak then retendered for international competition. The bonus money already paid by the company to the Afghan government would need to be returned, but this could be built into the new tender as a responsibility of the winning bidder. This option would take additional time, but if the company is unable or unwilling to operate in the current security situation, a change would be necessary.

A third and hybrid option would be, again by mutual agreement, for the Aynak contract to be taken over by another experienced, reputable international mining company and renegotiated on a realistic basis. This could be a face-saving solution for both sides by bringing in a credible third party, and would avoid the second option's possible adverse signal (which might be sent by the company's withdrawal from the contract) and a very lengthy retendering process.

In conclusion, it is strikingly incongruous to leave this proven, contracted mega-resource to languish indefinitely even while other, smaller mineral deposits are being rampantly looted. Moreover, efforts to develop other major mines will most likely be hindered by lack of Afghan government credibility in the absence of progress with Aynak. Thus the best approach is to quickly come to an agreement on how to proceed, and to pursue the selected option vigorously. Reviving the commercial development of Aynak, though challenging, would send a powerful signal of beneficial exploitation of Afghanistan's mineral resources, potentially also catalyzing broader development of the extractives sector in the future.

Notes

1. See William Byrd and Javed Noorani, "Industrial-Scale Looting of Afghanistan's Mineral Resources," Special Report no. 404 (Washington, DC: US Institute of Peace), www.usip.org/sites/default/files/2017-05/sr404-industrial-scale-looting-of-afghanistan-s-mineral-resources.pdf.
2. See MoMP, "The Aynak Copper Deposit," May 2013, http://mom.gov.af/Content/files/AYNAK%20PROJECT%20UPDATE%20MAY%202013.pdf.
3. For a detailed report, see Michael Stanley and Ekaterina Mikhaylova, "Case Study: The Aynak Copper Deposit, Afghanistan," World Bank, September 2011, http://siteresources.worldbank.org/INTOGMC/Resources/EITI22weboct17.pdf. For the Aynak Copper Contract and agreements, see MoMP, "Aynak Copper Contract," http://mom.gov.af/en/page/momp-contracts/aynak-copper-contract.
4. For comparison, see *South China Morning Post*, "China's MCC turns back on US$3b Mes Aynak Afghanistan mine deal," March 20, 2014, www.scmp.com/news/world/article/1453375/chinas-mcc-turns-back-us3b-mes-aynak-afghanistan-mine-deal.
5. The contract provides for a BOOT (build, own, operate, transfer) arrangement, with the company covering the entire investment cost. This cost as well as operating expenses would be recovered from transport charges for railway customers, and once investment costs are fully recovered, the railway would be transferred to the Afghan government. This scenario seems quite unrealistic, especially with regard to full cost recovery within a reasonable time frame.
6. Estimates of the time required to preserve and remove the archaeological remains generally fall in the two-plus years range. A report commissioned by the World Bank indicated such a timeline (Andrés Hevia, Jorge Bande, Juan Carlos Guajardo, "Afghanistan Resource Corridor Development: Strategic Input on the Development of the Aynak Copper Mine," World Bank, July 2012, http://documents.worldbank.org/curated/en/831801468184173777/pdf/796330WP0P12820Box0377383B00PUBLIC0.pdf, table 1). Far more time has passed without this work being completed, but even now, archaeological preservation should not be a binding constraint because other investments and preparations for commercial extraction will take longer.
7. Subsequently, in March 2017, the former MCC chairman, who had signed the Aynak contract, was expelled from the Communist Party over unspecified corruption charges (*South China Morning Post*, "Fallout from Fall of Chinese Executive who Sealed Copper Mine Deal in Afghanistan," April 1, 2017, www.scmp.com/news/china/policies-politics/article/2084043/fallout-fall-chinese-executive-who-sealed-copper-mine).
8. See MCC, "Guo Wenqing Meets BYD Corporation President and CEO Wang Chuanfu," November 7, 2016, www.mcc.com.cn/mccen/focus/_325419/431256/index.html.

9. See MMG, "Minmetals Resources offer for Anvil Mining proceeds following agreements and approval," February 20, 2012, www.mmg.com/en/Investors-and-Media/News/2012/02/10/Minmetals-Resources-offer-for-Anvil-Mining-proceeds-following-agreements-and-approval.aspx.
10. See *The Economist*, "Mining companies have dug themselves out of a hole," March 11, 2017, www.economist.com/news/business/21718532-electric-vehicles-and-batteries-are-expected-create-huge-demand-copper-and-cobalt-mining.

About This Brief

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