



## Follow up Report of the VCA on Importation of Fuel and Liquid Gas

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## Introduction:

MEC has conducted a comprehensive Vulnerability to Corruption Assessment (VCA) of the Importation and Supply Process of Fuel and Liquid Gas in 2016 (link to the original VCA: [http://mec.af/files/2016\\_04\\_30\\_Fuel\\_and\\_%20Liquid\\_Gas\\_Report\\_%20\(English\).pdf](http://mec.af/files/2016_04_30_Fuel_and_%20Liquid_Gas_Report_%20(English).pdf)). The assessment included an extended study and review of the relevant legislative documents as well as the involved institutions and stakeholders. The data collection for the VCA included interviews with public officials, private sector companies, drivers of fuel tankers as well as focus group discussions with fuel importing companies. The Research team had visited border crossings of Aqeen, Hairatan, Torgundi, Islam Qala and provincial customs of Balkh, Herat and Kabul provinces.

The major findings of MEC's VCA was an illustrative example of *corruption as a collective action problem* in which the cost of being honest and playing by the rule is considerably higher for each actor and thus corrupt behavior is the preferred behavior for all actors. Since corrupt behavior is the regular behavior and the cost of ethical behavior is perceived to be considerably higher<sup>1</sup>, all actors benefit from being corrupt. This phenomenon is especially prevalent in the huge amount of smuggled fuel because of high custom duties and other fees, lengthy bureaucratic procedures and at the same time the existence of open, uncontrolled informal borders with the neighboring countries.

MEC has started the comprehensive assessment of the Fuel and Liquid Gas Importation Process in a time when a major public debate was underway about the raising fuel and gas prices, the low quality of the imported fuel and its possible consequences for the environment as well as the criminal networks controlling the fuel industry. Discussion was also going on the bulk of the fuel designated for the National Army, the National Police and the International Security Forces that was traded on the black market.

## Initial VCA 2016:

In the mentioned VCA, MEC reviewed the entire process of Fuel and Liquid Gas Importation, including the related laws and regulations, the role of the involved institutions, the actual practice in the customs departments, the imposition of duties, fees and other charges as well as the procedure for exemption from these charges.

### 1. Institutional and Legislative Framework

In order to import fuel and liquid gas, importing companies were required to have a company license, which was issued by **the Afghanistan Investment Promotion Agency (AISA)**<sup>2</sup>. Additionally, a second license for the importation of fuel and liquid gas was issued by **the Sub-Directorate of Fuel and Liquid Gas Regulation of the Ministry of Commerce and Industries (MoCI)**.

The 3<sup>rd</sup> involved institution and one of the major players in the fuel market was the **Afghanistan Fuel and Liquid Gas Enterprise (AFLGE)**. The AFLGE as a State Owned Enterprise was established in 1986 under MoCI. It was operating based on the its Charter

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<sup>1</sup> The cost of ethical behavior is perceived to be higher because:

- a) The probability of being caught is perceived to be low.
- b) The size/amount of penalty after being caught is perceived to be low

<sup>2</sup> AISA was merged with the Ministry of MoCI's Directorate of Central Business Registry and Intellectual Property

which mandated AFLGE to “Import, distribute and sell Fuel and Liquid Gas”. This mandate was in accordance with the than prevalent planned economy. The mentioned charter of AFLGE was amended during the Taliban Regime with the addition of two more responsibilities: “providing boarder services to the private sector and regulating/controlling the fuel prices”. Although this mandate was not compliant with the new Constitution of Afghanistan, and was a clear violation of the principles of Market Economy, AFLGE kept existing with this contradictive authority and a Tashkeel of 1,767 staff as of 2016. In practice, AFLEGE was not importing and distributing fuel and liquid gas, nor was it regulating/controlling the market price, as per its mandate. It was basically registering the fuel and liquid gas imported by private companies at the boarder customs and charging fees for some other services that was not received by the private sector.

The **Afghanistan National Standards Authority (ANSA)** is the official authority whose mandate is to inspect, analyze and audit the quality of imported goods in its laboratories. However, since ANSA did not have the technical equipment and personal capacity to inspect and verify the quality of the imported fuel and liquid gas, this services has been subcontracted to an international company called **Geo Chem Middle East**. Based on the contractual agreement between ANSA and Geo Chem, testing laboratories are established by Geo Chem at five border customs of the country (Hairatan, Aqina, Islam Qala, Toor Ghundi and Nimrooz borders) for quality examination of the imported fuel and liquid gas. The results of the tests are officially communicated with AFLGE and then with the customs departments at the borders. If the quality of the imported fuel and liquid gas is in accordance with the defined standards, the goods are allowed to enter the country. Otherwise, the goods are locked in the custom houses until a joint appointed delegation assesses a possible refining or disposal of the low quality fuel or liquid Gas, in accordance with the **Regulation on Quality Control of Fuel**.

The customs duty is paid by traders after the quality assurance of ANSA to the **Customs Department of the Ministry of Finance** with an additional charge for road maintenance, which is levied and payed into the account of the **Ministry of Public Works (MoPW)**.

Fuel and liquid gas is not only imported for the open market, but also for International Military forces and Afghan security institutions. According to the Bilateral Security Agreement between Afghanistan and USA the Afghan Government will not impose any taxes or duties on goods imported for international military forces.<sup>3</sup> The exemption of customs duty for international military forces is processed through the **Ministry of Foreign Affairs (MoFA)**. International Military Forces share the list of their contracted companies including the contract through the MoFA with MoF. Additionally, they submit their application for exemption forms including the amount of required fuel through the MoFA to MoF. The MoF provides the exemption form through the MoFA.

## **2. Identified Vulnerabilities and Corruption Risks**

MEC has identified several weaknesses and vulnerabilities in the importation process of fuel and liquid gas in the legal and institutional arrangements as well as in the practical implementation of the related laws and regulations. The major findings of MEC were as follows:

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<sup>3</sup> Additionally, based on resolution #4 of March 22, 2015, of the Council of Ministers, tax exemption in Afghan customs was approved for MOD, MOI.

- a. The mandate and authority of AFLGE was not in compliance with the Constitution of Afghanistan and the enshrined principles of market economy. AFLGE as a state owned enterprise should not be in charge of importing fuel, regulating the market, controlling the prices of fuel and providing services to the private sector. In practice, AFLGE was charging 1.78% of the total value of the imported fuel and liquid gas on private companies for a list of 10 services that AFLGE was supposedly providing. Additionally, AFLGE was distributing fuel and liquid gas in the market, in order to prevent unnecessary price ups during the winter months. Although the Fuel and Liquid Gas Policy, as approved by the Cabinet in January 2007, clearly mentions that importing companies should be only charged for services that they request and use, AFLGE was charging for all 10 services. Some of these services was neither provided by AFLGE nor received by the importing companies, while some services (for example providing the lading bill and unloading at the buffer point of the border) were irreplaceable and inevitable for the private sector. While the private sector perceived charging fees without the provision of services by AFLGE as unfair, the AFLGE complained that an optionality of some of charges have paved the way for collusion of its staff with the private companies and corruption.
- b. Overlapping responsibilities of the MoCI's Sub-Directorate of Fuel and Liquid Gas with AFLGE and unclear distinction of responsibilities between AFLGE and ANSA due to numerous Resolutions of the Cabinet and the High Council of Economics had created uncertainty about roles and responsibilities of each institution.
- c. The Afghanistan National Standards Authority (ANSA) did not have the technical and personal resources to test the quality of the imported fuel. The contracted company for providing quality assurance (Geo Chem) had laboratories at 5 border customs and attested the quality of the imported fuel at the borders. The sample taking mechanism of the fuel and liquid gas gave the company discretion for choosing the tankers with the associated risk of collusion with the importing company. Allegations of bribery by Geo Chem was raised by several companies and institutions.
- d. The Customs Department of MoF levied custom duties of 12% based on a uniform set price of USD 800 for fuel and USD 400 for liquid gas. This imaginary price was 50% - 80% above the regular market price in February 2016, thus raising the effective custom duty to ca. 20%.
- e. The process of exempting international security forces and national security institutions (MoI and MoD) from taxes and custom duties was susceptible to misuse by the importing companies. The companies that supplied the international security forces and MoI/MoD were also importing fuel and liquid gas for the regular market. The exemption forms were used by these companies for importing fuel for the open market, thus giving them an unfair competitive advantage. Other companies could easily buy the exemption forms (original or faked ones) on the market and so illegally bypass the custom duty. Private companies would profit from supplying the international security forces and MoI/MoD at a price below their purchase price in order to take advantage of the tax exemption for their remaining imported fuel. Additionally, these companies would not allow the ANSA to attest the quality of the imported fuel and liquid gas and deny paying the due fees to ANSA and AFLGE. This led to serious disturbance of the fuel market with the resulting implication for the customers.

- f. In addition to the custom duties imposed by the MoF and the service charges of AFLEGE, other institutions are charging different fees for their services, facilities and properties (MoCI for providing license, MoPW for road maintenance, Municipalities for entering the cities, ANSA for quality assurance etc.). Illegal payments to the police and local police on highways added to these fees. This raised the number of involved entities and the amount of fees and duties accordingly, thus making the illegal importation of fuel and liquid gas as well as formation of criminal networks and collusion of private companies and public officials an attractive source of income.

As a result of this VCA, MEC has issued 36 recommendations to 6 institutions, including MoCI, AFLGE, ANSA and MoF. Now, more than two years after the issuance of the original VCA Report, the government in general and the involved institutions in particular, have taken some concrete steps to reform and rearrange the institutional and legal framework and close the identified gaps. However, the implement of these reform initiatives will require more time.

## **The Situation 2 Years after the original VCA**

Based on MEC's recommendations, AFLGE has started an assessment of its mandate, HR and organisational structure as well as an evaluation of its properties and equipment. Based on these assessments, AFLGE has prepared several proposals for structural and functional reform. In cooperation with the Independent Administrative Reform and Civil Service Commission (IARCSC), AFLGE has reviewed its HR structure. Their findings showed that of the 1,767 employees, 56% have no educational decree at all and a further 33% are 12 grade graduates. Together, this makes 89% of the total staff that are not able to cope with the changing requirements of a regulatory body of one of strategically important sectors. Consequently, AFLGE and IARCSC have prepared an incentive package to encourage 507 employees to go in early retirement. The proposed plan has been approved by the government, but the implementation has not started yet, mainly due to the enactment of the new Hydrocarbon law and its implication for the existence of AFLGE.

Parallel to that, on 5<sup>th</sup> September 2017, the **new Hydrocarbon Law** has been endorsed by the President. Based on the new Law, the **Afghanistan Oil and Gas Regulating Authority (AOGRA)** should be established as an independent budgetary unit. Subsequently, **Presidential Decree #52** was issued on 13<sup>th</sup> August 2018 to establish AOGRA for "controlling, overseeing and managing" the oil and gas sector. Based on PD 52, AFLGE should be merged with AOGRA and the entire HR Tashkeel and budget of AFLGE for 1397 (2018) should be transferred to the new authority (AOGRA). However, also based on PD 52, AOGRA is obliged to develop its new Tashkeel in cooperation with IARCSC within 3 months and submit it for approval. Additionally, a committee comprising the MoF, MoMP, MoCI and AOGRA is assigned to identify the overlapping and parallel functions and responsibilities of other institutions with the newly established AOGRA and submit their proposal to the President's office.

As delineated above, the endorsement of the new Hydrocarbon Law, the envisaged establishment of the new regulating authority (AOGRA) and the issuance of PD 52 not only eliminated the duplication/overlap of responsibilities and the constitutional non-compliance of AFLGE, it also created some confusion and uncertainty about the effective establishment of AOGRA and the future of AFLGE. The assigned committee for identifying overlapping and parallel functions has not been formed yet and none of the mentioned institutions seems to

take the lead nor is a deadline specified in the PD 52. As of December 2018, only the position of the General Director of AOGRA has been approved and the former Director of AFLGE has been appointed as the new General Director of AOGRA. Furthermore, while the PD 52 clearly states that the “AFLGE is merged with AOGRA. Its 1397 budget and Tashkeel, **including all its staff**, is transferred to AOGRA”, AFLGE’s interpretation is that while its regulatory responsibility is transferred to AOGRA, its commercial responsibility should be dealt with based on the new **State Owned Cooperation Law** and transferred to a new company, the **Afghanistan National Oil and Gas Company**.

The new State Owned Cooperation Law (SOC Law) was endorsed on 5<sup>th</sup> September 2018. Based on the new SOC Law, the legal status of all State Owned Enterprises (تصدی) should be converted to State Owned Companies/Cooperation by December 21<sup>st</sup> 2019. The current **SOE law will be abrogated by December 21<sup>st</sup> 2019**. The General Directorate of SOEs at the MoF will be changed to General Directorate of SOCs and a **Supervisory Board for SOCs** will be created, chaired by the minister of Finance. In order to convert to a SOC, the current SOEs should develop their Charter based on the template provided by the Supervisory Board of SOCs. The Charter should be submitted to the Supervisory Board of the SOC for confirmation and then to the Cabinet for approval. Based on Article 10.6 of the new SOC Law, the Supervisory Board of SOCs also needs to oversee the mandates of the SOCs and make sure there is no parallel regulatory activity and commercial activity of the SOCs.

AFLGE’s interpretation of its new role is that while its current regulatory function is transferred to AOGRA, based on the new Hydrocarbon Law and PD 52 on the Establishment of AOGRA, the rest of its assets including storages, tankers and gas stations should be transferred to a new SOC, based on the new SOC Law. This SOC, named the Afghanistan National Oil and Gas Company (ANOGC) would be responsible for supplying the Government Institutions with fuel and gas. It would also be in charge of managing the national strategic reserves of oil and gas. AFLGE has also prepared the structure of the ANOGC and shared it with the GD of SOEs. However, no decision has been made in this regard yet.

Regarding the **role of ANSA**, the sample taking, testing and quality assurance responsibility (at the border customs) has been transferred to the AOGRA, based on Article 10.22 of the new Hydrocarbon Law. While ANSA considers this as a relief, not being responsible for one of the complicated activities, the transfer of responsibility also created a contradiction between the **Standardization Law** and the new Hydrocarbon Law. Based on the Standardization Law Article 7, ANSA is responsible for defining the national standards, testing all produced and imported goods and certifying the quality, while according to the Hydrocarbon Law, AOGRA is assigned to conduct quality control of the imported oil and gas, based on national standards, as developed by ANSA.

The contract of GeoChem Middle East expired in 2018, after 5 years and a new international company, the Indian TCRC has been selected by the National Procurement Authority to check the quality of the imported oil and gas. The contractual partner on the Afghan side would be AOGRA.

In total, ANSA has quality tested 2.05 million tons<sup>4</sup> of fuel and liquid gas in the national borders during the calendar year 1396.<sup>5</sup> Of this total amount, 31,700 tons of oil and gas has

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<sup>4</sup> The total amount of required fuel and liquid gas is estimated at 4 million tons p.a. , as verbally communicated by the relevant institutions. This shows that 50% of the oil and gas are illegally imported or bypass the quality test of ANSA and the registration process of AFLGE.

been identified as substandard and denied entering the country. According to the Standardization Law Article 27, the imported goods violating the national standards should be confiscated. ANSA and the related institutions should assess if it can be used for other purposes after refining and processing. The importer should be fined in accordance with the Standardization Law, Article 26. In case the importer wants to transport the imported goods back to the country of origin, it should be processed through the official diplomatic channel with the involvement of the Commerce Attaché of Afghanistan in the respective country. However, after follow ups by MEC, ANSA could not provide any information on the whereabouts of the identified substandard oil, adding that ANSA's job is done after sending the negative lab reports to the customs department. Substantial part of this oil and gas is apparently entering the country eventually.

In order to stabilize the price of fuel and gas and in order to base the **imposed custom duties** on the real market price of the imported fuel and gas, rather than a set price, the Cabinet of the GiRoA on November 29<sup>th</sup> 2017 has **decreased the custom tariff to from 12% to 6%**. The set price for oil was reduced to from USD 800 to USD 450 and the set price for liquid gas from UDS 400 to USD 350. Additionally, the MoF was assigned to procure two user licenses of PLATTS South Asia<sup>6</sup> in order to adjust the set prices for levying custom tariffs on real market prices and update the prices on a quarterly bases. The fees charged by AFLGE for its services was reduced in the same Cabinet Session from 1.78% to a uniform rate of 0.6% imposed on all importers. The optionality of using AFLGE services, as enshrined in the 2007 Fuel and Liquid Gas policy was abolished with that.

## Conclusion:

Oil, liquid gas and other fossil fuel are considered to be politically and economically of strategic importance for any country. In Afghanistan, this importance was neglected in the past; the central government was not a major player in controlling the sector. Despite the recent efforts to coordinate the regulatory functions and create a framework for the activities of other stakeholders, the strategic role of the sector has not been recognized yet.

The enactment of the new Hydrocarbon Law and the planned establishment of the new regulatory authority (AOGRA) can be a good start to build the regulatory framework for the fuel sector. However, the real implementation of these efforts doesn't seem realistic before the 2019 presidential election, although the reforms are urgently needed. Lack of technical capacity in the national institutions is another important issue which will require contracting international companies to provide the necessary services.

The process of exempting fuel and liquid gas imported for international security forces as well as MoD and MoI are susceptible to misuse and corruption and at the same time create market turbulences.

MEC's 36 recommendations, as issued in 2016, will be amended as the responsibilities of the involved institutions and the legislative framework are changing. However, as delineated above, some measures have already been taken by the involved institutions

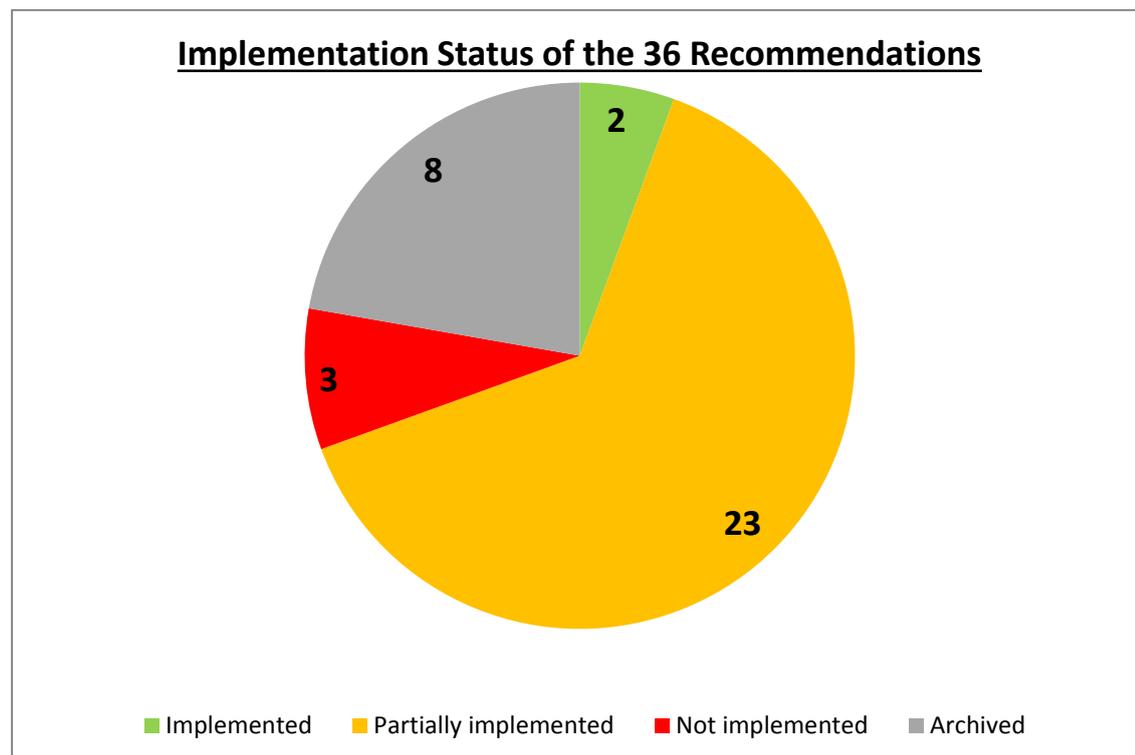
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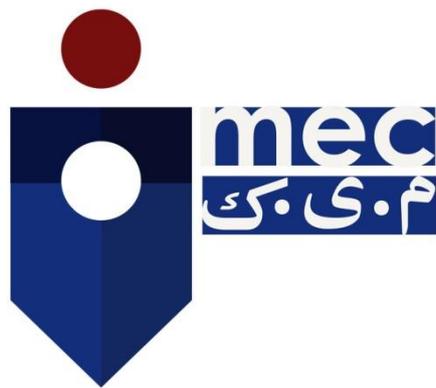
<sup>5</sup> This does not include the amount of fuel imported for international security forces, since the imported fuel for international security forces is not quality checked by ANSA, although an exemption from quality control is not covered by the BSA.

<sup>6</sup> Platts South Asia is a benchmark for the region provided by S&P Global Platts, a provider of energy and commodities information and a source of benchmark price assessments in the physical energy markets

within their current mandates. As illustrated in the below chart, of the 36 recommendations, 2 have been completely implemented. 23 have been partially implemented and 3 have not been implemented at all. Additionally MEC has archived 8 recommendations because they were covered by other MEC studies, or were not relevant anymore.

Of the 36 recommendations, 12 are related to the MoCI and AFLGE. One of these 12 recommendations have been implemented and eleven have been partially implemented by MoCI and AFLGE. The completion of the implementation process of these eleven recommendations is subject to the realization of the above discribed changes in the institutional and legal framework.





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