Sierra Leone Diamond Sector Financial Policy Constraints

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Author: Chaim Even-Zohar
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Sierra Leone
37 Circular Road
Freetown - Sierra Leone
Cell: +232 76-665-797
e-mail: peacedia@sierratel.sl
www.peacediamonds.org

U.S.A.
600 Water St., SW
Washington, D.C.
(202) 484-7170
e-mail: mfanning@msi-inc.com
www.msiworldwide.com

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EXECUTIVE SUMMARY

The Purpose of This Study

The United States Agency for International Development (USAID) and the United Kingdom's Department for International Development (DfID) have been working in partnership with the Government of Sierra Leone (GOSL), civil society, international NGOs, Chiefs, and local leaders to address problems associated with alluvial diamond mining in Sierra Leone. Significant progress has already been made in building consensus among the various parties. Now the partners are in the process of launching operations based on the following principles:

- Local communities must benefit from the diamond resource;
- Accountability must be increased;
- Problems must be addressed simultaneously on local and international levels;
- Dialogue is essential;
- Private sector must be part of a community-based solution.

However, since most alluvial diamond activity in Sierra Leone is clandestine, the program has been hindered by a lack of accurate data on the mechanics of the industry. Efforts have also been hindered by the scope of the smuggling problem, by exploitation of local residents by the industry, and by the formidable scale of production.[1] This study was commissioned jointly by USAID and DfID to overcome some of these obstacles and come up with strategies to address the underlying problems. [2]

Principal Findings and Conclusions

1. The plight of alluvial miners and diggers in Sierra Leone mirrors problems often seen in the Democratic Republic of Congo, Guinea, Angola, Central African Republic and other diamond-rich African countries. In Sierra Leone *de facto* control and ownership of most production is in the hands of a small but powerful trading elite, depriving licensed miners and their diggers the opportunity to secure a fair return for their labor.

2. The actual (Antwerp) market value of Sierra Leone's 2002 diamond production is conservatively estimated in the $320-$400 million range.

3. Since the work of diggers is seasonal, employment figures vary, but there is a consensus that in the post-war reconstruction period there has been a massive movement of people back into the diamond areas. As a result both legal and illicit production are rising. We estimate the number of miners and diggers to be between 300,000 and 400,000.

4. Between 85% and 90% of the production is smuggled out – a figure that has been repeatedly stressed by both private players and government officials. (Since officially-recorded diamond exports tend to be significantly undervalued at export, official channels also constitute one "smuggling" channel.)[3]

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[1] Estimates contained in this document are based on best efforts to gauge a secretive industry. We believe our figures are close to the mark, but, as with any effort to examine black market phenomena it is not 100% precise. We welcome further input as to reliable data sources.

[2] Chaim Even-Zohar, of Tacy Ltd. Diamond Industry Consultants, with over 30-years of experience in developing corporate strategies and governmental policies for the diamond industry, was commissioned to perform this study.

3 Since an institutionalized interest prevails for most players involved in the sector to downplay the dimensions of the illegal market, the production/smuggling figures publicly quoted tend to be more moderate.

5. To facilitate smuggling and money laundering, both in Sierra Leone and "downstream" (that is, in the direction of the ultimate consumer), record keeping and transaction transparency are kept to a minimum or are totally absent. Some of the existing paper trail is fraudulent.[4]

6. Virtually no export proceeds are visible in Sierra Leone's banking system; the diamond business (including exports) is entirely cash-based and operates mostly in the parallel market.

7. The sector's cash basis is facilitated by the fact that cash needs for local inputs are relatively minor – estimated at $40-$60 million annually. This is no more than 10% to 15% of the diamond output value.

8. As the diamond business is conducted entirely in cash (with, at best, questionable documentation), it appears that annually more than $300 million in profits are applied to unknown uses both domestically and abroad. Money laundering appears to be occurring on a massive scale.[5]

9. The diamond "money trail" begins where the stone is converted into cash through the sale to someone at arm's length from the seller. The only documented expenses for the seller in Sierra Leone proper are the inputs costs (equipment and wages, rice and other staples paid to diggers) and the "winnings" paid to licensed miners. This means that some 85%-90% of the money derived from the final product conversion into cash takes place elsewhere, mostly in Belgium (certainly close to 90%) with the balance in a dozen or so other locations.

10. The main dealers and exporters (who control 85%-90% of the Sierra Leone diamond market) are "selling" their goods to affiliated companies in Antwerp, Switzerland, Dubai or other markets. Consequently, transfer pricing is only of theoretical interest for government statistics, and has no impact on the actual flow of funds. The sole expenditure in Sierra Leone is settled either by imported cash or, more often, from the local Leone proceeds of domestic sales of other imported goods (such as rice) available to the diamond trading community. None of the actual added value (profits) passes through Sierra Leonean hands in Sierra Leone, except for the small margins sometimes made by the miners and some intermediaries.

11. It is not appropriate to blame the money laundering and smuggling solely on weak governance or corruption in the relevant institutions (e.g. GGDO, banking system, Ministry of Mineral Resources), since even in the best of circumstances these organizations are no match for the extremely powerful international actors that are driving the system. Moreover, while its staff is skilled, the Ministry is woefully short of resources and incapable of fully enforcing Sierra Leone's laws.

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[4] Such as recording a 94 carat single stone as a "parcel of mixed stones" at a very low per carat value; or recording high value gem qualities as cheap "industrial goods".

[5] Money laundering can be defined in many ways. Generally, in U.S. federal law, "money laundering is the flow of cash or other valuables derived from, or intended to facilitate, the commission of a criminal offense. It is the movement of the fruits and instruments of crime." Smuggling of a national resource out of its country of origin, evasion of tax payments on the proceeds; violating laws applicable to licensed mining, trading and exporting; turning the mineral resource into "cash" overseas to be applied and moved around to uncertain and undefined uses, justifies referring to the non-declared/non-recorded part of Sierra Leone's diamond production as money laundering. (See: "International Money Laundering Abatement and ant-Terrorism Act of 2001," Title III of the USA Patriot Act of 2001. Oct. 26, 2001.)

12. The smuggling that takes place at the level of licensed miners and their diggers (which is a small share of the total smuggling) is chiefly motivated by a desire to avoid payments to financial supporters and evade the local prices controlled by the diamond cartel. If better prices were available locally through the structures we recommend, this type of smuggling would diminish greatly, provided the debt bondage situation that requires miners to hand their winnings over to their supporters can be broken as well.

13. Many of the obstacles to a clean diamond industry are external. At the root of most smuggling operations is the desire of an exporter to rake in hundreds of millions of dollars on overseas markets – not simply to evade export duties or other taxes in Sierra Leone. The 3% export tax alone does not constitute an impediment to legal exports, and indeed money laundering and smuggling involve transactions costs that far exceed the costs of official export duties. Thus a further reduction in export duties would do little to shift diamond movements from illicit to licit channels.

14. Money laundering in the diamond sector must be attacked at the source of alluvial production. The worldwide annual production of diamonds is valued at about $8.5 billion (It may be slightly higher as data on informal small-scale alluvial production is incomplete). Approximately 85% of the world's production is in the hands of international mining conglomerates (De Beers, Debswana, Alrosa, BHP-Billiton, Rio Tinto, Namdeb) engaged in kimberlite mining. Their initial sales of the diamond product into the market are (a) well documented, and (b) settled through bank transfers. By contrast, the bulk of small-scale alluvial-production centers in Africa share the dubious distinction of being about the last places in the world where the initial sales of the diamond product are both (a) poorly documented or not documented at all; and (b) in cash. And this goes for many subsequent sales as well. Though it seems to be accepted that the alluvial mining business in Africa is cash-based, there is, in theory, no reason why financial settlements cannot take place by transfers through banking channels at both the export and – overseas – the import level. This would enhance transparency, limit vulnerability to money laundering, and provide governments with a visible (taxable) revenue base.

15. In the case of Sierra Leone there are two major impediments to using the banking system. First, the Sierra Leone banking system has a reputation for being unreliable and insecure; working through the system carries a 15% "penalty" because of high banking charges and the forfeit of exchange rate premiums available in the parallel market. The second impediment is more serious: As some of the exporters involved want to apply their earnings in the invisible shadow (parallel) economy, it seems unlikely that the present dominant players would utilize such banking options in any case.

16. Monitoring cross-border cash payments is virtually impossible. Many of Sierra Leone's dominant players have family and corporate ties to diamond traders in the Democratic Republic of Congo (DRC) and other African diamond markets. Cash transfers that take place among these players are untraceable. These players also rely on nontraditional remittance systems that provide for the transfer of value outside of the regulated financial industry.[6] Non-traditional remittance systems constitute an integral part of the Sierra Leone diamond-trading mechanism.

[6] Such systems (including "hawala") rely primarily on trust and the extensive use of family connections or ethnic affiliations. (Hawala makes minimal or often no use any sort of negotiable instrument. Money transfers take place solely on the basis of communications between a network of "hawaladars", or hawala dealers.) "Because of its anonymity and secrecy, hawala is known by law enforcement to have been used as a money laundering mechanism in

17. Many observers have identified the need to have more exporters operating in Sierra Leone, in order to enhance competition and secure better prices (and options) for miners. However, in the past, dominant business interests have made it extremely difficult for outsiders to operate on the level of traders and exporters. The dominant players appear to use the diamond industry as a monetary vehicle to finance other profitable enterprises (construction contracting, cement, building materials, rice imports, etc.) in which they also hold dominant positions.

18. Outsiders invariably have failed to properly understand the intricacies of the domestic trading system, which relies on paid informants who scout the alluvial mining areas for interesting goods and try to lure miners to the offices of their employer. Local traders often exploit the inexperience of the outsiders, who are viewed as short-term players. The diamond scene in post-conflict Sierra Leone has failed to attract outsiders committed to a sustainable long-term presence in the market.

19. Small-scale mining is a subsistence activity. As more people migrate to the mining areas, more mining will take place. Many migrants are refugees from neighboring countries and there is evidence of tension among indigenous mining "gangs" and foreigners. Foreigners tend to have an advantage as they usually have better access to funds, but their ties to outside contacts encourage smuggling.

20. The need for efficient and rational license allocation is self-evident, while illicit mining needs to be curtailed. A critical prerequisite is the need to more accurately define the "ownership" of findings among gangs, gang-leaders, possible sub-gangs, miners and financial supporters.

Recommendations (Internal Actions):

One of the key objectives of this study is to understand the magnitude of the rents currently absorbed by Sierra Leone's diamond cartel. It appears that approximately $300 million in diamond value was smuggled out of Sierra Leone in 2002, providing virtually no benefit to the rest of Sierra Leone. The figure is likely to be significantly higher in 2003.

The primary lesson emerging from this study is that with relatively minor adjustments to the credit, production and marketing systems, hundreds of millions of dollars annually could be redirected to the 300,000-400,000 Sierra Leoneans engaged in the diamond industry. Such focused reforms would also help sustain Sierra Leone's fragile peace and provide a basis for a sustainable development paradigm. However, such adjustments will undoubtedly be strongly resisted by those with a financial interest in perpetuating the status-quo. A secondary lesson is that money laundering appears to be occurring on a massive scale. Cracking down on laundering will require the intervention of the international community.

The following recommendations address these issues:

1. International diamond buying concern(s) should be invited to serve as a "marketing channel" for diamonds that are mined appropriately. Larger conglomerates have more leverage to resist efforts by Sierra Leone's cartel to frustrate and sabotage efforts by small-

some parts of the world." See: Fletcher N. Baldwin, Jr. "National Money Laundering Strategy for 2002," issued August 2002, Oceana Publications, New York, page 30.

or medium-weight players. This should initially be introduced as part of the Peace Diamond Alliance in Kono as an example for the rest of the country.

2. Any efforts to increase the competitiveness of the diamond-buying and exporting businesses should be coupled with “protection” for new buyers, lenders and producers, and a commitment by the current diamond cartel to participate openly in the new scheme for the sake of Sierra Leone’s long-term security. The main actors in the diamond cartel in Sierra Leone are few. Donors and the GOSL should enter into a dialog with those individuals and make it clear that if diamonds continue to fail to benefit the economy or create visible added value, the donors may contemplate other measures.

3. Providing the licensed miners and the paramount chiefs with an alternative sales option that bypasses the local dealing structure will by itself create a positive spillover effect: Dealers will have to pay more in order to remain competitive and retain their access to goods. If licensed miners have alternatives, the likelihood that the diamond cartel will maintain a dialog with the donors (previous paragraph) is also enhanced.

4. In addition to working with the central government to bring about meaningful changes, some of the new structures for credit, mining and marketing should be implemented in partnership with the traditional owners of the ground (i.e., the chiefs) and with their communities (who would be the principal beneficiaries of such change). USAID has already spearheaded this process in Kono District, with the Peace Diamond Alliance.

5. GGDO valuators should be trained to more accurately valuate rough diamonds, and methods of crosschecking the value of export parcels should be improved both in Sierra Leone and in the importing countries. The cooperation of the importing country should be secured to assist with the latter. Currently there is neither a legal requirement nor any desire by governments in importing countries to valuate rough diamond imports. Consequently, there is neither a mechanism nor the manpower in place to facilitate such value verification.

6. A credit system must be established – as a very high priority – to enable indigenous miners to free themselves from the “debt bondage” currently prevailing in the alluvial fields. Miners must be free to sell their production to the highest bidder in order for the first sale to be clean and documented. This should be piloted in Kono District, through the Peace Diamond Alliance, and may require initial donor subsidies.

7. The credit system to be piloted in Kono District should be developed through a commercial bank, with offices in Kono. That same bank could serve as a pilot for developing best practices and linkages with foreign banks with experience in diamond-industry financing. This will enable the eradication, or minimization, of cash as a basis for the purchase of alluvial diamonds in Kono District. Cash flow from diamond purchases could eventually be used to offset loan costs.

8. The GOSL should develop systems to ensure that a clear money trail exists for the purchase of all diamonds. This will involve reviewing current regulatory regimes and working with local and international banks and government authorities to develop systems that eliminate the need for transporting briefcases full of currency for those who would otherwise be inclined to work under internationally accepted business practices. The U.S. Department of Treasury could assist the GOSL in this regard.

Recommendations (External Actions):

In addition to addressing internal factors in Sierra Leone, the international community should consider *external* issues that affect trade in this international commodity, as it affects international security:

9. A comprehensive regional approach should be considered to understand alluvial mining practices in the other countries with alluvial diamond mining. Particular focus should be put on how such practices impede domestic economic development and threaten both regional and international security.

10. The valuation system of exports must be strengthened and better cooperation must be demanded from the recipient countries. There is no adequate matching of the actual value with the value reported on the export certification. Ideally, authorities of the countries on the receiving side should be put on notice that under-valuations or over-valuations must be reported in the context of worldwide money anti-money-laundering efforts. The basic technical mechanism to implement this is already in place, though to initiate it would require statutory amendments and the building of an industry consensus that is presently absent.[7]

11. U.S. Treasury efforts to stamp out money laundering through the PATRIOT Act should be focused to address on-the-ground realities in Sierra Leone, the DRC and Angola. The USG should use its offices to track the diamond money trail in order to better understand the destination and uses of funds laundered through the rough-diamond industry in Africa. The USG should also help ensure that alluvial production enters legal marketing channels from the moment the stones are discovered. The continued capacity of terrorist groups to wreak havoc adds urgency to this call.

12. USAID and DfID should build on the Peace Diamond Alliance by recruiting major players in the diamond industry – players that have demonstrated accountability, transparency and a commitment to the vitality of the industry – to address the illicit use of diamonds on a continental scale. While De Beers has been a fine partner to date in the Peace Diamond Alliance, it is reasonable for the international community to expect much more from it and other key players in the diamond industry in terms of building a model of clean alluvial-diamond management – a model that could be applied to all countries where alluvial mining occurs.

13. Cash that has been withdrawn from banking systems may become difficult to monitor. The donor nations ought to alert the relevant countries and banking institutions of this specific sector-related concern and encourage them to impose more stringent reporting systems. Perhaps it would be appropriate to demand that each and every diamond-related withdrawal of cash above a $20,000 threshold be reported. More thought ought to be given to establishing a regional or international mechanism to monitor the flow of rough-diamond proceeds. It must also be taken into account that "overregulation" in this traditional laissez-faire industry has often led to the establishment of parallel systems. To avoid such a counterproductive backlash, it is imperative to engage the industry in dialogue.

14. Certain Antwerp banks are the principal bankers for the diamond community in Antwerp. Their knowledge of the business of their clients is considerable and there may be great

[7] Recognizing the difficulty in getting importing countries to agree on import valuation, the USG may find it easier to get ad hoc agreement on the verification of imports only from Sierra Leone.

advantages to working with them. If one of these banks were to open a regional office in West Africa serving the diamond sector, this might contribute to greater accountability and transparency. Joint ventures or consortia agreements for the purpose of diamond-industry support and financing among banks are not uncommon in the international diamond-financing industry (especially India and Israel.) Some such models could be applied in Sierra Leone.

15. Lastly, continue to focus on all the traditional tools for improving the industry's performance. Education, price information, geological information, logical allocation of license areas, introduction of mechanized mining and the establishment of a generation of young entrepreneurs are all important.

1. GENERAL BACKGROUND

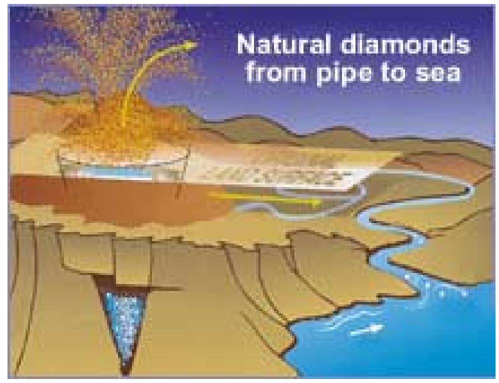
1.1. Introduction

Kimberlite vs. Alluvial Diamond Deposits

Diamonds are formed deep in the Earth's core, where the enormous pressure of miles of soil and rock overhead creates the heat necessary to convert carbon into diamonds. That same heat can form molten rock, or magma, which seeks weaknesses in the geologic structure of the planet as it rises in magma pipes, called "dykes", carrying the diamonds with it. Sometimes it may reach the Earth's surface as a volcano, spewing diamond-rich lava, and leaving the remainder underground as a hard, diamond-laden dyke. These are called "kimberlites" (please see the picture to the right, taken from the DeBeers Group website.) Kimberlite deposits have been mined very profitably using a secure, high-capital, high-technology, low-labor mix. For example, Debswana, in Botswana produced gross profit in 2001 of $1.5 billion, employing barely 6000 people, with virtually the entire production being exported legally.

By contrast, "Where kimberlite pipes have been eroded by millions of years of rainy seasons, and the diamonds they contained have been washed away by countless changing rivers, the result is alluvial diamonds. Scattered over hundreds of square miles – along river beds, in valleys where rivers once flowed, on beaches and on the seabed where rivers eventually deposited them, alluvial diamonds are close to the surface, they are often available to individual diggers with little more than shovels, sieves and a source of water for straining the gravel." (from "Motherhood, Apple Pie, and False Teeth, by Ian Smillie, Partnership Africa Canada, June 2003.)

Diamonds in alluvial deposits are spread across national and chiefdom boundries in Sierra Leone. They are very difficult to regulate, and local residents are very possessive of the resource. The capital/labor mix is very different from large kimberlite mines: we estimate that in 2002, 200,000 to 400,000 laborers toiled in Sierra Leones mines to produce between $300-400 million worth of diamonds, 90% of which was exported illegally.



Sierra Leone's diamonds are highly prized both for their high quality and for the handsome margins afforded by their low production costs. But historical and political circumstances have shaped what is, from a public policy perspective, an inefficient and socially irresponsible diamond-mining sector. Inequitable internal trading and export mechanisms deprive most of the indigenous stakeholders (especially the miners and diggers) and the domestic economy of any benefit from this enormous mineral wealth. Virtually none of the proceeds of even the officially recorded diamond exports have been deposited in Sierra Leone's banks, nor are they invested into the domestic economy.

About two-thirds of Sierra Leone's working-age population engages in subsistence agriculture. The country's manufacturing consists mainly of raw materials processing light manufacturing for the domestic market. Diamond mining is the nation's primary source of hard currency and its only source of widely available wealth. Effective management of the diamond economy *should* provide the government with the means to govern - and its people the resources to prosper. By all accounts it has provided the opposite: Perverted diamond management during the protracted civil war empowered rebels to challenge government rule and devastated hundreds of thousands of lives in the region. It has been concluded that "diamond wealth in combination with poor governance led to the state's collapse and created the incentive, as well as the opportunity, for a rebellion throughout the 1990s. Sierra Leone is now ranked among the poorest countries in the world, with a per capita annual income of about US$480."[8] Throughout Sierra Leone's history governments have depended on their relationships

[8] Paul Collier, Lani Elliott, Håvard Hegre, Anke Hoeffler, Marta Reynal-Querol, Nicholas Sambanis, ***Breaking the Conflict Trap: Civil War and Development Policy,*** a co-publication of the World Bank and Oxford University Press, Washington, D.C., 2003, page 127.

with domestic resources (i.e. diamonds), political elites, colonial powers and the international market to remain in power.[9] To bring about change in the diamond sector management those relationships may have to be redefined. The key to a better future lies in sustainable, democratic, grassroots solutions and constructive engagement by the international community.

During the first decades of Sierra Leone's independence, the government exercised considerable control over diamond areas through a monopolist mining structure inherited from colonial days. Diamond exports grew to represent some 60%-70% of the country's total exports, contributing greatly to governmental revenues.

About 30 years ago illicit diamond mining, which had been growing in response to tight regulations in the sector, became uncontrollable. The government deregulated the sector, introducing alluvial licensed mining schemes that provided illegal miners with an option to become legal.

After independence illicit diamond mining opportunities triggered huge labor migrations from both inside and outside the country to the diamond fields. With them came diamond brokers and merchants, mostly of Lebanese origin, who managed the commercial linkages between miners and global markets, and the political linkages between the country's main source of ready cash and the networks of prominent politicians. The growth of illicit diamond mining not only challenged the ability of the state to raise taxes from the diamond fields, but also created powerful local political interests. Those who controlled the illicit diamond trade carried enormous political clout.[11] Paradoxically, facilitating legal alluvial mining gave further impetus to the expansion of the illicit activities alongside the duly licensed operations. This development didn't take place in a vacuum; other regional diamond producers adopted similar policies.

Diamond mining and marketing continued through the civil war of the 1990s, albeit at a severely curtailed pace. As the government grew weaker and the RUF-miners established linkages with global markets (through both Liberia and the readily available domestic channels), dealers and merchants saw their positions on the market strengthened even further. Today, a handful of players control over 85% of the Sierra Leone diamond market and their ability to influence the domestic economic and political agendas has been enhanced significantly. There is justification for applying the frequently used local epithet, "diamond cartel."[12] The financial, political and commercial interests and allegiances of these cartel players, many of whom have strong ties to other countries, are strongly external. Discriminatory local laws contribute to the alienation of some of the non-indigenous ethnic groups. Consequently, hundreds of millions of dollars every year appear to be laundered through an "invisible" international circuit.

Some members of this cartel have direct and indirect links with Hezbollah, Hamas, Fatah and similar organizations (though it should be noted that some of these organizations are also involved in social and charitable activities in the Middle East, and reject charges of links with terrorists.[13])

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[9] See: Christopher Clapham, "Sierra Leone: the global-local politics of state collapse and attempted reconstruction," paper delivered at the Failed States Conference, Florence, April 10-14, 1991.

[10] Small-scale alluvial digging operations are not dissimilar to structures in Angola, the DRC, and, to some extent, Guinea.

[11] From Professor Christopher Clapham's excellent paper, that also made reference to H.L. van der Laan, *The Sierra Leone Diamonds: An Economic Study covering the years 1952-1961*, Oxford University Press, 1961.

[12] See also: Lansana Gberie, "War and Peace in Sierra Leone: Diamonds, Corruption and the Lebanese Connection," published as Occasional Paper #6, The Diamonds and Human Security Project, Partnership Africa Canada, Ottawa, Canada, November 2002. Another useful publication is "The Usual Suspects: Liberia's Weapons and Mercenaries in Côte d'Ivoire and Sierra Leone," a Report by Global Witness, London, U.K., March 2003.

[13] "The allegations of links with terrorism by members of my community are without foundations," says S. Hassanyeh, President of the Lebanese Community, Freetown, March 5, 2003.

The Washington Post has repeatedly reported that there is evidence that al-Quaeda agents have purchased Sierra Leone's rough diamonds in the past. This report is not intended to investigate the use of the funds laundered through diamond sales. However, it is important to note that hundreds of millions of dollars worth of diamonds exited Sierra Leone in 2002, and we cannot rule out the potential nefarious application of those funds.

Our primary concern is that the diamond sector lends no added value to the economy of Sierra Leone. Neither the public nor local private businesses benefit significantly from this sector. Furthermore, the conversion of the diamond resources into laundered money makes it virtually impossible to identify final uses of Sierra Leone's stolen wealth. In order to fix these problems, an incentive structure that promotes legal exports and discourages smuggling and money laundering is desperately needed.

1.2. The Purpose of this Study

The world was alarmed by the role diamonds played in fueling in Sierra Leone's 10-year civil war and related atrocities. The United States Agency for International Development (USAID) and the United Kingdom's Department for International Development (DfID) have been working in partnership with the Government of Sierra Leone (GOSL), civil society, international NGOs, Chiefs, and local leaders to address the situation. Significant progress has been made in gaining consensus on the following principles:

- **Local communities must benefit from the diamond resource** if changes are to occur. Projects like the GOSL's Diamond Area Community Development Fund (DACDF), which returns one-fourth of all diamond export tax revenues to communities engaged in legal mining, must be continued.
- **Accountability must be increased.** The DACDF Coalition teams government and non-governmental organizations (NGOs) to ensure that DACDF funds are spent as intended, and that communities are empowered to use them effectively.
- **Dialogue is essential.** Community meetings, radio shows, workshops and print articles have been an essential part of opening community/central government discussion on how to revamp the diamond sector to ensure that diamonds contribute to long-term peace and prosperity in Sierra Leone
- **Private sector must be part of a community-based solution.** A Peace Diamond Alliance has been established to prove that diamonds can be a positive force for peace and development. International diamond businesses – such as the DeBeers Group, Rapaport Group and Branch Energy – have joined hands with the GOSL, USAID, DfID, Chiefs, the DACDF Coalition, international NGOs, and CBOs to develop solutions that recognize that the problem has many dimensions: local and national; domestic and international; business and government; government and NGO.

However, since most alluvial diamond activity in Sierra Leone is poorly - if at all – documented, the program has been hindered by a lack of data on the mechanics of the industry, the scope of the smuggling problem, the degree of exploitation of local residents by the industry, and the scale of production. Estimates contained in this document are based on best efforts to gauge a secretive industry. We believe our figures are close to the mark, but, as with any effort to examine black market phenomena, our figures are not 100% precise. We welcome further input on reliable data.

This is a diagnostic study focusing on the internal dynamics of the Sierra Leone alluvial diamond industry and identifying issues requiring the most urgent attention. It also places Sierra Leone's circumstances within the context of the larger international diamond industry to present policy makers with viable options for Sierra Leone. The present study attempts to quantify the value of the domestic industry and begins to trace the diamond money trail, acknowledging that money laundering has critical national and international economic and security implications. In addition, the distorted allocation of diamond wealth is keeping hundreds of thousands of Sierra Leoneans in abject poverty.

1.3. Methodology

The illicit nature of many of the activities covered in this study render impractical the use conventional surveys and quantitative techniques. Much of the data was secured from industry intelligence sources or drawn from interviews with key informants in Freetown, Kono and the diamond centers of London, Antwerp and Tel Aviv. Much of the analysis relies on observations and personal knowledge collected in the author's 30+ years of relevant experience. The researchers also had access to public and private documents, both current and historical, and conducted an elaborate search of relevant literature. The views of reliable local Sierra Leone sources were considered when appropriate.

As the work progressed, it became apparent that the main problems cannot be addressed, nor alternative strategies or policies implemented, without considering national and international security issues. Therefore, researchers explored some global diamond industry issues that may go beyond the immediate welfare of the diggers and miners, but that may directly impact the future of the nation.

2. SIERRA LEONE'S DIAMOND SECTOR

2.1. Historical Antecedents

Appendix A presents a brief history of Sierra Leone's diamond industry. Readers are encouraged to read it to learn how current problems in the diamond sector have their roots in politicized relationships between the government, foreign capital, colonial powers and local ruling elites. Some key points to consider (drawn from *Appendix A*) that will facilitate subsequent discussion:

- Local people have never benefited significantly from the diamond resource, nor have they had any significant influence over fundamental management issues related to mining;
- Nevertheless, local attempts to assert control over the diamond resource is a recurring theme;
- External security imposed on the community has never proven sustainable;
- At times the state has been able to extract significant levels of tax revenue, rising to as much as 70% of reported exports – with mining companies still making sufficient profits to remain in business;
- A number of diamond management models have been applied, ranging from state monopoly to near anarchy;
- The state's effective control over alluvial mining has steadily eroded over the years;
- Various political elites have vied for control of the resource over the years, creating fundamental governance challenges.;
- Local business elites have dominated the diamond sector, exerting tremendous influence over its management.

2.2. Contemporary Alluvial Diamond Mining

The Scorecard: Diggers, Miners, Supporters, Dealers and Exporters

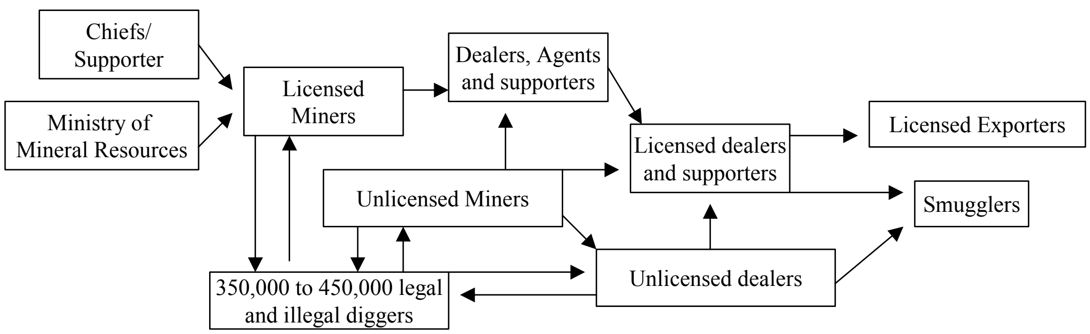
Alluvial diamond mining is a messy business. Although there are many variations in approach. pits are typically dug in current or past river beds, and water often rushes in, resulting in big, muddy holes with as many as 100 or men working on each one-acre site. Those who do the vast majority of the manual labor, are referred to as "**diggers**", although they might also include those who carry dirt, "wash" the gravel seeking diamonds, or provide other unskilled labor. **Miners** are the individuals who hold the alluvial mining license, entitling them to mine. They are also normally the managers of the operation, although often – where an external "**supporter**" is financing the enterprise – a mining supervisor may be involved. The Miner or supporter often engage the diggers in "**gangs**", units of five individuals working together. In the simplest arrangement, the miner sells the diamonds he and his gangs discover (their "**winnings**") to a **dealer**. The dealer, in turn, works for an **exporter**, who holds a license with the GOSL, entitling him to

Artisanal diggers mine alluvial deposits in an exceedingly complex system in which the main stakeholders include **diggers, license holders, dealers, supporters** and **exporters**. Holders of alluvial mining licenses operate within an integrated system that requires them to sell their winnings to licensed dealers/agents or to exporters, at prices that are supposedly negotiated on a case-by-case basis. The miners' financial dependency on and legal obligations to their financial supporters prevent the formation of a willing-buyer/willing-seller environment that could provide the desired competitive operating theater. Licensed miners are not authorized to buy rough diamonds from others, although small-scale licensees may export their winnings directly under certain approved guidelines.

Other mining stakeholders include the paramount chiefs (who own the land, collect surface rents, and in some cases grant mining rights), the Ministry of Mineral Resources (which owns the mineral rights, issues the mining license, and regulates the industry), and the "gangs" of diggers (who constitute the main labor force). There are also less significant players such as the "coaxers" and the "trafficants."[14]

Dealers often also play an active role in the management and supervision of mining work, either personally or through employees, mostly to protect their investments and assure that winnings are not diverted to smuggling channels or to rival dealers. Finally, licensed exporters (mostly foreign nationals) continue to conduct the formal export of diamonds. In principle, the latter are not supposed to be involved in mining or related supporting activities, but in practice they appear to be a major source of funds for mining.

Main Stakeholders in Artisanal Mining



Mining is conducted through *de-facto* partnerships in which the dealers/supporters (1) sublease concession areas from mining license holders; (2) fund the operating costs; and (3) provide key supplies like food, tools and medicine, and meet the operating cash requirements of the party that will manage the mining activities (which may or may not be the license holder).

Though the licensed miners, who each employ up to 100 "diggers" to work their one-acre sites, would appear to be "the principal force" driving the sector, this is often not the case. "The license holders often play a passive role, mostly dealing with the authorities, paying license fees and collecting their share of production values. Upon settlement/valuation of the production of diamonds, the direct operating costs are usually deducted, and in a typical arrangement the remaining value is split up, with the dealer, license holders and workers (diggers or "tributors") each taking one-third. The high risk of theft of diamonds and supplies explains the strong involvement of dealers in direct management and control of mining."[15] This arrangement, which conveys the financial supporters' distrust of licensed miners, results in the "marginalization" of the position of the miners. It also strengthens the hands of the supporters in the continuing battle for winnings.

Miners are intensely dependent on their "financial supporters." Supporters use this dependence to essentially turn miners into mere figureheads and turn diggers into gambling serfs. Supporters, who usually have close ties to the domestic diamond buying cartel, advance funds, shovels, sieves and rice to diggers and miners. In return they assume *de facto* control of a "supported" miner's mineral output. Hopes for meaningful profit sharing among the financial supporter, licensed miner and

[14] Coaxers work on behalf of dealers/exporters and their task is to induce/cajole miners to sell their diamonds to their principals. Trafficants are scouts, spies, conducting reconnaissance in the mining areas to report interesting recoveries back to the dealer.
[15] See: The World Bank, "A Mining Strategy for Sierra Leone's Post-War Recovery Efforts," Revised Working Draft, October 23, 2002, page 25.

diggers end when, at the end of the season, the financial supporter claims that his expenses matched or exceeded the value of the diamond winnings. This arrangement offers the miners little hope of escaping debt.

This relationship has been characterized as "a system of debt bondage, which is monitored worldwide by the U.N. Commission on Human Rights and is classified as a contemporary form of slavery."[16] Providing the miners with access to working capital has been identified as a prerequisite to any "unbundling" of the present arrangements, though it would be erroneous to view this solely as a credit problem.[17] Dealers are using their financial leverage to underpin their domestic market dominance and to maximize their profits at the expense of the miners and diggers. The prevailing price-fixing arrangements among dealers run contrary to normal commercial behavior and would be considered illegal restraint of trade, illegal collusion to control the market and illegal anti-competitive behavior in most free-market economies.

Often the only real chance for diggers and licensed miners to get a decent price for their winnings is to smuggle their higher-value diamonds to Guinea, Gambia or elsewhere. This smuggling is not done to avoid export taxes or out of a preference for moving otherwise fully legitimate production through illicit channels. Rather, it is done solely to steer clear of their "financial supporters," who, at best, offer minimal rewards - and then only after deducting real and imaginary costs and existing debts. Hence, smuggling by diggers and miners is mainly motivated by the irrational and inequitable system in place for mining Sierra Leone's diamonds. Of course traders and exporters carry out smuggling on a much grander scale than diggers and miners. We will provide an in-depth examination of the many reasons behind this more serious type of smuggling later in this paper.

The artisanal diamond mining sector functions like an exploitive economic island: The labor force is seduced into poor wages in the hopes of immediate wealth, while mining proceeds offer little contribution to either local communities or the national economy. While the region's vast wealth is exported illegally to Europe and Asia each year, diamond communities remain bankrupt. Laborers have little chance to increase consumer spending beyond the purchase of life-sustaining essentials, to create savings, to develop entrepreneurship, to make investments or to be involved in capital formation. Despite performing all the labor, having indigenous rights to land and a having a history of working that land, locals remain in poverty while the financiers illegally export hundreds of millions of dollars annually.

Alarmingly, there are signs that the laborers' plight is worsening. Diamond diggers' debts are on the rise as they slip further into poverty. Their plight is in sharp contrast to those dozen or so companies that enjoy most of the fruits of the diamond resource. Hardly any of the profits generated by the diamond sector are reinvested in the Sierra Leone economy.

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[16] See: Reese Moyers (Management Systems International) The Feasibility of Establishing a Formal Credit Delivery Mechanism for Small-Scale Diamond Miners in Kono District, Sierra Leone; May 2003.

[17] According to the World Bank, the critical constraint for entry to diamond trading is access to capital, particularly to working capital. It provides the following cost breakdown for a typical artisanal operation based on some mechanization. Note that this calculation excludes food and (occasional) housing for diggers, their wages, etc.

(i)	Cost of acquiring license	\$ 200.00
(ii)	Land clearance, use of bulldozer for 8 hours for digging area	\$ 500.00
(iii)	Stripping: \$1,000/acrea/day for 5 days	\$5,000.00
(iv)	Extraction (water pumps)	\$8,000.00
(v)	Miscellaneous	\$1,000.00
	Total (approx.)	\$15,000.00

Indeed, the diamond sector, once the mainstay of the domestic economy, is viewed as a leading cause of the recently concluded war in Sierra Leone. According to a British government report, "From the late 1970s onwards, the diamond trade became increasingly dysfunctional and dominated by corrupt practice and poor policy. By the 1990s, the diamond industry had not only ceased to serve the needs of the country, but had become a motor for its destabilization and collapse into civil war."[18] The return of peace to Sierra Leone has brought little in the way of fundamental changes to the pre-war diamond mining or marketing structure. If anything, the war has aided and further consolidated the stranglehold that the cartel maintains over the diamond sector. Unless the dominant players agree to share the wealth more equitably, the plight of the diamond sector will remain a powder keg that could lead to future civil wars with possible spillover effects on neighboring countries.[19]

2.3. The Diamond Pipeline: The Creation of Value

Restructuring the diamond sector requires the creation of economic incentives to change behavior. In order to gauge whether it is possible, we first need to get a handle on the scale of Sierra Leone's actual production and on the scale of both its legal and illicit exports. We have estimated added value in each phase of the diamond pipeline: from digger, to miner, to the local trading mechanism, to the exporting/marketing system, and ultimately to the Antwerp importer. The total value on the Antwerp market of Sierra Leone's annual production is estimated conservatively at $320-$400 million. (Please see *Annex B* for a description of how that figure was derived.)

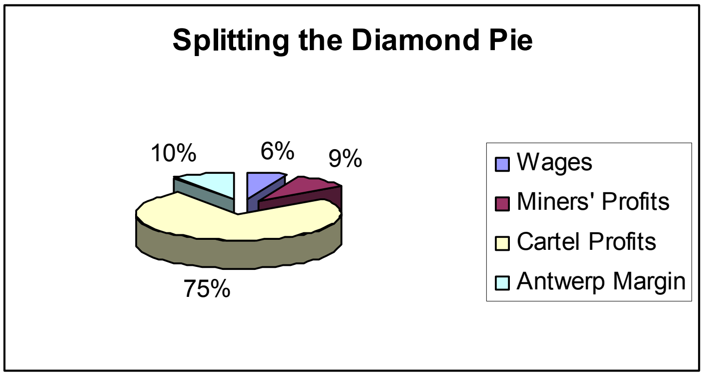
However, the opaque control structure of the domestic cartel and the unique nature of the diamond product obscure the true value of diamonds at every phase of the diamond pipeline. A trader/agent/dealer/miner may collect his "added value" (i.e. commission, winnings), but the conversion of the lion's share of diamonds' value into money often occurs outside of the Sierra Leone economy in the cutting centers. For example, a domestic player may earn profits worth 30%-50% of the value of the stone, but he will usually only receive the money overseas after the stone has been sold at arm's length to the first truly unrelated party. The profit supposedly made in Sierra Leone thus may lend nothing to the economy. Understanding the diamond pipeline and distinguishing between the flow of goods and the flow of money are prerequisites to measuring the sector's contribution, or the lack of it, to the national economy.

The evidence suggests that if the Antwerp market value of Sierra Leone's exports is 100, the actual value of the goods at export from Freetown ranges from 85-93. This considerable (7%-15%) margin is explained by various factors:

1. Many exports are made to related parties in Antwerp, and the transfer of value is mainly an internal bookkeeping matter;
2. Transaction costs of smuggling through third and fourth countries are high;
3. Many transactions are of a barter nature, leaving room for subsequent selling costs and currency differentials;
4. When exports are used for non-legitimate transactions (i.e. money laundered), there is less pressure to optimize export prices.

[18] "Sierra Leone Diamond Policy Study," prepared by AMCO Robertson Mineral Services, the U.K.'s Department for International Development (DFID), 1 Palace Street, London, U.K., January 2002, page 1.
[19] This view is expressed by UN officers, by many miners themselves, and quite a few responsible local and foreign observers in Sierra Leone.

The independent government diamond valuator estimates that "the differential discount between Sierra Leone selling prices and Antwerp market buying prices ranges from 7%-10%."[20] Any larger margins cannot be explained by transparent market forces.



This, at first, seems inconsistent with the claim by foreign players trying to penetrate the Sierra Leone export sector that selling prices in Sierra Leone are "too high." These players claim that it makes more economic sense to purchase rough diamonds in Antwerp than to purchase them in Sierra Leone. These claims, however, appear valid because in practice established traders in Sierra Leone collude to eliminate price competition. When a foreign buyer appears, they simply bid the price up to a level the foreigner won't touch. Once the newcomer has been scared away, they revert to paying more modest sums for diamonds.

So on the "selling side" in the internal market, miners faces an uncompetitive environment. They must sell at low prices set by the domestic traders. When newcomers (or non-cartel members) who might create competition (and drive up prices) wish to purchase on the local market, they are driven off by colluding cartel members.

In reference to the Antwerp price of 100, mentioned previously, the actual costs of production (including diggers' and miners' earnings) amount to approximately 15, of which 5-7 is expended on diggers (wages, rice, staples, sieves, shovels, etc.) and 8-10 on miners (including their profits).[21] If the diggers and miners jointly earn a maximum of some 15% of factual (Antwerp) market value then, assuming a total production value of $320-$400 million, the total "cash" required (mostly in Leones) for the annual operation of the mining sector would be approximately $50-$60 million. As this sum includes minimal profits, some of it could be applied to capital formation and/or be reinvested in the business. Other independent research reaches a similar conclusion. [22]

The combined gross revenues of the local dealers, exporters, and their agents is thus about 75% of true (Antwerp) value (i.e. the spread between 15 cost and 90 export value), which would come to $260-$300 million. As the system now operates, this figure is only of theoretical relevance, since the main exporters sell to their affiliate offices in Antwerp or elsewhere. The transfer price used also has limited practical significance, as the proceeds are not accruing to the local economy.

The level of repatriation of export proceeds may be a direct function of the exporter's business (foreign currency) needs (not only diamonds) in Sierra Leone and is not necessarily related to the actual export values. In Sierra Leone's inefficient mining and marketing system, these are the cumulative profits made by the cartel and the few fringe exporters/dealers that are allowed to operate alongside the dominant players.

[20] Martyn Marriott of International Diamond Counselors, in March 2003 interview with author of report.
[21] It may be of interest to note that local "brokers," who claim to possess know-how of market prices and assist miners in getting optimum value from the dealers or exporters, will charge the artisanal miner 10% for that service. However, as the miner seldom gets more than 10%-20% of the actual (Antwerp) market value, that commission is *de facto* 1%-2% of the true market value, which is similar to commission charged internationally for the brokering of transactions.
[22] Dr. L.J. Tani Pratt, joint managing director, Cemmats Group Ltd., "The Contribution of the Diamond Industry to the Economy of Sierra Leone," paper presented at the DFID Diamond Sector Policy Workshop, Freetown, March 5, 2003.

2.4. Profitability of Sierra Leone's Diamond Sector

Sierra Leone's elite has much to lose from fundamental changes to the present mining and marketing structures. One can expect denial from such interests about the origin of the problem and its magnitude.

The following comment by the Independent Government Diamond Valuator is an example of the position aired by vested economic interests:

> *"The main problem facing the diamond industry in Sierra Leone has nothing to do with diamonds: it is the fundamental problem of restoring good governance, discipline and law and order after the ravages of the civil war and the damage done by previous corrupt and incompetent regimes. Legislation and systems exist for the control of alluvial diamond mining and the marketing of its production. Workable arrangements for issuing licenses to diggers and concessions to small mining companies are in place. The pyramid-shaped marketing structure with the miners at the base and the diamonds flowing upwards through dealers to exporters before export through the GGDO is sound. Moreover there is a widespread knowledge of diamond values amongst Sierra Leoneans, many of whom have been involved in the diamond market for decades. If properly organized and implemented, the existing infrastructure provides a good basis for development."*[23]

Similar sentiments were expressed by the head of the Sierra-Lebanese community, expressing full satisfaction with the present arrangements and policies in effect in the diamond sector.[24]

The "vested interests" invariably point to the marginal profitability of Sierra Leone's alluvial small-scale diamond mining. At a recent Freetown national diamond policy workshop sponsored by DfID and USAID, the view was aired that demanding higher payment to the diggers and miners would inevitably lead to a reduction in the level of employment and therefore cause more hardship. Such an argument might be reasonable if it applied to a marginally profitable enterprise, but it is ludicrous when applied to an enormously profitable business like diamonds in Sierra Leone.

Discussion of the profitability of diamond mining in various countries provides a sense of the likely magnitude of diamond mining and marketing profitability in Sierra Leone. At the world's most profitable mine, Jwaneng (in Botswana), operating profits are 94% of total revenues. Russia's International Mine enjoys an 85% gross profit margin, Canada's Diavik A-154-S pipe, which has just come on stream, has an 84% profit margin. South Africa's Venetia Mine makes 85%, Botswana's Orapa 86%, Botswana's Letlhakane 81%, South Africa's Premier (inclusive of its large specials) 48%, and Canada's Ekati Panda pipe has a 76% profit margin.[25]

All of the above are kimberlite mines, in which the tonnage, the per-carat values, the grade (i.e. the number of carats recovered out of the total tonnage) and the per-tonnage costs of production are all very "hard" data, quite predictable and auditable. There is less uniformity in alluvial production grade and profitability, and virtually no transparency or available data. So there are pitfalls in attempting to compare alluvials with kimberlites (open pit or underground). But if anything, alluvial operations require smaller investments than kimberlite operations and yield superior diamonds and grades.

In the absence of hard data, our conclusion is that the profitability of alluvial mines likely lies in the upper end of the spectrum outlined above. The position of vested interests that there are only

[23] Martyn Marriott, in e-mail to author, February 2003.
[24] S. Hassanyeh, President of the Lebanese Community, in Diamond Sector Workshop, March 5, 2003.
[25] See: Chaim Even-Zohar, *From Mine to Mistress: Corporate Strategies and Government Policies in the International Diamond Industry,* Mining Journal Books Ltd., London, U.K., 2002.

marginal profits to be had in alluvial-diamond mining is thus misguided. It's also worth noting that the often-heard position that the country has been "over-mined," and that what remains is barely profitable, is not supported by the facts we have found.

2.5. Contribution of Diamond Profits to Tax Revenues: the "Giant Mine"

Worldwide mining margins provide a general picture of the international profitability of diamond mining and of the level of profits to which the main producers have grown accustomed. When the alluvial mining joint venture between the National Diamond Mining Company (Sierra Leone) Ltd. and the GOSL was operating, and its output was sold at market value to DICOR (i.e. De Beers) and a handful of other exporters, the joint venture paid a corporate tax of 70% on its taxable profit. To be exact: NDMC (which was previously called Sierra Leone Selection Trust) paid in the 1962-1967 period a corporate tax rate (including a special Diamond Industry Profit Tax) of 60%, plus a service fee of 5%. In 1967, the service tax was dropped, and a straight corporate tax rate of 70% was applied on taxable profits.

If the NMDC was once willing to pay a 70% tax rate, it is not unreasonable to assume that it found it worthwhile despite the high taxes. Since Sierra Leone's production remains among the most attractive in the world, it would seem likely that, collectively, the diamond cartel continues to reap profits in excess of 75% - corroborating the figures presented in the pie chart above (in Section 2.3).

The dealers and exporters now capture the lion's share of profits, which in the past went to the mining company, which in turn shared its profits with the government through corporate taxation. Conceptually, one might view the present Sierra Leone diamond production sector as one "giant mine," financed by a dealing and exporting cartel. Lamentably, this "giant mine" fails to provide workers with a decent income, grant workers proper rights and social benefits, or pay workers reasonably irrespective of winnings. Rather, this "giant mine" mostly rewards labor "if and when" winnings are produced. Essentially, the diggers and licensed miners shoulder a large share of the "giant mine's" commercial risk. When winnings are meager in a particular concession area, the "giant mine" simply reduces production costs by lowering payments to miners and diggers. It is the miners and their diggers ("the gangs") who suffer most, as often they are forced to get up – in the middle of the season – and leave their miner in search of better prospects.

Under the present "giant mine" (cartel) system, those with the capital hold a tremendous leverage over the 300,000-400,000 diggers.

3. IDENTIFICATION OF PRINCIPLE INTERNAL CONSTRAINTS

3.1. Lack of Clarity Regarding Title to Diamonds

Considerable ambiguity exists around title to the diamonds ("winnings") that are mined. Ostensibly, the miner is the owner of the goods. More often than not, however, there are also sharing arrangements between the miner and the "gangs" of diggers, and, as will be discussed later, in many instances there are further intricate secondary and tertiary divisions of winnings among gangs.

Approximately 80% of the licensed miners in Sierra Leone's alluvial mining areas lack the means (or lack the desire) to finance the surface rents, the license fees, the equipment (shovels, sieves, and machinery rental) and the advances (staples and funds) to the diggers. They enter into agreements with financial supporters, which in turn are directly or indirectly financed by the diamond cartel. For all practical purposes, the "supporters" (i.e. the dealers) tend to see themselves as the "shareholders" in the mining operations, and feel entitled to the production. Not surprisingly, the miners hold to a different interpretation, seeing the supporters more as bankers, providing a service.

The licensed miners, chiefs and supporters enter into written contractual agreements that define the status of the parties. All contractual parties seem to have a right to control the operations. The relevant clauses of a standard Mining Agreement illustrate the intricacy of this relationship:

> *"We agreed as follows:*
>
> *1. The Financier/Supporter shall provide all finance to meet the expenses involved in mining the plot of the License Holder/Landowner under the Alluvial Diamond Mining License No. ... issued at ..... dated ..... including the issue and renewal of the Mining License and other matters of works related thereto.*
>
> *2. The Financier/Supporter shall appoint a representative who shall be responsible for all the Mining Operations under the said Licenses.*
>
> *3. License Holder/Landowner shall appoint his Mine Manager during his absence from the Mining Operations.*
>
> *4. The Financier/ Supporter and the License Holder/Landowner shall have full control of the Mining Operations, and all the diamonds won under the said Mining Licensed Plot shall be weighed, sealed and signed in the presence of the Financier/Supporter's representative and the License Holder/Landowner or his Mine Manager, and delivered to the Financial Supporter for safe keeping on a daily basis.*
>
> *5. The sale of diamonds won under the said Mining Operations shall be sold on a weekly basis, or as mutually agreed by both parties.*
>
> *6. All diamonds won under the Mining Operations in the said plot shall be bought by the Financier/Supporter. In the event of any disagreement in sale price of such diamond(s), a third person(s) or party shall be invited with the mutual consent of both the parties to do an independent valuation. The payment of such third person(s) or party shall be incurred by both parties, that is, the Financier/Supporter and the License Holder/Landowner.*
>
> *7. In the event of the Mining Claim proving to be unproductive, the Financier/Supporter will not be bound by the agreement if he decides to discontinue financing the Mining Claim, and shall not be held liable for any failure to perform."*

Though it is clear that the Supporter has the option to withdraw his financial support at any time if he deems the claim it unproductive, the miner is locked in by another, seemingly contradictory clause:

> *"9. This agreement is irrevocable and non-cancelable by either party, valid for an initial period of five years and renewable at the end of the period by mutual consent of both parties. No variations, alternations or substitutions are permitted without the written agreement by both of the parties."*

The supporters are supposed to advance money to the miners to cover working capital, equipment and wage costs, which will be offset against all "winnings" (rough diamonds) recovered. There is no requirement in the contract, nor is it a customary practice, for the supporter to provide a written receipt to the miner indicating the size, number or quality of the daily winnings. This lack of a "paper trail" is doubly troublesome: It severely curtails the ability of the miner to "track" his earnings, and it makes it easier for supporters to smuggle the goods through illegal channels.

3.2 Subcontracting to "Gangs": The Pile System

Diggers occupy the wide base at the bottom of the mining-hierarchy pyramid. These diggers work on behalf of the mining license holder (sometimes also called the "landowner"). The license holder sells his winnings to his supporter, who is (or should be) an authorized dealer. As dealers are allowed up to five agents, often the supporter is the agent of a dealer. Eventually, the dealers sell to the authorized exporters.

The typical scenario runs as follows: The licensed (or unlicensed) miner works with a supporter.[26] The supporter is simultaneously involved in scores of mining areas. As a supporter discovers that winnings in one area are not sufficient, he may reduce his support to the miner in that area. He may even withdraw support altogether – something that is always his prerogative. This creates a vicious cycle for the miner: He has paid for the license fees, he has received advances and he has made a commitment to his gangs. If he doesn't pay his gangs, they'll leave and he'll be left without workers and in debt.

A "two-pile system" emerged to protect miners abandoned by their supporters. An abandoned miner – who no longer has funds – calls his gang leaders and suggests that all the gravel be divided into two piles: one will belong to the miner, the other to the gangs. In effect, the "gangs" become independent sub-contractors. The miner forfeits all interest in the gangs' piles or sub-piles. To wash his own pile he brings in his trusted family.

Meanwhile, the diggers are suddenly highly motivated to avoid the supervisor ("manager") appointed by the supporter, who still has a claim on the miner's winnings (even though the miner has defaulted).

In this example (of a not very successful mining area) there may be only four or five gangs, consisting of 5 diggers each. So the "two-pile system" becomes a "multi-pile system," as one of these piles is further subdivided into an additional four or five piles. Anyone walking the mining areas can clearly distinguish these systems.

For the supporters, the post-war mining era is extremely attractive. It is a "seller's" market: there is so much need for support (need for money), that the supporter can afford the luxury of being very

[26] Earlier it was stated that 80% of all licensed miners require supporters; 20% have their own means. Illicit miners incur fewer costs and they find it easier to get supporters. Therefore, in practice almost all miners work with supporters.

selective in choosing the miners he wants to support. The pile system serves to shield him from too many complaints when he withdraws support. Pile systems are therefore proliferating at an enormous rate. These practices are far more widespread than officially acknowledged.

3.3 Lack of Liquidity Promotes Illicit Mining

Miners' leverage over their supporters has diminished since the war. Relatively recent developments add urgency to the situation:

1. *Shortages of supporters***.** The war ruined most miners financially. Many of those who previously did not require credit now must work with a supporter. The post-war influx of people into the mining areas has created a surplus of available manpower and a shortage of supporters willing to support miners. This has considerably strengthened the leverage of the supporters over the miners.

2. *Lack of funds leads to illegal mining*. A number of licensed miners noted that a lack of finances and a surplus of diggers have led them to resort to illegal mining. The requirement that licenses and rent be paid in advance is another chief complaint.

3. *Chiefs often prefer foreign miners.* Many miners have noted that the chiefs, whose financial situation has also deteriorated, give preference to foreigners, who have the means to pay the surface rent (and even pay some extras) and don't require domestic supporters. Citizenship requirements are easily circumvented through straw people.[27] Indigenous people feel that the current situation works against them. The winnings of these foreigners are not necessarily marketed through Sierra Leone's formal channels.

4. *Supporters cease support without valid cause, perpetuating pile systems*. A number of miners reported that the shortage of available credit enables supporters to cease support for mines that are slow to produce. This is mostly done informally, through withholding the minimum daily payments for diggers (of Le. 1000 = $0.45). This has forced miners to agree to cede their rights to piles of gravel to the gangs, creating a situation in which an acre of land may host multiple gravel piles over which competing diggers have gained ownership.

5. *Increase in smuggling by licensed miners*. There is considerable anecdotal evidence pointing to a dramatic increase in smuggling. Licensed miners are increasingly motivated to smuggle stones in order to fetch higher prices than those paid by their supporters. Standard agreements between miners and supporters provide for great penalties in the event diamonds are stolen.[28]

   Recommendation: A credit system must be established – as a very high priority – to enable indigenous miners to free themselves from the "debt bondage" currently prevailing in the alluvial fields. Miners must be free to sell their production to the highest bidder in order for the first sale to be clean and documented. This should be piloted in Kono District, through the Peace Diamond Alliance, and may require initial donor subsidies.

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[27] The law requires the mining license holder to be indigenous Sierra Leonean.

[28] A typical clause will read as follows: "Any tributor who is involved directly or indirectly in a diamond theft shall be dealt with by forfeiture of any remaining piles of gravel where there is a balance of gravel to be treated or washed and/or the tributor shall be prosecuted by law. That notwithstanding, both parties shall use their best efforts to pursue, recover and reclaim such theft diamonds."

3.4 Financial Transactions Operate Solely In Parallel Market

3.4.1 Constraint: Smuggling as the Norm

Today's efforts to direct the business into formal channels have no foundation or precedent. Quite simply, smuggling has become the norm in Sierra Leone's diamond business.

Smuggling became entrenched in the late 1980s and early 1990s when the government placed heavy restrictions on the flow of local and foreign currencies. The commercial banks were prohibited from allowing any one customer to withdraw more than Le. 50,000 per day. The possession of foreign currency was made a crime punishable by law.[29] In response, the entire diamond industry went underground. Legal exports became negligent, giving way to widespread illegal mining and marketing practices.

In the 1990s, various periods of economic and legal upheaval that might have reversed the trend proved to be short-lived. The government lifted the economic emergency and repealed the ban on holding foreign currency in 1990; the military coup took place in 1992; civilian rule was briefly reintroduced in 1996; the next coup came a year later, in 1997; that triggered another brutal war that raged until late 2001. While most legal players in the diamond business fled the raging violence, at least some agents of the diamond cartel apparently used the conflict to further consolidate their control over the sector.

Recent increases in official diamond exports in 2001 and 2002 resulted from a (positive) decision by the diamond exporters to move more goods through formal channels. This was a direct response to international political pressure on the diamond exporters to eliminate smuggling. UN requirements for rough-export certification increased the transaction costs of smuggling, contributing to the greater use of official channels.[30] Nevertheless, official channels can still be used to "smuggle" goods, through undervaluing and other methods.

3.4.2 Analyzing the Motivation for Smuggling

The smuggling of both currencies and diamonds serves myriad different objectives. Based on conversations with informants, the following points were raised:

Internal incentives for smuggling include:

1. **Low prices for diamonds:** The prices miners receive from local buyers are lower than the "fair market value" they would obtain from legitimate competitive buyers. This discount promotes black market activity and smuggling.
2. **Inequities in resource distribution:** The allocation of value in the chain from digger to exporter is exploitive. The licensed miner may thus attempt to "bypass" his supporter and attempt to secure a better price for his production through smuggling.
3. **Widespread money laundering and/or other criminal activity:** Smuggling goes hand-in-hand with laundering and other crimes.
4. **Tax evasion:** The drive to evade Sierra Leone's taxes and controls leads many to resort to smuggling.
5. **Exchange rate manipulations:** Smuggling facilitates earnings from such manipulations (a few percentage points on turnover).

[29] See: Draft to the "Response to the DFID Study on the Diamond Industry", by the Director of the Ministry of Mineral Resources.

[30] There is anecdotal evidence about traders who told licensed miners that "because of the added problems of certification, the dealers' costs have increased and therefore the purchase price of the rough from the miners needed to be reduced by 10%-15%."

External incentives for smuggling include:

1. **Tax evasion in importing countries:** Evading taxes is among several reasons to keep the diamonds "off balance sheet."
2. **Cross-border crime (and possibly terrorism):** Smuggling facilitates the "white-washing" of illicitly earned cash funds brought in from abroad by turning these funds into readily tradable diamonds. Diamonds can subsequently be converted back into cash through bank transfers from Europe.
3. **Optimization of the efficient use of cash**.[31]
4. **Demand for cash to fuel other licit and illicit business activity:** Smugglers may need access to funds to pay for imports, other investments, bribes and kickbacks, etc.

More often than not, a diamond-producing country's political leaders are "hidden partners" of key players in the diamond business. This provides a certain "legitimacy" to smuggling in countries like Sierra Leone. This situation affects the pace of enactment (or non-enactment) of regulations and control mechanisms (although, perversely, such mechanisms may facilitate smuggling rather than curb it[32]).

Surging official exports in Sierra Leone are not the result of major changes in the existing mining and marketing arrangements, but rather appear to demonstrate a growing realization by the dominant exporters that it is politically advantageous to demonstrate higher levels of official exports. Under the current trading system it makes little difference to the small miner whether the exporter chooses an official or parallel export channel. As the bulk of official exports are not on an arm's length basis (i.e., exporters tend to export to their own affiliated companies abroad) it doesn't make much difference to the exporter either. Whether official or unofficial export channels are used, the exporter retains great flexibility as to how the export proceeds are used.

A further advantage that licensed players derive from supplementing their illicit activities with licit activities is the creation of the appearance that they are operating legally. Having a license also makes it easier to mask clandestine operations. It's worth noting also that the expansion of licit activities tends to increase the demand for mining licenses.

The reality is that the increase in licenses masks the failure to solve most of the diamond industry's underlying problems. In 2002, for example, of about 35 official exporters (foreign nationals and Sierra Leone nationals), there were some 15 exporters whose total annual export volumes ranged in single thousands or the low five figures. This defies logic, as there is no justification to pay for a $5,000 license if total exports are less than the license fee.

To be fair, in many instances one would like to believe that securing licensing reflects sincere attempts by individuals to move their businesses toward greater legal and financial transparency. So one can view the issuance by the government of some 1,262 alluvial small-scale diamond-mining licenses in 2002 (to some 44 chiefdoms in the Bo, Kenema, Pujehun, Kailahun, Bonthe and Kono districts) as at least a moderate boost toward the restoration of normalcy in the artisanal sector.

For many reasons – some of which might be as frivolous as "changes in habit" – a large part of the legally mined output is still channeled through parallel markets. In respect to the indigenous

[31] The dry season in Sierra Leone is before the dry season in the DRC. Seasonal shifting of the funds between producing countries could create cartel efficiencies.

[32] Non-enforcement of a country's regulations regarding the declaration of cash imports at point of entry is a classic example.

miners, there appears to be little hesitation to move legal production into illicit channels if they can obtain higher margins.

The continued high levels of smuggling should not be viewed as a sign of policy failure or a condemnation of officials' performance. Rather, such high levels reflect a failure by many of the players in the sector to support the considerable efforts being made by the GOSL toward restoring the regulatory infrastructure. Indeed many sector participants – miners and exporters alike – are responding positively to the post-war challenges, taking out licenses and gradually and hesitatingly adjusting their commercial behavior. But there is still much work to be done. In order for these efforts to garner more support and provide sustainable results, the rewards obtained through legal activities must begin to outweigh the benefits of smuggling.

Where the Ministry of Mineral Resources makes sincere efforts to raise the bar, it should be supported vigorously. Chiefs and other local leaders have expressed frustration with the status quo, a strong desire to ensure that civil war will not return, and a willingness to work toward establishing a new system. Chiefs and mining community members are allies in reform.

> **Recommendation:** In addition to working with the central government to bring about meaningful changes, some of the new structures for credit, mining and marketing should be implemented in partnership with the traditional owners of the ground (i.e., the chiefs) and with their communities (who would be the principal beneficiaries of such change). USAID has already spearheaded this process in Kono District, with the Peace Diamond Alliance.

3.4.3 No Restrictions on Inward or Outward Cash Movements

Sierra Leone may be one of the few remaining countries where one may freely import briefcases full of hard cash. At Freetown's Lungi Airport, there are no signs requiring arriving passengers to report cash imports, nor are incoming passengers provided with any currency declaration forms.[33]

The lax rules are the result of the GOSL significantly relaxing its banking and foreign currency control procedures in order to facilitate execution of very large cash transactions. Current banking guidelines state that "residents and non-residents are allowed to finance their diamond operations in Sierra Leone in United States dollars, in bank notes, drafts, or bank transfers."[34] A private agreement was made between the central bank and the diamond exporters that "payment for any diamond purchases shall be made in U.S. dollars brought into Sierra Leone through banking channels or, if in notes, declared at the point of entry into Sierra Leone by the exporter and lodged with certification at any commercial bank … [the exporter] shall be entitled to repatriate any unused balance of such dollars.[35] To effect the above, diamond exporters shall ensure that the inflows of U.S. dollars for their transactions are channeled through commercial banks in Sierra Leone."

[33] According to the International Finance Department, Bank of Sierra Leone, the official position is that "travellers can take foreign exchange out of Sierra Leone up to US$5,000 without restriction. Residents on departure from the country should declare foreign exchange in excess of US$5,000 with supporting documents. Non-residents can take foreign exchange out of Sierra Leone up to the amount brought in by them. Incoming non-residents are therefore advised to disclose amounts of foreign currency brought into Sierra Leone if they anticipate taking out amounts in excess of the permitted allowance. Disclosure is however optional." (Regulations of December 20, 1995).

[34] Paragraph 1, in Annexure I ("Banking Guidelines Diamond Exporters"), promulgated by the Bank of Sierra Leone, December 12, 2000.

[35] Agreement dated 4, December, 2000, between the Sierra Leone Government and would-be exporters.

Despite the regulations, the Governor of the Bank of Sierra Leone has complained that “none of the export proceeds of the diamond sector are visible in the banking system.” Several passengers, exporters and importers that were questioned admitted to regularly carrying large sums of money with them, wholly unaware that they might be committing an offense by not declaring it. Some in the GOSL are reluctant to enact anti-money laundering legislation, under the pretext that “this would ruin the diamond business.”[38]

The Government Gold and Diamond Office (GGDO), as part of its export procedures, requires proof of payment in foreign currency. A diamond exporter would, typically, deposit a check made out to himself at an Antwerp bank. The money is withdrawn in Antwerp as cash. Papers submitted by the exporter would normally include a copy of the check and a letter from the Antwerp bank confirming delivery of cash to its customer in Belgium. When the exporter comes to Freetown he simultaneously deposits and withdraws the funds. Basically, the main document the exporter needs to prove receipt of the export proceeds is the following letter issued by a local Freetown bank:

> 'We confirm that Mr....... of ......Freetown, had on 4th February 2003 submitted to us and immediately withdrawn eight sealed packets of US dollar notes together with confirmation dated 31st January 2003 by the Antwerp Diamond Bank, Antwerp, and Customs Foreign Currency Declaration form at Lungi Airport dated 3rd February 2003 for $.......US dollars.

The banks charge a handling and withdrawal fee for this basically “artificial” revolving door transaction. According to our informants, the letters and forms could probably be obtained with a minimal bribe.

The Antwerp banks have, in recent years, become more reluctant to provide huge volumes of cash. Costs are involved. The cash normally is acquired from banks in London or Switzerland, although it is sometimes couriered in directly from the United States. Preference is given to new notes, still in original Federal Reserve Bank wrappings. Banks buy the cash wherever it is cheapest to do so. “When we raise too many questions with our clients, they will simply obtain the cash from alternative sources in other countries. That is, in itself, disadvantageous to us as we lose grip on an important part of a client’s diamond business,” commented one banker, underscoring the bank’s need to monitor and understand its customers’ activities. It is assumed that some $2 billion in cash is supplied to the diamond business on the African continent annually.

> **Recommendation:** The GOSL should develop systems to ensure that a clear money trail exists for the purchase of all diamonds. This will involve reviewing current regulatory regimes and working with local and international banks and government authorities to develop systems that eliminate the need for transporting briefcases full of currency for those who would otherwise be inclined to work under internationally accepted business practices. The U.S. Department of Treasury could assist the GOSL in this regard.

Official regulations state that “the receiving commercial bank should be informed by the remitting bank abroad through a tested telex message of the incoming funds.” That is not happening.

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[36] According to the International Finance Department, Bank of Sierra Leone, the official position is that “travellers can take foreign exchange out of Sierra Leone up to US$5,000 without restriction. Residents on departure from the country should declare foreign exchange in excess of US$5,000 with supporting documents. Non-residents can take foreign exchange out of Sierra Leone up to the amount brought in by them. Incoming non-residents are therefore advised to disclose amounts of foreign currency brought into Sierra Leone if they anticipate taking out amounts in excess of the permitted allowance. Disclosure is however optional.” (Regulations of December 20, 1995).

[37] Agreement dated 4, December, 2000, between the Sierra Leone Government and would-be exporters.

[38] The Hon. J. Sanpha Koroma, Governor of the Bank of Sierra Leone, interviewed by author in the Governor’s Offices in Freetown, on February 13, 2003.

Incoming funds should also be supported with certification issued by the remitting bank. U.S. dollar notes brought in by the exporter should be lodged with certification issued by the remitting bank at any of the commercial banks for their use. Commercial banks are required to issue two certificates – one to be submitted to the International Finance Department of the Bank of Sierra Leone for processing, and another to be attached to the Certification of Origin. Diamond exporters are allowed to export up to the amount of funds confirmed by the commercial banks as brought in.[39] The relevant official at the Bank of Sierra Leone confirmed having "occasionally" seen such letters. Moreover, the regulations also allow bank transfers into Sierra Leone from overseas and their subsequent withdrawal in cash.

Sierra Leone's export regulations require that "proceeds should be repatriated within 90 days of the date of export. Prior permission will be required from the Bank of Sierra Leone for an extension beyond the 90-day period. Where a commercial bank (Authorised Dealer) does not receive proceeds from an exporter within the 90 days, no further Export Form should be endorsed by the commercial bank (Authorised Dealer) for that exporter." One wonders whether artificial cash-in/cash-out transactions meet these relevant regulations.[40]

This system is conducive to transporting enormous quantities of currency – cash that is not held with commercial banks, nor exported through commercial banks. The money trail is lost the moment the cash is withdrawn.[41]

[39] See: Annexure I ("Banking Guidelines Diamond Exporters"), promulgated by the Bank of Sierra Leone, December 12, 2000.

[40] Bank of Sierra Leone, "Exchange Control Regulations Governing Current International Transactions," Paragraph 3.0 (on page 3 of Regulation Booklet.)

[41] Actually, the trail of money may well be lost even earlier: when an exporter withdraws millions of dollars from an Antwerp or other bank, stating that he requires the funds for Sierra Leone, there is really no effective way anyone can trace whether these funds indeed were hand carried to Sierra Leone, DRC, Switzerland or elsewhere. In Freetown the same "cash" can be used multiple times to satisfy GGDO requirements to show that money has come in.

4. IDENTIFICATION OF PRINCIPLE EXTERNAL CONSTRAINTS

4.1. Export Regime and Product Pricing

Mined diamond production figures are rarely reliable. Even when government authorities release official figures, these numbers often (unwittingly) understate reality.[42] Smuggling, illegal diggings and unrecorded discoveries have always been significant, and production from the informal alluvial sector does not lend itself to easy monitoring. Researchers often need to infer figures from market intelligence and by studying the diamond pipeline.[43]

In virtually all African diamond-producing countries (and also in Russia and Australia), governments have the legal right to cancel or deny the rough-diamond marketing arrangements of diamond producers. From a government perspective, each marketing option provides for different government revenue streams and domestic added-value opportunities. Where diamond sales are made to local polished-diamond manufacturers, all the revenue, employment and infrastructure benefits will accrue to the national economy. The optimum scheme for selling rough diamonds at any given time may depend on market conditions: A sales method that is optimum in a rising market might be disadvantageous in a declining market.[44] (See *Appendix F* for a fuller description.)

Diamond extraction is a straightforward and predictable process. Maximizing production revenue is less so. Unlike other commodities, there is no easy reference price for run-of-mine output. The optimization of the margin between the producer's rough-diamond production costs and the selling price of the output requires considerable skill. Sierra Leone's indigenous artisanal mining sector, with some few hundred thousand players, is missing out on huge potential economic benefits by being largely unskilled at determining rough-diamond prices. It is in the interest of international rough-diamond traders (dealers) to perpetuate marketing systems that make "price discovery" an exceedingly difficult exercise. As no two diamonds are truly alike, so are the prices of no two diamonds alike. In the diamond mining areas geographically removed from Freetown, the lack of accurate value information is stunning. (Dealers with satellite cellular phones with direct access to Antwerp offices are invariably among the better informed.) Even in Freetown some educated rough-diamond valuators showed little perception of how to accurately valuate diamonds when they are still in the "rough" stage.[45]

Ultimately, rough and polished diamonds are sold by weight. Whether trading in rough diamonds in Antwerp or buying loose polished stones in New York, the price demanded by the seller will be expressed in US$ per carat (a carat being one fifth of a gram). Many criteria are involved in the calculation of a polished price.[46] Thousands of categories have been developed in both rough and polished diamond classifications for many reasons. However, in the final analysis only one price is most significant: price per carat. This is stressed since the average size (i.e. weight) of Sierra Leone diamonds is legendary. There have been times in the past that half of the output consisted of stones larger than one carat.

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[42] In Russia, for example, exact output data are still considered a state secret.

[43] See: Even-Zohar, Chaim, "Special Report: A Breakdown of World's Rough Output and the Demand for Rough From the Cutting Centers: An Overview", *Diamond Intelligence Briefs,* Vol. 14, No.266, June 25, 1998.

[44] As a former manager of Angola's Endiama diamond concern once put it: "In good times it is easy to sell our rough independently; in adverse times it is better to have a marketing contract with the De Beers".

[45] The fact that many a rough stone (depending on shape) will produce two polished stones was met by disbelief by some informants.

[46] The renowned "C's" of carat weight, clarity, color (i.e. lack of color) and cut (the shape of the polished), and what the trader thinks he can achieve in the market place for either a parcel or individual stone.

When a rough-diamond expert examines a stone, he tries to imagine the shape of the polished stone that is, in effect, sitting inside the rough. It is analogous to a sculptor who states that his sculptures had always existed inside the block of stone; all the sculptor has to do is to break off the stone and reveal it. Yield is defined as the weight of the polished stone remaining after polishing. A high-yielding rough stone will obviously command a higher price than a low-yielding stone.

Diamonds come in all shapes and sizes, but it is often not appreciated how critical a rough diamond's yield is in determining price. What determines yield? In diamond jargon, it is known as the "blockiness" of the diamond piece. To achieve the classic polished "brilliant" or "round" diamond shape, the rough stone should also be round and broad at its central point. The highest yielding pieces are generally cushion shaped octahedrons that can be sawn in half against the diamond's natural grain. These categories of rough diamonds therefore command the highest prices on the market. The quantity and percentage of these types of diamonds in a given mine are crucial in determining whether the average price will be sufficient to support that mine.

Most diamond mines are characterized by a certain type of diamond. Diamond experts will instantly recognize which type that is. Sierra Leone's diamonds are generally considered the most attractive alluvial production in the world. Its diamonds have an uncommon ability to improve in color when cut. Cutters rarely get any nasty surprises from this production.

Sierra Leone and other producing nations have various incentives to more accurately ascertain the market value of their diamond productions. In countries such as Botswana and Namibia, where the government is a partner in the mines and the total taxation (royalties, etc.) is as much as 70% of the mining profits, valuations are a necessary means of checking on the producers' revenues. In Sierra Leone, however, export duties are minimal, at a level of 3%.[47]

4.2. Export Undervaluation and Smuggling

4.2.1. Undervaluation to Smuggle through Formal Channels

Reliable informants have confirmed that, on average, official Sierra Leone diamond exports are undervalued by almost 60%. Diamond exports in 2002 were officially valued at $41.7 million. It appears, however, that these exports actually represented an Antwerp spot-market value of $125 million.[48] While one might think that the exporters undervalue exports in order to avoid a portion of Sierra Leone's export taxes, it seems that the more significant incentive is to avoid taxation in their affiliated importing countries in Europe. Exporters confirm that the actual "transaction costs" involved in legally exporting rough diamonds – a combination of the 3% export tax on GGDO valuation of export parcels and gratuities – actually amounts to 2%-5% of the real value of the exports.[49] The 3% export tax (which is consistent with regional norms) is thus not reason enough by itself to undervalue diamond export, so it should not be reduced. Rather, controls at both the exporting and importing nodes should be improved.

> **Recommendation:** GGDO valuators should be trained to more accurately valuate rough diamonds, and methods of crosschecking the value of export parcels should be improved both in Sierra Leone and in the importing countries. The cooperation of the importing

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[47] Exporters are "required to export a minimum of US$250,000 per month (in the case of an individual diamond exporter) or US$500,000 per month (in the case of a corporate diamond exporter.)" These targets are reviewed periodically, and failure by an exporter to achieve these targets for three consecutive months may result in his license being revoked.

[48] The technical analysis to support these figures is presented *Appendix B*

[49] If declared value is 60% of real merchandise value, the "effective" export tax is only 1.8%. There are other transaction costs beyond this figure.

country should be secured to assist with the latter. Currently there is neither a legal requirement nor any desire by governments in importing countries to valuate rough diamond imports. Consequently, there is neither a mechanism nor the manpower in place to facilitate such value verification.

Undervaluation of official exports negatively impacts government revenues and undermines governance structures, both in Sierra Leone and in importing countries. From the Sierra Leonean perspective, it steals "value" from of the country. The primary beneficiary of Sierra Leone's lost "value" is the exporter, who effectively smuggles "diamond value" through official channels into another diamond center. Another unfortunate by-product of undervaluation is that it damages the integrity of the Kimberley Process of certification. [50]

4.2.2. Lack of Valuation at the Point of Import

The Belgian Diamond High Council (HRD) says it is not its role to "double-guess" the value as set by the GGDO. That position is justifiable, as the purpose of the Kimberley Process certification regime is to keep conflict diamonds out of the market. It was never meant to facilitate fiscal monitoring.[51]

According to the HRD:

"*The controls at the Diamond Office aim to check whether the parcel that arrives is identical to the one that was sent by the GGDO. Elements for that are the security slip on the box, the carat & value mentioned on the certificate, the characteristics of the stones and the digital photography of the box and goods.*

The value of the goods as mentioned on the certificate is in essence to determine the tax revenue for the producing country. That value is checked during an examination by the Government's independent diamond valuator in SL. His estimation will take into account the market situation in general, the local market prices, the overhead costs of distribution companies and the profit margins. Therefore, this valuation is only one element in the identification process in the importing country and the value might be different when the same goods are presented for expertise in another country."

In the United Kingdom the authorities do interpret Kimberley as requiring them to check valuations. But the UK is probably the only government to take that position.[52] Says a spokesman: "On imports, it is Customs that perform all necessary checks, including a physical one if necessary. UK Customs operates a risk analysis-based system, which among other things means that it does

[50] The Kimberley Process is an international initiative aimed at breaking the link between legitimate trade in diamonds and conflict diamonds. Conflict diamonds are rough diamonds used by rebel movements or their allies to finance conflict aimed at undermining legitimate governments. By effectively controlling the trade in rough diamonds through national certification schemes, the trade in polished diamonds will be more transparent and secure, thereby giving consumers the confidence that the diamonds they buy are clean. (Source: Kimberly Process website: www.kimberleyprocess.com)

[51] The EC Kimberley regulations DO NOT REQUIRE THE IMPORTING COUNTRY TO INDEPENDENTLY VALUE THE GOODS. The regulations state, "The import of rough diamonds into the Community shall be prohibited unless all of the following conditions are fulfilled: (a) the rough diamonds are accompanied by a certificate validated by the competent authority of a participant; (b) the rough diamonds are contained in tamper-resistant containers, and the seals applied at export by that participant are not broken; (c) the certificate clearly identifies the consignment to which it refers." [Council Regulation (EC) No. 2368/2002 of December 2002, Chapter II, "Import Regime", Article 3.] The Kimberley Process System also refrains from demanding such verification, though it contains (in a sub-annex) a generally phrased recommendation that "the Importing Authority should open and inspect the contents of the shipment to verify the details declared on the Certificate." [Par. 23 of Annex II to Annex I, pursuant to Section IV (par. F) of the Kimberley Scheme.]

[52] We believe that this policy represents the view of the Head of the Government Diamond Office rather than the view of the UK government. The only precedent we could find of a parcel ever to be returned to Sierra Leone because of a valuation problem involved the United Kingdom (confirmed to us in April 2003.)

not necessarily physically inspect each and every consignment. However, any physical check would involve assessing the value. This is a subjective exercise and we would not be unduly alarmed by a variation of up to 15% between the declared value and our assessed value. Other than any physical check, UK Customs are examining and retaining each Kimberley certificate, comparing the data on it with the invoice and import declaration form, and checking that the goods are in a properly sealed container. Our Government Diamond Office deals with exports, which has contracted six independent valuators who conduct physical inspections of a random selection of exports."[53]

The practice in importing countries of issuing "local invoices" that recognize larges differences between the actual value and the value listed on the exporting certificates puts the authorities in importing countries in the position of unwittingly collaborating in tax evasion and money laundering in the rough-exporting countries.[54] That the issuance of such "local invoices" to replace import documents has been the practice for many years underscores that the under-valuation of goods both imported and exported has become an accepted trade practice.

> **Recommendation:** The valuation system of exports must be strengthened and better cooperation must be demanded from the recipient countries. There is no adequate matching of the actual value with the value reported on the export certification. Ideally, authorities of the countries on the receiving side should be put on notice that under-valuations or over-valuations must be reported in the context of worldwide money anti-money-laundering efforts. The basic technical mechanism to implement this is already in place, though to initiate it would require statutory amendments and the building of an industry consensus that is presently absent.[55]

4.3. Fiscal and Control Arrangements in Recipient Markets

4.3.1. U.S. Anti Money Laundering Laws Affect Flow of Trade

[Discussion on findings and conclusions confidential at this time]

> **Recommendation:** U.S. Treasury efforts to stamp out money laundering through the PATRIOT Act should be focused to address on-the-ground realities in Sierra Leone, the DRC and Angola. The USG should use its offices to track the diamond money trail in order to better understand the destination and uses of funds laundered through the rough-diamond industry in Africa. The USG should also help ensure that alluvial production enters legal marketing channels from the moment the stones are discovered. The continued capacity of terrorist groups to wreak havoc adds urgency to this call.

4.3.2. Fiscal Arrangements in Rough Diamond Trading Centers

[Confidential at this time]

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[53] Clive Wright, Head of Government Diamond Office, UN Department, Foreign and Commonwealth Office, London, U.K.; communication to author dated March 17, 2003.

[54] It is our understanding that, in light of the many questions posed by research, the authorities are now reviewing this practice. A consensus may emerge that tolerance be allowed in a 15%-20% range and if the deviation is greater, goods will not be allowed to be imported. Apparently, discrepancies between "locally produced" invoices and the export documents will also not be allowed anymore in the future.

[55] Recognizing the difficulty in getting importing countries to agree on import valuation, the USG may find it easier to get ad hoc agreement on the verification of imports only from Sierra Leone.

4.3.3. Interpretation of Local Sierra Leone Rules

Another factor cited by exporters as contributing to smuggling is inconsistent export regulations, or, more likely, erroneous interpretation of those regulations. The regulations state that "exporters shall be allowed to effect purchase of precious minerals in US dollars. All exporters shall be required to bring in their foreign exchange to purchase precious minerals and must show evidence of the importation of such foreign exchange as and when required by the Bank of Sierra Leone."

Exporters purchase diamonds at a price that will enable them to make at least 10%-15% profits when the rough is resold on the international diamond markets in order to recover the costs of the Sierra Leone operations, recover transactions costs and earn some margins. The snag is that the $1 million that is "brought in" - and the documents confirm this - must match the declared export value. So declaring the correct export value of $1.15 million "simply is not an option," declared one exporter, who also expressed reluctance to acknowledge that a profit margin has been made.

The regulations ought to make a provision that export value should not exceed the funds brought in to purchase the goods, plus a reasonable profit margin.

4.3.4. Local Valuation Expertise and Good Governance

Though it is common to raise issues like "good governance" and "corruption" when discussing Sierra Leone, one must have sympathy for the GOSL view that outside observers wrongly "assume that expatriate officers are above corruption in the diamond industry."[56] It is quite a challenge to find a team of experienced valuators. The Sierra Leone government's experience has not always been positive. A (yet unpublished) Sierra Leone document notes that the government recently "had cause to terminate services of an expatriate firm as independent diamond valuator employed by the Government to provide a second opinion on the valuation of diamonds for export at the GGDO, for reasons relating to unprofessional conduct."

The present Independent Government Diamond Valuator, Martyn Marriott, stresses that although his association with the Sierra Leone industry goes back many decades (when he still managed DICOR for De Beers), his organization was only reappointed in mid-2002. "I can't comment on the periods when I wasn't involved. I can only say that upon being reappointed, I had some long and hard conversations with the major exporters. Since then you will see that the per-carat realization of the official exports has risen by some 20%."

According to Marriott, "there is a wealth of expertise in the Minerals Ministry, the GGDO and the industry;" however, there is still a need for "outside expert diamond valuation, the cost of which can be deducted from the diamond revenues it yields. In this area there is scope for localization in the relatively short term."

Indeed, the GGDO and its personnel are, in a way, in an "adversarial" position vis-à-vis the exporters. These two extremely sophisticated market players have exactly the opposite interests at heart: The GGDO wants to maximize valuations (and hence increase official exports and, subsequently, tax revenues), while the exporters want to minimize valuations. There is certainly a need for strengthening and supporting the GGDO system in order to prepare the GGDO to stand up to the powerful exporters.

[56] Remark made in a draft of a yet unpublished Sierra Leone government document.

4.4 Europe as Starting Point of Cash Trail

The lion's share of Sierra Leone's official diamond trade is conducted between Freetown and Antwerp. It is presumed that most of the smuggled goods are also traded in Belgium, as some goods may require certification "on the way." As the links between the exporters and associated or affiliated companies in Belgium are well established, Belgium's financial system must be considered in any sector reform in Sierra Leone.[57] A large part of the monetary value created by Sierra Leone's diamonds (the conversion of diamonds into cash or into money-in-the-bank) ends up in Antwerp.

Currently three-quarters of the value created by the Sierra Leone diamond sector is physically located in Belgium and other rough-diamond trading centers. The proceeds of initial and subsequent diamond sales can be credited to bank accounts and freely transferred anywhere in the world. Antwerp diamond bankers confirmed that diamond profits don't remain in the Belgian banking system. The profits, or any excess capital beyond working requirements, are mostly transferred to "intermediate companies" in Switzerland, Dubai or other countries. There currently is no effective way the Antwerp banks can ascertain the final destination of the Sierra Leone diamond profits.

Belgian authorities do not require the reporting of multi-million dollar cash withdrawals. While internal rules vary greatly among diamond-industry financial institutions, virtually every bank requires the withdrawer to declare why he requires the funds. However, no banks appear to have mechanisms to verify that the funds were applied to the stated purpose. There are a dozen-or-so bank branches worldwide that specialize in serving diamond trade and industry customers; they don't target other customer groups. These banks are reluctant to "antagonize" their customers and risk losing them. Consequently, the leverage of these large customers over their banks is considerable. This, in part, may explain why historically banks have not made great efforts to verify the uses of the cash dispensed. Nor are they legally bound to do so.

The main diamond-industry banks in Belgium confirmed that presently they are trying to match the cash withdrawn for purposes of buying stones with the actual value of stones imported They admitted, however, that they have no system in place to verify that cash withdrawn for use in Sierra Leone actually ends up in Sierra Leone.[58] The remark was also made that "it is far better that we, who know the clients and see their diamond turnover, provide the cash than that they have to resort to external non-banking sources to meet their cash requirements." It was intimated that the movement of cash into Sierra Leone is very small compared to the amounts withdrawn for destinations such as Angola, DRC, Guinea, Central African Republic (CAR) and other destinations. "It is our understanding that there is a considerable movement of cash between Sierra Leone and surrounding countries through helicopters and other ways of transport. The main Lebanese players in Sierra Leone are also the main players in the diamond economies of some of the surrounding and other African countries."[59]

Cash-declaration provisions similar to those that exist in Sierra Leone also exist in the Democratic Republic of Congo (DRC), Angola, Liberia, Guinea and other African countries. Sierra Leone's exporters usually work through Antwerp, whereas exporters from other countries may work through different countries, such as Israel. Sierra Leone exporters do little business with Israel. Israeli authorities state that "in 2002, total rough diamond imports from Sierra Leone were less than

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[57] About 77% of all Certificates of Destination issued by the GGDO in Freetown in the 2000-2002 period list Belgium as the rough parcels' export destination, followed by the United States (8%), United Kingdom (6%) and Israel (3%).

[58] One bank, which wasn't aware that cash imports must be registered at customs in Freetown, is considering tightening its rules by insisting that clients must submit copies of certified customs declarations.

[59] From conversation with executives at the Antwerp Diamond Bank, Antwerp, February 26, 2002.

$1 million." They confirmed that Israeli banks do provide cash for diamond purchases in other African countries and that this is consistent with Israeli banking laws.[60]

Technically, there is no advantage to working in cash, except of course that working through the banking system denies the dealer and exporter the added profits generated by currency trading on the parallel market.[61] The Sierra Leone banking system is expensive and, by most accounts, unreliable. This prevents diamond traders from using banks to transfer funds. The diamond trader who transfers money to a Sierra Leone bank and withdraws it as cash in Freetown may lose some 8% on the exchange rate differentials (official and parallel rates) and another 4%-5% on the withdrawal of the cash. Such transaction costs are prohibitive and must be addressed if we hope to shift the diamond trade from a cash-basis to a banking-basis.[62] On the bright side, the Finance Minister recently reported that "the government is committed to maintaining liberal trading and exchange systems and … efforts will be continued to encourage the development of an interbank market and to narrow the spread between the official and the parallel exchange markets."

However, in the same breath, referring to the undesirable role of foreign cash in the economy, he said, "This spread is partly explained by the different instruments used in the official and parallel markets: In the former, transactions are overwhelmingly done through wire transfers and drafts; in the latter, transactions are almost exclusively made in currency, largely U.S. dollar bills."[63] The irrelevance of the local banks in financing diamond transactions is further underscored by the almost complete absence of cash held by commercial banks. Any foreign currency balances held by the local banks are kept solely with overseas banks.[64]

The external trading community lists three reasons for avoiding Sierra Leone's banks: (1) the exorbitant fee structure, which penalizes the diamond exporter and trader at a rate of up to 15% of the transactions; (2) the perception that banks are not stable and reliable, and that foreign currency deposits maintained in local banks are not safe (governmental expropriation is not ruled out); and (3) the absence of an appropriate international banking correspondence system.

It falls beyond the scope of this study to examine the deposits of Sierra Leone's six commercial banks in overseas banking institutions, or to examine their sources of overseas borrowings. But in order to reform the management of the diamond sector it is imperative to understand the flow of funds, since one key to diamond-sector reform lies in achieving economic (investment), fiscal (taxation), and redistribution (through more equitable distribution of diamond income) benefits from these funds. In a country that (at the end of 2001) had an external debt of $1.38 billion, debt service payments of $86.8 million and total annual exports of $30.5 million (of which 86.2% consisted of diamonds), it would be irrational from a public policy perspective to allow such an

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[60] Explanations provided by Udi Sheintal, Controller of Diamonds, Ministry of Industry and Trade, Ramat Gan, Israel. Interviewed on February 27, 2003.

[61] An official connected to the Angolan diamond marketing system explained that, for security and safety reasons, the buyers in the field have no knowledge of the money transport mechanism. Major diamond companies will operate separate systems (often including the use of private airplanes or helicopters) to move the cash around. Needless to say, these same systems could well be used to transport diamonds as well.

[62] Depending on the spread between parallel and official currencies, some informants have placed the added costs at above 15%.

[63] J. B. Dauda, Minister of Finance, Freetown, Sierra Leone, "Memorandum of Economic and Financial Policies of the Government of Sierra Leone," submitted to the International Monetary Fund, Washington, D.C., August 12, 2002.

[64] On December 31, 2001, total foreign cash balances of the entire commercial banking system were $70,000.

[65] One bank, which wasn't aware that cash imports must be registered at customs in Freetown, is considering tightening its rules by insisting that clients must submit copies of certified customs declarations.

[66] From conversation with executives at the Antwerp Diamond Bank, Antwerp, February 26, 2002.

important export sector to conduct its business entirely in the parallel currency market.[67] The proliferation of parallel market activity increases the GOSL's vulnerability and is surely contributing to official diamond exports amounting to only 10% of total production. It has even been reported that, in the past, diamond exporters would first create foreign currency shortfalls by depriving the country of its foreign currency income, and then arrange for foreign banks or international "suppliers" to lend money to the government, thus tightening their grip on key government officials.

> **Recommendation:** Certain Antwerp banks are the principal bankers for the diamond community in Antwerp. Their know-how of the business of their clients is considerable and there may be great advantages to working with them. If one of these banks were to open a regional office in West Africa serving the diamond sector, this might contribute to greater accountability and transparency. Joint ventures or consortia agreements for the purpose of diamond-industry support and financing among banks are not uncommon in the international diamond-financing industry (especially India and Israel.) Some such models could be applied in Sierra Leone.

> **Recommendation:** Cash that has been withdrawn from banking systems may become difficult to monitor. The donor nations ought to alert the relevant countries and banking institutions of this specific sector-related concern and encourage them to impose more stringent reporting systems. Perhaps it would be appropriate to demand that each and every diamond-related withdrawal of cash above a $20,000 threshold be reported. More thought ought to be given to establishing a regional or international mechanism to monitor the flow of rough-diamond proceeds. It must also be taken into account that "overregulation" in this traditional laissez-faire industry has often led to the establishment of parallel systems; to avoid such a counterproductive backlash, it is imperative to engage the industry in dialogue.

[67] See: Bank of Sierra Leone, "Annual Report and Statement of Accounts for the Year Ended December 31, 2001," Table 7: Bank of Sierra Leone Foreign Exchange Cash-Flow., page 19-21. It shows that out of total inflows during the year of $136.03 million, some $130.34 million was derived from disbursements and grants from donor nations and institutions.

[68] About 77% of all Certificates of Destination issued by the GGDO in Freetown in the 2000-2002 period list Belgium as the rough parcels' export destination, followed by the United States (8%), United Kingdom (6%) and Israel (3%).

5. INTRODUCTION OF NEW BUYING REGIME FOR SIERRA LEONE'S ROUGH DIAMONDS

The Sierra Leone, U.S. and UK governments are interested in manipulating incentives to encourage improved diamond management. As should be clear from the previous sections of this report, two essential points along the financial chain merit particular attention. The first is the extension of credit to miners, which we have already discussed. An alternative system of credit is desperately needed. The second is the point of sale; that is, when the rough diamonds are sold by indigenous miners to buyers. This section will discuss how new buying regimes can support upstream innovations. Options to consider in designing a buying regime are described in much greater detail in *Appendix F*.

To keep diamonds out of illicit channels – and reduce risks to national, regional and international security – it is essential that a system be established to purchase stones at much higher prices than are currently available to indigenous producers.

> **Recommendation**: International diamond buying concern(s) should be invited to serve as a "marketing channel" for diamonds that are mined appropriately. Larger conglomerates have more leverage to resist efforts by Sierra Leone's cartel to frustrate and sabotage efforts by small- or medium-weight players This should initially be introduced as part of the Peace Diamond Alliance in Kono as an example for the rest of the country.

It may be possible to set up a system that will bypass certain phases of the local Sierra Leone trading structure so that the winnings of the diggers are sold on a commission basis through such large conglomerates. The proceeds of such sales would be repatriated through the banking system and be returned to their beneficial owners (i.e. the miners), the paramount chiefs and the government. It is good public relations for these conglomerates – and good business as well.

So far, because of concerns about conflict diamonds, large groups (De Beers, Rio Tinto, BHP Billiton and others) have been reluctant to become active in the alluvial purchasing markets in Africa. However, these companies are likely to respond positively to an international call by donor nations to get involved.

Such a program would dramatically benefit diggers and miners. In addition it would:

1. Strengthen the financial banking structure;
2. Diminish the cash economy and move more funds to and through banks;
3. Decrease the influence of the diamond cartel;
4. Give the government a stronger handle in the management of its foreign-exchange-rate regime;
5. Effectively decrease the incidence of money laundering;
6. Put in place a model that can be replicated in other Western African nations.

Based on the experiences of the DRC, Angola and other countries with comparable situations, we are reluctant to suggest that one monopoly/entity should become the sole exclusive buyer of the production. It is recognized, however, that the largest corporate players in the worldwide industry will have a better chance to resist pressure from entrenched interests and set about reforming the sector. Such large corporations could serve as *de facto* agents of the miners and market output on a commission basis. But to succeed these businesses need a commitment from the GOSL and the international community to safeguard them from local political pressures.

Recommendation: Any efforts to increase the competitiveness of the diamond-buying and exporting businesses should be coupled with "protection" for new buyers, lenders and producers, and commitment by the current diamond cartel to participate openly in the new scheme for the long-term security of Sierra Leone. The main actors in the diamond cartel in Sierra Leone are few. Donors should enter into a dialog with those individuals and make it clear that if diamonds continue to fail to create visible added value or benefits to the economy, the donor states may contemplate other measures.

Recommendation/Observation: Providing the licensed miners and the paramount chiefs with an alternative sales option that bypasses the local dealing structure will by itself create a positive spillover effect: Dealers will have to pay more in order to remain competitive and retain their access to goods. If licensed miners have alternatives, the likelihood that the diamond cartel will maintain a dialog with the donors (previous paragraph) is also enhanced.

Recommendation: The credit system to be piloted in Kono District should be developed through a commercial bank, with offices in Kono. That same bank could serve as a pilot for developing best practices and linkages with foreign banks with experience in diamond-industry financing. This will enable the eradication, or minimization, of cash as a basis for the purchase of alluvial diamonds in Kono District. Cash flow from diamond purchases could eventually be used to offset loan costs.

6. BEYOND SIERRA LEONE

Sierra Leone's alluvial diamond resource, and the way it is being exploited, bears many similarities to the experiences of Angola, Democratic Republic of Congo, Central African Republic and Guinea. In those countries, as in Sierra Leone, poor management of the diamond resource has negative impacts on national development, national security, regional security and international security. The U.S. and UK governments should consider applying lessons learned in Sierra Leone to other countries with alluvial mining. They should also consider exploring regional approaches to the diamond-sector issues. Both economies of scale and considerable synergies would result.

> **Recommendation:** A comprehensive regional approach should be considered to understand alluvial mining practices in the other countries with alluvial diamond mining. Particular focus should be put on how such practices impede domestic economic development and threaten both regional and international security.

> **Recommendation:** USAID should build on its Peace Diamond Alliance by recruiting major players in the diamond industry – players that have demonstrated accountability, transparency and a commitment to the vitality of the industry – to address the illicit use of diamonds on a continental scale. While De Beers has been a fine partner to date in the Peace Diamond Alliance, it is reasonable for the international community to expect much more from it and other key players in the diamond industry in terms of building a model of clean alluvial-diamond management – a model that could be applied to all countries where alluvial mining occurs.

APPENDIX A: A BRIEF HISTORY OF THE SIERRA LEONE DIAMOND INDUSTRY

The country was founded in 1787 as a British colony, mostly as a refuge for Africans liberated from slavery, but also to provide the British a naval base. Beyond Freetown, the British had little interest in the country. Only in 1896 did Sierra Leone assume its current territorial form when the British extended their control into the hinterland. Diamonds were first discovered in Sierra Leone around 1930, long before the nation gained its independence from the United Kingdom in 1961.[69] Unlike neighboring countries (like Ghana) where tribal chiefs held the concessions, mining rights in Sierra Leone were vested in the colonial power, which was the virtual architect of the mining regime.[70] In 1934, the British authorities gave an exclusive license to explore, mine and market diamonds for a period of 99 years to a single company, Consolidated African Selection Trust (CAST), which had rapidly become one of Africa's largest diamond-mining houses soon after its establishment in 1924.[71,72] Records show that CAST's Sir Alfred Beatty had undertaken to provide the government with 27% of the net profits, while wages and working and living conditions for the African labor force were meant to conform to a single high standard. Having one company was intended to ease the collection by government of its share of profits, customs duties and other proceeds.[73]

From the mid-1920s, the Ernest Oppenheimer family interests (and its flagships Anglo-American Corporation and De Beers) acquired hefty shareholdings in CAST (enabling them to have representatives on its Board of Directors). The Oppenheimers tried to secure a controlling interest, but failed.[74] In the end they had to be satisfied in 1931 with a 'non-compete' agreement under which "CAST would face no competition in West Africa from De Beers, who in turn would maintain 'jurisdiction' over Southern Africa".[75] By the 1950s, the Oppenheimers held around 20% in CAST. When the UK Government provided CAST with an exclusive license for Sierra Leone, the company established (in 1934) a wholly owned subsidiary, the Sierra Leone Selection Trust (SLST), to run the diamond operations. A township was built near Yengema, close to the diamond fields. Very quickly, Sierra Leone became one of the world's richest diamond countries, producing an extraordinarily high proportion of gem-quality goods.

Even though the Colonial Government had granted the SLST exclusivity very much as a "revenue-generating device," records show that SLST paid rather modest amounts prior to Sierra Leone's independence and "massive" amounts thereafter. The company paid income tax, a profit tax and, after 1962, a service fee of 5% of sales revenue. The service fee was allowed as a charge against the two main taxes. In late 1953 (still well before independence), the original 1934 mandate was amended and a new levy, the Diamond Industry Profit Tax (which was calculated on a sliding scale), was introduced. The sum of total taxes had been capped at 60% of taxable profits, but it is not clear how often that level was achieved (and, of course, SLST enjoyed double-taxation relief in

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[69] The first diamond was found in January 1930 by a young British mining engineer named Jack Pollett, while panning gravel on the Gboboro River, near Fotingaia, in the Kono District.
[70] Edward Wharton-Tigar, *Burning Bright*, Metal Bulletin Books Ltd, London, UK, 1987, page 161.
[71] In the 1930s, CAST had made major investments in diamond mining in South Africa through Cape Coast Exploration Ltd, in French Guinea through Société Guinéenne de Recherches et d'Exploitations Minieres, and in Liberia, Tanganyika, Ivory Coast, Ghana, Nigeria, Namaqualand, Sierra Leone and elsewhere.
[72] The government drew its authority from the 1927 Mineral Ordinance, which vested control over mining rights in the Crown.
[73] A.J. Wilson, *The Life and Times of Sir Alfred Chester Beatty,* Cadogan Publications Ltd., London, U.K., 1985, pages 159-160.
[74] For a very extensive discussion on CAST see Peter Greenhalgh, *West African Diamonds 1919-1983: An Economic History*, Manchester University Press, Manchester, UK, 1985.
[75] Professor Peter Greenhalgh had access to the archives of Selection Trust. He found minutes dated May 20, 1935. The agreement was a verbal one. Part of it was a commitment by CAST to offer any new production it acquired to the Syndicate.

the UK). After independence, the total tax burden was raised to 70% of taxable profits and, because of the vast profits that the company was earning, there was little resistance to that taxation level.

Mounting opposition to SLST from local diggers, combined with the growing unpopularity of the company, made it more difficult for the Colonial Government to protect SLST's (and its own) interests. In 1955, it was forced to yield some of its monopoly power when a group of local diggers stormed the mining company's security forces and police station. With no other option, the government reduced SLST's exploration and mining territory (limiting it to two Yengema and Tongo leases), and granted local miners the right to engage in small-scale mining operations. Note that this occurred prior to independence. It was then that the Alluvial Diamond Mining Scheme for Sierra Leoneans was introduced, enabling any licensed citizen to mine diamonds within an area of 315 meters by 127 meters after obtaining a permit from the relevant chiefdom authorities. At that time, a licensed miner was allowed to employ 20 laborers.

At the same time the government tried to remove all foreigners (mainly from Guinea and Lebanon) from the Kono concession areas.[76] But the foreigners quickly returned. At independence in 1961, Sierra Leone produced (in carats) some 10% of world production; by value its position was even more preeminent. After 1961, local antagonism against SLST increased. The massive numbers of local laborers flocking to the mining sector had harmful consequences for the agricultural industry. This may well be the real tragedy of Sierra Leone: Hardworking indigenous people were lured to the diamond fields in hopes of earning more than the subsistence income they received in the agricultural sector. This destroyed the economic and social infrastructure of rural Sierra Leone, and the unexpected (and seemingly unstoppable) inflow of migrants further undermined the capacity of the chronically under-financed local administration. In 1970, the government partly nationalized SLST. It bought 51% of SLST and turned the company into the newly formed National Diamond Mining Company Sierra Leone Ltd. (Diminco). SLST's owners had to turn over all of SLST's assets to Diminco. In return they got a 49% shareholding in Diminco. [77] Widespread illicit mining and smuggling continued unabated. Of historic interest is a remark published in an official 1969 document:

> "The unchecked influx of strangers, many thousands of whom are unlawfully present in the diamond protection area, has created what one newspaper has called the Wild West Town of Koidu, the main center in the mining district, where roads have been dug up, houses flooded and water polluted by the anti-social activities of illicit miners, and where private grudges and old scores are now settled by violence. The boastful presence of so-called diamond dealers, many of whom run their own gangs of illicit miners, provides a ready market for stolen diamonds, contributes in no small way to the open flouting of, and contempt for, authority, and is directly responsible for the increasing corruption of all types in the area."[78]

The root causes of the present crisis may well be directly related to the first discovery of diamonds in the Kono district. According to former U.S. Ambassador to Sierra Leone John Hirsch, "the British colonial government sought to maintain political stability in the rebellious hinterlands in the face of decreasing financial support from London. Their solution was twofold: to institute indirect rule through the traditional paramount chiefs, and to use a tributary system whereby miners received a share of any gold or diamonds they recovered in lieu of wages. These dual arrangements progressively degraded the state's control and thwarted the development of strong, legitimate

[76] Columbia University scholar and former US Ambassador to Sierra Leone, John L. Hirsch, reports that in 1955 some 40,000 foreigners were expelled from the mining areas.
[77] The Sierra Leone government paid some $6.1 million for its share in SLST's fixed assets through the issuance of negotiable sterling bonds, repayable in sixteen equal semi-annual installments, bearing an interest rate of 5.5%.
[78] From the 1968-9 half-yearly report of the Consolidated African Selection Trust, dated March 11, 1969.

governmental institutions to prevent corruption. The efforts to control the production and export of diamonds and gold led, over time, to what has been called the "shadow state." This parallel structure, with no responsibility or accountability to the public, ultimately dominated the minerals sector. Moreover, the larger the sway and extent of the shadow state, the weaker and poorer the official government apparatus has been."[79]

After assuming the status of nationwide monopoly in the 1930s, the Sierra Leone Selection Trust (SLST) generated further discord by demanding that outsiders be removed from the mining areas and that illicit mining be stopped by any means. The colonial administration granted the Paramount Chiefs control of settlement and local migration in order to placate the local population. As local chiefs obtained the power to decide who would live in Kono, illicit mining grew apace in the 1940s and 1950s, as those with money and connections found ways to circumvent the SLST. The company was allowed to field a "security force" of 35 armed men to patrol the mining areas. Its role foreshadowed the arrival of Executive Outcomes, Lifeguard and other private security forces to protect state and private mining resources in the 1990s.[80] This development ran very much contrary to local customs.

The government was constantly searching for the optimum way to exploit its diamond resource. The Mining Area Development Administration (which was established in the mid-1950s) provided some of the resources for the development of the region's economic potential. However, it has been reported that in the 1960s much of its funds were used to buy electoral support for the Kono Progressive Movement (KPM) as it entered into competition with the ruling Sierra Leone People's Party (SLPP). Professor Hirsch notes, "Thus diamond money and control of the region became interlaced with the broader political agendas of the day. The informal illicit diamond market and those who benefited from it became players in the rivalry between the SLPP and the APC, which had emerged as the major political parties. The Lebanese and other foreigners still residing in Kono were caught in the middle. Often perceived as responsible for corruption, they had in effect no choice but to participate if they were going to continue to operate."

The mining sector continued to decline after independence. Unfortunately, inflated salaries and the construction of expensive housing cut into Diminco's assets. In 1984 the government nationalized SLST's remaining 49% shareholding in Diminco. SLST was itself sold by CAST to Precious Minerals Marketing Co. (PMMC), which assumed responsibility for all diamond exports. PMMC was a private company, controlled by a Lebanese businessman, Jamil Said Mohammed, who for decades had dominated much of the country's diamond business. The government also held 35% in PMMC.

PMMC terminated Diminco's marketing contract with the Central Selling Organization of De Beers (CSO) for 50% of the country's output. By that time official diamond exports amounted to US$11-$17 million annually, with hundreds of millions being smuggled out. The official diamond sector was clearly failing, and the state had lost control of its assets, enabling private entrepreneurs to take over Kono and adjacent diamond-rich regions.

Since 1991, civil war has undermined Sierra Leone's already fragile institutions. Ahmed Tejan Kabbah became President in 1996 in the country's first contested elections in 30 years. The

[79] Quote from: John L. Hirsch, "Sierra Leone: Diamonds and the Struggle for Democracy," published by the International Peace Academy, Occasional Papers Series, Lynne Rienner Publishers Inc., Boulder, Colorado 2001, page 26. Professor Hirsch served for 30 years in the US Foreign Service, most recently as US Ambassador to Sierra Leone. The reference to the 'Shadow State' comes from: William Reno, *Corruption and State Politics in Sierra Leone*, Cambridge University Press, Cambridge, 1995.
[80] John Hirsch, page 27.

president was overthrown by the army in 1997, only to be reinstated one year later by a Nigerian-dominated regional intervention force. The strong support from the UK, United States, UN, regional African leaders of the Economic Community of West African States (ECOWAS) and the international community at large have succeeded in ending the conflict, disarming the rebels and in reintegrating the former Revolutionary United Front (RUF) members into society.[81]

[81] The civil war started as an insurgency by street youths and diamond diggers led by British-trained army corporal Foday Saybana Sankoh, who trained in Libya and acted as adviser to Liberian President Charles Taylor. It is through Liberia that the RUF smuggled its diamonds.

APPENDIX B: ESTIMATES OF VALUE OF ANNUAL ALLUVIAL DIAMOND PRODUCTION LEVELS

Rough diamonds are mined in some 25 countries from underground, open-cast and offshore sites. They are processed in manufacturing operations in 30 countries.

Significant new diamond mines are about to come on stream in the near future, as some existing mines are expanding. Other mines are reaching their final productive years. In Sierra Leone new mines are coming on stream (Koidu Kimberlite Project), while exploration is attracting more funding.

Around the world, the smuggling of stones from organized mines, illegal diggings and unrecorded discoveries has always been significant, and production from the informal alluvial sector does not lend itself to easy monitoring. Researchers often need to infer figures by analyzing market intelligence and studying the diamond pipeline. That will be our approach in this Appendix.

The GGDO faithfully records official export figures based on GOSL valuation. This is the first step in estimating production and export ($41 million in 2002, projected at $60 million in 2003.) However, since the vast majority of the diamond trade occurs *outside* formal marketing channels, we must extrapolate from other observations to get a better estimate of true production. The key to this lies in determining how much value is smuggled outside the country.

The following sections show how we have tried to draw conclusions from disparate data. We begin by estimating the amount of "smuggling" that occurs as a result of undervaluation. We then estimate the total number of laborers before finally attempting to connect this data and make estimates for total production and smuggling. It will be clear that these are conjectures – but they are educated conjectures. It is possible that these figures could be revised as further data become available. But the following will provide a useful context for discussion and will illustrate that production and smuggling levels are very substantial.

1. Estimate of the Extent of Undervaluation in Official Diamond Exports
As described in detail in Appendix D, while official diamond exports in 2002 (all alluvial) were $41 million, the actual value for the parcels exported was probably closer to $125 million. This implies an undervaluation of almost 60%, with "smuggling" (using official channels) valued at over $80 million.

2. Estimate of the number of laborers
The key variable in alluvial mining production is labor. Peace in the diamond areas has attracted many more laborers, and hence more digging and more stones. Local informants report that the rate of growth in diamond mining is far more brisk than the rate of increase in official diamond exports. Estimating the actual output based upon the number of laborers and their likely output can substantiate this.

Miners employ "gangs" of diggers. A typical "gang" consists of five workers. A licensed miner is allowed to use up to 50 tributors (diggers) on a single license. At the end of 2002, some 1,260 small-scale diamond-mining licenses had been issued. Government officials and others state that the number of illegal mining sites is twice that number, indicating a total of approximately 3,500 mines. Miners informed us that during the high season they employ about double the number of gangs they are legally allowed to employ (swelling the number of individual diggers employed to 100 miners). Assuming that nationwide some 3,500 mining areas (of about one acre each) are being mined, this would potentially allow for a total of 350,000 diggers working at peak periods. In fact, the actual number of diggers seems even larger than that, which gives rise to the question of how some of these diggers are being supported. The answer lies in the widespread system of "sub-contracting" among diggers.

Irrespective of the system employed, the cost per digger (his "consumption" subsistence) amounts approximately to $0.80 per day. Mining activity is seasonal, with peaks and lows during the year. Assuming a high of 450,000 diggers and lows below 100,000, the average for a 10-month year would probably be in the range of 250,000-300,000 (allowing for two months with no activity at all.) The cost associated with mining would come to $65 million.[82] The official export figures show a considerable uniformity of export figures throughout the year, suggesting that mining is a year-round activity. When regular mining slows down in the rainy season, many miners (and their whole families) wash piles of dirt set aside earlier for "processing" at a later date. Regular mining, meanwhile, continues, albeit at a slower pace. Still, using 10-month figures seems the most reasonable way to achieve conservative and defendable figures. There are other researchers who use full-year figures.

The "pile system" (see *Section 3.2*) creates considerable conflict and tensions. The supporter feels that he is deprived of his earnings, even though it is the miner who has passed on his rightful share to his gangs. Inevitably, if the miner opted to pass a large part of his winnings to the gangs, this is the result of a prior (partial or total) default by the "supporter," who thus has lost much, but not all, of his leverage over the gangs and the miner. Some studies suggest that the earnings of the diggers and the miners (i.e. costs to supporters) represent a larger part of the diamond pipeline than this study suggests. Such studies fail to recognize the impact of the "pile system."

There are, undoubtedly, unsuccessful operations where the revenues just barely match the costs. But, especially in the current market, supporters tend to withdraw support to unproductive areas rather than offsetting their losses in unproductive areas with profits made in productive areas. The number of diggers is mostly of relevancy from a security/aid perspective; the thrust of our argument is that the costs on this level represent only 15%-20% of the total value of the production.[83]

3. Production per laborer.

Many researchers calculate the value of the output based on the carat winnings per digger.[84] But there isn't sufficient geological data on the grades of what remains in most alluvial areas or enough information about digging efficiency in these areas to rely heavily on such formulas. We queried half a dozen informants in the Kono area who provided anecdotal (i.e. firsthand)

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[82] Please note that this calculation does not include any cost for rental of earth moving equipment, which is sometimes used. Exclusion of this factor tends to make our estimates conservative.

[83] Nevertheless, it may be useful to demonstrate the general confusion around these figures. The available literature makes the following estimates:

"Assistance to Artisan Miners" (1997)	500,000 diggers
Mineral Resources Development Policy (1998)	1,000,000 (including dependents)
Andy Coxen, De Beers (2001)	200,000 diggers and 800,000 carats
Hall (1965)	25,000 men
Tomus Astorga (1994)	200,000 men and 255,000 carats
Tomus Astorga (1995)	145,000 diggers
UNAMSIL (2003)	over 300,000

[84] Amco Robertson, in the DFID-financed study, developed a regression analysis, which indicates a relationship of 1 digger equaling 0.027 times the total carats produced. On this basis the report estimates the number of diggers at 10,000 producing 300,000 carats. The reasonableness of these estimates has been checked by developing the following relationship: Production in carats = 180*x*y/(z+1) where: X = number of men digging; Z = overburden: gravel ratio assumed to be 6; Y = grade of the ground in carats/cubic meter.

evidence that, on average, a digger will produce between 1.8-4.2 carats in a season. The output in the Kenema and Bo regions is believed to be lower.

As the approach of "following the pipeline values" has so far been the most reliable, we have come to a similar conclusion. A digger costs some $145 per six-month season. It is convenient to calculate this figure based on a six-month period because that is about how frequently supporters settle accounts with the miners and their gangs. After the six-month season, the level of activity is somewhat reduced. What activity there is of a different nature (washing of inventory piles) and requires fewer costs, though this is not likely to affect the per-carat cost averages. As production costs equate to 15% of product value (at Antwerp market prices), a digger creates $960 of value per season, which equates to 3.5 carats at a $270 per-carat average (see Annex D for explanation of Sierra Leone's average carat value). These figures certainly should provide comfort for those who estimate annual production values in the $350 million range.

Further confirmation comes from Cemmats Research, which reasons that "existing financial reports enable establishing the gross margin or profit level of any of the major diamond producing companies in the world." Analysis of data from P.K. Hall suggests that the gross margin of Sierra Leone Selection Trust was between 30% and 60%, dependent on the average grade of ground mined. With the high level of corporate taxes, it is assumed that the returns from the present day artisanal operation cannot be lower than 30%. Today, the exporters control the industry through a network of agents and dealers. *The industry can therefore be considered as one large mine with the exporters as the owners*. A very rough estimate of revenues can be made as follows:

Assume number of miners	200,000
Assume subsistence support of Le 2,000/day	$60 million per year
Assume costs of dealers/Agents/unofficial taxes etc	$60 million per year
Assume export costs	$10 million per year
Total Costs	**$130 million per year**
Gross Margin	$30%
Revenue	**$186 million**

The estimated revenue would almost double if the number of diggers was increased to, say, 400,000."[85] We fully support these findings and note that diamonds with an export market value of $186 million should fetch $206 million on the Antwerp market. We would view the costs of the dealers and the agents, unofficial taxes (i.e. bribes) and export costs as part of the margin made by "owner" of the "Sierra Leone Mine," (i.e. the diamond cartel.)[86] At mining costs of $60 million, this mine enjoys a gross profit margin of 70.9% if we rely on Dr. Pratt's figures. Assuming a higher number of diggers (400,000), the Antwerp value of exports would be approximately $400 million. This should be considered a "floor," as in our estimate the margin is between 80%-85%. In any event, the margins are sufficiently wide to support endeavors to rearrange the Sierra Leone pipeline in a more equitable manner.

4. Reports from Informants.

[85] Dr. L.J. Tani Pratt, joint managing director, Cemmats Group Ltd., "The Contribution of the Diamond Industry to the Economy of Sierra Leone," paper presented at the DFID Diamond Sector Policy Workshop, Freetown, March 5, 2003.

[86] It is well known in Sierra Leone that the dominant exporter will, every Friday, collect all the weekly purchases made by his agents and dealers around the country and replenish their cash in the equivalent amount of purchases. This underscores that the exporter fully supports the pipeline.

A wide range of government officials, private sector workers and miners in the field stated that they would estimate that 90% of production is smuggled out of the country. Since official diamond exports in 2002 totaled $41 million, this logic would suggest that total exports were $369 million. However, as indicated in *Appendix D*, it also appears that the $41 million in legal exports was undervalued and that the stones exported through official channels were most likely closer to $125 million in value. Accordingly, a conservative estimate of production in 2002 according to this formula would be $450 million. Official exports in 2003 are anticipated to rise by 50%. If this same ratio holds (and increased mining activity seems to bear that out) then total production in 2003 would be considerably higher.

5. Historical Profits

As mentioned in the body of this report, when alluvial diamond mining was centralized, National Diamond Mining Company (Sierra Leone) Ltd. was willing to pay a 70% corporate tax on alluvial exports. If we assume that they would not have been willing to pay such high taxes unless it was profitable to mine, and if we assume comparable productivity today, then we can conclude that collective mining activity today is as profitable as it was back then. This level of profitability corroborates the assumptions in the prior approach.

APPENDIX C: FISCAL ARRANGEMENTS IN DIAMOND TRADING CENTERS

[Confidential at this time

APPENDIX D: EVIDENCE OF UNDERVALUING OF OFFICIAL EXPORTS

Government officials report that in recent years "the ratios between industrial and gem qualities in the production are shifting toward more industrial."[87] This arguably might be the case, but (1) its impact would be limited; and (2) it runs counter to direct evidence presented by many dealers and exporters. The argument also ignores that Sierra Leone's production breakdown, in terms of qualities, is among the world's best. Martyn Marriott, undoubtedly one of the leading experts on diamond production in the world today, estimated (in 1984) the following breakdown for the Sierra Leone diamond production:[88]

Sierra Leone Diamond Production [by weight]

Gems > 2 carats: 13% Small Gems: 22% Indian Goods: 35% Industrials: 30%

With the tremendous rise of the Indian diamond industry, in which formerly industrial type diamonds are now successfully cut and polished and used for jewelry, some 65% of the annual world output of diamonds is suitable to cutting. Accordingly, many diamonds that in the 1960s would have been considered "industrial" should now be classified as "gem" (or near-gem) quality. We conservatively maintain that (by weight) Sierra Leone's output will never be inferior to worldwide averages; if anything, it will be significantly better. In 2002, Sierra Leone's official exports of gem-quality stones totaled 147,300 carats at an average value of $256.22 per-carat, while industrial diamonds totaled 204,558 carats at an average of $19.51 per carat. In other words, 58% of the Sierra Leone production is recorded as representing industrial qualities. That is highly unlikely. Belgian importing authorities confirm that they consider some industrial goods exported from Sierra Leone as being of gem quality.[89]

Another way to view this is to examine the expected revenue projections of new mining operations. Mining concerns have recently begun to invest $10-$20 million to redevelop the Koidu Kimberlite Project. In developing their revenue projections, investors concluded that the average production value, at 2002 prices, would be in the range of $240-$270 per carat.[90] Since kimberlite diamond output is generally less attractive than alluvial production, we can conservatively assume that stones exported through the GGDO would be *at least* as valuable, on average as kimberlite production. The Independent Government Diamond Valuator, Martyn Marriott, who has not seen recent samples, was nevertheless willing to make an "informed guess" that this would be the range. Our informants on the Antwerp market consider the average price of Sierra Leone's output to be in the range of $270 p/c. (The occasional +100 carat stones, will, of course, skew this further upwards.) The investors in the Koidu project would not put their money at risk if they did not have a reasonable comfort level on the realizable value of the expected output.

In sharp contrast to the aforementioned figures, the official average value/carat reported by GGDO was $116.94 p/c for 2001, and $118.60 p/c. for 2002. This implies that official exports are valued at

[87] Lawrence N. Myers, Managing Director, Government Gold and Diamond Office, Freetown, in interview with author, February 4, 2003.
[88] Martyn Marriott, *A Survey of the Market for Fine Large Diamonds*, Diamond Counselor International, London, 1984, page 8.
[89] "We are aware that the data registered on the [GGDO] certificate classify more stones as industrial than what the Belgian experts would accept as industrial. The origin of this discrepancy can most of the time be related to the classification system that is used in SL. At the GGDO, all valuators have been trained using the De Beers classification system. Ultimately, this has a reducing effect on the value with a tendency to undervalue. However, as the differences were small, they have been accepted." Communication by HRD Chief of Staff Youri Steverlynck, February 28, 2003.
[90] See: *Technical Report on the Koidu Kimberlite Project in Sierra Leone*, by Venmyn Rand (Pty) Ltd., Sandton, South Africa, November 2002.

less than 45% of their actual worth. This is not possible unless the official exports in these years accounted for only a small fraction of the actual output and somehow was not a representative sample of the average value of production. A much more likely explanation is that many gem-quality stones were priced and categorized as industrial goods.

It is not known how many huge diamonds (of 10.8 carats and larger) are discovered every year. Most are smuggled out. Others may inadvertently be misclassified as "mixed goods" or as industrials, winding up being officially exported at a fraction of true value. Only a few years ago, largely rigged tenders led to the eventual export of some large stones through official channels. But such tenders have since been halted.

Much of the evidence concerning the preponderance of large stones is anecdotal. But back when De Beers was still operating in Sierra Leone, the company officially stated that "15% of the total production value represents diamonds of 10.8 carats and above."[91] We estimate that exceptionally large, high-value stones account for some $40-$60 million of the $350-$400 million worth of diamonds being exported from Sierra Leone annually.

The phenomenon is not recent. In 1992, extensive research published by an eminent geologist reported that "the Sierra Leone diamonds are of high value; the average per carat price is $270."[92] Other research confirms this figure.[93] In the yearly GGDO report from 1992, the average per-carat value of official exports was listed at $94 – some 65% below actual value.[94] [The same report estimated that official exports in the preceding years constituted less than 4% of total output; "The clandestine production is sold on the open market in Antwerp," the report stated.]

There is, of course, some justification for the market price in Sierra Leone being below that in Antwerp. Official Independent Government Diamond Valuator Martyn Marriott confirmed this: "We recognize that the ex-Freetown price must be some 7%-10% below the Antwerp spot market price and we value accordingly."[95] If we make such an allowance, our estimated per-carat value is reduced to $250 p/c, and the value of official exports grows somewhat to 47% of actual value – still a huge differential.

Exporters have become very skillful at circumventing full-value declaration and, indeed, the GGDO ought to be given the benefit of the doubt in respect to many of our findings. We have seen, for example, "Diamond Exporter's Purchase Vouchers," which record transactions of very large single stones (>40 carat stone; >70 carat stone; >20 carat stone) between dealers/miners and exporters, in which the document refers to "mixed goods" rather than one stone. Consequently, the declared value is only a fraction of the real value. Valuable cube-coated rough, which in the cutting centers would obtain high prices, are as a matter of routine classified as "industrial" goods for export purposes.

The managing director of the GGDO has made it very clear that his office is making every effort to maximize the value of the declared exports. "If we reach annual exports over $26 million, the

[91] See: "Letter of Information," National Diamond Mining Co. (Sierra Leone) Ltd., April 16, 1984, page 41.
[92] Dr. Luc P. Rombouts, Consulting Geologist, *World Diamond Production,* Terraconsult bvba, Antwerp, Belgium, December 1992.
[93] Research conducted on behalf of the National Diamond Mining Company (Sierra Leone) SL, which included forecasts for the Koidu Kimberlite project (and kimberlite production is generally inferior to alluvials; in addition, some of the larger stones will be crushed in kimberlite mining), calculated the 1993 price at $266.
[94] GGDO: 1992 Exports $31.3 million; Carats 331,800.
[95] Martyn Marriott confirmed that discounts are applied on his company's valuations in other countries as well, depending on specific circumstances. The Guinea "discount" is not identical to the one applied to that country's Aredor production. Interviewed in London, February 17, 2003.

management of this office is entitled to a bonus of 0.25% of the excess. We have a vested interest in trying to put the highest possible value on the parcels." The GGDO director is faced with a reality that, except for the GGDO itself and perhaps the Treasury, there is hardly anyone who shares the objective of maximizing export value declaration. Ironically, the Belgium Diamond High Council may unwittingly create a ceiling on the maximum allowable under-valuation of under-valuation. "If the exports are under-valued by more than 50%, there is a chance that in Antwerp some questions may be raised on the discrepancy between declared and observed values. But up to 50% you are fine," said an exporter.

APPENDIX E: US PATRIOT ACT AND MONEY LAUNDERING

The international diamond industry is in the middle of a movement toward greater transactions transparency, accountability and legal compliance in all places of operation. It must be added that the September 11, 2001, tragedies and the U.S. and international determination to attack the sources of funds of terrorism are expediting this process. Some U.S. domestic legislation may well have a bearing on U.S. policies toward Sierra Leone and its diamond industry.

For example, the PATRIOT Act requires that all "financial institutions" institute anti-money-laundering programs that guard against exploitation for the purpose of financing criminal enterprises. Under separate federal law, it is proposed that many non-traditional financial entities are considered financial institutions, including dealers "in precious metals, gemstones and jewels." The classification of diamond dealers under U.S. law as "financial institutions" is having considerable ramifications for the industry.

In order to comply with the law, all entities covered by the law are required to develop internal policies and procedures, designate compliance officers, train employees and institute independent audit functions to test the programs. Recently, the United States Department of the Treasury issued rules for its anti-money laundering program specifically for diamond dealers and jewelers. The laws require that each diamond dealer develop and implement an anti-money laundering program reasonably designed to prevent the dealer from being used to facilitate money laundering or the financing of terrorist activities.

The U.S. federal law requires each diamond dealer to assess the money laundering and terrorist-financing risks associated with its products, customers, suppliers, distribution channels and geographic locations. In addition, the merchant must take into consideration the extent to which the dealer engages in transactions with non-established customers or sources of supply. Finally, all dealers must analyze the extent to which they engage in transactions that involve transfer of funds to or from accounts located in jurisdictions that have been identified as vulnerable to terrorism or money laundering.

It's not good enough "just to warn employees to be careful." Now, a diamantaire's anti-money laundering program must be in writing and should set forth clearly the details of the program, including the responsibilities of the individuals and the departments involved. To ensure that this requirement receives the highest level of attention throughout the company, provisions of the U.S. federal law suggest that each dealer's program must be approved in writing by its senior management. A dealer must make its anti-money laundering program available to the U.S. Treasury or its designee upon request. While it is permissible for a dealer to delegate certain functions relating to its anti-money laundering program to a third party, the dealer remains responsible for ensuring compliance with these requirements.

The rules warn diamantaires "where to look" and list several examples of factors that may indicate that a transaction is designed to facilitate money laundering or terrorist financing. Behavior to watch includes: (1) Unusual payment methods, such as the use of large amounts of cash, multiple or sequentially numbered money orders, traveler's checks, or cashier's checks, or payment from unknown third parties; (2) unwillingness by a customer or supplier to provide complete or accurate contact information, financial references, or business affiliations; (3) attempts by a customer or supplier to maintain a high and unusual degree of secrecy with respect to the transaction, such as a request that normal business records not be kept; (4) purchases or sales that are unusual for the particular customer or supplier or type of customer or supplier; and (5) purchases or sales that are not in conformity with standard industry practice.

The U.S. government provides examples of "bad experiences" with the diamond and jewelry industry. One money laundering scheme cited involved a customer who ordered items, paid for them in *cash*, cancelled the order, and then received a large refund by *check or bank transfer*. In another case, funds were laundered through large cash purchases of a dealer's goods at artificially inflated prices, followed by repurchase by the dealer of the same goods at lower prices. A dealer should make reasonable inquiries when transactions appear to vary from standard industry practice, or from the standard practice of an established customer or supplier.

Over- or under-invoicing, structured, complex or multiple invoice requests, and high dollar shipments that are over- or underinsured may all be indications that a transaction involves money laundering or terrorist financing. The list of factors contained in the law is intended to provide examples of indicators of illegal activity, and is by no means exhaustive. Israeli, Belgian and Indian diamantaires with offices in New York must develop anti-money laundering programs that require describing to one's staff what money laundering is all about, how money laundering is carried out, what types of activities and transactions should raise concerns, what steps should be followed when suspicions arise, and the need to review various governmental rules.

APPENDIX F: MARKETING OPTIONS FOR SIERRA LEONE'S ROUGH DIAMONDS

Overview of Options Generally Available to Producers

In virtually all diamond-producing countries, governments maintain a legal right to give/withhold consent to the rough-diamond marketing arrangements of diamond producers. Sierra Leone is no exception. From a government perspective, each marketing option provides for different revenue streams and added-value opportunities. When diamond sales are made to domestic polished-diamond manufacturers, revenue, employment and infrastructure benefits accrue to the local economy. The optimum scheme for selling rough diamonds at any given time depends on market conditions: a sales method that is optimum in a rising market could be disadvantageous in a declining market. As a former manager of Angola's Endiama diamond concern once put it: "In good times it is easy to sell our rough independently; in adverse times it is better to have a marketing contract with De Beers".[96]

During the past half century, diamond output has increased dramatically (from about 14.4 Mct in 1945 to 115 Mct in 2002). The value has remained fairly constant in recent years, with volumes perhaps declining slightly. In 2002, production value reached US$8.4 billion. The worldwide output of diamonds has an average value of some US$68/ct. At about $270/ct, the value of Sierra Leone's production is well above average. . Recovery of large stones is common in Sierra Leone; several +100 carat stones have been reported.[97] So while Sierra Leone's actual production represents only about 0.5% of total world production by value, its share of the world large-stone market is considerably higher.

The Challenge of Revenue Optimization

Rough diamonds are not a homogenous product. DeBeers sorts them by their shape, size (carat weight), quality and color into some 14,000 different categories. There are no publicly available price benchmarks for rough diamonds; no financial newspapers or exchanges publish rough diamond prices. Their value depends mostly on the probable market value of the resultant polished product. A polished stone might also have a different price as a single stone than as part of a large parcel. It has been suggested that the true price of a diamond can only be established at the time of final sale. Since the beginning of diamond exploration, it has widely been held that two conditions can threaten the very existence of the diamond industry: excessive production in relation to current demand, and disorganized market conditions.

Historically, the common perception has been that stability can only be maintained by limiting the quantity of diamonds entering the market and selling through a single channel market. When South Africa was still the dominant producer back in the late 1920s and early 1930s, it responded to severe downturns in the diamond business by imposing production quotas on diamond mines. The diamond producers opposed this, and the stage was set for a decades-long conflicting relationship between the government and diamond miners. In the 1930s, the then infant Sierra Leone production also fell under quota arrangements, as coordinated distribution systems and various cartel ("pooling" of sales) arrangements were embraced. Accordingly, quota arrangements were around in the world long before the establishment of De Beers' Diamond Trading Company. Such arrangements actually date back to the end of the 19th Century.

In general, it is fair to say that rough-diamond prices have always been maintained in a quasi-artificial manner by controlling output and/or limiting sales. Unlike other commodities, governments are faced with having to regulate and tax a natural commodity that lacks any

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[96] Noe Balthazar, in an interview with the author, April 1989.

[97] See: Lyndon de Meillon, John W. Bristow, The Global Minerals Network, "An Appraisal of the Koidu Kimberlites," July 2002.

opportunity for clearly defined valuation, a frustrating situation that invariably leads to mutual distrust and suspicion. Temporary mine closures and other output restraints mean reduced taxes and royalty payments, less foreign currency revenues and a fall in employment. The interdependence of diamonds and the state are reflected in the evolution of the pricing and marketing system.

Selling through De Beers Single Channel Marketing System

In the early years of Sierra Leone's production, its output was marketed through the Diamond Trading Company of De Beers (actually through its DICOR subsidiary). Since some 65% of worldwide production is still marketed through this channel, this marketing arrangement can be viewed as one of the options open to Sierra Leone.[98] It is often advantageous for the governments of producing countries (where the sale of rough stones takes place on European rough markets) to have their producers sell to the DTC rather than employ alternative marketing methods.

A normal contract with the DTC involves selling diamonds to DTC for cash at a 10% discount. Sale prices are established on the basis of the DTC selling assortment and Standard Selling Values (SSV). The DTC is normally prepared to structure the arrangement so DTC pays its profit taxes (after deduction of expenses) in and to the producing country. It is for this reason that in many producing countries, the producer sells first to a locally incorporated DTC company. The 10% savings (basically, the producers' marketing costs) basically becomes revenue for the local DTC Company (such as DICOR in the past).[99] The advantages of selling to the DTC are that it offers a guaranteed minimum price that is verifiable against the SSV. From the perspective of a government or corporate partner, the fixed pricing system is easier to monitor than open-market selling. The DTC also guarantees to buy the entire production.

In Sierra Leone, the Government retains the nation's mineral rights and, technically, it might claim ownership of its mineral wealth. But under current arrangements a small group of dealers/exporters accumulates most of the mineral wealth. Any major change to the status quo will be met with considerable resistance by vested interests. This limits the government's flexibility in choosing policies. De Beers has withdrawn itself voluntarily from involvement in the African alluvial markets, but under the right conditions it might be persuaded to review that position.

There are advantages and disadvantages to a producer country in selling through the DTC. Although the DTC purchases and sells diamonds on the basis of a much more detailed assortment than others (some 14,000 categories are used, compared with the 125 in the normal market-type assortment used by some government valuators), there is still considerable scope for variation. In a given category the DTC varies the overall price paid within a band of about 20%, depending on color, quality, size and shape. There have been several disputes between producers and the DTC about how the DTC valuates stones. During sorting the DTC can increase its margins in the buying process by between 2% and 10%. However, the contracts allow for dispute resolution, and it is only natural that both sides want to protect their interests. The arguments are mostly over whether certain goods belong in category X or category Y.

It has helped the DTC that its traditional marketing partners have been mostly governments instead of private-sector companies whose shareholders would demand optimum prices and total transparency in the pricing process. When Russia embarked on a privatization drive in the early 1990s, DTC managing director Gary Ralfe expressed relief that the drive did not extend to Russia's

[98] It is worth noting, however, that DTC's current policy is not conducive to selling alluvial production from environments like Sierra Leone's.

[99] Hypothetically, assuming a 30% tax rate, this reduces the effective gross selling margin from the government's point of view to 6.3% (a 10% discount allows a 10 point profit on an item costing 90, i.e. an 11% gain, less 2% expenses and then 30% tax). In addition, the DTC charges an advertising fee (up to 5%) to finance its worldwide promotions.

diamond resources: "As long as a rational political authority is in ultimate control over the diamond industry as it exists today in Russia, I have absolutely no doubt that the political authority would be persuaded by the experts that the partnership formed with De Beers should continue."[100] It is certainly no coincidence that the challenges to DTC's time-honored system have come from the new corporate producers in the developed world (Australia and Canada), rather than from the African sources. It was only for those two countries and Russia that De Beers agreed to accept less than full run-of-mine production. In the case of Russia, the DTC only recently ceased to be the sole purchaser of Russia's rough diamond exports.

The agreements generally contain clauses that require the run-of-mine material to be sorted in accordance with the Standard Selling Assortment – the system according to which diamonds are sold to the DTC (The DTC buys "assortments" of diamonds sorted according to the size, color, shape, purity and crystallization and other factors). This sorting system is identical for all parcels, with assortments corresponding to the assortments used by the DTC for sales to its customers (and so they are altered whenever the DTC makes alterations to its sales assortment for its customers).

These assortments have corresponding values (SSVs). De Beers pays South African producers an initial 86% of the SSV, with the remaining 4% paid after the DTC has sold the diamonds to its sightholders. De Beers must inform sellers of any changes in the SSV, in advance of altering the purchase price. Such a scheme, with buyers paying a "reserve price" paid in advance and an additional consideration post-sale, is being discussed as a possible marketing option for the alluvial miners in Sierra Leone.

The advantage to a producer of a contract with the DTC is that it establishes a price floor. Negative commodity price surprises are eliminated, since the DTC guarantees that purchase prices can move in only one direction – upwards – for the duration of the contract. The disadvantage of a contract with the DTC is that the contracted producer renounces any opportunity to profit from premiums that might become available in the secondary market. These premiums can at times be significant, especially in a rising market. The DTC's buying price, which is officially always about 10% below its selling price, might turn out to be below the prevailing market price. At times (for example, in the period of strong demand immediately preceding a DTC price adjustment) the difference between the DTC's buying price and the open market price may be considerable.

The above, of course, is a static analysis that ignores the impact on prices of a producer trying to place goods on a weak market. The premiums in the secondary market only exist because the DTC is willing to accumulate a stockpile during periods of weak demand and not flood the market. Any producer of significant size that wished to market its entire production independently must be prepared to do likewise.

Rough Marketing Options: Selling through Tenders

In an attempt to maximize domestic added value, governments of diamond-producing countries will often sell through tenders. Historically, several producers (Angola, Trans Hex, MIBA, Sierra Leone and, to some extent, the CIS) have been successful at selling goods on tender. Some producers use small tenders to check their sale prices (or to establish a new base price for production). There is no doubt that this method of sale is advantageous in a rising market. But this method also has pitfalls.

The system normally works as follows: A preliminary valuation is put on the goods and four to ten buyers are invited to view the goods and make sealed bids. Great care must be taken over the selection of the buyers in order to prevent collusion. (In Sierra Leone, past tenders for large stones reportedly were rigged, with the handful of participating buyers [and their local silent partners]

[100] DTC managing director Gary Ralfe, at a press meeting in Moscow, December 18, 1991.

agreeing in advance who would win the bid.[101]) The sealed bids are subsequently opened in front of the buyers or their representatives, with the highest bidder paying cash on collection. In MIBA there have been instances where the successful bidder failed to make payment. In such a situation the next highest bidder gets the goods or a new tender is held. Tenders in Russia have been known to generate prices 30% above the DTC buying price (Although in such cases it may be that the buyer simply wanted to curry favor with the Russian producers by paying a high "entry price.") Certainly, some tenders in Africa have been rigged (The industry is rich with stories of instances where the winner of a rigged bid failed to honor its obligations to its co-conspirators).

But the tender system is not without risks, and some dealers are concerned that the market is becoming saturated with this type of sale. Those participating in the various tenders are finding reduced profit margins on the stones they succeed in buying. If the situation continues, interest in the tenders may ebb and the risk of collusion will increase.

Rough Marketing Options: Competitive Marketing

Angola, which has a small-scale alluvial mining community similar to Sierra Leone's, has experience with many different marketing mechanisms. A remarkable and very workable system was adopted in 1989, when the Governmental Marketing Company ENDIAMA moved from selling through tenders to selling through agents/dealers on commission. The main agents were Jack Lunzer's IDC in London, and George Evens, Beny Steinmetz and Arslanian Brothers in Antwerp. Run-of-mine rough was sorted and categorized and its value established by a Government diamond valuator (GDV). Each category was divided into three roughly equal parcels and allocated to the three dealers via a random draw. The exercise was considered fair since each dealer essentially received goods of similar weight and quality.

The dealers paid up-front at prices established by the GDV. Each dealer had an ENDIAMA representative at its home office in London or Antwerp monitoring the actual selling prices of the Angolan rough. The commission paid by ENDIAMA was performance related: Any premium of up to 4% over the GDV price the dealer kept;[102] any premium of 4% to 7% was split equally between the dealer and ENDIAMA; any premium over 7%, the dealer kept 25% of, with the rest going to ENDIAMA. There is some anecdotal evidence that the agents/dealers seldom earned more than 4%. Thus ENDIAMA's selling mechanism was most lucrative to the Government. The system had the added benefit of training Angolan nationals in the selling of rough diamonds, as they were actively involved in the Antwerp selling offices.

When the demand for rough diamonds weakened, ENDIAMA changed policies again and opted for a marketing contract with De Beers (1990-1995). Law 16/94 granted ENDIAMA exclusivity on the concession of mining rights. "For the exercise of its activities, ENDIAMA can enter into partnerships with national and international partners, of any size, provided these partners have technical and financial capacity." This is still the situation, and so ENDIAMA is part of each and every diamond mining joint venture in Angola. There are a many similarities to Sierra Leone. In Angola "official exports" at times have been below $25 million (1993), and at other times have exceeded $700 million (recent years). It very much depends on the selection of the appropriate marketing mechanism.

Rough Marketing Options: Exclusive Buyer

These arrangements are typically found in countries that contain hundreds of small-scale diggings, such as Angola and the Democratic Republic of Congo (DRC). Both of these countries have

[101] Based on direct testimony from participants in these tenders.
[102] That GDV was Martyn Marriott, who enjoyed the trust of the Angolan Government.

recently experimented with exclusive buyer (and thus exclusive exporter) arrangements for their respective rough productions.

Such arrangements are chosen based is the expectation that that they will provide greater tax revenue. In both Angola and the DRC, the previous system - which involved major international diamond merchants operating buying offices - had failed to provide the governments with the desired amount of tax revenue.

These schemes are difficult to operate and monitor. The exclusive buyer has a few dozen buying offices (or buying agents) operating throughout the country. Licensed diggers must sell their goods to these offices. So it is far from a "willing buyer - willing seller" environment. Arbitration mechanisms have been created to solve disputes, but the system has proven far from ideal. In many instances the system has encouraged smuggling, especially of larger, more expensive stones (with smugglers seeking payment in a "hard" currency such as U.S. dollars).

In the DRC, Government officials have publicly lamented that their own appointed exclusive buyer was only paying "dumping prices." (These charges may be unjustified, as other sources of market information state that government revenue has risen and that the value per carat paid by the present agent is significantly higher than in the past.) The absence of competition has made smuggling the only option for diggers when they feel that the price is too low.

One factor in governments choosing exclusive buyer arrangements is the concern about "conflict diamonds." United Nations resolutions have placed sanctions on the purchase of such diamonds. It is believed that having only one exporter entitled to issue the government certificates of origin will prevent the imposition of sanctions on the country's entire production.

For all practical purposes the success of these arrangements will depend on whether or not the relevant organizations are satisfied with them. It is unlikely that these systems have long-term potential.

Contemporary Preferences

In their desire to maximize the benefits derived from this non-renewable mineral resource, diamond-producing nations have consistently endeavored to stimulate domestic downstream processing. Therefore, restrictions are often imposed on the free trade in rough diamonds. For example, all categories of rough diamonds mined in South Africa (and deemed appropriate for domestic diamond cutting) must be offered to local cutters. The law provides for heavy penalties (in the form of outrageously high export duties) if a producer fails to comply with these requirements.[103] Legislation was recently passed in Namibia giving the Government the power to force producers to sell a portion of their rough diamond output locally in an attempt to create a domestic cutting industry.[104]

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[103] Rough exports are regulated through the Diamond Act of 1986. Chapter 59 of the Act allows diamond producers to enter into agreements with the government on supplies to local industry. All large stones and all fancy-color stones must be sold and processed within South Africa. In 1999, the local producers sold some US$400 million worth of rough to the domestic South African market in compliance with the law and resultant agreements; this was far more than the requirements of the domestic market.

[104] The Diamond Act of Namibia, which came into effect on April 1, 2000, exempts the producer from paying royalties if he sells the rough domestically to cutters. The Minister of Mines and Energy has the right to compel the producers to sell a regular supply of rough diamonds to domestic cutters in the quantities, classes, qualities and descriptions as may be required by any cutter. The Minister shall only use the aforementioned authority if the cutter failed to reach a satisfactory agreement with the producer. When the Minister intervenes, he has also the right to "fix and determine terms and conditions of sale. Said purchase price shall be paid against the delivery of the unpolished diamonds."

In Russia, the Government controls (through licenses) the exports of rough diamonds, and the government-owned producing company sells rough stones at significant discounts (sometimes 30% or more below market value) to the domestic cutting industry.[105] Large stones, by law, can never be exported from Russia, and must be processed locally. In Canada, Ekati, Diavik and Snap Lake (well before a decision to develop the mine was made) are being cajoled into entering into agreements with domestic cutters in Yellowknife. This will have the effect of allocating some 10% of output to the domestic industry. The Government of Botswana has demanded that producers support a local industry that, so far, has proven to be non-economic (there are two major plants operating in the country).

Worldwide some US$1.2 billion worth of rough diamonds are sold directly to domestic cutters and are thus not freely traded on the international market. Such policies, aimed at increasing added value domestically by boosting local processing facilities, have generally failed dismally. Out of US$13 billion worth of worldwide polished consumption in 1999, only about 7.5% was attributable to processing in producing countries (mainly Russia). This situation can be partly explained by the long-held policy of De Beers that diamond processing should only take place in those countries where it is most economically efficient.[106]

Single-Multiple Channel Evolution

Historically, De Beers has played the role of “market custodian,” underwriting a demand and supply equilibrium through its single-channel marketing system for rough diamonds. Stability was obtained through a system in which producers would willingly maintain “buffer” stocks and/or reduce production. De Beers marketed the rough-diamond output on behalf of all producers.

Today De Beers primarily mines and sells its own rough diamonds, with two exceptions: It sells about 40% of Russia’s output and (until recently) 35% of Canada’s Ekati’s production (and both Russia and Ekati compete with De Beers in selling their remaining output). De Beers has ceased buying rough diamonds on the “open market.” Selling output immediately after producing the goods is now the declared policy of De Beers, BHP, Rio Tinto, Ashton, Trans Hex, Namco, Catoca and SDM. Even Russia adheres to this policy; in past five years its annual rough sales have far exceeded production, pointing to a consistent and continuing de-stocking process.

Belgium’s Role

One of the reasons given by producers for marketing their output through Belgium is that it is best able to provide financing. It is also undoubtedly the most "open” and accessible market. The DTC consistently sells 43-46% of its rough output to clients in Antwerp, who subsequently sell it on to mostly overseas manufacturers. BHP, Diavik, Argyle, Namco and other producers sell most, if not all, of their rough through the Antwerp market. The smaller African producers, some of which have historical colonial ties with Belgium, also prefer the Antwerp market.

Producers tend to ally themselves with small groups of rough customers. The DTC has some 45 clients (out of a total list of slightly over 100) in the huge Antwerp market. BHP sells to 10 core clients, and Argyle has some 14 principal customers. The heterogeneous nature of the product requires skillful sorting to be able to deliver the assortments needed by individual manufacturers. Manufacturers are willing to pay premium prices for parcels consisting only of those qualities and

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[105] The 1999 annual report of Alrosa Diamond Co. confirms that US$720.4 million worth of rough stones mined in Russia were sold to the domestic industry. These diamonds never entered a competitive international rough market. The subsidization of these sales (at about 30%) was confirmed by Alrosa’s vice president, Sergei Oulin, at the 2nd International Rough Diamond Conference, March 2000, in Tel Aviv.

[106] The recent (and reluctant) involvement by De Beers in processing activities in some producing countries is the direct result of political pressure by the host governments.

sizes needed. Therefore, rough diamonds may change hands many times in Antwerp to sort diamonds in a commercially optimal manner.

Review of Sierra Leone's Earlier Marketing Systems

Recently, some GOSL officials have advocated returning to previous marketing arrangements through which the Government Gold and Diamond Office (GGDO) was either the single purchaser and seller of all productions, or a partner in the marketing regime. It is therefore imperative to review some of the earlier systems as they operated in Sierra Leone.

(a) Marketing systems prior to independence

Before independence Sierra Leone's principal production came from the SLST operations. SLST sold the majority of the diamonds it produced to DICOR. The company's diamonds were sorted and sold in London. Eventually the GOSL felt there was a need to bring in a few other independent buyers so as to introduce some degree of competition into the industry. Similarly, it felt that if Sierra Leoneans were going to learn more about the industry, the sorting and selling of its diamonds would have to be done in Freetown and not in London.

Virtually all the buyers of Sierra Leone diamonds at the time did not conduct business in the country and so could not be asked to pay taxes on their off-take. The Government, therefore, took steps to rectify its position soon after independence. With De Beers there were always disputes on prices and the discounts applicable on its rough diamond purchases. At the time Sierra Leone became independent, the GOSL felt that DICOR's prices were too low. It decided that it could not continue to grant a generous discount of 12% on those already low prices. At one point the argument led to no diamonds being sold for about 12 months.

The conclusion the Government drew at that time was that Sierra Leone should not be dependent on a single buyer for its production. This led to the establishment of the 1962 diamond marketing rules.

(b) Marketing systems after independence

For a few decades (from the 1960s until the early 1980s) the so-called "Diamond Rules of 1962" were in effect, applicable mostly to diamonds produced by the Sierra Leone Selection Trust and its successor organization, the NDMC. The diamonds were sorted and sold in Freetown. Sales took place under the watchful eye of the GGDO – the body that was charged with buying and selling diamonds in Sierra Leone.[107]

Under the Rules, NDMC delivered the diamonds produced in Yengema and Tongo to their sorting office in Freetown (located in the GGDO) in the presence of a Government representative and a representative of GGDO. The diamonds arrived in secured parcels, sealed with wax or lead in such a way that they could not be opened without breaking the seal or leaving traces of violation. These diamonds were then checked, weighed, cleaned, sorted and valued by NDMC sorting staff, in accordance with a sample parcel provided by DICOR.[108]

DICOR also acted as advisor to the GGDO and, in that capacity, its team was able to examine the sorting and valuation done by NDMC. The Government valuator also double-checked the work of

[107] In those days the GGDO had a board of six members: three from the Government, two from the marketing arm of De Beers called DICOR (West Africa) Limited and one from NDMC.

[108] Diamonds that were 10.8 carats and above were not sorted according to the sample parcel, but were set aside and valued individually by the Government valuator. Prior to this, they were valued for NDMC by the sorting staff and a consultant retained for this purpose.

these two parties. When both DICOR and NDMC disagreed as to the price or value of a particular stone or stones, it was the Government valuator who adjudicated. His decision was final.

In the 1970s, the NDMC sold its diamonds to DICOR and four other buyers, licensed by the Minster of Mines. The rules provided for offering at least 50% of the company's output (by value) to DICOR. The balance was sold to licensed exporters. For a long period there were only four other license holders: Leon Tempelsman & Son (who was entitled to 27% of the output), Jamil Said Mohammed (12%), Jack Lunzers (S.L.) Ltd. (8%) and Kaplan (3%). After the NDMC was paid, upon request it arranged for packing, insurance and shipment of the goods of these latter four buyers; DICOR handled these responsibilities itself.

DICOR (i.e. De Beers) was entitled to a discount on its rough purchase price. Through the discount Sierra Leone effectively paid for its part in DICOR's international commercial promotions to enhance the sale of Sierra Leone diamonds. DICOR also provided certain services to the GGDO in exchange for this discount. It had been agreed in 1962 that DICOR would enjoy a discount of 10% on GGDO prices, while the other buyers would enjoy a 6% discount. After December 1981, these discounts were suspended, although DICOR continued to receive 5% until January 1983, when it was increased back to 10%. Not long thereafter, DICOR ceased its operations in Sierra Leone after NDMC was privatized to Jamil Mohammed.

The 1962 system, as it operated, was a cross between a 100% tie-up with the Central Selling Organization, and the tender system that some African countries use. De Beers could live with it and noted that the system "enjoys the advantages of both and hardly any of the disadvantages. For example, because Specials (i.e. diamonds of 10.8 carats and above) could be put out on tender, it enabled some degree of competition to take place among the buyers. On the other hand, given the allotment procedure outlined for those below 10.8 carats, there was an assured market for the run of mine diamonds produces by NDMC."[109]

[109] Most of the historic marketing data was obtained from NDMC documents.