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# PROPERTY RIGHTS AND ARTISANAL DIAMOND DEVELOPMENT (PRADD)

FEASIBILITY OF DIRECT MARKETING OF ARTISANAL  
DIAMONDS FROM LIBERIA AND CAR TO THE USA



**JUNE 2011**

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**Cover Photo:** Artisanal small-scale diamond mining along the Lofa River, Liberia.

Photo by Steven Van Bockstael, 2010.

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**DISCLAIMER**

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# ACRONYMS AND ABBREVIATIONS

ADM	Artisanal Diamond Mining
ARM	Alliance for Responsible Mining
ASM	Artisanal and Small-Scale Mining
AMZ	Artisanal Mining Zone
BECDOR	<i>Bureau d'Evaluation et de Control de Diamant et d'Or</i>
CAR	Central African Republic
CASM	Communities and Small-Scale Mining
CFA	Central African Franc
CoC	Chain of Custody
COFTA	Cooperation for Fair Trade in Africa
COV	<i>Chocó Oro Verde</i>
CSR	Corporate Social Responsibility
CSER	Corporate Social and Environmental Responsibility
DAPM	<i>Direction d'Appui à la Production Minière</i>
DDI	Diamond Development Initiative International
DDS	Diamond Development Standards
DIPAM	Diamond Industry Management Program
DM	Directly Marketed
DRC	Democratic Republic of Congo
EA	Environmental Assessment
EITI	Extractive Industries Transparency Initiative
EU	European Union
FJA	Fair Jewelry Action
FLO	Fair trade Labeling Organizations International
GDO	Government Diamond Office
GoCAR	Government of Central African Republic
GoL	Government of Liberia
ICG	International Crisis Group
IDMP	Integrated Diamond Management Program
ISEAL	International Social and Environmental Accreditation and Labeling Alliance
JoA	Jewelers of America
KNK	<i>Kwa Na Kwa</i> —Work, Nothing But Work

KPCS	Kimberley Process Certification Scheme
LEITI	Liberian Extractive Industries Transparency Initiative
LIMEP	Liberian Mining, Energy and Petroleum
LNP	Liberian National Police
LRA	Lord's Resistance Army
LSM	Large-Scale Mining
MCDP	Mwadui Community Diamond Partnership
MDA	Mineral Development Agreements
MDDG	Madison Dialogue Diamond Group
MDDWG	Madison Dialogue Diamond Working Group
MLME	Ministry of Lands, Mines and Energy
MoU	Memorandum of Understanding
MSI	Management Systems International
NGO	Nongovernmental Organization
PDA	Peace Diamond Alliance
PPCA	Public Procurement and Concessions Act
PRADD	Property Rights and Artisanal Diamond Development
RJA	Retail Jewelers Council
ToR	Terms of Reference
UK	United Kingdom
UN	United Nations
UNCMCA	National Union of Mining Cooperatives
UNMIL	United Nations Mission in Liberia
UNPoE	United Nations Panel of Experts
USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollar
USDoS	United States Department of State
USGS	United States Geological Survey
VAT	Value Added Tax
WGAAP	Working Group on Artisanal-Alluvial Production

# EXECUTIVE SUMMARY

The purpose of this research was to ascertain the feasibility and desirability of establishing more direct trading relations between artisanal miners in the Central African Republic (CAR) and Liberia and international buyers—with special attention to the US diamond industry—on the premise that increasing the price achieved by artisanal miners may make them more able and thus likely to formalize their activities. The key lines of enquiry were:

1. What are the trading scenarios that would enable the miners to work under better conditions, achieve closer to fair market value, and operate within the formal sector?
2. What are the trading scenarios that could help revive the portions of the US diamond industry that have been in decline?
3. Is it possible for there to be a win-win situation for both artisanal diamond miners and US industry players that would incentivize formalization of artisanal diamond mining (ADM) and ultimately be developmental?

The research approach involved consulting key stakeholders from along the supply chain to get an understanding of the present political economy and supply chain logic, including key incentives and obstacles to formalization within Liberia and the CAR, the achievement of fair market prices by ADM, and what profitable engagement might look like for the manufacturers and jewelers. Research therefore involved *review of relevant documents, collection and analysis of relevant statistics, and field research* in the CAR in March and April 2011 and Liberia in April 2011; *semi-structured telephone interviews* with key informants in the US diamond manufacturing and “mainstream” and “ethical” jewelry retailers; and *semi-structured telephone interviews* with 13 key informants with experience of successful and unsuccessful direct marketing schemes with artisanal miners. The interviews with US industry and direct marketing experts were designed to generate information and opinion from leading industry figures on key opportunities and challenges to establishing more direct trading relations between the US and CAR and Liberian diamond industries. As such, the interview findings are *indicative* of industry opinion, and not *conclusive* as “facts.”

All interviewees’ identities are protected in this report.

## THE SELLERS

### FEASIBILITY OF DIRECT MARKETING FOR ARTISANAL DIAMOND SELLERS IN THE CAR AND LIBERIA

The most positive aspect of the CAR diamond industry is the relatively lower cost of licensed mining, a superior legislative environment and a positive attitude from government oriented toward capturing and directing the development potential of artisanal and small-scale mining (ASM). However, potential investors would basically be on their own, confronting a government that requires a more than significant financial commitment from exporters and takes a sizable proportion of the diamond’s value at the point of export. This would likely mean that any direct-marketing scheme would have to be arranged through an established diamond exporter. Existing diamond cooperatives in the CAR may prove to be an interesting exception to this given their right to export directly through the National Union of Mining Cooperatives (UNCMCA). While only a fraction of those “cooperatives” are actually mining diamonds, the legal provision for cooperatives and their actual existence does provide the possibility of directly exporting local production to international buyers from these organizations.

The Liberian government is actively seeking international investment. This makes the operating environment more amenable to international buyers. However, in Liberia, one cannot buy directly from the mines so the only choice would be to work with a local broker intermediary, or otherwise make it possible for local miners to come to Monrovia to negotiate and later sell their diamond production, something which people with experience of buying directly from miners warned would be unlikely.

## KEY FACTS

CAR	Liberia
<b>Production</b>	
<ul style="list-style-type: none"> <li>Total production ranges between 300,000 and 420,000 carats of rough diamonds per annum. This is believed to be 80% of actual production.</li> </ul>	<ul style="list-style-type: none"> <li>Liberian production of and revenue from rough diamonds is a small fraction of the same sector in the CAR, ranging between 22,000 to 47,000 carats per annum.</li> </ul>
<ul style="list-style-type: none"> <li>400,000 people depend on ADM for their livelihood.<sup>1</sup> This translates as approximately 1.4 carats (\$200 export value) per person per annum.</li> </ul>	<ul style="list-style-type: none"> <li>50-100,000 men, women and children do ADM.<sup>2</sup> This translates into 0.2 to 1 carat (\$240 export value) per person per annum.</li> </ul>
<ul style="list-style-type: none"> <li>Exploration by juniors is minimal; most withdrew during the 2008 crisis.</li> <li>100% of production is artisanal and the government appears to have a realistic view on the lack of significant potential for industrial-scale diamond mining</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing prospection by exploration companies in search of primary or economically viable secondary deposits, yet diamond mining remains exclusively artisanal and small scale. The government is focused on encouraging industrialization of the sector.</li> </ul>
<b>Trade &amp; Export</b>	
<ul style="list-style-type: none"> <li>High entry costs for international buyers; high export tax (12%; 9% for a mining cooperative)</li> </ul>	<ul style="list-style-type: none"> <li>Export taxes at 3%</li> </ul>
<ul style="list-style-type: none"> <li>Lack of available funding for artisanal miners</li> </ul>	<ul style="list-style-type: none"> <li>Miners report a lack of available funding</li> </ul>
<ul style="list-style-type: none"> <li>Decentralized buying networks, with diamond exporters required by law to establish regional buying offices</li> </ul>	<ul style="list-style-type: none"> <li>Diamond buying is significantly more centralized than in the CAR, as it is currently forbidden for diamond exporters to buy diamonds up-country.</li> </ul>
<b>Price</b>	
<ul style="list-style-type: none"> <li>Average dollar per carat value range is \$125-\$160/ carat, however this is likely inflated (see below)</li> </ul>	<ul style="list-style-type: none"> <li>High dollar per carat value (\$243 average) but the sources do not give dependable numbers.</li> </ul>
<b>Other issues:</b>	
<ul style="list-style-type: none"> <li>Present instability in the east, where significant diamond deposits are located, makes it difficult for foreign investors and diamond buyers.</li> </ul>	<ul style="list-style-type: none"> <li>Diamond smuggling remains a problem in Liberia, including possible Ivorian conflict diamonds.</li> </ul>
<ul style="list-style-type: none"> <li>Diamond production is strategically important for revenue collection (second biggest export)</li> </ul>	<ul style="list-style-type: none"> <li>Lack of significant government revenue from diamonds likely goes a long way in explaining the "lack of political will" to pursue significant reforms in the diamond sector.<sup>3</sup></li> </ul>
	<ul style="list-style-type: none"> <li>Artisanal mining remains grossly underrepresented in the Mining Code.</li> </ul>

## REASONS FOR INFORMALITY OF ADM IN LIBERIA AND THE CAR

While most miners simply do not have the money to pay for a license, even those miners who should be able to scrape together the money required to pay for a mining license and associated costs often do not do so. Why not?

Apart from the legal aspect, there is often no advantage associated with being a licensed miner. This is particularly the case in remote rural areas where people have little contact with "the government." A lack of

<sup>1</sup> Levin and Hinton, 2010.

<sup>2</sup> Hinton, 2010.

<sup>3</sup> UNPoE, 2010.

visible government action to improve public welfare, and a limited trust in government to do so in the near future, means that the average miner sees no real benefits to formalization. If, in addition, the whole process of getting formalized turns out to be actually complex and expensive (like in Liberia), then only the more professionalized and visible miners will find it in their interest to do so.

Part of a much broader process of de-agrarianization that has engulfed large parts of sub-Saharan Africa in the past decades and has encouraged growth of non-agricultural rural employment because of diminishing returns of traditional smallholder farming, artisanal diamond miners and laborers mostly remain ranked at the bottom of most wealth and livelihood indicators. Spending significant amounts of money and efforts on acquiring a mining license when the expected return of such an investment is almost negligible is clearly not an option for most miners.

## **AVENUES TO FORMALIZATION IN THE CAR AND LIBERIA**

Changing the present dynamics will have to involve not only a significant relaxation of current legal requirements from the point of view of the artisanal miner, but will also need to be coordinated with an increased focus on the middlemen. Rather than the individual miners, it can be argued that the middlemen are the key actors in the artisanal mining sector—barring a few exceptions to the rule, they provide the bulk of the financing available to miners, making mining operations possible in the first place. An increased focus on getting these actors to formalize, rather than the miner, will result in a far more effective strategy to diminish illicit mining. Given the wide dispersal of alluvial diamonds, illicit mining will always exist to some extent. However, if the actors providing most of the funding for illicit mining are coached into formalizing, the overall transparency of the sector will increase dramatically, and with it the advantages individual miners may see in formalizing their mining operations.

## **THE BUYERS**

### **GLOBAL MARKET CONDITIONS**

In early 2011, a bullish market in rough diamonds is also driving high prices for polished, though presently “the polished is worth less than the rough.”<sup>4</sup> This is due to a delay in mines coming back online following the global financial crisis, but also upward price pressure generated by Indian buyers in particular, who are benefiting from protectionist government policies to safeguard the huge diamond manufacturing industry in that country. The economic downturn of 2008 saw liquidity in ADM sites dry up, the effect of which continues to this day. Access to finance is a major constraint for ADM, including in Liberia and the CAR. The artisanal sector is becoming more important to the diamond industry. Its proportional contribution to the supply chain is estimated to increase over time while no significant industrial-grade discoveries are anticipated in the next few years. This makes it strategically important that more and more reliable sources of artisanal diamonds with diminished commercial (reputational and legal) liabilities become available.

### **THE US DIAMOND AND JEWELRY MARKET**

In the past decade, the US diamond industry, which has relatively high labor costs, has found it hard to compete with cheap labor in India and China.<sup>5</sup> Thousands of retail jewelers have had to close their shops; manufacturers have lost so much business that they cannot afford their rent and unemployment levels are high. This has translated into a move to source secondhand rough and polished diamonds, as well as participating in “closed” buying situations where Indian-financed buyers are not present. It has also led to increased specialization, as it is typically only cost-effective for US manufacturers to cut and polish the larger, higher quality stones and “fancies.”

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<sup>4</sup> Member of the diamond industry, interview with authors, 2011.

<sup>5</sup> A knowledgeable 2007 estimate put the percentage of diamonds cut and polished in India at 90% by volume and 60% by value.

## US JEWELERS' INTEREST IN SOURCING FROM ADM

All the jewelers consulted were interested in sourcing artisanal diamonds. Most of the jewelers were of the opinion that the value of an ethically branded diamond would be in creating a new, specialized market segment that would help capture the dollars of value-conscious consumers, including those who might otherwise not buy jewelry. For the boutique jeweler, they believed there is real profit potential in marketing certified, legitimate artisanal diamonds with a positive back story to consumers and, for the larger jewelers, it is in their strategic interest to secure artisanal diamond sources as the forecast is for the artisanal sector to deliver an increasing proportion of diamonds from mined stocks in the years ahead. However, issues arise were jewelers to promote directly marketed (DM) diamonds as somehow different to mainstream diamonds, given the human rights and environmental problems that exist in the artisanal sector—particularly relating to child labor, environmental impact, and tensions with non-mining locals.

The diamonds of choice for ethical US jewelers typically come from large-scale operations in Canada or Namibia, where brands assure the corporate social responsibility (CSR) credentials of the stones. This seemingly has more to do with the lack of availability of artisanal diamonds and metals to US jewelers, given the concentration of efforts to supply these in Europe where momentum is presently greater, than lack of interest. Nonetheless, European jewelers, who are proactively sourcing artisanal precious metals and diamonds,<sup>6</sup> may be more able to work with an artisanal diamond source, including one that is not yet fully in line with all ethical issues, provided they see it to be *somehow* developmental. A functional direct marketing chain may be more likely if the DM diamonds are initially oriented at European jewelry markets where the market is currently booming. On the other hand, through networks one could find enthusiastic US-based jewelers willing to work with less perfect artisanal diamonds, but the concept is less tested in the US market.

In addition, US industry interviewees were clear that quality, price and being fashion-forward are more important to customers when choosing a jewelry product. This means that an ethically branded artisanal product oriented at the US consumer must not be too much more expensive. There is also a huge knowledge and communication gap that prevents direct sourcing by most jewelers. This means that you must also find a suitable buyer and manufacturer of the rough diamonds.

## US ROUGH DIAMOND BUYERS AND MANUFACTURERS' INTEREST IN ARTISANAL DIAMONDS

US manufacturers and importers were clear that they would only source from the artisanal sector if it were commercially sensible to do so. Uniformly highlighted was the importance of price, supply, quality, and accessibility of the product as critical commercial issues. Ethical considerations at the point of production were not as important to the manufacturers and rough diamond importers we consulted as they are to jewelers. The manufacturing sector traditionally turns a profit based on volume rather than value, making it very price sensitive. As a rule, this means that buying run-of-mine is not at all attractive to most US buyers, although some have business models which may allow for this. Given the present fragile economic climate in the US, industry is not interested in engaging in a risky or expensive endeavor. On the other hand, innovation is born in desperate times. In the words of one member of the jewelry industry: “This is a good time to be exploring, beginning. But this is not the robust time where interest in expansion would be greatest. But the smartest people will be thinking about the future.”

## THE ELEMENTS OF A SUCCESSFUL DIRECT MARKETING INITIATIVE

Our limited foray into the critical factors that underpin a successful direct trading initiative revealed that:

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<sup>6</sup> This is significant. The majority of colored stones are artisanally mined anyway; but artisanal gold and diamonds are much harder to get and must be actively sought. Indeed competition for them is so high, that certain firms are recruiting managers whose primary responsibilities are to ramp up supply to meet demand.

1. **Trust, transparency, and a partnership approach between the seller and buyer is the foundation for success.** Even more than in other industries, trust is crucial in the diamond business, where the price of a diamond cannot be easily ascertained by simply weighing the good on a scale and referring to an international standard price, fixed to a unit of weight. Interviewees were unanimous that without trust, failure is inevitable. It was also clearly put that without transparency, there is no trust, and without partnership, there is no transparency.
2. **Inconsistency and uncertainty of supply in terms of volume, price, and quality at the producer side pose serious challenges to the manufacturer and jeweler.** It is important that it either works with enough artisanal production units to absorb variability in production *or* with buyers who are able to buy run-of-mine and for whom the DM diamonds would be optional (“nice-to-have”) rather than essential (“need-to-have”) for its commercial success as a business.
3. **Middlemen matter.** In almost every case, interviewees emphasized the importance of the middlemen in terms of their commercial functions in the supply chain and the larger socio-political roles they play in the lives of artisanal diamond miners. Bypassing them is not necessarily developmentally or commercially desirable.
4. **Understand the artisanal miners’ mindsets and existing marketing strategies.** Be realistic as to what the artisanal miners’ interests are and what they can do. Such interests include the price, a sense of duty because the buyer has lent him money or tools, fear of reprisal if he does not sell the diamond to supporters / financiers, a lack of alternative buyers, a sense of trust based on a history of sales and/or ethnic ties, and so on.
5. **Work with existing supply chains as much as possible!** These exist because they work; using them as a starting point reduces complexity and the potential for failure.
6. **Start the scheme with producers and buyers who have existing, demonstrable commercial and/or development successes.** One should start with producers who can demonstrate productive land, good organization, proficiency at commercializing the product, and the ability of local leaders to convert their diamond wealth into some type of valid development outcome. One should start with buyers who have a successful track record of sourcing more directly from ASM.

## THE SCENARIOS FOR A SUCCESSFUL DIRECT MARKETING SCHEME

### CRITICAL ISSUES THAT INFLUENCE WHICH SCENARIO IS MOST LIKELY TO SUCCEED

**Level of Ethical Branding.** Some thought needs to go into how developmental the DM diamonds need to be. Prioritizing development outcomes over profitability will make the initiative less interesting to many key actors. Recommended actions include:

- Conduct a “Corporate Social and Environmental (CSER) baseline” of the diamond production and process methods of potential participant producer organizations and their impacts to see how much would need to be done to allow the diamonds to be branded as more than artisanal. This could be done as an assessment against an existing ethical artisanal standard such as the Diamond Development Standards or the Fairtrade/Fairmined Gold Standard.
- Engage interested jewelers in a frank discussion about the ethical credentials and liabilities of their diamonds and what realistically would be significant enough to prevent or allow them to market these diamonds as “ethical” or “fair trade” or “developmental” to consumers so they could command a higher price and/or secure a new consumer base without having to be perfect. It would be wise to explore the different sensitivities of US (and possibly Canadian) and European markets through a proper market survey. Consider previous research done.
- Think through what the DM diamonds’ marketing story could be, what the positive impacts are of the direct marketing support program, and why this might appeal to a consumer. If the diamond jewelry is to be marketed as more than artisanal but also ethical, developmental or fair trade, then Kimberley Process (KP) certification alone will be inadequate and a third-party certification system will need to be put in

place along the entire supply chain to assure chain of custody and potentially the process and production methods. There are actors developing systems that could be replicated.

**Getting the Jewelers' and Manufacturers' Priorities in Alignment.** There is a tension between trying to get win-win solutions for buyers and sellers given that trading relations in existing supply chain structures are not a partnership; it is about getting the best price at both sides. The CAR and Liberia are not attractive purchasing sites for US buyers because of probable issues of uncertainty and inconsistency of volume, quality and regularity of supply, and the cost of making buying forays to these countries. Similarly, US buyers are not attractive marketing options for ADM because they cannot offer the same type of financing and social support that present financiers are able to give. So, what is in the interest of the US diamond industry might not be in the interest of development for ADMs and vice versa.

**Miners' Level of Organization and Capacity to Engage.** Presently, organizational structures in the CAR and Liberian diamond sectors are largely informal. Most miners do not possess the required legal papers, nor do many diamond buyers. While a small number of legal miners have the capacity to engage with international buyers given their financial independence (and possibly "cooperative" structures), they represent a small minority within their national industries. Nonetheless, these few viable, independent mining enterprises should be contacted in the first instance to explore their interest in marketing their diamonds more directly to US or other international buyers.

**Competing with Existing Buyers.** The CAR and Liberia have been producing diamonds for decades, and their diamonds easily find their way onto the world markets. A viable direct marketing scheme to US buyers will therefore have to either incorporate the local buyers in a way that is developmental, or compete with them to attract miners to engage in the first place. This will require a substantial commitment on behalf of the US diamond industry, as well as a willingness to cooperate with the direct marketing support project in providing added benefits to artisanal miners, beyond offering slightly better prices.

**Pre-financing the Mining.** Buying diamonds from artisanal miners is only the final step in an economic relationship that starts with the prospective buyer agreeing to sponsor the necessary mining operations to recover the diamonds, which ultimately get sold to the established diamond exporters.

- Unless US diamond manufacturers are willing to invest in their own local supporting and buying networks, and take an approach that demonstrates a clear developmental impact, they will have no choice but to buy from the Monrovia and Bangui-based exporters. Such diamonds could only be marketed as "artisanal" and their impact on improved developmental outcomes and formalization rates would be negligible.<sup>7</sup>
- Not all artisanal diamond mines will be profitable. Most experienced local brokers support a range of operations in diverse places and run by a variety of miners. In this way, the profitable mines usually subsidize activities and thus employment in mines that are not. Any pilot to pre-finance direct marketing diamond miners would be wise to adopt the same strategy. While this reduces commercial risk, it increases the risk of failure in achieving the development gains necessary to market the diamonds as better than "artisanal" as there will be a large number of producers who will each need capacity building and facilitation in tackling their liabilities.
- The unpredictability of returns is likely to present major problems to international buyers. Reliable estimates on average volume and quality are needed; getting a notion of production quantity and quality is key. It is not surprising that the only people currently interested in funding mining operations do so on the condition that all discovered diamonds are sold to them.
- To bring about any significant change through direct marketing, at least partial pre-financing of mining operations will be necessary. There are five options for this.
  - Finance and work directly with an individual miner, who will need to adequately demonstrate the investment-grade of the deposits in his/her claim on a full or shared responsibility basis. The miner

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<sup>7</sup> They could, however, be marketed as artisanal, and conflict-free.

must either have existing financial (cash), physical (machinery), or human (labor) capital to deploy. There is a relatively high risk of miners defaulting, especially for foreign investors who are not locally visible, and thus have no prior established social relationships that can be used to safeguard the investment.

- Fund a group of miners on a collective basis. Essentially copying the middlemen's *modus operandi*, this transfers the risk to the group of miners being funded. Such a group, whether an informal miner's association or a more formal "cooperative"—whatever that may imply—will essentially become the debtor. As the experience of one development project, the Peace Diamond Alliance (PDA) in Sierra Leone has shown, it needs to be clear to the miners that this is not the traditional "support" or "pre-financing" from a foreign supporter instead of a local one, but a *loan* to a group of miners.<sup>8</sup> They need to understand that their handling of this loan will determine their eligibility for future loans. Altogether, this option would take some serious capacity-building efforts in the field of money management, savings, and investment. Finding a way to ensure the miners have a sense of collective benefit and responsibility would also be crucial.
- Help groups of miners become self-funding through the pursuit of supplementary economic activities with more predictable income and profit, which can be used to invest in the diamond mining. This follows the logic of artisanal miners' own household livelihood profiles as a strategy to manage risk and build resiliency. Gold mining should be especially promoted because it can increase value and returns without having to invest in other production activities or find other markets. Activities that make use of mined-out land, like fish farming or agriculture, are also good options because they incentivize environmental rehabilitation. This requires a long-term commitment (over five years).
- An adequate spreading of the risk inherent in funding ADM operations could potentially attract outside investors, such as traditional banks, or dedicated microfinance organizations. Successful repayment of initial loans could then be used to build up the creditworthiness of miners' associations. However, it remains unclear to what extent such a form of risk management would be deemed sufficient for non-buying actors to become involved. In the meantime, the financial support of potential US diamond buyers will remain necessary. Pilots will have to be undertaken to test the concept and prove its validity to potential financiers outside the diamond industry.
- The last option, a joint venture, is a combination between the first three models. It is this approach that some existing "fair trade" mineral suppliers carry out successfully with collectives of miners, not individuals. These operators are successful because, by working under the principles of transparency and partnership, they *do* have the local presence and trusting relationships that middlemen identify as crucial. They also bring other development benefits to the miners and their communities, and a condition of engagement is that all operations be legal.

## THE SCENARIOS

Present value chains in Liberia and the CAR comprise individuals or small gangs of laborers working under a miner, who then sells to a broker (middleman), who sells to an exporter, or a cooperative exporting directly (which is unusual). The middlemen perform essential commercial functions: pre-financing, transporting the diamonds from mine site to point of export, aggregating and sorting the diamonds, and marketing them to the right buyer. It is not conceivable for the miners<sup>9</sup> to do all this themselves or for the international buyers to come to multiple miners. Thus, there needs to be an entity performing these functions in *any* of the possible direct marketing structures.

The possible selling structures are individual miners (who employ groups of laborers) who sell directly to a buyer, as is the primary existing model OR individual miners organized into a cooperative or association

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<sup>8</sup> Levin with Turay, 2008.

<sup>9</sup> For example, mineworkers, mine managers; landowners who identify as miners but do not direct the work may be in a better position to go to other places to market their diamonds.

which has a marketing arm, e.g., as is done right now in the CAR or as Corporación Oro Verde (COV) does in Colombia. In both these scenarios, the miners may be independently financed, or not. Regardless of the funding situation, if international buyers are to source from individual miners, there will need to be a trusted local middleman to sort and aggregate the stones into parcels. A cooperative structure would allow the buyers to bypass local middlemen, provided the miners were self-funded or the international buyers offered finance. Though cooperatives do exist, the lack of “real” functioning cooperatives in the CAR poses a problem, as these will need to be developed, which is not a small feat.

There must also be an exporter. For example, the cooperatives could elect an individual to act as middleman exporter who would aggregate their wares, market them to the buyers, and stockpile these until the time came for export (e.g., when the buyers’ representative came to collect and export the parcel). Some capacity building and monitoring may be necessary. Alternatively, the buyers could pay for their export office to be manned with a trusted, local, experienced buyer/exporter, whose job it would be to buy, aggregate, sort, and parcel the diamonds in preparation for export on behalf of the syndicate. Monitoring would be necessary. Either way, this “DM diamond exporter” is an essential function and one that will be costly to set up, especially in the CAR.

Given these universal requirements, the possible direct trading scenarios are as follows:

- A **syndicate of US buyers** sources in the open market or, through setting up pre-financing, has structured relations with the miners. This would be a simple business deal to get artisanal diamonds from the CAR and Liberia straight over to the US. The only developmental aspect would be the potentially higher prices the cooperatives could achieve from the economies of scale to be gained from having just one middleman, being the “DM diamond exporter”. The prospects of such a scenario incentivizing formalization are slim unless the US buyers can offer a sizeable price improvement to the miners. **Next steps:** engage US diamond industry actors in a workshop to hammer out the nitty-gritty of developing such a syndicate from the buyers’ point of view. Then take the concept to the artisanal miners in the CAR and Liberia to solicit input.
- An **auction system** is introduced through which *any* local seller or international buyer could trade. This is an anonymous trading relationship that aims to transparently help both parties achieve “fair market value.” It may be important to find an independent certification monitor for rough diamonds mined by legal miners involved in the direct marketing support program. If such auctions and the volume of diamonds being offered through them become sufficiently widespread in the region, US manufacturers and other international buyers will have a reliable supply of diamonds. However, it is difficult to see how such auctions would be able to significantly change the availability of capital to fund mining operations. Added to that is the fact that miners typically have to sell their diamonds quickly, so may not be able to afford to wait for the auction to take place. US diamond industry stakeholders have also commented on the controversial nature of such auctions in the current trading climate, arguing that they are highly subject to boom and bust cycles. While the current sustainability of regional diamond auctions remains highly unclear, what is evident already is that, besides improving understanding among local industry as to how national diamonds are priced, auctions in themselves are unlikely to provide significant added benefits to diamond mining communities themselves, with the biggest beneficiaries being situated among diamond traders. **Next steps:** the introduction of an auction system could serve as an avenue for helping existing buyers get a higher price, and so engage them in a conversation on how to formalize the activities of this supply chain tier to enable them to market their wares through this mechanism and how they might increase the prices offered to miners. This option requires further probing.
- A **junior mining company** has open or structured relations with miners mining on their exploration concession. This can be either a trading relationship or a joint venture. For this to work there must be junior mining companies operating in the countries and interested in participating in a scheme like this; there are presently no such companies in Liberia or the CAR. Should any emerge, this option could be investigated. The legal ramifications must be confirmed in Liberia (though it would be legal in the CAR). **Next steps:** consult with national governments on the feasibility of this option and await the engagement of a suitable junior mining company.

- **An international “fair trade” buyer**, who has established successes in developing mining/marketing partnerships with artisanal miners works with the miners in a joint venture type of arrangement. Out of all the businesses occupying this space who were approached for the research, only one was willing to talk to us about its business model, but then in confidence. Its model clearly makes the miners co-responsible for the risks and co-beneficiaries in the rewards. It also involves bringing local authorities into the partnership. One of its main responsibilities is to commercialize its business partners’ (the miners’) diamonds. This means finding the right organizations to sort and cut them. A second option is to bypass manufacturers and manufacture jewelry directly using rough diamonds (in which one company, Ruff and Cut, presently specializes). Since fair trade requires capacity building of artisanal miners in a wide range of areas, as well as the allocation of a portion of profits in a development fund to be invested locally, this is a model that would bring the highest development benefits to the miners and would be most likely to encourage formalization. **Next Steps:** explore interest in bringing existing models to the direct marketing diamond countries either individually or in collaboration. Then a scoping mission should be conducted for them to assess the feasibility of applying their models in either country.
- **Piloting Development Diamond Standards (DDS)** is a further option. According to the definitions proposed in the DDS framework, “development diamonds” are diamonds “that are produced *responsibly; safely; with respect for human and communities’ rights; in conflict-free zones; with beneficiation to communities and payment of fair prices to miners.*” The most interesting aspect of the DDS is that it is a grassroots-oriented model, focused on community involvement, and is based on the reality of artisanal diamond mining and trading. Instead of trying to impose the most stringent requirements right away, the strength of the DDS lies in its evolutionary model, whereby miners are empowered to gradually improve their compliance with the more advanced standards in the DDS model. **Next steps:** Seek further information from the Diamond Development Initiative (DDI) as to how the DDS pilots work in practice and could be implemented in the CAR and Liberia to further assess the feasibility of collaboration. Consider how the DDS pilots are oriented at encouraging formalization, or not.

## CONCLUSIONS

Our research has found that most of the scenarios for the direct marketing scheme will probably do little to encourage formalization unless they find a way to incentivize the middlemen to aid the formalization of the sector and improve benefits to the miners. It will be extremely hard to lure miners away from their existing financiers given the cultural and social security aspects of their relationships. The costs of extra assurances that the diamonds bought through local middlemen are legally mined would have to be borne by international buyers, as they would be the ones benefiting from it: the current reality of diamond mining and trading in both countries shows that existing middlemen would have no problems with sustaining the status quo. On the other hand, if US buyers would be willing to engage more directly— that is to at least partially play a role in funding mining operations themselves, thereby empowering miners and shifting responsibility away from middlemen— a “snowball” effect may well result in a significant increase in formalization. Miners might then shift their selling relationships away from middlemen, to include international buyers as well.

The **fair trade partnership model** is the option most likely to encourage formalization because it is the only option explored which viably involves co-financing of the mining/marketing joint venture by the miners’ association and international buyer. The **junior mining company model** may also work to encourage formalization, provided the law provides protection for artisanal miners mining on an exploration concession and selling their diamonds to the concession-holder. The **DDI’s development diamond standards** may also prove an appropriate vehicle, but this must be further explored. Given the fact that only the jewelers seemed to be interested in establishing buying relationships with artisanal miners themselves, and that most buyers and manufacturers indicated their unwillingness to buy so directly from the source, the resulting “light” version of direct marketing will be mainly played out between US buyers and established local middlemen. In such cases, assuring the legality of all offered diamonds would be difficult, and being able to claim developmental benefits would be largely impossible. If the primary objective is to find cheaper sources

of rough diamonds, given the costs of setting up and running buying operations, and the limited extra supply it will bring to the US, it might not be worth the trouble for most US diamond buyers and manufacturers.

Given all existing caveats, a **direct marketing scheme** (whether a “full” or “light” version) **will not provide the significant advantage sought by US diamond buyers and manufacturers** who are facing strong international competition. Conversely, a “full” direct marketing scheme with associated development benefits for artisanal mining communities could bring such advantages to US jewelers. Branding a diamond as “helping development” does require significant investment to back up such statements. While this would create extra costs associated with it, and while such costs will be determined by the kind of assurances the jeweler will want to give to clients that such diamonds actually benefit local communities, it is too early to see what the correlation would be between such costs and the added premium that can be demanded for “ethical” or “development” diamond jewelry, and as such whether selling such jewelry would actually result in a significantly higher mark-up for the jewelers. Whatever the outcome, a fully implemented direct marketing scheme could result in giving jewelers the required tools needed to reach out to a socially and environmentally conscious consumer market. It should be realized also that a direct marketing scheme, likely to be capturing only a tiny segment of the diamond markets of both the CAR and Liberia, could not on its own effect the change needed to successfully transform those economies or stimulate the formalization of these sectors.

# 1.0 INTRODUCTION

## 1.1 PURPOSE OF THE RESEARCH

The research for this feasibility study was carried out under the US government-funded Property Rights and Artisanal Diamond Development (PRADD) project.<sup>10</sup> The purpose of this research was to ascertain the feasibility and desirability of establishing more direct trading relations between artisanal miners in the Central African Republic (CAR) and Liberia and international buyers—with special attention to the US diamond industry—on the premise that increasing the price received by artisanal miners may contribute to making them more able and thus likely to formalize their activities. The key lines of enquiry were:

1. What are the trading scenarios that would enable the miners to work under better conditions, achieve closer to fair market value, and operate within the formal sector?
2. What are the trading scenarios that could help revive flagging portions of the US diamond industry?
3. Is it possible for there to be a win-win situation for both artisanal diamond miners and US industry players that would incentivize formalization of artisanal diamond mining (ADM) and ultimately be developmental?

The scope was minimally expanded to introduce consideration of microfinance and auctions as possible solutions to likely impediments to direct marketing, on which our findings are preliminary.

## 1.2 METHODOLOGY

The research approach involved consulting key stakeholders from along the supply chain to get an understanding of the present political economy and supply chain logic, including incentives and obstacles to formalization within Liberia and the CAR, the achievement of fair market prices by the ADM sector, and what profitable engagement might look like for the manufacturers and jewelers. Research involved the following methods:

- *Relevant documents were reviewed*, namely legal codes, and reports and articles by journalists, academics, nongovernmental organizations (NGO) and consultancies on ADM in the CAR and Liberia and direct marketing experiences from artisanal miners elsewhere in the world.
- *Relevant statistics were collected and analyzed* from government publications and sources.
- *Field research* was conducted in the CAR in March and April 2011 and in Liberia in April 2011, comprising primarily:
  - Semi-structured interviews and focus groups (where appropriate) with key informants in six diamond mining communities as well as with international experts on artisanal mining, the diamond industry, and the political economy of Liberia and the CAR:
    - For Liberia, such experts included representatives from the US Embassy, academics, consultants, the United Nations Mission in Liberia (UNMIL), and a civil society organization. In the CAR, experts included, but were not limited to, representatives from the Kimberley Process (KP); and
    - In both countries, consultations were held in the capital with the respective mines ministries, as well as with dealers (including buying houses), brokers, and artisanal miners.

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<sup>10</sup> Section 9 of Public Law 108-19, The Clean Diamond Trade Act, provides the authority for “the appropriate agencies of the United States Government to make available technical assistance to countries seeking to implement the Kimberley Process Certification Scheme.” In cooperation with the US Department of State, the US Agency for International Development (USAID) Economic Growth, Agriculture and Trade (EGAT) Land Tenure Unit manages the PRADD project. Tetra Tech ARD, which implements the project in the Central African Republic and Liberia, contracted Estelle Levin, Ltd. for this study.

- The second part of each research trip was spent visiting mining areas:
  - o In the CAR, time was spent interviewing local government officials, local dealers and brokers, artisanal miners, diggers, and *débrouillards* in the villages surrounding and including Boda and Nola<sup>11</sup> in the western part of the country; and
  - o In Liberia as well, attention was focused on the western counties,<sup>12</sup> with work done in the villages of Weasua and Mano River Kongo, where interviews and focus group discussions were organized with Ministry of Lands, Mines and Energy/Government Diamond Office (MLME/GDO) representatives, artisanal miners/diamond boys, and local diamond brokers.
- *Semi-structured telephone interviews* were held with nine key informants in the diamond manufacturing industry and “mainstream” and “ethical” jewelry retailers. People were purposively sampled and snowballing was also done.
- *Semi-structured telephone interviews* were conducted with 13 key informants with experience of successful and unsuccessful direct marketing schemes with artisanal miners.

### 1.3 RESEARCH LIMITATIONS

In the CAR and Liberia, the research was limited by the following factors:

- A short period of time was allocated for research in both countries (10 days each), including weekends, when it is often difficult to meet officials; interesting stakeholders could not be interviewed due to time constraints.
- In Liberia, the communication infrastructure is far more limited.
- Due to a previous research trip to Liberia, key contacts in Monrovia and in the field had already been made.
- We could not find serious civil society organizations working on artisanal and small-scale mining (ASM) or large-scale mining (LSM) in the CAR. In Liberia only one such organization was found. Civil society voices are unfortunately lacking in our research.
- Due to elections (2<sup>nd</sup> round parliamentary) and a national holiday while in the CAR, it was impossible to meet some people, or revisit them with extra questions after the field trips.

The consultation of key informants in the US diamond and jewelry sectors, and of people who have attempted to set up programs with ADM elsewhere, was supposed to take just two days; in the end the authors spent a total of seven days organizing, conducting, and analyzing these interviews. Nonetheless, these interviews are designed to generate information and opinion from leading industry figures on key opportunities and challenges to establishing more direct trading relations between the US and the CAR and Liberian diamond industries. As such, the interview findings are *indicative* of industry opinion, and not *conclusive* as “facts.”

### 1.4 TERMINOLOGY AND KEY CONCEPTS

***Direct Marketing*** means attempting to bring the miner closer to the market by shortening the value chain. Direct marketing suggests proactive marketing of diamonds by miners to an international buyer. In this report, however, we are as interested in the potential for buyers to source more directly from miners. Rather than speaking of “direct sourcing” or “direct marketing” we frequently use the phrase, “more direct trading relations” to signify relationship building from both sides of the diamond supply chain.

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<sup>11</sup> The villages of Boda and Nola were selected because the PRADD project has been engaged in this region since its inception, and as a result they offer the best possibility to identify formal mining operators with the capacity to engage in a direct marketing scheme.

<sup>12</sup> As the PRADD project was still in its infancy in Liberia at the time of the fieldwork, and did not yet have a permanent regional presence as in the CAR, there were at the time no “PRADD-villages”. However, PRADD has since set up field offices and commenced activities in the western counties of Gbarpolu and Grand Cape Mount.

**Middlemen** are the intermediaries operating between diamond exporters and artisanal miners. Usually, two or more levels of intermediaries are needed to successfully bring the diamonds from the mine to the point of export, though there may in fact be many more involved. The roles and responsibilities of middlemen are firmly identified in the Mining Codes of both the CAR and Liberia, although a great many of them are informal operators who do not possess the required legal papers.

**“Directly Marketed” (DM) Diamonds** are diamonds that have been mined by artisanal miners associated with a direct marketing support project. For a direct marketing scheme of these diamonds to have a significant impact on formalization of the diamond sector and development of mining communities, certification will be necessary to demonstrate such an impact to the jewelers and their clients and distinguish such “developmental” diamonds from other artisanally mined stones.

**Formalization** is “*the process of integrating rather than controlling extralegal enterprises by recognizing local arrangements in legislation, reducing barriers to legalization and creating clear benefits from participation in the formal system.*”<sup>13</sup> Through formalization, informal or illicit miners are encouraged to join the legal economy by becoming registered miners operating in accordance with the Mining Code and other relevant legislation. This is a requirement of the Kimberley Process Certification Scheme (KPCS), the credibility of which depends on the traceability of diamonds to their mines of origin. While formalization can bring benefits to artisanal miners by giving them access to legal protection, it remains a costly and time-consuming process. Current government-led formalization strategies have largely reached their maximum effectiveness, with the majority of miners continuing to work on an informal basis.

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<sup>13</sup> Hinton 2009, in Hinton and Levin, 2010, p. 10.

# 2.0 THE SELLERS

## 2.1 KEY FEATURES OF THE CAR'S AND LIBERIA'S ARTISANAL DIAMOND SECTORS

The table below shows diamond exports from CAR and Liberia. Given the UN diamond sanctions which lasted until 2007, KP statistics for Liberia go back to 2007 only. Data is from the Kimberley Process Certification scheme, 2011.

<b>CAR Diamond Exports 2004-2009</b>					<b>Liberia Diamond Exports 2007-2009</b>			
<b>Year</b>	<b>Production</b>		<b>Export</b>		<b>Production</b>		<b>Export</b>	
	<b>Volume cts</b>	<b>Value US\$/ cts</b>	<b>Volume cts</b>	<b>Value US\$/ cts</b>	<b>Volume cts</b>	<b>Value US \$/ cts</b>	<b>Volume cts</b>	<b>Value US\$/ cts</b>
<b>2004</b>	348,205	\$148.50	349,451	\$147.64	N/A	N/A	N/A	N/A
<b>2005</b>	382,756	\$158.25	382,756	\$158.25	N/A	N/A	N/A	N/A
<b>2006</b>	419,528	\$140.79	415,526	\$142.15	N/A	N/A	N/A	N/A
<b>2007</b>	467,711	\$127.98	417,711	\$143.30	21,699.74	\$122.47	21,699.74	\$122.47
<b>2008</b>	377,209	\$126.59	377,210	\$126.59	47,006.50	\$210.43	47,006.54	\$210.43
<b>2009</b>	311,779	\$151.03	402,679	\$115.98	28,368.27	\$396.94	27,731.85	\$329.07
<b>Average</b>	<b>384,531</b>	<b>\$142</b>	<b>390,889</b>	<b>\$139</b>	<b>\$32,358</b>	<b>\$243</b>	<b>32,146</b>	<b>\$221</b>

### 2.1.1 CAR

- Production:
  - Total production ranges between 300,000 and 420,000 carats of rough diamonds per annum. This is believed to be 80% of actual production.
  - 400,000 people depend on ADM for their livelihood.<sup>14</sup> This translates as approximately 1.4 carats per person per annum.
  - Over 2.8 million people directly or indirectly depend on the diamond sector for their livelihood.<sup>15</sup>
  - Exploration by junior companies is minimal; the few investors seem to have mostly withdrawn during the 2008 crisis.
  - 100% of production is artisanal and the government appears to have a realistic view on the lack of significant potential for industrial-scale diamond mining.

<sup>14</sup> Hinton and Levin, 2010.

<sup>15</sup> Hinton and Levin, 2010.

- Trade & Export:
  - High entry-costs for international buyers;
  - High export tax (12% or 9% for a mining cooperative);
  - Lack of available funding for artisanal miners; and
  - Decentralized buying networks, with diamond exporters required by law to establish regional buying offices.
- Price:
  - Average dollar per carat value range is \$125—\$160 / carat; however this is likely inflated (see below).
  - Lower prices of diamonds to ADM because of few marketing options, structured relations of support and high costs borne by exporters.
- Other issues:
  - Present instability in the east, where significant diamond deposits are located, makes it difficult for foreign investors. Attacks on diamond buyers by the various militias operating in those territories are frequently reported.
  - Diamond production is strategically important for revenue collection (second biggest export).

## 2.1.2 LIBERIA

- Production:
  - Liberia's first shipment of diamonds after the lifting of UN sanctions was made late in the year on 5 September 2007.<sup>16</sup> This explains the low volume of exports in 2007, while the 2009 drop can be ascribed to the 2008 global financial crisis.
  - Liberian production of and revenue from rough diamonds is a small fraction of the same sector in the CAR.
  - Total production ranges between 22,000 to 47,000 carats per annum.
  - 50-100,000 men, women and children do ADM.<sup>17</sup> This translates into 0.2 to 1 carat per person per annum.
  - Exploration companies continue to prospect in search of primary or economically viable secondary deposits, yet diamond mining remains exclusively artisanal and small-scale. However, the government is focused on encouraging the industrialization of the sector and does not have the same constructive attitude toward artisanal mining as the Government of the CAR (GoCAR).
  - Highest quality diamonds are found in the western mining counties, bordering Sierra Leone.
- Trade & Export:
  - Diamond buying is significantly more centralized than in the CAR, as it is currently forbidden for diamond exporters to buy diamonds up-country. Instead, they are forced to work with brokers.
  - Miners report a lack of available funding to sustain mining operations.
  - Export taxes are at 3%.
- Price:
  - High dollar per carat value is noticeable. Recent statistics show a steady increase in value/carat of rough diamonds, however, the statistics for these years do not give dependable numbers: Liberia was only able to export part of its annual production in 2007; 2008 and 2009 were exceptional years owing to the global financial crisis, and 2010 figures are likely to be inflated by a number of 80+ct. stones.

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<sup>16</sup> Date mentioned by Hon. Carlton S. Miller, the KP Focal Point, and Deputy Minister of Lands, Mines & Energy for Planning and Development during his presentation at the 2011 LIMEP conference.

<sup>17</sup> Hinton, 2010.

- Other issues:
  - Excellent lines of communications must be maintained with ministries, given the massive changes such direct-marketing schemes may bring about;
  - Diamonds are *not* strategically important for revenue production. On average, the Government of Liberia (GoL) earns \$1 million from diamonds annually. The cost of implementing the KPCS is estimated at about \$750,000, meaning that the country barely benefits from its diamond industry.
  - Artisanal mining remains underrepresented in the Mining Code.

## 2.2 CENTRAL AFRICAN REPUBLIC

The CAR is located in the heart of the African continent. A landlocked country, its neighbors are Chad (north), Sudan (east), both Congos (south), and Cameroon (west). The CAR (known as Oubangui-Chari during the colonial period), gained its independence in 1960, and like many other former colonies, still retains strong ties with France. International observers argue that France’s support remains a major factor.<sup>18</sup> The current president took power by means of a military coup in 2003, and in 2005 was elected to the position and reelected in 2011. The president’s party, KNK,<sup>19</sup> has a very comfortable majority, although a multi-party political system seems to be slowly blossoming, with a media that is deemed reasonably independent by foreign observers.

Despite these encouraging trends, the eastern part of the country has been the home of a number of “rebel” groups, some more hostile than others. Recent years have seen a rising number of incursions by the Lord’s Resistance Army (LRA), which is operating in several countries surrounding its Ugandan homeland.<sup>20</sup>

The CAR’s diamond industry is a close-knit community counting only a handful of important players, all under the watchful supervision of the presidency. Together with timber, diamonds are the country’s top export product. The stones are highly lucrative for political and commercial players, and they earn the second largest amount of foreign currency for the country. Indeed, 2009 diamond exports valued 49.3 million USD, with timber exports totaling 52.3 million USD.<sup>21</sup>

Diamond mining operations in the CAR are conducted in the southern, western and eastern parts of the country. Deposits are considered to be part of the same diamondiferous “belts” that link to mining sites in Cameroon, the Republic of Congo and the DRC in the east. Extraction is primarily artisanal in nature, with some small-scale (semi-mechanized) operations undertaken by the limited few who have access to sufficient funding partnerships. Given the highly informal nature of these operations, it is difficult to quantify the economic importance of the diamond mining sector, but estimates suggest that around 400,000 people are active as diamond miners and diggers (the latter are called “nagbata” in Sango, the most widely spoken indigenous language). Taking into account the family members these individuals support, it becomes clear that ADM is one of the principal livelihoods in this sparsely populated country.<sup>22</sup> CAR diamonds are of generally very high quality, especially those coming from the eastern mining zones.<sup>23</sup>

Diamond prospecting and exploration activities have been conducted in the past by a number of international companies, including the diamond giant De Beers, but to date none has returned to advance projects due to the lack of economically viable deposits for industrial-scale endeavors. As a result, ministry officials have generally acknowledged the primacy of the artisanal and small-scale structure of the country’s diamond industry and are more amenable to suggestions to improve artisanal mining than other governments in the

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<sup>18</sup> Hansen, 2008.

<sup>19</sup> Kwa Na Kwa, meaning “Work, nothing but Work”.

<sup>20</sup> International Crisis Group, 2010.

<sup>21</sup> Economist Intelligence Unit, 2011.

<sup>22</sup> Levin and Hinton, 2010, p. 1.

<sup>23</sup> Interviews with diamond buyers, 2011.

region. This attitude, coupled with the existence of projects like PRADD, offers great opportunity for reforms that can lead to the development and further professionalization of this hitherto highly informal sector.

Despite the degree of attention at the highest levels of government, Bangui's involvement in the diamond sector seems limited to the highest echelons of the diamond value chain. The few government units (primarily the *Brigades Minières*) located outside of Bangui are tasked with monitoring the implementation of the Mining Code. These units, however, are chronically underfunded. The estimations of the degree of formalization do not exceed 10%. Yet, according to government sources, no less than 80% of the CAR's diamonds exit the country legally, i.e., attached to a legitimate CAR Kimberley Process Certificate. Much of this has to do with the way diamond trading is set up in the CAR. Through their local branches, the Bangui-based buying houses function as hubs for dense networks of independent collectors, tasked with engaging directly with artisanal mining communities. In addition, there are numerous semi-legal operators who connect formal and informal trading networks.

## 2.2.1 FORMAL DIAMOND MINING AND TRADING STRUCTURES

Under the new government of April 2011, the Ministry of Mines, Energy and Hydrology that was led by Lieutenant-Colonel Sylvain Ndoutingäï, has been split into two ministries. Ndoutingäï's former responsibilities are now divided between a regular Minister in charge of Energy and Hydrology while a special "Minister delegated to the Presidency" has been put in charge of a new Ministry of Mines.<sup>24</sup>

### ARTISANAL AND SMALL-SCALE MINING

The current Mining Code,<sup>25</sup> dated April 2009, is the main legal document outlining rights and responsibilities of all stakeholders in the mining industry. It was further expanded by a presidential decree presenting the Mining Code's practical application.<sup>26</sup> The Mining Code has different sections for what it calls "artisanal," "semi-mechanized artisanal mining," and "industrial mining." "Artisanal mining" is defined as "all activity by which a physical person of Central African origin, in an artisanal exploitation zone (AMZ) delineated in area and depth to a maximum of 30 meters, extracts and concentrates mineral substances using non-industrial, manual tools, methods and processes that are limited in mechanization"(Art. 1). Article 15 states the government's wishes to see artisanal mining operations evolve into small-scale mining operations. This shows intent to help professionalize the sector, for which formalization and the types of intervention PRADD is doing are important first steps.

According to the mining code, ASM is allowed for all CAR citizens, as well as mining cooperatives whose capital is Central African in origin. To mine a deposit in an artisanal fashion, it must first be established that said deposit could not be exploited in an "industrial or semi-mechanized" manner. Following that, the specific zone is to be marked an "artisanal mining zone," an act which can be revised under the following conditions: if and when "circumstances" that have justified the institution of this zone are revised; or new deposits have been discovered which may be exploited in industrial or semi-mechanized fashions (Art. 64). In practice however, the CAR government has never established these designated AMZs. Article 67 goes on to state that artisanal miners who want to mine one of these AMZs should possess a "*carte d'exploitation artisan*," commonly called a *patente*. The *patente* is valid for one year and can be renewed annually. A miner is called the *chef de chantier*, indicating that the miner is often the one with customary title to the mining area, or has negotiated access with the landowner. In addition to the *patente*, a miner is obliged to buy additional permits for his/her laborers, with a minimum of five permits. The miner must also buy a production notebook for recording all diamond recoveries. When one speaks of the CAR's formalization rate being just 10%, the implication is that just 10% of operations are run under a *patente*.

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<sup>24</sup> Ministre délégué à la Présidence du République, chargé des Mines: M. Obed Namsio, ND.

<sup>25</sup> République Centrafricaine, 2009a.

<sup>26</sup> République Centrafricaine, 2009b.

A potential miner can also apply for a prospecting license, issued to all nationalities for a period of one year, with a maximum coverage of 5000 km<sup>2</sup> (Art. 76-77). This type of license, however, is not relevant for the overwhelming majority of informal miners. Those wishing to mine outside delineated AMZs are required to pay for a special license (or “*autorisation d’exploitation artisanale*”) valid for two years renewable, to mine an area of maximum 6,500 m<sup>2</sup> (Art. 68-70). Legally speaking, given the absence of specific “artisanal mining zones,” this would mean that all legal mining operators have to possess both the *patente* and a license, although in practice this is only required of cooperatives.<sup>27</sup>

These cooperatives are another option for legal ASM, and one that is strongly encouraged by a government that sees in it a perfect vehicle to boost both transparency and production. However, this has little applicability in encouraging formalization, as one of the pre-conditions for setting up a cooperative is that it must be an organization comprised of at least 10 licensed miners. In other words, the cooperatives are only possible for already licensed miners. One of the ways in which the government is encouraging the formation of cooperatives is by allowing them to export directly—thereby by-passing the established buying houses—if the exported diamonds are valued at a minimum of 40,000 USD. Furthermore, instead of the regular 12% export tax, cooperatives only have to pay 9%.<sup>28</sup> Cooperatives can do this by applying for membership to the National Union of Mining Cooperatives (UNCMCA), a body formed specifically for this reason.<sup>29</sup>

Finally, any stake in the mining industry, whether it is artisanal, small-scale, or industrial mining, is forbidden for government employees (Art.48), although this aspect of the Mining Code is rarely enforced.<sup>30</sup>

## TRADING

Whether formally or informally recovered, most CAR diamonds are exported by one of the few Bangui-based buying houses. Currently, only four buying houses conduct regular business, with a fifth in the process of being established.<sup>31</sup> All buying houses have their headquarters in Bangui, and are obligated to establish at least 5 regional offices within one year of commencing operations. They are also required to construct a 350,000,000 CFA (784,000 USD) building, on grounds released freely by the state for this purpose. The building is turned over to “the state or local collectivities” after completion. In addition, buying houses are obligated to turn over a sum of 50,000,000 CFA (112,000 USD) to the Treasury as a warranty. This warranty can only be repaid when the buying house decides to terminate its activities in the country—provided the required building has been constructed and turned over to the government. At this point, 5 million CFA (11,200 USD) will be deducted for each year of operation, counting back to the installation of the buying house (Art. 154-155). These and other measures have limited the number of buying houses, which means the formal market remains uncompetitive. Since 80% of diamonds are exported through these legal buying houses, this translates into lower prices for the miners, be they formal or informal.

Regional branches of the buying houses are led by a buyer or *acheteur*, who is an employee of the buying house and controls a vast network of diamond buyers called collectors (*collecteurs*). These collectors are funded as independent contractors by the buying houses and engage directly with the *chefs de chantiers* and their laborers (or *nagbata*). The collectors are often the ones supporting (or pre-financing) mining operations. In return, they have a right of first refusal of the product. The collector then goes on to sell the diamonds either to the buying house that has contracted him or another exporter. In the former case, the product makes its way to

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<sup>27</sup> Interview, Director-General of Mines. Bangui, March 2011.

<sup>28</sup> Though the export rate for cooperatives is 3% lower than for the exporter buying houses, this does not necessarily translate into higher prices for the miners as the cost of being a cooperative is high (e.g., UNCMCA registration, membership of cooperative and Chamber of Commerce, legal paperwork, etc.).

<sup>29</sup> Interview, UNCMCA leadership, government officials. Bangui, March 2011.

<sup>30</sup> International Crisis Group, 2010, p.20.

<sup>31</sup> These four are ADR, SODIAM, BATICA, and COMIGEM (a government-established buying house). A fifth buying house, SINOSANGO, has reportedly been opened recently with Indian backers, and sometimes a sixth—INICA—is mentioned, although that one is not known to have exported anything.

the head offices of the buying houses in Bangui. In the latter case, the product makes its way into whatever supply chain the exporter is part of.

## **THE ROLE OF THE GOVERNMENT, AND THE IMPLEMENTATION OF THE KIMBERLEY PROCESS MINIMUM REQUIREMENTS**

Based on a legacy monitoring system introduced in the 1980s and adapted to meet the Kimberley Process's minimum requirements, the CAR's paper-based diamond traceability and internal controls system is comprised of buying slips (*bordereaux d'achat*). These are slips of carbon paper that accompany diamonds on their voyage from mine to exporter. These are issued by BECDOR, the government agency responsible for the evaluation and certification of diamonds and gold, to all legal diamond buyers. The carbon copies of these *bordereaux* are meant to enable the traceability of diamonds exported from Bangui back to the collector or regional buying house which bought them from the artisanal miner. The latter is obliged to record the diamond in its own production notebook. Mining officials working for one of the regional Mines Directorates regularly collect the slips from regional buying houses and collectors in order for BECDOR to be able to reconcile diamond production with exports. BECDOR also conducts a second diamond valuation (the first being done by the buying house wishing to export), in order to eliminate deliberate under-valuation of diamonds. The export taxes are calculated using the higher of the two valuations.<sup>32</sup>

After their value has been determined and they have been approved for export, the diamonds have reached the end of their long road from mine to export in the office of the government's KP Focal Point. A Mines Ministry official is responsible for making the final call over whether all minimum requirements of the KPSCS have been followed, and adequate traceability levels have been assured. After, a KP Certificate is then created and the diamonds are sealed in a tamper-proof container, awaiting export to Antwerp, Dubai, or other diamond trading and/or manufacturing centers.

Locally, the integrity of the CAR's internal controls system is monitored by the Mining Brigades, in conjunction with one of the four Regional Directorates of the Ministry of Mines. As the Mining Brigades are stationed in all major mining and trading hubs, they perform an essential function in the regulation and monitoring of the CAR's diamond industry. Comprised of active-duty *gendarmes* (paramilitary police, second to the Ministry of Defense) and policemen working under their command, their role entails issuing the required legal papers to all CAR nationals who wish to become legal artisanal mining operators and curbing illicit mining and trading activities.

Apart from the aforementioned institutions that apply and enforce the Mining Code and implement the KP minimum requirements, a special entity, the *Direction d'Appui à la Production Minière* (DAPM), exists within the Mines Ministry. The role of the DAPM is to encourage formalization of artisanal mining and provide training and technical assistance. However, the DAPM does not provide pre-financing to miners, although it recently (December, 2010) provided free equipment (shovels, pumps) to interested artisanal miners. According to DAPM's director, however, only miners belonging to registered cooperatives were eligible for the support.<sup>33</sup>

### **2.2.2 ACTUAL DIAMOND MINING AND TRADING CHAINS AND REASONS FOR INFORMALITY**

The overwhelming majority of ADM activities in the CAR are conducted in varying levels of informality at greater or lesser variance from the formal diamond value chain as described in the Mining Code. The reasons for this are fairly straightforward; most miners simply do not have the funds to pay for the *patente*, the cards for their laborers, and their production notebook.<sup>34</sup> Ultimately, the main challenge to overcome in order to develop the CAR's artisanal diamond sector is the widespread lack of funding. According to miners, this is a fairly recent development in the CAR.

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<sup>32</sup> Interview with the director of BECDOR, diamond buyers. Bangui, March, 2011.

<sup>33</sup> Interview, Director of DAPM. Bangui, March 2011.

<sup>34</sup> Interviews with CAR artisanal miners, March 2011.

Miners that do not have agreements with legitimate collectors (who often pay for the required legal paperwork) find themselves in a very insecure position. It is unrealistic to ask individual miners who have no way to ensure that they are going to find funding, to spend a lot of money (which they are unlikely to have without mining illicitly) on procuring a license without knowing if they are actually going to be using that license. Also, especially in remote rural areas, the risk of getting caught mining illicitly by the government is very low, further reducing the incentive for miners to formalize.

The common view is that mining legally versus illegally is primarily the responsibility of the artisanal miners. As some portion of miners (perhaps the majority) is sponsored by and sell diamonds to informal middlemen, in this case having a *patente* would not change their illegal status. According to the law, having a *patente* brings miners who sell to unlicensed middlemen no legal security. This state of affairs also undermines KP internal controls, as diamonds bought and sold by unlicensed middlemen enter the government's official chain of custody only when the illicit middlemen sell to licensed buyers. *In other words, the legality of mining operations is largely dependent on the legality of the actor funding those operations.*

This element is not mentioned in the Mining Code. Only approximately one third of legitimate collectors attend to the legal paperwork for the miners they support. Thus, while the law is treating artisanal miners as independent economic actors, they are in reality employees of their sponsors. As employees, miners mine diamonds in exchange for the price that the sponsor is willing to pay minus incurred costs. Given the fact not mentioned in any of the legal frameworks that most miners are working exclusively under verbal agreements that bind them to sell their diamonds to their sponsors, it seems unreasonable to expect them to be responsible for their own licenses. In many instances the miners are not contractors who have a certain degree of freedom to choose to whom they sell their diamonds.<sup>35</sup> Furthermore, given the generally higher levels of education and business skills of diamond buyers, it is unreasonable for the Ministry to expect miners to shoulder similar kinds of legal responsibility. Therefore, rather than trying to “flush out” illicit miners directly, emphasis should be placed on monitoring the activities of diamond buyers, who provide the funding without which most illicit miners would be unable to carry out their activities. The government's emphasis should be on encouraging diamond buyers, rather than miners, to formalize their activities.

## **LES DÉBROUILLARDS**

In most other countries in sub-Saharan Africa, illicitly mined diamonds can enter the legitimate diamond trade in a number of ways. One scenario is that illicit miners sell their product to informal middlemen who subsequently sell to licensed diamond buyers, whereby the latter usually perform some creative accounting in order to pass off said diamonds as originating from a licensed mining operation. A second option is for licensed diamond buyers themselves to straddle the legal-illegal divide, sponsoring both legal and illegal mining operations. A third option is for the illicit miners to sell the diamond to a licensed miner who subsequently sells the diamond as if it was recovered from his or her own mine. Which of these avenues is ultimately taken depends largely on the identity of the sponsor of the mining operations, and the extent to which that individual is engaged in the diamond industry as a full-time actor or an occasional investor.

In the Central African Republic, one sees all of the above selling strategies. Significantly, given the extremely low levels of formalization and the large numbers of actors who are willing to provide such services, they are known by the common denominator as “*les débrouillards*.” These are probably the most significant actors in the CAR diamond industry, and fill the vacuum left by the buying houses and legitimate collectors, who are unable to provide sufficient funding.

A *débrouillard* often possesses a *patente*, though they rarely operate their own mines and generally have no mining claims linked to their license. Instead, these middlemen take up the function of informal collectors. According to the law, such actors are illegal operators. It is forbidden for artisanal miners to buy diamonds

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<sup>35</sup> It appears that the Mining Brigade actively supports this practice, taking sides with collectors in eventual disputes, as it would improve overall transparency of the trade. Artisanal miners however, argue that the mining brigades are too closely involved with the collectors, and are not independent.

from other claims, just as collectors are not allowed to buy diamonds from other collectors.<sup>36</sup> Nevertheless, *débrouillards* provide an essential service to the vast numbers of miners who cannot receive these services from the legitimate collectors. By doing so, a *débrouillard* serves a purpose: he accumulates illicit production, passing it off as coming from his own—usually nonexistent—claims. At this point, he enters that production into the legitimate diamond value chain. This is likely to be the main reason why the CAR, despite having only a 10% formalization rate, manages to keep approximately 80% of its diamond production from getting smuggled out, even with its high export taxes (presently at 12%). While artisanal miners generally complain about these informal middlemen, some of them have suggested that they prefer dealing with them instead of legitimate collectors. Despite reportedly offering better diamond prices (likely made possible by not having to buy the licenses), they are also better situated within the mining communities. These actors fulfill a type of social security role, stepping in with assistance in times of crisis. This trend is similar to other instances reported of such patron-client relationships, whereby the client gives up independence in return for a certain degree of protection by his patron. The Sierra Leonean mining areas are an example of one such scenario.<sup>37</sup>

Often, these *débrouillards*, who may eventually rise to become legitimate collectors, are not CAR nationals.<sup>38</sup> Most commonly referred to as “the Muslims” (*les musulmans*), many are of West African background, though some are also from neighboring Chad.<sup>39</sup> During the course of interviews and focus groups, artisanal miners expressed frustration with offering hospitality to ostensibly poor foreigners, who, after only a few diamond transactions, started large construction works in neighboring villages and towns. In other words, the artisanal miners realize that they are being “cheated,” yet prefer to work with the proverbial devils they know. After all, being unlicensed miners, they do not have much latitude or bargaining power to look for better alternatives. In addition, they have given their word to the *débrouillards* to sell them any recovered diamonds. This cultural aspect of artisanal mining is often neglected in the literature, where both actors (the miner and the middleman) are represented as rational individuals acting out of a profit motive only. Added to that, many interviewed miners reported being physically threatened by *débrouillards* (as well as some collectors) when they felt the miners were withholding stones, or attempting to sell their product to others.

#### COOPERATIVES IN NAME ONLY

The formation of artisanal mining cooperatives is strongly encouraged by the government, which sees in it a vehicle to boost transparency as well as diamond production. To this end, the government has set up the National Union of Mining Cooperatives or UNCMCA, through which cooperatives are given the right to directly export their production, and this at lower levels of taxation (9% instead of 12%) than the commercial buying houses.<sup>40</sup> In order to create a cooperative, a minimum of ten licensed miners must agree to work together, draft internal regulations, and apply to the Ministry of Mines for permission to formally set up a cooperative. They must also pay the necessary fees to the Chamber of Commerce and other business-related government institutions. Once a cooperative is legally incorporated, it can apply for membership to the UNCMCA, for which another 60,000 CFA is needed, after which an annual renewal fee of 30,000 CFA needs to be paid for continued membership. All in all, it is a relatively expensive and burdensome process, and one that is beyond the reach of the vast majority of subsistence miners, who are currently unable even to pay their *patente*.

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<sup>36</sup> Interviewed independent collectors have however confirmed that, after they pressured the government on this point which they saw as detrimental to their business activities, the President supposedly agreed to suspend this specific piece of legislation, making it once again legal for collectors to buy diamonds from non-miners.

<sup>37</sup> Levin with Turay, 2008; Levin and Gberie, 2006.

<sup>38</sup> The reverse can also be true: it has been reported that many collectors have become *débrouillards*. This would make it impossible for them to obtain a *patente*, making it logical to assume that “*débrouillard*” is in fact a name attached to anyone involved in the informal mining industry as either a sponsor of diamond miners or a buyer of diamonds.

<sup>39</sup> Some Muslim collectors are CAR nationals. Between 9 and 15 percent of the population of CAR is Muslim.

<sup>40</sup> It is unclear to what extent the government-owned COMIGEM buying house, which is now undergoing a series of internal reorganizations after fraud and mismanagement allegations, will be exempt from certain taxes as well.

The existence of cooperatives suggests that direct marketing is more possible than not, as these institutions benefit from economies of scale that make more direct trading relations with international buyers appear feasible. However, the majority of registered cooperatives are not what they appear to be. Of the more than 130 cooperatives registered to the UNCMCA, only 20-25 are considered to be “real” cooperatives by the UNCMCA management. Other stakeholders in the diamond industry have confirmed this, explaining that most of these “cooperatives” have no intention of conducting diamond mining operations but were set up only to enable the trade of diamonds more cheaply than working through regular diamond trading channels. UNCMCA spokespersons confirmed this. More significantly perhaps, is the fact that even the few “real” cooperatives have very little to do with the income-pooling, profit sharing institution that a cooperative is supposed to be. In reality, given the overall lack of funding, these “cooperatives” function like small enterprises, with one *primus inter pares* who has access to capital and who is paying all the required licenses for his or her fellow cooperative miners, essentially becoming the head of a small-scale mining business. Given the complete failure of incorporating actual profit-sharing cooperatives in the global artisanal diamond mining industry, it is not necessarily a bad thing that these “business cooperatives” have nothing to do with cooperatives in the true sense of the word.<sup>41</sup> On the contrary, they can be regarded as promising examples of a much-needed professionalization and development of the artisanal mining sector.

However, only the happy few who have access to outside capital investment or have substantial savings of their own can envisage operating such a cooperative. Most ordinary miners who have tried to set up a cooperative did so out of enthusiasm and the hope that this would enable them to find sponsors. In reality, most of these cooperatives are barely in existence today because they have not been able to pay the required annual fees, and have only one or two members that are still mining and able to pay their *patente*. Although provisions were made to make it possible for cooperatives to pay one single license for the cooperative as a whole instead of individual *patentes* for the members, this has seemingly not been implemented, leading to considerable confusion among struggling members of cooperatives and local mining officials.

In addition, considerable misgivings exist over the UNCMCA itself. Almost every stakeholder in the CAR diamond industry has criticized the current management of the organization. This problem largely stems from the fact that the current leadership of the organization were not voted in place by their peers. Rather, the government appointed them. Various members of the UNCMCA have expressed puzzlement regarding what is happening—or not—with the substantive member fees they contribute, and what services the organization actually provides for them, given that most cooperatives choose to sell their diamonds locally. Government officials as well have lamented the fact that the government’s initial appointment of the current UNCMCA leadership may have given the wrong impression that the UNCMCA will become a government institution, and its leadership civil servants. Relations between the regular diamond buying community—especially the collectors—and the UNCMCA are strained as well. For them, cooperatives present a potential competitor as they have the right to directly export their product. However, given the general lack of funding for miners, and the fact that only the collectors provide these services legally, collectors often question the usefulness of stimulating cooperative development among miners who do not have an independent source of funding.

Given the high degree of informality, it is clear that current formalization and enforcement strategies such as incentivizing miners to form cooperatives are not working as well as planned. While the government has deployed the *Brigades Minières* as the major tool to combat smuggling and illicit mining, the Mining Brigades lack adequate funding. This compromises their mission to the point of crippling the investigative capacity of the Brigades. Mining Brigade officers are forced to rely on transport provided for them by willing third parties, making it possible for others to notify illicit miners of upcoming inspections.

### 2.2.3 INTERESTED PARTIES

UN observers maintain a generally positive outlook on the possibility and likelihood of progressive reforms in the CAR. The recent decrease of the *patente* price suggests that the government is coming around to accepting

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<sup>41</sup> See Blore, 2008, pp. 159-189

the need for artisanal mining reforms.<sup>42</sup> The players who have the keenest interest in preserving the status quo are the *débronillards* and the collectors who also dabble in illicit production. For them, interventions such as the direct marketing scheme under review in this report pose significant threats. However, it is unlikely that these actors have the necessary influence to pose actual threats to any such reforms. With regard to the legitimate collectors and buying houses, a proposed direct marketing scheme would directly impact them as well. However, it is unlikely that a direct marketing scheme can be implemented without significant local support, which could provide new opportunities for legitimate actors with previous experience in the diamond trade.

In addition, given the ongoing reorganization of the global diamond industry and the increasing importance of “clean” and “fair” mineral supply chains for OECD countries, the case can be made for reorganizing the CAR diamond industry in order to better respond to these changes in the market. At a time when many large scale diamond producers are trying to “brand” and certify their own diamond production, the biggest disadvantage of the CAR’s diamond industry—the disorganization of the artisanal mining sector—has the inherent possibility of being turned into an advantage instead: the essential importance of artisanal mining to the livelihoods of the country’s rural poor. When successfully connected to a clear developmental agenda, the CAR’s diamonds could very well be marketed as helping fight poverty and urbanization, making them “different” from other diamonds, whether mined by artisanal miners in other countries without such development programs, or by faceless employees working on behalf of the traditional large scale mining enterprises.

## 2.3 LIBERIA

Liberia has emerged from decades of civil war and unrest. Today Liberia is overcoming the trauma of war and reconstruction efforts are underway. Unlike the CAR, Liberia receives substantial amounts of foreign assistance and international support and attention. The government remains heavily reliant on the support of UNMIL and the international aid community to help manage the vast challenges it faces. International observers suggest aid flows might further increase if the presidential elections scheduled for later this year are successfully held.<sup>43</sup>

Located on the coast of West Africa, Liberia’s progress is strongly linked to that of its neighbors: Sierra Leone in the west, Guinea in the north, and Côte d’Ivoire in the east (with which many of its citizens have close family ties). Like its neighbors, Liberia is blessed with many natural resources, including diamonds. However, while its iron ore deposits are considered to be world class, Liberia’s diamond industry remains relatively small, especially when compared to neighboring Sierra Leone. Presently, Liberian exports stand at about 25-30,000 carats per year, almost exclusively artisanal. Diamond mining occurs mainly in the western counties (Grand Cape Mount, Bomi, Gbarpolu and Lofa), in Nimba county in the north-east (bordering Guinea and Côte d’Ivoire), to a lesser extent in Margibi County in the center, and in Sinoe County in the east.

Despite reported diamond findings as early as 1906, interest in diamond mining started to soar only after the 1957 discovery of the Lofa river deposits, which sparked the country’s first diamond rush. Liberia was already a major exporter by that time, exporting over 1 million carats in 1956, but only a small fraction of these were actually Liberian diamonds.<sup>44</sup> Liberia quickly became something of an “exporter of choice,” attracting smuggled stones from neighboring countries due to its usage of the US dollar as national currency and negligible restrictions of imports and exports. In this sense, the sale of Sierra Leonean conflict diamonds by Charles Taylor only continued a trend that had started decades earlier. As a result, reliable estimates of

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<sup>42</sup> The PRADD project actively advocated in favor of lowering the *patente* fee by providing key ministries with a comparative analysis of other ADM countries that had successfully done so, and by supporting the costs of a fact-finding tour of key deputies in the National Assembly to diamond mining areas in the southwest. As it was, the fee was lowered by presidential decree late in 2010, but not to the level that many, including PRADD, had hoped. The further lowering of the *patente* was supported by some candidates during the elections of 2011.

<sup>43</sup> Interviews, UN officials. Monrovia, April 2011.

<sup>44</sup> Quoted in Greenhalgh 1983, p. 244.

Liberian diamond production are hard to come by—an issue that has posed problems for the MLME as well. During the first Liberian Mining, Energy and Petroleum Conference and Exhibition (LIMEP) in April 2011, MLME Deputy Minister Carlton Miller declared, possibly for the first time, that the production estimates prepared by external consultants in 2004 prior to KP accession, and which put Liberian annual production capacity at 200,000 carats, were based on incorrect numbers. These figures failed to negatively adjust for smuggled diamonds which had been inflating official Liberian diamond exports since the 1950s.

Although there are companies presently exploring for primary deposits—much like they did in the 1950s—it is unlikely that this will significantly alter the dominance of ASM in Liberia’s diamond sector anytime soon. While geologists remain optimistic, arguing that Liberia’s vast amounts of unexplored kimberlitic pipes and dykes hold great potential, previous explorations have failed to discover deposits that were economically viable for large-scale mining, and the potential transformation of exploration activities into significant large scale diamond mining operations will take several years at least.

As in the CAR, the majority of diamond mining activities in Liberia are conducted informally. It is estimated that between 50,000 and 100,000 men and women are directly involved in mining activities. Conservatively factoring in indirect labor and dependent households suggests that 1.5 million men, women and children are directly and indirectly reliant on artisanal diamond (and gold) mining.<sup>45</sup> Indeed, in diamondiferous rural Liberia, it is hard not to find artisanal miners or persons directly benefiting from the industry.

### **2.3.1 FORMAL DIAMOND MINING AND TRADING STRUCTURES**

#### **ARTISANAL AND SMALL-SCALE MINING**

The Liberian Mining Code of 2000 is a document that is clearly geared towards large-scale mining operations falling under Class A mining licenses and the Mineral Development Agreements (MDAs). With regard to less capital-intensive ways of mineral extraction, the Mining Code distinguishes only between Class B and Class C mining licenses. The Code itself remains extremely vague over these differences, and to date no specific mining regulations have been developed. This incongruity has caused considerable problems for certain miners. Additionally, the promulgation of urgently needed Class C regulations has been hampered not only by the realization that the Mining Code itself needs to be revised, but also by the existence of other, competing legislation, such as the Public Procurement and Concessions Act.<sup>46</sup>

The 2000 Mining Code makes no reference to “artisanal mining.” Instead, the “lowest” mining license (Class C) is described as giving the holder the right to “conduct mining predominantly as a small-scale operation” with the explicit mention that those who are “not predominantly engaged” in small-scale operation may be penalized by the Minister. “Small-scale” mining is defined only as “a mining operation other than an industrial operation.” It is only in the 2004 addition of a 40th chapter in the law, providing for controls on the export and import of rough diamonds as per the minimum requirements of the KPCS, that “artisanal” mining is mentioned. This is a problematic lack of definition, not least because of the myriad ways a word like “predominantly” can be interpreted. Many advanced artisanal miners who wish to use earth-moving equipment for a limited amount of time are complaining they are being required to apply for the far more costly industrial Class B licenses. Trying to address this grievance, the Liberian Ministry of Lands, Mines and Energy (MLME) has paved the way for cooperatives to use limited earth-moving equipment on Class C mining licenses. Given the limited development of Liberia’s artisanal mining sector, however, there are only a handful of cooperatives in operation. Furthermore, the ability of this measure to encourage illicit miners’ formalization is limited, as this measure is only feasible for miners who already possess significant amounts of capital to even consider using such equipment.

Artisanal diamond miners of Liberian origin are required to hold a Class C license. It covers 25 acres, and must be renewed annually, at a cost of 150 USD, with an additional 150 USD demarcation fee if it is the first

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<sup>45</sup> Hinton 2010, p.2.

<sup>46</sup> See Hinton, 2010 for a detailed analysis.

time the miner has requested a license for a particular claim. Given the large size of the individual mining claims, and the fact that Liberians can hold up to four of these licenses, it should be clear that this legislation was not written with the realities of Liberia's artisanal mining sector in mind.

As in the CAR, most artisanal miners are the landowners—often under a customary system—of the given mining claim. In some cases, however, the landowner is not interested in mining. A would-be miner must then first come to an agreement with the landowner. Although some miners are known to work in the mines as well, the diggers, or “diamond boys” carry out the actual diamond mining. These are a highly mobile group of both Liberians and non-Liberians.

## **TRADING**

The Monrovia-based diamond dealers, likewise composed of both Liberians and non-Liberians, are the only actors legally permitted to export diamonds. In sharp contrast to the CAR where diamond buying houses are obliged to establish regional presences, the dealers are not allowed to leave Monrovia to buy diamonds directly in the mining regions. Instead, they must work with licensed middlemen called diamond brokers. Only Liberian citizens are allowed to work as brokers, and they channel the diamonds from miner to dealer, either as independently financed operators, or directly funded by a dealer. As the main buyers of diamonds, in most cases a broker also provides financial and logistical support to artisanal miners, in return for which he has the right of first refusal. Unlike the buying houses in the CAR, Liberian diamond dealers have no local representation, and the only licensed diamond buyers are brokers, who travel up and down the country. Perhaps mirroring the state of the country after decades of conflict, there are no visible diamond buying offices outside of Monrovia, contrasting sharply with the colorfully decorated local buying houses and collectors' offices which are abundant in the CAR's major mining hubs.

Although dealers are not allowed to engage directly with mining operations, they do sponsor a minority of Class C miners. These miners are likely to be more advanced than their subsistence mining counterparts, as they not only have the means and capacity to undertake frequent trips to Monrovia and negotiate directly with the dealers, but also given the fact that these agreements are often enshrined in a Memorandum of Understanding that is submitted to the MLME for verification. Contrary to most agreements between supporting brokers, illicit middlemen, and artisanal miners, these MoUs clearly state that the miner is required to sell all diamonds produced under this sponsoring agreement to the diamond dealer or the brokers working on his behalf.<sup>47</sup>

## **THE ROLE OF THE GOVERNMENT, AND THE IMPLEMENTATION OF THE KPCS**

The main government agency in charge of implementing the Kimberley Process minimum requirements is the Government Diamond Office (GDO). Based in the MLME and headed by a manager (who is not a public servant), it reports directly to the Minister. Unlike in CAR, where the internal controls system relies on the accumulation of diamond buying slips that are reconciled with proposed exports by BECDOR in Bangui, the GDO has a regional presence in all major diamond mining hubs. Whenever diamonds are recovered, the licensed miner is required to report to one of these regional offices, where the diamonds' statistics are noted down. As in CAR, a paper-based system of carbon-paper slips is used to track the diamonds from the mine to the local GDO office, where they are registered. From here, they travel to the GDO offices in Monrovia for valuation prior to export. Here too the paper trails attached to the diamonds are reconciled with the GDO's own production data, after which the authorization is given and a KP Certificate is created.

Production information, namely the original document on which the regional GDO office has registered the diamonds, as well as the copies which accompany the diamonds as they are bought and sold on their way to Monrovia, is periodically picked up by a Regional Diamond Officer, who is in charge of several regional GDO offices. Interestingly, the GDO has a Filemaker-based database to record all this information and link it to the correlating KPCS certificates as an electronic archive. Supported by the USGS (although the project is scheduled to end later this year), this database had not yet been operating at full capacity as of March of

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<sup>47</sup> Interview, Liberian Diamond Dealers Association. Monrovia, April 2011.

2011, when the latest version of the software was delivered by CD-ROM to the GDO. At the time electrical problems meant the computers on which the database is stored were not functioning regularly pending repairs to the ministry building in which the GDO is located.<sup>48</sup>

The MLME also has a significant field presence with Mining Agencies in all major mining areas. Headed by a Mining Agent who is assisted by several Patrolmen, the Mining Agencies are in charge of enforcing the Mining Code and, most importantly, of curbing illicit diamond mining and trading. They are further assisted by the Mining Chairman of important mining towns. These chairmen are local miners who are supposed to be elected by their peers in order to represent the community to the Mining Agent. In reality, however, they are mostly appointed by the Mining Agents.

In addition to this local presence, the MLME also houses a Mining Inspectorate, based in Monrovia, which has the authority to carry out inspections and can be called in by Mining Agents in case of suspected non-compliance with the Mining Code. The role of the Mining Inspectors is not well defined, and it remains unclear what distinguishes them from the locally based Mining Agents.

### **2.3.2 ACTUAL DIAMOND MINING AND TRADING CHAINS**

Illicit mining remains as widespread in Liberia as it is in the CAR. Many miners and diggers remain trapped in structural poverty, living a hand-to-mouth existence, whereby incomes are quickly spent on (often conspicuous) consumption and repayment of outstanding debts. While some succeed in investing their incomes (for example to send their children to school in Monrovia), the savings culture is considered to be very poor, with no formal banking and credit systems around to stimulate this. Many of the grievances aired by miners are similar to the ones voiced by their Central African peers and focus mainly on the lack of available funding for diamond mining operations and the high costs associated with obtaining licenses.

In comparison with the licensing system in the CAR, obtaining a Class C mining license in Liberia is a far more expensive and complicated process. The official cost for an unlicensed miner to become a legal mining operator is 300 USD. However, unlike in the CAR, mining licenses can only be applied for, approved, and issued by the MLME in Monrovia, requiring trips to the capital. Already, the official sub-total of 300 USD is slightly more than what most Liberians make in a year. When transport costs to Monrovia and other costs incurred over the course of the lengthy licensing process (sometimes it may take several months, for a one year license to be issued) are added, there is a grand total of between 400 and up to 600 USD. These numbers are universally agreed to be the total costs of a mining license. Delegating authority to the local Mining Agencies to issue Class C mining licenses, as well as reducing the acreage and total costs of the licensing process, would undoubtedly have a positive impact on the formalization process.<sup>49</sup>

Another thorny issue is the prospecting licenses. The Mining Code is unclear about this, stating on the one hand that eligible applicants for a Class C mining license “may apply” for a prospecting license (Section 5.2), while Section 6.2 clearly states that the law “shall be construed to require that an exploration license first be obtained in order to acquire a mining license.” This runs counter to the dynamics of artisanal mining, where most deposits are identified by prior illicit mining operations, and provides yet another hurdle for artisanal miners wishing to formalize their operations. In practice however, this requirement does not seem to be frequently observed, although some miners have mentioned the requirement.

Thirdly, the overall lack of funding of which artisanal miners frequently complain, serves as the second most important factor inhibiting formalization. If artisanal miners are unsure of finding funding, they will be reluctant to invest time and money in a license that may end up being useless. And fourthly, especially in

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<sup>48</sup> The PRADD project has begun working with the MLME. A specialist in global information systems will provide training and technical assistance to improve the GDO's use of the database, and the USGS is providing topographic maps.

<sup>49</sup> The system was recently centralized in order to end widespread problems in the collection of fees. Re-decentralizing the system would represent a reversal of policy.

remote locations in the bush, the lack of government enforcement capacity significantly reduces the risk of getting caught.

Although some significant diamond finds were reported in 2010, greatly inflating that year's average value per carat, most miners are still feeling the aftershocks from the global financial crisis in 2008. This has resulted in a severe labor shortage, with many miners and diamond boys relocating to mine gold deposits. Although diamond prices have since stabilized, some miners reported that it continues to be difficult to find diamond boys, especially for mining claims that only contain diamond deposits. Although this could also point to the fact that the recent revival of diamond prices has not yet been translated in the field, it is likely that the record-high gold prices have led some diamond boys to abandon the unpredictability of diamond mining in favor of gold mining's relative stability. Indeed, according to government sources, gold mining significantly picked up in 2008-2009, as opposed to 2007 and prior. Considering that tracking gold production is not a priority for the government, recorded production and official exports are likely to be only a fraction of actual gold production and trade.

Although some licensed brokers readily admit supporting illicit miners as well as licensed miners, most illicit miners are forced to look for funding among informal middlemen. Because of their lack of legality and the fact that news about discovered diamonds travels very fast in mining settlements, illicit miners are forced to sell their diamonds quickly. This leads to them being offered significantly lower "bush prices" from their supporters, making it difficult for them to accrue the necessary funding in order to obtain the required papers. The fact that the miners do not formalize to take advantage of potentially better prices that their legal status would afford them shows that higher prices alone are not enough of an incentive to formalize. The informal middlemen are of various nationalities, with Sierra Leonean supporters apparently playing a dominant role, given their experience with diamond mining, the open borders, and the history of Liberian-Sierra Leonean diamond trading.

Although the MLME has a significant field presence in place, local officials lack adequate logistical support. Mining Agents and their patrolman have to rely on third parties to take them to mining sites. MLME officials frequently mention walking for hours on foot to suspected illicit mining camps, with the intention of shutting down these operations, yet having no other alternative but to spend the night there and depend on the hospitality of the people they are supposed to be charging with violating the Mining Code. In most instances, MLME officials admit to "reprimanding" illicit miners and encouraging them to formalize, as they are rarely backed up by police agents to secure their personal safety. In some instances, MLME officials admit being too scared to actively seek out illicit miners, fearing for their safety or that of their dependents. The lack of police authorities in rural areas further underscores the difficulties faced by MLME officials in trying to curb illicit mining and trading activities.

Whenever diamonds are discovered, miners are required to report to the regional offices of the GDO. In practice, this often means several hours of walking, or spending money on a bush-taxi. Until 2010, GDO officials were forbidden to leave their offices and go to the mining sites themselves (though this has been changed since) in order to encourage miners to record their production directly on-site.

The GDO provides the miner with a voucher stating the total weight of the diamond(s), as well as a brief description (color, etc.) of the diamond(s). Some miners say they do not see the point in incurring the costs of registering their diamonds for no tangible benefit. For obvious reasons, illicit miners do not venture into the GDO offices to register their production. Local GDO officers have complained that miners do not always register their production at the regional GDO offices, and instead sell directly to their supporter/broker, making it possible for the diamonds to be incorrectly registered at another claim.

### **2.3.3 INTERESTED PARTIES**

Given the limited revenue from diamond mining—most of which is spent on paying for the KPCS-mandated infrastructure—the Liberian government expends what it can to comply with the KPCS to show that Liberia is once again on top of things, and ready for investment. Yet it is definitely no economic priority for the GoL.

Brokers and dealers are the main actors benefiting from the diamond trade. They are virtually the only ones providing financial support to miners, and as a result, are in the position to demand adequate compensation for this. Interestingly, brokers and dealers are making a strong effort to underscore their role as responsible players in Liberia's diamond sector, from donating motorbikes to the MLME, to helping fund road renewal and repair projects. While in general being very receptive to the prospect of international assistance in developing the country's diamond sector (provided they have a stake in it), they proved apprehensive of the idea of educating miners about the diamond trade and prices. They stressed their key role as providers of capital to the country's artisanal mining sector, indicating that they are the ones providing the funds which keep this crucial part of the Liberian rural economy going. Similar comments were made with regard to cooperatives; while these may be interesting in order to boost organizational capacity of miners, the brokers stressed the fact that, unless the cooperatives were self-sufficient, they would have to ask the brokers for funding, implying that the subsequent trading would be done on the latter's terms.

## 2.4 FEASIBILITY OF DIRECT MARKETING

Only a small minority among the minority of licensed miners in CAR and Liberia currently have the capacity to engage with international buyers. This is because the majority of both licensed and illicit miners are unable to independently fund mining operations. They depend on buyers for operating capital (support) which makes the diversion of their diamonds to new buyers virtually impossible, unless these new buyers are willing to match existing terms of support. Furthermore, benefits offered by international buyers would likely need to be significantly better in order for artisanal miners to give up established business and social relationships with local buyers they know. At a very practical level, for the majority of miners in both countries it will be necessary either to combine miners into associations, or to market their goods through a certified middleman, since the buyers will require diamonds to be aggregated and sorted into parcels, with the rare exception of highly precious stones.

Based on the current diamond supply chains in CAR and Liberia, both countries have their positive and negative aspects. However, the single most positive aspect of the CAR diamond industry is the relatively lower cost of licensed mining. While this is not the case in Liberia, concluding on this basis that CAR is better suited for direct marketing of artisanal diamonds is not warranted. In the CAR, potential investors would basically be on their own, confronting a government that requires a more than significant financial commitment from would-be international investors and which takes a sizable proportion of the diamond's value at the point of export. In Liberia on the other hand, the government is actively seeking out international investment. While the country does face some regional and national political challenges, it is relatively secure and stable at the moment, compared to the CAR. The costs of doing business therefore, will be significantly higher in the CAR, as described in the country profile. On the other hand, the political environment is superior in CAR where the Mining Code does at least make provision for ASM and the government is more oriented towards capturing and directing the development potential of ASM.

On the other hand, existing legislation in Liberia makes it impossible for licensed exporters to buy directly from the mines. In Liberia therefore, the only choice would be to work with a local broker intermediary, or otherwise make it possible for local miners to come to Monrovia to negotiate and later sell their diamond production. Given the expensive requirements made of new exporters in the CAR, this would likely mean that any direct-marketing scheme there would have to be arranged through an existing diamond exporter. Existing diamond cooperatives in the CAR may prove to be an interesting exception to this given their right to export directly through the UNCMCA. While only a fraction of those "cooperatives" are actually mining diamonds, the legal provision for cooperatives and existence thereof provides an opportunity for a suitable entity to establish cooperatives with the aim of directly exporting local production to international buyers.<sup>50</sup>

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<sup>50</sup> The PRADD project is helping its participating miners form associations, or "pre-cooperatives."

## OTHER AVENUES TO FORMALIZATION IN CAR AND LIBERIA

In both the CAR and Liberia, a lack of government funding means that local mining authorities lack the logistical support required to perform their duties effectively. Given the lack of foreign assistance in the CAR, and the lack of an economic rationale in Liberia, it is unlikely that this situation will change in the near future. Formalization based entirely on enforcement, therefore, is doomed to fail. The lack of government capacity is a reality, as is the highly informal nature of artisanal mining. As artisanal miners focus on alluvial deposits in riverbeds and in shallow depths, such minerals are easily exploitable and even the most capacitated governments cannot totally exclude illicit access to these minerals. Therefore, the common position of the legislator to induce compliance through “top-down” regulation is no viable option here. In such cases, the aim of the legislator should be to encourage compliance, making it attractive for informal miners to “opt-in” when the government is not in a position to force them to do so. New attempts at formalization must therefore dare to start formalization “from below”—encouraging artisanal miners that there are clear and present benefits to being legally recognized (and legally protected), presuming indeed that there *are* benefits and that these outweigh the costs. Obviously, this will run counter to existing tendencies of entrenched corruption and lack of transparency, but at a minimum an incentive-based approach will be better adapted to deal with local realities and challenges than a centrally-managed formalization scheme which relies on nearly nonexistent state capacity to enforce compliance. Also, the role of the middlemen in sustaining informality is often ignored, although middlemen are far more visible “targets” than miners working in the bush at several hours walking distance.

While most miners simply don’t have the money required to pay for their mining licenses and associated costs, even those miners who should be able to scrape together the funds often do not do so. The reason is quite simple: why should they? Apart from it being the law, there is often no advantage associated with being a legal miner, as the advantages associated with being legally recognized miners are usually undermined by the precariousness of their situation, being largely dependent on their supporters. Furthermore, especially in remote rural areas people have very little contact with “the government” and previous experiences in dealing with the state, especially in Liberia, are likely to have been bad. A lack of visible government action to improve public welfare, and a limited trust in government to do so in the near future, coupled with existing informal patronage networks reaching up to the highest levels and the lack of government capacity to do much about legal non-compliance anyway, all boils down to the average miner seeing no real benefits to formalization. And if in addition to that, the whole process of getting formalized turns out to be actually quite complex and expensive (like in Liberia), only the more professionalized and visible miners will find it in their interest to do so.

Ultimately, successful systems of taxation depend on the common realization of the citizens that it is necessary to provide government with the means to deliver public goods and services that neither individuals nor private enterprises can reasonably deliver themselves. In fragile and post-conflict states, cash-strapped and plagued by corruption, patronage and inefficiency, such a consensus does not exist. Paying for mining licenses for example, is thus not seen as contributing to enlarging the government’s revenue base or paying a reasonable fee that grants people the right to exploit the minerals (which the government is usually holding in stewardship for the collective benefit of its people), but rather is more like spending money with the bitter realization that this will likely not result in the betterment of themselves and their community. In addition, promises have frequently been made to redistribute the wealth generated by diamonds to the people: promises that generally have not been kept, hardly encouraging miners’ trust. In Liberia for example, as part of its campaign to explain the traceability requirements of the Kimberley Process, government officials promised that, if miners were to legalize their operations and record their production with the local GDO offices, the government would re-invest the revenue generated from diamond exports in the development of the mining communities, something which is clearly impossible given that most of these funds go to the KP implementation costs.

Mainstream development thinking generally neglects artisanal mining, and diamond mining in particular, believing that, given the value of the mined commodities, it should not be a priority for poverty alleviation and development interventions. The language used by many government officials discussing artisanal mining

characterizes miners at best as operating carelessly and having a “casino-mentality” and at worst as common criminals for not obeying the law. Such perspectives are often the result of a serious lack of understanding of the governing dynamics of artisanal diamond mining and ignorance of the harsh reality of unequal miner-sponsor relationships. The fact is artisanal diamond mining remains first and foremost a poverty-driven livelihood, part of a much broader process of de-agrarianization that has engulfed large parts of sub-Saharan Africa in the past decades and that has encouraged growth of non-agricultural rural employment because of diminishing returns of traditional smallholder farming. Artisanal diamond miners and laborers mostly remain ranked at the bottom of most wealth and livelihood indicators. Spending significant amounts of money and efforts on acquiring a mining license when the returns on such an investment are expected to be negligible is currently not an option for most miners.

Changing this dynamic will have to involve not only a significant relaxation of current legal requirements from the point of view of the artisanal miner, but will also need to be coordinated with an increased focus on the middlemen. Rather than the individual miners, it can be argued that the middlemen are the key actors in the artisanal mining sector. Barring a few exceptions to the rule, they provide the bulk of the financing available to miners, making mining operations possible in the first place. Getting these actors to formalize would be a far more effective strategy to diminish illicit mining than the current approach of focusing on formalizing the miner. Given the wide dispersal of alluvial diamonds, illicit mining will always exist to some extent. However, if the actors providing most of the funding for illicit mining can be formalized, the overall transparency of the sector will increase dramatically, and with it the advantages individual miners may see in formalizing their mining operations. Barring new approaches by the government, the current high levels of illicit mining are unlikely to change.

# 3.0 THE BUYERS

This section explores the commercial feasibility of sourcing more directly from artisanal African diamond producers by US buyers in particular capturing the perspectives of the US diamond industry interviewees, as well as individuals with experience developing in direct marketing initiatives elsewhere.

## 3.1 BUYING MARKETS

### 3.1.1 GLOBAL MARKET CONDITIONS

The global recession in 2008 saw the diamond industry batten down its hatches. Many industrial mines moved to maintenance only and production consequently fell as diamond traders concentrated on moving existing rough and polished stocks. In early 2011, however, the market looks totally different. A bullish market in rough is also driving high prices for polished though presently “the polished is worth less than the rough”. This is due to a delay in mines coming back online, but also upward price pressure generated by Indian buyers in particular who are benefiting from protectionist government policies to safeguard the huge diamond manufacturing industry in that country.

The economic downturn also saw liquidity in ADM sites dry up, the effect of which continues to this day. Access to finance is a major constraint for ADM. Consequently, many miners moved into other types of artisanal mining, especially gold mining. These miners are reluctant to return—as the Liberian example showed—because in gold returns are more reliable in terms of regularity and volume, and presently very high, thanks to record gold prices internationally.

The artisanal sector is becoming more important to the diamond industry. Its proportional contribution to supply is estimated to increase over time while no industrial-grade discoveries are anticipated in the next few years. This makes it strategically important that more and more reliable sources of artisanal diamonds with diminished commercial liabilities (i.e., free from human rights and environmental concerns) become available. As the strategic importance of ADM is increasing, in the words of a knowledgeable observer, the industry’s incentive “to invest to secure that future for themselves will increase dramatically.”

In the past decade, De Beers’ grip on the diamond markets has lessened and diamond markets have been opening up to competition. Physical and online auctions for diamonds are growing in popularity, with major players now offering this service. Could an auction system be an option for marketing to international buyers?

### 3.1.2 THE US DIAMOND AND JEWELRY MARKET

In the past decade, rising competition from cheap labor in India and China has been making it a challenge for other manufacturing centers to compete. The US diamond industry, which has relatively high labor costs, has been especially badly affected, with the financial crisis deepening this trend. Thousands of retail jewelers have had to close their shops; manufacturers have lost so much business that they cannot afford their rent and unemployment levels are high. This has translated into rising unemployment and a move to source second-hand rough and polished stones, as well as participation in “closed” buying situations where Indians are not present. It has also led to increased specialization, as it is typically only cost-effective for US manufacturers to cut and polish the larger, higher quality stones and “fancies.”

One manufacturer sums up the conditions in the US diamond industry quite well: “there are shortages of rough and polished in the market, particularly apparent shortages. And more than making it difficult to actually source the goods, it just drives the price up. Profit is a problem.” Another member of the diamond industry explains further: “It used to be, you sit down, look at the rough, make your calculations, and if I can clear myself on paper 10% profit, you would be happy. Today you look at it and you want to at least break

### **COST TO MANUFACTURE DIAMONDS IN EACH COUNTRY IN 2007<sup>51</sup>**

Country	Cost (USD) per carat
India	\$1-8
China	\$6-12
South Africa	\$45-100
Israel	\$50-100+
Europe and the USA	\$100+

even. ... Because the price of rough is exorbitant at the moment.” Whether that is due to a “manic” diamond market, or to the inflated prices of rough diamonds due to India’s seemingly never-empty wallet, it is to the ultimate disadvantage of American buyers and manufacturers.

The US industry is also facing a downturn on the demand side, not just because of the financial recession, but because jewelry is less

fashionable among young people who would prefer to buy electronics or other luxury goods for themselves or for loved ones. In the words of a member of the diamond industry: “The girls don’t care about any jewelry beyond an engagement ring. ... We need to, as an industry, get these kids to buy jewelry.” The high-profile “blood diamond” campaigns of the early 2000s, when the current public for engagement and wedding rings were growing up or enrolled in colleges and universities, as well as the current campaigns on “conflict minerals” from the Democratic Republic of Congo have probably not helped matters. Being able to attach a positive story about the origin of diamonds and gold might help recapture the interest of critical young people with regard to jewelry, as well as their willingness to spend accordingly.

Research into the feasibility of developing a Fair Trade Diamond Standard in 2008 suggested an ethically branded diamond would appeal most to the US bridal market.<sup>52</sup> According to a jewelry sector interviewee, the luxury jewelry market is presently recovering, but the ordinary market, which incorporates engagement and wedding rings, is not. Thus, the market to which a direct marketed diamond would most likely appeal remains very price sensitive.

## **3.2 US JEWELERS’ INTEREST IN SOURCING FROM ADM**

All the jewelers consulted were interested in sourcing artisanal diamonds. It is in the context described above that manufacturers and jewelers seemed to agree on the limited potential for an ethically branded diamond to secure a higher price in the US marketplace at present.<sup>53</sup> One marketer of diamonds with experience developing an ethical brand of diamonds stated, “in my experience marketing this brand, even ethically minded people are price oriented.” An up-to-date market analysis would be prescient.

What is certain is that an ethically branded diamond costs more to bring to market owing to the extra costs associated with creating a discrete and traceable (i.e., de-commoditized) supply chain, but also specifically with the promise that the diamond contributed to getting a miner a fairer price, which generally means a higher price. A critical question then is how is this extra cost to be paid, without increasing the price of the end product too much or decreasing the price achievable by the ADM?

Instead, most were of the opinion that the value would be in creating a new, specialized market segment that would help capture the dollars of value-conscious consumers, including those who might otherwise not buy jewelry (as described above). For the boutique jeweler, there is real profit potential in marketing certified, legitimate artisanal diamonds with a positive back-story to consumers and, for the larger jewelers, it is in their

<sup>51</sup> Burger, 2007; Levin et al., 2008.

<sup>52</sup> Levin and Mitchell, 2009 based on Mohr, 2008.

<sup>53</sup> Prior to the recession a small margin was deemed possible. Mohr, S. in Levin and Mitchell, 2009.

strategic interest to secure artisanal diamond sources as the forecast is for the artisanal sector to deliver an increasing proportion of diamonds from mined stocks in the years ahead.<sup>54</sup>

On this basis, it may actually be enough for a segment of the US jewelry industry to be able to source a certifiable “artisanal” diamond and potentially market it as a niche product. An artisanal diamond could be promoted as an ethically positive purchase in so far as the customer would be supporting the industry’s most vulnerable participants, who tend to be politically and economically marginalized. It would be enough to source diamonds from existing (legal) supply chains within CAR and Liberia as production is 100% artisanal; the KP certificate should therefore suffice as an assurance of the diamonds’ artisanal status.

While a couple of the jewelers interviewed expressed their wish to simply source artisanal diamonds, issues arise were they to market them as somehow different to mainstream diamonds, given the human rights and environmental problems that clearly exist in the artisanal sector. Their interest in participating in a direct marketing scheme in CAR and Liberia was tempered only by their concern that the social and environmental performance of the diamonds could be assured.<sup>55</sup> In other words, it seems that for the US market “artisanal” isn’t good enough. For example, “All the money in the diamond industry should also be going toward education, services, adequate supply of fresh water; meeting mining communities’ basic needs—all in addition to ADMs being paid fairly. There needs to be a benefit to the entire mining community. This is the most important thing. Cutting and polishing facilities should be taking place in that same community. Providing jobs, healthcare, infrastructure. The more money staying in the community, the better. Then I could buy the cut and polished diamond.”<sup>56</sup> These rather idealistic requirements, and comments from other interviewees, suggest that American mission-based jewelers may be less likely to engage with a scheme marketing artisanal diamonds from producer communities where any corporate social and environmental responsibility (CSER) issues remain.<sup>57</sup> This inspires the consideration that jewelers (and their customers) also need education on artisanal mining and how it can be developmental when facilitated appropriately.

So what are some of the issues that would prevent CAR’s and Liberia’s diamonds being marketed as “ethical?” The following corporate social and environmental responsibility (CSER) issues are present in these countries’ artisanal diamond sectors.

- **Child labor:** children frequently help out with washing gravel, or in transporting gravel from the pits to the washing place.<sup>58</sup>
- **Environmental impact of mining:** “mined out” sites are frequently left as they are, with little or no reclamation practiced.
- **Tensions with non-mining locals:** though limited in both CAR and Liberia, mining opportunities always attract “strangers”, which can lead to resentment among “locals.” An interesting example of this was seen in Mano River Kongo, a Liberian town on the border with Sierra Leone. Diamonds were only discovered there in 2009, exciting many local landowners-turned-miners, but also bringing in large numbers of foreign diggers. Additionally, mining operations were being conducted dangerously close to the only road into the town, resulting in a conflict between miners and non-mining locals that was stopped from escalating only when MLME officials ordered the immediate cessation of mining activities near the road.
- **Diamond smuggling:** given the high informality of diamond trading, no site not being monitored closely can currently be considered “closed” with no possibility of outside diamonds “contaminating” the

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<sup>54</sup> Interviews with authors, 2011.

<sup>55</sup> We only managed to speak to “ethical” or mission-based jewelers.

<sup>56</sup> Interview with authors, 2011.

<sup>57</sup> Interviews with the authors, 2011.

<sup>58</sup> However, research into the actual nature of the child labor (e.g., child labor vs. child work) could reveal that this contribution by children is not so problematic, for example if the children are performing these tasks after school or during summer break to earn money to support themselves in school.

supply chain. This is especially relevant in Liberia, as given the elevated royalties charged in CAR it would be foolish for a smuggler to try to legally export non-CAR diamonds through Bangui.

- **Conflict diamonds:** as of the time of this research the UN Panel of Experts on Liberia had repeatedly expressed concerns about possible Ivorian conflict diamonds being smuggled into the country. Though no official “conflict diamonds” exist in the CAR, several armed militias are operating in the eastern part of the country, and are also reported to have a stake in the local diamond industry, posing significant threats to the safety of diamond buyers and the integrity of an “ethical” diamond coming from the CAR.

However, even for jewelers and their customers who *do* care about a diamond’s ethical credentials – whether for developmental or profit motives – US industry interviewees were clear that quality, price and being fashion-forward are more important to customers when choosing a jewelry product. This means that an ethically branded artisanal product oriented at the US consumer must not be too much more expensive or too alternative to commodity diamond products in terms of quality and style if it is going to be bought; people will not buy it just because it is developmental.

The diamonds of choice for ethical US jewelers come from large-scale operations in countries such as Canada and Namibia where the brands assure the CSR credentials of the stones. According to one jeweler interviewed, given the concentration of efforts to supply these in Europe where momentum is presently greater, this has more to do with the availability of artisanal diamonds and metals to US jewelers than lack of interest. However, European jewelers who are pro-actively sourcing artisanal precious metals and diamonds<sup>59</sup> may be more able to work with an artisanal diamond source, and particularly one that is not yet fully in line with all ethical issues provided that they see it to be somehow developmental. There are some American jewelers working with these suppliers, but these are few. Thus, a functional direct marketing chain may be more likely if the diamonds are initially oriented at European jewelry markets. On the other hand, through networks such as Fair Jewelry Action, US-based jewelers willing to participate potentially could be found.

Except for jewelers that source their own diamonds for their collections and for specialist US-based buyers, there is a huge knowledge and communication gap which prevents direct sourcing by most jewelers. In the words of one: “I am not a gemologist and therefore ... I don’t know enough about gems and their quality. ... I wouldn’t know which questions to ask. Instead I rely on my knowledge of sustainability and I go through trusted suppliers.” Another agrees, “The idea of retail jewellers getting involved is pie in the sky as they won’t know what to do with the rough diamonds. A retail jeweller would need to do it in conjunction with someone who knows what to do with the goods.” This means that it is not enough to find interested jewelers; you must also find a suitable buyer and manufacturer, unless the jewelry line is based on rough stones only. An option would be for jewelers to take charge of the supply chain themselves: sourcing the rough, and then contracting out the manufacturing process to a third party. This could be where the US manufacturers could come in. A developmentally very interesting option would be to arrange the manufacturing process in Africa itself,<sup>60</sup> though the US manufacturers would most certainly resist this option.

### **3.3 US ROUGH DIAMOND BUYERS AND MANUFACTURERS’ INTEREST IN ARTISANAL DIAMONDS**

US manufacturers and importers were clear that they would only source from the artisanal sector if it were commercially sensible to do so. Significant motivations would include helping overcome existing commercial challenges (e.g., high prices), securing new diamond sources, as well as giving them the ability “to say that you’re doing well by doing good.” Uniformly highlighted was the importance of price, supply, quality, and accessibility of the product as critical commercial issues.

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<sup>59</sup> Competition for artisanal gold and diamonds is so high that some firms are recruiting managers whose main responsibility is to ramp up supply to meet demand.

<sup>60</sup> There is a growing capacity for diamond manufacturing in the continent, although these are not readily apparent in the CAR and Liberia,

Manufacturers and rough diamond traders were clear about their distaste at supporting an initiative for any charitable motive, especially if the benefit were to go more to people outside the US industry. In the words of one industry member: “I’ll be blunt. When you have people in the industry in the US who have been unemployed for quite some time and we say we’re benefitting Liberia and CAR, they go cross-eyed and ask ‘why don’t we start at home?’ Today it’s all about jobs here in the US. The government needs to understand this.”

Consequently, ethical considerations at the point of production were clearly not as important to the manufacturers and rough diamond importers we consulted as they are to jewelers. The only “ethical” issue of importance at this tier of the supply chain was that the supply chain be demonstrably legal, i.e., compliant with KP traceability requirements but also other legal criteria. As one put it, “You don’t want to taint the product by having it not be ethical. It makes people cozy inside if you’re buying ethical products. But it shouldn’t cost more.” On the other hand, one manufacturer sees a direct marketing scheme as an opportunity to have a positive economic impact in the US through the possible resuscitation of a flagging US diamond manufacturing industry by allowing “the US diamond industry to have a certainty of supply” and so enabling “people in the US to make direct purchases at reasonable levels and we can start employing people in the US industry again.” Another member of the industry disagrees, saying that the amount of rough to come out of Liberia and CAR would not tangibly affect the dynamics of the US diamond industry, except perhaps to benefit a few small operations.

Indeed, even if 100% of Liberian and CAR diamonds were to be marketed to US buyers, it is unlikely that this would have a significant enough effect on a US industry that is growing increasingly uncompetitive in a globalized market. The manufacturing sector traditionally turns a profit based on volume rather than value, making it very price sensitive; very small price differences are critical for manufacturing profitability. Competition from cheaper manufacturing centers means that this price sensitivity has reached extreme levels in the US, where buyers are very particular about what types of diamonds they can buy, with most only dealing with large and valuable stones. As a rule, this means that buying run-of-mine is not at all attractive to most US buyers, though those which have a broad consumer base or produce jewelry using rough diamonds perhaps could do so. A word of caution came from one member of the industry: “Run of mine means different things to different people. It could mean three different types of stone or it could mean thousands of stones. Any buyer of run-of-mine has to believe he’s getting an advantage or he’s not going to buy that way.”

Setting up the right type of buying experience would also be important. First, the US buyers emphasized their preference for an open market over a tender or auction system. Secondly, guaranteeing the safety of US buyers travelling to CAR and Liberia to source diamonds would be essential. Protecting them from the discomfort of witnessing African misery would be another preference. As one member of the industry put it, “The begging, people trying to sell anything to you or get your old clothes. I don’t think that people would want to be exposed to feeling like they’re in that kind of environment.” One way round these issues would be to have a middleman to do the buying on their behalf.

Given the present fragile economic climate in the US, industry is not interested in engaging in a risky or expensive endeavor. There must be a clear commercial motive for US manufacturers and jewelers to participate. On the other hand, innovation is born in desperate times; the present economic recovery that is driving rising prices and increasing demand in certain jewelry sectors makes market conditions presently ripe for trying something new. In the words of a member of the industry: “This is a good time to be exploring, beginning. But this is not the robust time where interest in expansion would be greatest. But the smartest people will be thinking about the future.”

# 4.0 LESSONS FROM OTHER DIRECT MARKETING INITIATIVES

If direct marketing is to be used as a strategy for encouraging formalization, then taking lessons from other initiatives that are attempting or have attempted to establish more direct trading relations between artisanal miners and international buyers is crucial. We sought an understanding of the likely challenges in setting up a direct marketing scheme by consulting existing literature on past and present schemes and interviewing individuals and organizations.

Most of the efforts of note have related to gold (and associated precious metals) and diamonds, though initiatives are also emerging in colored stones too. The most successful initiatives have been those which presently supply assured artisanal minerals to market, particularly in Europe.

## 4.1 OTHER EFFORTS TO DEVELOP DIRECT MARKETING SCHEMES FOR ARTISANAL DIAMONDS

In 2005, there was only one supplier of diamonds marketed as artisanal. In the same year, a fair trade workshop was held by the Communities and Small-scale Mining (CASM)<sup>61</sup> Secretariat to explore whether it might be possible to set up assured artisanal mineral supply chains.<sup>62</sup> By 2007, a plethora of initiatives had emerged to deliver ethical artisanal minerals to the jewelry industry. The Madison Dialogue conference brought these initiatives together with a variety of supply chain operators in October 2007, and the Madison Dialogue Diamond Working Group (MDDWG), which comprised a wide range of stakeholders with a specific interest in developing assured artisanal diamond supply chains, was born. A paper written by Kirsten Hund documented these emerging efforts, of which at least six at the time were specifically oriented at delivering some type of ethical diamond to market:<sup>63</sup>

Since then, only two continue to develop methods for supporting artisanal diamond miners at a global level. Among marketers, one markets “ethical” diamonds while another markets diamonds as “traceable” and “fair trade.” Four separate efforts to develop a “fair trade” diamond were shelved between 2007 and 2010.<sup>64</sup>

As to why so many projects have fallen by the wayside, one interviewee compared formalizing the artisanal sector to pharmaceuticals, saying “the cures for cancer will be delayed years if not generations because of

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<sup>61</sup> CASM is an international initiative promoting the sustainable development of artisanal and small-scale mining, and based at the World Bank in Washington DC. The initiative is currently being reformed in order to provide more direct technical assistance to artisanal miners and their host countries.

<sup>62</sup> CASM, 2008.

<sup>63</sup> Hund, 2008.

<sup>64</sup> Levin, Mitchell and Macfarlane, 2008, Levin with Turay, 2008; Temple, 2008, interview with authors, 2011.

competing and not cooperating interests. .... (If) you find a group is an obstacle to accomplishing the goals, I don't care if they're doing good or have turned around a little village somewhere, it's nice they did that, but if they're an obstacle, get rid of them."<sup>65</sup>

This attitude of consolidation of the mainstream is problematic, because it is through alterity and dissent that innovation and pressure for continual improvement of the mainstream is induced. While the recent history of efforts to develop some type of assured ethical diamond show that we are at a critical moment for harmonizing and consolidating the various efforts, and indeed with finance an issue for funding any type of development agenda at present, nevertheless a small number of independent efforts to bring an assured artisanal diamond to market persist.

## **4.2 OTHER EFFORTS TO DEVELOP DIRECT MARKETING SCHEMES FOR ARTISANAL MINERALS**

Since 2005, various non-diamond initiatives to develop assured artisanal mineral supply chains have also emerged. This is driven by demand from the electronics industry to manage the issue of conflict minerals in Central Africa and from the jewelry industry to supply some type of "ethical" gold and colored gems to market.

There are a number of individual traders who demonstrate good practice in establishing more direct buying relationships from artisanal miners.<sup>66</sup> They clearly know how to make it work and so it would be recommendable to invite them to engage, should the US Government decide to advance a direct marketing initiative. Indeed facilitating the entry of these buyers is more likely to be successful than starting from scratch as they clearly have proven models with a track record of bringing "ethical" artisanal gems and metals to market.

On the other side of the trading relation, the most significant initiatives are those that work with the miners themselves. Lessons from these initiatives are presented next.

## **4.3 THE ELEMENTS OF A SUCCESSFUL DIRECT MARKETING INITIATIVE**

There is scope to write a substantial paper on the critical factors that underpin a successful direct trading initiative. The factors of most significance in determining the success of a direct marketing scheme are as follows:

1. Trust, transparency and a partnership approach between the seller and buyer is the foundation for success.
2. Inconsistency and uncertainty of supply in terms of volume, price and quality at the producer side pose serious challenges to the manufacturer and jeweler.
3. Middlemen matter.
4. Understand the artisanal miners' mindsets and existing marketing strategies; be realistic as to what the artisanal miners' interests are and what they can do.
5. Work with existing supply chains as much as possible!
6. Start the scheme with producers who have existing, demonstrable commercial and / or development successes.

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<sup>65</sup> Interviews with US diamond industry actors, 2011.

<sup>66</sup> Interviews with authors, 2011. See also CASM 2008 though some of these are now out-of-date.

### 4.3.1 TRUST, TRANSPARENCY, PARTNERSHIP

Trust, transparency and a partnership approach between the seller and buyer is the foundation for success. Without trust, failure is inevitable; without transparency, there is no trust; without partnership, there is no transparency.

Interviewees were of the view that unless the miners trust you, they simply will not sell you their diamonds. To echo one observation, miners work with “the one they know and trust.” Trust is born of a number of factors, but it was generally agreed that it is something that must be built over time, especially when outsiders are seeking to work through a new business model, and will be broken if expectations are not well managed.<sup>67</sup> As one knowledgeable informant put it, “artisanal miners are very wary of new actors coming in. The miners have a lot of good reasons not to trust foreigners, even if the foreigners are working through a [reputable] initiative.”<sup>68</sup>

One major way to elicit the trust of the miners is to demonstrate that the price you are offering is indeed a “fair market price.” This can only be done by having the miner witness your own efforts to sell their product (e.g., through an auction or having them travel with you to the international market) or having government field agents act as independent valuers in the mining centers.<sup>69</sup> However, in both CAR and Liberia miners have repeatedly expressed their reluctance to view government field agents as independent actors.

Speaking the local language, having open communication channels<sup>70</sup> and engaging with the miners on their own terms culturally are other, vital strategies for building trust between buyers and the miners; working with transparency as the underlying principle is something that one knowledgeable informant emphasizes because, while it helps build trust, it also ensures accountability and good practice.<sup>71</sup>

A partnership approach is especially important if the scheme is to be empowering for the artisanal miners and sustainable in the long run. The beneficiary mentality of the miners and their unwillingness “to take responsibility for their own role in making the cooperatives a success or failure” was a crucial flaw that meant they “continually sought external assistance, rather than driving the process themselves.”<sup>72</sup> These principles of partnership and transparency are at the heart of the fair trade model in particular, which is defined as “a trading partnership, built on dialogue, transparency and respect that seeks greater equity in international trade.”<sup>73</sup>

Even more than in other industries, trust is crucial in the diamond business, where the price of a diamond cannot be easily ascertained by simply weighing the good on a scale and referring to an international standard price, fixed to a unit of weight. But ultimately, trust building is a risk management strategy. One way is by ensuring there are demonstrable development benefits from participation which translate into political strength for government officials. The strategy of establishing goodwill from authorities and communities on the ground—whomever they might be—not only fosters the miners’ trust in the initiative, but gives miners confidence to divert their product from existing buyers to the new ones sanctioned by the authorities.

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<sup>67</sup> Levin with Turay, 2008.

<sup>68</sup> Interview with authors, 2011.

<sup>69</sup> This is fine in theory, but efforts to do just this in Sierra Leone proved that miners are reluctant to take their diamonds to a government office or official, even if it is mined legally, because of concerns that they will have to pay extraordinary taxes to the individual valuers or that word will get out as to the value of their winnings.

<sup>70</sup> Levin with Turay, 2008, p. 6.

<sup>71</sup> Interview with authors, 2011.

<sup>72</sup> Levin with Turay, 2008.

<sup>73</sup> See [http://www.fairtrade.org.uk/what\\_is\\_fairtrade/fairtrade\\_foundation.aspx](http://www.fairtrade.org.uk/what_is_fairtrade/fairtrade_foundation.aspx). Accessed, 29th May 2011.

### 4.3.2 CERTAINTY OF PRICE, VOLUME AND DELIVERY OF SUPPLY

Rough and polished diamond buyers tend to have specialized needs. This is especially the case for a) smaller operators, b) those servicing discrete portions of the jewelry sector, and c) the US industry on the whole owing to the cost of manufacturing. Combined with the low profit-high volume equation for manufacturers (even for those dealing in more special stones where the financial risk and reward can be much greater), this means that rough buyers need to know what they are buying in terms of volume and price. Certainty of volume, price and indeed delivery of supply are critical factors in profitability for the diamond manufacturer and jeweler. This issue is not confined to diamonds. Inconsistency of supply is a major stumbling block to ramping up both production and supply in gold as well.

It is extremely hard for the artisanal sector to deliver volume predictably. Artisanal miners rarely prospect or explore and, when they do it is usually not done with much scientific rigor. Artisanal producers often operate seasonally. Both these factors make supply extremely variable (and occasionally non-existent). Furthermore, the US buyers cannot viably set up shop to buy from individual miners; indeed the types of volumes necessary to be of commercial interest to international buyers would typically be at levels at which exporters in artisanal nations are presently operating. All of this serves to emphasize the importance of the middleman as an essential conduit for sorting, aggregating, and marketing diamonds from diverse and multiple sources into larger parcels for sale to an interested buyer.

In order to make a scheme viable, then, it is important that it either works with enough artisanal production units to absorb variability in production *or* with buyers who are able to buy run-of-mine and for whom direct marketed diamonds would be optional (“nice-to-have”) rather than essential (“need-to-have”) for its commercial success as a business. Experience from other sectors suggest that “working with smaller, niche market jewelers ... whose volume and specificity demands are more narrowly defined” is more likely to succeed than trying to supply the “large jewelers who can’t satisfy their customers with the limited production.” The commercial case is also stronger for the smaller jewelers for whom the artisanal diamonds would comprise a larger proportion of their supply and so justify the hassle of setting up and nurturing the supply chains. This also enables the concept to be tested in the market, before the larger organizations would be willing to jump on board. This view of starting slow, at the grassroots level with small, ethical jewelers was supported by interviewees but contradicts the need to start large in order to source from multiple miners and mines (as existing brokers do) for the simple fact that lack of prospecting and the geological reality of alluvial diamonds means that not all deposits worked by ADM are profitable.

### 4.3.3 MIDDLEMEN MATTER

A key aim of this research was to establish whether or not it would be possible or desirable to bypass the middleman. In almost every case, interviewees emphasized the importance of the middleman in terms of their commercial functions in the supply chain and the larger socio-political roles they play in the lives the artisanal diamond miners. Understanding the function that artisanal diamond trading plays in their own livelihood strategies can also reveal how vested they are in maintaining their position.

The middlemen are those who perform functions in the portion of the supply chain that exists between the miner and the manufacturer. In the simplest (and most expensive) scenario a manufacturer<sup>74</sup> could source directly from a miner and bypass the middleman, but this would only be feasible were a miner to produce only one type of diamond or if the manufacturer were able to profitably process any type of diamond. In fact, this does happen, but only in the vertically integrated supply chains composed of large mining, manufacturing and/or jewelry organizations, where volumes are substantial enough and information on quality reliable enough to make diversity of supply inconsequential.

For artisanal diamonds, this direct trading chain does not happen and would only be possible were consumers willing to pay substantially higher prices for their artisanal diamonds, which they are not. Each middleman

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<sup>74</sup> Or a large jeweler with an outsourcing relationship with a number of manufacturers

provides a variety of essential commercial functions in the artisanal diamond supply chain—namely aggregating, sorting and transporting the diamonds—so that the diversity of diamonds produced by any one mine site can be appropriately channeled to the manufacturer who can cut and polish the diamond most profitably and at a cost that is bearable by the consumer.

A closer look at the journey of a rough diamond from mine to manufacturer usefully demonstrates this:

**TABLE 4.1. FUNCTIONS ALONG DIAMOND VALUE CHAIN**

DESCRIPTION	FUNCTION
1. The cash for doing the mining is provided by the <b>miner</b> or a <b>buyer</b> .	Mining
2. The diamonds are extracted at the <b>mine site</b> by the <b>miner</b> .	Mining
3. The diamonds are sold to a <b>buyer</b> . This may happen at either: <ul style="list-style-type: none"> <li>a. The mine site (in which case the buyer has invested time and money to come there)</li> <li>b. A <b>local commercial center</b> (in which case the miner has invested time and money to go there)</li> </ul>	Sale to buyer Diamond transported elsewhere Diamond transported elsewhere
4. This <b>buyer</b> will buy from many sources and aggregate the individual diamonds into parcels.	Aggregation Sorting
5. The parcel of diamonds is then transported to wherever the exporter is based, typically in another, <b>larger commercial center</b> , specifically the capital or the principal diamond trading town.	Diamond transported elsewhere
6. The parcel of diamonds is then sold to the <b>exporter</b> , who will aggregate a variety of parcels before he makes a shipment.	Sale Aggregation Sorting
7. The diamonds are put through the Government Diamond Office for registration and valuation in observance of KPCS export protocols.	KP Certification
8. The diamonds are exported. Either: <ul style="list-style-type: none"> <li>a. The exporter or a trusted individual transports the diamonds overseas</li> <li>b. The buyer or a trusted individual comes to the country of origin to collect the diamonds</li> </ul>	Export (Diamond transported elsewhere)
9. The diamonds are imported by the buyer. This <b>importer</b> may be a diamond trader or an agent for a manufacturer. The importer will further aggregate and sort the diamonds for sale and/or distribution through the appropriate forward channels.	Aggregation Sorting (Sale)
10. The diamonds may be subsequently re-sorted and traded a few times and/or once again exported and imported elsewhere (e.g., to take advantage of different taxation regimes) before finally reaching the manufacturer.	Tax avoidance Manufacture

Even in the Fairtrade gold model, which is commonly presented as being about bypassing the middlemen and in which sorting is not necessary, there is still a middleman between the international buyer and the miners whose function is to buy and aggregate the mineral to make the purchase cost-effective for the international buyer.<sup>75</sup>

Most crucially important is the middleman between the international buyer and the miners whose function is to buy and aggregate the mineral to make the purchase cost-effective for the international buyer. One informant knowledgeable about the roles of the middlemen in gold supply chains said, “The win situation is for the seller with multiple buyers... Bank, refiner, person that took it to the refiner, the person who got it

<sup>75</sup> Interviews with authors, 2011.

into the country where the refiner is, that may or may not be the same person who got it out of the country where it was produced, the guy who put it in a packet that got it through the airport, the guy that has to get it in bulk to that guy who wants to take out a kilo, then the guy that transports it from the place where it was purchased rurally in the market to the city where the airport is, then there's the guy who bought it at the market and maybe the guy that owned the grocery store who bought it before it went to the big buyer, and then there's the miner. The exporter could be the guy that buys it from [the dealer] i.e., transports it, bulks it, formalizes it and exports it. And his brother might be the importer, but he doesn't own the refinery and bank. And each of those jobs is a separate job even if it's in the same company."<sup>76</sup>

Only certain types of individuals succeed in the role of middleman. Middlemen have to be able to bridge the cultural gap which exists "between formal diamond buying and the way artisanal producers sell" in order to build trust with both parties. As one informant puts it, "One group places orders and buys in a catalogue kind of way, and the other group meets for a beer and discusses."<sup>77</sup>

Besides these various commercial functions they perform, local buyers also play important social, political and cultural roles for the miners, often stepping in to help in times of trouble. One industry consultant asks rhetorically, "Would an international buyer pay for a miner's wife to go to the hospital if she were sick?" Some laborers have been unwilling to participate in cooperatives for fear of abandoning or jeopardizing their relationships with dealers / supporters.<sup>78</sup> This dependency can make it exceedingly hard to lure miners to work through new structures, especially if they do not offer the same social security net.

If one is going to attempt to bypass a middleman, it is crucial to understand what function the diamond business plays in the middleman's wider livelihood strategy. For example, one most typically thinks of diamond as a good to be traded in its own right as the primary product. But, like gold, a diamond's primary function for the trader can be as a financial instrument either to store wealth, to raise finance for investment in another sector (e.g., importing consumables), as a currency to minimize costs related to this other business, or as a vehicle to launder dirty money. The middlemen who trade diamonds may therefore be embedded in other recalcitrant economic networks that make challenging their status in the diamond sector not just problematic, but even dangerous for both their competitors and the miners. We were not able to investigate the traders' livelihood strategies in such detail, but this is something that would be recommendable should the decision be made to advance the direct marketing idea.

In all the direct marketing examples studied, middlemen were generally not threatened by the initiatives enough for them to pose problems besides possibly spreading rumors and vocalizing their displeasure. This is because these initiatives did not aim to capture more than a small minority of product from a locality. Interviewees felt, however, that once demand increases, they are likely to meet resistance.

If the objective is to ultimately have an industry-wide impact by using direct marketing as a tool to encourage formalization, it is more likely, therefore, that a direct marketing scheme would meet some resistance from local buyers unless there was a role for them or it started small enough to be inconsequential to them. Indeed, during the field research local buyers went to great lengths to explain their key roles in the CAR and Liberian diamond industry, and expressed dissatisfaction at not being included in any such proposed schemes. It is important to involve diggers, as well as middlemen and other buyers. As one influential activist puts it, "If we shy away, thinking that all the intermediaries will go to war with us, then we will never change the artisanal sector."<sup>79</sup>

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<sup>76</sup> Interview with authors, 2011.

<sup>77</sup> Interview with authors, 2011.

<sup>78</sup> Interview with authors, 2011. Levin with Turay, 2008.

<sup>79</sup> Interview with authors, 2011.

Often, these local buyers—whether informal middlemen or licensed buyers—are stereotypically viewed as dishonest and morally questionable people.<sup>80</sup> The fact that many of them are black African or Arab Muslim “foreigners” (even though they may have been living in country for several generations), as opposed to the mainly Christian and animist “locals” probably further encourages such views. While these traders, often connected to long-established regional trading networks, are clearly benefiting most from their relationship with miners, they perform essential services to the mining community, including those beyond a standard business relationship. The reality of artisanal mining being far from ideal, it should come as no surprise that a lot of actors involved in it are not perfect as well. Trying to remove these middlemen without the explicit backing of the community is an exercise in futility, as the communities know full well that nobody else is really interested in funding their mining operations, and few others will step in with the occasional, but extremely vital support they need to cope with extraordinary personal crises that affect them and their families.

In sum, the question should not be which middlemen should be removed from the chain of custody, but rather how can these middlemen be incentivized to aid the formalization of the sector and improve benefits to the miners?

#### **4.3.4 UNDERSTAND THE ARTISANAL MINERS’ MINDSETS AND EXISTING MARKETING STRATEGIES**

If one is to capture an artisanal miner’s product, one needs to know what makes an artisanal miner sell to his existing buyer. It could be one or some of the following factors: the price; a sense of duty because the buyer has lent him money or tools and fear of reprisal if he does not; a lack of alternative buyers; a sense of trust based on a history of sales and/or ethnic ties, and so on. Understanding these motivations is critical in knowing how to encourage the artisanal miners to enter into a more direct marketing relationship. In practice however, in both Liberia and the CAR miners are obliged to sell to those who sponsored their mining operations. Usually just an informal understanding between miner and supporter/buyer and not codified in the relevant legislation, government authorities in both countries operate under the assumption that in cases of conflict between a miner and buyer, government should intervene with the protection of the buyer’s “rights” to the diamonds as a primary objective.

#### **4.3.5 BASE THE SCHEME ON EXISTING STRUCTURES AND INSTITUTIONS AS FAR AS POSSIBLE**

The issues of trust, the importance of existing middlemen to miners’ individual and household welfare, and the difficulty in getting miners to sell to new buyers all lead experts to the conclusion that working with existing supply chains as much as possible is highly advisable. One interviewee noted that it is more beneficial to the miners to bring transparency to the existing supply chain than it would be to cut out middlemen, unless the market decides that a particular middleman is redundant. Attempts to impose external structures that are alien to local political dynamics are likely to be dysfunctional. One way to build associations might be to base the scheme on existing structures and institutions, e.g., by incorporating systems of weekly savings.

#### **4.3.6 START THE SCHEME WITH PRODUCERS WHO HAVE EXISTING, DEMONSTRABLE COMMERCIAL AND/OR DEVELOPMENT SUCCESSES**

This means that one should work with producers who can demonstrate productive land, good organization, proficiency at commercializing the product, and the ability of local leaders to convert their diamond wealth into some type of valid development outcome. This is a risk management strategy, which must be carried out in collaboration with formalization measures for the miners.

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<sup>80</sup> Several interviewees stated as a fact that “these middlemen are not nice people” or words to that effect.

At the other side of the trading relation, this principle is also applicable: working with buyers who have existing, demonstrable commercial and development successes in sourcing from artisanal miners, and ideally diamonds or gemstone miners, would be highly advisable.

# 5.0 DIRECT MARKETING STRUCTURES

The research has revealed a number of different trading structures that are theoretically possible for setting up more direct marketing relations between artisanal miners in CAR and Liberia, and international buyers. However, there are a number of critical issues that will determine which of the scenarios is judged to be the most appropriate option. These are the level of ethical branding the participating jewelers deem to be marketable, the level of organization of the miners, and the level of financial dependency of the miners on existing buyers to pre-finance their mining activities.

## 5.1 CRITICAL ISSUES

### 5.1.1 LEVEL OF ETHICAL BRANDING

We propose a typology of diamonds that shows the different levels of ethical quality based on a diamonds' contribution to development:<sup>81</sup>

1. **Problematic**– meaning not KP certified and thus possibly contributing to conflict situations<sup>82</sup>
2. **Conflict-free “artisanal”** – meaning no conflict only (i.e., KP-certified) and legal
3. **Ethical** – meaning do no harm, going beyond legal compliance, i.e., risk mitigation.
4. **Fair Trade** – meaning the act of producing and trading the diamond has somehow created sustainable economic development using the product i.e., development optimization.<sup>83</sup>

In other words, artisanal is what presently comes from CAR and Liberia; ethical would be artisanal diamonds from these countries that can also prove they “do no harm” (risk mitigation), and fair trade diamonds would go further and also ensure they contribute to sustainable economic (and we would propose also social and environmental) development. Some thought therefore needs to go into *how* developmental the diamonds need to be because the less developmental they are, the easier it will be to start something though level 2, conflict-free “artisanal,” which would be the minimum developmental level possible.

Given that outstanding social and environmental issues in the artisanal sectors of Liberia and the CAR may prove obstacles to engagement by jewelers, *it is advisable first to conduct a “CSER baseline” of the diamond production and process methods of potential participant producer organizations and their impacts to see how much would need to be done to allow the diamonds to be branded as more than conflict-free “artisanal.”* This could be done as an assessment against some type of ethical artisanal standard.

*Interested jewelers should be engaged in a frank discussion as to the ethical credentials and liabilities of their diamonds and what realistically would be significant enough to prevent or allow*

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<sup>81</sup> This typology is derived from an interview with a leading diamond industry actor, seeking to promote a version of “fair trade” diamonds.

<sup>82</sup> This is a little problematic given that diamonds mined in Mali and Cameroon, whilst not yet KP-certified, are not necessarily conflict diamonds.

<sup>83</sup> Note that this is Rapaport's definition of “fair trade” in contrast to FLO-CERT's own definition, given on page 30. Both essentially amount to the same thing, being that the process and production methods by which the good is made and traded actively contribute to sustainable development.

*the jewelers to market them as somehow “ethical” or “fair trade” or “developmental” to consumers such that they could command a higher price and/or secure a new consumer base. It would be wise to explore the different sensitivities of US (and possibly Canadian) and European markets through a proper market survey.* In doing so, it should be noted that while previous research has been done on this, much of this research is now out of date or not publicly available.

It would also be prescient to *think through what the diamonds’ marketing story could be*, what the positive impacts are, and why this might appeal to a consumer. Once agreement is made on the diamond story, helping the jeweler tell this convincingly, even producing brochures for them to distribute, would help ensure they can market jewelry containing the artisanal materials.<sup>84</sup> Being a USAID-funded initiative might further improve credibility of the diamond’s developmental value for US jewelers in particular, when compared with other initiatives claiming to “help” artisanal miners.

If the diamonds are to be somehow marketed in the jewelry market as more than artisanal but also ethical, developmental, or fair trade, then KP certification alone will be inadequate. In addition, there will need to be a third-party certification system put in place along the entire supply chain to assure chain of custody and potentially also process and production methods. This will cost money and is not a simple thing to implement.

## **5.1.2 GETTING THE JEWELERS’ AND MANUFACTURERS’ PRIORITIES IN ALIGNMENT**

There is a chasm between diamond manufacturers and jewelers. While jewelers would likely see great commercial value in a branded “ethical” diamond, interviewed diamond manufacturers stated almost unanimously that the ethical side of things was far less important to them. They need some convincing that there is a market for ethical diamonds. Until the research is done on this issue, it would seem that US diamond manufacturers are mainly looking for cheap diamonds, rather than comprehensively ‘ethical’ or ‘developmental’ ones. While the cost of acquiring diamonds from less convoluted supply chains entails evident financial savings, the necessary costs associated with developing and sustaining new buying networks will have to be factored in as well. In other words, a minimum amount of (quality) diamonds (which could turn out to be pretty high) will be required for each “buying trip” in order for it to become profitable.

The situation for the jewelers is completely different. Unlike the diamond manufacturers, they have a clear interest in “development,” “fair-trade”, or “ethical” diamonds, and the varying degrees of community benefits such tutelage may represent. If they can attach a “good story” to a diamond ring and charge a premium for it, this will undoubtedly benefit themselves and the artisanal diamond mining communities in Africa and South America. However, in order to source such diamonds, they will likely have to take control of the value chain themselves: buy the rough, have it cut and polished, and integrate it in their diamond jewelry. Unless they form partnerships with diamond manufacturers, it is unlikely that they will find the rough with the associated assurances there.

In a sense, it can be argued that the diamond manufacturers are pushing themselves out of the market. For the jewelers, diamond manufacturers are proverbial middlemen as well, presenting an obstacle to the reforms the former want to achieve in the market. While the jewelers (channeling the interest of the consumers) are demonstrably interested in “development diamonds,” they cannot reasonably source them through the traditional rough diamond buyer-manufacturer-jeweler value chain, which can be considered obsolete in this regard. Instead of gatekeepers who buy rough, process it and sell it, diamond buyers and manufacturers risk becoming simple service providers to the jewelers if they do not pick up on this specific trend, and jewelers will have little option but to source rough diamonds themselves.

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<sup>84</sup> One jeweler interviewed for this study suggested “a full pantheon of marketing back-up including stories about how diamonds are having an impact on the ASM communities where they’re being mined. Ideally you would be able to say that this diamond came from this village. And because it was mined here, then these diamond miners are able to, for example, educate their kids, restoring the roads, restoration projects etc.” The jeweler stated that diamonds with this type of development story attached would appeal to the jeweler’s network.

### 5.1.3 MINERS' LEVEL OF ORGANIZATION AND CAPACITY TO ENGAGE

Presently, organizational structures in the CAR and Liberian diamond sectors are largely informal. Most miners do not possess the required legal papers, nor do many diamond buyers. While some legal miners have the capacity to engage with international buyers given their financial independence (and possibly “cooperative” structures), they represent a small minority within their national industries. Nonetheless, these few viable, independent mining enterprises should be contacted in the first instance to explore their interest in marketing their diamonds more directly to US or other international buyers.

Also, while miners undoubtedly are taken advantage of to a certain extent by their supporters, miners in focus groups started throwing around figures they got for earlier diamonds, going into thousands of US dollars. A major problem is the lack of education on the part of miners, not with regard to diamond prices (they are stuck with single buyers anyway), but with regard to how to handle large amounts of cash in general. Not only is there no way to save money; there is a general lack of awareness of how investing money, rather than spending it conspicuously, can help miners become self-supporting business people, and reduce their dependence on supporters and their imposed prices. *Training in these things would be fundamental to success.*

### 5.1.4 COMPETING WITH EXISTING BUYERS

CAR and Liberia have been producing diamonds for decades, and their diamonds easily find their way onto the world markets. A viable direct marketing scheme to US buyers will therefore have to either incorporate the local buyers in a way that is developmental *or* out-compete them if it is to attract miners to engage in the first place. This will require a substantial commitment on behalf of the US diamond industry, as well as a willingness to cooperate in providing added benefits to artisanal miners, beyond offering slightly better prices.

### 5.1.5 PRE-FINANCING THE MINING

The key factor constraining artisanal diamond mining in the CAR and Liberia is the availability of, and access to, finance for funding the mining operations. As discussed above, buying diamonds from artisanal miners is only the final step in an economic relationship that starts with the prospective buyer agreeing to sponsor the necessary mining operations to discover the diamonds, which ultimately get sold to the established diamond exporters. Unless US diamond manufacturers are willing to invest in their own local supporting and buying networks, and doing so in such a way that their approach demonstrates a clear developmental impact, they will have no choice but to buy from the Monrovia and Bangui-based exporters. Evidently, while they may succeed in getting slightly cheaper prices—provided they are not too picky on which diamonds they want to buy—buying directly from the exporters instead of buying in the international marketplace, such diamonds could only be marketed as “artisanal.”<sup>85</sup>

While some US industry actors have indicated their willingness to invest certain amounts of money “up-front,” the high risk associated with doing so has led to the proposal that the US government should be willing to guarantee and/or match these investments. This riskiness is born of the fact that not all artisanal diamond mines will be profitable, as some mines simply do not yield enough quality diamonds to even cover the mining investment. The consequent strategy of most experienced local brokers is to support a range of artisanal operations in diverse places and run by a variety of miners in order to increase odds that some will be sufficiently productive to cover the losses of the others. In this way, the profitable mines usually subsidize activities and thus employment in mines that are not. This logic behind financing arrangements in CAR and Liberia is much as it was in Sierra Leone in 2006, where Levin and Gberie discovered that the tendency was that the majority of licenses were unproductive (60%), a minority broke even (30%) and the balance were profitable (10%).<sup>86</sup> On this basis any pilot to pre-finance miners would be wise to adopt the same strategy of

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<sup>85</sup> They could, however, be marketed as artisanal, conflict-free.

<sup>86</sup> Levin and Gberie, 2006.

diversity in production units in order to spread the risk. This, however, means starting quite big with multiple producers at multiple sites. Whilst this reduces commercial risk, it increases the risk of failure in achieving the development gains necessary to market the diamonds as better than “artisanal” as there will be a large number of producers who will each need capacity building and facilitation in tackling their liabilities.

When interviewing both Liberian and CAR middlemen, it was clear that neither had developed any risk-free way of dealing with the unpredictability of diamond production and thus profitability, as every potential miner will tend to claim that his/her mine contains vast amounts of diamonds.<sup>87</sup> Middlemen frequently liken this aspect of their business to gambling, as the only way to find out if a given site contains diamond deposits or if a miner knows what he is doing is to start digging first.

The unpredictability of returns is likely to present major problems to international buyers interested in directly sourcing from artisanal mining communities. Interviewees expressed their unwillingness to invest on a purely arbitrary basis, arguing that reliable estimates on average volume and quality needed to be present; getting a notion of production quantity and quality is one key strategy for attracting buyers. It should therefore not come as a surprise that the only people currently interested in funding mining operations are doing so on the condition that all recovered diamonds are sold to them: the key element that defines the reality of artisanal diamond mining.

In order to bring about any significant change through direct marketing, at least partial pre-financing of mining operations will be necessary. There are several options for this. First, investors could choose to work directly with an individual miner, which is only likely if said miner can adequately demonstrate the investment-grade of the deposits in his claim on a full or shared responsibility basis. In the latter case, the miner takes a certain degree of responsibility for the investment as well. This means the miner must either have existing financial (cash), physical (machinery) or human (labor) capital to deploy. Importantly, experienced diamond dealers have warned about the relatively high risk of miners defaulting, especially for foreign investors who are not locally visible, and thus have no prior established social relationships that can be used to safeguard the investment.

A second option, far more suited to deal with both the geological as well as sociological realities that make funding on an individual basis such a risky endeavor, is to fund a group of miners on a collective basis. Essentially copying the middlemen’s *modus operandi*, this transfers the risk to the group of miners that is being funded. Such a group, whether an informal miner’s association or a more formal “cooperative”—whatever that may imply—will essentially become the debtor. The funds invested in the group will then be divided among the individual miners. Not only does such collective funding provide extra security by diversifying the number of mining pits that are funded, it also results in the collective putting social pressure on the individual miners in order to fairly report any found diamonds. If diamonds were to be smuggled out and offered to other buyers, this will affect the ability of the collective as a whole to repay the loans, which will likely result in the termination of the agreement with the funder, with associated negative consequences for all miners involved. Transferring responsibility in this regard to a collective of miners would result in significant empowerment of this group of people, the benefits of which cannot be underestimated. The focus should therefore be on incentivizing grass-roots risk-mitigation strategies, rather than the top-down imposition of those. As past experiences have shown, it needs to be clear to the miners that this is not the traditional “support” or “pre-financing” from a foreign supporter instead of a local one, but a loan to a group of miners instead.<sup>88</sup> Most importantly, they need to understand that their handling of this loan will determine their eligibility for future loans. Altogether, this option will take some serious capacity building efforts in the field of money management, savings and investment. Finding a way to ensure the miners have a sense of collective benefit and responsibility will also be crucial.

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<sup>87</sup> Although middlemen probably make a selection based on prior findings at a certain mine, interviewed artisanal miners reported rarely having to prove this with anything other than their word. Interestingly, a properly kept production notebook or, in the case of Liberia, GDO vouchers from previously sold diamonds, would offer such a capacity to (new) sponsors, while at the same time (if properly explained to miners) offering an additional benefit to formalization.

<sup>88</sup> Levin with Turay, 2008.

The availability of support to promote supplementary livelihoods for miners and laborers would further provide assurances for miners whose claims might not reach the levels of productivity required to retain their membership in the association. This should be done through the concerted diversification of each cooperative's economic activities (following the logic of artisanal miners' own household livelihood profiles as a strategy to manage risk and build resiliency<sup>89</sup>). Gold mining should be especially promoted given that it more or less uses the same production methods, has greater certainty of yield and profit, and can be potentially marketed to the same buyers and ultimately jewelers, so increasing value and returns without having to invest in other production activities or find other markets (as could be the case for other products). Activities which make use of mined out land, like fish farming or agriculture, are also good options because they incentivize environmental rehabilitation.

Ideally, funding under such an agreement would not necessarily have to come from a potential diamond buyer, marking the total independence of the miners with regard to their potential funders. An adequate spreading of the risk inherent in funding artisanal diamond mining operations could potentially attract outside investors, such as traditional banks, or dedicated microfinance organizations. Successful repayment of initial loans could then be used to build up the credit worthiness of miners' associations, and entitle them to larger loans in the future. However, it remains unclear to what extent such a form of risk management would be deemed sufficient for non-buying actors to become involved. A more clear integration of artisanal mining into mainstream development thinking could be a key factor in changing negative perspectives, changing the popular image of the "casino"-mentality in favor of a more realistic perspective on the processes and structures governing this sector.

In the meantime however, the financial support of potential US diamond buyers will remain necessary. Pilots will have to be undertaken of course, in order to test the concept and, beyond that, prove its validity to potential financiers outside the diamond industry. If US diamond buyers are unwilling to partner up with more specialized organizations to do so however, even to a lesser extent, it will significantly downgrade the usefulness of a direct marketing scheme as a tool for development as well as the ethical assurances that can be made of the sourced diamonds.

The last option, a joint venture, is a combination between the first two models. It is this approach that existing "fair trade" mineral suppliers do successfully with collectives of miners, not individuals. For example, a buyer could provide an excavator to remove the overburden so that an association of miners can immediately start mining for diamonds that the buyer would then sell. This could be in the form of a joint venture partnership with artisanal miners who have committed a certain amount of labor time (including "supporting" these workers with food and shelter) to match the hard cash the buyer provides for machinery and other costs. In the agreement a certain amount of money ought to be committed to community development funds. Such operators where they exist are successful because, by working under the principles of transparency and partnership, they *do* have the local presence and trusting relationships that middlemen identify as crucial. They also bring other development benefits to the miners and their communities.

#### **A NOTE ON MICROFINANCE**

One thing that has not been adequately discussed in this report is the potential inherent in bringing microcredit/microfinance institutions to the artisanal diamond mining sector. While we have attempted to include it where relevant, this field requires significantly more attention than we have been able to give it under our present SOW. A number of pilot projects have been conducted on providing support to artisanal miners (mainly directed towards gold mining however, which somewhat lessens the geological risks associated with funding artisanal mining activities), and these require thorough study in order to deduce appropriate lessons from them.

Two major obstacles for potential microfinance initiatives can already be identified. Firstly, the risk of miners defaulting on their payments is extremely high. Given the lack of adequate geological information to predict

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<sup>89</sup> Levin, 2005.

dispersal patterns of alluvial diamonds, the risk that a miner will not be able to repay the loan is very real, and is in all likelihood too high for financing institutions. This risk can be managed however, by conducting baseline geological samplings that can help in eliminating mining sites that are likely to have the highest default risk. Such samplings, which will have to be financed by someone, also carry a potential risk however, as they might result in the discovery of economically viable deposits for industrial mining operations, leading to the disenfranchisement of ADM which would have serious consequences when building trust for microfinance operations. Another way to manage the geological risk, is to encourage the miners to organize into associations that could handle the loan, diversifying the risk over a number of mining claims rather than a single one (as above).

A second obstacle for using microfinance in supporting artisanal miners is the fact that the resulting loans won't be very "micro." Unless the gravel is easily reached (something which is getting increasingly problematic in Weasua, Liberia), sustained mining operations require at least several hundred, sometimes several thousand US dollars. The steep interest rates associated with microfinance loans may also put additional burdens on the economic profitability of the mining claims. On the other hand, it might also attract outsiders, willing to invest their money if it's considered "safe" enough by a microfinance institution, and also willing to offer interest rates that are significantly lower than those offered by microfinanciers, but will still return a handsome profit. This sort of outsider funding is generally only found in Brazil however, where diamond buyers have largely ceased their financial support activities. In the city of Coromandel for example, local business people often serve as financial backers, expecting a certain percentage of the diamond's value in return.<sup>90</sup>

## 5.2 THE SCENARIOS

Present value chains in Liberia and CAR comprise: individuals or small gangs of laborers working under a miner, who then sells to a broker, who sells to an exporter, or a cooperative exporting directly (which is the minority situation). The broker performs essential commercial functions—like pre-financing—transporting the diamonds from mine site to point of export, aggregating and sorting the diamonds, marketing them to the right buyer. It is not conceivable for the miners to do this themselves or for the international buyers to come to multiple miners. Thus, there needs to be an entity performing these middleman functions in *any* of the possible direct marketing structures.

The possible selling structures are as follows:

1. Individual miners (who employ groups of laborers) sell direct to a buyer, as is the primary existing model
2. Individual miners organize into a cooperative or association which has a marketing arm, e.g., as is done right now in CAR or as COV does in Colombia.

In both these scenarios, the miners may be independently financed, or not. Regardless of the funding situation, if international buyers are to source from individual miners, there will need to be a trusted local "middleman" to sort and aggregate the stones into parcels. A cooperative structure would allow the buyers to bypass local middlemen, provided the miners were self-funded or the international buyers offered finance. Though cooperatives do exist, the lack of "real," functioning cooperatives in CAR, however, poses a problem as these will need to be developed. The PDA experience demonstrated that this is not a small feat in these types of contexts.

There must also be an exporter. This could happen in two ways: first, the cooperatives could elect an individual to act as middleman exporter who would aggregate their wares, market them to the US (and other) buyers and stockpile these until the time came for export (e.g., when the buyers' representative came to collect and export the parcel). Some capacity building and monitoring may be necessary. Alternatively, the buyers could pay for their export office to be manned with a trusted, local, experienced buyer/exporter,

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<sup>90</sup> Blore 2008, pp.71-72.

whose job it would be to buy, aggregate, sort and parcel the diamonds in preparation for export on behalf of the syndicate. Monitoring would be necessary. Either way, this exporter is an essential function and one that will be costly to set up in CAR especially.

The possible buying structures are:

1. A **syndicate of US buyers** sources in the open market or, through setting up pre-financing, has structured relations with the miners. This is a trading relationship, not a partnership.
2. An **auction system** is introduced through which *any* local seller or international buyer could trade. This is an anonymous trading relationship.
3. A **junior mining company** has open or structured relations with miners mining on their exploration concession. This can be either a trading relationship or a joint venture.
4. An **international “fair trade” buyer**, who has established successes in developing mining/marketing partnerships with artisanal miners works with the miners in a joint venture type of arrangement.

Type of selling Type of buyer	Open market sales (Independent financing)	Structured selling relations (Dependent financing)	Both
<b>Local</b>	Local buyers source from independently financed miners who sell in an open market	Local buyers pre-finance miners, who must sell to them. (Present reality for majority of diamond miners)	
<b>International</b>	Syndicate of US buyers or junior mining company who don't pre-finance	Syndicate of US buyers or junior mining company who do pre-finance	Fair trade joint venture partnership
<b>Both</b>	Auction system allows international and local exporters to compete for miners' diamonds		

Each of these scenarios has different parameters in terms of feasibility given the local context and international buyers' conditions, their potential to contribute to development and incentivize formalization, and the complexity and cost to establish.

### 5.2.1 SYNDICATE OF US BUYERS

One interviewee envisions a scenario in which a syndicate of US buyers would purchase diamonds in either CAR or Liberia. This would give US buyers new sourcing opportunities by creating entry points in the actual producer nations, allowing them to bypass the main trading centers of Antwerp, Dubai, and Tel Aviv. There are obvious cost-saving gains to be made in this scenario.

This interviewee proposed that the syndicate would function as a US-based cooperative and would trade with registered ADM cooperatives or associations. The members would elect a buying team that would “slowly but surely redirect the flow of merchandise.” At the very minimum, it would be possible to facilitate the entry of this syndicate into the CAR and/or Liberia markets. This could be as simple as setting up an export business, including getting the necessary licenses, and helping staff the business.

In this scenario, it would be a simple business deal to get artisanal diamonds from CAR and Liberia straight over to the USA. The only developmental aspect would be the potentially higher prices the cooperatives could achieve from the economies of scale to be gained from having just one middleman, being the exporter. In the interests of ensuring fair market value for the miners (i.e., equivalent to what they could get in the local market or better), there would need to be some independent, reliable valuation mechanism. Otherwise the producers would need to be free to sell to whomever they please.

The diamonds could be marketed as “artisanal” using KP certification as evidence only, given that the Liberian and CAR diamond sectors are 100% artisanal.

At the buying side, and from the perspectives of the US manufacturers, this syndicate scenario must be sold to potential members as a viable business proposition and not charity. One member of the industry insists that the players in the diamond supply chain need to see the profitability of this venture; the ethical slant takes second priority. The prerequisites were:

- The syndicate must be led by an industry actor who is respected at all levels of the industry
- Each member would need to pay a reasonable membership fee. The cost of membership must be reasonable for the membership and it should be far less than the proposed returns
- Profits should be equal to or greater than what the members could make from alternative buying arrangements.
- The cooperative cannot be seen as giving handouts to miners.
- There must be a steady source of production for buyers who are coming to the table
- The arrangement needs to be regulated

The prospects of such a scenario incentivizing formalization are slim unless the US buyers can offer a sizeable price improvement to the miners. As our interviews showed, the US jewelers were not convinced that they would be able to command a much higher price in the present retail market, and manufacturers emphasized that the main incentive for them to participate would be to be able to secure diamonds “at the right price”, meaning to help ensure profit in a currently brutal market. Altogether, the potential for offering the miners a high enough price to encourage them to a) engage, and b) formalize, is low.

#### **NEXT STEPS**

Engage US diamond industry actors (manufacturers, large retail jewelers, mission-based jewelers, industry associations) in a workshop to hammer out the nitty-gritty of developing such a syndicate from the buyers’ point of view.

#### **5.2.2 AUCTIONS**

In order to address the frequently heard grievances aired by artisanal miners that they do not receive fair prices for the diamonds they sell, one expert on the industry has proposed a system of anonymous auctions for rough diamonds. The idea being that such auctions would open up the market, create greater competition, and bring the miners a higher price for their product. This again would require a trusted individual or institution to set fair prices and serve as an independent certification monitor for rough diamonds mined by legal miners. This would be a means of ensuring the transparency of the supply chain. As such, the supply chain would be significantly shortened, as licensed miners or mining cooperatives would be selling their product directly to the international or local buyer. The transparency created by such an auction will improve local understanding of how the international market values their diamonds. Additionally, this would help to significantly address the issue of mistrust amongst local supply chain actors, as miners come to better understand the value of their diamonds, and local buyers realize they need to become more transparent in their dealings with miners, if they are to remain competitive.

If such auctions and the volume of diamonds being offered through them become sufficiently widespread in the region, US manufacturers and other international buyers will have a reliable supply of diamonds. The result, as a proponent of this system has said, would be “a fair price for a fair trade.” If properly implemented, and with the necessary safeguards to ensure that the resulting “fair prices” will actually benefit artisanal mining communities, such auctions would be particularly suited for the ethical jewelers closer to the end of the supply chain, as they will end up selling unique diamonds that are flawless from an ethical point of view, and with demonstrated benefits to local mining communities. Interestingly, the small section dedicated to artisanal mining in the Liberian government’s 2010 Mining Policy document, makes specific reference to

the potential “development of an internet-based portal for marketing precious minerals,”<sup>91</sup> likely facilitating potential cooperation of the Liberian government with such auctions.

However, it is difficult to see how such auctions would be able to significantly change the key aspect that currently structures the entire diamond mining and trading economies in both the CAR and Liberia: the availability of capital to fund mining operations. Added to that is the fact that miners typically have to sell their diamonds quickly so may not be able to afford to wait for the auction to take place. In other words, an auction mechanism must also provide for the institution of a competitive funding mechanism (not just price-wise, but also accounting for the fact that this will mean breaking important if unbalanced social relationships and somehow paying the miners before the goods are actually auctioned) in order to allow miners to become independent actors. If alternatives to these established processes of funding-mining-selling are not provided, the main beneficiaries of such auctions and resulting higher prices would be the middlemen instead of the artisanal miners themselves.

While the organizers of such auctions could contractually demand from all non-mining diamond sellers that they demonstrate how their participation will improve the welfare of mining communities, without verification, such promises are likely to remain moot. On the other hand, the necessary capacity needed to take part in such auctions will prohibit the participation of ordinary miners, making established middlemen the most likely candidate-sellers, unless the auctions could take place near the mine site. While this may still prove to be economically interesting from the point of view of international buyers, it is doubtful how such diamonds could be considered more ethical or “fair trade” than other presently marketed diamonds coming from these countries, if these auctions are not backed up by significant follow-up architecture. At best, then, they could be marketed as “artisanal”.

US diamond industry stakeholders have also commented on the controversial nature of such auctions in the current trading climate, arguing that they are highly subject to boom and bust cycles. Furthermore, their need for dependable sources of supply seemingly runs contrary to the auction idea. On the other hand it may provide more open competition in undermining the dominant position of sight holders. One industry player clearly stated not being interested at all, fearing that US participants would not be able to compete with Indian diamond buyers who have access to superior financial backing. The subsequent inflation of prices would therefore be a good thing for the miner-seller, but not for the US diamond industry.

The profitability of such auctions needs to be clearly established as well, taking into consideration not only the financial investment required to legally export diamonds (especially in the CAR), but also the volume that could be attained by these auctions. While some stakeholders have commented negatively on the prospect for auctions today, they were positive about the opportunities such auctions could bring in the future, opening up relatively closed markets through increased competition, raising prices in the countries of origin as well as creating access points for the US diamond industry.

While the current sustainability of regional diamond auctions remains highly unclear, what is evident already is that auctions in themselves are unlikely to provide significant added benefits to diamond mining communities themselves, with the biggest beneficiaries being situated among diamond traders, instead of miners. Therefore, in order to speak of “fair trade” or ethical diamonds, such auctions need to be integrated with strict demands on behalf of diamond sellers, and possibly with a verification and certification mechanisms integrated into it as well.

## **NEXT STEPS**

The potential for auctions to bring very high prices for local miners during global upturns in rough diamond prices, to improve trust and transparency between mines and local buyers, and to educate local industry actors on diamond pricing means that the auction idea should be explored further. The introduction of an auction system could serve as an avenue for engaging existing buyers and starting a conversation on how to formalize their activities to enable them to market their wares through this mechanism. However, it would be advisable

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<sup>91</sup> Republic of Liberia, 2010. *Mineral Policy of Liberia*, p. 12.

to introduce this in combination with other structures to ensure miners have other options for selling diamonds during bearish markets when auctions are likely to command lower prices than they would achieve in more structured relationships. Further research is necessary.

### **5.2.3 JUNIOR MINING COMPANIES AS BUYERS**

On occasion, junior mining companies use artisanal diamond miners to prospect for them. It is in their interest to buy the miners' production in order to analyze this to assess productivity. To ensure the miners *will* sell to them, they tend to offer competitive prices. This is possible because they do not necessarily wish to make a profit on their diamonds, as the primary objective is to gain knowledge. Also, juniors will tend to export the artisanal diamond miners' production themselves, so cutting out the middlemen.

In the CAR town of Ngotto for example, local miners bemoaned the disappearance of an international junior mining company. Forced to pull out of the country as a consequence of the 2008 financial crisis, the company was exploring for diamonds in the region. As stipulated by the CAR Mining Code, local artisanal miners were allowed to keep mining on the company's concession during the exploration stage. Miners enthusiastically explained the arrangement they had had with the company, which provided them with monthly payments to hire labor and purchase equipment, and in return all diamonds produced were sold to company officials, with miners being generally very happy with the offered prices.

In order for this to work, there must be junior mining companies operating in the countries and interested in participating in a scheme like this. At the time of research, the Government of Liberia was working hard to develop interest in its mining sector by corporate actors, as evidenced by the LIMEP 2011 conference, and the strong support from both President and Vice President of the Republic. In the future there may be more exploration activity by juniors, but for the time being these players are few and far between. Should any emerge, this option could be investigated. Relations with artisanal miners should however only be established after it has been made clear that such relations are by definition only temporary: exploration will at some point stop, and so will the buying relationships established with local miners. If exploration evolves into large-scale or semi-industrial mining, however, the relationships with local miners will have to be re-evaluated. While it will become even more important for mining companies to establish good relations with the local communities, past experiences have shown that very few mining companies are interested in allowing artisanal miners to "encroach" on their concessions. Much of this will depend on the host government, as well as the management of the mining companies involved.

#### **NEXT STEPS**

Consult with national governments on the feasibility of this option and await the engagement of a suitable junior mining company. This may or may not happen.

### **5.2.4 FAIR TRADE – PARTNERING THE ARTISANAL DIAMOND MINERS**

There are a number of middlemen international buyers who are presently supplying ethical minerals to mission-based jewelers. They are all proving that direct marketing of artisanal jewelry minerals can be done. If some type of "ethical" diamond is possible, then these are the people who should be approached to try to make it happen. These "fair trade" actors do not always agree on what fair trade is, but they generally agree that their business models are precious. The principles emphasized are transparency, partnership (joint venture), and trust. The models make the miners co-responsible for the risks and co-beneficiaries in the rewards. It also involves bringing local authorities into the partnership. The critical role of the international actor is in inspiring the confidence of miner business partners and commercializing the diamonds. This means finding the right organizations to sort and cut them.

Since fair trade requires capacity building of artisanal miners in a wide range of areas, as well as the allocation of a portion of profits in a development fund to be invested locally, this is a model that would bring the highest development benefits to the miners. Combined with the higher price, this has proven to be an adequate incentive to artisanal miners around the world to engage with a fair trade process. This combination

and scale of benefits is more likely to encourage formalization than any other scenario set out above. Indeed, a condition of fair trade is that the mining and marketing be entirely legal and transparent.

It would, however, be potentially complex to establish and will take time.

#### **NEXT STEPS**

Engage interested parties in a discussion to confirm their interest in exploring bringing their models to countries either individually or in collaboration. Then a scoping mission should be conducted for them to assess the feasibility of applying their models in either country.

### **5.2.4 PILOTING DEVELOPMENT DIAMOND STANDARDS<sup>92</sup>**

The Development Diamond Standards (DDS) are currently being developed and tested by the DDII. Unlike other efforts promoting responsible diamond mining that only focus on large scale mining, the DDS are explicitly geared towards “addressing development issues and formalizing the artisanal diamond mining sector”. The DDII expressly positions the DDS as going “beyond the idea of fair trade diamonds”, arguing that most informal miners do not have the capacity to engage in such a process. According to the definitions proposed in the DDS framework, “development diamonds” are diamonds “that are produced *responsibly; safely; with respect for human and communities’ rights; in conflict-free zones; with beneficiation to communities and payment of fair prices to miners.*” These definitions are further expanded by a number of operational Principles. Designed to be applied by artisanal miners in cooperation with local NGOs directly working with mining communities, the DDS aims to provide a number of assurances regarding the legal, social, and developmental status of such diamonds by setting a number of minimum requirements. In addition, the Standards are meant to provide space for optional tasks, implemented at the discretion of the mining operators.

The most interesting aspect of the DDS is that it’s a grassroots-based model, focused on community involvement, and is based on the reality of artisanal diamond mining and trading. Instead of trying to impose the most stringent requirements right away, the strength of the DDS lies in its evolutionary model, whereby miners are empowered to gradually improve their compliance with the more advance standards in the DDS model. Additionally, it provides ample space for the inclusion of existing middlemen, provided they are willing to make the necessary changes required by the DDS framework. Not only will this reduce potential resistance from middlemen, but if existing middlemen are able to integrate into the DDS framework, this would significantly reduce the need for alternative pre-financing arrangements.

What is not clear is which of the commercial scenarios outlined above would be viable under the DDS and whether setting something up from Liberia and CAR would optimally be done under the framework of the DDS or some other ‘ethical’ diamond system.

#### **NEXT STEPS**

The DDS is partially developed, and it is recommended to more fully explore the feasibility and desirability of piloting a direct marketing scheme under their structure. Further research is required, however.

## **5.3 THE ROLES OF SUPPORTING INSTITUTIONS**

One thing that needs to be made clear is that interested buyers wishing to source directly from artisanal mining communities instead of through licensed middlemen or exporters would require some form of organization on the part of those communities, as sourcing directly from individuals would likely be uncompetitive with established buying and supporting networks. Support to such mining communities could, for example help them set up community development funds, whereby miners choose to deposit a small percentage of their earnings in such funds, for the development of the community as a whole. Miners in these

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<sup>92</sup> Factual information in this chapter is based on internal DDII documents on the DDS system, communicated to the authors, 2011.

communities would also benefit from financial management training, in order for them to properly use their profits for the development of themselves, their households and, ultimately, the community at large.

However, any efforts to increase the welfare of artisanal diamond mining communities have to be open and free for all interested miners, not just those who are involved with US diamond buyers. While USAID activities in selected mining areas can undoubtedly give an extra level of assurance as to the developmental benefits of diamonds mined there, there can be no direct link between USAID-supported miners and US diamond buyers other than voluntary ones, based on open and free competition among the various licensed diamond buyers.

The buy-in of the governments in both countries would be absolutely critical for a direct marketing scheme to succeed. Governments are likely to be very interested in any initiatives, especially if they themselves do not have to pay for it, which can increase the rate of formalization and improve the wellbeing of artisanal mining communities. In order to avoid rent-seeking behavior however, the link between foreign private investment and local benefits should be made very clear indeed, in order that all necessary steps will be taken to encourage the success of such an initiative that, if successful, might easily be replicated in other contexts and with other players.

Finally, as for the donor community, historically averse to meddling with artisanal diamond mining, they will likely opt to sit on the fence for a while, before committing to replicating such projects. Also, given the fact that foreign private entities will be benefiting from the arrangement, any donor investments in developing artisanal mining communities would have to be at least matched by the private sector.

# 6.0 CONCLUSION

The purpose of the research has been to see if increasing the price paid to the miner will incentivize him/her to formalize; and if facilitation of the commercialization of “ethical” or “development” diamonds, that can be marketed by jewelers as truly benefiting the social and economic development of artisanal miners, their households, and their communities is feasible. Specifically, we have tried to ascertain if the creation of direct buying links between artisanal miners on the one hand, and interested US diamond buyers, manufacturers and jewelers on the other hand, could have a significant impact on these joint goals of formalization and development. The scope of the research has been limited to the Central African Republic and the Republic of Liberia could aid in providing assurance and/or assistance to interested buyers.

The idea would be that by offering artisanal miners the opportunity to sell their diamonds directly to international buyers, this would “break open” a hitherto closed diamond value chain. Furthermore, the additional inclusion of beneficiation initiatives aimed at improving the general welfare of diamond mining communities could present US jewelers with the opportunity to market these diamonds as being “ethical” or promoting rural development. This would enable them to reach out to consumers who have grown increasingly critical and may be less inclined to be traditional diamond-based jewelry. Similarly, it has been suggested that such new sourcing arrangements may also present opportunities to the ailing US diamond manufacturing industry, although these are generally interested in acquiring cheaper diamonds, rather than investing in a diamond value chain that brings more benefits to artisanal miners.

## IS DIRECT MARKETING THE BEST WAY TO INCREASE PRICE?

To get higher prices to the miners, one must either:

1. Reduce the production and supply chain costs (e.g., take advantage of structures that offer lower export tax options; improve certainty of production through better prospecting and recovery techniques, etc.),
2. Be able to achieve higher prices for their diamonds at the end user, and transfer these profits back,
3. Bypass existing supply chain operators, and/or
4. Force those into paying a fair share to the artisanal miners.

Our Scope of Work was based on the premise that price could be reduced by bypassing existing supply chain operators; we did not investigate the other options for increasing prices paid to artisanal diamond miners. We have found, however, the following:

- The global economic downturn has made business much harder for expensive supply chain operators owing to competition. Supply chain rationalization is taking place.
- The quality of prospecting by ADM in CAR and Liberia could be improved. Conducting a baseline geological analysis could prove to be a particularly effective way of boosting diamond production, by guiding miners toward those areas which likely contain the most concentrated diamond deposits.<sup>93</sup>

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<sup>93</sup> A number of problems are associated with this, however. The first has to do with the relatively high costs of such an operation, in particular, identifying who is going to pay for it. If this is clearly associated with a developmental direct marketing scheme, or with a microfinance initiative geared at empowering ADM, international donors could be approached to pay for this. If supported by private sector funding, these will have to be integrated in the resulting mining and trading operations to recover their investments. A second problem is related to the results of the samplings. One the one hand, some mining claims will be revealed as sub-economical, even for artisanal mining operations resulting in possible loss of employment. On the other hand, deposits could be recovered that might attract the interest of junior mining/exploration companies, leading to the potential disenfranchisement of ADM in that area and artisanal miners losing confidence in the initiative that is conducting the geological analysis, posing further systemic risks to the success of the initiative for which the geological analysis was conducted. A similar experiment in the CAR illustrates this last fact quite well. In the 1980s, a World Bank-sponsored study to redress then dwindling

- Not all middlemen can be bypassed—they play important commercial functions; one might speak rather of consolidating these functions into one middleman (e.g., an exporter to sit between miners and buyers in a diamond trading chain).
- While the local buyers seemingly do best out of the present trading relations, they also bear the risk. Only by helping them manage this risk and thereby increasing certainty of returns, might one help give them scope to pay more to the miners they support. Ensuring they pass a fair amount of any extra profits down to the miners will require the adjustment of these existing trading relations to be more like joint venture arrangements than the current hierarchy.
- Diamond-buying markets in Liberia and the CAR are uncompetitive; prices could be raised by simply introducing more local buyers, e.g., through rationalizing the CAR's export requirements to encourage re-entry into its diamond buying markets by export companies or by introducing any of the possible alternative buyers into the local market.

If price is the real impediment to miners formalizing their activities, then properly exploring the above options for increasing price, bearing in mind the likely ease, cultural acceptance and most importantly *cost* of each of these routes should be considered.

### **IS DIRECT MARKETING THE RIGHT ROUTE TO FORMALIZATION?**

Our research in the CAR and Liberia found that there are a number of factors that determine miners' ability and wish to formalize. These include the lack of government capacity to properly perform their duties and enforce the law; the perception of artisanal miners that there is no benefit to legalizing their activities; a lack of visible government action to improve public welfare, and a limited trust in government to do so; complexity and expense of the licensing process; the role of middlemen in financing the mining (and thus deciding if a mining license is worthwhile).

We have found that most of the scenarios for the direct marketing scheme will probably do little to encourage formalization unless they find a way to incentivize the middlemen to aid the formalization of the sector and improve benefits to the miners.

First, the few producers ("cooperatives" or elite individual miners) that would be able to interact directly with foreign buyers are already formalized. In so far as the majority of diamond miners require pre-financing, then one must either find a way to provide them with finance—a complicated and risky venture—or work with existing financiers, the middlemen. Even if one does find a solution for pre-finance, it will be extremely hard to lure miners away from their existing financiers given the cultural and social security aspects of their relationships. If one has to work with the middlemen, it will be necessary to create an incentive for them to ensure that the diamonds they are buying are legally mined. Unless interested US buyers would be willing to include extra assurances in their dealings with the middlemen, and back this up with regular controls, artisanal diamond miners will likely continue to conduct their businesses as they have done for decades, staying largely in the informal circuit.

The costs of the extra assurances that the diamonds bought through local middlemen are legally mined will have to be borne by international buyers, as they will be the ones benefiting from it; the current reality of diamond mining and trading in both countries shows that existing middlemen would have no problems with sustaining the status quo. The formalization benefits of that would understandably be nil. Even with

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diamond exports was conducted by geologists and diamond experts to identify ideal and less ideal sites for diamond mining. Geologists drew up a map, indicating the areas with the highest likelihood of significant diamond deposits, and distributed and explained it to local miners and middlemen. Soon afterward, miners started working on claims in an area which was essentially marked as "do not mine here". Clearly, miners distrusted the geologists, believing that those areas actually contained the best diamonds, which they suspected "the outsiders" simply wanted to keep for themselves. When, in defiance of the statistically low likelihood of it happening, a few diamonds were ultimately discovered, this further eroded the fragile trust placed in the accuracy of said map, and basically terminated that part of the technical assistance project. During a focus group discussion in a CAR village, one of the authors was similarly confronted with the significant value placed in stories about past discoveries, but also of mysticism and supernatural forces in "reading the signs" to identify good places for mining activities. (M. Van Bockstael, 2008, p. 60)

guarantees made, however, this will only mean that those diamonds have been mined legally, something which the government's own KP implementation is supposed to have covered already, and would not provide assurance as to the "ethical" status of the diamonds. The diamonds offered would be legally no different from other artisanally mined diamonds from these countries, raising doubts as to whether international buyers would be willing to invest in providing such guarantees, with no clear added benefits.

On the other hand, if US buyers would be willing to engage more directly—that is, to partially play a role in funding mining operations themselves, thereby empowering miners and shifting responsibility away from middlemen—a "snowball" effect may result in a significant increase in formalization. This might encourage miners to shift their selling relationships away from middlemen, to include international buyers as well. Obviously, this would largely depend on the ability of the buying scheme to be expanded (and the associated development initiatives as well, if such diamonds are marketed under a "development" umbrella) to other mining sites. If not, miners there will have no alternatives, and initial enthusiasm will quickly wither away.

It is with this conclusion that the fair trade partnership model is the option most likely to encourage formalization because it is the only option explored which viably involves co-financing of the mining/marketing joint venture by the miners' association and international buyer. The junior mining company model may also work to encourage formalization, provided the law provides protection for artisanal miners mining on an exploration concession and selling their diamonds to the concession-holder. We are not able to comment on the potential for the DDS to encourage formalization as we did not have enough information on how the DDS will actually work on the ground.

#### **IS DIRECT MARKETING THE RIGHT ROUTE TO DEVELOPMENT?**

If a direct marketing scheme is to have a development impact, it is clear that the focus should be put on the miners instead of the middlemen. Empowering miners by giving them access to new sources of financing and new buyers will significantly improve their livelihoods. It will also send a clear signal to other miners, and more importantly to the middlemen, that there are new players on the market from whom miners can expect reasonable and transparent prices for their diamonds, putting pressure on existing markets to adopt more transparent business practices. Additionally, development benefits can further be increased to impact non-mining community members as well, depending on how much US buyers are willing to invest in such activities, further strengthening the marketing potential of such diamonds.

However, given the fact that only the jewelers seemed to be interested in establishing buying relationships with artisanal miners themselves, and that most buyers and manufacturers indicated their unwillingness to buy so directly from the source, the resulting "light" version of direct marketing will be mainly played out between US buyers and established local middlemen. In such cases, even assuring the legality of all offered diamonds would prove to be difficult, and being able to claim developmental benefits would be largely impossible, unless a significant commitment is made to validating, and basically, certifying such diamonds. In that case, it might be commercially more attractive to go directly to the miners themselves. This can still be done with the cooperation of established middlemen, but a large part of the responsibility (and subsequent empowerment) will be shifted to the miners, with middlemen losing much of their current dominance of the diamond sector.

In short, while direct marketing can prove to be a significant ally to the cause of rural development, the requirements associated with it are not insignificant at all. "Doing well by doing good" means going beyond replicating the strategies of existing buyers and exporters, and actually making a difference on the ground. Only then can the bought diamonds be presented as being somewhat nobler than their common counterparts.

Profits can be made by everyone in a fair artisanal diamond sector that is conducive to poverty alleviation and rural development, but simply buying diamonds from people at the higher end of the value chain will do little to achieve this. In this scenario, the biggest part of the sector will remain as "unfair" as it is today unless some way of engaging the middlemen in making the diamonds more developmental can be found. If the primary objective is to find cheaper sources of rough diamonds, given the costs of setting up and running buying

operations, and the limited extra supply it will bring to the US, it might not be worth the trouble for most US diamond buyers and manufacturers.

### **IS IT POSSIBLE TO BRING US DIAMOND INDUSTRY AND ADM INTERESTS INTO ALIGNMENT?**

There is a tension between trying to get win-win solutions for buyers and sellers given existing supply chain structures. It is not a partnership; it is about getting the best price at both sides. How do you achieve fair market value? The CAR and Liberia are not attractive purchasing sites for US buyers because of probable issues of uncertainty and inconsistency of volume, quality, and regularity of supply. Similarly, US buyers are not attractive marketing options for ADM because they cannot offer the same type of financing and social support that present financiers can. So, what is in the interest of the US diamond industry might not be in the interest of development for ADMs and vice versa. We must bear in mind that the ideal is not going to happen right away, if ever. The most we can hope to achieve is having the USG present in the CAR and/or Liberia to create a space for US industry to conduct business. Yet the diamond sectors in these two countries will not be transformed overnight. A direct marketing project has the potential to bring something good to all parties involved, but it will not transform the diamond political economies in CAR or Liberia and it cannot address all the issues on the table.

A significant issue is the lack of capacity of US diamond industry actors to buy run of mine, and their wish to “pick and choose”. If only selected rough diamonds are commercially interesting, these actors will probably not be willing to make the necessary investments to create an ethical or developmental supply chain. This however, will leave them more open to competition from other international buyers, which can cause problems, given the US diamond industry’s current lack of “deep pockets” such as possessed by their Indian counterparts. Furthermore, it is not assured that buying diamonds from Bangui and/or Monrovia-based exporters instead of through the regular international marketplace will result in substantial savings, given the limited supply of rough diamonds that can be sourced and the transportation costs to be considered. The alternative, such as buying from local middlemen or sourcing development diamonds from artisanal mining communities themselves (and setting up beneficiation strategies) will require setting up shop as an exporter at least, something which does not come cheap. Given that the primary concern for US diamond buyers and manufacturers would be the access to cheaper diamonds, it remains unclear whether they can essentially beat existing diamond exporters at their own game, by not only sourcing cheaper diamonds, but by potentially adding an “ethical” or “developmental” component to the diamonds as well. Especially given the specific volume and carat requirements made, the economics of such a scheme might be quite disappointing.

In conclusion, given all existing caveats mentioned in the report, a direct marketing scheme (whether a “full” or “light” version) will not provide the significant advantage sought by US diamond buyers and manufacturers who are facing strong international competition. Conversely, a “full” direct marketing scheme with associated development benefits for artisanal mining communities will certainly bring such advantages to US jewelers. Branding a diamond as “helping development” does require significant investment to back up such statements, however. While this would create extra associated costs, and while such costs will be determined by the kind of assurances the jeweler will want to give his/her clients that such diamonds actually benefit local communities, further research is necessary to see what the balance would be between such costs and the added premium that can be demanded for “ethical” or “development” diamond jewelry, and whether selling such jewelry would actually result in a significantly higher markup for the jewelers. Whatever the outcome of that, a fully implemented direct marketing scheme could result in giving jewelers the required tools needed to reach out to a socially and environmentally conscious consumer market.

Finally, it should be realized that a direct marketing scheme, likely to be capturing only a tiny segment of the diamond markets of both the CAR and Liberia, could not on its own affect the change needed to successfully transform those economies. Government policies remain highly inadequate, the reform of which should remain the primary target of those wishing to structurally change the political economy of artisanal diamond mining to a trade more transparent and “fair” than it is today. Also, given the importance of these issues, there is a clear need for a separate and adequately financed ASM unit in the respective mines ministries. Such a unit already exists in the CAR, but is structurally underfinanced and works only with formal miners. This

does not exist in Liberia yet, but as natural resources governance (with a special focus on diamonds) remains one of the key areas that the UN is monitoring through UNMIL and the UNPoE, (partial) funding for such a unit may be acquired from the UN.

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# ANNEX: UNITED NATIONS MAPS OF CAR AND LIBERIA



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