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## Africa Meeting Summary

# Regulatory Initiatives Concerning Natural Resources: Lessons for Supply Chain Management in Africa

4 February 2013

Meeting sponsored by De Beers as part of the 'Diamond Dialogue' series.

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## PREFACE

This document is a summary of a workshop that took place on 4 February 2013 at Chatham House. The event was focused on regulatory initiatives in natural resource extractive industries, particularly concerning supply chain management in Africa.

There is a growing number of government, industry, and civil society-led regulatory initiatives that directly and indirectly impact companies with supply chain concerns in Africa. The purpose of this workshop was to bring together a range of experts to explore these initiatives, clarify the implications for supply chain management in Africa and draw out lessons.

The event was part of the De Beers 'Diamond Dialogue' series. The aim of the series is to facilitate the process of encouraging multi-stakeholder responses to sustainability challenges within the industry. This is done by bringing together representatives from governments, NGOs and the industry to engage in open and frank discussion on the issues.

The following summary is intended to serve as an aide-mémoire for those who took part and to provide a general summary of discussions for those who did not.

The meeting was held under the Chatham House rule and the views expressed are those of the participants.

### The Chatham House Rule

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## INTRODUCTION

A single item of jewellery may contain numerous minerals and metals from up to a dozen sources. After extraction, these resources go through manufacturing processes that take place in multiple countries before reaching the retail market. For example, De Beers has multinational supply chains providing for over 8,500 stores. This presents a broad range of operations and actors that need to be covered by industry-mandated corporate social responsibility (CSR).

It was argued that the extractive industry tends to define ethical business as 'doing no harm' and one of the most successful examples of the industry's interpretation of CSR has been in South Africa where a flagship programme was agreed.

The timeliness of the meeting was noted as 2013 marks the 10th anniversary of the Kimberley Process Certification Scheme (KPCS), the global multi-stakeholder initiative to rid the diamond trade of 'blood diamonds'. The KPCS has become a much-cited example of multi-stakeholder partnerships and, more importantly, it positively demonstrates how the link between the mineral market and conflict can be broken.

There has been a lot of academic debate explaining how rebel movements, notably in sub-Saharan Africa, have sought to profit from the trade in high-value natural resources. However, some popular explanations of the root causes and motivations for conflict are simplistic. It was pointed out that civil wars are the result of very complex processes in which political, demographic, geographic, social and economic factors interact. The availability of relatively accessible natural resources, which can be looted, sometimes plays a very important role in this complex web of factors, but it is a role that often differs greatly according to the specific context.

It was argued that the KPCS is an administrative response to a practical problem: how to identify blood diamonds and ban them from being traded? The answer: a certificate of origin attached to all shipments of rough diamonds, and the creation of a closed market for rough diamond trading. Although the diamond industry has additional safeguards of its own under the World Diamond Council (WDC) chain of warranties, the credibility of the KPCS ultimately lies with the participating governments and the credibility of their claims that their diamonds for export were mined where the governments maintain they were.

It was stated that problems associated with artisanal, alluvial diamond production are rooted in simple geography, but are also linked to the economic development of a country. Artisanal and small-scale mining (ASM) occurs only in developing countries, where no adequate alternative employment opportunities exist for uneducated, sometimes illiterate rural labour. It was claimed that artisanally produced diamonds represent roughly 20–25 per cent of annual diamond production, by volume.

It was argued that within the Kimberley Process (KP), cash-strapped governments in developing countries have to do the hardest work of controlling vast alluvial diamond fields, but they are often the most ill-equipped to do this. The structures used by these governments, including the Mining Code and associated regulations, are often out of touch with reality. This is no fault of the KP – in fact the process has often improved this situation. It is part of the general lack of understanding of ASM, its causes and drivers.

One lesson from the KP is the success of the stakeholder approach, bringing obvious benefits to the negotiation table. But it was suggested that perhaps the most crucial lesson has been the approach taken to ASM. The KP remains ineffective and insufficient in controlling diamond mining, trading and smuggling in artisanal mining countries. Many KP participants view ASM in technocratic terms as a capacity problem and an issue of law enforcement, rather than acknowledging the reasons of ASM's continuing informality. Furthermore it was argued that the 'blood diamond' and conflict mineral campaigns have framed ASM in a way that overlooks its reality as an economically viable livelihood provider in much of rural sub-Saharan Africa. It is an important part of the global mining sector which is resistant to change. Donors and development NGOs often regard artisanal miners as victims who would be better off returning to their farms. Yet ASM is intricately linked to de-agrarianisation and the subsequent rise of rural non-farm employment, which is essential to economic growth and development.

The KP has the potential to be a leader in promoting ethical and responsible sourcing of minerals. Artisanal mining communities are almost always ignored in policy debates, and incentive-based approaches to formalization must now be considered. The United States was the 2012 KP chair and put ASM back on the agenda. USAID has implemented a project in the Central African Republic focused on strengthening artisanal miners' rights to mine, as a way to increase formalization and therefore government oversight. Rebel advances in late 2012 and early 2013 could result in these diamonds being considered as 'conflict diamonds' if the political settlement does not hold.

## PRIVATE SECTOR AND INTERNATIONAL INITIATIVES

This section deals with the policies and programmes of the diamond, gold and jewellery industries that were outlined at the meeting. Much of the debate centred on the incentives for implementation and the effectiveness of the policies and programmes.

### De Beers Best Practice Principles

The De Beers group created its own Best Practice Principles (BPP) because the diamond industry recognizes that having a vested interest in CSR beyond its legal obligation is good for business. The BPP are non-negotiable and require compliance on a range of environmental, legal, and operational requirements relevant to operations. All practices that occur within the De Beers chain must meet with the BPP, as must any contractor that gains 75 per cent or more of its income from De Beers, and any site-holding entities that deal with De Beers. These regulations are applied to all De Beers operations and contracts across 57 countries. It was stated that the BPP require adherence to industry-wide programmes such as the Kimberly Process (KP), local and international law and specific 'in house' best practice.

More specifically, they encourage working partnerships between clients to raise standards. For example, the BPP requires clients to pay the minimum wage of the country in which they operate. Non-compliance can result in the suspension or termination of a contract. As a non-branded industry, any problem within a single company's supply chain reflects badly on the entire industry.

There are initial costs incurred in adopting the principles and De Beers grants up to £500,000 worth of assistance to companies joining the process. However the understanding is that the BPP help to lower employee turnover and consultation fees in the long run.

Remaining areas of risk include:

- **Conflict diamonds:** The role of the diamond industry in facilitating finance and resource flows to rebel groups lead to the KP. However the KP framework was set up to prevent money from diamond extraction passing to rebel groups. It does not account for conflict that is perpetuated by governments. This issue has come to dominate the debate surrounding the KP recently, as attention on diamond extraction in Marange, Zimbabwe intensifies.
- **Money laundering:** There are links between diamond extraction money laundering and corruption. Diamonds are high in value and relatively easy to transport.
- **Labour relations:** The BPP has been crucial in lowering risk in extractive supply chains, and the improvements of labour relations in India and China are stated achievements of De Beers. Yet there are still many countries that have very large mining sectors and very poor labour relations.

- **Conflicting legislation:** The industry faces risks where enterprises cannot comply with conflicting or contradictory legislation or regulation.

The BPP is a benchmark for existing industry initiatives. It is based on external legislation and it also includes internal best practices and standards.

### **London Bullion Market Association (LBMA)**

There are roughly 720,000 bars of gold in London with a combined value of over US\$ 4 billion. As gold is traded where it is physically located, London may be the world's largest gold market. The London gold fix is an international pricing standard.

Part of the London Bullion Market Association (LBMA) is the London Good Delivery List, which is another industry standard used to assess the quality of gold and silver bars. In order to appear on the list, suppliers need to be accredited by the LBMA. This requires third-party audit guidance.

The LBMA is committed to harmonization between other regulatory bodies, such as the Responsible Jewellery Council (RJC), WGC and the Electronic Industry Citizenship Coalition (EICC).

The aim of the LBMA is to ensure that the gold market continues to operate in accordance with international investment rules. The LBMA also encourages other exchanges to adopt the Organization for Economic Co-operation and Development's (OECD) due diligence guidelines, although this has proved more challenging. Smelters are increasingly interested in the source of their gold, but further down the supply chain there is more to be done in raising companies' awareness and ensuring that they are applying due diligence.

Policy-makers continue to look into compliance enforcement but there are complications. Not only is it difficult to ensure compliance, it is even more difficult to implement policies that might impose higher costs on the industry. It is crucial that audits demonstrate transparency and ethical sourcing.

The LBMA has a mutually supportive relationship with the World Gold Council, although there are technical differences in membership and audit methodology. It was argued that more active engagement from China, Russia and Japan is required in order to develop wide-reaching international partnership.

### **Responsible Jewellery Council (RJC)**

The RJC is a member-based standard-setting accreditation body bringing together over 420 organizations committed to advancing practices in the jewellery industry.

The RJC standards include a code of practice, auditor accreditation, independent verification and RJC certification.

Joining the council is a statement of intent. There are no prerequisites for joining, but once they have joined, members must become certified within two years.

## **INCENTIVES**

There was much debate around the incentives for implementation and compliance.

It was stated that CSR in the diamond industry is a response to market pressures. Consumers are becoming more aware and concerned about where products come from. Addressing these concerns is core to the business model. Companies need to retain consumer confidence in purchasing their products. The cost of not carrying out CSR procedures is greater than the cost of their implementation. The opportunity cost is far greater than the actual cost. As a result the

industry response is inherently flexible, demonstrating an ability and willingness for positive contribution to the environments in which they operate.

The BPP is an example of the response to consumer concern over the supply chains that diamonds take to reach market, and especially concerns over conflict diamonds.

The RJC is based on similar market-driven concerns. Consumers need to be able to purchase any jewellery with the confidence that the proceeds from the sale are not fuelling conflict or organized crime. The council represents a coordinated response from suppliers to protect the reputation of the market.

In contrast to this, it was argued that if the incentive for participation in CRS derives from market demand rather than the desire to fundamentally change operational procedures, then the industry response is a means to convince consumers that products are ethically sourced rather than ensuring that they actually are. It was questioned whether industry-led frameworks are effective in ensuring that products are ethically sourced, or whether they were only effective in appeasing consumer concerns.

## Effectiveness

It was claimed that the industry's motivations are revealed through the effectiveness of the policies and programmes.

There are two concerns regarding the various extractive regulations. The first is that there is a long list of rules and regulations that are at times highly technical and difficult to impose. The second is that if companies do implement the regulations fully, this could impede the ability of these firms to make profit.

These concerns are acknowledged by the diamond industry, but some argued that they are not empirically valid.

78 per cent of the world's diamonds pass through De Beers' entities and affiliates. All of these firms are required to apply the BPP.

Areas of the industry where there remains a risk include alluvial mining operations and some sub-contractors. Since 2005 however, there has been a considerable fall in the number of infringements.

The effectiveness of policies must be measured against what they are trying to achieve. For example, in relation to eastern Democratic Republic of the Congo (DRC), it was highlighted that expecting such policies to lead to a reduction in conflict was unrealistic. Artisanal mining will always involve an element of risk, as miners clearly do not have compliance officers.

Despite limitations, it was argued that such policies have achieved a fundamental shift within the industry. There is an increasing awareness of the collective responsibility of the industry and an internalization of the problem.

It was suggested that there is also awareness of a disjuncture between the policies on a technical level and the ability to implement them on an operational level. The attention is now focused on embedding these best practices at the project level in projects, contracts and compliance.

It is yet to be demonstrated whether the BPP will be as effective in ASM as it has been in the formal sector, but the breadth and scope of the industry response is growing.

## MULTILATERAL GOVERNMENT INITIATIVES AND LEGISLATION

This section summarizes multilateral initiatives and legislation at the governmental and industry level. Much of the debate that took place at the meeting was concerned with whether the parallel diamond trade was a matter of security or of illegality and organized crime.

## **The Forest Law Enforcement, Governance and Trade Action Plan (FLEGT)**

It was stated that the FLEGT Action Plan, agreed in 2003, is based on the assumption that forest governance can be improved using market incentives. FLEGT aims to reduce the consumption of illegal timber in the European Union (EU). It also includes measures to develop the market for legal products in the EU, as well as support for improving law enforcement and governance in producer countries.

It was claimed that there have been a number of outcomes from the Action Plan to date, most notably the establishment of Voluntary Partnership Agreements (VPAs) with producer countries and the development of the EU Timber Regulation (EUTR).

Under the VPAs, only products that have been licensed as legal can be imported into the EU from partner countries, and so in each country a licensing system is to be established for legal timber. The development of this system begins with a multi-stakeholder negotiation to define how legal timber should be defined for that particular country. Capacity building is provided to help establish the licensing system, improve enforcement and to implement any necessary legal reforms. Six such agreements have now been finalized and negotiations are under way with a further six countries, while 15 other countries have expressed interest in negotiating a VPA. It is estimated that the first FLEGT-licensed timber will be available in 2013.

The EUTR prohibits operators from placing illegally harvested timber and timber products on the European market, and requires that they exercise due diligence to minimize the risk of doing so. The regulation was agreed in 2010 and came into force on 3 March 2013. This legislation was established as a complementary measure to the VPAs. The VPAs only cover timber imported directly from partner countries, and so a broader measure was needed to cover timber imported via third countries where it may have been processed, for example, and non-VPA countries.

As the VPAs are at an early stage of implementation and the EUTR did not come into force until March 2013, it was argued that it is too early to assess their long-term impact on the forest sector and whether they will serve to reduce the flow of illegal timber products coming into Europe. However, some lessons have been learnt from the process of developing both these instruments.

It was argued that establishing a national legality assurance system requires considerable time and resources. This is partly because of the complexity of the legal situation in many countries, and also because of the need for multi-stakeholder negotiations to ensure robust and broadly acceptable outcomes. Furthermore, the scale of the task in setting up a national system is considerable, because of low capacity and weak communication infrastructure in producer countries, as well as the large number of businesses implicated.

Concern was expressed at the slow rate of implementation of the VPAs, particularly in light of changes in the timber market. There has been a significant growth in markets for timber in many developing countries. Additionally, China has become a major processing hub for the timber trade. The EU market is therefore of less importance for some producer countries, and so it may no longer provide a sufficient incentive for countries to implement expensive licensing systems and difficult reforms.

It was argued that the effectiveness of this legislation will derive from its uniform enforcement across the member states to avoid the creation of weak spots. This is particularly the case because it is only those who first put illegal timber on the market who will be infringing the legislation. Those further down the supply chain are not liable. There was concern that a number of member states are not dedicating sufficient resources to ensure effective enforcement.

It was argued that capacity-building and awareness-raising are required to ensure effective implementation. Information and training also need to be targeted at small and medium businesses (SMEs) to ensure that they are not excluded from the legality requirements.



## **Dodd Frank**

Section 1502 of the United States' Dodd Frank Act stipulates that minerals from the DRC must be obtained without contributing to the conflict in the region.

It was argued that as a tool for peace-building in the DRC, the Act focuses on minerals as drivers of conflict, thus ignoring the broader nature of the 'war economy'.

The idea that restricting revenue from minerals will stop the rebellion overlooks the complex nature of the war economy in DRC. Every aspect of the eastern DRC economy is part of a war economy, which even the auditors of the BPP principals contribute to in some small ways, such as by spending money on visas, hotel rooms, taxis and goods and services.

It is too early to assess the impact of the Dodd Frank Act. There was a brief period when the Dodd Frank conditions were met, following President Joseph Kabila's 2010 ban on exports from the Kivus. However, there was little reduction in the volume of minerals leaving the region.

The wellbeing of the local population increased as soldiers left, but for many people the mineral trade is their only access to the cash economy. So despite being more secure following the soldiers redeployment, there was less money for food and school fees.

Some argued that the complex political situation in the DRC creates a very difficult business environment, and that the economy of the eastern DRC is characterized by smuggling and opacity. It is impossible to identify clear supply chains in the DRC. There are very complex informal tax systems and there are many incentives to provide false information to auditors. These auditors do not have the time or resources to fully understand the complexity of the networks and links that are characteristic of the region. In many cases, auditors are told that the supply chains are clean and they report these results.

The Kimberley Process is an 'all or nothing' compliance regime. Even if a firm is 99 per cent clean, it is still regarded as being non-compliant because of the outstanding one per cent. This results in companies being incentivized to pull out of the DRC entirely rather than deal with non-compliant contractors. Despite these companies trying to do the right thing, it is argued that they are undermining the alluvial mining sector on which local livelihoods depend.

Some participants maintained that the gold trade is even more problematic, because gold is easy to disguise and difficult to trace. This has resulted in a transfer of human capital into gold mining areas.

Effectiveness could be increased by harmonizing efforts to curtail conflict minerals. Currently there is little clarity across sectors and programmes, and there is no funding for compliance officers to deal with the numerous processes.

The key problems that need to be targeted are security, sexual violence, slavery, human rights abuses and child labour. A resolution of these deep-rooted social problems cannot be achieved through the Dodd Frank Act – this is not the purpose of the legislation. But it is vital that any international legislation does not prevent local economic diversification. If alluvial mining decreases as a result of these policies, jobs must be created in other sectors.

## **OECD Due Diligence Guidelines**

The OECD guidelines are demand-driven. The OECD was called upon by companies to help them better manage minerals sourced from conflict zones.

Companies identified this as a complex issue and indicated that they were worried over alleged instances of conflict diamonds being exported specifically from the eastern DRC. At that time there were no guidelines on how companies could operate without contributing to conflict.

The OECD guidelines are structured around four components designed to explain how risk management programmes can work. Efforts were made to combine the guidelines with existing



corporate efforts. The guidelines do not define conflict. Instead they determine the risks that companies can identify that highlight potential for conflict and human rights abuses.

One important element is identifying problems along the supply chain. While downstream companies need to identify potential risks for sourcing conflict diamonds, upstream companies and mines need to ensure that they are complying with regulation in order to participate in the market.

One positive achievement has been the inclusion and incorporation of standards into host governments. In this respect, industry initiatives are crucial.

It was argued that host government engagement is currently lacking. All stakeholders have a role to play, as the industry alone cannot solve all the challenges associated with operating in these environments.

In the pilot implementation phase of the guidance scheme there have been some changes in corporate behaviour. Companies are becoming more risk-averse, and some have stopped sourcing from countries such as the DRC altogether. This reluctance to source from the region was seen by many as a positive thing, although others argued that it undermines the local cash economy and does more harm than good.

The certificates have been aligned with OECD governments, and there is a normative framework between these governments and the host governments.

Much needs to be done to address the limited leverage that downstream companies can wield over upstream companies. For example, downstream gold companies have faced difficulties in getting upstream companies to comply. A key challenge is the need to build traceability and due diligence into the industry.

## EU Initiatives

Natural resources can play a role in conflict, as different groups and factions of a society fight for their share. The importance attributed to this understanding by the international community is demonstrated by the number of initiatives in place. Examples include the United Nation's (UN) Guiding Principles on Business and Human Rights, the Extractive Industries Transparency Initiative (EITI) for oil, gas, and mining, and the OECD due diligence guidelines mentioned above.

The EU has a number of commitments related to natural resources in support of these initiatives. One priority for the EU is the transparency of revenues. In this regard the EU supports the EITI, helps developing countries to implement it and, through the 2011 Draft Directives, to promote the disclosure of payments to government adopted by the European Commission (EC).

Another priority is the promotion of transparency in supply chains. The EU is achieving this through FLEGT and through its support of the OECD due diligence guidelines.

The 2011 Draft Directives include a proposal for country-by-country reporting. This is to increase the transparency of payments to governments in the extractive industry. It will also help society at large and national supervisory bodies to hold governments to account. Furthermore it will help to hold companies to account for revenue payments and receipts, which will decrease fraud, corruption, and tax avoidance.

The stated aim of the EU's 2011 communication on raw materials is to examine ways of improving transparency throughout the supply chain and, in coordination with key trade partners, tackle situations where revenue from extractive industries is used to fund wars or internal conflicts.

In its 2012 Communication on Trade and Development, the EC announced that it would explore ways of improving transparency throughout the supply chain, including aspects of due diligence. The EC advocates for greater support for and use of the recently updated OECD guidelines for multinational enterprises, and the OECD's recommendations on due diligence and responsible supply chain management.

As a follow-up to the 2012 Communication, an internal workshop was held on 5 December 2012. Further public stakeholder consultations are envisaged.

The EU recognizes a number of uncertainties including debates around the definition of conflict, the scope of the initiatives and which industries they should cover. There is an additional question of geographical coverage. Questions were asked as to whether the EU's initiatives should focus on the DRC exclusively, or on Africa more widely. The greater the geographical area covered, the more complex the initiatives need to be.

It was highlighted that a dichotomous split exists between voluntary agreements, such as the OECD guidelines and mandatory arrangements' such as the Dodd Frank legislation.

Critics argued that the EU legislative process is cumbersome, but its advocates stated that the lengthy process allows for lessons to be learned from the mistakes of others.

## SECURITY OR CRIMINALITY

Many of the initiatives currently in place address resource extraction in conflict and high risk areas. For example, the Kimberley Process was specifically set up to prevent the diamond industry from inadvertently fuelling conflict. Increasingly, organizations are identifying areas that are not conflict zones as defined by international law, but demonstrate issues of political instability. These can be characterized by human rights abuses and contraventions of international law, for example the use of torture, forced labour and child labour.

The broader debate around areas of political risk has progressed beyond a narrow focus on conflict. The attention is now on legality, particularly organized crime, and the ability of states to implement and enforce both domestic and international law. This is starting to be reflected in CSR initiatives.

One problem that has been encountered by some companies is that laws are neither applied nor enforced in the areas where they are operating. This is often the case on the peripheries of states with weak capacity.

The DRC is an example of such a state. The cyclical crises of the eastern DRC are as much a problem of legality and criminality as they are of security. This is important when assessing the role which the Congolese army has played. The army is simultaneously an arm of the Congolese state and its authority, and an independent actor. Many individuals within the army have personally benefitted from their access to minerals. The inclusion of the military is missing from many of the international governmental and CSR initiatives, and there are no incentives for the military to disengage from this activity.

It was argued that the army would have less incentive to involve itself in the mineral supply chain if soldiers were regularly paid. To this extent, some people argue that the reform of the extractive industry must be part of broader security reform.

While the mineral industry is vital to some politically unstable areas, there was debate over whether this warrants disengagement by companies. Operations in these complex political environments can be productive and economically viable, but when the risks outweigh the benefits, or when customers are not purchasing the product because of concerns over the source, companies will disengage. Companies are ultimately accountable to their shareholders and political engagement and development is beyond their mandate.

The debate between security and legality was most prevalent with regards to the KP and Zimbabwe. The emphasis of the KP was on stopping the funding of rebel groups through mineral sales, however the political context has now shifted in two specific ways. Firstly, Western governments have started engaging with rebel groups. This was most notably seen during the crisis in Libya and more recently, Syria. Secondly, governments may be the perpetrators of conflict, illegality and organized crime. This defines much of the debate on the KP in relation to Zimbabwe, where there are allegations that revenues from the Marange mines are funding human rights abuses and political violence perpetrated by the state.

It was argued that many of the international initiatives focus on non-state actors. There are concerns that this means that if a person is recognized by the UN as head of state, then the political groups affiliated with that person are legitimized, irrespective of domestic behaviour.