
The Kimberley Process Certification Scheme one year ahead: state of affairs in the EU

Executive summary and recommendations



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General conclusions and recommendations

General conclusions

The KPCS

On 5 November 2002, fifty-two diamond producing, processing and importing countries adopted the Kimberley Process Certification Scheme (KPCS) to stop conflict diamonds from entering international diamond markets. They agreed to comply with certification requirements for exports of rough diamonds, assuring that all mined and traded diamonds are produced by, or procured from, legitimate sources. In practice, the KPCS was only fully implemented by 1 September 2003. This report has investigated the functioning of the system in the European Union one-year after this date. It examined how the European regulations for the KPCS and System of Warranties the are being implemented.

A lot has changed in the certification and control systems of rough diamonds since our last body of research in 2001. The complete ban on rough diamond imports from Liberia is still in place, but only imports from Sierra Leone and Angola required certificates at that time. The 2001 report concluded, among others, that inspection and monitoring systems for rough diamond imports were very different in the UK, Belgium and The Netherlands. The differences reflected the adoption of rules and regulations, knowledge, political will and available resources. Belgium, by far the largest importer, was more advanced than the other two countries and more transparent.

Under the KPCS, all participating states now must comply with the certification requirements for rough diamond exports. Countries have to pass the necessary laws and regulations to implement the system. Within the European Union (EU), all member states are instructed to import and export rough diamonds via a Community Authority, where the shipments are inspected. Until mid-August 2004, there were two European Community Authorities, one based in London and the other Antwerp. Therefore this report focussed on these countries.

Kimberley Process participants that have complaints about the way others implement the scheme can request a review mission to that particular country. A system of voluntary peer-reviews has also been put in place, under which a volunteering country can invite a team of observers to examine its implementation of the KPCS.

Statistics

Information about trade flows is extremely important for the monitoring of the KPCS. In order to detect potential discrepancies between imports and exports of a country and sudden diversions of trade flows, participants are obliged to collect and exchange statistical data on the trade and production of rough diamonds.

However, for some countries this is sensitive information, which is not made public. The unwillingness of some participants to provide this data, even on confidential terms to the Kimberley Process (KP) Working Groups on Statistics, had slowed the creation of a

consistent and thorough database. The European Commission has decided to publicly disclose detailed KP statistics for the EU as a whole. This initiative is welcomed as a way of increasing the transparency of the system.

The KP statistics for EU imports reveal that the origin of millions of carats of diamonds has been incorrectly cited on KP certificates. Furthermore, for several diamond producing countries, EU imports declared as originating from those countries substantially exceeded their domestic production.

Implementation of the KPCS

Because the diamond sector is of such importance to Belgium, the country has been a strong supporter of the KPCS. As one of the two initial entry points in the EU, Belgium has implemented the system quickly and thoroughly, in close collaboration with, and under supervision of, the European Commission.

According to trade statistics, despite the instant fears of notably Belgium, there has not been a drop in diamond imports into the EU because of the strict regulations. Imports of rough diamonds from outside the EU have not decreased or transferred to, for example Tel Aviv, as the Belgian government feared. On the contrary, the country seems to have strengthened its position, as imports into the EU are increasingly going directly to Antwerp and London, no longer passing through other EU countries.

In the UK, the diamond industry is dominated by De Beers, the world's leading diamond company. Similar to Belgium, the other EU point of entry for rough diamonds, the United Kingdom has clear import and export procedures. In contrast to Belgium though, the UK does not inspect all shipments, but only those selected on the basis of a risk assessment.

The Netherlands is not an important diamond trading country. As trade in rough diamonds is very small, there is no need for a separate entry point. Diamonds are imported through the Belgian Community Authority. However, the Dutch diamond trade data show some strange irregularities that cannot be accounted for. Stock declarations are not required in The Netherlands.

A weakness in implementing the KPCS in the EU, which applies to exports via both Belgium and the UK, is that rough diamond exports may be declared as coming from unregistered pre-2003 stocks from companies based in other EU countries. These stocks are not registered and can therefore not be verified.

Another issue that has not been addressed so far is the fact that diamonds may easily be smuggled into the EU through overseas territories like French Guyana. It was not clear whether all overseas territories remain outside the KPCS.

Sanctions

Several 'irregularities' in the import and export regime of the KPCS have been discovered since the start of the process.

When not caused by mistakes, the cases were passed on to national authorities.

Several procedures are currently in place against companies in violation of KPCS provisions. None of the cases have concluded as of yet and no legal sanctions have thus been imposed, which makes judging the effectiveness of the monitoring mechanism extremely difficult. The lack of quick action on irregularities in the system remains a weakness, because it allows companies that have violated the KPCS to continue trading until a final judgement is reached, and this can take years.

Export valuation

The valuation of rough diamond exports is an important issue in the KPCS. As many countries charge export taxes, this sometimes results in severe undervaluation of export shipments. Some countries allow imports of which the declared value is considerably lower than the market value, while others, notably Belgium, require the declared value be consistent with fair market value. Consequently, companies are increasingly exporting via countries that allow undervaluation, such as Switzerland, the US and the United Arab Emirates. This decreases profit margins for Belgian companies.

An indirect effect of the KPCS is that the tax earnings on diamond exports of some countries are rising, because of a larger control on trade flows and an increase in the value mentioned on KP certificates. This can be considered a positive effect for developing countries, notably post-conflict countries in the middle of a reconstruction process, like Sierra Leone.

Industry self-regulation: the System of Warranties

The KPCS is an agreement between states and the certification requirements apply to international trade only. However, rough diamonds are also traded between companies within a country's borders. The European Community is a single market and therefore it is a single participant to the KPCS, represented by the European Commission. The KPCS does not apply to trade between EU member countries.

The EU statistics show diamonds that are traded within the EU are usually mixed with diamonds from other origins. The source of diamonds becomes harder to trace with each transaction. It is impossible to keep track of a set of rough diamonds once it has been split and mixed with rough diamonds from other sources.

To address this problem, the diamond industry established a voluntary system of self-regulation called the System of Warranties. This is also a major change, compared with the situation described in the 2001 report. Under the System of Warranties, all companies trading in diamonds have to make a statement on invoices that the diamonds they sell are conflict-free. These warranties must be supported by proof that the diamonds were obtained from legitimate sources. The System of Warranties applies to all transactions, domestic and international, and complements the KPCS.

Implementation of the System of Warranties

In contrast to the arrangements for other KPCS participants, the European Union has made the system of industry self-regulation part of its legislation, supervised by the European Commission. So, although the system of warranties is in principle voluntary, under the EU regulation it becomes an obligation for all companies that wish to export rough diamonds from the EU. The EU currently has the strictest legal framework on trade in rough diamonds of all KPCS participants.

In Belgium and the UK, diamond bourses adopted a common code of conduct. Bourses have the obligation to publish the names of all individuals and companies that have been found guilty of violating KPCS or System of Warranties regulations. Members of the bourses are prohibited from buying rough diamonds from these persons or companies. As of August 2004, there had not been any audits of the records of warranties received and issued by diamond companies in Belgium. The UK was ahead of Belgium in this respect and had started such audits, but they have not yet concluded. Therefore no investigations have been carried out on violations of the System of Warranties and no sanctions have been imposed. There are no guarantees yet that the system is functioning correctly and effectively.

There is a major weakness in the implementation of the KPCS in the EU. The warranties issued by members of bourses in other EU countries are generally considered equally reliable as those issued by members of the Antwerp and London bourses. However, this is not justified, because the European Commission does not supervise the bourses in other EU countries.

In the Netherlands, industry self-regulation is not well developed. The diamond trade organisations in the Netherlands are not supervising the full implementation of the System of Warranties. Audits of the warranties issued and received are not required. Ensuring that warranties are included on every invoice without verification, which is currently happening, is insufficient. Like in Belgium, there are no guarantees yet that the system of self-regulation is functioning correctly

The KPCS and System of Warranties in new EU member states

The Czech republic, Hungary, Poland and Slovenia were individual KPCS participants before their accession to the EU on 1 May 2004. They currently do not meet the requirements to become a separate entry point. It is yet unclear which of these countries is going to have its own Community Authority. Nor do we know how these countries are going to monitor industry self-regulation.

The EU and internal controls in Africa

Although there are flaws in the implementation of the KPCS and System of Warranties in the EU, the main problems do not occur on this side of the world. There is general consensus that the biggest weaknesses in the system exist in African countries. Probably the most important strategy for laundering conflict diamonds is to smuggle them into the local markets of a diamond producing country that is a KP participant, and mix them with domestic production.

Member states and the European Commission have stated their commitment to provide additional assistance to developing countries to assist their implementation of the KPCS. However, apart from some support by the UK, EU countries have not made any funds available so far for KPCS-related technical assistance. Theoretically, countries could use support from the European Development Fund (EDF). It is extremely complicated to get access to EDF funding, though, and using EDF money for the KPCS means less money will be left for other causes like education and health. In spite of all the effort and resources that have been put into the implementation of the KPCS in the EU, it is strange that except for the UK there have been no commitments to support the implementation of the KPCS in developing countries. After all, the root causes are in developing countries.

Recommendations

Belgium

- The Ministry of Economic Affairs and the Antwerp diamond bourses need to demonstrate that the System of Warranties is functioning correctly and that sanctions to enforce compliance are effective. Audits of the records of warranties received and issued by diamond companies during the year 2003 should be carried out in Autumn 2004, in order to sustain the credibility of the system.
- The Ministry of Economic Affairs should pay extra attention to shipments with suspicious origins. This becomes even more important now the Republic of Congo is expelled from the KPCS and conflict diamonds will try to find other ways into international markets. It should ask for clarification when imports with a certain origin are exceeding domestic production of that country (e.g. Togo, Ghana, Sierra Leone). Furthermore, it should pay special attention to the very large imports of rough diamonds with mixed origin coming from Russia.
- The Ministry of Economic Affairs should publicly disclose trade statistics for rough diamonds based on KP certificates, with an explication of the errors, discrepancies and anomalies in the data. It seems odd that the Ministry continues to refuse releasing this data despite the fact that statistics for the UK and the European Community as a whole are available. This information would allow for the rough calculation of Belgium trade flows as well as provide other relevant trade flow information. However, this method may cause even more confusion than directly disclosing the statistics for Belgium.
- The Antwerp diamond bourses should require stronger evidence of the conflict-free origin of diamonds for purchases from companies affiliated to bourses outside the UK and Belgium. At present, a warranty is considered sufficient evidence. The warranties issued by members of these bourses are generally considered as reliable as those issued by members of the Antwerp and London diamond bourses. However, the implementation of the System of Warranties by these bourses and their members is not supervised by the European Commission and therefore less

reliable. This is a serious weakness in the system of industry self-regulation in Europe that needs to be addressed.

The UK

- The Government Diamond Office and the London bourse need to demonstrate that the System of Warranties is functioning correctly and that sanctions to enforce compliance are effective. To this end, the audits of the records of warranties received and issued by diamond companies should be completed in autumn 2004.
- The Government Diamond Office should pay extra attention to shipments with a suspicious origin. This becomes even more important now the Republic of Congo is expelled from the KPCS and conflict diamonds will try to find other ways into international markets. It should ask for clarification when imports with a certain origin are exceeding domestic production of that country (e.g. Tanzania, Canada). It should also continue to clarify other errors, discrepancies and anomalies in the data from KP certificates and other trade data, including the small but strange discrepancies for trade with The Netherlands.
- The London diamond bourse should require stronger evidence of the conflict-free origin of diamonds for purchases from companies affiliated to bourses outside the UK and Belgium. At present, a warranty is considered sufficient evidence. The warranties issued by members of these bourses are generally considered as reliable as those issued by members of the Antwerp and London diamond bourses. However, the implementation of the System of Warranties by these bourses and their members is not supervised by the European Commission and therefore less reliable. This is a serious weakness in the system of industry self-regulation in Europe that needs to be addressed.

The Netherlands

- The Amsterdam Diamond Bourse and the Dutch Diamond Manufacturers Association should make a greater effort to ensure the correct implementation of the System of Warranties. Verifying that warranties are included on every invoice, without requesting audits of the records of warranties issued and received by a company, is insufficient. Audits should be carried out before the end of 2004, covering the whole period from January 2003 onwards, in order to sustain the credibility of the system.
- The diamond industry organizations, together with the Ministry of Economic Affairs and/or the European Commission, should find a solution for the matching of warranties issued and received by companies that process rough diamonds. At present, this is impossible due to the losses in weight and changes classification. There are therefore no guarantees for the correct implementation of the System of Warranties. They should seek an appropriate solution that does not cause an onerous administrative burden for the companies.

The Kimberley Process certification Scheme One year ahead

- The Ministry of Economic Affairs should clarify errors, discrepancies and anomalies in the statistics on trade in rough diamonds, especially industrial rough diamonds. This includes the small but strange discrepancies for trade with the UK.
- Several KPCS participants, most of them diamond-producing countries, are partner countries of The Netherlands for development cooperation: Armenia, Ghana, Sri Lanka, Tanzania, Vietnam and South-Africa. The Ministries of Foreign and/or Economic Affairs should provide funds for technical assistance to these countries to support the implementation of the KPCS.

All EU member states

- More EU member states should make additional funds available for technical assistance for the implementation of the KPCS in developing countries. Considering the effort and resources that are being put into the implementation of the KPCS in the EU, it is strange that except for the UK there have been no commitments to support implementation of the KPCS in developing countries. After all, that is where the root causes of the problem lie.

The European Commission

- The European Commission should insist on timely audits of the System of Warranties and reports from the bourses on the functioning of the system. Without this information, it does not have sufficient insight in the implementation of the regulations.
- The European Commission needs to find a solution to ensure the correct implementation of the System of Warranties by diamond bourses not listed on Annex V of the EC Regulation and their members. The implementation of the System of Warranties by these bourses and their members is not supervised by the European Commission and therefore less reliable. There should be an arrangement for strengthened supervision of these bourses, or listed bourses should require stronger evidence of the conflict-free origin of diamonds from companies affiliated to unlisted bourses.
- The European Commission should seriously consider the declaration and certification of all rough diamond stocks in all EU member states. While unregistered stocks continue to exist in EU countries without a Community Authority, there are no guarantees that rough diamonds are conflict-free because they can always be declared as coming from pre-KPCS stocks. For countries with limited trade in rough diamonds, this would be a small effort only.
- The European Commission should clarify errors, discrepancies and anomalies in the data from KP certificates and insist that other KPCS participants put an end to incorrect declarations. The KP statistics for EU imports reveal that the origin of millions of carats of diamonds has been mentioned incorrectly on KP certificates.

Furthermore, for several diamond producing countries, EU imports declared to originate in those countries substantially exceeded their domestic production.

- The European Commission needs to alert Community Authorities to watch for shipments with suspicious origins. This will have to be coordinated at the EU level, using aggregate KP statistics for the European Community. When imports with a certain origin are exceeding domestic production of that country but enter the EU at different entry points, for example, this will be easier to detect at the EU level. In such a case the European Commission should request Community Authorities to detain shipments with this origin, pending clarification from the exporting authorities.
- The European Commission should clarify how the system of industry self-regulation will be implemented in the new EU countries. The creation of new points of entry for rough diamonds should be discouraged. There are currently three Community Authorities (in Belgium, the UK and Germany). If this number increases, the import and export regime will become more fragmented, more difficult to supervise and coordinate, and probably less efficient.
- Potential smuggling routes of rough diamonds into the EU through overseas departments, such as French Guyana, require extra attention. The European Commission should take all necessary measures to prevent conflict diamonds from entering the EU via such routes.
- The European Commission should continue to insist on the introduction of an independent monitoring system for the KPCS.