Botswana's Diamond Deception

Khadija Sharife

Credits

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> *"Governments only role is as an auditor. The value is the price which is in the [De Beers] Price Book. So the government valuator has got no input into the value of a diamond."*
>
> Bertie Lincoln, former De Beers director, under oath to a South African court

INTRODUCTION

Since its independence from Britain in 1966, Botswana has been hailed as Africa's model nation, a "political diamond." The country, which is the size of France but with only about 2 million residents, is stable—its democratic elections so peaceful and predictable they've garnered an enviable epithet, "boring." Fifty years ago, Botswana was one of the world's 10 poorest nations; now it's considered a middle-income country. It's true that diamonds were discovered just a year after its founding, but that could have just as easily been a "resource curse," not the economic bonanza it proved to be.

Far from the usual tales of corporate looting, Botswana's primary business partner, De Beers, has been involved with the government in what is one of the longest running public-private partnerships of its kind. To operate in the country, De Beers founded the De Beers Botswana Mining Company in 1968, which became Debswana. Initially, Botswana held a 15 percent share, but several years later when especially exceptional diamonds were unearthed, Botswana's share was increased to 50 percent. De Beers wanted to ensure it could keep its monopoly and control production so this find would not disrupt market prices. Then in 2004, Botswana acquired a 15 percent share in De Beers itself, an unprecedented entangling of a sovereign country with a single private company.

At the same time, Botswana also has some of the largest incomes disparities in the world, with a Gini coefficient—a common measure of inequality—that suggests it's one of the top 10 most unequal countries on earth. It's a place where the job market outside of mining and government is so small that economists daylight as taxi drivers and teachers take second jobs selling mobile phone airtime to make ends meet.

For a country often ranked by Transparency International as Africa's least corrupt, where does this wealth gap come from? The answer lies partly in the relationship between De Beers, the government of Botswana, and its ruling party, the Botswana Democratic Party (BDP). While these ties provide some stability, the blurring of corporation, state, and party may be costing the nation hundreds of millions of dollars in lost tax revenue every year and has created an opaque system that involves the country's most critical resource—diamonds.

De Beers and the BDP have knit the political and corporate structures together in such a way that they undermine accountability and regulatory systems with a culture of secrecy (framed by De Beers as "confidentiality"). As a private entity, De Beers' dealings are largely protected from scrutiny. Unlike the EU and U.S., where governments once banned or prosecuted De Beers for price-fixing and other anti-competitive activities, Botswana's government and its ruling party have been direct collaborators.

During the course of research for this report, Debswana declined to answer any queries, referring questions to the government of Botswana. For its part, Botswana's Ministry of Minerals acknowledged receipt of questions but failed to respond. De Beers did reply but said, "We are not able to answer all your questions as most of them concern confidential information, which we are not in a position to disclose." And when a local journalist in Botswana contacted the BDP, the party declined to answer any questions.

MULTI-FACETED, DEEPLY SET

Botswana and De Beers are dependent on each other. For Botswana, diamonds generate over 80 percent of Botswana's foreign exchange earnings and almost half of its government revenue. According to De Beers, the diamond industry directly accounts for one in 20 jobs in the country.

But the connections between De Beers and Botswana's economy run even deeper. The relocation of a De Beers aggregation center from London to Gaborone, Botswana's capital, in 2013 increased the liquidity of the Bank of Botswana since a great deal more money started to flow through it. The bank's annual report discloses that while the revenue generated from the diamond sorting process is not substantive and "largely offsetting," the net re-export of diamonds from the aggregation center "is important for balance of payment surpluses." That is, the money helps the bank but does not remain in the country. A former senior Bank of Botswana employee said, on the condition of anonymity, "De

Beers is controlling the State of Botswana, because it's [helping] guarantee the liquidity of its Central Bank."

But by producing the bulk of De Beers' diamonds, Botswana also has considerable leverage with its business partner. In 2013, for instance, De Beers recovered 31.1 million carats in Namibia, South Africa, Botswana, and Canada combined. Of that, Botswana accounted for about 22.7 million carats. By value, Botswana accounted for more than 70 percent, or $4.2 billion, of De Beers' $5.9 billion in revenue. In short, De Beers needs Botswana even more than Botswana needs De Beers.

With this mutual dependence, it's not surprising that Botswana would insist on a greater share of the spoils than is provided for in its normal gains in royalties and taxes and that De Beers would want to hold some political sway in Botswana. The form that this takes is unique: In 2004, Botswana's government received a 15 percent share in De Beers in exchange for 25-year renewals on four mines, including the world's largest diamond mine, Jwaneng, whose license had been set to expire in 2017.

LACKING CLARITY

The exact structure of this deal between Botswana and De Beers is complex and confidential in a few key places, but it promises Botswana continued revenue while handing power of the diamond industry to De Beers. The 2004 mining licenses Botswana granted De Beers reaffirmed the company's right to control the price of diamonds, pace of production, purchase partners, and other concessionary terms. The system was designed to ensure that while Debswana was, according to De Beers, a "minority acquiring shareholder ... its diamond production is fully attributable to the De Beers Group."

Until 2014, financial details related to Debswana were kept under wraps, but in an effort to show the value gained by Botswana through the relocation of the company's sorting center, De Beers published what they said was the first attempt "to quantify the economic value generated by the Partnership in Botswana in any one year." De Beers calculated that it provided Botswana with $6.9 billion in revenue in 2014. The largest proportion, about $2.3 billion, is invested in rough diamond imports from South Africa, Namibia, and Canada, which were then aggregated in Botswana to be sold to bulk diamond buyers. The remaining figures are vague—$0.6 billion in service fees, $0.7 billion in dividends for shareholders, and $0.3 billion in retained earnings. The most interesting figure, though, is the $2.2 billion remitted to the government in taxes, royalties, and dividends. Figures pertaining to these key financial aspects are rarely published.

The relationship between De Beers and the ruling BDP is also murky. There is past evidence that the BDP relies on direct funding from De Beers. In his memoirs, the former minister of mineral resources, David Magang, wrote that De Beers financially supported former presidents. In one case, confirmed by local media, De Beers used a shell company incorporated in Panama to send money to a deeply indebted business owned by then-President Quett Ketumile Masire. De Beers responded to Botswana's press saying that the payments to presidents and others were mere "donations."

At the time, De Beers was also funding consultants to guide the political direction of the BDP, and, since the BDP has never lost an election, the diamond giant was de facto steering the nation. According to a classified U.S. cable published by Wikileaks, Debswana paid Lawrence Schlemmer, a consultant selected by De Beers, to re-organize the internal structure of BDP: "The BDP first contracted Schlemmer after the 1994 election ... Schlemmer recommended that President [Quett Ketumile] Masire retire early and that the BDP bring Ian Khama into politics to unify the Party. The BDP scrupulously adhered to his recommendations."

Despite such disclosures, the structure of mining contracts and the exact value of extracted diamonds, as well as Botswana's 15 percent share in De Beers, remain unclear. The corporate structure of the Debswana system operates through secrecy jurisdictions, such as Luxembourg and the British Virgin Islands, which allow shareholdings and associated companies to withhold details about the real beneficiaries of companies.

Another part of the business structure that allows De Beers to manipulate the diamond trade out of the public eye is the use of sightholders, the bulk diamond buyers approved by De Beers. The contracts with sightholders are secret, but De Beers is open about one factor it considers when approving a diamond buyer: De Beers has to know that the sightholder will keep the whole process hidden.

This allows De Beers to determine the quality and value of diamonds purchased and to whom and where the sightholder can sell or trade. On approving sightholders, De Beers also demands to know their clients, markets, profits, and other details. While De Beers allows sightholders to refuse the parcels provided to them, they cannot choose the individual diamonds contained in those packages. Sightholders are then vulnerable to De Beers, who have not only learned every aspect of their business but can determine their profits by controlling the contents of their parcels.

In theory, sightholders are required to cut or polish some diamonds within the country of purchase. The costs, however, of doing this in Botswana range from $60 to $120 per carat— compared to $10-$50 in India. Exact figures aren't public, but in practice, the high costs means little beneficiation actually takes place Botswana. The lack of transparency along the value chain makes it easy for companies to avoid following what rules there are.

A contract negotiated between De Beers and a prominent sightholder, Diacore, showed that De Beers traded high-value diamonds through corporate structures that operated entirely through tax havens such as the British Virgin Islands. For instance, say a diamond is exported from Botswana and classified as "exceptional." Exceptional refers to a gem quality rough diamond that is valued at more than $250,000.

In this instance, De Beers, through an unknown set of criteria, valued a single diamond at $19.5 million with the sightholder paying half. The sightholder is incorporated in the British Virgin Islands as a holding company with financial advisers based in Switzerland. The company maintains over two-dozen shell entities, constantly changing names and forms. The agreement passes due diligence requirements as tax havens require little. The holding company is owned by several foundations, also incorporated in tax havens, acting as ultimate beneficial owners. There is no official exceptional diamond registry in Botswana, so it is impossible to know the volume and value of exceptional diamonds exported either monthly or annually. In this way, it is nearly impossible to track who owns what, where the money is going, and how much money is flowing out of the country. The leak, known as the Panama Papers, from the offshoring law firm Mossack Fonseca demonstrated that this is not some outlandish hypothetical but rather business as usual.

Unlike other minerals bearing benchmarked prices, diamonds in Botswana are internally valued by De Beers. Depending on the quality of diamond and the valuators involved, one carat can be worth $1,000, $100, or $1. According to a former De Beers director, Bertie Lincoln, in a rare quote given under oath at a South African court, the government's only role is as "an auditor." Lincoln told the court, "The value is the price which is in the [De Beers] Price Book. So the government valuator has got no input into the value of a diamond."

Through this process, De Beers can essentially set its own tax rate by determining the value of the diamonds on which government fees are levied. De Beers has established about 12,000 categories that can affect the formula, which is secret. That coupled with only sporadic checks on exported parcels against a price list provided to the government allows for rampant undervaluation of diamonds sent out of the country.

Another way of avoiding taxes is to import high-value and low-volume rough diamonds and then re-export those same diamonds in parcels with high-volume, domestic rough diamonds. In 2010, for instance, when the stated export value of diamonds is compared to the production value at mine-gate, over $438 million vanishes at an undervaluation of $19 per carat. As the sole valuator in Botswana, De Beers runs the show.

ACHIEVING TRANSPARENCY

By partnering with De Beers, Botswana is party to the secretive, monopolistic business practices that underpin the diamond industry. The Botswana government's ability to reel in corporate misbehavior is hamstrung by the fact that it works so closely with De Beers—the most important player in the system that keeps diamond prices high through artificial pricing and scarcity. It's a system that benefits Botswana through elevated diamond prices, but at the same time, De Beers also seems to participate in business practices that deprive Botswana of taxes. So, what is the lesser evil?

It's impossible to tell since the necessary data isn't public. And, even if the answer was to root out transfer pricing in an effort to acquire higher taxes, the governing party is compromised by its entanglements with De Beers.

There are ways, however, to make Botswana's economy more transparent. To start, there should be disclosure of mining contracts in order for citizens to access and influence the terms and conditions. The secretive valuation formula of diamonds produced in Botswana should also be made public to ensure that transfer pricing manipulation doesn't allow profits to escape the country untaxed. The internal financial structure of the BDP, including "donations" to the party and any corporate ties to the diamond sector, should further be disclosed.

Country-by-country reporting for the diamond sector needs to be released showing disaggregated information, such as the names of linked companies and jurisdictions, where profits are recorded, where taxes are paid, net assets, and beneficial owners. Moreover, an exceptional diamond registry that is publicly accessible must be created so that citizens can see the value of their diamonds and ensure their respective countries profit from them.

In Botswana, democracy has been perverted. A company needs a country to thrive; a political party needs the company to maintain its hold on the government; and a company benefits from a friendly party in power. Within this incentive structure, De Beers will help Botswana to a certain degree, and as long there are diamonds in the mine, revenue will continue to be generated. Yet Botswana's paper success does not translate to the kinds of gains the country should be receiving. Disclosure of key information and removal of De Beers' monopoly would liberate the economy and its democracy. [1]

1. *A shorter version of this report was published in the World Policy Journal (WPJ) Summer Issue, 2016.*

ALL SHARES NOT EQUAL

The actual shareholding of GRB in De Beers is complex. In August 2004, the GRB formally received a 15% shares in DB Investments SA (Luxembourg) ceded from Debswana in exchange for 25 year renewal on Jwaneng, the world's largest diamond mine by value, alongside Orapa, Damtshaa and Letlhakane. The licenses were originally meant to expire in 2017. The license gave De Beers the right to control the pace of production, pricing of produced diamonds, purchase partners and other concessionary terms. The total assets held by DB Investments as of 2013 totalled $1.59 billion. Assessing the value of 15% shares from DB Investments, according to 2013 data, is $238 million.

Earlier, in 2001, DB Investments was formed as a special purpose vehicle through which Anglo-American, Debswana and the Oppenheimers could control 100% of De Beers. De Beers then became a wholly owned subsidiary of DBI. The purpose of DBI's creation, it appeared, was also to intertwine Debswana with the Oppenheimer family, then acting as the leadership of De Beers: ("the continued leadership and expertise of the Oppenheimer family and Anglo; developing a closer, strategic relationship with Debswana and the Botswana Government"). Debswana was locked as the sole diamond producer in Botswana. The system was designed to ensure that while Debswana was a, 'minority acquiring shareholder....its diamond production is fully attributable to the De Beers Group.'

In 2007, DB Investment (Luxembourg) documents revealed a complex system of A shares, B shares, preference shares, scheme A shares and scheme B shares. All shareholders, according to dated documents obtained, grant power-of-attorney to Charl Brand, a South Africa attorney employed by Maitland which holds offices across numerous tax havens and which represents the offices of the shareholders in the Isle of Man, Guernsey, Luxembourg and South Africa. The corporate structure of the De Beers-Debswana system is not only opaque but primarily operates through tax havens including Luxembourg and the British Virgin Islands.

These are also secrecy jurisdictions which allow shareholdings and associated companies connected to the entities to withhold details of who ultimately benefits and what the purpose and power within the overall company is of these entities. Unknown beneficiaries or ultimate owners of shares are potential vehicles for lifestyle accounts of political as well as financing and legitimation of the BDP as a political vehicle/party potentially through dividends. The sale of Oppenheimer interests from 2011 directly followed the close of a 60 year upward ban on De Beers in the US due to the Oppenheimer-led price-fixing monopoly over diamond valuation that violated anti-trust laws.

Consequently, Anglo-American purchased the Oppenheimer's 40% shares of 4.5 million B shares for $5.1 billion. An estimate of Debswana's shares, using the dated De Beers configuration, reveals a share value of $1.8 billion – effectively one quarter of Debswana's annual production in 2013. Meanwhile, all shares are not equal: some enable decision-making, others represent a purely economic interest. While Debswana receives dividends from De Beers, apparently through Delibes, the British Virgin Islands-based financial entity, it is unclear whether or how Debswana is able to influence any decision-making in De Beers. When posed with questions, the former reverted all interview queries to the latter.

POLICY RECOMMENDATIONS

Political finance:

- Disclosure of Botswana Democratic Party (BDP) internal financing structure including domestic and foreign entities, shareholdings, investments, donations and other inflow and outflow;
- Cap on political finance donations related to elections and other;
- Separation of BDP and De Beers interests including principals shared in both party and corporate structures.

Diamond industry:

- Removal of monopoly, oligopies, and cartels in the diamond industry;
- Disclosure of mining and sightholder contracts;
- Disclosure of valuation formulas by De Beers;
- Creation of a bespoke electronic diamond platform accessible to the public;
- Creation of an exceptional diamond registry by value, volume, buyer/company and jurisdiction;
- Publication of the terms, companies and benefits of GRB shareholding in De Beers.

National:

- Implementing foreign exchange controls;
- Implementing mandatory Automatic Information Exchange;
- Strengthen anti-trust legislation in relation to monopolies, oligopolies, and cartels;
- Publicly accessible company ownership and company accounts;
- Publication of country-by-country reporting including names of
  a) linked companies,
  b) transactions between subsidiaries,
  c) names of beneficiaries,
  d) where companies pay tax,
  e) where companies record profits,
  f) where employees are based and wage,
  g) value, interest, and extent of loans,
  h) cost and net book value of assets in each jurisdiction,
  i) gross and net tangible assets, etc.
- Natural sanctioning on the use of tax havens for linked company purposes – jurisdictions must pass the test of substantive economic activity relevant to the industry.

OSISA is a growing African institution committed to deepening democracy, protecting human rights and enhancing good governance in the region. Its vision is to promote and sustain the ideals, values, institutions and practices of open society, with the aim of establishing vibrant and tolerant southern African democracies in which people, free from material and other deprivation, understand their rights and responsibilities and participate actively in all spheres of life.

In pursuance of this vision, OSISA's mission is to initiate and support programmes working towards open society ideals and to advocate for these ideals in southern Africa. Established in 1997, OSISA works in eleven southern African countries: Angola, Botswana, DRC, Lesotho, Malawi, Madagascar, Mozambique, Namibia, Swaziland, Zambia and Zimbabwe. OSISA works differently in each of these ten countries, according to local conditions.

OSISA is part of a network of autonomous Open Society Foundations, established by George Soros, located in Eastern and Central Europe, the former Soviet Union, Africa, Latin America, the Caribbean, the Middle East, Southeast Asia and the US.

SARW is a formative project within the Natural Resources Governance Initiative of OSISA. Its main objective is to monitor corporate and state conduct in the extraction and beneficiation of natural resources in Southern Africa. It seeks to assess the extent to which the policies, practices and efforts of the players in the sector can and do contribute to sustainable development. Other specific objectives include:

- To consolidate research and advocacy on natural resources extraction issues in Southern Africa;
- To put a spotlight on the specific dynamics of natural resources in Southern Africa, building a distinctive understanding of the regional geo-political dynamics of resource economics;
- To provide- for researchers, policy makers and social justice activists especially in academic and civic spaces- a platform of action, coordination and organisation, in the watching and strengthening of corporate and state accountability in natural resources extraction;
- To highlight the relationship between resource extraction activities and human rights as they obtain on the ground, and develop advocacy efforts that engage this reality.

African Network of Centers for Investigative Reporting (ANCIR) represents a network of Africa's best muckraking newsrooms, collaborating on in-house and cross-border investigations and who pool their resources to build the technnologies and investigative expertise to expose corporate, political and criminal networks and activities.

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