



## Testimony

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# INTERNATIONAL TRADE

## Significant Challenges Remain in Deterring Trade in Conflict Diamonds

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G A O

Accountability \* Integrity \* Reliability

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<b>Abstract</b> I am pleased to be here today to discuss our observations on the conflict diamond trade and U.S.and international efforts to deter this trade.The United Nations General Assembly defines conflict diamonds as rough diamonds used by rebel movements to finance their military activities,including attempts to undermine or overthrow legitimate governments.These conflicts have created severe humanitarian crises in countries such as Sierra Leone,Angola,and the Democratic Republic of the Congo.The United States and much of the international community are trying to sever the link between conflict and diamonds while ensuring that no harm is done to the legitimate diamond industry, which is economically important in many countries.The principal international effort to address these objectives,known as the Kimberley Process,aims to develop and implement an international diamond certification scheme that will deter conflict diamonds from entering the legitimate market.The Kimberley participants,including government,diamond industry,and nongovernmental organization officials,have reported back to the United Nations General Assembly with a proposal they believe 1 provides a good basis for the envisaged scheme.Consistent with the Kimberley Process,the U.S.Congress has legislation pending that would require countries exporting diamonds to the United States to have a system of controls to keep conflict diamonds from entering their stream of commerce.		
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# INTERNATIONAL TRADE

## Significant Challenges Remain in Deterring Trade in Conflict Diamonds

Highlights of GAO-02-425T, testimony before the Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia, Committee on Governmental Affairs, U.S. Senate

### Why GAO Did This Study

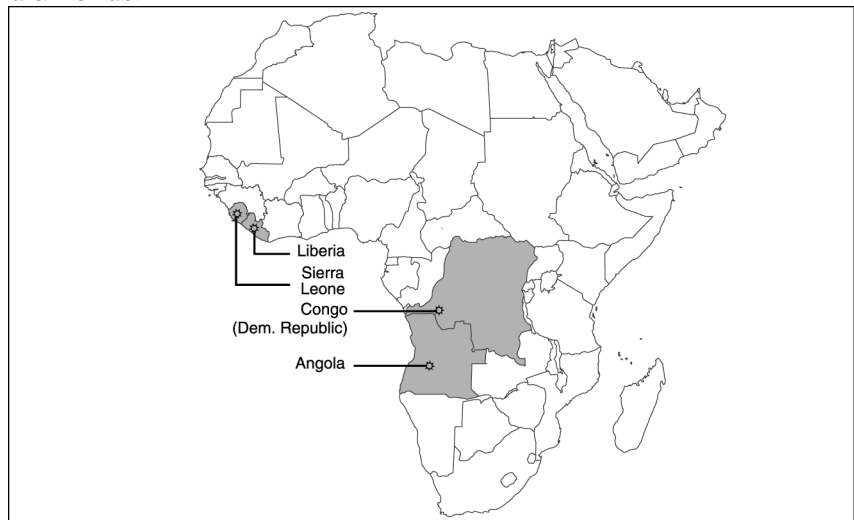
Conflict diamonds are used by rebel movements to finance their military activities, including attempts to undermine or overthrow legitimate governments. These conflicts have created severe humanitarian crises in countries such as Sierra Leone, Angola, and the Democratic Republic of the Congo. An international effort called the Kimberley Process aims to develop a diamond certification scheme to prevent the flow of conflict diamonds. Legislation is also being developed to address U.S. consistency with the Kimberley Process. GAO was asked to assess the challenges associated with deterring trade in conflict diamonds.

### What GAO Found

The nature of diamonds and the international diamond industry's operations create opportunities for illicit trade, including trade in conflict diamonds. Diamonds are a high-value commodity easily concealed and transported, are mined in remote areas worldwide, and are virtually untraceable to their original source. These factors allow diamonds to be used in lieu of currency in arms deals, money laundering, and other crime. Further, the diamond industry lacks transparency, which limits information about diamond transactions.

U.S. controls over diamond imports generally do not require certification from the country of extraction—just from the country of last import—and thus are not very effective in identifying diamonds from conflict sources. While the United States bans diamonds documented as coming from the National Union for the Total Independence of Angola, the Revolutionary United Front in Sierra Leone, and Liberia—all of which are subject to U.N. sanctions—this does not prevent conflict diamonds shipped to a second country from being mixed into U.S.-destined parcels.

GAO's assessment of the Kimberley Process's proposal for an international diamond certification scheme found it incorporated some elements of accountability. However, the scheme is not based on a risk assessment, and some activities experts deem high risk are subject only to "recommended" controls. Also, the period after rough diamonds enter the first foreign port until the final point of sale is covered by a system of voluntary industry participation and self-regulated monitoring and enforcement. These and other shortcomings provide significant challenges in creating an effective scheme to deter trade in conflict diamonds.



Main Countries Associated With Conflict Diamonds

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our observations on the conflict diamond trade and U.S. and international efforts to deter this trade. The United Nations General Assembly defines conflict diamonds as rough diamonds used by rebel movements to finance their military activities, including attempts to undermine or overthrow legitimate governments. These conflicts have created severe humanitarian crises in countries such as Sierra Leone, Angola, and the Democratic Republic of the Congo. The United States and much of the international community are trying to sever the link between conflict and diamonds while ensuring that no harm is done to the legitimate diamond industry, which is economically important in many countries. The principal international effort to address these objectives, known as the Kimberley Process, aims to develop and implement an international diamond certification scheme that will deter conflict diamonds from entering the legitimate market. The Kimberley participants, including government, diamond industry, and nongovernmental organization officials, have reported back to the United Nations General Assembly with a proposal they believe provides a good basis for the envisaged scheme.<sup>1</sup> Consistent with the Kimberley Process, the U.S. Congress has legislation pending that would require countries exporting diamonds to the United States to have a system of controls to keep conflict diamonds from entering their stream of commerce.

Today I will discuss (1) how the nature of diamonds and industry operations are conducive to illicit trade; (2) U.S. government controls over diamond imports; and (3) the extent to which the Kimberley Process international diamond certification scheme, in its current form, has the necessary elements to deter trade in conflict diamonds. My observations are based on our ongoing work on conflict diamonds. Our work was initiated by a request from Senator Judd Gregg, ranking member of the Subcommittee on Commerce, Justice, State & Judiciary of the Senate Appropriations Committee; Representative Frank Wolf, chairman of the Subcommittee on Commerce, Justice, State

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<sup>1</sup>The proposal was presented in the form of a Kimberley Process Working Document titled *Essential Elements of an International Scheme of Certification for Rough Diamonds, With a View to Breaking the Link Between Armed Conflict and the Trade in Rough Diamonds* (Nov. 29, 2001).

& Judiciary of the House Appropriations Committee; Representative Cynthia McKinney, ranking member of the Subcommittee on International Operations and Human Rights of the House International Relations Committee; and Representative Tony Hall, ranking member, Technology and the House Subcommittee of the Rules Committee. In conducting our analysis, we met with and obtained information from numerous U.S., U.N., and diamond industry representatives in the United States, Belgium, and at various meetings of the Kimberley Process. Before I get into the specifics of these topics, let me provide a brief summary.

## **Summary**

The nature of diamonds and the operations of the international diamond industry create opportunities for illicit trade, including trade in conflict diamonds. Diamonds are mined in remote areas around the world and are virtually untraceable back to their original source—two factors that make monitoring diamond flows difficult. Diamonds are also a high-value commodity that is easily concealed and transported. These conditions allow diamonds to be used in lieu of currency in arms deals, money laundering, and other crime. Lack of transparency in industry operations also facilitates illegal activity. The movement of diamonds from mine to consumer has no set patterns, diamonds can change hands numerous times, and industry participants often operate on the basis of trust, with relatively limited documentation. All of these practices reduce information about diamond transactions. The lack of industry information is exacerbated by poor data reporting at the country level, where import, export, and production statistics often contain glaring inconsistencies.

U.S. control over diamond imports is based on its general control system for most commodities. This control system requires that diamond import documentation include the country of last export—which U.S. import requirements consider the country of origin. Because the current import control system does not require certification from the country of extraction—just from the country of last export—it is not effective in identifying diamonds that might come from conflict sources. Beginning in 1998, rough

diamond imports from Angola and Sierra Leone not bearing the official government certificate of origin as well as all rough diamonds from Liberia were banned from the United States.<sup>2</sup> U.S. Customs requires that all shipments from Angola and Sierra Leone have a certificate of origin or other documentation that demonstrates to Customs authorities that the diamonds were legally imported with the approval of the exporting country governments.<sup>3</sup> However, without an effective international system that can trace the original source of rough diamonds, the United States cannot ensure that conflict diamonds do not enter the country.

The Kimberley Process proposal for an international diamond certification scheme lacks some key elements of accountability. We evaluated the scheme using aspects of established criteria for accountability—control environment, risk assessment, control activities, information and communications, and monitoring.<sup>4</sup> While we do not expect the Kimberley proposal to fully address all these elements, this examination provides insights into its ability to deter trade in conflict diamonds. Our assessment of the scheme showed that it incorporates some elements, such as requiring that Kimberley Process Certificates that designate country of origin for unmixed shipments accompany each shipment of rough diamond exports. But some important elements are lacking, and others are listed only as optional or recommended. For example, the scheme is not based on a risk assessment—an essential element. As a result, some activities that would be deemed high-risk by industry experts as well as Kimberley participants, such as the flow of diamonds from the mine or field to the first export, are subject only to “recommended” elements. Additionally, the period after rough diamonds enter a foreign port to a final point of sale will be covered by an industry system in which participation

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<sup>2</sup>The United Nations Security Council has imposed international sanctions on rough diamond imports from the National Union for the Total Independence of Angola, the Revolutionary United Front in Sierra Leone, and Liberia.

<sup>3</sup>Executive Order 13213 dated May 22, 2001, banned all rough diamond shipments from Liberia for an indefinite period.

<sup>4</sup>The U.S. government, industry, and international entities such as the World Bank accept these internal control standards applied to organizations. See *Standards for Internal Control in the Federal Government*, (GAO/AIMD-00-21.3.1, Nov. 1999), and *Internal Control—Integrated Framework (1985)*, published by the Committee of Sponsoring Organizations of the Treadway Commission and used by the World Bank.

is voluntary and monitoring and enforcement are self-regulated. Other issues relating to accountability are also being discussed by four Kimberley working groups: the establishment of a secretariat; compliance with World Trade Organization rules; sharing of statistics; and monitoring needs. Although the Kimberley Process participants have achieved significant cooperation among industry, nongovernmental organizations, and governments to address trade in conflict diamonds, our work suggests that the participants face considerable challenges in establishing a system that will effectively deter this trade.

## **Background**

Conflict diamonds are primarily associated with four countries: Sierra Leone, Liberia, Angola, and the Democratic Republic of the Congo.<sup>5</sup> In all four countries, the production and/or trade of diamonds have played a role in fueling domestic conflict, or, as is the case with Liberia, fueling conflict in neighboring Sierra Leone through the Revolutionary United Front (RUF). Today, Sierra Leone is experiencing relative peace with the aid of the United Nations and other efforts. Nonetheless, diamond mining remains one of the only viable economic opportunities for ex-combatants, and thus experts believe the ability to adequately manage this resource will be important for efforts at establishing long-lasting peace. In Angola, the National Union for the Total Independence of Angola (UNITA) retains control of some diamond production areas, as well as unknown quantities of stockpiled diamonds. And in the Democratic Republic of the Congo, diamonds continue to serve as a source of revenue for armed militias fighting in the north of the country. To date, United Nations sanctions have been targeted solely at rough diamond exports from the RUF in Sierra Leone; Liberia; and UNITA in Angola. Also, both the governments of Sierra Leone and Angola have national diamond certification schemes in which certificates of origin are issued and accompany rough diamonds from their first export to their first import into a foreign country.

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<sup>5</sup>Adjacent countries, such as Congo-Brazzaville, Guinea, Cote d'Ivoire, and the Gambia, have all been listed in U.N. reports as countries through which conflict diamonds are smuggled. People named in U.N. reports for their involvement in trading conflict diamonds have been citizens of the Middle East, Europe, and the United States. Also, recent media reports have focused on the possible use of diamonds by terrorists to fund their activities.



## **Structure of Diamond Industry**

The international diamond industry comprises three sectors: mining, rough diamond trading and sorting, and cutting and polishing. This industry structure includes both large and well-organized components as well as small, uncontrolled operations. For example, due to the substantial capital required for deep mining, just four companies mine 76 percent of the world supply of rough diamonds.<sup>6</sup> Yet, across Africa, countless individual diggers mine widely scattered alluvial fields<sup>7</sup> for diamonds. Similarly, while De Beers controls a large percentage of diamond shipments to key trading centers, U.N. data suggest that more than 100 countries worldwide participate in rough diamond exporting. In terms of cutting and polishing, markets have largely evolved to reflect labor costs, with 9 out of 10 rough diamonds cut and polished in India. However, mining countries such as Russia, South Africa, Botswana, and Namibia are trying to expand their cutting and polishing activities to supplement mining revenues.

## **The Kimberley Process**

In May 2000, African diamond producing countries initiated the Kimberley Process in Kimberley, South Africa, to discuss the conflict diamond trade. Participants now include states and countries of the European Union involved in the production, export, and import of rough diamonds; as well as representatives from the diamond industry, notably the World Diamond Council,<sup>8</sup> and nongovernmental organizations. The goal is to create and implement an international certification scheme for rough diamonds, based

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<sup>6</sup>These four companies are De Beers Consolidated Mines Ltd., Alrosa Ltd., Rio Tinto, and BHP Billiton.

<sup>7</sup>Alluvial fields are surface areas containing secondary deposits of weathered volcanic rock called kimberlite deposited by river systems.

<sup>8</sup>The World Diamond Council is an industry association comprising the World Federation of Diamond Bourses and the International Diamond Manufacturers Association, which formed this body expressly to address conflict diamonds.

primarily on national certification schemes<sup>9</sup> and internationally agreed minimum standards for the basic requirements of a certificate of origin. The scheme's objectives are to (1) stem the flow of rough diamonds used by rebels to finance armed conflict aimed at overthrowing legitimate governments; and (2) protect the legitimate diamond industry, upon which some countries depend for their economic and social development. U.N. General Assembly Resolution 55/56, adopted on December 1, 2000, requested that countries participating in the Kimberley Process present to the General Assembly a report on progress developing detailed proposals for a simple and workable international certification scheme for rough diamonds.

According to the South Africa Department of Foreign Affairs, the Kimberley Process submitted a report to the U.N. General Assembly in late 2001.<sup>10</sup> The report was accompanied by a proposal for an international certification scheme for rough diamonds dated November 28, 2001, which was to provide the basic elements envisaged for the certification scheme. Participants asked that the certification scheme be established through an international understanding as soon as possible, recognizing the urgency of the situation from a humanitarian and security standpoint. The report also requested an extension of the Kimberley Process mandate to the end of 2002 to enable finalization of the international understanding. Those in a position to issue the Kimberley Process Certificate were to do so immediately. All others were encouraged to do so by June 1, 2002. Further, it was the intention of participants to start full implementation of the scheme by the end of 2002. Finally, a draft resolution seeking an international endorsement of the scheme will be submitted to the U.N. General Assembly for consideration, possibly as soon as late February.

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<sup>9</sup>National certifications schemes have been set up in Angola, Sierra Leone, and Guinea. The High Diamond Council in Antwerp provides technical assistance.

<sup>10</sup>The report has to be translated into the working languages of the United Nations before it can be distributed. This work is almost complete, and the report is expected to be distributed to U.N. members in New York very shortly.

## **U.S. Participation in the Kimberley Process**

In May 2000, the U.S. government established an interagency working group to provide input to and representation at the Kimberley Process meetings. The working group is headed by the Department of State; other participants include the Departments of Commerce, Justice, and Treasury, U.S. Customs Service, Federal Trade Commission, Office of U.S. Trade Representative, U.S. Agency for International Development, National Security Council, Central Intelligence Agency, and the Office of Science and Technology. The United States is currently chairing the Kimberley Process working group on World Trade Organization compliance issues.

## **Nature of Diamonds and Non-Transparent Industry Operations Create Opportunities for Illicit Trade**

The illicit diamond trade, including that in conflict diamonds, is facilitated by the nature of diamonds and the lack of transparency in industry operations. Although industry and nongovernmental organizations have made estimates of both the illicit and conflict diamond trades, the criminal nature of the activity precludes determination of the actual extent of the problem. Conflict diamond estimates vary from about 3 to 15 percent of the rough diamond trade and are often based on historical production capacities for rebel-held areas. Some industry experts dispute the larger percentage, believing it includes non-conflict illicit trade.

## **The Nature of Diamonds Facilitates Illegal Trade**

The nature of diamonds makes them attractive to criminal elements. Diamonds are found in remote areas of the world and can be extracted both through capital-intensive deep mining techniques as well as from alluvial sources using rudimentary technology. Individual diggers across west and central Africa mine alluvial fields that are widely scattered and difficult to monitor, a problem made worse by porous borders and corruption. Diamonds are easy to conceal and smuggle across borders, and smuggling

routes are well established by those who have done so for decades to evade taxes. Though it may be possible for experts to identify the source of an unmixed parcel of rough diamonds, once diamonds from various sources are mixed, they become virtually untraceable. Identifying the origin of alluvial diamonds is complicated by the fact that the river systems depositing those diamonds run across government- and rebel-held areas as well as national borders. Although rough diamonds can be marked, once they are cut and polished, any form of identification is erased. All of these factors, combined with inadequate customs and policing worldwide, make diamonds attractive to criminal elements who may use them to trade arms, support insurgencies, and plausibly engage in terrorism. Likewise, diamonds can be used as a means of currency in connection with drug deals, money laundering, and other crime or as a store of wealth for those wishing to hide assets outside the banking sector where they can be detected and seized.

#### Industry's Lack of Transparency Also Facilitates Illicit Trade

The flow of diamonds from mine to consumer, referred to as the “diamond pipeline,” has no set patterns. Diamonds can change hands numerous times as shown by the fact that the value of world rough diamond exports is three times as large as the value of world rough diamond production. According to industry experts, diamonds are sold back and forth and mixed and re-mixed making tracking a particular shipment through the pipeline and across borders an arduous if not impossible task. Diamonds can be traded in smaller markets and diverted through alternative routes either to disguise origin or in response to low taxes and less burdensome regulations. Thus, the mobility of the trade has also acted as a disincentive for individual governments to implement stricter controls.

Limited transparency in diamond flows is reflected in inconsistent and insufficient data. U.N. data show large discrepancies between export and import data. For example, while Belgium reported selling \$355 million worth of rough diamonds to the United States in 2000, the United States reported buying only \$192 million worth of rough diamonds from Belgium. U.N. data also suggest that reported world imports of rough diamonds from

many countries far exceed those countries' production. For instance, the Central African Republic's production of rough diamonds was worth \$72 million in 2000, while global imports from that country totaled \$168 million, and the Democratic Republic of the Congo's production was worth \$585 million in 2000, while global imports from that country totaled \$729 million. Similarly, global imports of rough diamonds from the United Arab Emirates totaled \$177 million in 2000, while that country neither mines rough diamonds nor reports having imported rough diamonds from producing countries.

These data inconsistencies can be attributed to a wide variety of factors including:

- differences in how customs officials appraise shipments so that export values differ from import values;
- industry practices such as selling goods on consignment or unloading stockpiles so that trade data differ from production capacities;
- false declarations by importers on where they obtained their shipment, leading to data indicating a country's exports exceed its production; or
- smuggling.

Unfortunately, diamond trade data limitations have been difficult to rectify given that the industry has historically avoided close scrutiny. According to industry experts and government officials, U.S. and international diamond firms do not share trade information freely and business may be conducted on the basis of a handshake, with limited documentation. Furthermore, information problems resulting from industry's lack of transparency are made worse by poor data reporting from many mining and trading nations.

Another factor with the potential to limit transparency in the international diamond industry is the current trend toward merging mining with cutting and polishing activities at the country level. In response to reduced demand and declining rough diamond prices, a number of mining countries are encouraging domestic cutting and polishing. However, when diamonds are cut and polished in mining countries, the source of the rough diamonds used cannot be verified.

## **The United States Cannot Detect Conflict Diamonds With Present Import Controls**

Under its current import control system, the United States cannot determine the true origin of diamond imports nor ensure that conflict diamonds do not enter the country. In 1998, the United States began to enhance controls to prevent conflict diamonds from entering the country from U.N. and U.S. sanctioned sources. Since 1998, there have been six diamond-related investigations. However, none of these cases resulted in federal prosecutions relating to diamond smuggling. Without an effective international system to identify the origin of rough diamonds, the United States remains vulnerable to diamonds from conflict sources sent to second countries and then shipped to the United States.

### Diamond Imports Subject to General Import Controls; Limited Controls Added to Implement U.N. Sanctions

Diamond imports are subject to the same import controls used for most commodities. Documentation accompanying diamond shipments entering the United States must include a commercial invoice, country of last export, total weight, and value. However, the regulations do not require exporters to specify the country of extraction nor the place of first export. For example, rough diamonds could be mined in one country and traded several times before reaching their final destination. The ability to determine the true source of origin is further impeded because U.S. import shipments can contain diamonds mixed together from numerous countries. Under the current system, Customs would only have documentation citing the last export country.

Until 1998, the United States did not consider conflict diamonds a commodity of focus. But beginning in 1998, the United States put into place import controls to target diamonds documented as originating from the National Union for the Total Independence of Angola, the Revolutionary United Front in Sierra Leone, and Liberia—all of which are subject to U.N. sanctions. Rough diamonds from Liberia have been

banned indefinitely from the United States. U.S. Customs requires that all shipments from Angola and Sierra Leone have a certificate of origin or other documentation that demonstrates to U.S. Customs authorities that they were legally imported with the approval of the exporting country governments. However, the controls do not prevent diamonds from these conflict sources from being shipped to a second country and mixed within shipments destined for the United States.

In fiscal year 2000, about \$816 million of rough diamonds from 53 countries officially entered the United States through 19 different ports of entry. According to Customs officials, 35 random physical inspections of rough diamond mixed shipments have been performed since 1998. Of these, five cases were found to have minor discrepancies primarily because of incorrect documentation or the diamonds were misdelivered.<sup>11</sup> Customs officials stated that it is virtually impossible to determine the original source of rough diamonds based on physical inspection; thus U.S. Customs officials must rely on the accuracy of the source cited in accompanying import documentation.

### **Current Kimberley Certification Scheme Lacks Key Aspects of Accountability**

The Kimberley Process working document describing the essential elements of an international diamond certification scheme<sup>12</sup> does not contain the necessary accountability to provide reasonable assurance that the scheme will be effective in deterring the flow of conflict diamonds. Without effective accountability, the certification scheme may provide the appearance of control while still allowing conflict diamonds to enter the legitimate diamond trade and, as a result, continue to fuel conflict.

The Kimberley scheme primarily provides a description of what participants should do as well as “recommendations” and “options.” The document describing the scheme is

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<sup>11</sup>According to U.S. Customs officials, these inspections were suspended after September 11, 2001, because the agencies’ primary focus has shifted to security and anti-terrorism efforts.

<sup>12</sup>*Essential Elements of an International Scheme of Certification for Rough Diamonds, With a View to Breaking the Link Between Armed Conflict and the Trade in Rough Diamonds* (Nov. 29, 2001).

divided into sections covering definitions, the Kimberley Process certificate, undertakings concerning international trade, internal controls at the national and industry levels, cooperation and transparency, and administrative matters. Elements of internal controls are addressed throughout the document, such as the requirement that the Kimberley Process certificates, designating the country of origin for unmixed parcels, accompany each shipment of rough diamonds and that the certificates be readily accessible for a period of no less than 3 years. However, the scheme lacks key aspects of effective controls, and some “controls” are considered “recommended” or “optional.” Some of the areas needing further attention include issues on which agreement has not yet been reached. Working groups have been assigned to address these issues, which include the possible establishment of a secretariat, compliance with World Trade Organization rules,<sup>13</sup> sharing of statistics, and the level of monitoring needed.

To assess the current scheme, we looked at evaluations of other international certification schemes and other sources for criteria that can be used to evaluate the Kimberley certification system. We believe the best criteria available are based on standards for internal control that have been developed for organizations.<sup>14</sup> The Kimberley Process participants recognize the importance of internal controls,<sup>15</sup> and the U.S. government, industry, and the international entities such as the World Bank have accepted these standards. While the Kimberley Process is not an organization, the criteria provide useful insights into the ability of the Kimberley Process to achieve basic objectives of accountability and transparency. The guidelines include five control elements—control environment, risk assessment, control activities, information and

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<sup>13</sup>Under the Kimberley scheme, participants are to ensure that no shipment of rough diamonds is imported from or exported to a non-participant. However, article XI of the General Agreement on Tariffs and Trade (GATT), 1994, obligates countries to refrain from imposing quantitative restrictions or similar measures on the importation of products from other countries. Two possible exemptions under GATT are being discussed—article XX provides general exemptions and article XXI provides a security exemption.

<sup>14</sup>See *Standards for Internal Control in the Federal Government*, (GAO/AIMD-00-21.3.1, Nov. 12, 1999), and *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.

<sup>15</sup>According to the November 2001 Kimberley Ministerial statement, “an internal certification scheme will only be credible if all participants have established effective internal systems of control designed to eliminate the presence of conflict diamonds in the chain of producing, exporting, and importing rough diamonds within their territories...”



communications, and monitoring. I will discuss each element and some of the key aspects lacking in the current Kimberley scheme.

*Control Environment:* A control environment is one with a structure, discipline, and climate conducive to sound controls and conscientious management. The Kimberley scheme faces serious challenges in meeting these criteria.

- Kimberley participants have been unable to agree on the form of administrative support at the international level, whether it is a secretariat or some other mechanism. According to the Kimberley document, institutional arrangements, or the administrative support for the scheme, will be discussed at a future plenary meeting, and no commitments have been made with regard to staffing or funding.<sup>16</sup>
- Individual participants are required to set up a system of national internal controls and effective enforcement and penalties. It is unclear how and when the capabilities of different participants to do so will be assessed and, where needed, assistance provided. If countries fail to comply with the essential elements of the scheme, then according to the scheme, they can be excluded from trading with participants. However, whether this provision complies with trade agreements such as those under the World Trade Organization has been a point of contention since early in the process and remains under discussion by one of the working groups.
- Political willingness as well as industry commitment to support and implement Kimberley vary. Membership is voluntary, and despite efforts to recruit more members, some key countries have not participated in the Kimberley Process. Further, the United Nations discontinued its “name and shame” policy concerning trade in conflict diamonds because of the lack of clear and consistently applied investigative standards. How the United Nations responds to the Kimberley

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<sup>16</sup>Researchers reviewing multilateral environmental agreements have noted that institutional arrangements have come to be seen as crucial to their effectiveness and that the lack of institutions limits the capacity to monitor states’ implementation of and compliance with treaty requirements or to take action when noncompliance is ascertained.

document and what form the final document will take (an agreement, memorandum of understanding, or some other form) are not known.

*Risk Assessment:* A risk assessment is a mechanism for properly identifying, analyzing, prioritizing, and managing risks to meet objectives. The Kimberley Process does not include a formal risk assessment and thus participants cannot be assured that appropriate controls are in place. Three potential high-risk areas not adequately addressed in the Kimberley scheme include the following.

- Industry experts and Kimberley participants agree that unless the segment of the diamond pipeline from when the diamond is first discovered in the alluvial field or mine to the point it is first exported is subject to controls, conflict diamonds may enter the legitimate trade. The scheme does little to address this issue, offering only recommendations encouraging participants to license diamond miners and maintain effective security.
- Industry and others hold stockpiles of diamonds with undocumented sources and the number of diamonds held in stockpiles may be considerable. Since the Kimberley scheme requires information on origin, it is unclear how these diamonds will be addressed. Apparently, any conflict diamond could be claimed as a stockpiled diamond at the scheme's initiation.
- The period after rough diamonds enter a foreign port until their point of sale as rough diamonds, polished diamonds, and jewelry will be covered by an industry system called a chain of warranties in which participation is voluntary and monitoring and enforcement are self-regulated.<sup>17</sup>

*Control Activities:* Control activities consist of policies, procedures, techniques, and mechanisms that ensure that management directives are being carried out in an effective

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<sup>17</sup>According to industry officials, the World Diamond Council will strongly recommend that its member organizations require their individual members to make the following statement on all invoices for the sale of rough diamonds, polished diamonds, and jewelry containing diamonds. "The diamonds herein invoiced have been purchased from legitimate sources not involved in funding conflict and in compliance with United Nations resolutions. The seller hereby guarantees that these diamonds are conflict free, based on personal knowledge and/or written guarantees provided by the supplier of these diamonds."

and efficient manner to achieve control objectives. The Kimberley scheme's inconsistent attention to control activities raises concerns, such as the following.

- While some internal controls are delineated, others are recommended or considered optional without clear justification, and many controls are to be developed at the national level where capabilities and political will differ.
- The industry chain of warranties is based on voluntary participation and self-regulation. Although the scheme requires that all sales invoices of participating industry be inspected by independent auditors to ensure that the diamonds come from non-conflict sources, an audit trail is problematic in an industry where diamonds are sorted and mixed many times.

*Information and Communications.* An information and communication mechanism is needed for recording and communicating relevant and reliable information to those who need it in a form and time frame that enable them to carry out their internal control responsibilities. Two concerns regarding the Kimberley scheme's mechanism for information and communication are as follows.

- Although the Kimberley Process has identified information to be communicated among participants, it has not fully worked out the details of what, how, and when the information will be shared and used. Participants had a great deal of difficulty reaching agreement on sharing statistical data, and a number of issues remain open. The working document states that the content, frequency, timing, format, and methods of handling and exchanging statistical data are to be developed by an ad hoc working group and adopted at a plenary meeting.
- The European Union will function as one trading partner under the Kimberley scheme. It remains unclear how its data will be compiled and shared in a timely manner.

*Monitoring.* A monitoring mechanism consists of continuous monitoring and evaluation to assess the quality of performance over time in achieving the objectives and ensuring that the findings of audits and other reviews are promptly resolved. Participants had a great deal of difficulty reaching agreement on the need for monitoring. Concerns were

raised about sovereignty. A working group is currently addressing this element. The Kimberley scheme's monitoring mechanisms lack details and rely heavily on voluntary participation and self-assessments. For example,

- Monitoring is based on participants' reporting of other participants' transgressions to initiate a verification mission. A participant can inform another participant through the Chair if it believes the laws, regulations, rules, procedures, or practices of that other participant do not ensure the absence of conflict diamonds in the exports of that other participant.
- Review missions are to be conducted with the consent of the participant concerned and can include no more than three representatives of other participant members. Membership and terms of reference of the review missions have not yet been determined. The scheme does not discuss a mechanism for ensuring that the findings of the review missions are promptly resolved.
- No guidelines have been established for developing required self-assessments.
- No system has been proposed for monitoring the industry system of warranties.
- No external audit of the scheme's administration is discussed.

While we do not expect the Kimberley Process proposal to completely address all aspects of accountability, we hope our analysis will be useful in enhancing the scheme's ability to deter the conflict diamond trade. Further, we acknowledge that while the Kimberley Process has brought together industry, nongovernmental organizations, and governments to address a serious humanitarian issue, the participants face significant challenges in deterring the trade in conflict diamonds.

Mr. Chairman and Members of the Committee, that concludes our prepared statement. We will be pleased to answer any questions you may have.

## **Contacts and Acknowledgments**

For future contacts regarding this testimony, please call Loren Yager or Phillip Thomas at (202) 512-4128. Individuals making key contributions to this testimony included Kathleen Monahan, Zina Merritt, Kendall Schaefer, Sharla Draemel, and Janey Cohen.