DE BEERS
FAMILY OF COMPANIES

Dialogue 8: Business responsibility, African development and the economic slowdown

Participants: De Beers (Andrew Bone, Patricia Klein, Stephen Lussier), Africa Matters (Debbie Goldthorpe), Business and Human Rights Resource Centre (Mauricio Lazala), International Council on Mining and Metals (Aidan Davy), Maplecroft (Gus Macfarlane), Standard Chartered (Victor Lopes) Transparency International (Robert Barrington, Laurence Cockcroft), University of Vermont (Saleem Hassan Ali), World Vision (Ian Gray)

Moderator: Professor Alyson Warhurst (Warwick Business School and Director, Maplecroft)

Dialogues are convened by De Beers and moderated by Professor Alyson Warhurst. Dialogues take place under the Chatham House Rule. The Chatham House Rule reads: "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed". Participants discussed two main questions:

Question 1: What are the potential impacts of the economic slowdown on the socio-economic development status of African nations with mineral wealth, especially diamonds?

- The severe nature of the current economic crisis: The specific shock-like nature of the current economic crisis makes it challenging for responsible businesses to develop appropriate responses. It is unprecedented in terms of:
  - Speed of impact, which makes it very hard to adapt to. For example, the market for diamonds and other luxury goods essentially disappeared in the space of a few months and many junior miners are unable to raise finance. Indeed, many of these juniors are now worth 10 percent of what they were at the peak of the market, whilst senior listed companies (De Beers is not listed) have fallen fast to around half of their previous values.
  - The global nature of the problem. This had hitherto been underestimated amidst hopes that 'decoupled' economies such as China and India would cushion the blow. In fact, few markets, with the exception of those in Africa, were shielded due to the integrated nature of banking.
  - The likely length of the downturn, which could range from two years to a decade depending upon the success of mitigation measures, the availability of finance and the recovery of consumption.
  - The psychological impact, which has resulted in a serious and widespread undermining of confidence and optimism, with people now raising searching questions about the trustworthiness of financial institutions and the long-term outcome of the situation.
- The need to cut costs: The full significance of the crisis is not yet apparent, with the possibility of an extensive depression. Nonetheless, the long-term prospects for miners in Africa remain good – with China and India expected to lead the way in terms of economic recovery and engagement in Africa. As such, it is imperative that companies ensure their survival over the next few years and are prepared for when global demand recovers.

  In the short-term, this means cutting costs – either in terms or energy or labour. Energy consumption is already decreasing. Likewise, decreases in production and cuts in exploration activities – particularly in higher risk countries such as DR Congo – are also pertinent. Some countries (e.g. Botswana) may look on this as an acceptable compromise as it "stretches" revenue streams for a further period into the future. Other than this, the priority for De Beers is to conserve cash, continue to protect diamond equity and maintain high safety standards. In terms of corporate social investment (CSI), it is inevitable that activities will need to be prioritised. A set of criteria to assist in this prioritisation and decision-making process will need to be defined. However, De Beers will honour CSI commitments already underway.

  The crisis will have significant impacts on unemployment in Africa. There will also be numerous "knock-on" impacts including reduced revenues to dependents of employees, wider communities, local businesses and government.
- Africa's specific strengths and vulnerabilities in relation to the global economic downturn: Africa's banking system is relatively insulated from the global financial crisis, but its wider economies will still be affected by worsening economic conditions in terms of commodity prices, capital inflows and banking/finance. Nonetheless, the continent is better placed to deal with such impacts than in the past.
  - Whilst commodities have been a strong driver of growth in Africa (recently averaging over 6%), other factors – including increased political stability, accelerating reforms, debt relief, domestic investment and private consumption – have arguably been more important. Non-mineral producing or food exporting African countries are likely to benefit from reductions in commodity prices – particularly food and fuel, which make up 50 percent of imports in many sub-Saharan African states.

- In the oil producing countries, of which there are only a few, revenues will be lower, but there is unlikely to be significant economic stress thanks to their large fiscal reserves – unless the downturn proves prolonged. Likewise, the downturn will have to last for some time to seriously affect the mining countries – with Botswana enjoying foreign exchange reserves equivalent to two years of imports.
- In terms of capital inflows, portfolio investors are getting increasingly risk averse, and are pulling out of countries such as Ghana, Uganda and others. Nonetheless, not many countries are reliant on this, so the impact should be limited. The scaling back of FDI in the form of the cancellation of large projects, as well as financing constraints on junior mining companies, will have a much larger impact.
- Likewise, a cutting back of ODA will also have a serious effect, potentially undermining large scale projects and infrastructure developments.
- Finally a cut in remittances as a result of weaker northern economies, mass unemployment and more restrictive immigration policies will have a serious impact. In many cases, money sent from relatives abroad supports entire families, yet has the potential to be overlooked when examining economic impacts.

Overall, GDP growth is likely to slow to 4-5 percent (not enough to alleviate poverty), but underlying fundamentals will mean the recession will not have as serious effect as those in the past. These include increased scope for regional African trade and an increased economic role for China and India.

Question 2: What is the current and future role of responsible business during an economic slowdown, and how can positive relationships with host governments be maintained despite short-term operational pressures to reduce production?

- Diversification as a potential long-term means of mitigating impacts: Botswana, in partnership with De Beers, has had some success in reducing its reliance on diamond mining, focusing on beneficiation in particular as well as the energy sector more broadly, as well as tourism. Indeed, there is a target to process a third of diamonds produced in Botswana locally. Nonetheless, the cutting and polishing sector needs to seek government support in order to improve its competitiveness due to its higher costs compared to other cutting centres in e.g. India and China. The country has many innate advantages including stability, low corruption etc. that put it in a strong position to make itself a southern African corporate centre.
- The need for a gradual approach to diversification: Arguably, before most African countries seek to diversify their economies, a first step needs to be the prudent accumulation of extractive revenues to help support future gradual diversification. In the short-term, the main barriers to diversification in most sub-Saharan African countries are infrastructure bottlenecks, including severe power-cuts. These need to be resolved before true diversification can take place. Furthermore, agricultural development is likely to prove more rewarding than other value-adding activities, due to the labour intensity of this sector. This is especially the case with respect to ‘grass-roots’ agricultural development (i.e. smallholders etc.). Nonetheless, large, high profile agro-projects such as multibillion dollar, foreign-funded bilateral land leasing deals are also starting to have positive national revenue impacts, although they are not without controversy (e.g. recent deals on land leasing in Madagascar).
- The need to take an informed approach to retrenchment: Every miner employed is likely to support multiple dependents, with the South African Chamber of Commerce putting the ratio at 1:10. As a result, it is important for mining companies to examine the potential impacts of different strategies used to cut costs – for example reduced time, compulsory holidays, consultative approach to job losses versus wage cuts, etc. Companies could potentially benefit from joint studies with DFID, unions and other stakeholders. From a company point of view, specific studies would need to be carried out for each operation due to differences in workforces, social structures, working practices etc. The CSI plans of many companies are based on past needs that no longer apply, and may need to be adapted accordingly. Nonetheless, the speed of the current crisis means that a ‘disaster response’ approach (i.e. rapid action based on pre-existing but imperfect data and information) may be more appropriate than more rigorous, time-consuming approaches used in the past.
- ‘Social safety nets’ as a short-term means of mitigating impacts: Past experience shows that OECD countries are likely to reduce their ODA. Arguably, what remains should be focused on providing ‘social safety nets’. These are direct cash payments to families to stop them from having to sell essential assets during hard times, so they are in a position to take part in recovery during better times. This would be a good short-term approach in the current situation. Both NGOs and companies, in partnership with governments, have a potential role to play in pushing for this kind of aid. De Beers would also benefit from direct negotiations with the unions to understand best alternatives.
- The need for innovative approaches to ensuring economic security: Mitigation measures may need to go beyond managed retrenchment or short-term aid. For example, there may be scope for the use of innovative financial instruments such as development bonds, designed in partnership with local governments, NGOs and INGOs. Also, but more challenging, it was suggested that within a country, it might be possible to boost mineral production in vulnerable areas and reduce output for sale later on following economic recovery. Whilst this kind of approach could

help transfer risk in the short-term, it would be not be possible for dominant market players such as De Beers to do this due to competition concerns. However. In De Beers' particular case, an alternative approach suggested could be to raise funds from the Botswana government, for example, in order to increase the financing available to diamantaires to purchase rough diamonds. Given that access to financing is currently a key competitive advantage, this would help ensure their longer-term resilience – and help support Botswana's long-term beneficiation process.

- The advantageous nature of partnerships with local governments: Where responsible business works in partnership with host governments, the process of adjusting to economic turmoil is likely to be easier because interests are more closely aligned (with the possible exception of maintaining employment figures within the context of cost cutting). Whilst partnerships with governments can facilitate relatively swift adaptation to the challenges posed, the situation is more complicated where the government is just a royalty collecting regulator.
- The need for dialogue and openness with governments: Where local governments are mainly regulators of business activity, relationships tend to be more difficult due to suspicion around the motives of companies when they are engaged in cutting investment or production. This can lead to a more combative relationship. Vale, for example, has been complaining about the restrictive nature of labour laws in Brazil, which they say are acting as a barrier to the development of innovative solutions to the economic crisis. Whilst governments often have regulations in place to control retrenchment processes etc, their ability to implement these regulations is often restricted. Legislation that was formulated during 'boom' times is often inappropriate during recession. Likewise, the shrinking of mining revenues threatens to encourage resource nationalism as governments seek to secure a larger proportion of a smaller 'pie'.

  Dialogue between business and government helps mitigate the negative impacts of recession. In many cases governments and INGOs actually need (and indeed would welcome) advice from companies to explain the situation and to explore what responses are needed and how best to mitigate the impacts of adjustment. This is due to the often limited capacity of local bureaucracies, potential mistrust of companies' motives and a relative lack of perception regarding the severity of the current economic situation due to distance and insulation. The speed with which change is happening sometimes makes this difficult, but nonetheless the suggestions constitute a useful reminder.
- The potential effect on anti-corruption measures: Whilst small but important gains have been made in the promotion of human rights, especially in the diamond industry, company CSR departments are a natural target for corporate cost-cutting. This raises the risk that progress in protecting human rights could be rolled back due to an acceptance of lower ethical standards e.g. in terms of transparency and adherence to schemes such as the EITI. As with other areas of CSR, it is imperative that companies resist this kind of temptation, as it would risk undermining a lot of good work already achieved. It could also undermine companies' reputations, as well as those of their sectors for when economic growth returns.
- The potential effect on security and human rights: There are already concerns regarding potential loopholes in the Kimberley Process (KP), as well as ongoing smuggling of diamonds from locations such as DR Congo. Nonetheless, it is necessary to differentiate between 'conflict' diamonds and 'smuggled' diamonds. Whilst the KP has been instrumental in eradicating conflict diamonds, it is difficult to eradicate all smuggling per se. This can only be achieved through effective cooperation between government agencies and organisations such as the KP. Likewise, whilst the situation in Zimbabwe raises serious concerns, piecemeal solutions will not be effective. What is required is a concerted effort by governments, the UN, civil society and the private sector. The KP can play a part, but only as a component in a more strategic approach by all sectors. The World Diamond Council is constantly applying pressure on member states of the KP to strengthen procedures and work more closely and effectively with customs and police. Revelations about conflict diamonds and smuggling are considered a negative distraction at a time of difficult economic conditions, and the KP remains the industry's primary safeguard in maintaining consumer confidence. Diamond companies have everything to gain by continued active support of the KP.

Summing up

- Any measures to adapt to the current economic crisis must be transparent, and frank dialogue must be maintained with host governments in order to build trust and lay the basis for positive cooperation
- Focus should be placed on the mitigation of negative impacts (in terms of time and geography), and innovative solutions should be explored
- Safeguards should be put in place to ensure the proper spending of reserves if used to mitigate negative impacts of the economic crisis, particularly if the downturn is prolonged
- Companies should maintain emphasis on CSR, human rights and anti-corruption despite pressure to "cut red tape". These are "must haves" not "nice to haves". Critical gains have been achieved and pedalling backwards will undermine future consumer confidence and hard won reputational gains
- CSI should focus on building skills, promoting local agriculture and education in the areas of mining activities with a view to long term recovery and sustainability. Emphasis should be placed on innovative mitigation solutions, as well as the potential to draw in funds and expertise from a wide range of sources such as INGOs, NGOs etc.

- Approaching the crisis like a disaster relief exercise may be helpful, to enhance responsiveness and action

Next steps:

- To provide feedback. Please send revisions to this note to: alyson.warhurst@maplecroft.net by Wednesday 10 January. The final version of this report will be uploaded to our shared websites at http://share.maplecroft.com/Diamond_Dialogue, http://www.business-humanrights.org/Documents/DiamondDialogue. Other stakeholders interested in hosting these reports are invited to contact Alyson Warhurst as above.
- De Beers will ensure insight and questions from the Diamond Dialogues are addressed in the Report to Society 2008, so all feedback is welcome.
- De Beers will continue the Diamond Dialogues in 2009. A programme of work is in development and we value your opinion and suggested topics for discussion. The topics likely to be covered by request from participants include: economic impacts of the downturn on diamond producing countries, corporate social investment, engagement with governments, environment (energy, climate and water).