THE FREE MARKET FOUNDATION
of Southern Africa

progress through freedom

Submission on the Diamonds Amendment Bill [B27 – 2005]

Introduction

This submission is made to the Parliamentary Portfolio Committee on Minerals and Energy by the Free Market Foundation of Southern Africa, which is an independent non-profit public policy research and educational organisation founded in 1975 to promote the principles of limited government, economic freedom, and individual liberty. It is financed by membership subscriptions and sponsorships.

The submission concentrates on the economic implications of the existing legislation, the proposed amendments, and their effects on the future economic growth of South Africa and the well being of its citizens. The submission further gives specific attention to those proposed amendments to the Diamonds Act 56 of 1986, which will have the most far-reaching economic consequences. It also carefully analyses the stated purpose of the Bill and background information as contained in the Memorandum on the Objects of the Diamond Amendment Bill as set out at the end of the Bill.

The Bill has four principal objectives:

- Beneficiation
- BEE
- Regulation
- Tax

In this submission we address principles and theory in Part 1 and comment on specific provisions and aspects of the Bill in Part 2.

Part 1
Principles and Theory

Beneficiation

Notwithstanding popular rhetoric to the contrary there is only one logical case to be made for "beneficiation", namely that its benefits for a country exceed costs. Popular beneficiation rhetoric makes all sorts of claims, which are simply not justified by logic, economic theory or experience in the real world.

Johannesburg
1sr Floor, Norfolk House, Sandton Close 2,
cnr Norwich Close & 5th Street, Sandton
PO Box 785121, Sandton 2146
Tel: +27 (0)11 884 0270 • Fax: +27 (0)11 884 5672
Email: fmf@mweb.co.za

Cape Town
1st Floor, Equity House,
107 St George's Mall, Cape Town
PO Box 805, Cape Town 8000
Tel: +27 (0)21 422 4982 • Fax: +27(0)21 422 4983
Email: fmf.ct@mweb.co.za

Website: www.freemarketfoundation.com

Non Profit Organisation Registration No 020-056-NPO

A regulatory impact assessment should be carried out

The main reason for the support for beneficiation is that its protagonists, usually narrow vested interests seeking benefits for themselves at the expense of others and the country in general, articulate only *primary* benefits as if benefits can be achieved without costs – and conceal, perhaps inadvertently, considerable costs implied by *artificial* beneficiation. Before the government considers promoting beneficiation in excess of what profitable market conditions dictate, it should, at the very least, have a proper and independent regulatory impact assessment done, including a cost benefit analysis. Indeed, in keeping with modern international regulatory practice, it should require such analyses as an absolute precondition for any form of market intervention or other regulation.

In this submission we do not do a RIA or CBA simply because a sophisticated and elaborate exercise is needed including considerable data capture for a measure of this complexity and importance. Instead, we indicate what economic theory and experience predicts an objective assessment would reveal, namely that diamond beneficiation in South Africa entails, and will continue to entail, costs far in excess of probable benefits.

There are two reasons why beneficiation occurs:

- It is profitable to do so on a level playing field where a country's resource allocation is determined by markets.
- It is profitable to do so because government intervention distorts market so as to divert resources from more to less profitable activities.

In other words, market-determined beneficiation yields more benefits than costs for a country whereas artificially imposed beneficiation incurs more costs than benefits in direct proportion to the extent to which the economy is distorted and resources misallocated.

The evidence worldwide is that freer markets enable governments to achieve all their policy objectives more substantially than unfree markets to the point where there is no longer room for informed debate. The objective evidence is now so overwhelming as to settle the matter with the highest degree of certainly obtainable in social science. See, for instance, the empirical research on www.freetheworld.com.

Diamonds are not a special case

Seductive though arguments to the contrary appear to be when presented and viewed superficially, beneficiation is no special case, and diamonds in particular are not a special case. There is no reason why distorting markets to promote beneficiation artificially and excessively should be regarded as any different from promoting anything else excessively. It would be counter-productive for a government to promote the manufacture of bicycles at twice the cost of importing them, rather than have producers manufacture something else that can be exported competitively. Very simple elementary economics and arithmetic makes it clear that diverting resources from what countries do efficiently and competitively to what they do inefficiently and uncompetitively shifts the country from wealth-producing to wealth-consuming activities, which makes everyone poorer on average.

Regardless of whether the government is considering the diamond industry or any other industry it can and should promote beneficiation by producing optimal economic conditions – the so-called "enabling environment". Internationally competitive and sustainable industries in the world's winning nations are those where the industries are not over-regulated or over-taxed. To increase diamond and other forms of beneficiation the government should deregulate the diamond market, including exports of cut and uncut

diamonds, and reduce taxes on diamond processing. If, having brought the diamond industry in line with other industries that are internationally competitive, beneficiation does not take place spontaneously it means that the country's resources are best allocated elsewhere where they will generate more wealth and jobs.

The diamond legislation constitutes a form of expropriation

An important point about beneficiation-by-regulation which we have not seen mentioned in any discourse on the matter in South Africa, is that forcing a producer to sell into local markets at lower prices than are available internationally – in other words to create conditions where buyers get special treatment because they are local – is a form of expropriation, called a "taking" in America and some international jurisdictions. The constitution may therefore require, under the property rights clause, that the government compensate diamond producers to the extent that they have been expropriated. That would be a further artificial cost to the country and subsidy to down-line processing.

The point becomes clear if one presupposes taking the measures proposed in the Bill to their logical conclusion. If it makes sense to penalise producers for not selling at less than international prices to local buyers, it makes sense to increase the penalty. The measure only appears to make sense when it is modest. To understand the logic of the law and the cost it imposes in excess of benefits one should imagine what would happen if it were absolute, if it provided that *all* diamonds produced in South Africa *must* be processed completely to final product stage domestically. That would mean that all diamonds would have to be finally mounted in consumer-ready jewellery, industrial equipment and the like. It would mean that it would be so costly to produce and process diamonds to the point where they can be sold internationally that it would be possible to do so only in rare instances or with massive subsidies. The consequence would obviously be the virtual if not total destruction of the country's diamond industry in all its forms.

Countries should do what they can do best

The optimal thing for any country to do is to do what it does well and refrain from what it does not do competitively without market distortion.

What we wish to draw to the government's attention is the well-established principle of "comparative advantage" in economics on which there is virtual unanimity amongst economists. The "law of comparative advantage" states essentially that people and countries should confine themselves to doing that in which they have the greatest *comparative advantage*. It may be true, for instance, that you, the reader, are better at cleaning your office than the cleaners who are now employed to do so. However, the degree to which you are better at office cleaning is less than the degree to which you are better than the cleaning staff at doing whatever you do instead – i.e. your present occupation. Countries, like individuals, maximise their welfare by identifying their areas of greatest comparative advantage – which freely competitive markets do automatically.

The beneficiation argument makes even less sense than it does for bosses to fire cleaning staff and do office cleaning themselves because it does not amount to doing that for which there is a *smaller* comparative advantage, but actually that for which there is a *disadvantage*. It is like employers cleaning their own offices instead of doing what they do best, even though the office cleaner is *better* at office cleaning than they are.

South Africa is in the top 40% of economically free countries

In the newly released *Economic Freedom of the World: 2005 Annual Report* South Africa is listed joint 38th in the economic freedom ratings, together with Cyprus, France, Greece,

Jamaica and Peru. The rating improved from 5.3 (out of 10) in 1990 to 6.9 in 2003, reflecting that the improvement has occurred since 1994, much of it because of the greater freedoms brought about by the displacement of apartheid by the current democratic government, but also as a result of improved monetary management, vastly improved property rights and access to justice, and greater freedom to trade.

All South Africans, irrespective of political or other affiliations, should jealously guard our current status and attempt as far as possible to improve it. The reasons are pragmatic and have nothing to do with adherence to any form of ideology. All the evidence shows that free economies function better and deliver a better quality of life to all their citizens, including the poorest of the poor. Consider the following impressive list of benefits provided to citizens by free economies according to the latest research:

- Higher per capita incomes – an average of $25,062 (R159,000) in the freest economies and $2,409 (R15,300) in the least free (PPP constant 2000 international $)

- Higher growth rates – an average GDP growth of 2.5% for the most free and 0,6% for the least free (Average Growth Rate of Real GDP per Capita 1994-2003)

- Higher levels of investment per capita – $4,983 (R31,640) for the freest and $195 (R1,240) for the least free.

- Lower unemployment – 5.2% for the freest and 13.0% for the least free (2000-2002).

- Longer life expectancy – 77.7 years for the most free and 52.5 years for the least free. (2003)

- Higher incomes for the poorest 10% of the population – $6,451 (R40,950) versus $1,185 (R7,525) – (1999-2003).

- Lower infant mortality – 5.4 per thousand versus 81.2 per thousand (2003).

- Lower adult mortality – 103 versus 406 per thousand (2000).

- Share of income earned by the poorest 10% of the population – 2.7% versus 2.7% – the same percentage in the freest and most unfree countries but $6,451 (R40,950) versus $1.185 (R7,525).

There is consequently much to be said for striving to make South Africa as economically free as possible. If an individual can choose where to be poor, the place to be is in a free economy. South Africa is in the second quintile (1/5th) of economically free countries, which had average per capita incomes of $13,789 (R87,560) – (PPP constant 2000 international $), which is considerably higher than that of South Africa. However, the entrepreneurial energy created by the current level of freedom is visible all around us. South Africa will catch up rapidly as long as that energy is not dimmed or even extinguished.

This brings us to the reason for raising this issue. The current Diamond Bill will reduce the level of economic freedom in South Africa. It will specifically reduce the economic freedom of all the people involved in the production of diamonds, which includes the employees working in the mines. The cumulative effect of legislation that chips away at South Africa's

level of economic freedom, also chips away at South Africa's overall GDP, and chips away at the potential incomes of the people working in the mines.

The rights of the miners

In formulating policy, and instituting legislation based on such policy, government officials are all too often inclined to forget the consequences for the employees of firms engaged in a particular industry. According to our information there are more than 13,000 people employed in diamond mining in South Africa. These employees probably support in the order of another 50,000 people. Anything that is done that impacts negatively on the diamond-mining firms will inescapably impact negatively on the diamond miners, their support staff, and their families.

In the case of the Diamonds Act, 1986, instituted by the apartheid government, a lack of concern for diamond miners and their families tended to be consistent with overall government policy. However, in our post-1994 democracy, such a lack of concern is inconsistent with the country's constitution, which states in section 9(1) that: "Everyone is equal before the law and has the right to equal benefit and protection of the law." Naturally, the firms employing the miners have a right to similar protection against unequal treatment under government legislation.

In this instance we have legislation that imposes costs on the diamond-mining firms and the 13,000-plus people employed in the diamond mining industry (an estimated 60,000-plus people taking into account their dependents) in order to benefit just over 2,000 people employed in the cutting and polishing industry. The matter is further complicated by reports that some of the diamond mines are already unprofitable and face possible closure without the additional costs that the current Bill intends to impose on the producers. Miners could lose their jobs if this should occur. Diamond miners are therefore justified in asking whether the proposals contained in the Bill are not in conflict with section 33(1) of the Constitution, which states that "Everyone has the right to administrative action that is lawful, reasonable and procedurally fair."

The role of South Africa's major diamond firm in the diamond industry

South Africa's policy makers should take care not to disturb any further the delicate balance that the Central Selling Organisation (CSO), created by a South African diamond firm, managed to establish in the worldwide diamond industry. Governments of other countries have already mistakenly compelled the diamond industry to alter its methods of operation and the South African government, in its own interests as a tax-gatherer and in the interests of its citizens-as-mine-employees should not exacerbate the risks already faced by the industry.

Economist Duncan Reekie showed clearly that the traditional trading methods followed in the diamond industry are in the best interests of all concerned. Professor Reekie showed in the monograph *Diamonds: The Competitive Cartel*, published by the Free Market Foundation, that no one will benefit from low prices for diamonds: not the producers, not their employees, not the current owners of diamonds and diamond jewellery, not the potential future purchasers of diamonds, not the cutters and polishers of diamonds, not the jewellers, and certainly not the governments of diamond-producing countries like South Africa.

In his conclusion, Reekie said: "The CSO, of course, would be easy to break up. Legislative rulings to that effect would be quite enough. This, in turn would impact on the entire industry. If the argument is correct viz., that diamonds are a Veblen* good, there

could be very great hardship indeed for all industry members, miners, cutters and polishers, and consumers." He could have added that governments of diamond-producing countries would lose a considerable amount of revenue.
(* named after Veblen's theory of conspicuous consumption – the higher the conspicuous price, the more people are impressed, and so the greater the satisfaction of the purchaser.)

Essentially, what Professor Reekie warned was: Don't destroy the goose that lays the golden eggs. Don't tamper with something you don't understand and that nobody understands totally. The South African government should, if nothing else, have consideration for the interests of the miners and for its own future tax income. And if government officials are too stubborn to appreciate the dangers of meddling with the delicate mechanisms of the diamond industry, then Parliament should step in to protect the interests of the miners.

Regulation

South Africa is currently enduring a deluge of regulation that is needlessly distorting the economy towards less efficiency and competitiveness, and imposing enormous costs, which no one is quantifying. This means that the government has no way of knowing whether the flood of new regulations is generating benefits exceeding direct and secondary costs.

The regulatory imperative is such that regulations are often justified without even the slightest attempt to compare benefits with costs. In many cases the sole argument for regulation is that a given activity is supposedly unregulated. Of course, all activity is regulated in many ways, starting with common law, and invariably by way of numerous forms of legislation. There is and has been nothing in South Africa that is "unregulated". The question is at which point regulation becomes counter-productive.

The incontestable fact is that highly regulated economies do not produce intended benefits, even primary benefits, to the extent that freer economies achieve.

Black Economic Empowerment (BEE)

With BEE there is a tendency towards considerable confusion and lack of coherent analysis because it is such a sensitive issue. The problem is that any criticism of a single proposed form of BEE is presumed to be a criticism of BEE in principle. It should be obvious that a criticism of some aspect of BEE does not represent opposition to black advancement but unfortunately for South Africa it has become virtually impossible to criticise individual ill-conceived BEE proposals. It is not in the government's interests to allow this policy myopia to continue, nor is it in the interests of BEE beneficiaries.

Those arguments and fallacies relating to BEE are similar to the arguments that characterise the beneficiation debate. Every resource allocated to one form of BEE is at the expense of other forms of BEE. In other words the contest is not necessarily between BEE and non-BEE resource allocation but between efficient and inefficient forms of BEE.

There is obviously an important consideration for government policy regarding the extent to which it wants to generate BEE benefits at the expense of alternative benefits but we do not concern ourselves with it here.

BEE in diamond processing is probably a sub-optimal form of BEE. The government has at its disposal BEE alternatives where more substantial BEE can be achieved at less cost, ideally with net profits for the country. Artificial BEE, as with artificial beneficiation, happens when resources are diverted from producing more substantial opportunities for black South Africans than are possible in areas where BEE occurs only if it is forced on the economy – for example, in areas where there is a lack of skills, capital and competitive advantage. Indeed, the BEE benefits envisaged by this Bill are indistinguishable in economic theory from the benefits envisaged for beneficiation, in that the costs of achieving these benefits will far exceed the value gained.

Part 2
Comment on specific provisions and aspects of the Bill

In our submission and oral evidence to the Commission of Enquiry into the South African Diamond Industry in October 1997 we proposed, giving detailed reasons, that the Diamonds Act, 1986, should be repealed. The fundamental reasons for that proposal and views on the matter have not changed.

This submission nevertheless deliberately concentrates on discussing the fundamental principles involved in the proposals contained in this Bill and also some of the content of the original legislation However, there are certain specific changes contained in this Bill that require special comment:

The establishment of a State Diamond Trader and Board of State Diamond Trader (Sections 14 to 17G)

Government neutrality in the economy
Government should be totally neutral in the economy. A neutral government concentrates its attention on providing the best possible environment for the achievement of high economic growth. Personal choice, protected property rights and freedom of exchange are key ingredients of such an environment. An important characteristic of the highest growth economies is that government involvement is limited.

Regulation and interference in business are minimised, and most importantly, government does not own enterprises. Having government own businesses is like having a soccer referee participate in the match he is supposed to be adjudicating. The result is not good for the players, it does not produce a good product, and the consumers do not get value for money.

Government's neutrality should also mean its total disinterest in the identity of the owners of businesses, and this neutral stance should extend to foreign owners. As long as there are no artificially imposed barriers to entry, and open competition prevails, the ownership and control of businesses would gravitate to those who are most efficient at supplying the goods and services consumers want. And the satisfaction of citizens as freely choosing consumers should be government's primary objective, whether they want material goods, services, higher levels of safety, or the right to pursue happiness in a manner of their own choosing.

Government has to stay out of the hurly-burly of business if it wishes to play its proper role of impartial arbiter, setting rules that will bring about the best outcomes for the whole

population. This means that it has to dispose of its business holdings, not acquire more as is envisaged in this Bill.

The State Diamond Trader and Board
All the evidence suggests that the establishment of a State Diamond Trader would be most unwise, for the reasons of impartiality as described above but also because of the constraints faced by state representatives. They cannot and may not operate entrepreneurially, which requires the taking of risks. Whoever the trader might be, these constraints will either prevent efficient trading or cause the trader to overstep the bounds of prudence expected from a state official. As risk, security and potential for fraud are particularly high in diamond trading, the entry of the state into the diamond business is highly inadvisable.

The Bill does not provide adequate information on the reason why the Department of Minerals and Energy wishes to become involved in such a risky undertaking. Interposing another agent between the producers and the beneficiators merely raises costs with no discernible benefits. Who is to bear such costs? The producers by artificially or arbitrarily reducing their selling prices, or the beneficiators by increasing the prices they have to pay for diamonds.

We recommend that sections 14 to 17G be deleted from the Bill and necessary amendments be made to other sections of the Bill that may be required as a result of such deletion.

The arrangements for the supply of diamonds to beneficiators, exemption of producers from export duty, and fines in respect of valuation differences (sections 59 to 67 of the Bill)

Supply of diamonds to diamond beneficiators
The system currently in place appears to ensure cutters and polishers of very favourable supplies of cuttable diamonds, exceeding the quantity of economically cuttable diamonds mined in South Africa. There appears to be no reason to change the arrangement. In fact, cutters and polishers appear to be destined to be worse off if the proposed Bill is adopted in its current form.

There is fundamentally no justification for an export duty on diamonds or any other commodity. South Africa should be attempting to create the most business-friendly environment possible in order to attract investment, and especially foreign direct investment (FDI). If that is the intention, government cannot allow a business-unfriendly, and especially not an exporter-unfriendly message to be sent out to the world's investors. If the export duty is not to be abolished entirely, which would appear to be desirable, then the producers should be enabled to continue with the section 59 agreements they have entered into in the past.

The substitution of Section 59 should therefore not be proceeded with.

Exemptions from Export Duty
Section 32 of the Bill, which provides for the amendment of section 63 of the principal Act by the deletion in subsection 1 of paragraphs (a) and (c) should itself be deleted.

Deletion of Section 32 would result in the retention of exemption from export duty of all diamonds that have been duly offered to local beneficiators and not purchased by them, or

come from a loss-making mine that both the Ministers of Minerals and Energy and of Finance believe should in the national interest continue to be worked.

Deferment of payment of export duty
Section 33 of the Bill, which provides for the repeal of section 64 of the principal Act should be deleted.

Deletion of section 33 of the Bill would allow producers to continue in special cases, such as unusually large diamonds, to take the diamonds overseas to exhibit or display them, or to find buyers, without first having to pay the duty.

Fine in the case of difference in value
Section 36 of the Bill should be amended by deleting the proposed amendment that would require a producer to pay a fine of 20% of the total value of a diamond rather than 20% of the difference between the producer's stated value and the value placed on the diamond by the regulator's valuer.

Valuations are notoriously difficult and "experts" often tend to differ. The reason is that such valuations are based on the subjective value judgement of the valuer. Differences of opinion are consequently bound to occur. A producer who places a legitimately-held value of R50,000 on a diamond will be delighted if the government valuer happens to find someone who requires just such a diamond and is prepared to pay R80,000 for it. Under such circumstances the imposition of a fine of R16,000 on the producer instead of the existing R6,000 would be unfair. It is not merely a matter of weighing a diamond and doing a calculation. Because of the subjective nature of valuations, a fine of 20% of the total value of the diamond is considered to be punitive.

Memorandum on the Objects of the Diamonds Amendment Bill

Purpose of Bill and background information
The purpose of the Bill and its background as described in the *Memorandum on the Objects of the Diamonds Amendment Bill* is as follows:

1.1 At present, the Diamonds' Act, 1986 (Act No. 56 of 1986) ("the Act"), does not drive the beneficiation of the diamond resources in the Republic even though South Africa is one of the largest producers of diamonds in the world. In addition, the Board of Directors of the South African Diamonds Board ("the Board") is dominated by the industry and the Board, as an institution, is funded through levies, thereby further strengthening industry control. Government initiatives and policies are not always in the best interest of the Board, resulting in decisions not being implemented or being delayed indefinitely.

FMF Comment:

► **Do the producers currently supply diamonds to local cutters and polishers?**
The first sentence in Par. 1.1 is misleading. The inference in the words "does not drive" is that the 1986 Act has no influence, or inadequate coercive influence, to persuade diamond producers to sell diamonds to the local industry for purposes of beneficiation.

The reality is totally different. The local cutters and polishers are reportedly interested only in diamonds that are described as "economically cuttable in South Africa", which are diamonds of a sufficiently high quality and size for South Africans to cut economically. According to published figures the largest producer, De Beers, through the Diamond Trading Company (DTC), in 2003 provided local cutters and polishers

with “economically cuttable diamonds” valued at 127% of the value of such diamonds mined by the company in South Africa – the balance having been mined elsewhere and imported into South Africa to make available to the local beneficiation industry.

The distinction “economically cuttable in South Africa” is made because cutters and polishers in China and India can do the work at from 3% to 34% of the cost in South Africa.

According to reports, De Beers established a subsidiary, The Diamond Development Company (Diamdel) for the express purpose of supplying and developing the local diamond industry, which in 2003 supplied rough diamonds with a value of R665 million to South African cutters and polishers. In addition CTM supplied South African “sightholders” with rough economically cuttable diamonds valued at approximately R2.5 billion, making a total of more than R3 billion.

Members of Parliament should ask themselves why they are being presented with a Bill that makes such a misleading statement in describing its purpose bearing in mind that if the description of the purpose is invalid the validity of the Bill itself becomes questionable.

- **Is the Diamond Board dominated by the industry?**

The second sentence in Par 1.1 is also misleading. It states that the South African Diamond Board is “dominated by the industry” (which the reader must surely assume refers to the producers) when it has representatives from the Departments of Minerals and Energy, Finance, and Trade and Industry, a member of the South African Police, the Executive Officer of the Board 9appointed by the Minister) and “so many other persons as the Minister may deem necessary” appointed by the Minister. There are consequently **at least five government representatives** on the Board, and as many more as the Minister wishes to appoint.

The “industry” members must be divided into producers and customers of the producers, the latter being the intended beneficiaries of the Diamonds Act.

One nominee each of the dealers, cutters, employees of cutters, and jewellers represents the customers of the diamond producers. That is, **four representatives of customers of producers**.

One person nominated by the Diamond Trading Company and another two “who are either producers or in the opinion of the Minister are capable of representing the producers” represent the producers on the Board. There are therefore a maximum of **three producer representatives.**

There is no possible manner in which the producers can dominate the Board. If the customers and producers are in agreement with each other, their stance must surely be in the best interests of the entire South African diamond industry. On the other hand, if the government wished to dominate both producers and beneficiators, the Minister could appoint further members to the Board in terms of paragraph (m) of section 5 of the Act.

The suggestion that the payment of levies “strengthens industry control” is ill-founded. The Minister, in whose power it is to appoint all the members of the Board, is in total control.

Members of Parliament should therefore be somewhat sceptical of the contention that the industry dominates the Diamond Board.

► **Is the Board in a position to frustrate government initiatives?**
The statement that "Government initiatives and policies are not always in the best interest of the Board, resulting in decisions not being implemented or being delayed indefinitely" is puzzling.

Considering that "the Board" has at least five government representatives on it, and the Minister has the right to appoint an unspecified additional number, do we have to assume that the frustration of the Department of Minerals and Energy lies with representatives of other government departments and not with necessarily with industry members.

1.2 The Act does not provide for the local supply of rough diamonds to the local diamond cutting and polishing industry. However, in terms of Section 59 of the Act the Board may enter into an agreement with "any producer, dealer or any association or organisation of producers or dealers in pursuance of which any such producer, dealer, association or organisation allocates or offers unpolished diamonds … cutters or tool-makers" in order to ensure that cutters and tool-makers obtain a regular supply of unpolished diamonds. There is no obligation on producers to offer a portion of their unpolished diamonds to the local market. Local beneficiation (value addition) is hampered by these "Section 59 agreements" with producers in that the majority of producers choose to export rough diamonds for beneficiation elsewhere in the world, creating wealth and jobs in those countries.

FMF Comment:

► **Does the existing Act, or does it not, result in the supply of rough diamonds to the local diamond cutting and polishing industry?**
It is difficult to find words to respond to the first sentence in Par. 1.2 which states that "The Act does not provide for the local supply of rough diamonds to the local diamond cutting and polishing industry" when that was the sole purpose of the Act and, as described above, the Act has been very effective at achieving its intended objective.

The original act introduced the threat of a 15% export levy, a threat that was so high that it would threaten the continued existence of marginal mines, in order to compel diamond producers to sell to local cutters and polishers. The quoted statement therefore has no validity.

It is disturbing that a statement that amounts to obfuscation should be included in a Bill being presented to Parliament. It borders on a lack of respect for the Members of Parliament.

► **Section 59 agreements is what the government intended should result from the threat of imposing a punitive 15% levy**
No producer could avoid making a deal with the Diamond Board. If it did not, it would be subject to the punitive 15% tax threatened by the apartheid government. As we have noted, the result has been highly beneficial for the local cutters and polishers. They have had the benefit of more high quality "economically cuttable diamonds" than would otherwise be the case.

The tactic of the apartheid government was unjustifiable, reprehensible and contrary to the interests of the general South African economy. However, to contend that it did not achieve its objective is incorrect.

It is also incorrect to state that: “there is no obligation on producers to offer a portion of their unpolished diamonds to the local market”. The section 59 agreement places an absolute requirement upon the producer to meet its obligations under the agreement, failing which the producer will be subject to the 15% duty and could become liable to penalties that may even include imprisonment.

The producers have entered into section 59 agreements with the Board and they do have an obligation to provide “a portion of their unpolished diamonds” to local cutters and polishers and they do carry out that obligation.

To state that there is no such obligation has no factual basis.

- **Do section 59 agreements hamper local beneficiation?**
  The statement that: “Local beneficiation (value addition) is hampered by these ‘Section 59 agreements’ with producers in that the majority of producers choose to export rough diamonds for beneficiation elsewhere in the world, creating wealth and jobs in those countries” is inaccurate.

  It is clear from all reports that as a result of the section 59 agreements South African cutters and polishers have the choice of all the “economically cuttable diamonds” produced in South Africa. In addition “economically cuttable diamonds” are brought in from elsewhere by producers and made available to local cutters and polishers, thus adding more value to the local beneficiation process.

  The producers are only able to export what is left over after satisfying the demands of the local cutters and polishers.

- **Concluding remarks on the “Purpose of Bill and Background Information”**
  We do not understand how the description of the purpose of the Bill could contain so many inaccuracies. Generally available information, for instance, shows the description of the existing functioning of the diamond industry to be inaccurately portrayed. The memorandum, in its current form, should therefore not have received the approval of the Government Law Advisers.

  It is not right that Parliament should be presented with such an inaccurate picture of an important industry in the description of the purpose of a Bill that is set to have far-reaching consequences for the industry, its employees, and the total economy. As a consequence, we do not believe that the memorandum provides the Members of Parliament with fair and reasonable information upon which to make informed decisions.

  Members of the industry (more especially the producers) will undoubtedly attempt to correct the inaccurate portrayal. However, they will be at an immediate disadvantage. Instead of spending their time dealing with the factual situation everyone understands, they will be compelled to first spend time attempting to correct the fallacies. In such a situation, whom will the Parliamentary portfolio Committee believe – the self-interested producers or the “impartial” officials? We dwell on the issue because we believe, as Baron Gordon Hewart, Lord Chief Justice of the United Kingdom in the early part of the 20th century said: “Justice should not only be done, but should manifestly and undoubtedly be seen to be done.”

Submitted by:
Temba A Nolutshungu
Director
Free Market Foundation
1st Floor Equity House
107 St Georges Mall
PO Box 805
Cape Town, 8000

Tel: 021-422 4982
Fax: 021-422 4983
email fmf.ct@mweb.co.za
www.freemarketfoundation.com

21 September 2005