

Memorandum

To: Dr. Soule M. Funna, Director
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Ministry of Finance/Sierra Leone

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In Respect Of: **IMPROVING SALE OF SIERRA LEONE GOLD AND DIAMONDS**

1. In the Study Seminar on Policies for Structural Adjustment and Transformation we discussed ways of improving levels of exports and means to ensuring that foreign exchange proceeds were more available for national use. The discussion turned to marketing improvements in cases in which under-invoicing and/or smuggling engrossed a high proportion of exports.
2. You and I then discussed the topic further in respect of diamonds and gold produced in and exported from Sierra Leone. You requested I produce a memorandum on this topic for your use in advising Sierra Leone's senior political decision takers on possible ways to improve performance in this area.
3. Sierra Leone gold and diamonds are now largely parallel marketed yielding neither tax nor forex receipts to the Treasury/Central Bank. Furthermore, there is every reason to believe small Sierra Leonean diggers are underpaid in Leone and these Leone secured from domestic businessmen in a means serving capital and/or profits flight.
4. Basically the final buyers/exporters in Sierra Leone are de facto expatriates. (Some are citizens of Sierra Leone as well as other

countries but view other countries as their family, financial and retirement homes.) Most are in fact Levantine (Lebanese, Syrian, Cypriot, Greek, Israeli) but the problem is not ethnic. Rather it is a style of operation designed to minimize capital and investment in Sierra Leone, to maximize profits in Sierra Leone and to export those profits. In practice these objectives are in conflict with national goals and, to pursue them, these business men use what are politely called "occult influences", and more bluntly, corruption.

5. The basic mechanism is well known. Businessman A buys Leones for forex (say in accounts in Switzerland, London or - less than formerly - Beirut). Thus he provides Businessman B a means to get his profits and/or capital out of Sierra Leone. (B then may or may not then import - openly or via smuggling or openly but paying Customs Officers not Customs Duty - goods to Lebanon to repeat cycle.) Businessman A uses Leones to buy gold and diamonds from intermediate Businessman C and/or Sierra Leonean diggers. (The intermediates are both expatriate and Sierra Leonean.) Businessman A then uses smuggling and "occult influence" to export the gold/diamonds to Europe/Levant/Middle East/Indian Sub-Continent.
6. At a rough estimate the financial flows for diamonds are as follows:

A (in forex)

Value ex-Europe	100
Leones Purchased	50
External costs	<u>10</u>
Profit	<u>40</u>

A-2 Breakdown Leone Uses

To Diggers (direct or via intermediaries)	10/15
To Intermediary Businessman	10/15
To 'Normal' Operating Costs	10
To Smuggling/"Occult Influences"	15

To Sierra Leoneans (in Leones)

Diggers	10/15
Citizen Intermediaries	6/10
Domestic Component Operating Costs	3/5
"Occult Influences"	<u>10/12</u>
Total	<u>35</u>

Officially recorded exports and taxable incomes are very low.

Imports out of capital/profits expatriated via businessmen B's sales of Leones to may be half of the total forex received.

7. This is a slightly simplified model. Some intermediary and "occult" payments are in forex. All %'s are best guesses from very fragmentary data (not all from Sierra Leone). To guess the total volume of gold/diamonds "paralleling" is a very speculative exercise. Frankly \$25 million to \$100 million a year would be as plausible a range estimate as any and a more precise one would require a detailed (and if serious in data seeking dangerous) study.
8. But the main points are clear:
- a. Diggers are badly paid;
 - b. Sierra Leone as a whole receive little over a third of proceeds and much of that to "occult rent seekers";
 - c. Exporters make large profits;
 - d. They bring in little forex because they buy Leones from other businesses which wish to ship out profits/capital. Imports out of these payments do increase goods available in Sierra Leone but frequently "avoid" paying duty.
9. This wholly unsatisfactory state of affairs cannot be solved by a government buyer (single channel or other). Sierra Leone does not

have the expertise to value gold (never 100% pure) nor diamonds and it cannot pay public sector employees enough to lead them out of temptation to sell out (directly or indirectly) to parallel exporters.

10. An expert, reputable (concerned with long term and with global reputation) private sector buyer or buyers could improve the situation.
11. At present the reputation of Sierra Leone (however unjust it may be, especially to present senior personnel) deters such buyers. Reputable firms believe "occult influences" and bullets/matchets of present parallel exporters will put them out of business. (UAC, CFTC, SCOA, et al have totally or almost totally closed for parallel reasons.) This has to be countered and to do that requires serious Sierra Leone approaches to 1 or 2 or 3 reputable firms.
12. The key diamond buyer world-wide is De Beers. It has every reason to wish to scoop up 'loose' diamonds to get them back into Central Selling Organisation channels to manage (sustain price in) diamond market. (That is mildly in Sierra Leone interest - good prices to CSO do feed back to producers.) Therefore, De Beers sometimes does open offices to buy out 'shadowy' diamonds, e.g. in Brazzaville (for Zaire and Central African Republic stones). De Beers is not a philanthropist - far from it. But it has a global market management concern; it cares about its global reputation (it is worth money to them!); it is in business for the long haul (going on 100 years now) not quick profits.

13. De Beers has restructured recently. All operations outside South Africa are now organised under a separate, quoted company De Beers-Centenary which is a Swiss company in registration with its main operations in UK (sorting/selling), Botswana (producing), Namibia (producing). Any Sierra Leone operation would be via Centenary. If Sierra Leone wished De Beers might formally agree Sierra Leone buying unit was linked to Centenary via the Botswana company (which is a Botswana/De Beers joint venture).

14. A possible proposal to De Beers would be:

- i. De Beers open a buying subsidiary in Sierra Leone;
- ii. it would open one or more offices to buy as it saw prudent (including up-country in digging areas);
- iii. security to be provided either by a special constabulary group hired by De Beers or a new branch of SL constabulary with special arrangements on use/pay negotiated with De Beers;
- iv. De Beers to be authorised to pay diggers or intermediaries in forex at prices it deems prudent. It wants to sweep market so will pay more than the present buyers. As it wants to hold costs down it will also prefer to buy direct from diggers;
- v. De Beers will export the diamonds declaring a pro forma estimate of value. At that stage it will pay tax:

a. Export Duty	10%
b. Advance Company Tax	<u>20%</u>
Total	<u>30%</u>

vii. the diamonds will be valued in London (or Amsterdam or Zurich)
by:

- a. Central Selling Organisation valuer;
- b. Independent valuer agreed and jointly paid by De Beers/Sierra Leone with provision how to settle differences between a/b (ultimately but, hopefully rarely!, arbitration);

viii. Centenary (Sierra Leone) would then present tax return:

- a) Valuation Europe
- b) Less CSO Selling Commission 10% (standard)
- c) Less Cost Freetown/Europe
- d) Value - Free on Board Sierra Leone
- e) Less Payments for stones
- f) Less Royalty Paid
- g) Plus/Minus Correction Royalty Paid to 10% of "c"
- h) Less Other Sierra Leone expenses
- i) Less Agreed share of external Centenary overheads (say 10% of e + h?)
- j) Taxable Profits
- k) 50% Company Tax on Diamond Dealing (Negotiable - should not be below 40%).

Payment would be:

- l) 50% company tax
- m) less pre paid Advance Co. Tax
- n) plus 10% on d
- o) less pre paid Royalty
- p) Balance of Tax Due

15. A hypothetical arithmetical example:

▪ <u>Pro Forma</u> declared export value	20,000,000
a) Export Tax	\$2,000,000
b) Advance Company Tax	\$4,000,000
Paid To Government In Forex At Export -	<u>\$6,000,000</u>
▪ a) Valuation In Europe	\$26,000,000
b) Less: CSO 10%	2,600,000
c) Less: Freetown to Europe Cost	500,000
d) Value FOB Sierra Leone	<u>\$22,900,000</u>
e) <u>Less</u> Payments for Stones	8,500,000
f) <u>Less</u> Royalty Paid	2,000,000
g) <u>Less</u> Additional Royalty Due	290,000
h) <u>Less</u> Other Sierra Leone Expense (Including 'Constabulary')	2,000,000
i) <u>Less</u> Agreed External Centenary Overheads (10% of e + h)	<u>1,050,000</u>
j) Taxable Profits	<u>9,060,000</u>
k) Company Tax	<u>4,530,000</u>
k) Company Tax	4,530,000
m) <u>less</u> Advance Co. Tax	(4,000,000)
n) Royalty	2,290,000
o) <u>less</u> pre paid Royalty	(2,000,000)
p) Balance Payable	<u>820,000</u>

This is a good deal more than probable revenue/forex receipts on stones won by diggers now. (Any functioning company concession is excluded. They can be expected to market/pay on same basis as De Beers for their own output.)

16. Note that additional forex to Sierra Leoneans would be about \$9,500,000 (\$8,500,000 to diggers/intermediaries and \$1,000,000 local content of other expenditures in Sierra Leone). Normally I would advise pay Leones to diggers and let recipients buy goods and require De Beers to buy Leones from Central Bank. But today the Leone is not well regarded. To pay in forex or goods will lower cost/increase attractiveness of De Beers offer. And De Beers has no desire to become an import house/retail barter dealer! So for time being let them pay in forex. If situation improves review after 12 months with

a view to shift to 50% forex/50% Leone payments (i.e. a parallel to normal forex retention scheme for exporters).

17. Gold is analogous to diamonds. If De Beers (using its connections with Anglo American via, one assumes, its UK - i.e. Charter - or Caribbean - i.e. Minorco - units) would buy that would be worth negotiating. There probably are economies of joint operation.
18. Gold cost structures for buying are not likely to be identical to diamonds. But on buying operations some companies have been willing to pay 33% of gross exports as tax. Thus 10% royalty plus 50% company tax looks possible initial target. (Diamonds in example comes to \$6,820,000 on 22,900,000 or 29%.) Gold independent valuation mechanisms would be different perhaps by using independent refiner to determine standard quality gold content.
19. In gold if 2 or 3 reputable firms wish to come in on terms analogous to above then all should be licensed. There is no case for a single channel (monopoly) licence.
20. Diamonds are a special case. There is no full alternative to De Beers. (Previous Sierra Leone concession operator was a much smaller operator; almost a fringe one relative to De Beers/CSO.) De Beers will probably want a monopoly because it wants maximum % of stones to go to CSO. If independent valuation and royalty/tax roughly analogous to those proposed can be negotiated, then a 3 year sole buying licence could be given De Beers and opening to a second buyer reviewed in year 3.
21. The above is a sketch of a strategy and approach. If it is seen as a way forward then a carefully prepared brief for a proposal to De

Beers (and/or others) and negotiations if they respond as well as a high level official negotiating team (responsible to Ministers of Finance and of Mines and through them to Cabinet) will be needed.

22. Whether Sierra Leone would need technical assistance on data collection, brief preparation, negotiation advice is for Sierra Leone to decide. Given the expertise of De Beers and lack of data and prior experience of Sierra Leone the probable answer is yes.
23. If Sierra Leone agrees with that (need for ta) then:
- a. data on independent valuation is available from Botswana, Tanzania and Technical Assistance Group of Commonwealth Secretariat;
 - b. TAG has expertise in mining legislation and negotiations (including, I think, on Sierra Leone mining code modernisation?) and has finance to respond to requests;
 - c. individual experts (e.g. Mike Faber, Phil Daniel, Reg Green at IDS; Roland Brown nominally retired after UN TNC Centre, TAG, IDS, African government legal career centred on business negotiations including diamonds) exist. Those listed could probably be funded as part of a TAG team if requested by Sierra Leone. Tag would know of others.

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