



No. 218

The Illicit Market in Diamonds

Rebecca Tailby

Diamonds may be a symbol of loving partnership and a girl's best friend, but are they also becoming a close friend to organised crime? There is growing evidence of organised crime syndicates becoming involved in the lucrative international diamond trade. Found only in certain regions of the world, diamonds are a finite natural resource—often difficult to mine. Limited abundance combined with strong consumer demand for gem-quality stones make diamonds a highly valued commodity. Desire by criminal operators to tap into this wealth through illicit means has encouraged the growth of theft and fraud within the diamond industry. Furthermore, diamonds are being used in certain parts of the world to finance more insidious activities including drug and arms dealing. On 22 October 2001, the Australian Institute of Criminology held a roundtable meeting on "Illicit Aspects of the Diamond Industry", where many of these issues were examined by stakeholders from government and industry. This paper explores the nature of illicit activity within the diamond industry, reviews Australia's experience with diamond-related crime, and considers potential responses.

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Director

Criminal Opportunities within the Diamond Industry

The Advantages of Diamonds for Illegal Trade

Diamonds have numerous features that make them highly attractive as a commodity that may be used in connection with illegal trade. They are:

- small and durable (hence readily concealed and easily smuggled);
- of inherent value (with a very high value-to-weight ratio), serving as a form of "compressed cash";
- easily exchanged for cash or other commodities (for example, drugs, arms); and
- virtually untraceable once in polished form.

In addition, the origin of individual stones and/or mixed "parcels" is impossible to determine in any cost-effective or practical manner. These combined qualities make diamonds a seemingly ideal currency for organised crime.

Diamonds vary in quality from industrial grade to gem quality. There is marked variation in the value of gem-quality stones, determined according to "the four Cs": cut, colour, clarity and carat-weight. Diamonds targeted for theft by criminals are typically gem quality, as these stones produce the highest comparative return. There is a relatively narrow market for high-end gems given their rarity and expense and the fact that they are readily noticed once they enter the market. Yet if criminal syndicates succeed in procuring and selling even a small number of high-quality diamonds illegally, this can return enormous profits. Alternatively, if syndicates are engaged in systemic theft of lesser-value gem-quality diamonds, this still provides the potential for solid returns.

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The Criminal Acquisition of Diamonds
Like most industries, the diamond industry is subject to internal regulation to ensure its integrity and to protect what is a valuable commodity and resource. Internal regulation and security measures have not, however, prevented organised crime groups from targeting the industry. Some of the criminal strategies adopted include the following.

- Persons associated with criminal groups seek employment in mining operations, with intent to steal diamonds once “inside” (that is, placement/insertion).
- Existing employees within the industry are targeted by criminals to steal diamonds for supply to the criminal group (that is, recruitment/corruption). Theft can involve misappropriation of stones before they are brought to account on the production books, or diamond substitution later in the pipeline, whereby low-value goods are substituted for high-value gems (stages in the diamond pipeline are outlined in Figure 1).
- Opportunistic theft of diamonds may take place during transit between major points in the pipeline, for instance, by those in a position to handle goods during local or international transfers.
- Criminal syndicates may purchase diamonds sourced from rebel-held diamond-rich territories in various conflict regions around the globe. The trade in so-called “conflict diamonds” is perceived as one of the most significant threats to the legitimate diamond industry (Corkill 2001).

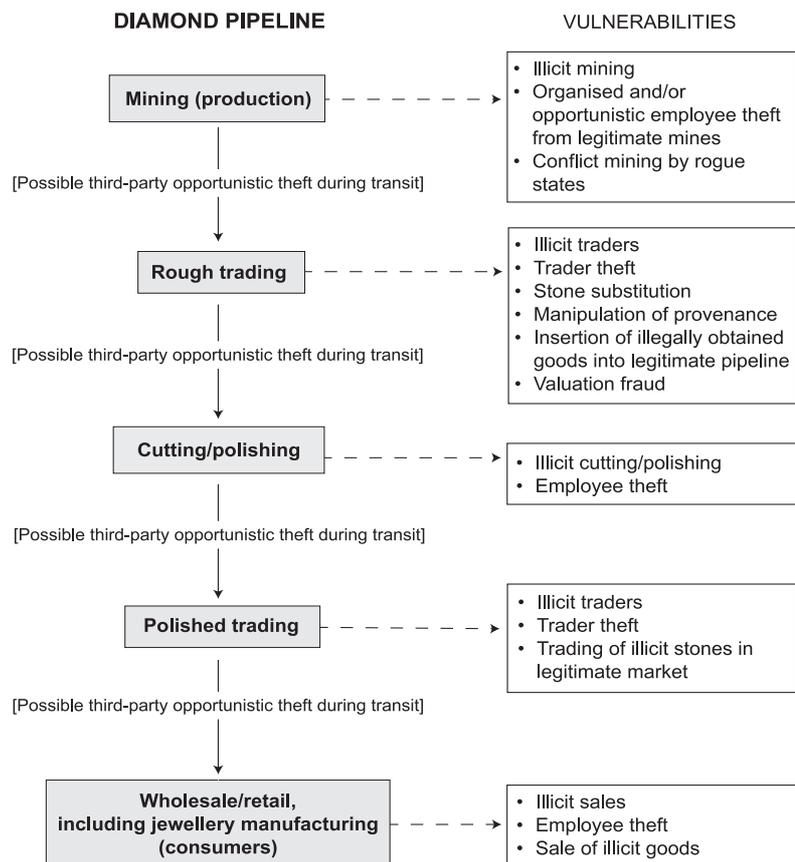
The first three scenarios constitute theft of diamonds that have been legitimately produced. While such theft is often perpetrated by individuals, offenders are typically linked to a broader criminal network into which stolen diamonds pass. Such theft may be distinguished from trade in conflict diamonds, in which the mining enterprise itself is not legitimate.

The trade in conflict diamonds has received considerable international attention and condemnation in recent years (see, for example, Global Witness

2000). Prohibitions have been imposed under United Nations Security Council resolutions against the purchase of conflict or non-certified diamonds from countries such as Angola and Sierra Leone (see Security Council Resolution 1173 [1998] in relation to Angolan diamonds and Resolution 1306 [2000] in relation to diamonds from Sierra Leone). The United Nations has also sought to limit the role of other countries such as Liberia in providing provenance for illicit stones, and has imposed similar sanctions (Security Council Resolution 1343 [2001]; see also Expert Panel on Liberia 2001). Australia has responded legislatively to the first two resolutions, prohibiting the importation of diamonds from Angola and Sierra Leone unless written permission is granted by the Minister for Foreign Affairs. Provisions of the *Customs (Prohibited Imports) Regulations 1956* (Cwlth) govern importation of unset diamonds originating from Angola (reg. 4M) and rough diamonds originating from Sierra Leone (reg. 4N).

While the conflict diamonds issue has gained prominence in the international press, and efforts to publicise and condemn conflict mining are laudable, the media focus on this issue has been selective and arguably disproportionate. The United Nations has, for example, estimated that 20 per cent of the world’s rough diamond trade is illicit in nature and that conflict diamonds constitute less than four per cent of world production (Expert Panel on Sierra Leone 2000). De Beers (2001) now place this latter figure at approximately 2.5 per cent. On the basis of these figures, only between 12 per cent and 20 per cent of diamonds in the illicit trade are conflict diamonds—the majority of the global illicit trade involves stolen, non-conflict diamonds. In either case, however, corruption (whether of individuals, segments of industry or national governments) is a core issue which must be addressed in local and international response strategies (Shaxson 2001).

Figure 1: The diamond pipeline and its vulnerabilities to illicit activity



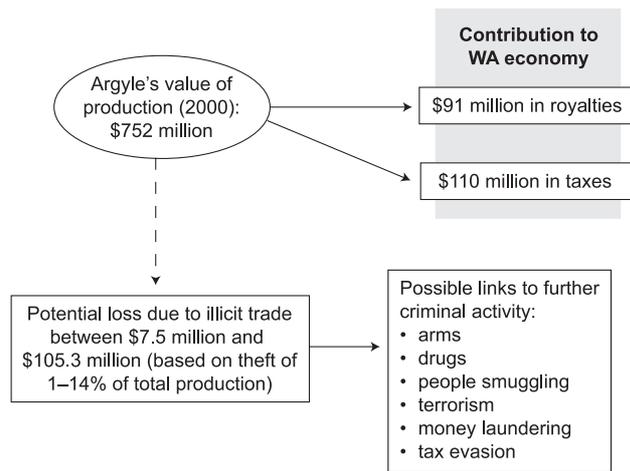
Trade in Illegally Obtained Diamonds

Profits may be derived from the illegal acquisition and trade in diamonds in a variety of ways. First, diamonds may be sold in international diamond markets (known as “bourses”). This may occur via clandestine trading of illicit stones, or through successful insertion of illicit diamonds into the legitimate marketplace. One example of the latter is legal miners “salting” their production with illicitly obtained diamonds (including conflict diamonds), thereby “laundering” them.

Second, illicit diamonds may serve as tradeable items of value, a form of “extra-national” currency, to be used in other illicit market transactions. Recent history has seen diamonds associated with the arms trade, the drug trade and, quite recently, with people smuggling (Corkill 2001). Within industry and law enforcement circles, awareness of these links is growing. Evidence of the association between illicit diamonds and other more established “high-profile” transnational criminal markets provides cause for serious concern. Adding to this concern, there are emerging reports of diamonds being used to finance terrorist activities. *The Washington Post* reported on 2 November 2001 that the terrorist group al-Qaeda has reaped millions of dollars in the past three years from the illicit sale of diamonds mined by Revolutionary United Front (RUF) rebels in Sierra Leone. The article alleged that other terrorist networks including Hezbollah are also buying conflict diamonds from the RUF. With the enhanced focus on following criminal money trails since the terrorist attacks in the United States on 11 September 2001, there may be a move by such groups to increase their use of commodities other than cash; diamonds may provide an attractive alternative.

Diamond transactions may also be used as a vehicle for laundering the proceeds of other criminal activities, for instance, through the manipulation of

Figure 2: Cash flow case study—Argyle Diamond Mine, WA, in 2000



diamond valuations. If a collusive arrangement exists between buyer and seller (who may be based in different countries), a diamond or diamond parcel may intentionally be over-valued by the seller. This enables the buyer to transfer payment at the inflated price, incorporating the actual value of the stones topped up with additional illicit funds which then become laundered and legitimised. Alternatively, stones may be under-valued in order to avoid or minimise taxation and customs duties. Over- or under-valuation is facilitated by the fact that diamonds are one of the few commodities valued on the characteristics of individual stones rather than on linear mass (Halwas 2001). Other criminal activities forming part of the illicit mosaic include the smuggling of diamonds across borders to evade customs duties or to enhance their provenance. This helps disguise the true origin of stones, and in the case of conflict diamonds can assist in establishing an appearance of legitimacy.

An important feature of the international diamond market is the somewhat parallel nature of the licit and illicit streams. Stones may remain in one or the other stream, or illicit and licit goods may cross over at virtually any stage of the pipeline (see Figure 1). To illustrate, conflict goods may remain fully contained within the illicit market, being polished then traded to criminal groups in exchange for other criminal

commodities. Alternatively, the origin of conflict or stolen diamonds may be successfully disguised and the diamonds may enter the legitimate market. Licit diamonds may also cross over to the illegitimate market (as when stones are stolen at some point in the legitimate chain and sold at a reduced price on the illicit market). The veil of secrecy surrounding diamond transactions and the lack of an adequate global regulatory and certification regime are two (but not the only) factors contributing to poor transparency within the industry. This in turn facilitates illicit activity in its various forms.

The Level of Risk in Australia

Diamond mining in Australia is an important sector of the national minerals industry, which is Australia’s largest export earner (PMSEIC Working Group 2001). Australia has diamond mines in Western Australia (the Argyle mine) and the Northern Territory (the Merlin mine), both of which are controlled by the international mining conglomerate Rio Tinto. Further diamond exploratory ventures are currently underway in Western Australia and the Northern Territory, as well as in South Australia and New South Wales. Australian mining venture capital is also invested in South Africa through diamond mining and exploration (Syvret 2001).

The Argyle Diamond Mine is Australia’s largest diamond

venture and is, by volume, the largest single source of diamond production in the world. In 2000, the Argyle mine produced \$752 million of the \$768 million that was Australia's total diamond production for that year. A large proportion of this revenue is returned to the local economy: in 2000, Argyle paid \$91 million in royalties and \$110 million in taxes to the Western Australian government (see Figure 2). This represents a significant source of revenue and, given forecasts that Australia's diamond industry will experience growth over the next few years, this revenue is set to increase.

In Australia, there are no significant indicators of systemic diamond theft although, as indicated previously, it is estimated that 20 per cent of the worldwide rough diamond trade is illicit. Based on estimated industry norms of losses of between one and 14 per cent of total production, risk exposure for Argyle is quite substantial (Corkill 2001). Based on these industry norms, Argyle's potential loss exposure in dollar terms may be between \$7.5 million and \$105.3 million at run-of-mine per-carat value (that is, the average per-carat price for the mine's annual production volume). While there is currently no evidence suggesting such losses are occurring, estimated losses within this range are within the norm for diamond production overseas, and are also consistent with estimates of losses to the Australian gold industry. The potential loss may be considerably higher if offenders are sophisticated enough to target high-value diamonds for theft. These costs represent potential economic and reputational losses to industry, and losses to government in terms of unpaid royalties and taxes. Unfortunately, as the industry expands and awareness of the value of this resource grows, it is likely that increased targeting of industry by organised criminals will occur. Even if the level of theft remains within current

estimates, the growth of industry will result in a concomitant rise in potential economic losses due to theft.

Cases of internal theft have prompted greater attention to and implementation of internal security procedures within the diamond industry internationally. The industry continues to explore new monitoring and screening technologies which facilitate effective crime prevention and promote "protection at source". Clearly, however, vulnerabilities occur not just during production but also at other points in the market. Given recent assessments that employees within Australia's diamond industry continue to be targeted by criminal individuals and/or criminal groups (Corkill 2001), recognition of vulnerabilities to penetration and/or corruption by organised criminal groups remains an ongoing part of the crime-prevention process.

A final threat to Australia's diamond industry concerns the movement of conflict diamonds. Although Australian diamonds are conflict-free, this does not mean that Australia can be complacent with regard to conflict diamonds. Australia may be strategically targeted as a country of choice for legitimising conflict goods due to our proximity to south-east and north Asian

manufacturing bases, and the fact that Australian diamonds are considered to be of sound provenance.

Response Options

The burgeoning trade in illicit diamonds has gained increasing global recognition over the last two years, and serves as a timely reminder of the risks for the consideration of Australian stakeholders. While industry must maintain a significant level of responsibility for "minding its own shop", law enforcement and government agencies have the potential to play complementary roles in policy-making and investigation of illicit activity within the diamond industry. There are a variety of ways in which industry self-regulation might be supplemented by external regulation at the local, national and international level.

Local

Theft from individual mines has a local impact, such as loss of revenue to State economies. At present, law enforcement investigations are typically a State responsibility—cases of theft at source are investigated by State police. In the Western Australia and Northern Territory police services there are specialist units

Case Study: Argyle Diamonds

Anecdotal evidence suggests that the Argyle Diamond Mine was targeted by criminal groups very early in the venture, possibly even prior to production commencing. The so-called "Argyle Diamonds affair" is the most publicised case of illegality within Australia's diamond industry. In this case, a highly placed security employee at the Argyle Diamond Mine was recruited by a Perth organised crime figure to steal rough diamonds from the mine. From the mid-1980s until 1990 this security superintendent engaged in systemic organised theft, and was subsequently convicted of stealing diamonds. Also convicted was the criminal associate who had recruited him into the criminal venture. This associate served as the intermediary for the stolen diamonds. The stones were moved offshore for trading and processing, reportedly passing through a highly regarded, well-connected diamantaire in Switzerland to legitimate buyers in Hong Kong and Europe. While the exact number and value of the stolen diamonds was not established at the trials, industry has estimated the loss may have been in excess of \$30 million. This case highlights the damage that can be done by a single corrupt insider, particularly one in a position of considerable trust and access.

for investigating natural resource crime (the Diamond and Pearl Investigation Unit in WA Police, and the Gold Squad in NT Police). These units have developed a strong understanding of industry, cooperative links with mining operators, and are experienced in conducting specialised investigations within these industries. Yet, being State agencies, their jurisdiction is limited to the State. Their capacity to pursue interstate or transnational aspects of illicit diamond activity is limited. This poses difficulties given that stolen Australian diamonds are almost always moved offshore for trading and polishing.

National

Although mining is largely a State affair, upon export diamonds become an Australian product. Within the international diamond community, stones are identified according to this national identity rather than local origins or provenance. As such, any future threats posed by consumer or industry concerns over the security or legitimacy of Australia's diamond industry would affect Australia as a whole. Furthermore, due to the growing geographic spread of diamond interests within Australia (including the retail end of the market which is heavily centred on the east coast), illicit diamond activity may potentially occur in locations all around the country. As such, consideration of diamond-related crime as a State or Territory problem neglects the bigger picture.

The criminal threats described above are not unique to the diamond industry. Similar exploitation of other natural reserves (for example, gold, pearls, opals and tantalum) is occurring in other regions of Australia. If controls on the diamond industry are tightened, organised criminal syndicates may displace their activity to other lucrative natural resources. A pragmatic approach may be to recognise that these valuable resources are not inherently the

issue, they are merely another vehicle or commodity used by organised crime groups to expand their profit-earning repertoire.

Organised crime groups target opportunity. The evidence suggesting that Australia's natural resources are being targeted as criminal commodities—resulting in significant financial loss to private companies as well as to government and local economies—reinforces the need to establish a coordinated national framework for dealing with criminal involvement in the diamond industry (and other natural resource industries). A model response framework would ideally enable crime prevention approaches to:

- be concordant nationwide;
- cover Australia's range of natural resources (including diamonds);
- have the capacity to cover all points in the market chain (from production and processing to retail); and
- engage all relevant stakeholders.

At present, responsibility for monitoring resource-related crime remains split between various sectors. Using the diamond industry as an example, State police investigate crime at the mine or sorting facility. Certain federal agencies may investigate diamond-related crime on a case-by-case basis if the activity falls within their area of responsibility. For instance:

- the Australian Customs Service would investigate if there was suspected illegal export or import (including import of conflict diamonds);
- the Australian Taxation Office would investigate in the case of federal tax evasion or revenue fraud;
- the National Crime Authority would investigate if organised crime groups were engaging in diamond-related crime in conjunction with other serious offences (such as money laundering or drug offences); and
- the Australian Federal Police would investigate if there were transnational criminal connections.

The private sector (for example, diamond companies and financial institutions) also has an interest in maintaining the security and legitimacy of diamond commerce.

Clearly, these various agencies hold a range of information and intelligence. Yet information emerging during the course of investigations by any of these stakeholders typically remains "in house". This creates a situation in which pockets of information concerning diamond-related crime remain isolated within numerous agencies. In the absence of some form of coordinated information exchange between stakeholders at the national level, the full picture concerning the nature of illicit diamond activity within Australia cannot emerge. The benefits of information-sharing are numerous, yet at present there is no formal mechanism facilitating this. Partnerships need to be established, not just within government but also between government, industry and the private sector.

A national-level response would be an effective means of ensuring:

- the engagement of all key stakeholders;
- the sharing of information to enable fuller understanding of the problems and threats; and
- a coordinated approach to tackling the issues.

National cooperative arrangements exist in other diamond-producing countries (such as Canada, with its Diamond Protection Service, a division of the Royal Canadian Mounted Police) and may serve as a "good practice" model for the establishment of a similar national taskforce or coordinating mechanism in Australia. However, Australia's privacy legislation may be an impediment to information-sharing and may limit the ability of law enforcement agencies to investigate organised crime involvement in diamond theft and to pursue lost revenue.

A national-level approach would facilitate international engagement. Given that the diamond industry is highly

transnational, establishment of a central national focus point would have advantages. This focal point could assume responsibility for liaison with overseas contacts and engagement in international fora concerning the diamond industry. As the national coordinator or taskforce would be supported by and have access to information from all stakeholders, it would be well placed to present “whole-of-country” input rather than just input from particular sectors or States.

International

The diamond market is geographically fragmented. There is an extended pipeline, spanning many operators and countries, through which diamonds pass in proceeding from the mine to the end consumer. The illicit market appears to follow similar pipelines to the legitimate market (and in some cases individuals may be involved in both the legitimate and illegitimate trade). The relative lack of transparency in the commercial trade, and weaknesses in the auditable trail of diamond movements from the mine to the consumer, facilitate the partial overlap of the legal and illegal markets.

Given the international nature of these markets, any successful action aimed at reducing the illicit trade in diamonds must include not only national measures but also a transnational dimension. There is recognition within industry that international frameworks for action are critical, and cooperative international rallying has been seen through the development of mechanisms such as the Kimberley Process. The focus of this multilateral forum is the establishment of a legal channel—specifically, an international chain-of-custody certification scheme—through which rough diamonds must be traded. The scheme requires proof of legitimacy before diamonds are permitted to enter the legal trading channel. It also creates an offence for dealing outside this legal channel. Once implemented,

the Kimberley Process will assist in preventing the trade in illicit rough diamonds. Full implementation of the Process is anticipated to occur by the end of 2002.

Additional international action to respond to illicit diamond trading might use the recently signed United Nations *Convention against Transnational Organized Crime* to pursue the forfeiture of criminal assets from illicit diamond sales. If the terms of the Convention are not sufficiently broad to capture this activity, an additional optional protocol on diamond (or natural resource) smuggling could be proposed. Australia could take a proactive role, both by examining our existing national capacity for detecting and deterring diamond (and other natural resource) theft/smuggling, and also by encouraging and supporting international recognition and response to what is an international criminal problem.

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