The De Beer’s Diamond Cartel

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Contents

Durable Goods

•Definition: Goods that last for several time periods

•Renting vs. selling for a monopoly

Renting yields same choice of durability as a competitive firm, but with less quantity produced (Perloff p. 501)

No difference in outcome between renting and selling if consumers are convinced that the monopoly will continue with its pricing policy in the future (p. 502) …but this is not believable

Coase's Conjecture

- "*A durable goods monopoly that sells its product has less market power … when compared to a monopoly that rents the durable good*" (p. 509-10)
- Paradox: when selling a durable good, more market power leads to less market power
- Monopolies that sell rather than rent their good have an incentive to lower the prices in the future: consumers expect this and make decisions accordingly

- Solving the problem of consumer expectations (p. 518-9):
- Rent instead of selling
- Convince consumers that future production will be limited
- Produce less durable goods
- Guarantee to buy back products at the original price
- Get a reputation for never lowering prices

Historical Information

- Until the late nineteenth century, diamonds were found only in a few riverbeds in India and in the jungles of Brazil, and the entire world production of gem diamonds amounted to a few pounds a year.
- In 1870, however, huge diamond mines were discovered near the Orange River, in South Africa, where diamonds were soon being scooped out by the ton. Suddenly, the market was deluged with diamonds.

- The British financiers who had organized the South African mines quickly realized that their investment was endangered; their price depended almost entirely on their scarcity.
- If new diamond mines were found in South Africa, the price of diamonds would drop.
- Thus, the major investors in the diamond mines realized that they had no alternative but to merge their interests into a single entity that would be powerful enough to control production and perpetuate the illusion of scarcity of diamonds.

•The instrument they created, in 1888, was called De Beers Consolidated Mines, Ltd., incorporated in South Africa. As De Beers took control of all aspects of the world diamond trade, it assumed many forms.

•In London, it operated under the name “The Diamond Trading Company”.

•In Israel, it was known as "The Syndicate."

•In Europe, it was called the "C.S.O." -- initials referring to the Central Selling Organization, which was an arm of the Diamond Trading Company.

• In Africa, it disguised its South African origins under subsidiaries with names like Diamond Development Corporation and Mining Services, Inc.

•At its height -- for most of this century -- it not only either directly owned or controlled all the diamond mines in southern Africa but also owned diamond trading companies in England, Portugal, Israel, Belgium, Holland, and Switzerland.

Statistics

- Headquarters: Johannesburg, South Africa
- Has a presence in 25 countries
- 22,936 Employees
- Revenue in the U.S. = $6.5 billion (2005)
- Net Income in the U.S. = $554 million (2005)
- De Beers now owns about 70% of diamond mines in Africa. The De Beers “family of companies” collectively are responsible for around 40% of world diamond production by value (2007)

Legal Aspects

- 1994: U.S. regulators at the Department of Justice brought a price-fixing suit against De Beers and General Electric.
- 2004: De Beers agreed to pay $10 million to settle suit of conspiracy of fixing the price of industrial diamonds.
- De Beers is the largest supplier of rough diamonds in the world. Beginning in 2001, Plaintiffs in several states filed lawsuits against De Beers in state and federal courts alleging that De Beers unlawfully monopolized the supply of diamonds, conspiring to fix, raise, and control diamond prices, and issued false and misleading advertising.

- On November 30, 2005, De Beers announced an agreement had been reached and a preliminary approval order issued to settle the majority of civil class action suits filed against De Beers in the United States.

- De Beers settled a class lawsuit for $295 million dollars. Refund eligibility for diamonds purchased between 1994 and March 2006.

- 2005: European Commission filed charges complaining that De Beers was breaking European competition laws.

- February 2006, De Beers voluntarily entered into legally binding commitments with the European Commission to cease purchasing rough diamonds from Alrosa as of 2009.
- De Beer's decision to settle legal actions coincide with implementation of a new strategy.

Political Image

- De Beers is now looking to put their legal issues behind them, and concentrate on it's marketing, specifically to the United States, who buys half the world's diamonds.

- Since 1999, De Beers enacted a zero-tolerance policy in order to stop all outside purchasing of diamonds to guarantee diamonds were purchased in conflict-free regions of Africa. Eliminating past issues of possible funding of rebel groups.


AND SHE THOUGHT
THESE THINGS
ONLY HAPPEN IN THE
MOVIES
A DIAMOND IS FOREVER

- Additionally, marketing has been successful with ads such as “Diamonds are Forever”, used since 1947, also successfully associating diamonds as proper wedding and engagement rings. Nearly $150 million per year is spent on advertising.

- In 2001, De Beers entered a joint venture with Moet Hennessey Lour Vuitton in order to establish an independently diamond jewelry company managed by De Beers. De Beers retail stores now operate out of U.S. cities such as Houston, Dallas, New York City, Beverly Hills, Houston, and Las Vegas.

- With the $295 million international settlement, De Beers is trying to wash its hands of a monopolistic past by providing reparations, but simultaneously not acknowledging any actual liability. Instead De Beers is attempting a good faith effort emphasizing business is completed legitimately world-wide.

Conclusion

- Diamonds are luxury product
  - Diamond industry based off idea that more expensive diamond = more luxurious
  - Diamonds would only be $2 -$30 for industrial use
- De Beers cartel relies on controlling quantity to artificially increase price

Anticompetitive Tactics

- If prices falling, De Beers reduces supply
- If new suppliers emerge, De Beers will flood market & sell below market prices
- De Beers sells only 10 times a year at “sights”
  - 125 –150 “sightholders” invited to purchase diamonds

Anticompetitive Tactics (continued)

- Sightholders essentially powerless
  - can only accept or reject boxes (no negotiation)
  - not allowed to resell to retailers (who will lower prices)
  - De Beers has right to audit them
- Summary: De Beers has had the largest and longest lasting monopoly of all time
  - But, De Beers is losing this market power and is shifting its focus to marketing & brand name

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