




De Beers : A Monopoly in the Diamond Industry

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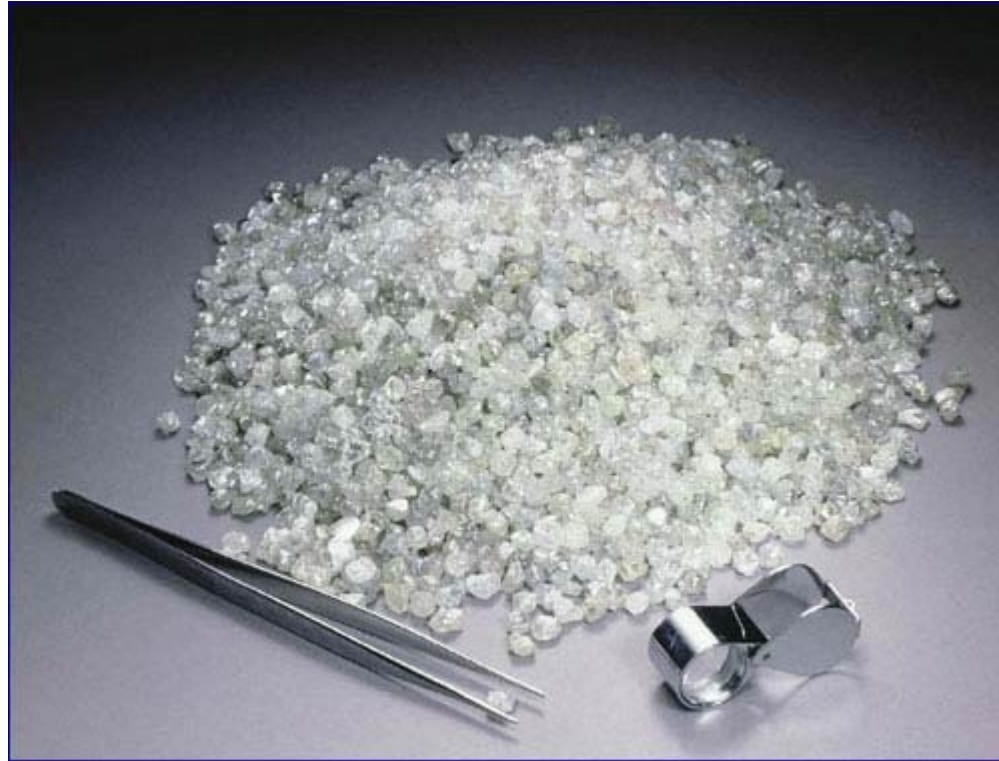
I am the instructor for the Introduction in
Macro course of the Dep. of Economics

My main research interests are:

International Economics

Growth Theory

Rough Diamonds



Cut Diamonds





Jewelry Stores

What is De Beers?

- not retailer
- not manufacturer

BUT

- miner and buyer of 70-90% of the world's rough diamonds up to the end of the 20th cent
- arbiter of their prices

DE BEERS

A DIAMOND IS FOREVER

DE BEERS

CUTTERS

JEWELERS





□ Outline

- Facts about De Beers
- Origin
 - How it achieved market power and the control of the market
- How the Monopoly operates
- Inefficiencies created by monopolies
 - High Prices
 - “Blood” Diamonds
- Monopoly and competition

□ Facts about De Beers

- Most successful monopoly of modern trade
 - Other commodity prices (e.g. gold, silver, grains) fluctuate greatly in response to economic conditions
 - Diamonds' prices are constantly rising
 - 20th century, De Beers sold 85% to 90% of the diamonds mined worldwide

De Beers is a typical example of monopoly!!!

- Up to the end of the 20th cent. It was almost the sole seller of diamonds. (sells almost 90% of world production)
- Sells a commodity with no close substitutes (created this illusion by advertising)
- It restricts output and it responds to changes in market demand



Are diamonds rare?

Before the 19th century:

- Diamonds were exceptionally rare
- Small quantities in India and Brazil
- No diamond mines were discovered

Nowadays:

Many diamond mines:

- Republic of South Africa
- Sub-Saharan countries
- Siberia
- Australia
- Canada's NWT

□ Origin

■ 1869

- First diamond mines in the colonies of southern Africa
- Drastically increased the number of stones available

■ 1870

Many diamond hunters bought mines

Cecil Rhodes



Bought the rights to two mines on the farm of :

■ Nicolas

and

■ Diedrick De Beer

in the Cape Colony (now South Africa).

Diamond hunters realized that scarcity increases diamond prices.

- Had no other alternative than to merge their interests into a single entity:
 - control the mines' production
 - keep the scarcity illusion



De Beers Consolidated Mines Limited

- Established 12th March 1888
- Rhodes, founding chairman



De Beers:

- South African company
- By 1890, De Beers controlled 95% of the world's diamond production

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?

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Wholesalers

- Group of 10 Jewish merchants
(London Diamond Syndicate)
 - Agree to be purchasing the entire production from all the De Beers mines
 - Resell them to cutters

DE BEERS

SYNDICATE

CUTTERS

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Ernest Oppenheimer

- Started buying his own mines
(Consolidated Diamond Mines)
- Started competing with De Beers
- Took over De Beers
- Chairman in 1929
- Oppenheimer family still controls De Beers





His thinking was:

“The only way to increase the value of diamonds is to make them scarce, that is to reduce production”

Example: Great Depression

- Public stopped buying diamonds (demand shifted left)
- London Diamond Syndicate could not absorb the world's diamond production at the high prices
 - Huge Stockpiles
 - Wanted to put them in the market
- Oppenheimer realized that:
 - Prices will fall
 - People will lose faith in diamonds

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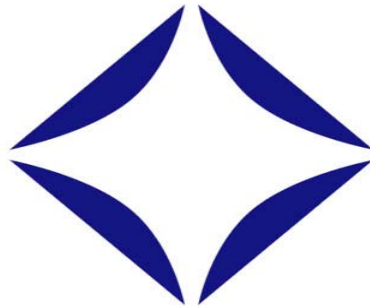


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- Took over the Syndicate



DTC

A DIAMOND IS FOREVER

- Sell the diamonds to a selected group of cutters that abide De Beers rules.
- To eliminate excess supply closed all major mines in South Africa

<u>Year</u>	<u>Production (carats)</u>
1930	2,242,000
1933	14,000



De Beers' Stockpile.....

By 1937 De Beers stockpile of diamonds
had grown to.....

40 million carats (20 years supply) !!!

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□ How the Monopoly Functions

- sends invitations to 250 chosen clients (diamond cutting factories in NY, Tel Aviv, Antwerp) to attend the 10 annual “**sights**”
- client receives a small box:
 - uncut diamonds
 - price of the box (\$1-\$25 million)
- client can only buy the whole box and he cannot resell it in a rough form

Thus, De Beers decides:

- How many diamonds of each quality will be distributed in total
- How this supply will be divided among the clients
- Price of diamonds.

What determines their decisions?

Demand

- Information about rate of family formation in USA and Japan
- Economic conditions

Supply

- Questionnaires



Using Demand and Supply.....

- Find the categories of diamonds in excess supply
- Omit from the boxes in next “sights”

□ Monopoly and Inefficiencies

■ High Prices

- Only activity in USA: advertising
- USA: Half of the world's \$56-billion retail diamond market
- Since a monopoly cannot operate because of the anti-trust US legislation, It is represented by Ayer's, a marketing firm



Things to consider.....

- Diamonds are easy to carry around
- Due to the monopoly, they worth a lot...




What happens if they go to the wrong hands?



■ Angola and “Blood” Diamonds


- 25-year civil war
- Began as a struggle against the Portuguese occupation
- Now it is over the country's natural resources: oil and diamonds (\$600-800 million annually)

- 
- De Beers buys lots of diamonds from areas controlled by rebels.
 - Rebels used the money to finance the war.
 - By 1998, De Beers' Angolan adventure threatened to become a PR nightmare.
 - Fearful of a consumer backlash, De Beers closed its buying offices in Angola and the Democratic Republic of Congo (DRC).



□ Monopoly and Competition

- The last 4-5 years the structure of the market had changed dramatically
- In July, 2004, De Beers pleaded guilty in a U.S. court for price fixing.
- However the bigger threat for the monopoly is competition
- Mr Leviev an Israeli of Uzbek descent is building his own diamond empire.

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- Is this duopoly going to lead to prices of diamond near the average cost?
 - Probably not! The oligopolists will prefer not to start a price war that will benefit only the consumer.
 - They will probably secretly agree in setting higher prices and making higher profits for both.



Conclusion

- Price Maker
- Controls Supply of Diamonds



**“De Beers:
A diamond is forever...”**



De Beers:

A monopoly is forever?