

## *Ethnic Networks, Extra-legal Certainty and Globalisation: Peering into the Diamond Industry*

BARAK D RICHMAN\*

### INTRODUCTION

AS THE CONTRIBUTORS in this volume colourfully illustrate, it is no small task to ensure legal certainty in transnational commerce, and the challenge becomes increasingly acute as commercial exchange becomes ever more globalised. One might expect, however, that the diamond industry would remain largely unaffected by this trend of globalisation. Because diamonds are easily portable, universally valuable and virtually untraceable, state courts are incapable of enforcing executory contracts for diamond sales (Richman, 2004; 2006). In other words, the diamond industry has *never* enjoyed legal certainty. Instead, it has relied on *extra-legal* certainty—a non-state system of contract enforcement that rests on personal exchange and reputation mechanisms. What then does globalisation mean for diamond merchants?

In fact, globalisation has had, and is having, a striking impact on the diamond industry, and the millennia-old distribution system that relied on multiple layers of personal exchange is showing cracks, or growth marks, depending on the perspective. This chapter explores how globalisation has affected the diamond industry's distribution networks, and some extrapolation might inform how globalisation affects not just legal certainty, but even a well-developed system of extra-legal certainty. As increasing transnational commerce pushes many industries away from state-sponsored law and towards new forms of private ordering (Appelbaum *et al*, 2001),

\* The author thanks Joy Hanson and Qasim Jami for their excellent research assistance, the participants of the Oñati workshop for their valuable insights and lively discussion and, especially, Volkmar Gessner for his spirited and steady leadership in organising both the conference at Oñati and this very useful volume.

the changing diamond industry can offer insights not only into how globalisation is affecting networks relying on extra-legal enforcement, but also into globalisation itself.

#### ALTERNATIVE UNDERSTANDINGS OF PRIVATE CONTRACTUAL ENFORCEMENT

Two fairly distinct accounts have emerged from prior examinations of contractual enforcement in the diamond industry, and these separate, although not mutually exclusive, reports mirror alternative theoretical expositions of private contractual enforcement. The first account was made famous by Bernstein's (1992) seminal article explaining how diamond merchants have 'opted out' of employing the state-sponsored legal system to adjudicate contractual disputes. Bernstein's approach, which she later applied to the food and grain (Bernstein, 1996) and the cotton industries (Bernstein, 2001), illustrates how merchant groups create tailored substantive contract law and private arbitration procedures to govern their transactions. In this account, social norms reinforce industry customs and trade rules to provide a private system of expert and efficient dispute resolution that is faster, more accurate and thus more reliable than enforcement in state-sponsored courts. Konradi (2008, in this volume) usefully applies this template to understand how industry associations, relational contracts and standardised arbitration support transnational transactions in the timber industry, and this approach has brought scholarly attention both to the pervasiveness and economic significance of industry contract rules and private arbitration.

A second account of the diamond industry focuses not on the attractiveness of private arbitration, but, rather, on the ineffectiveness of state-sponsored courts. This approach, which I chart in previous works (Richman, 2004; 2006), begins with the recognition that state courts simply cannot credibly enforce a diamond credit sale: a party that refuses to make payment can easily escape the reach of a particular court and enjoy the value of unpaid (stolen) diamonds in a foreign jurisdiction. According to this approach, the ineffectiveness of public courts compels the industry to devise its own system of extra-legal enforcement. Tailored systems of law and efficient arbitration procedures are thus built atop an enforcement system that employs social norms, community coercion and sharp reputation mechanisms. Reliance on extra-legal enforcement comes at considerable costs—entry is limited to parties, usually individuals with ethnic or family connections to current merchants, who are familiar to

industry members; thus the industry is deprived of entrepreneurial newcomers and the dynamism that accompanies the threat of entry (Richman, 2004)—but extra-legal enforcement is the only credible governance mechanism available.

While the first account of the diamond industry offers a template that is readily applied to other industries with repeat players and standardised transactions (including the timber industry), the second account suggests that the diamond industry is rather unique, or is at least an extreme illustration of the limitations of public courts. The first account suggests that tailored law and specialised arbitration procedures can offer efficiencies to many industries, and thus explains the proliferation of industry-wide arbitration and a pervasive trend of ‘opting out’ of state court enforcement. Although the second account recognises the many inefficiencies created by state court procedures and the costliness of resolving disputes in public courts, it suggests that wholesale abandonment of public courts is an act of necessity that is required of very few, perhaps no, other industries.

This second approach explains why the diamond industry is insular, ethnically homogeneous and has remained largely unchanged for nearly one millennium. The industry resorts today to the same community enforcement mechanisms that it did before the rise of modern courts, when most other industries were transformed by the rise of credible impersonal exchange and the introduction of dynamic entrants (Greif, 2006a). This second approach also reveals the forces that determine the industry’s structure. The central challenge in diamond transactions is enforcing the credit sale, and institutions that can assure credible exchange for such portable, untraceable and extremely valuable goods will play a role in the industry’s future.

#### BACKGROUND—THE DIAMOND SUPPLY CHAIN, THE ECONOMICS OF CUTTING AND SORTING, AND THE PRIVATE ORDERING OF GLOBAL NETWORKS

Appreciating transactional governance in the diamond industry first requires an exploration of the industry’s global architecture, which is illustrated by a diamond’s path from the mine to the jewellery manufacturer. The journey for most diamonds begins in African, Russian, Australian and Canadian mines, with approximately 65 per cent of rough diamond production being controlled by DeBeers, either through direct ownership or long-term exclusive buying contracts. DeBeers distributes rough stones through its Diamond Trading Company (or DTC, formally known as the Central Selling Organisation, or CSO) in London, and the DTC sells the stones in pre-sorted boxes, with take-it-or-leave-it price

offers, to approximately 100 specific merchants known as ‘sight-holders’. The DTC’s centralised distribution system enables DeBeers to control global supply and quality, and consequently diamond prices have remained remarkably stable compared to other commodities (Spar, 2006).

From this small collection of sight-holders, diamonds descend into a thick web of intermediaries and slowly make their way down the supply chain to jewellery manufacturers (rough diamonds not controlled by DeBeers, and sold directly from mines, descend into the same distribution network). Sight-holders and other players atop the distribution pyramid sell parcels of their rough diamonds to individual dealers, who in turn resell smaller parcels to other dealers. For many stones, and for approximately 80 per cent of the DTC diamonds, the second round of transactions takes place in Antwerp at its four large diamond bourses, and from there diamond dealers disperse to sell their stones throughout the world.

The primary activity in diamond distribution is sorting. Diamond dealers atop the distribution pyramid (a profitable location to occupy) have comparatively large inventories, and they sell parcels of gradually declining size to downstream dealers. The sorting process goes hand-in-hand with the process of cutting or polishing, which converts opaque rough diamonds into gem-quality diamonds for retail. Some Antwerp merchants arrange to polish the stones themselves, and many others sell rough diamonds to other dealers, who then orchestrate cutting in India, China, Israel, New York and other locations. Many merchants also use brokers, who work on small commissions, to assist these sales and find the best price for a given stone. Parcels are sold and resold, stones are cut and recut, and gradually they make their way to jewellery manufacturers for commercial sale.

The process of sorting and cutting adds significant value to the stones—the total value of diamonds in retail jewellery is approximately 75 per cent more than the value of mined stones. Since there is little retail demand for uncut diamonds, it is clear that cutting and polishing stones for jewellery manufacturing adds value. However, cutting raw diamonds is not a commoditised process, like refining oil into usable gasoline. It is both an art and a science. With the exception of cutting very small stones, which can be cut in large quantities through an industrial process, diamond cutting is done by hand. A cutter sits before a spinning grinding wheel and carefully applies the stone to the wheel. Although diamond cutting is a skilled occupation (there are cutting schools, run by ‘master cutters’, in several diamond centres throughout the world), the requisite skills vary significantly. Cutting small stones of relatively little value, for example, requires far less training and specialised skills than cutting large diamonds with few flaws. Accordingly, cutting factories vary significantly in the prices they charge, the labour they employ and the wages they pay.

A good amount of value is also created through the nuanced process of matching individual stones with the manufacturers and retailers who value

them highly. Diamonds, especially high-end stones, feature subtle differences—beyond the standard qualities reflected in grading for the ‘four Cs’—colour, cut, carat and clarity—that translate into significant variation in manufacturers’ willingness to pay. Accordingly, the objective of the distribution chain is to find the optimal buyer for the individual stone, and the middlemen who can find the optimal match can secure a substantial profit. The process requires synthesising significant market information with inventory availability—hustling to know what sellers have and what buyers want. Like most open exchanges (including stock exchanges) that facilitate transactions between sellers and buyers, the matching process is significantly aided by organising trading in centralised locations, so most matching occurs at the 25 diamond bourses located in the world’s major diamond markets.

Extra-legal enforcement is especially relied upon at these downstream locations on the supply chain, and thus the downstream supply chain is populated by ethnically homogeneous merchants who are subject to, and are acutely motivated by, extra-legal social sanctions that punish merchants who fail to comply with their contractual obligations. Accordingly, one of the most distinguishing features of the downstream distribution network is the predominance of Jewish merchants, and this predominance has deep historical roots. Jewish merchants enjoyed a virtual monopoly of Europe’s diamond market for several centuries, reaching back as early as the late fifteenth century, when Jews escaping the Spanish Inquisition set up the world’s largest diamond market in Amsterdam. Jewish merchants also dominated the German market in the seventeenth century, England’s early diamond trading with India in the eighteenth century, and the DeBeers syndicate in the twentieth century. Jewish merchants remained deeply active in the twentieth century’s downstream markets of cutting, polishing and brokering diamonds, and developed major diamond centres in New York, Antwerp and Tel Aviv (Grayzel, 1968; Baron, 1975; Richman, 2006). I have argued previously that the community ties that bond Jewish diamond merchants to each other give the community’s merchants a comparative advantage over non-members. Core community institutions provide Jewish merchants with a reliable private contractual enforcement and enable Jewish merchants to commit credibly to credit sales (Richman, 2004; 2006). Thus, intimate and pervasive community institutions provide the extra-legal certainty that enables Jewish merchants to overcome the hazards of the diamond transaction.

In summary, the distribution chain collects uncut stones in London and Antwerp and matches them with high-valuing jewellery manufacturers located throughout the world. In the process, stones pass through the hands of several middlemen—cutters, brokers, and dealers—to find the ultimate buyer. Each middleman profits from each transaction—cutters are paid for their services, brokers earn commissions on sales, and dealers

profit by mark ups—so the ultimate objective is to maximise the value created by an optimal match, while minimising the required cutting and sorting costs of doing so. This pyramidal distribution system, with monopolist DeBeers sitting at the top, has been in place and has remained largely unchanged since Cecil Rhodes founded the company in 1880. Furthermore, for centuries, including long before DeBeers controlled global supply, diamonds relied on an army of middlemen to reach the world's buyers. Until the entry of relative newcomers in the 1980s, this distribution system was dominated by Jewish merchants.

#### ENTER INDIA

Perhaps the most significant feature of economic globalisation has been the entry of low-wage labourers in developing countries into the labour market for producing goods that are marketed in developed economies. This has occurred in the diamond industry with tremendous force as India has become a major centre for diamond cutting, and in doing so it has transformed the diamond global distribution network.

India's recent entry into modern diamond production has by no means been the country's first encounter with the diamond industry. To the contrary, the Indian subcontinent was from 800 BC (the time of the first diamond discoveries on record) until 1844 (when diamonds were discovered in Brazil) the world's only source of diamonds. During the height of India's diamond production period in the late 1600s, approximately 50,000 to 100,000 carats were extracted annually from India's deposits.<sup>1</sup> India's rich past in diamonds is also reflected in many elements of Indian culture. Early Sanskrit manuscripts contain numerous references to diamonds, including elaborate descriptions of precious gemstones and associations with mythical figures at the foundation of Hinduism, and as Hindu symbols were incorporated into Buddhism, the diamond became a Buddhist symbol of religious virtue.<sup>2</sup> Diamonds have also played a role in India's caste system, as the different castes were only permitted to own

<sup>1</sup> Indian mines have also produced some of the world's most famous diamonds, including the Koh-i-Nur, which was the object of tribal battles from 1304 through 1850, when the East India Company presented it to Queen Victoria (it later adorned the crown worn by Queens Alexandria, Mary and Elizabeth), and the Hope Diamond, which was purchased by King Louis XIV, stolen during the French Revolution and eventually repurchased by Harry Winston, who donated it to the Smithsonian.

<sup>2</sup> The *Ratnapariksa*, a sixth century text on gems by Buddha Bhatta, noted: 'He who, having pure body, always carries a diamond with sharp points, without blemish, free from all faults; that one, as long as he lives, knows each day will bear some things: happiness, prosperity, children, riches, grain, cows and meat. He who wears [such] a diamond will see dangers recede from him whether he be threatened by serpents, fire, poison, sickness, thieves, flood or evil spirits.'

diamonds of a specific colour—Brahmins wore white, merchants wore yellow, lower classes wore gray, and only kings could possess diamonds of all colours.

Since the discoveries in African mines in the late nineteenth century, India's contribution to the world's diamond production has been extremely small, leaving control of the diamond market to DeBeers and the diamond merchants, mostly Jewish and Belgian, who controlled the downstream distribution chain. However, India's history and familiarity with gemstones permitted a re-emergence in the 1980s. For centuries, the Jains of Palanpur, a religious minority from a parched, dusty village in Northern Gujarat, served as India's diamontaires and harvested a centuries-old tradition for diamond cutting and polishing. The community maintained the tacit skills required for cutting and polishing diamonds even while India's role in the industry receded: before India's diamond boom, Palanpuri cutters owned and operated small cutting workshops even as they remained unconnected to the global market that was dominated by cutters in Israel and Antwerp. Subsequently, certain entrepreneurial Palanpuris sought to exploit their community's rich history and deeply rooted expertise with diamonds. They turned to the master craftsmen in their home villages and asked them to guide large-scale cutting operations. Led by this home-grown and hard-to-replicate expertise, comparatively low labour costs and a global family network, the Palanpuris' cutting operations quickly made India a leader in the diamond industry. Today, nine out of ten diamonds purchased annually are polished in India, Mumbai is home to an active bourse, Palanpuri diamond entrepreneurs are among the nation's wealthiest<sup>3</sup> and thousands of cutting factories, employing over 700,000 Indians, populate nearby Gujarat province.

This is a classic instance of globalisation, where the size of the global market for a good (in contrast to the national or regional market) dramatically heightens the value of certain skills or assets. In many respects, India's Palanpuri diamond cutters present the paradigmatic case of globalisation's success story—a small community in a remote location is able to exploit its unique skills to reap fortunes in the global marketplace. The inevitable flip side is paradigmatic as well, and the Palanpuris' success has come at the expense of higher-wage cutters in the West. In fact, the Palanpuri cost advantages are so significant, and their entry into the market has been so large, that they have sufficiently disrupted the global

<sup>3</sup> One of India's foremost business journalists remarked: 'Ordinary people cannot understand how a handful of families, all belonging to one small community—Palanpuri Jains—have become so rich, so quickly' (Piramal, 1990). India's successful Palanpuri families include Vijay and Bharat Shah, college drop-outs who now operate one of India's largest corporate empires. Their interests include operating construction companies and directing one of Bollywood's largest movie production companies.

distribution network to have transformed the face of the industry. Antwerp is now much less of a haven for wealthy Jewish merchants, while becoming home to a very substantial Indian community, and Israel's cutting industry has been in steady decline. Indian diamond cutters have also become deeply embedded in New York's diamond market, with an Indian merchant recently getting elected to the board of New York's diamond bourse. India's success in diamond cutting has fuelled further globalisation, as many diamond dealers have opened cutting factories in low-wage countries in Eastern Europe and South-East Asia.

India's diamond success also offers some generalisable insights into commercial globalisation. Relational exchange—exchange, such as ethnic exchange, that relies on the familiarity that commercial parties have with each other—is in many respects deemed to be inferior to systems of arms-length transactions and impersonal exchange. Personal exchange limits entry only to those who are familiar to trading partners, keeping out the market dynamism introduced by low-cost or innovative entrepreneurs, and such familiarity requirements also impose limits on the size and breadth that trading networks can achieve. For these reasons, scholars have explained that public courts and impersonal exchange have gradually replaced and supplanted systems that rely on private ordering (Greif, 2006a). The Palanpuris' success, however, reveals that ethnic trading networks can flourish in a globalising economy. Furthermore, the Palanpuris are not alone—it is well documented that the wildly successful Chinese ethnic trading networks, for example, continue to capitalise on extra-legal certainty to organise transnational commerce in South-East Asia (Landa, 1999). Palanpuri success and the success of other ethnic trading networks illustrate that ethnic networks continue to occupy an important place in the modern global economy.

However, a stronger point can be made. Commercial networks that can succeed in an industry like the diamond market, where routine transactions are beyond the reach of public courts and require extra-legal enforcement, are strongly suited to excel in global exchange since cross-national transactions are also routinely difficult to enforce. The Palanpuris' centuries-old experience with diamonds transactions, which were always imbued with legal uncertainty, prepared them for the legal uncertainty in transnational exchange. Since Palanpuris were adept at domestic extra-legal commerce, they were well equipped for international extra-legal commerce. It is nonetheless ironic that trading practices resting upon ancient family or ethnic traditions—thought to have been replaced by sophisticated government institutions—can suddenly offer an advantage in the ever-modernising global economy.

However, even with its advantages, relational exchange has limits, and continued globalisation will pose a severe test to the durability of the diamond industry's ethnic networks. Since reputation-based exchange

works only with familiarity, relational networks will fail when their expansions dilute the intimacy the members share. Economic history contains many illustrations of reputation-based systems of contractual enforcement that became victims of their own success—transactional credibility broke down when parties were sufficiently unfamiliar that they could (and did) misrepresent themselves as reliable, long-term commercial partners (Greif, 2006b). If the diamond market continues to expand, the relational constraints of diamond networks might fail to match the growth, and diamond merchants might have to find alternative systems to organise distribution.<sup>4</sup>

Globalisation's invitation to ethnic-based exchange also invites other challenges. Just as Palanpuri diamondaires found themselves capable of succeeding in the international marketplace, other ethnic networks that have excelled in transnational trade found themselves well positioned to thrive in the diamond industry. For example, the Palanpuris have been joined by other ethnic networks, including some recent entrants who sensed that ethnic connections offer a competitive advantage in the industry (Richman, 2006). This presents one of globalisation's more interesting challenges: how members of different ethnic networks can engage in commerce—and enforce contracts—with each other. If each member is beyond the reach of public courts, and thus can only be disciplined by other members of his or her network, then extra-legal methods are required to secure transactions between parties from different relational circles. Theoretically, communities will be incentivised to police their own members in trade with other groups. If a community's members are deemed to be credible business partners for merchants from all groups, then the business opportunities for each member expands and the community as a whole will benefit (Greif, 2004). Putting this into practice, however, will require substantial political resolve within each community, and coordinating transactional assurance becomes harder as each trading community grows and familiarity inevitably decreases.

Still, diamond centres such as Antwerp and New York have successfully organised cross-community exchange despite the substantial transaction costs, and many different ethnic networks succeed internationally. Ethnic networks might be ideally suited to enter and prosper in global exchange, but since they cannot rest on institutional supports, and instead must police exchange and compel contractual compliance on their own, they might be vulnerable to strain as globalisation moves forward.

<sup>4</sup> Diamond merchants who are most likely to feel the limits of personal exchange are those with limited family networks. One Indian dealer lamented: 'This business demands personal attention and trust. Only your family can give you both. I have remained a small diamond exporter because I do not have a brother whom I can send to live in Antwerp' (Piramal, 1990).

ENTER ANGOLA, AND DEMAND FOR INTERNATIONAL  
REGULATION

Globalisation has also meant the entry of diamond merchants of a very different kind. Rebel movements and warlords in war-torn African nations, such as Angola, Sierra Leone and the Ivory Coast, have exploited diamond mines in their countries to fuel their bloody campaigns. The diamond's immutable qualities make it the smuggler's and guerrilla's currency of choice.

Turning a blind eye to the unpleasant origins of a product that is marketed to affluent consumers in developed nations might also be a central feature of globalised commerce. Salient examples include sweatshops manufacturing designer clothing, children forgoing school to assemble athletic equipment, and natural resource exploration that pollutes farmland and natural habitats (Spar and La Mure, 2003). Stark inequalities in both wages and purchasing habits between the developing and developed worlds create tremendous incentives to produce in the former and sell in the latter. This understandably fuels the growing separation of a product's origins from its ultimate consumer (Kysar, 2004; Friedman, 2005).

However, this separation creates a particularly acute danger for the diamond industry. Diamonds are marketed, with remarkable success, as timeless ornaments to signify important emotional events—the sort of product that would be quickly spoiled if associated with a brutal warlord. The possibility that the purchase of the engagement ring heirloom might sponsor bloody civil strife threatened the core of the industry's highly successful advertising efforts and attacked the root of a diamond's romantic appeal. It became a grave concern for the entire industry.

However, an easy solution is not obvious. Because the structure of the diamond industry's distribution network relies on many layers of middlemen, and because of the diamond's essential features, tracing a diamond's origins is profoundly more difficult than following other goods, such as designer apparel manufactured by sweatshop labour. Consequently, for many decades the industry turned a blind eye to the ugly origins of much of its product. Diamond dealer networks have long operated in Africa and purchased diamonds from military warlords. Those 'conflict diamonds' were then funnelled to Antwerp and other diamond centres and mixed in with diamonds from less controversial sources. The independence and multitude of the diamond dealers, the industry's lack of vertical integration and the inability to trace a diamond's origins made prohibiting and policing such diamond sales extremely difficult.

However, the threat to global demand was too severe to ignore, particularly as NGOs and social activists—Global Witness in the lead—organised a highly effective media campaign. The industry, led by DeBeers,

was compelled to develop a sweeping response. The end solution arrived in 2002 with the creation of the Kimberley Process, a vast international program to certify the origin of each diamond and to prohibit trade with countries that could not confirm that their diamond exports did not finance entities seeking to overthrow a UN-recognised government. The Kimberley Process requires that each international shipment of rough diamonds must be transported in a tamper-resistant container and accompanied by a government-verified certificate that indicates the origin of each stone. The importing state's customs must then confirm that the contents of the shipment are in accord with the certificate, and each individual who thereafter handles the stone is obligated to maintain the identity tag. Although enforcement, the integrity of the certifications and the overall effectiveness of the Kimberley Process remain unknown and are a matter for ongoing debate, in theory it provides jewellery manufacturers, reflecting the interests of engagement ring purchasers and other romantics, proof that the diamonds they purchase come from wholesome origins. Peddlers of conflict diamonds should have much greater difficulty in finding buyers and slipping into the mainstream pipeline.

For a number of reasons, DeBeers's cooperation with global activists demanding restraints on industry leaders is self-explanatory. The Kimberley Process reduced diamond output and aided DeBeers's ongoing efforts to control global supply; it cleansed DeBeers's brand name of very sordid associations (although DeBeers has quite a chequered history of its own); and it created a global infrastructure that adds highly valued assurance to diamond purchasers. However, it also represents DeBeers's adjustment to the politics of globalisation and its willingness to become a partner in an increasingly typical political manoeuvre.

The lack of public governance in global exchange has prompted a rise in what some have called 'private governance' (Gereffi and Mayer, 2006). Private governance includes self-regulation by multinational corporations, codes of conduct promulgated by international organisations and trade associations, and consumer standards—including the famous 'fair trade' movement—that impose minimum labour or production standards. It is not unprecedented, nor is it unreasonable, for for-profit corporations to join those demanding private governance and collaborate with social activists to bring reform: such cooperation was been dubbed 'the NGO-industrial complex' (Gereffi *et al*, 2001).

However, this sort of international scrutiny and regulation is quite new to the diamond industry even though, unlike other industries that have only recently globalised, international distribution networks had always been required to bring diamonds from mines to jewellery stores. The globalisation of industries such as textiles and chemicals prompted consumer alarm and the mobilisation of international private governance because the internationalisation of those industries meant less legal and

political oversight. The diamond industry, in contrast, was always globalised and had received relatively little scrutiny (despite brutal treatment of workers in diamond mines, poor labour relations in many cutting factories and, of course, the prevalence of conflict diamonds). Thus, the politics of globalisation has meant something very different to the diamond industry. Ironically, globalisation has meant the involvement of more, not less, consumer regulation and political scrutiny. Moreover, the regulatory structures arose to create a legal certainty of a different kind: global oversight mechanisms now provide consumers with regulatory compliance certainty. They aim to solve a transactional hazard between the diamond seller and the uninformed but socially aware consumer.

What lessons can be drawn from the diamond industry's experience with the politics of globalisation? Prior to the swell of globalisation, the diamond industry seemed to avoid the scrutiny it probably deserved. Just as its transactions remained beyond the reach of public courts, the industry's practices remained largely beyond the attention of social activists and constituencies that demand regulatory oversight. These parallel trends of nesting outside the public arena are interconnected. Since the industry was forced to rely on self-governance to police transactions and enforce contracts, it assumed a self-regulatory governance structure that distrusted outsiders and demanded regulatory autonomy. However, when globalisation enabled multinational corporations (MNCs) to escape the regulation of the industrialised democracies, the political backlash fuelled scrutiny towards all MNCs active in the developing world, and that included DeBeers. Diamond sellers now need global private governance to assure consumers, and instruments of regulatory certainty replace the unsupported anonymous transaction. In short, the general lawlessness of globalisation has meant the end to lawlessness in the diamond industry.

#### ENTER LOUIS VUITTON AND THE POWER OF BRANDS

In 2000, DeBeers launched its own 'millennium' diamond, limited edition stones of the highest quality, of substantial size, and with a microscopic laser-inscribed DeBeers 'centenary logo' etched along the side (each millennium diamond came with its own viewing lens, certificate of assurance from De Beers and a time capsule). Later that year, DeBeers announced a plan to market 'designer diamonds' with unusual shapes and sizes, with promises that each stone would exhibit top grades in colour and clarity. Furthermore, in January 2001, DeBeers created a joint venture with LVMH Moët Hennessy Louis Vuitton, a leader and trend setter in the luxury goods market, to create a network of own-brand stores that would sell, under the DeBeers brand, exclusive lines of diamonds (Handleman, 2000; Weber, 2001). These initiatives—the first to bring the company

towards the retail market—were in response to several years of declining DeBeers market share,<sup>5</sup> a sense that DeBeers was not fully capturing the value from its brand name and a decision to execute a change in corporate strategy (Spar, 2006).

Although DeBeers's strategic initiatives have garnered complimentary press coverage, the business world has yet to appreciate how dramatic this departure is from past practices. For years, DeBeers's focus on wholesale distribution was explained by the transaction costs of 'block booking'. A famous paper by Roy Kenny and Benjamin Klein observed that for goods that varied significantly in quality but required substantial measurement costs to evaluate quality, transaction costs are economised when the good is sold in bundles in which the price for each individual item is the average price. Thus, block booking would economise on over-searching and make productive use of items of below-average quality (Kenny and Klein, 1983). The Kenny and Klein explanation has been the most generally accepted understanding of DeBeers's operations (Hanssen, 2000). It explains both DeBeers's unusual distribution methods—selling pre-sorted bundles to individual sight-holders, sight unseen—and DeBeers's decision to remain atop the distribution system as a wholesaler without vertically integrating downstream.

However, with the DeBeers-LVMH joint venture, Kenny and Klein's explanation no longer applies. Somehow, DeBeers now finds value in integrating downward into the retail market. It also means that DeBeers, in dealing directly with the ultimate consumer, is bypassing the many layers of middlemen who had organised the industry's distribution system for nearly one millennium.

It is possible that DeBeers's moves are products of new technologies. Perhaps the art of diamond cutting has been refined such that DeBeers can credibly claim that all of its hallmarked stones achieve a certain quality. If DeBeers can now produce homogeneous branded diamonds, but was previously unable to, then the branded effort obviates the requisite search and inspection costs in diamond sales; ie whereas before diamond buyers needed to inspect each stone carefully, now they might trust DeBeers. A second explanation points to technological developments of a different sort. Perhaps the internet and the rising facility to share information has offered low-cost replacements for the army of middlemen. If a major value-added activity of these middlemen—a swarm of aggressive brokers and resellers who gobble and relay market information on available inventories and the particularities of demand—was to match individual

<sup>5</sup> DeBeers's declining market share was largely attributable to the opening of new diamond mines, including large finds in Canada and Australia that did not sell through DeBeers's DTC, and the periodic departures by Alrosa, Russia's large mining operation, from the DeBeers cartel.

diamonds with optimal buyers, then a branding campaign would obviate this as well. The DeBeers brand would reflect known characteristics, and buyers demanding stones of that kind can purchase them directly from the manufacturer.<sup>6</sup> A third explanation is the simplest, that DeBeers is losing global market share and now has to compete more vigorously against other suppliers, and its competitive advantage over other mines is its name recognition. Whereas before, DeBeers invested in advertising for the entire industry—its ‘Diamonds are Forever’ campaign, in addition to being hailed by *Advertising Age* as the slogan of the century, marketed all diamonds, not just DeBeers diamonds—now it also advertises its own wares. Capitalising on its brand name in the retail market might simply be the competitive response of a former monopolist.

However, DeBeers’s transformation might also shed insight into the economics of globalisation. Previously, DeBeers stood atop the distribution chain and relied on ethnic networks to disperse diamonds to local markets. With globalisation’s convergence of regional markets, the effect of branding is magnified. A unifying global market decreases the likelihood of brand confusion, increased communication extends the reach of brand marketing, and improved brand recognition enables brand holders to build and capitalise on quality reputation. One might also argue that if globalisation has led to a homogenisation of preferences for luxury goods, DeBeers’s offering of specific designer stones might, despite the limited variation, meet the demands of the high-end market as it never could before. The true lesson is that these globalising forces have created a third type of legal certainty: the certainty of quality assurances that trademarks and trademark law are designed to promote. These assurances are useless if a brand is unfamiliar, but cultural and commercial globalisation might enable DeBeers to extract previously unattainable value from its brand.

Although it is too early to determine whether DeBeers’s strategy will be successful, the significance of its reorientation for the rest of the industry cannot be understated. With its focus on its brand name, DeBeers is using a vertical integration strategy to supplant the trust-based exchange that for generations has been organised by ethnic networks.

<sup>6</sup> These developments in information technology also suggest that internet sites could similarly create a forum of information exchange and create virtual diamond exchanges, thus further obviating the role of middlemen. In fact, several such internet brokerages have emerged, featuring an inventory of diamond with GIA-certified features and high-resolution pictures. By some measures, internet sales are growing and have already achieved 15% of all US sales, but many remain sceptical that internet pictures will erode the perceived need to personally inspect a diamond before purchase (Berger, 2001; Rozhon, 2005).

## CONCLUSION

The diamond industry's distribution system had remained intact and relatively stable for nearly one millennium. It emerged long before the DeBeers cartel arrived and it has survived technological booms, continental wars and economic shocks of every sort. However, it is now threatened by certain forces of globalisation. Globalisation has meant entry by low-wage ethnic groups that have displaced incumbent Jewish merchants who had long dominated the downstream market. It has brought political scrutiny to an industry that previously enjoyed secrecy, autonomy and lawlessness. Furthermore, it has enabled DeBeers to pursue marketing strategies that skip the middleman. These developments might mean the end of 1,000 years of Jewish predominance.

However, watching the diamond industry change with globalisation also yields insights into globalisation itself. The lawlessness of transnational exchange means that ethnic networks that have historically shunned public courts and have instead employed extra-legal mechanisms to enforce transactions are particularly well suited to excel in the globalised economy. The absence of public regulation to govern global commerce has led to consumer-driven private governance, which ironically can reach and influence secretive international networks, such as the diamond networks, much more than state-sponsored regulation. Furthermore, globalisation has changed the economics of brand names such that branding strategies can now reach larger markets and exploit profit opportunities as never before. De Beers's recent ventures suggest that vertical integration strategies that focus on maximising value from brand reputations might offer a superior organisational form than the historic use of multiple middlemen, personal reputations and trust-based exchange.

Moreover, changes in the diamond industry illustrate new paths through which globalisation will bring legal certainty. Ethnic networks able to create transactional certainty in domestic markets have brought additional security to international commerce. The politics of globalisation and the corresponding demand for private governance has brought attention to the origins of diamonds that are later sold in developed nations, and the Kimberley Process was constructed to provide the regulatory certainty to assure consumers of their purchase. Furthermore, the expanded reach of trademarks, which spread on the commercial and cultural currents of globalisation, give additional meaning to brands and thus bring greater quality certainty to the global marketplace.

The diamond industry, to be sure, is an unusual industry—few others can boast features such as a predominance of ethnic networks, artificially created demand, the rejection of sophisticated public courts in developed economies and an organisational structure that has remained largely unchanged for one millennium. However, since 'the study of extreme

instances often provides important leads to the essentials of the situation' (Behavioral Sciences Subpanel, 1962; Williamson, 1999), peering into the diamond industry, with all its refractions and distortions, produces revealing insights on the legal, political and economic challenges of the globalising world.

## REFERENCES

- Appelbaum, RP, Felstiner, W, and Gessner, V (2001) *Rules and Networks—The Legal Culture of Global Business Transactions* (Oxford, Hart Publishing).
- Baron, S (1975) *Economic History of the Jews* (New York, Schocken Books).
- Behavioral Sciences Subpanel, President's Science Advisory Committee (1962) 'Strengthening the Behavioral Sciences' 136 *Science* 233.
- Berger, S (2001) 'Diamonds in the Rough' *The Jerusalem Post* (6 April 2001) 4B.
- Bernstein, L (1992) 'Opting Out of the Legal System: Extra-legal Contractual Relations in the Diamond Trade' 21 *Journal of Legal Studies* 115.
- (1996) 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' 144 *University of Pennsylvania Law Review* 1765.
- (2001) 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions' 99 *Michigan Law Review* 1724
- Friedman, T (2005) *The World is Flat* (New York, Farrar, Strauss and Giroux).
- Gereffi, G, Garcia-Johnson, R and Sasser, E (2001) 'The NGO-Industrial Complex' 125 *Foreign Policy* 56.
- Gereffi, G and Mayer, F (2005) 'Globalization and the Demand for Governance' in G Gereffi, *The New Offshoring of Jobs and Global Development* (International Institute for Labour Studies: ILO Social Policy Lectures).
- Grayzel, S (1968) *A History of the Jews* (New York, Jewish Publication Society).
- Greif, A (2004) 'Impersonal Exchange without Impartial Law: The Community Responsibility System' 5 *Chicago Journal of International Law* 109.
- (2006a) *Institutions and the Path to the Modern Economy Lessons from Medieval Trade* (Cambridge University Press).
- (2006b) 'The Birth of Impersonal Exchange: The Community Responsibility System and Impartial Justice' 20 *The Journal of Economic Perspectives* 221.

- Handleman, L (2000) 'The Once-in-a-Millennium Gift' *Princeton Packet* (2 January 2000) <<http://www.pacpubserver.com/new/news/1-2-00/diamonds.html>> accessed 17 June 2008.
- Hanssen, A (2000) 'The Block Booking of Films Reexamined' 43 *Journal of Law and Economics* 395.
- Kenny, R and Klein, B (1983) 'The Economics of Block Booking' 26 *Journal of Law and Economics* 497.
- Konradi, W (2008) 'The Role of *Lex Mercatoria* in Supporting Globalised Transactions: An Empirical Insight into the Governance Structure of the Timber Industry' in V Gessner (ed), *Contractual Certainty in International Trade* (Oxford, Hart).
- Kysar, D (2004) 'Preferences for Processes: The Process/Product Distinction and the Regulation of Consumer Choice' 118 *Harvard Law Review* 525.
- Landa, JT (1999) *Trust, Ethnicity, and Identity* (Ann Arbor, University of Michigan Press).
- Piramal, G (1996) *Business Maharajas* (New Dehli, Viking).
- Richman, B (2004) 'Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering' 104 *Columbia Law Review* 2328.
- (2006) 'How Communities Create Economic Advantage: Jewish Diamond Merchants in New York' 31 *Law and Social Inquiry* 383.
- Rozhon, T (2005) 'Competition is Forever' *New York Times* (9 February 2005) C1.
- Spar, D (2006) 'Markets: Continuity and Change in the International Diamond Market' 20 *Journal of Economic Perspectives* 195.
- Spar, D and La Mure, LT (2003) 'The Power of Activism: Assessing the Impact of NGOs on Global Business' 45 *California Management Review* 78.
- Weber, L (2001) 'The Diamond Game' *New York Times* (8 April 2001) ss 3 and 1.
- Williamson, OE (1975) 'Franchise Bidding for Natural Monopolies—In General and with Respect to CATV' 7 *Bell Journal of Economics* 73.