



CVCFG: ASGM Logistics in Eastern DRC

Learning Brief

USAID's Commercially Viable Conflict-Free Gold Project, known locally as “Zahabu Safi” is a five-year project, implemented in the Democratic Republic of the Congo (DRC) by Global Communities and Levin Sources. The project is designed to build on recent successes achieved by donor-funded initiatives to export responsibly sourced gold to jewelry buyers in North America and Europe.

Purpose

This learning brief is designed to deepen understanding of the logistical barriers and incentives when transporting, storing, and preparing to export gold from eastern DRC. We have focused this report on the aspects of logistics most relevant to the aims of the CVCFG project, to ensure better decision-making as we move closer to supporting responsible gold exports. The brief provides a snapshot of the situation, correct as of the second half of 2020, and draws on the research, interviews and learning from the project's due diligence partners who are present in eastern DRC. At the end of the document, we draw conclusions about potential solutions for the barriers we have highlighted. These solutions will need greater development and may ultimately vary from supply chain to supply chain. This is an iterative process, so we have also set out proposed next steps for the project to develop the ideas further, with the input of the local stakeholders. We aim to test the potential solutions as the project starts to piece together end-to-end supply chains and begins to support responsible ASM gold exports from eastern DRC, learning and adapting as we go. We will continue to share this learning.



Introduction

Levin Sources carried out an analysis of the logistics sector supporting ASM gold exports from Eastern DRC, with the aim of deepening the project's understanding of the barriers and incentives for the sector. By better understanding how gold is transported and managed from mine to first export, the project will be more able to support the development of systems which work in the specific context of eastern DRC, whilst also ensuring these are commercially viable, scalable, and acceptable to the downstream buyers of the gold.

There is an existing and functioning system of logistics operating in DRC, which moves large amounts of gold out of the country on a daily basis. It is mostly informal, however, using illicit channels and based on relationships of trust rather than legal contract. This system functions mostly outside formal legal and regulatory norms. The system as it currently stands would be difficult to scale up, replicate, formalize or insure. Neither is it attractive to responsible refiners who are used to working within highly formalized systems. As a result, only a fraction of ASM gold mined in Eastern DRC leaves the country legally.

Completely superseding this system or creating a parallel system for trade and logistics (e.g. through a formal, international service provider) would be cost- and resource-intensive. It would create unnecessary direct and indirect risks to supply chain and project stakeholders, by disrupting existing supply chains and current vested interests. It could also cut out the very communities the project is looking to support from the current systems. As a result, a parallel system is unlikely to generate long-term positive impact once the project ends.

Key recommendations for the project are:

1. The project should explore ways to work with existing actors and aim at increasing transparency and formalization by targeted interventions at specific points in pre-existing supply chains.
2. The project should aim to increase transparency and reduce secrecy in the sector, including through improving due diligence on and by supply chain actors and encouraging the involvement of formal financial institutions in the payment system.
3. The Corrective Action Plan process should support supply chain actors and exporters (comptoirs), not only the mining cooperatives.

Key Findings

- Refiners are used to – and most comfortable - working with formal logistics solutions. But almost all existing solutions in DRC are highly informal and the cost of establishing these formal services – if the business case exists at all – would be high. Any intermediate and ultimate solutions in the CVCFG project will need to bridge this gap.
- There are currently few market incentives for what would be considered traditional, formal logistics service providers: banking, insurance, transport, and security. Disincentives include high commercial and reputational risk exposure, high barriers to entry and widespread informality.
- No insurance is used – gold is generally moved at the risk of whoever is in possession of the gold at any given time.
- Because of the informal methods of transport there is an even higher risk of illegal taxation, corruption and bribery including from officials and armed groups. Despite this, the cost of informality is offset many times over by avoiding onerous taxation associated with operating in the formal sector.
- The national and local bureaucracy makes legal/formal export processes slow, further encouraging the use of more informal and flexible methods. This is a particular deterrent in the gold sector which relies upon a rapid circular flow of finance and a large number of small transactions to achieve economic viability since margins in the upstream value chain are low.
- It is impossible to separate an assessment of the current operational logistics system from the challenges associated with the widespread informality of the gold sector. Recognizing the limited agency of the project to influence this wider context gives rise to the conclusion that we should explore ways of complementing and improving existing logistics solutions within the supply chains with which the project is working. We could work with these systems to encourage greater transparency and reporting, providing alternative solutions to counteract the risks or challenges this might generate or where solutions could benefit from a genuine market advantage.



Methodology

This briefing note was developed by Levin Sources to guide the CVCFG decision-making process on the appropriateness and feasibility of different logistics solutions that could be employed by the project. These preliminary findings are the result of desk-based research, consultation with consortium members, insights from DRC-based consultants, reflections from a small number of refiners and logistics providers and internal discussion and debate on the initial findings. The note provides a starting point for the consortium to reflect on its approach to upstream logistics, by highlighting the opportunities, challenges and unresolved questions that need to be answered. Specific next steps are set out at the end of the report.

Additional Background from Our Research

Why Are Logistics So Important To ASM Gold Supply Chains?

The movement of minerals through supply chains from producer to end user is made possible by the logistics solutions employed. These encompass the following services: banking, insurance, transport, and security. Rather than being a straightforward movement of physical goods from one place to another, consideration of appropriate logistics solutions is an essential ingredient for ensuring both that the supply chain is commercially viable, and that risks associated with it can be managed to the satisfaction of all parties. Furthermore, a logistics solution that might work in one context or supply chain will not necessarily be appropriate for another, due to a variety of factors including: cost, cultural acceptance, competition, vested interests, mineral types, pre-existing infrastructure and regulatory environment. We therefore need to be aware of the specific

context in which the project operates to identify what the most suitable solution or solutions are.

Logistics services are – in general terms – vital to creating confidence along the supply chain that commercial risks or bottlenecks can be managed so that the cost-benefit calculation of trading in a given supply chain is favorable. The solutions employed should respond to supply chain stakeholders' requirements relating to liability, transfer of ownership and security. In doing so these services should facilitate transactions along the supply chains. Another key ingredient is being cost sensitive, especially where margins and volumes transacted are low as is likely to be the case at least initially with supply chains facilitated by the CVCFG project.

The widespread informality of the ASGM sector, as well as the unique characteristics of gold that make it susceptible to smuggling, money laundering and criminal terrorist financing risks, only redouble the need for effective logistics solutions. They are critical to the implementation of chain of custody and traceability solutions that assure the provenance of gold and thereby to making assurances in relation to the management of attendant risks.

Traditional, formal logistics services tend to be most effective and profitable when operated at scale. The infrastructure in the DRC and profile of the ASGM sector in the DRC present specific impediments in this regard. There are few roads in mining areas, and those that do exist are often impassable by most vehicles. Commercial airlinks are not widespread and are largely unreliable. Sites are often situated well away from major towns and trading hubs. This contextual backdrop should be kept in mind as we assess the barriers and entry points to build (or perhaps more accurately, to support) logistics solutions that are responsive to the needs and requirements of all supply chain actors.

Barriers and Entry Points

ASGM supply chains in eastern DRC are well-organized but dominated by informality and are highly dependent on discreetness and secrecy. Conversely, gold procured from ASM sources by responsible refiners is generally based upon highly formalized, transparent movement of gold. Whereas in the DRC gold tends to be kept undercover thereby reducing the incidence of theft and extortion, formal ASGM supply chains rely on insurance, secure storage and aggregation which in high risk settings comes at a premium. It is this fundamental difference in the cost and way of doing business that the CVCFG project will need to overcome should it be successful in reassuring supply chain operators that it presents a commercially viable and sustainable alternative to the status quo.

And yet bridging the gap will not be easy. Simply replacing existing, informal upstream logistics solutions with formal alternatives that are more responsive to the risk requirements of mid-stream and downstream buyers is likely to fail on the sustainability and commercial viability criterion. It will also exceed project resource availability as significant market entry barriers will be both costly and risky to overcome. The timeframes to establish formal systems – building interest amongst service providers, developing pilot models or investing in operations – also means that this approach is unlikely to be viable for the project, which has three years left to run. Finally, replacing an existing system will necessarily put it in conflict with pre-existing interests. If it remains marginal to the gold economy, it may not pose any real problem. However, the project aims to support scalable solutions, at which point the conflict risk resulting from disruption becomes greater.

We may therefore need to look at the problem from another angle. How can we build upon what is already in place; and, importantly, how can we incentivize the migration of opaque and undercover operations towards a transparent and traceable logistics system?

The principal barriers to this are as follows:

- A transparent system that permits the traceability of gold will mean higher tax payments than selling through informal channels. Currently the economic disadvantages of such a regime are likely to outweigh the advantages of access to responsible markets. Gold already finds its way to markets and often at prices that are more competitive than the project will be able to offer, even before deducting the cost of formal logistics provision. Without addressing the fiscal issue, a formal gold trade will struggle to be competitive.
- The opaque and secret movement of gold appears to offer for many the best available strategy to mitigate these costs, which also reduces the risk of threats and bribery which are symptomatic of the informal system. This does result in losses, but these are accounted for as collateral and minimized by moving gold undercover. In contrast, formal transport solutions require aggregation to benefit from economies of scale and therefore render them financially viable. This in turn renders them susceptible to the abovementioned risks, which can only be offset with costly insurance policies, where such policies are available.
- Informal movement of gold may further be covered by protection networks or informal security services, which diminishes the risk along certain supply chains where effective control is held. Clearly, such protection is not available to formal logistics providers. Using formal security providers once again generates costs, thereby applying downward pressure on the margins of supply chains actors, especially producers. Only the major buying houses employ recognized security providers and this only at the point of aggregation in major trading hubs.
- The gold trade in eastern DRC is often linked to criminal activity; whether the gold is used as a currency to avoid transactions being detected through the formal banking system; to avoid import and customs duty on trade items (other than gold) that are reimported; or as a way to launder money (as it is notoriously easy to clean gold). This means that the associated trade of gold can afford to extend highly competitive prices to miners and small traders (often above London fix), thereby undercutting competition and feeding the opacity of the movement of the mineral. Furthermore, it builds in benefits for those than can operate as intermediaries in the supply chain and who can easily get access to finance at low or even zero interest rates.



- A diverse investment portfolio is the best way of managing risk. This is how pre-financing of gold purchases works in the DRC and is factored into the cost of doing business. It is plausible that the extension of credit solutions by formal financial service institutions could operate similarly when scaled and within a strict KYC (Know Your Customer) and compliance framework. However, it is unlikely that this scale can be achieved through the CVCFG project, which at least initially, is designed to source from a small number of pilot sites.
 - The business case in the gold sector is made at high-volumes and low margins. This means that finance needs to be recycled quickly to ensure liquidity in the upstream supply chain. This results in a borrower's market, which further makes it difficult for formal service providers to provide competitive alternatives. This is compounded by the administrative delays that come with the formal, registered and therefore traceable trade of gold, which will be required by any solution that is acceptable to the responsible international market. Applying the relevant legal and regulatory requirements from mine to aggregation (and perhaps transformation), and export, not only results in a high fiscal burden but slows the process down, thereby undermining market opportunities.
- Margins are further eroded by exposure to para-fiscal levies.
- Mine sites and traders are not necessarily wed to specific buyers or pre-financiers. In fact, whilst buyers might set the price of an individual purchase, there are often multiple options for producers to sell to, which ensures prices tend to remain buoyant and margins along the supply chain remain suppressed. This poses challenges for a Project which is predicated on channeling the production of sites into supply chains that can be tracked and traced to the point of export. The project must therefore ensure that the financial and non-financial benefits available to mining operations and other supply chain actors offsets the benefits of selling to competitors.
 - So, the problem is not only the availability of formal and transparent logistics solutions, but also ensuring that gold is channeled into them in the first place. This is hardest at the points of production prior to the registration of gold – without permanent ground presence (and even then) outbound gold leakages are likely to occur. If unmanaged this may undermine the project's ability to produce and export at volume and further diminish the commercial logic of formal service providers engaging with the sector.

Conclusions

Despite these major obstacles, several potential conclusions can be drawn that may help to inform the project logistics approach. These are summarized below:

1. Structural barriers in the upstream gold supply chain render the establishment of a comprehensive, formal logistics solution within the timeframe of the project impracticable. The scalability of such a solution is also questionable and as such would not make good use of limited project resources. However, this does not preclude support for discrete logistics services in the upstream supply chain that may make commercial sense, especially when employed as a “bolt on” to diminish risk of pre-existing supply chain logistics solutions (see below).

2. The project should work with existing supply chain actors to create a network of vetted parties. The purpose of this should be to increase transparency within the upstream chain of custody. This should be aligned with the work of the due diligence providers.

- The continuous improvement of supply chain actors should be supported through the Corrective Action Plan process, which should support supply chain actors and exporters (comptoirs) and not only the cooperatives.
- Capacity building of local comptoirs and their trusted agents / transporters / negotiants will be important: helping them to address the risk of theft so that they can be more transparent with the project’s due diligence partners and the mid and downstream customers.
- Exporter level capacity building: build improved performance of the entity by first focusing on the project-specific supply chain and extending out from there to improve wider management systems. (This is a current debate within OECD and should be explored further with the Responsible Business Conduct team).
 - This has the potential to increasingly incorporate additional sources into the CVCFG pipeline over time. RCM Blue Status is likely to be relevant here as there are presently no RCM-validated gold exporters in the DRC.
 - Synergies should be explored with other initiatives operating in Eastern DRC that are building a similar supply chain model.

- Due diligence and traceability partners within the project should also explore the extent to which their solutions incorporate elements of logistics and how their implementation can be harnessed to build long-term capacity within the supply chain; identifying challenges within the “ecosystem” of pre-vetted supply chain actors and working with them to overcome these challenges. This work may give rise to potential project investment recommendations beyond those covered in point 4 on the next page.

3. The project should seek to explore and facilitate small logistics infrastructure improvements, making use of the Responsible Gold Innovation Fund (RGIF) where appropriate. Whilst it may be impracticable to superimpose formal logistics solutions across the entire supply chain there are nonetheless specific points in existing systems, where small improvements may make a big difference and may even provide incentives to formalization. Stimulating new market services is nonetheless highly sensitive and should be explored from the point of view of all supply chain actors before investments are made. A non-exhaustive list of examples of areas that might be valuable to explore include:

- **Secure Storage:** Gold will require aggregation, likely over periods of time prior to export. This creates potential challenges with the current dominant model, which is based on storage of smaller amounts of gold for short periods of time in residential properties. Increased aggregation before export poses challenges for two reasons:
 1. It increases the risk of theft and corruption.
 2. It exposes the exporter to significant liabilities because the current approach would not provide securities to buyers that may permit exploration of a prefinancing relationship based on equity release once a particular volume threshold has been met.

As such, it may make sense to explore costs associated with building an infrastructure for the secure storage (vaulting) of gold in major trading hubs with commercial banks and airlines.

- **Reliable / certifiable assay solutions:** Where physical verification of gold purity cannot be achieved between the exporter and the buyer, this can lead to disputes and uncertainty surrounding the cash value of gold stocks. This may undermine the commercial incentive of aggregating gold for sale to a “new” buyer, as trust and record of performance is a key element of

building confidence for doing business together. Working with the DRC authorities or a private service to provide certified assays that meet the robust criteria of international buyers may serve to overcome this challenge. This risk of misreporting the purity or value of gold, also exposes upstream actors to cheating and the supply chain to eventual money laundering risks. There would therefore be value in supporting the extension of cruder assay facilities further up the supply chain.



- **Insurance provision:** Where aggregation of gold at significant volumes is required before onward shipping, it is reasonable to assume that supply chain actors will require coverage for liabilities resulting from loss of assets. Our research shows that formal insurance provision is limited / non-existent within the ASGM supply chain. The project may wish to scope the interest of insurance companies piloting the extension of insurance to project supply chains. It is unlikely given the cultural norms in the upstream supply chain that there would be uptake of traditional insurance provision prior to the point of final aggregation / export. Liabilities here should be managed by mitigating risks through effective due diligence on actors.
- **Mobile banking:** A major liability in financing gold purchases comes with the physical movement of money into and out of mining areas. This could potentially be overcome by providing mobile money solutions, for example Pepele Mobil provided by TMB (currently being piloted at Kampene sites in Maniema).

4. The project should work closely with public authorities to overcome structural governance issues impacting logistics. These issues provide significant barriers to formalization and transparency and render the scaling of the above solutions challenging if not tackled head on. Nevertheless, the project should be realistic about what it can achieve in this area, noting previous efforts have had limited success or impact. The following areas seem most relevant to explore:

- **Bribery and illegal taxation:** Working with authorities to reduce the levels of bribery and illegal taxation (often perpetrated by government agents), which increases when logistics become more transparent and open; establishing or working with pre-existing multipartite monitoring system (CLS/CPS – local and provincial monitoring committees) with options for all actors to flag instances of such requests within project supply chains.
- **Fiscal disincentives:** As detailed above, the fiscal burden is heavy in ASGM supply chains in eastern DRC. Neighboring countries conversely have attractive fiscal regimes (inc. 0% export tax for refined gold in Uganda). This in itself is a driver of illicit gold flows. We are unlikely to be able to address the wider fiscal framework within the project timeframe and therefore should consider negotiating tax exemptions for pilot supply chains to demonstrate that this can contribute to greater formalization and higher state revenue capture.
- **Administrative burden and delays:** Documentary validation and presence of state authorities at various stages of the supply chain render it burdensome and slow, and incentivize untransparent and discrete logistics systems. We should explore working with authorities to reduce the administrative effort associated with trading through formal systems. Such an approach was successful in the USAID funded PRADD II (precursor to AMPR) project in CAR, where Kimberley Process checks prior to export were taking up to 6 months and were identified as a major driver of contraband. In that project the wait times were reduced to approximately one week stimulating a growth in formal exports.
- **Regulatory framework:** There is often confusion about what the legal obligations of upstream actors entail. We observe a dual system of legality between the RCM and the wider suite of DRC regulations. International buyers are mostly concerned with the RCM, which is aligned with the OECD DDGs. The new RCM allows for industry due diligence in the place of government checks in contexts of limited capacity. This is important to open supply chains that have not been validated under the system. At present the new RCM has not been fully incorporated into DRC law. We therefore suggest that the project work with government to raise awareness and advocate for the blue status and train officials and supply chain stakeholders on how this works in practice.



Next Steps

- Build on the supply chain assessments conducted by the due diligence and traceability providers to improve understanding of the concrete logistics barriers within the project's supply chains. This should also serve to test options for improvements with key stakeholders and to shape options and solutions that fit the different types of supply chains, which could then potentially be supported through the RGIF.
- Prioritise identifying supply chain actors where there are gaps in the project, in particular exporters, in order to explore logistics solutions with them and include them in continuous improvement plans.
- Further develop options for logistics solutions and interventions, pulling together further concrete examples of options and learnings from ASM gold supply chain and direct purchasing projects both in DRC and elsewhere (for example West Africa).
- Explore the needs, requirements, and ideas of refiners through the refiner community of practice, in order to get a better view of logistics barriers, opportunities and solutions at the point between exporter and refiners.
- Explore potential logistics infrastructure improvements with DRC-based service providers (such as mobile banking services, assaying, secure storage, insurance) and other projects being implemented. This should especially focus on potential synergies with the Madini project and with TMB's mobile banking project.

