NISHNAWBE ASKI NATION

100 Backstreet Road, Unit # 200
Thunder Bay, ON
P7J 1L2

(807)623-8228
(807)623-7730
Website: www.nan.on.ca

Striking it Poor? The De Beers Victor Diamond Mine, the Mushkegowuk Poverty Trap and the Resource Curse.

The Chief of the Attawpiskat First Nation meets with the Grand Chief. "Sir," he says, "I have got some good news and bad news." The Grand Chief asks for the good news first and is told that the De Beers has just discovered diamonds near Attawapiskat. The Grand Chief is happy. He says, "Well, this is great. Hope for our youth. What could the bad news possibly be," he asks the Attawapiskat Chief. The reply is, "The bad news is that De Beers have just discovered diamonds near Attawpiskat."

I am writing in response to one bold claim made by De Beers, it's consultants and many officials of the government and mining industry.

In the Comprehensive Study Report the company claims that: "Overall, economic growth, employment and increased incomes are associated worldwide with improvement in the quality of life." 7-3.

The consistent message delivered by De Beers and many other "believers" in industry, governments, First Nations and the media is that, the "economic growth" represented by a De Beers diamond mine will be a blessing to the Mushkegowuk people and not a curse.

I wish to challenge that claim. Make no mistake I believe that this project will go ahead. However, I want to be on the record as a "skeptic" when it comes to the project's impacts and benefits and perhaps most importantly its social legacy. And I want to demand the highest standards of monitoring the socio-economic impacts of this project on the Mushkegowuk Cree.

In my view the most significant effects of this project will be the social impacts on the Mushkegowuk. The curse of the muskeg may bedevil the engineering of the pit, but in the end it's people that matter.

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In his opinion piece in the Globe and Mail, Deputy Grand Chief Dan Kooses had it exactly right when he drew an analogy with the fur trade. The last time the Mushkegowuk built an economy on the production of a luxury good for a large corporation the story ended badly for the Mushkegowuk when the market for beaver hats collapsed and many people starved and died -a curse that the communities are stilling living with.

Nothing I have read in the CSR reassures me that a mine can succeed where the fur trade failed.

Let's begin with a "baseline" portrait of the Mushkegowuk region.

The Poverty Trap.

The Mushkegowuk people are currently caught in a "poverty trap". The De Beers Victor diamond mine is being developed in one of the poorest regions in Canada, The Mushkegowuk region mirrors many Third World countries with negative growth in income per capita during the last five years and likely over the last twenty. Health conditions in the Mushkegowuk First Nations are among the worst in Canada. There is a widely acknowledged lack of effective public education. The region's population continues to grow, adding to the economic strain.

Policy-based development lending to the region by the federal government over the past 20 years has not solved the problem. The region has been a development Disneyland where economic development fantasy spinners have gone to sell their fantasies to the Cree. Sadly, to no good end. In general, First Nation communities in the Mushkegowuk region remain mired in poverty and many communities are paralyzed by debt to the federal government.

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The Mushkegowuk region, is stuck in a classic poverty trap, too poor to achieve robust, high levels of economic growth - simply too poor to grow at all. More policy or so-called governance reform, by itself, will not be sufficient to overcome this trap. Specifically, the regions extreme poverty leads to low saving rates, which in turn lead to low or negative economic growth rates.

Low domestic saving is not offset by large inflows of private capital, for example direct investment, because the region's poor infrastructure, harsh climate, geographic isolation and weak human capital discourage such inflows. With very low domestic saving and low rates of market-based capital inflows, there is little in the Mushkegowuk regions current dynamic that promotes an escape from poverty. Current federal transfers simply maintain the basic necessities of life.

Impoverished households do not save, but rather must use all (or more than all) of their current income in the struggle just to stay alive. Once basic needs are met, poor households may save quite a lot of income, but not before.

Very rapid population growth at these low levels of domestic saving and direct investment is only compounding the problem for the Mushkegowuk.

The Mushkegowuk communities face enormous transport costs in shipping and receiving goods between urban Canada and the places where they live and work. Transport costs have played a fundamental role in impeding prosperity in the region:

In the classic model of economic development, agriculture provides a surplus that can be leveraged into capital accumulation and growth in the industrial sector. In the Mushkegowuk region the equivalent of agriculture would be the production of country foods and trapping. To say that the region has low-productivity in this sector would be an understatement. The productivity of the traditional economy has been too low to generate a surplus, while remaining essential to the way of life and culture of the Mushkegowuk.

The Mushkegowuk region carries a disease and health burden that is unique in Canada in its severity. In recent years the most prominent disease in the region has been diabetes. The communities continue to struggle with substance abuse and a long list of other social maladies.

To recap. The Mushkegowuk region is currently too poor to grow. The region is uniquely burdened by geography, climate, the absence of agriculture, disease, substance abuse and numerous other social ills. As a result, it can attract and amass too little capital to support a growing population. Short of capital, it is too poor to save. And without sufficient saving, the region cannot overcome its shortage of capital.

To escape the poverty trap the Mushkegowuk need a "big push". But is a diamond mine that "big push"? Will a diamond mine provide the Mushkegowuk with the tools they need to pull themselves out of the "poverty trap?"

Let's consider the experience of other regions of the world that saw mining as the answer to their development needs.

The Resource Curse

It's a striking and painful paradox: In the developing countries, a region that the Mushkegowuk region most closely resemble, wealth dug or pumped out of the ground may not help the poor, and often seems to do more harm than good.

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Contrary to the "growth is good " message of De Beers and many other mining boosters, economists have identified a strong negative empirical link between long-term economic growth and the share of the economy which originates in the natural resource sector.

Since 1945, not a single natural resource dependent economy in the world has managed to sustain over several decades anything approaching respectable average real GDP growth; scarcely any has even achieved positive long-run growth.

High and sustained rates of economic growth are linked to producing complex products and services, not to extracting minerals out of the ground.

The counter example appears to be Botswana-a diamond dependent county in Africa. Since 1966 Botswana has used the proceeds from a rapidly growing diamond industry to develop the country's infrastructure. The result has been that Botswana, since the first discovery of diamonds in 1967, has probably had the fastest-growing economy in the world. In the past few years Botswana has even achieved a higher country credit rating than Japan.

But let's look more closely at the Botswana story.

Economists have argued that the resource curse is attributable to the fact that commodity exports generate little growth in other sectors of the economy. This is certainly true in Botswana. International ratings agency Moody's says there is little evidence that diversification efforts have resulted in a significant expansion of Botswana's non-mining sectors since 1990.

Even after what appears to be a run of spectacular economic growth, Botswana continues to face the twin challenges of poverty and unemployment. The government has reduced the number of people living below the poverty line from 36% in 2001 to an estimated 30% in 2003. Botswana's official unemployment rate stands at around 21% despite 9000 new jobs being created in 2002/03. Some analysts, however, put the unemployment rate at closer to 40%.

What will happen when the Botswana diamonds run out?

The resource curse appears to cut across virtually every barrier. Countries that have little or nothing in common ethnically, geographically, culturally, or politically still seem to face the same predicament. Mining dollars have not helped to reduce poverty. In fact, in most cases, they have actually exacerbated it.

To further complicate matters, the project we are responding to is not an oil well or a metal mine, but a diamond mine.

An Economy Based on Illusion.

De Beers sells illusions. It sells the idea that diamonds bring love, romance and sex. Forever. Surprisingly it works.

On the face of it the next few years are a particularly good time to be selling the diamond illusion and developing a diamond mine. Global demand for diamonds looks set to outstrip the available supply over the next five years, a worldwide shortfall in rough has been projected recently to reach $ 7 billion in value by the year 2012.

But then again the price of diamonds has declined in the past. For example, rough diamond sales by De Beers' dropped 13 per cent in 1992. In 1981-84, under pressure from high interest rates the market for big diamonds collapsed. The price of the famous D' one carat flawless diamond dropped from its peak in 1980 of $60,000 to $10,000.

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Let's face it you can't eat diamonds. Unlike many metals, diamonds (other than industrial diamonds) are simply luxury goods. Diamonds are extremely vulnerable to downturns in the world, and specifically the U.S., economy.

What would a fall in diamond prices mean to the Victor mine? Hard to say, but if the oversupplied market in a downturn is "big diamonds" and Victor is a producer of "big diamonds" then the "marginal" Victor mine would be among the first to feel the effects.

The Victor mine puts the Mushkegowuk region in a precarious position. As time goes on the communities will become increasingly dependent on a single product luxury industry with a limited life expectancy that is vulnerable to a global economic downturn, market changes and fluctuations in currency prices.

It is unclear to me how the real possibility that the mine may not actually operate continuously or to its projected lifetime has been considered.

Monitoring

As I said at the outset I believe that this mine will go ahead. Accepting this "brute political fact" I want to offer a few observations and suggestions.

To break out of the poverty trap, the Mushkegowuk need help, and it has not yet gotten it in the form and to the extent that is necessary.

Any resource development project must confront many complexities, especially regarding the conditions under which economic benefits are provided. Unconstrained resource revenues to communities and individuals would probably be consumed rather than invested. A strategy needs to be designed to ensure that the communal and

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regional benefits from the mine are properly invested, and there must be a credible mechanism for enforcing the strategy over a relatively long period.

The escape from the poverty trap, requires investments in both human capital and physical capital, and that poverty itself is multidimensional, involving not only income but also lack of food security, health, education, gender equality, environmental management, and access to basic amenities.

For example, improved education leads to many benefits, including reductions in income poverty, hunger, and child mortality. Conversely, meeting each poverty reduction goal (poverty, hunger, education, health, housing and the others) requires multiple interventions.

Consider the issue of gender equity, that is, to an improved economic and social status for Mushkegowuk women. To a great extent, women are the caregivers, and child raisers of the Mushkegowuk. They perform an incredible amount of physical labor every day merely to keep their households alive and well. Of particular concern in many parts of northern Ontario are persistently high levels of violence against women and girls; this violence needs to be confronted.

The Mushkegowuk region will require large numbers of teachers, nurses, doctors, infrastructure specialists, scientists, and so forth- experts who are in very short supply in northern Ontario.

This project requires a region-level social monitoring plan, one that works backward from the outcome targets to identify needed input targets and then identifies infrastructure, human, and financial resource requirements to meet the targets- a "needs assessment" approach.

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The focus in the plan should not be on growth per se, but on monitoring the preconditions for growth, especially following closure of the mine.

The socio-economic monitoring of this project should be directed at indicators that are measurable, monitorable, and audited and run like a business. Socio-economic monitoring should be run with the rigor of a business.

I was particularly troubled by the number of references in the CSR to the lack of community participation in the environmental assessment process. And on the basis of media reports it appears that the IBA was not ratified by a majority of a majority of the on and off reserve population. One could draw the reasonable conclusion that existing community capacity and institutions had difficulty in coping with the process and the project.

I am concerned that the massive and rapid scaling up of community capacity in response to the mine might even exacerbate existing weaknesses.

The delivery of many health and education services requires the collaboration of multiple individuals who make highly discretionary choices in an environment where many key actions are unobservable. Such services cannot be delivered by a few outsiders, but will take a community effort.

Most fundamentally, the success of this project at a community and regional level requires coming to grips with the deep inverse correlation of poverty with institutional capability. We need to monitor existing community capacity and its changes over time.
Revenues flowing through incapable structures and organizations will give you perverse outcomes. Not only can the money be put to bad use, but encouraging dependence on natural resources also tends to

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result in a single-industry economy. When the mine closes or is shutdown it's often much worse for the dependent communities than it would have been otherwise

We know that economic growth depends on minimum standards of health, education, and infrastructure in order to attract the new investments and technology that in turn are needed to raise income levels. The monitoring program must address the current condition of community health, education and infrastructure and track how these conditions change over time. We need to see how transfers from mining project impact the interlocking crises in health, education, and basic infrastructure.

The idea is to see how the mine is (or is not) increasing investments in people (health, education, nutrition), the environment (soils, land, water, biodiversity) and infrastructure (roads, electricity, housing ports), based on the specific needs of each Mushkegowuk community.

The social impacts of the project should be measured against interim benchmarks on a clear calendar basis. Governments, working with the communities, should prepare specific compliance guidelines that include spot audits, evaluation and publication of performance indicators.

You can evaluate the results of a specific project like a mine by comparing them with conditions in another community (of which there are many in Treaty 9) without the mine, and you can get feedback from those affected and hold the company accountable.

One last item deserves mention. Careful analysis shows that all the communities of Treaty No. 9 need a total cancellation of debt to the federal government. Think of the recent efforts to cancel debt in Africa. Money that could be directed towards public health and education is instead siphoned off to pay debts owed to the federal government.

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The IBA-Publish What You Pay.

Finally, I want to discuss the IBA.

The regulators were handcuffed by an inability to review the IBA. We can only assume that many concerns regarding the social impacts of the project are addressed in the IBA and other agreements yet to be made with the Attawapiskat and other First Nations.

The international Publish What You Pay campaign, has urged oil and mining companies to disclose payments to governments. In response, the British government launched the Extractive Industries Transparency Initiative (EITI).

Put simply, everything that is paid by the companies is published.

The World Bank backs the idea, as do 70 private aid agencies around the world.

The initiative requires regular publication of all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive and comprehensible manner.

In my view, the IBA, which provides significant payments to the First Nation government should be made public.

Research on the resource curse tells us that several things usually happen when mining comes to a poor region. Prices rise, the government and community loses interest in everything else, officials can become corrupt, companies reward individuals or corporations via secret accounts, democracy is undermined, and prestige white elephant projects get built.

Showered with sudden windfalls, communities increase spending, creating programs that are hard to undo when the mine closes.

A cycle begins. The economy can't absorb the sudden influx of money, causing wages and prices to. That makes it harder for local businesses to compete. Incentives, meanwhile, become wildly distorted. When free money is flowing out of the ground, people who might otherwise start a business or do something innovative instead busy themselves angling for a share of the spoils. Why slog it out in a local business when steering some mining business toward a community contact could make you a lot of money? Thus a doubly deadly dynamic: a ballooning band council economic sector, and a withering community or private one.

It's very simple: There's too much money in diamonds. Everybody wants a piece of the action. And the most powerful get a piece of the action. This kind of wealth makes a little-known, region a target for every kind of investor, entrepreneur, political opportunist and criminal.

Publishing what is paid helps create the transparency and accountability that are an important part of throwing off the "resource curse".

The Victor mine will be heaven, hell or purgatory, depending on the choices made. The true test will come after De Beers leaves and the Mushkegowuk must rely on their own knowledge and institutions to sustain the economy. May the Mushkegowuk avoid the resource curse, and become the only small, undeveloped region on the planet ever to have found diamonds in large quantities, shared the benefits equitably and guaranteed future generations sustainable development.

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Diamonds are not an economy. Creative economic activities have spillover effects that become self-sustaining-forever. Diamonds end up in a jewelry store and from there usually onto the hands of a favored few.

David Peerla
July 11, 2005.