Responsible sourcing of minerals from conflict-affected areas


Background

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission’s Impact Assessment (IA) accompanying the above proposal adopted on 5 March 2014.

Armed groups and security forces in conflict regions partly finance their activities from the proceeds of the extraction and trade of minerals. These products later enter the global supply chain, meaning that business operators further down this chain are at risk of supporting armed activities through their purchases of mineral ores or their derivatives. Business operators from the EU and third countries have therefore expressed an interest in sourcing responsibly from such regions. (IA, p. 8)

The concept of responsible sourcing is not new and the proposal builds on existing international due diligence frameworks. The EU has been actively engaged in the process leading to the adoption of the so called OECD Guidance on responsible sourcing of minerals from conflict regions1. At the OECD Ministerial Council (May 2011), the Commission ‘advocated greater support for and use of the OECD Guidelines for Multinational Enterprises, and of the OECD Guidance – even beyond OECD countries’ (IA, p. 9). In addition, the EP Resolution of 7 October 2010 on human rights failures in the Democratic Republic of Congo (DRC) already expressed the need for the EU ‘to legislate along the lines of the US “conflict minerals” law’ (The Dodd-Frank Act) (IA, p. 9). Also in 2010, the United States passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (US DFA), section 1502 (Annex I/5) of which requires companies listed on US stock exchanges which use ‘conflict minerals’ to declare the origin of such minerals, and to perform due diligence. (IA, p. 8).

Although the problem is worldwide, the UN Security Council Resolution 1952 (2010) specifically targeted the DRC and surrounding areas in Central Africa, calling for due diligence to be observed. (IA, p. 8).

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1 OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas.
**Problem definition**

The impact assessment provides a clear and detailed overview of the extent and nature of the problems at stake, identifying the following three main problems (IA, p. 15):

i) The continued financing of armed groups via the (proceeds of) extraction and trade of minerals in conflict-affected and high-risk areas.

ii) Implementation challenges faced by EU downstream operators in performing due diligence within the current frameworks.

iii) Market distortion in the form of reduced demand and prices in the formal sector for minerals from the DRC and other Great Lakes Region (GLR) countries.

The affected populations are identified as those in countries which are rich in natural resources but vulnerable to armed conflict. Although it is recognized that the problem occurs worldwide, like the UN Security Council resolution 1952 this IA pays specific attention to the DRC and its neighbouring countries.

The case of DRC is the best documented and most well-known example of the conflict minerals problem. The DRC conflict, in which armed groups generate revenue through control of natural resources, has ‘claimed more than 5.5 million lives' and caused large scale sexual violence. (IA, p. 19). Moreover, EU companies have been involved in sourcing minerals from dubious local private operators in the DRC (IA, pp. 18-19).

The IA includes a ‘problem tree' (IA, p. 16) which clearly sets out the main problems, consequences and the underlying drivers. The scale of each of the above problems is then examined thoroughly, with the consequences and drivers for each being explored and the affected parties identified.

The difficulty for downstream operators to conduct due diligence with regard to the 3T2 minerals involves the responsibility of the smelters earlier on in the production chain: most of these are located outside the EU and are state-owned, ‘yet few of them are exercising due diligence’ (IA, p. 22).

Estimation is given in the IA that currently 150 000-200 000 EU companies need to act in order to safeguard due diligence, especially due to the requests from their clients to indicate the origin of the minerals. (IA, p. 24).

**Objectives of the legislative proposal**

The proposal in question is designed ‘to help reduce the financing of armed groups and security forces through mineral proceeds in conflict-affected regions', and is in line with the EU foreign policy goals and development strategy of better governance, sustainable management and law enforcement in this area (Explanatory Memorandum, p. 2).

The Commission proposal aims to achieve three general objectives:

1. Contribute to reducing the funding from proceeds of minerals' extraction and trade that reaches armed groups in conflict-affected areas.
2. Improve the ability of EU downstream operators to comply with existing due diligence frameworks, including US Dodd-Frank Act.
3. Contribute to reducing the distortions in the market for minerals from the Great Lakes Region.

These correlate directly to the three main problems identified in the IA.

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2 Tin, tantalum, and tungsten.
Within this, there are further **specific** objectives:

1. Increase the proportion of EU and global smelters/refiners that perform due diligence.
2. Raise the level of public accountability for due diligence performance (and level of compliance) by EU and global smelters.
3. Increase the ability of EU downstream companies to successfully identify smelters/refiners.
4. Improve the bargaining position of EU downstream companies (on due diligence) vis-à-vis companies further back in the supply chain.
5. Improve awareness of due diligence, of the importance of due diligence compliance, and of ethical dimensions throughout the supply chain - both inside and outside the EU.
6. Increase the uptake (performance) of due diligence practices by downstream companies.
7. Offset/reduce the adverse commercial incentive created or exacerbated by US DFA.

These specific objectives are further translated into a set of **operational** objectives, all relating to the enhanced awareness, transparency, promotion and support of due diligence practices among EU operators and downstream users.

In the words of the IA, ‘the proposal's objectives are coherent with EU trade and enterprise policy, which concerns corporate social responsibility safeguarding the free and responsible choice of supply of EU operators.’ (IA, p. 31).

**Range of options considered**

The IA considers the following six options. In its comparison of the policy options, the IA excludes the baseline scenario, but does give a description of the situation in case of non-action by the EU (IA, p. 41).

**Baseline scenario**

No additional EU action would be taken, with Member States not expected to adopt legal due diligence requirements or introduce the application of performance clauses on due diligence in their public procurement contracts. Without EU intervention, the stated consequences include, inter alia, the continuation of conflict and human rights abuses, the loss of clients for EU companies further downstream and the failure of GLR countries to benefit from their natural resources (IA, p. 16), the IA stating that ‘EU non-action would undermine global efforts to reduce funding to armed groups.’ (IA, p. 41).

1) **Stand-alone EU Communication**

This option consists of a number of measures to be included in a joint Communication of the Commission and of the High Representative:

(i) National Contact Points (NCPs) and the Enterprise Europe Network (EEN) to advocate the uptake of the OECD Guidance; (ii) EU public procurement: the application of performance clauses in Commission and EU Member States’ public procurement contracts for relevant products; (iii) financial assistance to the existing OECD programmes; (iv) Commission support to 'Letters of Intent' by the European Industry, and (v) government-to-government actions. (IA, p. 34-35).

2) "**Soft-law" approach"

This option combines the measures of option 1 with a Council Recommendation to raise awareness and promote the voluntary uptake by EU enterprises of the OECD Guidance. (IA, p. 35).

3) **Regulation establishing obligations under an 'EU responsible importer' certification based on OECD Guidance - Voluntary**

This option combines the measures of option 1 with a Regulation targeting all EU importers of 3T and gold, regardless of their origin. Importers can opt to be self-certified, and are then obliged to integrate all elements of the OECD Guidance in their management system, as well as to disclose annually the identity and geographical location of the smelter/refiner in their supply chain. Through an implementing act, the Commission would keep and annually update a list of responsible smelters/refiners. (IA, p. 36).
4) Regulation establishing obligations under an ‘EU responsible importer’ certification based on the OECD Guidance - Mandatory

‘This option combines the measures of option 1, with a compulsory version of the Regulation described’ under option 3. This concerns more than 300 traders, 19 smelters/refiners and more than 100 manufacturers of components and semi-finished goods’. (IA, p. 38) Annex I.9 explains that 330 large and SME companies were surveyed for the purpose of the conflict minerals study via an on-demand software iPoint Conflict Minerals Platform (p. 19). Yet, it is not clear from the IA if the above business operators were specifically consulted on this option, as they are relatively few compared to the number of companies affected by other options.

5) Directive establishing obligations for EU-listed companies based on the OECD Due Diligence Guidance

This combines the measures of option 1 with a Directive defining the obligations for at least 1000 EU-listed companies to integrate the "five-step" OECD Guidance framework in their management system. In case of infringement of the Directive, financial penalties would be applied. (IA, p. 38). However, it is not explained in the IA report why the number of companies varies so dramatically from option 4 to option 5.

6) Prohibition of imports when EU importers of ores fail to demonstrate compliance with OECD Guidance - import ban

This includes the measures of option 1, and would also require ‘EU importers to mandatorily demonstrate compliance with OECD Guidance’. (IA, p. 39). Importers would be eligible to access the EU market upon providing evidence of compliance, in accordance to the approach described in the Kimberley Process Certification Scheme (IA, p. 39). Annex I.1. explains that the Kimberley Process is an international agreement bringing ‘together 75 diamond producing, trading and manufacturing countries, including the 28 EU Member States’, in order to follow the flow of conflict diamonds (IA, p. 3). In the EU, it is implemented by Council Regulation 2368/2002 (based on Article 207 of TFEU), setting out the rules regarding imports and exports of rough diamonds (Annex I.1, p. 3).

Comparison of the policy options

The policy options are closely linked to both the causes of the problem and the objectives, and are largely based on the existing OECD Guidance. Early on in the assessment it is clear that preference is shown to option 3, which is given the most detailed consideration.

The IA concludes that policy options 1, 2 and 5 are among the least effective options in achieving the objectives set (IA, p. 61). This is clearly shown in a table comparing how the options are supposed to meet the objectives (IA, Table 3 to 6, p. 62 to 64). However, the IA lacks more profound content explanation of effectiveness of the options.

Policy option 3, consisting of a voluntary self-certification scheme for EU importers in addition to the set of measures in option 1, is seen as one of the most effective measures of achieving the set objectives. According to the IA, option 4 would be equally effective as option 3, but would also generate negative impacts (although these are not specified) and would not address one of the key problems - the market distortion in the Great Lakes Region. (IA, p. 61)

Policy option 6 is considered to be mid-way in terms of effectiveness between the least effective options 1, 2 and 5, and most effective 3 and 4. (IA, p. 61)

Options 3 and 4 are therefore chosen for further comparison in terms of their broader impacts. Under a mandatory scheme compared to a voluntary one, the IA finds that although participation would increase, benefits would not necessarily be maximised (IA, p. 53). Option 3 is therefore assessed to be favourable, as it carries less administrative burden for importers. (IA, p. 61)

The Commission’s preferred option is option 3, which is assessed to have the highest rate of effectiveness. (IA, p. 61).

Scope of the Impact Assessment

The IA examines each of the following impacts: economic, social, environmental, IT, administrative, as well as weighing up costs and benefits.
Economic impact
If no EU action is taken there is expected to be an adverse economic impact for the Great Lakes region as market distortion would be likely to worsen. (IA, p. 41).

Positive contributions of options 1 and 2 to reducing market distortion are expected to be limited. The options do not address all of the set objectives and it is implied that not all companies are expected to successfully take up due diligence. (IA, p. 42). Therefore, some of them may face downstream clients switching to other suppliers with negative economic consequences. (IA, p. 43).

Under option 3, those choosing to self-certify will incur costs associated with such activities as risk mitigation, switching supplier, reporting and IT systems. (IA, p. 47). The costs for companies already applying due diligence within the framework of USA DFA are estimated around EUR 13 000 as initial costs for due diligence and reporting efforts, and EUR 2700 for recurring efforts. These costs are considered to be relatively low, according to the IA (Annex I, p. 19) and there should not be any significant impact on the competitiveness of EU industries. The market is gradually expected to offer incentives for self-certification, such as a premium on certified products. (IA, p. 49). EU companies are also expected to better serve US clients' due diligence requests under option 3, as the regulation is in line with the US DFA, and thus could expect to keep these clients. (IA, p. 49)

The IA notes that, due to the voluntary nature of option 3, the overall costs of due diligence for EU importers will depend upon the exact participation rate and also the cost in relation to company turnover. (IA, p. 48).

Regarding option 4, the more binding the regulation, the more market distortions there are likely to be. (IA, p. 53). The regulation may provide incentive for some EU downstream product manufacturers to avoid buying certified EU materials and instead shift their production to outside the EU where due diligence requirements do not exist. (IA, p. 53) Therefore competitiveness in these sectors could be affected. (IA, p. 53). Businesses may also seek the least burdensome ways of complying, for example, by avoiding sourcing from conflict-affected and high risk areas. These areas might therefore experience a relative fall in demand. (IA, p. 53).

Self-certification under options 3 and 4 is expected to incur associated costs. Nevertheless, such costs are expected to be manageable. (IA, p. 47).

Option 5 would directly refer to approximately 1000 EU-listed companies in the relevant industry sectors, and indirectly affect up to 800 000 EU downstream companies, 99 per cent of which would be SMEs. (IA, p. 56) There would also be an excessive burden on EU industries using 3Ts and gold. The IA finds that this option could easily become 'unworkable' due to the large number of companies involved and the length of related supply chains. (IA, p. 56).

The limiting of the availability of imported non-certified products in option 6, 'could potentially lead to an increase in price for certified minerals' (IA, p. 59). Therefore the delocalisation of smelters/refiners may potentially be an issue and lead to a negative economic impact. (IA, p. 59).

Social impact
Options 3 and 5 would have a limited positive impact upon job creation in the areas of audit, consulting, training etc., although a noticeable impact on overall EU employment would not be expected. (IA, pp. 49 and 57).

In the case of option 3, there would be significant positive impacts in the GLR which could include increased government revenue through taxation, reduced corruption, more sustainable development and environmental protection, increased prospects for jobs and private investment. There is also the potential for this to translate into improved public services and benefits for local communities. (IA, pp. 49-50).

The EU initiatives proposed under option 4 and option 5 could create a potential de facto embargo, resulting from disengagement with conflict zones. This would lead to an increase in conflict mineral smuggling into neighbouring regions. A fall in mineral exports could then lower the chance for economic and social
development in the affected regions, and worsen conditions in the mines. It was decided that considerable capacity building measures would be required to mitigate this. (IA, pp. 54 and 57).

Option 6 could be problematic for the overall employment situation in the EU if important mineral consuming countries were not to participate, as smelters and refiners might delocalise. (IA, p. 59).

Environmental impact
Option 1 & 2 are considered to have no environmental impact, although there is no mention in the IA of how this conclusion was reached. (IA, p. 43 and 44). Some respondents to the consultation considered that the scheme proposed under option 3 would contribute to strengthen environmental aspects (IA, p. 50). Options 4 and 5 could have a potential negative impact on the environment, if operators replacing companies that have redirected their sourcing elsewhere are less environmentally responsible. (IA, p. 54 and 57). The IA does not explore this aspect any further.

IT impact on public procurement contracts
Information Communications Technology implications regarding the European Commission’s public procurement contracts for IT hardware are applicable to options 3, 4, 5 and 6. (IA, p. 50-51). For example, the costs related to these contracts amount to EUR 7000 for DG DIGIT budget per annum (0.014% of its total annual budget) (IA, p. 43). For all options there would be low implementation complexity at a low budget for Member States and concerned companies. There would be negligible fees or costs in terms of staff time for EU institutions. (IA, p. 50).

Cost-benefit analysis
The IA recognises that some of the benefits for companies participating in self-certification are likely to be unquantifiable, for example an improvement in public image, Corporate Social Responsibility (CSR) and consumer satisfaction. (IA, p. 47).

Over 80 per cent of business respondents indicated that they were interested in responsible sourcing - indicating that the benefits for companies are expected to exceed the cost. (IA, p. 47). If all of the roughly 400 EU importers, such as smelters, traders and manufacturers, were to take up due diligence voluntarily, the total cost would be EUR 5.4 million, and recurrent annual cost — EUR 1.1 million (IA, p. 47).

Subsidiarity / proportionality
External trade is an exclusive EU competence, and therefore the subsidiarity principle does not apply (Article 207 TFEU). Option 5, however, is based on Articles 50 (freedom of establishment) and 114 (approximation of laws), but no reference is made to subsidiarity here (IA, p. 29).

Budgetary or public finance implications
The IA compares the levels of administrative cost imposed by each of the options to the European Commission and EU Member States. Generally, public costs are associated with promotion via the National Contact Points (NCP) and the Enterprise Europe Network. There is also an expected level of cost for Member State public authorities and European Commission public procurement contracts, but these would be small cost increases that would not be passed on to the final consumer (IA, p. 43).

SME test / Competitiveness
A separate SME test has not been carried out; instead this has been assessed within the overall economic impact of the various options. The analysis of the impact on SMEs is therefore brief. Comparing preferred options 3 and 4 in terms of their administrative burden for SMEs, option 3 is assessed to be the least burdensome as it affects those companies that decide to opt for self-certification based on their own cost-benefit analysis (IA, p. 47). Contrary to this, option 4 imposes requirements (IA, p. 53). The IA provides a table under Option 3 which gives an overview of costs (from annual turnover) to SMEs per industry sector in which the SMEs operate (IA, p. 48). Under option 5, the IA mentions that 99 per cent of the affected companies would be SMEs (IA, p. 56). Recurrent costs of complying with due diligence do tend to be slightly
higher for SMEs than for larger companies (IA, p. 47). However, although the impact on SMEs is somewhat greater, these costs are expected to be manageable, with no significant impact on competitiveness (IA, p. 47).

**Simplification and other regulatory implications**

The Explanatory Memorandum lists the following existing EU initiatives in relation to natural resources, financial transparency and conflict-sensitive management of international diamond trade and forestry (p. 3):


The Kimberley Process scheme is reflected in Option 6 — importation ban of conflict minerals (IA, p. 39), but no comment is made on how exactly the existing EU initiatives will interact with the new proposal. Other than referring to the existing similar measures above, the IA does not identify any simplification or other EU regulatory measures affecting the proposal.

**Relations with third countries**

The three main objectives of the proposal (see the Objectives section above) directly affect third countries: from the conflict regions themselves and the conditions of the affected population therein (especially the Greater Lake region), to both upstream and downstream operating international businesses, and European businesses operating internationally. Nevertheless, the IA does not provide a separate part on third countries in the analysis, and there is no explicit treatment of any development aspects.

The IA claims that apart from the US, ‘other third countries are not expected to promote the uptake of due diligence by their operators’ (IA, p. 34). At the same time, the proposed Regulation aims to improve the situation in the mining sector in the conflict areas, and also the goal of the OECD guidelines is to ‘help improve working conditions in producer countries’ (Annex II, p. 36). However, it should be added that stakeholder consultation pointed to a significant weakness in application of the OECD Guidance regarding ‘the lack of an objective and measureable definition’ of what areas can actually be considered as high-risk and conflict-affected areas (Annex II, p. 36). The IA explains that in case the situation in the EU remains unchanged, the likely outcomes in the affected regions would be continuous conflicts, political instability, and human rights abuses (IA, p. 41).

**Quality of data, research and analysis**

The Commission has relied on an external study for the assessment of impacts of the proposed Regulation. The full study is annexed to the IA report. The IA would nevertheless have benefited if more details had been analysed and presented within the main IA report itself. The data obtained via stakeholder consultations and desk research is comprehensive and interesting, but the IA is not always straightforward in presenting them. A lot of useful information is included in the Annexes, and its accessibility is thus somewhat limited. The IA includes under each option an analysis of the effectiveness of the option in achieving the objectives set, which is a useful approach. However, it could have merged the analysis of impacts by type, rather than by objective, which is the more comprehensible and usual approach adopted. A lot of useful analysis is included in the annexes, even though it could have been usefully incorporated into the main outline of the IA itself. The IA does not really explain why the 3T and gold are the minerals to which this initiative applies, and what is the situation regarding other minerals mined in conflict zones, other than by mentioning that the ‘OECD so far identified ores containing tin, tantalum, tungsten and gold [as] the minerals supporting armed groups’ (IA p. 18).
Stakeholder consultation

The main stakeholders include business operators (smelters, refiners, manufacturers, traders) in their respective industries (mining, metals, electronics, plastic and rubber, etc.), the Member State authorities, the third country mining sector and business operators, as well as consumers, citizens and unions (IA, p. 10). A public consultation was carried out between 27 March and 26 June 2013, which received 280 responses. It has to be noted that this number seems quite low compared to the number of companies affected under various options (73.2 per cent of responses to the stakeholder consultation came from the business sector; large companies represented 47.2 per cent of all replies and SMEs represented 23.4 per cent). Other responses came from the NGO sector, citizens, academics, unions and government authorities. All relevant sectors were represented and most answers originated in the EU, although there was a significant response from the US and DRC. (IA, p. 10). The preferred option (Option 3 – voluntary self-certification) is supported by business operators. Nevertheless, civil society organisations prefer option 5 (Directive based on OECD guidance establishing obligations for EU-listed companies), and 90 per cent of them are in favour of obligations for business actors (IA, p. 5). However, the IA evaluates that policy option 5, together with 1 and 2, are the least effective in order to achieve the declared objectives of the proposal (IA, p. 61).

Stakeholders were also consulted by means of a workshop, and through numerous focused interviews. Annex II of the IA provides an interesting overview of the responses to the questionnaire, which is unfortunately less well presented in the IA itself.

Results from the consultation are well represented in the IA, however, it is not entirely clear if they are fully taken into account when policy options are explained.

Monitoring and evaluation

The IA identifies clear monitoring indicators and specifies that monitoring of implementation will be carried out in co-operation with Member States, with relevant information to be gathered primarily by the Member States. (IA, p. 66).

The Commission is to inform the European Parliament and Council regularly on the progress of implementation, and is to undertake an intermediate evaluation of the new initiative within three years of its adoption. According to the results of the implementation analysis, a mandatory regulation may be considered in the future (IA, p. 66). Article 15 of the proposal foresees that Member States submit a report on implementation of the Regulation, and on that basis the Commission will draw up a report and submit it to the European Parliament and to the Council every three years.

Commission Impact Assessment Board

The IA Board issued its first, negative, opinion on the draft impact assessment in September 2013, recommending that the report be strengthened in a number of important respects.

The resubmitted draft received a positive opinion in December 2013, in which it was acknowledged that the report had been enhanced along the lines of the Board’s recommendations. However, further improvement was still deemed necessary in a number of respects, including the strengthening of the problem description and baseline scenario, giving more detailed assessment of policy options, and better assessment and comparison of the impacts. DG TRADE appears to have largely followed the Board’s recommendations in these areas.

Coherence between the Commission’s legislative proposal and IA

The proposal and the preferred option in the IA appear to correspond. It should be noted that a certain bias is shown throughout the IA towards the preferred option (Option 3), which is explained in much more detail than the others.
Conclusion

The overall quality of the IA is good; however, it is regrettable that the wealth of core information included in Annexes is not fully exploited in the analysis of the policy options and possible impacts. More readily available synthesis and analysis of data could have been presented in the body of the IA for better readability. Finally, it should be noted that the usefulness of some options, for example, Options 1 and 2, is not clear, as the comparison tables (on pp. 62 and 63) show that few of the declared objectives could realistically have been met by these options.

This note, prepared by the Ex-Ante Impact Assessment Unit for the Committee on International Trade (INTA) of the European Parliament, analyses whether the principal criteria laid down in the Commission’s own Impact Assessment Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work.

This document is also available on the internet at: www.europarl.europa.eu/committees/en/studies.html

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