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Myanmar's extractive industries: An institutional and regulatory assessment

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ABSTRACT

Myanmar is undergoing rapid political, economic and social transition. This paper examines the regulatory governance of Myanmar's extractive industries amidst this reform process. Based on the literature review, the paper develops an evaluative framework for assessing regulatory governance in the extractive industries, which includes six criteria: (1) clarity of roles and objectives; (2) stability and predictability; (3) participation; (4) capacity; (5) autonomy; and (6) transparency and accountability. The regulatory governance of Myanmar's extractive industries is evaluated against the criteria, using original qualitative data to illustrate the key issues and challenges. Overall, the country has made notable improvements in recent years. The out-dated regulatory framework that has governed Myanmar's extractive resources during military rule is transitioning to a framework that may enable improved industry practice and lead to responsible investment. However, reform processes of this scale cannot materialise over a short timeframe. The paper identifies priority area for the government in order to shift away from hitherto dominant norms and practice.

1. Introduction

Myanmar's vast and diverse mix of natural resources includes gems, industrial minerals, oil and natural gas. Natural resources are Myanmar's principal source of foreign exchange earnings and a major attraction for foreign direct investment (FDI). As such, they contribute significantly to the government budget. In recent years, natural resource exports accounted for two-thirds of national exports, or over 10 per cent of GDP, with natural gas alone making up 40 per cent of the total (IMF, 2015).[1] Extractive projects, when well managed, offer an opportunity to transform resource wealth into equitable development outcomes in developing countries. For Myanmar, growing export earnings and inward investment in the extractive industries have the potential to generate a significant level of economic and social development. However, in spite of being relatively well-endowed with natural resources and located within a region that has experienced significant economic, social and political development, Myanmar remains the least developed country in Southeast Asia, and faces significant challenges with natural resource management (EITI, 2015a).

Over the past several decades, Myanmar's extractive industries have operated within a framework of limited information, plagued by "bad governance" (Thein and Pick, 2010). Relations between government, companies and civil society (and communities) have been dominated by conflict. The military-linked extractive projects, for example in the jade industry, have been perceived by civil society organisations (CSOs) as the drivers of conflict (Global Witness, 2015). Unsurprisingly, foreign investors in extractive industries have been heavily criticised by a variety of non-governmental organisations (NGOs), including trade unions, environmental activists and pro-democracy groups, for supporting the military junta and damaging the environment (Meyer and Thein, 2014). A significant challenge for international investors will be to overcome preconceptions and gain societal trust.

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[1] The exact share of revenues derived from natural resources is difficult to estimate. There are pervasive data gaps on prices and extraction volumes; the division of responsibility for revenue collection and appropriation between ministries and SEEs is unclear; payments are deposited in multiple bank accounts; and information on production volumes and payments is not publicly disclosed. All these factors make it particularly challenging to estimate revenue flows. Additional sources of uncertainty include the largely informal extraction and payment practices (especially in non-gas sectors); extensive tax holidays; the involvement of military-owned companies; and parallel administration of some resources by subnational entities.

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Myanmar was under military rule for nearly half a century. In 2011, the country commenced a multi-faceted economic and political reform process, including in the extractive industries (Hendrix and Noland, 2015). Initiated by former President U Thein Sein, this process is continuing under a new government elected in 2015 at a rapid pace and it includes significant legal and regulatory reforms.[2] As part of Myanmar's economic and political transition, greater transparency has become a core priority. Myanmar was accepted as an Extractive Industries Transparency Initiative (EITI) candidate in July 2014. Implementation of the EITI should improve transparency, and there is substantial scope and willingness to improve broader governance in the management of natural resources.

In the context of a long history of economic mismanagement, corruption, conflict and military rule, the extractive industries face a daunting task of adopting inclusive practices (Adam Smith International and MDRI CESD, 2015). Myanmar's natural resource wealth and interest from foreign investors presents the government with an opportunity to meet the country's development needs. For jurisdictions in which natural resources account for a significant share of revenues, they can be either a driver of, or detrimental to, good governance. When extractive activities are based on regulatory tools and principles that promote equitable development, they can bring positive social and economic gains for host countries and affected communities (Dupuy, 2014). Shielding societies from the negative impacts of resource dependence, such as environmental damage, inequality, conflict, corruption and erosion of democracy, is an urgent issue.

This paper addresses one of the most pressing issues facing developing resource-dependent jurisdictions, such as Myanmar: the governance of extractive industries and its implications for society. For developing countries, effective regulation of extractive industries is important if balanced development is to be achieved (Sing, 2015). In order to assist Myanmar in maximising the potential from its natural resources, this paper reviews structures and processes in regulatory governance of its natural resources. The aim of the paper is to inform broader efforts to improve natural resource governance of Myanmar's extractive industries, including investment climate, effectiveness of public institutions in developing and monitoring the sector, as well as the costs and benefits to stakeholders, such as affected communities. In Section 1 of the paper, we survey relevant literature on extractive industries governance and regulation. We propose a set of evaluative criteria for assessing regulatory governance in the extractive industries. In Section 2, we employ the framework to evaluate the regulatory governance of Myanmar's extractive industries against the criteria. We use examples from mining and oil and gas sectors to illustrate the key issues, challenges and priority areas. In Section 3, based on the findings, we outline major implications. Our conclusion summarises the main points.

2. Assessment framework and methodology

2.1. Regulatory regimes and foreign investment

Extractive companies and investors have numerous jurisdictions from which to select when determining their exploration activities and budgets. Over the past three decades, more than one hundred jurisdictions have amended their mining rules and regulations. In some cases, resource-dependent jurisdictions entered a "race to the bottom" by reducing the regulatory burden on project developers (Tienhaara, 2006; Maconachie, 2016). A common justification for this regulatory redux is that overregulation creates a disincentive for investment. Alternatively, in order to maximise their share of resource rent, other jurisdictions have asserted greater control over natural resources. For example, by increasing the state's share in new ventures, mandating domestic beneficiation, or escalating royalties and tax rates, they have effectively shifted to "resource nationalism" (Vivoda, 2009).

Despite the *prima facie* appeal of these two extreme policy paths, in most instances they do not lead to investment outcomes that promote equitable host country development. Such outcomes require regulatory processes that promote investment while ensuring fair distribution of benefits. In this sense, a well-functioning regulatory regime serves a twofold purpose. First, it promotes extractive activity by offering a range of incentives to investors, such as tax holidays and profit repatriation. These are "enabling" forms of regulation (Baldwin and Cave, 1999). They aim to provide a welcoming investment environment, which may lead to economic growth. The second purpose of the regulatory regime is to limit or manage certain activities. Rules and regulations can set limits to extractive activities or impose additional requirements. Regulations to safeguard the environment from extractive activities or host country beneficiation requirements are examples of such "restrictive" rules (Baldwin and Cave, 1999). These two aspects of the regime provide a set of guidelines, which, in theory, enable extractive companies to operate in a way that satisfies their commercial interests while serving the host government's objectives. Achieving the appropriate balance between enabling and restrictive elements of the regulatory framework is a futile endeavour in the absence of social acceptance of extractive activities. The regulatory framework needs to be supplemented by stakeholder engagement processes, which are essential for gaining the social licence to operate (O'Callaghan, 2009).

The term regulatory regime refers to a configuration of policies and institutions which structures the relationship between social interests, the state and economic actors (Eisner, 2000). Regulatory regimes consist of both formal rules and procedures, and informal influences and processes, such as norms, conventions and codes of behaviour (North, 1990). The characteristics of regulatory regimes governing the extractive industries are of key concern to companies investing in developing countries. A well-performing regulatory regime is the main pillar of an environment conducive to attracting foreign investment in the extractive industries (Hunter, 2014). Investors monitor the quality of governance in each country and reward better performance with a lower cost of capital (World Bank, 2016). A survey of 39 mining multinationals, conducted for the United Nations, ranked 60 investment criteria used by mining companies when deciding where to invest (Otto, 1992a,b). Of the top twenty criteria, all but two relate to the regulatory system. A recent study has found that mining companies have preferences for countries with a low level of corruption and a business environment characterised by predictability, efficient institutions, transparent laws and advantageous tax codes (Tole and Koop, 2011). What is clear from these studies is the preference for good regulatory governance. The following key questions emerge: how do we assess the performance of a regime and what features are likely to promote investment? Under what conditions can resource-dependent jurisdictions attract investment, capture the windfall and convert it into societal benefits?

2.2. Assessment criteria

A systematic method for assessing the performance of regulatory regimes has been developed in previous work on regulatory governance and determinants of foreign investment. Initial work identified general "appraisal criteria" to assess the

[2] Thein Sein was Prime Minister of Myanmar from 2007 to 2011 and he assumed the presidential office in 2011 under the new constitution. His party, the USDP, lost the 2015 elections and he will step down as President in early 2016.