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State-Owned Economic Enterprise Reform in Myanmar: The Case of Natural Resource Enterprises

RENAISSANCE INSTITUTE

Natural Resource Governance Institute

Myanmar's state-owned economic enterprises (SEEs) regularly generate approximately 50 percent of the Union's fiscal revenues and spend as much in the domestic economy. They operate in many sectors, from transport to textiles and banking to natural resources. Through their regulatory roles, they exert a considerable influence on Myanmar's economic composition and trajectory.

Yet, traditionally, many SEE mandates and objectives have remained unclear and most have operated inefficiently by international standards. Consequently, since the early 1990s, the government's stated aim has been to professionalize, corporatize or privatize SEEs, often by granting them greater independence.

These efforts have shown mixed results. On the one hand, many unprofitable SEEs have been privatized since the socialist era, easing their financial burden on the Union budget. More recently, the *Hluttaw* has taken steps to curb capital spending by chronic loss-making SEEs.

On the other hand, in general costs remain high, operations remain inefficient, revenue growth from productive activities remains weak, and SEEs' business operations lack substantive supervision. For example, Myanmar Oil and Gas Enterprise (MOGE) costs are inflated due to contracts that require the enterprise to pay all commercial tax, special goods taxes and duties on the total value of natural gas sales, even though the enterprise only owns 15 to 20.45 percent of offshore fields. Essentially, MOGE pays tax on behalf of its foreign joint venture partners. A similar provision requires MOGE to pay tax on behalf of pipeline joint venture partners. These provisions cost the enterprise more than MMK 200 billion in 2015/16. In another example, MOGE's onshore production generated 7 percent of its revenues in 2015/16 but up to 29 percent of its costs. This implies that majority foreign-owned offshore fields are much more profitable than MOGE-owned onshore fields.

Moreover, recent reforms designed to encourage SEE self-sufficiency have given rise to a new challenge. Since 2012, SEEs have retained 55 percent of their profits in so-called UFA-Other Accounts. This money was meant to make SEEs financially independent, since they can draw on their Other Accounts to cover their day-to-day needs.

Seemingly in conflict with the goal of financial independence, some capital expenditures are still covered by the Union budget via their line ministries, even for the most profitable SEEs. Also, unprofitable SEEs' losses are fully covered by the budget, even in cases when they have money stored in their Other Accounts. Therefore, this revenue retention system seems to undermine the government's stated goal of improving SEE efficiency in three ways, by (1) maintaining loss-making SEE dependence on the Union for all spending, removing an incentive to become more profitable; (2) maintaining profit-making SEE dependence on the Union for its capital spending, removing an incentive to control items defined as capital costs (e.g., drilling equipment); and (3) allowing profit-making SEEs to hoard cash, discouraging greater profitability since their cash holdings are more than sufficient and they therefore have little incentive to raise more revenue or cut costs.

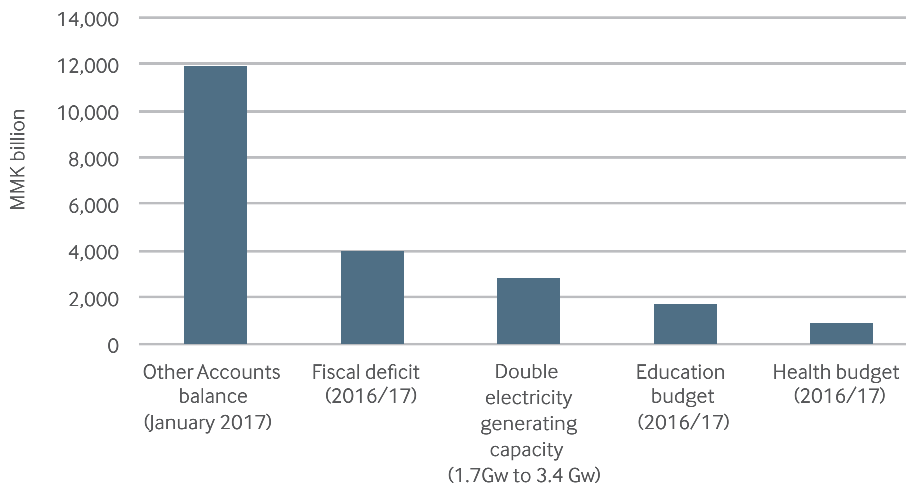
The revenue retention formula has led to the accumulation of large Other Account balances. As of January 2017, SEEs have accumulated MMK 11.45 trillion / USD 8.6 billion in their Other Accounts. Figure 1 puts this amount in context.

Rent collecting natural resource SEEs are among the largest hoarders of cash. This is mainly due to their large collection of passive forms of income—such as profit shares or license fees—from joint venture partners. MOGE cash-on-hand represents by far the highest share of total assets of any national oil company in the world (Figure 2). At current spending levels, MOGE has at least 7 years' worth of precautionary savings. Myanmar Gems Enterprise (MGE) has 172 years' worth.

Additionally, Other Account balances must be held in Myanmary's currency, kyat—which is depreciating in real terms—and cannot be invested in interest-accruing foreign assets. We estimate that SEEs have lost more than USD 2 billion in purchasing power over the last three years due to these rules.

Improvements can be made immediately, both to SEE revenue retention rules and to the management and allocation of Other Accounts. Ideally, the amount that SEEs would retain or be allocated from the budget would be a function of their strategic needs; the remainder would be transferred to the Union to be spent on social services and infrastructure for the benefit of the people of Myanmar. Excess savings could be invested in interest-accruing foreign assets. Account information could be published online. And idle Other Account balances could be reallocated to more productive uses. By our estimate, reallocation of excess savings from MOGE and MGE alone could provide more than MMK 2.8 trillion in available financing for the Union budget in this coming fiscal year without jeopardizing their ability to cover legitimate expenses.

Figure 1. Size of total SEE OA balances relative to other Myanmar budgetary figures



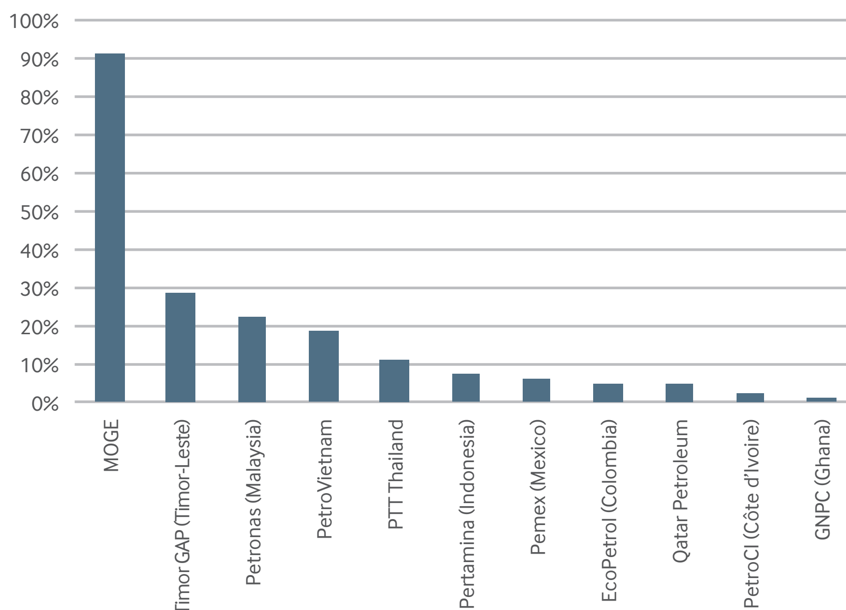
Changing the revenue retention rule by itself will not make SEEs more profitable or efficient. The Union government would also need to: (1) improve the legal framework governing SEE activities; (2) require that SEEs articulate their strategic objectives and performance targets; (3) strengthen SEE oversight; and (4) require much greater disclosure of SEE financial information and activities.

Legal framework. The 1989 SEE Law provides monopoly powers for SEEs over a number of sectors, yet does not clarify their roles or responsibilities. A new SEE law would bring statutory clarity to SEE management and make policymaking more consistent. Additionally, laws that prevent disclosure of crucial information to supervisory bodies could be amended. For example, the Auditor General of the Union Law could require that full audits of SEEs be made public. Also, the Financial Institutions Law could require that all SEE account information be published.

Strategic objectives and targets. While some SEEs have vision statements and mandates, most do not have clear objectives or performance benchmarks. As such, their financing needs remain unclear and their ultimate shareholder, the Union government, cannot monitor progress towards achieving their goals. Clear numerical and time-bound targets would be essential for improving SEE performance.

Strengthening oversight. While Myanmar has many of the organizations needed to monitor SEE activities, a combination of bureaucratic fragmentation, limited coordination and minimal grounding in clear statutory language limits supervisory bodies' effectiveness. For example, line ministries, which are in theory responsible for monitoring SEE alignment with Union objectives, generally provide operational autonomy to their SEEs and sometimes even act as their agents within the government. The Ministry of Planning and Finance has neither the mandate nor the

Figure 2. Share of cash to total assets for selected national oil companies (2015 or most recent)



access to information nor capacity to properly analyze SEE financial data for budgetary challenge purposes, restructure enterprises or hire and fire SEE managers. While the Office of the Auditor General audits SEEs, performance audits are not carried out and the highest authority to view the full audit findings is the SEE Managing Director.

Reforms could include: (1) empowering the Ministry of Planning and Finance or a new professional agency with responsibility over monitoring SEE compliance with performance targets and organizational objectives, approving SEE budgets on a project-by-project basis, and improving manager performance; (2) requiring greater disclosure of information to all supervisory bodies; (3) establishing independent boards of directors for SEEs; and (4) requiring independent external audit for SEEs.

Greater transparency. There is scant public information on Myanmar's SEE operations and finances. According to NRGI's Resource Governance Index 2017, MOGE ranked 36th out of 52 national oil companies globally in terms of transparency. MGE ranked 21st out of 22 state-owned mining companies. Full transparency not only allows supervisory bodies to do their jobs, it also helps build trust between the government and its citizens. As a first step, SEEs could publish financial and annual reports that meet international standards, like Chile's Codelco, Indian Oil or PTT Thailand.

Taken together, these reforms could generate trillions of kyat in new resources to finance Myanmar's development agenda. They would also help the government establish a legal and administrative structure for deciding which SEEs to keep within the budget framework, which to corporatize or privatize, and which to liquidate. Finally, by helping SEEs generate more revenue, lower costs and upgrade service delivery through better subcontracting and management decision-making, our proposals would make SEEs more efficient—allowing them to "stand on their own two feet."

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The Renaissance Institute (RI) is a policy institute in Myanmar that focuses on assisting the economic reform of Myanmar. Founded in 2013, RI provides analytical support and policy recommendations, assists government in capacity building and facilitates the communication between the government and other relevant stakeholders focused on revitalizing Myanmar economy. In particular, RI supports key policy priorities of the current government: fiscal decentralization and public financial management reform.

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