NATURAL RESOURCES AND SUBNATIONAL GOVERNMENTS IN MYANMAR: KEY CONSIDERATIONS FOR WEALTH SHARING

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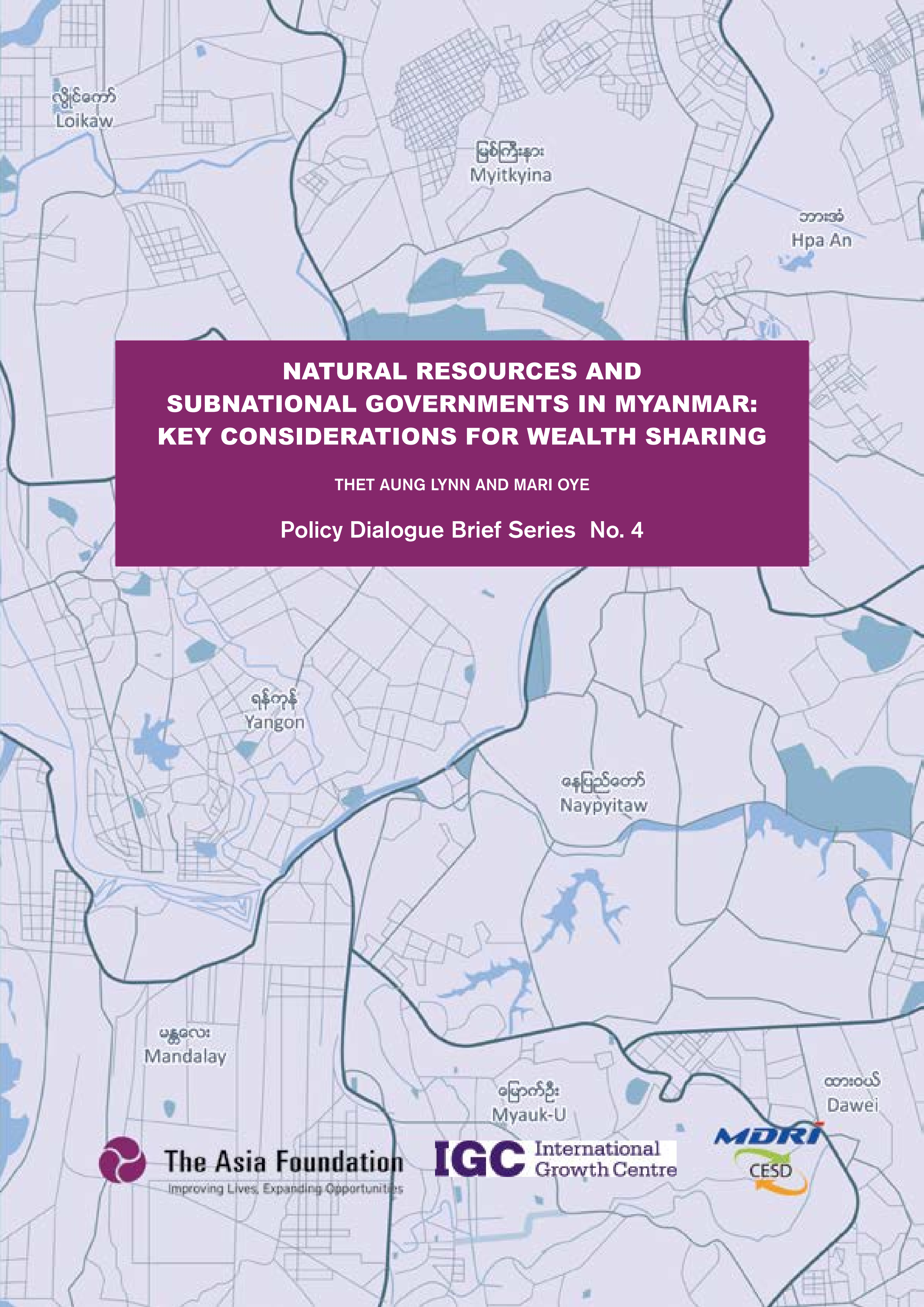

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ONE: NATURAL RESOURCES AND SUBNATIONAL GOVERNANCE IN MYANMAR

Myanmar is rich in many types of natural resources, including timber, oil and gas, minerals and gemstones, and potential hydropower. As part of Myanmar's economic and political transition, the government under President Thein Sein announced a commitment to both greater transparency in natural resource extraction and further fiscal decentralization.[1] However, there is a lack of clarity about both the extent and the distribution of natural resources in Myanmar, and the role of subnational government in natural resource management and in revenue flows.

A broader discussion about "wealth sharing" is emerging in Myanmar. Wennmann defines wealth sharing as "a negotiated agreement about the distribution of income derived from natural resources."[2] "Wealth sharing" or "revenue sharing" (*win ngwe kwe we mu*) has also been discussed in Myanmar's peace process, where some stakeholders say it has been supported by both government representatives and ethnic armed groups (EAGs) "in principle."[3]

Any discussion of wealth sharing in Myanmar relates to three, key, ongoing policy processes: an expansion of investment in the extractive industries accompanied by a push for transparency of revenue flows; proposed political/constitutional reform; and peace negotiations between the central government and non-state armed groups. This briefing provides a preliminary map of some known and unknown areas in natural resource governance in the hope of informing ongoing discussions.[4]

1.1: Framing the debate

It is important to distinguish between the two main policy issues explored in this paper: first, how to effectively manage resources and natural resource revenue, and second, how to share revenue (whether or not from natural resources) with subnational/local governments. Several broader points should be emphasized regarding natural resource management in Myanmar:

1. Myanmar relies heavily on natural resources as a percentage of total government revenue: This means that any line-ministry spending in the states and regions, or transfers from national to subnational governments, are already to some extent transfers of natural resource wealth.

2. Revenue from resource extraction goes uncollected: Unless revenues are collected from resources and used well, extraction and selling of resources does not benefit the country.[5] Moreover, tax holidays and enforcement gaps create many legal and illegal paths for resources to leave Myanmar.

3. The extent of resource endowments, rates of use, and impacts are unclear: Myanmar's proven reserves of natural resources are significant, but unproven energy reserves or new discoveries of mineral wealth could alter expectations. Informal extraction, especially in logging and mining, also makes depletion rates an unknown. At present, the environmental, social, and infrastructure costs to the country of resource extraction are not systematically measured.

4. Resource revenues should be saved or invested for the future: As a rule, natural resource revenues need to

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1 According to the Framework for Economic and Social Reforms, the government has initially decentralized 24 departments and agencies to be governed under the directives of state and region governments. In August 2013, the president ordered some Union responsibilities to be shifted to the state and region governments.

2 Wennman, A. (2012). "Sharing Natural Resource Wealth During War to Peace Transitions." In *High-Value Natural Resources and Post-Conflict Peacebuilding,* ed. Lujala and Rustad. Routledge. London: Earthscan Publications.

3 Interview, advisor to peace process.

4 In defining a "natural resource" for the purposes of this research, the authors focused on mining and gems, oil and gas, timber, and hydropower.

5 Humphreys, M., J. Sachs, and J. Stiglitz (2007). "Future directions for the management of natural resources." *Escaping the Resource Curse,* 322-336. Columbia University Press.

be saved for future generations, or invested in human capital or to support diversification of the economy, to ensure that resource wealth is used strategically in the long term.[6]

1.2: Wealth sharing and decentralization of natural resource management

Supporters of decentralization argue that it can deliver important benefits in terms of responsiveness and effectiveness, following the logic that the state/region government is closer to the people than the Union government. Conversely, evidence from other countries demonstrates that decentralization is very "risky and difficult in practice."[7] For example, decentralization has not been shown to help service delivery to the poor in most cases. When it has helped, as in the Indian states of Kerala and West Bengal, "positive outcomes are mainly associated with strong commitment by a national government or party to promoting the interests of the poor at a local level."[8]

Table 1: Aims, principles and considerations

1. Addressing environmental, social, or other costs	Costs from mining and extractive industries can be significant. A study in Ghana found that agriculture productivity decreased by 40 percent near mining areas, relative to areas further away.[9] In Myanmar, environmental, health, and social costs of natural resource extraction are not yet systematically measured. These are part of the cost of extraction — compensation is about bringing communities back to the baseline level; it is not an added "local benefit." Costs may also be indirect and felt outside of producing regions, as when, for example, natural resource exports cause the exchange rate to rise, hurting farmers in resource-poor regions.[10]
2. Administrative efficiency	According to a rule known as "subsidiarity," matters should be handled by the least centralized competent authority to improve responsiveness and effectiveness.[11] For example, in Myanmar, the public works department does not need to contact Nay Pyi Taw to clean the streets of municipalities.
3. Regional equity	When resource-producing regions are also poor, sharing resource revenues can be one way to address regional inequity, as it was intended to do in Aceh, Indonesia. However, resource revenue sharing can also worsen inequities: In Peru, a tax that gave certain municipalities an automatic share of revenues has created inequities between them.[12]
4. Peace processes and regional disputes	Wealth-sharing agreements allocating a share of resources to subnational governments have been set up in Indonesia, Iraq, the Philippines, and Sudan, among other places.[13] In peace processes, wealth-sharing agreements can demonstrate willingness to compromise. However, sudden increases in revenues without oversight and responsibilities for expenditure can also increase the risks of conflict.
5. Regional derivation	Often, "local communities view natural resource wealth as a heritage that must be preserved; thus, those who are selling off their heritage deserve a fair share of the revenues."[14] For example, indigenous populations in the United States and Canada have special rights to the resources from their areas.

It is important to consider the aims and principles behind any wealth-sharing policies or other decentralization of natural resource management, as different policies will be appropriate to achieve different goals. Table 1 presents some potential principles.

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[6] Van der Ploeg, F., and A. Venables (2012). "Natural resource wealth: The challenge of managing a windfall." *Economics*, 4.

[7] Balázs, E. and H. Blöchliger (June 2013). *Decentralisation and Economic Growth – Part 2: The Impact on Economic Activity, Productivity and Investment.* OECD Working Papers on Fiscal Federalism.

[8] Crook, R. C. and A. Sverrisson (2001). "Decentralisation and poverty-alleviation in developing countries: a comparative analysis or, is West Bengal unique?" IDS Working Paper 130. Brighton: Institute of Development Studies.

[9] Aragon, M. and J. Rud (April 2013). "Modern industries, pollution and agricultural productivity: Evidence from Ghana." Working paper. The International Growth Centre.

[10] Conflict also generates heavy costs for Myanmar, both to locals in conflict-affected areas and to the country as a whole.

[11] Nixon and Joelene (2014).

[12] Jungbluth, Werner. (October 2012). "Spending Wisely: Helping Peruvians Manage Resource Wealth." New York: Revenue Watch Institute

[13] Agustina, *et al.* (March 2012). "Political Economy of Natural Resource Revenue Sharing in Indonesia." In paper submitted to a conference on Alternative Visions for Decentralization in Indonesia, Jakarta (12-13).

[14] Wennman, A. (2012).

Mechanisms and evidence from other countries

Revenue sharing is one way to share benefits with local communities, but it is not the only way. Other methods include creating incentives to hire local workers (local content requirements), investing in local development, and distributing revenues directly to the population.[15] For revenue sharing with subnational governments, there are several options.

First, one might design a system of general revenue sharing or fiscal decentralization, combined with compensating certain states/regions or groups for the indirect or direct costs they bear due to natural resource development. In this case, the government would treat natural resource revenue like any other kind of revenue.

Second, one might treat natural resource revenue as something special for fiscal decentralization, for example by identifying specific taxes or royalties as payable to local governments of the areas where the resource is located. This approach requires motivation beyond costs borne by the subnational areas (such as regional political concerns).[16]

Transfers from the central government are the primary source of revenue for most subnational governments around the world. They can include all types of revenue, or treat natural resource revenues separately.[17] Of the 58 resource-rich countries in the Natural Resource Governance Institute's Resource Governance Index, 30 "have revenue-sharing mechanisms whereby national governments transfer natural resource income to state, regional, and local governments."[18] Where there is natural resource wealth sharing, "the transfer does not have to be of all resources, as some resources may be reserved for national purposes or to make equalizing transfers to less advantaged regions."[19] Where subnational governments receive funds specifically from natural resources, they may:

- Levy some taxes directly on the resource industry.
- Receive a direct transfer from the central government that is a defined share of the revenues originating in the region.
- Receive indirect transfers – through the national budgeting process – that reflect preferential treatment for producing regions.

Sometimes these arrangements share between the central government and the producing region (vertical sharing). Sometimes resource revenues are divided among all regions (horizontal sharing). In the Philippines, tax revenues and natural resource revenues are distributed among different levels of local government according to an allocation formula that includes population and other factors.[20] Indonesia developed a complex system in which natural resource revenues are shared with subnational entities according to a formula.[21] Because of concerns over inequity between regions, general fiscal transfers are also used to equalize the total budgets of the subnational units. Many Myanmar policymakers interviewed cited Indonesia as an example to emulate – perhaps because, like Myanmar, Indonesia has a variety of resources, which are widely distributed. However, a key point is that the design of fiscal decentralization arrangements in Indonesia has evolved over time.

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[15] Natural Resource Governance Institute. "Subnational: Harnessing Oil, Gas and Minerals for Local Development." Accessed 15 May 2014. http://www.resourcegovernance.org/issues/subnational

[16] Email communication, R. Conrad, Duke University. 30 April 2014.

[17] In Brazil, Ghana, Indonesia, and Nigeria, there are two separate intergovernmental transfer programs: a general tax pool transfer, and a separate, derivation-based transfer that applies only to mineral, oil, or gas revenues. In Canada, the United States, and South Africa, there is only a general transfer. Bauer, Andrew (2013). "Subnational Oil, Gas and Mineral Revenue Management." Natural Resource Governance Institute.

[18] Bauer, Andrew (2013).

[19] Nixon, H. and Cindy Joelene. 2014. "Fiscal Decentralization in Myanmar: Towards a Roadmap for Reform." Subnational Governance in Myanmar Discussion Paper Series. MDRI-CESD and Asia Foundation.

[20] International Monetary Fund. (August 2012). IMF Country Report No. 12/219. "Philippines: Reform of the Fiscal Regimes for Mining and Petroleum" 43. http://www.imf.org.gate2.library.lse.ac.uk/external/pubs/ft/scr/2012/cr12219.pdf

[21] Agustina *et al.* (March 2012).

TWO: NATURAL RESOURCES AND SUBNATIONAL GOVERNMENTS IN MYANMAR

2.1: Background

To date, Myanmar's natural resources have been predominately managed and taxed by the central (Union) government through line ministries and the state-owned enterprises (SOEs) under them.

Article 37 of Myanmar's 2008 Constitution states that the Union:

(a) is the ultimate owner of all lands and all natural resources above and below the ground, above and beneath the water and in the atmosphere in the Union;

(b) shall enact necessary law to supervise extraction and utilization of state-owned natural resources by economic forces.

During the ceasefire period of the late 1980s and early 1990s, increased extraction of natural resources was reported in the ceasefire areas, particularly mining and logging in Kachin, Shan, and Kayin States. The Myanmar government began the export of natural gas to Thailand in 1998, with the construction of the Yadana and Yetagun pipelines. The highly overvalued official exchange rate during this period "meant that the true value of the income of state economic enterprises did not appear in government accounts, with this problem being particularly acute for SOEs operating in the gas and oil industries."[22] The controversies of this period remain prominent in the public discourse regarding future natural resource management and revenue.

The government's reform agenda under President Thein Sein has emphasized the natural resource sector in several ways. The Framework for Economic and Social Reform, drafted in 2012, states a commitment to transparency and equitable sharing of benefits from natural resources.[23] The government has established a working group to improve public financial management, and Myanmar has submitted a candidacy request to the Extractive Industries Transparency Initiative (EITI).[24] As a member of EITI, Myanmar would be required to report on all payments made by companies and received by government, which would help to map revenues from Myanmar's natural resources, but would not directly address the management concerns. Transparency is also important as Myanmar is in the process of privatizing and/or corporatizing many of its SOEs.[25]

2.2: Sources of uncertainty and challenges

Despite steps towards greater transparency, mapping responsibilities for resource extraction and revenue flow in Myanmar remains an exercise in patching together available information and identifying gaps. Myanmar was ranked last on the 2013 Resource Governance Index,[26] a measure of transparency and accountability in the oil, gas, and mining sectors. There are several sources of uncertainty, including the following "known unknowns":

Composition, extent, and distribution of the resource endowment: Exploration for oil, gas, and mineral deposits is underway. Proven reserves of natural gas are set to come on stream in the next few years, but the size of potential discoveries is unknown.

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[22] The Asian Development Bank (2015). "Fiscal Management in Myanmar." ADB Economics Working Paper Series, no. 434, June 2015. http://www.adb.org/sites/default/files/publication/161213/ewp-434.pdf

[23] Framework for Economic and Social Reforms, The Republic of the Union of Myanmar.

[24] The EITI is a process, not a treaty or a law. EITI is based on (1) disclosure, allowing the payment records of companies and revenue records of governments to be reconciled by an independent third party; and (2) the establishment of multi-stakeholder groups, intended to generate civil society involvement and foster public accountability. Adapted from The Asian Development Bank (2015). "Fiscal Management in Myanmar" ABD Economics Working Paper Series. "Myanmar moving towards the EITI." 2014. MEITI Website. https://eiti.org/news/myanmar-moving-towards-eiti

[25] Corporatization is the process of turning the state's assets and liabilities into a corporation, with the government retaining at least majority, if not full, ownership.

[26] Natural Resource Governance Institute. 2013. Resource Governance Index.

Informal, formal, and mixed extraction practices: The level of informality varies between sectors. Due to the nature of extraction and investment, oil and gas are increasingly formalized, whereas informal extraction (i.e., smuggling) has been estimated to vastly exceed formal extraction in sectors such as jade and timber. However, there are also grey areas, which are pervasive in many parts of the extractive industries – for example, when registered and licensed companies engage in "negotiation" over assessments of tax liability.

Contested areas, parallel administrations, and militias: In some areas contested or controlled by non-state armed groups, parallel systems of resource governance exist.[27] Some, but not all, of these are codified, with licenses issued by parallel administrative bodies. These systems can conflict, overlap, or coexist with those of the Union government ministries and military. "Border guard forces" and pro-government militias are also reportedly active in the extractive sectors.

Military companies: Military-owned companies and holding groups such as Myanmar Economic Corporation are heavily invested in the extractive sector.[28] Given that mining sites are often located in areas affected by conflict between the *Tatmadaw* and non-state actors, the military has vested interests in maintaining control in such areas. This can stoke violence and diminish prospects of peace, with significant implications for the peace process. Further, the opaque nature of military operations can increase risks of corruption and human rights abuses.

Amount and flow of revenues: The Union government only discloses its formal revenue collection according to the contributions of each ministry to the budget. The disaggregated budgets of SOEs, audit responsibilities, and the procedures followed in practice are not always clear. Where state/region governments have taken initiative to set their own natural resource policies, the legal and practical limits of their role and that of the Union are still being set.

Impact on the environment and local communities: There is currently little or no systematic monitoring of the impact of extraction on the environment or local communities, though the Environmental Law will provide a legal framework to require environmental impact assessments for some resource development. Data about revenue flows from formal extraction are necessary to analyze the impact that wealth-sharing policies might have on economic growth and service delivery to those in need.

2.3: The legal and administrative framework

A recent legal review report provides a thorough analysis of the legal framework for the EITI in Myanmar.[29] The report notes that in addition to the relevant laws governing each sector, "rules and regulations" and "notifications" from the executive branch also determine resource governance. Within departments, procedures followed and longstanding practices sometimes are not codified in law. At a local level, people frequently "are not aware of the existing law" and "only know about customary law,"[30] which often governs local management practice.[31] As Myanmar undergoes rapid reforms, multiple laws may sometimes cover the same sector without harmonization.

There are sometimes areas of overlap between administrative responsibilities, for example when a mine site is in a "designated forestry area."[32] The Asian Development Bank's sector assessment reports that "energy sector activities are scattered among seven ministries: within each ministry, the functions of policy,

[27] Joliffe, K. (2014). *Ethnic Conflict and Social Services in Myanmar's Contested Regions.* The Asia Foundation.

[28] As of the 2011-12 fiscal year, UMEHL, MEC, and MDI (Myanmar Defence Industries) were recorded paying fees/taxes to the Ministry of Mines for limestone, coal, copper, quartz, iron ore, and marble, operating sites in Shan, Mandalay, Kayin, and Tanintharyi. (Interviews, sector specialists and policymakers).

[29] Tun, M. (2014). "The Extractive Industries Transparency Initiative in Myanmar: Legal Review Report." Baker and McKenzie.

[30] Interview, Chin civil society organization.

[31] European Forest Institute (2011). "Baseline Study 4, Myanmar: Overview of Forest Law Enforcement, Governance and Trade." http://www.burmalibrary.org/docs15/Forest_Trends-Overview_of_Forest_Law_Enforcement-en-red.pdf

[32] Interview, Ministry of Environmental Conservation and Forestry. Interview, Ministry of Mines.

regulation, implementation, and operation exist." Administrative reforms may include "functional reassignment" for greater efficiency, and as laws relating to these sectors are amended, areas of overlap should be reduced.

2.4: Significance of natural resources revenues

Myanmar has a wide variety of natural resources distributed across the country. The recorded value of exports of gas, oil, coal, jade, gems, metals, and wood made up about 70 percent of national exports, or about 10 percent of GDP in 2012-13.[33] Natural gas revenues "represent the largest source of foreign income for the government."[34] Natural resource-related payments comprise both tax and non-tax revenue.[35] The exact share of Myanmar's revenue deriving from natural resources is difficult to measure because (1) tax revenue collected by the Internal Revenue Department (IRD) includes taxes paid by companies in the extractive sector and tax payments from SOEs, as well as taxes unrelated to natural resources; (2) SOE revenues from loss-making and profit-making enterprises are aggregated at the level of the supervising ministry, making it hard to tell how much loss or profit each enterprise makes; and (3) payments, royalties, and fees collected by Union line ministries and subnational entities are not all uniformly recorded and made public.

Table 2: IRD targets for tax collection on state-owned resources 2014/15 (million kyat)[36]

Tax	Ministry	Target
Land tax	Home Affairs	0.89
Water tax	Agriculture and Irrigation	1,016.54
Dam tax	Home Affairs	0.03
Taxes on extraction of forest products	Environmental Conservation and Forestry	1,848.06
Tax on mineral resources	Home Affairs	7.45
Fishery tax	Livestock, Fisheries, and Rural Development	1,083.70
Tax on rubber	Environmental Conservation and Forestry	0.50
Tax on oil and gas extraction	Energy	329,343.27
Tax on minerals and gems	Mines	1,400.00
Tax on power generation	Electric Power	11,460.00

Source: MDRI-CESD translation from the *Mirror* newspaper, 14 April 2014.

According to International Monetary Fund calculations, tax revenue from all sectors in Myanmar for 2013-14 made up only 4.4 percent of GDP, among the lowest in the Southeast Asian region.[37] For comparison, in 2012, Cambodia collected 11.6 percent of GDP in tax, Thailand 16.5 percent, and the Philippines 12.9 percent.[38] It is not clear what share of Myanmar's tax revenue comes from the taxes paid by SOEs, most significantly the Myanmar Oil and Gas Enterprise, or from private companies active in the extractive industries. Although not all SOEs are involved in the

[33] World Bank (October 2013). "Myanmar Economic Monitor."

[34] Myanmar Centre for Responsible Business (March 2014). 'Oil and Gas Sector-Wide Impact Assessment' PowerPoint presentation. http://www.myanmar-responsiblebusiness.org/news/summary-march-2014-swia-consultation-meetings.html

[35] Agustina, *et al.* (March 2012).

[36] The tax on telecoms, included in the published table, is omitted here.

[37] International Monetary Fund. Myanmar budget data. "Summary Operations of the Non-Financial Public Sector."

[38] World Bank. World Development Indicators. http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS (accessed 4 June 2014).

extractive industries, the most profitable are, including those under the Ministry of Energy and the Ministry of Mines. Their profits effectively subsidize loss-making SOEs such as those under the Ministry of Electric Power.

Though the bulk of natural resource taxes are collected via the relevant line ministries, other entities also collect tax. The General Administration Department of the Ministry of Home Affairs collects some taxes (see Table 2).[39] Some taxes are collected directly by state and region governments under Schedule Five of the 2008 Constitution. In addition, some individual state or region governments have established their own fees or taxes related to natural resources.[40] Private companies and SOEs are required to pay corporate income tax (also known as "profit tax") at a rate of 25 percent of profits.[41] This is paid to the township officer of the Internal Revenue Department where the company is headquartered, not necessarily near the extraction site.

Some companies, but not all, make "corporate social responsibility" (CSR) payments. Such spending does not go through the state/region budget. At times, this has led to some confusion about the responsibilities of government regarding CSR projects, and how spending decisions should be made.[42] For example at Letpadaung Copper Mine in Sagaing, a joint-venture with investment from the military-owned Union of Myanmar Economic Holdings Limited, the Chinese Wanbao Corporation spent US $1.8 million on CSR projects in 2013. It is contractually obligated to contribute at least US $1 million each year as local CSR spending, to be replaced by two percent of profits once the mine becomes operational.[43] These payments were established during contract renegotiation following protests from local communities and a report from an investigative commission. The fund is not part of the Sagaing Region budget, and it is not clear how spending decisions will be made.[44]

2.5: Environmental law

Myanmar's 2008 Constitution includes important references to environmental conservation and sustainable development. Section 390 provides that "every citizen has the duty to assist the Union in carrying out the following matters: (a) preservation and safeguarding of cultural heritage, (b) environmental conservation, (c) striving for development of human resources, and (d) protection and preservation of public property."

The Environmental Conservation Law 2012, Myanmar's main environment law, provides basic principles and guidance for integrating environmental conservation into the nation's development, though many of its rules and procedures are still being finalized.[45] The Environmental Conservation Law requires the development of implementing regulations. The first regulations that have been prepared will give effect to the law's environmental impact assessment (EIA) provision for economic development activities involving natural resources in Myanmar.[46] The EIA system dovetails with the Foreign Investment Law's process for considering investment proposals from foreign entities.

In 2012, a new department, the Environmental Conservation Department (ECD), was added to the Ministry of Environmental Conservation and Forestry. The ECD is responsible for environmental policy, and subnational ECD offices are being created around the

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39 Arnold, M. and Kyi Pyar Chit Saw (2014) *The General Administration Department: An Overview of the Administrative Backbone of Myanmar.* Subnational Governance in Myanmar Discussion Series. MDRI-CESD and the Asia Foundation.

40 Arnold, M. and Kyi Pyar Chit Saw (2014).

41 Myanmar Union Budget Law, 2013-14. (Pyidaungsu Hluttaw Act – 20 / 2014).

42 Myanmar Centre for Responsible Business (2014).

43 "Kidnapped: A Chinese miner tries to be nice." *The Economist* (24 May 2014) http://www.economist.com/news/business/21602719-chinese-miner-tries-be-nice-kidnapped.

44 Myo Zaw Linn (16 July 2013). "Commission approves contract giving govt larger share of Laptadaung profits." *Democratic Voice of Burma.* http://www.dvb.no/news/commission-approves-contract-giving-govt-larger-share-of-laptadaung-profits/29945.

45 Environmental Conservation Law 2012, s3.

46 Environmental Conservation Law 2012, s7(m).

country at district and township levels. Its rollout presents an opportunity to consider how best to share institutional responsibilities, both among the ECD offices at various levels, and with state, region, and local governments.

2.6: Subnational government budgets and revenue collection

Myanmar's 2008 Constitution sets state and region governments' authority to legislate and tax some limited areas of natural resource governance, such as salt and less-valuable forest products, as listed in Schedule Two. Schedule Five lists the taxes that are collected by states and regions, and those from natural resources are also relatively minor.

Additional decentralization of some natural resource-related functions has taken place (1) via the transfer of some responsibilities to state/region governments by the Union ministry side, and (2) through new legislation or orders from individual state/region governments themselves. Though the scope of these changes has been limited, the administrative structures and natural resource management responsibilities of subnational government are important, as they form the beginnings of institutions and structures for managing natural resources. The stated rationale for these changes has been efficiency – that subnational governments are "closer to the people" than the Union government, and can be more responsive.[47] The current trend in Myanmar has been to simply *deconcentrate* revenue collection without aligning incentives through *devolution*.[48] State/region budgets are composed of both "own-source revenue" from taxes, fees, and SOE payments, and grants and loans from the Union government.

The overall state/region budget is decided through a process of proposals and negotiations between the states/regions and the Union, starting from the level of deficit between local revenues and expenditures and past patterns. Yet for most types of own-source revenue, additional revenue collection in the state or region does not appear to increase the state budget. This separation of political control of natural resource revenues from the point of collection of revenues removes the incentive for subnational governments to increase collection efficiency.

2.7: Recent changes and proposed reforms

Following deconcentration, as opposed to decentralization, the pattern of change has been to transfer an entire department (such as the State Forestry Department) or SOE to the state/region level and the state/region budget, while maintaining reporting requirements to the line ministries.

Proposed revisions to the 1994 Myanmar Mines Law include the transfer of responsibility for licensing small-scale mines to the state and region level. Under the proposed amendments, responsibility for licensing small-scale and artisanal mines would fall to state/region governments or self-administered zones, while revenues from these mines would be deposited in the Union Ministry of Mines account. Some state/region governments and *hluttaws* had previously advocated for small-scale mining to be transferred, and said they would welcome the change.

One Shan State official stated, "There are many illegal mines that we will manage better and could generate revenue for the state government." However, others have expressed concern about a lack of accountability.[49] Unless small-scale mining is clearly defined, and measures are implemented to support the process, these transfers could create perverse incentives. For local governments to collect effectively, they should be able to retain what is collected without decreasing their other sources of support. Where the discretion to issue licenses and the benefits of good enforcement are separated, corruption has a tendency to flourish.

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[47] Interviews, Kachin and Shan State governments.

[48] In *devolution*, powers are transferred to local governments with significant autonomy. In *deconcentration*, lower administrative levels are given more authority or discretion but remain accountable to the center.

[49] Interview, Shan civil society leader.

Though the Environmental Law sets a framework for closer environmental regulation, there are not yet institutions or staff in place to enforce regulation and to prevent environmental damage. Box 1 provides examples of where states have passed their own legislation or issued notifications regarding natural resources. This reflects a growing awareness among state/region leaders and some of their constituencies of the potential to generate revenues from natural resource wealth. However, individual initiatives will need to be well-coordinated to prevent distortions.

State revenue generation from natural resource wealth

- The Shan State government established its own Fund for Poverty Reduction and Environmental Conservation by decree of the chief minister. According to the state minister of forestry and mines, the fund has raised about 240 million kyat since its inception.[50] Mine sites pay a fee up front according to the size and type of mine. The fund is mainly used to provide microloans to farmers, which are disbursed by state cabinet ministers and leaders of self-administered zones.[51]

- The Kachin State *Hluttaw* is now drafting a state law to regulate cutting and polishing gemstones.[52] However, state *hluttaw* members explained that it would be difficult to do jade cutting and polishing within Kachin State, because the 1996 Myanmar Gemstone Law requires that jade mined in Kachin State be sold at the Jade Emporium in Nay Pyi Taw.

- In 2014, the Kachin State government began requiring gem-mining companies to contribute 10 million kyat each for construction of one of the main roads to the Hpakant jade mines.[53]

2.8: Civil society engagement

The establishment of subnational environmental agencies also represents an important development, which will have to be handled carefully to strengthen the enforcement of protections and improve accountability for the costs of resource extraction. In some countries, civil society groups have been able to act as checks on, and guides to, elected officials, and have increased the success of decentralized natural resource management programs.

If aspects of natural resource management in Myanmar will be devolved to the subnational level, then there needs to be a "demand side" for accountability at the local level and avenues for constituents to engage with subnational government, whether at the state/region or even the township or village tract level. There are some signs that this is developing and should be supported.[54] However, in many areas, the political landscapes of local media, civil society groups, and elected officials are just taking shape, and many powerful subnational actors are unelected and/or have dual accountability requirements. Some civil society groups participate in the Extractive Industries Transparency Initiative multi-stakeholder group alongside business and government representatives.

[50] Interviewees did not report exactly when the fund began or how the payments are administered.
[51] Interview, Mining Association of Southern Shan State.
[52] Interview, Kachin State Hluttaw members.
[53] Aung Kyaw Zin. (10 March 2014.) "Lawmakers demand legal clarity on gem-road fund." *Myanmar Freedom Daily.*
[54] Examples of "demand side" accountability include the suspension of Myitsone Dam in Kachin and the Letpadaung Copper Mine in Sagaing. Organizations advocate for greater local involvement in natural resource management decisions and enforcement of regulations to protect the environment and secure land rights.

THREE: POLICY CONSIDERATIONS

3.1: Trade-offs and risks

Natural resource governance presents many challenges, both for getting the incentives for resource management right, and for handling revenues. Without strong, accountable subnational institutions, national environmental regulation, and fiscal management processes, these risks are heightened.

Aligning central and local interests: Where benefits go to the center but costs are felt only in the local area, projects can go ahead that do not help the country. One solution is to devolve some of these decisions to subnational government, or ensure adequate representation/safeguards for the interests of states and regions in the central government's decision-making.

Aligning politicians' and populations' interests: There can be problems when local officials' incentives are not in line with those of the population. In Indonesia, decentralization of permission for timber extraction led to "local governments issuing as many permits as possible, with the goal of generating additional local revenue," resulting in excessive legal logging.[55]

Effect on informal extraction: The interaction of new policies at all levels of government with patterns of informal extraction is a key consideration. In Indonesia, a 2012 study found that different townships essentially competed with each other to attract illegal logging, lowering timber prices.[56]

Effect on formal investment: Private-sector stakeholders interviewed expressed concerns that "an ambiguous and contradictory legal/regulatory environment with different demands at different levels would likely deter investments that could benefit all parties."[57] On the other hand, conflict with local communities also presents a risk to investors.

Accountability: If natural resource wealth sharing delivers extensive funds to entities poorly equipped to manage them, there is an increased risk of corruption.[58] In other countries, complementary budget and infrastructure monitoring activities have supported subnational governments.

Capacity to tax: Where resource revenues have been shared through direct taxes or direct transfers, subnational governments have faced certain challenges and may need institutional capacity to administer complex types of taxes or to tax foreign firms. Yet decentralizing some tax collection and keeping own-source revenue can incentivize subnational officials to collect tax more effectively.

Capacity to budget: If a local economy is small and dependent on its resource base, it will not be insulated from changes in the international price of the resource (volatility). This means that changes in commodity prices can make it hard for subnational governments to plan their expenditure. Subnational expenditure responsibilities and capabilities must match the level of revenue.

Inequity and conflict risk: Depending on poverty levels in resource-producing and non-resource-producing areas, resource revenue sharing on a derivation principle could represent a payment from poorer to richer areas or from richer to poorer. Increases in inequity between states/regions can prove destabilizing and can increase the risk of conflict.[59]

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55 Siegle, J. and P. O'Mahony (2006). "Assessing The Merits Of Decentralization as a Conflict Mitigation Strategy." Paper for U.S. Agency for International Development, Office of Democracy and Governance. Bethesda, MD: Development Alternatives, Inc.

56 Burgess, R., M. Hansen, B. Olken, P. Potapov, and S. Sieber (2012). "The Political Economy of Deforestation in the Tropics." *The Quarterly Journal of Economics*, 127(4), 1707-1754.

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3.2: Conclusions

To date, the role of subnational governments in natural resource management, and their shares of natural resource revenue, have largely been addressed together in Myanmar, and sometimes conflated. Public debate so far has mainly not distinguished between the issues of natural resource concessions, revenues, ownership, and environmental impact. It is important that these distinct policy issues be identified.

As Myanmar undergoes simultaneous reforms, the future role of natural resource wealth is a major topic for discussion and potential collaboration. This discussion is particularly important given the serious risks and trade-offs involved. Further, any changes to natural resource management or revenue-sharing arrangements will also affect economic restructuring and political/constitutional reform.

Key policy considerations include:

The goals of natural resource governance and the range of available policy options: Consideration of natural resources and subnational governments in Myanmar should begin with a discussion about what goals new policies would aim to achieve. There are several different ways to achieve the goal of more efficient, inclusive natural resource management, or the goal of more independent fiscal authority for subnational governments. Wealth-sharing discussions so far have largely been seen as a zero-sum game with winners and losers, limiting the argument.

Simply increasing natural resource extraction does not help the country unless revenues are collected and used well to prepare for the day when resources run out. Stakeholders should consider the long-term goals of natural resource management. This could mean investment for future generations, spending on building "human capital," or other measures to enhance Myanmar's growth and diversify the economy.

Transparency and subnational communication channels: To understand the potential effects of natural resource wealth sharing, stakeholders need more knowledge of what is being shared and how it is measured. Current *ad hoc* information-sharing should also be routinized, and information should be easily accessible to policymakers within different branches and levels of government.

Increased transparency in resource management can help to build trust and to move public discussion about wealth sharing beyond debates about numerical splits – a zero sum game. If stakeholders can be reassured that management practices will be transparent and local concerns will be represented, they may be more willing to design a system for the use of revenues to maximize overall efficiency, rather than pushing for the greatest share of all decisions and of all revenues to be handled locally.

Legal regulation and implementation: The several separate laws pertaining to natural resource governance should be harmonized, and enforcement of these laws should be improved.

Measurement, mitigation, and compensation for environmental damage or other costs: Environmental, health, infrastructure, and social costs of natural resource extraction need to be systematically measured. State/region governments, local governments, and communities could play a role in these initiatives, perhaps via the state/region environmental conservation departments.

Natural resources, the peace process, and federalism: The landscape of armed actors in Myanmar is complex, and the relationship between natural resource extraction and conflict is far from straightforward. The situation varies in different areas, and incentives are likely to change from conflict onset through stages of fighting or ceasefires. In some areas of active fighting, natural resource smuggling has been cited as the proximate cause of clashes, though the facts are highly contested.[60]

[60] "Why Conflict Continues in Kachin State." *Eleven News Media* (21 April 2014).

Against a history of centralization and non-transparent practices, EAGs and political parties from both relatively resource-poor and resource-rich areas have all called for greater state and region government involvement in natural resource management and for wealth sharing. Ethnic national conferences held in the states have issued statements on natural resources, many of them citing the 1947 Panglong Agreement as precedent for a federal system. The rollout of the subnational ECD offices presents an opportunity to reform and streamline the fragmented governance system.

Careful sequencing in Myanmar's multi-layered transition process: Stakeholders in Myanmar's peace processes have identified natural resource revenue sharing and natural resource management as among the biggest issues of the political dialogue. Any changes to fiscal decentralization or resource-wealth sharing arrangements will have a strong bearing on the peace process. Under a government led by the National League for Democracy, there may be renewed energy behind political movements for reform of the 2008 Constitution. Interactions between the peace process and the simultaneous economic and political/constitutional reform processes will need to be considered, and resource-specific reforms should be well coordinated with broader fiscal decentralization. The sequence and process of discussing wealth-sharing arrangements must be carefully designed for the result to be seen as fair and representative of the people's interest.

FOUR: KEY QUESTIONS AND FURTHER READING

Discussion Questions

• • What steps should be taken to make information on resource management more easily accessible to policymakers and the public, to help build trust and understanding? Should information sharing between EAGs and the government of Myanmar be encouraged, and how?

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• • What policy considerations exist to ensure equity and conflict sensitivity in developing an appropriate formula for natural resource revenue sharing? What would be the role for peace process stakeholders in contributing to decisions on the formula for resource revenue sharing?

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• • What measures could be taken to create incentives for subnational governments to increase the efficiency of, and accountability in, revenue collection, and reduce rent seeking? What additional steps would be required to address informal extraction?

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• • What institutional capacity development would be required to address the challenges of natural resource governance if states and regions gain a larger role in subnational resource management and revenue collection?

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• • If responsibilities for resource governance shift, what bodies will be responsible for measuring and mitigating environmental impact? What measures can be taken to ensure that local people are adequately represented in these bodies?

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• • How can the potential destabilizing effect of mega-development projects be reduced? What special considerations exist in areas where EAGs operate?

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