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Betwixt ‘Burmese’ Cottages and Cronies: The Political Economy of ‘Myanmar Inc.’

*By Nick J. Freeman**

EXECUTIVE SUMMARY

- A critical component of the reform process is the creating of a competitive corporate community out of one that has previously been dominated by a relatively small group of ‘connected persons’. To date, the normal approach of many investors has been to try and largely work around such individuals and their assets, with some sanctions still targeting their business activities.
- But such an approach adds to the risks and transaction costs of investing in Myanmar, and as such, runs a real risk of being counter-productive. In cases where such ‘connected persons’ can be motivated to become responsible members of ‘Myanmar Inc.’, this should be encouraged.
- This is primarily because, for some time to come, they will offer some of the most effective delivery mechanisms for investment, job creation and income improvements

in the country. Capacity weaknesses in government institutions and the rest of the private sector in Myanmar mean that a pragmatic approach to business development – and poverty alleviation – is the best way forward.

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INTRODUCTION

It is widely recognized that Myanmar is in the process of attempting a root and branch transition; a transition of both its polity and its economic structures. From one of military dictatorship and thinly-veiled kleptocracy to that of partial democracy. And from a quasi-socialist economy to one that is more market oriented, albeit with Myanmar characteristics. Opinions tend to vary on the precise drivers, merits, scope, depth and likely prospects of this transition process. Regardless, something quite unique is occurring that will impact the economic fate of Myanmar's 50 million or more citizens. This includes the rather particular, indeed peculiar, business sector in the country, which is hopefully on the cusp of meaningful change. Not change for change's sake; but rather shifting to a level of capacity, competency and competitiveness that will allow the business community to generate jobs across the value chain spectrum.

Both the country's policy-makers and its development partners aspire to see a more robust and competitive corporate sector evolve that can help raise the incomes of Myanmar's large number of poor households. The challenge is: how do we get from here to there? While the goal may be relatively clear, the means of attaining it are less obvious. In particular, will an 'off the peg' and relatively well-established portfolio of economic reform and business liberalization initiatives – that have worked with some success in other Asian transitional countries – also work in Myanmar's case, or does something more tailored need to be pursued? Or does the fact that Myanmar is simultaneously pursuing political reform, peace and decentralization agendas, in parallel with that of economic transition, have a bearing on what should be attempted, and precisely how?

This brief paper argues in favour of the latter approach, despite the added transaction costs entailed. This stems from Myanmar's very particular recent history, and the legacy effects that still impact adversely on today's business enabling environment. While Myanmar's desired destination of economic modernity is essentially no different from that of virtually all other Southeast and East Asian transitional countries, the starting point is dissimilar. The political economy landscape of the country is quite distinct, as are the various policy levers that need to be gripped with firm intent if meaningful and positive change is to happen. A failure to be cognizant of this distinction risks not attaining the kind of impact on 'Myanmar Inc.' that is widely desired. Put simply, Myanmar's transition process is more than Vietnam's '*doi moi*' redux.

It is also important to keep in mind that economic transition in Myanmar is a *process* that will take time to enact. While business laws and regulations can be changed with the flick of a pen, their implementation and enforcement requires a build-up in institutional capacity, as well as a pragmatic and strategic approach.

THE CONTEXT: *CAVEAT EMPTOR*

A good starting point in any bid to sculpt a new corporate community is to take a sober look at the materials at hand, and with which to work. In this context, it is often said that a surprisingly small number – some suggest around fifteen – ‘connected persons’ and their families dominate large parts of the private sector, with highly diversified portfolios of business assets across a range of disparate business sectors.¹ They were able to create these conglomerates almost entirely because of their connections with the previous ruling elite, rather than through any particularly astute business acumen. Indeed, some observers would argue that such individuals are essentially rent-seekers, rather than value creators in the conventional sense of business endeavor. Their assets have been made to ‘sweat’ for their immediate cash flow-generating capabilities, rather than as vehicles in which to invest and thereby create robust and sustainable long-term businesses.

The networks that gave the ‘connected persons’ privileged access to resources and rare business licences, and in some cases allowed them to carve out oligopolies or monopolies, did not wholly evaporate with the advent of the current administration. To varying degrees, these contacts remain a reality of conducting certain kinds of investment and business in today’s Myanmar. In some cases, those special connections have morphed into different kinds of elite networks, but they remain something of a ‘connected party fortress’, for which the high barriers to entry remain beyond the abilities of most (unconnected) businesses that find themselves on the outside.² To take the fortress analogy further, while various stakeholders would claim to see the ‘connected persons’ being under siege at present, their battlements remain surprisingly intact, if not as impregnable as once seemed the case.

In addition, largely sitting under two military-run holding companies are several hundred business entities, along with a smaller number of State-owned enterprises and commercial banks. Some of these entities are loss-making, while others are lucrative, depending largely on the relevant sector and the way they are managed. For the more profitable ones, these business activities serve as a useful source of additional operating revenues, given the thin tax base of the country and the paucity of the State budget. Turning to those businesses on the ‘outside’, there are perhaps a quarter million or more cottage, household and small-scale enterprises; some formally incorporated and many more that are quasi-informal. Finally, there is a small but burgeoning number of foreign investors, clustered around a handful of the more attractive sectors currently (partially or wholly) open to overseas capital inflows, such as minerals extraction and energy, telecommunications, tourism, garments and some financial services.

¹ See Stuart Larkin ‘Myanmar at the Crossroads: Rapid Industrial Development or De-industrialization’, Paper, January 2012. Larkin labels the country’s best connected businessmen with their large family-owned conglomerates as the ‘Biz-15’. Other collective nouns used include ‘cronies’ and ‘proxies’.

² It is interesting to note the role played by some Business Associations in certain sectors, and their membership profiles. In some business sectors they perform roles that are usually kept within government.

Into this corporate sector environment feeds the legacy of economic and financial sanctions that have either been wholly or partially lifted, suspended in some way, or remain in place. The main sanction that continues to be imposed on Myanmar is the US Treasury Department's embargo on any business conducted with individuals – and their assets – cited in the (regularly updated) Specially Designated Nationals (SDN) List.³ That list includes most of 'connected persons', along with all enterprises run by the military. As a sanction instrument, the SDN list has been highly impactful on the economy of Myanmar (and the economics of doing business in the country), if perhaps not in the way it was presumably intended.⁴ For example, most international banks effectively decline to conduct any transaction with a Myanmar-based entity, for fear of criminal prosecution in the US for falling foul of the SDN list, whether unwittingly or not. In February 2013, four local commercial banks – two State-owned and two private – were explicitly approved by the US Treasury for foreign transactions. To this day, however, a degree of confusion in the international banking sector surrounds this decision, and numerous international banks are taking no compliance risks by simply opting to forego any business related to Myanmar.⁵

Similarly, foreign investors must conduct relatively intensive due diligence to ensure that their local suppliers and other host country counterparts are also 'SDN-negative'. For US firms, anyone investing US\$500,000 or more in Myanmar – as well as any investment amount in the oil and gas sector – must adhere to additional reporting requirements of the Department of State.⁶ Here again, the restrictions entail higher transaction costs for those considering an investment in Myanmar, as well as adding to the compliance-related risks of doing so. This observation is not to suggest that foreign investors should be free from the obligation to behave as responsible corporate citizens in host countries in which they invest. But where the benchmark for those obligations is put at a higher level than in neighbouring Thailand, Bangladesh or China, for example, then Myanmar is put at a distinct disadvantage in attracting the kinds of FDI inflows that could generate significant numbers of jobs and raise incomes.⁷

³ US firms and individuals are prohibited from dealing with listed SDNs and any entities that are 50% or more owned by an SDN. The Treasury Department's Office of Foreign Assets Control (OFAC) publishes a list of SDNs, with the most recent iteration available at: <http://www.treasury.gov/ofac/downloads/crylst.txt>. The SDN list is regularly revised, with 12 revisions made in the final two months of 2014 alone.

⁴ Some US firms are alleged to have found ways to go around the sanctions. See 'US Firms Skirting Myanmar Sanctions Fuel Record Investment'. Bloomberg, 17th November 2014.

⁵ The Central Bank of Myanmar recently issued nine foreign branch licences, all of which went to banks in the Asia Pacific region. Not one US bank was able to apply, and just one European bank applied (and failed). Banks that opted not to apply included such emerging market-oriented 'majors' as HSBC and Standard Chartered.

⁶ The State Department notes that "... the information collected [is used] as a basis to conduct informed consultations with U.S. businesses to encourage and assist them to develop robust policies and procedures to address a range of impacts resulting from their investments and operations in Burma." See: <http://burma.usembassy.gov/reporting-requirements.html>

⁷ Further, one might argue that if those firms in the international business community concerned about compliance are deterred from investing in Myanmar, then less desirable investors (ie. those willing to flout, ignore or side-step sanctions) will probably fill the gap created.

It would be disingenuous to suggest that Myanmar's economic problems stem from external factors, such as the legacy effect of sanctions. Many of the market failures and regulatory inadequacies that have cumulatively served to constrain the development of 'Myanmar Inc.' are homegrown. And the economic reform process entails in large part an attempt to address those constraints. There is much needed to be done in this regard, particularly in improving the enabling environment for business endeavour, and technical assistance provided to the relevant government agencies will be a major part of this approach. But the capacity of most government agencies in Myanmar is weak (and inversely proportional to the tasks that confront them), posing absorption issues that serve to limit what can be done and how quickly.⁸ It is with this lacuna in mind that development partners and other stakeholders should seek to galvanise other agents of positive change, in addition to the executive wing of the government. And this includes the private sector itself, including both local and foreign firms, where incentives and inducements can be carefully employed to catalyse initiatives that are not only commercially viable, and therefore sustainable, but also economically, socially and environmentally impactful.⁹

THE IMPLICATIONS FOR ECONOMIC REFORM: THE NEED FOR NUANCE

So what are the implications of all of this? First, given current concerns about being seen to work with 'connected persons', it is little wonder that so much emphasis is being placed on initiatives with 'unconnected persons': SME development, business clusters, start-ups and incubators for young innovators and the returning diaspora. And such activities are undoubtedly of utility. But achieving economic growth in this way will inevitably be a long-term exercise, notwithstanding any aspirations of development 'leap frogging'. The fruits from seeding, germinating and cultivating small-scale business will take a considerable period of time to ripen and be harvested. In the meantime, jobs need to be found for all those entering the labour force for the first time, or are already unemployed or under-employed, and incomes in rural communities need to be raised in order to bring millions of households out of poverty. That kind of 'heavy lifting' requires some considerable muscle – a point we will return to later – and cannot be left to small firms alone.

Crucially, some signs of restructuring and reform of the State enterprise sector is also evident, notably through tenders conducted for various much-needed transport, telecommunications and energy projects.¹⁰ After decades of under-investment in public goods, Myanmar's creaking infrastructure and utilities are in dire need of substantial public and private investment. Making State enterprises more commercially oriented and

⁸ Also see 'Too Much On' (Banyan piece), *The Economist*, 13th September 2014.

⁹ Indeed, various initiatives are being pursued in this regard, such as the multi-donor funded Myanmar Centre for Responsible Business and the Pyoe Pin Programme, to name just two, and merit further support.

¹⁰ Examples would include the recent tender for a new Yangon airport, as well as two mobile telecommunications licences, awarded to Ooredoo of Qatar and Nortel of Norway.

‘corporatising’ their business models may also be of utility, but some policy-makers in parliament hesitate to advocate for more strident privatization. Their reasoning is that with such business assets effectively off-limits to foreign investors, because of the domestic regulatory framework and remaining sanctions, the only prospective buyers with the financial wherewithal to consider such trade sales are ... you guessed it ... ‘connected persons’ and their businesses.¹¹ And if that should happen, then they fear asset stripping will be the order of the day, rather than injecting new investment capital and other inputs needed to ‘turn round’ loss-making State enterprises, or take viable State firms to a higher level of productivity. The spectre of an entrenched (Russia-like) oligarchy also hangs over the privatization issue. But with ‘unconnected persons’ unable to cumulatively make up an adequate universe of domestic investors to support a privatization campaign, then foreign institutional funds and overseas strategic investors provide the only other viable option.

Secondly, increased consideration needs to be paid to the issue of institutional capacity, or rather the lack of it. Not only are most companies in Myanmar small, but the institutional depth and acumen of government agencies is also weak. This adversely impacts on what the government can reasonably be expected to do in terms of implementing the legal and regulatory framework for business, and enforcing it, let alone working to foster a conducive business enabling environment for private sector development, or help catalyse entrepreneurship and innovation. In this context, various pertinent laws may get revised for the better, but the implementing regulations needed to give such legislative reform real meaning are often absent. Thus, some government agencies continue to act as before, for want of clear instructions on what precisely they should now do differently. Laws may have changed, but actual practices have not.

This is not to suggest that the promulgation of a revised company law, the merging of the two investment laws, and numerous other legislative initiatives are not without merit. On the contrary; they are important milestones on the new economic journey that Myanmar has embarked upon. But without the ability to translate the sentiments contained in these laws into implementable, enforceable and legally-binding deliverables that make ‘doing business’ in Myanmar easier, their utility becomes somewhat moot, or at least makes for an unclear – and therefore more risky – business-enabling environment.

Thirdly, this disconnect between the sentiments embodied in new laws and the daily realities faced by firms goes a long way to explain a divergence of sentiment in the business sector. While the international business community seems to be largely buoyed by the prospects of Myanmar’s ‘opening up’, and look quite positively at the various legal reforms that have been announced, their local counterparts discern less change in their day-to-day business activities, and thus are less sanguine about the reform process. Tellingly perhaps, while the aggregate scale of FDI inflow pledges is up markedly over the last two years, the rise in new

¹¹ Revisions are currently being drafted to the 1914 Company Act, as well as the domestic and foreign investment laws. However, at present, if a single share in a company is held by a foreign investor, then the company is automatically deemed to be foreign-owned, and therefore ineligible for various privileges that only domestic firms can enjoy, such as land ownership.

domestic company incorporations is less pronounced. Indeed, and as ironic as it may seem, some anecdotal evidence would suggest that the lifting of economic sanctions has not been an unalloyed piece of good news for some business communities in Myanmar. Established during the decades of semi-isolation, with business models based on a fairly insular domestic market, numerous firms have found it difficult to contend with a more liberalized economic environment. Greater inflows of imported goods that are cheaper and/or of better quality have served to undercut some domestic production, and as a result numerous firms are said to be struggling to survive or have seen their operations mothballed.

Much has been made of the likely impact of the impending ASEAN Economic Community in 2015, and whether or not Myanmar firms are adequately prepared for this development. But some observers would argue that parts of the local corporate community are already reeling from the effects of the past 2-3 years, let alone future regional initiatives. Little wonder, then, that elements of the business community have sought to put up a rear-guard action, lobbying to dilute or delay the liberalization of business laws and regulations that would potentially bring about even more foreign competition.¹²

Fourthly, there is virtually no non-debt financing (eg. angel, venture capital or private equity investing) available in the country. The only debt financing is mostly plain vanilla lending, typically no more than one year in tenor, and with onerous collateral requirements typically attached. There is virtually no trade financing available for exporters, little financial leasing activity, and no factoring. Little wonder, then, that most capital investment enacted by businesses has to be financed from their own modest cash flows, or through informal sources. As macro-economists would see it, the banking sector is failing in its primary role as a financial intermediary, channeling excess funds and idle savings to places where it can be best put to work. Instead, the banking sector in Myanmar largely comprises (mostly loss-making) State-owned commercial banks and private banks that are components of larger conglomerates. Such is the lack of public trust, that deposits are relatively small, while the capital base is weak, and some banks lack even the most basic internal systems. Governance practices are often poor, and systemic risk is real in Myanmar's banking sector, as memories of the 2003 banking crisis remain quite vivid in many peoples' minds. But it is the heavy hand of outdated regulations that are the greatest constraint to financial sector development in Myanmar, particularly for smaller firms in need of funds but typically lacking in the onerous collateral requirements demanded by law. Meanwhile, a number of government agencies have sought to establish 'policy banks' intended to provide special help to firms in their respective bailiwicks.

Fifthly, the establishment of an elected parliament is undoubtedly a welcome development, notwithstanding the Constitution's stipulation that 25% of all seats be ring-fenced for

¹² This was seen with preparations for the revised foreign investment law, where local business lobbies sought to ensure that the law was not too favourable towards foreign-owned business ventures. Similarly, the branch licences issued to foreign banks contain stringent restrictions on what kinds of business they may conduct, effectively shutting them out of both the local retail and corporate banking markets.

representatives of the military. A number of opposition parties, not just the NLD, are now represented in the lower house, as well as in 14 sub-national parliaments at the state and regional level, and their presence is quite likely to be even more pronounced after the national elections set for late 2015. But it will take time for the legislative arm of government to find its voice, and begin to steer the executive wing of the government more effectively on issues relating to economic development and business sector liberalisation.¹³

PROCEED WITH OR WITHOUT ‘CONNECTED PERSONS’?

Given all of the above, how then to proceed to best effect? As noted earlier, some serious muscle needs to be flexed if average incomes are to rise, and poverty levels are to fall across Myanmar, in a genuinely inclusive and sustainable fashion. As noted above, inclusive economic growth is needed to ensure that the ongoing peace process is not undermined by income disparities and economic marginalisation. This clearly entails a long-term strategy and a multi-decade roadmap of implementation, the funding requirements of which will be not inconsiderable. But there is a need for ingenuity as well as financial firepower in developing a robust and competitive ‘Myanmar Inc.’. And if that necessitates shifting away from some more established comfort zones of policy-making pertaining to development, then so be it.

It is in this context that a different approach to Myanmar’s ‘connected persons’ and their conglomerates should be given some serious consideration. In particular, a meaningful appraisal as to whether some of the ‘connected persons’ can actually play a positive role, primarily as willing delivery mechanisms in the pursuit of economic development and the creation of a robust corporate sector? And if so, would some be willing to take on this mantle? Tellingly perhaps, it has been reported that a number of ‘connected persons’ have already made overtures to the National League for Democracy (NLD) and other opposition parties, seeking to create political bridges.¹⁴ Some ‘connected persons’ would no doubt like to see their names and assets removed from remaining sanctions lists, and the ‘cost of omission’ would be to pursue meaningful inclusive business practices and corporate responsibility programmes. They would need to shift away from short-termist ‘sweating and stripping’ of assets, to one of strategic investment and more meaningful business endeavour. Tangible deliverables in this regard could be rewarded by removal from the SDN List.

But perhaps most importantly, as owners of some of the larger corporate entities in Myanmar, ‘connected persons’ are arguably best able to serve as local partners and suppliers to the growing number of foreign investors. And it is in this role that they are much better placed

¹³ Also see International Crisis Group, ‘Not a Rubber Stamp: Myanmar’s Legislature in a Time of Transition’. Asia Briefing No. 142, 13 December 2013.

¹⁴ In conversations this author had with economic advisors in the NLD, they recognised the merits of working with at least some ‘connected persons’, if they were willing to adopt better business practices, and as part of the wider reconciliation process. Also see Khine Win, ‘Inequality and the Need for Redistribution’, *The Irrawaddy*, 18th August 2014.

than most ‘un-connected’ firms to serve as host country conductors in the transfer of capital, technology, skills and other inputs that ‘Myanmar Inc.’ needs if it is to develop, and start making in-roads into overseas markets, as well as plugging into international production networks. If one takes a process-based perspective on Myanmar’s private sector development, then it will take time for mostly small and medium-sized ‘unconnected’ enterprises to attain the momentum and scale to begin to deliver the kind of employment demand that can satiate supply. And while that is gradually happening, there is a need to plug the gap.

This is not to propose that crony-related firms should be, yet again, the beneficiaries of largesse (this time from foreign investors, rather than from leadership connections), but rather to see them as vehicles through which economic advances can be attained in Myanmar. The aim is not to metastasize ‘connected persons’ and their business interests in the economy, but to consider them as potentially willing delivery mechanisms in the pursuit of economic growth and poverty alleviation.¹⁵ It would also serve to incentivize ‘connected persons’ to align themselves with – or at least not block – the transition process. And with the international business partners and other stakeholders insisting local firms adhere to best practices in areas such as labour and human rights, worker safety, corporate governance and social responsibility, environmental and social safeguards, then such an approach would also assist in reforming the corporate sector in Myanmar. There are obviously some downside risks entailed in such an approach, including whether connected persons can indeed make the shift from being simply owners of privileged business interests to something more akin to creating value by making astute investments. But surely that is preferable than turning a blind eye to their existence, and trying to work around them, as if they are the proverbial elephant in the room. And with the institutional capacity of government agencies to administer and enforce better business practices particularly weak, then a business environment strategy that entails ‘more carrot and less stick’ seems optimal.

Besides, to leave ‘connected persons’ marginalized and feeling imperiled will only increase the temptation for them to try and put a brake on the transition process at some point, and particularly to resist the kinds of market liberalization efforts that should support the development of a more competitive and successful corporate sector – the kind of corporate sector that can generate jobs. Their ability to potentially disrupt on-going development efforts, through various direct and indirect means, should not be discounted. There is no inevitability about where the country is destined to be in the years to come. The extent to which the once widely-lauded economic transition processes in neighbouring Laos and Vietnam have largely fizzled out in recent years, as the low-hanging fruit of economic reform

¹⁵ The World Bank’s recent Systematic Country Diagnostic notes that “... Myanmar today is one of the poorest countries in Southeast Asia. With a population of 51.4 million, the country has a per capita GDP of \$1,105, and the poverty rate is 37.5 percent, one of the highest in the region. Among ASEAN countries, Myanmar has the lowest life expectancy and the second-highest rate of infant and child mortality.” *Myanmar: Ending Poverty and Boosting Shared Prosperity in a Time of Transition*. December 2014.

are picked clean, and entrenched lobbies in the State enterprise sector and elsewhere have resisted the kinds of changes that would imperil their privileges, should serve as a salutary lesson in this regard. Aligning the economic interests of all key actors is an essential part of any reform process. It is obviously not the sole solution, but it could be part of the overall mix.

IN CONCLUSION

In this context, all stakeholders invested in achieving inclusive growth and equitable economic development in Myanmar need to be mindful of, not just correcting for policy errors and malpractices of the past and the long-term vision for the future, but also what can be done in the more immediate period. A greater sense of urgency is arguably required, as the country lacks the luxury of time to try and catch up with its ASEAN peers, and not become marginalized by falling further behind. If this requires adopting a highly pragmatic approach, as this brief paper would contend, then so be it. The simple points of focus should always be alleviating poverty in Myanmar, through inclusive and sustainable job and income creation, so as to attain improved livelihoods for all those living within the country's borders, irrespective of ethnicity, religion, and even past affiliations. The challenge is in identifying and harnessing the best delivery mechanisms to achieve the greatest positive impact, and thereby attain the goal as speedily and efficiently as possible.

In embarking on the current reform process, Myanmar's leadership took some bold risks. The international community should consider doing likewise. A good start would be to radically review and reduce the size of the SDN List; an economic sanction that this paper argues is no longer appropriate for the challenges currently facing Myanmar and its citizens. The country needs substantial capital inflows, FDI inflows and development partner aid flows, and where economic or financial sanctions serve to inhibit such flows – whether directly or indirectly – then their removal merits serious consideration.¹⁶ Ultimately, this issue is not about the 'connected persons' per se, but rather the millions of households in Myanmar that need to be brought out of poverty.

¹⁶ Some in the development partner community are (understandably) sensitive to the issue of being seen to benefit 'connected persons', particularly since the publication of the 'Trickle Town' article, by Aung Zaw, published in *The Irrawaddy*, August 2014, and the 'The Spoils of Aid in Burma: Transition a Boon for Former Dictators' article by Jonathan Hulland, also published in *The Irrawaddy*, June 2014.

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