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Private enterprises in fragile situations: Myanmar

Cormac Mangan

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Cormac Mangan is a former IGC Country Economist for Myanmar.

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Overview of state fragility and the private sector

1 Elements of Myanmar’s fragility and conflict dynamics

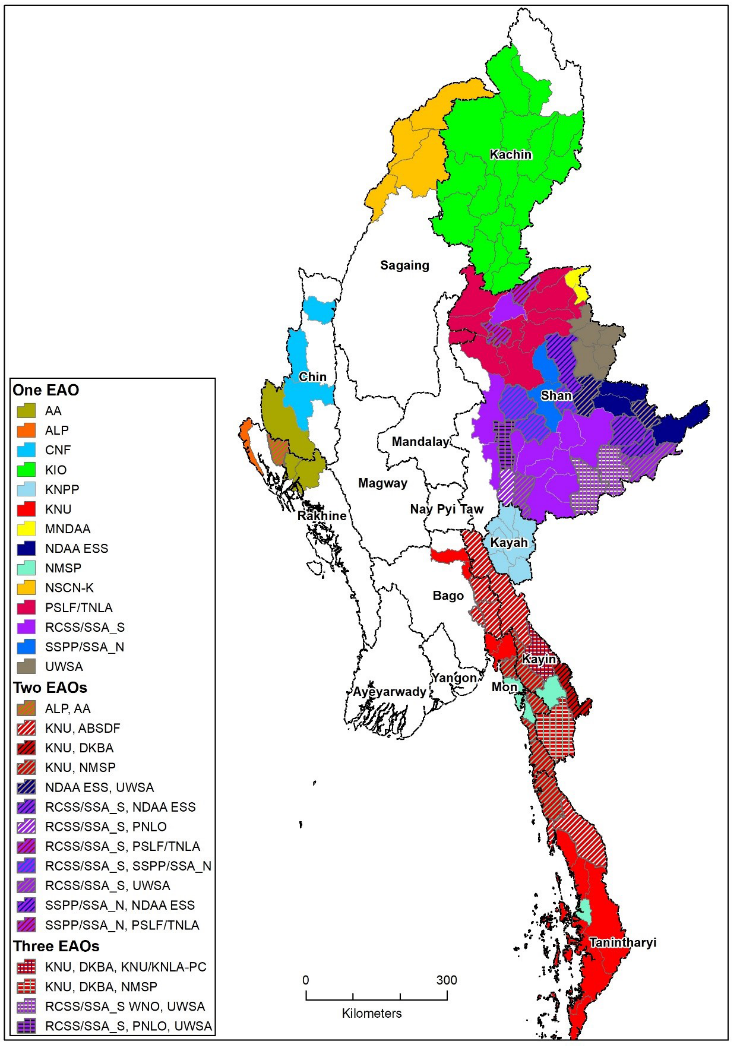
Myanmar has suffered decades of authoritarian rule, self-isolation, and the world’s longest protracted civil war – three elements at the core of the country’s fragility.

Long considered a pariah state, its trajectory in recent years highlights how characteristics of fragility evolve in response to largescale political and institutional change. In the early 20th century, many of the institutional preconditions for state-led economic growth were in place in British Burma. World War II and independence, however, precipitated the deterioration of the state apparatus and rise of domestic insurgencies. The challenge of state-consolidation under these circumstances proved overwhelming for successive democratically-elected governments and ultimately set the stage for a military intervention in 1958. Military rule, defined by repression and economic mismanagement, persisted in various forms until 2008, when the military government’s roadmap to a “flourishing-disciplined democracy” culminated in a new constitution enshrining joint military and civilian rule. Gradual political and economic liberalisation followed, although the military retain veto power over constitutional changes. In 2015, the National League for Democracy (NLD) won an overwhelming majority in the country’s first free elections of the modern era, entering a delicate power-sharing arrangement with the military. The military-led transition seemingly put the country on a path towards a quasi-democratic state, at the same time exposing the risks of a fast-liberalising complex political economy shaped by a legacy of ethnic conflict and colonialism.

While the political and economic transitions will continue to define the path of state institutions, in the long-run, Myanmar as a nation will also be sculpted by ethnic conflicts in the borderlands. Its central state is cushioned by territories that are either contested, governed autonomously, or co-administered by the state and an array of armed groups (Figure 1). Approximately one-quarter of the total population of Myanmar lives in townships that are affected to some extent by conflict (Burke et al. 2017). Some armed groups control effective mini-states that have a large economy and provide public goods and services to their populace. Others are no more than small-scale outfits engaged in illicit activities. Conflict is thus at the centre of Myanmar's fragility through both entrenching its borderlands in cycles of violence, war-based economies, and underdevelopment, and being employed by successive military regimes to legitimate and assert their control in the interest of national security. The vast natural resource endowments in conflict areas have long defined their economies, however, their strategic location connecting two of the world's most populous markets, China and India, is set to become increasingly important as they integrate within transnational infrastructure networks.

The regional dimension of armed conflict has resulted in highly heterogeneous political economy dynamics across different parts of the country. As such, perhaps the most important consideration when studying Myanmar is the plurality of fragile contexts within its borders. Its transitional critical juncture and multiplicity of contexts offer a unique case study from which to examine the characteristics of state fragility as they relate to the private sector.

Figure 1: Presence of armed groups in 2016



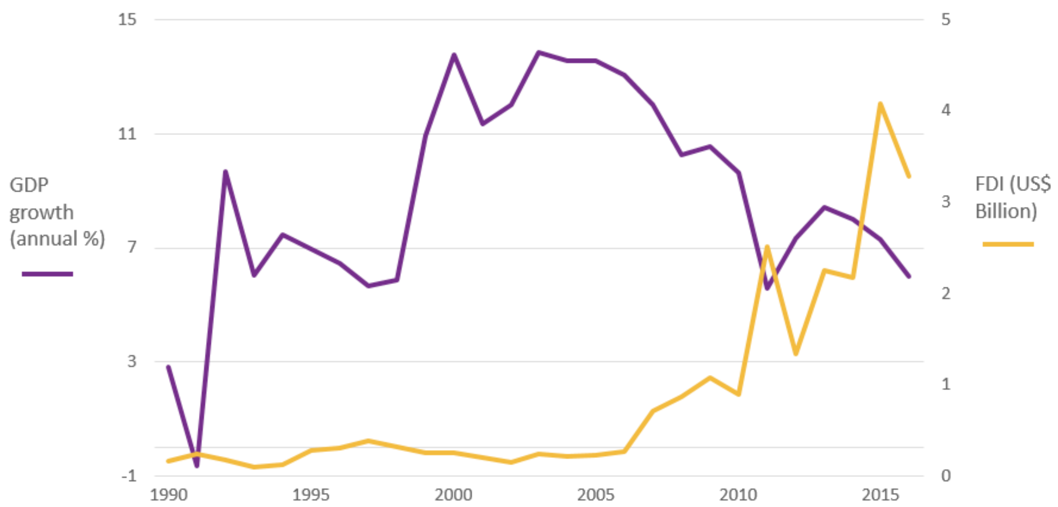
Source: Adapted from Burke et al. (2017)

From a planned economy to a state-dominated private sector

During the rule of successive military regimes, free enterprise was restrained in Myanmar. Post-independence governments implemented state-centric systems, stemming a dysfunctional economy shaped by weak institutions, autarky, and state ownership (Tin Maung Maung Than 2007). After the military seized power in 1962, they initiated 25 years of a Marxist-inspired system: the 'Burmese Way to Socialism'. A second coup in 1988 precipitated the dropping of socialism in favour of state-led capitalism. Market transactions were liberalised and a portion of the vast black-market economy that had developed during the socialist era started to come into the fold – business registrations jumped from 27 in 1990 to 23,848 in 1991 before levelling off (Kudo 2005). As private investment was legalised, it was nonetheless within a context where the state had been the central actor across all facets of economic activity for decades and the distinction between the state, military institutions, and the new private sector was tenuous. For example, all major foreign investments were required to enter a joint venture with military firms as a precondition to entering the Myanmar market.

As a result, the Myanmar economy exhibits many of the typical characteristics of a low-income economy in transition: Myanmar has a narrow production base and large informal sector, with natural resources, in particular gas, driving export and GDP growth since 1990. A historically poor investment climate characterised by trade restrictions, currency controls, and weak rule of law resulted in a high concentration of FDI in the extractive sectors where short-term rewards are typically high. From the start of the transition in 2011, FDI began to diversify on the back of structural reforms, the gradual lifting of sanctions and trade restrictions previously imposed by western countries, and a reduction in reputational risk for investors. Growth picked up, no longer solely based on natural resource exports, and increased from 5.6% in 2011 to 8.4% in 2013, before falling in 2016 to 6.1% as reforms slowed and the economy suffered a shock from flooding (Figure 2).

Figure 2: GDP growth and FDI in Myanmar 1990-2016



Source: World Bank

The fruits of this transition are, however, unequally distributed: a growing urban/rural divide has emerged as economic growth and its benefits are narrowly concentrated on urban areas and central regions that have seen manufacturing and service industries quickly develop in recent years (World Bank 2017). Rural areas have experienced lower growth while the borderlands, disproportionally conflict-affected, confront unsustainable development primarily based on rapacious natural resource extraction.

The makeup of Myanmar's private sector today, for the most part, reflects the bifurcated structure that endured prior to the transition. The majority of firms are micro enterprises or smallholder farms while mid-sized firms, critical to job creation and creative destruction in a developing economy, have yet to emerge (UNDP 2014). Approximately 99% of 127,000 registered enterprises are classified as SMEs with an estimated additional 600,000 informal enterprises (World Bank 2016a). At the top of the pyramid is a handful of large conglomerates and state-owned enterprises engaged primarily in extractive, construction, banking, and import/export industries, often owned by the same actors that controlled largescale economic activity before the transition.

How has fragility shaped economic activity?

Fragility in Myanmar facilitated the rise of a particular class of elite business actors stemming from two extremes: tight state control in the central regions and a fractured political economy in the periphery as well as investment climate conditions that discouraged competitive enterprise.

Actors

While the far-reaching state structures developed in the 1990s impeded the emergence of a diverse and competitive private sector, they worked to prop up and entrench a minority of powerful and military-connected conglomerates (Jones 2014). Following the collapse of the socialist regime, the new military government adopted ostensibly pro-market reforms in an effort to rebuild the economy and reassert its legitimacy. Market transactions were legalised and a strategy of gradual privatisation was pursued that aimed to cultivate "the emergence and prosperity of national economic enterprises in the hands of national entrepreneurs," to drive industrial development in the country (Thein Tun 2002).

Those entrepreneurs were a select group of individuals tied to powerbrokers in the military, relying on political and family connections to secure access to economic rents. Although a co-dependence between business and government based on client-patron relationships had existed in Myanmar since independence, this was the first explicit policy to leverage state preferences with the aim of supporting the development of large-scale domestic firms (Kyaw Yin Hlaing 2002). The opportunities brought about by privatisation and liberalisation in the 1990s further intensified this complex relationship with the emergence of a myriad of small entrepreneurs, particularly of Chinese origin (Mya Maung 1994). Many firms built their capital base off revenues from illicit trade during this time, especially drug production and trafficking, and were long presumed to be laundering the proceeds through state banks, thereafter reinvesting in legitimate businesses and property (Meehan 2011).

In parallel, conglomerates encompassing numerous industries were set up to generate revenue for the military. Through restructuring the Defence Services Institute, a military-run conglomerate launched in 1951, the armed forces founded in 1990 two colossal corporations to directly fund military activities and personnel: The Union of Myanmar Economic Holdings Limited (UMEHL) and Myanmar Economic Corporation (MEC) (Maung Aung Myoe 2009). A new equilibrium of state-capitalism defined by military-directed rent-seeking set in.

In the border regions, economic activity has typically been controlled to various degrees by the military, local powerbrokers, and armed groups. In a marked change to the economic order, a series of ceasefire deals were negotiated from 1988 to pacify ethnic areas (Callahan 2007). In exchange for relinquishing varying degrees of territorial control, armed groups were permitted to continue their activities, retain arms, and access government services. The more influential rebel leaders were often co-opted through economic incentives in the form of natural resource concessions or government licenses. Entering a truce with the military, they benefited from the country's post-socialist opening up – especially toward the booming economies of China and Thailand – with the benefits mostly flowing to leaders of the ceasefire groups, the military, and foreign business partners. This created new forms of intricate informal economies in the borderlands while entrenching local patronage structures. It also gave rise to numerous local militias and small armed outfits without any ethno-nationalist agenda, only strong interests in remaining outside the central state's control.

Activities and markets

Initially concentrated in extracting natural resources in ceasefire areas and government construction contracts, the military conglomerates and connected firms diversified over time, especially with the help of a second round of privatisations immediately prior to the 2011 elections (Aung Min and Kudo 2014). At the advent of the transition, they had secured dominant incumbency positions in sectors more amenable to foreign investment such as banking and transport, and consolidated control over former state assets, natural resources, and agricultural land. This re-orientation set the stage for the transition by strategically placing them to sustain their dominance in a post-sanctions, liberalised economy with shifting centres of political power. They possess the connections, domestic capital base, and local knowledge required to navigate the burdensome regulatory environment on behalf of investors where joint ventures with local partners are still required in many capital-intensive sectors.

In ceasefire areas, business exploits evolved over time from extractive industries such as jade mining and logging, although these persist, to include largescale industrial agriculture development that required the expropriation of large swaths of land. Drug production in such areas also thrived in recent decades to the extent that it is likely one of the country's largest exports, with Myanmar estimated to be one of the world's most prolific producers of amphetamine type stimulants and the second largest producer of opium behind Afghanistan (UNODC 2016).

Trade through ethnic areas also suffers from the legacy and persistence of conflict. The expansive and porous border that lines Myanmar's mountainous periphery has provided one of the primary revenue sources for funding non-state armed actors where "transit fees" are levied at checkpoints (Jolliffe 2015). Although secondary to the destructive impact of conflict itself, such fees, as well as other arbitrary taxes, can disincentivise trade, business growth, and long-term investment in affected areas. These sources of revenue will pose a serious challenge to remove or formalise as their value increases in concert with the trade flowing through new infrastructure developments. Furthermore, the informal (i.e. untaxed) trade that transits through these areas, estimated at between 40-60% of total trade volume, undermines legitimate businesses as well as government efforts to mobilise taxes and build better trade facilitation institutions (World Bank 2016b). However, formalisation of both trade and taxes is inherently tied to the competing legitimacy of state and non-state actors and as such needs to be considered within the broader context of Myanmar's political economy.

Investment climate marked by institutional failures and skills scarcity

Institutions that regulate business activity have traditionally been weak in Myanmar. Due to the persistence of a state apparatus shaped during the socialist era, numerous formal and informal barriers to private sector development are embedded within vast bureaucratic webs compounded by widespread corruption. Since the first military coup in 1962, the sedate civil service had served to constrain the most private enterprises through erecting administrative barriers in order to extract fees and consolidate an inward-looking, protectionist development model (Mutebi 2005, Tin Maung Maung Than 2007). Adherence to a militaristic hierarchy further disconnected the government from public accountability while incentivising civil servants to maintain their positions by avoiding any initiative that could counter the status quo.[1] Regulatory institutions became dysfunctional, with the majority of the private sector facing exorbitant transactions costs for engaging in formal economic activity and therefore relying on informal institutions and networks (Bissinger 2014).

In a recent example of the barriers and costs still facing businesses, the Myanmar Business Forum chronicled the process required to build and license a guesthouse close to a tourist destination. Securing approval to change the land use designation and a business license took 25 months in total, required input from 13 agencies at levels of government, and about $1,000 in gifts and donations (Myanmar Business Forum 2017). Such an experience is typical for businesses of every size in Myanmar and demonstrates how the legacy of its previously state-controlled economy can suffocate enterprise through imposing prohibitive formal and informal transaction costs.

In addition, the necessary skills and other fundamental pre-conditions for business growth were largely missing as the market opened up. A dearth of skilled labour resulted from a weak education system and the exodus of much

1 Anecdotally, observers described the practice of ma lok, ma shot, ma pyot – "don't do any work, don't get implicated, and don't get fired", which embodied the indolent productivity of public sector employees (Taylor 2009: 378-9).

of the educated class. Economic policymaking has also historically proved ineffective, and as a result, the reach and depth of the financial system was amongst the worst in the world. Three demonetisations between 1960 and 1990 wiped out savings and undermined public trust in the monetary system. Several banking crises, most recently in 2003, crippled the financial sector and further eroded confidence (Turnell 2009). When private and commercial banks were reintroduced in 1990 after the socialist era, they were forbidden from offering credit for agriculture and faced prohibitive collateral restrictions, condemning most of the population to sourcing finance from informal moneylenders. From the late 1990s, the exorbitantly overvalued official exchange rate created severe inefficiencies and enabled the government and connected firms to import goods grossly undervalued by the official rate, thereafter reverting to the black-market rate (Hori and Ching Wong 2008).

In the productivity void that ensued, natural resources accounted for the vast majority of exports, a trend which intensified after 1988 (Bissinger 2012). The limited industrialisation that emerged during the era of state-led capitalism in the 1990s, such as a nascent garment sector, was ultimately decimated when international sanctions cut off access to Western markets from 2003, further elevating the importance of natural resource exports for government and business revenues (Turnell 2011).

The transition which started building momentum in the early 2010s exposed the Myanmar private sector's severe lack of productivity. Unsurprisingly, when the country was introduced to the World Bank's Doing Business Index in 2014, Myanmar placed 182 out of 189 and was considered one of the most challenging business environments in the world.

The reconciliation process has catalysed market transformation

Reforms and economic transformation began soon after the transition started gaining traction in 2011. In order to kick-start growth as part of its new economic agenda, the first transitional government led by the military-connected Union Solidarity and Development Party (USDP) commenced an ambitious programme, first targeting the core institutions that govern the economy – the exchange rate was partially floated, the Central Bank granted more independence, some trade restrictions lifted, and a handful of sectors opened to foreign investment through joint ventures. Growth rates picked up and, with the lifting of western sanctions from 2012, international investors started considering Myanmar as an alternative to regional manufacturing bases. A cheap labour force, access to trade preferences, and its own untapped domestic market all amplified its appeal. By 2017, Myanmar had made progress in the Doing Business Rankings, ranking 171 out of 189 countries.

Many of the "low hanging" and more politically palatable macro-focused reforms were enacted by the first transition government (2011-2016). The reform process has continued, albeit at a slower pace, with the new NLD-led government coming to power in March 2016. Revised foreign investment regulations and a companies law aim to better facilitate foreign investment where there was previously uncertainty amongst overlapping laws and regulations.

How has business activity shaped the dynamics of fragility?

Myanmar's trajectory to date offers some unique examples of the private sector's contribution to state legitimacy in both authoritarian and liberalising regimes. Myanmar's experience also offers sharp illustrations of how economic incentives can be used to appease conflicts, and what dynamics often underlie their failures. We turn in this section to these examples.

Contribution to public goods and the legitimacy of the state

As the reach and resources of the emerging business elite expanded in the 1990s, the military became more reliant on the capabilities of the commercial class with enterprises often supplementing state capacity through the provision of public goods in exchange for import permits or monopolistic concessions. Connected firms contributed to the construction of the brand new capital city of Naypyitaw in the early 2000s and led humanitarian and rebuilding efforts in the wake of Cyclone Nargis in 2008. In an effort to fortify public support, the military government also implemented an extravagant programme of cultural and religious activities, 80% of which was financed by private businesses (Kyaw Yin Hlaing 2002). Businesses had long financed programmes and activities aimed to increase the authorities' legitimacy, a trend which has re-emerged within the current political institutions. Thus, the interdependence between the state and a select group of firms grew to define many of the largest market interactions.

‘Ceasefire capitalism’: Economies of war and peace in the border areas

While revenue from natural resources has financed warring parties and fuelled instability during times of conflict, Myanmar presents a rare case whereby such sources of economic rents have also been leveraged to reduce hostilities. The relative stability brought about by ceasefires allowed for an escalation in resource extraction, industrial agriculture, and infrastructure development in areas previously off-limits, radically reshaping the political economy of volatile ethnic areas.

Following ceasefires in the 1990s, the ensuing largescale exploitation of natural resources – mining, logging, and rubber – in ethnic areas through business deals between local powerholders, military authorities, and foreign businessmen has been branded ‘ceasefire capitalism’ (Woods 2011). The military, through establishing business links with ethnic leaders, created a tenuous equilibrium founded on the distribution of resources. Along with a tolerant and often cooperative approach to drug production and illicit border trade, ceasefires worked to consolidate state control in the fragmented borderlands.[2] The underlying instability and corruption that defined the investment environment in ethnic areas also led to a selection of investors primarily focused on short-term extraction characterised by a lack of value addition and employing migrant rather than local labour.

Ceasefires founded on economic rents brought a degree of stability to conflict areas but have typically spawned disaffection amongst ethnic populations with some groups reengaging in active conflict with the military. While a new business elite built a large portfolio of investments, the broader population – primarily smallholder farmers – more often suffered the negative externalities of resource extraction and the drug trade in the form of land dispossession, forced displacement, environmental degradation, and social unrest (TNI 2012; Woods 2013; Global Witness 2015). Promises of economic and social development that accompanied the ceasefires rarely materialised and the state’s presence more represented an extension of militarised territorial control than the increased provision of public goods and services. These outcomes spurred growing resentment amongst ethnic communities where conflict was merely substituted for other forms of insecurity, particularly in war-torn Kachin State (Kiik 2016). A prominent example is the Chinese-financed Myitsone hydropower dam, the development of which was ultimately postponed by the first transitional government after public protests and indications by the Kachin Independence Army that it could spark a return to civil war.

At the core of the popular disaffection towards investment is the reality that ceasefires defined by unsustainable resource exploitation exacerbated rather than addressed ethnic populations’ underlying political and historical grievances, thereby undermining the legitimacy of both the state and ethnic armed organisations. In some cases, they may have contributed to fragmentation and internal revolts within armed groups, and a return to conflict (Brenner 2017). Where conflict has not re-ignited, ‘ceasefire capitalism’ persists and many areas

2 As a result, some have argued that a number of armed groups ‘have become more of an armed business venture than a political movement’ (Ballentine & Nitzschke 2003).

remain volatile and challenging contexts in which to pursue responsible private sector development. Although the appearance of stability still exists in these areas, communities have grown to perceive private sector development as a tool used to dispossess ethnic populations of their resources and circumvent their rights (South 2014). In an indicative survey carried out in conflict-affected communities in Tanintharyi region, three-quarters of respondents did not believe that private companies and businesses have a positive impact on their community and indicated that most tensions in the community result from conflict with private companies (Covenant Consult and Karen Development Network 2017).

Lessons and outlook

The nexus between fragility and business in the case of Myanmar is unique, marked by idiosyncratic characteristics of the country's historical trajectory, ethnic subnational conflict, and cultural elements that differ markedly to other fragile contexts. As such, the state-private equilibria produced in the case of Myanmar offer some rare lessons:

- Armed conflict can result in highly heterogeneous political economy dynamics across different parts of a country. Thus, it's important to consider the plurality of fragile contexts that can exist within a state's borders.
- Through contributing to the provision of public goods, the private sector can support efforts to build state legitimacy in both authoritarian and non-authoritarian regimes, entrenching existing institutional structures.
- Inertia of rules and common business practices are pervasive even when business-friendly reforms take place.
- The first-order challenge for mitigating conflict risk is to seek a permanent settlement that addresses the underlying grievances of different parties. Business concessions incentivise short-term stability but are unsustainable and harmful if not inclusive and predicated on long-term solutions to conflict.
- Democratic transitions offer a critical juncture to challenge business elites but open the risk of elite capture of new political institutions.

The challenge of rent-seeking inertia

Although the position of incumbent business elites in post-transition Myanmar continues to evolve, the inertia of an economy shaped by rent-seeking poses significant challenges for the country's business environment. First, the culture of clientelism is likely to persist as it underpins social and political power structures and has defined government-business relations since the colonial era (Kyaw Yin Hlaing 2002). The issue then is whether incumbents will evolve into powerful oligopolies, no longer reliant solely on past connections but exerting their economic influence to gain favour with the emerging networks of power and moulding the democratic transition. As such, opportunities for elite capture could lead to the endurance of rent-seeking practices (Ford et al. 2016).

The absolute governance power of the military in previous eras led to an equilibrium where business elites gained favours, but did not overly influence policymaking, instead creating a co-dependence predicated on the exchange of resources. In a fragile democracy this could potentially shift, enabling the capture of political institutions. A quarter of the parliamentarians elected in the first transitional legislature (2011-2016), dominated by the military-backed USDP, were indeed drawn from the business sector (Egreteau 2014). Other wealthy members of this elite embraced the fledgling NLD opposition. Irrespective of their evolving political connections, the ability of the business leaders to be given preferences to government concessions is likely to be somewhat diminished in the new quasi-democratic order.

Their dominant market positions and access to scarce capital could work to crowd out competition in the private sector or deter investment by erecting costly barriers to entry. In an economy badly in need of largescale infrastructure investment, the incumbent companies are, in effect, the only domestic firms in a position to facilitate and execute mega projects in partnership with foreign firms. The government thus faces the choice of either contracting them in public-private partnerships (PPPs) despite the related transaction costs, or relying solely on foreign firms from neighbouring countries, risking a nationalist backlash. Myanmar is not new to nationalist protectionism and episodes of, at times violent, anti-foreign sentiment have previously flared in opposition to foreign-owned businesses and developments (Min Zin 2012).

This dynamic emphasises the importance of empowering new actors. A well-resourced competition authority, full transparency of government tenders, further liberalisation of the banking sector, and opening up to foreign investment could work to challenge market dominance and create a more competitive business environment, opening space for new local and foreign actors to emerge. Also important will be the gradual changes to informal institutions and ways of doing business that have grown to regulate a significant portion of commerce in Myanmar such as relying on government connections and personal exchange, if not bribery (Kyaw Yin Hlaing 2002; Bissinger 2014).

The challenge for post-conflict capitalism

The volatile borderlands of Myanmar hold many attributes that make them promising investment destinations. They are byways to large regional economies, home to extraordinary landscapes, and replete with valuable natural resources. However, due to the complexes created by a legacy of conflict and underdevelopment, they have been unable to leverage their advantages to spur equitable economic growth. The confluence of underlying instability and a political economy defined by elite capture works to deter competitive and responsible businesses. Legitimacy of authority is highly complex, contested, and arduous for outsiders to determine. Where it has a presence, the state is ineffective and unwilling to regulate commerce in order to mitigate negative externalities that fall on communities. As a result, in many areas, the population’s only experience of economic development has been exclusively negative.

Even where stability has emerged, there remains the ever-present risk of resurging conflict due to ongoing contestation of territory and fragile ceasefires. In one example in late 2016, fighting between the military and an alliance of armed groups in eastern Shan State led to the closure of Myanmar's main overland trade routes, resulting in a significant shock to border trade (Chan Mya Htwe and Khin Su Wai 2016). Economic activity in the area also suffered as the population fled and businesses closed. Such circumstances will be compounded as Myanmar becomes further integrated into the regional trade and transport networks quickly being developed and financed by its powerful neighbours.

This history points to the risks of largescale investment in fragile areas in the absence of a political settlement that would confer legitimacy and impose accountability on the governance of state and non-state actors. Employing precarious ceasefires based on rent distribution has intensified long-term fragility through fomenting disaffection amongst the population and created largescale distrust of investment projects. The first-order challenge for mitigating fragility stemming from conflict in Myanmar is therefore to seek a permanent peace agreement that addresses the concerns of ethnic groups, including on issues related to the ownership and distribution of natural resources.

In the meantime, gradual steps can be taken to reform the opaque institutions that govern the business environment in ethnic areas. Both the government and ethnic armed organisations can increase their transparency around investment processes and regulation, incentivise businesses to operate responsibly, and incorporate the concerns of local communities in investment decision-making. Popular trust and legitimacy needs to be established in state structures through political processes focused on more transparent governance and equality of representation. SME growth can be supported through improved access to finance and business skills training, opening up opportunities for those who have long been economically marginalised. Most areas now have affordable telecom services, allowing mobile technology to offer new forms of financial and educational products in more isolated areas. Access to markets will also be key, but road network expansion must be approached in a conflict-sensitive manner given how experience demonstrates that infrastructure can shift the dynamics of conflict areas – either facilitating military control or providing new revenue sources to armed groups.

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