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# State fragility in **Myanmar:** Fostering development in the face of protracted conflict

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Commission on  
**State Fragility, Growth and Development**

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## Acronyms

ASEAN: Association of South East Asian Nations  
BSPP: Burma Socialist Program Party  
CPB: Communist Party of Burma  
FDI: Foreign direct investment  
GAD: General Administration Department  
IDPs: Internally displaced people  
MEC: Myanmar Economic Corporation  
NLD: National League for Democracy  
NCA: Nationwide Ceasefire Agreement  
SMEs: Small and medium enterprises  
SLORC: State Law and Order Restoration Council  
SOEs: State-owned enterprises  
SPDC: State Peace and Development Council  
UMEHL: Union of Myanmar Economic Holdings Limited  
USDP: Union Solidarity and Development Party

## About the commission

The LSE-Oxford Commission on State Fragility, Growth and Development was launched in March 2017 to guide policy to address state fragility.

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# Introduction

## 1

Myanmar has suffered decades of authoritarian rule, self-isolation and the world's longest protracted civil war. Long considered a pariah state, its trajectory in recent years highlights how characteristics of fragility evolve or diminish in response to largescale political and institutional change. Since 2010, a military-led transition to quasi-democratic rule seemingly put the country on a path towards a "modern" democratic state. At the same time, this transition has exposed the risks of a fast-liberalising and complex political economy that is shaped by a legacy of repression, ethnic conflict and colonialism.

While this political and economic transition will continue to define the path of the country's institutions, in the long-run, Myanmar as a "nation" will also be sculpted by continuing ethnic conflicts in its borderlands. Its central state is cushioned by an array of ethnic areas that are either contested, governed autonomously, or co-administered by the central state and numerous armed groups. Since the 1950s, the central state has been embodied by the military, thereby playing a key role in all facets of the country's political and economic institutions.

The legitimacy and effectiveness of state and non-state power-brokers vary significantly throughout the country, fluctuating in response to the impact of conflict, centripetal forces of the state, and the presence of economic resources. 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 by which to examine the characteristics of fragility both of the state, and within the state.

# From military to democratic rule: An incomplete transition

## 2

Myanmar has experienced one of the most durable and institutionalised military rules of the post-war world. In March 2011, the dismantling of the military-run, State Peace and Development Council (SPDC), marked the country's third attempt at transitioning from a direct military administration to a civilian form of government since its independence in 1948.

After a short-lived caretaker government between 1958 and 1960, the armed forces – or Tatmadaw – imposed a 12-year period of military rule between the coup d'état staged by General Ne Win in 1962 and the adoption of the 1974 Constitution. The latter allowed the Tatmadaw to partially retreat to its barracks while leaving the policy decisions to a single legitimate party remaining under a shadowy military guardianship, the Burma Socialist Program Party (BSPP).

In the midst of the pro-democracy uprising of 1988, another coup d'état opened a new era of direct military rule. The new junta, or State Law and Order Restoration Council (SLORC), ditched the BSPP's inward-looking socialist doctrine, reconnected with neighbouring powers and joined the Association of South East Asian Nations (ASEAN). In November 1997, an internal purge transformed the SLORC into the SPDC, but without weakening direct military control, which lasted until the SPDC was disbanded in 2011.

## A calculated retreat

The ongoing transition, which began at the turn of the 2010s, seems to follow a similar logic to the transition observed in 1974 (Egreteau, 2016). In both cases, the Tatmadaw has been in a position to dictate the terms, start and pace of the transitional process, from direct army government to a new, military-inspired Constitutional order, in which the Tatmadaw would remain a key decision-maker but share power with other newly empowered civilian institutions.

Recent change did not emerge from a regime collapse or popular street

protests; neither was it instigated by foreign pressures or the iconic pro-democracy figure of the country since 1988, Aung San Suu Kyi. Rather, it was prepared by a military institution confident enough to engage and direct the process. This was facilitated by the containment at the turn of the 2010s of the traditional perceived threats that have routinely justified military intervention in postcolonial Myanmar:

- **Internally**, the most rebellious segments of the Buddhist monastic community had been stifled after the crackdown on the Saffron Revolution in 2007, while most ethnic armed groups were curbed by the Tatmadaw in their peripheral fiefdoms (Slater, 2014; Jones, 2014).
- **Externally**, the international community was kept at bay after the passage of cyclone Nargis in 2008, and Western sanctions exacted a modest toll on the military establishment. Increasing economic and political reliance on China also rested uneasily with the military, which sought to re-balance the emerging geopolitical equilibrium with its neighbour.

Therefore, in 2011, the 78-year-old Senior-General, Than Shwe chose to retire after two decades as the uncontested junta leader. The army leadership felt secure enough to engage a calculated, but partial, retreat to the barracks.

## Post-junta state building

The political transformation of the post-1988 military regime has proven a very long process in the making. Unveiled in 2003, a roadmap to a “flourishing disciplined democracy” was intended to lay the groundwork for the restoration of a functioning “post-junta” parliamentary system in which the Tatmadaw’s tutelage was to be acknowledged (Egretreau, 2016). A new Constitution, with a strong praetorian hue, was ratified in 2008 and two years later general elections were held nationally. A novel legislature comprised of a bicameral Union parliament and 14 state and regional assemblies was shaped under the aegis of the USDP, the winner of the controversial military-controlled poll. In February 2011, the last SPDC Prime Minister, U Thein Sein, was elected and formed a semi-civilian government strewn with retired military officers and other members of the former military administration.

## Post-junta reform

The new “post-junta” executive and legislative powers soon initiated a series of sweeping political, financial and social reforms. Political prisoners were released: Aung San Suu Kyi, who was freed from house arrest a week after the 2010 elections, was allowed to run for office and entered Parliament through by-elections held in 2012. The rights to assemble and demonstrate were restored, state censorship was disbanded, and restrictions on the internet lifted. A Human Rights Commission was established, trade unions and worker strikes were legalised, the complex exchange-rate system was restructured, and steps were taken to dismantle the various monopolies of state-run and military-owned

conglomerates. At the same time, the government engaged in fresh peace talks with the myriad of ethnic armed organisations still fighting against the central state.

## International response

The “post-junta” environment nurtured an unprecedented level of optimism, at home and abroad. The international community – Western powers in particular – responded positively to the reformist agenda. Most international diplomatic and financial sanctions were lifted, save for those targeting drug and human trafficking. High-profile heads of state visited Myanmar and ASEAN granted its 2014 Chairmanship to the country. International financial and development organisations flocked into Yangon to support the burgeoning economy. Not since the 1950s had hopes for the improvement, democratisation and peaceful development of Myanmar been so optimistic.

## Democratic disillusionment

Despite this impressive progress, reversing decades of economic mismanagement, rent-seeking and military-led authoritarianism was never going to be easy. After a few years of bold optimism, efforts to pursue and deepen the reforms towards a more open and fair society faltered in the mid-2010s. Red tape, high levels of corruption, and a lack of political and institutional restructuring, slowed down the transition processes. Novel pieces of legislation prepared by the new Parliament proved hastily written or poorly implemented (Egreteau, 2017).

In November 2015, the organisation of free and relatively fair general elections further rekindled hopes for better political representation and the implementation of an extensive agenda for democratisation. Aung San Suu Kyi’s National League for Democracy (NLD) won the elections in a landslide. A new government was formed headed by President U Htin Kyaw<sup>1</sup>, a close confidant to Aung San Suu Kyi who had herself been barred from the presidency by the 2008 Constitution.<sup>2</sup> Expectations for radical change were sky high, both domestically and internationally (Blazevic, 2016).

Nevertheless, two years after taking power, many have become disillusioned with the first democratically elected government since 1960. If systematic corruption seems to have decreased at the highest level of the central state under the NLD, it remains rife throughout the country. State structures and institutions continue to face extremely limited human resources capacity, at least insufficient to absorb far-reaching foreign assistance. Only one major repressive law – the Emergency Provisions Act, 1950 – has been repealed, while legislation

<sup>1</sup> U Htin Kyaw subsequently resigned two years into his term on 21 March 2018. U Win Myint, former Speaker of the Lower House, was elected President on 30 March 2018.

<sup>2</sup> As her children are foreign citizens (article 59[f]). To counter this ban, the new Parliament, whose two chambers have been overwhelmingly dominated by the NLD since the 2015 polls, passed a first law creating the unique position of “State Counsellor” for her.

on defamation is still routinely employed to silence journalists. Peace talks have faltered despite the organisation of three major peace conferences under the leadership of Aung San Suu Kyi and some armed conflicts have even violently resurged in the borderlands.

## Religious radicalism and refugees

At the same time, forms of religious radicalism have continued to linger. Above all, the Rohingya issue became more pronounced than ever with more than 800,000 refugees – four times the number of previous exoduses of the very same population in 1978 and 1991– fleeing to Bangladesh after a massive crackdown led by security forces in August 2017, in response to attacks on border posts.

The plight of the Rohingya may not derail the ongoing transition – other states in the region have indeed shown that economic development and political stability can be fostered despite lingering ethno-religious conflicts. Yet, it considerably tarnishes the country's image, affects its relations with the international community, and reintegration in the global economy.

Moreover, while anti-Muslim sentiment has recently spiked in Myanmar society, perceived threats of violent Islam have emboldened support for the country's security forces.

## A state within a state

Another great unknown of the ongoing transition is the trajectory of Myanmar's civil-military relations under an NLD administration, and beyond. The 2008 Constitution has bestowed upon the Tatmadaw a guardianship role and full autonomy vis-à-vis the civilian government. Three significant ministries in the Union cabinet remain under the sole authority of the armed forces (Defence, Home Affairs, and Border Affairs) and a quarter of all Parliamentary seats are reserved for men in uniform, granting them veto power over any Constitutional changes.

The NLD has undoubtedly been allowed by the Tatmadaw to oversee the day-to-day administration of the country since the formation of a new government in 2016, yet neither the semi-civilian government, nor the legislature, nor the judiciary are able to check and oversee the military's activities.

The armed forces, having incarnated the state and taken charge of its construction for more than five decades, stand now as an unaccountable "state within the state". Its leadership continues to insist – and this is a key element of every official communication – that multifaceted threats to the "state security" and "national security" of the country still exist (Callahan, 2015: 47-48). All of this points to a delayed full military retreat to barracks, a situation that will define Myanmar's path for years to come.



# State- and nation-building

## 3

Myanmar has been a society at war with itself since its independence in 1948. Seven decades of conflicts have continued between the central state, its armed forces and an array of ideological, ethnic-based, or simply criminal organisations. This has been accompanied by conflict among ethnic, communal and political groups themselves, perpetuating a low-intensity, yet intractable civil war.

This protracted state of conflict has embroiled the Tatmadaw in a complex set of wars, militarised the society, and facilitated a recurrent military intrusion into politics. The shaping and reshaping of armed organisations, their political demands, economic resources, and cross-border and international support networks – all fluctuating through the decades according to the power, territorial control, and capacities of the Tatmadaw – have contributed to the failure of Myanmar’s construction as a “nation”.

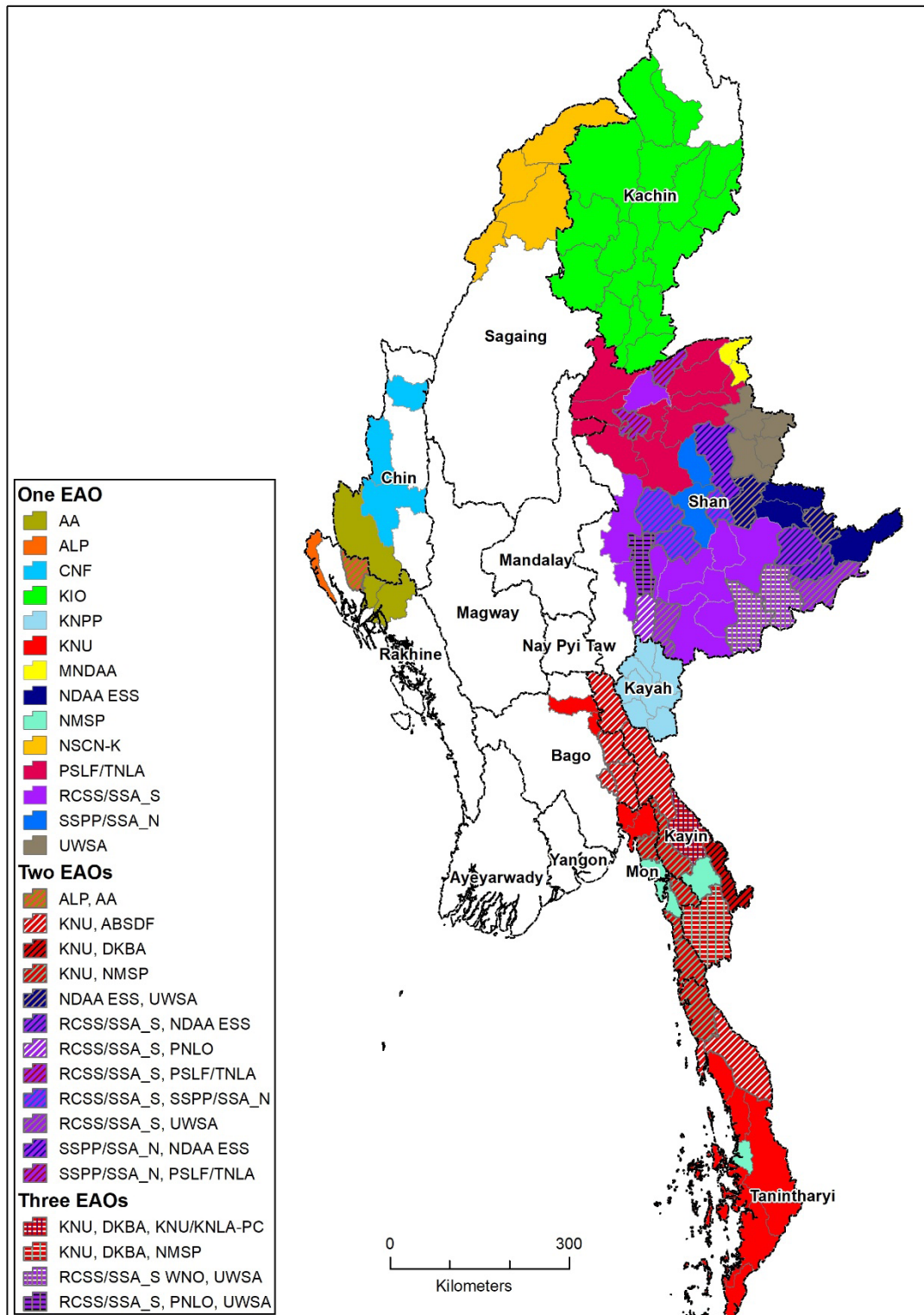
Although Myanmar still lacks a cohesive sense of nationhood after seventy years, its postcolonial “state” building is not necessarily construed as a failure.<sup>3</sup> Since the 1950s, the armed forces have led massive state-building efforts through the control of ever larger swathes of territory where it has developed state structures and administrative functions. In parallel with the rapid exclusion of other state institutions, the military has embodied Myanmar’s central state, captured its apparatus and guided its institutional development (Callahan, 2003).

## Territorial control

However, a myriad of small territories remain either under full control of autonomous armed organisations or a mixed Tatmadaw/militia administration, especially in the borderlands with China and Thailand (figure 1) (Dukalskis, 2015; Buchanan, 2016). Approximately one-quarter of the total population of Myanmar lives in townships that are affected to some extent by conflict (Burke et al., 2017). Nevertheless, Myanmar’s central government now controls far more territories than it ever has since independence.

<sup>3</sup> In Myanmar language, though, a major challenge lies in the fact that both concepts “state” and “nation” share the same etymology: “naing-ngan”, from prevail/overcome (naing) and wholly/to be complete (ngan).

Figure 1: Presence of armed groups in 2016



Source: Adapted from Burke et al. (2017)

## The politicisation of ethnicity

The politicisation of ethnicity during the colonial period laid the foundation of the current understanding of Myanmar's ethnic and identity conundrum. Then and now, the distribution of power and wealth, the delivery of public goods and services, and control of trade and natural resources all followed the politicisation of local ethnicities, and the subsequent asymmetric relationship between the historically dominant Bamar (or Burman) ethnic majority and all other ethno-linguistic groups, whether indigenous or not (Taylor, 2005).

A majority of about two-thirds of the population is still presumed ethnic Bamar, or of mixed Bamar origins.<sup>4</sup> Unlike the colonial era, political and military elites are heavily drawn from this ethnic group. The remaining third of the society is a patchwork of ethnic minorities. Continuing post-colonial internal migration (both forced and voluntary) and evolving ethnic identities have further added to the complexity of the country's ethno-linguistic landscape over the past few decades.

The military-led penetration of the Bamar-dominated postcolonial state into ethnic-dominated peripheries has been violently contested since independence. The Myanmar language as lingua franca, Buddhism, and a Bamar reading of the country's history, has accompanied state expansion.

## The central state and rebellion

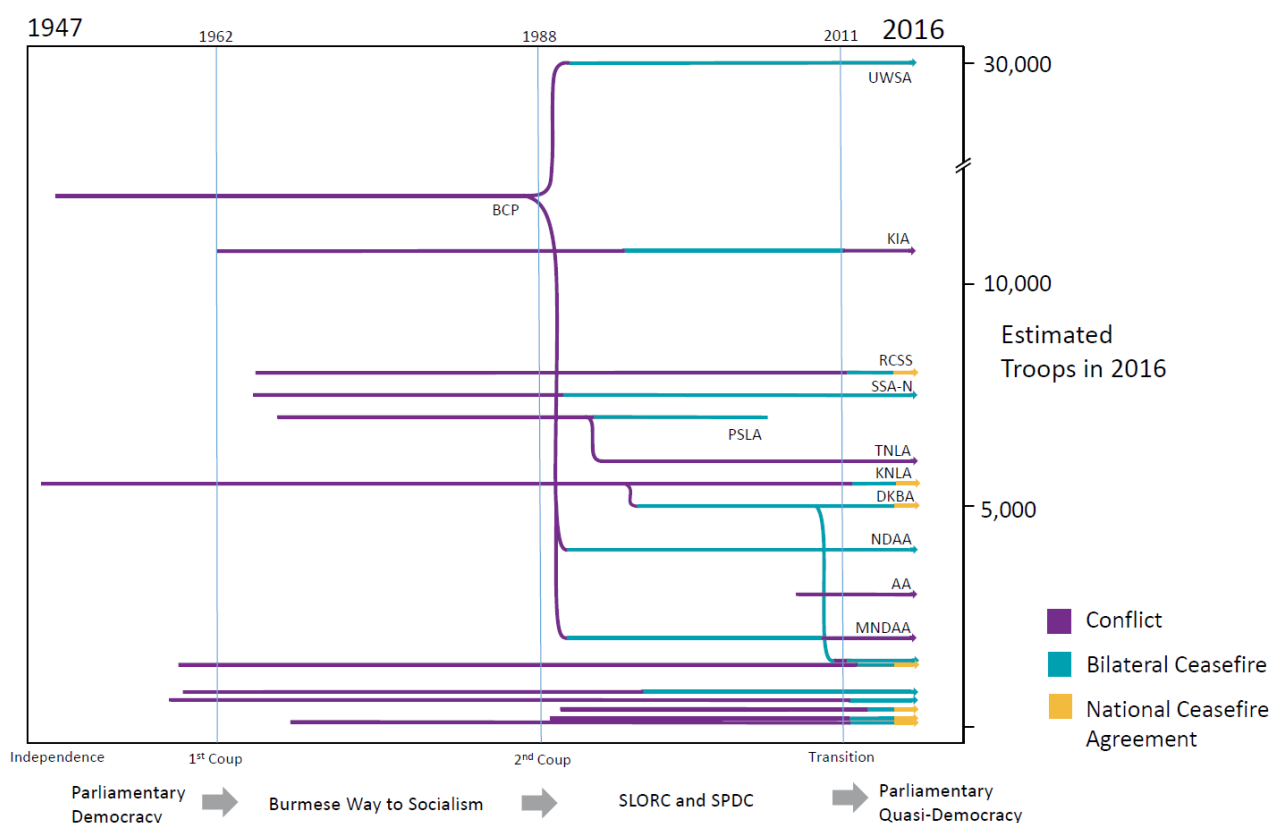
While powerful communist and ethnic Karen (Kayin) insurgencies emerged as early as the late 1940s, ethnic Arakanese (Rakhine), Karenni (Kayah), Shan, Mon, Kachin, and Chin communities developed popular armed rebellions against the central state during the 1950s and 1960s (figure 2). Many of the groups split into factions over time, often as a result of disagreements over the signing of ceasefires with the military, including the largest insurgent group – the Communist Party of Burma (CPB).

Over the subsequent decades, a wide range of policies has been defined by the central state to counter these post-independence centrifugal forces, including ruthless counterinsurgency operations and ceasefire negotiations. In particular, the skilful policy of "gentlemen agreements", initiated by the post-1988 military regime with several historical insurgency groups, shaped a new political economy in the country's borderlands (Callahan, 2007; Jolliffe, 2015). This approach is still strikingly dominant today.

Various ethnic armed groups chose to normalise relations with the central authorities in the early 1990s and, in exchange, these "ceasefire groups" gained control of economic flows and local administration in delineated territories while effectively ditching the armed secessionist struggle against the government (figure 2). It also gave rise to numerous local militias and small armed outfits devoid of any ethno-nationalist agenda, but with significant interests in remaining outside the central state's control. War lords and drug barons were particularly prevalent in this regard.

<sup>4</sup> Results on Myanmar's ethnic composition from the last nationwide census, carried out in 2014, are yet to be revealed by the government.

Figure 2: Timeline of conflict in Myanmar<sup>5</sup>



## Peace talks and resurgent conflict

A key element of the current transitional process is the new Constitution adopted in 2008. Although federalist in its spirit – it has made provision for fourteen regional parliaments and governments<sup>6</sup> – the new form of “post-junta” governance has not settled existing contentious issues. Ongoing ceasefires signed in the 1990s were incompatible with the unifying state-building process embodied by the 2008 Constitution. The latter implied the demobilisation and disarming of ceasefire groups and the unification of all armed organisations under sole Tatmadaw command.

While a handful of outfits accepted to play by the new rules and transformed into forces under the military’s command, others either stood by, continued, or resumed the armed struggle. Resurgent conflicts have proven particularly acute since 2011. Increasing opposition amongst ethnic populations arose from a failure of ceasefires to address their political demands and development needs as well as the negative impact of unsustainable natural resource extraction on their communities.

<sup>5</sup> Data on estimated troop numbers in 2016 from the Myanmar Peace Monitor ([www.mmpeacemonitor.org](http://www.mmpeacemonitor.org)). Data on group splits and ceasefires from Dukalskis (2015), Lintner (1999), Oo (2014).

<sup>6</sup> One for each of the country’s seven Bamar-dominated administrative “regions” and seven ethnic-dominated “states”.

In the northern Shan State and eastern Kachin State, revived fighting has generated new waves of refugees (into China's Yunnan province) and massive internal displacement of populations – around 100 -140,000 between 2011 and 2017. It has also rekindled dormant war economies and trafficking of all manner of goods along the China-Myanmar borderlands.

## **The Nationwide Ceasefire Agreement**

In 2011, the new semi-civilian administration, led by President Thein Sein, initiated a fresh round of peace talks. A series of seventeen new ceasefire agreements were signed, some with insurgent groups that had never concluded more than a fragile truce with the central state since Myanmar's independence. However, in October 2015, after four years of discussions, only eight armed groups had signed the Nationwide Ceasefire Agreement (NCA). Many others refused – as in the 1990s – to consider full disarmament and demobilisation under the sole supervision of the Tatmadaw or suffered from internal dissent (Brenner, 2017b).

In March 2016, the NLD took over the peace process following success in the 2015 polls. Three major conferences were held between August 2016 and July 2018. Even so, no progress has been achieved on the concrete steps to be made regarding the objectives, the contents of the talks, and the role of "outsiders" (international donors and neighbours with strategic interests). At the same time, conflict has continued to intensify in north-eastern Myanmar and has also resurged in the south-east.

## **The Rohingya and reconciliation**

The question of the Rohingya community has been deliberately omitted from peace parleys under successive administrations. Construed as "foreign" (from Bangladesh) by the overwhelming majority of Myanmar society, the Rohingyas have never been invited to national reconciliation processes. Although antipathy toward Indian-origin and Muslim communities has pervaded in Myanmar since colonial times, the perception of Rohingyas as interlopers that threaten the "national races" was gradually formalised from the 1960s.

Localised communal violence – mainly between Buddhist and Muslim communities – re-emerged in 2012 and 2013 throughout the western and central parts of the country. Since 2016, the rapid development of a violent militancy in Arakan (Rakhine) State, and the subsequent crackdowns by the Myanmar security, has generated some 100 - 120,000 internally displaced people (IDPs) and over 800,000 refugees fleeing to southeastern Bangladesh.

The Rohingya issue has also put the international community at odds with Aung San Suu Kyi and her government who appeared unwilling to be outspokenly critical of the renewed forced migration. The NLD has, however, made tentative moves towards repatriation and reconstruction through forming an Advisory Commission on Rakhine State headed by Kofi Annan.

# State legitimacy

## 4

In Myanmar's decade-long civil war context, the legitimacy of central state institutions, local non-state organisations and individual power-holders is particularly challenging for outsiders to determine. The concept of "legitimacy" is seldom construed by the many societies that comprise the country today as it is by Western-influenced societies (Steinberg, 2007).

Who is legitimate in the eye of whom? Who is providing political support to whom at the local or national level? This has been further complicated as Western states have long labelled "illegitimate" the military regime formed in Myanmar after the 1988 coup d'état and disbanded in 2011 – including its high-ranking officials who peppered the subsequent "post-junta" administration between 2011 and 2016.

Several authors have argued that the military has sought to recover higher levels of political legitimacy through the process of change since the 2003 roadmap to a "flourishing-disciplined democracy". By withdrawing from day-to-day politics and establishing a parliament-based regime after the adoption of the 2008 Constitution and 2010 elections, the Tatmadaw could hope to make the new regime "legitimate", acceptable, and legal – at least from the standpoint of its own partisans, including the ones most disappointed by years of mismanagement and autocratic rule (Ganesan, 2013).

## The two dimensions of legitimacy

Two intertwined dimensions of political legitimacy in present-day Myanmar are worthy of investigation:

**1.** First, the legitimacy of the successive authoritarian regimes has been heavily contested by a wide range of communities and pro-democracy leaderships – but not all – inside and outside the country since the Tatmadaw first intervened in politics in 1958. Their legitimacy will certainly continue to be contested as long as the armed forces remain involved in the country's politics and civilian affairs – as the 2008 Constitution guarantees.

Many groups have denounced the failure of the military-run governments to organise regular, free and fair elections after 1960, establish just governance, deliver efficient public goods and services throughout the country without discrimination, and bring about equitable development – all elements that comprise "legitimacy" in a Western sense (Alagappa, 1995; Gilley, 2009).

Yet, as observed in many authoritarian systems based on patronage and

clientelist power relations, the dichotomy between legitimate/democratic and illegitimate/non-democratic does not apply in Myanmar's postcolonial context.

Indeed, several state-sponsored policies and development programmes devised and implemented by General Ne Win's regime (1962-1988) and its immediate successors (1988-2011) have drawn unexpectedly large numbers of supporters, or at least a minimum level of grassroots and "passive" acceptance of the military-run state – a phenomenon especially visible in the country's Buddhist- and Bamar-dominated rural areas.

Another recent illustration of the unexpectedly high level of legitimacy bestowed upon past autocratic regimes is the relatively high share of the vote gained by the military-backed USDP in the 2015 elections – about 30% of the total valid votes in a free poll otherwise comfortably won by the NLD.

**2. The legitimacy of Myanmar's post-independence state – whether ruled by military or democratically-elected leaderships – has also been violently contested by non-Bamar and non-Buddhist minorities since 1948. Many communities have openly rejected "state"-building being used as a top-down means of enabling "nation"-building and refuse to acknowledge the legitimacy of the central state, which is perceived as dominated by ethnic Bamar and Buddhist elites.**

Local non-state actors have thus built deeper connections and clientelist relationships with local communities rather than the central state, which is considered either absent, inefficient, or hostile to these communities. The civil war has gradually allowed for the formation of multiple territorial pockets growing outside of central state control, whereby local populations have provided legitimacy to an array of smaller power-holders fighting, or ignoring, the central government (Callahan, 2007).

## **Quasi-autonomous zones**

By the 1970s, various ethnic and ideological rebellions had already created "liberated" zones in which they could effectively organise their own autonomous administrations, run lucrative informal economies and exploit local resources while pursuing distinct cultural and educational policies without posing a serious security threat to the central state. In the areas they controlled, the legitimacy of the Myanmar state has still never effectively taken hold (Buchanan, 2016).

More often than not, for populations in these quasi-autonomous zones the only visible incarnation of the Myanmar postcolonial state has been a Tatmadaw soldier. International donors and actors willing to invest in conflict areas will thus continue to struggle to determine which local and national actors can be considered legitimate in Myanmar, and in the eyes of whom.

This situation has since been further complicated by rapidly evolving relationships between competing groups at the local and national levels. These groups have either resisted, co-existed with, or supplanted the central state (i.e. the military) in many ethnic and border areas where secession has been a fact, but no longer a political goal in itself. Legitimacy in such areas has also been violently contested among local power-holders themselves, all vying for patronage and political benefits within one given community (Brenner, 2017b).

The size of the territory outside the central state's reach has, however,

considerably shrunk since the 1990s. In the 2015 general elections, voting was cancelled in only seven entire townships – out of the country’s 330 – where war was raging and partially cancelled in about only 30 other conflict-affected constituencies.

## Leadership and local communities

The promises and hopes raised by the first “post-junta” government (2011-2016) significantly altered the perceptions of the international community. The combination of extensive and unprecedented peace talks with the liberalisation of Myanmar’s socio-political landscape received considerable praise at home and abroad. International actors committed extensive funds and technical support to the peace process. This conferred greater levels of legitimacy to the central government’s development agenda, while at the same time, risked enhancing and funding the expansion of Myanmar’s “post-junta” state – whose dominant actor, the military, retained power through the transition – to the detriment of local agendas.

Tentative extension of the central state, particularly in times of peace or during ceasefire negotiations, is often construed as a threat to local communities and a blunt intrusion by external forces into the life and culture of a society. This, in turn, tends to perpetuate conflict, despite reaching a ceasefire (South, 2014). Gauging the legitimacy of local elites in the eyes of a particular community, which itself is marred by internal rivalries and overlapping spheres of political influence, will thus long remain for outsiders a perilous exercise (Jolliffe, 2015).

The second “post-junta” administration set up after the 2015 elections has clearly gained far more legitimacy in the eyes of the majority of the population as well as the international community. The NLD has long construed its legitimacy as derived from free and fair electoral results, not armed struggle. Yet, the new ruling party is also construed by many ethnic elites as a political force dominated by ethnic-Bamar and Buddhist individuals and its power and authority are still contested domestically and internationally.

Not only is there a lingering reluctance to trust the promises made by the NLD of a peaceful national reconciliation among the country’s various minority leaderships, but the international stature of Aung San Suu Kyi herself has also greatly suffered from her perceived lack of empathy towards the ongoing plight of the Rohingya minority, particularly since 2017.



# State deficiency and inefficiency

## 5

While it has made progress in some sectors in recent years, the state in Myanmar remains characterised by high levels of centralisation, opaqueness, corruption, and inefficiency, reflecting a dire institutional decline since independence was won in 1948.

In the late 1930s, many of the institutional preconditions for state-led economic growth were in place in British Burma, a path subsequently demonstrated by the success of many of Myanmar's neighbouring countries. World War Two and independence, however, precipitated the deterioration of the public administration, which suffered heavily from war damage and the massive exodus back to British India of Indian migrants who dominated the colonial civil services. After the departure of the British, successive democratically elected governments were soon confronted with a devastated infrastructure, a diminished public sector and rising insurgencies.

## A military dominated civil service

The challenge of state-consolidation under these circumstances proved overwhelming and ultimately set the stage for military intervention in 1958. During the country's first extensive period of military dominance (1962-88), government institutions were gradually transformed and further eroded by the Tatmadaw's intrusion into the state apparatus.

General Ne Win's socialist regime cultivated an expansive, lethargic bureaucracy tasked with implementing grand plans that aimed to impose state control and direct the country's economic and social development (Mutebi, 2005; Than, 2007):

- The military dictated all major civil service appointments and purged those perceived as disloyal (Englehart, 2005).
- Low salaries, control of infinite bureaucratic barriers and permissions, and the prioritisation of loyalty and patronage over competence, bred endemic corruption within the public administration, and continue to do so today.
- 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.<sup>7</sup>

Reluctance to exercise initiative has been institutionalised, along with the centralisation of decision-making characterised by directives rather than policy, has continued to severely impede the efficiency of the civil service. As a result, high-level administrators, such as mayors and ministers, typically commit a vast amount of their time assessing and endorsing numerous insignificant bureaucratic processes.

## Corruption and military intrusion

At the advent of the transition in the early 2010s, Myanmar was perceived by its citizens to be highly corrupt, languishing second last in the world in Transparency International's corruption perceptions index (Transparency International, 2010). The first transitional government was well aware of the hurdles it faced.

One of the challenges of public sector reform today is the continued dominance of the military, which controls some of the central institutions of government. It is constitutionally allocated 25% of the seats in national and state and region parliaments and control over three of the most powerful ministries at the Union level - Defence, Home Affairs and Border Affairs. It also monopolises sub-national administration through the all-encompassing General Administration Department (GAD), which acts as the civil service for the subnational governments and coordinates activity at the local level.

These administrators are accountable only to the central Ministry of Home Affairs, which 'significantly impairs the ability of subnational governments to manage staff, execute policies and hold officials accountable for their performance' (World Bank, 2015a). Despite mounting criticism and recent public expressions of discontent, the military has also pursued a policy of appointing freshly retired senior officers to major administrative posts in civilian ministries.

## Access to public goods and services

Another defining characteristic of public service provision in Myanmar is its lack of reach (Hook et al., 2015). Access to public goods and services are limited in rural and conflict areas, estimated to account for 70% of the population. Growing disparities have emerged, as urban areas experienced a faster rise in standards of living in recent years, with urban poverty levels now estimated at 19% compared to 29% in rural areas (World Bank, 2017a).

Inequity of access is exacerbated by the effective military "state within a state", which provides privileges to members of the armed forces and their families, including subsidised food, pensions, healthcare and exclusive education of comparatively better quality than is available to civilians (Myoe, 2009).

In addition to governance failures, Myanmar has consistently deprived the social sectors of resources leading to deteriorating human development

<sup>7</sup> 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).

outcomes. Health care infrastructure remains extremely weak and lacks skilled professionals. Compared to neighbouring countries, Myanmar has the second lowest life expectancy and the second highest rate of infant and child mortality (World Bank, 2017b).

The education sector also suffered from decades of inward-looking military rule. Schools starved of funding have long survived – and continue to do so – by levying informal fees and expensive, quasi-compulsory private tutoring to pupils offered by teachers themselves, exacerbating low completion rates.

The higher education system has been decimated, not just through underfunding, neglect, and the poor quality of teachers' training, but also by a concerted strategy to avoid conspiracy amongst students after repeated confrontations with successive military regimes. Student unions were long banned, universities ousted to the fringes of cities after the 1988 student uprising, and academic independence revoked. Combined with a propagandised curriculum focused on an ethnic Bamar reading of history and society, and learning traditionally based on rote recitation, the human capital potential of Myanmar has thus been severely depleted (Hayden and Martin, 2013).

In recent years, the two post-transition governments have significantly increased expenditure on health and education, helping relieve some of the associated burdens for households (World Bank, 2015a). Large-scale cash transfer programmes have been introduced and some essential health services made available for free.

Although investment in social services is rising, it remains low. For the 2017-2018 fiscal year, the NLD government allocated 13% of the total national budget towards health and education combined, still less than the official national defence budget, at 14% of government expenditure for the same fiscal year, excluding other sources of hidden and unofficial military revenues (World Bank, 2017c).

## Public infrastructure

The state's inability to raise and administer revenues adequately had other negative consequences reflected in its approach to resource mobilisation for public infrastructure. In the early 2000s, the construction from scratch of a sprawling new capital city, Naypyitaw, mobilised considerable resources at the expense of any other nation-wide infrastructure plans (Turnell, 2011a).

In the absence of sufficient funding, and in order to maximise opportunities for corruption, government licenses and resource concessions have long been provided to companies favoured by the pre-2011 regime in exchange for infrastructure construction. Military authorities have also routinely conscripted forced labour for public works to the extent that unskilled labour was omitted from budget estimates (Horsey, 2011; ILO, 1998).

Present day power and transportation infrastructures are for the most part in disrepair. The existing power infrastructure can only provide electricity to approximately 52% of the population and blackouts are routine in major cities, including Yangon and its five million inhabitants (World Bank, 2017b). Transport infrastructure, much of it dating from colonial times and only marginally renovated since the early 1990s thanks to loans from Myanmar's neighbours and

allies (Japan, India and China in particular), is limited to the main cities and cross-country arteries, with many rural areas being inaccessible, especially during the rainy season.

Only 20% of the country's road network is paved and about 40% of the population has no access to an all-season road (Asian Development Bank, 2016). Infrastructure has buckled under the increasing demand from a growing economy as the government struggles to raise capital spending, which fell from 9% of gross domestic product (GDP) in 2012-2013 to 6% in 2015-2016 (World Bank, 2017c).

One glowing success has been the telecommunications sector where Myanmar has experienced an unprecedented rise in mobile phone usage owing to the liberalisation of the sector from 2012. The price of a sim card subsequently dropped dramatically from USD 250 to USD 1. Today, more than three-quarters of the population own a cell phone, most of them smartphones.

## **Self-reliance and the politics of everyday life**

In the absence of sufficient state provision of public goods and services, while facing chronic funding shortages, local community-based institutions guided by religious and cultural principles expanded to fill the gaps, whether in government areas or pocket territories controlled by armed groups. Such institutions are financed primarily by donations and represent the self-organisation of communities to fund essential services. They are typically involved to varying degrees in the provision of health care, education, food assistance, disaster recovery, and infrastructure at the local level, thereby supplementing and substituting for the absent, or inefficient central government (Thawngmung, 2011). This self-reliance phenomenon has been observed for decades but has grown since the 1990s.

In addition to entirely self-financing community services, it is also common for communities to receive some financial or in-kind assistance from local government departments and military garrisons acting as patrons, or conversely to contribute to government projects such as schools or health clinics. The vast majority of people in Myanmar - regardless of their religious affiliation - donate to and receive services from such community groups, thereby creating a complex overlap of state and non-state roles in service provision, of which the government is just one of many actors.

Although offering a limited snapshot, one survey carried out in Bago Region and Kayin State in 2016 suggests that donations account for a substantial proportion of household expenditure, with households donating more than twice as much to community groups as they pay in taxes annually (McCarthy, 2016). In the same study, most respondents perceived state taxes as unfair and ineffective, while the opposite was true of donations, highlighting the legitimacy afforded to community groups. Another implication of this research is that considering such donations as effective informal taxes suggests the overall 'real' tax burden that households shoulder is larger than otherwise assumed.

As the government builds its capacity to provide services and expands its

presence, it needs to consider how it can efficiently converge with organisations already serving the public. Given their proximity to the taxpayers and perceived effectiveness compared to the government, community groups will continue to be an important partner.

## **Tax mobilisation**

Since the colonial era, the state has struggled to collect taxes from citizens and enterprises, relying disproportionately on earnings from state-owned companies which have themselves long been primarily sourced from natural resource extraction (Turnell, 2011b). Tax mobilisation has also suffered due to the weak capacity of the administration, corruption, endemic evasion and granting of exemptions, and a complex and arbitrarily applied taxation structure (Oo et al., 2015).

The limited national tax system remains in effect highly centralised, thereby empowering many actors to levy various taxes and charges at the local level, including sub-national councils, the military, government-supported non-governmental organisations (NGOs), and armed groups. This has been especially prevalent in areas outside of government control since the 1960s. Accordingly, Myanmar's level of revenue mobilisation remains one of the worst in the world.

Excluding receipts from mining activities, mobilisation currently stands at 10-12% of GDP, significantly lower than countries at similar levels of income, but better than the decade prior to the transition when it hovered around 6% (World Bank, 2017a). Gas exports and other transfers from state economic enterprises continue to account for an excessive proportion of revenue.

## **Decentralisation**

It is widely recognised that Myanmar's highly concentrated governance system, stemming from a history of centralised planning, acts as a serious barrier to improving state effectiveness. Significantly, the 2008 Constitution construes, albeit in vague terms, decentralisation across eight broad sectors as the main channel shaping the relationships between the Union and fourteen regional and state governmental entities. Decentralisation has thus emerged as a key pillar of Myanmar's transition, as well as one of the issues being addressed through the post-2011 peace process.

However, one pervading obstacle is the lack of clarity as to which services are the responsibilities of each level of government from the Union down to wards and villages, leading to confusion over the accountability of public services provision (Shotton et al., 2016). In the absence of a clear delineation of responsibilities, decentralisation has involved raising transfers to states and regions without consideration as to how revenues can be spent effectively.

Revenues raised at the sub-national level still represent an insignificant proportion of states and regions' own finances, at about USD 1 per capita in 2015, despite having the power to mobilise a range of taxes and fees (Dickenson-Jones et al., 2015). At the same time, political decentralisation remains minimal,

limiting citizens' opportunities to demand accountability for subnational government spending and responsiveness to public preferences. Most of the key government officials in states and regions are appointed by the central government or armed forces, including the Chief Ministers.

Nevertheless, one of the more promising areas for harnessing the efficiency of decentralisation is through local municipal authorities, known as Development Affairs Organisations (Arnold et al., 2015). Under the remit of the state and region governments, they are tasked with providing a range of infrastructure and social services in urban areas. Critically, they also have the authority to mobilise local revenues through property taxes, user fees and business licenses. The close connection between their locally-focused service delivery and revenue collection mandates makes them an ideal testing ground for strengthening accountability and bridging the divide between the government and the public.

## **Public service provision by armed groups**

In areas controlled by armed organisations or under mixed-administration, militias and armed groups solicit taxes and provide essential services to local populations through parallel governance systems and legitimacy developed during decades of autonomy. The provision of social services is central to the authority of many armed organisations – but not all. Those with a mere criminal agenda confer the power and legitimacy that defines their ethnic and political struggle for the right to self-governance. Often ethnic local populations harbour a deep distrust of the central government – viewed synonymously with an intrusive and violent military – and have had little if any positive interactions with government institutions.

There is a large variation in the range of services provided by armed rebel groups, as well as their quality, but they do cover health, education, infrastructure, security, justice, emergency relief and agricultural support (Jolliffe, 2014). Smaller armed outfits more typically provide security and ad-hoc donations to community organisations or those displaced by conflict (Buchanan, 2016). Larger groups, some that exercise complete autonomy within their territories, provide social services, including health and education, sometimes of a relatively high standard compared to neighbouring state-controlled areas.

In one case demonstrating the capabilities of the larger ethnic armed groups, the Kachin Independence Organisation engaged in a contractual arrangement to sell electricity generated by hydropower dams within its territory to the central government. This came to an end when conflict resumed between the two parties in 2011. While formal taxation processes do exist in some areas controlled by armed organisations, their social and military activities are primarily financed through illicit trade, natural resource rents, arbitrary taxation, business activities, and drug production and trade (Woods, 2013).

## State and non-state armed group convergence

Convergence of state and armed groups' public services, and thereby governance systems, represents one of the main challenges of the country's ongoing peace process. The right to self-determination is at the centre of many ethnic groups' grievances and the provision of social services is closely linked to ethnic identity and political complexes that define tensions with the central state.

The extension of the state into ethnic areas is not simply a case of increasing access to public services. To many it represents the dilution of political and cultural norms. For militias without any ethno-political agenda, state penetration represents a threat to their vested economic interests, as opposed to a threat to the identity of the people residing in the territories they control.

In this context of a convergence of the state with a myriad of non-state armed groups, fighting it is unlikely to be a smooth or short-term process. It must be developed with a view of securing a central role for the existing social institutions (at least the efficient ones) in territories under the control of armed groups alongside the central state apparatus. Carefully negotiated and sequenced collaboration can ultimately serve to improve the quality and efficiency of public service delivery by diverse institutions, but only if guided by a unanimously agreed upon political settlement.

Photo: Protests against the National Education Law in 2013. Credit: Sithu Naina | VOA



# State fragility and the private sector

## 6

The first transitional government in 2011 inherited a largely insular and traditionally dirigiste state that restrained free enterprise. Successive postcolonial governments had implemented state-centric systems, stemming a dysfunctional economy shaped by autarky and state ownership (Than, 2007). After the military seized power in 1962, it imposed twenty-five years of a loose mix of Marxism and a military-run economic dirigisme: the 'Burmese Way to Socialism'.

### State-led clientelist capitalism

A second coup in 1988 precipitated the dropping of socialism in favour of state-led clientelist 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 gradually liberalised 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.

### A weak private sector

Institutions that regulate business activity have traditionally been weak. Since the first military takeover, the sedate bureaucracy served to constrain the majority of the private sector by erecting bureaucratic barriers to extract fees and consolidate an inward-looking, protectionist development model (Mutebi, 2005; Than, 2007). 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). The reach and depth of the financial system was amongst the worst in the world, in particular following arbitrary demonetisations in 1964, 1985



and 1987, as well as multiple banking crises (Turnell, 2009).

The necessary skills and other fundamental conditions for business growth were largely missing as the market opened up. A dearth of skilled labour had resulted from a weak education system and the exodus of much of the educated class. In the productivity black hole 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 to the coffers of the military regime (Turnell, 2011b).

As the transition started building momentum and gaining credibility in the early 2010s, the Myanmar private sector was characterised by a 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 countries, and was considered one of the most challenging business environments in the world.

## Post-2011 reforms and private sector development

Today, the makeup of Myanmar's private sector for the most part reflects the bifurcated structure that endured prior to the transition. The majority of firms are micro enterprises or smallholder farms. 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 small and medium enterprises (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 (SOEs) engaged primarily in extractive, construction, banking and import/export industries.

To kick-start growth as part of its new economic agenda, the first transitional government led by the USDP commenced an ambitious programme of economic reform in 2011. The core institutions that govern the economy were first targeted: 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.

Thanks to these reforms, 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 some 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 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' aimed to better facilitate foreign investment where there was previously uncertainty amongst overlapping laws and regulations.

## Barriers to private sector development

Despite progress, the process of deeper structural reforms and institution rebuilding that remains poses significant challenges given the path-dependence of prevailing institutions. Numerous formal and informal barriers to private sector development are embedded within vast regulatory arrangements, bureaucratic webs and widespread petty corruption.

In a recent example, the Myanmar Business Forum chronicled the process and costs required to build and license a guesthouse close to a tourist destination. Securing approval to change the land use designation and acquire a business license took 25 months in total, required input from 13 agencies at four levels of government, and about USD1000 in 'tea money' (or bribes), gifts and donations (Myanmar Business Forum, 2017).

Such an experience is typical for non-connected businesses in Myanmar and demonstrates how the legacy of its state-controlled economy can suffocate enterprise by imposing prohibitive formal and informal transaction costs. The complexity and lack of clarity of the legal system compound these issues – often empowering the bureaucracy to selectively apply regulations and use them to extract bribes.

## Rent-seeking elites

While the far-reaching state bureaucratic structures impeded the emergence of a diverse and competitive private sector, they worked to prop up and entrench a minority of powerful rent-seeking military-connected conglomerates (Jones, 2014). Following the collapse of the socialist regime in 1988, the military 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 (cited in Tun, 2002).

Those entrepreneurs were a select group of individuals with close ties to powerbrokers in the military, relying on connections and nepotism 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 (Hlaing 2002).

The opportunities brought about by privatisation and liberalisation in the 1990s further intensified this complex with the emergence of a myriad of small entrepreneurs, particularly of Chinese origin (Maung, 1994). Many firms started to build their capital base off revenues from illicit trade during this time, especially drug production and trafficking, and were long "permitted" to launder the proceeds through state banks, thereafter reinvesting in legitimate businesses

and property (Meehan, 2011).

In parallel, conglomerates encompassing various industries were set up to generate revenue for the military. For example, restructuring of the Defence Services Institute, a military-run conglomerate of various industries launched in 1951. The armed forces also 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) (Myoe, 2009).

A new equilibrium of state-capitalism defined by military directed rent-seeking set in. Despite two decades of international sanctions and a partial dismantling of their monopolies after 2011, both retain considerable economic power. As the reach and resources of the emerging business elite expanded, the military became more reliant on their capabilities 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 new capital city of Naypyitaw in the early 2000s and led humanitarian and rebuilding efforts in the wake of Cyclone Nargis in 2008. Businesses had long financed programmes and activities aimed to shore up the military's political legitimacy, a trend which continues to this day. During the 1990s, in an effort to fortify public support, the junta implemented an extravagant programme of cultural and religious activities, 80% of which was bankrolled by business people (Hlaing 2002). Thus, the interdependence between the state and a select group of firms grew to define many of the largest market interactions.

## **Cronyism in a new democracy**

Military-championed 'national entrepreneurs' are commonly known in Myanmar as 'the cronies'. Along with military-owned conglomerates, they likely account for a substantial portion of the private sector. The cronies initially amassed fortunes primarily by extracting natural resources in ceasefire areas and government construction contracts. Military-owned and other connected firms diversified over time, which was accelerated by a second round of SOE privatisations immediately prior 2011 elections (Min and Kudo, 2014).

At the advent of the transition, the cronies had secured dominant incumbency positions in sectors more amenable to foreign investment, such as banking and transport, and consolidated control over former state assets and natural resources. This re-orientation set the stage for the transition by strategically placing them in positions to sustain their dominance in a post-sanctions, liberalised economy with shifting centres of political power.

The position of the cronies is bolstered by their connections, domestic capital base, and local knowledge. These assets are required to navigate the burdensome regulatory environment of Myanmar on behalf of investors, and joint ventures with local partners are still required in many capital-intensive sectors. Although the position of the cronies 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.

## Elite capture

The culture of clientelism is likely to persist as it underpins social and political power structures in Myanmar and has defined government-business relations since the colonial era (Hlaing 2002). The issue is whether crony firms will evolve into an oligarchy. This will mean they will no longer be reliant solely on military connections, instead exerting their economic influence to gain favour from emerging networks of power, thereby moulding the democratic transition. As such, opportunities for elite capture could lead to the endurance of a rent-seeking elite as has been observed elsewhere in south-east Asia (Ford et al., 2016).

The absolute governance power of the military in previous eras led to an equilibrium where cronies 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, dominated by the military-backed USDP (2011-2016) were indeed drawn from the business sector (Egreteau, 2014). Other wealthy tycoons have embraced the fledgling opposition, donating to and voicing support for the Aung San Suu Kyi's National League for Democracy. Irrespective of their evolving political connections, the ability of the cronies to be given preferences to government concessions is likely to be somewhat diminished in the new democratic order.

Their dominant market positions and access to scarce capital (often from illicit sources) 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 large-scale 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, in spite of the related transaction costs, or relying solely on foreign firms from neighbouring countries, risking a nationalist backlash. Myanmar is not new to ethno-economic nationalism, and anti-foreign sentiment has previously surged, at times violently, in opposition to foreign businesses and developments (Zin, 2012). Therefore, while old sources of uncompetitive advantage have been eroded in the new quasi-democratic era, others persist.

## Ceasefire capitalism

As described previously, civil war is at the centre of Myanmar's fragility by entrenching the borderlands in cycles of violence, war-based economies, and underdevelopment. It has been employed by successive military regimes to legitimise and assert control in the interest of national security. The vast natural resource endowments of the county's conflict affected areas have long defined their economies. However, their strategic location, which connects two of the world's largest economies (China and India) and Thailand, is set to become increasingly important as they integrate within regional infrastructure networks.

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 induce peace between warring parties. From 1988, the new military regime negotiated a new series of ceasefires to pacify conflict areas. 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 form of truce with the Tatmadaw, armed groups made the most of the country's post-socialist opening up - especially towards the booming economies of Yunnan (China) and Thailand. This created new forms of intricate informal economies in the borderlands while entrenching local patronage structures. The relative stability brought about by ceasefires allowed for an escalation in resource extraction, facilitated by industrial agriculture and infrastructure development in areas previously off-limits, thereby radically reshaping the political economy of volatile ethnic areas.

The ensuing large-scale exploitation of natural resources - mining, logging and rubber - in ethnic areas through business deals between local power-holders, the military, and foreign businessmen has been branded 'ceasefire capitalism' (Woods, 2011). The military, by establishing business links with their former enemies, created a tenuous equilibrium founded on the distribution of rents. 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. As a result, it has been observed that some armed groups 'have become more of an armed business venture than a political movement' (Ballentine & Nitzschke, 2003).

## Popular disaffection towards private sector investment

Ceasefires founded on economic rents brought a degree of stability to conflict areas but have typically spawned disaffection amongst the broader ethnic populations, with some groups re-engaging in active conflict with the military. The benefits of the business deals resulting from the new peacetime economy were mostly concentrated amongst leaders of the ceasefire groups and armed militias, the military and foreign business partners. While a new business elite built a lucrative portfolio of investments, the broader ethnic populations - 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).

Over time, business exploits in ceasefire areas evolved from extractive industries, such as jade mining and logging, towards large-scale industrial agriculture development, which required the expropriation of large swaths of land. Investors primarily focused on rapacious short-term extraction characterised by a lack of value addition and employing migrant rather than local labour. 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 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 as well as indications by the Kachin Independence Army that it could spark a return to civil war.

At the core of this 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 local armed organisations. In some cases, they led to fragmentation and internal revolts within armed groups, and a return to conflict (Brenner, 2017a). Where conflict has not re-ignited, 'ceasefire capitalism' persists and many areas remain volatile and challenging contexts in which to pursue responsible private sector development.

Although the appearance of stability still exists in these ceasefire 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).

## Reconciling a legacy of conflict with investment and growth

Trade through the borderlands 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, using "transit fees" which are levied at checkpoints (Jolliffe, 2015). The military has tried to circumvent or eliminate these sources of revenue in the past, but many remain, and their removal will pose a serious challenge as their value increases in concert with the trade flowing through new infrastructure developments.

Furthermore, the illicit 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, 2016). These issues will be compounded as Myanmar becomes further integrated in the regional trade and transport networks quickly being developed and financed by its powerful neighbours.

The volatile borderlands of Myanmar possess many attributes that make them promising investment destinations. They are close to large regional economies, home to extraordinary landscapes, and replete with valuable natural resources. Yet they have been unable to leverage their advantages to spur equitable economic growth due to the complexes created by a legacy of conflict and underdevelopment.

The confluence of underlying instability and a political economy defined by elite capture works to deter competitive and responsible businesses. Where it has a presence, the state is ineffective and unwilling to regulate commerce in order to mitigate the negative externalities that fall on communities. Legitimacy of authority is highly complex, contested and arduous for outsiders to determine. As a result, in many areas, the population's only experience of economic development has been exclusively negative.

At the same time, in a post-peace process Myanmar, job creation will play an important role in generating alternative livelihood opportunities for demobilised combatants. This history points to the risks of large-scale 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 armed actors.

Therefore, the first-order challenge for mitigating fragility stemming from conflict in Myanmar is to seek a permanent peace agreement that addresses the concerns of ethnic groups prior to pursuing large-scale investment and changes to the political economy. In the absence of political solutions, a conflict sensitive approach to investment needs to be implemented that incorporates the concerns of local communities.

Photo: Produce sellers in Myanmar market.



# Economic resilience

## 7

After 50 years of mismanagement, Myanmar's economy is highly susceptible to external shocks, exacerbated by enduring conflicts and governance challenges. Core weaknesses that define its volatility include a dependence on natural resource revenues, vulnerability to all sorts of natural disasters, and a limited financial sector.

### Macro-economic stability

The Myanmar economy exhibits many of the typical characteristics of a low-income economy in transition: it has a narrow production base and large informal sector, with natural resources, in particular gas, driving export and GDP growth since 1990. Economic policymaking throughout the reign of successive regimes typically proved arbitrary, uninformed, and misguided, with the resulting weak investment climate concentrating foreign direct investment (FDI) in the extractive sectors.

Until recently, Myanmar's Central Bank, which was created in 1976, was primarily used to finance budget deficits, inevitably shifting the financial burden to the public through inflation. Three demonetisations wiped out savings, undermined public trust in the monetary system, and led to a significant dollarisation of the economy from the 1990s.

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 the purpose of agriculture and faced prohibitive collateral conditions, condemning the vast majority of the population to sourcing finance from informal moneylenders.

From the late 1990s, the exorbitantly overvalued official exchange rate created massive inefficiencies and enabled government to import goods grossly undervalued by the official rate, thereafter reverting to the black-market rate (Hori and Ching Wong, 2008). The bloated exchange rate also shielded the true value of the state's income from oil and gas resources from the current accounts, massively underestimating revenues while the remaining value was siphoned off by the military (Turnell, 2011a).

The post-2011 transition has heralded a more prudent approach to economic



polycymaking:

- The government started weaning itself off central bank financing and officially allowed the exchange rate to edge towards full flotation.
- 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.
- GDP growth picked up, no longer solely based on natural resource exports, increasing from 5.6% in 2011 to 8.4% in 2013, before falling in 2016 to 6.1% as the economy suffered a shock from flooding.

The fruits of the 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, 2017a). The rural borderlands, which are disproportionately conflict-affected, have experienced lower and less sustainable growth that is primarily based on natural resource extraction and compounded by a lack of infrastructure.

## Natural resources revenue

Myanmar's wealth of natural resources harbours perhaps its greatest potential as well as its greatest governance challenges. The country is endowed with oil, natural gas, high value timber, minerals, hydropower potential, and gemstones. Much of these natural resources are situated in the conflict-prone borderlands or off-shore. They have long been the single largest source of government income, with oil, gas, minerals and gems alone accounting for 24% of government revenues in the 2014-2015 fiscal year (NRGI, 2016).

Official figures likely understate the true value of such revenue sources to the government due to a lack of transparency as to the destination of revenue once it is gathered and a lack of capacity to efficiently tax natural resources. Smuggling and underreporting compound losses, with the government only capturing an estimated 10% of the market value of jade, one of the most valuable natural resources in Myanmar in terms of gross value extracted, along with oil and gas (NRGI, 2016).

Highlighting this stark example, Global Witness estimated that total jade production could have amounted to as much as \$31 billion in 2014, while just 3% of that value was officially declared (Global Witness, 2015). Although this is likely a high-end estimation, output from the jade sector certainly equates to a significant portion of Myanmar's GDP. Through improved governance and fiscal management of the sector the government could capture more of its natural resource wealth and amass sufficient funds to build a foreign reserve buffer.

As well as the threats to macroeconomic stability presented by the resource curse, natural resources have long defined war economies, military dominance, and ethnic claims for autonomy in postcolonial Myanmar. The military and elites of some armed groups exercise control over much of the sector and have strong incentives to retain control. This dynamic protracts conflict and provides the

Tatmadaw with the resources to sustain its dominant political role while siphoning public funds for its own purposes and vested interests. In the long-run, natural resource governance is one of the key issues to be addressed through the peace process.

## Natural disasters

Perhaps the gravest threat to lives and livelihoods in Myanmar is posed by natural disasters, exacerbated by climate change, environmental degradation and socio-economic vulnerability. Myanmar is ranked the second most affected country by natural disasters and the tenth most at-risk globally (Kreft et al., 2016; UNISDR, 2015). Coastal regions are regularly devastated by cyclones and storm surges while the central dry zone is prone to droughts compounded by large-scale deforestation.

### Cyclone Nargis (2008)

Cyclone Nargis in May 2008 was the worst disaster in Myanmar's living memory, resulting in the death of over 140,000 people, the displacement of 4.3 million, and a loss in GDP of 12% (IMF, 2017). The destruction wrought offers a perturbing example of how weak governance can exacerbate the toll of natural disasters, with ripple effects for the political direction of the country.

In the wake of the cyclone, the paranoid military regime initially refused access to international actors until four days after the event, then only allowing limited involvement. It downplayed the scale of the disaster, reluctant to acknowledge its inability to rapidly mobilise an adequate response. When civil society stepped in, many community-based organisations and individual citizens were prevented from reaching affected areas, while activists were even imprisoned for their efforts. The military finally relaxed restrictions, which ultimately set the stage for a greater role for civil society organisations in the country at large (Howe & Bang, 2017).

### Floods and earthquakes

In 2015 alone, floods and subsequent landslides displaced 1.6 million people and affected over 9 million, severely impacting agricultural production in rural and ethnic mountainous areas (World Bank, 2016). The knock-on effects for food price inflation across the country compounded the impact on the most vulnerable groups. Owing to improvements in institutional frameworks for disaster preparedness, the government was more prepared than in previous disaster situations to effectively respond (UNOCHA, 2016).

In August 2016, a mild earthquake destroyed parts of the country's main archaeological site, the temples of Bagan. This event echoed massive earthquakes of the past, particularly those of 1930 and 1975, and acted as a prescient reminder of how Myanmar's state and society remain ill-prepared to face such large-scale disasters, even as they continue to pose an increasing threat to the country due to climate change. The rural poor, who represent two third of the country's population and rely on agriculture, will continue to be

particularly vulnerable.

Maintaining macroeconomic stability is perhaps the largest challenge facing the current and future democratically-elected governments. Years of mismanagement have resulted in a weak institutional base with which to counter shocks and enact policies for sustainable growth. A stronger economy is a priority for a public that has nurtured sky-high expectations for their future under the leadership of Aung San Suu Kyi (Blazevic, 2016). In the past, economic shocks have led to civil strife in Myanmar (including the 'Saffron Revolution' in 2007) and in the context of a volatile transition the deterioration of the economy could similarly undermine any positive political trajectory.

Photo: Aftermath of the 2011 earthquake in Myanmar. Credit: VOA



# Conclusion

## 8

Myanmar presents several symptoms of state fragility: enduring political violence, low levels of development, and state ineffectiveness, to name a few. But the country also contradicts many traditional concepts of fragility. In areas either without a state presence or home to an inefficient one, which are also frequently conflict-affected, public goods and social services are nonetheless often effectively provided by non-state actors and local religious, political, or economic power-brokers.

Natural resources have at times been leveraged to incentivise peace rather than conflict. The elites of the central state and those of non-state armed groups can cooperate economically, while simultaneously engaging in conflict. As such, it offers perhaps the most discerning example of the importance of considering the plurality and complexity of multiple fragile contexts that can be embodied within a single “state.”

Myanmar today confronts a complex set of challenges that few of its successive leaderships have proven capable of addressing. Two years after the country’s first open and fair elections of the modern era, the economic and political progress that was assumed to accompany liberalisation and democratisation has wavered. The new government, even with an overwhelming popular mandate, has faced constraints to continuing difficult structural reforms within highly centralised and weak state institutions.

The military has evolved from embodying the state to being an unaccountable “state within a state”, whose extra-ordinary prerogatives are guaranteed by the 2008 Constitution. Conflict in the borderlands has intensified and the NLD-led peace process has so far failed to build bridges and address the historical grievances and inequalities faced by ethnic groups. Western support has faltered in response to the 2017 crisis in Rakhine State, where the military’s actions have emboldened its popular support and brought to the fore the ethno-nationalism that has long defined Myanmar’s polity.

This reality counters the unrealistic expectations and hopes of rapid transformation previously harboured for an inherently fragile state sculpted by decades of authoritarianism, isolation, and colonialism. It highlights the fact that underlying causes of fragility cannot be rehabilitated through short-term political change, but rather through the long-term rebuilding of the institutions and norms that govern a country.

In Myanmar, the multiplicity of contexts within its borders represent widely different realities, which in turn require differentiated and tailored responses from domestic and international actors to “remedy” their states of fragility in the long-term.

# Remedying fragility in Myanmar

1. Myanmar demonstrates the risk of state-building through outside intervention – whether domestic (such as Myanmar’s military spearheading state-building efforts in areas long outside of state control) or foreign. It must therefore endeavour to **pursue state-building in the interest of all its people.**

- There must be a clear understanding among ethnic groups of how the state can be construed as a non-intrusive, non-hostile entity representing external vested interests.
- Moving towards peace requires a marked change from current security-based policymaking and from the continuation of military responses to Myanmar’s challenges more broadly – both stemming from ethnic conflict and other forms of domestic dissent.

2. **Working towards stable and constructive state-society relations** more generally, but particularly in borderlands, will be crucial.

- Popular trust and legitimacy needs to be established in central state structures through political processes focused on improved, more transparent governance and equality of representation.
- An important factor in improving the quality and efficiency of public services will be a carefully negotiated and sequenced convergence with non-state institutions (religious, local armed groups, etc.) already serving the public and state entities, leveraging the strengths of both.
- At the same time, as decentralisation expands, building the capacity of sub-national institutions to efficiently implement new revenue raising and expenditure powers will allow local authorities to respond more effectively to citizens’ preferences.

3. **Building a productive, resilient and inclusive economy** will increase incomes and provide the means for the state to improve the welfare of its citizens.

- Eliminating opportunities for rent-seeking both in the central state and ethnic areas will foster a competitive private sector and responsible foreign investment.
- Precarious ceasefires and client-patron relations should no longer determine the allocation of state resources.
- In the long term a strong education system, a reliable and fair legal system, and a competent civil service will serve to build the foundations of an economy that will better serve its citizens.

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