Natural Resource Governance Institute

Modernizing Oil, Gas and Mining SEEs in Myanmar: Some Considerations for a Reform Plan

The Natural Resource Governance Institute (NRGI) has launched a new report, *Gilded Gatekeepers*, which illustrates significant governance challenges associated with the state-owned economic enterprises (SEEs) in the oil, gas and mining sectors. Reforming these enterprises is critical if Myanmar is to improve the impact of these extractive industries on the lives of its people.

According to Myanmar's first EITI report, SEEs collect 85 percent of all revenues that the state earns from oil, gas and mining. In the oil and gas sector, they also play a dominant role in decisions about how to award licenses and how to interact with local populations.

Myanmar cannot tackle public financial management reform in a serious way without improving oversight of these SEEs. Government estimates indicate that oil, gas and mining SEEs account for 20 percent of all public revenues and 15 percent of all public expenditures. And in many cases, they manage this money with little accountability to other government entities or the public. According to the EITI report, between April 2013 and March 2014, the Myanma Oil and Gas Enterprise (MOGE) alone deposited more than 1.3 trillion kyat (approximately USD 1.4 billion) into off-budget accounts that are not subject to ordinary processes of financial control.

Reforming the oil, gas and mining SEEs will not be easy. They sit at the intersection of complex industries and large financial flows, and appear to be closely linked to networks that advance the economic agendas of well-connected companies and officials. But in keeping with the reforms initiated during the past several years, and as a vehicle for pursuing concrete changes during this moment of political transition, the new government can take several steps to initiate a serious reform process:

1. As part of a broader legislative reform process, develop stronger rules regarding the roles and responsibilities of the extractive SEEs.

The legal frameworks governing what the oil, gas and mining SEEs are empowered to do and how they may execute that power are less elaborated in Myanmar than in any other country we have examined. SEEs' actions appear to be based more on habitual practices than formal rules. This is understandable given the country's history of central control. However, this lack of structure can confuse and discourage investors, impede strategic decisions, and limit the ability of government and citizens to hold the SEEs accountable for their success or failure. This problem is especially acute in light of the fact that in the oil and gas sector, MOGE plays commercial, licensing and oversight roles simultaneously, which can create conflicts of interest in the management of the sector.

For more information on international experiences on the definition of state-owned-enterprise roles and responsibilities, see the section on "defining commercial and non-commercial roles" in our companion briefing *Reforming State-Owned Enterprises in the Extractive Industries: International Experiences and Implications for Myanmar.*

Stronger rules governing SEEs would represent an important part of any new legislation governing the petroleum and mining sectors. It may not be possible to tackle all necessary elements of SEE legislative reform at once, but at a minimum Myanmar could enact language that more clearly establishes the SEEs' responsibilities, delineates the intersection of their authority with those of the relevant line ministries, and requires clear reporting to the public. Myanmar can draw on examples of legislation in neighboring countries and others worldwide and adapt those experiences to suit the country's circumstances.

2. Reexamine the amount of money the SEEs control, including the sums they are allowed to deposit into "Other Accounts."

The figures above illustrate the oversized role that Myanmar's extractive SEEs play in the management of public revenues. Not all countries give such a large role in revenue collection to SEEs—in some cases the largest shares of payments flow directly from private extractive companies to the treasury or to some sort of dedicated petroleum account, rather than through the state-owned enterprise.

Similarly, Myanmar's oil, gas and mining SEEs are given a large degree of autonomy over how they spend these revenues and how much they retain. Following a set of changes initiated in 2012, the extractive SEEs—along with all other SEEs—are allowed to keep the majority of the revenues they earn each year in "Other Accounts," rather than transferring them to the state budget. According to Myanmar's first EITI report, from 2013 – 2014, 58 percent of the gross revenues of the five leading upstream extractive SEEs was withheld in these Other Accounts. MOGE alone withheld more than 60 percent of its revenues.

For more information on international experiences with the management of state-owned enterprise financial flows, see the section on "developing a workable approach to revenue collection and retention" in our companion briefing *Reforming State-Owned Enterprises in the Extractive Industries: International Experiences and Implications for Myanmar.*

The accumulation of significant funds into the Other Accounts reduces the money that the Myanmar government has available to spend on national development goals. The amount ($1.4 billion) placed into MOGE's Other Accounts between April 2013 and March 2014 exceed the total amount that the Myanmar government spent on health ($750 million) or education ($1.1 billion) in fiscal year 2013/14.

The accumulation of large bank accounts and the control over huge shares of public revenues may be appropriate for state-owned enterprises that lead cutting-edge, highly complex, capital-intensive oil or mineral projects—such as Norway's Statoil or Malaysia's Petronas. They are harder to justify for enterprises that act most of the time as non-operating parties relying overwhelmingly on private partners for project execution, as is the case in Myanmar. Thus we recommend that the new government conduct a thorough analysis of whether to reduce the amount of revenue that the SEEs are allowed to control and retain, in order to determine whether a larger share should be allocated to the Union Budget to be spent on development priorities through regular budget processes.

3. Improve financial reporting by SEEs to the Ministry of Finance and other government bodies, and conduct an internal assessment of strengths and weaknesses.

Like all SEEs in Myanmar, the enterprises in the extractive sector have operated with a significant degree of financial autonomy. Even the Ministry of Finance has experienced difficulty obtaining detailed information on the activities and expenditures of the SEEs. Given the dramatic impact that oil, gas and mining SEEs play on public financial management and the management of the extractive industries, enhancing intra-governmental reporting and oversight could have a positive impact on the use of public money in the public interest. It would also strengthen the incentives for the SEEs to become more effective and efficient commercial entities.

As part of the ongoing public financial management reform process, the government has begun to work closely with Myanmar's development partners to develop a more rigorous set of internal reporting templates and procedures to ensure thorough reporting by the SEEs to the Ministry of Finance and other public bodies. In the short term, a firm commitment by the new government to these efforts — and to ensuring that the SEEs and other key players within the government abide by them — will send a powerful signal and will begin to instill stronger norms of internal accountability. The new government can also use this as an input and commission a thorough internal assessment of the strengths of the different SEEs and the detailed opportunities for improvement. In the longer term, Myanmar can work toward a more comprehensive system of internal oversight.

4. Convene a group of technical advisors to support the development of the SEEs' commercial agendas.

The world's best-performing state-owned enterprises are managed by boards of directors with strong technical experience and the independence to implement strategies based on commercial considerations. Where leadership is selected more on the basis of political connections than technical skill and experience, enterprises have been less successful. Assembling boards of directors with strong technocratic credentials would be a powerful step toward helping these enterprises develop and execute strategic commercial agendas. As a short-term step, Myanmar's new government could develop advisory groups of industry experts and other professionals with relevant financial or economic skills. Members of these groups could be drawn from within Myanmar and abroad, including experts from elsewhere in Southeast Asia. Such a technical body could aid in the review and development of the commercial strategies of the oil, gas and mining SEEs, to help ensure that they pursue agendas that take advantage of available opportunities and manage risk effectively.

For more information on international experiences in creating a competent and effective state-owned enterprise, see the section on "Limiting political interference in technical decisions" in our companion briefer *Reforming State-Owned Enterprises in the Extractive Industries: International Experiences and Implications for Myanmar.*

5. Invest in the vigorous implementation of the Extractive Industries Transparency Initiative.

The release of the first report of the Extractive Industries Transparency Initiative (EITI) provided an immediate illustration of the power of the initiative to promote stronger public accountability of the extractive SEEs. Over more than a year, NRGI met with officials from the Myanmar government and other researchers and international officials, to develop a sense of revenue flows and the transfers between the SEEs, the Union Budget and the Other Accounts. We were able to develop a set of estimates with heavy caveats, and which presented as many questions as answers. With the release of the first EITI report, Myanmar's citizens immediately had a much more thorough picture, which enables stronger public understanding and a clearer set of benchmarks against which future performance can be assessed.

But significant challenges remain for effective implementation of EITI, especially regarding SEEs. As stated in the recommendations section of the first Myanmar EITI report, key steps for the next report should at least include: reconciling the revenues collected by SEEs from companies with the transfers made by SEEs to the Ministry of Finance; disclosing more information on Other Accounts; and considering treating military-affiliated companies such as UMEHL and MEC as SEEs.

6. Move toward conducting independent external audits.

The most commercially successful state-owned enterprises in the oil, gas and mining sectors are subjected to independent audits by private firms, carried out according to international standards. Such audits can identify irregularities and can create good benchmarks for performance. In Myanmar, SEE finances are reviewed by the Auditor General, but not by independent auditors using the most modern techniques. It may not be feasible to conduct thorough and comprehensive independent audits of Myanmar's extractive SEEs right away. But the new government could take meaningful steps in the near term by working with a "Big Four" accounting firm to assemble the information available in the SEEs' and the government's records into a format consistent with standard international practice.

For more information on international efforts to bolster public accountability, see the section on "promoting transparency and oversight" in our companion briefing *Reforming State-Owned Enterprises in the Extractive Industries: International Experiences and Implications for Myanmar.*

7. Develop a regular schedule for reporting to parliament—and the public.

Myanmar's recent election provides hope that parliament's ability to monitor progress in key economic sectors will continue to grow. In order for Myanmar to realize this ambition in the extractive industries, it is critical that the SEEs report regularly to parliament on their commercial plans, revenues, activities and ambitions. As a first step, the new government could plan for a top official from each SEE to appear before parliament at least once every six months, to provide a headline report and respond to detailed questions. Similarly, routine reporting to Myanmar's citizens is crucial, so that they may understand better what the SEEs are doing and why. The new government could require the release of annual reports with key data and strategies from each oil, gas or mining SEE.

8. Clarify relationships with military-affiliated companies

Military companies UMEHL and MEC occupy important positions in Myanmar's economy, including in the mining sector. They are not formally state-owned enterprises, but play a major role in the generation of revenues from mining and the day-to-day management of many mining projects. They report to the Directorate of the Defence Procurement and are granted protections and privileges similar to state-owned companies. This situation creates substantial confusion among Myanmar's investors and citizens. As is mentioned above, the first Myanmar EITI report suggests treating them as SEEs in the next round of reporting, which would shed greater light on these companies' activities. Even if the new government opts not to treat these companies as SEEs, we recommend a thorough review of their status, roles and obligations.

NRGI has worked with governments, researchers and civil society organizations throughout the world to support efforts to enhance the effectiveness and accountability of state-owned enterprises in oil, gas and mining. We would be happy to have further discussions on any of the above-mentioned issues or to provide any additional support to the new government as it continues to develop its strategy for SEE management.