

State-Owned Economic Enterprise Reform in Myanmar: The Case of Natural Resource Enterprises



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This report has identified a number of challenges associated with SEE governance in Myanmar, including revenue retention rules, management of Other Account balances, transparency, and budgeting and oversight. Furthermore, we have detected a number of specific risks to natural resource SEE profitability, specifically at MOGE and MGE. Here we provide recommendations on areas for reform and discuss what policy changes Myanmar officials could consider to address these risks and challenges. We also suggest a draft timeline on implementation of reforms.

RECOMMENDATION 1. IMPROVE MANAGEMENT OF OTHER ACCOUNT BALANCES

By our estimate, Myanmar's SEEs, hence the Union government, have lost more than USD 2 billion in purchasing power over the last three years through overly conservative Other Account management rules. Requiring foreign SEE earnings to be converted into kyat has prompted most of this loss due to exchange rate depreciation. Prohibiting investments in interest-accruing assets has generated even greater losses.

In the short run, we recommend that two directives be changed to allow for SEE savings to retain their value. First, we recommend that state-owned banks (MEB and MFTB) be allowed to invest SEE savings not expected to be drawn upon in the next six months in interest-accruing foreign assets. This rule would maintain liquidity of a portion of OA balances for use as "working capital" while the remainder would retain or enhance its purchasing power. A specific list of low-risk

investments could be specified to prevent excessive risk-taking or politically motivated investments. For example, OA balances would only be allowed to be invested in high-grade sovereign or corporate debt available in convertible currencies.

Second, we recommend that SEEs no longer be required to convert foreign currency sales into kyat in order to repatriate the profits. Instead, foreign currency OA balances could be held at the central bank or at custodian banks.

Third, in order to facilitate good record-keeping and ensure that all OA balances are accounted for, the government could publish all SEE bank account balances at MEB, MFTB and the central bank, including OAs. This could be done on an SEE-by-SEE basis or by MOPF.

RECOMMENDATION 2. REALLOCATE A PORTION OF OTHER ACCOUNT BALANCES

As of January 2017, MMK 11.9 trillion was held idle in Other Accounts. Of this amount, approximately MMK 11.5 trillion was held in SEE OAs. These balances represent a considerable misallocation of resources.

As we have shown, a reallocation of a portion of these balances to other Union accounts would not impair the operations of certain SEEs, including MOGE and MGE, especially if revenue retention rules remain unchanged. What percentage of any given OA balance can be reallocated depends on the SEE it belongs to. A much larger share of MGE's OA balances than MOGE's can be reallocated without impairing its ability to carry

DRAFT TIMELINE FOR REFORM

POLICY OPTIONS	2018	2019	2020
R1 – OA management	■		
R2 – OA balances	■		
R3 – Revenue retention	■		
MOPF OR INTERMINISTERIAL ACTIONS			
R4 – New forms and oversight	■	■	■
R5 – Coordination	■	■	■
R6 – New SEE oversight body	■	■	■
R7 – SEE independent boards			■
PARLIAMENTARY/LEGAL ACTIONS			
R8 – New SEE law	■	■	
R9 – Hluttaw training	■	■	■
R10 – Auditor-general law	■	■	
R11 – Financial inst. law	■	■	
R12 – Investment law		■	■
STATE-OWNED ECONOMIC ENTERPRISE ACTIONS			
R13 – SEE targets	■	■	■
R14 – Annual reports	■	■	■
R15 – Independent ext. audit	■	■	■
R16 – Performance incentives			■

out its operations. Based on our assessment, at least 65 percent of MGE’s OA balances can be reallocated without jeopardizing MGE’s operations, whereas at least 45 percent of MOGE’s OA balances can be reallocated safely.¹ Reallocation of excess savings from these two SEEs alone could provide more than MMK 2.8 trillion in available financing for the Union immediately.

If a portion of these OA balances are reallocated, to where should they be reallocated? Several non-mutually exclusive options are presented.

Option 1. Allocate for deficit financing

While deficit financing may be the most straightforward option, it may not be the most salient. On the one hand, the budget ought to represent the government’s development plan. As such, its financing should be considered a priority.

The deficit can be covered either by domestic or foreign borrowing, both of which (especially the latter) could have negative consequences. Domestic financing

of the deficit implies either selling government bonds to domestic financial institutions or the central bank essentially printing money. If money demand does not grow as fast as money supply, this can generate inflation. However, given economic growth rates in Myanmar, the size of the deficit and the small size of the government sector as a share of the overall economy, it is unlikely that deficit financing can generate significant inflation.

Foreign borrowing can also have high costs since the Myanmar kyat is likely to depreciate in the future. Given that much of the government’s revenue is generated in kyat, the cost of servicing foreign debt may increase. Additionally, interest rates can increase in the future when debt has to be rolled over, placing Myanmar’s debt sustainability outlook at risk.

Other Account balances can help fill this gap without increasing the money supply or relying on foreign borrowing. However, this option does not signal to Myanmar’s citizens the government’s commitment to improving livelihoods or economic development. Nor does it leverage this money for infrastructure or education financing.

¹ Calculation is based on granting SEEs a full year of precautionary savings given average costs and tax payments over the last four years.

Option 2. Earmark for infrastructure, healthcare or education

A portion of OA balances can be earmarked for specific expenditure items that improve people's lives and generate broad-based economic growth, such as a national infrastructure plan, education or healthcare. Earmarking is most effective when it is used to finance projects that would not otherwise be funded.

There are several advantages of this option. First, funds flow through the normal budget process. Therefore they are subject to the same oversight procedures as other government spending and would not undermine the public financial management system. Second, the option would provide financing to underfunded expenditure items, such as electric power generation and distribution, water and sanitation infrastructure or the national healthcare plan. Third, it would signal to Myanmar's citizens the government's commitment to improving livelihoods and promoting economic development.

There are at least two disadvantages of this option. First, earmarking takes some annual spending decisions out of the hands of parliament, though parliament would have to approve the earmark. Second, since money is fungible, it may not lead to a net increase in spending for the earmarked expenditure items. Essentially, OA money could be shifted into a project line and the money that was already allocated to that project could be shifted elsewhere. Still, the costs of earmarking are manageable.

Option 3. Earmark for debt repayment

This option is similar to the previous option, except that a portion of OA balances are earmarked for debt repayment rather than development projects. The advantage of this option is that it would reduce the government's debt burden, lowering the amount paid in interest to the government's foreign or domestic

lenders. This, in turn, would generate additional fiscal space in the long run to spend on infrastructure, healthcare or education.

The disadvantages are that this option does not signal to Myanmar's citizens that the government is committed to poverty reduction or growth. Furthermore, this option may not be feasible if debt contracts include large penalties for early repayment.

Option 4. Create a permanent fund for education or infrastructure

A portion of OA balances could be used to finance a permanent fund for underfunded expenditure items, such as education or infrastructure maintenance. Under this option, only a five-year average of the interest on fund investments would be used to finance the chosen expenditure items; the principal would remain protected, hence the reason it is called a "permanent" fund. A professional agency would invest the money, mainly in foreign assets, to maximize returns. External fund managers could be hired. However, there would need to be a clear legislative framework to guide how the money is spent and which assets the fund could and could not invest in.

Several permanent fund models exist. For example, the interest earned on the USD 17.5 billion Texas Permanent University Fund—established in 1876 and financed out of natural resource revenues—is used to finance Texas' tertiary education system.² The USD 55 billion Alaska Permanent Fund, also financed by natural resource revenues, provides an annual cash dividend to every Alaskan resident.³ Interest earned from the USD 7 billion Permanent Wyoming Mineral Trust Fund finances the annual budget, rather than being earmarked.⁴

While this option can help provide a stable source of financing for government priorities, it requires a strong legal framework to function effectively. Should investment guidelines or safeguards be inadequate,

2 NRGI-CCSI. *Texas Permanent University Fund* (2013). Online: https://resourcegovernance.org/sites/default/files/NRF_Texas_October2013.pdf.

3 NRGI-CCSI. *Alaska Permanent Fund* (2013). Online: https://resourcegovernance.org/sites/default/files/NRF_Alaska_August2013.pdf.

4 NRGI-CCSI. *Permanent Wyoming Mineral Trust Fund* (2013). Online: https://resourcegovernance.org/sites/default/files/NRF_Wyoming_October2013.pdf.

mismanagement of the fund could lead to excessive risk-taking or losses. For example, both the Kuwaiti and Libyan funds have lost billions of dollars due to mismanagement and excessive risk-taking.⁵

Option 5. Finance a stabilization fund

The government could establish a stabilization fund to smooth fiscal expenditures, as a number of countries have done. In theory, these funds are meant to accumulate savings in years when fiscal revenues are unexpectedly high, for example, due to high oil prices. Money is then withdrawn when fiscal revenues decline unexpectedly and placed into the treasury fund.

Chile's Social and Economic Stabilization Fund and Peru's Fiscal Stabilization Fund both effectively stabilize their national budgets, counteracting volatility in revenues, which is largely driven by fluctuations in commodity prices. Saudi Arabia's SAMA Foreign Holdings and the Qatar Investment Authority also play this stabilization role. Given Myanmar's historical pro-cyclical fiscal policy, a stabilization fund could help the government better implement its medium-term fiscal framework.

On the other hand, there are many more examples of ineffective stabilization funds than effective ones. Funds in Kazakhstan, Mexico, Mongolia, Trinidad and Tobago, and Venezuela each have stabilization objectives, yet none have been successful at reducing expenditure volatility. The reasons differ from case to case; however, in general, funds are ineffective where there is an inadequate statutory framework, a lack of transparency and oversight, and where parliaments do not see the value in budget stabilization.⁶ Furthermore, it is unclear whether budget stabilization ought to be the government's principal objective.

Option 6. Establish a development bank and use as seed capital

The government could use a portion of OA balances to provide seed money for a national development bank, similar to Brazil's BNDES, the Korea Development Bank or Qatar Development Bank. In each of these cases, the state makes loans to domestic businesses based on both commercial and social criteria. In other words, projects must generate a return on investment and spur economic growth.

Myanmar needs domestic investment at this time, making this an attractive option. However, development banks are highly susceptible to becoming agents of patronage and corruption, as we have seen in countless examples, like the Mongolia Development Bank or at BNDES. As such, we believe this to be a high-risk option.

RECOMMENDATION 3. INTRODUCE IMPROVED REVENUE RETENTION RULES

As this report highlights, the current revenue retention rules have inadvertently generated perverse incentives for SEE profitability and efficient allocation of public finances. First, rent collecting SEEs—such as MOGE and MGE—have accumulated large Other Account balances. These savings represent a large opportunity cost; the money could be put to more productive uses—such as healthcare, education or infrastructure spending—but instead languishes at the Myanmar Economic Bank.

Second, the recurrent and capital costs of loss-making SEEs, such as No. 3 Heavy Industry Enterprise, have been covered by the Union budget while a large percentage of profitable SEE revenues have been withheld in Other Accounts, thwarting any incentive for SEEs to become more profitable. As a result, some SEE have high costs relative to production value and revenue growth remains weak.

5 NRGI–CCSI. *Managing the Public Trust: How to make natural resource funds work for citizens* (2014). Online: <https://resourcegovernance.org/natural-resource-funds>.

6 *Ibid.*

Third, since certain SEEs include passive revenue streams—such as profit share or transit fees—in their official revenue calculations, cash flows are in some cases artificially inflated. High rent collection masks weak profitability of SEEs’ more active operations, such as onshore oil production or pipeline operations.

In theory, a state-owned company’s revenue retention should reflect its expenditure needs, which in turn should reflect its government-approved mandate and strategic vision. Problems can arise when retained revenues far exceed needs—meaning resources are being misallocated from productive uses, such as education and infrastructure, to unproductive uses. Equally, when a state-owned company does not have adequate funding, it sometimes cannot fulfill its mandate, as in the case of PEMEX (Mexico), which underinvested in new wells for decades.

Several options are available to improve revenue retention rules and incentivize profitability. Each of these options implies a different degree of state control over SEEs. (See Figure on next page.) At the one extreme are cases such as Cameroon and Mexico’s national oil companies (prior to the recent energy sector reform), where the state-owned company transfers all revenues—sometimes in excess of costs—to the central government’s treasury. The government then allocates it an annual budget and some money is transferred to the company from the treasury. This option can generate a high degree of official oversight of state-owned companies, but risks underfunding companies if the government does not properly assess their needs.

At the other extreme, SEEs are taxed at the same rate as private sector operators and audited in the same way. Examples include Brazil, Malaysia, Norway and Russia. In each of these countries, the national oil company retains its profits then transfers royalties, fees, taxes, an annual dividend and sometimes its profit share to the treasury.⁷ However, in each, dividend policy is highly politicized. The government

as owner may decide what percentage of net profits are reinvested in the company versus transferred to the treasury as dividend. While Russian national oil companies Rosneft and Gazprom have generally retained the majority of their earnings, Malaysia’s Petronas transfers most of its profits to the treasury. While this option generates a lot of self-sufficiency, it reduces government oversight and risks allowing companies to retain too much of their profits.

Between these two extremes is a statutory revenue sharing formula that defines the share of revenues retained by the state-owned company to the national government, and the amount transferred from the national government to the state-owned company. This is the option Myanmar has chosen implicitly, though there remains much discretion in Myanmar in terms of the transfer from the Union budget to SEEs.

Though such formulas are difficult to calibrate, Ghana, Kuwait and Vietnam are three countries that have attempted them. Revenue retention for Ghana National Petroleum Corporation, for instance, is capped at 55 percent of carried and participating interest (which averages at approximately 30 to 40 percent of oil revenue in any given year). The government may cap revenue retention below this amount in the annual budget law. All remaining revenue is transferred to special oil funds belonging to the central government. The Kuwait National Petroleum Company retains its costs, sales from refineries and 50 cents per barrel. Ten percent of revenues are deposited into a sovereign wealth fund. The remainder is sent to the government treasury.⁸ PetroVietnam also retains a set percentage of various revenue flows (e.g., 50 percent of dividends and royalties) and pays the rest to the treasury.⁹

While the above represent archetypes, below are presented four more options more appropriate to the Myanmar context. Each of these options’ advantages and disadvantages are discussed. It is important to mention that *none* of these options will improve the

7 Patrick R.P. Heller et al. *Reforming National Oil Companies: Nine Recommendations* (Natural Resource Governance Institute, 2014). Online: <https://resourcegovernance.org/analysis-tools/publications/reforming-national-oil-companies-nine-recommendations>.

8 Paul Stevens. “Kuwait Petroleum Corporation: An enterprise in grid,” in *Oil and Governance: State-Owned Enterprises and the World Energy Supply*, eds. David G. Victor, David R. Hults and Mark C. Thurber (Cambridge University Press, 2012).

9 Heller et al., *Reforming National Oil Companies*.

General revenue retention options for state-owned companies

	Degree of state control	Explanation
<p>1 All revenues to UFA, SEE to receive allocation from parliament</p>	<p>HIGH</p> <p>LOW</p>	<ul style="list-style-type: none"> All revenues transferred to UFA SEE presents its budget and receives budget approval
<p>2 SEE can retain a predefined part of natural resource revenues</p>		<ul style="list-style-type: none"> Part of petroleum revenues that can be retained are set by law All revenues in excess are transferred to the general fund
<p>3 SEE treated similar to a private sector operator</p>		<ul style="list-style-type: none"> SEE operated as a normal commercial entity with the state as majority (or sole) shareholder SEE retains returns on equity pays production share, royalties, taxes and dividends to the state

performance of SEEs by themselves. What improves SEE performance—increasing revenue, lowering costs and achieving their strategic investments—is (1) elaborating clear strategic objectives and performance targets; (2) ensuring compliance with those objectives and meeting targets, for instance through more professional management (including remunerations based on performance), improved staff integrity and capacity, strong oversight (e.g., independent boards; effective MOPF, OAG and parliamentary monitoring) and transparency; (3) improving cost efficiency, for example through improved contracting procedures; and (4) raising revenues, for example by reexamining tax incentives.

Option 1. Rent-collecting SEEs are granted a separate revenue retention formula, for instance dependent on achieving targets or as a percentage of revenue

This option is similar to that which has been adopted in Ghana, Kuwait and Vietnam: a statutory formula that splits revenues from profit-making SEEs more efficiently between the Union and those SEEs. It is an option that MOPF officials have suggested previously. Under this option, loss-making SEEs would still face the same challenges as before; however, the natural

resource SEEs would no longer accumulate such large OA balances. Importantly, the risk of revenue leakage would be limited to the agreed percentage of revenue retention.

This option can also be designed to address the other issues raised here, namely weak incentives to raise revenues and better manage costs in certain operational units. For instance, SEE revenue retention can be dependent on achieving targets, such as increasing profitability in onshore oil field operations by at least 10 percent. Alternatively, revenue retention can be based on a percentage of revenue, with revenue defined as receipts derived from productive activities. For example, SEEs might be able to retain X percent of the returns on their state equity share plus USD X per barrel/ounce of ore/board of timber produced by the SEE itself. Each SEE might need its own revenue retention rule that reflects its strategic needs, which may make sense given the varying needs and costs of different SEEs (e.g., MOGE controls and manages some onshore operations while MGE does not). The challenge would be to design one or multiple revenue retention formulas that encourage profitability. The formula would also need to balance the SEE needs against other productive uses of SEE profits (e.g., healthcare, education, infrastructure).

The disadvantage of this option is that it is quite difficult to design the correct formula, particularly since SEE expenditure needs shift year-to-year. In Myanmar, it is especially difficult since most SEEs have not articulated and costed their strategic plans. Therefore the formula may need to be flexible, or only apply to recurrent expenditures. Capital expenditures could still be covered out of the Union budget, as they are now, provided that revenue retention is curtailed significantly and the definition of capital expenditures is broadened to include cash calls and other items more naturally categorized as capital spending.

Option 2. SEE revenues are redefined to exclude all but returns on state equity and revenues generated through SEE-controlled operations

This option proposes that SEE revenue be redefined to exclude production shares, rents, license fees and service fees, and that these revenue streams are collected not by SEEs but by relevant tax collection authorities (e.g., IRD, Treasury Department). Under this option, the share of profits retained would remain at 55 percent; however, revenues would be limited to returns on state equity and revenues generated through SEE-controlled operations. Revenues generated by the other streams would be transferred directly to the treasury, perhaps with some nominal processing fee to be retained by the SEEs.

This option would help address the large accumulation of OA balances by profit-making SEEs and would align Myanmar with international standards of how revenues are calculated. However, it is unclear whether profitability would be improved. On the one hand, the amount management would have at its disposal would be based more on the returns SEEs would generate from their own activities rather than just passive investments by the state. On the other hand, SEE managers' interests would need to be aligned with those of their SEEs, which may not always be the case. Also, revenue retention would still not be linked to SEE expenditure needs, meaning that large profits may still accumulate, especially if capital budgets continue

to be financed by the Union via line ministry budgets.

Option 3. All revenues accrue to the treasury; the Union allocates a budget to each SEE based on strategic objectives and needs

This option is similar to the system that existed prior to the 2012 reforms. As such it represents a return to a system where SEE transfers to the government were much higher but where SEEs were dependent on union transfers to cover costs.

The advantages of this option are threefold. First, the Union gains a high level of control over SEE activities. Since parliament and government have to approve the planned activities of SEEs for the following year, companies would be subjected to high levels of public scrutiny and would have to develop and justify their plans carefully. Second, this option forces the government to consider the trade-off between investments in SEEs and other sectors of the economy. The annual budget process is the platform for debate on how government revenues should be allocated. The question of whether petroleum revenues are invested in public infrastructure or exploration activities could be an integral part of this debate.¹⁰ Third, this option would address the large accumulation of OA balances.

The disadvantages are threefold as well. First, expenditures, and hence losses, would still be covered out of the Union budget. Therefore, there would still be little incentive to improve performance, at least absent significantly enhanced capacity for scrutinizing performance as part of the budgeting process. Second, this option requires that SEEs articulate clear objectives and targets, and provide costed estimates of expenditures needed to achieve these targets. It would also require government ministries, especially MOPF, to be able to independently assess SEE needs and costs. None of the SEEs we have examined in this study are at the stage where they are prepared to carry out such an exercise, and MOPF does not yet have the information or capacity yet to assess SEE needs and costs. Third, this option could lead to delays in funding for critical projects, hampering SEE ability to

10 Thomas Lassourd. "Financing Options for the Ugandan National Oil Company," NRGJ Briefing (2015). Online: https://resourcegovernance.org/sites/default/files/documents/nrgj_financing-options-noc.pdf.

meet operational requirements, especially if multi-year contracts must be signed. However, this last risk can be addressed by approving multi-year capital budgets for some SEEs.

Option 4. Revenue retention is based on market assessment of strategic needs

This option essentially corporatizes certain SEEs, subjecting them to the same revenue retention rules as private sector enterprises. Several national oil companies operate in this manner, including Statoil, Rosneft and Gazprom. In each of these cases, the company operates internationally, possesses world-class technology and capacity, and is extremely transparent. These companies do not tend to be responsible managing state equity interests in joint ventures or acting as a state agent in production-sharing agreements like MOGE; rather they are responsible for taking decisions on a commercial basis and financing their own activities in their entirety. Each is listed on a stock exchange with comprehensive disclosure requirements, such as the London Stock Exchange.

The advantage of this option is that it allows SEEs to “stand on their own two feet” by providing them with their own source of income, independent of the government. This option may generate a greater incentive to become more profitable. It would also eliminate capital expenditure transfers from the Union via line ministries for even the most profitable SEEs.

However, the disadvantages are many. First, since the government remains the owner, should the company experience financial losses, it would either have to borrow or receive subsidies from the Union. Given that SEE debt would be explicitly or implicitly guaranteed by the government, losses would automatically become a Union liability. Second, this option does not address the issue of misallocation of resources. Rent collecting SEEs, such as MOGE and MGE, could still retain too much revenue, especially if they are allowed to retain what is currently defined as SEE revenue. Third, unless independent and professional boards are appointed with a mandate to oversee SEE operations and determine appropriate reinvestment criteria, dividends are likely to reflect management’s will rather than the public interest.

If management is beholden to the government, dividends could be high. However, if management serves its own interests, transfers to the government could be quite low. Fourth, since the entity would not require a Union budget or perhaps even Union approval to carry out operations, this option could lead to less accountability and greater mismanagement within SEEs. Finally, in order for this option to improve SEE profitability, management’s interests must be aligned with those of the companies. In reality, interests may not always be aligned. The post-Soviet experience shows that corporatized or privatized entity management may sell state-owned company assets for personal gain unless strong oversight prevents such activity.

MOPF AND INTERMINISTERIAL ACTIONS

RECOMMENDATION 4. INTRODUCE NEW FINANCIAL FORMS AND MOPF OVERSIGHT SYSTEM

Financial reporting is the process of turning transaction level data into financial reports that serve, among other purposes, as high-level indicators of performance and risk. While effective reporting is a critical component of risk and enterprise management, ineffective reporting can indicate weaknesses in management control, a lack of capacity for operations and reporting, and/or a critical risk of misappropriation. Financial reporting is only effective when it is combined with controls that promote confidence that the reports can be relied upon by decision makers.

First and foremost, financial reports ought to be relevant to the users, in this case MOPF (including IRD, Budget Department and Treasury Department), line ministries, the Financial Commission, parliament and OAG. The public is not considered a primary user, but public disclosure and analysis represents a useful control. Thus, reporting should include all material information that could influence the decisions of the users, such as performance indicators and disaggregated cost data. (What constitutes material information is discussed in detail below.)



Diggers at the Hpakant jade mines. *Khin Saw Htay*

Information should also be accurate, verifiable (collected using established processes and standards), verified (audited) and timely. Information should be understandable to each user group. This may include notes to the financial statements that define each line item, the accounting methodology and significant accounting estimates used to establish the reported numbers. Finally, the information should follow an accounting standard and consistent reporting periods. While international standards such as IFRS are the most comparable to other countries, Myanmar accounting standards are sufficient (if slightly outdated), and even the existing budget standards could be useful to compare state-owned companies. This allows for intertemporal comparisons as well as intercompany comparisons.

At present, the information provided by SEEs to MOPF and other government entities is not presented in a format that allows for reliable analysis. Financial forms do not include all the information required, contain verified calculation errors, and possible errors in presentation and anomalies in activity and price. For

example, oil is presented in both barrels and gallons and capital and recurrent cost categories are atypical globally. Also, large costs are sometimes left unexplained, such as “other income” in MOGE’s financial forms. The information should be presented with a narrative of the activities that the information represents in order to provide insight and clarity.

As a primary recommendation for immediate action, we suggest that the SEE division conduct strategic risk assessments of SEEs. A risk management program evaluates the highest level risk associated with the industry in Myanmar. This involves clarifying objectives, assessing risk, and identifying potential controls that can be enacted and implemented to improve the performance of SEEs and guide the reform process. Appendix B provides a sample of high level risks and relevant financial statement information to help monitor these risks.

As a secondary recommendation, we suggest, as a matter of course, that a comprehensive management letter be provided with all financial disclosures. The letter would be similar to the non-financial

information in any annual report and include a description of the entity, its objectives, the activities of the year in summary, and any other information that would shed light on anomalies in the financials themselves. In addition, there should be notes to the financial statements where the definitions of each line item are disclosed and explained in order to promote consistency and understandability. A template for such a letter could be designed.

Finally, there is a significant opportunity for improvement through new SEE financial forms. These forms could be slightly reorganized and could disaggregate the data to provide much more valuable information to decision makers.

As a first step, financial disclosures could be disaggregated based on type of activity. By disaggregating revenues and expenses by type of contract—onshore, offshore and transit, for example—and having investment plans disclosed in a management letter or report, it would provide significant information on appropriate revenue retention for MOGE and slightly better information on performance.

A second step would be to add the following details:

- A narrative description of company activities and events during the year, including:
- Contract signings
 - Phase of project delivery
 - New discoveries and production
 - Significant changes from the prior year
- Definitions of each of the line items in the financials that maps the data to the budget submission
- Production numbers for each type of product, disaggregated by the categories of the financials and further disaggregated to identify domestic sales and international sales

While improvement would be significant, the resulting information would still not meet the standards to effectively assess performance and compliance and inform policy-makers. A third step would be needed which would include the following information:

- All onshore and offshore contracts, plus the following contract details:
 - Block and ownership share
 - Phase of exploration, development or production
 - Percent of obligations met for the phase
 - Carried and participating interest
 - Production quantities and qualities per field/ mine
- Quantity sold domestically and internationally
- Quantity change in storage
- Sales by SEE and contractor in the case of operators
- Revenue from domestic and international sales
- Average international and domestic price
- Disaggregated revenue by stream: production share, returns on equity, royalties, bonuses, license fees, transit fees, contributions to funds, etc.
- Value of non-fiscal contributions to SEEs, including training
- Opening and closing balances for Other Accounts



An amber stone in Kachin State, Myanmar. *Hkun Hlat for NRG*

RECOMMENDATION 5. PROMOTE GREATER INTRA- AND INTER-MINISTRY COORDINATION

This report has identified several weaknesses in coordination within and between ministries. For example, MOPF's Budget Department has different tax figures than its Internal Revenue Department. All ministries look to OAG for oversight of SEE transactions, yet OAG does not have sufficient mandate, access to information or expertise to carry out these tasks. Though they both audit SEEs, OAG and IRD do not share information. And MOPF relies on line ministries to monitor SEE project-level behavior, though this is not done in practice. This system has resulted in significant gaps in oversight, allowing SEEs to function virtually without supervision.

All government oversight bodies—including the Privatization Commission, Financial Commission, MOPF (Budget Department, Planning Department and Internal Revenue Department), OAG, line ministries

and parliament—could benefit from greater coordination and information sharing. While a legislative framework that requires disclosure of information would be ideal, internal government procedures could provide a temporary reprieve from the culture of secrecy that has developed within the government. For instance, executive directives could require:

- SEEs to share contracts, project-level data and other relevant information with all of MOPF, OAG and parliament on timely basis (e.g., within a month of request)
- OAG to share full audit findings with parliament and MOPF immediately
- All ministries to post directives and notices publicly, preferably online, in a single repository
- The establishment of an interministerial procedure committee, perhaps chaired by MOPF, to identify practical steps to improve interministerial communication and implement them

RECOMMENDATION 6. IMPROVE SUPERVISION OF SEEs WITHIN THE BUREAUCRACY (COULD BE MERGED WITH RECOMMENDATION 8)

The information listed in Recommendation 5 is only valuable if it is used to inform MOPF, parliamentary and other oversight bodies' decisions. However, at present, MOPF does not have the mandate to effectively challenge SEE budget decisions. MOPF may only set budget ceilings for recurrent budgets paid out of Other Accounts and relies heavily on line ministries to provide capital budget oversight, rarely challenging budget decisions. Part of the reason is a lack of access to information, which could be partially addressed by recommendations 4 and 5. However, another reason is MOPF's weak mandate.

Our suggestion is that MOPF's mandate to oversee, challenge and approve SEE expenditures, or alternatively to establish a separate unit, company or commission to oversee and approve SEE spending. Several non-exclusive supervision and state-owned company administration models are presented from international experience.

Option 1. Establish state-owned holding company or equivalent

Several governments have established state-owned companies to manage state equity and act as the principal shareholder. As owner of state-owned enterprises, they manage state equity, oversee state-owned company management and operations, and ensure they are meeting their business objectives. Examples include Bhutan's Druk Holding and Investments Limited, Kazakhstan's Samruk-Kazyna, Malaysia's Khazanah Nasional Berhad, Peru's FONAFE, Qatar Holding and Singapore's Temasek Holdings. China's State-Owned Assets Supervision and Administration Commission, while not a state-owned company, essentially has the same mandate.

State-owned holding companies (SOHCs) can help governments consolidate their state-owned company monitoring and management expertise under a single roof. Procurement, IT, human resources management and auditing capacity can each be centralized easily. SOHCs can also train managers, test them in some firms and rotate the most capable ones to run underperforming companies. Sometimes a SOHC can also restructure firms and fire and hire workers with more flexibility than under a structure where companies fall under the jurisdiction of a line ministry.

SOHCs are not a replacement for regulatory agencies such as OAG and MOPF. Furthermore, the larger a SOHC's holdings, the more difficult its job becomes in monitoring state-owned companies effectively. Given that Myanmar has 32 SEEs in varied sectors, it may not be realistic to assume a single SOHC would be able to oversee all SEE activities effectively. As a result, some governments, such as those in Brazil and Spain, have established multiple SOHCs for different industries.¹¹

Option 2. Enhance MOPF's mandate

In almost every country, the Ministry of Finance or equivalent has a role to play in supervising state-owned enterprises. However, in Korea and Vietnam, for example, the finance ministry has the authority to exercise state ownership rights and coordinate state-owned company policy as well. These powers can include requiring disclosure of information; reviewing and approving financial management plans; carrying out performance evaluations; and approving company budgets. Ministries of finance do not generally have influence over human resource decisions or the right to buy and sell state equity.¹²

At present, Myanmar's MOPF has limited powers. While it sets SEE recurrent budget ceilings and approves capital budgets of line ministries, it cannot require disclosure of additional information, demand strategic plans or suggest internal SEE reforms. Furthermore, its ability to carry out performance evaluations and challenge budgets is constrained not just by limited capacity but also by a limited mandate.

11 Aldo Musacchio et al. "State-Owned Enterprise Reform in Latin America: Issues and Possible Solutions," Discussion Paper No. IDB-DP-401 (Inter-American Development Bank, 2015).

12 OECD and KIPF, *State-Owned Enterprises in Asia*.



Jade for sale at the Gems Emporium in Naypyitaw. Andrew Bauer

Under MOPF's current mandate, SEEs can usually disregard MOPF assessments since they are largely unenforceable.

MOPF's mandate can be enhanced in several ways. First, it can be legally empowered to demand disclosure of information such as contracts and disaggregated costs. Second, it can be given the right to challenge SEE budgets on a project-by-project basis and recommend changes to the cabinet. Third, it can be mandated to review and assess SEE strategic plans, targets and performance measures to inform human resource decisions within SEEs.

Option 3. Establish a professional commission or ministry

Some countries establish a coordinating agency to monitor state-owned company performance or act as advisors to line ministries that maintain control over their companies. For example, India's Department of Public Enterprises under the Ministry of Heavy

Industries and Public Enterprises is responsible for monitoring state-owned company performance. Powers over budgeting and human resources remain with other government entities. Indonesia's Ministry of State-Owned Enterprises has a similar mandate, though it also has authority to determine remunerations policy, propose members of state-owned company boards and prepare regulations governing state-owned company activities.¹³ The Philippines' Governance Commission for Government Owned or Controlled Corporations, consisting of five members of the executive and sitting under the Office of the President, has a slightly stronger mandate. It advises, monitors and oversees state-owned companies and may formulate and implement policies in coordination with line ministries.¹⁴

This model is similar to the SOHC model with two important differences. One, other entities such as line ministries or the president's office remain company shareholders rather than the commission or ministry.

13 World Bank. *Corporate Governance of State-Owned Enterprises: A Toolkit* (IBRD-World Bank, 2014). Online: <http://documents.worldbank.org/curated/en/228331468169750340/pdf/913470PUB097810B00PUBLIC00100602014.pdf>.

14 OECD and KIPF, *State-Owned Enterprises in Asia*.

Two, commissions and state-owned company ministries' mandates are usually limited to advising on policy or helping to implement, rather than enforcing policy. In general, SOHCs are stronger at enforcing their decisions.

RECOMMENDATION 7. ESTABLISH INDEPENDENT BOARDS OF DIRECTORS FOR SEES (COULD BE MERGED WITH RECOMMENDATION 8)

Professional, independent supervisory boards can improve the performance of SEEs by frequently monitoring SEE activities, helping SEEs meet their targets, and hiring, firing and promoting senior managers based on performance. While four Myanmar SEEs currently have boards of directors who sit above senior management, none are independent or politically autonomous.

Globally, boards differ in terms of mandate and powers, structure and tenure, and board nomination. In most cases, boards set the corporate strategy and monitor results, such as profitability, essentially acting on behalf of the ultimate owner, the government. In some countries, state-owned companies' boards of directors are also responsible for performance-based human resource decisions for senior management.¹⁵

Boards can consist of anywhere between two and 20 members, though ideally they should consist of five to eight members. In one survey of 12 national oil companies surveyed, nine boards were nominated by the executive (e.g., Petronas [Malaysia], PetroVietnam and KazMunaiGas [Kazakhstan]), two by the executive with legislative confirmation (NIOC [Iran] and Petrobras [Brazil]) and one by independent election committee and employees (Statoil [Norway]). In general, appointments are based on technical expertise, though minis-

ters were appointed in five cases.¹⁶ In most countries, state-owned company boards are also evaluated, either by the state-owned holding company, finance ministry or independent external evaluator.¹⁷

PARLIAMENTARY/ LEGAL POLICY OPTIONS

RECOMMENDATION 8. INTRODUCE A NEW SEE LAW

While a new SEE law will not address all the challenges identified in this report, it would help bring statutory clarity to SEE management, and improve intra-governmental coordination and consistent policy-making. Elements of an SEE law could include:

- SEE definition and list
- Strategic plans and targets
- Fiscal management
- Procedures for purchase and sale of government equity
- Board mandate, structure (including committees), tenure and nomination
- Code of conduct for SEE management and employees
- Oversight responsibilities of MOPF, parliament, OAG, internal auditor and other entities
- Independent external audit requirements
- Internal reporting requirements
- Public disclosure requirements
- Penalties for misconduct

15 OECD, *Board of Directors of State-Owned Enterprises: An Overview of National Practices* (OECD Working Party on State Ownership and Privatization Practices, 2012). Online: [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/CA/SOPP\(2012\)1/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/CA/SOPP(2012)1/FINAL&docLanguage=En).

16 Heller et al., *Reforming National Oil Companies*.

17 OECD, *Board of Directors of State-Owned Enterprises*.



Meeting of parliamentarians in Naypyitaw. *European Parliament via Flickr, Creative Commons BY-NC-ND 2.0*

RECOMMENDATION 9. PROVIDE ADDITIONAL TRAINING AND RESOURCES FOR PARLIAMENTARY OVERSIGHT OF SEEs

As highlighted in this report, parliament currently lacks access to information, relying on extremely limited analysis of SEE finances by MOPF and OAG. JPAC also lacks the capacity, institutional support and experience to independently analyze government data. Yet their oversight role remains crucial to controlling SEE finances.

Already, JPAC and other parliamentary agencies are receiving some support from the European Union and the United Nations Development Programme. However, this support is not focused on SEE governance and remains inadequate in fully preparing parliamentarians to oversee SEE finances. We therefore recommend additional and guaranteed support for JPAC and other parliamentary agencies in the form of training and financial resources allocated from the Union budget.

RECOMMENDATION 10. AMEND THE AUDITOR GENERAL OF THE UNION LAW

The Auditor General of the Union Law (2010) currently does not require that (1) full audit findings be provided to parliament or MOPF; (2) audit reports be made public; or (3) audit reports meet international standards in terms of verifiability, comprehensiveness, accuracy and robustness. The law also does not specifically mention that it is within the mandate of OAG to audit SEEs for performance. Finally, the law does not state what types of audits should be completed on SEEs, timeliness of audits or what information SEEs must share with OAG in compliance with audits. Amendments strengthening the office's oversight of SEEs could be considered by the government and parliament.

RECOMMENDATION 11. AMEND THE FINANCIAL INSTITUTIONS LAW

The Financial Institutions Law (2016) could be amended to allow banks to share financial information with audit authorities and to share information with the public. Sections 81 and 83 prohibit even audit authorities from accessing bank accounts, records or transactions, whether from private or state-owned banks. Only the central bank may provide information to audit authorities, and even then only in consolidated form and on a confidential basis. Several exceptions are listed in Section 82, notably in relation to compliance with anti-money laundering or counter-terrorism laws.

This law has been used to keep information on Other Account balances and other financial information on government activities secret. As a result, we recommend amendments that, at a minimum, make clear that state-owned institutions are not subject to these secrecy provisions. Furthermore, we suggest that the government and parliament reconsider Sections 81 to 83 to allow IRD, OAG, the attorney general's office and other government agencies to audit bank accounts in order to track SEE and joint venture partner finances.

RECOMMENDATION 12. AMEND THE MYANMAR INVESTMENT LAW

The Myanmar Investment Law (2016) currently allows significant tax exemptions and holidays, subject to approval by the Myanmar Investment Commission (MIC). According to IRD and our own calculations, tax incentives of this kind cost the Union of Myanmar billions of dollars in lost revenue annually and make auditing of both private sector natural resource companies and SEEs exceedingly difficult. We encourage the government and parliament to consider amendments to the Myanmar Investment Law prohibiting such tax exemptions and holidays.

STATE-OWNED ECONOMIC ENTERPRISE ACTIONS

RECOMMENDATION 13. REQUIRE THAT EACH SEE PUBLICLY DECLARE CLEAR OBJECTIVES, NUMERICAL AND TIME-BOUND TARGETS AND PERFORMANCE BENCHMARKS

International governance standards for state-owned companies stress the need for clear company objectives, targets and benchmarks. These serve several purposes. First, they allow the government as ultimate shareholder to measure performance and ensure that the company is serving the public interest. Second, they help management stay on course and make good decisions. Third, they allow the government to measure management performance, which can inform decisions around appointments, dismissals, promotions and financial incentives.

While some of Myanmar's SEEs have vision statements and mandates, we have been unable to identify clear policy objectives, targets or performance benchmarks. Ideally, SEEs could develop them in coordination with line ministries, MOPF and parliament.

As mentioned, most state-owned companies in Asia have clear objectives, targets and performance benchmarks. For example, PTT Thailand's performance indicators are: net profit to total sales revenue percentage, return on equity percentage, return on total assets percentage, debt to equity, net debt to equity, net debt to EBITDA and interest coverage. PetroVietnam's performance indicators are: gross profit/revenue, net profit/revenue, return on assets and return on equity.¹⁸ In both these cases, company performance is benchmarked against other countries and past experience. Management is expected to improve performance over the medium term.

18 PTT Thailand and PetroVietnam annual reports.



Forestry activities near Warabaw Amber Mine in Danai Township, Kachin State, Myanmar. *Hkun Hlat for NRGi*

RECOMMENDATION 14. REQUIRE SEEs TO PRODUCE COMPREHENSIVE FINANCIAL AND ANNUAL REPORTS (COULD BE MERGED WITH RECOMMENDATION 8)

As mentioned, improved transparency not only provides crucial information to oversight bodies—such as parliament, MOPF, OAG and even the media—but also builds trust between SEEs and the public. While some information on SEE finances and operations is available through Myanmar Extractive Industries Transparency Initiative (MEITI) reports, the Union budget and SEE websites, unlike Chile’s Codelco, Indian Oil or PTT Thailand, for example, none of the SEEs we examined posted financial or annual reports online that meet international standards. These reports ought to include, at a minimum:¹⁹

A description of major activities, progress against goals and projections of future activities, including descriptions of specific projects with lists of associated joint venture partners

- Corporate structure, including composition of senior management and responsibilities of key divisions
- Revenues, on a project-by-project and stream-by-stream basis (past, current and future)
- Expenditures on a project-by-project basis (past, current and future)
- A detailed accounting of the fiscal relationship between SEEs and the Union, including flows to and from the Union budget
- Assets, including in subsidiaries and joint ventures, on a project-by-project basis

¹⁹ List is drawn from state-owned company annual reports, OECD standards and Heller et al., *Reforming National Oil Companies*.

- Disaggregated debts
- Non-fiscal activities (activities not directed related to the SEE's core mandates)
- Other relevant financial information, such as detailed reporting of oil or mineral sales, including buyers, volumes, types and sale price

RECOMMENDATION 15. REQUIRE INDEPENDENT EXTERNAL AUDITS OF SEEs

While the roles, responsibilities and capacities of existing oversight bodies—including OAG, MOPF, parliament and the financial committee—can be enhanced, there is no replacement for independent external audits of SEEs. Independent external auditors can guarantee accuracy and quality of reporting, building confidence and trust in Myanmar's SEEs. Furthermore, they can help identify gaps in internal processes, improving the performance of these companies. While the services of companies like Ernst & Young, PwC, Deloitte or KPMG can be expensive, the assurances of integrity they offer generally provide good value for money. We recommend immediate external audits of SEEs, with priority on the largest and most unprofitable SEEs. Ideally, such audits would be made public.

RECOMMENDATION 16. CONSIDER PERFORMANCE INCENTIVES FOR SEE MANAGERS

One of the challenges highlighted in this report is that SEE management incentives are in no way linked to the performance of SEEs, meaning internal incentives to improve profitability could be strengthened.

Management pay is low by international standards, there are no financial or non-fiscal rewards for stronger company performance or meeting targets, and penalties are not linked to poor SEE performance.

Many governments have introduced performance incentives for SEE executives, managers or staff. In Bhutan, for example, reappointment of the equivalent of managing directors and senior management is dependent on meeting performance indicators. China, Indonesia, Kazakhstan and Vietnam have similar systems. Additionally, in China, a management assessment determines executive salaries.

Bhutan, India, Indonesia, Kazakhstan, Korea, Philippines, Singapore and Vietnam each provide financial rewards to middle managers or staff based on performance. In Korea, for example, public corporation CEOs can receive bonuses of between 0 to 120 percent of their salaries from the previous year, while employees can receive between 0 to 250 percent of their monthly salary. In Kazakhstan, in order to increase accountability for results and create objective justification for incentives, a supervisory board assesses the activities of the CEO and members of the executive body through the use of key performance indicators for the company. Executive compensation is then linked to both overall corporate performance and individual functional efficiency. Executives receiving a strong performance evaluation can then be placed in a “talent pool” for future transfers or promotions.²⁰

Our suggestion is that, should this option be considered, it be implemented only after SEE transparency and oversight reforms have been enacted. Without transparency and effective supervision, it is unlikely that performance incentives will improve SEE profitability.

20 OECD and KIPF, *State-Owned Enterprises in Asia*.

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The Renaissance Institute (RI) is a policy institute in Myanmar that focuses on assisting the economic reform of Myanmar. Founded in 2013, RI provides analytical support and policy recommendations, assists government in capacity building and facilitates the communication between the government and other relevant stakeholders focused on revitalizing Myanmar economy. In particular, RI supports key policy priorities of the current government: fiscal decentralization and public financial management reform.



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