



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

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JANUARY 2018



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ACKNOWLEDGEMENTS

The authors are grateful to the Minister of Planning and Finance and the dedicated management and staff of the Ministry of Planning and Finance (MOPF), who were not only gracious with their expertise and time, but also provided the majority of the data presented in this report. A full list of data sources is provided in Appendix A. Specifically, we wish to thank the Budget Department (especially the SEE division), Central Statistical Office (CSO), Internal Revenue Department (IRD) including the Large Taxpayer Office (LTO), Planning Department, Project Appraisal Progress Report Department (PAPRD) and Treasury Department. We also wish to thank the management and staff of the Ministry of Natural Resources and Environmental Conservation (MONREC), Myanmar Gems Enterprise (MGE), Ministry of Energy and Electricity (MOEE), Myanmar Oil and Gas Enterprise (MOGE), Myanmar Economic Bank (MEB), Myanmar Foreign Trade Bank (MFTB), Central Bank of Myanmar, Office of the Auditor General (OAG), the *Hluttaw's* Joint Public Accounts Committee (JPAC) and members of the National Economic Coordination Committee (NECC).

The authors are also grateful for the indispensable and gracious support of U Myo Myint (Renaissance Institute) and U Soe Win (Renaissance Institute). Additionally, the authors wish to thank Nour Berro (independent consultant), Patrick Heller (Natural Resource Governance Institute), Khin Moe Myint (Renaissance Institute), Marcia Maurer (U.S. Treasury advisor), Declan McGee (DFID), Mya Nandar Thin (Renaissance Institute), Vidar Ovesen (NORAD) and Laura Robinson (Swale House Partners) for their contributions to the analysis presented this report.

Content

FOREWORD	2
EXECUTIVE SUMMARY	3
INTRODUCTION	7
GLOBAL GOOD GOVERNANCE OF STATE-OWNED NATURAL RESOURCE COMPANIES	10
GOVERNANCE OF SEEs IN MYANMAR.....	14
SEE governance framework and financial relationship with the union	14
SEE public financial management system.....	27
Government accounting	27
Management of ‘Other Accounts’	32
SEE budget process, oversight and transparency.....	36
SEE policy-making and reform agenda	44
MYANMA OIL AND GAS ENTERPRISE (MOGE)	49
MYANMAR GEMS ENTERPRISE (MGE)	75
BENCHMARKING SEE GOVERNANCE RULES AND PRACTICES AGAINST INTERNATIONAL EXPERIENCES	87
MOGE and MGE’s financial health	87
Myanmar’s SEE revenue retention rules	88
Myanmar’s transparency and oversight provisions.....	92
POLICY OPTIONS.....	98
BIBLIOGRAPHY	117
APPENDIX.....	118
Appendix A. Data sources for this report.....	118
Appendix B. Sample of high-level risks and relevant financial statement information	120
ACRONYMS.....	121

Foreword

State-owned enterprises belong to all the people and are an important force in any country's economy. In Myanmar, state-owned economic enterprises (SEEs) are particularly important, generating approximately 50 percent of Union fiscal revenues, largely from the natural resource sector. Partly on account of the 1989 SEE law, SEEs enjoy extensive autonomy and monopoly powers over different sectors of the economy.

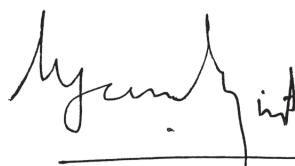
Since 2012, the Union government has initiated reform efforts that were intended to enable SEEs to operate commercially, so as to eventually to stand on their own feet. However, the reforms implemented thus far have not addressed long-standing challenges of lack of accountability and oversight.

For instance, Myanmar's SEEs control vast amounts of public money. In recent years, some of these companies appear to be amassing large sums—at levels reaching trillions of kyat—in so-called "Other Accounts" that are not subject to the same rules as other government funds.

Proper SEE reform is a prerequisite for the improvement of Myanmar's economy.

The Renaissance Institute has collaborated with the Natural Resource Governance Institute (NRGI) in this research on SEE reform in Myanmar, focusing on the case of natural resource enterprises. We are pleased to present the following analysis and recommendations. The SEE reforms proposed in this report to improve accountability and oversight, as well as SEE operational efficiency, could potentially generate trillions of kyat in additional financing for essential investments in education, healthcare and infrastructure.

We hope that this report will be an important contribution and initiative toward broader SEE reform and economic development in Myanmar



Myo Myint
Chairperson
Renaissance Institute

Executive summary

Myanmar's state-owned economic enterprises (SEEs) regularly generate approximately 50 percent of the Union's fiscal revenues and spend as much in the domestic economy. They operate in many sectors, from transport to textiles and banking to natural resources. Through their regulatory roles, they exert a considerable influence on Myanmar's economic composition and trajectory.

Yet, traditionally, many SEE mandates and objectives have remained unclear and most have operated inefficiently by international standards. Consequently, since the early 1990s, the government's stated aim has been to professionalize, corporatize or privatize SEEs, often by granting them greater independence.

These efforts have shown mixed results. On the one hand, many unprofitable SEEs have been privatized since the socialist era, easing their financial burden on the Union budget. More recently, the *Hluttaw* has taken steps to curb capital spending by chronic loss-making SEEs.

On the other hand, in general costs remain high, operations remain inefficient, revenue growth from productive activities remains weak, and SEEs' business operations lack substantive supervision. For example, Myanmar Oil and Gas Enterprise (MOGE) costs are inflated due to contracts that require the enterprise to pay all commercial tax, special goods taxes and duties on the total value of natural gas sales, even though the enterprise only owns 15 to 20.45 percent of offshore fields. Essentially, MOGE pays tax on behalf of its foreign joint venture partners. A similar provision requires MOGE to pay tax on

behalf of pipeline joint venture partners. These provisions cost the enterprise more than MMK 200 billion in 2015/16. In another example, MOGE's onshore production generated 7 percent of its revenues in 2015/16 but up to 29 percent of its costs. This implies that majority foreign-owned offshore fields are much more profitable than MOGE-owned onshore fields.

Moreover, recent reforms designed to encourage SEE self-sufficiency have given rise to a new challenge. Since 2012, SEEs have retained 55 percent of their profits in so-called UFA-Other Accounts. This money was meant to make SEEs financially independent, since they can draw on their Other Accounts to cover their day-to-day needs.

Seemingly in conflict with the goal of financial independence, some capital expenditures are still covered by the Union budget via their line ministries, even for the most profitable SEEs. Also, unprofitable SEEs' losses are fully covered by the budget, even in cases when they have money stored in their Other Accounts. Therefore, this revenue retention system seems to undermine the government's stated goal of improving SEE efficiency in three ways, by (1) maintaining loss-making SEE dependence on the Union for all spending, removing an incentive to become more profitable; (2) maintaining profit-making SEE dependence on the Union for its capital spending, removing an incentive to control items defined as capital costs (e.g., drilling equipment); and (3) allowing profit-making SEEs to hoard cash, discouraging greater profitability since their cash holdings are more than sufficient and they therefore have little incentive to raise more revenue or cut costs.

The revenue retention formula has led to the accumulation of large Other Account balances. As of January 2017, SEEs have accumulated MMK 11.45 trillion / USD 8.6 billion in their Other Accounts. Figure 1 puts this amount in context.

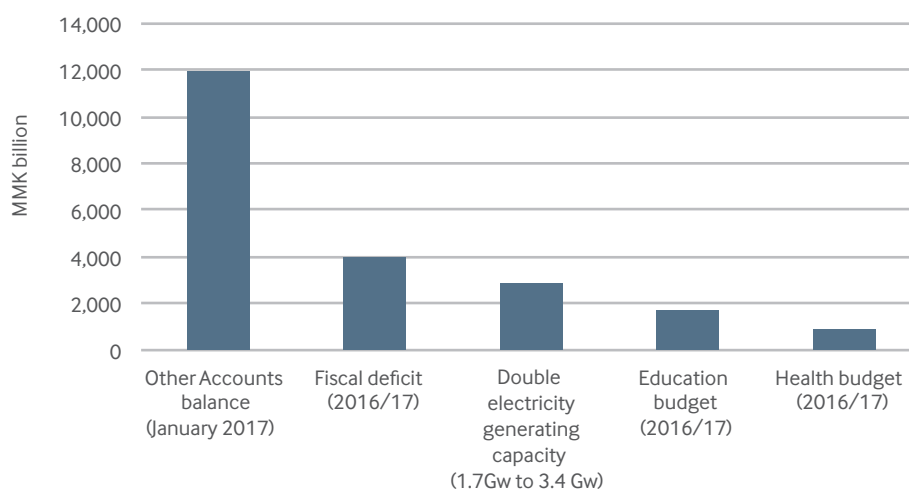
Rent collecting natural resource SEEs are among the largest hoarders of cash. This is mainly due to their large collection of passive forms of income—such as profit shares or license fees—from joint venture partners. MOGE cash-on-hand represents by far the highest share of total assets of any national oil company in the world (Figure 2). At current spending levels, MOGE has at least 7 years' worth of precautionary savings. Myanmar Gems Enterprise (MGE) has 172 years' worth.

Additionally, Other Account balances must be held in Myanmar's currency, kyat—which is depreciating in real terms—and cannot be invested in interest-accruing foreign assets. We estimate that SEEs

have lost more than USD 2 billion in purchasing power over the last three years due to these rules.

Improvements can be made immediately, both to SEE revenue retention rules and to the management and allocation of Other Accounts. Ideally, the amount that SEEs would retain or be allocated from the budget would be a function of their strategic needs; the remainder would be transferred to the Union to be spent on social services and infrastructure for the benefit of the people of Myanmar. Excess savings could be invested in interest-accruing foreign assets. Account information could be published online. And idle Other Account balances could be reallocated to more productive uses. By our estimate, reallocation of excess savings from MOGE and MGE alone could provide more than MMK 2.8 trillion in available financing for the Union budget in this coming fiscal year without jeopardizing their ability to cover legitimate expenses.

Figure 1. Size of total SEE OA balances relative to other Myanmar budgetary figures



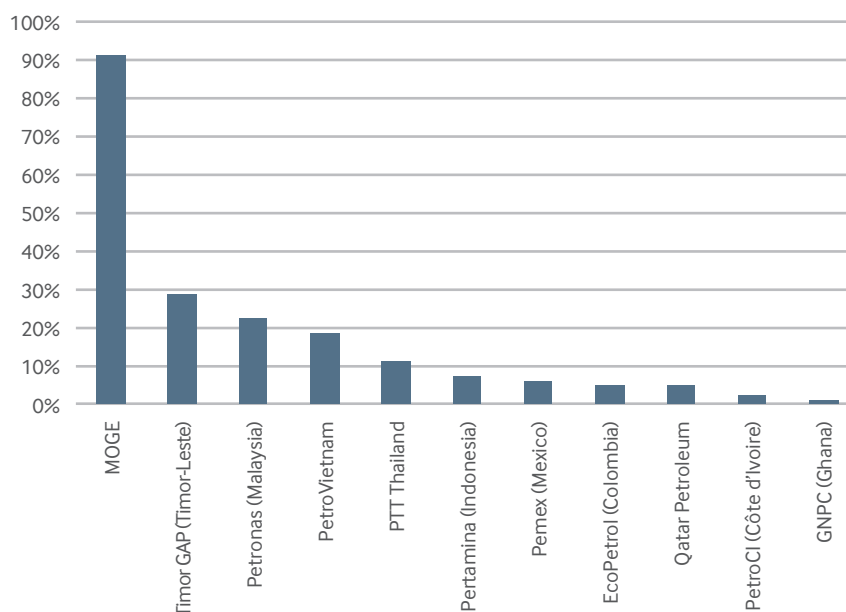
Changing the revenue retention rule by itself will not make SEEs more profitable or efficient. The Union government would also need to: (1) improve the legal framework governing SEE activities; (2) require that SEEs articulate their strategic objectives and performance targets; (3) strengthen SEE oversight; and (4) require much greater disclosure of SEE financial information and activities.

Legal framework. The 1989 SEE Law provides monopoly powers for SEEs over a number of sectors, yet does not clarify their roles or responsibilities. A new SEE law would bring statutory clarity to SEE management and make policymaking more consistent. Additionally, laws that prevent disclosure of crucial information to supervisory bodies could be amended. For example, the Auditor General of the Union Law could require that full audits of SEEs be made public. Also, the Financial Institutions Law could require that all SEE account information be published.

Strategic objectives and targets. While some SEEs have vision statements and mandates, most do not have clear objectives or performance benchmarks. As such, their financing needs remain unclear and their ultimate shareholder, the Union government, cannot monitor progress towards achieving their goals. Clear numerical and time-bound targets would be essential for improving SEE performance.

Strengthening oversight. While Myanmar has many of the organizations needed to monitor SEE activities, a combination of bureaucratic fragmentation, limited coordination and minimal grounding in clear statutory language limits supervisory bodies' effectiveness. For example, line ministries, which are in theory responsible for monitoring SEE alignment with Union objectives, generally provide operational autonomy to their SEEs and sometimes even act as their agents within the government. The Ministry of Planning and Finance has neither the mandate nor the

Figure 2. Share of cash to total assets for selected national oil companies (2015 or most recent)



access to information nor capacity to properly analyze SEE financial data for budgetary challenge purposes, restructure enterprises or hire and fire SEE managers. While the Office of the Auditor General audits SEEs, performance audits are not carried out and the highest authority to view the full audit findings is the SEE Managing Director.

Reforms could include: (1) empowering the Ministry of Planning and Finance or a new professional agency with responsibility over monitoring SEE compliance with performance targets and organizational objectives, approving SEE budgets on a project-by-project basis, and improving manager performance; (2) requiring greater disclosure of information to all supervisory bodies; (3) establishing independent boards of directors for SEEs; and (4) requiring independent external audit for SEEs.

Greater transparency. There is scant public information on Myanmar's SEE operations and finances. According to NRG1's Resource Governance Index 2017, MOGE ranked 36th out

of 52 national oil companies globally in terms of transparency. MGE ranked 21st out of 22 state-owned mining companies. Full transparency not only allows supervisory bodies to do their jobs, it also helps build trust between the government and its citizens. As a first step, SEEs could publish financial and annual reports that meet international standards, like Chile's Codelco, Indian Oil or PTT Thailand.

Taken together, these reforms could generate trillions of kyat in new resources to finance Myanmar's development agenda. They would also help the government establish a legal and administrative structure for deciding which SEEs to keep within the budget framework, which to corporatize or privatize, and which to liquidate. Finally, by helping SEEs generate more revenue, lower costs and upgrade service delivery through better subcontracting and management decision-making, our proposals would make SEEs more efficient—allowing them to “stand on their own two feet.”

Introduction

State-owned economic enterprises (SEEs) play a dominant role in Myanmar's economy. First, SEEs are involved in nearly every sector, from transport to textiles to banking to the natural resource sector. Together, they employ approximately 145,000 people, collect more than 12 percent of GDP in fiscal revenue and spend approximately the same amount in the domestic economy.¹

Second, SEEs directly finance the Union government, mainly through their collection of taxes and other revenue streams. Since 2010/11, they have regularly contributed approximately 50 percent of the Union's fiscal revenues, principally through their payment of commercial taxes, income taxes and state contributions/dividends. These streams are complemented by equity returns, telecommunications license fees, and oil, gas, mineral and gem sector royalties and profit shares. Many of these revenue streams, such as royalties and profit shares, might in other countries be collected by the Internal Revenue Department or equivalent. However in Myanmar they are collected and sometimes managed by SEEs. In fact, the majority of Myanmar's SEE revenues are currently being generated through passive activities—such as collecting telecommunications license fees or profit shares from mines operated by private companies—rather than through the sale of goods and services produced by SEEs.

Third, SEEs have been assigned regulatory responsibilities that allow them to exert considerable influence on Myanmar's economic composition and growth. Not only do they regulate private sector activities that generate most of the remaining 50 percent of the Union's

fiscal revenues—largely derived from the natural resource sector—but they also shape private sector investment.² For example, SEEs recommend specific tax exemptions to the Myanmar Investment Commission on behalf of private sector joint venture partners, which is a significant factor in determining which companies operate in Myanmar and how much revenue is collected by the government from the private sector. Moreover, SEEs often monitor private sector companies' compliance with contracts, which has implications not only on fiscal revenues but also on environmental and social impacts of private sector operators.

Finally, industrial sector control provides SEEs with disproportionate influence on Myanmar's political economy. According to the 1989 SEE Law and common government practice, SEE managers have nearly unfettered discretion to award contracts and licenses to private sector partners and suppliers in 12 economic sectors, including telecommunications, air and rail transport, and teak, oil and gas, gems and mineral production and sale. As a result, SEE managers dispense, for example, contracts to drill onshore fields, licenses to mine for jade, licenses to harvest timber and licenses to provide telecommunications services, largely without substantive oversight. In practice, contracts do not always go to the most qualified or efficient contractor but are sometimes allotted based on political or personal considerations. In short, through their contracting and licensing roles, SEEs help determine who in Myanmar has access to resources and who does not, strengthening and legitimizing economic elites and networks.

1 Based on figures in World Bank. *Myanmar: Public Expenditure Review* (2015).

2 Private sector fiscal payments data sources include the Myanmar Extractive Industries Transparency Initiative (MEITI) report (2015) and the IRD's annual list of largest taxpayers.

Natural resource SEEs—by which we refer to state companies that manage raw materials such as Myanmar Oil and Gas Enterprise (MOGE), Myanmar Gems Enterprise (MGE), Myanmar Timber Enterprise (MTE), Mining Enterprise No. 1 (ME1), Mining Enterprise No. 2 (ME2) and the Myanmar Pearl Enterprise—are particularly important actors. Through their Union transfers and regulatory roles, they directly contribute or regulate approximately two thirds of the Union’s fiscal revenues. Further, these are some of the few consistent “profit-making” SEEs, compared to the vast majority that are a chronic drain on Union finances.³

Myanmar’s natural resource SEEs are powerful, in part due to the SEE Law, which grants them monopolies over their sectors. However, while SEEs have certain rights and authorities, they have not been subjected to the checks and balances associated with the world’s most successful state-owned companies, including consistent reporting to the cabinet, parliament or public. While formal SEE supervisory institutions exist in Myanmar, in practice they have often not been granted the legal mandates, authority or resources necessary to keep these powerful enterprises in check and ensure that they serve the public interest.

Natural resource SEEs also differ from most other SEEs in that the vast majority of their revenues are not derived from productive activities—such as making t-shirts or refining crude oil into fuel—but rather from their passive *rent collection*. From a purely financial perspective, the natural resource SEEs are largely tax collectors acting on behalf of the Union, not producers of value for the state. As

this report will show, the operating divisions of natural resource SEEs—such as MOGE’s onshore production arm—are generally underperforming or unprofitable.

Government reform efforts to date have been focused principally on changing the financing formula for SEEs with the ultimate aim of corporatizing or privatizing loss-making SEEs, or at least limiting the financial losses to the state. However, the reforms implemented progressively since 2012 have not addressed the underlying challenges of lack of accountability and oversight of SEEs and Union subsidization of chronically unprofitable enterprises. Instead losses have continued to be assumed by the Union while vast amounts of money have been diverted from productive uses—such as healthcare, education or much-needed infrastructure—to unproductive so-called “Union Fund Account-Other Accounts” (UFA-OAs) of profit-making SEEs. Some profitable SEEs have even gone “off-budget”—retaining a large percentage of their profits, becoming fully self-sufficient and becoming less accountable to the Ministry of Planning and Finance—while loss-making SEEs have remained dependent on government subsidies, as explained in Section 2 of this report. Furthermore, high SEE costs, weak revenue growth and unaccountable awarding of contracts remain significant challenges.

The Union government is well aware of these challenges and is committed to addressing them. This report attempts to serve the Union of Myanmar’s existing SEE reform agenda by highlighting opportunities for reform and greater

3 According to the MOPF’s Budget Department, only eight of Myanmar’s 32 SEEs are loss-making; however, this designation is due to a partial accounting of SEE finances. Capital expenditures, which are covered by the Union budget through SEEs’ respective line ministries, are not included in balance sheet calculations. Also, Union transfers to SEEs may be counted as SEE revenue. Finally, natural resource SEE profits are artificially inflated since revenue streams that would normally not be counted as state-owned company revenues in other countries, such as profit shares and license fees, are included in SEE revenue calculations in Myanmar.

Taken together, the reforms proposed in this report could generate trillions of kyat in new resources to finance Myanmar's development agenda.

SEE efficiency, especially for profit-making natural resource SEEs. Taken together, the reforms proposed in this report could generate trillions of kyat in new resources to finance Myanmar's development agenda.

Building on NRG's *Gilded Gatekeepers: Myanmar's State-Owned Oil, Gas and Mining Enterprises*, which identified key governance gaps, the report analyzes SEE finances and operations, proposing several policy options for new revenue retention rules that both support SEE organization goals and allocate a greater proportion of revenues to productive uses. It then examines the management of UFA-OAs and proposes options for improved management and reallocation of balances. Finally, it examines the management, transparency and oversight of SEEs with the aim of proposing new legal regimes, monitoring frameworks and disclosure requirements for Myanmar's SEEs.

Section 1 examines the global governance of state-owned natural resource companies, highlighting their roles and how we can measure and assess their performance. Section 2 reviews the governance of SEEs in Myanmar. It examines the financial relationship between SEEs and the Union, how SEE budgeting works, how SEE retained revenues are managed, and oversight and transparency of their operations. It also looks at decision-making around SEE reform. Section 3 then dives deep into the finances and operations of MOGE and MGE, as case studies of profit-making SEE governance. It also examines the finances of other natural resource SEEs in brief. Section 4 benchmarks Myanmar's SEE finances and practices against international experiences. Finally, Section 5 provides a list of policy options on reform, covering SEE financing, management, oversight and transparency.

Global good governance of state-owned natural resource companies

Governance of state-owned natural resource companies can have considerable implications for public finances and the economy generally. NRG1's *Gilded Gatekeepers: Myanmar's State-Owned Oil, Gas and Mining Enterprises* emphasizes that well governed state-owned natural resource companies can be:

"[...] effective and dynamic contributors to national strategies that generate revenue, develop long-term national expertise and promote broader positive spillovers to the national economy. [Yet] they can be drains on the efficiency of public revenue generation if they fail to manage projects effectively or to enforce strong contractor performance. They can [...] become a sort of 'parallel treasury' by holding onto large revenue flows and spending them without going through ordinary budgetary processes. Perhaps most damaging, state-owned enterprises can be sources of corruption, using their *de jure* or *de facto* control over the spoils of natural resource wealth to enrich well-connected individuals or companies at the expense of the greater public good."

Gilded Gatekeepers provides a detailed examination of state-owned company roles and responsibilities in Myanmar and around the world. We will not repeat this examination here. We only wish to remind readers that natural resource state-owned enterprises—those that operate in the oil, gas, mining and forestry sectors—are a special breed, for several reasons. First, unlike many other state-owned enterprises, they operate in a sector characterized by significant economic rents. Economic rents refer to profits in excess of the cost of production, or profits gained not from productive work but from collecting returns on assets. As a result, natural resource state-owned enterprises often generate super-profits. Examples include Malaysia's Petronas and Saudi Aramco.

Second, because they often control vast resources and operate outside of normal budget controls, natural resource state-owned enterprises are prone to behaving as states-within-states. They operate semi-independently, governed by their own rules regarding contracting and budgeting, and invest in assets outside their expected business sphere. Examples include Angola's Sonangol and Venezuela's PDVSA.

Third, natural resource state-owned enterprises often have competing roles. They can be given any or all of the following mandates:

- **Operational.** Participating in exploration and production activities
- **Commercial.** Managing state equity share in commercial projects and marketing the state's share of physical oil or minerals
- **Regulatory.** Negotiating oil or mineral contracts, licenses and permits, and monitoring and enforcing private sector compliance with these agreements and regulations
- **Development.** Capacity building in the extractive industry, promoting local content and corporate social responsibility initiatives

These competing objectives can lead to conflict of interest, especially where a single entity is both an operator or a commercial partner and a regulator of those same operations. Competing objectives can also make measuring company performance difficult since it may be unclear which mandate takes precedence.

Each of these characteristics generates unique risks for the state. For example, lack of public accountability caused by the "state-within-a-state" problem can lead to inefficient production, where costs are too high or revenues too low.

Likewise, lack of accountability can lead to agreements with private sector contractors or joint venture partners that may not serve the interests of the state well. Finally, unless the company's revenue retention rule is well designed, large economic rents can lead to an inefficient transfer of revenue to the treasury.

These risks justify a high degree of oversight and control by other government agencies or ministries. Control can take many forms, for example:

- Legal control through laws or regulations
- Preventive or *ex ante* control through review, approvals and training prior to the time of transaction
- Detective or *ex post* control through financial reporting, performance monitoring and audits following the time of transaction
- Corrective control such as judicial action for fraudulent activities, penalties for non-compliance and management removal

Risk management is the process of strategically aligning controls to optimize performance. Most of the challenge lies not in identifying the controls but in their coordination and implementation. For example, a government can require that International Financial Reporting Standards (IFRS) be used to measure costs, in order to limit a state-owned company's costs to appropriate sums. It could then require that invoices be sent to match reported costs with actual purchases. However, unless the government knows the true value of the products purchased and whether they are being used productively, and then takes punitive measures in the case of poor performance, reporting will be of minimal value.

Good governance standards for state-owned companies

Good governance of state-owned companies—especially those in the natural resource sector—are informed by a set of general standards that have been employed by governments and synthesized by international organizations and think tanks. The Organisation for Economic Co-operation and Development's (OECD) *Guidelines on Corporate Governance of State-Owned Enterprises* and its guide for practical implementation, *Accountability and Transparency: A Guide for State Ownership*, represent a list of standards for all state-owned enterprises endorsed by a set of governments. The World Bank's *Corporate Governance of State-Owned Enterprises: A Toolkit* is a more comprehensive resource for state-owned company governance, though not a set of standards. More recently, the International Monetary Fund (IMF) released *How to Improve the Financial Oversight of Public Corporations*, a how-to guide for ministries of finance.

While each of these guides emphasizes different elements of good public enterprise governance, they share a number of suggestions for policy-makers, for example:

- **Ownership policy.** State-owned companies should have clear objectives and mandate, and the government should clarify its functions as their owner, ensuring a high degree of professionalism and effectiveness.
- **Legal framework.** The legal framework should provide the government with powers to control public companies' finances, require that they publish accurate and audited financial statements and annual reports on operations.



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

- **Performance monitoring.** Public company performance should be measured against their objectives, which requires clear benchmarks and monitoring of performance by an independent government entity, for example, an independent board, president's office, ministry of finance or state-owned holding company.⁴

The U.K.'s Chatham House has developed a set of good governance benchmarks specifically for state-owned oil companies, *Good Governance of the National Petroleum Sector*. Similarly, the Natural Resource Governance Institute has provided a set of practical steps to make national oil companies more effective and accountable, *Reforming National Oil Companies: Nine Recommendations*. The latter includes a set of general recommendations based on international experience, some of which are applicable to

Myanmar's natural resource SEEs, including:

- Clarify the mandate of the company and limit its non-commercial role.
- Develop an appropriate revenue retention model.
- Empower professional, independent boards.
- Invest in company staff integrity and capacity.
- Report key data publicly.
- Guarantee independent audits and publish them.

Together, these standards provide a general framework for considering how state-owned natural resource companies ought to be managed. They also help us benchmark Myanmar's legal and institutional regime for SEEs. Section 4 specifically benchmarks Myanmar's SEE finances and practices against these standards and practice in other countries' state-owned companies.

4 The last two sections of this report discuss performance indicators in detail.

Governance of SEEs in Myanmar

State-owned economic enterprises play a significant, yet poorly understood, role in Myanmar's economy. Operating simultaneously within a sparse legal framework and a vast bureaucracy, their operations are the product of an institutional evolution quite distinct from most other countries in the world. Limited public information on their finances and activities has led to confusion amongst the many actors involved in managing and overseeing SEEs, including the general public.

This section clarifies the underlying governance structure for SEEs in Myanmar. First, we define SEEs and describe the financial relationship between SEEs and the Union. Second, we describe the management and control of SEEs. This includes a mapping of SEE monitoring. Third, we discuss how decisions are made around SEE reform in Myanmar today.

SEE GOVERNANCE FRAMEWORK AND FINANCIAL RELATIONSHIP WITH THE UNION

At latest count, the government had labeled 31 entities as SEEs, those listed in Table 1 minus the Central Bank of Myanmar. This down from 47 SEEs under 18 ministries just six years ago, a product of mergers and transformations of some SEEs into ministry departments.⁵ It is also down from the nearly 1,800 SEEs in the mid-1990s.⁶

SEEs range in size and function. Some take the form of financial institutions, others are licensing and regulatory agencies, and still others produce goods and services. There is little consistency as to what constitutes a state-owned economic enterprise in Myanmar, and this definitional vagueness has contributed to inconsistency in government policy and regulation of SEEs. This report focuses on extractive sector SEEs, but it is our hope that its findings can be used as a starting point for analysis of other SEEs.

5 Zaw Naing. *The State Economic Enterprises Reform in Myanmar (Fiscal Perspectives)* (Ministry of Finance, Treasury Department, 2014).

6 Tin Maung Maung Than. *State Dominance in Myanmar: The Political Economy of Industrialization* (Singapore: ISEAS Publishing, 2007).

Table 1. List of SEEs as of 2016

Source: MOPF Budget Department)

Responsible ministry	State-owned economic enterprise (SEE)	Profitability in 2015/2016 (MMK billion)
Ministry of Information	News and Periodicals Enterprise	-4
Ministry of Natural Resources and Environmental Conservation (MONREC)	Myanmar Timber Enterprise (MTE)	-3
	No. 1 Mining Enterprise	
	No. 2 Mining Enterprise	
	Myanmar Gems Enterprise (MGE)	
	Myanmar Pearl Enterprise	
Ministry of Electricity and Energy (MOEE)	Myanma Oil and Gas Enterprise (MOGE)	-21
	Myanma Petrochemical Enterprise (MPE)	
	Myanma Petroleum Products Enterprise (MPPE)	
	Electric Power Generation Enterprise	
	Electricity Supply Enterprise	
	Yangon Electricity Supply Corporation	
	Mandalay Electricity Supply Corporation	
Ministry of Transport and Communication	Myanmar Railways	-52
	Road Transport	
	Myanmar Postal Enterprises	
	Myanmar Port Authority	
	Myanmar National Airlines	
	Myanmar Shipyard Enterprise	
	Myanmar Inland Water Transport	
	Security Printing Works	
	Myanmar Post and Telecommunications	
Ministry of Industry	No. 1 Heavy Industry	-336
	No. 2 Heavy Industry	
	No. 3 Heavy Industry	
	Myanma Pharmaceutical Enterprise	
Ministry of Planning and Finance	Myanmar Economic Bank	-74
	Myanma Investment and Commercial Bank	
	Myanmar Foreign Trade Bank	
	Myanmar Insurance Enterprise	
Ministry of Agriculture and Irrigation	Myanma Agricultural Development Bank	+2
Central Bank of Myanmar	Central Bank of Myanmar	+112

All SEEs derive their authority from the 1989 State-Owned Economic Enterprises Law, enacted by the State Law and Order Restoration Council (SLORC). It grants a monopoly to the government in various spheres of economic activity. Most notably for this report, it grants a monopoly in the “extraction of teak”, “exploration, extraction and sale of petroleum and natural gas and production of products of the same”, and the “exploration and extraction of pearl, jade and precious stone and export of the same” to relevant SEEs.⁷ The law also enables SEEs to form joint ventures and allows the government to establish SEEs in other sectors not explicitly mentioned in the legislation.

The 2017 Budget Law defines SEEs as “business-oriented enterprises” as designated by the cabinet. Yet according to the Union of Myanmar’s Financial Rules 42/86 (now called 35/2017), which sets out many of the roles and responsibilities of government agencies, SEEs are defined as “business organizations designated by the Union government in order to carry out business or profit-oriented activities in the interest of the state.” Ministry departments, on the other hand, are defined as any department implementing its activities in accordance with the Union budget.

In practice, the distinction between an SEE and a department is far from clear. While SEEs may be defined as commercial, profit-oriented entities, many are chronically loss-making without any expectation of making a profit (e.g., No. 3 Heavy Industry Enterprise, News and Periodicals

Enterprise). Some departments, on the other hand, regularly make profits, such as the livestock department under the Ministry of Agriculture and Irrigation.⁸

Likewise, Myanmar’s SEEs are generally not independent of government ministries, but are rather firmly entrenched under ministry authority.⁹ According to the latest count, only four SEEs have quasi-independent boards to monitor SEE activities: Myanmar National Airlines, Myanmar Economic Bank (MEB), Myanma Investment and Commercial Bank, and Myanmar Foreign Trade Bank (MFTB). In the case of Myanmar National Airlines, the board consists of five retired civil servants, which would not constitute an independent board in most contexts.¹⁰ While other SEEs have boards, these act as management committees rather than oversight bodies. In nearly every case, SEE management reports to a line ministry, and its capital budget is set by the line ministry.

Further clarification of responsibilities or mechanisms for governance of SEEs is not provided in the law, nor have the powers of state-owned enterprises been circumscribed by additional legislation, but rather by a series of internal ministry directives and notices that tend to be reactive to challenges rather than clarifying of policy goals, as described below. As such, much of the relationship between SEEs and other governmental entities has emerged in an *ad hoc* fashion rather than through a clear statutory or policy framework.

7 *Union of Myanmar. State-Owned Economic Enterprises Law* (State Law and Order Reconciliation Council, 1989).

8 Based on analysis of MOPF financial reports.

9 Among countries surveyed by the OECD’s 2016 report *State-Owned Companies in Asia: National Practices for Performance Evaluation and Management*, state-owned companies in Bhutan, China, Indonesia, Kazakhstan, Korea and Singapore are independent of line ministries. State owned-companies in India, Pakistan, the Philippines and Vietnam have some link to their line ministries.

10 Interviews with U.S. treasury advisor and MOPF.



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

These ministry directives and notices—especially from the Ministry of Planning and Finance (MOPF)—have given rise to the principal difference between an SEE and a ministry department: the entity’s tax treatment and revenue retention rules.¹¹ Whereas departments are allocated a budget and must return unspent money at the end of the fiscal year, SEEs may retain a percentage of their profits in MEB funds called Other Accounts (OAs). The next section provides a more in-depth explanation of OA management.

Prior to 2012, SEEs were supposed to pay 70 percent of their profits to the Union Fund Account (UFA) via the MOPF Budget Department in the form of “dividends” and 30 percent of profits to MOPF’s Internal Revenue Department (IRD) in corporate income tax. Interviews with IRD confirm that, in practice, due to poor enforcement by Myanmar tax authorities, payments rarely reflected SEE profits. (Box 1 describes what constitutes SEE “profit” in Myanmar.)

Box 1. What is SEE ‘profit’?

Under Myanmar’s financial accounting system for SEEs, “net profit” and “gross profit” have distinct meanings. Gross profit has a definition similar to that in other countries, meaning revenue minus cost of goods sold.

In the case of MOGE, revenue includes: (1) profit or production shares; (2) returns on equity/state participating share; and (3) sale of goods (e.g., compressed natural gas) and services (e.g., data). For accounting purposes, revenue does not include royalties and bonuses, which are collected by MOGE but transferred directly to the Ministry of Energy and Electricity. This arrangement is unusual globally. More often, either all revenues are collected by the national revenue authority and some revenues are transferred back to the state-owned company or only sales of goods and services and/or returns on equity are retained by the state-owned company.

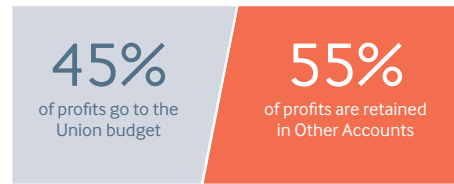
MOGE cost of goods sold includes: (1) cost of producing onshore crude oil, natural gas and condensed natural gas for vehicles; (2) cost of services provided to foreign companies; and (3) expenditure for offshore exploration and administration, which includes cash calls for ongoing work on gas fields.

Net profit is defined as gross profit minus: (1) management and research costs, which are largely salaries and pensions; (2) financial costs, which are largely interest and principal on SEE debt; and (3) commercial, special goods and crude oil taxes.

This is important because 25 percent of net profit is transmitted to MOPF as corporate income tax and 20 percent is transmitted to the Union’s SEE Account as a “dividend”, based on Ministry of Planning and Finance directives. The remainder is retained by SEEs and deposited into their Other Accounts. It is unusual globally that commercial, special goods and crude oil taxes be combined with salaries and debt servicing costs in calculating net profit.

11 The other main difference is the degree of recurrent expenditure supervision, which is somewhat weaker for SEEs than departments. We describe this issue in subsequent sections.

What happens with the money SEEs make?



In 2012, the system was changed. SEEs, with the exception of state-owned banks, began making the following payments to the UFA, net of commercial tax and, in the case of MOGE, a small crude oil tax:¹²

- 25 percent of net profits in corporate income tax, paid to the Ministry of Planning and Finance’s Internal Revenue Department
- 20 percent of net profits in “state contribution” (paid quarterly), paid to the Ministry of Planning and Finance’s Treasury Department¹³

SEEs may retain the remaining amount in their own funds/OAs indefinitely, meaning the savings are rolled over year after year. (MOPF officials use the terms “own funds” and OAs interchangeably.) The next section will discuss in detail the management of OAs.

This revenue retention policy has its genesis in the Framework for Economic and Social Reform put forth by the quasi-military U Thein Sein government, which called for a two-step reform process: “corporatization of State Economic Enterprises and privatization of certain activities so that the government can keep its fiscal regime in order and develop regulatory policies necessary to foster private investment.” (See Box 2 for explanation of corporatization in Myanmar.) These reforms were to be conducted in a “transparent and efficient manner to produce

greater benefits to the population without causing adverse environmental and social consequences.”¹⁴ The Framework for Economic and Social Reform’s SEE reform process, in turn, is rooted in the SLORC government’s stated objective, starting in the early 1990s, to professionalize management of SEEs by giving them greater independence.¹⁵ However, a recent review of the SEE reform described the military government’s SEE reforms as, “at best... *ad hoc* and discretionary,” despite an attempt to set a clear policy agenda.¹⁶

From 1989 to 2012, all SEE liabilities were assumed by the Union and expenditures were incurred by the Union according to budget allocations, identical to treatment of government departments. SEEs were not permitted to retain fiscal surpluses in any earmarked accounts.¹⁷ In 2012, an MOPF directive outlined a new policy, that SEEs would henceforth implement “commercially-oriented business ventures” and “stand on their own financial resources.”¹⁸ This goal has been reiterated by the government every year since, including in the 2017 Budget Law. The intent was that SEEs could no longer rely on Union subsidization to soften their budget constraints. This was attuned with the government’s “commercialization” strategy. This directive began a rather frenetic set of changes in the rules governing SEE revenue retention.

12 These payments are described in the MOPF directive released on 12 July 2012.

13 “State contribution” has also been called a “dividend” by government officials. According to the Union of Myanmar’s 2017 Budget Law, the cabinet of the union government can change the state contribution amount if it so orders or can delegate this power to the Minister of Planning and Finance. “State contribution” has also been called a “dividend” by government officials.

14 Union of Myanmar. *Framework for Economic and Social Reform* (2013). Online: <https://myanmarcesd.org/2013/01/30/publication-fesr>.

15 Than, *State Dominance in Myanmar*.

16 Lex Rieffel. “Policy Options for Improving the Performance of the State Economic Enterprise Sector in Myanmar,” ISEAS Working Paper (ISEAS, 2015).

17 The authors are unaware of the rules governing SEE revenues prior to 1989.

18 MOPF directive, 3 April 2012.

In FY 2012/13, mergers reduced the number of SEEs to 41 under 14 ministries, in addition to the Central Bank of Myanmar. State and regional SEEs were then placed under the nominal authority of the state or regional governments. OAs would be used to finance SEEs operating/recurrent costs while the Union budget would still cover capital expenditures. Most SEE revenues and expenditures would be recorded in the Union budget, though some SEEs would convert into fully “off-budget” entities.¹⁹

To put this plan into practice, from 2013 to 2015 the Ministry of Planning and Finance began changing the rules regarding how money retained in OAs could be used. In 2013, it was decided that profit-making SEEs would have to use their OAs to cover “raw materials,” such as fuel for trucks, as well as capital expenses, debt expenses and “other expenses.”²⁰ In 2014, it was decided that unspent salaries and expenses had to be returned to the UFA at the end of the fiscal year. MOPF also warned SEEs that their budget estimates should be more realistic.

The system went through a radical change in 2015. For most SEEs, all interest on foreign loans, debt expenses and capital expenses would

continue to be paid out of the UFA. Moreover, SEEs would continue to make budget requests to pay their commercial taxes, corporate income taxes and state contributions. However, all current expenses, such as salaries, would be drawn from OAs. If there was not enough in a given SEE’s OA, the SEE could borrow from state-owned banks at 4 percent interest, and the principal and interest had to be repaid at the end of the year.

SEEs labeled as “adequate,” on the other hand, would be treated differently. Many capital expenses and debt expenses would still be paid out of the Union budget. However a list of SEEs with sufficiently large savings—including the Myanmar Oil and Gas Enterprise (MOGE), Myanmar Petrochemical Enterprise (MPE), Myanmar Electric Power Enterprise, No. 1 Heavy Industry and Myanmar Railways—would use their OA savings on “raw materials”, current expenses, commercial tax, income tax, state contribution, and production and operational expenses.²¹

In practice, this has meant that SEEs have progressively increased the number of expenditure items covered out of their OAs. In the case of MOGE, the following items have been covered out of their OA/own account year-by-year. (See Table 2.)

19 Naing, *The State Economic Enterprises Reform in Myanmar*.

20 Other accounts are part of the union fund account and are therefore “on-budget.”

21 Drawn from MOPF directives and notices

Table 2. Year-by-year expenditures paid out of MOGE's Other Account

Fiscal year	Expenditure item out of OA
2012/2013	78 percent of raw materials (e.g., car fuel) and oil for production
2013/2014	100 percent of raw materials, oil for production, income tax and state contribution
2014/2015	100 percent of raw materials, oil for production, income tax and state contribution
2015/2016	100 percent of raw materials, oil for production, income tax, state contribution, crude oil from foreign companies, commercial tax, cash calls for offshore projects and socioeconomic expenses
2016/2017	100 percent of raw materials, oil for production, income tax, state contribution, crude oil from foreign companies, commercial tax, cash calls for offshore projects, socioeconomic expenses and "other current expenditures" minus interest
2017/2018	100 percent of raw materials, oil for production, income tax, state contribution, crude oil from foreign companies, commercial tax, cash calls for offshore projects, socioeconomic expenses and "other current expenditures" plus interest

The government expects that all profit-making SEEs will eventually stand on their own feet by funding all of their expenditures with retained profits.²² As of FY 2017/18, eight SEEs are required to fund both their current and tax expenditures with their OAs, which includes fuel and interest on debt but not the principal on debt: News and Periodicals Enterprise, Myanmar Post and Telecommunications, Myanmar Timber Enterprise, No.1 Mining Enterprise, No.2 Mining Enterprise, Myanmar Gems Enterprise, Myanmar Pearl Enterprise and Myanma Oil and Gas Enterprise.²³

A further 10 SEEs are now required to use their OAs to fund a portion of current expenditures, specifically taxes, state contribution, raw materials (mainly fuel and electricity) and production costs. Salaries, pensions and interest on debt are still covered out of the Union budget. These 10 are: Myanmar Railways, Road Transport, Myanmar Postal Enterprise, Electricity Supply Enterprise, Myanma Petrochemical Enterprise, Myanma Petroleum Products Enterprise, No. 1 Heavy Industry, No. 2 Heavy Industry, No. 3 Heavy Industry and Myanma Pharmaceutical Enterprise. Another two SEEs—Inland Water Transport and Electric Power Generation Enterprise—must cover 50 percent of some current expenses out of their OAs, including corporate income tax and production costs.

22 As described in the 2016/2017 Citizens' Budget published by MOPF, the three-step process aims to gradually cut the funding for SEEs and make them financially independent. It is not clear whether the process is meant for all SEEs or only for profit-making SEEs. The policy does not specify a timeline.

23 Union of Myanmar. *2017/2018 Citizens' Budget* (2017).

Allowing SEEs to retain such large cash holdings comes at a significant opportunity cost in terms of foregone spending on social services and infrastructure.

The remaining SEEs' costs are fully covered by the Union budget. Continuing a practice inherited from the period before the 2012 SEE financing reform, loss-making SEEs must make budget requests to cover their tax and dividend payments, and must borrow from the Union to cover salaries if their revenues are not large enough.²⁴ Profit-making SEEs, on the other hand, may retain 55 percent of net profits. If they become *overly* profitable, some of these savings must cover raw materials, such as fuel, as well as some production and operational expenses, such as administrative and research expenses. Some SEE capital expenditures remain fully covered by the Union budget via the line ministries responsible for each SEE.

Furthermore, in its 12-point economic policy, the government has committed to improving SEE operations by publishing their financial and payments statements and making them more cost effective. To date, MOPF has published aggregate information on SEE finances in the *Citizens' Budget* and annual budget documents.

Based on our research, Myanmar differs from global norms in that the money that SEEs are allowed to retain in their OAs is not tied in any way to companies' investment strategies or financial needs. This revenue retention formula has resulted in an exceedingly high degree of cash

holdings by the larger profit-making SEEs, as will be described below. Allowing SEEs to retain such large cash holdings comes at a significant opportunity cost in terms of foregone spending on social services and infrastructure.

This revenue retention system seems to undermine the government's stated goal of improving SEE efficiency in three ways, by (1) maintaining loss-making SEEs' dependence on the Union for all spending, removing an incentive to become more profitable; (2) maintaining profit-making SEEs' dependence on the Union for its capital spending, removing an incentive to control capital costs; and (3) allowing profit-making SEEs to hoard cash, discouraging greater profitability since, as will be shown later, their cash holdings are more than sufficient and SEEs therefore have little incentive to raise more revenue or cut costs.

One interesting consequence of this system is that many loss-making SEEs have become ministry departments in order to have all their costs covered by the Union budget. Table 3 shows a partial list of SEEs that have been converted to departments in recent years. Each is a case of a loss-making SEE either becoming a ministry department or being placed under a ministry department. Furthermore, several SEEs have merged, such as No. 1 Mining Enterprise and No. 3 Mining Enterprise.

24 This system is also described in Myanmar's Budget Law (2017).

Table 3. Partial list of SEEs converted to departments

(Source: MOPF Budget Department)

Year	Responsible ministry	SEE name	Department name
2012/2013	Agriculture, Livestock and Irrigation	Myanmar Agriculture Services	Agricultural Department
2013/2014	Economics and Commerce	Myanmar Agricultural Products Marketing Enterprise	Trade Promotion Department
	Labor, Immigration and Social Security	Social Security Board	Social Security Department
2014/2015	Information	Myanmar Motion Picture Enterprise	Moved under Information and Public Relations Department
	Finance	Myanmar Microfinance and Supervision Enterprise	Financial Supervision Department
	Hotel and Tourism	Myanmar Hotel and Tourism Enterprise	Move under other departments
2015/2016	Construction	Public Work Cooperative Enterprise	Moved under Building, Bridge and Road Departments
2016/2017	Natural Resources and Conservation	Myanmar Salt and Marine Chemical Enterprise	Moved under Department of Mines
	Information	Printing and Publication Enterprise	Printing and Publication Department

What’s more, some profit-making departments or SEEs have become even less accountable and retained a larger share of their profits by going “off-budget”—or in government parlance become “out-of-UFA.” In doing so, they have appropriated their OA savings into their fully self-controlled Capital Finance accounts but have transferred their liabilities, such as debt obligations, to the Union budget. Figure 1 explains the difference in financing arrangements for Union “off-budget”/“out-of-UFA” SEEs, regular SEEs and ministry departments.

Over the past few years, six profit-making SEEs have gone “off-budget.” These are: Myanmar

Port Authority, Myanmar Shipyard Enterprise, Myanmar National Airlines, Yangon Electric Power Supply Corporation, Mandalay Electric Power Supply Corporation and Inland Water Transport. (See Box 2 for explanation of corporatization in Myanmar.)

Inland Water Transport is a particularly interesting case. Several years ago, when the company was making large profits, it was placed off-budget so that it could set its own capital budget without line ministry oversight. However, now that it is losing money, it has been transformed into a regular SEE again so that some of its costs are covered by the Union budget.²⁵

Figure 1. Financing of Union government entities

Source: MOPF Budget Department

<p>Off-budget/Out-of-UFA SEEs (e.g., Myanmar National Airlines)</p>	<ul style="list-style-type: none"> Retain 55 percent of profits allocated to (current account) capital finance account, which is governed in the same manner as OAs; remainder sent to union budget All current and capital expenditures come out of their own fund
<p>SEEs (e.g., MOGE, MGE, MTE)</p>	<ul style="list-style-type: none"> Retain 55 percent of profits in OAs; remainder sent to Union budget Some or all current expenditures come out of their own fund, depending on profitability Capital expenditures come out of Union budget via line ministry
<p>Departments (e.g., Social Security Department)</p>	<ul style="list-style-type: none"> All revenues sent to Union budget All expenditures come out of the Union budget

25 Union of Myanmar. 2017/2018 Citizens' Budget.

On a positive note, the Union of Myanmar's debt management policy has greatly improved in recent years. Previously, SEEs were permitted to borrow directly from private sector lenders or bilateral partners to cover capital expenditures, with MOPF issuing letters of credit. This left a significant legacy of debt in many SEEs. MOGE, for example, owes approximately MMK 1.7 trillion, mainly to Chinese state creditors. More recently, the Ministry of Energy and Electricity (MOEE) borrowed to finance electric power generation. Other large loans have been made to Myanmar Railways and Myanmar Post and Telecommunications.²⁶

The Public Debt Management Law (2016) now prohibits direct foreign borrowing by SEEs. SEEs may now only borrow directly from Myanmar's state-owned financial institutions. However, SEEs may still borrow from private sector lenders or bilateral partners through MOPF, meaning that MOPF can borrow on behalf of SEEs and on-lend

to SEEs. In practice, MOPF rarely challenges SEE loan requests.²⁷ Loans must also now be approved by the *Pyidaungsu Hluttaw*, providing a degree of monitoring over foreign SEE debt.

In conclusion, one of the positive developments in recent years has been to provide a greater degree of oversight over SEE debt with the expectation that this will make SEEs more attractive assets. Yet this reform is dependent on the capacity of MOPF, the cabinet and parliament to analyze SEE borrowing decisions. On the other hand, the rules governing SEE financing, and particularly the creation of SEE-Other Accounts, have undermined some of the stated goals of the government's SEE reforms. Furthermore, these changes have been accompanied with little requirement for SEEs to clarify their corporate function, establish an independent board of directors, or publish financial reports that meet international accounting standards, all issues which will be dealt with in subsequent sections of this report.

26 MOPF Treasury Department

27 *Ibid.*

Box 2. Corporatization reforms in Myanmar

Corporatization refers to a process whereby a government entity, whether SEE or department, is restructured under the relevant company law so that it becomes a limited liability firm with the government as a shareholder. In the Myanmar context, the relevant law, the Myanmar Companies Act (1914), states that 100 percent of the shares would be held by the relevant line ministry; assets and liabilities would legally belong to the SEE (though pension and debt liabilities are likely to be transferred to the relevant line ministry prior to corporatization); and staff would receive new contracts aligned with public sector standards. Since the corporatized entity would be subject to the Myanmar Companies Act, it would be subject to stronger accounting and reporting requirements, corporate governance regime (meaning a board of directors) and auditing requirements than is currently the situation. The difference between corporatization and privatization is that, in the case of corporatization, 100 percent of the shares are held by the Union whereby privatization involves sale of shares to private entities.

All corporatizations of public entities—in fact any public–private partnerships, franchising of public entities, joint ventures and privatizations—must be reviewed and approved by the Privatization Commission.¹ While certain SEEs such as Myanmar National Airlines and Myanmar Port Authority have gone “off-budget,” meaning that their recurrent and capital expenditures are fully covered out of their own funds and MOPF does not approve their budget line-by-line, no SEE has been corporatized or privatized since at least 2012.

In the event that SEEs are corporatized or just placed “off-budget”, it is generally assumed by SEE managers that SEEs would retain their accumulated profits, while shedding their debt and other liabilities by passing them off to the Union government, as has been done in the case of Myanmar National Airlines. The corporatization of large profit-making SEEs along these lines—a stated goal of Myanmar Timber Enterprise and Myanmar Gems Enterprise managers, for instance—would not only risk the Union’s fiscal sustainability but also shrink fiscal space for spending on higher impact expenditure items, such as education, healthcare and much-needed infrastructure.

28 Notification 10/2016, Formation of the Privatization Commission, Office of the State President.

SEE PUBLIC FINANCIAL MANAGEMENT SYSTEM

Government accounting

Much of the Union of Myanmar's SEE policy is driven by the government's accounting structure rather than a conscious weighing of policy options followed by a political choice. As such, it is important to understand how government accounting works if one wishes to understand how the government controls SEEs' finances and activities.

The Union of Myanmar's complex accounting structure is a hybrid of British colonial accounting, central planning, SLORC-era reforms and a more recent slow evolution in government accounting practices. Additionally, Myanmar still employs a traditional line item budgeting approach, whereby an annual budget's starting point is the previous year's budget. This is in contrast to a project-based or performance-based budgeting framework whereby budget decisions are based on policy goals.

The Union of Myanmar's principal bank account, held at the Central Bank of Myanmar, is called the Union Fund Account (UFA). There are seven types of State Fund Account (SFA) within the UFA, which are all held and managed by the MEB, a state-owned bank.²⁹ These are: SEE Account, Development Committee Account (DC), Ministries and Departments Account (M&D), Bank Sub-Treasury Account, revolving funds, central bank fund and Other Accounts (OA). (See Figure 2.)³⁰ A similar system exists for state and regional accounts, but is not covered in this report.

Each of these SFAs has its own function. For example, SEE Accounts are used to finance current and some capital expenditures of SEEs. M&D Accounts play the same role for ministries and departments, though they also finance SEE capital expenditures. DC Accounts are used to finance the municipal-level development committees, which are responsible for local service delivery and public works, city planning, urban land administration, tax collection, business licensing, public health and urban development.³¹ Bank Sub-Treasury Accounts are opened where there is no MEB branch, yet are still managed by MEB. Revolving funds are special purpose funds or loans without interest, such as loans for housing to the housing department at zero percent interest. OAs are used for a number of purposes, as will be described in detail.

SEE and M&D Accounts are allocated money from the UFA at the start of the fiscal year through the normal budget process which SEEs, ministries and departments can draw down upon until the end of the fiscal year. Occasionally, these accounts receive money directly from SEEs, ministries or departments, but only in cases where they have withdrawn more than was permitted by the Union budget and therefore must return money to their accounts.

Most major capital expenditure items for SEEs are not financed directly out of their SEE Account, but are rather financed out of their line ministry M&D Accounts. In other words, line ministries request capital budget allocations on behalf of themselves and their SEEs and in turn allocate the capital budget to their different entities.

29 The terms "union fund account" and "state fund account" are sometimes used interchangeably by government officials.

30 These accounts are used by the central bank and available to the MOPF's Treasury Department.

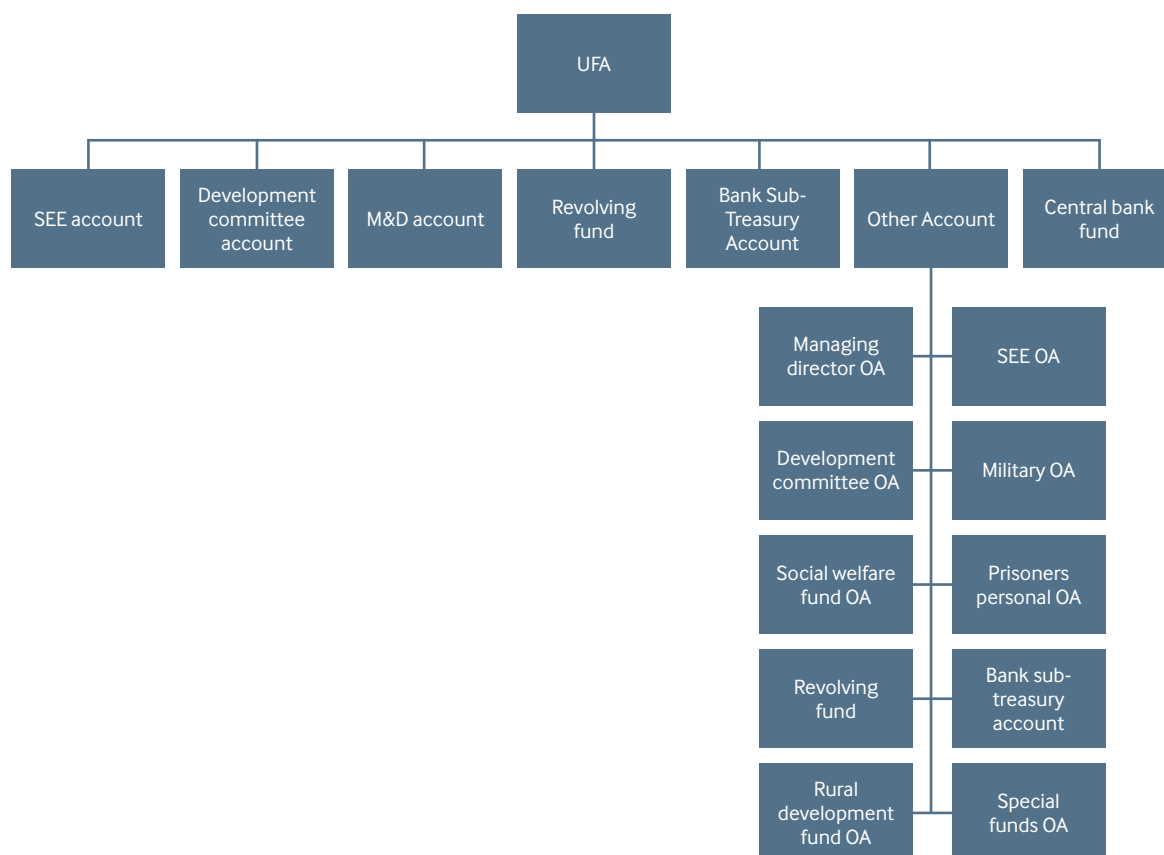
31 Matthew Arnold et al. *Municipal Governance in Myanmar: An Overview of Development Affairs Organizations* (The Asia Foundation-MDRI [CESD], 2015).

For accounting purposes, SEEs themselves have four types of accounts held separately at MEB: A SEE Account for recurrent and some capital spending, which is money allocated by the annual Union budget; a financial (debt) account; a capital account, which receives money from the SEE's line ministry M&D account for capital expenditures; and Other Accounts.³² The SEE account is simply a line item dedicated to a specific SEE in the annual national budget; allocations to

the SEE Account are treated in the same manner as any other government department or agency account. The OA, on the other hand, while noted in the budget and remaining an account within the UFA, is subject to unique deposit and withdrawal rules, as described below. It is an extra-budgetary account by international standards.³³ As such, a greater degree of oversight and transparency of OAs may be warranted.

Figure 2. Union Fund Account (UFA) structure

Source: MOPF Treasury Department



32 Central Bank of Myanmar. *State Organization Accounting Directives*.

33 Richard Allen and Dimitar Radev. "Managing and Controlling Extrabudgetary Funds," IMF Working Paper 06/286 (IMF, 2006). Online: <https://www.imf.org/external/pubs/ft/wp/2006/wp06286.pdf>.



Jade valuation. Minzayar Oo for NRGJ

The foreign exchange budget system is important in that it gives rise to offshore SEE accounts.

To complicate matters, ministries, departments, SEEs and the central bank all have foreign exchange (FE) budgets and accounts. At the beginning of the fiscal year, each of these entities (except the central bank) draws up a foreign exchange budget, which is submitted to the foreign exchange division in MOPF's Budget Department. This budget allocates a certain amount of foreign currency to each entity that it may draw on to purchase foreign goods. The foreign currency is held at any of the MFTB's approximately 50 corresponding banks outside Myanmar. Similarly, any foreign currency sales by SEEs or ministries are deposited into their offshore MFTB accounts; the money does not physically enter Myanmar.³⁴

As with any part of the Union budget, foreign exchange budgets must be approved by the cabinet and parliament. SEEs and ministries therefore have a cap on how much foreign exchange they can use in a given quarter. This system was developed in response to the shortage of foreign currency during the socialist period and under the sanctions regime starting in the 1990s. It remains as a control on overuse of foreign currency, though SEEs as a whole are net importers of foreign currency. In 2015/16, Myanmar's SEEs ran a combined MMK 1.6 trillion trade surplus, generating essential foreign currency for the state. Still, while most SEEs are net importers of foreign currency—the largest by far being MOGE, MPT, MTE, MGE and the Central Bank of Myanmar—

certain SEEs run persistent and sizeable trade deficits.³⁵ For example, in 2015/16 the Myanmar Electric Power Production Enterprise ran a MMK 458 billion trade deficit and Heavy Industry No. 3 ran a MMK 39 billion trade deficit. This year, both are expected to run similar trade deficits.³⁶

The foreign exchange budget system is important in that it gives rise to offshore SEE accounts. SEEs that either purchase foreign equipment, repay loans or sell goods or services in foreign currency—as MOGE, MTE and MGE do—must have at least one offshore account with MFTB. If MFTB does not have enough foreign currency to repay a loan or purchase equipment, the Central Bank of Myanmar must get involved, but this rarely happens. The balances of SEE offshore foreign currency accounts are currently unknown. Box 3 goes into further detail on the management of foreign currency accounts.

While the above represents the standard foreign currency management system, exceptions exist. For instance, MGE holds a euro account at MEB for funds collected at the Gems Emporium. These euros are converted to kyat by MEB and credited to MGE. It is unclear where MEB receives the authority to hold foreign currency accounts, possibly due to notices and directives not being made publicly available; officials in MOPF's foreign exchange division were unaware of the existence of these accounts until told by this report's researchers.

34 MOPF Budget Department.

35 In 2015/2016, these five SEEs ran the following trade surpluses: MOGE – MMK 929 billion; MPT – MMK 349 billion; MTE – MMK 230 billion; MGE – MMK 157 billion; Central Bank of Myanmar – MMK 319 billion.

36 MOPF Budget Department.

Box 3. How SEEs repatriate foreign currency receipts... or keep them abroad

Some of Myanmar's SEEs, especially natural resource SEEs, earn most of their income in foreign currency. Oil and gas, for example, are generally sold on international markets in U.S. dollars. The jade emporium sells its product in euros, though US dollars will also soon be accepted. SEEs earning in foreign currencies must therefore exchange their dollars, euros or yuan into kyat and repatriate them in order to conform to the MOPF directive that all retained revenue must be held at the Myanmar Economic Bank (MEB) in kyat.

According to Union of Myanmar procedures, most foreign exchange transactions by the government must be managed by the state-owned Myanmar Foreign Trade Bank (MFTB). MEB may carry out foreign currency transactions, but only in "frontier areas."³⁷ As a result, most foreign currency earnings by SEEs are collected first by MFTB before being transferred to SEEs in kyat. The money may be held at any of MFTB's 50 or so corresponding banks located in Singapore, the U.K., Malaysia, Bangladesh, the U.S., Germany and Switzerland, among others. The use of so many different banks is meant to manage different currencies and hedge risk. Foreign exchange conversion occurs at the rate set by the Central Bank of Myanmar.

SEEs may open MFTB accounts for receipt of foreign currency payments. They can also open MFTB accounts for payment of foreign suppliers. The foreign currency itself remains outside Myanmar in MFTB *nostro* bank accounts, though budgets—both inflows and outflows—must be approved by the MOPF Budget Department (foreign exchange division), cabinet and parliament. All imports of foreign currency also require an export permit from the Ministry of Commerce. SEEs may hold positive balances in these accounts. While we were unable to access any account records, officials told us that the balances are usually small.

During the sanctions period prior to 2012, MOGE, MGE and MTE requested opening of offshore accounts in order to purchase equipment and sell goods. Shell companies were created and the accounts were opened in China, Singapore and elsewhere under individuals' or company names. It is unclear whether these accounts are still active.³⁸

MFTB makes a profit in several ways. First, MFTB charges fees to government agencies, including SEEs, for different transactions, such as money transfers or issuing letters of credit. Second, the bank uses its positive balances to earn interest on loans to foreign commercial banks. Third, MFTB provides trade financing services. Fourth, and most profitably, MFTB often acts as an intermediary between foreign donors—such as the Japanese Agency for International Cooperation, the World Bank or KfW—and ministries when financing infrastructure projects. Usually, MOPF will negotiate loans at concessional or near-concessional rates (e.g., 1 percent). MFTB will manage these loans on behalf of MOPF, then charge higher interest rates (e.g., 4.5 percent) to line ministries. While MFTB accepts the risk of kyat depreciation, it can make a hefty profit on the difference. MFTB also acts a guarantor on loans made directly to line ministries, for example, on the Kinda Dam, charging a 1 percent annual fee. Of note, MFTB also negotiates some loan agreements itself, especially loans at market rates.

MFTB is officially overseen by the Central Bank of Myanmar. However in practice the central bank's capacity to provide effective oversight remains weak.³⁹ In fact, given that foreign currency is transferred to and retained by MFTB, it may be as powerful an institution as the central bank, if not more so.

37 For example, in 2010, MEB opened a euro-denominated account for MGE to manage its Gems Emporium earnings. Prior to 2010, MFTB managed MGE's Gems Emporium transactions.

38 Based on interviews with MOPF Budget Department and MFTB.

39 Based on interviews with the Central Bank of Myanmar.

Management of ‘Other Accounts’

UFA-Other Accounts (OAs), while simply a type of account within the UFA, are of particular interest since they are governed by a completely different set of rules than other types of SFAs. The most important difference with OAs is that, unlike other types of SFAs, unspent money at the end of the fiscal year in OAs is rolled over to the next fiscal year without the need for budget approval. An OA is a permanent fund that is earmarked for a specific government entity. OAs are the *only* such funds within the Union Fund Account. Essentially, OAs are sovereign wealth funds by a different name, albeit sovereign wealth funds that chronically earn negative real returns, as we shall see.

OAs are special-purpose vehicles used by both line ministries and SEEs to serve as “working capital.” SEEs were only allowed to open their own OAs beginning in 2012/13 as part of the government’s reforms. There are many types of OAs, including SEE, development committee, military and prisoners OAs. (See Figure 2.) For ministries, sources of such revenues include community donations, revolving funds and user fees. Public hospitals and clinics managed by the Ministry of Health, for instance, have their own OAs to keep donations for the trust fund, while MOPF has OAs for projects funded by donors. Military OAs are meant to provide a source of immediate funds for the Ministry of Defense. Rural development fund OAs were created for the same purpose. Development committee OAs are used to finance municipal-level spending. OAs opened at hospitals and prisons, for purposes of cost sharing or to pay for prisoners’ expenses, are not mentioned in the Union of Myanmar budget, unlike other OAs.

According to the Financial Regulations of 1986, a ministry or SEE must seek approval from MOPF to open OAs. The regulations explicitly allow OAs for the Ministry of Defense, rural development funds, personal funds of prisoners, compensation for government employees, and income from state-owned lands and buildings. The new regulations issued in 2017 add SEEs to the list, officially sanctioning standard practice in recent years.

The funds themselves are held at the Myanmar Economic Bank (MEB), a state-owned bank. All OA balances are physically located at MEB branches inside Myanmar. Assets must be held in kyat and may not be invested in any interest accruing assets. In other words, they must be held in Myanmar-denominated cash or cash equivalents.⁴⁰

There is no statutory limit on withdrawals by an SEE. SEEs are required to report annually on how much they are planning to spend from their OAs in the budget proposal to MOPF and seek approval through the Union Budget Law. The amount spent out of OAs is also recorded in the annual Union budget. While money can be drawn flexibly for recurrent expenditures, spending out of OAs must be approved by MOPF, the cabinet and parliament as part of the normal budget process.

Though OAs form part of the Union Fund Account, they are earmarked and therefore belong to the entity that opens them. However, it remains unclear whether MEB manages large OA balances as hard cash or holds a portion in interest-earning assets. What is clear is that SEE OA accounts do not earn any interest for SEEs. However this money was returned at the end of the fiscal year. Since then, OA balances have not been used except for their intended purposes.⁴¹

40 Based on interviews with MEB.

41 Based on interviews with MOPF.

The depth of these oversight processes remains check-off-the-box, with little verification or analysis of information.

In terms of reporting, MEB informs the Central Bank of Myanmar of OA balances; however, by the central bank's own admission, it provides little oversight over the management of these balances. Rather it simply compiles the data provided from MEB and sends aggregate reports to the MOPF Treasury Department. The Treasury Department in turn verifies these figures against SEE reports. According to MEB, most non-matching figures are due to errors in paper-based calculations; OA balances are not yet computerized.

The depth of these oversight processes remains check-off-the-box, with little verification or analysis of information. The auditor general's office audits OAs, but as a general rule is only required to audit an OA once it is closed. OAs belonging to SEEs, in contrast, must be audited at the end of every fiscal year. However, according to the Office of the Auditor General, audits do not check OA transactions against activities; there is no way to know what activity each transaction refers to. The audits therefore seem to simply involve verifying that SEE figures match bank statements.

Since they belong to specific institutions and do not expire at the end of the fiscal year, OAs have proliferated. As of 30 September 2016, there were 8,085 OAs at the Union level and 1,251 OAs at the regional and state level.⁴² There are so many open OAs that MOPF reports that line ministries

are occasionally not aware of the existence of certain OAs. Paper rather than computerized records of OA balances enables this situation to persist. The government is now working to identify inactive OAs and close them. The vast majority of these OAs have small balances, especially the many social welfare accounts or those that belong to prisoners.

Each SEE generally controls many discrete OAs. MOGE, for example, has 23 OAs, at least one per onshore oil field, six for its compressed natural gas (CNG) stations and several others. The basis and rationale for establishing an OA per project is unclear. The new financial regulations (35/2017), similar to the previous ones, lack a detailed structure for oversight of these OAs.

What is particularly concerning with OAs is the sheer amount of money they have accumulated. The largest of these OAs belong to MOGE (MMK 5,360 billion), Myanmar Post and Telecommunications (MMK 2,202 billion), Myanmar Timber Enterprise (MMK 1,681 billion) and Myanmar Gems Enterprise (MMK 688 billion) (figures as of January 2017). The total value of the union-level OAs was more than MMK 11.9 trillion in January 2017 (approximately USD 9.2 billion at that time). The total value of state and regional OAs was just MMK 14 billion in March 2016. See Table 4 for a list of OA balances in 19 SEEs as of 31 January 2017.⁴³

42 Meeting with MEB.

43 MOPF Treasury Department.

Table 4. 'Other Accounts' balance of 19 SEEs as of 31 January 2017 or most recent (MMK billion)

Responsible ministry or SEE	OA balance as of 31 January 2017 (Balance as of 31 March 2016 for those marked by an asterisk)
MONREC	2,559
Myanmar Timber Enterprise	1,681
No. 1 Mining Enterprise	30
No. 2 Mining Enterprise	100
No. 3 Mining Enterprise (merged with No. 1 Mining Enterprise)	28
Myanmar Gems Enterprise	688
Myanmar Pearl Production and Marketing Enterprise	32*
MOEE	6,175
Electric Power Production Enterprise	177
Electric Power Distribution Enterprise	238
Myanma Oil and Gas Enterprise (MOGE)	5,360
Myanma Petrochemical Enterprise (MPE)	67*
Myanma Petroleum Products Enterprise (MPPE)	333
Ministry of Information	35
News and Periodicals Enterprise	35
Ministry of Transport and Communication	2,467
Myanmar Railways	107
Inland Transport Enterprise	156*
Myanmar Post and Telecommunications	2,202
Myanmar Postal Service Enterprise	2*
Ministry of Industry	212
No. 1 Heavy Industry	52
No. 2 Heavy Industry	55*
No. 3 Heavy Industry	63*
Myanmar Pharmaceutical Industry	42*
Total of 19 SEEs (estimate)	11,448

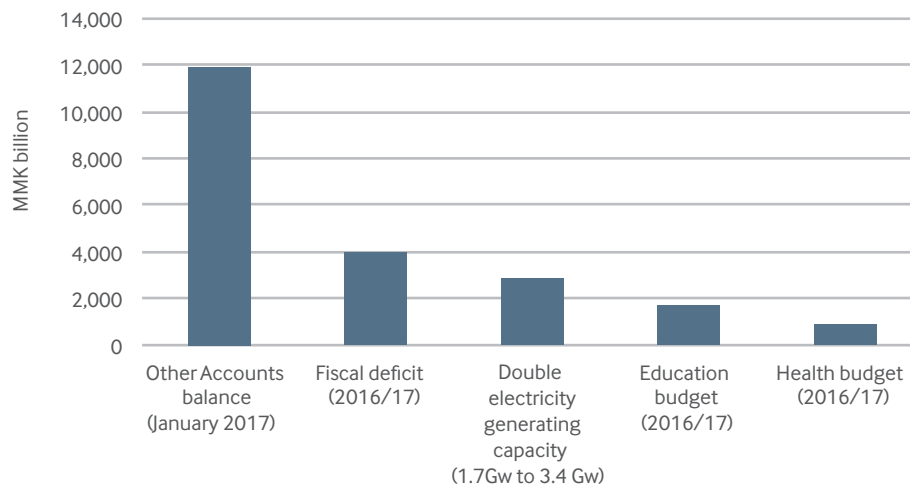
OA nominal balances are also growing at a phenomenal speed. The World Bank's Public Expenditure Review stated that aggregate OA balances grew by MMK 280 billion in 2011/12. From March to December 2016, MOGE alone added MMK 544 billion to its OA balance (though some was spent the following year).

Furthermore, several loss-making SEEs—such as Heavy Industry No. 1, No. 2 and No. 3, as well as the News and Periodicals Enterprise—have also added to their OA balances in recent years. For example, Heavy Industry No. 1 added MMK 30 billion to its OA over the final nine months of 2016; News and Periodicals Enterprise added MMK 5 billion over the same period. Given that

SEEs are only meant to grow their OAs out of profits, it is unclear how loss-making SEEs such as these have been able to increase the size of their savings, unless profits are being artificially lifted through Union budget contributions.

With Myanmar struggling to pay for important infrastructure—such as electricity, sanitation and transport and other government services, especially in the health and education sectors—the opportunity cost of these savings is enormous. It goes without saying that fiscal savings may not be the most productive use for these funds. Figure 3 puts the total OA balance of 11.9 trillion in context.

Figure 3. Size of total Other Account balances relative to other Myanmar budgetary figures



Another concern is that OAs are losing real value at an astonishing rate. All OAs are held in cash in kyat at MEB. Even if companies, like MOGE and MGE, earn their revenues in foreign currency, by regulation they must immediately convert their earnings into kyat and deposit them into their MEB account.⁴⁴ The kyat experienced nearly 30 percent nominal effective exchange rate depreciation over the last three years. Essentially, Myanmar has lost billions of dollars in purchasing power by requiring foreign earnings to be converted into kyat. A MMK 1 trillion balance in August 2014 could have purchased USD 1,050 million in foreign goods and services. Today, it can purchase less than USD 750 million in foreign goods and services.

Furthermore, MEB is not allowed to invest OA balances to gain interest, though MEB has interest-accruing accounts that serve other purposes. Since they must remain in cash, OAs lose even more value. Had total OA balances been invested in U.S. treasury bills—the lowest risk investment available—they would have accumulated approximately USD 40 million in 2016. Had total OA balances been invested in a basket of U.S. publicly traded stocks, they would have accumulated approximately USD 900 million the same year.⁴⁵ These amounts reflect the opportunity cost of MOPF directives prohibiting accrual of interest on OA balances.

Like all government accounts, record-keeping for OAs remains weak. MEB is just now starting to place all of its financial information into computers. Errors due to miscalculation on paper are common. Furthermore, some OA records were lost when MEB moved from Yangon

to Naypyitaw.⁴⁶ OA balances are not publicly available on a government website.

The governance of SEE OAs raises the specter of a broader set of structural questions about SEE governance. There has been little effort to determine how much working capital is appropriate for the various enterprises, and there is inadequate oversight of the management of these accounts and expenses from the government. For this reason, some accounts have accrued significant money without it being put to use by the enterprise. Without clear costed strategic plans for each enterprise that justify such cash holdings, it may be more efficient and pro-development to reallocate a portion of OA balances to more productive uses.

SEE budget process, oversight and transparency

Up to this point, we have examined SEE financing and management of SEE savings in Other Accounts. To understand how the government controls—or fails to control—SEE spending, revenue generation and contracting, we have to examine the budget process as well as external monitoring of SEE activities.

The Union of Myanmar employs a dual-budgeting system whereby recurrent and capital budgets are separated in the annual budget law. This is particularly important for SEEs given that the budget approval and oversight process is somewhat different for recurrent and capital spending. However, capital and recurrent expenditure categories are not well defined and do not conform with the IMF's *Government Finance Statistics Manual*, allowing for shifting of costs

44 The extent to which these regulations are enforced is unknown due to opacity of MFTB accounts.

45 Based on 0.51 percent average return on three-month U.S. treasury bills and 11.74 percent average return on S&P 500 stocks in 2016. OA balances were valued at approximately USD 8 billion in 2016.

46 Based on interviews with MEB.

between recurrent and capital budgets. The MOPF is working with the World Bank to clarify these categories.⁴⁷

The Union Budget Law allocates recurrent budgets on an SEE-by-SEE basis, based on budget estimates and requests drafted by the SEEs themselves, assembled by their line ministries and then sent to MOPF. Based on these estimates, and the overall fiscal envelope, the MOPF's Budget Department sets a ceiling on recurrent spending for each SEE, even if the money used to finance recurrent spending comes out of their own fund/Other Account. However the MOPF Budget Department *does not* review the contents of SEE spending out of their OAs.⁴⁸ Box 4 describes the budget approval process in detail.

On the other hand, capital budgets are allocated not to SEEs but rather to responsible line ministries, to be distributed to their SEEs and departments according to the line ministry's priorities; line ministries are ultimately responsible for drafting their SEEs' capital budgets.

In brief, each SEE prepares a budget and submits it to its line minister's office. The line ministry then compiles these budgets and makes a ministry-wide budget proposal to MOPF. MOPF reviews the budget and may demand budget cuts. According to some line ministry officials, MOPF budget ceilings are largely based neither on any government-wide strategic plan nor on capital investment needs, but on the revenue generating capacity of the ministry, its departments and SEEs.⁴⁹

The scale of these capital budget allocations varies substantially from SEE-to-SEE. For example, in 2015/16, the Electric Power Generation Enterprise was allocated MMK 320 billion from MOEE's capital budget. In the same year, MOEE allocated only MMK 2.5 billion to the Myanmar Petroleum Products Enterprise.⁵⁰

Anecdotal evidence from our research suggests that the MOPF rarely demands significant changes to capital budgets. This is partly due to the lack of information available to MOPF to make a compelling case to cut the budget. The MOPF does not have contextual information or analysis allowing it to determine which capital projects provide value-for-money. However, new guidelines will require capital project contracts to be sent to MOPF, the attorney general's office and the Ministry of Commerce, which could help in such analysis.⁵¹

MOPF's Project Appraisal Progress Report Department (PAPRD) also has a role in overseeing capital budgets. PAPRD benchmarks budgeted costs against price-per-unit databases at the Ministry of Construction and Ministry of Industry, or against a five-year average price of that line item. International benchmarks are not used and, to date, contracts have not been analyzed to determine whether the tender process was carried out according to the rules, the contract provides value-for-money or the project is necessary to begin with.⁵²

47 Based on interviews with MOPF.

48 *Ibid.*

49 Based on interviews with MONREC and MOEE.

50 Based on MOEE M&D accounts. In 2016/2017, MOEE allocated MMK 32 billion in capital budget to MOGE. In the same year, MONREC allocated MMK 104 billion to MTE, MMK 52 billion to MGE, MMK 43 billion to Myanmar Pearl Enterprise, MMK 9 billion to Mining Enterprise 1 and MMK 9 billion to Mining Enterprise No. 2.

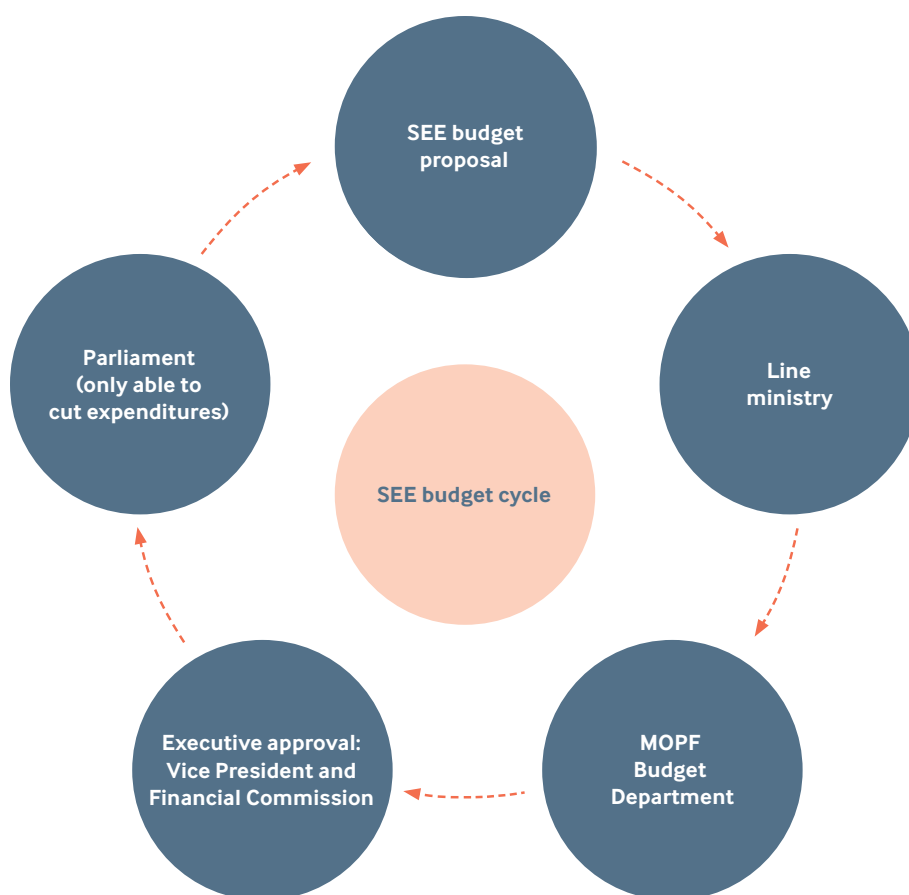
51 Based on interviews with MOPF.

52 Based on interviews with MOPF's PAPRD.

If cuts are made, the line ministry’s planning department determines which budgets to cut in coordination with its SEEs and departments. For example, in 2016/17, new guesthouses, telecommunications, maintenance for staff vehicles

and some new computers were cut from MOGE’s capital budget.⁵³ Finally, MOPF forwards the final version of the line ministry’s capital budget for approval by the Financial Commission, cabinet and eventually parliament (see Figure 4).⁵⁴

Figure 4. Budget cycle for SEEs in Myanmar



53 Based on interviews with MOGE.

54 The Financial Commission is made up of the president, two vice presidents, attorney general, auditor general, state and regional chief ministers, and the Minister of Planning and Finance.

Given that capital budgets are allocated by line ministries to their SEEs and departments, line ministries must choose between different capital projects. In general, existing projects, cash calls and other contractual obligations are prioritized. Once contractual obligations are met, capital budgets are generally allocated based on ministerial priorities. For example, given Myanmar's severe power shortage, MOEE is currently prioritizing new liquefied natural gas imports and hydropower projects.⁵⁵

Line ministries are also responsible for ensuring that SEE operations are aligned with their objectives. Yet SEEs maintain significant autonomy within their line ministries. Instead of providing meaningful oversight of their SEEs, line ministries generally play the role of representing the interests of SEEs in intra-governmental meetings. The relationship between SEEs and their line ministries can best be described as symbiotic, albeit where the degree of cooperation differs from ministry to ministry. In MOGE's case, the relevant line ministry is MOEE. For MGE and MTE, the relevant line ministry is the Ministry of Natural Resources and Environmental Conservation (MONREC). In practice, neither MOEE nor MONREC challenge the decisions taken by MOGE, MGE or MTE managers.

Ultimately, neither recurrent nor capital budgets force SEEs to spend money as budgeted. First, money can be transferred between projects or even between government departments and SEEs, provided they receive approval from the cabinet and the *Pyidaungsu Hluttaw*. Second, and perhaps more importantly, supplementary budgets in June or July (the fiscal year ends in March)—usually to cover unforeseen expenses—are the norm in Myanmar. These cannot exceed 50 percent of SEE's annual budget allocation. MOGE, for example, has overspent in the past, often due to lower than expected revenue from a drop in oil or gas prices. In response, it has sometimes made supplementary budget requests, which require a rationale, usually quite vague. The annual budget therefore does not represent a hard constraint on SEE finances. However, MOGE has not spent up to its budget constraint over the past two years.⁵⁶

Some SEEs face challenges in delivering on projects on time. Unused money from the fiscal year must be returned on 31 March, though tenders are generally signed in October due to the slow government approval process.⁵⁷ Therefore all work must be done from October to 31 March. Electronic budget approval and payment systems would greatly speed up the process.

55 Based on interviews with MOEE.

56 Based on interviews with MOPF.

57 Based on interviews with MOGE.

Box 4. SEE budget process and reporting in Myanmar

The Ministry of Planning and Finance (MOPF) plays a key role in assessing, modifying and approving SEE budgets, and monitoring compliance. The budget approval process, as it is discharged in practice, is as follows:⁵⁸

- **Step 1:** SEE sends commercial tax, income tax and state contribution estimates to MOPF for revenue estimation purposes. MOGE, MGE and MTE regularly *underestimate* their revenues. The reason for this appears to be that if there is an overestimate, the Joint Public Accounts Committee will review the estimate and ask questions. In response, before the budget is sent to the Financial Commission (Step 5), the MOPF deputy minister often asks the SEEs to increase their revenue estimates.
- **Step 2:** Based on these estimates, the MOPF SEE division—which is in the Budget Department and has approximately 40 staff—sends separate current budget ceilings to line ministries and SEEs. A single capital budget ceiling is sent to line ministries as a total amount, which then separates this budget by SEE and department.
- **Step 3:** The line ministry sends the SEE division its departmental and SEE capital budget estimates. MOEE must explain any increase or decrease from the previous year.
- **Step 4:** The SEE division examines budget requests line-by-line. MOPF can cut expenses if it chooses, but this rarely happens in practice. If there are no objections, budget requests are sent to the Minister of Planning and Finance for signature. Occasionally, MOPF does want to make changes to the budget request. In this case, the director of the SEE division can consult on cuts with line ministries or SEE management face-to-face, though a written back-and-forth is more common. Deputy ministers also sometimes meet. Rarely, but occasionally, MOPF will put its foot down and deny a line-item request. (This happened in the electricity sector last year.)
- **Step 5:** The budget is sent to the Financial Commission who can also adjust the budget.
- **Step 6:** The budget is approved by parliament following committee hearings.

The system encourages incremental increases and decreases in the budget rather than any broad changes. Strategic plans and political vision play virtually no part in budget decisions. In order to change this, project-based or performance budgeting is part of the IMF's public financial management reform plan.

However, this budget does not represent a hard constraint on SEE finances since they can request a supplementary budget, usually in June or July. (The fiscal year runs from April to March.) The increase can be no more than 50 percent of their budget allocation. SEEs must submit an explanation of overspending to MOPF. SEEs have occasionally received less than their request.

MOPF also has a role in monitoring budget compliance by SEEs. MOPF receives a number of reports from SEEs or their line ministries, including:

- Ministry and department (M&D) reports sent from line ministries that include salaries, royalties received from SEEs, transportation costs, purchase of capital equipment, telecommunications, and office costs.
- SOE report from SEEs that includes salaries, pensions, "raw materials" and explanation of revenues.
- Budget estimates, monthly reports, quarterly reports and annual financial reports (colloquially called "Forms 1–18" due to their format which has not changed dramatically since 1986 and does not meet international accounting standards) from SEEs, some of which have a short narrative description of company activities.

These reports are mostly compiled and crafted into statistics to be sent to senior managers and eventually the Office of the President. There is virtually no analysis of the data. Nor is the information conducive to analysis, since data is aggregated into categories that are poorly defined and ill-suited to a detailed analysis of the company's activities. For example, the official definition of "socioeconomic development expenditures" in MOGE financial forms is "expenditure for socioeconomic development in various oil fields."

The Treasury Department verifies whether MEB Other Account balances match the figures in SEE reports sent to parliament. However, there is no way to verify the validity and accuracy of the data since neither MOPF nor parliament have access to full audit reports on Other Accounts.

In theory, the Office of the Auditor General (OAG) should provide some analysis, at least on financial compliance. The OAG has greater access to financial data than MOPF; however, their reports are not public or available to MOPF. SEE management also has several opportunities to review and modify OAG reports before they are finalized, meaning that audit reports may not accurately reflect SEEs' true financial transactions or activities.

58 Based on interviews with MOPF

As we have shown, there is much scope for *ex ante* supervision of SEE spending to be improved. Line ministries provide scant oversight of SEE budgets and MOPF does not have enough information or the proper mandate to challenge most budget decisions. Therefore, in practice, it has been the Financial Commission, the cabinet and the *Hluttaw* Joint Public Accounts Committee (JPAC) that provide a true degree of *ex ante* SEE spending control. For instance, the JPAC recommended in March 2017 that 44 of 52 new SEE investment projects be suspended since they are not viable in the long term.⁵⁹

Ex-post oversight of SEEs may suffer from more serious weaknesses than *ex ante* oversight. In theory, MOPF (Budget Department, PAPRD and IRD), OAG and the *Hluttaw* are each meant to monitor and control SEE operations. Regrettably, for reasons described below, these institutions are largely unable able to provide substantive accountability.

The MOPF Budget Department is potentially the most important external oversight institution due to its knowledge of public finances, dedicated SEE division, and explicit mandate to oversee and challenge SEE budgets. As described in Box 4, the Budget Department receives numerous reports from SEEs, including detailed breakdowns of revenues and expenditures. At times, it even receives a narrative report of activities, though this is entirely voluntary on the part of SEEs. In fact, there are serious inconsistencies in reporting formats and information disclosed from SEE-to-SEE. The accuracy of data provided to MOPF also varies greatly from SEE-to-SEE.⁶⁰

Unfortunately, all this information is mainly used in the compilation of government reports such as the statistical yearbook published by the MOPF's Central Statistical Office (CSO). While PAPRD has plans to investigate progress on capital budget execution, at the moment there is almost no analysis of these figures, nor are the figures provided used to verify that money has been spent in accordance with the approved budget. This is the job of the Office of the Auditor General, though in practice it is unclear whether OAG accomplishes this task, as will be described in more detail below. The *ex-post* role of the SEE division, at this time, remains limited to assembling reports. The MOPF plans to create an SEE policy unit, modeled on a similar unit in Thailand, to provide greater oversight of SEE activities.⁶¹

One possible roadblock is that there is little tradition of interdepartmental coordination and information sharing within MOPF, which was created when the Ministry of Finance and Revenue and Ministry of Planning merged in 2016. For example, the Planning Department's production targets are set independently from the Budget Department's revenue and expenditure projections, and neither institution performs its function with consensus awareness of the SEEs commercial activities. Oversight is most often a "check the box" rather than a coordinated mode of implementing policy and achieving ends desired by the government.

The MOPF's Internal Revenue Department, which both sets tax policy and administers tax collection, is also part of the ministry but largely functions independently. In another example

59 Htoo Thant. "Pyidaungsu Hluttaw told 44 state projects should be suspended," *Myanmar Times*, 13 March 2017. Online: <http://www.mmimes.com/index.php/national-news/nay-pyi-taw/25282-pyidaungsu-hluttaw-told-44-state-projects-should-be-suspended.html>.

60 Based on RI-NRGI analysis of SEE financial reports.

61 Based on interviews with MOPF.

of lack of coordination between departments within MOPF, IRD and Budget Department tax data is inconsistent. (See Table 13 for an example from MOGE.) The Large Taxpayer Office, within the IRD, is responsible for collecting income taxes from SEEs. As such, it is mandated to audit SEEs for these purposes, which could provide a significant degree of *ex post* supervision.

Prior to 2015, SEEs did not permit IRD to conduct comprehensive audits on them. Not only did SEEs not provide required documentation to IRD, but IRD audits were also conducted by township-level officials with little power to question SEE managing directors. IRD therefore based its income tax assessments on reports from the Office of the Auditor General, which shared little information. Since 2015, IRD has employed a new self-reporting system and has begun auditing SEEs. While MOGE, MGE and MTE have not yet been audited, IRD's Large Taxpayer Office plans to assess the last nine years of SEE finances.⁶²

Perhaps the government's most empowered SEE oversight body outside of MOPF, at least in theory, is the Office of the Auditor General (OAG), which has 6,000 staff. OAG is responsible for auditing all government institutions, including SEEs. OAG audits are governed by the Auditor General of the Union Law (2010), which broadly defines the role of the office as inspecting the government's finances, ensuring compliance with the budget and determining whether public funds have been utilized effectively. In practice, OAG only conducts financial and compliance audits and does not conduct performance audits, which would determine whether Myanmar taxpayers are getting value for money. Moreover,

financial audits usually do not prioritize high-risk transactions; minor expenses are given similar attention to multi-million dollar transactions. OAG is undertaking a modernization drive with international support and has plans to start carrying out performance audits in due course.⁶³

Currently, OAG oversight of SEEs consists of one audit per year carried out by eight staff members. These audits generally take 15 working days but often take 20 to 25 days in the case of MOGE. Half of the staff focuses on revenues while the other half focuses on expenditures. OAG faces ongoing challenges in understanding contracts and receiving supporting documents from audited agencies in a timely manner. The office conducts field visits; however, the details of the full reports are unknown. The highest authority that receives the full audit report is the managing director of the SEE. However, even before, SEE mid-level management has many opportunities and up to three months to change the audit findings.

A summary report—which could be as short as a single paragraph—must be sent to Office of the President and parliament; however, even these do not see the full audit findings. Parliament's Joint Public Accounts Committee (JPAC) is meant to review summary audits and post them online; however, our research showed that none of the current committee members are aware of having seen the report nor have these reports been posted online.⁶⁴ The OAG is, in practical terms, more of an internal audit office than a source of external accountability. It mainly serves the SEE itself rather than oversight actors such as parliament or the public. However government officials take OAG audits quite seriously. Consequences of a

62 Based on interviews with MOPF's IRD.

63 Based on interviews with OAG.

64 *Ibid.*

failed audit can be severe, such as dismissal of certain SEE managers.

JPAC is fairly keen to provide oversight of SEEs and has begun to do so over the past year. Regrettably, the committee 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. As such, committee members usually appreciate support from non-governmental sources.

The Central Bank of Myanmar and MEB are meant to oversee SEE cash management, in conjunction with the Treasury Department. Both the MEB and Treasury Department are part of MOPF but function independently. These government agencies or departments are meant to verify OA transactions, along with OAG; however, in practice they simply reconcile figures without providing analysis or verifying whether recorded transactions are linked to a specific purchase or activity.⁶⁵

There is little information sharing across entities with overlapping functions. For example, both the IRD and auditor general are meant to perform audits on SEEs, but there is no pooling of resources to do so more effectively despite limited capacity within both entities.

The public and media, which could provide some oversight, are also limited by severe constraints on access to information. CSO only releases SEE data on production volume, exports, taxes,

duties and aggregated revenues and expenditures, which is collected from line ministries.⁶⁶ The Financial Institutions Law prohibits state-owned banks from disclosing their information. In fact, we could not identify a single law that requires public disclosure of SEE financial information. Ministerial approval is needed for all public disclosures. Furthermore, the data that is available is generally unreliable.

Structural impediments, not just implementation and capacity constraints, hinder substantive and sustained reform. While division of responsibility and oversight is often fragmented to meet the demands of specialization, there is almost no communication or information sharing across the various principals: line ministries (MOEE for MOGE and the Ministry of Natural Resources and Environmental Conservation for MGE), the Ministry of Planning and Finance (Budget Department, IRD, SEE division within the Budget Department, Treasury Department), Central Bank of Myanmar, MEB, Financial Commission and parliament. This is equally true when different principals share overlapping responsibilities for monitoring and oversight of SEEs. Information is collected but generally not shared nor analyzed nor applied to solve problems and make decisions. Moreover, key information is rarely shared *within* ministries. For example, each MOPF department has its own directives and notices, which are not held centrally or shared across the ministry.

65 Based on interviews with the Central Bank of Myanmar and MOPF Treasury Department officials.

66 Based on interviews with Central Statistical Office.

SEE POLICY-MAKING AND REFORM AGENDA

The institutions tasked with policy-making are nascent in Myanmar, where a legislative branch was only re-established with the 2008 Constitution. The Financial Commission, created by the same constitution, is the most significant relevant policy-making unit within the executive branch. Composed of various ministers, chaired by the president and ostensibly influenced by the state counselor, it considers and ratifies the budget prior to its submission to parliament.⁶⁷

The Office of State Counselor, National Economic Coordination Committee and Privatization Commission are other entities of policy-makers within the executive branch who can, to a varying degree, exert influence on the SEE legal and policy framework.⁶⁸

Various parliamentary committees have jurisdiction over SEEs, yet within the committees there is little experience, staff support or even clarity in understanding their specific responsibilities. JPAC oversees the budgeting and auditing processes; it is entitled to review and cut expenditure from the budget proposal prior to

parliament's final approval of the budget. Each SEE also has a committee with jurisdiction over their sector of the economy. In absence of clear agenda setting by each committee, the Commission for the Assessment of Legal Affairs and Special Issues has emerged as a significant parliamentary body, often setting the agenda and direction for legislation to be considered by the entire parliament.

There are many groups of policy-makers within the government who can exert influence over SEE financing, policy and reform, but none has yet to emerge as a leader of the process. The sparse statutory framework and lack of clarity from policy-makers has helped maintain the policy-making functions for bureaucratic entities responsible for SEE governance. As such, the bureaucracy has taken on both administrative and policy-making functions in absence of clearer guiding legislation or direction from elected politicians or the cabinet.

The MOPF has an SEE division inside the Budget Department that is well-positioned to engage in a coordination and planning function amongst various relevant government institutions. It could

67 Union of Myanmar. *Constitution of the Republic of the Union of Myanmar* (2008), Section 230.

68 Interviews suggest that the Privatization Commission has yet to meet under the new government, and remains a vestige of the prior government's reform plan. To date, the commission has not carried out any evaluation of which SEEs should and should not be privatized. The extent of its continued ability to shape policy and coordinate its implementation is an open question.



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

translate policy demands into tangible changes. But, in practice, it often serves as another flow of information without much ability to make decisions and lead in coordination. Information ultimately is aggregated and parsed through governmental entities on its way to the key policy-making institutions.

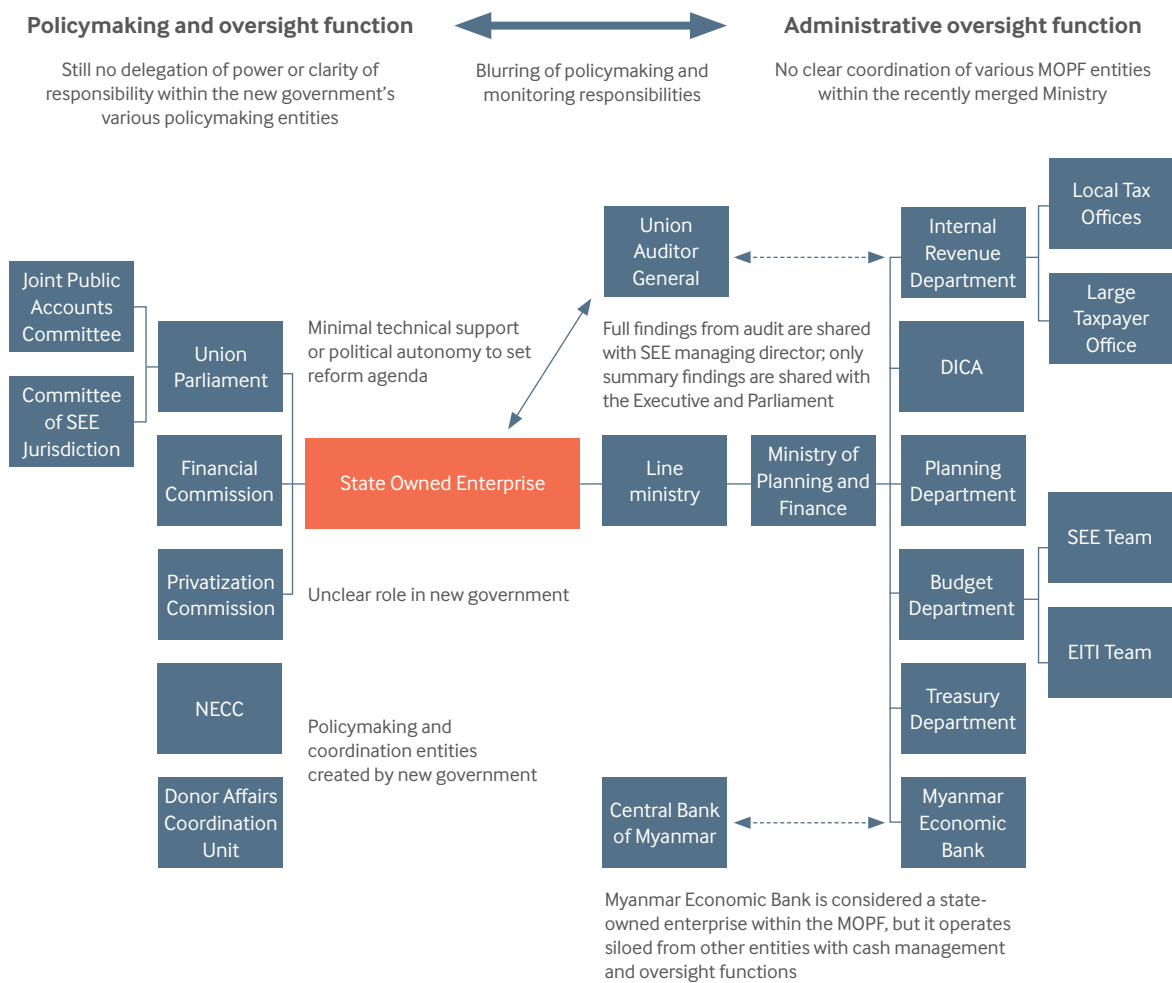
Policy-making is neither top-down nor bottom-up. Information is aggregated as it is reported, such that areas of discrepancy or contention in the policy-making process are not passed up for adjudication by policy-makers. Nor is a clear agenda set by the key policy-making institutions to drive clear changes. Rather, the status quo is protected: SEEs are insulated from policy-making given the way the bureaucratic culture and fragmented bureaucratic structure interact.

MOPF and parliament are further constrained by their lack of resources and authority. MOPF in particular has been left to both craft and enforce the rules governing SEEs, but is hampered in its efforts by the opacity of SEEs even within the government and, ultimately, a weakness of

MOPF relative to SEEs in both policy-making and enforcement functions. Evident at times in our study, this has rendered different governing entities insular and protective of their specific governance function, but generally unable to collaborate with other governing institutions to clarify practices and coherently exercise their governance function upon SEEs. In turn, SEEs have been able to maintain inefficiencies with little pressure for meaningful change—shirking from, or co-opting, demands from various oversight institutions.

We conclude that bureaucratic fragmentation, limited coordination and minimal grounding in clear statutory language limits supervisory bodies' effectiveness in overseeing SEEs. It renders, in our findings, the SEEs relatively independent from effective political or legislative oversight. It allows the SEEs to continue to define and redefine their commercial and regulatory roles, without any countervailing institution to set limits on its function. The dense bureaucracy, ironically, renders Myanmar's SEEs highly autonomous.

Figure 5. Policy-making and oversight bodies governing SEEs



While the legislative framework does little to specify the powers of SEEs and the functions of various governmental institutions in governing SEEs, there are other related pieces of the legal framework for economic activity relating to SEEs that are quickly evolving.⁶⁹ At least 24 pieces of legislation related to investment and economic activity have been enacted since 2011.⁷⁰ A draft Companies Act is currently being considered by parliament. This legislation will replace the 1914 Burma Companies Act for the first time. A 1950 Special Companies Act further clarifies the status of companies where the state is a shareholder. A new investment law and implementing regulations took effect at the beginning of the 2017/18 fiscal year. It is the third investment law enacted within the past five years, and details spheres of economic activity where foreign investment is to be limited and geographic regions where investment is to be incentivized. Still, a clearer delineation between administrative and policy function—for instance by way of a new SEE law to replace the 1989 law—could allow the government to more effectively manage and oversee SEEs.

While the new government, which took office in early 2016, identified a plan to review Myanmar's SEEs, it has yet to detail and deepen the approach begun under the last government or set forth a new strategy for reform.⁷¹ However, Myanmar's

government, in collaboration with development partners, has launched an ambitious public financial management reform concurrent with the proposed SEE reforms. Much of this work is meant to boost the government's capacity to manage and mobilize revenues, especially SEE revenues.

In addition, the Myanmar government continues to work towards increased transparency in the extractives sector through its ascension to EITI, the international standard for extractive sector reporting. The MEITI process has already drawn attention to the issue of OAs and the role of SEEs in managing the extractive sector. The government has also accepted international support to boost audit capacity in both OAG and IRD, and to help institutionalize SEE oversight within the MOPF's Budget Department by establishing a new SEE monitoring unit.⁷²

The governance challenges are significant, but can be addressed with reasonable effort. An understanding of the structural challenges can lead to a well-designed reform plan. The next sections look closely at the mandate, function and finances of MOGE and MGE. Synthesizing that analysis and these challenges, this report suggests a template for reform, where initial steps can build momentum and capacity for broader changes in Myanmar's SEE governance framework.

69 Recent developments are consistent with the findings of *Gilded Gatekeepers*, which reported that the "legal framework establishes a large number of rules to govern the relationships between the SEEs (and the state more broadly) and private companies, but does significantly less to spell out the reporting relationships between the SEEs and state agencies." See NRGI, *Gilded Gatekeepers*, 45.

70 See DICA (Directorate of Investment and Company Administration) http://www.dica.gov.mm/sites/dica.gov.mm/files/document-files/related_law_eng_1.pdf.

71 Steve Gilmore. "Government starts SOE review," *Myanmar Times*, 10 May 2016. Online: <http://www.mmmtimes.com/index.php/business/20201-governments-starts-soe-review.html>.

72 The World Bank has developed a performance monitoring report template for SEEs, which includes a detailed performance assessment. Also, a "Performance Monitoring Manual" is currently being finalized through a technical assistance program provided by the U.S. Treasury's Office of Technical Assistance (USOTA). This manual, though, is based on practice in other countries. This report suggests instead a series of sequenced improvements to the system in Myanmar grounded in an understanding of impediments to reform.

Myanmar Oil and Gas Enterprise (MOGE)

Overview

MOGE was founded in 1963 as the People's Oil Corporation, a product of oil sector nationalization. Originally run by a board of directors, in 1965 the national oil company was placed under the control of the Ministry of Mining. In 1970, the name was changed to the Myanmar Oil Corporation and the company was given a commercial mandate to work with foreign companies to expand Myanmar's oil and gas production. At the same time, the company independently developed its own oil and gas exploration, production, refining and distribution arms, along with mining activities.

In 1975, the company was split into three entities: the Myanmar Oil Corporation (under the Ministry of Mining), the Petrochemical Industry Corporation and the Petroleum Products Supply Corporation (both under the Ministry of Industry). Thus refineries, marketing and distribution of petroleum products were carved away from the upstream business. In 1977, the Myanmar Oil Corporation was also transferred to the Ministry of Industry.⁷³

In 1985, a Ministry of Energy was established and all three entities were placed under this ministry. In 1989, they were transformed into state-owned economic enterprises, subject to the SEE Law. Around the same time, a Foreign Investment Law was promulgated, which allowed for foreign investment and partnerships. In the early 1990s, onshore and offshore blocks were awarded to domestic companies in addition to Amoco, Shell, Total, Idemitsu and Unocal. For example, Total signed a production sharing contract (PSC) to develop the Yadana offshore gas project in 1992.

By 1997, due to economic sanctions and pressure on foreign companies to divest from Myanmar investments, most foreign companies began withdrawing from Myanmar. The principal exception was Total. In response, several Asian companies acquired offshore blocks. In 2000, MOGE and South Korea's Daewoo International began exploring the Bay of Bengal, eventually discovering the Shwe gas field. In mid-2009, the Chinese government signed an agreement making China the sole buyer of Shwe gas reserves. The China National Petroleum Corporation has built parallel oil and gas pipelines from the coast to Yunnan Province in China; the oil pipeline is to transport oil from Africa and the Middle East to China easily, by passing the Strait of Malacca.⁷⁴

In 2012, U.S. and EU sanctions were suspended, leading to rounds of onshore and offshore bid rounds on blocks. While a model PSC was drafted and publicly released by MOGE, signed contracts have not been released. The Myanmar Investment Commission, following recommendations from MOGE and MOEE, has offered tax incentives and other changes to the model PSC in some of these contracts.

Today, the Myanmar Oil and Gas Enterprise (MOGE) sits under the newly-formed Ministry of Electricity and Energy, along with three other oil-related entities: The Energy Planning Department, the Myanmar Petrochemical Enterprise (MPE), responsible for downstream petroleum production (e.g., refineries, fertilizer plants, liquefied natural gas), and the Myanmar Petroleum Products Enterprise (MPPE), mandated to provide retail and wholesale distribution of petroleum products in Myanmar (e.g., filling stations, aviation depots, import of fuel).

73 Website of the Ministry of Electricity and Energy, accessed 3 May 2017. Online: <http://www.moep.gov.mm/>.

74 Myanmar Centre for Responsible Business, Institute for Human Rights and Business and Danish Institute for Human Rights. *Myanmar Oil & Gas Sector-Wide Impact Assessment* (2014).

Mandate and vision

MOGE is responsible for managing Myanmar's upstream oil and gas sector. While its formal mandate is neither included in any legislation or regulation, nor in Myanmar's National Comprehensive Development Plan (2014), in practice MOGE is simultaneously a petroleum sector operator, shareholder in foreign-operated fields, regulator, trainer for petroleum sector workers, energy sector research organization and energy sector promoter. By itself, it has enumerated 10 responsibilities:⁷⁵

- 1 Exploring new oil and natural gas fields
- 2 Drilling and production of oil and natural gas
- 3 Supervising and producing according to the mining policy
- 4 Producing, marketing and distributing oil and natural gas safely
- 5 Minimizing wastage and loss in distribution of oil and natural gas
- 6 Supervising petroleum sector activities to reduce costs
- 7 Formulating a budget for the annual activities
- 8 Providing security of the oil and natural gas fields
- 9 Providing for staff welfare
- 10 Drafting six-monthly budget and income and expenditure statements, including profit and loss accounts and balance sheets

The IMF and Norwegian Agency for Development Cooperation (NORAD), among others, have highlighted the conflict of interest inherent in MOGE's mandate as both petroleum operator and regulator. Offshore fields are operated by foreign joint venture partners with MOGE owning minority shares in offshore production. Since MOGE profits are dependent on controlling joint venture partner costs and offshore subcontracts are awarded by foreign operators based on open, competitive tenders, MOGE has every incentive to monitor and control offshore costs. However, MOGE's conflict of interest is particularly problematic in the case of onshore production, which is owned and managed by MOGE and which is also regulated by MOGE. MOGE essentially monitors its own contracting and production. Given the broader governmental supervisory gaps described above, this conflict of interest raises questions vis-à-vis cost effectiveness of MOGE contracts, compliance with tender processes, and accuracy of declared costs and revenues.

While MOGE officials have indicated the existence of a five-year strategic plan for the organization, this document is neither publicly available nor were MOGE or MOPF officials interviewed aware of its contents. Instead, MOGE has listed 16 separate self-declared organizational objectives on its website.⁷⁶ These include:

- Providing oil and natural gas for the development of the state's economy
- Providing fuels, fertilizers and raw petrol products for industrial, agricultural and other sectors

75 Website of the Ministry of Electricity and Energy, accessed 3 May 2017. Online: <http://www.moep.gov.mm/>.

76 Ministry of Electricity and Energy. *MOGE About and History* (2017). Online: <http://www.energy.gov.mm/eng/index.php/about-ministry/myanma-oil-and-gas-enterprise/moge-history>.

- Encouraging sustainable energy sector development, including promoting greater energy production and promoting energy savings
- Promoting greater participation of private sector actors in the energy sector
- Holding strategic fuel reserves for state security and economic stability
- Building skills of nationals and nurturing future professional in the energy sector
- Minimizing the negative environmental and social impacts of energy production
- Studying and preparing Myanmar’s energy needs and keeping up-to-date records
- Prioritizing domestic energy security, for the benefit of all people, including those from oil and natural gas producing areas
- Promoting alternative and renewable energy
- Working with other organizations in energy affairs and to collect energy-related data and estimate energy demand

In practice, many of the responsibilities listed, especially from bullet eight onward, are carried out by MOEE, MOGE’s parent ministry, rather than by MOGE itself. MOGE is a *de facto* department within MOEE, albeit a department with its own financial resources in the form of Other Accounts.

While MOGE does not have a clear vision of what kind of company it wishes to become—for instance whether it would like to focus on domestic production, improve profitability or rely less on foreign expertise—officials have noted MOGE’s desire to create several joint ventures with foreign companies, presumably

to transfer skills and technology to MOGE. New joint ventures are already planned for onshore drilling, seismic surveying, pipeline restoration and expansion of the Thaketa onshore supply base. MOGE also plans to modernize by digitizing geological and financial information and by improving staff capacity. MOGE managers have no plans to corporatize.

Organizational structure

MOGE management is ultimately responsible to the Minister of Electricity and Energy. The company does not have a board of governors but is rather managed by a managing director who is advised by the board of directors, which consists of the directors of MOGE’s 10 departments and chaired by the managing director. MOGE also has a deputy managing director. Decisions of the board are submitted to the minister for review and approval.

The 10 directors under the managing director are each associated with one of 10 departments:

- 1 Drilling Department
- 2 Production Department
- 3 Engineering Department
- 4 Material Department
- 5 Administration Department
- 6 Finance Department
- 7 Exploration and Development Department
- 8 Planning Department
- 9 Offshore Department
- 10 National Energy Management Committee

There are approximately 43 staff at the deputy director/general manager level.

According to the MOGE's financial statement, the company employed 11,240 people as of 31 March 2016, with a maximum allowable number of employees at 16,764. The maximum allowable employees figure is proposed by MOGE, then approved by its line ministry (MOEE). The figure is then checked by the MOPF Budget Department in order to ensure that it fits into the budget envelope. It is then approved by the Union Civil Service Board, followed by the Ministry of Home Affairs and the cabinet. This is the case for all maximum allowable employee figures. The average salary in FY 2016/17 was MMK 1,853,000 annually (MMK 154,000 monthly),

including managers, staff and daily wage workers. This figure does not include housing, transport and other benefits. The managing director earns approximately MMK 6 million annually (MMK 500,000 monthly) plus benefits.

Balance sheet

Our financial information comes from two data sources, which are difficult though not impossible to reconcile: the MOPF's standard SEE financial forms and MOGE's internal balance sheet (see Tables 5a and 5b). One major difference is that cost figures in the MOGE forms often include commercial tax payments whereas commercial tax is separated out in MOPF forms.



Offshore oil rig in Myanmar. *Paranyu Pithayarungsarit/Getty Images*

Table 5a. MOGE balance sheet (Source: MOPF) (MMK billion)

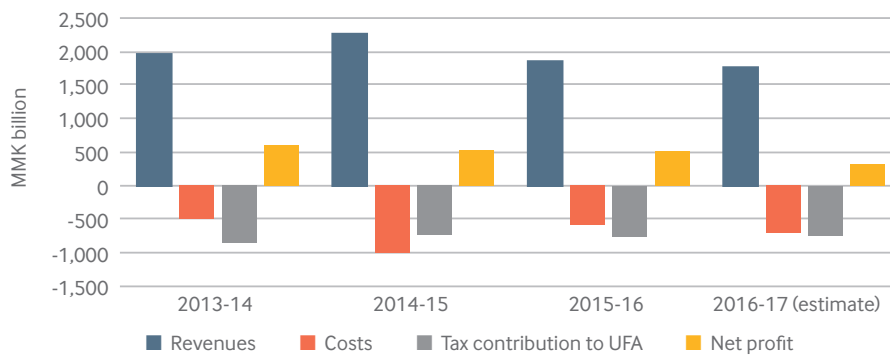
	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
Revenues	1,960	2,262	1,853	1,763
Costs	498	1,003	586	704
Commercial tax	359	304	337	484
Income tax	276	239	232	144
State contribution	220	191	186	115
Net profit	606	525	511	316

Table 5b. MOGE balance sheet (Source: MOGE) (MMK billion)

	2014/2015	2015/2016
Revenues	2,261	1,853
Costs	1,307	923
Income tax	239	232
State contribution	191	186
CSR payment	10	10
Net profit	514	501

Figure 6. MOGE balance sheet (MMK billion)

Source: MOPF

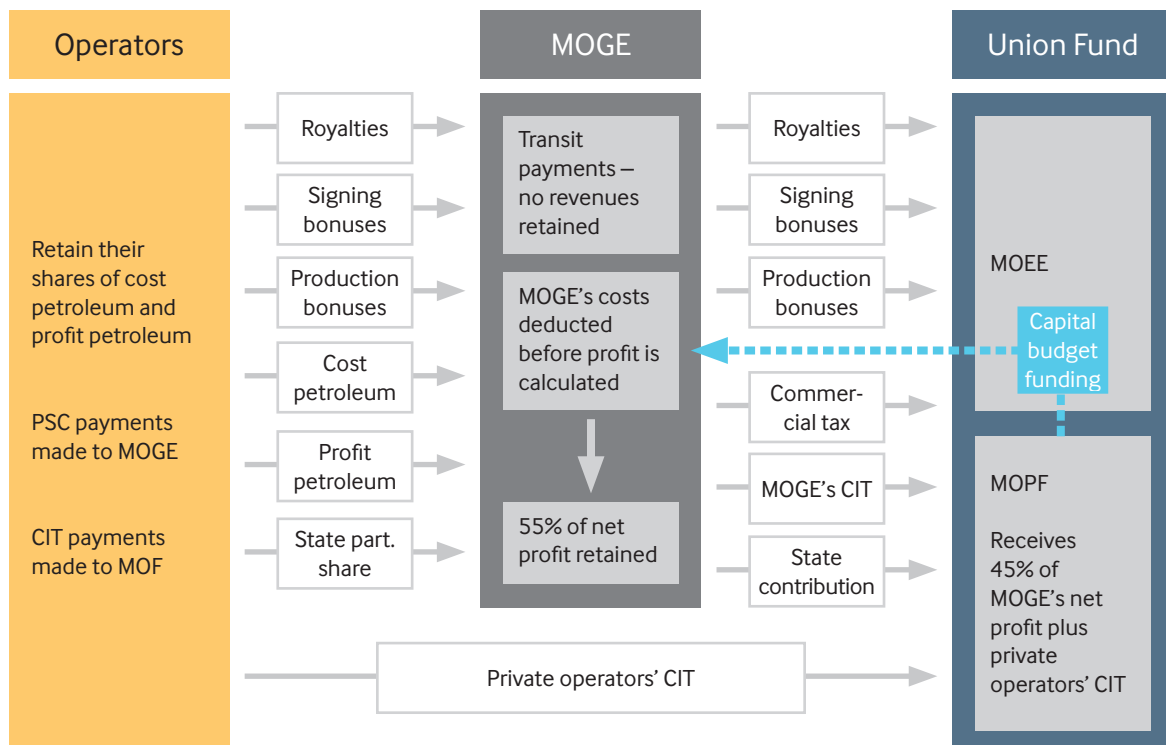


Revenues and flow-of-funds

MOGE collects many different revenue streams from its oil- and gas-related activities. In the case of royalties, signature bonuses and production bonuses, MOGE simply acts as a tax collector, transferring the proceeds from private oil and gas companies directly to MOEE monthly, which

then transfers the money to the MOPF Treasury Department. However, other revenue streams— notably “profit petroleum” according to PSCs, returns on state equity and pipeline income— are considered part of MOGE’s official revenues and are, as such, included in MOGE’s profit calculation. (See Figure 7.)

Figure 7. MOGE flow-of-funds as of 2017/2018 (adapted from NORAD)



Similar to other recent years, the vast majority of MOGE's approximately MMK 1,853 billion in revenues in 2015/16—in fact 82 percent—were generated from offshore gas production. (See Tables 6a and 6b.) These revenues are the product of passive investments by MOGE; though MOGE is an investor in these offshore fields, all are operated by foreign joint venture partners. Revenues are derived mainly from the

government's share of natural gas as stated in the PSCs—which MOGE receives in cash rather than physical natural gas—and returns on MOGE's equity. As such, MOGE's revenues from these projects come primarily from its contractual rights as an agent of the state, not because of any particular commercial investment or efficiency on the company's part.

Table 6a. MOGE revenues by year (MOGE) (MMK billion)

	2014/2015	2015/2016
Offshore returns on equity, profit petroleum and transit income	2,048	1,521
Onshore oil and gas	162	138
Profit from offshore gas price change	1	129
Domestic natural gas sales	4	21
Gas sales for vehicles/CNG	44	41
TOTAL	2,259	1,853

Table 6b. MOGE revenues by year (MOPF) (MMK billion)

	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
Offshore returns on equity, profit petroleum and transit income	1,763	2,052	1,653	1,560
Onshore oil and gas	147	162	138	139
Domestic natural gas sales	6	4	21	22
Gas sales for vehicles/CNG	44	44	41	42
TOTAL	1,960	2,260	1,853	1,763

Offshore oil and gas and pipeline revenues

Myanmar currently has four operating offshore gas fields:

- **Shwe project.** Operated and 51 percent owned by Korean company Daewoo International, the Shwe field has been operating since 2013. MOGE has a 15 percent stake; the equity investment is gradually offset by profits on the field. The China National Petroleum Company has exclusive rights to buy all gas, most of which is transported to China via pipeline. The project generated MMK 405 billion for MOGE in 2015/16. Production was 550 cubic feet per day (cfpd) in 2016/17.
- **Yadana project.** French petroleum company Total E&P operates the field with a 31.24 percent interest. The field has been operating since 1999. U.S. company Unocal and Thai

state-owned company PTT own minority shares. PTT is the principal gas purchaser, though some gas is used domestically. MOGE has a 15 percent stake, which was financed by a loan. The project generated MMK 559 billion for MOGE in 2015/16. Production was 700 cfpd in 2016/17.

- **Yetagun project.** Malaysian state-owned company Petronas holds a 40.91 percent interest and operates the field, which has been in production since 2000. MOGE has a 20.45 percent stake while PTT and Japanese company Nippon Oil and Energy own minority shares. MOGE’s equity investment is gradually offset by profits on the field. PTT is the principal gas purchaser. The project generated MMK 297 billion for MOGE in 2015/16. Production was 250 cfpd in 2016/17.

Figure 8. MOGE revenues 2013/2014 to 2016/2017 (MMK billion)

Source: MOPF

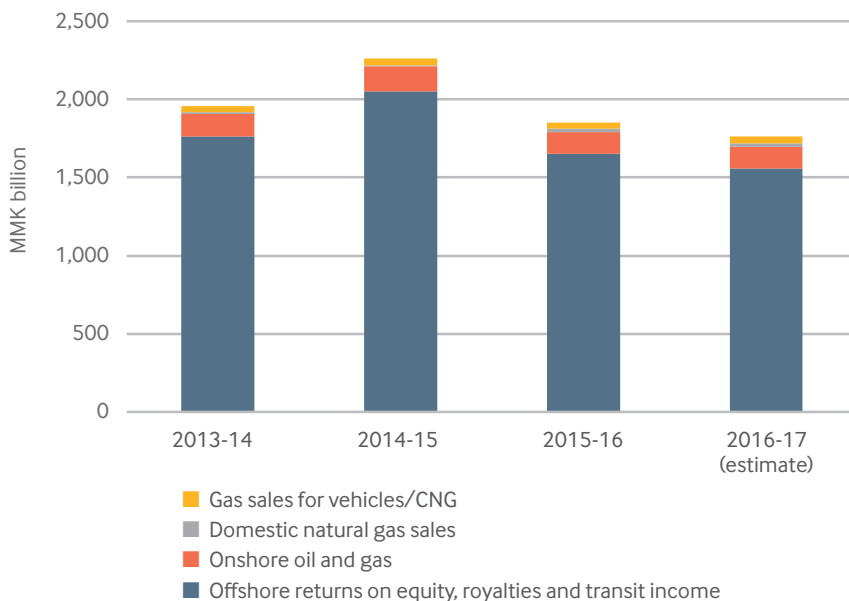


Figure 9. Map of Myanmar's operating fields and pipelines

Source: Frontier Myanmar



- Zawtika project.** PTT is the operator of the field with an 80 percent stake. MOGE has the remaining 20 percent stake; the equity investment is gradually offset by profits on the field. The field began producing gas in 2014, with some gas used for domestic purposes and the majority exported to Thailand. The project generated MMK 184 billion for MOGE in 2015/16. Production was 350 cfpd in 2016/17.

As offshore gas production has increased over the last decade, royalty and profit share payments have grown steadily. (See Figures 10, 11 and 12.) Drops in production from the Yetagun and Yadana fields have been largely offset by increases in production from Shwe and Zawtika, maintaining a steady stream of royalties. Returns on equity for Shwe and Zawtika are expected to rise significantly in the coming years as production rises and the cost recovery phase of production ends.

Figure 10. Offshore gas production (million standard cubic feet)

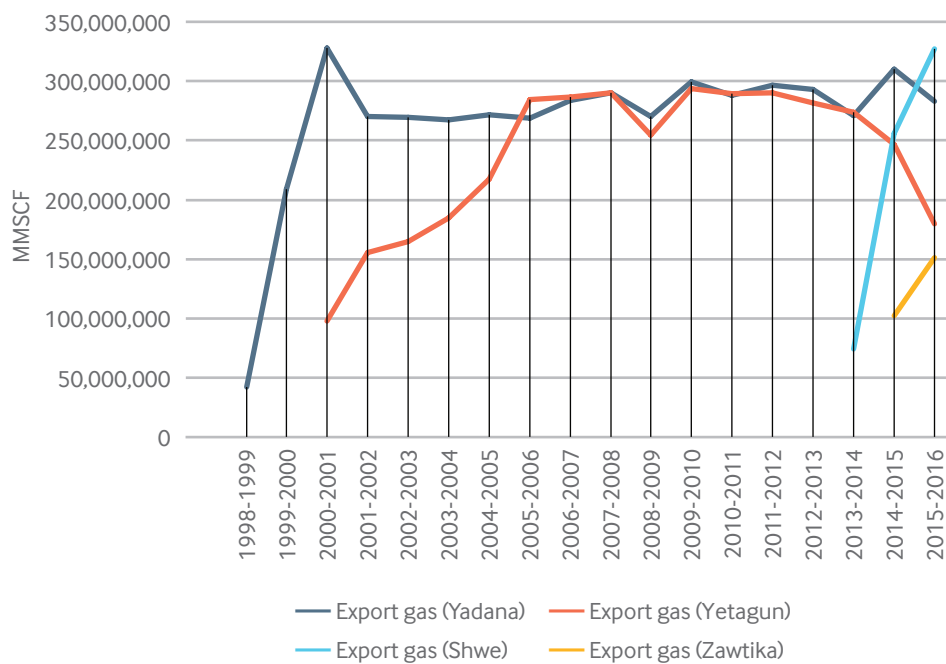


Figure 11. Royalty payments on offshore projects

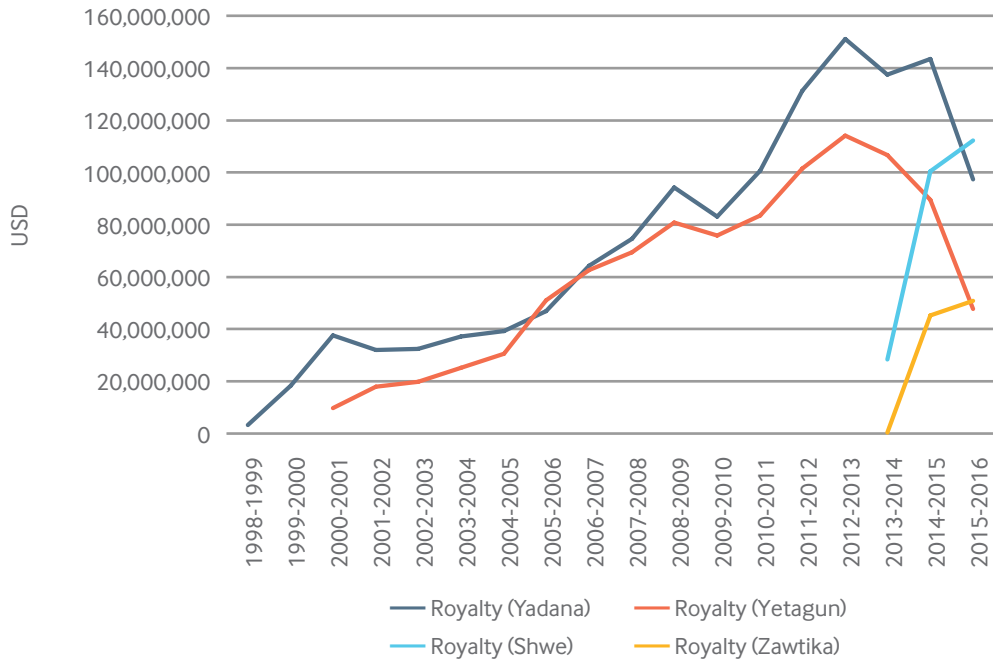
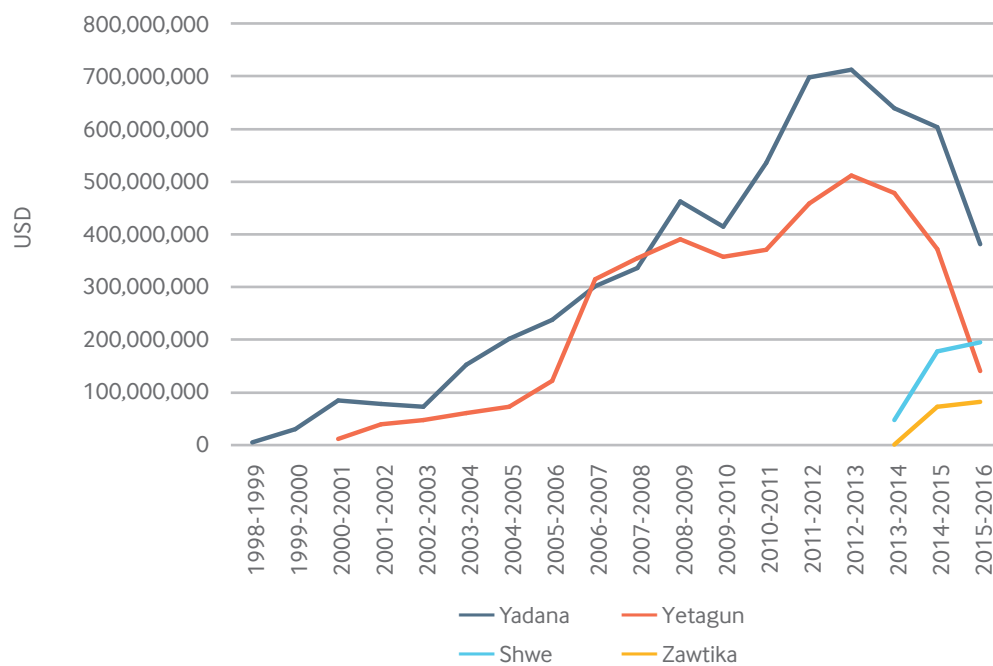


Figure 12. Profit share to MOGE for offshore projects



Of the approximately 1,900 cfpd of gas production—1,850 offshore and 50 onshore—only 450 cfpd is set aside for domestic use according to signed contracts. However, demand is at least 800 cfpd. As a result, the government plans to import gas with a new liquefied natural gas terminal. The government is trying to renegotiate with the Shwe field and pipeline operators to allow for greater domestic use, but the agreement is signed. Besides, there are no facilities at present to process additional gas domestically.⁷⁷

Offshore operations generated an additional MMK 77 billion for MOGE in 2015/16. These came from several other income streams, including revenues associated with the different oil and gas pipelines—such as the Southeast Asia Crude Oil Pipeline (SEAOP), the Southeast Asia Gas Pipeline (SEAGP) and the Zawtika field pipeline—as well as services provided to foreign companies and domestic market obligation payments. The largest of these in 2015/16 were MMK 36 billion from SEAGP domestic tariff fees and MMK 9.7 billion in income from data fees. New large gas fields (2 to 3 trillion cubic feet) are expected to begin production within the next decade.

Offshore oil and gas revenues are determined largely by PSCs between MOGE and its joint venture partners, as well as by the Export Gas Sales and Purchase Agreement that cover pipelines and final gas sales to China and Thailand, and which have been signed by all 11 pipeline operators and partners. None of the export gas sales and purchase agreements, and only one of the four offshore gas field contracts is publicly available, that for the Yadana field. However, MOGE has released model contracts for shallow and deep water offshore blocks. Table 7 shows some of the details.

Table 7. Key private sector revenue streams from offshore natural gas

Source: MOGE

Revenue stream	Collected by	Model contract
Royalty	MOGE	12.5% of gross value of available petroleum
Profit petroleum allocation	MOGE	60–90% of value of “profit petroleum,” once allowable costs have been reimbursed (depending on depth of gas and volume of production)
Production bonus	MOGE	USD 1–10 million (depending on volume of production)
State participation	MOGE	20–25% interest in rights and obligations under the contract
Corporate income tax	IRD	25% of taxable income (5-year tax holiday from start of production)
Returns on sale of joint venture partner share	IRD	40–50%
Commercial and special goods tax	IRD	Statutory rate paid after production begins
Customs duties	IRD	Statutory rate

These contract terms are not necessarily a good indication of Myanmar’s fiscal regime since the signed and approved PSCs differ significantly from the model PSCs. Tax deductions and exemptions are granted by the Myanmar Investment Commission (MIC), which approves contracts with foreign companies, with recommendation coming from MOGE via MOEE. Exemptions are then included in PSCs.

MIC’s secretariat is the Directorate of Investment and Company Administration (DICA), which is also within MOPF, but largely functions independently as it both drafts and enforces Myanmar’s investment policy, including approval

77 Based on interviews with MOEE.

of oil, gas and mining contracts. However, in practice, MOGE often makes recommendations on contract terms to MIC, which subsequently approves them without significant independent analysis or review. Big contracts by SEEs also require approval by their line ministries, MOPF, the attorney general and the cabinet. In practice, these processes are generally rubber stamps.⁷⁸

Little known is that the four offshore contracts each state that MOGE pays all taxes and duties except corporate income tax on behalf of its joint venture partners, despite only owning and profiting from 15 to 20.45 percent of these fields.⁷⁹ The tax-shifting covers commercial tax, special goods tax, stamp duties and customs duties. Furthermore, the profit petroleum allocation and other terms are less favorable to the government than in the model PSCs. Similarly, the Shwe project's Export Gas Sales and Purchase Agreement states that MOGE must pay 100 percent of domestic tariff fees despite MOGE only owning 7.635 percent of the pipeline. MIC also regularly extends the cost recovery period, provides tax exemptions and allow companies to shift profits from their upstream activities to downstream activities and vice versa.⁸⁰

The IRD (MOPF) estimates that more than USD 100 million is lost annually to tax exemptions in the oil sector. Our estimates place the cost somewhat higher, in the hundreds of millions of dollars annually.⁸¹ However, even this may be an underestimate since the IRD's auditing capacity is weak, especially as it relates to corporate income

tax payments, which have been described by at least one IRD official as "practically voluntary."

Furthermore, as the petroleum sector regulator, MOGE must audit gas field operator costs. However, interviews suggest that MOGE faces significant challenges with regard to its auditing capacity. As a result, revenues could be even higher were operator costs better controlled.

Onshore oil and gas revenues

MOGE's onshore activities generate significantly less revenue than its offshore activities; however, onshore upstream production alone still totaled MMK 138 billion in 2015/16. The largest revenue generator is crude oil and gas sales from five onshore fields, each of which operates under a different contract:⁸²

- **Kyaukkwet/Letpando.** Oil and natural gas field in Magway region. The field is 100 percent MOGE owned and managed. Generated MMK 29 billion for MOGE in 2015/16, 76 percent of which came from oil.
- **Chauk.** Oil-producing field in Magway region. Singapore-based Interra Resources owns 60 percent under an improved petroleum recovery contract (IPRC); 40 percent owned by MOGE. The two companies operate the field under the joint company name GoldPetrol. Under this agreement, MOGE pays the contractor and receives crude oil when production is above a specified amount; however, the contract terms are

78 Based on interviews with MOPF.

79 For example, the 1992 Total contract explicitly states that MOGE will assume all taxes and duties imposed upon the contractor (Section 17).

80 Based on interviews and documents from MOGE.

81 Our estimates are based on the size of commercial tax and special goods tax payments by MOGE as a share of overall costs, given tax-shifting provisions in PSCs.

82 MOGE financial data; Aung Htoo. *Development Project of Energy and Resources in Myanmar*. Presentation made 10 March 2009 (MOGE, 2009); MOEE. *Opportunities for Cooperation* (2017).

unknown. Generated MMK 24 billion for MOGE in 2015/16.

- **Yaynanchaung.** Oil-producing field in Magway region. Singapore-based Interra Resources owns 60 percent under an IPRC; 40 percent owned by MOGE. The two companies operate the field under the joint company name GoldPetrol. Under this agreement, MOGE pays the contractor and receives crude oil when production is above a specified amount; however, the contract terms are unknown. Generated MMK 30 billion for MOGE in 2015/16.
- **Mann.** Oil and natural gas field in Magway region. Operated under a performance compensation contract (PCC) joint venture with Myanmar and British Virgin Islands-based MPRL E&P. Terms of the contract are unknown. Generated MMK 28 billion for MOGE in 2015/16, 96 percent of which came from oil.
- **Htaukshabin.** Oil and natural gas field in Magway region. Unclear which type of contract was signed; however, a PCC may have signed with British Virgin Islands-based Focus Energy in 1997; Focus Energy was still operating the field as of 2009. Today the field is 100 percent MOGE owned and managed. Generated MMK 22 billion for MOGE in 2015/16, 98 percent of which came from oil.

Onshore fields operate under many different types of contracts, though the three most

common are PSCs, IPRCs and PCCs. While onshore contracts are unavailable, MOGE's model IPRC indicates that contractors ought to pay a 12.5 percent royalty and a production bonus of USD 200,000 to USD 3 million, depending on volume of production. MOGE also receives a share of "profit petroleum" at between 60 to 85 percent similar to that found in PSCs, depending on volume and whether oil or gas are being produced, and can take a 15 percent share in the field.⁸³ However, according to MOGE officials, actual deals—many of which were signed before the promulgation of the model—differ significantly from the model contract. For instance, MOGE must pay a combined 13.4 percent commercial and special goods taxes on all petroleum produced onshore despite in some cases only owning a minority equity share.⁸⁴

MOGE also earns revenue from 13 smaller onshore producing fields. Only revenues from two of these are recorded in MOGE financial forms, the Pyay and Myanaung fields. Revenues from the others seem to be off the books, possibly because they are operating under exploration contracts even though they are producing oil. These smaller fields include:

- **Pyay.** Oil-producing field in Bago region. Operating under an IPRC service contract with Myanmar and British Virgin Islands-registered MPRL E&P. Terms of the contract are unknown. Field is 100 percent MOGE owned. Generated MMK 1.5 billion for MOGE in 2015/16.

83 MOEE, *Opportunities for Cooperation*.

84 Based on interviews with MOGE.

- **Myanaung.** Oil-producing field in Ayeyarwady region. Operating under an IPRC service contract with Myanmar and British Virgin Islands-registered MPRL E&P. Terms of the contract are unknown. Field is 100 percent MOGE owned. Generated MMK 2.5 billion for MOGE in 2015/16.
- **Nyaungdone.** Located in Ayeyarwady region near Yangon. Field is 100 percent MOGE owned and managed. Revenues are unknown.
- **Shwepyitha.** Located in Ayeyarwady region. Operating under an IPRC service contract with Malaysia-based Petronas Carigali Myanmar Inc., Singapore-based United National Oil and Gas (UNOG) Petroleum Ltd. and Myanmar-based PB Myanmar Company Ltd. Terms of the contract are unknown. Field is 100 percent MOGE owned. Revenues are unknown.
- **Ma-U-Bin.** Located in Ayeyarwady region. Field is 100 percent MOGE owned and managed. Revenues are unknown.
- **Thargyitaung.** Located in Magway region. Field is 100 percent MOGE owned and managed. Revenues are unknown.

According to MOEE, several more onshore blocks in Myanmar are currently operating; however, MOGE did not report any activities or revenues from these for unexplained reasons.⁸⁵ Furthermore, MOGE issues licenses for hand-dug wells, otherwise known as artisanal oil drilling, in collaboration with state and regional governments. Production volumes for these are unknown and untaxed, though they represent many millions of dollars' worth of production annually.⁸⁶

Together, Myanmar produces approximately 7,000 barrels of oil per day onshore. MPE is given the first right to buy condensate oil and picks up oil from the project site with its own trucks. However, MPE's refineries often cannot take on extra capacity, so the condensate oil is usually sold to foreign companies. MOGE sells oil to MPE at a fixed price of 50,000 to 60,000 kyat per barrel, depending on cost of production, rather than the market price. Oil is therefore usually sold at a subsidized price.

85 MOEE, *Opportunities for Cooperation*.

86 Based on interviews with MOGE.

Miscellaneous revenues

Domestic sales of natural gas—approximately 50 cfpd—generated an additional MMK 21 billion in 2015/16. These are mostly sold to state-owned and private power plants. Sales to state-owned power plants have been highly subsidized since 2012, following an executive order designed to make Myanmar’s state-owned heavy industries more profitable.⁸⁷ Compressed natural gas (CNG) sales for vehicles generated another MMK 41 billion in 2015/16. When MOGE is unable to sell its gas to private power plants due to lack of demand, the priority is given to government-owned CNG stations for public buses and taxis in Yangon. CNG prices are also highly subsidized.

Income from services rendered to foreign companies—which remain undefined—plus housing rental, electricity, labor and so-called “general income” generated an additional MMK 2.1 billion in 2015/16. These are of concern since they may be prone to governance challenges and can influence MOGE’s incentive structure. For example, in 2015/16 MOGE received the following fees from foreign oil and gas companies, unrelated to production:

- Total E&P (France) – MMK 176 million
- PC Myanmar (Hong Kong) – MMK 174 million
- PTTEP International (Thailand) – MMK 195 million
- Machinery Solution (U.S.) – MMK 52 million

In 2015/16, MOGE also made more than MMK 5 billion on returns from a loan from Andaman Transportation Limited, a transport company working on the Zawtika project, which it received

as a 20 percent shareholder in the company. MOGE made MMK 9 billion on similar deal stemming from its ownership of the SEAGP gas pipeline. The enterprise also made MMK 10 billion on data fees, presumably selling geological data to prospective investors.

Profit from offshore gas price change generated a significant MMK 129 billion in 2015/16. This figure is left unexplained in MOGE’s financials.

Subcontracting

Subcontracts for work done on MOGE’s onshore fields are awarded by subcommittees and approved by a steering committee headed by MOEE’s deputy minister or director general. MOEE has four subcommittees: technical, accounting, procurement and management.

Every contract for onshore and offshore PSCs above a certain threshold must be reviewed by the technical and accounting subcommittees, who meet daily. First, tenders are submitted to the technical subcommittee. If approved, they go to the accounting subcommittee. The process can take anywhere from a month to many months. This is because the technical subcommittee will visit supplier production sites, even if in China or elsewhere, to check on a potential supplier’s technical competence. Contracts are then sent to the other committees for review and award of tender. If relevant, the contract is also reviewed by other MOGE departments. The management committee makes a final decision on award of contracts in consultation with MOGE’s legal department.

On the other hand, onshore non-PSC subcontracts are approved using a different process. In these cases, only the field’s three-person management

87 Based on interviews with MOGE.

committee awards contracts without any oversight by the rest of MOGE. In theory, to be awarded a contract a bidder must be listed officially and technical requirements and speed of delivery must meet MOGE criteria. However, there is no independent verification that these criteria are being met.⁸⁸

Expenditures

In general, much less information is available on expenditures than revenues, though 2017/18 budget data is more disaggregated than in

previous years. In some ways, MOPF's financial forms provide a clearer description of MOGE's expenditures, though they are aggregated quite differently than MOGE's internal financial records.

Much of the challenge stems from the manner in which data is aggregated or disaggregated such that it is not helpful for analyzing MOGE's performance or to understand what activities each figure refers to. Even where figures are comparable, they are sometimes inconsistent. As such, we provide information from both data sources.

Table 8a. MOGE expenditures by year (MOGE) (MMK billion)

	2014/2015	2015/2016
Onshore	102	85
Offshore production	459	660
Pipeline and CNG distribution	45	45
Staff costs	11	10
Debt payments (principal and interest)	140	122
Foreign exchange loss	369	1
Loss from subsidized sale of offshore gas	181	-
TOTAL	1,307	923
Commercial tax	304	337
TOTAL net of commercial tax	1,003	586

Table 8b. MOGE expenditures by year (MOPF) (MMK billion)

	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
Onshore production and cost of domestic natural gas sales	89 ⁸⁹	140	117	184
Offshore production	263	343	336	424
Staff costs	9	11	10	11
Debt payments (principal and interest) and foreign exchange loss	132	509	123	85
TOTAL	498	1,003	586	704

88 Based on interviews with MOGE.

89 MOPF's financial forms miscalculate this figure as 99, adding deferred expenses rather than subtracting them. These types of errors occur occasionally in the forms. This also explains why the total does not equal the sum of the lines above.

Offshore oil and gas, pipeline and supply base costs

By far the largest expenditure item in 2015/16 was offshore exploration, which cost a substantial MMK 660 billion. According to MOPF figures, approximately half can be attributed to “tax for crude oil”, which is unexplained, but must consist mostly of commercial tax. As explained, MOGE is covering much of its offshore operators’ share of the commercial and special goods tax bill.

The other half can be attributed to “variable expenses” or “variable work expenses” (the terminology is not always consistent), which include cash calls, electric power for production, fuel for transport and other transport expenses for offshore gas and pipelines. Variable work expenses represented MMK 222 billion in 2013/14, MMK 162 billion in 2014/15, MMK 340 billion in 2015/16, and MMK 413 billion (estimate) in 2016/17. As of this year, MOPF breaks down these expenses by project. (See Table 9.)

Figure 13. MOGE expenditures 2013/2014 to 2016/2017 (MMK billion)

Source: MOPF

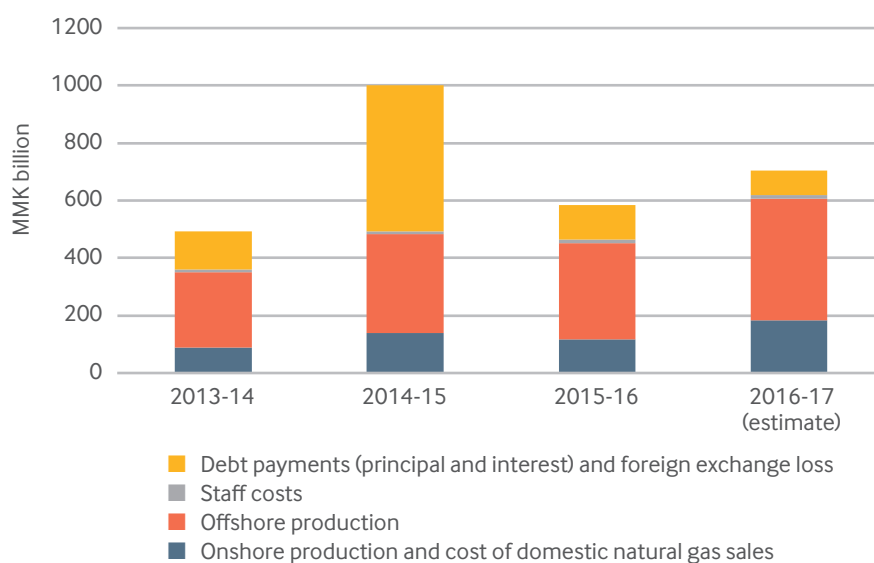


Table 9. ‘Variable work’ costs of offshore fields and pipelines in 2017/2018 (estimates) (MMK billion)

	Yetagun	Yadana	Shwe	Zawtika	SEAOP	SEAGP	Domestic MOGE use
Variable cost	41	64	71	150	13	95	46

By far the largest cash calls in recent years have come from the PTT-controlled Zawtika field. Cash calls for Zawtika from the start of project development until 2015 totaled USD 560 million (MMK 364 billion).⁹⁰ Part of the MMK 150 billion allocated to Zawtika this year will likewise cover cash calls. The Shwe gas project and the SEAGP and SEAOP pipelines have also cost MOGE quite a lot in recent years, though exact figures are unknown. The size of cash calls is determined by offshore field management committees, on a project-by-project, case-by-case basis. Joint venture partners monitor each other to ensure that cash calls are warranted and equitably shared among the partners. As such, there is a higher probability that offshore gas field cash calls represent justified costs than for MOGE's other projects.⁹¹

Pipeline transit and distribution of natural gas costs totaled approximately MMK 45 billion in 2015/16, half as a result of asset depreciation. Some onshore pipelines are old and need constant maintenance. Costs for pipeline-related electric power, fuel, salaries and "service fees for using natural gas" were also large. By 2017/18, pipeline costs seem to have risen to MMK 153 billion. The high costs are partly due to domestic tariff fees, which must be paid by MOGE even though it only owns a small share (7.635 percent) in SEAGP. On the other hand, we do not know whether MOGE is being compensated for these high costs with greater SEAGP revenues over the long-run.

Given that much of MOGE's debt and the approximately MMK 80 billion it pays in interest annually is a result of loans taken to

cover pipeline capital expenses, it may be fair to assert that the pipelines are not particularly profitable for MOGE, and may in fact be losing the government many billions of kyat annually. This is particularly vexing given that domestic demand for gas exceeds supply. Essentially, MOGE may be losing money in order to export gas that is needed for domestic use. However, we cannot make a definitive assertion to this effect without analyzing the export gas sales and purchase agreements, which remain secret.⁹²

The Taketa offshore supply base near Yangon cost MMK 2.8 billion in 2015/16. Petroleum warehousing and losses from strategic reserves could also account for some of the costs. According to MOGE reports, as of 31 March 2016, MOGE had stocked nearly MMK 86 billion in oil and fuel reserves, of which 64 percent was warehoused at the Thaketa supply base. According to MOEE officials, losses of warehoused fuel average approximately 100 gallons per day, which costs approximately MMK 125 million per year.

Onshore oil and gas costs

Surprisingly, an in-depth analysis of MOGE's onshore oil and gas operations shows that they are generally unprofitable. According to MOGE's aggregate figures, onshore production generated a MMK 53 billion profit in 2015/16. However the project-level and other cost data is inconsistent with this figure. As Table 10 shows, onshore production generated a nearly MMK 73 billion profit in 2015/16, excluding the fields that are not reporting. However this does not take into account so-called "development costs" nor capital costs, mainly drilling equipment, which has

90 Exchange rate calculated on annual basis.

91 Based on interviews with MOGE.

92 Our analysis is based on two discrete years of data; therefore, we do not infer that the pipeline agreements are unprofitable over the lifespan of the pipelines.

been covered out of the MOEE budget. (See Table 12.) While we cannot calculate onshore profit with certainty due to non-reporting of certain fields and incomplete data, we can estimate that onshore production profitability ranged from approximately MMK 15 billion profit to MMK 5 billion loss in 2015/16. Given that capital costs were higher in previous years and that onshore fields are at peak production on average, we deduce that MOGE's onshore field life-cycle profitability is weak by global standards. In short, there is much room for improvements in onshore production efficiency, especially through cost reductions and enhanced oil recovery technologies.

Most oil is transported by onshore pipeline; however, oil is trucked from the Kyaukkwet and Chauk oil field to refineries. This additional cost is not evident in the data. Exploration and production also occurs at several other fields, such as Nyaungdone and Ma-U-bin. While production figures are available for these fields, revenue and cost figures are not.

Onshore production costs can be broken down into crude oil, natural gas and natural gas for vehicles, which is CNG. Crude oil production represents the largest cost, which is consistent with the size of onshore oil production relative to natural gas.

Table 10. Net revenue of onshore fields in 2015/2016 (MMK billion)

	Kyaukkwet	Chauk	Yaynan-chaug	Mann	Htauk-shabin	Pyay	Myan-aung	Nyaung-done	Ma-U-Bin	Other fields
Crude oil production (million gallons)	18.5	16.3	20.7	17.5	14.1	1	0.5	2.6	1.1	4.0
Sale to refineries (million gallons)	13.1	14.9	18.6	16.0	12.6	0.9	0.4	2.4	1.1	3.3
Revenue	29	24	30	28	22	1.5	2.5	unknown	unknown	unknown
Production cost	9	18	10	18	9	0.2	0.2	unknown	unknown	unknown
Profit pre-capital costs	20	6	20	10	13	1.3	2.3	unknown	unknown	unknown
Development cost ⁹³	0	0	0	25	0	0	0	unknown	unknown	unknown

93 It is not clear which activities "development cost" refers to.

In 2015/16, MOGE's onshore oil and gas activities generated up to 29 percent of costs but only 7 percent of revenues.

The striking element here is that onshore oil and gas production represented 20 percent of costs but only 7 percent of revenues in 2015/16 using MOPF figures, the latest year we have actual figures instead of estimates. Using MOGE figures for the operational and development costs of production, onshore oil and gas represented 29 percent of costs and only 7 percent of revenues in the same year. Clearly, MOGE's onshore operations are much less efficient than its offshore operations, which may themselves not be particularly efficient at controlling costs due to weak auditing of operators or generating revenue for the Union of Myanmar due to tax exemptions.

What is more, these costs are likely to be a gross underestimate of the true cost of onshore

production since it does not include capital costs covered by the annual MOEE capital budget. Each year, drilling accessories represent 80 to 90 percent of the capital budget.⁹⁵ MOGE's capital costs over the last few years are provided in Table 12. If these figures are included, onshore oil and gas represented 24 percent of costs but only 7 percent of revenue in 2015/16, using MOPF data.

This discrepancy may be a result of various factors, including future-looking investments in exploration that are not yet generating revenues and less bountiful geology onshore than offshore. Nevertheless, the discrepancy warrants scrutiny by the government's oversight agencies about MOGE's investment of public revenues, which is difficult given the current practices.

Table 11. Onshore production costs (MMK billion)

	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
Crude oil	90	140	122	183
Natural gas	4	4	4	4
Natural gas for vehicles	2	2	2	2
Cost of inventory	-2	0	-1	0
Deferred expenses	-5	-6	-10	-5
Total cost of onshore production	89 ⁹⁴	140	117	184
Onshore oil and gas revenue	147	162	138	139
Net revenue	58	22	21	-45

94 MOPF's financial forms miscalculate this figure as 99, adding deferred expenses rather than subtracting them. These types of errors are common in the forms.

95 Based on interviews with MOGE.

Table 12. MOGE capital costs by year, financed via MOEE

Source: MOPF

Year	MOGE capital cost (MMK billion)
2012/2013	61
2013/2014	25
2014/2015	76
2015/2016	33
2016/2017	32
2017/2018 (estimate)	16

Staff costs

MOGE staff cost MMK 10.5 billion in 2015/2016, of which 86 percent was head office cost and the remainder was onshore exploration and development cost. MOGE usually has one staff member on each offshore platform for regulatory purposes; therefore, offshore operations do not cost much in terms of salaries and pensions. Pension costs are generally four times higher than staff salary costs.

However, staff salaries are paltry by global state-owned company standards. As mentioned, the average salary in FY 2016/17 was MMK 1,853,000 annually (MMK 154,417 monthly), including managers, staff and daily wage workers. This figure does not include housing, transport and other benefits. The managing director earns approximately MMK 6 million annually (MMK 500,000 monthly) plus benefits. Most CEOs or managing directors of companies with the number of staff and revenues of MOGE make many times that amount annually. In other countries, low official remunerations often contributes to an environment where patronage and illicit payments are the norm.

Miscellaneous or unexplained costs

Given that the MOGE budget is set in kyat but that most of its loans are in USD, unexpected depreciation has caused MOGE to experience an exchange rate loss in some years. MOGE lost MMK 1.2 billion from changes in the kyat exchange rate in 2015/16. This was a vast improvement on the MMK 369 billion loss in 2014/15. This enormous exchange rate loss is explained by the revaluation of MOGE's debt following the 2012 shift from an exchange rate of 6 kyat per dollar to the market rate. The change was only reflected in 2014/15. It is unclear whether this money was therefore transferred to MFTB or not.

A further MMK 85 billion in "net production costs" and MMK 134 billion in "other expenses" are left unexplained in the MOGE balance sheet. However, MOGE paid approximately MMK 89 billion in interest and principal on foreign loans in 2015/16, which could explain part of this amount. If so, that leaves MMK 130 billion in costs unexplained.

MOGE uses generous depreciation rules to lower its taxable income. For instance, while some depreciation rates are set by MOPF notification, MOGE sometimes uses its own rates. Also, PSCs set a standard 25 percent rate of depreciation across the board, which is normal for private sector contractors. According to MOGE's own forms, in 2015/16, MOGE declared nearly 109 billion in depreciated assets on MMK 461 billion in assets.⁹⁶ This 24 percent rate of depreciation, on average, could explain some of the declared losses. MOGE also defers expenses from previous years and uses them in future years for tax planning purposes. In 2015/16, MOGE deferred MMK 49 billion in drilling expenses.

96 MOPF's financial forms for MOGE show MMK 27.8 billion in depreciation on a subset of MMK 75.4 billion in costs, which represents a 37 percent depreciation rate. However, some of these costs are not capital expenditures; therefore, MOPF figures do not provide accurate depreciation rates.

In the same year, MOGE listed a large number of smaller expenditure items, which are mostly unexplained. These include:

- Payment to Myainggalay cement factory (MMK 144 million)
- Payment for gas fee to the MEC cement factory (MMK 974 million)
- Yangon office costs, including plane tickets (MMK 166 million)

MOGE debt

MOGE has borrowed significant amounts of money over the years. MOGE currently holds approximately MMK 1.7 trillion in outstanding loans. While a small amount is owed to domestic creditors, the vast majority is owed to foreign governments or foreign government agencies. Debts are mostly denominated in foreign currency, increasing their servicing costs as the kyat depreciates.

The China Development Bank, a Chinese state-owned bank, is by far MOGE's largest creditor, with a balance of MMK 1,641 billion owing as of March 2017. About half of this amount is denominated in Chinese yuan and another MMK 500 billion is denominated in euros. The loans, which were made through MFTB, charge 4.5 percent annually in interest over 15 years. The Chinese government is also a direct lender, along with Japan (JICA) (0.01 percent interest over 40 years) and the Indian government (1.75 percent over 25 years). MOGE has recently paid off legacy loans from West Germany, Japan and Thailand.⁹⁷

The interest paid on MOGE debt over the years has been significant. MOGE paid MMK 72 billion in 2013/14, MMK 76 billion in 2014/15, MMK 89 billion in 2015/16 and MMK 83 billion in 2016/17.

Previously, MOGE borrowed heavily, paying high interest rates, at the same time as it saved money in its Other Accounts at zero percent interest. While MOGE is no longer permitted to borrow directly due to the Public Debt Management Law (2016), MOPF may still borrow on its behalf. It remains to be seen whether this trend of borrowing at high interest rates and saving at a zero interest rate continues.

MOGE assets

As of 31 March 2016, MOGE owned non-cash assets worth MMK 461 billion. Of this amount MMK 222 billion was pipeline, MMK 84 billion was plants and machinery, and MMK 68 was drilling equipment. MOGE also has stocked crude oil worth MMK 87 billion. Most of this stocked crude is held at the Thaketa supply base, though MMK 13 billion is also held at the Mann oil field.

Additionally, MOGE currently holds 23 OAs with a total balance of MMK 5.4 trillion as of the end of 2016. The vast majority of these balances—MMK 4.2 trillion—are held in the Yangon office. The Naypyitaw office holds another MMK 953 billion. The remaining OAs are relatively small; each onshore oil field holds some balances as do the Thaketa supply base and CNG stations. As of 2016, cash on hand represented more than 3 times revenues and more than 7.5 times expenditures. This can be interpreted to mean that MOGE could cover its costs for more than seven years without generating any income.

MOGE's cash-on-hand also represents the highest share of total assets of any national oil company in the world. (See Figure 14 for a sample.) MOGE's cash holdings are far greater than what is needed to finance operations.

97 Based on interviews with MOPF Treasury Department.

Figure 14. Share of cash to total assets (2015 or most recent)
(a measure of precautionary liquid savings and opportunity cost)

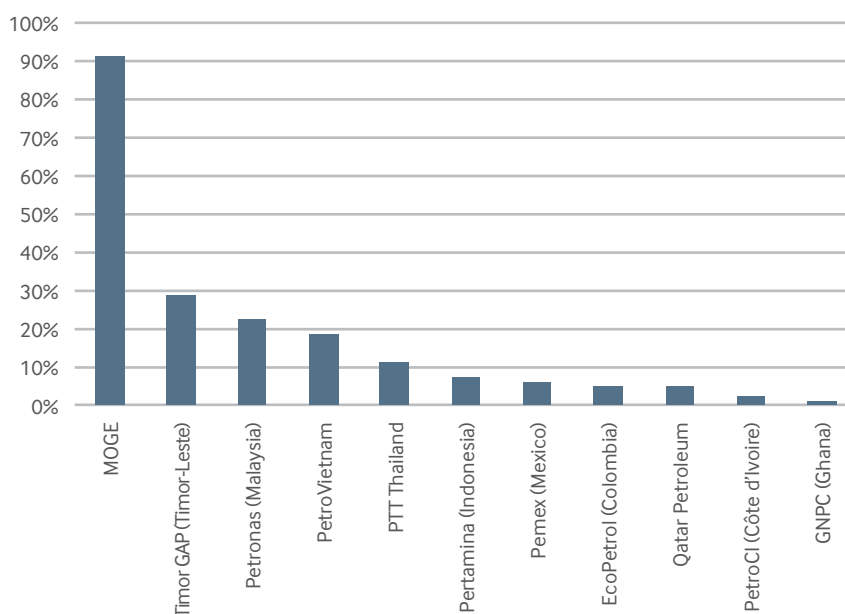


Figure 15. Corporate income tax and dividends paid by MOGE, by year (MMK thousand)⁹⁹



98 In order to make the figures comparable, black market exchange rates are used to calculate income tax and state contributions prior to 2012. Black market rates were drawn from Koji Kubo. *Transition from black to official markets for foreign exchange in Myanmar*. IDE Discussion Paper No. 511 (Institute for Developing Studies, 2015).

MOGE taxes, dividends and corporate social responsibility activities

As with other SEEs, MOGE pays 25 percent of its net profit (calculated as revenues minus costs minus commercial tax) in income tax annually to MOPF's IRD. It pays another 20 percent directly to MOPF's Treasury Department as "state contribution" or dividend. Of the remainder, 2 percent is allocated to corporate social responsibility (CSR); we have not identified which regulation requires MOGE to make this contribution. According to interviews with MOGE officials, MOGE's CSR activities consist of education, health and roads projects. For example, roads to work sites are being extended to reach neighboring communities. MOGE also plans to create a human resources training center for oil workers, focusing on vocational skills. This center will be modeled on a Petronas program, issuing oil sector proficiency certificates to graduates. The Thaketa supply base also has CSR projects, though details are unknown. These are all in addition to CSR activities required of operators found in PSCs. There is no written record of CSR transactions.

As seen in Figure 15, MOGE paid much higher income tax and dividends prior to the change in SEE financing rules in 2012. This is to be expected given that all revenues were to be paid to IRD and the Treasury prior to the 2012 SEE financing reform. Interestingly, today all corporate income tax payments are being made based on offshore profits; the onshore sector is paying virtually no income tax since it is either loss-making or breaking even.

Oddly, the income tax figures provided by MOGE and MOPF's Budget Department (which does not independently verify the figures it receives from MOGE) do not match the figures from MOPF's IRD. The same can be said for commercial tax payments. In some cases, the discrepancies, which are shown in Table 13, are over MMK 100 billion. According to MOGE, part of the explanation may be that MOGE pays its taxes in advance and reports on these, whereas future adjustments made by IRD are not reported by MOGE to MOPF's Budget Department. These statements are backed by IRD. Regardless, these major discrepancies reinforce the earlier statement that there is a lack of coordination not just between but also within ministries, enabled by paper rather than electronic government accounting.

Table 13. Discrepancies between MOPF Budget Department and IRD's MOGE tax payments (MMK billion)

	2013/2014	2014/2015	2015/2016 (estimate for IRD)
Income tax			
Budget Department	276	239	232
Internal Revenue Department	282	358	212
Commercial tax			
Budget Department	359	304	337
Internal Revenue Department	364	368	259

Commercial tax is treated somewhat differently than other taxes; MOGE considers it a cost of production. According to the Commercial Tax Law (1990 – amended), commercial tax of 5 percent is paid on most imported goods and certain listed domestic goods sold. Almost all of MOGE’s imported goods, such as drilling equipment, are subject to this tax. If the goods are resold, MOGE would collect commercial tax.

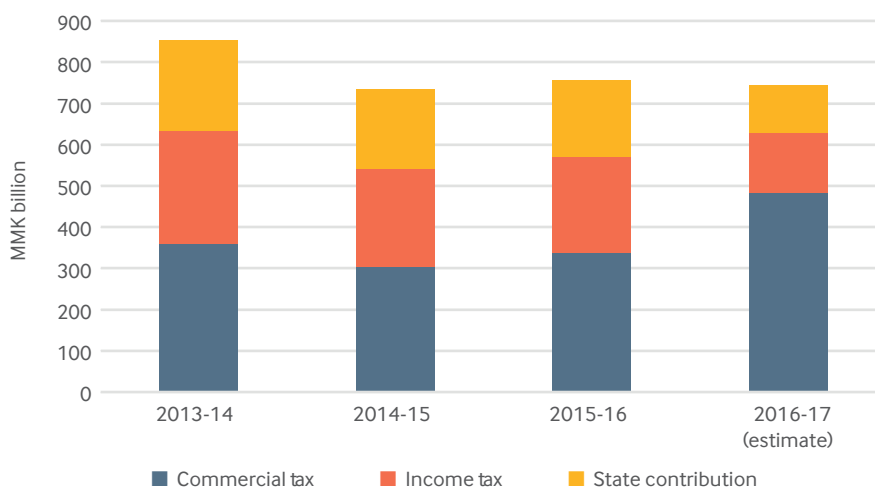
Natural gas purchases are also subject to a special goods tax (SGT) of 8 percent. Commercial tax is paid on top of SGT, so the gross tax rate is 13.4 percent on natural gas. MOGE also pays some custom duties and withholding taxes on large imports.

Commercial tax payments have been extraordinarily high in recent years, representing

32 percent of gross revenue in 2014/15 and 38 percent in 2015/16 (see Figure 16). While MOGE does import significant amounts of equipment from abroad, this does not explain the high commercial tax payments. In fact, the commercial tax figure actually represents commercial tax, special goods taxes, stamp duties and customs duties (the latter two of which are quite small). Alarming, MOGE pays all commercial, special goods tax, stamp duty, and customs duties for the *total* value of gas sales, even though the enterprise only owns 15 to 20.45 percent shares of offshore fields and is not the operator of pipelines. MOGE is therefore paying tax on behalf of foreign joint venture partners. This provision is included in all signed production sharing contracts (PSCs).⁹⁹

Figure 16. MOGE tax contribution by year (2013/2014 to 2016/2017)

Source: MOPF



99 Based on interviews from IRD and MOGE.

Myanmar Gems Enterprise

OVERVIEW

MGE was officially responsible for all mining and trading of gemstones under the socialist government that maintained power through the late 1980s, though informal small-scale mining accounted for most production during this period. A system of public–private partnerships was adopted in the 1990s under the State Law and Order Revolutionary Council (SLORC) and a framework for granting concessions to private companies was established under the 1995 Myanmar Gemstone Law.¹⁰⁰

Companies belonging to the Myanmar military hold significant jade and gemstone interests. The military itself has been directly involved in the sector’s management with the president directly overseeing the licensing process in certain years. MGE’s leadership consists almost entirely of former military officials and is generally considered to have been responsible for safeguarding the significant interests of the armed forces and associated businesspersons.¹⁰¹ Under military rule, MGE exercised significant autonomy from other branches of the Ministry of Mines (now MONREC).

Interaction between MGE and MONREC has improved under a new, National League for Democracy-led government. Yet the future of the state-owned enterprise remains unclear in light of revisions to the Myanmar Gemstone Law and other reforms to the sector.

MANDATE

MGE’s authority is not clearly defined in available laws or regulations. Rather, MONREC has delegated its authority under the Myanmar Gemstone Law (1995) to MGE via ministry rules and regulations. MGE’s self-stated duties are identified on its website as: (a) the designation of gemstone blocks in gemstone tract areas; (b) the issuing of gemstone production permits to national entrepreneurs and cooperative societies; (c) the imposition of taxes on gemstone production and the sale of raw or finished gemstones and jewelry; and (d) the holding of gems emporiums under the supervision of MONREC.¹⁰² In practice, however, the enterprise has assumed wide-ranging commercial and regulatory responsibilities:

Commercial activities

MGE participates in jade and gemstone joint ventures on behalf of the state, which are based on a model contract. While the size of licenses granted to private operators are capped at 1 acre, companies entering into joint venture agreements may mine up to 50 acres under a single permit at a minimum price of MMK 1 million per acre.¹⁰³ The criteria by which MGE’s joint venture partners are determined are not specified in laws or relevant internal directives; in practice, most private companies selected have ties to the military.¹⁰⁴

100 Based on analysis provided by MGE.

101 See Global Witness. Jade: Myanmar’s “Big State Secret” (October 2016).

102 Website of the Ministry of Natural Resources and Environmental Conservation, accessed 12 June 2017. Online: <http://www.mining.gov.mm/>.

103 MGE licensing directives.

104 *Ibid.*, 2.

MGE's interest in mining joint ventures is freely carried, and MGE is not obligated to bear any operational costs. Joint ventures are required to market their production at semi-annual jade and gemstone emporiums, with MGE and private partners receiving 25 percent and 75 percent of revenues from these sales, respectively. Under its model contract, the MGE may alternatively receive a 50 percent share of production from joint ventures; however, the government does not appear to have pursued this option in recent years.¹⁰⁵

MGE also sells illegally mined stones and gems that are transferred to it from law enforcement authorities. Prior to this fiscal year, 80 percent of the value of the confiscated gems was transferred directly to the MOPF Treasury Department by MGE, 10 percent was transferred to local police and 10 percent to informants. As of 2017/18, 50 percent goes to MOPF, 30 percent goes to local police and 20 percent goes to informants.

Of note, MGE officials have stated a desire to corporatize MGE. This would imply absorbing the cash available in MGE's Other Accounts into a new corporate entity. It is unclear why MGE intends to corporatize and what its broader corporate vision would be.¹⁰⁶

Regulatory activities

Policy-making

MGE has been responsible for composing regulations and directives under the Myanmar Gemstone Law. At the time of this writing, these documents have not been made available to the public.

MGE participates in the Central Gemstone Supervisory Committee, which is responsible for tendering advice to MONREC on regulatory matters (including the designation of gemstone tracts, licensing, taxation and gemstones sales) and hearing disputes over gemstone valuation. The supervisory committee is chaired by the deputy minister of MONREC (formerly deputy minister of mines) and also includes representatives from other relevant government departments, gemstone experts and technicians, and members of the Myanmar Gems and Jewelry Entrepreneurs' Association, the country's national-level industry group.¹⁰⁷

Further, MGE's leadership serves on the new, Multi-Stakeholder Supporting Committee for Jade and Gemstones formed by MONREC in early 2017 under the new NLD-led government. The supporting committee is chaired by the advisor to the minister, and its mandate includes developing a first-ever jade and gemstone policy, and convening a national conference on jade and gemstone issues.

105 MGE joint venture model contract.

106 Based on interviews with MGE.

107 Myanmar Gemstone Law (1995) and Amendment to the Myanmar Gemstone Law (2016).



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

Licensing

Under the former government, MGE handled the review of license applications, collection of associated revenues, and maintenance of permit records. Until 2016, ultimate licensing authority was vested in the Leading Committee for the Development of Myanmar Gemstone Industry.¹⁰⁸ The leading committee was formed by a notification from the president's office, and for a time included direct participation by the president. This committee has now been dissolved. Under the U Thein Sein administration, the leading committee was composed of the:

- Union minister, Ministry of Mines
- Deputy minister, Ministry of Mines
- Deputy minister, Ministry of Home Affairs
- Deputy minister, Ministry of Finance
- Deputy minister, Ministry of National Planning and Economic Development
- Deputy attorney general, Union Office of the Attorney General
- Director general, Forest Department
- Director general, Directorate of Water Resources and Improvement of River Systems
- Director general, Ministry of Mines

MGE also participated in the Working Committee for Issuing Permits, Inspecting and Supervising Gemstone Blocks,¹⁰⁹ which made recommendations to the leading committee on license allocation and the designation of gemstone tracts. Under the U Thein Sein administration, the working committee was composed of the:

- Union minister, Ministry of Mines
- Deputy minister, Ministry of Mines
- Permanent secretary, Ministry of Mines
- Director general, Department of Mines
- Director general, Department of Geological Survey and Mineral exploration
- Managing director, No. 1 Mining Enterprise
- Managing director, No. 2 Mining Enterprise
- Managing director, Myanmar Pearl Enterprise
- Managing director, Myanmar Gems Enterprise
- Director, Myanmar Gems Enterprise

MGE's future involvement in the licensing process remains uncertain in light of ongoing reforms. The issuing and renewal of jade and gemstone mining licenses in Myanmar has been frozen since mid-2016 pending reform of the sector. Although the parliament is considering amendments to the Myanmar Gemstone Law, discussions to date have not specifically addressed MGE's responsibilities.

108 *Ibid.*, 4.

109 *Ibid.*, 4.

Monitoring

Although the legal basis for its role is not clear, MGE has exercised de facto authority over enforcement of monitoring jade and gemstone mining companies' compliance with fiscal and operational terms included in licenses and contracts, including environmental, social, health and safety standards.

The broad enforcement responsibilities assumed by MGE overlap with the responsibilities assigned to other government institutions, including the Ministry of Labor, Immigration and Population, the Ministry of Health, and the environmental conservation department, the department of geological survey and exploration, and the department of mines under MONREC. MGE's commercial role also appears to conflict with its duties as a regulator and its dependence on revenues from joint ventures.¹¹⁰

Revenue collection

Companies are required to report their gemstone production to the local MGE office. Royalty payments are determined by eleven regional "valuation bodies" composed of:¹¹¹

- Three officers from MGE (one of whom serves as the chair of the valuation body)
- A representative from the region/state government
- A member of the region/state parliament
- A township revenue officer
- A representative from Myanmar Gems and Jewelry Entrepreneurs Association (MGJEA)
- Two business owners with expertise in jade/gem

MGE sits with MGJEA on the Central Committee for Holding the Myanmar Gemstone Emporium jointly manages the semi-annual jade and gemstone emporiums held in Naypyitaw and collects associated revenues, which consist of royalties, emporium service fees and special goods taxes. Separately, MGE also collects license fees (sometimes called rent or worksite hiring charges) as well as its 25 percent production share, which is collected in the form of hard currency rather than physical gems. Details of the fiscal regime are provided below.

110 Paul Shortell. *Governing the Gemstone Sector: Considerations for Myanmar* (Natural Resource Governance Institute, May 2017). Online: <https://resourcegovernance.org/sites/default/files/documents/governing-the-gemstone-sector-considerations-for-myanmar.pdf>.

111 MGE valuation directives.

Organizational structure

MGE falls under the jurisdiction of MONREC.¹¹² Although it exercised a unique degree of autonomy during previous administrations, under the NLD its relationship to the ministry has begun to more closely resemble that of other SEEs.

MGE employs approximately 580 staff between its head office in Naypyitaw, satellite offices in gemstone-producing regions, and two state-run gemstone museums. Overseen by the managing director, its Naypyitaw headquarters oversees the licensing process, communicates with regional offices and liaises with other government institutions. MGE's eight regional extraction departments are responsible for monitoring company activities, reporting production volumes and collecting royalties on rough gemstone production.¹¹³

MGE organizational structure

No.	Department/station	Location	Supervising officer
(a)	Head office	Naypyitaw	Managing director
(b)	Gems extraction department	Mandalay	Director
(c)	Gems extraction department	Mogok	Deputy director
(d)	Gems extraction department	Mong Hsu	Deputy director
(e)	Jade extraction department	Lone Khin	Director
(f)	Jade extraction department	Myitkyina	Assistant director
(g)	Jade extraction department	Moe Hnyin	Assistant director
(h)	Jade extraction department	Khamti	Assistant director
(i)	Museum	Naypyitaw	Deputy director
(j)	Museum	Yangon	Deputy director

Balance sheet

Table 14. MGE balance sheet (MOPF) (MMK billion)

	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
Revenues	303	227	162	159
Costs ¹¹⁴	4.2	4.9	6.1	2.8
Change in inventory (incl. associated costs)	7.4	35	-2.6	-1.0
Commercial tax and special goods tax	0	0	0	0.1
Income tax	77	65	39	39
State contribution	61	52	31	31
Net profit ¹¹⁵	168	140	84	85

112 MONREC's other SEEs are Mining Enterprise No. 1, Mining Enterprise No. 2, Myanmar Pearl Enterprise and Myanmar Timber Enterprise. MONREC's department of mines is meant to oversee MGE.

113 Based on interviews with MGE.

114 Production costs and purchase of gems left off MOPF Profit/Loss statement but included in MOPF detailed financial forms.

115 Net profit miscalculated by MOPF since production costs not included in calculation. Income tax and state contribution are accurate.

Flow-of-funds and revenues

Key fiscal terms for gemstones are laid out under the Myanmar Gemstone Law and subsequent regulations/directives and the annual Union Tax Laws. (See Tables 15 and 16.) Revenue streams collected by MGE include rents (also known as “worksite hiring charges”), the 20 percent royalty on rough production, the 25 percent state share of production from joint ventures, and

fees incurred at the jade and gems emporiums (which most recently include a 1-3 percent service fee and a 1 percent emporium fee). Of these, license fees (including signature bonuses) and the state’s share of production represent the greatest share of MGE’s inflows. In part due to a lack of synchronization between these laws, the cumulative *de jure* tax burden on gems companies in Myanmar is unusually high.

Table 15. Key revenue streams during licensing and production phases

Revenue stream	Collected by	Sent to	1995	2016
Production royalty	MGE	MONREC (Department of Mines)	20% of gross revenue	20% of gross revenue
Rent/“worksite hiring charges”	MGE	MGE OA	Varies	Varies
Rental payments from properties	MGE	MGE OA	Varies	Varies
License fees and fines	MGE	MGE OA	Varies	Varies

Table 16. Key revenue streams at the Gems Emporium

Source: MGE

Revenue stream	Collected by	Sent to	1995	2016/2017
I. According to Union Tax Law				
1. Commercial tax from domestic jewelry traders	IRD	IRD	5%	5%
2. Special goods tax				
a) Jade rough stone	IRD	IRD	30%	15%
b) Gems rough stone	IRD	IRD	-	15%
c) Jade and Gems polished or finished products	IRD	IRD	15%	5%
II. According to Jade and Gemstone Law				
a) Jade rough stone	MGE	MGE OA	-	3%
b) Gems rough stone	MGE	MGE OA	-	3%
c) Jade and Gems polished or finished products	MGE	MGE OA	-	1%
III. According to joint venture agreement				
a) Emporium supervision fees on sale of jade and gems (after tax and fees)	MGE/MGJEA	MGE/MGJEA	1%	1% to 2%
b) State production share	MGE	MGE OA	40%	25%

Similar to MOGE, MGE is simply a pass-through organization for some of these revenue flows. MGE collects royalties and signature bonuses on behalf of the Union and transfers them immediately to MONREC's department of mines. Rents on property owned by MGE, such as buildings in Yangon, goes directly to MOPF's Treasury Department.

The other revenue streams mentioned in law—namely the state share of production from joint ventures, Gems Emporium fees, license fees and worksite hiring charges (mining area rents charged at approximately MMK 500 million per acre)—are collected and held by MGE.¹¹⁶ They are then used in the calculation of MGE's profit for tax and state contribution purposes. These revenues, plus changes in MGE's inventory, are provided in Table 17.¹¹⁷ As the table shows, state production share represents by far the greatest official source

of revenue for MGE, followed by Gems Emporium fees and worksite hiring charges/rent.

MGE stores and warehouses its own gems. This inventory rises over time and falls after gems are sold at the Gems Emporium. Sales and purchases of inventory can represent a large share of MGE's annual revenues or expenditures. For instance, in 2014/15 MGE started the fiscal year with MMK 11 billion worth of gems and ended with MMK 49 billion worth of its inventory. As a result, at the end of the year, MGE increased the value of its inventories by MMK 38 billion. It is unclear why these figures are accounted for as revenues in MGE's financial forms rather than assets.¹¹⁸

Despite Myanmar's onerous tax regime on gems, revenues collected by MGE appear low compared with the assessed value of gemstone production. This may be due to several factors.

Table 17. MGE revenues, FY 2011 to 2015 (MMK billion)

Source: MOPF

	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
State production share received in foreign currency	173	116	84	81
State production share received in kyat	13	9	-	2
Gems Emporium fees	51	31	11	16
Worksite hiring charges	57	50	62	59
Jewelry tax	6	7	-	-
Other income (e.g., licenses, fines)	3	14	6	3
Net inventory gain (physical gems)	10	38	1	-
TOTAL¹¹⁹	313	265	163	160

116 Based on interviews with MGE.

117 Jewelry tax is no longer applicable.

118 Total is different from Table 14 because net inventory gain is added.

Vague tax loopholes

The 1995 version of the Myanmar Gemstone Law provides that "...when sale is effected in Myanmar currency, following the payment of royalty under sub-section (a), [companies] have the right to be exempted from payment of taxes under any other existing law in respect of the sale of the said gemstone."¹¹⁹ Although it is unclear how the clause has been applied in practice, the vague language of the law opens the door for broad exemption of gemstone companies from their tax obligations.

Although modifications to the Myanmar Gemstone Law closed this loophole in 2016, newly proposed revisions would allow companies to "apply for exemption" from special commodity tax determined under the Union Tax Law.¹²⁰

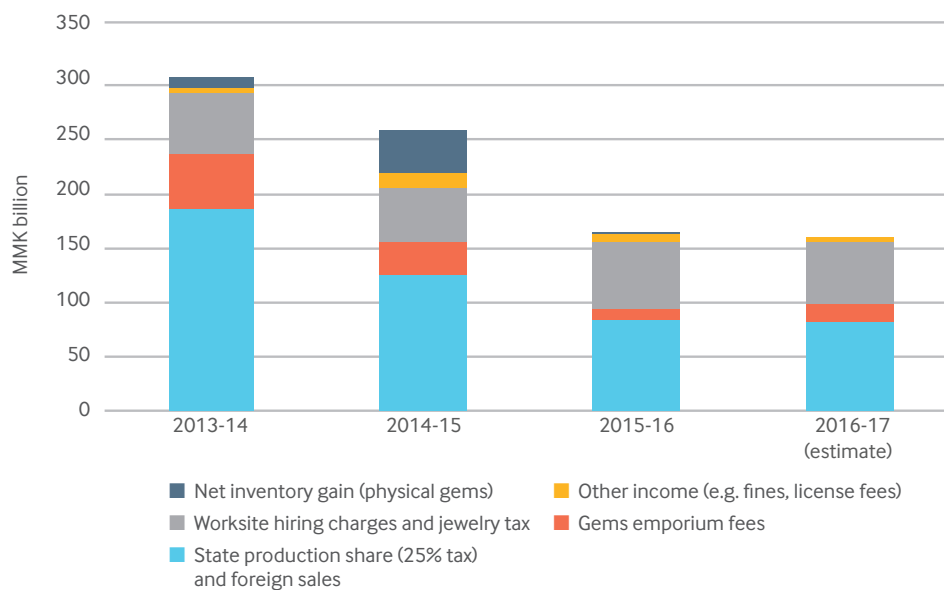
Underreporting of production

MGE lacks adequate oversight of privately-held gemstone blocs and sales occurring outside the official emporium. While unofficial sources estimate that the emporiums represent less (and perhaps much less) than a quarter of total transactions in the jade and gemstone sector by value, they accounted for 64 percent of MGE's revenues on average between 2013/14 and 2015/16.

Undervaluation of gemstones

Weaknesses in Myanmar's valuation process have led to chronic and severe undervaluation of the country's jade and gemstone production. From 2011 to 2016, for example, the government received royalties of MMK 337 to MMK 450 per

Figure 17. MGE revenues by year (MMK billion)



119 Myanmar Gemstone Law (1995).

120 Amendment to the Myanmar Gemstone Law (2016).

kilogram of jade produced. This implies an assessed value of between USD 1 and USD 2 per kilogram of jade declared, though even the lowest-grade rough jades have been known to sell for between USD 3 and USD 10 per kilogram in recent years.¹²¹

Expenditures

As Table 18 shows, MGE's costs are decreasing. MGE has no major production costs. Up until 2016/17, security costs represented the largest single expenditure item. Previously, MGE paid for two military units based near the gems mine sites. The military now covers these costs.

The only increasing expenditure item is staff and overhead. About half of this amount goes to salaries, with the other half going to overhead and benefits such as pensions, electricity for offices, and petrol for office vehicles. The steady increase in staff spending helps MGE grow capacity at a sustainable rate over time, provided they are adequately trained and used to improve MGE's monitoring of the gems sector.

MGE has a miniscule capital budget, which it receives from the Union budget via MONREC. The enterprise was allocated MMK 31 million in 2015/16 and MMK 52 million in 2016/17, mainly for machinery and office supplies.

Table 18. MGE expenditures, FY 2011 to 2015 (MMK billion)

Source: MOPF

	2013/2014	2014/2015	2015/2016	2016/2017 (estimate)
Production costs (approx. 90% security expenses)	2.2	2.6	3.3	0.1
Purchase of gems	0.3	0.3	0.5	0.1
Staff and overhead	1.7	2.0	2.3	2.6
Costs associated with purchase and storage of physical inventory	2.5	2.9	3.7	0.7
Net inventory loss (physical gems)	-	-	-	0.3
Debt payments (principal and interest) and write-offs	-	-	-	-
TOTAL	6.7	7.8	9.8	3.8

121 Shortell, *Governing the Gemstone Sector*.

Figure 18. MGE expenditures, FY 2011 to 2015 (MMK billion)

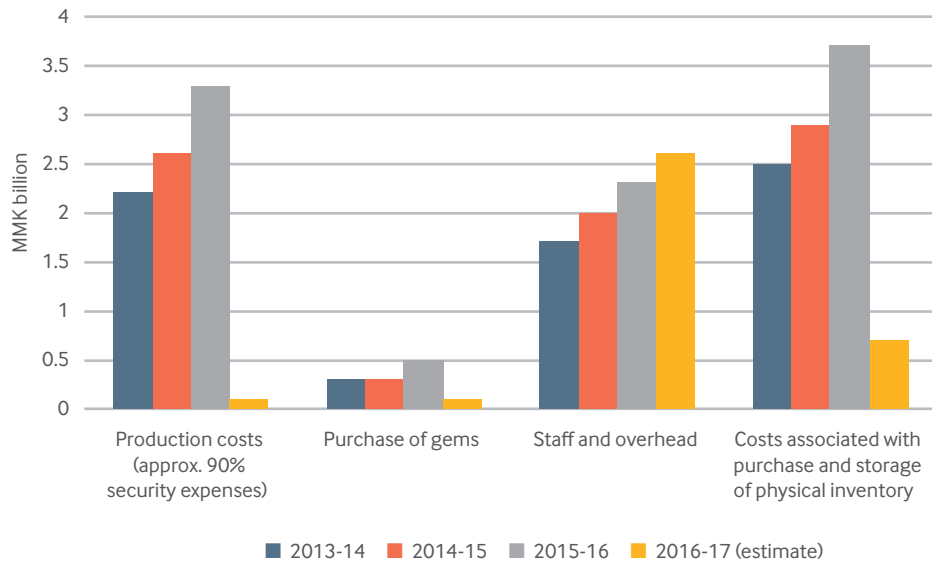
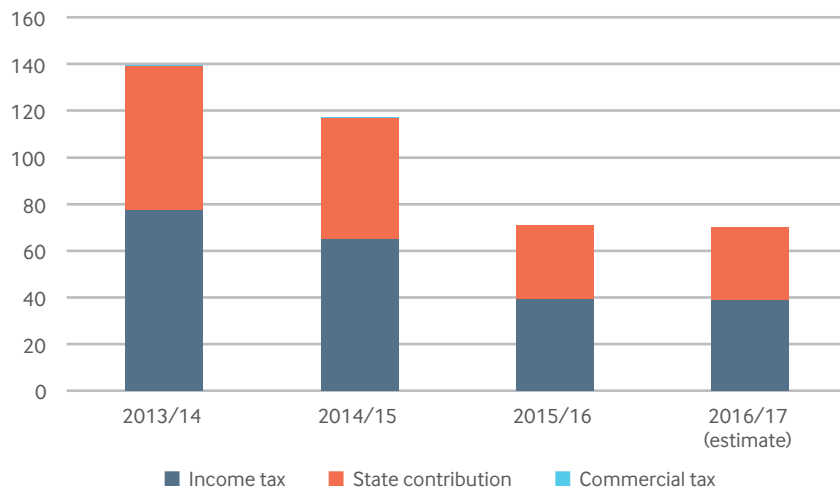


Figure 19. MGE transfers to Union Fund Account, 2013/2014 to 2016/2017 (MMK billions)

Source: MOPF



Taxes

As with other SEEs, MGE pays 25 percent of its net profit (calculated as revenues minus costs minus commercial tax) in income tax annually to MOPF's Internal Revenue Department. It pays another 20 percent to MOPF's Treasury Department as "state contribution" or dividend. MGE also paid miniscule amounts of commercial until 2014/15. MGE's tax transfers are provided in Figure 19.

Liabilities and assets, including Other Accounts

MGE has virtually no debts to speak of; however, it has two sets of liabilities. First is MMK 144 billion in what is called a "reserve fund" liability. This represents seed capital provided to MGE years ago and represents a historical liability. Second is MMK 161 billion owed to "other creditors", which refers to deposits/securities of private companies held in trust by MGE in case that a gems company breaks its contract or incurs unexpected costs that must be borne by the state. Fifty percent of these deposits are remitted to gems companies after the first year, another 25 percent are remitted after the third year, and the rest are remitted at the end of the life of the mine. To date, MGE has never withheld these deposits from companies for having broken the terms of a contract.¹²²

MGE has physical assets, including buildings and office equipment, worth approximately MMK 1.5 billion today after depreciation. It is also owed

MMK 132 billion by "other organizations"; it is unclear what this figure refers to.

Finally, as of January 2017, MGE had MMK 688 billion saved in its Other Accounts, which were opened in 2012. At current spending levels, it would take MGE 172 years to use up all its cash, even if it collected not a single additional kyat in revenue. When tax payments are included in the calculation, MGE has six years of precautionary savings.

Auditing

MGE undergoes an audit by the Office of the Auditor General on an annual basis. The primary purpose of the audit appears to be to determine whether the correct percentage of MGE's reported income is paid to the state in terms of income tax, commercial tax and state contribution. The OAG is also responsible for appointing a third party auditor to review the finances of MGE's joint venture partners.¹²³

Oversight of MGE's activities and finances remains weak under the current auditing system. State and third party auditors do not receive records of individual transactions necessary to identify financial irregularities. Although OAG receives the results of joint venture partner audits, these reports are summary in nature and the government lacks the expertise and resources to review them. No operational audits are conducted, and the limited financial audits performed are not made publicly available.¹²⁴

122 Based on interviews with MGE.

123 Based on interviews with OAG.

124 *Ibid.*

Benchmarking SEE governance rules and practices against global experiences

Myanmar's SEEs can be benchmarked against international standards or other countries' state-owned company performance. In this section we will benchmark against both. Benchmarks will be used to evaluate MOGE and MGE's financial health and performance, Myanmar's revenue retention formula, and Myanmar's transparency and oversight provisions for SEEs. State-owned companies with similar mandates, in the same sector or from the same region, in this case Asia, will be compared.

MOGE AND MGE'S FINANCIAL HEALTH

Based on international experience, the IMF has identified several indicators to measure state-owned company financial performance, include profit margin (earnings/revenues) and return on assets (earnings/assets). Debt sustainability can

be measured by debt ratio (total debt/total assets) or interest coverage ratio (earnings before interest and taxes/gross interest expenses). Financial risk can be measured by indicators, such as liquidity (asset/liabilities) or solvency (liabilities/revenue).¹²⁵ The indicators we were able to calculate given our data constraints are provided in Table 19.

While we would have wanted to benchmark other measures of MOGE and MGE's financial performance and risk, such as return on equity, we are unable to due to lack of information. Specifically, we lack data on the value of Myanmar's SEEs' full pension and other liabilities. It is also difficult to benchmark costs due to the different contexts and mandates of state-owned companies around the world.

Table 19. Benchmarked financial performance and risk indicators (2015/2016 or most recent)

Sources: MOPF, financial reports of companies and own calculations

	Profit margin	Return on assets	Debt ratio
MOGE	28%	9%	29%
MGE	52%	10%	0%
EcoPetrol (Colombia)	-5%	-2%	43%
Pertamina (Indonesia)	7%	7%	24%
PetroVietnam	24%	26%	28%
PTT Thailand	8%	6%	24%
Petronas (Malaysia)	24%	6%	11%

125 IMF. *How to Improve the Financial Oversight of Public Corporations* (Washington, DC: IMF, 2016).

As mentioned earlier, MOGE and MGE do not pose any risk to Myanmar taxpayers. Just the opposite, cash holdings far exceed any reasonable requirements for either to carry out their mandates. While MOGE has at least seven years' worth of precautionary savings at current spending levels, MGE has 172 years' worth. In comparison, the IMF encourages central banks to hold at least three months' worth of reserves and private sector businesses in advanced economies hold on average 10 percent of their wealth in precautionary savings. And as Figure 14 shows, at almost 90 percent, MOGE's cash-on-hand as a share of total assets dwarfs every other national oil company in the world. In brief, these SEEs are holding too much cash given their needs, justifying a reallocation of some of these savings to more productive uses.

MOGE and MGE's profit margins, which are greater than 25 percent, indicate a high degree of profitability. As mentioned earlier, this is in large part due to the way SEE profits are defined in Myanmar, combining not just returns on equity investments but also production shares, rents, transit income and service fees in revenue calculations. These latter revenue streams boost SEE profitability without requiring additional effort from SEEs themselves. Large passive revenues mask MOGE's low and sometimes negative profit margins on its onshore activities, which represent the majority of its active operations.

Equally importantly, only two out of 11 Asian countries surveyed by the OECD and the Korean Institute of Public Finance (KIPF) did not have a performance evaluation system for its state-owned companies in 2016. Entities in Bhutan, China, India, Indonesia, Kazakhstan, Korea,

the Philippines, Singapore and Vietnam each measure performance systematically, either annually or quarterly. Each of these countries also publish annual reports on state-owned company performance. While in some, measurement is carried out by state-owned holding companies (e.g., Bhutan, Kazakhstan, Singapore), in others it is carried out by the Ministry of Finance (e.g., Korea, Vietnam) or another ministry or commission (e.g., China, India, Indonesia, the Philippines). Only Myanmar and Pakistan do not systematically review state-owned company performance.¹²⁶

MYANMAR'S SEE REVENUE RETENTION RULES

Myanmar's profit-making SEEs are permitted to retain 55 percent of their profits. However, this simple formula does not accurately describe the share of net revenue retained by SEEs, nor does this formula easily allow us to compare Myanmar's system to other countries for several reasons. First, profit is calculated somewhat differently in Myanmar than in most countries and is not consistently calculated across SEEs. As explained, Myanmar's SEEs calculate profit as revenues minus costs minus commercial tax. In most countries, profit is simply calculated as revenues minus costs. However, the most significant issue is that those SEEs that pay a lot of commercial tax—for instance because they buy significant inputs such as machinery for production—are treated differently for revenue retention purposes than those that are essentially tax collecting and regulatory agencies, such as MGE.

Second, almost all SEEs receive capital budgets from the Union budget via their line ministries,

126 OECD and KIPF. *State-Owned Enterprises in Asia: National Practices for Performance Evaluation and Management* (2016).



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

including large profit-making SEEs like MOGE. The scale of these capital budget allocations varies substantially from SEE to SEE, but run into the many hundreds of billions of kyat annually for all SEEs combined. Hence a SEE's self-declared costs usually do not accurately represent its actual costs.

Third, while some SEEs' full recurrent costs are covered by their own funds/Other Accounts, others are subsidized by the Union budget, depending on profitability and size of cash holdings. Whether or not a certain cost is covered by the Union budget changes year-to-year and varies across SEEs.

These three facts together mean that 55 percent of profits for one SEE can be calculated quite differently than 55 percent of profits for another SEE; the revenue retention rule is not applied uniformly across all SEEs even today.

Notwithstanding these caveats, we can compare MOGE's revenue retention against other state-owned resource companies. Figure 20 shows the transfers to government per barrel or barrel equivalent of natural gas produced in dollars.¹²⁷ Of course, this chart shows gross transfers rather than net transfers, meaning it does not express how much money was allocated *to* the national oil company *from* the treasury.

Among our six comparator companies, MOGE transferred the smallest share of gross oil revenues to the central government's budget in 2014/15, when oil prices averaged USD 73 per barrel globally.¹²⁸ Whereas PEMEX transferred approximately USD 62 per barrel to the Mexican government and Petronas transferred approximately USD 29 per barrel, MOGE transferred only USD 10 per barrel.

The differences between the share of gross profits transferred to the national budget can be explained by four variables: the value of the resource being extracted; profit share collected by the state-owned company (as opposed to private partners); state-owned company costs; and revenue retained by the state-owned company. Up until the recent energy sector reforms in Mexico, PEMEX owned 100 percent of Mexico's oil and gas fields and transferred 100 percent of its revenues to the central government. It was then allocated a budget by the government to cover costs. This explains why PEMEX's transfer per barrel is so high.

The Ghanaian case is perhaps more relevant to Myanmar, because Ghana produces petroleum volumes that are closer to the level produced in Myanmar and its mandate is similar to MOGE's. Ghana National Petroleum Corporation (GNPC) owns 10 percent in the Jubilee field, Ghana's largest producing field by far. Like MOGE, GNPC is responsible for collecting/lifting the state's production share of crude oil and marketing it. In Myanmar, though, MOGE accepts its production share in cash from foreign operators. Unlike in Myanmar, the revenue authority is responsible for collecting returns on its equity, royalties, surface fees and additional oil entitlements, though in practice returns on equity and royalties are often collected in the form of crude oil by GNPC and marketed by the company. Like in Myanmar, corporate income tax is collected by the revenue authority. Of its revenues, GNPC is allowed to retain up to 55 percent of the value of carried and participating interest in Ghana's oil fields by the government to cover its costs and for reinvestment—essentially 55 percent of returns on equity and production share. Despite

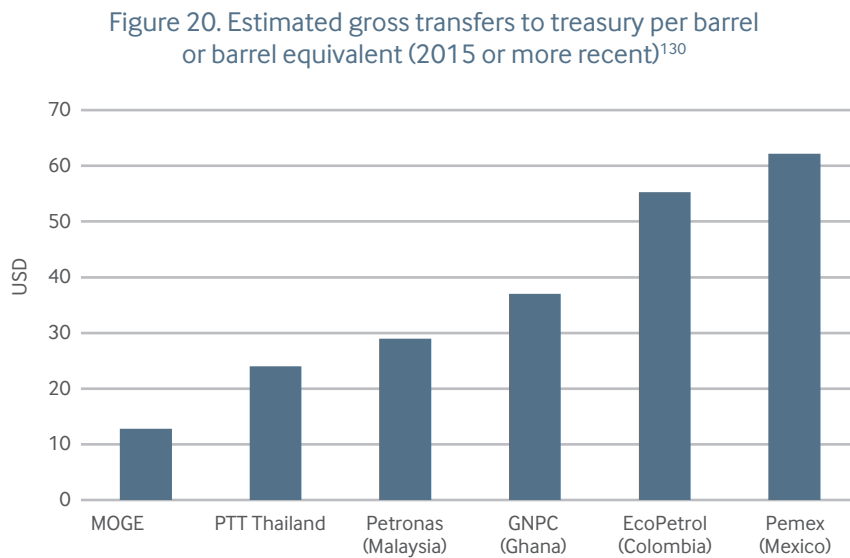
127 The comparators are drawn from a soon-to-be-released national oil company financial dataset collated by NRGi.

128 Average annual price from 2014 and 2015, using selected OPEC crude oil prices (Source: OECD).

employing revenue collection rules similar to Myanmar's, Ghana's national oil company's transfer share is nearly three times higher than MOGE's.

In short, MOGE's transfer share cannot be as high as PEMEX's since MOGE only owns 15 to 20 percent of offshore gas production compared to PEMEX's 100 percent. However, due to high costs

of production—especially for onshore production, which is 100 percent MOGE owned—and high revenue retention, MOGE's transfer share is among the lowest of the companies NRGi has studied. Aligning MOGE with international standards in terms of revenue retention and cost controls would give the Union budget a significant boost, providing fiscal space for increased public spending.



129 MOGE figure based on commercial tax, corporate income and state contribution as a percentage of barrels of oil and barrel equivalents of gas. Barrel equivalents of gas calculated as 43 percent of offshore production. Estimate is based on EITI data on share of profit oil to MOGE plus returns on equity.

MYANMAR'S TRANSPARENCY AND OVERSIGHT PROVISIONS

As mentioned in Section 2, transparency and independent oversight are fundamental to good governance of state-owned resource companies. Transparency requires not just public availability of information, but also clear roles and responsibilities, open decision-making processes and assurances of data quality.¹³⁰ Transparency can help build trust between a government and the public, as well as lead to more consistent policy-making by state-owned companies themselves. Full transparency also allows oversight bodies—such as the Office of the Auditor General, MOPF, the executive and parliament—to do their jobs. Oversight bodies, in turn, can encourage consistency with institutional objectives and compliance with rules by raising concerns or testing the management of public institutions. In short, they can help state-owned companies address their own challenges.

For these reasons, the OECD, the IMF, Chatham House and NRGi have each included transparency provisions in their standards of good state-owned

company governance. For instance, the OECD's *Guidelines on Corporate Governance of State-Owned Enterprises* calls for public disclosure of “a clear statement to the public of enterprise objectives and their fulfillment; enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives; and the governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation process.” The government as a whole rather than the state-owned companies should publish annual reports online. The guidelines also call on independent external audit rather than reliance purely on state audit procedures.

While MOGE and MGE have made their objectives public in broad terms, and some information on SEE finances is made public through the Union's budget process (for example, SEE revenues and expenditures), the other OECD standards have not been met. Box 5 provides one example from Norway of a strong degree of transparency by a state-owned oil company.

130 Perrine Toledano and Andrew Bauer. “Natural resource fund transparency,” in *Managing the Public Trust: How to make natural resource funds work for citizens*, ed. Andrew Bauer (NRGI and Columbia University, 2014).

Box 5. Statoil (Norway) transparency

Statoil provides some of the most complete set of financial and associated non-financial disclosures of any national oil company. The objectives of Statoil—which include meeting safety targets, production targets, lowering unit costs, improving cost efficiency relative to peers and improving shareholder returns—are clearly defined and the disclosures are directly related to the users' ability to assess performance against those objectives.

Statoil's website and reports provide comprehensive overviews of the company's structure, past activities, financials and planned activities. Statoil also provides significant supplementary information, beyond exchange-required disclosures, that provide greater insight into the company and allow for significant oversight of activities. Details include field-level equity share, operator and production quantities as well as average sales price by country. Most questions that a user would have about the company's performance are answered in the annual report or in the supplementary information.

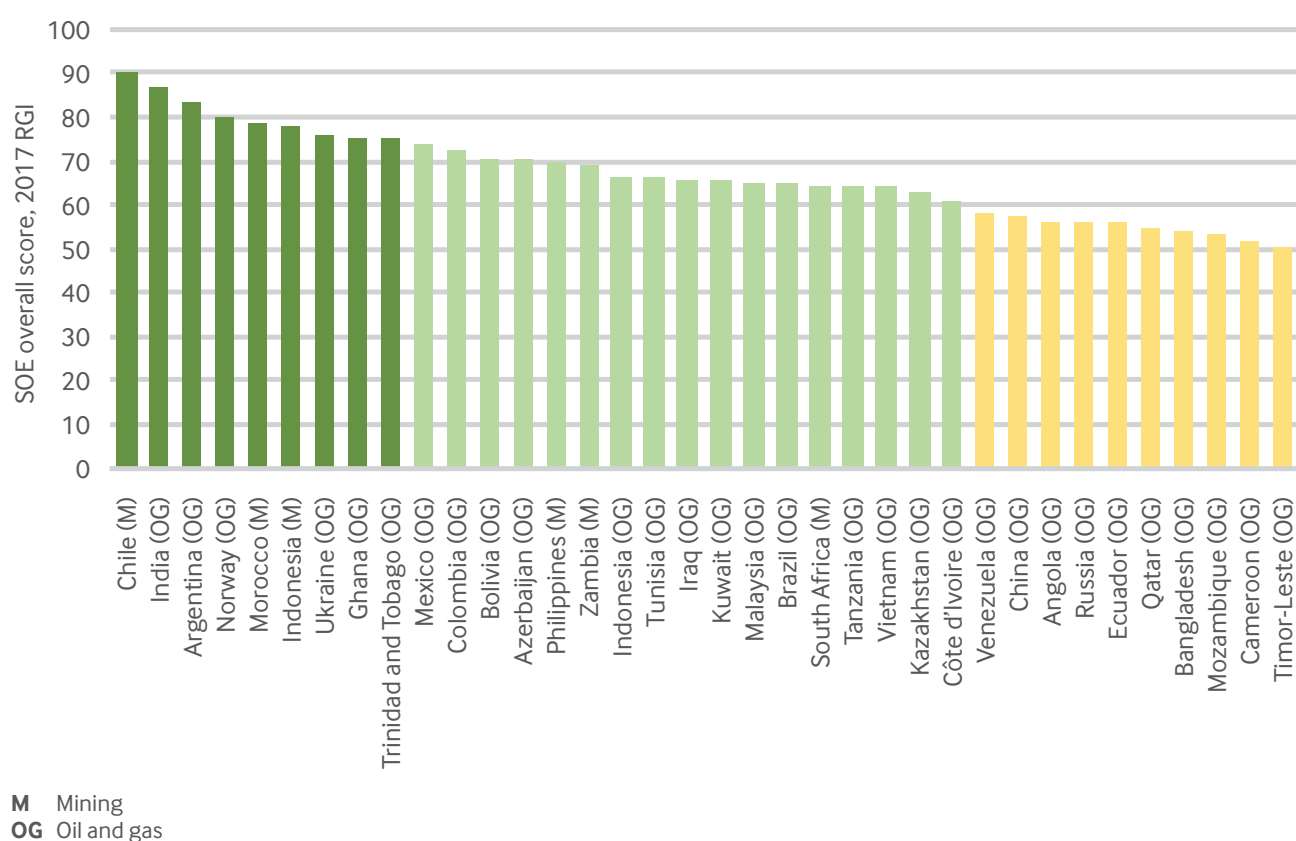
The financials are presented in accordance with International Financial Reporting Standards (IFRS) as required by the European Union. The 2015 Annual Report includes an independent auditor's report with an unqualified opinion on the financial statements of Statoil ASA and its subsidiaries as well as an opinion that Statoil ASA maintained effective control over financial reporting.¹³²

The financial statements have been disclosed under the strictest and most complete financial reporting standards and reviewed based on some of the highest audit standards in the world. The methods for information collection to be able to consistently present this level and quality of data suggest that the same quality of information is provided to different users as necessary to allow for informed decision making at any level.

Statoil provides a useful example of the highest standard of external financial disclosures. This level of disclosure, however, comes with significant expense and capacity to be able to collect and aggregate this level of data, significant political will to be transparent with this level of reporting, and a structure and policy mandate for disclosure due to the laws, regulations and consequence of publicly traded shares.

131 Online: <https://www.statoil.com/content/dam/statoil/documents/annual-reports/2015/statoil-2015-annual-report-on-form-20-F.pdf>.

Figure 21. Ranking of all state-owned natural resource companies according to 2017 Resource Governance Index score

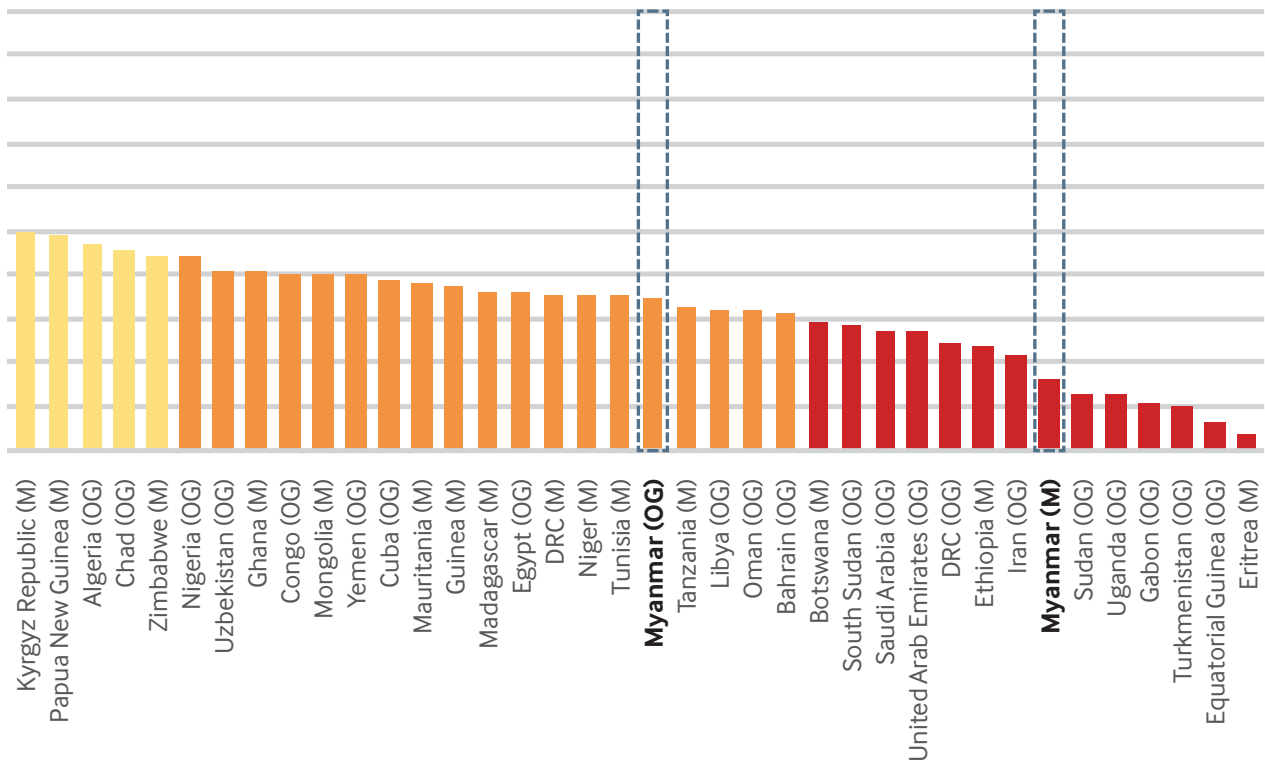


NRGI's 2017 Resource Governance Index (RGI) compares governance across 74 state-owned oil, gas or mining companies. The index looks at rules covering transfers to the treasury, corporate governance, and reporting on finances, production volumes, commodities trading, joint venture partners and subsidiaries. As Figure 21 shows,

MOGE and MGE rank 56th and 68th respectively.¹³²

Breaking down the scores, we see that MOGE ranks 36/52 among all state-owned oil and gas companies in terms of transparency and 42/52 in terms of accountability (Figure 22). MGE, on the other hand, ranks 21/22 among mining state-

132 NRGI. *2017 Resource Governance Index* (2017). Online: <http://www.resourcegovernanceindex.org>.



owned companies in terms of transparency and last globally in terms of accountability (Figure 23). The main differences between MOGE and MGE’s scores lie in the slightly higher degrees of reporting on finances, operations, production and joint ventures partners by MOGE.

Whereas MGE’s transparency and accountability scores are among the weakest globally, MOGE also has much room for improvement. Most national oil companies publish more comprehensive annual reports and data than MOGE, including in China, India, Indonesia, Malaysia, Timor-Leste and Vietnam.

Figure 22. RGI transparency and accountability scores for national oil companies

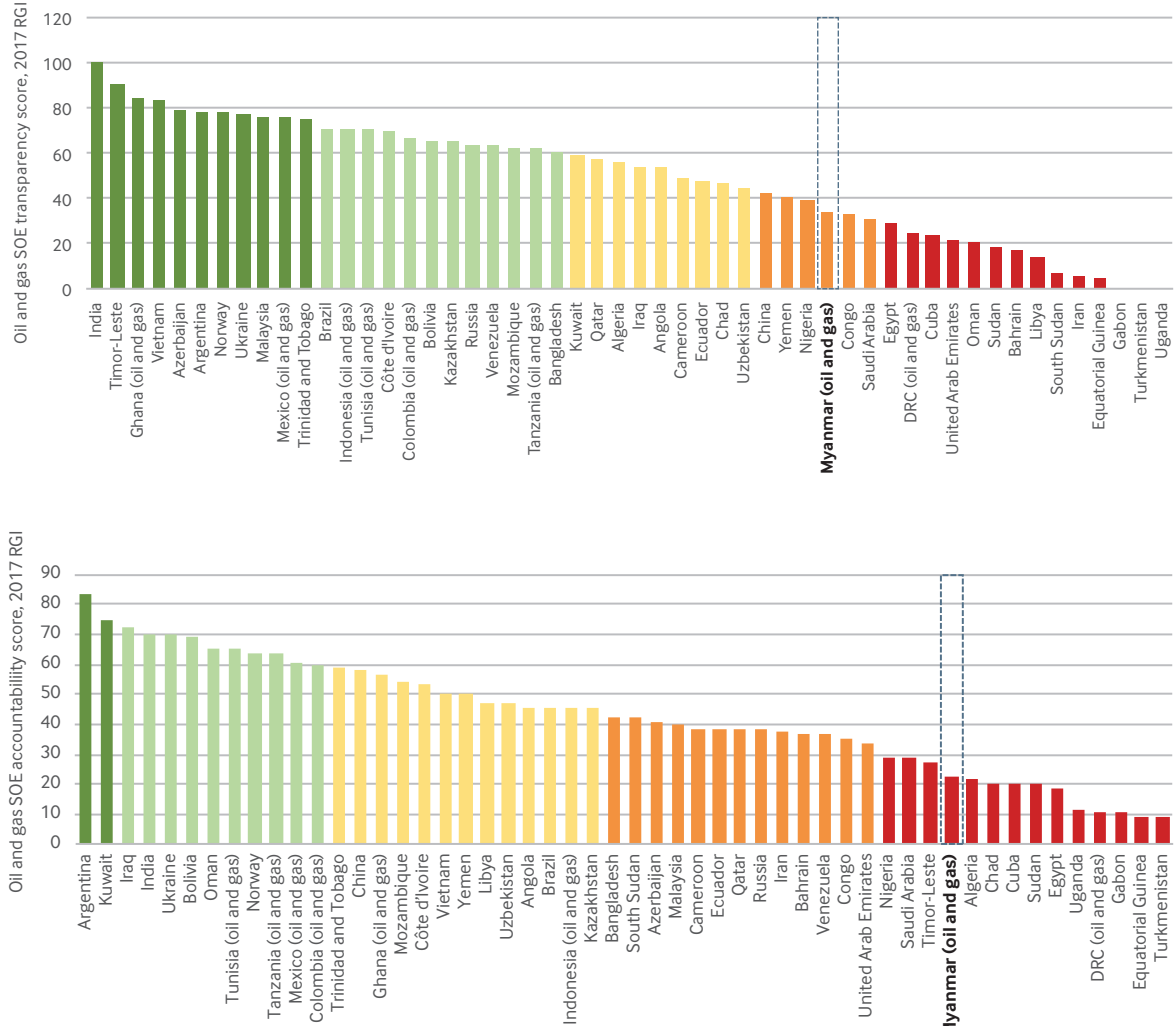
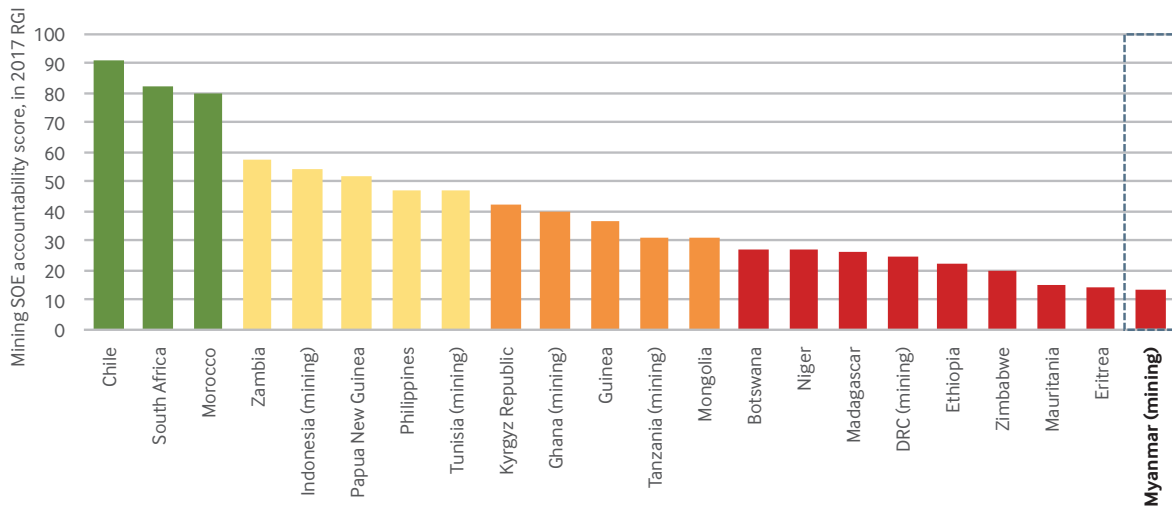
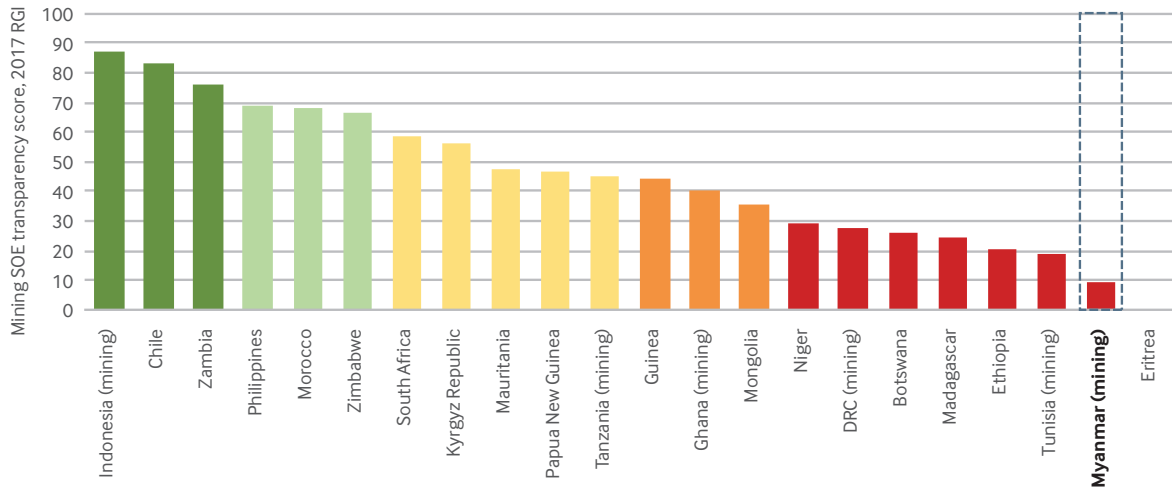


Figure 23. RGI transparency and accountability scores for national mining companies



Policy options

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.

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		■	■

R Recommendation (see next section)

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 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.¹³³ 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.

¹³³ Calculation is based on granting SEEs a full year of precautionary savings given average costs and tax payments over the last four years.

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.

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.¹³⁴ The USD 55 billion Alaska Permanent Fund, also financed by natural resource revenues, provides an annual cash dividend to every Alaskan resident.¹³⁵ Interest earned from the USD 7 billion Permanent Wyoming Mineral Trust Fund finances the annual budget, rather than being earmarked.¹³⁶

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, 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.¹³⁷

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.

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

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

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

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

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.¹³⁸ 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.

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.

138 *Ibid.*

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 24.) 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.¹³⁹ 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

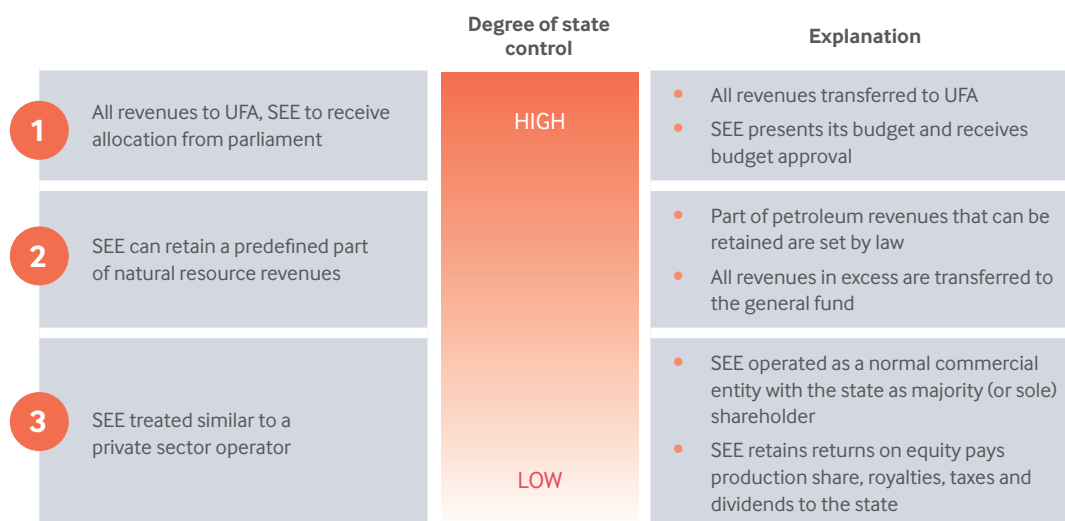
139 Patrick R.P. Heller et al. *Reforming National Oil Companies: Nine Recommendations* (Natural Resource Governance Institute, 2014). Online: <https://resourcegovernance.org/analysis-tools/publications/reforming-national-oil-companies-nine-recommendations>.

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.¹⁴⁰ 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.¹⁴¹

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 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.

Figure 24. General revenue retention options for state-owned companies



140 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).

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

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.¹⁴² 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 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

142 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.

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.)

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
- 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

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

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.¹⁴³

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.¹⁴⁴

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.

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.¹⁴⁵

The Philippines' Governance Commission for

143 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).

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

145 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>.

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.¹⁴⁶

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. 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.¹⁴⁷

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 ministers were appointed in five cases.¹⁴⁸ In most countries, state-owned company boards are also evaluated, either by the state-owned holding company, finance ministry or independent external evaluator.¹⁴⁹

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:

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

147 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).

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

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

- 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

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.¹⁵⁰ In both these cases, company performance is benchmarked against other countries and past experience. Management is expected to improve performance over the medium term.

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:¹⁵¹

- 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
- 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.

150 PTT Thailand and PetroVietnam annual reports.

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

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.¹⁵²

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.

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

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Appendix

APPENDIX A. DATA SOURCES FOR THIS REPORT

Data and financial forms

- Myanmar Gems Enterprise
 - Full financial reports (Actual 2012–2015; Estimate 2015/2016; Proposal 2016/2017) – SEE division
 - MGE pages – MGE – some contracts and production data + valuation information
 - MGE clarification of provisional receipt and expenditure account for first six months of 2015/2016 – SEE division
 - Narrative description
 - Sheets 1–4
 - MGE capital budget
- Myanmar Oil and Gas Enterprise
 - Full financial reports (Actual 2013–15; Estimate 2015/2016; Proposal 2016/2017) – SEE division
 - MOGE provisional receipt and expenditure account for 2015/2016 – SEE division
 - Narrative description
 - Sheets 1–4
 - MOGE provisional receipt and expenditure account for second 6 months of 2015/2016 – SEE division
 - Narrative description
 - Sheets 1–4
 - MOGE full financial forms (internal)
- Myanmar Timber Enterprise
 - Full financial reports (Actual 2013–16; Estimate 2016–18) – SEE division
- MOEE financial forms (M&D account) (2013/2014–2017/2018) – Budget Department
- MONREC financial forms (M&D account) (2013/2014–2017/2018) – Budget Department
- MEB financial forms (2013/2014–2017/2018) – Budget Department
- Five-year balance sheets (2010/2011–2016/2017) for MOGE and MGE – SEE division
- SEE receipts and expenditures by line ministry (2012/2013–2016/2017) – Budget Department
- MOGE and MGE current receipts and expenditures (up to 2016/2017 approved) – MOPF
- Balance of Other Accounts – 31 January 2017 and prior – Treasury Department
- SEE implementation report (for meeting targets) (MOGE 2013–2016; MGE 2010–2016; MTE 2010–2016) – Planning Department
- SEE production data (2016/2017 provisional) for MOEE, MGE and MTE – Planning Department
- SEE production report (Q2 2016/2017 provisional; target and production by field for MOGE) for MOGE, MGE and MTE – Planning Department

- Income and commercial tax by SEE (2013/2014–2015/2016) – Internal Revenue Department
- SEE commercial budget 2017/2018
- OA balance for each oil field as of 31 December 2016 – MOGE
- Surplus/deficit of current expenditure from OA A/C – MOGE
- Schedule of investment in Shwe Project, Zawtika Project, Southeast Asia Crude Oil Pipeline project (SEAOP), Southeast Asia Gas Pipeline project (SEAGP) A/C balance as of 31 March 2016 – MOGE
- Daily production for first week of March 2017 for all offshore projects – MOGE

Directives and internal government documents

- Central bank reporting directives – Central Bank of Myanmar
- Definitions of SEE forms – SEE division
- Generic SEE Forms 1–18 – SEE division
- Seminar with NRGi on taxation in the gemstones industry – MONREC (2016)
- Letters/directives on SEE finances – Budget Department
- *Myanmar Citizens' Budget* – MOPF
- *MOEE Opportunities for Cooperation* – MOEE (January 2017)
- MGE Gems Block PowerPoint
- MGE organizational information PowerPoint
- MGE operations information document
- Directive 42/86 (SEE chapter) – MOPF

Legislation, regulation and contracts

- Union Budget Law, 2015
- Auditor General of the Union Law, 2010
- Public Debt Management Law, 2016
- State-Owned Economic Enterprise Law, 1989
- Myanmar Companies Act, 1914
- Myanmar Gemstone Law, 1995 and 2016 amendments
- Myanmar Mines Law and Rules, 1994 and 1996, and 2015 amendments
- Myanmar Investment Law 2016
- Budget Submission Law 2015
- 2016/2017 National Plan Law
- TOTAL–MOGE Contract (1992)
- MOGE onshore, offshore (deep) and offshore (shallow) model contracts (2013/2014)
- 2015/2016 Supplemental Appropriations Law

APPENDIX B. SAMPLE OF HIGH-LEVEL RISKS AND RELEVANT FINANCIAL STATEMENT INFORMATION

Risk	Reported line items	Activity	Purpose
Inefficient production	<ol style="list-style-type: none"> 1. Production volume 2. Resource base 	Divide total production by resource base and compare to prior periods from the same block and to other similar blocks in Myanmar and around the world.	To identify if production is higher or lower than expected. If higher than expected, identify reason and consider applying lessons to other blocks. If lower than expected, investigate further. Technical capacity may be the challenge and a switch to stronger technical partners may be appropriate.
Loss of physical oil or minerals	<ol style="list-style-type: none"> 1. Production volume 2. Volume used in production 3. Change in storage 4. Sales volume 	<p>Calculate:</p> <p>Production volume – volume used in production – change in storage = sales volume</p> <p>Calculate the percentage of each line item over the production volume and compare to prior periods from the same block and to other similar blocks in Myanmar.</p>	To identify instances of theft. This calculation can be verified by requesting reports from the block operators, by confirming average storage volumes by physical inventory procedures (checking periodically) and by comparing to sales numbers and reports. These controls may identify red flags that can be further controlled.
Inefficient sales revenue	<ol style="list-style-type: none"> 1. International sales volume 2. Average int'l sales price 3. Domestic sales volume 4. Average domestic sales price 5. Total sales 	<p>Calculate:</p> <p>[(International sales volume) x (average price)] + [(domestic sales volume x average domestic price)] = total sales</p> <p>Compare prices to international prices (discount to Brent, established domestic price, etc.).</p> <p>Compare to expectations, prior periods and similar blocks.</p>	<p>To identify if sales volumes are being sold for the appropriate and optimized price.</p> <p>These procedures can identify noncompliance and suboptimal sales pricing, and provide greater confidence for all payments calculated based on sales volume or total sales.</p>
Inefficient transfer of revenues to the treasury	<ol style="list-style-type: none"> 1. Total sales 2. Total recoverable expenses 3. Profit 4. Payments to government 5. All other relevant data 	<p>Calculate payments to government per the contract.</p> <p>Compare recoverable expenses to expectations.</p>	<p>To identify areas for further investigation with regard to recoverable expenses and profit calculations.</p> <p>Recoverable expenses should be pre-approved through the budget process, reviewed upon submission and audited regularly. Cost recovery represents one of the highest risk areas for countries that enter into production sharing contracts (PSCs).</p>

Acronyms

CFPD	cubic feet per day	MONREC	Ministry of Natural Resources and Environmental Conservation
CIT	Corporate Income Tax	MOPF	Ministry of Planning and Finance
CNG	compressed natural gas	MPE	Myanma Petrochemical Enterprise
CSO	Central Statistical Office	MPPE	Myanma Petroleum Products Enterprise
CSR	corporate social responsibility	MPT	Myanma Post and Telecommunications
DC	Development Committee	MTE	Myanmar Timber Enterprise
DICA	Directorate of Investment and Company Administration	NECC	National Economic Coordination Committee
EBITDA	earnings before interest, taxes, depreciation and amortization	NIOC	National Iranian Oil Company
GNPC	Ghana National Petroleum Corporation	NORAD	Norwegian Agency for Development Cooperation
IFRS	International Financial Reporting Standards	NRGI	Natural Resource Governance Institute
IMF	International Monetary Fund	OA	Other Account
IPRC	Improved Petroleum Recovery Contract	OAG	Office of the Auditor General
IRD	Internal Revenue Department	OECD	Organisation for Economic Co-operation and Development
JICA	Japan International Cooperation Agency	PAPRD	Project Appraisal Progress Report Department
JPAC	Joint Public Accounts Committee	PEMEX	Petróleos Mexicanos
LTO	Large Taxpayer Office	PSC	production sharing contract
M&D	Ministries and Departments	RI	Renaissance Institute
ME1	Mining Enterprise No. 1	SEAGP	Southeast Asia Gas Pipeline
ME2	Mining Enterprise No. 2	SEAOP	Southeast Asia Crude Oil Pipeline
MEB	Myanmar Economic Bank	SEE	state-owned economic enterprise
MEITI	Myanmar Extractive Industries Transparency Initiative	SFA	State Fund Account
MFTB	Myanmar Foreign Trade Bank	SGT	Special Goods Tax
MGE	Myanmar Gems Enterprise	SLORC	State Law and Order Restoration Council
MIC	Myanmar Investment Commission	SOHC	state-owned holding companies
MMK	Myanmar kyat	UFA	Union Fund Account
MOEE	Ministry of Energy and Electricity		
MOGE	Myanma Oil and Gas Enterprise		



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