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Can Economic Reform Open a Peaceful Path to Ending Burma's Isolation?

Summary

- After decades of domestic conflict, military rule and authoritarian governance, Burma's economy could provide a viable entry point for effective international assistance to promote peace. Doing so would require a detailed understanding of the country's complex and evolving political economy.
- The lingering income and distributional effects of the 2008 Cyclone Nargis, anticipated changes associated with the new constitution and the 2010 elections and the Obama administration's decision to devote more attention to Burma suggest that the time is ripe for the creative application of economic mechanisms to promote and sustain peace.
- Looming challenges could derail Burma's prospects for economic and political stability. These challenges include irrational macroeconomic policies, failing to ensure all citizens enjoy benefits accrued from natural resources, endemic corruption, a flourishing illicit economy, a dysfunctional financial system and critical infrastructure bottlenecks. Failure to address these problems would frustrate peacebuilding efforts.
- A conflict sensitive economic strategy for Burma would focus on effective capacity-building, sustained policy reform, progressive steps to reduce corruption, fiscal empowerment of subnational authorities and prudent natural resource management. Success in these areas requires unwavering political will for sensibly sequenced policy improvements by domestic actors and finely targeted support from Burma's international partners.

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Background

Burma's civil war—unresolved since the country gained its independence in 1948 and now the world's oldest—is rooted in ethnic differences and an abundance of natural resources.¹ Sixty years of misguided policies have moved the country from being the Southeast Asian country with the brightest economic prospects at the end of World War II to ranking among the lowest in the world by almost all socioeconomic indicators.

A period of dysfunctional parliamentary democracy was followed by General Ne Win's deliberate move to inward-looking socialism starting in 1962. In the wake of a popular uprising in 1988, Ne Win was pushed aside and a new military junta began to experiment with market reforms and a more democratic political order. After national elections in 1990 were won by the anti-military National League for Democracy led by Aung San Suu Kyi, the junta repudiated the results of the

election and has ruled with an iron fist since then. Aung San Suu Kyi, awarded the Nobel Peace Prize in 1991, has been under house arrest most of this time.

The military junta has used economic policies and instruments to entrench their authority and ensure the collecting of 'rents' from both legal and illegal activity. In the 1990s, the junta allowed insurgent groups to acquire 'franchises' in the opium trade as an exit strategy from violent conflict via a series of ceasefire agreements.² These arrangements bought a tenuous peace but facilitated the doubling of opium production between 1986 and 1996 and added production of amphetamines. De facto 'joint extraction' arrangements benefited junta leaders who had a stake in the trade. Most economic reform efforts had the effect of reinforcing the junta's control over the economy. The tax amnesty of 1990 apparently facilitated money laundering by drug lords, while the introduction of foreign exchange certificates in 1993 helped those involved in the drug trade repatriate ill-gotten, offshore wealth.³ In addition, in spite of international isolation, the start of natural gas exports in 2000 further boosted the domestic economy and strengthened the grip of the junta on both the economy and domestic politics.

Essentially, the Burmese economy has been hijacked by the junta. Military commanders underpin rampant corruption at every level and preside over institutionalized rent extraction mechanisms. Opacity has been their main cover.

Three Potential Game-Changers

The first one is Cyclone Nargis, which struck Burma in May 2008. The cyclone devastated a large portion of the country's rice-growing delta region. An estimated 85,000 lives were lost and over 50,000 are deemed missing. By destroying a significant proportion of the country's livestock and half the fishing fleet, and flooding a million acres of rice paddies, the cyclone created a humanitarian disaster in rural Burma, which was already suffering from the junta's misguided policies. The junta's inability to manage the crisis forced it reluctantly to accept an unprecedented regional relief and recovery effort led by the Association of Southeast Nations (ASEAN). Serious questions were raised about the ability of the junta to provide for the people of Burma. The humanitarian intervention opened the door for some regional involvement in the country's economic and social affairs – a hitherto unprecedented development. This paved the way for the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) to organize an open forum on the country's economic prospects in Naypyidaw, the country's new capital, in December 2009. This forum has been interpreted by some Burma watchers as a sign of interest in further openness by the junta.

The second potential game-changer is the elections planned for 2010. In a carefully managed referendum in 2008, a new constitution was adopted that affirms the dominant role of the military but also establishes the framework for a multiparty political system with checks and balances, and respect for most basic human rights. In mid-March 2010, the junta issued five electoral laws that will govern the national and regional elections.

The civilianized government expected to emerge from the elections will be under great pressure from both internal and external sources to implement policy changes required to bring the country out of the economic cellar and closer to the norms of its ASEAN partners. Even though most observers do not expect the elections to be anywhere near perfect, the new constitution and 2010 elections could represent the first tentative steps towards a dismantling of Burma's oppressive political economy.

The third potential game-changer is the junta's reaction to the recent change in U.S. policy. In February 2009, U.S. Secretary of State Hillary Rodham Clinton acknowledged that neither sanctions by Western countries nor constructive engagement by Burma's neighbors had changed the junta's

behavior.⁴ In September, she announced the results of a review of U.S.-Burma policy with a view towards an eventual normalization of relations if the junta takes steps to abandon its repressive policies, achieve national reconciliation and promote peace.

The new policy of “pragmatic engagement” features more engagement while maintaining economic and political sanctions. Responsible economic stewardship lies at the heart of this approach. Further elaboration of the new U.S. policy could help galvanize international support for the adoption of a much-needed and long overdue reform agenda by the next government of Burma.

Gas, Narcotics and China's Growing Presence

Natural gas piped to Thailand from the Gulf of Martaban is Burma's major export earner, accounting for \$2 billion or more annually. A larger pipeline from the Gulf of Arakan to China's Yunnan Province now under construction will significantly increase earnings. Exports of timber, jade and other precious stones are also substantial. The junta has devised ‘ingenious’ mechanisms to siphon these funds but has spent relatively little on improving the quality of life for most Burmese.⁵ Using a system of multiple exchange rates, the junta deprives the government coffers of hundreds of millions of dollars each year. Unsurprisingly, the resultant large fiscal deficits have been financed by printing money, which has led to persistently high inflation.

Agriculture accounts for almost half of Burma's gross domestic product (GDP). In spite of the high percentage of the population in agriculture, productivity is very low.⁶ Burma has the potential to be Asia's premier rice bowl once again; but only if rice production is modernized, marketing is liberalized, land tenure issues are resolved and agricultural credit constraints are eased.⁷ Lack of economic opportunity and political repression has created an exodus of more ambitious and better educated citizens, totaling an estimated 3 million over past 20 years.

Narcotics (heroin, methamphetamine) were estimated to be largest export earner in late-1990s before gas exports to Thailand kicked in. Opium production has declined substantially in recent years, but sizeable hard currency earnings from methamphetamine flow into the gray/black economy in amounts large enough to have an impact on government policies through the power of interested parties.

Another gray/black economy issue is the growing Chinese presence, with the Chinese renminbi circulating as the main currency in parts of Burma bordering on China and with more than one million illegal immigrants believed to have settled into northern regions and states in the recent years. These developments reinforce issues created by Burma's multiple currencies and could undermine macroeconomic stability.

Ten Challenges for the Post-Election Government

1. *Boost the agriculture sector.* There is no better way to increase employment and raise the standard of living. Small improvements can yield large benefits. Critical parts are restoring sustainable credit system and removing obstacles to exports (to raise farmgate prices).

2. *Socialize the benefits of extractive industries.* Lack of transparency means that Burma is earning below-market prices for its gas, timber, and other exports. The government's share of earnings is not flowing to services (including infrastructure) that make the economy broadly more productive and competitive. An excessive share is being diverted to powerful individuals and groups affiliated with the junta.

3. *Devise pro-growth fiscal decentralization.* Generous revenue sharing with regions and states can contribute importantly to national reconciliation as well as improving government services at both the central and local levels.

4. *Privatize sensibly.* Although de-monopolization could yield significant benefits by making the economy more competitive over time, the stifling political economy could undermine effectiveness in the near term by rewarding military actors. Privatization should be sensitive to the Burma's political economy.

5. *Carefully target and condition foreign aid and investment.* Without a defensive strategy for dealing with an outpouring of interest from aid donors and private investors, it will be difficult for the government to adopt coherent, mutually reinforcing policies for sustainable economic growth.

6. *Address critical infrastructure bottlenecks.* The most critical need appears to be reliable electric power in cities and towns. Next most critical could be access to the global communications network, i.e., mobile telephones and the Internet. Other needs include highways to Thailand, China, Bangladesh, and India, ports to reduce shipping costs, farm-to-market roads, and facilities that encourage tourism.

7. *Improve macroeconomic management.* Improving statistics, especially completing a credible census (the last one was in the 1930s), is a critical step in this area. It will be hard to achieve a "disciplined flourishing democracy" without a disciplined fiscal policy and a disciplined monetary policy. Strengthening the institutional capacity of the central bank is necessary to achieve the high rate of private sector savings required to boost domestic investment.

8. *Properly fund the armed forces.* Adequate funding is essential to discourage individual units from engaging in economic activities that misallocate or misuse resources. If the size of the army can be reduced as part of national reconciliation, a substantial commitment of budget resources may be required to facilitate a partial de-mobilization.

9. *Fix the financial system.* No part of the financial system is working close to international standards. The payment system is rudimentary. Commercial banking is severely repressed. Rural credit has largely collapsed. Well-managed microcredit programs are constrained by the absence of a statutory framework. An interbank market and a domestic capital market are lacking.

10. *Open gradually to trade and investment.* Pressures to open abruptly could be strong, and being too responsive to these pressures could produce a political backlash. Special efforts may be required to ensure that Chinese investments do not trigger social unrest.

Recommendations for Engagement

Engagement by the international community with the new Burmese government could contribute to national reconciliation and economic progress by taking into account the following recommendations:

- **Go slow.** Avoid overwhelming the new government in its first weeks and months with visitors seeking special deals and offering conflicting advice.
- **Focus on capacity-building.** The policymaking and policy implementation capacity of the central government is rudimentary. Vast amounts of money will be wasted, and troublesome social problems will be created if foreign aid and investment leads capacity-building instead of following it.
- **Follow regional institutions.** Let ASEAN, ESCAP and the Asian Development Bank lead the capacity-building effort, drawing more on Asian talent and models than on Western ones. This approach probably offers the best hope for defusing the nationalist and xenophobic

ABOUT THIS BRIEF

This USIPeace Brief reflects discussions at the full-day workshop captioned "Burma's Economy on the Eve of Elections," jointly organized by USIP's Center for Sustainable Economies and the U.S.-ASEAN Business Council on March 4, 2010. Details of this event are available on the USIP Web site; conclusions and recommendations will be published as a USIP Special Report in April 2010. This Peace Brief was written by Lex Rieffel, a non-resident senior fellow at the Brookings Institution, and Raymond Gilpin, associate vice president for USIP's Sustainable Economies Center. The authors' views do not necessarily represent the positions of the organizations with which they are affiliated.

sentiments that are deeply rooted among the military officers who will continue to govern the country in the period ahead.

- **Understand the political economy.** Post-conflict reconstruction has floundered in other parts of the world because aid agencies and other external players seeking to help have ignored or discounted the power of individuals and groups with a vested interest in the status quo. It may be possible, however, to work with these individuals and groups to advance broad social objectives and enlarge the space for new high-value entrepreneurial activity.
- **Encourage wise management of natural resources.** Burma's natural resources, like those in other poorly governed nations, are being over-exploited. The new government is likely to face intense pressure to produce more natural gas, for example. A short-term moratorium on new investment in the gas sector would give the new government time to revise relevant regulations, strengthen key institutions and maximize resource flows to government coffers. A strong case can be made for a similar moratorium on hydropower projects.

Endnotes

1. In this report, Burma/Myanmar will be referred to as Burma.
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