

Chinese Investment in Myanmar: What Lies Ahead?

By Yun Sun

This issue brief examines reasons for the sharp drop in Chinese investment in Myanmar since 2011, the impact of the reduced investment, and the prospects for future Chinese investment in the nation formerly known as Burma.

KEY FINDINGS:

1 After a reformist government replaced a military junta in Myanmar in 2011, Chinese investment in the nation plummeted – approximately \$12 billion from 2008 to 2011 to just \$407 million in the 2012/2013 fiscal year.

2 The three largest Chinese investments in Myanmar – the Myitsone Dam, the Letpadaung Copper Mine and the Sino-Myanmar oil and gas pipelines – have sparked local opposition and criticism in Myanmar to varying degrees, creating problems and uncertainties for Chinese investors.

3 China perceives that Myanmar is now a more unfriendly and risky place to invest and is displeased that the Myanmar government is not doing more to protect Chinese interest in the country.

4 In a move to gain greater acceptance of its investments in Myanmar, China is improving its profit-sharing, environmental and corporate social responsibility programs in the nation.

5 China has learned important lessons about investing in other countries from the problems it has encountered in Myanmar.

6 Reduced Chinese investment in Myanmar could hurt Myanmar's economy in unexpected ways. Greater foreign investment is needed in Myanmar, particularly in the nation's underdeveloped and inadequate infrastructure that is acting as an obstacle to industrialization.

7 Chinese investors and the government of Myanmar should work together to reduce distrust and hostility on both sides and increase responsible and mutually beneficial investment in Myanmar to benefit both nations.

This is the first of a series of four issue briefs on the changes and challenges that Myanmar faces in its domestic and foreign policies since the beginning of democratization in the nation in 2011. These briefs will explore how external factors and forces influence and shape various aspects of Myanmar's internal development, including economic growth, ethnic conflicts and national reconciliation.

This first brief focuses on the status and future of troubled Chinese investment projects in the country and their potential implications for Sino-Myanmar relations. Future briefs will explore the development of the Myanmar government's peace negotiation with border ethnic groups in northern Myanmar as well as the external factors in the process, US-China dynamics inside the country, and the roles and policies of other regional players.

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Overview

Chinese investment in Myanmar has fallen dramatically since Myanmar's current reformist government took office in March 2011, replacing a military government. From 2008 to 2011 the total Chinese cumulative investment in Myanmar jumped from the equivalent of \$1 billion to the equivalent of nearly \$13 billion (US).¹ Most of these committed investments – perhaps \$7.5 billion according to Chinese official Xinhua News² -- were disbursed in 2011.³ However, political reforms since 2011 have substantially impacted Chinese projects, causing the rapid decline in Chinese investment. Myanmar reported that Chinese companies invested only \$407 million in the country in fiscal year 2012/2013, a major decrease from the previous two years.⁴ Other than the continued disbursement of previously committed investment, few if any new major investment projects have been announced.

Until about three years ago, China was not the largest investor in Myanmar, with smaller investments in the nation than ASEAN partners Thailand and Singapore. The boost came primarily in 2010, with the Myitsone Dam project, the Sino-Myanmar oil and gas pipelines and the Letpadaung Copper Mine project, collectively valued at more than \$8 billion in terms of committed investments.⁵ The sharp reduction of Chinese investment in 2012 is the direct result of the perceived “China-unfriendly” moves by Myanmar, as China has warned its companies of the “rising political risk against Chinese investment” in the country.⁶ From Beijing's vantage point, the local population turned hostile against Chinese projects and the Myanmar government has appeared reluctant to take actions to protect Chinese commercial interests.

Despite the earlier expectation that Western investments will pour into Myanmar after the financial sanctions were lifted, non-Chinese investment in Myanmar in fiscal year 2012/2013 is far from being enough to make up for the steep drop in investments from China, which remains Myanmar's largest trading partner. The drop in Chinese investment caused total foreign investment in Myanmar to fall to \$1.42 billion in the past fiscal year – down from \$4.64 billion and \$20 billion in the two previous years, according to the Myanmar government.⁷

Domestic politics and public sentiment in Myanmar have introduced major uncertainties and problems for Chinese investors. Since the current government of President Thein Sein took office in 2011, each of the three largest Chinese investment projects in Myanmar – the Myitsone Dam, the Letpadaung Copper Mine and the Sino-Myanmar oil and gas pipelines – has encountered serious difficulties. Construction of the Myitsone Dam has been suspended since September 2011 and will remain so at least until the end of the current term of President Thein Sein in 2015. The prospects for its resumption after that are unclear at best. The operation of the Letpadaung Copper Mine has been suspended since November 2012, following mass local protests and demonstrations and is likely to resume in the near future. Meanwhile, the Sino-Myanmar pipeline project has proceeded relatively smoothly – the gas pipeline began serving China in late July, with the oil pipeline presumably to follow – despite vocal local criticism and opposition.

These three projects symbolize China's most important economic interests in the newly transformed Myanmar. What happens with the projects will have major impact on

WHAT LIES AHEAD?



MYANMAR

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Sino-Myanmar economic and political relations, the future of Myanmar's economic development and even regional politics. China has already adapted its investment strategies in light of the perceived "deterioration" of the investment environment in Myanmar. In particular, the settlement recently reached on the Letpadaung Copper Mine between the Chinese investor and the Myanmar government will cast important light on the future of the troubled Chinese projects in the country.

Behind China's Plummeting Investment

While recognizing their cooperation with the previous military junta is a major source of local antagonism, many Chinese are displeased with the new Myanmar government for the difficulties they have encountered. Pointing out that a large number of current senior Myanmar government officials held high positions in the military junta that previously ruled the country and fully supported these projects in the past, Chinese stakeholders argue that these officials – including President Thein Sein – have now taken the opposite position. Thein Sein was Myanmar's prime minister from 2007 to 2011 and endorsed all the Chinese investments inked during this period.

Despite a lot of grumbling over the perception in China that the United States has promoted democratization in Myanmar in order to undercut China's strategic interests, the Chinese government and involved state-owned enterprises were under no illusions about the underlying cause of their situation. China's current top priority in Myanmar is to protect its existing investments from further damage caused by domestic politics and social unrest in Myanmar.

Understanding these projects' deficiencies in profit-sharing, environmental protection and corporate social responsibility programs, the Chinese appear willing to make concessions in these areas in exchange for consent by the local community and the government to allow the projects to move forward. This interpretation seems to be demonstrated by the renegotiation of the contract for the Letpadaung Copper Mine and the enhanced environmental protection efforts and corporate social responsibility projects in connection with the pipelines and the Myitsone Dam.

For now, new large Chinese investment initiatives are generally being suspended. To reduce the negatives associated with Chinese investment, China's investment authority advises Chinese businesses to seek joint ventures with other foreign companies to diversify their identity and reduce risks in Myanmar. The multinational nature of the Sino-Myanmar gas pipeline is believed to have partially shielded the project from unfavorable pressure and government decisions. Following the example, China Mobile joined hands with the British firm Vodafone in the bidding for telecom service license in Myanmar early this year. (However, China Mobile subsequently withdrew, saying the project did not "meet the internal investment criteria.")

The new trends of China's investment in Myanmar are having mixed effects. On the positive side, the renegotiated terms for profit-sharing and enhanced awareness and resources designated to environmental and social issues will create more benefits for the Myanmar government and people. In the long run, they represent a victory for

political liberalization in Myanmar and will strengthen the course of the country's economic progress. For China, the failures and losses generate important lessons regarding its mercantilist overseas investment in less developed countries and its relationship with authoritarian regimes and the local people, especially involving risk assessment and crisis management. The setbacks in Myanmar have translated into retrospection and policy adjustments by both the Chinese government and companies.

However, in the short-term, the direct impact of China's reluctance to invest might lead to unexpected negative consequences. As Myanmar scrambles to deliver economic benefits to its people in order to reinforce the viability of its democratic system, foreign investments are critical for the process. One major obstacle to the industrialization of Myanmar has been its underdeveloped and inadequate infrastructure, such as a shortage of electricity and an inadequate electric transmission system, along with a poor national transportation network. These are areas where Chinese investors could make a key contribution. In this sense, the decrease of Chinese investment could undercut the speed and scope of Myanmar's economic development if there is no timely substitution for the withdrawn Chinese capital. Many foreign investors are currently deterred by Myanmar's volatile investment environment, as seen in the legislative-executive struggles, ethnic and religious conflicts, poor infrastructure, and absence of an effective legal and regulatory regime – even without the negative experiences of Chinese investors.

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Status of Major Chinese Investment Projects in Myanmar

The three major Chinese investments in Myanmar we have been discussing – the Myitsone Dam, the Letpadaung Copper Mine and the Sino-Myanmar oil and gas pipelines – stand out due to their size and significance. All three projects were finalized between December 2009 and June 2010, when China consciously pushed to ink these deals before the 2010 elections to maximize its holding of Myanmar natural resources. (The move was motivated by the concern about possible uncertain policy direction of the new government and the potential influx of Western competitors.) However, the dramatic reform by the Thein Sein government – which went much further than almost every foreign country, including the US, anticipated – undercut China's original plan. As already noted, two of the three major projects are currently suspended and the other one is limping on, albeit with similar problems. Chinese investors have been working with the Myanmar government and local communities to address the issues they face.

The Letpadaung Copper Mine

The Letpadaung Copper Mine project is a joint venture between Wanbao Mining, a subsidiary of China's state-owned China North Industries Corporation (NORINCO) and Union of Myanmar Economic Holdings Ltd (UMEHL), with a total estimated investment of \$1.065 billion. The agreement was finalized June 3, 2010 during then-Chinese Premier Wen Jiabao's visit to Myanmar. The production of the mine commenced in the spring of 2012 but was halted in June due to local complaints and protests against land

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grabbing and environmental pollution. Operations were resumed in September but only lasted for two months before mass protests completely derailed work in November 2012.

After the police brutally cracked down on the protests, generating fierce and widespread domestic and international criticism, the Myanmar government set up an investigation committee chaired by Daw Aung San Suu Kyi to scrutinize the project and its alleged environmental and social damage. The investigation report released in March 2013 supported the continuation of the project. However, the report concluded that the compensation to local farmers was “improper” and “lacked transparency” and that the mine “lacked environmental protection measures and had been developed without an environmental impact assessment, a social impact assessment or a health impact assessment or an environmental management plan.”⁸ The report recommended that these requirements be fulfilled before the project continued.

Wanbao Mining and the Chinese government welcomed the report’s findings because the report reached a favorable verdict about the continuation of the project. Since then Wanbao, UMEHL and the Myanmar government have engaged in lengthy negotiations over the revision of the contract. In mid-July 2013, a new contract was approved by the Myanmar Investment Commission. The most striking revision has been on the profit-sharing of the project. The new contract stipulates that Wanbao and UMEHL will give up 21 percent and 26 percent, respectively, of their original 51 percent and 45 percent share of the profits and hand them over to the Myanmar government.⁹ Compared to the old structure, where Wanbao, UMEHL and the government would receive 51 percent, 45 percent and 4 percent of the profits, respectively, the Myanmar government will receive the largest share of profit – 51 percent, followed by Wanbao’s 30 percent and UMEHL’s 19 percent. The new contract also stipulates that the project will allocate \$1 million for corporate social responsibility and \$2 million for environmental preservation annually, in addition to increasing the amount of compensation to local farmers.¹⁰

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Such a dramatic change of profit sharing unfavorable to the foreign investor is highly unusual – especially for China – even though contract renegotiation is common in the resource extraction industry. While one assumes Wanbao will still make money, the project now will cost Wanbao more, while producing significantly less profits. The new agreement reveals important facts about the Letpadaung project. Faced with the alternatives of either complete shutdown or a 41 percent loss of profit, Wanbao made the rational choice to pursue the latter. Fully understanding that seeking to adhere to the original unfair terms would have threatened the viability of the whole investment, Wanbao was willing to accommodate higher standards on the environment, social issues and land issues. Interestingly, the military-controlled UMEHL accepted an even bigger loss, meaning it either lacked or failed to exercise enough political sway to protect itself, much less its partner, Wanbao. Given the widespread concern that hurting the military’s economic interests might jeopardize and reverse the reform process, the new Letpadaung agreement suggests that the military’s tolerance for reform and economic loss might be higher than people expected. This has potentially significant implications for the future.

Provided that the local community is satisfied with the new agreement, the Letpadaung project’s resumption is expected in the near future. The new contract sheds important light on the future of troubled Chinese projects in Myanmar with similar problems. It creates the legal, political and bilateral precedent for renegotiation on profit-sharing and

for how Chinese investors should address the inadequacies of their projects.

The Myitsone Dam

The agreement on the development of Myitsone Dam was finalized between the China Power International (CPI) and the Ministry of Electrical Power No. 1 on Dec. 20, 2009 during then Chinese Vice President Xi Jinping's visit to Myanmar. According to the original plan, the Myitsone Dam was to be the largest of seven dams on the upper Irrawaddy River, with 90 percent of its eventual power output to be sold and transmitted to China's Yunnan Province. With an estimated total investment cost of \$3.6 billion,¹¹ it is structured as a Build-Operate-Transfer (BOT) project: after 50 years, it will be transferred to the Myanmar government at no cost.

The Myitsone Dam has drawn criticism since its beginnings for several reasons. First, the dam is located in a sacred area for the local Kachin population and the Irrawaddy is known as the "mother river" for all Burmese. Second, the enormous project – with a reservoir the size of Singapore – would send 90 percent of electric power it produced to China. Third, the dam would have tremendous environmental and social impact for the region. It would require the relocation of local villages and affect fisheries, sediment flows and the livelihoods of people hundreds of kilometers downstream.

The controversy has been exacerbated by the widespread belief that corruption was rampant during the negotiation and implementation of the project between the military government, CPI and its local partner – the Burmese Asia World Company. The project stirred up massive anti-China, anti-Myitsone Dam sentiment in Myanmar society in 2011, leading to President Thein Sein's Sept. 30 decision to suspend the Myitsone Dam during his tenure. The project has been on hold since then.

President Thein Sein's first term will last until at least 2015. However, the future of the Myitsone Dam beyond that date is yet to be settled, although many in Myanmar see the suspension (even cancellation) as a "done deal." The Chinese Embassy and the ambassador appear pessimistic and do not have "full confidence" that the project will be resumed.¹² However, CPI remains hopeful, continues to push for the resumption of the project and is willing to wait until after 2015 for what it hopes will be a positive verdict.

CPI's continuous efforts are based on several calculations. First, CPI sees a dire need for electricity in Myanmar to promote industrial growth and foreign investment. The shortage of electric power has become a major obstacle for industrial activities, with the government reportedly able to only provide only 4 to 6 hours of power daily to some factories in Yangon. Although Myanmar enjoys rich natural gas reserves, CPI sees the abundant hydropower resources as the most direct and economical solution to the poor nation's power shortage problem. As a result, CPI hopes Myanmar will eventually acknowledge and support the economic benefits of the Myitsone Dam. Second, CPI is willing to engage in renegotiation of almost all major aspects of the original contract, including the sharing of the power output, the relocation and compensation of local villages, environmental preservation and the corporate social responsibility projects. Profitability is another main consideration. Although the current suspension is not economical and will raise the company's costs and reduce its profit margin, in CPI's calculation the project will still

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be profitable if it is to be resumed after 2015. The original profit margin was large enough to allow for the delay, which is not optimal but still better than halting work on the dam.

The cancellation of the project by the Myanmar government would generate major legal battles and create financial consequences. Although the specific terms on the unilateral breach of the agreement are not known to the public, the common expectation is that if the Myanmar government unilaterally cancels the project, it will have to fulfill its legal obligation and make proper compensation to CPI. This is the other source of CPI's belief that the losses and interest expenses incurred during the suspension will eventually be paid by the Myanmar government, making the cancellation a less desirable option for Myanmar.

CPI currently continues to engage in corporate social responsibility programs in the Kachin state, lobbying both opinion leaders and the general public about the benefits of the Myitsone Dam and pushing for a favorable judgment about its future. One initiative that CPI is particularly interested in is an investigation commission similar to the one formed after the Letpadaung Copper Mine protests to objectively examine the merits and weaknesses of the dam project. CPI claims privately to be committed to full transparency to such a commission regarding all documents, data and records necessary to dispel what it calls the public's misunderstanding and doubts.

The Sino-Myanmar Oil and Gas Pipelines

The Sino-Myanmar oil and gas pipeline project was finalized between China National Petroleum Company (CNPC) and Myanmar's Ministry of Energy in December 2009 during Xi Jinping's visit to Myanmar, with a total investment of \$2.54 billion. Construction commenced in summer 2010 and the gas pipeline was completed in May 2013 and is now operational. The oil pipeline is expected to be completed in late 2013. Labeled as China's "fourth largest energy transportation route" after the Central Asia pipelines, sea transportation and the Sino-Russia pipelines, the project is seen to be of national strategic importance by diversifying China's energy transportation system.

The problems faced by the pipeline projects are less severe than those related to the Myitsone Dam and the Letpadaung Copper Mine. This is fortunate for China, because the pipelines are perceived to be a national strategic project with significant implications for the nation's energy security. Therefore, Beijing's tolerance for any problems is much lower – a point that Chinese officials and analysts have made abundantly clear since the suspension of the Myitsone Dam in both official and private discussions with Myanmar. In addition, although the pipelines have a Chinese identity, the project is a multinational endeavor. The gas pipeline involves six stakeholders from four countries (China, Myanmar, India and South Korea) and is aimed at delivering gas from a Daewoo-led consortium operating in the Shwe field to China. The participation of other countries effectively helps to mitigate the risks for China alone.

Controversy over the pipeline project is focused on its social and environmental impact. Shwe Gas Movement, a Thailand-based nongovernmental organization, has been vocal about the "human rights abuses, environmental damage and poor revenue distribution"

associated with the pipeline project. These accusations were echoed by local Rhakhine residents, who have staged multiple protests and demonstrations. However, compared to the scale and depth of the criticisms and opposition against the Myitsone Dam and Letpadaung Copper Mine, the pressure on the pipeline project is significantly less. Since the suspension of the Myitsone Dam, CNPC and the Chinese government have made considerable efforts to address the criticisms of the pipelines and to meet local demands.

For instance, on profit-sharing, the project agreement allows for allocating a maximum of 2 million tons of crude oil and 20 percent of the natural gas annually to Myanmar for local consumption.¹³ CNPC has also enhanced its spending on local communities, committing \$2 million per year for the local corporate social responsibility programs.

Interestingly, the controversy over the pipelines' environmental and social impact does not only apply in Myanmar, but also in China itself. As a part of the pipeline project, CNPC has been building a refinery near Kunming, the capital city of Yunnan, as the first such facility in the province. Since the beginning of this year, the province has planned to build a paraxylene (PX) project related to the refinery.¹⁴ But the PX project raised major concern about pollution among local population. In May, thousands of local residents staged protests in Kunming that so far reportedly have delayed the approval of the project. The explosion of a PX plant in Fujian in late July will likely reinforce the opposition.¹⁵

Look Ahead

Not all Chinese investment projects have had difficulties in Myanmar. The Tagaung Taung Nickel Mine that drew investment from the China Nonferrous Metal Mining Group, the Shweli River Hydropower Project I that drew investment from China's Huaneng Group, and many other smaller projects have encountered no major problems in their construction and operation. Including the three major projects discussed here that have sparked widespread opposition, Chinese investors are navigating their course by making concessions, correcting their mistakes and working with the Myanmar government and people. Although they are paying the price for their past behavior, the Chinese are not without grievances of their own. Chinese officials and companies have privately complained about the Myanmar government's dramatic change of position. The lack of consistency and credibility of the Myanmar side, in their view, will further damage foreign investors' confidence and hurt Myanmar's effort to develop its economy.

The economic success of the new democratic system in Myanmar is critical to the sustainability of the nation's political transition. Therefore, looking ahead, there is a need for both Chinese investors and Myanmar to recalibrate their positions to reduce distrust and hostility, and assume mutually beneficial cooperation that is not perceived to be a one-sided "exploitation" of the other side. As the Myanmar politicians and government prepare for the 2015 elections, their economic policies may well experience further conflicts between near-term political needs and long-term economic gains. It will be a true test for both Chinese investors and the Myanmar government to amend their terms and navigate through the inevitable turbulence.

The future of Chinese investments in Myanmar has a critical impact on their bilateral

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relations. China's state-run newspaper Global Times has warned: "The implementation of agreed projects is the important foundation of the normal Sino-Myanmar relations. Myanmar must be serious about its relationship with China."¹⁶ China essentially holds a zero-sum perception about its national interests in Myanmar and sees the warming ties between Myanmar and the West (especially the US) as undercutting its positions. The view is problematic and needs to adapt to the new realities of the country. Strategic thinkers in Myanmar and in US should also contemplate how potential pushbacks by Beijing, such as falling investment, will impact the future of Myanmar and its reforms.

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