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SPECIAL REPORT

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About the Report

This report examines the economy of Burma at a crucial moment in Southeast Asia's most troubled country. A low-intensity conflict based on ethnic and religious differences has simmered since independence in 1948. The country's military rulers have been waging an existential struggle with a democratic movement led by Nobel laureate Aung San Suu Kyi since they repudiated her party's election victory in 1990. Before the end of 2010, an election will be held that is more about transferring power to a new generation of military officers than making a transition to civilian rule. To focus attention on the economic dimension of peacebuilding in Burma, this report draws on the discussion at a day-long workshop sponsored by USIP's Center for Sustainable Economies. The workshop brought together experts on key aspects of Burma's economy and employees from Congress and U.S. government departments and agencies directly concerned with U.S. relations with Burma. The workshop sessions focused on macroeconomic policy, the extractive sectors, agriculture, the private sector, trade and investment, and the narcotics economy. Professor Joseph Stiglitz led the concluding session on a more productive agrarian economy.

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The Economy of Burma/ Myanmar on the Eve of the 2010 Elections

Summary

- The government of Burma is undergoing a critical transition: Before the end of 2010, the military regime that has ruled the country since a palace coup in 1998 will hold an election based on a constitution drafted in a nondemocratic process and approved by a referendum in 2008. The referendum fell far short of global standards of credibility and the election is likely to yield a government that neither the antimilitary movement nor the international community view as legitimate. However, the constitution and election also may offer opportunities for further international involvement that began in the wake of Cyclone Nargis in 2008.
- Burma's lagging economic performance—socioeconomic indicators placed it among the world's most impoverished in 2000—is due to a simmering internal conflict based on ethnic and religious differences. Successive military regimes after the failure of Burma's parliamentary government in 1962 have managed to further alienate the population and monopolize the benefits of Burma's abundant natural resources. Growth-disabling economic policies and brutal suppression of dissent since 1988 have caused an exodus of political and economic refugees estimated to be in excess of 3 million.
- However, Burma occupies a strategic space in the Southeast Asian region. It is a major supplier of natural gas to Thailand and could be a major agricultural exporter, as it was before World War II. Also, Burma is arguably the greatest obstacle to the 2015 integration objectives of the Association of Southeast Asian Nations (ASEAN), and its internal conflict contributes to tension between China and India.
- There is a glimmer of hope that the next government will consider economic policies conducive to sustainable economic growth, thereby improving the environment for political reconciliation. If so, the challenge for the international community will be to find ways to support economic policy changes in this direction that do not trigger a backlash from the

country's military rulers. Though difficult, it may be possible to accomplish this through a patient economic strategy that involves more nuanced use of sanctions and effective collaboration with other actors in the region, particularly ASEAN.

The experience of several Asian countries—Korea, Taiwan, Indonesia—shows that rapid economic growth under relatively authoritarian regimes can lead to homegrown democratic transitions that bolster political stability without sacrificing economic prosperity. The case of Burma, however, runs against the grain. A government-in-exile, dissidents inside the country, and democracy advocates around the world are marshaled behind the proposition that economic progress can occur in Burma only if a civilian-led government emerges from an election that is free and fair by global standards. Given the much greater likelihood that Burma's new government will still be tightly controlled by the military, the international community should be looking for more effective ways to encourage better governance than the sanctions and engagement of the past twenty years. This challenge extends beyond the specific case of Burma to the art of peacebuilding itself, which has focused in recent decades on the security and political dimensions of the work. Where progress has been made in these areas, sustainability has been elusive because of shortcomings in the economic dimension, including but not limited to insufficient private sector job creation, depressed household incomes that preclude the savings required for investment, dysfunctional financial systems, and misallocation of public sector resources. An approach by the international community that could be more successful in the case of Burma would ensure that capacity building precedes financial assistance, provides strong rewards for effective Burmese-initiated polices and programs, and relies primarily on regional institutions such as the UN Economic and Social Commission for Asia and the Pacific (ESCAP), ASEAN, and the Asian Development Bank (ADB).

Burma's Politics

In 1990, Burma's National League for Democracy (NLD), the political party led by Aung San Suu Kyi, won an overwhelming electoral victory, but the country's military rulers decided to repudiate the results. Burma's political landscape was frozen in a stalemate for eighteen years after that. Four recent events, however, began to thaw the situation, offering a glimmer of hope for Burma's long-suffering population of 50 million.

The first event was Cyclone Nargis, the country's worst natural disaster in recorded history, which devastated a large portion of the country's rice-growing delta region in May 2008. The number of dead and missing people exceeded 130,000. After initially resisting the outpouring of aid the international community offered, the military regime opened the door to a limited relief and recovery effort led by ASEAN and the United Nations. The door has remained ajar and the global aid community is poised to scale up its activities if the next government begins to address the concerns about human rights and democracy that have put Burma on the agenda of the UN Security Council.

The second event was the referendum on a new constitution, which also occurred in May 2008. It fell far short of Western standards of credibility, as the military regime drafted the constitution without any meaningful public debate, and over 90 percent of voters approved the document in a process that did not come close to being free and fair. The 2008 constitution establishes a multiparty parliamentary system with checks and balances and an unexpected degree of protection for basic human rights. At the same time, it explicitly puts Burma's armed forces in a position to control political outcomes.

Third was the U.S. presidential election in November 2008, won by Barack Obama on a platform of change that included a commitment to a more multilateral and flexible foreign policy. On Secretary of State Hillary Clinton's first foreign trip after Obama's inauguration in January 2009, she announced a review of U.S. policy toward Burma, noting that neither the sanctions imposed by Western nations nor the engagement pursued by Asian nations had ended the country's internal conflicts successfully or halted the population's impoverishment. In August 2009, Senator Jim Webb, chairman of the Subcommittee on East Asian and Pacific Affairs of the Senate Foreign Relations Committee, visited the Union of Myanmar. He was the highest-ranking U.S. official to call on the regime's military leaders in almost fifteen years. A new policy of "pragmatic engagement" was announced in September 2009,[1] and a few weeks later, the State Department's assistant secretary for East Asia and the Pacific, Kurt Campbell, also went to Burma. As U.S. policy changed, other countries, multilateral organizations, global businesses, and international non-governmental organizations (NGOs) began to reassess their policies and explore the potential for fruitful engagement.

Fourth was a day-long meeting in Naypyidaw in December 2009, organized by ESCAP and anchored by Nobel Prize–winning economist Joseph Stiglitz. The meeting was a striking departure from the past because of the active participation of key ministers from the military regime and the candor of the discussions.

Though the effects of the four events have generated a wave of optimism about Burma's economic prospects, there are no comparable signs that the political stalemate among the military regime, the democratic opposition, and ethnic minorities will be resolved in the near term. The election laws announced in mid-March 2010 seem to move in the wrong direction. Without reconciliation with its political opponents, the new government will be missing one of the essential foundations for sustainable economic growth. The outcome of the election is uncertain, however. Developments unanticipated either by the military regime or its opponents could tip the balance toward better governance encompassing the security and political dimensions as well as the economic dimension.

Burma's Economy

Three features dominate the economy of Burma today: a traditional rice-based agriculture sector that is grossly underperforming, a pipeline supplying natural gas to Thailand from offshore fields, and a strong underground economy based on illegal exports of timber and other natural resources, plus narcotics (mostly methamphetamines). The economy is balkanized by the decades-long conflict between the central government (ethnically Burman and Buddhist) and a number of ethnic minorities (often Christian) inhabiting the country's mountainous borders with China, India, and Thailand. Furthermore, the military regime maintains control over most economic activity through a host of monopolistic state-owned enterprises and businesses owned by family members and cronies of the regime's senior generals. As a result, the space for spontaneous private initiative is severely restricted.

From a historical perspective, the Burmese economy is a sixty-year tragedy. At the beginning of World War II, Burma was the world's largest exporter of rice. At the end of World War II, it was considered to have strong prospects for economic growth because of its well-educated population and abundant natural resources. However, for the first ten years after independence from British colonial rule in 1948, the Burmese economy limped forward as successive parliamentary governments failed to pursue consistent or coherent economic policies. From 1962 to 1988, the private sector was all but wiped out as General Ne Win presided over an extreme form of socialism and isolationism. The military regime that pushed Ne Win aside in 1988 formally embraced a market economy, but pursued repressive policies that have prevented the market from functioning efficiently and caused the country to fall further behind its Asian neighbors.[2]

The Macroeconomy

The absence of reliable data on Burma's economy is a big stumbling block for analysts and policymakers. Even the range of estimates of Burma's population—between 48 million and 58 million—is unusually broad because the last census meeting international standards was carried out in the 1930s. Meanwhile, the government of Burma's official gross domestic product (GDP) figures for the past ten years put the average rate of GDP growth well above China's, which cannot be true.

Both the macro-level performance of the Burmese economy since independence and the macro-level policies of the three distinct regimes that have ruled the country over this sixty-year period can be described as miserable. GDP growth has lagged far behind almost all other Asian countries, inflation has been in the double digits, foreign investment and foreign aid are minimal outside the oil and gas sector, and much value has been lost in the illegal export of timber, jade, and other gemstones. The insurgencies that ethnic minorities have been waging since independence and the sanctions imposed by the United States and other Western nations since 1990 are not the main reasons for the economy's poor performance. Instead, misguided economic policies, compounded by extraordinary neglect of the education and health sectors, have deprived the economy of the basic foundations for sustainable improvements in living standards.[3]

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The one bright spot in the economy is a steady buildup in foreign exchange reserves, directly attributable to the export of natural gas to Thailand from offshore fields in the Andaman Sea. Gas deliveries by a pipeline across one of the narrowest parts of southern Burma began in 2000; Burma's foreign exchange reserves rose from $200 million at the end of 2000 to around $5 billion at the end of 2009—equivalent to eight months of Burma's total imports.

Since mid-2009, the international financial institutions that engage with Burma as a member country—the International Monetary Fund, World Bank, and the ADB—have witnessed a substantial improvement in the quality of their policy dialogues with their Burmese counterparts at the ministerial and subministerial levels. These dialogues also have revealed a number of recent positive steps by the military. For example, the regime has created a task force to focus on a key goal in the ASEAN Economic Community Blueprint: removing all foreign exchange restrictions on current account transactions by the end of 2011. To meet the goal, Burma will have to unify its exchange rate, which would qualify as a great leap forward in macroeconomic policy.

In monetary policy, the regime is in the process of financing as much as one-third of the budget deficit for fiscal year 2009–10 by issuing bonds, a remarkable change from the long-standing inflationary practice of having the central bank print money to finance the deficit. In addition, with support from the United Nations Development Program (UNDP), Burma's Central Statistical Organization is undertaking a household survey—the first in many years—that will provide a baseline for measuring future progress and hard data for evidence-based policy choices.

Meanwhile, the country's financial sector is dysfunctional. The private sector has insufficient credit to grow because the central bank provides so much credit to the central government. The banking system is dominated by state-owned banks that lend primarily to relatives and cronies of regime leaders as well as state-owned enterprises. Private banks are straitjacketed by regulations adopted after a banking crisis in 2002–03. This contrasts sharply with the financial sector Burma had a century ago, which provides one of the best examples in the world of the potential for a sound financial system to transform a national economy: In combination with the opening of the Suez Canal and the passage of a land-titling law by the colonial government, a network of moneylenders (ethnic Chettiars from the Madras region in southern India) transformed the Ayeyarwady River delta into the world's leading rice bowl in a period of less than forty years.[4]

Two other factors contributing to Burma's economic underperformance are the military's share of the budget and the state-owned enterprise sector. To support an estimated 400,000 personnel, almost 30 percent of the national budget is allocated to the country's armed forces, which substantially understates the resources devoted to the military because it does not include large amounts of money generated by a vast array of legal and illegal businesses.[5] Similarly, the country's diverse portfolio of state enterprises is a net drain on public sector financing and stifles private sector growth through monopolistic behavior. Two giant military conglomerates dominate the economy: Union of Myanmar Economic Holding Limited and Myanmar Economic Corporation.[6]

To support an estimated 400,000 personnel, almost 30 percent of the national budget is allocated to the country's armed forces, which substantially understates the resources devoted to the military because it does not include large amounts of money generated by a vast array of legal and illegal businesses.

How will the 2008 constitution affect the new government's economic policy choices? A textual analysis suggests that the constitution could provide a strong foundation for private sector–led economic growth, as it recognizes fundamental economic rights (e.g., private property, rule of law) and protections (e.g., against monopolies and nationalization). Demonetization of the currency, as occurred three times between 1964 and 1987 with devastating results, is explicitly ruled out. More significant, the constitution spells out specific tax and expenditure authorities for subnational levels of government.

Realistically, the new government most likely will feel no more bound by the 2008 constitution than its predecessors have felt bound by earlier constitutions. Instead the military leadership will probably maintain its grip on the commanding heights of the economy. However, it would be unwise to rule out the possibility that the new government will see the potential for consolidating its control over the country by adopting policies more conducive to broad-based economic growth. In this event, the main obstacle to achieving such growth will be weaknesses in the areas of human capital and institutional development. Thus the highest priority for foreign donors in the years ahead could be assistance focused on capacity building. ASEAN appears to be well positioned to play this role, based on the impressive performance of the office it established in Yangon to support its leadership position in the post-cyclone relief and recovery efforts.

The Extractive Sectors

As mentioned above, Burma's dominant form of resource exploitation, since 2000, has been natural gas delivered directly to Thailand from the Yadana and Yetagun gas fields in the Andaman Sea. This gas goes to Thai power plants that supply 40 percent of Thailand's electric power consumption; it is thus critical to Thailand's energy security.

Thai statistics report $3 billion of natural gas imported from Burma in 2008, a high point reflecting peak energy prices in the global market.[7] Over the past ten years, the value of gas purchased from Burma has averaged between $1 and $1.5 billion per year. As much as half of Thailand's total payments go to reimbursing the operating companies for their costs, with the remainder going to the government as royalties, taxes, and other charges.

Burma's reported export earnings in 2008 were $6.6 billion, meaning that gas exports alone accounted for about 45 percent of the total. Burma's export earnings from this sector are expected to at least double within five years as a result of dual pipelines to be built from a port and pumping station on the Arakan coast—less than 100 kilometers from the border with Bangladesh—diagonally across the country to Yunnan province in China. One pipeline, already under construction, will carry gas from the Shwe fields, which are considerably larger than the Yadana and Yetagun fields. The other will carry crude oil from sources in the Middle East and Africa.

The strategic significance of the pipelines for China is obvious. Less obvious is how China's evolving energy policies will affect Burma in the coming years. Recently, there has been a policy shift toward what a workshop participant described as a "protective energy strategy" of slowing exploitation of domestic sources—especially coal—in favor of exploiting foreign sources. This policy bias is likely to continue for some time, implying strong pressure from China on Burma to be an energy transportation link as well as a source of gas.

The major oil companies operating the Yadana field are Total (France) and Chevron (United States), which have grandfathered exemptions from their countries' respective sanctions. Both companies have attempted to meet a high standard of corporate social responsibility, committing $25 million over five years to a socioeconomic program benefiting not only communities in the vicinity of the pipeline to Thailand, but also neglected groups in the rest of the country, such as orphans and the blind. Both companies support the global Extractive Industries Transparency Initiative, launched in 2003, to fully disclose payments made by resource-extracting companies to host governments and help ensure that these funds are directed to social purposes and not diverted for private gain. Both companies are also advising Petronas (Malaysia) and other Asian operators in Burma on adopting credible socioeconomic programs. In this connection, the Chinese company building the pipelines to Yunnan Province recently commissioned a baseline study of the communities along the pipeline route. Meanwhile, because of investor concerns and related political pressures, an Australian company sold its majority interest in the Yetagun field to Petronas. All recent exploration and production licenses have gone to Asian firms that do not impose sanctions on Burma.

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It is significant that very little of the gas Burma produces is used domestically, despite extreme shortages of electrical power throughout the country. The government announced plans to complete, before this year's election, a new branch of the Yadana pipeline to supply gas to a power plant designed to ensure constant electrical power to Yangon, but even this modest goal appears out of reach.

Burma is also exploiting hydroelectric power at a rapid and problematic pace. Reportedly, more than sixty hydropower projects have been built, are under construction, or are under contract with Chinese companies alone.[8] Additional projects by Thai and Indian investors are in various stages of completion. Much if not most of the power from these projects will be exported rather than meeting domestic demand. Environmental concerns are given little attention and the potential for social unrest is considerable, especially because many of the projects are located where ethnic minorities live.

After natural gas, Burma's leading extractive exports are timber and minerals. The ranking varies from year to year, but the reported value of timber and mineral exports is problematic because a substantial share is exported illegally and therefore not captured in the official data. The reported value of Burma's timber exports in 2007–08 was $538 million, but illegal exports could easily represent another $150 million. India is the largest destination for timber exports by value, but China is the largest by volume.

China's clampdown on timber exported illegally from Burma, which began in 2006, decreased China's recorded log and sawn wood imports by more than 70 percent between 2005 and 2008.[9] Nevertheless, reliable sources report that timber is still being harvested in Burma at an unsustainable rate, with serious environmental consequences. The timber extraction process is also contributing significantly to an upsurge in illegal exports of wildlife and plant material, primarily to China.

Under the 2008 constitution, the decentralization of authority to states and regions implies a certain sharing of the revenues from resource extraction between the center and lower levels of government. Sorting out these arrangements is bound to be difficult. It could lead to better investment decisions, reduced conflict, and less environmental degradation, or it could make matters worse.

Agriculture and the Private Sector

The agriculture sector accounts for 40 to 50 percent of Burma's GDP, and 70 percent of its population lives in rural areas. Paddy rice is the main crop and the country clearly could be one of the world's major rice exporters.[10] The rice economy, however, is severely hobbled by misguided government policies. Even though production in the townships most severely affected by Cyclone Nargis in 2008 has recovered more quickly than many anticipated, traditional sources of agricultural credit have dried up and the state-dominated banking system is providing only a small fraction of the credit farmers require to purchase the seed and related inputs needed to raise yields. Post-harvest value is lost because storage facilities are rudimentary and obsolescent mills cannot produce high-quality rice for export. The cost of transporting rice from mills to ports is also much higher than in other Asian countries. As a result, Burmese rice farmers earn only 30 percent of the crop's export price, compared with the 50 percent of a higher price that Vietnamese farmers receive for the better-quality rice they produce. Rural incomes have stagnated and a worrisome number of farmers are losing control of their land to creditors. As the authors of a Harvard Kennedy School report argue, "Burma's rural sector is stretched to the breaking point and the natural resilience that has sustained it is leaching away."[11]

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Beans and pulses are Burma's second major cash crop and agricultural export, mainly to India. However, a potentially critical setback to producing them occurred in 2008 when a group of exporters colluded to raise export prices, causing Indian buyers to turn to other sources. The exporters were therefore unable to fully pay the local traders who had purchased the crop, leading to a breakdown in the seasonal credit chain.

A number of microfinance schemes operate in Burma, the largest of which is managed by Pact, a U.S.-based NGO, in a program initiated by UNDP. The Pact scheme is limited to three areas: the Ayeyarwady delta, the dry zone in the center of the country, and the Shan state. Altogether the scheme is capitalized at $24 million. Its 83,000 members, mostly women, represent almost 7 percent of all rural households in Burma. But this and other microfinance arrangements inherently cannot substitute for a bank-based rural credit system. Moreover, expansion of the Pact and other schemes is severely constrained by the absence of a statutory framework for microfinance, by interest rate ceilings, and by government policies that preclude borrowing from commercial banks.

In January 2010, U Myint, the highly regarded and retired ESCAP economist, spoke publicly about the rice economy with a candor that would have been unthinkable a year earlier. With a view to restoring Burma's position as a major rice exporter, U Myint proposed setting a goal for rice exports three years from now and creating an advisory group of technical experts to develop a plan to achieve it. At least some elements within the military regime appear to support the proposal.

Because Burma's cultivable land varies considerably across the country, approaches to raising agricultural productivity will have to be tailored to the potential of each locality. As administrative authority is devolved to subnational levels of government following the elections, the capacity of local authorities to implement agriculture sector programs could become a crucial constraint—or opportunity.

Beyond the primary production sectors, the manufacturing and service sectors have exhibited little dynamism since Burma's military rulers abandoned socialism in 1988 for a market economy. For about five years, private-sector growth was buoyant as activities reserved for the state were steadily opened to private enterprise. Then, as the first wave of economic sanctions was imposed on Burma around 1997, the scope for private enterprise began to narrow. Each subsequent wave of sanctions has in effect built a higher wall around the private sector, making business owners feel increasingly like prisoners.

A national trade council established in 1997 has been parceling out economic franchises at the discretion of the ruling generals. The manufacturing and service sectors are highly monopolized, leaving little room or incentive for private investment. Banking services are extremely limited and normal relations with foreign partners are problematic. It is virtually impossible now to form a limited liability company. Six years ago it was possible to get an export license in six hours; now it takes two to three weeks and requires a trip to Naypyidaw. Electric power is not reliable. Automobiles and mobile phones are ridiculously expensive. Corruption and rent-seeking behavior pervade the economy.

However, since 2007, a new twist in private sector development has appeared, as the military regime has begun to privatize a number of state enterprises. The pace of privatization accelerated sharply at the beginning of 2010 with the auctioning of state assets ranging from airlines to Yangon residences, albeit in a process that favored friends of the military regime. It is conceivable that the privatizations occurred to generate funds for the State Peace and Development Council, the junta, to pave the way to victory for its preferred candidates in the upcoming election. It seems more likely, however, that the privatizations are intended to provide an independent means of support for the generation of military leaders that is handing power, at least formally, to a younger generation.

Another issue concerning the private sector is the role of China, on which two divergent views exist. One view is that Chinese companies and individual entrepreneurs, mostly from Yunnan Province, are flooding into Burma and rapidly dominating the economy sector by sector. The other view is that ethnic Chinese have been major players in the Burmese economy for decades, just as they have in Thailand and other parts of Southeast Asia. They have an advantage over other businessmen because they have access to capital through the informal, pan-Asian Chinese financial system. Estimates of the number of recent immigrants from China range from around 100,000 to well over 2 million. There is no doubt that the Chinese presence in Burma is growing, and the extent to which the immigrants displace or complement the indigenous population could be a key factor in Burma's political as well as economic evolution in the years ahead.

Trade, Investment, and Sanctions

The data on Burma's trade and investment are no better than the data on any other aspect of its economy. Thus broad strokes convey a better sense of the economic reality than specific figures.

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The basic trade pattern in Burma is exporting primary products and importing consumer products. Manufactured exports are tiny for a country of Burma's size. Moreover, Burma's trade is also almost exclusively with Asian partners, as much as 95 percent of its imports and 90 percent of its exports.

Investment has been concentrated in two sectors: oil and gas, and infrastructure. In the oil and gas sector, the bulk of the investment has been by foreign companies. In the infrastructure sector, the military regime invested hundreds of millions of dollars over the past ten years to build the new capital of Naypyidaw. By contrast, investment in infrastructure in the rest of the country has been shamefully small, even though the military regime considers this one of its greatest achievements. The government's investment in roads and bridges has been reasonably beneficial for the general population, but its investment in dams may not yield more benefits than costs if social and environmental effects are taken into account.

In principle, Burma's most important trade and investment relations are with its nine ASEAN partners. Since joining ASEAN in 1997, however, Burma has been slow in meeting the norms of ASEAN's economic community—not to mention the norms of its political-security and its sociocultural communities. Furthermore, Burma has been the most obstructionist member on a range of issues as the ASEAN members seek to implement their vision of an ASEAN community by 2015. Nevertheless, ASEAN is doing more than any other external organization to help Burmese officials understand the potential benefits of regional cooperation and the policy adjustments required to realize them.

ASEAN was key in the international response to the devastation caused by Cyclone Nargis in May 2008. It was a member of the Tripartite Core Group, alongside the United Nations and the government of Burma, which coordinated external support for the relief and recovery effort. ASEAN's potential to help Burma's postelection government accelerate the pace of economic integration with its regional partners should not be discounted.

The trade and financial sanctions that the United States, the European Union, and a few other countries have imposed on Burma since 1997 have clearly constrained trade and investment, yet trade and investment with nonsanctioning Asian countries has grown steadily. There have been no studies of the sanctions' overall effect on Burma's economy, partly due to the absence of reliable data. Two opposing views exist based on circumstantial evidence. One is that the sanctions have negatively and severely affected the economy. The strongest evidence is the loss of as many as 50,000 jobs in the garment sector after sanctions were ratcheted up in 2003. The other view is that the sanctions have had little effect because Burma's nonsanctioning Asian partners provide the best market for its export products. Meanwhile, many multinational corporations would be reluctant to invest in Burma even without the sanctions because of the reputational risk of dealing with a country associated with so many human rights and other governance problems. Above all, corporations are deterred from doing business in Burma due to the government's practice of making whimsical policy decisions in every area of life.

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The latest U.S. sanctions on Burma were put on a fast legislative track following the Saffron Revolt in September 2007. They focused on Burma's exports of jadeite and rubies. The U.S. Government Accountability Office (GAO) published an assessment of the implementation of these sanctions that has a number of implications for sanctions more generally:[12] The GAO concluded that the sanctions provide little leverage over the regime, although for different reasons for the two gemstones.

Burma is essentially the sole producer of jadeite in the world. Jadeite mining is relatively capital intensive and companies owned or controlled by the military regime carry out most mining operations. The output is primarily sold in an auction market, and the vast bulk goes to China, which has a strong cultural affinity for the product. Industry experts estimate that 100,000 workers in China are engaged in carving and polishing jadeite, and as many as three million Chinese workers are employed throughout the jade and jadeite industry, suggesting how strongly China's government would resist restricting imports from Burma. As a result, the U.S. sanctions appear to have little effect on the trade as minimal quantities of jadeite were imported into the United States prior to the sanctions.

A dozen other countries produce significant amounts of rubies, although Burmese rubies have traditionally been prized by consumers and commanded higher prices. Ruby mining in Burma is carried out by smallholders and most rubies are smuggled out in raw form to Thailand. Raw rubies are heat treated, cut, and polished in a Thai jewelry industry that employs an estimated 1.2 million workers and exported $8 billion of jewelry to the United States in 2008 (of which less than $3 million was polished ruby stones). According to Thai industry sources, the U.S. sanctions imposed on ruby imports in 2008 caused the loss of more than 100,000 jobs, but some of this effect likely reflects the sharp recession in the U.S. economy in that year. The average ruby imported into the United States is valued in cents, while the cost of a physical test to certify its origin is on the order of $50 per stone. As a result, it is infeasible to selectively target rubies of Burmese origin as is done with diamonds under the international Kimberly framework, so the sanctions appear to have led to a sharp decline in

U.S. ruby imports regardless of origin. Given the large share of value added in Thailand, the major impacts of the sanctions appear to fall on the jewelry industry in Thailand and the network of traders and miners in Burma, with secondary impacts on the Burmese regime and on U.S. consumer markets. One lesson from this experience is the difficulty of designing effective U.S. sanctions when nonsanctioning countries have a dominant role as the consuming market or a critical role in the supply chain.

The Narcotics Economy

In the late 1990s, before gas exports to Thailand began, Burma's largest foreign exchange earner was believed to be narcotics. Opium had long been grown in the Golden Triangle region, where the borders of Burma, Thailand, and Laos come together on the Mekong River less than 200 kilometers from the border with China. Heroin produced by the remnants of the anti-communist Kuomintang units that had escaped into Burma around 1950 contributed to a rapidly growing drug problem in Southeast Asia in the 1960s. Other ethnic groups, especially those opposing the military regime in Yangon, also became involved in the heroin supply chain. Drug enforcement efforts and broader political trends in Burma and China began to curtail opium and heroin production around 1990. However, the production of methamphetamines began to expand, with precursor chemicals coming more from India than China. The pills go mostly to Thailand.

The U.S. Drug Enforcement Administration (DEA) has had a presence in Burma since 1982, working closely with the national police. The military regime has adopted a relatively strong anti-narcotics stance, and cooperation has been good for the past twenty years with the DEA, the UN Office on Drugs and Crime, and other drug enforcement authorities in the region. Assuming an optimum harvest from all the land believed to be planted with poppies recently, the annual crop value to the producers would be on the order of $100 million. Assuming 100 percent of this production were processed into heroin and exported, the hard currency earnings based on prices in Thailand would be approximately $260 million. For methamphetamines, the value of Thai seizures based on prices at the Burma border in the past year was around $120 million. As seizures represent only a small fraction of the actual flow, it is not hard to believe that Burma's total drug exports exceed $500 million per year.

The drug business has implications for both the political system and the economy in Burma. Much of the money earned from drugs flows to ethnic minorities opposed to the military regime. Without this source of income, they would be significantly less able to hold off the Burmese armed forces. Some of these minorities undoubtedly fear that they would lose this income if national reconciliation were achieved. While there is no evidence that the central government or the armed forces are involved institutionally in the drug business, some regional commanders, at least, are earning money from drug trafficking indirectly through taxes on output and transportation.

A case can be made that the drug business contributes more to the Burmese economy than it detracts from it.

A case can be made that the drug business contributes more to the Burmese economy than it detracts from it. One visible effect is the better transportation, power, and communications infrastructure in the border towns on known drug trafficking routes. The investment for these improvements could not have come from the central government or taxes on the local nondrug economy. A second visible effect is the establishment of legitimate businesses by people understood to be profiting from drug trafficking. These businesses include banks, airlines, and hotels, and to the extent that they succeed and provide productive employment, the economy gains. To the extent that they crowd or muscle out clean competitors, or rely on government-granted monopolies, the economy suffers. A third visible effect is the construction of houses, apartment buildings, and offices. Here the benefits to employment in the construction industry are significant and the economic losses appear to be low.

It is conceivable that the narcotics economy is so large that it can influence policy at the central level. It could favor one faction within the military over another. It could provide crucial financing for successful political candidates in the upcoming election. It could be financing some of the privatization that is occurring now. Burma's narcotics economy is one of the known unknowns that could tilt the political transition underway this year in a negative direction, and it could be an unanticipated constraint on policymakers in the next government.

Foreign Assistance

Among low-income countries, Burma receives the least foreign aid on a per capita basis because the major aid-giving countries are Western democracies that suspended bilateral aid after the military regime repudiated the result of the 1990 election. These same countries have used their voting power in the World Bank and Asian Development Bank to block loans, grants, and technical assistance to Burma.

However, in 2008, a number of major donor countries reassessed their aid strategies due to the opening for humanitarian assistance created by Cyclone Nargis. This reassessment also reflected a growing awareness of the slow but steady growth of civil society within Burma over the past twenty years. Even before the cyclone, a remarkable number of domestic and international NGOs were engaged in low-profile humanitarian assistance activities. Furthermore, in December 2009, the military regime agreed to host a day-long meeting in Naypyidaw organized by Noeleen Heyzer, the executive secretary of ESCAP.[13] The principal speaker was the Nobel Prize–winning economist Joseph Stiglitz, from Columbia University, who spent several days in Burma visiting projects and meeting with a cross-section of the population. Given the political sensitivities, Stiglitz consulted widely before making the trip, including with persons known to be close to Aung San Suu Kyi, and found a broad consensus in favor of his visiting Burma.

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Contrary to the general image of the country, the December meeting was well publicized and the discussions unconstrained. Senior officials gave presentations that acknowledged existing shortcomings; as an example, they presented data showing that the bulk of PhD degree holders in Burma are over the age of fifty. Government participants highlighted their prioritizing infrastructure investment in recent years, but also expressed concern that the benefits of this investment were not evident at the village level. The last mile was left unfinished. The crucial lack of rural credit at reasonable interest rates was examined in depth, including by a Japanese economist who had recently completed some basic field research. Independent Burmese economists who have remained in the country made other excellent presentations.

One of the problems Stiglitz stressed was Burma's resource curse, evident in the small benefits flowing to the general population from its large exports of natural gas to Thailand. He also pointed out that the low-density urban planning model for the new capital of Naypyidaw was obsolete—an unfortunate investment of scarce resources. The challenge for the next government of creating quality jobs for former combatants was also noted. Another issue will be providing a role for Burma's vocal exile community in future policy making that is not divisive and counterproductive.

The reasons for the Burmese government's openness and change in tone, evident at the ESCAP-organized meeting, are obscure. It is possible that a generational change in the country's leadership is prompting younger military officers to explore alternatives to the status quo. At the same time, it is evident that some military leaders are hesitant to pursue engagement more actively because they feel battered by the countries imposing sanctions. It is also possible that the military leaders are uncomfortable with China's growing role in their country.

If the next government takes steps to promote stability through a more inclusive political process, it would be especially important for Western democracies and multilateral agencies to lift the existing constraints on aid.

Within the diplomatic community in Burma, the Stiglitz visit revealed strong interest in expanding assistance in two directions: human resource development (education and training) and block grants at the village level for infrastructure development and other social needs. The depressing condition of universities in Burma and the great potential for tourism to benefit the population at the village level did not escape notice. If the next government takes steps to promote stability through a more inclusive political process, it would be especially important for Western democracies and multilateral agencies to lift the existing constraints on aid.

During the Stiglitz visit, the military regime agreed to the establishment of an ESCAP office in Yangon. As a complement to the existing ASEAN office, the ESCAP office could be key in avoiding an excessive response by donors if the next government opens the door more widely for foreign aid. In a number of other countries experiencing political transitions, generous responses by aid agencies—often accompanied by a flood of foreign investors and NGOs—have overwhelmed the new policymakers with conflicting advice. With that in mind, the following recommendations are offered.

Recommendations for the International Community

The Burmese economy today can be summed up in the words of a Burmese participant in the March 4 workshop: "The private sector is the driver of economic growth in Burma. The military regime controls the roads but it doesn't know how to build good roads. Therefore, capacity building [within the government] is the key to Burma's future economic prosperity." The recommendations below are designed to improve the odds that the international community responds effectively to any indication that the next government will move away from the policies and practices that have prevented the Burmese people from enjoying so many of the benefits of the modern world.

- **Be patient.** The United States tends to be impatient in its foreign aid programs, wanting to see measurable results in the short term. The cultural predisposition of Asians runs in the opposite direction. Western democracies are more likely to improve outcomes if they follow the lead of the Asian countries that are directly affected by the problems in Burma instead of trying to persuade them to buy into a Western-flavored strategy.
- **Be innovative.** Burma is one of the few countries in the world where multilateral and bilateral aid agencies may be able to initiate programs from a clean slate. Instead of the default approach of swarming in with an array of overlapping and sometimes conflicting programs, all parties could gain by opting for a joint approach, tailored to Burma's particular circumstances. For example, the Center for Global Development has recently proposed a "cash on delivery" approach built on the concept of rewarding good performance and minimizing administrative overhead.[14]
- **Keep a low profile.** Large resident aid missions and a high volume of short-term project development missions could disrupt newly appointed policymakers' attempts to start off on the right foot and sort out internal relationships that will determine their ultimate effectiveness. Aid interventions are more likely to succeed if they are seen as supporting Burmese initiatives rather than importing alien solutions.
- **Focus on capacity building.** Vast amounts of money will be wasted and troublesome social problems created if foreign aid and investment leads capacity building instead of following it. Every part of the economy suffers from human resource and institutional capacity constraints. The education system is broken, excepting the limited private-school sector that operates in the gray economy. Positive outcomes are inconceivable without wholesale training for civil servants in policy analysis and implementation. Governance training for

newly elected members of legislative bodies at the national and subnational level merits prioritizing as well.

- **Put regional institutions at the center.** The ASEAN office established to work on the Cyclone Nargis relief and recovery operation will close in mid-2010 unless its mandate is renewed. A concerted effort by the international community may be required to keep it open, to complement the new ESCAP office. A strong case can be made for creating a new Tripartite Core Group—consisting of the government of Burma, ASEAN, and ESCAP—to help the next government manage foreign aid. UNDP may resist including ESCAP, as UNDP has been the lead UN agency in the past, but inclusion would be appropriate in these circumstances. Japan has arguably done more work on the Burmese economy than any other country and therefore deserves a prominent role in economic assistance.
- **Be cautious in working with the exile community.** Tension will inevitably exist between sector and subject-matter experts who have remained in Burma and those who chose to leave the country. Favoring experts who have remained is likely to yield better results.
- **Link economic sanctions to economic policies.** The economic sanctions maintained by Western countries are tied most directly to political concerns, especially human rights and democratic rule. They might be more effective and command more respect if they were linked to economic concerns, such as arbitrary restrictions on private business. If the next government opts for more repressive and divisive measures, tightening the existing sanctions will be futile as long as China, India, Thailand, and ASEAN do not impose similar sanctions.
- **Advocate a limited moratorium on extractive industries.** The strongest step to address Burma's resource curse is probably politically infeasible but advisable in any case: a five-year moratorium on new oil and gas, hydropower, timber, and mining projects. The next government will not be financially constrained by such a moratorium if it implements a few basic improvements in macro-level policies, such as unifying the exchange rate. Meanwhile, new extractive projects will simply create more opportunities for rent seeking and more unproductive expenditure of the revenues that flow to the treasury. Support for such a moratorium by the governments of China and India would be necessary and may be politically feasible.

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Notes

1. Background briefing on Burma by a senior State Department official, September 23, 2009. Available at http://www.state.gov/r/pa/prs/ps/2009/sept/129541.htm (accessed May 4, 2010).
2. The following sections on major components of the Burmese economy are drawn from the discussion in a workshop of experts on Burma's economy as well as U.S. government department, agency, and congressional employees, at the U.S. Institute of Peace on March 4, 2010.
3. Ceasefires were negotiated between the central government and seventeen ethnic minorities between 1988 and 1997. In principle the 2010 election will make these agreements inoperative, but the election could also reignite armed conflict with some of these groups. A few groups refused to enter into ceasefire agreements. See Zaw Oo and Win Min, "Assessing Burma's Ceasefire Accords," Policy Studies 39 (Southeast Asia), (Washington, D.C.: East-West Center, 2007).
4. Sean Turnell, *Fiery Dragons: Banks, Moneylenders, and Microfinance in Burma* (Copenhagen: Nias Press, 2009).
5. Since the move to a market economy in 1988, the military has increasingly become the main avenue of social mobility in Burma. Even leading professional schools (e.g., medicine, engineering) are military institutions. As a result, the private sector is deprived of young talent.
6. Maung Aung Myoe, *Building the Tatmadaw: Myanmar Armed Forces Since 1948* (Singapore: Institute of Southeast Asian Studies, 2009).
7. The $3 billion figure is what Thailand reports in its trade data for gas imports from Burma in 2008. There are no reliable estimates for the amount of net revenue to the government of Burma from taxes, royalties, dividends, and production sharing.
8. EarthRights International, *China in Burma: the Increasing Investment of Chinese Multinational Corporations in Burma's Hydropower, Oil and Natural Gas, and Mining Sectors* (Washington, DC: EarthRights International, 2008). Available at http://www.earthrights.org/publication/china-burma-increasing-investment-chinese-multinational-corporations-burmas-hydropower-o (accessed April 30, 2010).
9. Global Witness, *A Disharmonious Trade: China and the Continued Destruction of Burma's Northern Frontier Forests* (London: Global Witness, 2009). Available at http://www.globalwitness.org/media_library_detail.php/855/en/dramatic_decrease_in_illegal_timber_trade_between_ (accessed April 30, 2010).
10. Burma exported 3.3 million tons of rice in 1938–39, representing 47 percent of total world exports that year. In 2007–08, Burma exported about 360,000 tons of rice, representing 1.3 percent of total world exports by volume. From U Myint, "Second Development Partnership: Roundtable and Development Forum, Naypyitaw, 15 December 2009," press briefing in Yangon, January 9, 2010, available at http://www.irrawaddy.org/web_images/U-Myint-Stiglizt.pdf (accessed April 30, 2010).
11. Harvard Kennedy School, Asia Programs, "Assessment of the Burma Agricultural Economy," unpublished report prepared for International Development Enterprises, January 2009.
12. Government Accountability Office, *U.S. Agencies Have Taken Some Steps, but Serious Impediments Remain to Restricting Trade in Burmese Rubies and Jadeite,* Report GAO-09-987 (Washington, DC: GAO, 2009), available at http://www.gao.gov/products/GAO-09-987 (accessed April 30, 2010).
13. UNESCAP News Services, Press Release G/105/2009, December 15, 2009, available at http://unescap.org/unis/press/2009/dec/g105.asp (accessed April 30, 2010).
14. Nancy Birdsall and William D. Savedoff, *Cash on Delivery: A New Approach to Foreign Aid* (Washington, DC: Center for Global Development, 2010).

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- *Can Economic Reform Open a Peaceful Path to Ending Burma's Isolation?* by Lex Rieffel and Raymond Gilpin (Peace Brief, March 2010)
- *Burma's Long Road to Democracy* by Priscilla Clapp (Special Report 193, November 2007)
- *Building Democracy in Burma* by Priscilla Clapp (Working Paper, July 2007)

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