MYANMAR: THE POLITICS OF ECONOMIC REFORM

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WORKING TO PREVENT CONFLICT WORLDWIDE

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EXECUTIVE SUMMARY

Myanmar has embarked on an ambitious program of sweeping reforms to end its isolation and integrate its economy with the global system. Closely entwined with its dramatic political transition, the end of longstanding Western sanctions is supporting this reconfiguration. If the reforms are done well, many across the country stand to benefit, but those who profited most from the old regime's restrictions and privileges will lose access to windfall profits and guaranteed monopolies. The crony businessmen, military and party elite will still do well but will need to play by new rules, meet domestic and foreign competition and even pay taxes. Perhaps recognising the opportunities a more vibrant economy in a fast-growing region will bring for all, there is no major pushback to these changes, rather attempts to adapt to the new economy. The challenges and risks are numerous for a government with little experience juggling the many changes required, but it cannot resist the pent-up political pressure for change it has already unleashed.

If done with reasonable equity and some care, there could be many winners from these economic reforms. Any successful reform package must ensure that the bulk of the population recognises it is better off as a result. That means including quick-impact measures that produce a tangible effect on their lives, such as improved access to electricity, land law reform, better public transport, cheaper telecommunications and lower informal fees of the kind that block access to health and education services. The three main losers would be the business cronies of the last regime, the military and politicians linked to the establishment Union Solidarity and Development Party (USDP). The system of monopolies and access to licenses, permits and contracts is being dismantled. The two massive military holding companies must now pay tax. The USDP and those around it have been sidelined, losing political and economic power.

Despite this reversal of circumstances for key pillars of the old regime, there is no major effort to derail the reforms. There is a strong sense in all quarters that the political winds have changed, and dramatic economic reform is inevitable. Those who benefited most from an advantageous position under the last government also realise they are well placed to profit from a revitalised and growing economy. The military is aware that its sprawling business interests, if not competitive, may become a drain on its budget rather than a supplement to it. With support for opening up the economy building across the country, previously favoured businessmen and rich politicians appear to recognise that the political risks of challenging economic reform could outweigh the likely benefits. With limited options, the cronies are trying to distance themselves from their murky past and rebrand themselves as valuable contributors to the new economy. Along the way, they hope not to draw too much scrutiny about how they acquired their personal wealth and the capital that will now give them a head start.

In recent months, the resignation of Vice President Tin Aung Myint Oo, which has been one of the most significant political events of the new administration so far, has had an economic impact. Widely regarded as a patron of the old business elite and an obstacle to key reforms, his departure may facilitate easier decision-making and smooth the way for President Thein Sein to push ahead with his economic agenda.

The economic reform process will not necessarily be without friction, and success is not guaranteed. The enormity of the task threatens to overwhelm the government's limited policymaking capacity. Decision-making is ad hoc, not yet based on a carefully-devised master plan. It will be a challenge to maintain a balance between the speed of the reforms and their effectiveness, as decades of isolation have created a political urgency that will be hard to resist. Despite the best-laid plans, changes in one policy area often create a quick or unintended need for adjustments in another. There is limited ability in the bureaucracy to deal with the workload of regulations and management that each policy and new law will create.

Myanmar's political transition and economic reconstruction are intimately entwined. Achieving either depends on achieving both. The ethnic peace processes are also closely bound up with the political economies of those border regions. As ceasefires are being secured, there will be new pressure to produce a peace dividend in these remote but

resource-rich regions. It is hard to imagine a successful political transition unless the government can ensure macroeconomic stability and sustained improvement in the lives of ordinary people, just as it is hard to imagine successful economic reform without political stability and a continued shift away from the authoritarian past. Unanticipated economic shocks, social unrest or political uncertainty in the lead-up to the next general elections in 2015 all represent potential risks to the process. But with the potential benefits of reform after decades of isolation so huge, Myanmar should not be hesitant. It sits in the middle of a vibrant region and in integrating with it has the opportunity to catch-up to its neighbours, as well as learn from their successes and failures.

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MYANMAR: THE POLITICS OF ECONOMIC REFORM

I. INTRODUCTION

Since a new semi-civilian government headed by President Thein Sein came to power in March 2011, Myanmar has embarked on an ambitious program of sweeping reforms to end its isolation and integrate its economy with the global system.

The new government inherited a dysfunctional economy, resulting from decades of mismanagement as well as the impact of Western economic sanctions.[1] Disastrous economic policies have led to many missed opportunities that have left Myanmar mostly disconnected from the world economy and exporting only $1 worth of products for every $25 sent abroad by its similarly-sized neighbour Thailand.[2] The origins of this imbalance go back to the country's independence in 1948, when it was known as Burma.[3] Devastated by the Second World War and plagued by subsequent communist and ethnic insurrections, post-independence Burma was "in shambles".[4] The two mainstays of the economy, natural resource extraction and rice production, declined precipitously. For a long time governed as part of British India, Burma failed to develop strong institutions of governance under colonialism, and the young politicians who took over in the 1950s had little relevant experience.[5] The country began life in economic and political crisis from which it has never really recovered.

The political crisis led to a military coup in 1962 that put in place a "Revolutionary Council" to run the country under the leadership of General Ne Win. The independence constitution was abrogated and all legislative, executive and judicial power placed in Ne Win's hands. Radical economic and social policies were instituted, including the nationalisation of all industries other than agriculture, with the aim of creating a socialist state isolated from outside influences.

The effects on the economy were disastrous, and by 1987 Burma was admitted to Least Developed Country (LDC) status by the United Nations. Economic malaise led to widespread political unrest. The trigger was a 1987 demonetisation of the largest currency notes, without any warning or compensation, that rendered three quarters of the currency worthless and wiped out the savings of millions.[6]

The military regime that took over in 1988 ended the failed socialist experiment and indicated that it would shift to a market economy. The regime began to reverse many socialist economic policies, but it lacked the vision and technocratic skills to successfully emulate other economically liberal authoritarian states in the region that were achieving high rates of growth. While the private sector did expand, and there was some foreign investment, many members of the regime continued to promote self-reliance over international engagement. They were stuck with the mindset of the Ne Win era and had no experience of modern governance. They found it hard to resist command economy reflexes. Rising domestic rice prices would lead to temporary bans on exports, and fluctuations of the black market exchange rate were dealt with by detaining money-changers or clumsy interventions that led to rapid and unpredictable shifts in the unofficial rate. The authoritarian and capricious leadership style of Senior General Than Shwe stifled discussion and hindered sound policymaking.

Out of concern for the political and human rights situation after 1988, many (mostly Western) countries suspended bilateral development programs, imposed economic sanctions and put in place restrictions on bilateral and multi-

[1] For background, see Crisis Group Asia Briefings N°136, *Reform in Myanmar: One Year On*, 11 April 2012; N°127, *Myanmar: Major Reform Underway*, 22 September 2011; N°118, *Myanmar's Post-Election Landscape*, 7 March 2011; and N°105, *The Myanmar Elections*, 27 May 2010; and Asia Report N°177, *Myanmar: Towards the Elections*, 20 August 2009.
[2] Ronald Findlay, "Export or die", in "16 Ways to Fix Burma", *Foreign Policy* (online), 30 March 2012. Findlay, the Ragnar Nurkse Professor of Economics at Columbia University, is originally from Myanmar.
[3] The country's official English name was changed from the "Socialist Republic of the Union of Burma" to the "Union of Myanmar" in 1989.
[4] Thant Myint-U, *The River of Lost Footsteps* (London, 2007), chapter 11.
[5] Ibid.

[6] This followed only two years after a similar demonetisation, in 1985. No warning was given on the earlier occasion either, although people were allowed to exchange limited amounts of old notes for new.

lateral engagement with the country. Sanctions were intensified after the 1990 elections, which the opposition National League for Democracy won in a landslide, but the results of which were never implemented. Myanmar became increasingly isolated from the West and from the global economy. Its external economic and political relations became skewed towards China and other countries in the region.[7]

At the time the new government took over in 2011, Myanmar was suffering from deep economic malaise, characterised by low levels of industrialisation and employment in the formal economy, a dysfunctional financial sector and gross distortions and inefficiencies.

[7] For detailed earlier reporting on China-Myanmar relations, see Crisis Group Asia Report N°177, *China's Myanmar Dilemma*, 14 September 2009; and Asia Briefing N°112, *China's Myanmar Strategy: Elections, Ethnic Politics and Economics*, 21 September 2010.

II. THE ECONOMIC LEGACY

A. Low Levels of Industrialisation

The mainstay of the economy has always been agriculture. In the 1938 fiscal year, it contributed around 48 per cent of the country's GDP; by 2007 the figure was estimated at around 43 per cent.[8] The structure of exports is also revealing. In fiscal 1938, four commodities – rice, minerals, timber and other agricultural products – accounted for nearly three quarters of the total. In the decade from 1990 to 1999, the picture was similar, with the same four commodities accounting for over 70 per cent by value (including border trade).[9] After 1999, garments briefly became the top export item (30 per cent), until U.S. sanctions imposed in 2003 caused a major decline in the garment industry. The other significant recent change has been natural gas, which became the top export item in fiscal 2001 and has accounted for up to 40 per cent of the total in recent years.[10] Industrial development is at a very low level. Little value is added to the country's abundant natural resources, and there is limited job creation.[11]

B. A Weak Banking Sector

In 2003, Myanmar suffered a major banking crisis.[12] Given the lack of transparency at the time, its origins are somewhat obscure. Part of the reason appears to have been the collapse of a number of trading companies that had been acting as informal financial institutions by taking deposits from the public (in violation of national law) and offering very high returns. These companies were involved in highly speculative investments, and some have suggested they were a type of pyramid scheme. When they started to collapse, the contagion quickly spread to the formal banking system, which was by that time dominated by a score of local private banks and a handful of state banks. In the absence of timely and effective intervention by the central bank, there was a run on the institutions. The government ordered restrictions on withdrawals and the recall of loans and mortgages at very short notice.

In addition to the significant impact on the real economy, the private banks were left crippled. Public confidence in

[8] Myint, "Myanmar Economy: A Comparative Review", Institute for Security and Development Policy, Asia Paper, Stockholm, 2009.
[9] Although the overall figures were the same, rice made up a much greater share of the total in 1938; in the 1990s, beans, pulses and teak dominated. Ibid.
[10] Ibid.
[11] In the case of natural gas, only part of the value of exports are net earnings; the rest is transferred to production partners.
[12] For detailed analysis, see Sean Turnell, "Myanmar's banking crisis", *ASEAN Economic Bulletin*, 20, pp. 272-282, 2003.

the banking system was lost and has yet to be fully regained. Myanmar now has the second-lowest level of access to credit in the world after North Korea.[13] This makes it difficult to start and grow businesses, as well as hard for farmers to invest in inputs and in increased mechanisation.[14] Banks have been serving the narrow interests of their owners, rather than providing a service to their customers, making "banking an extractive industry".[15] Reform of the financial sector is an urgent national priority.

C. Distortions and Inefficiencies

One of the major distortions in the economy has been the multiple exchange rate regime, which is now being dismantled. The kyat's official rate was used for external public sector transactions (such as imports and exports) and for accounting purposes. It was long pegged to the International Monetary Fund (IMF) "special drawing rights" (SDR) basket of currencies, giving an official rate of between five and six kyat to the U.S. dollar. In recent years, this was some 150 times stronger than the market rate of between 800 and 1,000 to the dollar.[16] Since the supply of foreign currency from public-sector exports was limited, and demand for imports at the massively overvalued official rate was insatiable, public imports were rationed under a foreign exchange budget managed by the finance and revenue ministry.[17]

The only legal way for private sector companies to obtain foreign currency for imports was from their own export receipts. This led to a situation where non-exporting companies would purchase local commodities – beans and pulses, for example – and export them in order to obtain foreign currency for imports. In many cases, informal (and technically illegal) markets were used to balance the supply and demand of foreign exchange between importers and exporters.[18]

This distorted system damaged the economy. The massive difference between official and market rates, and lack of transparency of transactions, provided lucrative opportunities for corruption and rent-seeking. The huge implicit subsidies on public-sector imports as a result of the distorted exchange rate did not necessarily result in cheap products for the public. It did encourage massive inefficiencies and wastage at state-owned enterprises and drove costs up.[19] Technical analyses suggest that the system has been a major drag on the national economy, restricting trade and stifling GDP growth.[20] The volatile and unpredictable market exchange rate undermined confidence and added to the costs of doing business.

Myanmar reportedly has among the highest costs in the world for starting a business.[21] This is symptomatic of a much broader problem of heavy government regulation that has introduced distortions and inefficiencies that have held back growth. Laws and regulations are complex or unclear and have been applied in inconsistent and non-transparent ways.[22] Permits required for many exports and imports can be difficult and costly to obtain. These obstacles have been used as an opportunity for rent-seeking and as a means of patronage.

The former government's practice of distributing licences and permits to favoured companies severely limited competition in many sectors or established lucrative monopolies. This has left a small number of crony firms dominating large sectors of the economy, resulting in high costs for consumers and businesses. Until recently, the costs of cars and mobile telephones have been massively inflated, with even old vehicles in poor condition that would be scrapped in most markets changing hands for tens of thousands of dollars and SIM cards sold for a few dollars in neighbouring countries costing $1,000 or more.

Other factors have also made it an unfriendly business environment. These include weak rule of law that has made it difficult to enforce contracts; widespread corruption; the high cost of importing new capital equipment that hampers production; extremely high transport costs as a result of poor infrastructure, expensive road tolls and antiquated vehicles; and, crucially for most industries, shortages and unreliability of electricity supply.

Myanmar also has a complicated, outdated tax system that is coupled with weak capacity in tax collection, leading to an extremely low rate of tax mobilisation. Taxes that are

[13] Crisis Group interview, World Bank official, Yangon, May 2012.
[14] "Industrial policy reform in Myanmar", paper prepared for Proximity Designs by Harvard Kennedy School and Rajwali Foundation, April 2012.
[15] Crisis Group interview, Yangon, May 2012.
[16] That is, a differential of 15,000 per cent. Several different market-determined rates exist, for dollars, for nominally dollar-equivalent foreign exchange certificates and for bank transfers, among others.
[17] For a detailed analysis, see Masahiro Hori and Yu Ching Wong, "Efficiency costs of Myanmar's multiple exchange rate regime", IMF Working Paper, August 2008.
[18] Ibid.
[19] Harvard Kennedy School, op. cit.; Myint, op. cit. An auditor general report to the public accounts committee of the legislature in March 2012 revealed "poor performance, losses and yearly falsified accounts at state-owned factories and projects" (a summary was given to Crisis Group by an individual with access to the original).
[20] Hori and Wong, op. cit.
[21] "Staff Report for the 2011 Article IV Consultation", IMF, March 2012, para. 37.
[22] Myint, op. cit.

administratively more straightforward but cause greater distortions, such as those on export and import, have been prioritised over those on income, business or sales.[23]

[23] Overall, however, tariffs are a relatively small proportion of total tax revenue.

III. ECONOMIC RECONSTRUCTION AND POLITICAL REFORM

The changes taking place in Myanmar involve simultaneous processes of economic reconstruction and political reform. Building new institutions for both sectors in tandem is a major challenge. The experience of the region has generally been of economic reform in the absence of real democratisation (such as China and Vietnam), or of economic reform followed by democratisation (such as South Korea and Thailand). This has allowed these countries either to use strong (if undemocratic) political institutions as a base for economic changes or for economic growth and the emergence of a middle class to drive democratisation.[24]

Despite the challenges involved, there may be advantages in such reforms proceeding together. Expanding freedom of expression, an increasingly independent media and freedom of association and assembly mean that it will be easier for the voice of the population to be heard by decision-makers. This can be very important in steering economic reforms, pushing for the benefits to be more equitably distributed, exposing corruption and ensuring greater respect for basic political and economic rights. The fairly strong role that the legislatures have built can also help ensure that there is some oversight of economic decision-making.

Comparative analyses have suggested that broad-based development and economic growth are most likely to be achieved in countries whose political and economic institutions are inclusive.[25] The current reform process provides a rare opportunity for Myanmar to put the right institutional framework in place. The wide-ranging political changes that are underway have also created openness to fundamentally rethinking basic economic approaches. As the country moves ahead, there are a number of important challenges.

A. Ad-hoc Decision-making

The speed with which political and economic reform is being pushed and the limited policymaking capacity of the government have meant that decisions tend to be ad-hoc, rather than carefully planned. Those driving the reforms have had little time to step back and make strategic decisions or develop any sort of master plan.

[24] In Indonesia, the experience was one of democratisation without significant economic changes.
[25] Crisis Group interview, development economist and head of a local NGO, Yangon, May 2012. See, in particular, Daron Acemoglu and James Robinson, *Why Nations Fail: The Origins of Power, Prosperity and Poverty* (London, 2012).

While well-connected individuals speak of an "instinctive desire" among President Thein Sein, lower house speaker Shwe Mann and other key reformers to move away from the old way of doing things, the government is not clear about precisely what the new economic policy approach should look like. The president has articulated in meetings with potential foreign investors his main investment priorities, such as power, telecommunications and transport links to neighbouring countries, as well as employment-intensive industry. These objectives have yet to be translated into a concrete policy framework with the right incentives.[26]

This lack of a detailed strategic vision for the economy has significant consequences. For example, following the decision to suspend the Myitsone dam project, policymakers are reportedly inclined towards a comprehensive review of major government contracts agreed prior to the transfer of power.[27] In the absence of a national economic plan and set of economic priorities against which to assess such projects, any comprehensive review will be difficult.[28] Myanmar has also signalled that it is considering joining the Extractive Industries Transparency Initiative, which is aimed at increasing openness in the use of revenues gained from the oil, gas and mining sectors.[29]

Without being able to lay out a clear roadmap for economic reform, the government will create uncertainty for businesses and thus discourage investment. It also means that specific policy decisions are not always predictable, such as the easing of restrictions on car imports.[30] The timing of that announcement caught car dealers by surprise, and the resulting drop in second-hand prices of over 50 per cent left many suffering large losses, including on vehicles that were in transit from Japan.[31] Part of the reason for the lack of transparency may have been that liberalising vehicle imports is a sensitive issue, given that strict regulation has been a source of economic rents for powerful individuals. The authorities did not want to announce their intentions too clearly in advance for fear that this might provoke a pushback from those whose interests would be adversely affected.[32]

Irrespective of whether this explanation is correct, it raises the more general question of the extent and seriousness of pushback to the economic reforms (see Section IV below). Within the government itself, those opposing the reforms are becoming less and less visible, and a prominent Myanmar political analyst has suggested that distinction needs to be made between "hardline" and "conservative" views.[33] The "hardline" view seeks to preserve the old system of politics, now widely regarded as untenable due to the nature and extent of the reforms and the momentum they have generated. The "conservative" view seeks to preserve the old economic system that provided considerable economic rents and monopolistic advantages to a small group. It has been associated with the departing vice president, Tin Aung Myint Oo, and some of his colleagues in cabinet (see Section V below).

B. The Continued Importance of Personal Connections

In the new political structure, decision-making and power are more diffused. Under the old system, a handful of generals – and ultimately a single individual – was responsible for all major decisions. This has ended. The economy was tightly controlled by a system of licences and permits. Decisions on these were made in a non-transparent way by a small number of senior military officers. Securing them required money and good political connections. This led to the dominance of two groups in the most regulated – and lucrative – sectors: a small number of crony businessmen and the military-controlled holding companies Union of Myanmar Economic Holdings Limited and Myanmar Economic Corporation (see Section IV below).

[26] Crisis Group interview, prominent Myanmar political analyst, Yangon, May 2012.
[27] The massive Myitsone hydropower dam, a $3.6 billion project in Kachin State being constructed by a Chinese company, had been the subject of widespread public protest, in Kachin State itself as well as across Myanmar. On 30 September 2011, President Thein Sein unexpectedly announced suspension of work on it. The decision – in effect a cancellation – was conveyed in a letter read out in the upper and lower houses of the legislature. In his letter, the president cited "public concern" as the reason for his decision. For more detail, see Crisis Group Asia Report N°214, *Myanmar: A New Peace Initiative*, 30 November 2011.
[28] Crisis Group interview, prominent Myanmar political analyst, Yangon, May 2012.
[29] Crisis Group interview, Myanmar cabinet minister, June 2012.
[30] On 7 May 2012, the commerce ministry announced that Myanmar nationals holding foreign currency bank accounts were permitted to import a car less than five years old without an import permit. See "Car Import Supervisory Committee meets", *New Light of Myanmar*, 8 May 2012.
[31] Crisis Group interview, member of the Union of Myanmar Federation of Chambers of Commerce and Industry, Yangon, May 2012; also "Car prices dive after rule change", *Myanmar Times*, 14-20 May 2012.
[32] One consideration cited in support of this interpretation is that on previous occasions when steps were taken to ease regulations on car imports, there was evidence of speculative activity in advance of the announcements, indicating that insiders were aware of the coming changes. On this occasion, no speculative activity was observed in advance of the announcement. Crisis Group interviews, member of the Union of Myanmar Federation of Chambers of Commerce and Industry, Yangon, May 2012; journalist, Yangon, May 2012.
[33] Crisis Group interview, Yangon, May 2012.

The new climate of political openness means that there is now greater transparency in decision-making. Government contracts are being put out to tender, and the Trade Council that used to control the allocation of permits has been abolished. Decisions are now more likely to be made by technocrats on the basis of their merits rather than by generals, and there is the prospect of a more level playing field emerging.

While the intention is clearly to open the economy and shift away from restrictive licences and permits, the necessary reforms to achieve this in practice have not yet been instituted.[34] In the meantime, much business activity still requires political approval. Personal connections remain indispensible to ensure the timely approval of requests and to circumvent the stifling layers of bureaucracy in ministries. Conducting successful business is still very much about whom you know.

C. Speed versus Effectiveness

If the impact of the reform process is to be felt by ordinary people, it is crucial that their welfare improves. This requires putting in place key economic reforms. With so much that needs to be changed, the government is impatient for change, as is the general population. With the issues complex and interlinked, there is the possibility that policy mistakes could have serious consequences on livelihoods, economic growth and the shape of the economy. It is important for reformers to find the right balance between the speed of the economic reforms and their effectiveness. Move too slowly and the impact will come too late, however well-crafted the policies. But move too fast, and policies may end up being ineffective or counterproductive.

Policymakers are aware of this and know that they are potentially moving too quickly.[35] But there is also a cascade effect: the reforms are highly interconnected, and making one change to the economic system usually requires making others. The managed float of the kyat on 1 April was done before the creation of an independent central bank with the ability to intervene effectively in the exchange market. The central bank neither holds the country's foreign exchange reserves nor has the necessary early warning systems in place to provide real-time information to guide timely action. Rectifying this has become an urgent priority. A top economic policymaker spoke of having "a sense that we are rushing into things that we don't know enough about".[36] The government has access to advice, including from the Bretton Woods institutions, but there is a feeling that in some cases it needs to move faster than they are able to respond.

The enormity of the task of economic reconstruction also creates a political imperative to move forward. President Thein Sein has identified his key economic priorities as rural development and equitable growth.[37] Such priorities only make sense if they are embedded within a process of totally reconfiguring economic governance. To be effective, they not only need to be clearly articulated, they also need to be linked to the prioritisation and sequencing of specific reforms, including incentive structures.[38] Although a master plan for comprehensive rural development has been prepared, no broader reform plan has been developed.

The government has begun to address key issues such as the float of the kyat to eliminate the multiple exchange rate system and the distortions it introduces; dismantling of monopolies (such as in edible oils, fuel, vehicles and possibly soon telecommunications); promotion of foreign investment,[39] with a stated emphasis on industries that add value to Myanmar's raw materials and those that promote job creation; human resources development and the return of skilled workers from the diaspora; boosting electricity generation; improving export-oriented transport infrastructure; boosting tax mobilisation and promoting growth through comprehensive tax reform; rehabilitating the banking sector and implementing broader financial sector reform.

This list, which is only a selection of the reform steps being taken, would be a major undertaking for any government. There are many other issues that the authorities cannot avoid dealing with, including: ensuring the exchange rate remains stable, but also not overvalued, so as to protect and promote manufacturing and agricultural produc-

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[34] Crisis Group interview, Yangon-based corporate adviser, May 2012.
[35] Crisis Group interview, economic adviser to the president, Yangon, May 2012.
[36] Crisis Group interview, Yangon, May 2012.
[37] Ibid.
[38] Crisis Group interview, economic adviser to the president, Yangon, May 2012.
[39] A new foreign direct investment law is due to be approved by the legislature at its current session. The legislation should make the country more attractive for foreign investors, although much will depend on the detailed implementing regulations. It will update the existing foreign investment law dating from 1988; permit fully foreign-owned businesses (also permitted under the existing law); create new tax incentives; allow foreigners to lease land for business purposes; and protect investments against nationalisation (a provision also contained in the existing law). A new requirement would be introduced that all unskilled workers must be from Myanmar, as must a minimum proportion of skilled workers that increases over time (from 25 per cent after five years to 75 per cent after fifteen years). Crisis Group interview, economic adviser to the president, Yangon, May 2012; see also "Myanmar drafts new foreign investment rules", Reuters, 16 March 2012.

tion; tackling corruption; protecting against the possibility of rising inflation; dealing with rampant land speculation and the potential for land grabbing; and ensuring that new land legislation does not lead to dispossession of small landholders and those holding traditional title.

It is inevitable in such a rush to reform that poor policy decisions will sometimes be made. Several new laws have been adopted that have turned out to contain flaws. Unlike in the past, when there was a reluctance to admit mistakes or revisit decisions once they had been taken, there seems to be greater willingness to rethink policies and revise decisions. The Myanmar Special Economic Zone Law was adopted in 2011 shortly before the new government took office and is being thoroughly revised only a year later.[40] A new bill is expected to be submitted shortly to the legislatures. While the scale of the task of economic reconstruction can be overwhelming, there is also some optimism among policymakers, who see this as an opportunity: "Myanmar", said a senior government figure, "has a fantastic opportunity to get this right".[41]

D. Limited Capacity

One of the major impediments to the economic reform process is the lack of expertise and technical capacity at all levels. This is a result of chronic under-investment in the education sector over many decades. The civil service was weakened under successive military governments by favouring loyalty and military background over technocratic capability. The restrictive environment encouraged a brain-drain of talent, with the best qualified citizens often leaving the country to work overseas.

This has left only limited policy formulation capacity in the government, civil service and the legislatures and created serious constraints on their ability to put in place new policies. Lower levels of the administration have become so used to top-down instructions that they rarely take any initiative, which can be particularly problematic at a time of major policy changes. Even when the policies are communicated by superiors, there is often a lack of comprehension or will among subordinates. Those at the implementation level can be perpetually "awaiting further instructions" – and implementation can be perpetually postponed with requests for detailed instructions or further clarifications from higher levels.[42]

When new policies are implemented in good faith, there can be other capacity challenges. The recent liberalisation of car imports allowed nationals holding foreign currency bank accounts to import a car less than five years old without requiring an import permit. People wishing to take advantage of this had to obtain a certificate from their bank showing that they held such an account with sufficient funds. The high demand in the days following the announcement created long queues at the banks, hampering normal operations for businesses and individuals.[43]

There continues to be pressure from the political level to speed up the reform process and for the administration to deliver concrete results. Ministers are putting pressure on their ministries to improve service delivery, for example by decreasing the time to process paperwork or issue documents such as identity cards or passports. But without a proactive administration ready to take the initiative to change organisational processes, rather than just push them to complete the same procedures faster, tangible results will remain elusive. Such restructuring requires careful assessments of regulations and proposals for streamlining them, and procedural audits to identify and remove red tape. These changes will not happen quickly, but there are examples of other countries in the region, such as Cambodia, that have implemented them.

Experience from elsewhere also highlights the enormous value of these kinds of changes, not only in terms of economic efficiency, but also in other ways. Some of the most lucrative opportunities for corruption arise from excessive regulation. Removing the bureaucratic obstacles can be one of the most effective ways to tackle corruption. Opaque, capricious and complicated rules also encourage cronyism, since only those with access to decision-makers are able to bypass the difficult institutional hurdles and get things done. Whether the new government leaders can move away from cronyism, as they say they desire, towards a rule-based system will depend on their success with the structural reform of institutions.[44]

Lack of capacity does not just affect the public sector; it is also a problem for private enterprise. Apart from issues with human resources development, there are limited support services, including lawyers, accountants and auditors. Many policymakers and members of the business community feel that Myanmar enterprises are not equipped to deal with the regional competition that will come in 2015, when the Association of South East Asian Nations (ASEAN) Economic Community comes into effect.[45]

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[40] State Peace and Development Council Law no. 8/2011 of 27 January 2011.
[41] Crisis Group interview, Yangon, May 2012.
[42] Crisis Group interview, economic adviser to the president, Yangon, May 2012.
[43] Crisis Group interview, editor, local economics journal, Yangon, May 2012.
[44] For a detailed discussion of corruption in the Myanmar context, see Myint, "Corruption: causes, consequences and cures", *Asia-Pacific Development Journal*, 7.2, December 2000.
[45] Crisis Group interviews, government policymakers and businessmen in Myanmar over the last year.

E. Remaining Economic Sanctions

Myanmar has long been subject to a patchwork of sanctions and other measures, implemented at different times by various Western countries. Crisis Group has long believed that, taken as a whole, these have been highly counterproductive.[46] In response to the rapid changes that have taken place in Myanmar, they have been considerably eased, but some remain in place.[47]

The European Union (EU) announced in April 2012 that it was opening "a new chapter in its relations with Myanmar" and that it was suspending – but not lifting – all its sanctions, except for the arms embargo.[48] The suspended measures include asset freezes on named individuals and enterprises, as well as sectoral investment and import bans. The EU also denies Myanmar access to preferential tariffs on its products under the Generalised System of Preferences. This measure was the result of a separate procedure, and access to these preferences has not yet been reinstated but could be very soon.[49]

The U.S. eased some of its financial and investment sanctions on 11 July 2012, following an announcement in May that it intended to do so.[50] While the underlying legislation remains in place,[51] President Obama has used his executive powers to authorise new U.S. investment in the country, prohibited since 1997. He has also authorised the export of financial services, prohibited since 2003 – a key step because this measure had in effect excluded Myanmar from the international, U.S. dollar-based clearing system. New investment over $500,000 is subject to a reporting requirement intended to promote responsible business activity.[52] The U.S. still prohibits its nationals from dealing with individuals and companies in Myanmar that are on the Office of Foreign Assets Control's designated list.[53]

For many years, the U.S. also used its voting power in international financial institutions to in effect prohibit their assistance to Myanmar, but it now supports their limited re-engagement. Limited technical assistance can now begin, but Myanmar will need to clear its arrears in order for lending to resume. The World Bank is in the process of opening an office in Yangon to begin implementing an interim technical assistance package. There is also a possibility for Myanmar to join the Multilateral Investment Guarantee Agency, part of the World Bank Group that provides political risk insurance to the private sector in markets where such insurance is not otherwise available.[54] This could be important in facilitating foreign direct investment.

Surprisingly, the ban on the import of all Myanmar products into the U.S. that was due to lapse in 2012 may now be retained.[55] On 18 July, the Senate Finance Committee recommended passage of a bill that would extend it for three more years, in what its supporters said was an effort to keep pressure on the government to maintain reforms.[56] Passage by both the full Senate and House is required to make this law. If this step is taken, it could have a serious impact on Myanmar's economic recovery, by hindering the growth of job-creating manufacturing industries and further skewing the economy towards potentially problematic extractive industries.

Prior to the introduction of the import ban, the largest exports to the U.S. were garments, an industry that was providing employment to many people. The measure would exert no obvious pressure on hardliners in Myanmar, who are not setting the political agenda and whose economic interests are not in manufacturing. Aung San Suu Kyi reportedly telephoned Senator Mitch McConnell (the leader of the Republican Party minority in the upper house) on 16 July to ask him to support the removal of remaining sanctions, as they could hinder investment that is badly needed to improve livelihoods.[57] It may be that election-year U.S. politics is driving this measure more than the situation in Myanmar. The president has the authority to issue a waiver

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[46] For the reasoning, see, for example, Crisis Group Briefing, *Myanmar's Post-Election Landscape*, op. cit., p. 10 and fn. 35.

[47] Australia, Norway and Switzerland have removed all their sanctions, with the exception of arms embargoes.

[48] "Council conclusions on Myanmar", 3159th European Union Foreign Affairs Council meeting, Luxembourg, 23 April 2012.

[49] Ibid. Paragraph 8 of the Council conclusions states that it "supports reinstating the Generalized System of Preferences (GSP) for Myanmar/Burma as soon as possible once the required conditions are fulfilled, following the assessment of the International Labour Organisation". The reference to the ILO relates to the fact that the original denial of GSP was in part related to the forced-labour situation in the country. The recent decision of the ILO to ease its own measures against Myanmar in light of progress on forced labour should open the way to an early reinstatement of GSP by the EU.

[50] "Administration eases financial and investment sanctions on Burma", Fact Sheet, Office of the Spokesperson of the U.S. Department of State, 11 July 2012.

[51] This includes, inter alia, the Burmese Freedom and Democracy Act of 2003 and the Tom Lantos Block Burmese JADE (Junta's Anti-Democratic Efforts) Act of 2008.

[52] U.S. Department of State Fact Sheet, op. cit.

[53] This list currently includes 111 entries for Myanmar; see http://sdnsearch.ofac.treas.gov.

[54] Crisis Group interview, World Bank official, Yangon, May 2012.

[55] The Burmese Freedom and Democracy Act of 2003 introduced the ban and made it subject to annual renewal for a maximum of nine years.

[56] Doug Palmer, "Senate panel votes to renew Myanmar sanctions", Reuters, 18 July 2012.

[57] Min Zin, "Can we fine-tune the sanctions against Burma?", *Foreign Policy* (online), 20 July 2012; "Suu Kyi asks U.S. to remove more sanctions", *Mizzima*, 18 July 2012.

at any time to overturn the measure, and the administration has indicated it is ready to consider using this flexibility.[58]

President Thein Sein has spoken out against the failure of some Western countries to remove their economic sanctions. He has said that the EU decision to suspend rather than lift its measures creates uncertainty and is thus a disincentive to investment. In a recent interview, he stated that "it is extremely important that sanctions be lifted – both financial and other economic sanctions – to make possible the sort of trade and investments that this country desperately needs at this time".[59] At this stage in the reform process, it is indeed hard to see how retention by the U.S. of its import ban could in any way serve the interests of the Myanmar people or assist the democratisation process.

[58] Thomas Kean, "U.S. will look at import ban waiver, says ambassador", *Myanmar Times*, 23-29 July 2012.
[59] Interview with correspondent Gwen Robinson, reported in "Myanmar leader urges end to sanctions", *Financial Times*, 11 July 2012.

IV. WINNERS OR LOSERS?

The major reforms that have been initiated, underway or planned will fundamentally reshape the economic landscape. The aim is to create a more level playing field for business by eliminating the distortions associated with the multiple exchange rate regime, dismantling monopolies, ending privileged access to licenses and import permits, and introducing competitive tendering procedures for government contracts. Those who have been shut out of the highly-controlled economy should benefit, but who will lose, how will they react and what impact could they have on the entire reform process? In the past, the three main economic power centres were the business associates of the military regime (the cronies), the military itself and the ruling party, the USDP. Each could lose out significantly in the transition, but will they have the will or the capacity to resist the changes?

A. Crony Businessmen

Economic liberalisation does not necessarily lead to a more equitable distribution of resources. It can provide entrenched business interests with an opportunity to consolidate their hold over the economy. Under the military government, a small number of entrepreneurs had privileged access to business opportunities. Though typically referred to a cronies, it was perhaps more accurate to regard them as proxies of the military regime. They received privileges because they were useful to it, not because they wielded any particular influence over it. Together, these fifteen to twenty individuals controlled a major part of the national economy.[60]

The reforms being initiated are a challenge to the dominance of these business interests. Their key sources of revenue are being removed, including control of monopolies as well as privileged access to permits, licenses, and major government contracts. They recognise they have much to lose in the new economic reality. For a number of reasons, it appears that they will accept a diminished role rather than try to challenge or disrupt the changes. First, they have limited political power, as the president is widely seen as incorruptible and without close connections to any major business interests. He and the other main architects of the reforms have spoken out against corruption and have stated their determination to establish a more level playing field and move away from the old sys-

[60] For a list of individuals considered by Western governments to be deriving privileged economic benefits from the former regime, see successive EU Common Positions on Myanmar and similar lists compiled by the U.S. and others, for example, European Council Common Position 2009/615/CSFP of 13 August 2009, Annex II, section J.

tem of special economic privilege.[61] Secondly, reformists feel that the cronies "have taken too much and done too little".[62] This leaves them with little opportunity to leverage wealth into political influence and challenge the reforms. Finally, as long-time rivals, they do not appear to be in a position to cooperate closely in pursuit of a joint agenda.[63]

The resignation of Vice President Tin Aung Myint Oo (discussed below) has also had an impact. He was seen as being very close to and a promoter of the interests of some key business conglomerates, particularly the large Asia World conglomerate. With his departure, the government has been able to move more decisively away from the old ways of doing business.[64]

Even if these businessmen were able to join forces, it is not clear that they would benefit from mounting a challenge to the reforms. The risk for them would be that they might provoke a backlash from the authorities, and from an increasingly active and aware civil society, which could lead to investigations of past business practices, potentially resulting in confiscation of their wealth and perhaps even criminal charges. They mostly appear to be following the alternative path of keeping their heads low, preserving their wealth and trying to rebrand themselves.[65] In this way, they could expect to maintain a reduced – but still substantial – share of a more dynamic and growing economy. They are also aware that the previous system, although they derived great advantage from it, was highly unpredictable. Their business can benefit from the rules of the game being clear and predictable.

There have been obvious attempts on the part of some of these individuals to rebrand or reposition themselves. They have shown a new openness to speak to the domestic and international media as part of efforts to build a new public profile.[66] They have also reached out to the leading opposition figure, Aung San Suu Kyi, in various ways – with offers of support to her National League for Democracy (NLD), as well as attempts to build closer relations with her personally.[67] They appear to recognise the country is changing dramatically, and they too must change. During Aung San Suu Kyi's first visit to Naypyitaw in August 2011, she attended a national workshop on economic reform convened by the president, at which several prominent businessmen lined up to greet her.[68] She also attended a football match in September 2011 at the invitation of the chairman of the football federation, himself a prominent businessman.

The NLD also received considerable support for its by-elections campaign from some in the business community.[69] There is also new talk of philanthropy.[70] This may be partly linked to cyclone Nargis in 2008, when some of the business community played a significant part in the relief effort, but it is also clearly linked to efforts at an image makeover.

The extent to which these dominant businessmen will be successful in the new economy depends on a number of factors. Even if they may now face strong competition, their dominant position in many markets gives them an early bird advantage. Their accumulated wealth provides access to otherwise scarce working capital. To date, they have also been able to attract the best staff from a very limited pool of skilled professionals in the country. But they also face major obstacles. Probably the most challenging will be to convert their business model from one based on privilege to open competition. Some are skilled businessmen, but others have been engaging mainly in rent seeking and may not have what it takes to run successful businesses in an increasingly free market.[71] Even those who have the skills may need to fundamentally restructure their companies, away from sectors that they were involved in purely because they received government permits in those areas and towards areas where they have a genuine competitive advantage.

To date, no major public sector contracts have been approved by the new government. All the major projects underway were awarded prior to the transfer of power. The new government has called a halt to some of the larger and more questionable of these – the Myitsone dam in Kachin State, as well as a $4.5 billion government mega-factory project to have been located in Myingyan (Mandalay Region) and run by a dedicated ministry, as well as a new mega-port to have been constructed 70km from Yangon by the Asia World company.[72]

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[61] For example, Vice President Sai Mauk Kham stated in a speech to policymakers on reform strategy that investment and trade must be "in the interest of the entire people, not in the interest of a handful of people", *New Light of Myanmar*, 14 May 2012.
[62] Crisis Group interview, long-time resident foreign businessman, Yangon, May 2012.
[63] Crisis Group interview, Myanmar academic, Yangon, May 2012.
[64] Crisis Group interview, individual close to the president's office, Yangon, May 2012.
[65] Crisis Group interview, Myanmar academic, Yangon, May 2012.
[66] Jason Szep and Andrew R.C. Marshall, "An image makeover for Myanmar Inc", Reuters, 12 April 2012.
[67] Crisis Group interview, opposition activist, Yangon, May 2012.
[68] Crisis Group interview, individual present at the event, Yangon, October 2011.
[69] Crisis Group interview, opposition activist, Yangon, May 2012.
[70] "An image makeover for Myanmar Inc", op. cit.
[71] Crisis Group interview, long-time resident foreign businessman, Yangon, May 2012.
[72] The mega-factory project was stopped by the legislature, which did not approve its budget allocation. The government is

When major government contracts are awarded in the future, it is intended to be on the basis of competitive tender.[73] With foreign companies entering the arena, winning such contracts will likely require strategic partnerships between them and local companies. These international companies can bring technology and expertise, but they will be looking for local partners with the best staff and strongest market position. Many foreign firms, and particularly Western companies, will be concerned with regulatory and reputational risk. This may lead them to avoid entering into partnerships with those who had close relations with the military regime. As long as some individuals remain on Western sanctions lists, a residual regulatory risk will remain.[74]

Some of the old business elite do wield formal political power. Ahead of the 2010 elections, the regime encouraged several prominent businessmen with whom it had close links to contest seats, and some are now in parliament. While there is no evidence of impropriety, observers have raised questions over their role in the crafting of new land legislation, which inter alia removes a cap of 5,000 acres on registered holdings. Some of the companies associated with these individuals have acquired control of vast tracts, the ownership of which they had previously been unable to register. Some of these parliamentarians also have voted against new environmental legislation or have introduced legislative proposals and questions relating to the development of the mining sector.[75] Myanmar will not be immune to the region's money politics.

B. The Military

Over its decades of control, the military has developed a huge footprint in the economy. Leaders of successive governments have used their power to issue licences and permits to privilege their own business interests and build up a powerful military-economic complex. The main component of this is a pair of vast military holding companies: the Union of Myanmar Economic Holdings Limited (UMEHL) and the Myanmar Economic Corporation (MEC). The MEC was formed to promote the establishment of heavy industries that could generate profit, but also for strategic reasons, to ensure the military would have access to supplies of important materials such as steel, cement and rebar. The UMEHL, headed by the adjutant-general, was set up to generate profits from light industry and trading in commercial goods.

These conglomerates performed several functions. First, they were a source of off-budget support for the military as an institution, which owned a significant stake in both. They provided the commander-in-chief with a revolving fund that could be used for special projects without budgetary oversight.[76] Secondly, they provided an income stream for retired senior officers, who could purchase shares in UMEHL and live off the dividends.

The companies made their profits mainly through the special privileges they received. In most sectors, major foreign investments had to be through joint ventures with them. They also monopolised many markets through their economic power and links to decision-makers, and because other companies would not dare to compete with them. UMEHL long dominated the rice trade, as well as cigarette and alcohol production and distribution, and had a virtual monopoly on car imports. While they never were allowed to bring goods into the country at the official grossly overvalued exchange rate (only the military itself did), they had privileged access to import and export permits. They were also exempt from corporate and import taxes.[77] Beyond this, there were opportunities for key individuals to make sizeable sums from corruption and kickbacks.[78]

The new government reportedly felt that given the power of these conglomerates and their intimate connections to the military, their status and privileges were a matter to be handled with some delicacy.[79] Nevertheless, from the outset there were strong signals that they would not be exempt from moves to create a more level economic play-

still formally considering the port project, but there are no indications of willingness to approve it. Crisis Group interview, individual with first-hand knowledge, Yangon, May 2012.

[73] Crisis Group interview, government economic decision-maker, June 2012.

[74] Crisis Group interview, long-time resident foreign businessman, Yangon, May 2012.

[75] Second Session of the Amyotha Hluttaw (upper house), 22 August-16 November 2011.

[76] There is currently a behind-the-scenes dispute over whether these holding companies should come under the military or the defence ministry. Crisis Group interview, Myanmar academic, Yangon, May 2012.

[77] Ibid.

[78] One recent case of alleged corruption involved a commuter bus line owned by Bandoola Transport Service, a subsidiary of UMEHL. After a number of accidents, a transport department investigation found that more than one quarter of the company's 400 drivers had fake driving licenses. According to an individual with knowledge of the case, company managers were allegedly using their positions to give jobs to members of their extended families. Crisis Group interview, individual having knowledge of the case, Yangon, May 2012. See also Yadana Htun, "Parami drivers caught in fake licence sting", *Myanmar Times*, 19-25 December 2011. That the transport department felt in a position to launch such an investigation and refer its findings to the police, and that it could be reported in the domestic media, are themselves indication the UMEHL is no longer untouchable.

[79] Crisis Group interview, adviser to the president, Yangon, May 2012.

ing field.[80] UMEHL's monopoly on edible oil imports, which it had held since 1999, was ended soon after the current leadership came to power in 2011; within weeks, prices had dropped 30 per cent.[81] Its dominance in importing vehicles was ended in October 2011, and its lucrative monopoly on beer licenses is also soon to be eliminated.[82] The two conglomerates were also required to start paying taxes.

Without such privileges, it is uncertain whether they can continue to be profitable, as their management has limited business experience, and senior appointments often had little to do with the business acumen of the appointee.[83] International joint-venture partners may question the value of these conglomerates as reliable local partners in an open economy.

The military's hold over the economy is diminishing. Why would it allow this to happen? In the case of the old business elite, one explanation for acceptance of the new policies may be that they lack the power to alter them. This can hardly be said of military leaders who retain significant formal and de facto political influence. There would seem to be several reasons. First, Commander-in-Chief Vice-Senior General Min Aung Hlaing and the institution (although not necessarily all its members) are supportive of the reform process. They understand that in order to have a well-functioning economy, the old ways of doing business must change, and this includes reduction of the military's control. One notable example is that in 2012, for the first time, budget proposals for the defence ministry and the armed forces were submitted to the lower house, where some legislators questioned the size of the request (around 15 per cent of the total budget). Previously there had been no transparency, much less any scrutiny of military expenditure.[84]

There are also reasons why the military's leadership may prefer a diminished economic role for the military conglomerates. It may prefer that the institution get as much of its resources as possible from the regular budget, since this is a more predictable source – even if the military portion is now subject to legislative scrutiny and approval. The loss of tax breaks creates new liabilities, and an end to monopolies means income is not guaranteed. There is a risk that the poorly-run conglomerates could become loss-making enterprises, requiring injections of capital and reformed management, rather than a source of profits.[85]

Beyond these balance sheet risks, the commander-in-chief's power base may actually be challenged rather than enhanced by the conglomerates. As a new leader inheriting a hierarchy selected by others, he has had to consolidate his power base within the institution. This has included a purge of a number of senior officers, many of whom were removed as part of an anti-corruption campaign. The military conglomerates represented a potential threat to this power base, as they were staffed by officers loyal to the previous leadership. The companies generate a revenue stream for – and hence bolstered the power of – retired senior officers whom the commander-in-chief did not necessarily trust.[86] In addition, once corruption has been used as the reason for removing people from senior posts, even if it was an excuse, it inevitably imposes some self-restraint. This may also have led the commander-in-chief to distance himself from the conglomerates, which are a well-known source of corruption within the military.

At the regional level, the reduced role of the military in the economy is even clearer. In the past, the military had a "self-reliance" policy for units in the field, which were required to generate their own revenue for non-operational expenses. Regional commanders were also simultaneously vested with both administrative and military power. This encouraged informal taxation, selling of concessions and income-generation projects, such as agriculture and aquaculture. Many of these relied for their profitability on use (or abuse) of administrative powers.

Since the transfer of power to the new government, the military commands have transferred their administrative responsibilities to the chief ministers of the states and regions, many of whom are retired senior officers, decreasing opportunities for profit-making by active duty commanders. In addition, it is probably not in the interests of the new commander-in-chief that such self-reliance practices continue. In the past, the huge powers and economic resources of the regional military commanders created virtual fiefdoms, where it was not always clear how far the writ of the central command extended. For a new leader trying to consolidate his power, too much financial autonomy for far-flung commands is a threat. This may be at least part of the reason why, immediately after taking office, he ordered that all self-reliance business activities

[80] For a detailed discussion of how the military's role has changed, see Mary Callahan, "Military politics in post-junta, constitutional Myanmar", *Journal of Democracy*, forthcoming (October 2012).
[81] Juliet Shwe Gaung, "New govt changes import/export licence system", *Myanmar Times*, 2-8 May 2011; and "Yangon's many faces of change", *The Wall Street Journal*, 5 November 2011. For background, see also Koichi Fujita and Ikuko Okamoto, "Agricultural policies and development of Myanmar's agricultural sector: an overview", discussion paper no. 63, Institute of Developing Economies, June 2006.
[82] Callahan, "Military politics", op. cit.
[83] Crisis Group interview, editor of a local economics journal, Yangon, May 2012.
[84] Callahan, "Military politics", op. cit.
[85] Crisis Group interview, Myanmar academic, Yangon, May 2012.
[86] Ibid.

and income-generation schemes by military units must stop, with only the two military holding companies allowed to conduct business on behalf of the military.[87]

C. The USDP and the Old Guard

The third locus of economic power in the past centred on a few rich ministers in charge of lucrative portfolios, several of whom became key figures in the USDP. The party was created by Senior-General Than Shwe to be the political platform for the establishment, and it dominated the flawed 2010 elections. Despite this, it has subsequently been sidelined. Under the new constitution there is no ruling party as such. Rather, elected representatives form an electoral college that votes for a president and two vice presidents, and the president then chooses his cabinet – the members of which need not be elected representatives or from the winning party. The president, vice presidents and members of cabinet are constitutionally prohibited from taking part in any party activities while in office. This establishes a formal – if minimal – separation between party and government.

Since March 2011, the USDP has found itself with very little influence or role, as in the reformist environment it is a political liability for those now in charge. It is a powerful symbol of the past – of dictatorship and military rule – that looks increasingly anachronistic. After it was routed by the NLD, winning only one of 45 seats in the April 2012 by-elections, it has descended into an even deeper crisis.[88] It seems very unlikely that it will be able to win, or even take a significant minority of seats, if the 2015 general election is free and fair.

It is not clear what the USDP could do to reverse its political or economic fortunes, since it is members of the party's own leadership that are pushing the reform process. Reportedly some of the party chiefs who are unhappy with the situation have made a number of attempts to encourage Than Shwe to take up the leadership. These have been unsuccessful, as have attempts by the party faithful to reach out to other heavyweights from the old regime.[89]

Economically, the party no longer receives benefits from the state, and although it controls a lot of fixed assets such as land and offices, it has little liquidity. Some senior members, including its first secretary, Aung Thaung, have great personal wealth and major business interests, but it is not clear to what extent they would be prepared to place these assets at the disposal of the party. Although these individuals are active in the legislatures and lobbying in support of a conservative agenda, there are no indications that they are inclined to use their money to build a political empire or mount any major challenge to the reform process. A well-connected individual observed: "If it's a question of the party or their personal wealth, they'll drop the party".[90]

[87] Crisis Group interview, Yangon, April 2011.
[88] For discussion of the by-elections, see Crisis Group Briefing *Reform in Myanmar*, op. cit., Section IV.
[89] Crisis Group interview, Myanmar academic, Yangon, May 2012.
[90] Crisis Group interview, individual close to the president's office, Yangon, May 2012.

V. THE DEPARTURE OF THE VICE PRESIDENT

Probably the most significant event in the new government's term so far with regard to shaping the political economy has been the departure of Vice President-1 Tin Aung Myint Oo. He was widely regarded as a hardliner, with very close links to the old business elite. He had been an obstacle to the reform process personally and because a number of cabinet ministers, including the finance minister, were aligned with him. This group has not been powerful enough to block key economic and political reforms, but they have complicated the decision-making process and frustrated the introduction of some changes. The president avoided direct confrontation with the vice president, instead containing his influence by not assigning him major responsibilities and giving clear backing to ministers who took a different view. "Tin Aung Myint Oo didn't prepare himself for the new paradigm, so he became a victim of the paradigm shift".[91]

This isolation and the sense that the winds of change were blowing against him likely contributed to his decision to submit a letter of resignation on 3 May. The official reason he gave was poor health, but this does not appear to be the full story.[92] He submitted his resignation not only to the president, but also to the other key legislative and executive leaders, and then entered the monkhood, began long sessions of meditation and avoided any contact with the government.[93]

The resignation created a complex procedural situation. Under the constitution, he could not have been removed from office other than via a lengthy impeachment process and it seems clear that his departure was his own decision. The constitution provides that on the resignation of a vice president, the Union legislature – if not already in session – must be convened within 21 days to select a replacement.[94] This period is supposed to start not from the day the resignation letter is submitted, but from the day the president informs the legislature. The vice president submitted his letter on the day after the third legislative session ended.[95] Since it had gone into its main two-month recess for the monsoon season, it would have been complicated and disruptive to have recalled it for an emergency session. It would also have required meeting without Aung San Suu Kyi, who was travelling in Europe until the start of the next regular session on 4 July.

The president did not immediately accept the vice president's resignation for these reasons and also because the informal behind-the-scenes process of selecting a successor was anticipated to be lengthy. This delayed the start of the 21-day constitutional deadline for convening the Union legislature and explains why no official confirmation was or could be given of the resignation, even though details were widely rumoured, reported internationally and publicly hinted. A newly-established official website for the president's office used as one of its main images a picture of a cabinet meeting at which Tin Aung Myint Oo's chair was conspicuously empty.[96] The second vice president, Dr Mauk Kham, was shown in his usual place. The same image was published in official media.[97]

The vice president's resignation was accepted on 1 July and officially communicated by the president to the legislature at its opening session on 4 July.[98] The military bloc in the legislature was given until 10 July to nominate a replacement.[99] Under the constitution, when a vice president leaves office, the group within the legislature that originally nominated him has the responsibility to choose his replacement. In the 2010 presidential election, President Thein Sein was nominated by the elected representatives in the lower house, Vice President Sai Mauk Kham by the elected representatives in the upper house, and Vice President Tin Aung Myint Oo by the military appointees from both houses. Following the departure of Tin Aung Myint Oo, Dr Mauk Kham automatically became vice president-1. The responsibility for identifying Tin Aung Myint Oo's replacement as the new vice president-2 thus falls on the military representatives.

There has been a delay in confirming the new appointee, because a constitutional problem arose with the initial choice. The military legislators agreed to nominate Myint Swe, a former general and current chief minister of Yangon Region.[100] However, it came to light that he has a son who has taken Australian citizenship, making him constitutionally ineligible to be vice president.[101] The appoint-

[91] Ibid.
[92] He is understood to have been receiving medical treatment in Singapore for throat cancer.
[93] Crisis Group interview, individual close to the president's office, Yangon, May 2012.
[94] 2008 constitution, section 73(g).
[95] The third session of the lower house ended on 2 May 2012.
[96] See www.president-office.gov.mm/briefing-room/daily-news/new4.
[97] "President U Thein Sein calls for more efforts in reform process for national development", *New Light of Myanmar*, 12 May 2012.
[98] "First day's Fourth Regular Session of First Pyidaungsu Hluttaw convened", *New Light of Myanmar*, 4 July 2012, p. 1.
[99] Ibid, p. 8.
[100] Crisis Group interview, Myanmar individual with personal knowledge of the process, July 2012.
[101] It is not clear why the citizenship status of the son came to light so late, but it has been suggested that Myint Swe was himself not informed of his candidature in advance. Ibid.

ment process has therefore been delayed while a new candidate is identified.

In addition to the appointment of a new vice president, which has the potential to make it easier for the president to implement his economic reform agenda, a cabinet reshuffle is expected very shortly. Here, the president would aim to remove under-performing ministers, so as to further bolster his reform plans.[102]

[102] Crisis Group interview, individual close to the president, Yangon, May 2012.

VI. POLITICAL ECONOMY AND PEACEBUILDING

In addition to the political and economic reforms, the third major transition taking place is that from a country at war to a country at peace.[103] The peace processes are still in their fragile initial phases, but there is a clear momentum towards ending long-running conflicts with armed ethnic groups. For the first time, the government has shown a willingness to consider solutions to the underlying political grievances. On the key issue of more equitable resource sharing between the centre and the ethnic states, it has been suggested that it will soon propose an amendment to the constitution.[104]

One conflict – with the Kachin Independence Organisation (KIO) – has yet to be resolved, although three informal meetings in May and June with the new government peace committee have given rise to some optimism that an end to the fighting is possible in the coming weeks. A deal would be an historic achievement – the first time in 60 years that the guns were silent across Myanmar.

Beyond ceasefires, a sustainable end to the conflicts is still a long way off. Securing a lasting peace will require not only shifting the politics of the borderlands from armed struggle to negotiated solutions. It will also require shifting from conflict to peace economies. Failure to ensure that the population of these areas obtains a clear peace dividend – not only political, but also economic – could seriously damage the agreements. A detailed understanding of the political economies of the conflict areas is vital for successful peacebuilding, as Myanmar's "troubled history since independence has long since shown that the political and economic dimensions of conflict can never be completely separated".[105]

Myanmar's borderlands are rich in resources. This includes gem and mineral wealth, forest products (especially teak) and enormous hydropower potential. The decades-long conflicts have become intimately entwined with resource extraction. In part, it has been the need of armed organisations to support standing forces and fund their operations that has driven resource exploitation. But at the same time, the lucrative profits from these activities have also been a driver of the conflicts. This has always been the case but has been exacerbated over the last twenty years

[103] For detailed analysis, see Crisis Group Asia Report N°214, *Myanmar: A New Peace Initiative*, 30 November 2011.
[104] The amendment is supposed to be introduced in the session that began in July 2012. Crisis Group interview, Myanmar cabinet minister, June 2012.
[105] Martin Smith, "State of Strife: The Dynamics of Ethnic Conflict in Burma", *Policy Studies* 36, East-West Center, 2007, p. 20.

by a combination of army offensives, the ceasefire deals in the 1990s and the splitting or splintering of armed groups. This created complex overlapping areas of control and influence, and for some groups the conflicts became as much about access to resources as about pursuing ideological goals.

The last round of ceasefires, in the 1990s, brought some peace dividends to the populations in conflict areas: reductions in insecurity and disruption of livelihoods associated with armed conflict and in human rights abuses, and greater freedom of movement that broadened economic opportunities. But the transition from war economies to ceasefire economies brought little benefit to ordinary people. The ceasefire agreements were only verbal and were achieved in part by offering armed group leaders lucrative business concessions and control over the resources in their areas. Ethnic leaders felt that the only guarantee they had was to maintain their considerable armed forces, and most of the revenues from the economic deals went to this purpose, or for personal gain. Those who had dominated the war economies came to dominate the ceasefire economies.[106]

This current peace process offers the opportunity to move beyond the exploitative economic practices of the past and to bring broad-based development to the borderlands. The willingness of the government to move beyond security agreements to address longstanding political grievances is unprecedented and could open the way to de-militarisation. However, the path ahead is not easy; political grievances and mistrust run deep, and powerful economic actors are deeply entrenched.

The close involvement of business interests on both sides in the recent rounds of peace discussions has raised concerns over the kind of peace economies that will develop in these areas. The Dawei Princess Company, which has substantial mining and logging concessions in areas controlled by the Karen National Union, has been facilitating contacts, making the logistical arrangements for talks and covering the costs involved.[107] Informal discussions between the government and the KIO have been facilitated by a prominent Kachin businessman – Yup Zaw Hkawng of Jadeland Company, which is a major player in jade mining and logging in Kachin State.[108]

As peace allows more secure and predictable access to former conflict areas, business interests will inevitably move in. Karenni groups were said to be ready to give the green light to logging companies to enter the areas controlled by the armed group "the moment an agreement on troop positions has been inked".[109] Exploitation of natural resources offers the easiest and quickest profit-making opportunities but will almost certainly be to the detriment of sustainable development and lasting peace. This kind of economic activity rarely benefits local populations and often represents a long-term threat to their livelihoods.

Another key concern is over land. As with other parts of the country, the borderlands have witnessed land-grabbing in recent years that will only intensify as security improves.[110] Recent legislation may facilitate this, by removing limits on the maximum size of commercial parcels and by failure to recognise traditional rights as a basis for land registration.[111] This opens the way for aggressive purchasing by commercial interests, including agri-business. Even the more equitable kinds of economic development in these areas will require land, but there are no effective policies in place to ensure that the rights of local communities will be respected.

The huge potential for profits in the border areas, combined with a highly militarised situation, also creates a risk of warlordism.[112] The key ethnic leaders generally have both political and business interests, and it is often difficult to separate ideological from economic motivations. Effective peacebuilding requires broad-based support for the peace process from local populations. If they see clear livelihood and human rights benefits, this will help create a broad constituency for peace that can constrain spoilers with personal economic and political agendas.

The political economy of the conflict areas is murky, complex and highly localised. The success of peacebuilding activities on the ground requires that government and international agencies develop a fine-grained understanding of the dynamics to ensure that their interventions first do no harm, and secondly can be as effective as possible.

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106 For a detailed analysis of these issues, see Tom Kramer, "Neither War nor Peace: The Future of the Ceasefire Agreements in Burma", Transnational Institute, Amsterdam, July 2009.
107 Crisis Group interviews, individuals present at the peace talks, Yangon, May 2012.
108 Crisis Group interviews, individuals close to the peace talks, Yangon, May 2012.
109 Crisis Group interview, armed group leader, Chiang Mai, June 2012.
110 For commentary on the land-grabbing issue, see "Myanmar at risk of land-grabbing epidemic", Statement submitted to the Twentieth Session of the Human Rights Council by the Asian Legal Resource Centre, 6 June 2012.
111 Crisis Group interview, head of a local environmental organisation, Yangon, May 2012.
112 This risk is not new. In 1988, a Karen National Union leader commented that "of all the problems that the Karen National Union faced – military, political or financial – warlordism was the greatest". (Cited in Smith, "State of Strife", op. cit., p. 19.)

VII. PROSPECTS FOR STABILITY AND GROWTH

For years, the economy has been hampered by poor policymaking, international sanctions and isolation. This is now changing, with better economic policies put in place as the reform process moves forward, and Myanmar reengaging with the global economy as sanctions are suspended or lifted. Going forward, economic prospects will be largely determined by two factors: macroeconomic stability and political stability.

The two are closely intertwined. If the macroeconomic situation is not stable, there can be political repercussions – with rising inflation, exchange rate fluctuations and unemployment all likely to lead to public disaffection and potential unrest. If the political situation is not stable, this would erode the confidence of consumers, business and investors and could undermine macroeconomic stability. A number of factors could impact on the prospects for stability and growth.

A. Political Stability

A stable and predictable political environment is vital for achieving economic growth. This does not appear to be a major issue in the short term. The president and other key reformers seem confident in the strength of their political position, and serious pushback from hardliners or the military does not appear likely. The reform process has gained much momentum, and there is increasing public support. Of course, an unpredictable event, such as the premature departure of the president, would have the potential to upset political stability.

In the medium term, the picture is less clear. President Thein Sein has indicated privately that he is not interested in a second term, probably due in part to his poor health.[113] Irrespective of whether he changes his mind, the elections in 2015 represent a moment of considerable political uncertainty. The NLD's recent by-election landslide suggests that the massive popularity of Aung San Suu Kyi will almost certainly propel the party to victory in 2015. Her own health is somewhat in question, given that she will be 70 in that year and is showing signs of frailty. Nevertheless, a landslide in which the NLD takes the vast majority of the seats would sideline the USDP, as well as other democratic forces and ethnic parties. This is partly due to the British-style plurality (first-past-the-post) voting system that disproportionately favours dominant parties and marginalises smaller ones.

It is unclear how the political elite and the military would respond to such a scenario, but it has the potential to create a political crisis. It is also unclear how the NLD would adapt to the responsibilities of government, given its lack of experience and weak policymaking capacity. This could create uncertainty on the part of the business community, which might impact on investment and growth. Aung San Suu Kyi's words of caution to potential investors at the World Economic Forum in Bangkok in May 2012, and similar comments in Europe in June, have been seen in some quarters as early indicators that her economic policies might diverge from those of the government and could impact negatively on the economic reform process.[114]

Such a scenario could also impact on the peace processes. The deal that is being presented to the ethnic armed groups is to give up armed struggle in return for the possibility to pursue their objectives through the political system. If an NLD landslide comes at the expense of minority ethnic representation – as the results of the recent by-elections and the 1990 elections suggest it well might – those deals might start to unravel. In the post-independence parliamentary era, prior to General Ne Win's 1962 coup d'état, there had been considerable ethnic disaffection that the plurality voting system favoured large Burman parties at the expense of minority ethnic parties.[115] Countries in transition often change their electoral system. Consideration should be given to the possibility that Myanmar would be better served during the transition by a system with greater proportional representation.

B. The Potential for Unrest

In any process of reform, there is a risk that popular expectations rise faster than the government can meet them. This is especially the case with economic reform; job creation, better living standards and improved social service delivery inevitably take time. When expectations are not met, there can be political consequences – particularly when longstanding authoritarian controls on the population are being simultaneously removed, allowing frustrations to come into the open.

Demonstrations for improved electricity services erupted on 20 May in Mandalay and spread to Yangon and some other cities. These were peaceful, and in most places were allowed to proceed unhindered by the authorities.[116] The

[113] He is known to wear a cardiac pacemaker.

[114] These concerns are well expressed by Vikram Nehru, "Aung San Suu Kyi must transition too", *The Wall Street Journal*, 20 June 2012.

[115] See "Burma at the crossroads: maintaining the momentum for reform", Transnational Institute, Burma Policy Briefing no. 9, June 2012, p. 8.

[116] There were exceptions; in some provincial cities some demonstration leaders were briefly detained.

government issued a notice in the state press calling for public understanding.[117] It gave assurances that it would urgently address the situation, and there have since been regular articles in the state media detailing efforts to add generating capacity.[118] The demonstrations ended after a few days. There have also been small protests demanding cheap mobile phones.[119] These could be an indication of things to come, and it is easy to imagine how a heavy-handed response from security forces unused to and ill-equipped for non-violent crowd control could provoke an escalation.

But it is not just that the expectations of a better life may fail to materialise. If economic modernisation intended to meet those expectations causes unanticipated economic shocks – such as increases in the cost of food or exchange-rate appreciation impacting on agricultural profitability – there would be potential for a serious impact on standards of living. Given that a substantial proportion of the population – around 25 per cent – is living below the poverty line, and many more are surviving precariously just above it, it would not take much of a shock to have a large negative impact on livelihoods.[120]

Land grabbing is a common phenomenon in countries undergoing political transitions.[121] If left unchecked, it can entrench economic and political elites, increase economic inequality, undermine development outcomes and lead to social tensions. Land legislation recently adopted aims to boost the agricultural sector by easing access to registration certificates and permitting land to be used as collateral for loans. As noted, it also removes caps on the maximum size of registered parcels and makes it more difficult for traditional forms of tenure to be recognised. This could promote land grabbing unless policies are quickly adopted to address this.

Deadly clashes erupted recently between Buddhists and Rohingya Muslims in Rakhine State. Communal violence is a concern in many parts of the country where there is a history of tensions – suppressed under authoritarian rule – with both Indian and Chinese communities.[122] This particular episode of violence began when three Muslims allegedly raped and murdered a Buddhist woman in late May. In revenge, on 3 June a mob stopped a bus carrying Muslim pilgrims, and ten passengers were beaten to death. Rival Buddhist and Muslim gangs then set fire to houses and attacked and killed people from the other community, in the three northern townships near the border with Bangladesh (a Muslim-majority area) and in Sittwe (capital of the Buddhist-majority state).

A government investigation was formed to look into the bus killings and prosecute those responsible for committing or instigating the violence. When clashes continued to escalate, curfews were imposed, then a state of emergency was declared in Rakhine State, giving the army wide powers to restore law and order. The situation is now under control, but tensions are still high and the underlying grievances are yet to be addressed.

C. Internal and External Economic Shocks

In this transitional phase from a managed economy to a market economy, there is a particular risk of economic shocks. Major changes are being made to an economic system about which little is known. Backward looking data for GDP, trade flows and so on are unreliable and inconsistent, and there is almost no real-time information to provide early warning of problems.

The managed float of the kyat has been a key reform for rationalising the state budget, reducing inefficiencies and rent-seeking opportunities in the economy and creating space for private-sector development.[123] It is also a risky move at a time of potentially large and rapid inflows of foreign direct investment, overseas development assistance and increasingly larger revenues from natural resource exploitation. All these factors could combine to put strong upward pressure on the kyat. This "Dutch disease" scenario could damage the broader economy, making exports less competitive as well as stifling agricultural production and manufacturing.[124]

[117] "Public request [in relation to] decreased power supply", *New Light of Myanmar*, 22 May 2012.
[118] The situation is serious, with supply estimated at only half of demand, even though less than one quarter of people have access to electricity. Major investments will be needed to increase capacity for the current unmet demand, as well as for the GDP-driven growth in demand. For a detailed discussion, see "Electricity in Myanmar: The missing prerequisite for development", paper prepared for Proximity Designs by Harvard Kennedy School and Rajwali Foundation, May 2012.
[119] See Min Zin, "What we have here in Burma is a failure to communicate", *Foreign Policy* (online), 29 June 2012.
[120] A 2011 poverty assessment conducted in Myanmar by the UN Development Programme (UNDP) found rates of around 25 per cent, with a relatively large percentage living just above the poverty line. "Myanmar Integrated Household Living Conditions Assessment-II, Poverty Profile", Myanmar, 2011.
[121] Crisis Group interview, head of an international NGO specialising in land issues, June 2011.
[122] See Crisis Group, "Myanmar Conflict Alert: Preventing communal bloodshed and building better relations", 12 June 2012.
[123] Crisis Group interview, World Bank official, Yangon, May 2012.
[124] "Dutch disease", or the "resource curse" is an effect whereby countries rich in natural resources can tend to have slow economic growth and poor development outcomes, in part the

A first priority of the central bank will be to take steps to relieve upward pressure on the kyat. A stable and predictable exchange rate is vital for business and for domestic confidence in the currency.[125] Many economists have also suggested that the kyat is overvalued at 800 to the dollar and should be closer to 1,000 for agriculture and export manufacturing to be competitive.[126] A major threat to a successful export-oriented strategy is the appreciation of the unofficial exchange rate as a result of the influx of capital induced by the optimism over prospects for a better economic future.[127] It is uncertain whether the government and central bank have the tools to be able to shift the exchange rate to make exports cheaper for foreign buyers. Failure to get the float right, in terms of both rate-stability and the appropriate level, could have a major negative impact on the export sector and damage the whole productive base of the economy.[128]

In the long term, it is necessary to ensure balanced development that diversifies the economic base by supporting new job-creating industry and lessening the over-reliance on exploitation of natural resources. At the same time, the country needs equitable pro-poor growth that can lift a large segment of the population out of poverty. These are goals that cannot be achieved overnight. They will require enlightened macroeconomic policymaking, effective institution building and sound strategies for boosting agricultural production and industrialisation, as well as capacity development and improvements to the education system.

They will also require addressing the skewed budgetary priorities inherited from the former government, including high military spending, and very low levels of spending on social service provision. Improved budget priorities and increased social service spending could be financed through a combination of revenue forms (for example, some simple measures to rationalise the taxation system) and harnessing some of the revenues from natural resources – rather than through printing money, the usual practice of previous governments.[129]

result of an overvalued exchange rate damaging the manufacturing sector. Other factors that are thought to contribute to the resource curse include the volatility inherent in natural resource revenues and mismanagement or corrupt use of resources.

[125] Crisis Group interview, economist for a leading global bank, Yangon, May 2012.

[126] IMF Staff Report, 2011, op. cit.; and Harvard Kennedy School, "Industrial policy reform", op. cit.

[127] Findlay, *Foreign Policy* (online), op. cit.

[128] An overvalued exchange rate not only hurts exporters; it also makes imports cheaper, such that domestic manufacturers may find it hard to compete.

[129] Suggested by an economist and tax expert who reviewed a draft of this report.

In the meantime, it is vital to find ways to meet rising popular expectations. This can include reassuring citizens that change is real and will benefit them, and that the impact will be felt soon rather than at some undetermined point in the distant future. Any reform package must include quick-impact measures that will have a tangible effect on people's lives. These could include short-term fixes that boost the availability of electricity for households, improve public transport (making it less crowded, safer and more modern), remove telecommunications monopolies to allow cheap mobile phones or cut informal fees for access to health and education services. Ultimately, it is public support for the reform process that will determine its sustainability and success.

D. The Regional Context

Although Myanmar's efforts to open up its economy are happening at a time of strong headwinds in the global economy, its geographical location is fortunate. It is situated between three key drivers of global growth – China, India and South East Asia – which greatly boosts its opportunities and potential.[130]

Massive infrastructure projects are being planned, or already constructed, to take advantage of the country's geostrategic location and boost connectivity between regional economic powerhouses. These include: a deep-sea port being constructed on the Indian Ocean near the Rakhine State capital of Sittwe, and parallel road, high-speed rail, and oil and natural gas pipelines that will create an energy and trade corridor to China's landlocked south west; the Kaladan multi-modal project that will create a transportation corridor between the Indian Ocean and India's eastern seaboard and its landlocked north east; and the Dawei Development Project which, if completed according to plan, would include a large industrial estate and modern deep-sea port in the south, with road and rail links for transhipment of goods to Thailand and on to Vietnam, cutting several days off the sea route through the Straits of Malacca. There are clear benefits from being located at the nexus of regional trade.

There are also disadvantages in being located next door to economic and manufacturing powerhouses. It is difficult for local industries that are inefficient, lack technology and small to compete in global export and domestic markets. The situation is set to become even more challenging from 2015, when Myanmar is committed to regional economic integration in the ASEAN Economic Community.

[130] For a detailed examination of the history and potential of Myanmar's geostrategic location, see Thant Myint-U, *Where China Meets India: Burma and the New Crossroads of Asia* (London, 2011).

According to its architects, that will "transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and freer flow of capital".[131]

This will be a huge adjustment for Myanmar and bring a level of competition that most enterprises – and the economy as a whole – are not well-prepared for. Some companies are lobbying to retain certain tariff and non-tariff barriers after 2015, which would likely be a violation of ASEAN obligations. There are no indications that the government would consider this. What it would be able to do is provide short-term support in the form of subsidies in the lead-up to 2015 to help enterprises adjust to the new competitive marketplace;[132] whether this would be an effective policy, however, is uncertain.

Two other events in the next few years will also add to the considerable strain on government capacity and infrastructure. The first is Myanmar's hosting of the biennial Southeast Asian Games in 2013, a major regional sporting event. The second is its chairmanship of ASEAN in 2014. This involves organising and running a large number of meetings and hosting the ASEAN summit, the annual meetings of foreign ministers, the post-ministerial conference with dialogue partners and the ASEAN Regional Forum.

VIII. CONCLUSION

Along with sweeping political reforms, Myanmar has embarked on an ambitious program of economic changes, aimed at rebuilding its moribund economy and integrating it with the global system. It has begun a managed float of the currency, and is dismantling the old system of monopolies and privileged access to licenses, permits and contracts. These changes will have a big impact on the entrenched economic elite – crony businessmen, the military and former political heavyweights linked to the government party – who will have to compete on a more level playing field and even start paying tax.

Given their wealth or political influence, these interests might have been powerful spoilers, but there are no indications that they are attempting to derail the economic reforms. They know which way the winds are blowing and appear to have accepted the inevitability of the changes. They are aware that the political risks of challenging the reforms would outweigh the likely benefits and see that they may be well-positioned to benefit from a vibrant and growing economy, even if their share of it is reduced. To this end, the business elite have embarked on efforts to reposition and rebrand themselves. The military recognises that its sprawling business interests, if they continue to be inefficiently run, could become a drain on its budget rather than a supplement to it.

Yet, the path of economic reconstruction will not be smooth or straightforward. To achieve President Thein Sein's objective of broad-based and equitable growth, well-crafted and effectively implemented policies are also required. With so much to be changed, and limited capacity at both the policy-formulation and policy-implementation levels, there is a risk that the administration will be overwhelmed. Beyond this, success in such an endeavour depends on ensuring macroeconomic and political stability. Unanticipated economic shocks, social unrest or political uncertainty in the lead-up to the next elections in 2015 all represent potential risks to that stability. But if it is able to manage this complex process, Myanmar has the possibility to finally realise its enormous economic potential, catching up with its neighbours while avoiding some of their mistakes.

Jakarta/Brussels, 27 July 2012

[131] ASEAN Economic Community Blueprint, adopted at the thirteenth ASEAN summit, Singapore, 20 November 2007, para. 4.
[132] In the words of a government adviser, "we have given promises and made commitments on this. Don't ask the government for protectionism; ask it to give transitional support". Crisis Group interview, Yangon, May 2012.

APPENDIX A

MAP OF MYANMAR

Map No. 4168 Rev. 2 UNITED NATIONS
May 2008

Department of Field Support
Cartographic Section

APPENDIX B

ABOUT THE INTERNATIONAL CRISIS GROUP

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 130 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international decision-takers. Crisis Group also publishes *CrisisWatch*, a twelve-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

Crisis Group's reports and briefing papers are distributed widely by email and made available simultaneously on the website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policy-makers around the world. Crisis Group is chaired by former U.S. Undersecretary of State and Ambassador Thomas Pickering. Its President and Chief Executive since July 2009 has been Louise Arbour, former UN High Commissioner for Human Rights and Chief Prosecutor for the International Criminal Tribunals for the former Yugoslavia and for Rwanda.

Crisis Group's international headquarters is in Brussels, and the organisation has offices or representation in 34 locations: Abuja, Bangkok, Beijing, Beirut, Bishkek, Bogotá, Bujumbura, Cairo, Dakar, Damascus, Dubai, Gaza, Guatemala City, Islamabad, Istanbul, Jakarta, Jerusalem, Johannesburg, Kabul, Kathmandu, London, Moscow, Nairobi, New York, Port-au-Prince, Pristina, Rabat, Sanaa, Sarajevo, Seoul, Tbilisi, Tripoli, Tunis and Washington DC. Crisis Group currently covers some 70 areas of actual or potential conflict across four continents. In Africa, this includes, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of the Congo, Eritrea, Ethiopia, Guinea, Guinea-Bissau, Kenya, Liberia, Madagascar, Nigeria, Sierra Leone, Somalia, South Sudan, Sudan, Uganda and Zimbabwe; in Asia, Afghanistan, Burma/Myanmar, Indonesia, Kashmir, Kazakhstan, Kyrgyzstan, Malaysia, Nepal, North Korea, Pakistan, Philippines, Sri Lanka, Taiwan Strait, Tajikistan, Thailand, Timor-Leste, Turkmenistan and Uzbekistan; in Europe, Armenia, Azerbaijan, Bosnia and Herzegovina, Cyprus, Georgia, Kosovo, Macedonia, North Caucasus, Serbia and Turkey; in the Middle East and North Africa, Algeria, Bahrain, Egypt, Iran, Iraq, Israel-Palestine, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, Western Sahara and Yemen; and in Latin America and the Caribbean, Colombia, Guatemala, Haiti and Venezuela.

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July 2012

APPENDIX C

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APPENDIX D

INTERNATIONAL CRISIS GROUP BOARD OF TRUSTEES