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Political Economy Study of Extractive Industries

Institutional and Regulatory Assessment of the Extractive Industries in Myanmar

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As noted above, at the outset of the EITI process in Myanmar in 2012, a very large gap existed in basic knowledge of the workings of the extractive industries in Myanmar. This activity delivered the Institutional and Regulatory Assessment of the Extractive Industries in Myanmar in March 2015. This report was the first ever attempt to compile a comprehensive picture of the oil, gas, mineral mining, gemstone, and hydro power sectors in one report. The report covers institutional set up, regulation, financial flows, basic information on social and environmental issues, sub-national level regulatory powers, and data sources. The report was prepared by Adam Smith International and the MDRI EITI team, with significant involvement from Bank staff. The report team also met with several World Bank staff involved in the Modernization of Public Financial Management project and the Public Expenditure Review. In addition to providing key baseline information, the report also generated important lessons about data availability and financial flows which have helped to inform the approach to the Scoping Study and to the first EITI Report. The report was widely shared and reviewed within the Bank. The draft was also shared with the MSG, and comments were received from Ministry of Energy, Ministry of Mines, Internal Revenue Department, civil society, and other stakeholders. These comments were integrated and the document has been translated into Myanmar language. Dissemination efforts are ongoing and will be integrated into the standard package of EITI outreach. In addition to providing a knowledge base for the implementation of EITI, the report will have broad uses among those interested in extractive industries in Myanmar, including within the World Bank.

As the final report is close to 200 pages long, only the executive summary has been attached here. However the full report, in both Burmese and English, is available on the World Bank website at: http://documents.worldbank.org/curated/en/docsearch?query=P145465

Annex: *Institutional and Regulatory Assessment of the Extractive Industries in Myanmar – Executive Summary*, March 2015.

Institutional and Regulatory Assessment of the Extractive Industries in Myanmar – Executive Summary

Executive Summary:

This report provides a baseline institutional and regulatory assessment of the oil and gas, mining (including jade and gemstones) and the hydropower sectors in Myanmar.[1] As such the report is an input to Extractive Industries Transparency Initiative (EITI) in Myanmar. However, it is not exhaustive with respect to all the sectors that may be considered under a scoping study for EITI.

This report is the first in-depth study of the context within which EITI will be implemented in Myanmar, and can inform broader efforts to improve natural resource governance. This includes support for developing natural resource policy, law and regulations, fiscal regime design, tax administration (including support to the Large Tax Payers Office on the extractive industries sector), licence management and cadastre systems, community development agreements, strategic environmental and social mitigation and management, training needs assessments and capacity building.

Before all else, a baseline assessment must begin by acknowledging how recent the reform process is in Myanmar. In 2011, following five decades of authoritarian rule, Myanmar commenced a multi-faceted economic and political reform process. In the context of a long history of economic mismanagement, conflict and military rule, the extractive industries face a daunting task of adopting sustainable and inclusive practices. This is apparent in the institutions organised around natural resource management as elsewhere. From a political economy perspective, Myanmar is a country in transition – a democratic system still deeply conditioned by its recent militarised past, with Defence Services personnel still holding 25% of seats in parliament.

The extractive industries sector is still operating within a framework of limited information and relations between government, companies and civil society (and communities) which are characterised by grievances and disputes about benefit sharing. The starting position at the beginning of the reform process two years ago was poor. With EITI candidacy announced in July 2014, the work of the Myanmar Extractive Industries Transparency (MEITI) will be a significant challenge for all involved. Previously, many grievances with the extractive industries sector were resolved by fiat or use of force, rather than through policy-making, mediation or dialogue. We must therefore begin by acknowledging the reality that misinformation and historically derived distrust still exists. The implementation of EITI will not provide a quick fix: it will take several years for the quality of data on the extractive industries sector to live up to international standards and for platforms for dialogue on sector governance to emerge. What follows below is a summary of the key findings of the report, beginning with a review of the three sectors defined as the scope for this report.

The Mining Sector

› The Ministry of Mines (MOM) has six State Economic Enterprises (SEEs) and two administrative departments.

[1] While other extractives sectors such as forestry and fisheries are not assessed, the MEITI MSG may discuss and agree to include these sectors as in-scope for EITI reporting.

- Estimated export value of minerals for the year 2013/2014 was US$1,150.2 million[2].
- The SEEs are shifting from being owner/operators to regulator/administrators (although this transition is far from complete).
- Under proposed reforms to the Mining Legislation local authorities would gradually receive increasing responsibility for mining inspection and regulation., [3].
- The last geological survey took place in 2008. The most significant minerals are copper, gold, nickel, antimony, silver, lead, zinc, tin and tungsten. But few mineral reserves have been confirmed according to international standards due the poor quality and availability of data.
- The northern regions of Myanmar contain the highest quality of jadeite (a variety of jade) in the world. Recorded exports in 2013/2014 from Jade amounted to US$1,011.6mn. Over the same period Myanmar produced 17,286,64 carats of gemstones[4].
- The Myanmar Gem Emporium, which holds annual gem and jade sales, sold US$3.4 billion in the 2014 sale.
- There are currently 139 large-scale licences and 1,315 small-scale licences, but questions remain about validity, terms and actual ownership of the licences.
- Two parliamentary committees exist which are directly related to the extractive industries sector, from both the upper and lower house of parliament.
- There are many well-documented cases of poor industry practice: a lack of community engagement, widespread pollution, transparency deficits, forced relocation and land grabbing. There are numerous reports by Civil Society Organisations (CSOs) documenting the key issues with specific projects.
- Environmental and Social Impact Assessments (ESIAs) for existing projects are not generally available, although a new legal framework for ESIAs (in the Foreign Investment Law and the Environmental Conservation Law) will shortly be finalised.
- The lack of a mining cadastre contributes to inefficient administration and licensing processes.
- There are currently 24 artisanal (referred to as “subsistence mining” in Myanmar) mining permits and 141 small scale processing permits, where royalties and land rent are collected, However there is currently limited regulatory control over or support to artisanal mining, and the use of toxic chemical agents such as mercury.
- Considered analysis estimates that well over 50% of jade in Kachin State is smuggled to China.
- Security of tenure and high up-front fees are both perceived to be a deterrent to foreign investment.
- Mineral assets are viewed as overpriced due to liquid Chinese investors not shouldering the high cost of financing and reinvestment in property due to sanctions keeping cash within the country.

The Oil and Gas Sector

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[2] Data for July 2013- June 2014 taken from the GOUM Central Statistics Office, Selected Monthly Economic Indicators (June 2014). https://www.csostat.gov.mm/sdetails01.asp.

[3] International Growth Centre (July 2014) Natural Resources and Subnational Governments in Myanmar, pg. 30

[4] Data for July 2013- June 2014 taken from the GOUM Central Statistics Office, Selected Monthly Economic Indicators (June 2014). https://www.csostat.gov.mm/s14MA02.htm

- The Ministry of Energy (MOE) has an Energy Planning Department and three SEEs: Myanma Oil and Gas Enterprise (MOGE), Myanmar Petrochemical Enterprise (MPE), and Myanmar Petroleum Products Enterprise (MPPE).
- Myanmar produced 6.2 million barrels of crude oil and 500,190 million cubic feet of natural gas between July 2013 and June 2014[5].
- The legal framework is out of date (the Petroleum Act dates to 1934), and a new Petroleum Bill is currently being discussed. Contracts currently take precedence over legislation.
- There are currently 16 onshore and 19 offshore blocks in exploration and production. The offshore fields provide natural gas for the Shwe Gas, Yadana and Yetagun pipelines. While the Shwe Gas pipeline started producing in 2013, Yadana has been producing since 1998 and Yetagun since 2000.
- During the 2013-14 onshore and offshore bid rounds, 36 new blocks were awarded. New entrants include Shell, Eni, Statoil, BG and Woodside.
- Queries have been raised about beneficial ownership transparency in the recent bid rounds.
- The United States Geological Survey (USGS), in 2012 estimated 2.3 billion barrels of oil and 79.6 trillion cubic feet of gas reserves.
- Tax payments are made directly to the Internal Revenue Department in the Ministry of Finance (MOF), whereas non-tax payments (such as royalties) are sent to MOGE.
- Use of foreign accounts is permitted.

The Hydropower (Hydro) Sector

- The Ministry of Electric Power (MOEP) is responsible for the hydropower sector. Specifically, there is a Department of Hydropower Planning, a Department of Hydropower Implementation and a Hydropower Generation Enterprise (HPGE).
- The regulatory structure for the power sector is in a transition phase.
- A new Electricity Law and regulations will set up an Electricity Regulatory Commission.
- Three joint-venture hydro plants are currently in operation: Shweli 1 (600MW installed capacity), Dapein 1 (240MW installed capacity) and Chipwi (99MW installed capacity) However, only Shweli 1 generates electricity in commercially significant amounts at present.
- Total capacity of hydro plants increased to 2,780MW in 2013, however during the summer months generation capacity can decrease to 35% of installed capacity.
- Joint Venture (JV) partners send monthly fiscal reports to the Budget Department of the MOF which includes reporting on domestic sales of the free share of electricity sold by the Myanmar Electric Power Enterprise (MEPE).
- There are 18 other hydro plants also in operation (some owned/run by the HPGE) and, some in private hands), however, little is known about their combined generation capacity.
- The Government of the Union of Myanmar (GOUM) plans that by 2030; hydro will be the main source of domestic power in the country.

[5] Data for July 2013- June 2014 taken from the GOUM Central Statistics Office, Selected Monthly Economic Indicators (June 2014). https://www.csostat.gov.mm/S11MA0206.htm

- Seven projects on the Ayeyarwaddy are suspended (most significantly, the Myitsone dam). There is a paucity of data and high-quality planning with respect to river use. GOUM has recognised this gap and created the National Water Resources Management Committee, and launched a programme to improve data quality.
- Hydropower nonetheless represents an opportunity for export revenue (US$120m exports from Shweli 1 and Tapein 1 projects in 2011), but there are also huge domestic energy needs.
- The potential value of annual hydro production exceeds US$15bn (41 GW) if all proposed FDI projects are approved.
- Taxes (commercial, withholding, income) from Chinese Joint Venture companies are paid via the Export Import Bank of China.

Inter-Governmental Coordination

- Given that government agencies have historically been run in relative isolation from each other, this report reviewed existing inter-governmental coordination mechanisms regarding the extractive industries sector.
- The two line ministries (mines and energy) have historically operated on a self-funded basis (hence non-tax payments still being returned to ministry-controlled SEEs).
- From the perspective of EITI, the Leading Authority and the EITI Working Committee strike a potentially positive balance between executive-level buy-in and managerial oversight in contributing to the governance of EITI (via the Multi-Stakeholder Group) from the perspective of the GOUM.
- The coordinating body for energy matters is the National Energy Management Committee (NEMC), with the Energy Development Committee as its implementing body.
- The Ministry of National Planning and Economic Development (MNPED) is a key coordinating agency, particularly in terms of development partner coordination.
- The MNPED recently signed up to the International Aid Transparency Initiative (IATI).
- The MNPED has a working group on Public Financial Management (PFM) but currently no working group on Natural Resources.
- The PFM project supported by the World Bank includes some support related to EITI implementation.
- There is a potential information-sharing arrangement between MEITI and the Central Statistical Organisation (CSO) which will provide better quality data and analytical competency to the CSO and may contribute to evidence-based macro-economic policy-making and planning.

Role of Parliament

- As well as the MNRMC, the Public Accounts Committee (PAC), which has a lower house body and a joint-committee, may play a critical role in the implementation of EITI. The PAC works closely with the Office of the Auditor General (OAG), receiving summary reports bi-annually, which it uses to conduct engagements with sector stakeholders.
- The EITI Multi-Stakeholder Group (MSG) and the GOUM will need to decide what role may be appropriate for the Public Accounts Committee in EITI reporting.

Sub-national Governance

- The General Administration Department (GAD) under the Ministry of Home Affairs plays a dominant role in sub-national administration.
- State or Region governments do not have a substantive role in governing the sector and in some states have limited resources and access. This has led to limited accountability at sub-national levels.
- There are some large (multi-million dollar) Corporate Social Responsibility (CSR) projects, managed by the private sector companies operating extractive sector projects in the region.
- Examples include CSR projects implemented in connection with Shwe Gas and Yadana pipelines. However, as with ESIA reports, there is little availability of data on these projects, still less public domain budgets or audited reports.
- A number of civil society organisations have organised around EITI remarkably quickly. is The Myanmar Alliance for Transparency and Accountability (MATA) was established in early 2014. Members of its Steering Committee represent civil society on the MSG. e . The decentralised decision-making structure of the coalition should ensure that a diverse range of views filter up from all the MATA coalitions and platforms at sub-national level.
- The challenge for MATA will be to balance a focus on EITI with other initiatives of interest to the coalition. While MATA may function effectively at the national level, it is likely that the sub-national coalitions are on the one hand closer to the real issues that communities face from extractive industries sector operations in their midst. On the other hand, they will require increased capacity to effectively address those challenges and advocate responses to the sub-national government.
- In addition, historical legacies and the contemporary political economy realities of state and regional governments mean that local groups often have limited space to operate in than those operating at national level, and therefore face a restricted "enabling environment." The question of a responsive and inclusive set of strategic priorities that at the same time addresses sub-national capacity needs may continue to occupy MATA in the years to come.
- There are six self-administered sub-national units recognised in the 2008 constitution and more than 18 opposition Ethnic Armed Groups, who have historically opposed the Myanmar government and in some cases run parallel administrations. Findings from two field trips (to Shan and Kayin states) show that comprehensive nationwide EITI reporting will be difficult initially. This is partly because data may not be available from self-administered areas, but also because the legacy situation of "brown and black" contested areas[6] and shifting patterns of mining ownership and management mean that certain operations are difficult to access for data collection and research purposes.

Contracts and Beneficial Ownership

- While contract transparency is encouraged but not required by the EITI 2013 Standard, it remains a topic for MSG discussion and the Standard was expanded in 2013 to incorporate these issues.

[6] Brown, black and white are often used to explain Myanmar's conflict affected territories. The terms come from the Defence Service's categorises of insurgent held areas (black), mixed areas of Defence Services and EAG control (brown) and controlled areas (white).

- The contemporary global trend is for extractive industries sector contracts to be increasingly publicly available. Myanmar has an opportunity to support this trend.
- Some well-known beneficial owners are keen to expand their business internationally, and be removed from the Specially Designated Nationals (SDN) lists. They have a strong incentive in favour of transparency and EITI. However, there is also likely to be resistance from other entrenched vested interests.
- Extractive assets have in some cases been granted on an individual basis (for example, equity stakes in mines).
- For these reasons, ultimate beneficial ownership analysis is likely to be a sensitive topic for EITI.
- The military holding companies Union of Myanmar Economic Holdings Limited (UMEHL) and the Myanmar Economic Corporation (MEC) both have interests related to extractive industries. MEC is a joint venture partner in some mines.
- Both MEC and UMEHL are considered private sector entities by GOUM, not SEEs.
- There needs to be a formal mechanism to engage with these companies for a comprehensive assessment of the mining sector to take place within the terms of the EITI Standard.

Financial Flows

- The Budget Department of the MOF collects information on revenue flows from oil and gas, mining and hydropower and is projected to become the institutional home of the Myanmar EITI Secretariat. Taxes (such as Corporate Income Tax, Commercial Taxes and Capital Gains) are paid to the Internal Revenue Department (IRD) in the MOF.
- Non-Tax payments (such as royalties, production shares, signature bonuses) are paid to the SEEs.
- Accounting standards in Myanmar have been historically based on British accounting standards and Generally Accepted Accounting Principles (GAAP).
- Myanmar Accounting Standards still need to adopt five remaining International Financial Reporting Standards (IFRS) measures.
- Ministries and SEEs have off-budget “Other Accounts” lodged in the Myanmar Economic Bank which are not reported in the fiscal reports (financial regulations only allow for the Ministries of Defence and Home Affairs to have these types of accounts).
- The MOE has three Other Accounts (in Singapore) and MOGE has 14 Other Accounts. It is not clear what each of these accounts is used for and to what extent oil and gas revenues flow through these accounts.
- Myanmar has multiple Other Accounts. Other Account receipts for FY2011-12 total 2.54 trillion kyat, 44% of total budgeted revenue. While use of Other Accounts is not unusual, bringing these accounts into the formal budget process will ensure higher levels of transparency.
- Accounts overseas that receive payments from extractive industries sector operations in Myanmar are a transparency risk. Consideration may be given to ensuring that these accounts are also on budget and that the respective revenue flows go through Government’s State Funds Account. Similarly direct payments in Forex from these accounts should be reflected in foreign exchange budget appropriations. EITI may play an important role in assessing the use of overseas accounts, exchange rates and financial flows.

Auditing

- The OAG is formally expected to receive bi-annual and annual project-by-project audits from the SEEs (fiscal and production volumes). These reports would be the basis for EITI annual reconciliation reports, as well as potentially for interim reporting, analysis and dissemination by the MEITI Secretariat.
- OAG sends bi-annual summary reports both to the Presidency and to the PAC. However, there are no penalties for delayed submissions and even some IOCs are years behind on audit submission. In some cases, it may take up to a decade to produce an audited report. These delays are a risk to the timeliness of EITI reporting.
- The OAG has the power to audit joint venture partners and also MEC (but not UMEHL) but lacks capacity to do this effectively. This means that, for example, it may be difficult (at least initially) to source information on extractive projects in which UMEHL is a partner for EITI purposes.
- The Directorate of Defence Industries has its own audit function for UMEHL.
- For the first EITI report to be a success, the OAG will require support. This may come from a variety of sources, including development partner technical assistance, or back-office sub-contracting and capacity building in advance of the first EITI report.

Society and the Environment

- A fully-fledged new legal framework for the environment will shortly be in place, and it will subsequently require implementation across government. However, this framework still has shortfalls: most significantly, there is a powerful exemption clause in the Environmental Conservation Law. The on-going review of the draft ESIA for Letpadaung will be a test case for how effective the new governance framework is.
- The legacy of poorly regulated oil and gas and mining operations and the lack of publicly available information have created a huge backlog of work for the newly regionalised Environmental Conservation Department, which is in charge of implementing the legal framework concerning ESIAs.

Implications for EITI

The analysis summarised above and found in more depth in the main body of the report has a number of implications for the effective implementation of EITI in Myanmar:

The Peace Process

- Many of Myanmar's most rich natural resource areas are affected by the country's long-running civil wars. Myanmar is in the midst of the most comprehensive attempt at securing a national ceasefire and political dialogue since independence. This process will require careful sequencing for EITI reporting requirements for extractive operations in these areas.
- EITI stands to provide information on revenues, which can help inform discussions of revenue sharing, a key issue in the political dialogue.

Contracts and beneficial ownership.

- Current contracts are being negotiated with MOGE, the Myanmar Investment Commission (MIC) and the President's Office. The OAG has weak capacity in comparison with the IOCs.

- Ultimate beneficial ownership is a sensitive topic in every country and Myanmar is no exception. It may not be possible to draw definitive conclusions on this question in the short term.

Access To / Quality of Information

- Data quality presents a serious problem for EITI report reconciliation. Consultations have revealed an institutional culture of producing information by arrangement, rather than by empirical assessment. For instance, recorded production volumes in the mining sector cannot be verified and are based on an agreement between officials, rather than by measurement. Meanwhile, there appears to be instances of tax evasion in the mining sector, with two sets of books a common practice and under-reporting of revenues by up to ten times the apparent norm, according to private sector stakeholders.
- The Myanmar Accountancy Council (MAC) should adopt and institutionalise IFRS measures 9-13 ahead of the first MEITI report.
- Confidentiality clauses in oil and gas, mining, and hydropower agreements will require legal measures (perhaps via a second Presidential Decree on EITI) to facilitate access to commercial data in audited accounts, both for the planned scoping study and for the reconciliation process.
- There is an early opportunity to include initial transparency reporting provisions in the Mining, Petroleum and Electricity laws currently being amended/drafted, such as “Reports submitted by licence-holders must be in accordance with the Myanmar Extractive Industries Transparency Initiative.”
- The first EITI report should aim to map onto political incentives and timeframes, and the MSG could perhaps consider whether it would be beneficial to first produce a “pilot” report focusing on oil and gas, in the context of a reporting roadmap recommended by the scoping study. This would be in line with the EITI move away from large single-volume annual reports towards more targeted reports. MEITI could consider taking a sectoral approach to EITI reporting from the outset.
- The scoping study may therefore include contextual analysis which will satisfy Requirement 3 of the EITI Standard (that the EITI requires EITI Reports that include contextual information about the extractive industries), separately to the first reconciliation report.

Hydropower (hydro)

- Hydro joint ventures are apparently audited annually and can be included within the first EITI report, however only the Shweli 1 dam is a significant revenue earner for the GOUM at present.
- Given the ramifications of the suspension of the Myitsone dam project (and the reality that the project is not likely to be restarted in the near, middle or even long term), the political significance of the hydropower sector should not be underestimated. Reconciling financial flows in the hydropower sector should be a relatively easy quick win to garner further support for EITI.

Managing Expectations

- EITI provides a dialogue platform and high quality information and analysis, but not solutions.
- MEITI requires a sophisticated and well-resourced communications framework that enables both targeted messaging but also a responsive feedback mechanism.

› The bigger strategic question: “what should we extract and when?” is not addressed by EITI and should be asked elsewhere. This is an opportunity for macro-level policy-making in the MNPED.

Role of Government

› EITI can help to connect the finance function with extractive line ministries and planning.

› A Memorandum of Understanding (MOU) between the MEITI Secretariat and the Central Statistical Organisation could strengthen links between the MNPED and the MOF at an operational level, and perhaps lead to greater collaboration at the macro-economic policy making level.

› Given their potentially increased role on EITI, the MSG may wish to consider participation from other ministries, such as MNPED (or MOEP if hydro is included in EITI) on the MSG, as well as participation from the new IOC entrants.

The Scoping Study

The follow-up to this baseline assessment is a scoping study, which will determine which companies should be included within the first MEITI report and what payment flows they will need to report on. It is likely (and widely expected) that the oil and gas sector will require full reporting, in terms of disaggregated “project-by-project” reporting, as well as beneficial ownership analysis (including the most recent bid rounds). It is also likely that the major mining projects in the country will also be required to report under EITI. A reasonable expectation would be that the materiality threshold would be set to include the top twenty or thirty mining projects – any smaller number would be too small a percentage of total mining sector contributions to the economy, any larger number might pose too many logistical and information-based challenges to the independent administrator, although all large mining licences may be considered.
The jade and gemstones sector brings with it a unique set of challenges for EITI reporting, however it is in principle possible to reconcile payments to and from the annual government Gems Emporium.
The MSG will also need to consider whether the hydropower sector should be included in scope (whether in the first report, or in subsequent reports). Additionally it needs to assess whether other extractive sectors which are potential large revenue generators, such as forestry and fisheries could also be included at some point within EITI reporting, despite being non-core EITI sectors and not taken into account by the EITI system when a country’s validation of EITI takes place.

The MSG will draw up the detailed terms of reference for this scoping study, with advice as needed from the EITI International Secretariat. Consideration may be given to the following for inclusion in the scoping study TOR:

› Contextual analysis (fulfilling Requirement 3 of the EITI Standard);

› Recommend which companies/projects/sectors should report and when;

› Recommend a materiality threshold for the mining sector;

› Assess quality of data from small-scale mining licence-holders;

› Assess the quality of the audit reports received by the OAG;

› Detailed assessment of the receipt records/reports maintained in the MOF;

› Financial flow analysis for the SEEs (especially non-tax flows from the SEEs to the budget);

› Assessment of the Other Accounts;

› Assess pipeline transit fees;

- Recommend a 5 or 10 year reporting road-map (trade-off between comprehensiveness and feasibility), which takes into account political timeframes and incentives;
- Assess major CSR programmes;
- Analyse social development funds at state/region level;
- Provide training, allow for shadowing to local partner and GOUM agencies; and
- Design specifications for simple web-based data upload gathering process.