

Final report

Fiscal decentralisation and national reconciliation in Myanmar

Key issues and
avenues for reform

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**Fiscal Decentralisation and National Reconciliation in
Myanmar: Key Issues and Avenues for Reform**

Paul Minoletti, October 2016

Executive Summary

In the last few decades most countries around the world have attempted some form of decentralisation, and since 2011 Myanmar has begun its own (limited) decentralisation process. There are strong political pressures for further decentralisation, and this is expected to happen at some point in the future. Decentralisation can offer a range of possible benefits for Myanmar, including: making government more accountable, responsive, and efficient in providing services to its citizens; reducing abuses of power by officials (including corruption); improving political stability and reducing conflict; and raising political competition. However, an inappropriately designed decentralisation process can result in negative effects such as: subnational policy-making serving the interests of local elites; overspending by subnational governments resulting in large deficits and macroeconomic instability; increased corruption; and lower quality public services.

This paper outlines the current form of fiscal and administrative decentralisation in Myanmar, and the associated priorities for reform. It subsequently goes on to explore the relationship between fiscal decentralisation and three crucial related issues: i) political decentralisation; ii) natural resources; iii) conflict and the peace process.

Myanmar's 2008 Constitution gives State/Region governments the constitutional mandate to legislate on, and provide services for, multiple subcategories under eight broad sectors. However, there is frequently a lack of clarity as to which services are the responsibilities of the Union government, and which belong to States/Regions, and decentralisation of service provision has so far been quite limited in practice. Road building has accounted for the majority of subnational budgeted expenditure, followed by municipal services in urban areas.

The Constitution lists 19 categories of taxes and fees controlled by State/Region governments, but they currently collect very little revenue through these instruments. As a result, and even though subnational governments in Myanmar are responsible for spending only a small portion of total government expenditure, they are highly reliant on financial transfers from the Union government. This reliance on transfers may possibly reduce the effectiveness of subnational governments, and it is desirable that they improve their own revenue collection efforts. Unfortunately, the new formula for deciding transfers from the Union to States/Regions includes a variable that acts as a disincentive for State/Region governments to improve tax collection. Tax collection by both Union and State/Region governments is currently severely hampered by it being broadly socially acceptable in Myanmar for individuals and businesses not to pay the correct amount of tax, however, the popularity of the new government presents a great opportunity to begin building a less hostile attitude towards paying tax.

The government of Myanmar (GoM) is far from the only actor collecting revenues and providing services in communities. A recent study found that households pay far more in contributions to non-governmental or semi-governmental forms of service provision organised at the community-level, than they pay in taxes to GoM. In a number of areas in Myanmar's ethnic States armed groups – the Tatmadaw, Ethnic Armed Organisations, Border Guard Forces (BGFs), and/or militias – also collect revenues and provide services. In addition to providing security services of various forms, some EAOs are engaged in quite extensive provision of social services and/or building physical

infrastructure. Finally, the aid sector has expanded rapidly in Myanmar and international, national and local NGOs are now extensively involved in providing services across the country.

The U Thein Sein government (2011-16) initiated Myanmar's decentralisation process, but failed to articulate a clear vision of what it was intended to achieve. It also failed to provide clarity on exactly which public services should be provided by the Union government, and which should be provided by subnational governments. Instead decentralisation has largely been led by simply increasing the level of budget assigned to State/Region governments. This approach tends to lead to inefficient spending, and it is recommended that the new government sets out a clear vision for what the goals of decentralisation are, clearly defines the responsibilities of Union and subnational governments, and designs funding arrangements accordingly. Although political considerations will inevitably influence which level(s) of government certain responsibilities are assigned to, it is highly desirable that technical analysis that estimates the likely economic costs and benefits is also considered.

Citizens still have limited opportunity to demand accountability from subnational officials. Many of the key officials in the State/Region government are centrally appointed, rather than being elected, and elected MPs have only very limited scrutiny of State/Region budgets. At local levels, downward accountability is hampered by factors such as: a lack of opportunities for citizens to meet with officials; attitudes of local officials often discouraging citizen interaction; and a lack of information being provided to citizens and local civil society on local funding mechanisms and budget processes. If decentralisation is to make service delivery more efficient and more responsive to citizens' preferences, it is crucial that citizens are given greater opportunities to demand accountability from subnational officials. Fiscal transparency is generally low for all levels of government, and needs to be increased to facilitate enhanced accountability, help reduce corruption, and improve budgeting.

GoM has recently taken the important step of providing budget ceilings to subnational governments before they prepare their budgets – this should help to facilitate more effective planning. However, there are still a number of procedures that reduce the incentives for State/Region governments to efficiently plan and budget, including: not being allowed to retain budget surpluses for the following year; a lack of rules governing supplementary budgets; limited auditing of State/Region budgets; and many revenues and expenditures not being recorded in budgets. Effective planning and budgeting by governmental bodies operating below the State/Region level is hampered by similar issues.

The extent of political decentralisation in Myanmar has so far been limited: Chief Ministers are still centrally appointed; at least 25% of MPs in each State/Region are appointed by the military; and Schedule 2 of the Constitution is vague and only clearly grants legislative power to States/Regions on a narrow range of activities. Although it is unlikely to happen within the next few years, significant further political decentralisation is likely to take place at some place in the future. If/when this occurs it will result in a change of the expenditure responsibilities of subnational government entities, and this is important that fiscal arrangements are designed accordingly.

Myanmar's considerable natural resource wealth could potentially fund dramatic improvements in the quality of public services, and ultimately promote greater prosperity and well-being. However, until now the government has not used these revenues effectively, corruption has flourished, and grievances over the Union's control of revenues have contributed to political strife and conflict.

Improving the allocation and management of natural resource revenues is a vital aspect of both fiscal decentralisation and the peace process.

Sharing natural resource revenues with subnational governments will require decisions to be made on: the objectives of the scheme; if the sharing of revenues should be based on which areas revenues originated from, or with the aim of promoting equity between areas, or a combination of the two; and which taxation rights and responsibilities belong to the Union, and which to subnational levels. Both Union and subnational governments also need to focus on how to productively manage natural resource revenues, so that they can cope with volatile commodity prices, avoid harmfully pro-cyclical spending, and encourage economic diversification.

A desire among ethnic minority groups for greater subnational autonomy has been a key factor behind civil conflict and social strife in Myanmar since independence, and is central to EAOs' negotiating positions in the current peace process. An effective decentralisation process, incorporating sufficient attention to fiscal aspects, has the potential to reduce conflict and improve political stability. An understanding of armed groups' roles as both revenue collectors and service providers in many areas needs to be incorporated into planning and budgeting by GoM, as well as the donor/aid community. Issues related to control over revenues can be expected to continue being key to whether peace or conflict prevails.

Myanmar's long history of conflict has had a wide range of damaging effects, including: large numbers of refugees and internally displaced persons; negative effects on health and education; reduced private sector investment, particularly in more sustainable and employment generating sectors such as agriculture, manufacturing, and tourism; poor quality infrastructure; and damaged governance institutions and social bonds. Taking action to repair the damage and improve citizens' lives in areas that have experienced conflict will positively contribute to the likelihood that ceasefires will result in lasting peace. Decisions need to be made about what combination of Union GoM, subnational levels of GoM, civil society, the private sector, and EAOs, should be utilised to take this action.

1: Introduction

The last few decades have seen most countries around the world attempt some form of decentralisation process, frequently with the goal:

... to reconstitute government — from a hierarchical, bureaucratic mechanism of top-down management to a system ... characterized by participation and cooperation, where transparency is high and accountability to the governed acts as a binding constraint on public servants' behavior.¹

Myanmar's 2008 Constitution provided a formal framework under which decentralisation could begin. The most notable moves towards decentralisation have included:

- From early 2011 onwards, partially elected parliaments have been functioning in each State/Region, and these governments now have some control over budget allocations and service provision. Broadly equivalent governments have also been introduced to Myanmar's 5 Self-Administered Zones, and 1 Self-Administered Division.
- Greater decision-making powers have been granted to Township authorities, and elected committees were introduced at this level.
- In 2012, the position of Ward/Village Tract Administrator was made an elected one.

Despite recent moves towards decentralisation, Myanmar's state remains highly centralised. Further decentralisation seems likely at some point: it is desired by many citizens, Ethnic Armed Organisations (EAOs), and political parties; one of the Basic Principles of the Framework for Political Dialogue agreed at the Union Peace Conference in January 2016, is 'To establish ... a union based on democracy and federalism'²; and the new government's election manifesto affirmed their desire for Myanmar to become a 'genuine federal democratic union.'³

There are a number of possible motivations for decentralisation, including:

- Making government more accountable, responsive, and efficient in providing services to its citizens.
- Reducing abuses of power by officials (including corruption).
- Improving political stability and reducing conflict.
- Raising political competition.⁴

Many countries that embark on a decentralisation process hope it will help them achieve more than one of these goals, and decentralisation has multiple potential benefits for Myanmar. However, it is vital to appreciate that the potential gains from decentralisation are by no means guaranteed, an inappropriately designed decentralisation process can result in various negative effects, including:

- Capture of policy-making by local elites, resulting in increased corruption, decreased accountability to citizens, and/or policies that favour particular groups at the expense of others.

¹ Jean-Paul Faguet, 'Decentralization and Governance', *World Development*, Decentralization and Governance, 53 (2014), p.2.

² The Framework for Political Dialogue (Unofficial Translation), 2016. Chapter 2a.

³ National League for Democracy, '2015 Election Manifesto (Authorised Translation)', 2015, p.5.

⁴ Faguet, 'Decentralization and Governance', pp.4-10.

- Irresponsible overspending by subnational governments resulting in national level budget deficits and macroeconomic instability.
- Lower quality and/or less efficient public service provision due to a lack of appropriately skilled civil servants at subnational level, and/or subnational units' small size preventing them from achieving 'economies of scale'.⁵ [N.b. for a definition of 'economies of scale' please see Box 1]

Myanmar's own history shows how attempts at decentralisation can go wrong. In 1921 the colonial government passed the Burma Rural Self-Government Act, which created elected district councils responsible for providing: public health and medical services; local road and waterway maintenance, and certain other public works; vernacular education; and the regulation of various local services. However, this attempt at reform was badly designed, with the new district councils, '...superimposed more or less arbitrarily on the regular administrative system.'⁶ The new system soon resulted in increased corruption and lower quality public service delivery. The district councils were extremely unpopular with citizens, and, '...became synonymous in the public mind with inefficient and corrupt administration.'⁷ The failure of this decentralisation attempt illustrates how important it is to get decentralisation policy right.

Fiscal considerations are key to any effective decentralisation process – if subnational authorities do not have access to appropriate funding they will be unable to properly fulfil their responsibilities, and these authorities need to spend public revenues productively and efficiently. This paper outlines key considerations and questions for how fiscal decentralisation can best be implemented in Myanmar. Attention is given both to: policy changes that can be made to improve the quality of decentralisation under the current constitutional and legal framework; and, to options that would require legal and constitutional change. Section 2 provides an overview of the current form of fiscal and administrative decentralisation, and associated reform priorities. Section 3 discusses key considerations and options for reform regarding the relationship between fiscal decentralisation and three crucial related issues: i) political decentralisation; ii) natural resources; iii) conflict and the peace process.

⁵ Faguet, 'Decentralization and Governance', pp.5-8; Lucie Gadenne and Monica Singhal, 'Decentralisation in Developing Economies', *Annual Review of Economics*, 6 (2014), pp.591-92; Dilip Mookherjee, *Political Decentralization* (Working Paper, December 2014), pp.5, 10-11, 16-17.

⁶ John F. Cady, *A History of Modern Burma* (Ithaca, 1958), p.262.

⁷ Cady, *A History of Modern Burma*, pp.261-70, especially p.267.

2. Overview of Fiscal and Administrative Decentralisation in Myanmar

2.1 Myanmar's Fiscal and Administrative Decentralisation Framework

Revenue Rights: Schedule 5 of the Constitution lists 19 categories of own-source revenue controlled by States/Regions, including land taxes, excise taxes, municipal taxes, and taxes on certain forestry products. Constitutional amendments passed in July 2015 made it constitutionally permissible to devolve almost all revenue raising powers to States/Regions, but legislation would need to be passed by the Union government before any of these additional revenue raising powers are actually devolved.⁸ Since their inception, State/Region governments have received transfers from the Union government, and a 2016 policy change means that part of this transfer is composed of 15% of commercial tax revenues, 5% of income tax revenues, and 2% of stamp duty revenues collected from that State/Region. The 2016 Public Debt Law specifies that State/Region governments can borrow from both Myanmar and international lenders, subject to approval from the Union Ministry of Planning and Finance (MoPF) and the Union huttaw.

Development Affairs Organisations (DAOs) and City Development Corporations (CDCs)⁹ come under the authority of their State/Region governments, but have considerable latitude to collect and allocate revenues, primarily: i) user fees charged to households and businesses for services; ii) property tax;¹⁰ iii) regular licence fees for businesses; iv) tender licence fees for certain businesses.¹¹ Most Village Tract/Ward Administrators (VTAs) have *de facto* authority to collect informal ad-hoc taxes to fund expenditures such as local infrastructure, village celebrations, or sporting events.¹²

Expenditure Responsibilities: State/Region governments have the constitutional mandate to legislate on, and provide services for, multiple sub-categories under each of eight broad sectors – finance and planning; economic; agriculture and livestock breeding; energy, electricity, mining and forestry; industrial; transport, communication and construction; social; and management. The Constitution contains considerable ambiguity on the responsibilities of Ministries and Departments at Union and subnational levels, with little detail provided on what level of government is responsible for providing different services. Thus, there is an unmet need for appropriate legislation and policy that clarifies ministerial and departmental responsibilities at Union *and* subnational levels. Further, the Constitutional Tribunal, which has responsibility for resolving Constitutional disputes between different levels of government, has been largely ineffective.¹³ The resulting lack of clarity has created confusion over mandates and appropriate funding sources, reducing accountability and efficiency.¹⁴

⁸ Giles Dickenson-Jones and others, *Intergovernmental Fiscal Relations in Myanmar: Current Processes and Future Priorities in Public Financial Management Reform* (JICA & CESD, Forthcoming), Annex 3.

⁹ N.b. DAOs and CDCs are Myanmar's municipal governance bodies. CDCs are present in the three largest cities (Mandalay, Nay Pyi Taw and Yangon), whereas DAOs are present in all other urban areas. CDCs have a greater range of revenue and expenditure powers than DAOs.

¹⁰ N.b. this is known as the 'building and land fee' but (in theory at least) is designed as a form of property tax rather than being a fee for a particular service.

¹¹ Matthew Arnold and others, *Municipal Governance in Myanmar: An Overview of Development Affairs Organisations* (MDRI-CESD & The Asia Foundation, July 2015), p.13

¹² Giles Dickenson-Jones, Giles, S. Kanay De and Andrea Smurra, *State and Region Public Finances in Myanmar* (MDRI-CESD - The Asia Foundation, October 2015), p.27.

¹³ Dickenson-Jones and others, *Intergovernmental Fiscal Relations in Myanmar*, p.22.

¹⁴ Hamish Nixon and Cindy Joelene, *Fiscal Decentralisation in Myanmar: Towards a Roadmap for Reform* (MDRI-CESD & The Asia Foundation, June 2014), p.13; Zaw Oo and others, *Fiscal Management in Myanmar* (ADB Economics Working Paper Series, June 2015), pp.23-24.

These problems are exacerbated by the current lack of formal and informal coordination mechanisms for civil servants working in different ministries, and between Union and subnational levels.

District level authorities do not have any control over expenditure allocations, and their role is restricted to monitoring, administration, and reporting. Township authorities are responsible for carrying out much of the government's service provision (and tax collection). However, although some limited planning and budgeting decision-making power has been granted to line departments at Township level in recent years, these departments' budget allocations are still largely decided by line ministries at Union and (to a lesser extent) State/Region levels. Certain Township officials have considerable *de facto* input on the allocation of various Local Development Funds, but these only account for a small proportion of total spending carried out by Township authorities.¹⁵

DAOs and CDCs are responsible for providing a range of municipal services, including: waste removal; street lighting; water supply; drainage; local infrastructure; and business licensing, permits and inspections. It is notable that DAOs' expenditure mandate only covers urban areas, despite collecting revenue from the sale of business licenses in both rural and urban areas.¹⁶ VTAs' mandated role is providing local level security, administration, and dispute settlement; but they also often hold decision-making roles on official and unofficial local level development committees.¹⁷

Additional Governance Actors: The Government of Myanmar (GoM) is not the only actor involved in collecting revenues and providing services at subnational levels. EAOs play a considerable role collecting revenue and providing services in areas they control and in mixed-authority areas. Border Guard Forces and militias also play a notable role in the areas in which they operate. The role of these various armed groups is discussed further in Section 3.3.

The aid sector is expanding rapidly Myanmar, and local and international NGOs, UN agencies, and IFIs, now play considerable roles in service provision in all States and Regions.

Throughout Myanmar, it is common for communities themselves to organise and fund a range of basic public services with no input from the government, EAOs or NGOs based outside of the community – which services are provided in this way varies from place to place, but can include: roads; bridges; drainage; water supply; waste disposal; street lighting; electricity; insurance to cover costs related to healthcare, funerals, and flood damage. In addition to entirely self-financing and organising certain public services, it is also common for communities to largely self-organise and self-fund but also receive some financial or in-kind assistance from local government officials. Communities also frequently self-fund the addition of basic goods to public services provided by GoM – for example by building fences around schools or donating furniture to health clinics. And, many communities contribute ad hoc payments and labour to projects that are organised and

¹⁵ Paul Minoletti, *Gender Budgeting in Myanmar* (ActionAid, CARE, Oxfam and WON, forthcoming 2016).

¹⁶ Jared Bissinger, *Local Economic Governance in Myanmar* (Yangon: The Asia Foundation, February 2016), p.31.

¹⁷ Arnold and others, *Municipal Governance in Myanmar*, pp.23-24; Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, pp.13-14; Paul Minoletti, *Gender Budgeting in Myanmar* (ActionAid, CARE, Oxfam and WON, forthcoming 2016).

funded jointly by the community and subnational GoM entities.¹⁸ A recent study in Bago Region and Kayin State found that households contribute more than twice as much money to the various forms of non-governmental and semi-governmental service provision described in this paragraph than they paid in formal taxation to GoM, as well as providing considerable quantities of unpaid labour to non-governmental and semi-governmental service provision.¹⁹

2.2 The Current Level of Fiscal Decentralisation in Myanmar

The lack of clarity on the expenditure responsibilities of Union and State/Region governments, together with opaque rules governing which level expenditure is recorded at in the budget, makes it very difficult to know exactly how much of GoM's spending is decentralised – i.e. some of the spending officially recorded under States/Regions is actually budgeted at Union level.²⁰ The lack of clarity regarding how much of total government spending is budgeted at State/Region levels is compounded by many financial flows to and from government entities at Union and State/Region levels being 'off-budget'.²¹ Further, GoM budget data does not account for the substantial revenues and expenditures associated with non-governmental and semi-governmental service provision. In addition, much of the budget data that GoM does have is not publicly available. Despite these caveats, this section presents available GoM data that gives us some indication of various aspects of fiscal decentralisation in Myanmar, and discusses factors driving these figures.

In 2014/15 State/Region expenditure grew to around 11% of GoM's total budgeted expenditure. As Table 1 shows, this is very low by international standards. Nevertheless, it is considerably higher than previous years, and this low level is perhaps unsurprising given that Myanmar's decentralisation efforts only began recently.

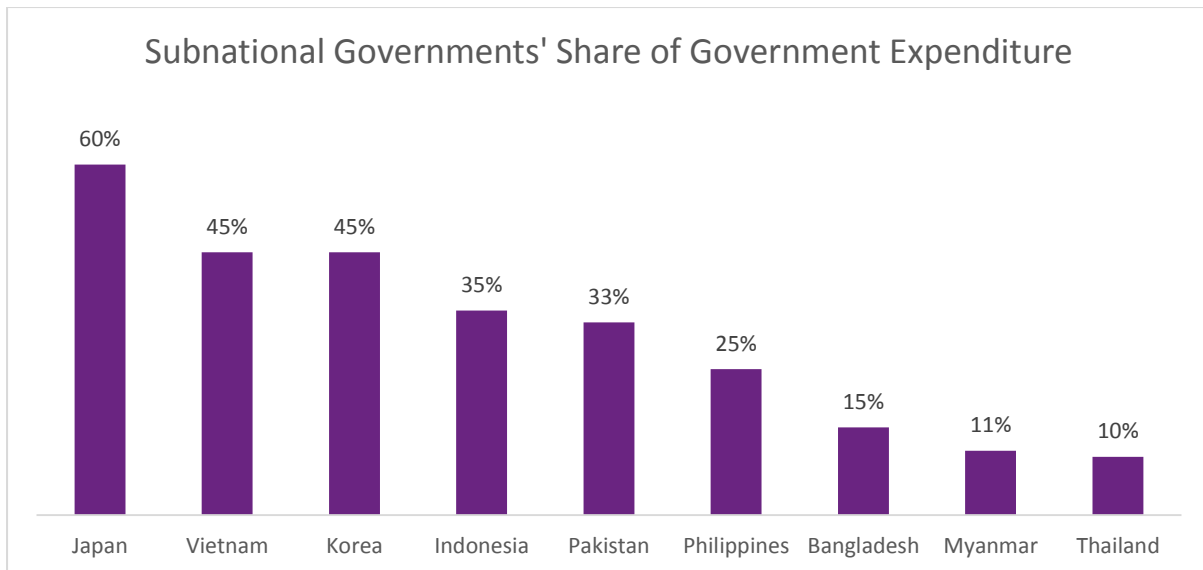
Figure 1: Decentralisation of Government Expenditure in Selected Asian Countries

¹⁸ Gerard McCarthy, *Building on What Is There: Insights on Social Protection and Public Goods Provision from Central East Myanmar S-53308-MYA-1* (International Growth Centre, September 2016), pp.2, 4, 5, 12-13; Minoletti, *Gender Budgeting in Myanmar*.

¹⁹ McCarthy, *Building on What Is There*, p.8.

²⁰ Nixon and Joeline, *Fiscal Decentralisation in Myanmar*, pp.13-14.

²¹ I.e. expenditures and revenues that are not recorded in the budget data submitted by government entities to the MoPF.



Sources: International figures (2009) taken from Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, p.44; Myanmar figure (2014/15) taken from The World Bank, *Myanmar Public Expenditure Review 2015*, p.83.

2013/14 figures showed more than half of State/Region expenditure being undertaken by the 'Public Works' department, with most of the remainder undertaken by CDCs, DAOs, and the General Administration Department (GAD).²² The latest data indicates that road building continues to dominate State/Region expenditures: analysis of the 2016/17 budgets for four States/Regions shows the Road Department receiving 70.2% of Kayin State's budget, 66.5% in Mon State, 55.8% in Sagaing Region, and 38.6% in Yangon Region.²³

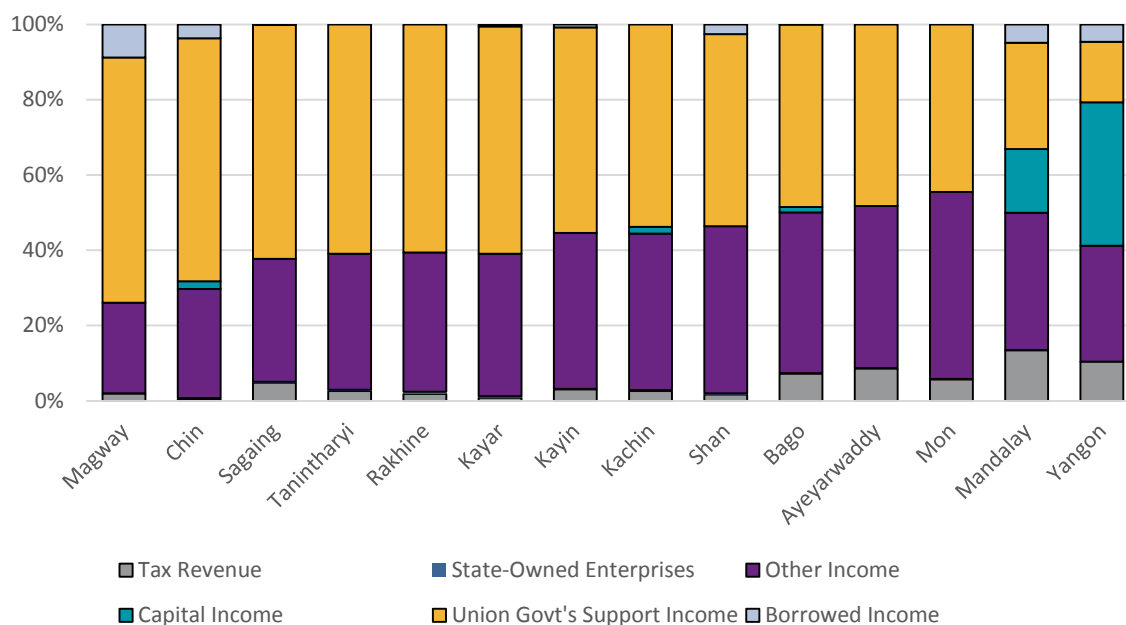
Despite States/Regions' low share of total government spending, they are highly dependent on transfers from Union level, with these transfers financing 64% of sub-national spending, compared to an international average of around 35%.²⁴ On average, only 5% of State/Region revenue comes from their own tax collection, and as Figures 2 and 3 show, a number of States and Regions collect hardly any tax at all. Mandalay and Yangon are the only States/Regions for which more than 10% of their revenue comes from their own tax collection (see Figure 2). Meanwhile, Ayeyarwady is the only State/Region to collect more than 1000 kyats per capita per year in tax revenue (see Figure 3).

Figure 2: State and Region Revenue by Category (2013-14)

²² Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, p.34.

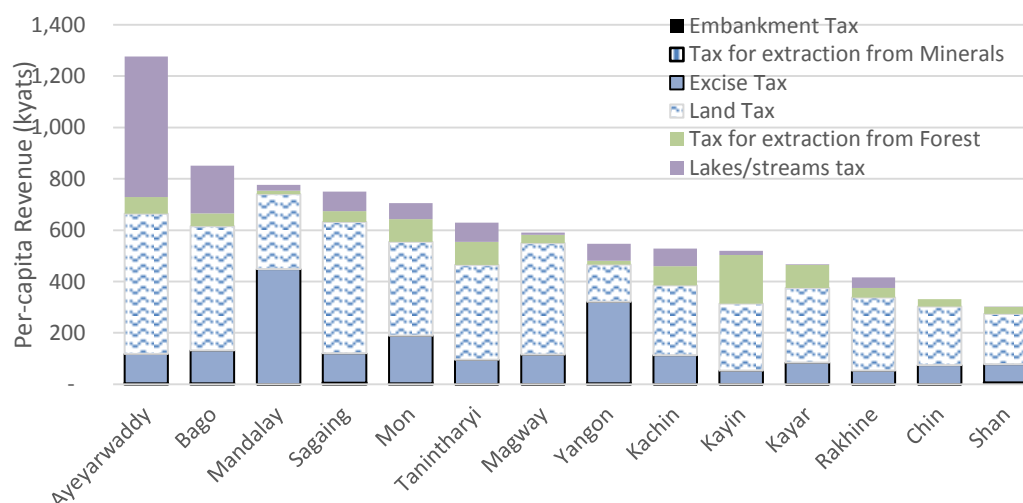
²³ N.b. the figure for Yangon excludes budgeted expenditure for YCDC.

²⁴ The World Bank, *Myanmar Public Expenditure Review 2015*, p.83.



Source: Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, p.24

Figure 3: State and Region Annual Per Capita Tax Revenue (2013-14)



Source: Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, p.26

2.3 Key Avenues for Improving Fiscal Decentralisation Efforts

Rationale and Sequencing: An 'ideal' sequencing of a decentralisation process might proceed as follows:

1. Establish a broad vision for what decentralisation is intended to achieve.
2. Decide which functions should be allocated to Union level, which should be allocated to subnational levels, and which should be shared between Union and subnational levels.
3. Design funding arrangements in line with the functional assignment decided in Stage 2.

Following on from this initial process, it would then be necessary to regularly review how effective this process has been, and whether the allocation of functions between Union and subnational levels

(Stage 2), and the funding arrangements (Stage 3), need to be revised. Over time, a country may also wish to change the overall goals of decentralisation (Stage 1).

Realistically, very few countries conduct their decentralisation process according to such a neat sequencing, and each country has to carry out their decentralisation process according to their own political and institutional realities, and trying to rigidly apply the 'ideal' approach is not advisable. Nevertheless, it is useful to try and follow the stages listed above when it is feasible to do so.

The U Thein Sein government did not clearly articulate what decentralisation was intended to achieve. And, as noted in Section 2.1, there has been considerable lack of clarity on which functions have been assigned to Union level and which to State/Region level. Thus, Stages 1 and 2 in the 'ideal' sequencing were barely addressed. Instead, Myanmar's decentralisation process has so far been led by increasing the level of budget assigned to States/Region governments. Such a funding-led approach can generate considerable inefficiencies due to: resources not being allocated in line with responsibilities; the State/Region budget process and reporting becoming distorted; and the possibility that a narrow range of services provided by State/Region governments are over-funded relative to other spending needs.²⁵

Ultimately, Myanmar's decision on which level(s) of government to assign functions to will partly be a political one. However, all political actors are advised to consider technical analysis that shows the potential costs and benefits of decentralising various functions of government, and optimal strategies for doing so. Similarly, while political factors are also bound to influence funding arrangements, it is important that funding arrangements are designed in line with the functions assigned to each level of government, including: the assignment of tax and other revenue sources (royalties, fees, fines etc); intergovernmental transfers; and what borrowing rights (if any) subnational governments have.

Key Technical Considerations for Deciding Which Expenditure Functions to Decentralise: In Myanmar, most major public services are currently exclusively or primarily the responsibility of the Union government. There is already considerable scope for 'deconcentration' of many responsibilities to State/Region levels, and it may be beneficial for future constitutional change to fully 'devolve' a range of powers currently held at Union level.²⁶ When deciding which functions to decentralise, it is advisable to follow the 'subsidiarity principle' – i.e. decentralising service provision to the lowest level of government that can efficiently provide it. The subsidiarity principle is widely considered to be part of decentralisation 'best practise', and for example is followed by the European Union when deciding whether a particular action/service should be carried out by the Union or by member States. Which level of government can most efficiently provide a particular service will be influenced by whether there are 'externalities', and what 'economies of scale' are available. Box 1 explains these key concepts.

²⁵ Nixon and Joelene, *Fiscal Decentralisation in Myanmar*, pp.14-15.

²⁶ N.b. 'deconcentration' involves granting a degree of decision-making, managerial and financial responsibility to government units at subnational levels for providing a service but with oversight and financing continuing to come from the national government. Devolution is a stronger form of decentralisation, under which responsibilities and powers are transferred to independent subnational governments, that are directly accountable to their citizens.

It is important to consider all levels of the state when deciding which aspects of public service delivery to decentralise – for a number of public services decisions on exactly what to provide and how to provide it can best be made by officials at levels lower than that of State/Region (e.g. District, Township, or Ward/Village Tract). Whichever functions are decentralised, it is vital that laws and policies are clear on which functions are the responsibility of Union government, which are the responsibility of subnational level(s) of government, and which are the responsibility of both.

When deciding which expenditure functions to decentralise, it is best to consider specific functions separately rather than assign whole sectors only – in many cases different functions within a particular sector can be most efficiently managed by different levels of government. For example, in the education sector it might be most efficient to decentralise management of primary schools to District or even Township level, but it would clearly not be efficient to decentralise management of universities to these levels. Similarly, for environmental regulation it might be best to fully decentralise regulation of small streams and lakes to subnational governments; but the Union should retain some legislative authority over air pollution, and the management of rivers that flow through multiple States/Regions.

Box 1: Technical Considerations for Deciding Which Expenditure Functions to Decentralise

Externalities: Externalities occur when the production or consumption of a good or service affects not only the producer and consumer, but also other citizens. Externalities can be 'positive' (i.e. other citizens benefit) or 'negative' (i.e. costs are imposed on other citizens).

Examples of positive externalities include:

- Vaccination – if you are vaccinated not only do you benefit from not being able to catch the disease, but others also benefit because you cannot pass the disease on to them.
- Education – if you are more educated not only yourself benefits; your friends, relatives, neighbours, colleagues, and acquaintances also benefit from the additional knowledge that you pass on in your conversations with them.

Examples of negative externalities include:

- Pollution – If a factory or mine pollutes the water, air, and/or ground this imposes costs on other citizens, including negative health effects, and reduced income earning opportunities.
- Congestion – If you drive your car this can result in increased congestion, making the journey time slower for others. Particularly in large cities such as Yangon, Manila, Jakarta etc, congestion can become a major problem

Where there are positive externalities the government should try to encourage production/consumption, and in many cases can provide an appropriate public service themselves (e.g. vaccinations, education). Where there are negative externalities the government should impose regulations that reduce production/consumption. When externalities occur only locally it is often appropriate for subnational governments to regulate, promote production/consumption, or directly provide services. However, when externalities occur outside of the subnational unit where production/consumption takes place, then that subnational unit should not have complete authority over this service. For example, it would not be a good idea to give the Shan State government complete control over the Shan State section of the River Salween/Thanlyin – if companies operating in Shan State pollute this river it is also affects citizens downstream in Kayah, Kayin and Mon States, and so they should be able to have some influence on how the river is managed in Shan State.

Economies of Scale: 'Economies of scale' refers to how the size of a government body affects how efficiently it can provide a particular service. In some situations, large government units are more efficient, for example: i) when drafting complex laws or regulations it is often more efficient for a single national government to employ/hire relevant experts that can draft the law, than for lots of subnational governments to all do this separately; ii) when negotiating with private companies to purchase a good or service, national governments can often negotiate a lower per-unit price. However, there are also several ways in which larger units of government can reduce efficiency and raise costs. For example, as the size of government increases, and more workers and layers of administration are added, communication becomes slower, reducing efficiency. In socially/ethnically diverse countries it is common for preferences to vary between subnational areas, and in these cases citizen welfare is improved by providing different types of services in different areas. Large national bureaucracies typically struggle to respond to these different preferences, whereas subnational governments are often more responsive.

Revenues – Subnational Tax Collection, Transfers and Borrowing: In the last few years, the small amount of tax revenue that has been collected by States/Regions has mainly come from taxes on transportation, fisheries, and excises. Although States/Regions have the right to collect the land tax and certain (limited) taxes on the extraction of minerals, very little revenue is collected through these instruments.²⁷ States/Regions' low levels of revenue collection leaves them highly dependent on transfers from the Union government.

Internationally, it is normal for subnational governments to receive transfers from central government, and this is particularly the case in developing countries, but Myanmar's current situation is extreme. Large transfers to State/Region governments will continue to be necessary for the immediate future at least, due to the need for States/Regions to provide services despite collecting very little of their own revenue. Nevertheless, strenuous efforts ought to be made to ensure that States/Regions' collect more of their own tax revenue – Box 2 presents some evidence from Brazil that indicates why increased own revenue collection can result in better public service outcomes than increased transfers.

State/Region governments, and the DAOs and CDCs that operate under their authority, already have control over a considerable number of revenue instruments, and have the potential to raise much more revenue than they currently do. There is a clear need for policy and administrative reform that raises subnational entities' incentives and capacity to collect more revenue through the revenue instruments already available to them.

²⁷ Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, p.27.

Box 2: Transfers and Subnational Tax Collection in Brazil

There are theoretical reasons to suggest that transfers from national to subnational authorities may be spent less efficiently than tax revenues collected directly by subnational authorities: i) citizens are likely to be more aware of how much tax they have paid directly to a particular subnational authority than they are to know the per capita size of transfers that a subnational authority has received from the national government, and so are more likely to demand accountability when they pay tax; ii) the more layers of administration there are, the higher the total level of money lost to corruption is likely to be.

Research on fiscal decentralisation in Brazil indicates that reality matches the theoretical predictions:

- When subnational governments collect more revenue through increasing their own tax collection this has a positive impact on both the quantity and quality of locally funded public education infrastructure (which is the main expenditure responsibility of local governments in Brazil). A similar effect also seems to occur for health infrastructure.
- Increasing transfers to subnational governments results in increased corruption, whereas no such effect is observed when subnational tax collection increases.

Source: Lucie Gadenne and Monica Singhal, 'Decentralisation in Developing Economies', *Annual Review of Economics*, 6 (2014), pp.592-93

In the last couple of years GoM has been using a formula to determine fiscal transfers to States/Regions. This formula has been expanded and is now designed to determine transfers based on States/Regions': population size, GDP per capita, poverty rate, number of Townships, land area, per capita tax collection, and urban population as a share of total population. However, in practice subnational officials still tend to see transfers as being determined more by the size of States/Regions' budget deficits than by the formula.²⁸ The large transfers granted through the supplementary budget process further increase uncertainty and decrease the transparency of the transfer system. Having a stricter formula-based process, and communicating more clearly to the public the formula that is used, will help to increase public trust in the system. Simplifying the transfer formula to just 2 or 3 key variables would make it easier for the public to understand how revenues are being reallocated, thereby further boosting trust, and would also make it simpler and less costly for GoM to calculate.

DAOs receive only small transfers, instead primarily relying on revenues that they collect themselves. However, they do receive transfers in the form of 5% of income tax revenues and 2% of stamp duty revenues collected from the Township in which they are located.²⁹ In some States/Regions transfers are also made from DAOs situated in larger townships to DAOs situated in smaller townships, but even where this practice occurs it only accounts for a very small share of revenues.³⁰

States/Regions in Myanmar currently do little borrowing to fund their expenditure. At some point in the future it may be desirable to encourage them to become more active borrowers, but doing so carries significant risks of irresponsible borrowing by subnational entities that can result in debt crises and national macroeconomic instability.³¹ If subnational borrowing is to be encouraged, a clearly defined framework for borrowing and long-term financial planning needs to be implemented, covering issues such as: borrowing limits; permitted lending institutions, rates and contract structures; allowable purposes for borrowing; and State/Region bankruptcy laws. It would also require that an active domestic debt market is developed. A lack of experience and relevant skills among subnational officials means that it would be extremely risky to substantially expand subnational borrowing in the next few years. If such an approach is to be followed in the future, sustained capacity building would be required *before* the expansion of borrowing takes place.

Lines of Authority and Accountability: The extent to which decentralisation will lead to improved service delivery depends considerably on the extent to which subnational decision-makers are accountable to local citizens, i.e. how much 'downward accountability' there is.³² Unfortunately, downward accountability mechanisms are still very weak in Myanmar.

State/Region Chief Ministers are still centrally appointed, meaning that their accountability is primarily upwards to the Union government, rather than downwards to citizens. The GAD plays a leading role in coordinating between Ministries and Departments at State/Region level, with senior

²⁸ Dickenson-Jones and others, *Intergovernmental Fiscal Relations in Myanmar*, p.26.

²⁹ Khin Pwint Oo, Roger Shotton and Zin Wint Yee, *State and Region Planning and Budgeting in Myanmar: What Are the Procedures and What Are the Outcomes?* (Yangon: The Asia Foundation & Renaissance Institute, Forthcoming).

³⁰ Arnold and others, *Municipal Governance in Myanmar*, p.18.

³¹ Faguet, 'Decentralization and Governance', p.8.

³² Faguet, 'Decentralization and Governance', p.6.

staff in this department acting as Executive Secretary of the Office of States/Regions, and GAD having responsibility for coordinating between State/Region ministries and departments. However, GAD staff are appointed centrally, and in practice report upwards to the Union Ministry of Home Affairs, rather than horizontally to the Chief Minister. GAD, together with many line ministries at State/Region level, are not accountable to the State/Region government, and, 'This significantly impairs the ability of subnational governments to manage staff, execute policies and hold officials accountable for their performance.'³³ Change needs to occur so that line agencies coordinate with, and are accountable to, State/Region governments – there are at least two possible mechanisms to achieve this: i) reassign GAD staff so that they are under the direct control of State/Region governments; or ii) assign GAD staff to different responsibilities and allow State/Region governments to recruit and manage their own administrative departments.³⁴

GAD have an even stronger role in planning and budgeting at the Township level than they do at State/Region level, and Township Planning Departments have little to no input on Township-level budgeting.³⁵ Under the U Thein Sein government various committees were introduced in all Townships with the intention of managing development planning and implementation. Some of the committees were elected or partially elected, but these have since been abolished by the new government. This would appear to leave the unelected Township Management Committee, which is headed by the Township Administrator (GAD), with an even more dominant role in planning and budgeting.

The Township Administrator sits at the head of the Township level hierarchy. This individual is unelected, and primarily accountable upwards to the Ministry of Home Affairs. In most Townships relations between officials and departments are strongly top-down and hierarchical, and opportunities for citizen inputs are scarce. The attitude of local officials can also be a significant barrier to citizens interacting with them more. The ability of citizens to demand accountability from Township officials is further hampered by them having little information on Township funding mechanisms and budget processes.³⁶ Further, although in the last couple of years' officials at Township level have had a little more opportunity than previously to influence decision-making in their line department at State/Region and Union levels, decision-making within line departments is still strongly top-down.

An important change that could help Township authorities become more downwardly accountable, would be the introduction of a policy requiring regular public meetings to be held at village and ward levels to which all are invited, and citizens have the chance to discuss relevant issues with local officials. Any major planned activities by Township authorities and DAOs that will affect the local community could then be presented to such meetings, with the feedback gathered from these forums then incorporated into Township and DAO planning and budgeting. This change would require formally reinstating the position of 100 Household Head/Village Head in rural areas, a move that would be likely to provide other local participation and accountability benefits.

³³ The World Bank, *Myanmar Public Expenditure Review 2015*, p.80.

³⁴ The World Bank, *Myanmar Public Expenditure Review 2015*, pp.80-81.

³⁵ Minoletti, *Gender Budgeting in Myanmar*.

³⁶ Minoletti, *Gender Budgeting in Myanmar*.

To increase the downward accountability of local authorities, there is also a clear need to: provide more information to NGOs, Community-Based Organisations and citizens on what services Township authorities, DAOs, and Village Tract/Ward authorities are responsible for providing, and what funding they receive; publicly post key announcements; and help GoM staff to change their style of interacting with citizens to one that is less top-down, and facilitates open and free discussion. Additional options for consideration include creating an elected committee at Township level that has input on planning and budgeting decisions, holding Township level public meetings, and publishing audits of local authorities' spending.

Key Subnational Decision-Makers: At the moment decision-makers at subnational (and national) levels are disproportionately likely to be older males drawn from socio-economic elites. Comprehensive data is lacking, but religious and ethnic minorities can have reduced access to public decision-making roles, and for example it is notable that no Muslim or Hindu candidates were successful in the 2015 elections. There is a high degree of gender inequality of representation, for example: women make up less than 10% of State/Region MPs, all Township Administrators are male, and (as of 2014) only 0.25% of Ward/Village Tract Administrators were female.

Inequitable representation tends to: result in inequitable decision-making in favour of the groups that are over-represented; negatively affect the efficiency and effectiveness of governance; and can reduce the perceived legitimacy of governance bodies.³⁷ If decentralisation is to deliver equitable decision-making, that responds to the preferences of all citizens, it is clear that much needs to be done to make participation in decision-making more representative of Myanmar's population, from village-level committees all the way up to State/Region and Union hluttaws.

The Budget Process: As noted in Section 2.2, a large majority of State/Region revenues are transfers from the Union. Until very recently ministries/departments at subnational levels were not told the size of the next financial year's transfers when they were preparing their budgets – i.e. they were not given a clear 'budget ceiling'. This encouraged subnational entities to create a 'shopping list' of proposed projects, rather than thinking carefully about which projects they wanted to prioritise, thereby discouraging effective planning. The ease with which overspending States/Regions have received large supplementary budgets is a disincentive to fiscal discipline. Most State/Region hluttaws have had very little influence on annual budgets, and there has been only very limited parliamentary discussion of these bills – this lack of scrutiny by elected representatives impairs downward accountability.³⁸ There is an absence of clear technical criteria for appraising budget proposals and a lack of procedural mechanisms through which to do so, making it very difficult to match budgets to policy priorities.³⁹ All subnational budgeting is done on an annual basis, making it difficult to implement large-scale projects.

There is a clear need to change the budgeting process from its past form towards one in which subnational entities:

1. Have a clear understanding of their responsibilities

³⁷ Paul Minoletti, *Gender (in)Equality in the Governance of Myanmar: Past, Present, and Potential Strategies for Change*, pp.1-3, 8, 11.

³⁸ Hamish Nixon and others, *State and Region Governments in Myanmar* (MDRI-CESD - The Asia Foundation, 2013), p.41.

³⁹ Khin Pwint Oo, Shotton and Zin Wint Yee.

2. Set annual and multi-year priorities for development in line with their responsibilities
3. Consider the appropriate role for the private and public sector to meet these priorities
4. Are given clear and transparent budget ceilings
5. Devise a budgeted list of projects in accordance with 1-4.

It is promising that GoM has recently started giving budget ceilings to subnational levels before they prepare their budgets. This should make it easier for subnational entities to start prioritising projects and setting budgets accordingly, albeit that this requires considerable skill to do well, and State/Region officials need assistance in building these skills. Also, a continuing problem is that State/Region governments still tend to see supplementary budgets as an easy option for covering any budget deficits – it is important for fiscal discipline that this stops being the case. Budget ceilings should also start to be given to line departments at District and Township levels, so that these entities can also start planning and budgeting more effectively.

Fiscal decentralisation and downward accountability can be enhanced by giving State/Region parliaments more opportunities for genuine scrutiny of their budgets, however for this to be effective it will require not only that sufficient time is allowed for parliamentary discussion, but also that a sufficient number of State/Region MPs receive high-quality training in the skills needed to analyse and debate budgets. In the medium and longer term it is important that: multi-year budgeting is introduced; subnational entities develop the ability to conduct cost-benefit analysis on proposed projects; proposed legislation submitted to State/Region parliaments is carefully costed.

Most of the expenditure carried out by Township authorities is allocated at State/Region and Union levels. However, Township authorities have a large degree of control over the various Local Development Funds. Although a minority of Townships have tried to use some kind of integrated planning process when allocating these funds, they have received little support to enable them to do so effectively.

DAOs' high degree of reliance on own revenues is accompanied by considerable freedom for how expenditure is allocated – although DAOs have to submit their budgets to the DAO office at State/Region level, there is typically little interference in their planned expenditure. DAO budgeting follows a similar annual cycle to Union and State/Region governments: they have to prepare a 'base estimate' (equivalent to the annual budget), and later in the year a 'revised estimate' (equivalent to the supplementary budget). As is the case for line departments and State/Region governments, DAOs cannot retain surpluses for future year(s), and are restricted to budgeting for a single year only.⁴⁰

Structural Incentives for Efficiency in Revenue Collection and Expenditure: State/Region governments currently face weak incentives to improve revenue collection and make their spending more efficient:

- State/Region governments cannot retain budget surpluses for the next year.
- Supplementary budgets are not rules-based, and the Union government appears to have been willing to 'bail-out' those that overspend.⁴¹

⁴⁰ Arnold and others, *Municipal Governance in Myanmar*, pp.27, 32-33.

⁴¹ For example, in 2012/13 supplementary transfers from the Union government appear to have made up 47% of Kayin State's total expenditure. See, The World Bank, *Myanmar Public Expenditure Review 2015*, p.82.

- Auditing of State/Region budgets: has been limited in scope, focusing only on compliance with accounting rules rather than also considering whether spending is appropriately matched to policy objectives; suffers from a lack of digitisation, standardisation, and there being large-scale of off-budget expenditures and revenues; and is hampered by insufficiently clear regulations on what State/Region governments can and cannot do.⁴²
- The current formula for determining transfers allocates higher transfers to those States/Regions' that collect the least tax. Although this might sound like a good way to make revenues more equal across States and Regions, it is not recommended because it considerably reduces State/Region governments' incentive to increase their own revenue collection.⁴³

DAOs' incentives to improve revenue collection and make spending more efficient are also harmed by not being able to retain budget surpluses for the next year. However, in contrast to States/Region governments, they retain nearly all of the revenue that they collect and receive only limited transfers.⁴⁴ As such, they should have strong incentives to collect revenue, but even here revenue collection is very low – ranging from a little over 3500 kyats per capita per annum in Kachin State to less than 200 kyats in Sagaing Region.⁴⁵ These figures for DAOs indicate the need not only to create better incentives for subnational authorities to collect more revenues, but also to improve tax administration. It also suggests the need to increase downward accountability – if citizens cannot exert any pressure on local officials to provide better services, some officials may have little incentive to exert extra effort to collect additional revenue and provide more and better services.

Administrative Aspects of Tax Collection: There is much scope for increased digitisation of tax collection efforts. The timing of tax collection can be changed so that it is targeted toward times of the year when citizens and businesses are most able to afford it, rather than being aligned with the government's financial year – this is a particularly important consideration in agricultural communities, but is relevant everywhere.

Individual tax collectors currently do not have any direct monetary incentives to collect more tax, and staff promotions have often been weakly connected to their tax collection effectiveness. The MoPF has recently expressed an interest in giving direct financial incentives to individual tax collectors to improve their collection rates. Such a change would be risky, and if such a scheme is to be introduced great care needs to be taken: giving tax collectors monetary incentives to collect more tax may encourage corruption and generate a backlash from citizens that negatively affects GoM's ability to create a 'social contract' on tax. A less risky change would be to try and more closely linked promotions with performance.

Creating a 'Social Contract' on Tax: It is currently quite broadly socially acceptable in Myanmar for individuals and businesses not to pay the correct amount of tax. This attitude is driven by: concerns over GoM's allocation of expenditure; high levels of corruption in the system; inefficient spending;

⁴² The World Bank, *Myanmar Public Expenditure Review 2015*, pp.90-91.

⁴³ N.b. The formula already includes GDP per capita (i.e. those States/Regions with lower GDP per capita receive higher transfers), which acts as a decent proxy for their *potential* tax revenues and thereby helps to equalise revenues across States and Regions. It is not desirable to have an additional variable that specifically measures tax collection and creates negative incentives.

⁴⁴ Arnold and others, *Municipal Governance in Myanmar*, pp.17-18.

⁴⁵ Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, p.25.

and the widespread perception that the wealthiest individuals do not pay enough tax. Under this situation individuals and businesses have little incentive to comply with the tax code, and it is prohibitively difficult and costly for GoM to force everyone to comply. The popularity of the new government in Myanmar offers a great chance to start to build a positive 'social contract' on tax, under which citizens and businesses become increasingly willing to pay tax and to censure those who do not. Strategies that can help to facilitate this change include:

- Make government spending allocations more closely aligned with citizens' preferences – large increases in education and health spending over the last few years are an important first step in this regard.
- Communicate more clearly what public expenditure is used to provide, and how this is funded.
- Increase and improve the quality of public service provision.
- Increase citizens' awareness of the services they are entitled to receive from GoM.
- Reduce corruption among tax collection agencies and service providers.
- In the short to medium term continue to focus increased tax collection efforts on the largest businesses and wealthiest individuals.
- Provide increased social recognition to those that pay the correct amount of tax.
- Increase citizens' opportunities to participate in decision-making.
- Try to cooperate with existing non-state organisations that collect revenues and provide services. This includes not only elements of certain EAOs' administrations, but also voluntary/religious-based organisations that currently fill this role in communities throughout Myanmar.⁴⁶

Budget Data Collection, Analysis and Publication: Although a lot of budget data is collected by GoM, much of it is currently not very useful for modern budgeting analysis. Budget clarity is hampered by a lack of rules specifying whether expenditures should be recorded under departments or State-Owned Enterprises (SOEs), and expenditures seem to have sometimes been shifted arbitrarily between them.⁴⁷ A lot of spending at subnational levels (as well as Union) is still 'off-budget', making it difficult to allocate resources fairly and efficiently. Off-budget revenues are typically channelled through 'other accounts'. The extremely limited public information available on other accounts makes it difficult to know their exact scale but they are undoubtedly very significant – the World Bank has estimated that across all ministries and departments at Union and subnational levels in 2011/12 there were over 13,000 other accounts in operation, and 44% of total budgeted revenue and 28% of total budgeted expenditure were channelled through them.⁴⁸

There is a clear need to bring off-budget revenues and expenditure on-budget. A fully comprehensive approach to budgeting would also incorporate revenue collection and service provision that occurs with zero or limited involvement from GoM, i.e. i) that which is organised at local levels by communities; ii) that which is organised by national and international NGOs; iii) that which is organised by EAOs. Given the scale of such forms of provision, they are highly important

⁴⁶ McCarthy, *Building on What Is There*, p.14.

⁴⁷ Dickenson-Jones, De and Smurra, *State and Region Public Finances in Myanmar*, pp.39-40; Nixon and Joelene, *Fiscal Decentralisation in Myanmar*, p.15.

⁴⁸ The World Bank, *Public Financial Management Performance Report*, p.37.

and GoM should try to incorporate information on these sectors in its decision-making. However, it should also be acknowledged that doing so will be highly complex.

In each of Myanmar's Townships at least 16 departments (i.e. over 5000 subnational spending units in Myanmar in total) must report monthly to the MoPF and the Myanmar Economic Bank, but a lack of standardisation and digitisation of this data severely constrains what analysis can be carried out.⁴⁹ Budget monitoring has been focused on allocations and compliance with rules, with very little data collected on how many citizens receive a particular service (i.e. budget 'outputs') or the impact that receiving the service has on citizens' welfare (i.e. budget 'outcomes').

Of the budget data that is currently collected, little of it is published. For example, while the size of transfers from Union to States/Regions is now published, very little information is publicly available on how State/Region budgets are allocated or actually used.⁵⁰ The BOOST dataset that has been developed by GoM and World Bank contains a lot of fine-grained data on spending at subnational levels, and should be made publicly available. Much more needs to be done at local levels to communicate basic information on budget processes, allocations, and who the key decision-makers are.

⁴⁹ The World Bank, *Myanmar Public Expenditure Review 2015*, p.91; author;s correspondence with World Bank staff.

⁵⁰ The World Bank, *Myanmar Public Expenditure Review 2015*, p.91

3. The Broader Picture: How Fiscal Decentralisation Relates to Political Decentralisation, Natural Resources, and Conflict and Peace

3.1 Fiscal Decentralisation and Political Decentralisation

Political decentralisation involves granting decision-making power to subnational authorities that are accountable to their citizens – in democratic countries this often includes elected subnational governments.⁵¹ So far, political decentralisation in Myanmar has been limited: Chief Ministers are still centrally appointed; at least 25% of MPs in each State/Region are appointed by the military; and Schedule 2 of the Constitution is vague and only clearly grants legislative power to States/Regions on a narrow range of activities. State/Region legislative activity has covered issues such as motor-vehicle regulation, forestry, fisheries, local industry, water transport, and agricultural concerns. Parliaments and States/Regions with large populations (and therefore larger parliaments) have tended to be more active legislators.⁵²

The NLD's public commitment to a 'genuine federal democratic union' and the importance of federalism to EAOs, many political parties, and many citizens, means that an increase in the level of political decentralisation is highly likely at some point. It is currently not clear when this will change will occur, but it seems unlikely to happen within the next few years. It is also currently unclear to what extent this decentralisation will be decided through the peace negotiations, and to what extent it will be decided in the Union hluttaw. Nevertheless, it is important to remark here that these expected future decisions will change the expenditure responsibilities of subnational entities, and fiscal arrangements will need to be designed in accordance with these responsibilities.

So far, most public debate on decentralisation in Myanmar has focused on devolving power to States/Regions. Key questions related to political decentralisation to States/Regions include:

- What role and level of authority should State/Region hluttaws have?
- How should the Chief Minister be selected?
- Should States/Regions have individual constitutions?
- What voting system should be used to elect MPs?

When considering political decentralisation, it is important to also look at all of the levels below State/Region. For many services it can be more efficient and responsive to citizens' preferences to decentralise their provision below State/Region level, and some limited steps have already been made in granting decision-making authority to Township and Village Tract Level. Elections are now held for Ward/Village Tract Administrators (VTAs), but the law grants only one vote per household, resulting in a restricted and highly male dominated electorate. The law further limits how democratic the elections are by having an indirect election process.⁵³ In practice, further problems with the election of VTAs have arisen from factors such as: a high level of variety in how the elections are conducted and organised, limited public information and debate, and low levels of citizen engagement.⁵⁴

⁵¹ Nixon and others, *State and Region Governments in Myanmar*, p.4.

⁵² Nixon and others, *State and Region Governments in Myanmar*, pp.64-65.

⁵³ Minoletti, *Gender (in)Equality in the Governance of Myanmar*, p.26.

⁵⁴ Helene Maria Kyed, Annika Pohl Harrisson and Gerard McCarthy, *Local Democracy in Myanmar: Reflections on Ward and Village Tract Elections in 2016* (Copenhagen: DIIS, 2016), pp.4-5.

As outlined in Section 2.3, in most Townships there are now no elected representatives at Township and DAO level, and civil servants here are primarily accountable upwards to their line ministries, rather than downwards to citizens. Elections were introduced for certain positions on CDCs but the election process was confusing, voter turnout was low, and most key positions (including mayor) are still unelected. As is the case with VTA elections, only the designated head of household has the right to vote in CDC elections.

As further powers are decentralised it will become increasingly important to make subnational entities more downwardly accountable to their citizens than is currently the case – if this does not happen the potential benefits of decentralisation are unlikely to materialise. This does not necessarily require creating more elected positions, and a range of options for promoting downward accountability of local officials are suggested in Section 2.3. Nevertheless, there is a clear need to improve the electoral process for local officials that are elected, i.e. VTAs and elected CDC members.

3.2 Fiscal Decentralisation and Natural Resources

The Importance of Natural Resources in Myanmar: Many of Myanmar's States and Regions are richly endowed with extractive natural resources: minerals, oil, and gas. At the moment almost all of the budgeted government revenues accruing from these resources go to the Union government. Natural resource revenues have helped fund many armed groups' activities and given them a greater financial incentive to fight; while the Union's control of natural resource revenues has fuelled political grievances, particularly in ethnic minority areas. There are thus large political pressures for State/Region governments in Myanmar to receive a considerably increased share of natural resource revenue. Such a move would reduce States/Regions' reliance on transfers from the Union government.

Transparency: The natural resource sector in Myanmar has long suffered from a lack of transparency, which has contributed to widespread dissatisfaction among citizens and greater political instability. The absence of transparency has facilitated large-scale corruption that has deprived the government budget of vast revenues that could have been used to provide more and better services to citizens. For example, Global Witness' recent estimates for the jade sector alone suggest that in a single year (2014) the value of Myanmar's total jade sales may have been 30 billion USD higher than the value of the jade sold through official channels.⁵⁵

In 2014 Myanmar became a 'candidate country' for the Extractive Industries Transparency Initiative (EITI), and is now working towards attaining 'compliant' status under EITI. This effort represents an important step for promoting transparency, but much more remains to be done. It is vital that natural resource extraction that is currently totally unrecorded by the government is increasingly brought under government oversight and appropriate government revenues are collected in accordance with the law. Further, all natural resource revenues that are currently recorded by individual departments/ministries but are currently off-budget need to be brought on-budget, rather than being managed through 'other accounts.'

⁵⁵ Global Witness, *Jade: Myanmar's Big State Secret* (Global Witness, October 2015), pp.26, 99-103.

Designing a Transfer Scheme: Myanmar will need to decide whether to share natural resource revenues as part of a single general system of transfers, or separately from transfers of other revenues. Given the political sensitivity of natural resource revenues, it will probably be better to have a separate sharing mechanism for these, so that it is clearer to everyone where natural resource revenues from each State/Region are going. When designing a system for sharing (any type of) revenues between national and subnational levels of government, it is necessary first to establish the objectives of doing so. A common key general objective is ensuring that subnational governments have sufficient funding to effectively carry out their expenditure responsibilities. Another common objective is to try to reduce inequalities between regions. National governments can also help insure subnational governments from fiscal risks that can arise from environmental, social or economic crises. There are also potential objectives that are specifically relevant for natural resource revenue sharing schemes:

- Compensation for the negative impacts of extraction, e.g. environmental damage, relocation of communities, negative public health effects.
- Conflict mitigation and prevention.
- Acknowledging certain groups' right to benefit from the extraction of a resource from an area seen as belonging to that group, for example resources situated under land that has historically been inhabited by particular ethnic group(s).⁵⁶

When deciding on objectives it is best not to choose too many, or the revenue-sharing formula will become very complicated, which will negatively affect public comprehension and trust in the system. Once the objective(s) of the natural resource revenue sharing scheme have been decided it is then necessary to decide which revenue streams to share, such as, "...royalties, signature bonuses, profit taxes, property taxes, goods and service taxes, border taxes, dividends from government equity, production entitlements, and fines and penalties."⁵⁷ A transparent formula system then needs to be developed in accordance with the objectives of the scheme, that sets clear rules for how these various revenue streams are allocated between national and subnational levels. States/Regions are the most obvious subnational level to receive shares of natural resource revenues, but lower levels of authority can also possibly be included all the way down to village level, or even to individual landowners or residents.⁵⁸

Revenue-sharing formulas can be 'derivation-based', 'indicator-based', or a combination of both. Globally, derivation-based systems are the most common, especially in less developed countries. Box 3 describes these different systems, and outlines their pros and cons.

⁵⁶ Adapted from, Andrew Bauer, Paul Shortell and Lorenzo Delesgues, *Sharing the Wealth: A Roadmap for Distributing Myanmar's Natural Resource Revenues* (Natural Resource Governance Institute, February 2016), pp.30-32.

⁵⁷ Bauer and others, *Sharing the Wealth*, p.35.

⁵⁸ Bauer and others, *Sharing the Wealth*, p.46.

Box 3: Pros and Cons of Derivation-Based and Indicator-Based Transfer Systems

Derivation-based transfer systems link the size of transfers to the size of natural resource revenues coming from each subnational area – i.e. areas in which higher natural resource revenues are produced receive a higher share of revenues.

Advantages of derivation-based systems include:

- They are relatively easy for citizens to understand.
- Data requirements are relatively low.
- *In countries where ethnic or other forms of local identity are important, linking the receipt of revenues to the geographical area from which they originate can be seen as 'fair'.*

However, a major risk associated with derivation-based systems is that they tend to be 'pro-cyclical', i.e. subnational government revenue and spending tends to increase when the local economy is growing fast, and tends to decrease when the economy is struggling, thereby amplifying boom and bust cycles.

Introducing a derivation-based system in Myanmar would require the publication of more detailed data on natural resource production than is currently the case. As a minimum, payments information will be needed on each revenue stream for each project. If subnational governments are to independently verify that companies are paying the correct revenues, they may also need to collect information on '...costs, profits, price assumptions, volume of production, quality of ore/oil and even contracts.'

Indicator-based transfer systems allocate revenues according to a formula based on specific goals aimed at improving equity between different sub-national areas. Indicators commonly included in transfer formulas are: poverty, wealth/income levels, access to public services, education levels, environmental damage, and subnational governments' potential to collect tax revenues.

Advantages of indicator-based systems include:

- They are less likely to be pro-cyclical than derivation-based systems.
- *If achieving higher equivalent living conditions across different subnational areas is a primary goal, then they are more 'fair' than derivation-based systems.*

A problem with indicator-based systems is that they require lots of accurate data if they are to operate accurately and fairly. They also tend to be less easy for the public to understand than derivation-based systems, which can limit trust in the system.

Source: Adapted from Andrew Bauer, Paul Shortell and Lorenzo Delesgues, *Sharing the Wealth: A*

Assigning Revenue Rights: In most countries the national-level government is assigned the revenue rights and responsibilities for natural resource extraction, and this revenue is then shared with subnational governments according to the agreed formula. Negotiating contracts with large mining and oil companies, and subsequently enforcing them and collecting the revenues, is often extremely complex and national level governments are typically more likely to have the capacity to be able to adequately manage this. National level governments are also more likely to have the capacity to manage volatile natural resource revenues. However, in some countries all or some of the revenue rights have been granted to subnational governments, and there have been calls for this to happen in Myanmar.⁵⁹

Most theoretical arguments are in favour of the Union retaining revenue rights and responsibilities for large natural resource investments, but it is vital to consider that in Myanmar many ethnic minority communities have very low trust in the Union government to fairly share the revenues it collects. Hitherto, the Union government has done a poor job of negotiating and managing contracts, revenue collection has been plagued by corruption, and there has been very limited transparency on both contracts and revenues. If it is decided in Myanmar that the Union government will retain all or nearly all of the natural resource revenue rights and responsibilities for large natural resource investments it is particularly essential that: revenues are consistently shared according to the agreed formula, corruption is strongly curtailed, transparency is greatly increased, and capacity of Union officials to negotiate and manage contracts is raised.

National governments have much less of a theoretical advantage for managing small-scale mining than for large investments: contracts tend to be simpler and revenues lower, and it is often easier for subnational governments to monitor small mining companies than it is for national governments to do so. Therefore, Myanmar may want to assign revenue rights and responsibilities differently according to the size of the operation. Decentralising control of small-scale mining is permitted under the updated Mines Act (2015), and there is currently debate over whether such a policy change should take place.

Managing Resource Wealth: Managing natural resource revenues effectively is far from straightforward, and considerable capacity building is needed for MoPF at Union and State/Region levels on issues such as: coping with volatile commodity prices; avoiding harmfully pro-cyclical government spending; and, encouraging economic diversification – these challenges are explained in Box 4. Box 5 gives examples of two subnational governments in Latin America that have struggled to manage resource revenues effectively. Some countries with large natural resource endowments have made effective use of Stabilisation or Sovereign Wealth Funds to manage these challenges, with Botswana and Chile being two particularly successful examples.⁶⁰ Myanmar could utilise such funds at the Union level, and possibly also for certain individual States/Regions (i.e. those that have particularly large resource endowments). However, it should be noted that not all sovereign wealth or stabilisation funds have been successful, and in some cases they have been used as channels for patronage and corruption.⁶¹ Clear rules mandating that revenues be invested productively and sustainably, revenues being managed transparently under appropriate oversight mechanisms, and the technical competency of those managing the fund are key for success.

⁵⁹ Bauer and others, *Sharing the Wealth*, p.16.

⁶⁰ Zaw Oo and others, *Fiscal Management in Myanmar*, p.15.

⁶¹ Bauer and others, *Sharing the Wealth*, p.50.

Box 4: Key Issues for the Economic Management of Natural Resource Revenues

If managed well, natural resource revenues can be a great boon to national and subnational governments, facilitating greater investment in productive infrastructure and improved public services. However, natural resource revenues are difficult to manage, and if managed poorly can actually hinder development. Key challenges include:

- Commodity prices are highly volatile: For example, between July 2008 and December 2008 global oil prices fell from 145 USD/barrel to only 38 USD (i.e. in half a year the price fell by 74%), and they have continued to fluctuate dramatically since, from as high as 114 USD (April 2011) to as low as 29 USD (January 2015). Revenues accruing to governments from natural resource extraction are usually closely linked to the global price, and so in countries with lots of natural resource extraction these global fluctuations in price result in dramatic changes in government revenue. This instability of revenue makes it difficult to plan spending, and it is easy for governments to be over-optimistic when revenues are high and commit to spending they are later unable afford, resulting in debt crises and/or the cancellation of public services. The unpredictability of natural resource revenues means that they are particularly unsuitable for governments to use to fund recurrent costs such as salaries.
- Natural resource revenues tend to be pro-cyclical: To avoid harmful 'boom-and-bust' cycles government spending should be designed to increase when the economy contracts, and decrease when the economy is expanding. However, in economies that are rich in natural resources, the economy tends to grow rapidly when commodity prices are high, and contract rapidly when prices are low. Thus, the economy is already growing quickly when government revenues are increasing, and is contracting when government revenues are decreasing. If government spending changes in line with government revenue, it amplifies rather than reduces boom-and-bust cycles.
- Reliance on natural resources can limit economic diversification: If a country is exporting lots of natural resources demand for the country's currency increases, causing the value of the currency to appreciate. This currency appreciation means that the goods exported by that country exports become more expensive, while imports become cheaper. This results in reduced domestic and foreign demand for domestically produced goods. Thus, a country with a large natural resource sector can become weak in other sectors such as agriculture and manufacturing. This presents at least three big problems for development: i) the natural resource sector generates less employment than growth in sectors such as agriculture and manufacturing; ii) economic growth driven by the natural resource sector tends to increase inequality; iii) when the natural resources run out, and when commodity prices are low and the natural resource sector is in recession, there is a lack of alternative employment resulting in low or negative economic growth, unemployment and reduced income for many households;

Sources: Andrew Bauer, Paul Shortell and Lorenzo Delesgues, *Sharing the Wealth: A Roadmap for Distributing Myanmar's Natural Resource Revenues* (Natural Resource Governance Institute, February 2016); www.fedprimerate.com/crude-oil-price-history [Accessed 13th Oct 2016]; Norman Loayza, Alfredo Mier y Teran and Jamele Rigolini, *Poverty, Inequality and the Local Natural Resource Curse*, Discussion Paper Series (IZA, February 2013).

Box 5: Difficulties with Managing Natural Resource Revenue - International Experience

Governments often struggle to effectively manage natural resource revenues. This problem can be particularly acute at subnational levels in countries where transfers are derivation-based.

- In Peru, the municipal government of Ite had its annual budget jump from 500,000 USD to 13million USD thanks to revenues from a local copper mine. Peruvian law requires that these revenues be used for investment projects, and the municipality has spent heavily on infrastructure. While some of the improved infrastructure is undoubtedly beneficial to citizens (such as improved roads and school buildings), this spending has had noticeable downsides:
 - The construction boom has raised wages for construction workers, and in response farmers and agricultural labourers have shifted into the sector. This not only lowers agricultural output now, but also threatens local agricultural production for the long-term.
 - The municipal government has not saved enough funds to maintain spending in the future, with revenues mostly being spent rather than invested or saved.
 - Insufficient resources have been allocated to training teachers, building health systems, or financing social programs.
 - In sum, “Once the copper mine has been depleted, Ite risks a decline in standards of living, perhaps even leaving citizens worse off than before the boom.”
- In Colombia, the local annual budget of the municipal government of Puerto Gaitan increased by around 10,000% due to increased oil revenue transfers in the early 2010s. Although some useful infrastructure was built (such as modern well-equipped schools), much of it was wasted on vanity projects (such as an expensive amphitheatre and a concrete arch monument). Now that commodity prices have dramatically fallen, Puerto Gaitan’s government is suffering.

Sources: Andrew Bauer and others, *Natural Resource Revenue Sharing* (NRGI & UNDP, September 2016), p.59; Andrew Bauer, Paul Shortell and Lorenzo Delesgues, *Sharing the Wealth: A Roadmap for Distributing Myanmar’s Natural Resource Revenues* (NRGI, February 2016), p. 22

Accounting for Social and Environmental Costs: In January 2016 GoM issued a new set of rules that require all new investment projects that could have negative social and/or environmental effects to first conduct an Environmental Impact Assessment (EIA). As is the case in most countries that have EIAs, Myanmar's rules require that the firms that wish to undertake an investment project procure and pay for their own EIAs, which gives firms that carry out the EIAs an incentive to understate potential social and environmental costs. Nevertheless, this rule change represents an important shift from the practice of the 1990s and 2000s in which potential negative environmental and social costs of new investment projects were given little or no consideration in investment approval decisions. The widespread failure to account and compensate for costs incurred by local populations has been hugely problematic, both in terms of citizens' welfare and political stability – the controversies over the Letpadaung copper mine and the Myitsone dam project are just two of the best known examples among many. For the benefit of Myanmar's new EIA regime to be maximised it is important that both GoM and Myanmar civil society have the resources and skills needed to effectively monitor EIAs for quality and possible bias, and ensure that adequate compensation is paid to communities that are negatively affected by investments.

3.3 Fiscal Decentralisation, Conflict and Peace

The Relationship between Decentralisation, Conflict and Peace: A desire among ethnic minority groups for greater subnational autonomy has been a key factor behind civil conflict and social strife in Myanmar since independence, and is central to EAOs' negotiating positions in the current peace process. As such, an effective decentralisation process, incorporating sufficient attention to fiscal aspects, has the potential to reduce conflict and improve political stability. However, it is important to be aware that there are mechanisms through which decentralisation can possibly increase social divisions, conflict, and political instability: decentralisation can potentially accentuate differences between geographical areas/ethnic groups and decrease citizens' identification with the nation as a whole, thereby encouraging politicians and leaders of armed groups to adopt increasingly strong positions in favour of greater subnational separation.⁶² Overall, although there is a clear need for further decentralisation in Myanmar, it is not a panacea for solving conflict, and the possible risks it poses for national fragmentation need to be acknowledged.

Overview of Armed Groups' Governance Roles and Legitimacy: Since the fall of the Communist Party of Burma and GoM's abandonment of socialism in the late 1980s, there have not been major differences in economic ideology between Ethnic Armed Organisations (EAOs), the government, and the Tatmadaw⁶³ – all support various forms of market capitalism. Nevertheless, there has been considerable heterogeneity in the economic governance role and style of these groups, with some groups taking a strongly top-down statist approach to development (for example the GoM/Tatmadaw in the 1990s and 2000s, and the United Wa State Army (UWSA) until present), whereas others have taken a less interventionist approach. Many EAOs play an active role in providing services to local populations, including: health, education, infrastructure, security, justice,

⁶² Joseph Siegle and Patrick O'Mahony, *Assessing the Merits of Decentralisation as a Conflict Mitigation Strategy* (USAID, 2006), especially p.1.

⁶³ N.b. the 'Tatmadaw' is the name for Myanmar's armed forces.

forestry management and/or agricultural support.⁶⁴ In some locations an EAO has sole control of governance, but they also commonly play a governance role in ‘mixed-authority’ areas alongside GoM, Tatmadaw, other EAO(s), militias, and/or Border Guard Forces (BGFs). In some locations the governance actors operating in mixed authority areas have positive relations and some sort of an agreement on their respective responsibilities, however in other areas they are in conflict with one another. In all cases, demarcation of different groups’ territory is rarely clear.⁶⁵

EAOs enjoy considerable legitimacy as governance actors among certain communities, and their role as public service providers are a key aspect of this legitimacy. However, there is a high degree of variation between EAOs for the quantity and quality of services they provide, their treatment of local populations, and levels of corruption. There is also considerable variation within many EAOs – since the post-independence period, insurgent (and Tatmadaw) field commanders have tended to have a high level of discretion over what services to provide and how, and what revenues to collect.⁶⁶ BGFs and militias⁶⁷ often enjoy legitimacy as security providers with some citizens/villages in the areas in which they operate, and some also provide additional services such as supporting cultural organisations, religious ceremonies, or assisting those displaced by conflict.⁶⁸

The issue of EAO, BGF and militia legitimacy with local populations is a highly complex one, and varies not only between armed groups, but also for any given armed group can vary considerably between individual villages, households and individuals. The heterogeneity in citizens’ attitudes towards armed groups is influenced by factors such as their past experiences of interacting with a particular group, the individual’s own political ideas, and whether they have the same ethnic identity as the EAO(s) operating in the area.

Despite the various complexities surrounding issues of legitimacy, EAOs’ right to act as public service providers was partially recognised by Myanmar’s last government, and recent years have seen efforts at collaboration between the health and education systems of GoM and certain EAOs, which may eventually result in a form of convergence of these systems.⁶⁹ The inclusion of political issues/federalism in the peace negotiations represents some acceptance of EAOs’ legitimacy to negotiate on political issues on behalf of ethnic minority communities, although exactly how much legitimacy these groups have to act as political representatives, and the scope of topics for which they are legitimate negotiators, is contested.

A number of EAOs make efforts to consult with independent and quasi-independent civil society organisations, and incorporate these inputs in their decision-making process. In the last few years,

⁶⁴ Kim Jolliffe, *Ethnic Armed Conflict and Territorial Administration in Myanmar* (Yangon: The Asia Foundation, 2015), pp.46-81.

⁶⁵ Jolliffe, *Ethnic Armed Conflict and Territorial Administration in Myanmar*, pp.41-44.

⁶⁶ Ashley South, *Ethnic Politics in Burma* (Abingdon, 2009), p.36.

⁶⁷ BGF units are subdivisions of the Tatmadaw numbering 326 soldiers. BGFs are headed by a Tatmadaw commander, but most of their troops are former members of EAOs. Militias are localised armed groups that often have a direct or indirect relationship with the Tatmadaw or a certain EAO, but in some cases operate independently. John Buchanan describes how militias may, ‘...combat other militias or insurgent groups, pursue criminal activity, or support an insurgency.’ See, John Buchanan, *Militias in Myanmar* (The Asia Foundation, July 2016), p.2.

⁶⁸ Buchanan, *Militias in Myanmar*, pp.32-33.

⁶⁹ For health, see, Bill Davis and Kim Jolliffe, *Achieving Health Equity in Contested Areas of Southeast Myanmar* (The Asia Foundation, June 2016) especially pp.25-31.

some EAOs have also undertaken donor-supported ‘community consultation exercises.’ However, EAO decision-making on revenue collection, service provision, and setting negotiating positions, is still largely the outcome of discussions between a small number of individuals that are overwhelmingly male; older and middle-aged; and tend to be drawn from elite backgrounds. As mentioned in Section 2.3, this is likely to negatively affect the equitability of decision-making and the effectiveness of governance.

Service Provision by EAOs

Table 2 provides a summary of the type of services provided by 11 of the largest EAOs, their governance structure, and the extent to which their administration is militarised.

Table 2: Summary of EAOs Administrations and Service Provision

Ethnic Armed Organisation	Designated governance/administration department(s)?	Governance/Administration department(s) separate from military?	Investment in infrastructure and public buildings	Fully provided social services
DKBA	No	N/A	Yes	No
KIO	Yes	Yes	Yes	Yes
KNPP	Yes	Yes	Limited	Yes
KNU	Yes	Yes (but with automatic military representation)	Limited	Yes
NDAA	Unknown	Unknown	Yes	Unknown
NMSP	Yes	Yes	Yes	Yes
PNLO	Yes	No	Limited	Limited
PSLF	Yes	No	Limited	Yes
RCSS	Yes	No	Limited	Limited
UWSA	Yes	Yes	Yes	Yes
SSPP	Yes	No	Unknown	Limited

Source: Adapted from Kim Jolliffe, *Ethnic Armed Conflict and Territorial Administration in Myanmar* (The Asia Foundation, 2015), p.100.

There is not space here to discuss the exact service provision role of each EAO but it is important to appreciate the high level of diversity in terms of prioritisation of services, and the extent to which administrations are militarised. For the purpose of illustration, the KNU can be contrasted with the Restoration Council of Shan State (RCSS). Of the KNU’s 14 line departments (which are similar to ministries), the ‘...most active departments are education, health and welfare, agriculture, and

forestry which all have significant representation and activities at all levels [of the administration].⁷⁰ These departments are largely staffed by civilian officials. Whereas, in the RCSS the most important departments are defence and civil administration, and the civil administration department is effectively staffed by soldiers that have undergone special training.⁷¹

Armed Groups' Revenue Collection

In addition to providing services, EAOs collect revenues. The approach to revenue raising is highly varied both between and within armed groups, but in general 'formal' taxation – i.e. that which is collected in accordance with clear taxation rules written by the EAO – makes up a small proportion of revenues relative to: arbitrary taxation, negotiated payments for investments made in areas under EAO control, and/or revenues arising from the black economy. Ever since independence, insurgent groups, as well as Tatmadaw and militias conducting counter-insurgency operations, have given a lot of *de facto* freedom to field commanders for how to raise revenues. It is expected that some of these revenues will then be shared with higher levels, but enough is retained to fund local operations, and frequently to enable the personal enrichment of the local commanders and their associates.⁷² Unsurprisingly, budget transparency is very low for most EAOs and the Tatmadaw, and comprehensive and detailed data on their revenues and expenditures is not available.

During the 1970s and 1980s many armed groups on the Thai and Chinese borders were able to collect large tax revenues from international trade, aided by their control of many of the border crossings, and the huge black market for foreign consumer goods arising from the Ne Win government's attempts at autarchy. However, from the late 1980s onwards, this revenue source dwindled, as Tatmadaw offensives brought more border crossings under GoM control, and trade regulations were relaxed somewhat. From this period, EAOs began to increasingly rely on revenues they were able to levy on mining and logging, with both of these sectors expanding rapidly.

Some EAOs have (in theory) developed quite sophisticated revenue schemes for the natural resource sector. For example the KIO/KIA have a system designed to collect tax on jade mining companies in the Hpakant area calculated partly as a percentage of the value of their output and profits; as well as accounting for the number of miners working, the type of machinery used, and the fuel used to run the machinery. However, in practice, it seems that the amount of tax that companies actually pay to KIO/KIA is negotiated. Further, the taxes are collected by a middleman with connections to the UWSA, and there is a common perception among the citizens of Kachin State that many of the jade revenues collected by KIO/KIA are lost to corruption.⁷³

Armed groups (as well as various government officials) have profited from taxing illegal trade passing through their areas. A minority of armed groups are also actively involved in the illegal drugs trade as producers and distributors. Myanmar is one of the world's largest producers of opium, heroin and methamphetamine, and vast profits have been made from this trade.⁷⁴

⁷⁰ Jolliffe, *Ethnic Armed Conflict and Territorial Administration in Myanmar*, p.48.

⁷¹ Jolliffe, *Ethnic Armed Conflict and Territorial Administration in Myanmar*, p.67.

⁷² South, *Ethnic Politics in Burma*, p.36.

⁷³ Global Witness, *Jade: Myanmar's Big State Secret* (Global Witness, October 2015), p.93.

⁷⁴ Bertil Lintner, *Burma in Revolt: Opium and Insurgency since 1948*, 2nd edn (Chiang Mai, 1999), pp.379-80; Bertil Lintner and Michael Black, *Merchants of Madness: The Methamphetamine Explosion in the Golden Triangle* (Chiang Mai, 2009), pp.67-89; South, *Ethnic Politics in Burma* (Abingdon, 2009), pp.143-45.

There are a number of businesses working in a wide range of sectors that operate under or have close links with EAOs and militias. However, it is generally not clear how revenues from these businesses are shared between private individual returns and EAO budgets.

EAOs that are currently active in providing social services to their populations are generally keen to continue having some role in doing so. EAOs are also pushing for some kind of federal army to be created, that would give their soldiers a continued role in internal and external security. As yet, it is unclear exactly what EAOs' future roles will be as service providers and revenue collectors, but it is important that the peace process results in clear agreement on what their role as service providers should be, and that funding arrangements are designed accordingly. Vagueness and/or unfunded mandates is likely to encourage arbitrary/informal revenue raising methods.

Return of Internally Displaced Persons (IDPs) and Refugees: Myanmar has hundreds of thousands of IDPs and refugees. Some of these have been displaced in the last few years, while others have been away from their home for decades. A range of services need to be provided to help these people return to their original home, or settle elsewhere in Myanmar, such as: settling landownership claims, education and training, providing jobs, providing citizenship rights and access to government services, housing, and landmine clearance. Decisions need to be made about what combination of Union GoM, subnational levels of GoM, civil society, the private sector, and EAOs, will be used to provide these services. And then, funding needs to be designed accordingly.

Peace Dividends: The chances of Myanmar's ceasefires and peace process delivering lasting peace will be greatly enhanced if communities in conflict areas experience a material improvement in their circumstances soon after conflict is halted. Such 'peace dividends' can take the form of reduced arbitrary taxation, improved public services, and/or improved opportunities for employment and income generation. Paying attention to these economic aspects of citizens' welfare is now standard practice in international peace building efforts, and it is important that GoM and other development actors strive to deliver quick and tangible benefits to communities in post-conflict areas.

It is vital to appreciate that efforts to deliver peace dividends can be counter-productive if insufficient attention is given to 'do no harm'/conflict sensitivity'. In many communities that have experienced a long history of conflict there continues to be considerable mistrust and even resentment towards GoM, and expanding provision of social services and physical infrastructure into ceasefire areas can be seen as an unwelcome projection of GoM's power by communities, local civil society, and/or EAOs. Projects in ceasefire areas by GoM, and international and national development organisations, need to carefully consult and regularly communicate with local communities. In locations where service providers under or linked to EAOs are already well established, it is important to carefully consult with them, and in many cases it may be appropriate to formally cooperate with them.⁷⁵

Support for Non-State Armed Groups: As well as initiating programs that can rapidly deliver peace dividends to communities in post-conflict areas, GoM and researchers need to build their understanding of what motivates: i) individuals to join non-state armed groups, and ii) communities to support non-state armed groups. Policies can then be tailored accordingly, including decisions on

⁷⁵ Kim Jolliffe, *Ethnic Conflict and Social Services in Myanmar's Contested Regions* (The Asia Foundation, June 2014), pp.45-46.

what levels of the state should provide support, what role non-governmental actors should have, and how these activities should be funded. Motivations that have been found to matter in other countries include: group ideology; political grievances; monetary gain; protection from harm; inequality; coercive recruitment; and unemployment (especially among young males).⁷⁶ Given that large political and economic changes have occurred recently in Myanmar and further dramatic change seems likely, the motivations for joining/supporting non-state and armed groups and the number of citizens that do so are likely to change considerably over time.

Reintegration of Ex-Combatants: Currently, it is not clear what will happen in the future to the soldiers currently employed in EAOs, Border Guard Forces, and militias. However, if a peace agreement is reached, it seems likely that some of these soldiers will be released from their current occupation. It is also possible that the number of soldiers in the Tatmadaw will be reduced. Reintegrating ex-combatants into their societies and economies is one of the key challenges for successful peacebuilding, and is a long-term process. It is likely to be most effective for some of this work to be done by subnational GoM and nongovernmental actors, and it needs to be properly funded. International experience with reintegration efforts points to a number of key issues, including:

- The importance of addressing the socio-economic causes of conflict.
- Balancing the need to provide gainful employment and an adequate standard of living for ex-combatants, with not being seen to unfairly privilege ex-combatants (who may have committed abuses against those communities they are now living in) relative to other citizens.
- Promoting economic activity, private sector investment, and encouraging the private sector to employ ex-combatants.
- Ensuring that vocational education and training projects are well-designed and implemented.
- Reintegration strategies being designed in a politically sensitive way.⁷⁷

The Illegal Drug Trade: As previously noted, several major armed actors are actively involved in the drug trade as producers and distributors, and more receive revenue from taxing traders operating in areas under their control. In addition, the large quantity of illegal drugs being produced in Myanmar has contributed to high rates of drug addiction in certain parts of the country, with attendant negative social, health, and economic impacts. It has also fuelled armed conflict, and the export of drugs to other countries in the region is unpopular with Myanmar's neighbours. However, it is important to also recognise that opium production has long been an important source of income for many households living in upland areas, and strategies aimed at reducing opium production need to be designed so that these households' income does not drop precipitously.⁷⁸ It also has to be acknowledged that the vast revenues that some armed groups are making from illegal drugs will

⁷⁶ Christopher Blattman and Edward Miguel, 'Civil War', *Journal of Economic Literature*, 48.1 (2010), pp.32-35.

⁷⁷ Adapted from, Irma Specht, *Practice Note 4: Socio-Economic Reintegration of Ex-Combatants* (International Alert, September 2010), pp.3-5.

⁷⁸ Tom Kramer, Martin Jelsma and Tom Blickman, *Withdrawal Symptoms in the Golden Triangle: A Drug Market in Disarray* (Amsterdam: Transnational Institute, 2009), pp.26-30; Myanmar Opium Farmers' Forum, *Statement of the 4th Myanmar Opium Farmers' Forum* (Myanmar Opium Farmers' Forum, May 2016), South, *Ethnic Politics in Burma*, pp.144-45.

make them strongly resistant to effective government action against this trade, and this presents a considerable barrier to establishing a lasting peace.

Human Capital: Civil war has highly damaging effects on the stock of ‘human capital’ in affected areas, i.e. the population’s education, skills, mental attitudes, health and physical strength. As well as negatively impacting the human capital of individuals that survive, many civilians as well as soldiers die. Negative human capital effects can be particularly large for ex-combatants, who are particularly likely to suffer long run negative health effects, to have missed schooling, and to suffer from psychological trauma.⁷⁹ Not just in Myanmar, but internationally as well, the impact of war on human capital and the long-run economic, political and social effects this has are still poorly understood by policymakers and researchers:

“The leading question is not whether wars harm human capital stocks [we already know that they do], but rather in what ways, how much, for whom, and how persistently – all crucial questions for understanding war’s impact on economic growth and inequality, as well as priorities for post-conflict assistance.”⁸⁰

Investment: Investment is key for economic growth and employment, and is partially shaped by the policies of governance actors and the presence/absence of conflict. Historically, many EAOs have tended to oppose large infrastructure projects in the areas under their control, due to the fear that it will expand GoM/Tatmadaw’s reach into these areas and/or that local communities will suffer the downsides (such as relocation, environmental damage, forced labour), while receiving few of the benefits (such as increased income, or improved electricity supply).⁸¹ The attitude towards infrastructure projects has varied between EAOs and over time, and it is not the case that all EAOs have always been oppositional. For example, the UWSA has engaged in extensive road building and building of electrical infrastructure throughout its existence. EAOs’ future level of support for/opposition to infrastructure projects is likely to depend considerably on: to what extent they trust the government and the peace process (and therefore how resistant they are to GoM/Tatmadaw expanding into their areas); the extent to which local citizens receive benefits and are compensated for costs; financial and political benefits to EAOs from investment.

Over the last few decades’ investment into EAO-controlled and mixed-authority areas has primarily been directed towards natural resource extraction, particularly minerals and logging. This is unsurprising given that these areas are characterised by large resource endowments; highly uncertain property rights; and poor electricity, transport, and communications infrastructure. Few EAOs have had clear investment policies, and decisions on investment approval have often been ad-hoc and non-transparent. It is notable that decisions on smaller investment projects have often been made by local level decision-makers rather than central offices, and joint investments and business projects have sometimes been made by local Tatmadaw and EAOs commanders even in the absence of a ceasefire agreement between their groups.⁸² Details of the investment agreements made between EAOs and domestic and foreign investors are not well-known, but joint-ventures seem to

⁷⁹ Blattman and Miguel, ‘Civil War’, pp.41-42.

⁸⁰ Blattman and Miguel, ‘Civil War’, p.42.

⁸¹ For example, see, Karen Human Rights Group, *Development by Decree: The Politics of Poverty and Control in Karen State* (Karen Human Rights Group, April 2007).

⁸² South, *Ethnic Politics in Burma*, p.169.

have been used quite often. Joint-ventures between private investors and the ‘holding companies’⁸³ controlled by Tatmadaw have also been extremely widespread.

Going forward, it is highly desirable that businesses linked to Tatmadaw and EAOs do not receive preferential claims to be partners for joint ventures, and that investment projects are allocated through a competitive tendering process. A competitive process will promote efficiency and reduce opportunities for corruption. It is important that these businesses also do not receive preferential treatment for tax liabilities. In general, GoM policy at national and subnational levels should look to minimise tax breaks available to all firms, so that the government at Union and subnational levels receives sufficient revenue to pay for badly needed infrastructure and social services, and the tax system is seen to operate fairly.

Internationally, armed conflict is associated with decreased investment and this effect is often large.⁸⁴ The destruction of human capital and physical infrastructure, together with insecure property rights, is a deterrent to investors, particularly in sectors with more complex supply chains or that require more skilled labour and/or complex forms of labour management. There was huge destruction of physical (and institutional) infrastructure throughout Myanmar during World War 2.⁸⁵ Although more geographically limited, the various insurgencies since independence have also led to the destruction of existing physical infrastructure and a lack of investment in new infrastructure. Meanwhile, the health and education of those living in conflict areas has been badly affected.⁸⁶ The militarised nature of GoM from the 1960s has also had various negative impacts on the quality of governance even in non-conflict areas which has discouraged private investment, and contributed to poor infrastructure, health and education.⁸⁷

The effect these historical legacies have on future investment levels is difficult to predict with any precision: the destruction of and underinvestment in physical capital means that higher returns to investment should be available, therefore giving incentives for investment; but fear of future conflict, the low quality of many governance institutions, and low levels of human capital and trust will act as disincentives. The last few decades in Myanmar have shown that attracting investment in post-conflict areas for natural resource extraction is relatively easy. The challenge for GoM and other governance actors is to create an investment climate that promotes investment in sectors that are more sustainable and create more employment – such as agriculture, manufacturing and tourism.

Institutions and Society: A range of institutions and social norms are important for economic growth and development, including: property rights; social capital, cohesion and trust; rational and effective bureaucracies; and work ethic. However, despite the importance of institutions and social norms, the short and long run impacts of civil war on these is still very imperfectly understood by

⁸³ I.e. Myanmar Economic Corporation (MEC) and Union of Myanmar Economic Holdings Limited (UMEHL).

⁸⁴ Blattman and Miguel, ‘Civil War’, pp.37-38.

⁸⁵ Mary Callahan, *Making Enemies: War and State Building in Burma* (Ithaca, 2003), pp.45-47; Martin Smith, *Burma: Insurgency and the Politics of Ethnicity*, 1st edn (London, 1991), p.60.

⁸⁶ Davis and Jolliffe, *Achieving Health Equity*, pp.7-10; South, *Ethnic Politics in Burma*, p.77-113.

⁸⁷ Davis and Jolliffe, *Achieving Health Equity*, p.7; Sean Turnell, ‘Fundamentals of Myanmar’s Macroeconomy: A Political Economy Perspective’, *Asian Economic Policy Review*, 6.1 (2011); The World Bank, *Myanmar: Empowering People for Inclusive Growth, Country Partnership Framework for the Period 2015-2017* (The World Bank, April 2015), pp.5-12.

researchers for all regions of the world.⁸⁸ The militarisation of Myanmar's government 1960s-2000s contributed to an environment featuring very weak individual property rights, high levels of corruption, institutions that provide low quality public services, and very low levels of trust.⁸⁹ Conflict may have promoted *certain* forms of social cohesion within *certain* groups,⁹⁰ but conflict and militarisation has almost certainly harmed cohesion and trust between groups and many forms of cohesion and trust within groups, with damaging political and economic effects. Understanding how to repair the damage done to Myanmar's institutions and society is one of the most difficult but also important areas for future research and policy-making.

⁸⁸ Blattman and Miguel, 'Civil War', pp.42-44.

⁸⁹ Mary Callahan, *Making Enemies*, pp.208-28.

⁹⁰ To give just one example the resumption of conflict between the KIA and the Tatmadaw since 2011 appears to have contributed to a stronger sense of group identity among many Kachin people, and has also inspired certain civil society activities and the creation of CSOs and alliances.

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