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Fueling the Future: Furthering Theater Security with Burma's Energy Industry

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Introduction

Neighboring both India and China resides a significant supply of untapped oil and natural gas within a nation eager to redefine itself on the world stage. Strategically located, endowed with abundant natural resources and engaged in democratic reform, Burma represents an attractive and geopolitically relevant partner for the U.S. in the Asia-Pacific region. Conditions are converging, assuming the U.S. takes an active role in engagement and assistance, to cultivate a strategically beneficial relationship with this promising Asian partner. Plagued with a significant development gap and woefully inadequate energy infrastructure, Burma is in dire need of economic assistance and industrial development, especially within its energy sector. Burma turned to China, during decades of U.S. isolation, to exchange natural resource rights for economic and political support

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of its military junta regime. However, China's "extractive" approach to foreign investment in Burma has inflicted more harm than good on the Burmese population. With Burma's awakening to democratic ideals, Chinese anxiety over reliable energy supply and access place Burma at the epicenter of China's strategic interests.

In contrast, by shifting from isolationism to engagement with Burma, the U.S. now holds an opportunity to build a viable partnership while advancing security in region. Specifically, the U.S. should provide investment and technical assistance in Burma's energy industry to foster financial partnership and energy access in Asia while assisting Burma to strengthen its economy and improve its governance. Moreover, a strong Burmese economy, fortified by growth in its energy sector, will produce domestic security and stability, an outcome congruent with the U.S. strategy of furthering peace while countering China's hegemony in the region.

Burma's Energy Sector: Challenges and Opportunities

Burma is endowed with substantial natural resources including "extractable" oil and natural gas. A recent geology-based assessment of undiscovered technically recoverable oil, natural gas and gas liquids, conducted by the U.S. Geological Survey (USGS) in Burma, estimated "mean volumes of 2.3 billion barrels of oil, 79.6 trillion cubic feet of gas, and 2.1 billion barrels of natural gas liquids" are present in the Central Burma Basin, the Irrawaddy-Andaman and the Indo-Burman Geologic Provinces (fig. 1).[1] While not the largest deposits in the world, these provinces certainly represent significant resource reserves.

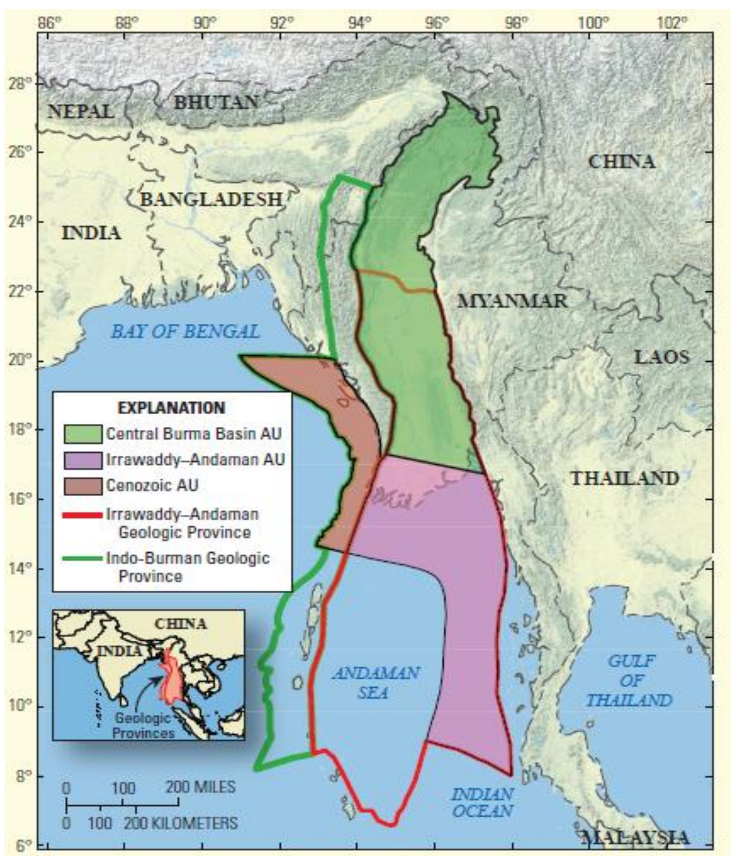

Figure 1.
Extractive Energy Assessment of Geologic Provinces in Burma, U.S. Geological Survey, 2012

Due to Middle East market volatility, cross-regional transportation challenges and exponential growth in energy demand, the presence of both on and offshore untapped oil and gas reserves in Burma is of compelling interest to Burma and her neighbors alike. According to U.S. State Department projections, “if Asia continues its current trajectory, the region will likely account for nearly one-half of the expected growth in the world oil demand between 2008 and 2030.”[2] To meet insatiable energy requirements, Burma’s closest neighbors of India, China and Thailand are all net importers of oil and natural gas.[3] Interestingly, although Burma’s domestic crude oil production increased 38% in the last decade, underdeveloped production and refining capacity results in Burma importing crude oil as well to meet its own growing annual domestic demand.[4] Within its natural gas industry, Burma is on the positive side of the import/export equation, exporting 300 billion cubic feet of natural gas last year primarily to Thailand and China.[5] However, there is still significant demand for greater supply of natural gas within the Asian region – a market opportunity Burma may miss without foreign assistance. The irony is although Burma is blessed with ample natural resources, it must seek energy supply from outside its borders while significant economic potential lays idle in the ground. Why the imbalance?

Attributable to the previous Junta regime’s corrupt governance and resulting Western economic sanctions, a significant “development gap” now exists between Burma and other nations in the Asian region. For example, the richest country in the Association of Southeast Asian Nations (ASEAN) is Singapore with a per capita annual income 45 times higher than Burma (ASEAN’s poorest country.) The United Nations Human Development Report placed Singapore in the “very high human development” category, while Burma shares the same “low human development” rating as some sub-Saharan African countries.[6] Contributing to the poor human development rating, Burma’s electricity sector fails to provide power to over 51% of its population and suffers from severe power outages due to antiquated power plants and dismal electrical transmission infrastructure.[7] Consequently, the U.S. Energy Information Administration (EIA) reports “traditional biomass and waste (typically consisting of wood, charcoal, manure, and crop residues) is widely utilized and accounts for about two-thirds of Burma’s primary energy consumption,” which illustrates Burma’s uphill climb to modernize its energy industry and provide reliable power to meet its domestic demand.[8] As is true of any economic union, Asia is only as strong as its weakest nation. As such, ASEAN prioritized “narrowing of the development gap” for Burma as a key agenda item in its recent Initiative for ASEAN Integration.[9]

Acutely aware of the need for growth, Burma is attempting to address its energy sector challenges. The EIA describes these efforts as “investment in more hydroelectric, natural gas, and coal-fired electric capacity” and infrastructure to improve the reliability and management of energy delivery.[10] However, Burma also realizes external assistance is needed and thus is seeking to attract foreign direct investment (FDI) and technical expertise to bolster the industry. Defined by the World Bank, FDI is investment to acquire a lasting management interest in an enterprise operating within an economy other than that of the investor. As an example of Burma’s interest in boosting industry capacity, production-sharing contracts for numerous blocks within deepwater and shallow-water oil and natural gas fields were recently awarded to both foreign and domestic energy companies.[11] Although recent trends in FDI appear to indicate progress, not all forms of FDI portend beneficial results for a developing nation in need of support, as evidenced by China’s energy intervention to date in Burma.

China’s FDI in Burma: An Example of “What Not to Do”

China’s appetite for energy in recent years is nothing less than voracious. As a result of the burdensome weight of the world’s largest (and growing) population combined with rapid economic growth, Suisheng Zhao describes China as contending with “energy-gobbling industries which devour electricity and fuels…and automobiles and modern apartment buildings that consume growing quantities of gasoline and heating oil."[12] China's economy is dependent on an infrastructure capable of bearing the weight, which must be fed by reliable and readily available sources of energy. Although China's world-wide ranking is 4th for oil production and 7th for natural gas, it is incapable of producing even half of the 11 million barrels per day (bbl/d) of oil or 5 trillion cubic feet of gas it consumes annually, thus falling just behind the U.S. as the world's second-largest net importer of oil.[13] Compounding the issue is the fact China's largest oil fields are mature, meaning production has peaked creating more difficulties for sustaining oil flow and forcing China to focus on offshore reserves and oil imports.[14]

Historically, Chinese foreign investment in Burma has blatantly aligned with its energy interests. Between 2009-2011, over 66% of Chinese FDI in Burma was made in hydrocarbons projects and overall energy related investment accounts for at least 9 billion USD of the cumulative 14 billion USD China has invested since 1990.[15] In return for this significant investment, among other things, China "secured leases to vast gas reserves estimated to be from 10.1 to 17.5 trillion cubic feet" as well as constructed twin crude oil and gas pipelines running from the Burmese port of Kyaukphyu to Kunming in southwestern China.[16] These pipelines hold strategic value to China, as they represent an alternate routing for oil and natural gas, enabling as much as 440,000 bbl/d to bypass the Strait of Malacca and flow directly from the resource rich region of the Andaman Sea.[17] The period of 2008-2011 saw the largest jump in Chinese FDI, which in retrospect corresponds with the twilight of Burma's junta regime. Since late 2011, coincident to Burma's recent democratic reform, Chinese FDI dropped precipitously in Burma, from 4 billion USD annually between 2008-2011 to only 190 million USD in 2012.[18] China's FDI in Burma generated positive strategic outcomes for Chinese energy security, and by extension national security; but did Burma really benefit by the influx of Chinese assistance?

In general, FDI can play a positive role in assisting a developing nation to grow its industry and achieve a stronger economy; but when, how, where and why one nation invests in another affects the outcome, either positive or negative, for the "supported" nation. According to McGillivray's review of the ASEAN development gap, "critics argue that policies to attract FDI can distort domestic incentives and displace domestic investment, crowding out employment and the activities of domestic firms."[19] Under the junta regime, precious little of the sizeable Chinese oil and gas proceeds were spent on domestic infrastructure or human development programs, resulting in the Burmese people never seeing the benefit of the extensive revenue that accumulated in the junta's coffers.[20] Randall, during his review of China's energy security ambitions on Burma's domestic affairs, observed "it's ironic that ninety percent of the people in Arakan and Chin, regions of Burma with some of the largest natural gas deposits in the country, use candles for light and firewood as their primary source of cooking fuel."[21] As is typical of autocratic regimes, most proceeds from the trade of natural resources for cash are allocated towards military spending in an effort to sustain the regime's control over its population and ensure its ability to retain power. Until late 2011, the situation in Burma was no different. Although an exact accounting of the Burmese junta's spending is difficult to acquire, Randall notes "economists estimate that nearly 60% of the state budget was allocated towards military expenditures," which was then used against ethnic groups to force compliance with state wishes and resulting in "poverty as the overwhelming life experience for most people."[22]

Another example of poor FDI implementation is evident with China's nearly six billion USD investment to build the twin trans-Burmese pipelines. A potential windfall for Burmese employment and domestic economy, this project instead represented a domestic policy and human rights catastrophe. As is common Chinese practice, China refused to hire indigenous Burmese labor, preferring instead to import Chinese workers to operate the critical project.[23] Instead of offering strong pushback against this policy, the Burmese regime turned a blind eye to protect its investment with China.[24] Worse yet, in a summary of various NGO and press reports, Randall confirms "during the construction of the pipeline the junta committed a range of human rights violations, from beatings, forced labor and rape to unlawful imprisonment and forced eviction."[25] So did Burma really benefit by the influx of Chinese assistance?

Clearly, Burma's junta utilized FDI to support itself at the expense of its population. When viewed in isolation, the Sino-Burmese example supports the opinion of FDI critics. However, China's approach is an example of "what not to do" when considering FDI to support a developing partner-nation establish economic strength and security. How can the U.S. do it better?

U.S. FDI in Burma: "Getting it Right" To Advance Stability in Asia

In today's globalized, industrialized and energy-hungry world economy, a nation's energy sector serves as a key leverage point against which the force of direct investment can offer promising results to cultivate the economic strength of a partner-nation. However, as previously cautioned in the Sino-Burma example of misapplied FDI, the principal issue to clarify prior to wielding this economic instrument of power is the intended purpose of FDI and the desired end-state as a result of such investment. U.S. foreign policy objectives reflect a desired end-state of peace and stability for the Asia-Pacific region. Sensitive to historical context within its area of responsibility, U.S. Pacific Command (PACOM) understands the propensity for protracted insurgency when poor governance and unresolved grievances are left to fester. Thus, in support of U.S. national objectives, PACOM's Theater Campaign Plan provides security cooperation planning guidance outlining the importance of assisting partner-nations to build domestic capacity and capability, thereby fortifying positive governance, prosperity and security.[26] But why is building partner capacity so important?

When a nation builds its domestic industrial capacity, it spurs economic development, which then generates revenue for the nation. Guided by its interests, an increase in revenue enables a nation to make, if it so chooses, "good governance" investments by improving security, infrastructure, health-care, education, and so forth. Economist and author Charles Wheelen writes "to grow and prosper, a country needs laws, law enforcement, courts, basic infrastructure, a government capable of collecting taxes – and a healthy respect among the citizenship for each of these things."[27] Prudent investment back into the nation, for the benefit of the population, leads to public perception of government competency and legitimacy. Thus, the government is perceived as upholding the responsibilities expected by the population, thereby fostering cooperation and respect between the governed and the government. The trick, of course, is for the government to realize investment in "good governance" is truly in its best interest, which is where U.S. engagement may play an effective role. For the U.S., the goal of assisting a partner to build domestic industrial capacity and strengthen its economy goes beyond any possible financial benefit; it reflects U.S. democratic values to enhance a partner's legitimacy and positive influence with its own population, especially a population battered by decades of human rights abuse and disenfranchisement as is the case in Burma.[28] So with the importance of this "end" in mind, what are the "ways" and "means" available to achieve the objective?

From a foreign policy perspective, "ways" in which the U.S. can engage Burma align primarily into three political approaches – Ostracism, Business-as-Usual, and Principled Engagement.[29] As the name implies, Ostracism in foreign policy equates to denying recognition of (and deliberately avoiding interaction with) the country being politically isolated. Conversely, Business-as-Usual can be characterized as one country's indifference to the current and/or past actions of another, thereby deliberately avoiding confrontation to facilitate a relationship deemed beneficial to the country that, in essence, is turning a blind eye.[30] Striving to build a middle-ground by interweaving the promotion of human rights with development assistance, Principled Engagement seeks to address a reprieve of past injustice while extending an offer of support dependent on observed and sustained reorientation towards human dignity, international law and transparent governance.[31] Rejecting a Business-as-Usual approach due to mass atrocities committed by the military junta, and likewise concluding decades of Ostracism failed to produce positive results, U.S. foreign policy now embraces Principled Engagement as the preferred path forward.[32] Since one policy extreme is clearly incongruent with American humanitarian values while the other extreme is counter to the U.S. goal of mutual cooperation and partnership in the region, the middle ground of Principled Engagement now appears the best "way" to approach Burma.

With the "ways" and "ends" understood, a review of the "means" available will complete the strategy equation and answer the question of how to build capacity and capability in Burma's energy industry. Of the myriad methods available for investment and technical assistance, the U.S. approach must not only boost Burma's energy output, but also bolster industry competency and enhance government credibility. Hence, the most promising "means" involves a combination of U.S. interagency initiatives in partnership with private investment. Fortunately, several promising initiatives already underway in Burma include utilization of the Overseas Private Investment Corporation (OPIC) to facilitate private U.S. investment and the Energy Governance and Capacity Initiative (EGCI) to offer U.S. technical expertise in natural resource extraction, as well as adherence to the Extractive Industries Transparency Initiative and Responsible Investment Reporting Requirements to enhance credibility and legitimacy.

Led by the U.S. State Department, the EGCI includes robust interagency participation to "provide a wide range of technical and capacity building assistance to the host governments of select countries…with world class hydrocarbon resource potential and expecting to receive sizable, near-term financial windfalls from the development of their oil and gas resources" and focuses on environmentally responsible management of extractive resources while encouraging "sound and transparent energy sector governance for the benefit of national economic development."[33] Describing specific support already underway in Burma's energy sector, the U.S. State Department notes "the United States is providing technical assistance for the implementation of international best practices in oil and gas management and oversight, financial accountability, and safety and environmental stewardship."[34] Assuming Burma implements the extractive resource technical expertise being offered by the U.S., transparency and accountability in the energy sector will increase, resulting in enhanced credibility for Burma's government, both domestically and internationally.

Many private investment vehicles exist to provide U.S. FDI to developing nations. One such vehicle is the OPIC. Nested under the U.S. State Department and known as the U.S. Government's development finance institution, OPIC "mobilizes private capital to help solve critical development challenges…and helps U.S. businesses gain footholds in emerging markets, catalyzing revenues, jobs and growth opportunities both at home and abroad."[35] The four avenues of support OPIC provides to its investors are project financing, guarantees, political risk insurance and support for private equity investment funds.[36] In May 2013, OPIC signed an Investment Incentive Agreement with Burma, representing a first step in OPIC's ability to "support U.S. businesses interested in investing in Burma" and contributing to the $243M of approved foreign investment in Burma by U.S. companies to date.[37] As a direct reflection how Principled Engagement links financial support to human rights, U.S. policy now requires private investors to adhere to the Burma Responsible Investment Reporting Requirements and report on such items as "labor rights, land rights, environmental stewardship, anti-corruption, risk and impact assessment and mitigation, and payments to the government."[38] Moreover, OPIC offers a catalyst to connect private investors, backed by investment guaranties, to a lucrative energy market in desperate need of development, while remaining synchronized with U.S. policy aims of improving Burma's legitimacy and governance.

Another "means" for building industry competency and government credibility was put in action when, in May 2013, Burma's Minister of Energy Than Htay released a joint statement with U.S. Special Envoy Carlos Pascual on "Good Governance and Transparency in the Energy Sector," wherein both nations committed to implement the Extractive Industries Transparency Initiative (EITI).[39] Attracting international participation by 31 compliant and 17 candidate countries, the main premise of EITI is the idea that natural resources belong to and should benefit a country's citizens.[40] By implementing the "EITI Standard," participants ensure "full disclosure of taxes and other payments made by oil, gas and mining companies to governments" to enable accountability of resources and thereby inform "public debate about how the country's resource wealth should be managed."[41]

Particularly for Burma, the landmark political decision to adhere to EITI standards reflects what appears to be a sincere attempt by President Thein Sein to reverse what is acknowledged as "challenges in the extractives sector, including lack of transparency, relationship to conflict, and concerns associated with land acquisition, labor rights and other human rights…"[42] This type of voluntary political action suggests the recent U.S. approach of Principled Engagement, combined with the mechanisms for investment (OPIC) and technical assistance (EGCI), is encouraging Burma's transformation from poor governance to good governance. By continuing this current strategy, the U.S. appears well postured to help build Burma's energy capacity as well as its government credibility, thus strengthening Burma's economy and prospects for security.

How a Strong Economy Leads to Security

Mentioned earlier, growth in domestic industrial capacity spurs economic development, generating increased revenue into government coffers which, if properly managed, can strengthen the economy and improve quality of life for the population via re-investment back into infrastructure, institutions and human services. A strong energy industry, however, can go even further to improve Burma's economy without the direct involvement of the government. Oil and gas exploration and extraction are significantly more profitable when "downstream" refinement and distribution capacity exists; thus, energy companies are motivated to invest in further development. As energy companies earn higher incomes from development, their capital holdings increase facilitating more re-investment back into further energy sector development, as well as capital injection into the domestic economy writ large.

A reliable, pervasive and affordable energy distribution system fuels growth in all other sectors of the national economy. From the garment industry to telecommunications to health services to education, all areas of Burma's economy quite literally gain better access to the fuel required to flourish. Additionally, because energy development requires skilled labor, Burma will not only see increased employment opportunity, but in conjunction with U.S. technical assistance and training, growth of skilled laborers and enrichment of human capital. Describing the importance of human capital to a developing nation's economy, Wheelen points out "human capital is what makes individuals productive, and productivity is what determines standard of living…all countries that have had persistent growth in income have also had large increases in the education and training of their labor forces."[43] So as the economy flourishes, the standard of living within Burma's society increases, resulting in a population motivated to maintain economic progress, market stability and security.

Ultimately, domestic security is derived from the stabilizing force of economic prosperity and open markets on both the population and government alike. Increased domestic investment, growth in consumer and investor confidence, improved education and health care, and even defense modernization are just a few examples of how economic strength can help reinforce Burma's democratic reform. Good governance, transparent and credible management of resources and services, and honest institutions responsive to the population are the antidote for past grievances of abuse and disenfranchisement. Resolved grievances and increased prosperity dramatically lower the risk of domestic insurrection. Furthermore, a secure, stable, and energy exporting Burma adds to Asia's regional security via a regional increase in energy supply, amplified trade, strengthened alliances within ASEAN and India, as well as offering a positive example of democratic ideals to its neighbors in the region.

Strategic Implications for China

Strategically, Burma represents an important avenue for access to the vast natural resources of the Bay of Bengal and the Indian Ocean. As Burma grows stronger politically and economically, it becomes less attracted to China's façade of friendship in exchange for access to energy. Positive results from U.S. engagement and investment will further reinforce Burma's pivot towards democratic reform, open markets and regional partnerships, resulting in a counterbalance to Chinese hegemonic aspirations.

China correctly views energy security as directly related to its national security. Zheng Bijian, a senior advisor to former Chinese President Hu Jintao, listed "the shortage of domestic energy resources as the first of three fundamental challenges to China's peaceful rise in the twenty-first century."[44] Complicating China's supply challenge is an energy access problem, since over 85% of China's oil imports traverse the strategic choke point of the Strait of Malacca.[45] The "Malacca Dilemma" refers to China's vulnerability to a blockade of the strait in a notional future conflict which would "strangle the Chinese economy" by denying the flow of critical energy and food imports to its nation of over one billion people.[46] Disruptions in either energy supply or access contribute to what Bill Hayton describes as "intense paranoia" based on China's heavy reliance on imported energy. As such, China is diversifying its energy supply, as well as developing alternative pathways to oil and natural gas, such as its investment in 900 miles of twin trans-Burmese oil and natural gas pipelines to partially bypass its "Malacca Dilemma."

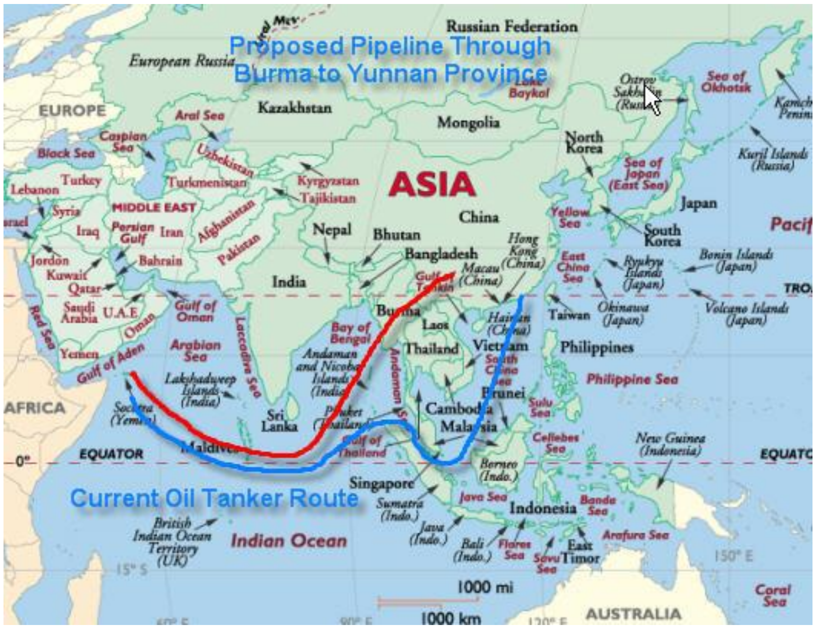

Figure 2.
China's "Malacca Dilemma" and Trans-Burmese Pipeline

China's paranoia appears well founded, especially due to a recent humiliating denial of access to hydroelectricity with Burma's suspension of China's $3.6B USD Myitsone Dam hydropower project in 2011.[47] This previously uncharacteristic policy reversal by the Burmese government, along with its recent commitment to transparent FDI and Western policy norms, amplifies Chinese anxiety about future Burmese energy cooperation. As evidence, during recent bilateral talks Burma's online Irrawaddy journal reported China's new president Xi Jinping as saying, "the Sino-Burmese friendship should not 'be disturbed by external forces,' an unusually direct statement reflecting China's growing concern over Western influence in Burma."[48]

However, the greater strategic concern for China is access to the Indian Ocean, and by extension, whether or not China can rely on the transport of energy resources across Burma's soil. India, the other elephant in the region, demands nearly as much energy as China and is on track to become the world's most populous nation by 2030.[49] With access to energy and key geographic terrain representing vital strategic factors, both giants will continue to compete for regional dominance and leverage as international power brokers, making the Indian Ocean the location where Robert Kaplan believes "global struggles will play out in the twenty-first century."[50] Hence, it behooves the U.S. to continue on its current path of positive Principled Engagement and partnership building with Burma as a strategic counter to China's rise in Asia.

Conclusion

Recent events in Burma place this nation, strategically shoehorned between two massive regional powers, at the crossroads of historic opportunity. Afflicted by oppressive governance for centuries, Burma endured imperialism, then colonialism, and then achieved "independence" only to suffer another half-century under the autocratic rule of a corrupt military regime. However, for the first time in Burma's history, a glimmer of true hope now exists to exchange oppression for democracy, as Burma appears to be moving towards an era of collective freedom and prosperity for its population.

Flanked by the world's largest democratic nation on one side and the world's largest communist nation on the other, Burma is finally tacking towards the West, at least ideologically. Now is an opportune moment for the world's strongest democratic republic to encourage a fledgling democracy to take flight.

The U.S., along with regional and international support, can inject both FDI and technical expertise into Burma's energy industry while holding Burma accountable to democratic values, human rights, and good governance. By doing so, the legitimacy of Burma's government can grow while the capacity and capability of Burma's energy industry expands, all to the benefit of Burma's population, economic strength, domestic stability and regional security. If done properly, U.S. engagement and investment can transition Burma from an "extractive" state to a "proactive and productive" state, providing the "fuel" to further security and peace in the region.

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