Rubber tree plantation in Myanmar. PC: Dale Winling (CC).

A Disappointing Harvest

China's Opium Replacement Investments in Northern Myanmar Since 2009

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Chinese small and medium-sized enterprises (SMEs) are understudied participants in the surge of Chinese outbound investment since the mid-2000s. This essay examines the fortunes of SME participants in the Opium Replacement Planting (ORP) program, a subsidy scheme established in 2006 for agricultural investments by Chinese firms in former opium-growing regions of northern Myanmar and Laos. The struggles of ORP firms in Myanmar highlight the importance of focused risk-assessment training and capacity-building work for Chinese SMEs in their outbound investments, especially where subsidies are involved. There is an extra black line under the heading 'Background and Early Stages'.

The launch of the 'Going Out' strategy in 1999 precipitated more than a decade of rapid growth in Chinese outbound investment activity. From trivial levels in the late 1990s, Chinese outbound foreign direct investment (FDI) reached US$20 billion in 2006 before surging up to US$196 billion in 2016, according to data from the Ministry of Commerce (MOFCOM 2017; MOFCOM et al. 2007). The past several years, however, have seen China's first major FDI retrenchment in the post–Going Out era, with MOFCOM-reported outbound FDI volumes down to US$137 billion in 2019 (MOFCOM 2020).

Much commentary on this shift has focused on the decline in outbound infrastructure investment and lending. Boston University's Global Development Policy Center, for instance, reported, as of May 2021, a roughly 95 per cent drop in its database of lending commitments by China's two major policy banks to governments, intergovernmental bodies, and state-owned entities between 2016 (US$75 billion) and 2019 (US$3.9 million) (Ray et al. 2021)[1]. More than half of the commitments in its dataset from 2008 to 2019 were for infrastructure projects (Ray and Simmons 2020). Large-scale infrastructure projects represent some of the most visible and well-publicised forms of Chinese outbound investment, with national-level government-to-government coordination, high project costs, and the involvement of China's largest state-owned enterprises (SOEs).

The outbound activities of China's small and medium-sized enterprises (SMEs) are more difficult to track. Domestically, SMEs are the bulk of the Chinese economy, accounting officially for more than 60 per cent of gross domestic product (GDP) and 80 per cent of urban employment as of 2018 (Xinhua 2019). But public data on Chinese SMEs' outbound investment are limited. Their investments are necessarily more disaggregated and on a smaller scale; the average outbound investment project by SMEs from Zhejiang Province in 2014 (excluding joint ventures) was just US$96,700, according to Chinese SME researcher Chen Nan (2016: 31). Their projects also may not take place through channels captured in either Chinese or host-country reporting. The sectors in which they concentrate, however—such as low-end manufacturing, services, and agroindustry—can have significant effects on local livelihoods, with higher local labour intensity and, in the case of agriculture, substantial land requirements (Xia 2019: 13; China Textile Industry Federation 2018: 4; Shen 2013: 7). These are also the sectors in which transaction costs can diminish significantly with the types of connectivity infrastructure upgrades driven by large SOEs; in this way, facilitating outbound SME investment represents one channel by which the Chinese state actualises potential gains in economic integration from infrastructure investment.

The recent retrenchment in outbound infrastructure lending, in addition to shifting domestic economic circumstances, reflects a process by which the Chinese state has sought to absorb the lessons of earlier waves of outbound investment relating to challenges of political risk and commercial sustainability. Big-ticket infrastructure investments, largely undertaken by large SOEs, have attracted much research. SMEs can face many of the same basic challenges, but with a different set of strengths and weaknesses. Their status (in almost all cases) as private actors can offer greater flexibility and responsiveness in adjusting to shifting business conditions. But they often have weaker access to a host of resources that SOEs can leverage in managing outbound investment risk: international business expertise and access to financing, as well as close state support (Wang et al. 2020: 33).

China's Opium Replacement Planting (ORP) program captures how those risks can end up severely harming the commercial profile of SMEs' outbound investment, particularly when accompanied by promises of subsidies. Since the early 1990s, authorities in Yunnan Province have been supporting crop-substitution projects by Chinese firms in former opium-growing regions just over the border in neighbouring Myanmar and Laos. These efforts, undertaken almost entirely by Yunnan-based SMEs, expanded significantly in the mid-2000s with hundreds of millions of renminbi in support from central authorities and reached 2,000 square kilometres across both countries, according to Chinese researchers.

These efforts prompted fierce debates between Chinese supporters and international sceptics, who regarded the program as a driver of peasant dispossession and environmental degradation with little impact on opium cultivation (Kramer and Woods 2012). Less well known, however, is that, since 2009, civil war and market fluctuations have severely undermined the profitability of ORP firms' investments in Myanmar, and ORP program subsidies proved a limited and at times unreliable tool for offsetting these risks.

Background and Early Stages

Assessing the fortunes of Chinese opium-replacement planting in northern Myanmar over the past decade requires a grasp of the complex political environment in Myanmar within which these initiatives take place. In the decades since achieving independence from the British Empire in 1948, the central government of Myanmar has never been able to fully assert political authority outside the central lowlands straddling the Irrawaddy River, which is the heartland of the Burman ethnic group. In the far northern hills, a number of ethnic armed groups (EAGs) have claimed authority over the China–Myanmar borderlands of Kachin and Shan states. In these regions, they contend for power with units from the Burmese army (the *Tatmadaw*), which has ruled the country intermittently for most of the past 50 years and retook power in a February 2021 coup from Myanmar's most recent civilian government, which was established during the early 2010s.

Conflict among these various power players in northern Myanmar has been entangled with the drug trade since the early days of independence. From the 1950s through to the 1970s, a succession of armed groups in the Shan State borderlands developed large-scale opium cultivation and trading operations to fund their activities, including anticommunist Kuomintang (KMT) units in the 1950s that had fled to Myanmar after their defeat in the Chinese Civil War (1945–49), and *Tatmadaw*-aligned militias in the 1960s and 1970s (Lintner 2000). The Communist Party of Burma (CPB) emerged as a major sponsor of the opium trade during the 1980s, after the Chinese Communist Party withdrew its support for the organisation after the end of the Cultural Revolution in the late 1970s. The CPB's embrace of opium cultivation drove dramatic production increases that would turn Myanmar into the world's largest opium producer. After a mutiny in 1989, those production networks would be inherited largely by the CPB's three successor groups in Shan State: the United Wa State Army (UWSA), based in the Wa Hills opposite Pu'er Prefecture in Yunnan, and the most powerful EAG in northern Myanmar today; the Myanmar National Democratic Alliance Army (MNDAA), based in the Kokang region opposite Lincang Prefecture in Yunnan; and the National Democratic Alliance Army (NDAA), based in the area around Mongla Township opposite Xishuangbanna Dai Autonomous Prefecture in Yunnan (UNODC 2001: 49, 2017: 3; Lintner 2019: 10).

Yet expanding opium cultivation in the borderlands was not welcomed so enthusiastically within China. The cross-border narcotics trade between Myanmar and China first began growing from the late 1970s, alongside the expansion of cross-border exchanges and broader transformations in Chinese society that followed the end of the Mao Zedong era and the opening of the Chinese economy in the late 1970s. These flows continued to expand during the 1980s amid the CPB-led opium boom and emerged as a major public health concern in neighbouring Yunnan Province, which in response developed some of the China's earliest drug addiction treatment centres and professional anti-narcotics expertise (Chin and Zhang 2007: 7–9; 2015: 210, 230–31).

As a result, the drug trade has become an important issue in China's relations with the EAGs. Chinese authorities supported crop-substitution efforts as part of their formal narcotics-control toolkit starting in the early 1990s, in the EAG territories of northern Myanmar and the borderlands of northern Laos. The first effort was a series of small-scale experiments in the 1990s and early 2000s undertaken by border counties in cooperation with neighbouring EAG elites in northern Myanmar and Laos. Central authorities consolidated and built on these efforts with a 2006 order that authorised a series of new regulatory supports, administered by Yunnan Province and funded largely by the Chinese central government. Most important was the provision of tax exemptions and import quotas, which offered legal importation routes for crops like rice, corn, and sugar that would otherwise have to rely on small-volume border trade or smuggling to avoid severe import tariffs.[2] The focus remained on EAG-controlled territories in the borderlands. EAG leaderships in Wa, Mongla, and Kokang forcibly banned opium cultivation in their territories during the 1990s and early 2000s, partly in response to Chinese and international pressure. The 2006 order spoke of eradicating opium cultivation and heroin production in target territories within 15 to 20 years by supporting local economic development, starting with agriculture and expanding eventually into industries like processing, mining, and tourism (State Council 2006).

The expansion of the ORP program in the mid-2000s prompted a surge of agricultural investments by Chinese firms in borderland EAG territories. The Yunnan Bureau of Commerce (BOFCOM) reported that the number of ORP program enterprises increased from 71 in 2005 to 198 in 2009, and statistics from a Chinese academic reported 127 ORP-backed firms with investments in Myanmar in 2009, more than three-quarters of which targeted EAG-administered 'special regions' (Yunnan BOFCOM 2009; Shao 2013: 190). Investors with ORP program affiliations received hundreds of millions of renminbi during this period in import tax exemptions and direct subsidies for their projects, and major crops registered under sponsored projects included rubber, corn, rice, and sugar, among others (Yunnan BOFCOM 2009; Shao 2013: 186). According to the Opium Replacement Office at the Yunnan BOFCOM, in 2010, the bulk of these firms were 'small and medium enterprises … from Yunnan border regions' (Yunnan BOFCOM Opium Replacement Office 2011: 235). Even ORP program quota applicants from the provincial capital of Kunming had a median registered capital—representing capital subscriptions by shareholders, and often exceeding the amount of capital actually injected by shareholders—of just over US$1 million. In contrast, one of the largest firms participating in the ORP program, the provincially owned rubber giant Yunnan State Farms, had registered capital of US$121.5 million in 2009 (Kunming BOFCOM 2009).

ORP Firm Struggles in the 2010s

The background paper for the Second International Conference on Alternative Development in 2015, an event sponsored by the United Nations Office on Drugs and Crime and the Thai and German governments, cited influential research by Woods and Kramer to state that the ORP program 'mainly benefits local authorities and Chinese businessmen instead of the local opium growing communities' (ICAD-2 2015: 14). But firms which participated in the investment surge of the late 2000s have faced enormous commercial challenges over the past decade. The resumption of conflict and a decline in rubber market prices made production in Myanmar riskier and less profitable for many firms—challenges the limited and at times unreliable subsidies associated with the ORP program could only partially offset.

The ORP program's expansion during the late 2000s took place in a period of relative stability in northern Myanmar produced by ceasefires between the *Tatmadaw* and major EAGs from 1989 onwards. It was by no means a risk-free zone for investors. They still faced concerns about expropriation and threats to physical safety in a region where the key power players were military and paramilitary groups (Liu 2011), but the ceasefires promised at least a minimal level of political stability.

From 2009 to 2011, however, *Tatmadaw* ceasefires with the MNDAA in Kokang and the Kachin Independence Army (KIA) in Kachin State broke down and the ensuing clashes displaced hundreds of thousands of civilians (Buchanan 2016: 19; Buckley 2009; The Irrawaddy 2014). The following decade has continued to see waves of conflict between the KIA and its allies and the *Tatmadaw* (Qiu 2014). These conflicts turned some of the sites of Chinese agribusiness investments in these regions into battlefields, with new risks of landmines, property confiscation, and more widespread extortion in the form of protection fees (Lushui County BOITIT 2011; SAFE Yunnan Branch 2018; Shao 2013: 194–95; Woods 2018: 19; Yang 2014: 90). In August 2012, Yunnan BOFCOM Vice Minister Yang Hui described the cumulative effects of the turmoil on ORP firms in these terms: 'Because the situation in northern Myanmar is not stable, and there are many elements of instability and hidden threats to safety, the confidence of firms has suffered a heavy setback' (Yang 2013: 66).

The resumption of conflict coincided with a major re-evaluation of the ORP program's pace of growth. Public statements by officials and businesspeople involved with the program described a 'three no-increases' (三个不增加) policy instituted around 2009–11: 'No increase in the number of ORP firms, no increase in the number of ORP products, and no increase in ORP planted land' (Menglian County BOICIT 2012). Public data on firm-level ORP quota applications suggest the three no-increases policy largely closed off the program to firms that did not at least claim to have already established agricultural investments in Laos and Myanmar by 2009 (Dehong Unity News 2019; Kunming BOFCOM 2019; Lincang BOFCOM 2019; Pu'er Daily 2019; Xishuangbanna BOFCOM et al. 2019). Conflict was at least one of the motivations for this policy's establishment, as acknowledged by local Chinese authorities in Dehong Dai and Jingpo Autonomous Prefecture, which borders KIA territory (Dehong BOFCOM 2017).

Meanwhile, ORP firms cultivating one of the program's most popular crops, rubber, suffered in the 2010s from plummeting market prices. The expansion of central government support for ORP investments in the mid-2000s came amid a decade of surging rubber prices and expanded domestic rubber demand within China, with one Singapore-based global benchmark seeing a real increase of more than 500 per cent (IMF 2016; OECD n.d.). Yunnan is itself one of China's major rubber-producing regions, and a wave of local producers established new projects in Myanmar and Laos with ORP support amid the program's expansion, turning rubber into one of the program's signature crops. The bulk of these investments in Myanmar were concentrated in Wa and Mongla—areas unaffected by the fighting.

Rubber trees take five to seven years before planters can start harvesting them for latex, so plantations established in the mid-2000s would be able to begin producing rubber around the early 2010s. But the rubber price peak in 2011 was followed by a rapid decline, driven by global oversupply. Global rubber prices have remained beneath US$1.00 per pound since April 2014 and averaged US$0.75 per pound in 2019—a real decline of 70 per cent since 2011 (IMF 2016). This drop has severely hampered the commercial profitability of rubber investments in northern Myanmar. A People's Bank of China researcher in Yunnan reported in 2014 that, 'even under quota benefit policies, prices for cross-border imported rubber are less than costs' (Ma 2014: 258). Representatives from a large ORP program–sponsored rubber investor said in an interview in 2018 that they had been unsuccessfully seeking to get a government price floor on rubber in the midst of volatility, as the prices they were receiving for their output had dropped by two-thirds since 2010–11 (Interview #1).

Firms planting crops with ORP program support also contended with limits on the availability of subsidies. The central government order that initiated the ORP program's expansion in 2006, as well as subsequent implementation regulations from Yunnan Province, proposed a host of different incentives for firms: import quotas and tax exemptions, per-unit subsidies for the total planted land, interest reimbursements, subsidies on financial guarantees, and insurance. As mentioned above, the most important of these supports during the 2010s were import quotas and tax exemptions. However, deeper constraints for SMEs around financing outbound investment, such as an absence of sufficient domestic collateral, hampered the utility of proposed financing supports, while subsidy volume more generally declined over time (Interview #2; Ma 2014: 258; People's Government of Mengla County 2011; Ruan et al. 2019: 10). Firms persistently expressed reservations that their quotas did not cover their production needs and they sought to enlist provincial and local authorities to lobby the central government on their behalf, with limited success (Bao 2018; Dehong BOFCOM 2018; Yunnan BOFCOM 2019a).

To be sure, it is not unusual for firms and local officials to want more quotas, and for central funders to view matters differently. Indeed, in both Laos and Myanmar, the program faced serious challenges around monitoring the proper use of quotas, as firms overreported the amount of planted land to claim larger quota volumes or resold quotas on secondary markets (Lu 2017: 732; Li 2015: 90; Shao 2013: 24, 197; Interview #3; Shi 2016). BOFCOM authorities themselves likewise acknowledged

Myanmar fields. PC: Thom May (CC).

the risk of encouraging firms' overdependence on subsidies: Vice Minister Hui in 2012 stressed that, in the program's implementation, 'support via the market should be primary [第一位], and government financial assistance should be secondary [第二位]' (Yang 2013: 66).

But SMEs' concerns about quota support also touched on a more basic issue around the timing of import windows. Firms seeking to import to China from Myanmar or Laos under the ORP program were granted authority to do so in specific windows during the year, but the central government's release of quotas to firms was slow and those windows did not necessarily align with firms' needs (Lu 2014: 224). Representatives from two firms with ORP rubber quotas in Laos and Myanmar noted in interviews in 2018 that slow government approval processes and narrow 10-day rubber import windows added difficulties in getting their crops home (Interviews #3 and #4). Poor import window timing also forced rubber producers to store their product for extended periods—an added expense that also degraded product quality (The Irrawaddy 2015; Shi 2016).

Looking Ahead

The ORP program's expansion and struggles underscore the consequences of subsidising outbound SME investment with minimal regard to their heightened risk profile. In the early years after the post-2006 policy expansion, hefty government subsidies and high prices for commodities like rubber and sugar attracted a surge of overly optimistic investments by Chinese firms with limited resources and expertise. From the start, the Yunnan

BOFCOM's Opium Replacement Office reported, in 2010, that 'enormous political, economic, and safety risks' meant that 'large domestic enterprises stepped back' from ORP program participation, while the SMEs attracted by the program were often not up to the task, as 'their capabilities [实力] are limited ... management and operations capacity levels and reliability among certain firms are low' (Yunnan BOFCOM Opium Replacement Office 2011: 235). The rubber and sugar price declines exposed firms that had overextended themselves in these crops. Other firms suffered substantial losses associated with the civil war. In 2017, the Yunnan BOFCOM described the cumulative effects of these struggles on participating firms in these terms:

> At present, replacement planting firms face increasing downward economic pressure, fairly capricious policies by cross-border governments, stubbornly high investment risks, and a tumultuous political environment in northern Myanmar. Firms' burdens are fairly heavy and their interests have suffered harm, and the energy of firms in replacement planting work has shown a level of decline in comparison to the past. (Yunnan BOFCOM 2017: 260)

The ORP program persists today with modestly reduced ranks (in at least some prefectures) and a stronger public campaign around reducing quota abuse and reasserting the central place of drug control in the ORP program's mission (Everbright Securities 2020; People's Government of Dehong Dai and Jingpo Autonomous Prefecture 2019; Yunnan BOFCOM 2019b). Official statements suggest there is no likely expansion of quota support on the near horizon (Yunnan BOARA 2020). Meanwhile, major resource-based growth sectors surfacing in Chinese outbound SME investment in Myanmar—like watermelon, bananas, and rare earth elements—have not relied on systematic subsidy schemes for their expansion, with the exception of some ORP program support for the banana industry.

When companies receive subsidies, it increases the risk of ill-advised investments that firms would not consider without state support. But lower expected risk profiles for unsubsidised SMEs' outbound investment do not mean risks are absent. Consolidation and tighter regulation in the rare earth mining industry in China have encouraged an influx of Chinese rare earth SMEs into Myanmar since the mid-2010s, and these operators have had to navigate several temporary bans on rare earth trade along the Yunnan border since 2019 (Roskill 2019a, 2019b). Fighting in Kachin State has disrupted the banana trade periodically across the past decade, while peasant dispossession and environmental degradation associated with banana plantations have attracted local protests and political declarations around intensified regulation, though the concrete impacts of these pledges were murky even before the February 2021 coup (Hayward et al. 2020; Liu 2011; Qiu 2014; Hu and Luo 2020). In this sense, even as the ORP program stagnates, it remains a salient example of the importance of focused risk-assessment training and capacity for Chinese SMEs in their outbound investment activities, in Myanmar and elsewhere. ■

[1] Some critics (for instance, Kenderdine and Yau 2020) have noted the growth of financing outside Chinese policy banks, as well as potential incompleteness in the data for 2019, and questioned whether the Boston University (BU) team's data can support broad claims about trends in Chinese outbound infrastructure financing. But the broad decline in the BU analysis does align with trends observed by other analysts (see Mingey and Kratz 2021).

[2] 'Border resident trade' (边民互市) offers exemptions on import and value-added taxes but must be carried out by border residents in small volumes (< RMB8,000/day) (China Customs Administration n.d.).

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