

# **Myanmar – Japan Cooperation Programme for Structural Adjustment of the Myanmar Economy**

## **Executive Overview**

**March 2003**

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**The Government of  
The Union of Myanmar**

**Japan International  
Cooperation Agency**

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## Foreword

This study was conducted within the framework of the technical cooperation program of the Government of Japan, in response to the request from the Government of the Union of Myanmar.

The study was carried out as a joint research by taskforce teams, consisted of professionals from both Japan and Myanmar, and assisted by consultant teams from leading institutes in both countries.

The taskforce and consultant teams held a series of discussions, and conducted several field surveys. This report was prepared jointly by Japanese and Myanmar taskforce teams based on a mutual understanding.

I hope that the useful suggestions presented in this report will contribute to the formulation of policies for sustainable development of Myanmar, and it would be my great pleasure if the report would be used practically by organizations, officials and experts concerned.

I wish to express my sincere appreciation to the officials in the Government of the Union of Myanmar and to other relevant organization and people concerned for their close cooperation and valuable input in the study.

March 2003



Takao Kawakami

President

Japan International Cooperation Agency



## Preface

The final report of the joint taskforce in charge of research leading to relevant policy recommendations consists of five volumes. This first volume presents the executive overview of the entire project findings and major policy suggestions, which was delivered at the last session of the fourth Myanmar-Japan joint workshop, held in Yangon on 25 December 2002. While its text has been subjected to slight editorial modifications after the workshop, its basic messages remain totally intact. Following the overview are nine supporting texts, which provide background information on the socio-economic context in which the overview was formed.

The second volume deals with the macroeconomic issues, starting with the strategic importance for the country of exchange rate unification, succeeded by discussions on macroeconomic policy issues, especially the handling of government finance and monetary policy, followed by analyses as well as prescriptions regarding the current state and future prospects of the country's banking sector, together with promising new possibilities for the mobilisation of domestic financial resources by way of micro-financing and other means.

The third volume spells out in detail the findings from field surveys on trade and industry issues, on the basis of which a concrete master plan for the country's industrial development has been developed. It is especially worth noting that this volume reports on the commodities that will command international comparative advantage and are therefore suitable for export promotion. The volume also ponders on the ways and means to encourage the modernisation of small and medium scale enterprises in the relatively labour-intensive industries, where comparative advantage mostly lies.

In view of the eye-opening advances in information technology in recent decades, the fourth volume concentrates on strategies for the promotion in Myanmar of information and communication technology (ICT). It seems indispensable for the country to lay a well-thought-out foundation for development of the industry. On the basis of this premise, the volume of the report spells out a concrete action plan that will ensure a steady growth as well as the spread of the benefits of ICT technology to the whole country.

The fifth and final volume deals with the issue of agricultural and rural development. The topics of the volume are of fundamental importance for the economic modernisation of Myanmar, inasmuch as the country pursues a unique, primary-sector dependent growth path. It argues that the time is ripe for a reorientation of the policy stance being contemplated, such that the welfare of the farming households, including the growth of food supplies, be placed at the centre of policy making. In the final analysis, we believe that such a reorientation of policy stance will bring forth a prosperous primary sector in the long run.

It is our sincere hope that the governments of Myanmar and Japan, to which the present final report is presented, will take time to carefully examine the contents of these documents and make their best effort in implementing our policy suggestions. After all, the ultimate purpose of our report is none other than the economic betterment of the lives of the Myanmar people.

We of the task force members would like to express our heart-felt thanks to all those who have gone out of their way to help us proceed with our joint task. Last but not least, we would also like to take this opportunity to extend our sincere appreciation and respect to the Japanese people and government, by whose support this joint project has been made possible.

Myanmar-Japan Joint Taskforce for  
The Structural Adjustment of the Myanmar Economy

25 December 2002

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# **Structural Adjustment of the Myanmar Economy**

## **Executive Overview**

The Final Report  
by  
Supervisory Group,  
Myanmar-Japan Joint Taskforce for  
The Structural Adjustment of the Myanmar Economy

25 December 2002



# **Structural Adjustment of the Myanmar Economy**

## **Executive Overview**

Myanmar, with its abundant natural resources and hardworking people has great potential for economic growth. Whatever difficulties it may face at present, the country can, and should, gain economic strength through its ingenuity and its own efforts, supplemented, if necessary, by the cooperation of the international community.

With this basic premise in mind, the Supervisory Working Group of the Japan-Myanmar Joint Taskforce for Economic Structural Adjustment of Myanmar has formulated the following set of policy suggestions, which are to be carefully studied by the two nations' governments in order to help Myanmar achieve sustainable economic development, which will contribute substantially to the social stability of the nation.

Please note, however, that the present overview is concerned with the very basic directions for possible policy actions, and that technical details are provided in the final reports of the four working groups of the task force, namely (1) government finance and monetary policies, (2) trade and industries, (3) information and communication technology (ICT), and (4) agriculture and the rural economy.

### **I.**

Building up foreign reserves and mobilising domestic financial resources are two important steps to encourage economic development.

In order to earn hard foreign currencies, promoting exports is essential. Also, exports will flourish in the fields where the country has a comparative advantage. Naturally, this brings our attention to the primary sector (i.e. agriculture, forestry and fishery), and to labour-intensive manufacturing. For this reason, the production capacity of the agricultural sector, both in terms of productive efficiency and product quality, needs to be enhanced. As an important side effect of improved production capacity of the primary sector, the tax-bearing capability of the sector will improve, if accommodated by the internal revenue system.

To help improve agricultural productivity, the taskforce suggests that the government of Japan prepare a technical-assistance package to improve the efficiency of Myanmar's agricultural research system. In this effort, emphasis should be put on the intensification of production and the diversification of the farming system, with area-specific approaches suitable to local agronomic conditions.

In order to ensure that all these activities bear fruit successfully, it is essential for the

government of Myanmar to stand ready to supply the necessary professional personnel.

## **II.**

In order to mobilise domestic financial resources, top priority must be placed on the country's financial development, through the expansion and the healthy development of financial institutions (*banks and quasi banks*).

Sound and robust financial institutions are important to avoid a financial crisis—one of the lessons from the Asian crisis of 1997. A “level-playing field” should be restored between state-owned banks and private banks by eliminating the advantages granted to state-owned banks. Enhanced risk management should be sought, so that banks will remain healthy in the face of internal and/or external shocks, including exchange rate fluctuations.

Micro financing institutions could supplement a sound and robust financial system, and could serve the poor who may have difficulty in accessing formal institutions. Accordingly, it is strongly recommended that micro financing endeavours, engaged in by non-profit organisations and financial cooperatives, be underwritten and encouraged by the governments of both Myanmar and Japan, and that the government of Japan make special effort to facilitate these activities by relevant organisations, with high professional skill and on ground experiences.

## **III.**

Considering the importance of labour-intensive manufacturing during the early phases of industrialisation, when many firms are small or medium in scale, the task force recognises the effectiveness of economic policies that will improve the production efficiency of such enterprises. The growth of such enterprises, especially when developed in conjunction with agro-based industrialisation in rural regions, will contribute to the creation of employment opportunities. It will be possible for Japan, if necessary, to provide expertise to diagnose the causes of current difficulties (if any) and to prescribe possible solutions, regarding both technological and organisational matters.

## **IV.**

The Taskforce is pleased to note that the size of ICT-related professional manpower in Myanmar is expected to increase due to continuing cooperation from the government of Japan and other countries. Not only the urban, but also the rural, areas of the country will benefit from easier access to economic and technical information if the ICT network is extended, as it will serve to reduce transaction cost and to encourage the breeding of new ideas.

## V.

The unification of currency exchange rates is the most important and most urgent macroeconomic- and financial-policy challenge for Myanmar. Not only has it great benefits in rebuilding the export sector and in promoting economic growth early on, but it also is a key for making the nation's fiscal and monetary policies more effective and stable, for developing agriculture and rural economy, for increasing industrial output and exports, and for promoting information and communication technology.

There is a possibility, however, that quick unification might entail sudden, large losses in some importing sectors. In order to minimise such pains caused in sectors relating to basic human needs, such as education and medical supplies, it is recommended that the Japanese government provide humanitarian aid for those sectors. If the shocks from the unification are larger than expected, the Japanese government could further consider providing temporary hard-currency liquidity. In addition, in the medium run, if and when the Myanmar economy shows a sound recovery, it is recommended that the governments of Myanmar and Japan agree on a scheme to deal with bilateral loans in arrear without putting burdens on the Myanmar economy.

After the unification of the exchange rates, it is desirable to let the exchange rate be determined by the market, rather than to attempt to set a fixed exchange rate. But, in order to avoid high volatility, the monetary authorities may intervene in the market to prevent too much appreciation or too much depreciation. A basket-band currency regime with a wide band would be a good choice as an appropriate currency exchange regime for Myanmar after the unification.

It also is desirable for the market exchange rate to be stable after the unification—with no trend toward appreciation or toward depreciation, and without very much volatility. In this regard, the importance of sound macroeconomic fundamentals cannot be overemphasised. Without sound macroeconomic fundamentals, in particular a balanced budget and low inflation, the market exchange rate cannot be stabilised—whether parallel or unified. After the unification and stabilisation, the Japanese government could explore the possibility of providing a short-term swap.

## VI.

Institutional reform on the government's side is urgently needed as a measure to improve the country's export earning capabilities. In this regard it is highly important to increase the transparency of administrative procedures, to minimise official control over the market transactions, and to avoid abrupt changes in policies and regulations. In addition, inviting foreign direct investment is an important way to help both Myanmar's infrastructure and the nation's productive capacity to develop rapidly, as it would bring in foreign currencies, market assistance

as well as foreign technology and efficient management. In order to encourage foreign direct investment, it is important to minimise regulatory procedures and to unify the exchange rates. More fundamentally, it would be highly significant to update the nation's legal system and due process, and to revitalise the basic spirit that underlies the relevant laws and make it more effective.

In regard to the matter of institutional shaping up, experiences (successes and failures) in other countries will provide important hints. The taskforce suggests, therefore, that the government of Myanmar request the government of Japan to supply technical assistance that will facilitate institutional renovations, including that of the legal system, so as to encourage international trade and capital movement to and from Myanmar.

## **VII.**

Reducing fiscal deficits is absolutely necessary to achieve sound and stable macroeconomic condition that is the foundation for a stable market-based exchange rate. Myanmar's fiscal deficits have been largely financed by the Central Bank credit, and expansion of the money supply has contributed to inflation, inevitably leading to depreciation of market-based exchange rates.

In order to close the gap of the nation's fiscal deficits, it is necessary to reduce government expenditures including subsidies to state economic enterprises, and to increase tax revenues. Although expenditures on social infrastructure should be maintained or even increased in the medium run, fiscal deficits must be reduced and expenditure items be revised. At present, about three-fourths of Myanmar's fiscal expenditures are for operating state economic enterprises. Serious reforms in state economic enterprises, including privatisation or cooperatisation in the medium run, are necessary to reduce the fiscal burden. Incentives and penalties can be introduced to induce managers to operate these enterprises more efficiently.

In light of the urgent need to improve the country's revenue raising capability, the taskforce believes that the government of Myanmar will benefit by requesting the Japanese government to cooperate in devising a workable plan to raise revenues, as well as overhauling and renovating the country's tax system. The training of experts may be helpful in implementing such a plan.

## **VIII.**

A primary goal of monetary policy is to control inflation. In order to do so, a nation's monetary base and domestic credit has to be monitored and managed by an independent central bank. It is recommended that the Central Bank of Myanmar be given autonomy for making monetary policy decisions. Setting the interest rate and providing Central Bank credit should be decided solely by the Central Bank.

In order to facilitate financial development and to enlarge the realm of monetary policy, it would be most appropriate to encourage the growth of domestic capital markets, where a variety of securities are traded and private funds freely raised.

In addition, computerised banking deserves serious consideration from the both governments.

## **IX.**

The joint taskforce envisages that in order for Myanmar to obtain first-hand experience in increasing foreign exchange earnings, it would be highly beneficial to establish special economic zones, both rural-based and manufacture-oriented, in which virtually all the economic transactions are deregulated for the qualified members of the zone. In order to ensure the stable and smooth operations of such zones, the taskforce strongly recommends that the government of Japan prepare a package of programmes to support the working the special economic zones, in particular to ensure better provision of social overhead capital (i.e. for supplying public utilities, such as electricity, gas and water, and transportation facilities), and that the government of Myanmar designate a few, most promising areas as such zones, which shall compete for better economic performance. It is expected that the both governments provide the necessary assistance, administrative or otherwise, to make such a plan a reality.

## **X.**

For the purpose of monitoring the performance of the socio-economic activities mentioned in the present report, and also for many other purposes, including academic research, it is vitally important to compile and accumulate accurate statistics. This is necessary not only to observe simple facts of daily living, but also to formulate and monitor government policies and to diagnose socio-economic ailments, if any.

The government of Japan, if requested, will be able to supply expertise and/or train needed personnel in the fields of data collection and statistical research.

## **XI.**

Investment in human beings is probably the most crucial element for long-range planning of economic development. Opportunities for the people of Myanmar to study/train abroad will be of great value for the nation as a whole, especially during the early stages of its economic growth, provided that areas and trainees are selected judiciously, and that the trainees sincerely pledge to return to their home country after their overseas study/training is completed. Conversely, it is recommended that Myanmar government and the nation's private sector formulate a plan to invite groups of foreign professionals to be locally stationed to provide on-site advice concerning



production operations.

In view of the long-run significance of enhancing the quality and the quantity of Myanmar's human capital, the taskforce believes that it would be highly expedient for the government of Japan, if judged appropriate by the government of Myanmar, to establish a Manpower Training Scheme for Myanmar so as to activate this important arena of social action.

## **XII.**

Last, but not least, the taskforce sincerely believes that the policy recommendations in the final reports of the taskforce's four working groups are both feasible and suitable for the government of Myanmar to adopt, and if implemented would bear appropriate fruit and also benefit neighbouring countries, including Japan.

The taskforce strongly hopes, therefore, that the governments of Myanmar and Japan will collaborate in initiating a preparatory work to establish an internationally supported special fund to help implement economic structural adjustments of Myanmar. To ensure accountability to the tax payers, on whose judgement the legitimacy of such a fund ultimately depends, it is necessary that the *currency exchange rates be unified (see Section V above) and that administrative procedures, especially relating to external economic activities, be substantially revised (see Section VI above) prior to the establishment of the fund.* The taskforce is convinced that, when time has come to establish the fund, the government of Japan will contribute generously to the working of this fund, because the economic prosperity of Myanmar will greatly contribute to the betterment of the politico-economic welfare of Asian countries in general.

# **Structural Adjustment of the Myanmar Economy**

## **Supporting Papers to The Executive Overview**

A Portion of the Final Report  
Prepared by the Japanese Members  
of the  
Supervisory Group,  
Myanmar-Japan Joint Taskforce for  
The Structural Adjustment of the Myanmar Economy

25 December 2002



## **Strategies for Immediate Actions**



# 1. Macroeconomic Foundations for Sustainable Development

## 1.1 Unification of foreign exchange rates

The unification of exchange rates is the most important macroeconomic and financial policy challenge for Myanmar. The unification is a key to making fiscal and monetary policy more effective, increasing industrial output and exports, promoting information and communication technology, and to developing agriculture and the rural economy. The official rate is clearly overvalued compared to the equilibrium rate. If the official rate is applied, the per capita income of Myanmar is somewhere in the league of a middle-income emerging market, disqualifying any international assistance to the country. Importing at the official rate implies that importers receive subsidies and exporting at the official rate implies that they are penalised by heavy export tax. Incentives are distorted and so is resource allocation. In order to attract inward foreign direct investment, the unification of exchange rates is absolutely necessary. The shortcomings of having multiple exchange rates in Myanmar are well known.<sup>1</sup>

All four committees, especially the Trade and Industry Working Group, emphasised that the unification of the exchange rates is extremely important for structural reforms and growth. Macroeconomic stability will critically depend on sound monetary and fiscal policy that goes with the unification of the exchange rates, as pointed out in the Monetary and Fiscal Policy Working Group. Without the unification, exports will continue to be discouraged, and foreign direct investment into Myanmar will be minimal. Rice and other agricultural products have potential in expanding exports, as pointed out by the Agriculture Working Group. The unification and the abolishment of export tax will make it possible to realise that potential. Without foreign investment, there is little chance that traditional industrialisation, let alone taking advantage of information and communication high-tech industrialisation, will take place.

The unification of exchange rates means that one exchange rate is applied to all export-

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<sup>1</sup> The multiple exchange rate system is detrimental to economic development in the following respects: (1) Prices are distorted to prevent efficient resource allocation; (2) Private sector activities are repressed due to de facto subsidies to state enterprises that can import resources and products at the overvalued exchange rate; (3) The efficiency and profitability of state enterprises is difficult to be judged due to subsidised imports; (4) Production and employment is discouraged as a result of subsidised imports by the public sectors; (5) Prices of energy, electricity, and other products and services by state enterprises are too low, and this results in more consumption than is desirable; (6) Export-oriented state enterprises suffer from an unfavourable exchange rate for exports, resulting in deficits and less exports; (7) The income of farmers and workers who produce goods that are exported by the state monopoly is artificially lowered; (8) Overseas workers are discouraged from repatriating their earnings; (9) Revenues from individual income tax, corporate income tax, and tariffs are lowered due to reduced economic activities and trade; (10) Complexity in accounting lowers productivity and efficiency; and (11) Inward foreign direct investment is discouraged.

import and cross-border capital transactions. Tourists and businesses should not be required to exchange certain amounts of foreign currencies into local currencies.

Practically speaking, the official rate (about 6.6 kyat per US dollar) and the parallel rate (more than 1,000 kyat per US dollar) and any exchange rates in between, will be unified at a level closer to the current parallel rate. All exchange controls for current account transactions should be abolished in order to promote trading activities. Since the gap between the official rate and the parallel rate has become so large, it is difficult to estimate a sustainable unified exchange rate as a fixed exchange rate or even with a narrow target range. Flexibility will be necessary to avoid the risk of a currency crisis caused by defending an unsustainable fixed exchange rate.

After the unification, it is desirable to let the exchange rate be determined by the market, rather than to attempt a fixed exchange rate. But, in order to avoid high volatility, the monetary authorities may intervene in the market to avoid excessive appreciation or depreciation. A proposal of basket band currency regime with a wide band will be a good reference in choosing an appropriate exchange regime for Myanmar after the unification.

In theory, only a modest level of foreign reserves is required for maintaining a flexible exchange rate regime. Countries like Myanmar that have not liberalised their capital account transactions should not require too much foreign reserves. However, realistically and practically, more than a modest level of foreign reserves is desirable when the unification of exchange rates is implemented very quickly. Suppose that the equivalent amount of three months of imports, as a minimum requirement, needs to be accumulated at the time of the unification. The current level (as of March 2002) of gross foreign reserves (total reserves minus gold) is US\$454 million, an amount equivalent to about two months of imports.<sup>2</sup> It is desirable to build up foreign reserves by an additional US\$215 million, to a level of US\$669 million, or the equivalent of three months of imports. Moreover, it is reasonable to assume that the current level of imports is underestimated. If all export-import controls are removed, then imports will increase to a “normal” level. It is difficult to estimate what this normal level will be before the controls are actually dismantled. Although the three-month equivalent of imports amounts to US\$669 million, it is recommendable to target somewhere between US\$700 million and US\$1 billion, to allow some margin for safety.

Without sound macroeconomic fundamentals, in particular a balanced budget and low inflation, the market exchange rate—whether it be a parallel rate or unified rate—cannot be stabilised. It is desirable to have a stable market exchange rate after the unification—without

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<sup>2</sup> Estimates are based on IFS data (October 2002) from the IMF. Average monthly imports from April 2001 to March 2002 were valued at 1,518 million kyat, or US\$223 million (import values were converted at the official exchange rate for each month). The three-month equivalent is estimated to be roughly US\$669 million, converted from kyat to US dollars at the official rate for the 12-month average from April 2001 to March 2002. The level of foreign reserve is for March 2002.

trends of appreciation or depreciation, and without excessive volatility. However, stability cannot be achieved merely by the use of foreign reserves. The recent sharp depreciation in the parallel rate is a reflection of high inflation, and high inflation is in turn a reflection of large fiscal deficits financed by an increase in monetary base. Therefore, having a sound macroeconomic environment is the key for a stable exchange rate under the flexible unified exchange rate regime.

One may argue that for unification it is recommendable to have foreign reserves totalling between US\$700 million and US\$1 billion and a balanced fiscal position with low inflation. However, political decision is required to actively achieve these conditions, rather than just waiting for such preconditions to emerge. The decision to achieve the unification will make it necessary to build up foreign reserves and to achieve fiscal balance. In that sense, the conditions for unification are not really 'pre-conditions,' but rather conditions that should be achieved simultaneously with the unification.

Two scenarios are provided regarding the unification: (1) a quick unification, that is, to declare and implement the unification of exchange rates as soon and as quickly as possible; and (2) a gradual unification, i.e. to declare now the intent of unification at some future date, and target a date by which such implementation is to be completed. The gradual process may be accompanied by partial implementation either in the sense of applying the market rate to a partial list of state enterprises or in the sense of raising the official rate partially toward the market rate.

The first approach offers the major benefits of rebuilding the export sector and promptly promoting economic growth. And trade surpluses may be achieved in the not-so-distant future. However, there is uncertainty regarding the sudden, major losses this may cause in some importing sectors. In order to lessen the pains in sectors that are related to basic human needs, such as hospitals and schools, it is recommended that the Japanese government provide humanitarian aid in these areas. If the shocks from the unification are larger than expected, the Japanese government should be ready to help further by providing temporary hard-currency liquidity by creating and activating a currency swap line. In addition, in the medium run, if and when the Myanmar economy shows a strong recovery, it is recommended that the Myanmar and Japanese governments should consult on a scheme to deal with bilateral loans in arrear, without putting heavy burdens on the Myanmar economy.

The second approach has both the advantages and risks of being gradual. Hardships resultant from losing cheap imports, and implicit subsidies to state economic enterprises, can be countered by shifting resources and improving production, because some time for adjustment is provided. Foreign reserves may be gradually built up by retaining export earnings from governmental-related businesses, including energy exports. No major assistance from outside will be necessary to build up foreign reserves gradually. However, there are recognised risks involved. The gradual



process may be stopped before full implementation of the unification of exchange rates can take place. Exports may be halted in anticipation of better exchange rates, and imports may be accelerated to take advantage of time-limited subsidies, meaning trade balances may deteriorate during the gradual process of unification thereby imposing extra burdens during the unification. The gradual process has another risk in that a gradual adjustment may not produce adequate benefits quickly enough—or it may produce adverse effects as previously described—preventing the exchange rates from converging to a single rate.

Lessons can be drawn from the experiences of other countries. China unified its exchange rates in 1994, which enabled high economic growth and low inflation since then. Vietnam meanwhile unified its exchange rates in 1989, and it took a few years to stabilise the inflation and depreciation of the unified exchange rate. Uzbekistan also declared in early 2002 that it would implement unification of exchange rates. Both China and Vietnam were able to increase the level of imports and exports as well as GDP growth rate after the unification of exchange rates. Although the inflation rates were high and accelerating in these countries prior to the unification, they significantly decelerated after the unification. Myanmar is capable of repeating these success stories, if and when political will is demonstrated.

In order to promote inward foreign direct investment and exports, restrictions on companies' trade activities have to be eliminated as soon as possible. For example, the practice of restricting the level of imports to the export earnings of a company is inefficient, and deters foreign direct investment. Sudden changes in governmental regulations and notifications without prior explanation have to be avoided in order to encourage inward foreign direct investment.

Macroeconomic conditions measured by the parallel exchange rate, inflation rate, and other factors in Myanmar are slowly deteriorating. A vicious circle of inflation and currency depreciation may be settling in. Another vicious circle of stricter trade controls to manage foreign currencies and shrinking exports may also be emerging. Foreign manufacturing companies are withdrawing from Myanmar, complaining that activities are adversely affected by nontransparent rules and notification procedures. The microeconomic business environment is deteriorating and this is affecting macroeconomic soundness. Trade restrictions that are aimed at curtailing imports discourage exports as well. There is a sense of urgency to reverse these trends and aim at the unification of the exchange rates. The unification of the exchange rates is essential to stop the deterioration and to make the business environment of sectors such as agriculture, manufacturing, information and technology and others, more transparent.

## **1.2 Fiscal policy**

Reducing fiscal deficits is absolutely necessary to achieve a sound and stable macroeconomic

condition that is the basis for a stable market-based exchange rate. Fiscal deficits are increasing, because the money supply is increasing at a rate of 50% a year (from March 2001 to March 2002).<sup>3</sup> Fiscal deficits are mostly financed by central bank credit, and the monetary expansion has contributed to inflation. The inflation rate was 54% (period average) from March 2001 to March 2002,<sup>4</sup> and such inflation has inevitably caused depreciation of the market-based exchange rate. The exchange rate has been depreciating in parallel with inflation. In short, fiscal deficits are financed by monetisation; monetary increases cause inflation; and inflation causes exchange rate depreciation. Unless fiscal deficits are eliminated, the market-determined exchange rate will not be stabilised with or without unification.

In order to close the gap of fiscal deficits, expenditures, including subsidies to state economic enterprises, have to be reduced and tax revenues have to be enhanced. In theory, several options are available. However, it is important to scrutinise which expenditures have to be cut, and which taxes should be increased.

Tax revenues in Myanmar, which total about 4% of GDP, are among the lowest in the world and are insufficient to support even a critical minimum of public expenditures necessary for socioeconomic development such as social and industrial infrastructure, education, and health. Further spending cuts in social infrastructure might diminish medium-term growth prospects. Tax revenues can be increased by better compliance, supported by increased morale and governance of tax inspectors, and eliminating complicated exemptions. The agricultural sector, which accounts for 60% of GDP, has to shoulder some of the tax burden. Foreign and domestic investors in the agricultural sector should be treated the same as other industries. In summary, efforts should be made to construct a broader tax base and to increase tax compliance.

Although expenditures on social infrastructure should be maintained or even increased in the medium run, fiscal deficits must be reduced. Revising expenditure items is necessary. About three-quarters of fiscal expenditures are directed at the operation of state economic enterprises. Serious reform of state economic enterprises, including privatising some of them in the medium run, is necessary to reduce the fiscal burden. Incentives and penalties should be introduced to induce managers to operate the enterprises more efficiently. Namely, enterprise executives should be rewarded for better management and higher profits and penalised for greater losses.

It is recommended that the Myanmar government increase transparency and efficiency of the state economic enterprise budget system. The budget for state economic enterprises, which is part of the central general budget, should be separated and made subject to hard budget constraints—that is, to set a ceiling for expenditures.

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<sup>3</sup> Estimates are based on IFS data (October 2002) from the IMF.

<sup>4</sup> Estimates are based on IFS data (October 2002) from the IMF.

In summary, fiscal deficits have to be reduced to make the unification of exchange rates successful. Tax revenues, in proportion to GDP, in Myanmar are extremely low, and they should be increased through better compliance and a broader tax base. The level of expenditures for socioeconomic infrastructure should be maintained. Accelerating reform of state economic enterprises and privatisation is needed to reduce fiscal spending, which is a necessity for restoring fiscal balance.

### **1.3 Monetary policy**

A primary goal of monetary policy is to control inflation. In order to control inflation, the monetary base and domestic credit has to be monitored and managed by an independent central bank. In Myanmar, the Central Bank of Myanmar lacks autonomy and has automatically financed public sector deficits. Monetary supply is now increasing at a rate of about 50% a year.<sup>5</sup> This has caused domestic inflation which is the source of depreciation. Inflation should be countered by higher interest rates and controlling the increase of monetary bases.

It is recommended that the Central Bank of Myanmar be given autonomy in making decisions on monetary policy. Setting the interest rate and extending central bank credit should be decided solely by the central bank. In order to enhance accountability of the autonomous central bank, *inflation targeting may be adopted, which is a transparent commitment for a moderate inflation rate.*

### **1.4 Financial sector**

Sound and robust financial institutions are important to avoid a financial crisis—one of the lessons from the Asian crisis. Myanmar has four state-owned commercial banks and 20 private commercial banks. The operation of state-owned commercial banks is quite inefficient. Private banks are in general performing better than state banks, and take in a larger share of deposits and loans. Transparent and equitable bank supervision is necessary to keep the banking sector robust. A level-playing field should be restored between the state-owned banks and the private banks by eliminating the advantages granted to state-owned banks. Enhanced risk management should be sought, so that banks stay healthy against internal and external shocks including exchange rate fluctuations after the unification.

### **1.5 Trade**

It is recognised that building up foreign reserves is an important step toward implementing the unification of the exchange rates without anxiety. In order to earn hard foreign currencies,

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<sup>5</sup> Estimates are based on IFS data (October 2002) from the IMF.

promoting exports is essential. However, introducing irrational and nontransparent regulations is counterproductive, no matter how good the intentions behind them are. Sudden changes in these regulations without explanation and due process will erode confidence in companies that engage in trade activities. Liberalising these controls will encourage greater foreign investment and exports.

In 1999, Myanmar's exports amounted to \$25 per capita, one of the lowest among ASEAN countries. One of the reasons for this is the ban, on private sector exports of key goods, including rice, rubber, and gems. Allowing rice exports by the private sector is a promising way to increase exports. The unification of the exchange rates will encourage exports and export-related domestic production, and discourage inefficient imports. The commitment to export-led growth that has been a hallmark of typical East Asian economies should be adopted, and again, the unification of the exchange rates is essential.

Imports are largely determined by the availability of foreign exchange and the authorities' policies based on priorities. In 1999, Myanmar's imports amounted to \$48 per capita, one of the lowest rates among ASEAN countries. For example, in Lao PDR, imports were at \$100 per capita in 1999.

In order to make a price mechanism work in trade activities, the unification of the exchange rates and liberalisation of both export and import policies are important. Myanmar's comparative advantage will be found through liberalised export and import activities.

Inviting foreign direct investment is an important way to help infrastructure and productive capacity in Myanmar develop rapidly. Such investment brings in foreign currency as well as foreign technology and efficient management. Experiences in many Asian countries show that foreign direct investment is significantly beneficial to developing countries at all stages. To encourage foreign direct investment, transparency in regulations and the unification of the exchange rates is essential. Ad hoc restrictions and regulations on exports, imports, and taxes significantly discourage additional foreign direct investment and cause existing firms to withdraw.

## **1.6 Concluding observations**

The unification of the exchange rates in Myanmar is essential for exports, investment, and economic growth. The main proposals of this paper are as follows. A prompt transition to the unified exchange rate is desirable. One option is to achieve the unification as soon as possible, with assistance from Japan regarding humanitarian needs. Another option is to gradually achieve the unification in two years time by shifting state economic enterprises from official exchange rate sectors to market exchange rate sectors and by building up foreign reserves during the transition. Both options come with benefits and costs. Sound and stable macroeconomic conditions

are essential in achieving a stable market-based exchange rate in either option.

## 2. The Significance of Agricultural and Rural Economy Development in Myanmar

### 2.1 Introduction

Reforms in the agricultural sector, which accounts for about sixty percent of GDP, will play an important role in resolving shortages of foreign exchange reserve and revenue deficits. The Myanmar government also regards the agricultural sector as the most important base for all-around economic development and places first priority on agricultural development. The major political objective of the Ministry of Agriculture and Irrigation is to achieve growth in agricultural production by reclaiming cultivatable wasteland and expanding irrigated areas in order to promote exports of agricultural products to earn foreign exchange.

Exports of agricultural products including fish and forest products account for about 30 percent of total export earnings. After the partial liberalisation of agriculture-related marketing and agricultural product exports, the increase in exports of pulses and beans and fish/fish products has been remarkable. On the other hand, rice exports which are under state control have decreased (see Table 2.1).

Table 2.1 Exports of primary products

	(Current price in million kyats)										
	1987/ 88	1989/ 90	1990/ 91	1991/ 92	1992/ 93	1993/ 94	1995/ 96	1996/ 97	1997/ 98	1998/ 99	1999/ 00
Agricultural Products	452	432	942	1,011	1,299	1,358	2,003	1,581	1,578	1,409	1,322
Rice and Rice Products	254	266	172	251	249	268	440	126	38	167	65
Pulses and Beans	131	123	515	429	667	725	1,357	1,272	1,403	1,136	1,178
Animal Feedstuff	11	15	12	14	27	38	26	12	3	5	3
Rubber and Others	31	28	244	317	328	328	180	171	134	101	76
Fish and Fish Products		134	165	156	259	368	159	226	302	328	233
Forest Products	745	1,014	1,131	943	1,120	1,357	1,049	986	852	790	1,236

Source: Ministry of Planning and Finance, Review of the Financial, Economic and Social Conditions for 1993/94, Asian Development Bank.

What initiatives the Myanmar government needs to implement to maintain and further increase exports of pulses and beans. Why rice exports have continued to remain languished for a prolonged period of time, and what the targets are to promote exports of other agricultural

products.

## 2.2 The current conditions of agricultural product exports

Exporters of agricultural products can be classified into three groups in Myanmar; private exporters, semi-state and private exporters, and state exporters, according to the type of crops. Herein the current conditions of agricultural product exports are examined by studying the cases of major export crops.

### Pulses and beans

In the 1990's pulses and beans replaced rice as the leading export crop and Myanmar became one of the world's major pulse exporters. The country's output has increased quite rapidly thanks to stimulus from exports. Output figures reached 1,678,000 tons in 1998/99, up substantially from the 453,000 tons recorded in 1989/90. Black gram, green gram and pigeon peas are the three major varieties and they are exported mainly to countries such as India, Malaysia, Indonesia and Singapore<sup>1</sup>.

The success story of pulse exports can be attributed to the fact that marketing of pulses has been largely left to the private sector. Myanmar Agricultural Produce Trading (MAPT) and Myanmar Agricultural Services (MAS) also export pulses. However they purchase them at market price from traders. There is no intervention by the state sector<sup>2</sup>.

The market situation is also favourable for Myanmar. The average annual growth rate for peas and beans in ASEAN member countries is rather insignificant, with Myanmar being the exception. Myanmar also commands a dominant position as a price taker in the market for peas and beans and has more leverage in competitive markets. However, Myanmar's yield for peas and beans is at an average level compared with other ASEAN member nations; Indonesia dominates in terms of highest yield level. Moreover the quality of peas and beans seems to be relatively inferior to that of competing countries<sup>3</sup>.

Regarding exports of peas and beans permitted by the private sector in Myanmar, the current export procedures are cumbersome and there are barriers that hinder the entry of private exporters. Also, the distortion in foreign exchange rates makes transactions complicated, thereby hindering export promotion.

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<sup>1</sup> Report on the structural adjustments for agricultural and rural economy development in Myanmar, vol. II: Background Report, distributed at the Tokyo workshop in June, 2002, p.97. Figures are cited from Table.2.

<sup>2</sup> *Ibid.* P.97.

<sup>3</sup> *Ibid.* P.133.

## Sesame

Following the liberalisation of agricultural marketing in 1987, sesame exports and output have also increased. However sudden bans were imposed on the private-sector export of sesame. This policy change was based on the priority for a stable domestic supply. Since then, private exporters have been able to export sesame through MAPT or Myanmar Economic Holding. Private companies conduct the actual harvesting of the produce as well as the transactions with buyers, however the official exporter must be a state-run organisation<sup>4</sup>. The foreign exchange earnings go to government organisations while private companies are able to receive only local currency. In this case, the exchange rate is \$1= 280 kyats<sup>5</sup>.

The domestic price of sesame has declined 30-35 percent following the export ban and it is most likely the cause of the decrease in sesame production over the past few years<sup>6</sup>.

Table 2.2 Output of major export crops

	(thousand metric tons)									
	1989/ 90	1990/ 91	1991/ 92	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99
Paddy crop	13,803	13,969	13,201	14,837	17,437	18,195	17,953	17,673	16,651	17,848
Pulses	453	552	720	889	993	1,109	1,337	1,370	1,597	1,678
Sesame	207	216	171	237	187	304	304	344	296	186
Maize	194	187	191	208	205	284	275	286	308	303
Rubber	15	15	15	16	16	27	26	26	27	26

Source: Ministry of Planning and Finance, *Review of the Financial, Economic and Social Conditions*

## Rice

Myanmar used to be one of the largest rice exporters in the world; during the 1930's the nation exported more than three million tons of rice. However the amount of rice exports dipped below the one-million ton mark sometime in 1964/65, and afterwards this figure declined to around half a million tons<sup>7</sup>. In 1994/95, rice exports exceeded one million tons, but this volume could not be sustained during subsequent years. The amount of rice exports has fluctuated in recent years<sup>8</sup>.

<sup>4</sup> *Ibid.* P.98.

<sup>5</sup> Institute of Developing Economies, *Ajia doko nenpo, 2000 (Annual report of Asian trends, 2000)*, Tokyo, 2001, p.420.

<sup>6</sup> Background Report, distributed at the Tokyo workshop in June 2002, p.133.

<sup>7</sup> Teruko Saito and Lee kin Kiong, *Statistics on the Burmese Economy*, ISEAS, 1999, pp.80-81.

<sup>8</sup> Koichi Fujita, *Kokusai nogyo koryu shokuryo shien kikin hokokusho [Report of Japan International Agricultural Council]*, 2001, V Myanmar, table V-12.



Although rice output has been rising since the 1990's (except for the years of 1996, 97, 98 when major flood damage was sustained), the amount of rice exports has not increased. The government has adopted a policy which gives first priority to domestic demand, and exports take place only when there are surpluses. Therefore, great efforts are concentrated for increasing rice production. Can the inactivity of rice exports be attributed to the lack of surpluses? Herein we attempt a rough estimation. Supposing that polished rice is consumed at a rate of 200kg/year per capita<sup>9</sup>, 10,224,800 tons of polished rice, which is equal to 200kg multiplied by 51.124 million (the population of Myanmar), is needed for domestic consumption. In 1999/2000, the amount of available paddy crop was about 18,000,000 tons, when seeds, other use and waste are deducted<sup>10</sup>. Calculating using a ratio of polished rice to total paddy crop weight of 63%, the available amount of polished rice is estimated to be about 11,340,000 tons. Therefore Myanmar had about 1,115,000 tons of surplus rice based on this calculation. Actual rice exports however reached only 60,000 tons<sup>11</sup>.

How about price competition? F.O.B. prices of B-II grade rice in Bangkok were about US\$200-250 per ton in 2000<sup>12</sup>. Rice wholesale prices in Yangon meanwhile were approx. between 20,000-40,000 kyats per ton in the same year<sup>13</sup>. At the market exchange rate (US\$1=410kyats in those days), these prices were approx. between US\$50-100. Myanmar's prices for rice are therefore below the international level. However, the government monopolises rice exports. According to the Asian Development Bank, Myanmar's rice exports currently receive F.O.B prices of US\$189.4 (as of 1999/2000). This price is not very competitive.

The monopoly on rice exports also affects the quality of rice. This is because the rice procured by the government for exports tends to be the lowest grade in Myanmar. One reason is that farmers do not have incentives to deliver quality rice at low procurement prices. And the other reason is that different varieties of paddy crop are mixed in during the process of harvesting and many broken rice is produced which is milled in together<sup>14</sup>. However, considering the present world market situation, which is unfavourable for Myanmar, the issue of quality is crucial. Rice exporters including Thailand, Vietnam and Pakistan are able to maintain a relatively stable flow

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<sup>9</sup> According to the Household Income and Expenditure Survey 1997 conducted by CSO, per capita consumption of rice in urban area is 5.25 pyi/month (=134 kg/year) and that in rural area is 6.20 pyi (=163 kg/year). The survey data shows the lower consumption level than the estimation calculated from macro-based production data. The discrepancy between two sources may be explained by the possibly inflated figures on the production data.

<sup>10</sup> Background Report, distributed at Tokyo workshop in June 2002, p. 128.

<sup>11</sup> *Ibid.* This calculation does not take the underestimate of Myanmar population into consideration.

<sup>12</sup> FAO, *The State of Food and Agriculture*, 2000, p.24.

<sup>13</sup> Background Report, distributed at Tokyo workshop in June 2002, p. 101.

<sup>14</sup> Koichi Fujita, *op.cit.*, p.9.

of rice exports. Myanmar's rice exports are unstable due to the increase in competition in the international rice market, while demand for rice is shrinking. Over-supply is putting pressure on producing nations. In order to avoid fierce competition in the rice market, Thailand and Vietnam – the world's two largest exporters – signed a Memorandum of Understanding in Bangkok in 2000 to set up a rice pool fund. Under this agreement, Thailand finds rice markets and sets the prices on low-grade rice, and then splits the export orders with Vietnam on a 50/50 basis. In this respect, the competitiveness of Myanmar rice in the international market highly depends on the rice quality, which is comparable to that of rice from Thailand and Vietnam. Improvements in rice varieties as well as in milling quality are very crucial<sup>15</sup>.

#### Agro-based industry

The agricultural products mentioned above are all low-value primary products. Growth of higher value added products is expected. The expansion of exports of fish and fish products in recent years, especially prawns, is quite noteworthy. Further expansion of prawn exports is achievable for Myanmar because prawn production has declined in some major exporting countries due to the spread of shrimp-related diseases and abnormal climatic conditions, while in Japan – a major importing nation for prawns – the amount of imports has increased<sup>16</sup>. However, importing countries usually impose strict requirements concerning quality and the shapes/sizes of the product. If these requirements are not satisfied, prices will be extremely reduced or the products may not be purchased. Furthermore, the safety of agricultural products is taken very seriously in the current times. Therefore it is impossible for the agro-based industry to develop without foreign technological transfers with foreign investment.

### **2.3 Recommendations for export promotion of agricultural products**

#### Immediate action

The first recommendation is to create favourable conditions for exports. It is hoped that further liberalisation and deregulation will take place. Government agencies' share of exports among major agricultural commodities, for example rice, sesame, rubber and so on, continues to remain high. Opening up opportunities for exports by the private sector on a wider scale will lead to increased exports and will also yield output growth, as has been demonstrated in the case of pulses and beans.

Especially in regards to rice, the government's monopoly poses obstacles to exports. Private

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<sup>15</sup> Background Report, distributed at Tokyo workshop in June 2002, p. 131.

<sup>16</sup> FAO, *Commodity Market Review 1999-2000, Japan FAO Association 1999-2000 Japanese version*, 2000, pp.108-109.

exporters are more capable of responding to international market demands in a flexible manner. Increasing rice exports will also contribute to price stability for rice. Now that the damage from severe weather phenomena has been overcome, Myanmar can enjoy sufficient rice surpluses. Actually, over-supply in the domestic market triggered the plummet in rice prices in 2000/01. If surplus rice had been able to be exported, this might not have happened. However, the liberalisation of rice exports may have negative impacts on low-income groups. Gradual export liberalisation is therefore preferable<sup>17</sup>.

Unification of the exchange rates is also crucial for further expansion of agricultural product exports. The distortion in foreign exchange rates is a burden to exporters in various aspects. Devaluation of exchange rates strengthens price competition as well.

The second recommendation is to adopt policy to promote foreign investment in the agro-based industry in order to export higher value-added agricultural products. Refer to the previous chapter regarding the concrete method for this.

#### Long -term action

The third recommendation is to improve quality and productivity in order to maintain and expand markets in the long run. Myanmar's agricultural yield is low compared with other countries. Use of agricultural input such as fertiliser is insufficient because of the shortages of foreign exchange reserve. Also, the government should assist in enhancing yield by implementing activities related to agricultural finance, R&D, and market information services, as well as others. In order to do so, a source of revenue is necessary, and finding a solution to the state revenue deficit problem is therefore an important issue.

## **2.4 The role of the agricultural sector in the state revenue**

It is difficult to grasp the flow of funds between the state revenue and the agricultural sector. A rough estimate of the direct flow between the two is attempted based on limited data.

Explicit sources of revenue from agriculture mainly come from land revenues and water tax. Although land revenues, including capitation tax and fisheries licence fees, accounted for about 50 percent of the tax revenue during the early 20th century, in 1992/93 they accounted for only 0.4 percent because land revenue rates have not been revised since 1948<sup>18</sup>. The cost for tax collection can not be paid.

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<sup>17</sup> Refer to Background Report, p. 204, concerning the concrete method of liberalisation of rice exports.

<sup>18</sup> Teruko Saito and Lee kin Kiong, *op.cit.* p.201, 207.

An implicit taxation on the agricultural sector comes from rice procurement below market price<sup>19</sup>. It can be assumed that the amount of implicit tax is the difference of the market price and the government purchase price multiplied by the volume of procurement. According to the official statistics, paddy crop procured by the government accounts for somewhere between 10 to 16 percent of total production. The procurement price is determined at the beginning of the fiscal year according to rice variety. It is normally about one half to one third of the market price at the time of harvest<sup>20</sup>. In 1998/99, 13.6 million tons of monsoon paddy crop was produced, of which 16 percent, or 2.2 million tons, was procured at 320 kyats per basket (20.89 kg). The market price was at around 400-700 kyats<sup>21</sup>. Given that the differential price was 200 kyats per basket, the amount of implicit tax was 21,063 million kyats. This amounted to only 2.8 percent of GDP by the agricultural sector (in 1998/99, the GDP of the agricultural sector reached 730,983 million kyats<sup>22</sup>). Moreover, in 2000/01, market prices were below the procurement price, therefore there was no implicit tax.

The procurement system is not appropriate as a taxation system even from an administrative standpoint. The government has to bear a huge amount of costs just to operate and maintain it. This includes the cost of planning, contracting, monitoring, and enforcement. The most important point is that farmers do not see it as an obligation to pay taxes. This turns out to be one of the major sources of mistrust between the government and farmers<sup>23</sup>.

On the other hand, public capital expenditures for the agricultural sector reached 6,858 million kyats in 1995/96 and 6,921 million kyats in 1996/97. Although the insufficient supply of electricity remains a serious problem, expenditures on the power sector totalled only 2,501 million kyats in 1996/97<sup>24</sup>. Expenditures for the agricultural sector are the highest among the productive sectors. These expenditures were mainly made for investment in the construction of dams, canals, land reclamation, and other like projects. In 2000/01, the cost for irrigation works was 6,051 million kyats<sup>25</sup>.

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<sup>19</sup> The main purpose of procurement of paddy crop lies in supplying rice to the government employees, hospitals and other social welfare institutions.

<sup>20</sup> Background Report, distributed at the Tokyo workshop in June 2002, p.99, 103.

<sup>21</sup> Koichi Fujita and Ikuko Okamoto, Myanmar kanki kangai inasaku keizai no jittai"Yangon kinkou nouson field chousa yori", [An Economic Study on Irrigated Summer Rice Production in Myanmar: Case of a Village near Yangon], *Tonan Ajia kenkyu (Journal of Southeast Asian Studies)*, Kyoto .2001, Table 2.

<sup>22</sup> Central Statistical Organization and Ministry of National Planning and Economic Development cited in the World Bank Mission Report, 1999, Table 2-7.

<sup>23</sup> Background Report, distributed at the Tokyo workshop in June 2002, p. 192.

<sup>24</sup> The World Bank Mission Report, 1999, Table 2-9.

<sup>25</sup> Background Report, distributed at the Tokyo workshop in June 2002, p.5.

## 2.5 Recommendations for the agricultural sector to play a part in resolving the revenue deficit issue

### *Immediate action*

Rationalisation of public investment in the agricultural sector is recommended. Commendable increases in agricultural output during the 1990's are attributed to the expansion of irrigation systems, however, over-investment in irrigation projects squeezed out government expenditures that were needed in other sectors. In regards to rice production, the increase in output that results from government irrigation construction projects and reclamation works does not correspond with the costs. Farmers should implement such projects themselves, spurred on by incentives from market demands. Instead of investing in irrigation projects, the government should support the social welfare of farmers by supplying market information and agricultural R&D, or constructing other infrastructure.

### *Long -term action*

The agricultural sector should contribute to the state revenue as a stable source of revenue through land revenue reform, together with the removal of the current rice procurement system. If the government can acquire 5 percent of its GDP from the agricultural sector through land revenue, the amount would comprise 49,341 million kyats in 1998-99, which was almost the same as the tax revenue of that year<sup>26</sup>. When such a policy is adopted, the government must focus further efforts toward the growth of farmers' income and welfare.

The current land revenue system is a continuation of the revenue scheme from the colonial period. Settlement operations were carried out by each of the districts and each settlement area was divided into several assessment tracts. In theory, the rate of land revenue should be half of the net produce defined as the balance left after deducting cultivation costs. Net produce per acre was assessed by type and grade of land in each assessment tract and demand per acre was determined and fixed over a several year period in the settlement operations<sup>27</sup>. However, it was judged as too excessive to take half of net produce as land revenue. Therefore, considering rents, living standards and other conditions, land revenue rates varied from between one fourth to one seventh of net produce, and were left to the discretion of each settlement officer<sup>28</sup>. Actual demand for revenue is calculated annually based on the acreage demand determined in the settlement

<sup>26</sup> *The World Bank Mission Report*, 1999, Tables 2-1, 4-1.

<sup>27</sup> *Report of the Committee Appointed to Examine the Land Revenue System of Burma*, Rangoon, 1928, pp.16-40.

<sup>28</sup> For examples, see *Report on the Second Revision Settlement of the Ma-Ubin District of Lower Burma, Season 1925-28*, Rangoon, 1929.

operations.

The current land revenue system has some problems that need to be resolved. In terms of fairness and equity, the variations that exist among land revenue rates – even within the same district – are the first issue that warrants objection. The second issue is that fixing the revenue demand over a several year period is not a flexible approach, in view of changes that occur in cultivation costs and crop prices. Revenue demand becomes relatively low when crop prices increase, and conversely, a decline in crop prices or an increase in cultivation costs means that the demand becomes excessively high.

Recommendations for reform of the land revenue system are as follows. (1) It is necessary to make the assessment of net produce more clear. Land revenue rates should be made the same across the nation, and set according to crop categories. (2) The demand for land revenue per acre should not be determined in the settlement operations. Instead the actual amount of demand should be calculated by an annual assessment. The administrative costs necessary for this would not be very different from what they are now. (3) Although this is actual taxation on agricultural income, the system is not progressive. It may be worth considering the introduction of a fixed property tax.

Together with the reform of the land revenue system, establishment of land-related laws is also required. Legal rights pertaining to land are a fundamental basis for executing economic development. Under the Land Nationalization Act (1954), which still remains in force, the former government made the interpretation that it was illegal for farmers to transfer or mortgage their tillage rights. The Myanmar government is considering introducing tillage rights that are entitled to transfer, lease, inheritance, and mortgage, in order to adjust to the market economy<sup>29</sup>. This is a ratification that is based on the current conditions. Liberalisation is also necessary, however, the problem of establishing land-related laws encompasses more than just simply formulating land rights. In regard to land-related laws, the key is how and to what extent private rights should be regulated.

The primary objective of regulation is to protect farmers from unexpected land alienations. The Land Nationalization Act was established to eliminate non-cultivating landowners and to return agricultural land back to the farmers. In the colonial period, non-residential non-cultivating owners owned about 50 percent of the agricultural land in the delta region and many tenants

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<sup>29</sup> Ministry of Agriculture and Irrigation, *Sait pyo yei maha simankein, 2000/01 hma 2030/31 ati (The great plan of agriculture from 2000/01 to 2030/31)*, Yangon, 2000, p.587. This models the situation in Vietnam. There is no practical difference between propertied tillage rights and proprietary rights, however, the meaning of the two are not the same in terms of legal principles. What land rights are granted to the people will serve as a touchstone of the Myanmar government's attitude toward market economy and democracy.

suffered from rack rent<sup>30</sup>. It is possible that a polarisation among farmers may occur again with the development of the market economy. Sharp and excessive polarisation will bring about high social costs. The present government has a policy to ensure that large farms are run by private companies. Economies of scale can be applied to certain crops, but it is questionable as to whether they can be applied to paddy crop production. In any case, land-related laws that are adjusted to the land and agricultural policies are needed.

Regulation of land user's rights is also required for the construction of infrastructure, planning of land use, and protection of the environment and so on. In the event that desirable social land use is not achieved through private transactions, the public sector must intervene based on systematic law, but not applying the provision "The authority can deprive of any land in its need"

## **2.6 Conclusion**

The Myanmar government faces two major macroeconomical challenges: revenue deficits and shortages of foreign exchange reserves. These two challenges pose obstacles to agriculture production which should be the main foundation of economic development, due to insufficiency of agricultural input and equipment, and regulations on agricultural product exports. Further liberalisation of exports and stabilisation of the macroeconomy will contribute towards agricultural and rural economy development.

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<sup>30</sup> *Report of the Land and Agriculture Committee, Part II, Land Alienation, Rangoon, 1937, p.39.*

### 3. Toward Market-oriented Industrialisation in Myanmar

#### 3.1 Introduction

Industrialisation is an essential element of the total development of a country. This theory has been shared among the newly independent countries after WW II, and such nations have expressed a craving for economic growth through industrialisation, i.e. growing from a traditional agrarian economy to a modern industrial one. Economic development had often been equated with industrialisation. Several academic works contributed as the backbone for the diffusion of this growth theory. For example, Rosenstein-Rodan [1943]<sup>1</sup> argued that industrialisation could be regarded as an 'initiator' of economic development. These academic papers were introduced in the Asian countries and became the fundamentals of industrialisation. Myanmar, which gained its independence in 1948, must have also shared the same aspirations for a modern industrial economy.

During the early phases of industrialisation, labour-intensive manufacturing plays an important role, because most firms are small or medium in scale and they are able to mobilize a limited amount of funds. Industrial policies in such economies should focus sufficient attention on providing support and promotion measures to improve the production efficiency of these enterprises. In Myanmar, agro-based industrialisation in rural regions is a promising area for the government to deal with regarding industrial promotion. Growth of these industries will create employment opportunities and also help to actively reduce poverty.

As already discussed in the previous chapters, the military government of Myanmar declared suspension of the Socialist Construction and adopted a market-oriented economy system in 1988. This shift in economic regime was widely recognized as a favourable momentum for the economic recovery and future development and growth in Myanmar. The government took various reform measures to promote the participation of the private sector in the national economy and established several basic laws for business activities to show its effort in shifting from the past state-controlled system to a market-oriented economy. The international community expected that Myanmar would undergo a complete economic liberalisation and establish a solid basis for industrialisation, and the country would thus develop a favourable economic environment for the business activities of the nation.

International community expected Myanmar to realise through its 1988 economic and political change was active industrialisation for a higher value-added economy. However in this area it fell short of expectations. The government of Myanmar seemed disappointed with its current

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<sup>1</sup> Paul N. Rosenstein-Rodan, "Problems of Industrialization of Eastern and South-Eastern Europe," *Economic Journal*, 1943, 53: pp.202-211.



economic status because it thought it had already installed a substantial number of industrialisation measures. The fact is though that the industrial promotion policies of the Myanmar government at that time had hardly been adequate compared to their potential prospects and there are a considerable number of possible improvements and amendments to be initiated to realise industrialisation in Myanmar.

Another thing that has gradually become obvious is that the government of Myanmar is reluctant to thoroughly liberalise its economic system and institutions, and it has taken stiff control over economic activities. And without appropriate economic liberalisation, privatisation in Myanmar also remains superficial. For example, although external trade was largely shifted from state trade agencies to the hands of private entities, the trade sector still remains totally bound by rigid and diverse regulations/laws, and private trading companies are not able to develop their businesses efficiently.

Subsidies to the State-owned Economic Enterprises (SEEs), which account for about three-quarters of Myanmar's fiscal expenditures, effectively inhibit a sound macroeconomy. A sound macroeconomy is a critical condition for allowing the private sector to operate businesses. Although reforms of the deficit-ridden SEEs were declared by the government of Myanmar, substantial progress was not achieved regarding privatisation of the SEEs or in improving the continuously inefficient management system at such SEEs.

Furthermore, foreign investors have hesitated at becoming actively involved in business in Myanmar due to the nation's irrational and incomplete business laws, which ideally should serve as the fundamental basis for activities of foreign investors.

It was even reported that the government had planned to reverse its previous liberalisation reforms and would revert back to the once abandoned socialist economic system and agro-based economy. *Our study team is highly anxious about this kind of hasty regression by the Myanmar government to its once failed economic system before the reforms are fully completed and before actual results can be gained.* The government of Myanmar is requested to sustain and proceed yet further with its privatisation, liberalisation, and industrialisation process, so that it may obtain the real fruits of economic reform.

In the sections below, we will discuss the following aspects of the Myanmar economy; 1) historical and current industrialisation status, 2) privatisation, and 3) prospects of further industrial development. Through these discussions, the expectations and recommendations the international community has for Myanmar will be explained in order to support economic growth in the country.

## **3.2 Industrialisation in Myanmar**

In this section, the status of industrialisation in Myanmar is summarized in the following three aspects; (1) the history of industrialisation in Myanmar following World War II, (2) recent industrialisation efforts, and (3) comparison with other ASEAN member countries in terms of industrial policies.

### **3.2.1 Historical description of industrialisation in Myanmar following World War II**

Myanmar, which gained its independence in 1948, must have also shared the same aspirations for a modern industrial economy as other countries which became independent after the World War II. Its abundant natural resources and highly literate population are obviously positive signs for development prospects. And chronicled economic data suggests that Myanmar was not too far behind Thailand by 1950, even though the country's economy was substantially devastated during the war period. Both countries started their path of quest for economic development by strategically utilizing their natural resources as other developing countries did. However, the current underdeveloped situation of the industrial sector in Myanmar is prominent, compared with neighbouring ASEAN countries, which succeeded in blooming an industrialised economy. There must exist a crucial difference between Myanmar and its neighbouring countries in terms of historical economic strategies and economic system management.

It is clear that Myanmar governments had long clung to control-oriented, or at least, interventionist, policy rather than utilizing market mechanisms. During the socialist period in particular, inward-looking growth strategy and nationalisation (Burmanisation) had long been pursued. However, the socialist governments failed to establish a solid basis and comprehensive policy measures for industrialisation, even though the government launched some projects to operate import-substituting industries. In Myanmar, the government's efforts to substitute imports with locally manufactured products were limited and, instead, the socialist government tried to control domestic consumption of imported goods.

Myanmar's centrally-planned economy, like that of other socialist countries, faced many obstacles and stagnant growth in not only the industrial sector but also in the whole economy. The socialist government relaxed several strict policies and introduced reforms of the SEEs, which used to be dominant in manufacturing, energy, financial and service sectors, along with prescription of commercial guidelines to improve their efficiency in the mid-1970's. Although the economy picked up shortly after such reforms, it could not be sustained mainly due to the shortage of imported material goods. Coupled with the failure of comprehensive solid policies and strategies for industrialisation in Myanmar, the leverage of the nation's economy for sustained

growth was quite shaky. After 1983, industrial production deteriorated once again, and other economic difficulties such as high inflation, rising cost of living and macroeconomic and monetary mismanagement, including demonetisation in 1987, worsened the situation, which eventually led to the collapse of the socialist regime in 1998.

### **3.2.2 Industrialisation in the 1990's**

SLORC/SPDC officially gave up the establishment of a socialist economic system and started to promote a market-oriented economy. Two pillar laws were promulgated: the Foreign Investment Law (November 1988) and the State-owned Economic Enterprises Law (March 1989). In addition to these, various reform measures were taken to promote the active participation of the private sector in the national economy. From 1988-97, twenty-seven new business-related laws were issued, including the two mentioned above. The military governments apparently committed themselves to the global trend of transition to market-oriented economy.

According to figures on nominal GDP, only the agricultural sector increased its share substantially during the 1990's. Most of the other sectors lowered their shares or achieved only slight change. It can be said that the industrial structure of Myanmar remained static throughout the 1990's. The economy is still characterized by the predominant importance of the agricultural sector.

Nevertheless, with the series of economic reforms and the transition to a market-oriented economy, steady economic development was seen during the period of the four-year plan (1992/93 – 95/96) with an average annual growth rate of 7.5 percent, which is certainly high for an agrarian economy such as Myanmar's. The success of this plan was due to various factors: private sector development following the liberalisation policy; an inflow of FDI following the open-door policy; substantial increase of agricultural produce (especially rice) following the introduction of summer paddy crops; growth of exports following decontrol of the state monopoly on foreign trade; and encouragement of tourism and the construction mini-boom.

But still, it must be noted that, according to data on relative importance in nominal GDP compiled by sector, only the agricultural sector was able to expand its relative importance in the overall economy, going from a share of 61.3 percent in FY 1985 to 69.3 percent in FY1989. The processing and manufacturing sector, which plays the most significant role in industrialisation, occupied a share of around 7 percent in nominal GDP throughout the 1990's.<sup>2</sup> There was growth

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<sup>2</sup> Even in terms of real GDP, the contribution of the processing and manufacturing sector in GDP was limited to 9.2 percent in FY1998 (based on fixed prices of FY 1985) and the share of this sector in GDP shrank by 0.7 percent from FY 1985 to FY 1998. Meanwhile, the share in GDP of agriculture and livestock/fishery were 34.5 percent and 7.2 percent, respectively, in FY 1998.

in the Myanmar economy in the 1990s, but it was mainly due to quantitative increases in production of agriculture, as mentioned above, and the price hike of agricultural-related charges.<sup>3</sup> Contrary to the public's general understanding, Myanmar's nominal GDP growth was an agriculture-led development without substantial industrial structural changes. In other word, it was not industrialisation but agriculturalisation that progressed in Myanmar in the 1990's.

The garment industry has recently been the most promising industrial sector in Myanmar, as it utilizes the country's inexpensive and reliable labour base. As a driving force in the early stages of industrialisation, the development of such labour-intensive industries is significant. However, the scale of factories in the garment industry in Myanmar still basically comprises relatively small operations and their level of managerial abilities requires higher sophistication. This problem includes a number of related issues which need to be solved by such firms, i.e. fund raising, gathering information regarding new/advanced technologies, and acquiring appropriate market information, etc. The garment industry still continues to account for only a relatively small section of Myanmar's entire economy.

Even in the agricultural sector, Myanmar's leading sector, productivity and production efficiency continue to require additional improvements, in order to achieve higher levels of productivity. And improving product quality control at the post-harvest stage as well as in the cultivation stage is critical. Meanwhile, in order to realize higher productivity in the agricultural sector, the introduction of more sophisticated technologies is also essential. In a developing country, such technologies must either be imported or the country must work hard to provide these technologies through local import-substitute industries. In Myanmar, where imported second-hand machinery and equipment is as expensive as imported brand-new ones due to high import duties and regulations, import substitutions and innovative activities in the agricultural machinery manufacturing sector must be strongly promoted and enhanced to enable farmers to utilize such machinery at reasonable prices. However, the development of this sector has so far remained quite limited in Myanmar.

Myanmar is classified as a least less-developed country (LLDC) based on its low per capita GDP which is less than \$US 200. Even though the people of Myanmar do not suffer from starvation mainly due to the country's favourable climate and its rich soil, many are forced to live at a level which is close to or under the poverty line. In order to eliminate poverty, economic growth, which is spurred by industrialisation, is a critical factor. Economic growth creates new jobs and

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<sup>3</sup> The price hike in agricultural-related charges generally means that the trade conditions for agricultural commodities improved compared to those for industrial goods. Unfortunately, this price hike was the result of arbitrary price setting by the government of Myanmar, and it served only to hamper the sound development of industrial sectors and did not contribute to the economic welfare of farmers in rural areas.

facilitates the active reduction of poverty. Taking Myanmar's national resource endowments and its abundant, inexpensive and high-potential human resources into consideration, the most plausible explanation for dwarfed industrialisation likely lies in the governmental industrial policies that the current military government has adopted. Therefore the government of Myanmar is required to initiate industrial policies that are actually effective, in order to stimulate and encourage industrialisation in the country.

### **3.2.3 Comparison with other ASEAN member countries in terms of industrial policies**

As is already mentioned above, the feeble development of industrialisation in Myanmar even in the 1990's shows a clear contrast with other ASEAN member nations. Most of the ASEAN countries had, in fact, remained agrarian economies until the 1980's, and it still seemed uncertain as to whether they would accomplish their industrialisation process, despite their long-held desire for industrialisation. Subsequently, they got their industrial promotion initiatives into gear, and succeeded in the structural change of their economies. Industrialisation in the ASEAN countries boomed in full-swing during the 1990's. The share of GDP for the manufacturing sector in these countries continued to expand even after the Asian Currency Crisis, when almost every type of enterprise, including manufacturing companies, received serious damage from the currency-related chaos and the collapse of financial systems in the region.

Thailand which defined itself as a Newly Agro-Industrialised Country (NAIC)<sup>4</sup> has seemingly taken similar economic management strategies which are based on inward-looking growth strategy and agro-based economy. Thailand had been reluctant to actively introduce an export-promoted industrial system until the 1980's and its economy had long relied on agro products. However Thailand achieved to create a higher value-added economy on solid foundations to growth, which were not be destroyed even by the Asian crisis, while Myanmar failed to do. The crucial difference between Thailand and Myanmar can be found not in the area of economic regime, but in the magnitude and depth of achievement of industrialisation. While Thailand adopted an agro-based economic development strategy, it also actively developed agro-processing industries and light industries in the rural areas. Most importantly, those industries were continuously improved in terms of product quality in order to comply with requirements of the international market. And also while introducing import-substitute industrial principles, the Thai government carefully prepared for the introduction of FDI and provided an export-led industrial system. When the Thai government finally changed the main stream of economic management from an inward-looking one to an export-oriented industry, it was able to avoid having to face uncompleted legal

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<sup>4</sup> Akira Suehiro and Yasushi Yasuda eds, "Tai no kogyoka – NAIC e no chosen (Industrialization in Thailand – Challenge to NAIC)", Institute of Developing Economies, 1987.

and administrative management infrastructure and could cope with the globally competitive market. Thailand eventually succeeded in fostering garment industry as well as automotive and semi-conductor industry.

Each government in ASEAN has been reinforcing and improving industrial promotion measures in search of better performance and productivity of the companies in its industrial sector. It is true that most of the ASEAN countries had to spend decades to establish firm institutional/policy fundamentals for their industrialisation, and at times, partial regression in their policies have interrupted the progress of industrialisation. But there has always been eagerness among these countries to make steps forward on the road toward industrialisation. The biggest problem in Myanmar regarding the industrialisation process is that the successive governments including the current military regime have never institutionalised comprehensive and tangible industrial promotion measures aside from price controls. This vacancy of effective industrial promotion policies and lack of human resources for developing them must be corrected in Myanmar.

Industrialisation inevitably accelerates the concentration of population in cities, especially into the capital cities, which is often accompanied by income level gaps between rural and urban areas. In the ASEAN countries, even though the discrepancy in income levels between rural and urban areas has not been totally erased, income levels on the whole have been improving also in the rural districts through the progress of industrialisation. The agricultural sector continues to retain an important position in these economies, and the respective governments have been devoting tremendous efforts towards the economic welfare of farmers in rural areas. Industrialisation does not mean neglect of the economy in rural districts. The Myanmar government should not hesitate to establish institutional supports for industrialisation and should review its own role in providing sufficient rules/laws and assistance for industries.

### **3.3 Privatisation in Myanmar**

In this section, privatisation in Myanmar is discussed, in order to assess the impact of economic change initiated in 1988 by the present military government.

#### **3.3.1 Impact of economic reforms on ownership pattern**

Herein we take a look at industrial structural changes in ownership pattern, especially regarding transition from the centrally-planned economy where the state sector is a major player, to a market-oriented economy where the private sector is expected to play a major role. Myanmar is a transitional economy and we will examine the impacts of economic reforms on ownership pattern.

The economic reforms of the military government began with the open-door policy and the recognition of private businesses. The government announced its Foreign Investment Law in 1998 and opened its doors to foreign investment after a 25-year-interval. It also announced the State-owned Economic Enterprises Law in 1989, in which the Law Conferring Power for Establishing the Socialist Economic System of 1965 was repealed.

The State-owned Economic Enterprises Law stipulated the twelve industries that SEEs would continue to monopolise. By stipulating these industries exclusive for SEEs, the government conversely allowed the private sector to enter other fields. The industrial policy for the private sector's participation in the national economy changed from "banned in principle" to "generally permitted."

Under the industrial liberalisation and open-door policy, the private sector has gained substantial momentum. The private sector accounted for nearly 70 percent of total GDP (real term) even in FY 1986, when the country still remained in the midst of the socialist regime. This high ratio of the private sector in the GDP of Myanmar sharply contrasts the situation in transitional economies in Central and Eastern Europe, where the state played a major role in the economy during the socialist period.

The high level of participation by the private sector in Myanmar's economy is largely due to the fact that most of the agricultural sector – the nation's largest industry which accounted for 40 percent of real GDP in FY 1986 – has long been categorised as part of the private sector in GDP statistics.

The government decontrolled the trade of key agricultural products in 1987, which had long been monopolised by the state under the socialist regime. Since then, farmers have become able to sell their products to markets after they sell a portion of them to the state. Farmers are now becoming more responsive to the market; they positively react to price incentives from the market. At present, farmers enjoy a relatively greater freedom of management compared to the socialist era.

### **3.3.2 Private sector development**

In contrast to agriculture, some sectors continued to remain largely occupied by state-owned enterprises even in FY 1998. Energy, electric power, communications and social and administration services were almost totally monopolised by the state. The state controlled a substantial share in industries such as forestry, construction, and financial institutions as well. Many of these industries that were monopolised or dominated by the state appear on the list of twelve industries exclusively designated for SEEs. However there exists an exception clause, in that in view of the interests of the state, private business enterprises may be permitted to enter the twelve industries in the form

of joint-ventures with SEEs or in some cases even in the form of pure private ownership. Accordingly, many private companies including foreign ones invested in the twelve industries. Large-scale foreign investment in Yadana and Yetagon for natural gas exploration provides a good example. On the other hand, although the ban on entering industries such as forestry, construction, and financial institutions was lifted, there remain some large-scale SEEs in those industries. This is the very reason why the state's share in such industries remains considerable.

In spite of the remaining entry barriers and other restrictions, the private sector has positively reacted to industrial liberalisation. The participation of the private sector has particularly increased in the areas of mining, construction and financial institutions. As for construction, private construction companies mushroomed during the construction mini-boom, which started in the early 1990's and burst by mid-1997. Some large business groups have been forged from these construction companies. Regarding the financial institution sector, although it had been one of the twelve industries exclusively designated for SEEs, the establishment of private financial institutions was allowed by the Financial Institutions of Myanmar Law, enacted in July 1990. Based on this law, 20 private banks have been established since 1992. The private sector's share in GDP rapidly increased from zero in 1991 (and in years prior) to 30.7 percent in FY 1998. In terms of deposits outstanding, the private banks accounted for 66 percent of total deposits as of the end of 2000.

The share of the private sector also increased in the area of trade, the second biggest contributor to GDP, and in the area of processing and manufacturing, the third largest contributor. All of these figures indicate the private sector's active participation in the national economy. As entry barriers and restrictions imposed on private business are lifted, the participation of the private sector in economic activities will become further enhanced, even in industries that are still monopolised or controlled predominantly by SEEs. Myanmar's private sector is active and sufficient enough to respond to the government's liberalisation policies.

Subsidies to the SEEs which contribute to the fiscal deficit gap, adversely affect sound macroeconomic management and should therefore be reduced. About three-quarters of Myanmar's fiscal expenditures are directed at the operation of SEEs. A sound macroeconomy is also a critical condition for allowing the private sector to operate businesses. Although reforms in the deficit-ridden SEEs were declared by the government of Myanmar, substantial progress was not achieved regarding improving the inefficient management system at such SEEs, while privatisation of SEEs remained virtually stagnated. The ministries and governmental agencies had basically focused their attention on the problems of these SEEs, and they were unable to launch sufficient promotion measures in order to stimulate entrepreneurship of private companies. The government should review the current reform procedures regarding SEEs and reconsider the agenda for



reforms, including setting the privatisation of SEEs as a measure to be executed in the medium run. Incentives and penalties could be introduced to induce managers to operate SEEs more efficiently. In the meantime, the ministries and governmental agencies involved should map out and commit themselves to comprehensive promotion policy measures to stimulate entrepreneurship in the private sector.

One of the unique characteristics of the Myanmar economy can be found in the existence of co-operatives. Co-operatives in Myanmar originated from the enforcement of the Indian common trust fund in 1904, and the present activities of co-operatives are based on the authoritative of the Co-operative Society Law of 1992 and the Co-operative Society Rules of 1998. The share of co-operatives in real GDP as a whole amounted to only 1.9 percent in FY 1998, but their share in the financial institution sector has been remarkable and it increased rapidly during the 1990's, achieving a share of 14.4 percent in FY 1998. The activities of co-operatives contrast well with those of the private sector.

Under the current Co-operative Society Law, a very unique type of co-operative is defined; limited liability co-operatives. These co-operatives are practically ordinary types of 'limited liability corporations' when viewed by the standards of other countries. Co-operatives in the socialist era in Myanmar functioned almost as medium-sized 'private' firms and were almost the only entities that accumulated the business experience of employing relatively large numbers of personnel. When it comes to the matter of business partnership between Myanmar and foreign companies, SEEs and ordinary private companies are generally considered to be counterparts in Myanmar. However, at least for the time being, limited liability co-operatives can also serve as adequate candidates for the business partners of foreign companies engaged in business in the country, including FDI firms. The support and promotion policies of the Ministry of Co-operatives seem to be more rational and effective in comparison with those of the Ministry of Industries (I) and (II) and other Ministries. Thus in order to observe the privatisation process in Myanmar, more attention needs to be focused on the status of co-operatives.

### **3.4 Prospects of further industrial development**

Currently focus has been fixed on the garment industry regarding industrialisation and progress for a market-oriented economy in Myanmar. And as was explained in the previous chapter, agro-based processing industries are expected to be a prospective industrial sector in the near future. But the process of modern industrialisation itself requires parallel development of another industry; that is information and communication technology (ICT)<sup>5</sup>.

Traditional industrialisation follows a certain course of development; from agriculture to

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<sup>5</sup> Refer to World Bank, *World Development Report*, 1998/99."

light manufacturing industry, then to heavy industry, and to tertiary industries, including the service industry. Usually the ICT industry is categorised as a service industry and thus the final step in the course of the industrialisation process. But the software industry could be fostered without following this traditional route of industrial development, because it requires a systematically trained brainpower group, which could be educated without social accumulation of technology.

It is also significant for the sound development of the Myanmar economy to seek higher value-added manufacturing industries and to provide policy supports and cooperation between state and private organisations. However frontier industries, such as the IT industry, might also contribute well towards economic growth in Myanmar.

### **3.5 Conclusion**

In Myanmar, comprehensive solid policies and strategies for industrialisation have not been introduced, and thus the leverage of the Myanmar economy for sustained growth has been quite shaky. The government of Myanmar has striven for privatisation in Myanmar, though its extent also remains insufficient. The progress of privatisation of SEEs and the promotion of strategies for private enterprises is still inadequate. The government of Myanmar should acknowledge the incompleteness of its own support measures for private companies and make additional efforts to decontrol the business system in Myanmar.

Meanwhile the economic and political changes made by the Myanmar government in industrial promotion policies have hardly been adequate in terms of the expectations of the international community. We are highly anxious about the Myanmar government making a hasty regression back to the once failed economic system before the reforms are fully completed and before actual results can be gained. It is strongly recommended that the government of Myanmar sustain and proceed yet further with its privatisation, liberalisation, and industrialisation process, so that it may obtain the real fruits of economic reform. In the market-oriented economy it will be possible for Japan, if necessary, to provide expertise to diagnose the causes of current difficulties (if any) and to prescribe possible solutions, both in technological and organisational matters.

Subsequently the government of Myanmar could proceed with further steps to foster frontier industries, such as the ICT industry, as well as the continuous promotion of manufacturing industries for future economic growth.



## 4. Export Promotion for Myanmar

### 4.1 Introduction

One of the serious economic concerns in Myanmar is the ever-growing trade deficit. Though the Myanmar government has already focused special attention on improving its trade balance, it has not been able to achieve any determinate results. In consideration of the sharp decline in foreign reserves since 1996, Myanmar should sincerely address the issue of export promotion in order to gain foreign currency.

Under the economic “open-door” policies initiated in 1988, Myanmar launched relaxed measures concerning external trade control, such as opening up the import/export business to private companies in the early 1990’s. As a result, external trade activities that had been almost exclusively handled by the state were largely shifted to the hands of private importers/exporters, and transaction values of both exports and imports also expanded rapidly. Even during this “booming” stage, the increase in exports remained quite lacklustre, going from 2 billion kyats in FY1988 to 5.3 billion kyats in FY1995, in comparison with the expansion in imports which rose from 3.4 billion kyats to 10.3 billion kyats over the same period. In the latter half of the 1990’s, even after the Asian Crisis, imports continued to grow rapidly, while conversely, the increase rate for exports became sluggish or levelled off. Thus, the trade gap has been widening contrary to the intentions of the Myanmar government.<sup>1</sup>

Table 4.1 Exports and Imports by Sector

	1990/ 91	1991/ 92	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99	1999/ 00
Exports										
Private sector	45.3%	54.3%	52.0%	62.0%	64.0%	66.0%	77.0%	71.0%	67.0%	77.4%
Cooper- ative sector	0.7%	2.4%	1.0%	1.0%	1.0%	1.0%	1.0%	0.0%	0.0%	0.0%
Public sector	54.1%	43.3%	47.0%	37.0%	35.0%	33.0%	22.0%	29.0%	33.0%	22.6%
Imports										
Private sector	42.5%	54.4%	54.0%	60.0%	50.0%	53.0%	65.0%	74.0%	69.0%	70.3%
Cooper- ative sector	0.1%	0.9%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	0.0%	0.0%
Public sector	57.4%	44.7%	44.0%	38.0%	48.0%	45.0%	33.0%	24.0%	31.0%	29.7%

Source: Central Statistical Organization, *Statistical Yearbook*

<sup>1</sup> However, since FY 2000, the trade deficit significantly reduced according to the CSO data. This is due to the full-fledged export of natural gas to Thailand as well as to curtailment of imports by regulatory measures.

Table 4.2 Trade Balance

		1988/ 89	1989/ 90	1990/ 91	1991/ 92	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99	1999/ 00
Exports (mainly f.o.b)	Million Kyat at the official rate	2,069	2,806	2,966	2,702	3,590	4,249	5,405	5,030	5,487	6,444	6,761	7,100
	US\$ million	320	424	477	431	591	696	917	895	929	1,036	1,082	1,138
Imports (mainly f.o.b)	Million Kyat at the official rate	3,464	3,696	6,027	5,285	6,137	7,852	8,766	10,295	11,778	14,254	16,954	15,846
	US\$ million	545	543	970	842	1,010	1,302	1,414	1,832	1,993	2,291	2,713	2,539
Trade Balance	Million Kyat at the official rate	-1,395	-890	-3,060	-2,583	-2,547	-3,603	-3,360	-5,266	-6,291	-7,810	-10,193	-8,746
	US\$ million	-225	-119	-493	-411	-419	-606	-497	-937	-1,065	-1,255	-1,631	-1,402

Source: Central Statistical Organization, *Statistical Yearbook* and Asian Development Bank (from 1995/96 to 1999/00)

## 4.2 Problems regarding export business in Myanmar

Myanmar's continued lacklustre export situation in the late 1990's was triggered by some rather external factors, including the Asian Economic Crisis of 1997, as well as a politically determined factor, i.e. the economic sanctions imposed by the international community. But the stagnation of export business in Myanmar was caused not only by such incidental/non-economic factors but rather resulted from internally incorporated economic policy problems, the seeds of which had already been sown long before. These can be categorised into the following three different factors; (1) external trade promotion policies, (2) management of import/export systems, and (3) composition of export items.

### 4.2.1 External trade policies in Myanmar

Though international trade business has mainly been transferred to private entities since 1988, the Myanmar government has not yet fully liberalised trade activities. Such activities have been rigidly bound by a mandatory import-export geared mechanism. The government initially employed a series of policy measures based on the "import first" principle. The underlying idea of this principle was to facilitate export activities by allowing exporters to acquire funds through the sale of imported goods in the domestic market. But it became obvious that this mechanism failed to work as a real driving force to increase exports, and instead it ultimately only encouraged imports, mainly due to strong demand for imported goods and remaining inefficient export procedures.

After the Asian Economic Crisis, the Myanmar government converted its trade mechanism to an "export first" approach. The government aimed to hold in check the overgrowing number of imports by permitting importers to trade only within the amount of dollars that were gained by exports in advance. This mechanism alone, however, could not resolve the problem of trade

deficit, and simply served as another distortion that crippled trade activities. It is even presumed to have functioned as a multiplier-acceleration mechanism for import promotion.

Another issue, which is the most crucial one for export promotion in Myanmar, is, as discussed in the Chapter One, reform of the nation's inefficient exchange rate system. In Myanmar varying exchange rates are currently imposed according to monetary purpose. In addition to the official rate (6 kyat/US dollar), there are also the "semi-official rate" for estimation of import duties, and the official FEC rate (currently 450 kyat/US dollar), with different rates being applied to the "bone price" (consigned for imports of essential goods between importers and exporters), the "meat price" (consigned for imports of non-essential goods between importers and exporters) and the "service price" (for domestic dollar denominated earnings), aside from the market cash rate and market FEC.<sup>2</sup> Trading companies are discouraged in their activities because they face difficulties in mapping out an adequate business plan for exports due to the complexity of the exchange rate system. And the gap between the actual market rate and "official rates" (including the official rate, the semi-official rate, and the official FEC) is widening. The complicated exchange rate system has discouraged export business in Myanmar. And as already examined in the previous chapter, Myanmar's macroeconomic stability and soundness cannot be established without rationalisation of the exchange rate system. Also without macroeconomic stability and soundness, export promotion measures applied in Myanmar will not fully function.

Furthermore, the current taxation on trade activities in Myanmar is not appropriate for export promotion, rather impedes the growth of exports. The government of Myanmar introduced "export duties" in 1999 which levy a 10 percent duty (an 8 percent commercial tax and a 2 percent income tax) on the total export sales of ordinary items (excluding items designated for export promotion), in addition to a corporate tax (formally 30 percent). Moreover, foreign companies in Myanmar have reported that the Myanmar government applies an informally determined "corporate tax" on their export earnings, the rate of which is not made public to the trading companies. Due to this "informal corporate tax" that is based on 'deemed' kyat-based export earnings and the arbitrarily determined tax rate, trading companies cannot estimate the exact amount of their assessed corporate tax even long after export business transactions have been completed.<sup>3</sup> It is clear that this kind of taxation benefits the government, in that it allows it to collect additional tax revenue to compensate for the decline in corporate tax revenues and also enables it to control dollar accounts. The magnitude of actual effect of these export duties and "informal corporate tax" on export activities cannot be estimated due to the lack of data, however this kind of excessive taxation poses a barrier to the activities of traders and squeezes out their

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<sup>2</sup> For details refer to the report written by the Trade and Industrial Policy Working Group.

<sup>3</sup> For details refer to the report written by the Trade and Industrial Policy Working Group.

profits from the export business. A more serious effect of these export duties is that they hurt the price competitiveness of Myanmar products, because exporters must add a certain amount to their prices in order to compensate for the loss in profit. In the end, export business becomes sluggish and the source of export duties itself also shrinks

Another area of Myanmar's past trade policies that has been conspicuous is its underdeveloped promotion measures for export-oriented industries. The government of Myanmar had previously announced its intention of promoting exportation by diversifying export items and by developing new export commodities. However except for a few industrial areas, like the apparel industry, such initiatives have failed to materialise as comprehensive industrial promotion. Public provision and channelling of necessary information on manufacturing technology, marketing and distribution is not institutionalised for export-oriented companies, and preferential treatment for such companies is also limited and inadequate.

#### **4.2.2 Management of trade system**

Throughout the 1990's, the government had attempted to eliminate trade deficits and to stabilise domestic commodity prices mainly by controlling import volume through the above mentioned mechanisms as well as through other rules and regulations, such as designating import restricted items and setting import quotas. Unfortunately, these measures did not achieve their initially expected results, and instead contributed to the expansion of trade gaps by functioning as disincentives for exports.

The import volume controlling regulations served not only to distort trade business but also generated more serious concerns such as hindering possible quality improvements of products and stunting growth of the industry as a whole. For a late-comer industrialising nation like Myanmar, the introduction of foreign technologies, machineries and tools is crucial for economic development. However the import restricting rules and import quotas that exist in Myanmar often impede the introduction of necessary, inexpensive machines and tools (mostly used) from abroad.

Another thing which has frustrated and highly discouraged importers and exporters is the frequent changes made to trade rules and trade-related directives/orders. This is particularly due to the lack of adequate advanced notice and the dearth of opportunities to consult with the government to understand the purposes and background of the policy changes. Because of this, the Myanmar government has been unable to win confidence and reliability in the international market, which has also affected the competitiveness of Myanmar's export goods. Once a country attains notoriety in the international market for being an unreliable trade partner, it is quite difficult for it to gain back its reputation and credibility which are essential for trade.

It is strongly recommended that the Myanmar government reconsider its trade policy priorities. Such policies should be shifted away from controlling import volume through import-export geared mechanisms and instead be focused towards genuine export promotion. Success in stable export promotion policies and export industry fostering measures is the only option for the government to resolve its trade deficit.

#### **4.2.3 Composition of export items**

Myanmar has traditionally exported primary commodities and low-value-added goods, such as agricultural products including rice, lumber, and minerals, since it enjoys abundant natural resources and fertile land. The conventional measures implemented in Myanmar to cope with the trade deficit have mainly comprised increasing the volume of existing export items. Such type of measures used to be successful. The recent major export earnings gained through sales of offshore gas to Thailand are proof of the validity of such symptomatic treatment measures. But the fact is that exported primary commodities from Myanmar have gradually been losing their international competitiveness due to their lower quality, meaning that simple export volume expansion measures can no longer be effective without additional quality improvements of export goods.

A noteworthy change in the composition of export items in the 1990's was the rapid growth of garment exports. Actually, it is hoped that Myanmar will develop and expand its apparel exports in order to eliminate trade gaps. However the present situation regarding export-oriented garment industries in Myanmar is that it remains difficult for further growth to take place. Myanmar has potential in that it is a resource-rich country with abundant human resources that have yet to be sufficiently developed. There are many possibilities for developing new export items by fully utilising the advantages that Myanmar commands, in order to gain higher profits.

### **4.3 Recommendations – Shift to genuine export promotion in the market economy**

There are a considerable number of recommendations for the Myanmar government regarding the revitalisation of its export business which is expected to stimulate the economy as a whole. However this section deals with only several of the most crucial points that have been selected concerning policy and institutional improvements.

#### **4.3.1 Removal of policy/institutional obstacles**

Under the present fiscal conditions in Myanmar, it is likely unrealistic to expect that the introduction of export subsidies will promote export business, even though many private trading companies may desire them. Even without financial supports, there are many other things that



can be done to promote exports.

First of all, the Myanmar government should declare its firm commitment to the promotion of market-based export business, by implementing policy and institutional reforms; i.e. the removal of restrictions on some export items and opening them up to the private sector, establishing public-private joint committees, and unifying the currently complicated official exchange rates into a single rate (the actual market rate). Exchange rate reform is critical not only for export expansion but also for sound macroeconomic management.

Rationalisation and streamlining of the procedures in the import/export system, including the law-related area, must be undertaken immediately, because some amount of time is required to complete systematic reforms while maintaining consistency. In any case, the import restriction list should at least be revised as soon as possible, to enable domestic industries to have access to foreign second-hand machines and to improve their quality and productivity. Other reforms such as gradual abolishment of the export tax and introduction of US dollar-based import tariffs, revision and minimisation of the export/import license system, phased elimination of quantitative import restrictions on essential/non-essential goods, and the abolishment of registered prices should also be initiated without delay.

In the meantime, a special public agency should be established to encourage external trade of Myanmar's commodities and to support the fostering of export industries.

#### **4.3.2 Development of exportation infrastructure**

In order to stimulate export business and overall external trade activities, the establishment of an efficient and rational financial system is essential. Under the present banking system in Myanmar, only two public banks are allowed to deal in foreign currencies and the volume of transactions for imports/exports has expanded beyond their capacity. Rules and actual service related to L/C opening and remittance require a substantial amount of improvement.

Therefore human resource development is also necessary in order to provide adequate administrative services and to manage an export-friendly trade system. In the implementation of export promotion policies, public officers need to establish transparent and comprehensive trade rules and supervise trade business activities, and they must also carefully and patiently coordinate/intermediate external trade information among the concerned parties. The role of administrative staff in the area of external trade is very significant.

#### **4.3.3 Development of items with growth potential**

As mentioned above, Myanmar has abundant natural resources and low-cost/high-potential human resources. So, it is quite natural for the country to utilise its given advantages in order to

promote exports. The first step for this should be the implementation of special measures to enable items with growth potential to be introduced into the export market, by setting lower export tariffs, and exempting import value caps etc.

Since its independence, Myanmar has been fortunate and has managed to run its economy without having to strategically and comprehensively introduce/develop higher value-added manufacturing goods to expand exports. But this means Myanmar has wasted some potential growth opportunities. Newly promoted items must be carefully developed for export purposes, taking into consideration Myanmar's current advantages. The government of Myanmar should select priority industrial sectors for export facilitation and set up systematic supports for promising industries with regard to technological improvement, marketing, and locating business opportunities. The study team has come up with specific "major growth potential items" from among existing exports as well as "promising new export items" as follows:

- 1) Major growth potential items; prawns, refined copper, footwear, pulses and beans, and apparel.
- 2) Promising new export items; kenaf, castings, recycled products from old rubber and wood, laminated wood, and electronic parts.

The apparel industry, which has increasingly been contributing to export earnings since the mid-1990's, has yet to fully utilise the potential available in Myanmar and there remains great room for quality and productivity improvements in the industry.

For the development and introduction of new export items, foreign investment with technological support is very important. The government is requested to prepare as much support and assistance as possible for foreign investment, including rehabilitation of industrial zones.

Another promising export promotion measure is to hold "trade fairs" or expositions which can introduce Myanmar's products in the global market. After World War II, the Japanese government, in cooperation with business organisations and the Japan Chamber of Commerce and Industry, chartered seagoing vessels and used them as "trade fair ships" to exhibit Japanese trade items and they made special voyages to various regions. These activities certainly contributed to the promotion of Japanese goods in the world market. Ordinary trade fairs and expositions within the country were also actively held in Japan, for the purpose of inspiring manufacturers and traders to introduce their export-oriented products, and to induce competition among them to improve the level of goods.

In Myanmar, the Ministry of Co-operatives has already organised trade fairs to promote Myanmar goods generated by co-operatives. Other Ministries, including the Ministry of Industry (I) and (II), are strongly recommended to systematically organise various expositions and trade fairs to actively introduce Myanmar goods both at home and abroad.

#### **4.4 Conclusion**

It is true that the types of trade policies which impose import restrictions and import quotas according to export amounts beforehand etc. are not very unique in the history of Asian countries, since there has always been a shared fear of being overwhelmed by an influx of imported goods in domestic markets and the possible threat this would have on local industries. Myanmar can be counted as one of these countries. But history also tells us that state control over each and every import item and over the volume of imported goods never works out as is originally intended, and it has even been harmful to the healthy development of national economies.

Vietnam, for example, abolished most of its import quotas in 1998 and rationalised other import impeding regulations following the Asian Economic Crisis in order to revitalise its economy. And it also plans to abolish export quotas by the year 2005. This is in sharp contrast to the behaviour of the Myanmar government during the same period. The results achieved by Vietnam and Myanmar have been mirror opposites of each other. And although the pace of export expansion in Vietnam has been recovering to the level prior to the Asian Crisis, in Myanmar levels have remained sluggish. Another distinguishing point is that in Vietnam the government declared its firm commitment to export promotion and launched various export supporting measures based on market-oriented policies. And they have been successful in winning a necessary amount of confidence and trust from the international market.

Therefore, it is recommended and requested that the government of Myanmar shift away from interventional controls on import/export business and move toward policies that are premised on the principles of free trade, in particular free export, based on market mechanisms. This should be done through the creation of a rational trade environment that is authorised and supported by the government.

By promoting export business, the Myanmar government will be able to gain more benefits and advantages than ever before.

## **5. On the Importance of Foreign Direct Investment in Myanmar**

### **5.1 Introduction**

Unlike other ASEAN countries, Foreign Direct Investment (FDI) after World War II began very late in Myanmar, and FDI was introduced for the first time only in 1988 after the government formulated the Foreign Investment Law. In the official statement of the Myanmar government at that time the necessity of FDI inflow into the country was underlined. It was obviously mentioned in the statement that FDI would serve as a driving force in the nation's economic development, considering current world economic circumstances surrounding Myanmar.

Myanmar experienced a mini investment-boom in the mid-1990's. However shortly after the opening of investment boom in the country, the Asian Financial Crisis broke out in 1997 and international investors lost drive to invest into Asian countries. In Myanmar the financial sector was damaged only little by 'contagion' of the Asian Financial Crisis, but foreign investment into the country became drastically constricted. The aftermath of the crisis affected Myanmar differently compared with other ASEAN countries. Myanmar has continued to be plagued by ever-shrinking FDI since the Asian Crisis while other ASEAN countries have already gotten back on the recovery track regarding FDI inflow. Such gaps occurred basically because the investment environment related to FDI in Myanmar has not yet reached a sufficient level and international investors, being more prudent in investment after the Asian Crisis, are reluctant to commit FDI projects in Myanmar. FDI companies in Myanmar have languished by state interventions at various stages of business as well as in many business aspects. Revision of systems and policies for FDI therefore is immediately required.

FDI is one of the most significant factors for economic growth and development in Myanmar and the government of Myanmar is recommended to review its inconsequent, conflictive and unreasonable policy measures and institutions regarding FDI business in order to win confidence among international investors.

### **5.2 Status of FDI in Myanmar**

After the opening of FDI via the enactment of the Foreign Investment Law in 1988, Myanmar for a time experienced a short-term explosion of FDI inflow from 1994-97, particularly a pronounced increase in FDI (approval base) in 1996. This FDI boom in the country suddenly ended in 1997 and the flow of FDI has continued to shrink considerably ever since.

Table 5.1 Approved and actual foreign direct investment inflow to Myanmar

(US\$ million)

	1995/96		1996/97		1997/98		1998/99		1999/2000	
	Ap- proved	Actual	Ap- proved	Actual	Ap- proved	Actual	Ap- proved	Actual	Ap- proved	Actual
Solely foreign- owned venture	453.7	210.7	1,374.6	310.5	518.7	220.5	32.4	126.5	34.1	57.1
Joint venture	181.3	106.6	1,031.8	267.1	316.3	290.3	22.0	204.8	2.7	117.1
Production										
Sharing	32.2	0.3	407.8	3.1	177.9	368.0		352.3	21.3	130.0
Other	-	-	-	-	-	-	-	-	-	-
Total	667.2	317.6	2,814.2	580.7	1,012.9	878.8	54.4	683.6	58.1	304.2

Source: Directorate of Investment and Company Administration

The drastic decline in the volume of approved FDI into Myanmar was no doubt largely triggered by the Asian Crisis and the international economic sanctions imposed against the present military government. However those events were not the entire causes of sudden fall in FDI volume and the real cause of the current continuous stagnation of FDI inflow in Myanmar can be found elsewhere.

The largest group of foreign investors in Myanmar is ASEAN investors.<sup>1</sup> Although ASEAN member states are not strictly in conformity with international economic sanctions, even those ASEAN investors are now rather reluctant to invest in Myanmar. That is, the sluggish FDI situation in the late 1990's in Myanmar was not just due to external factors such as inactive global investment activities or economic sanctions, but instead was caused by internal obstacles.

In terms of type of industry, the oil & gas sector principally led the investment boom in Myanmar. FDI in the manufacturing sector accounts for 22 percent of the cumulative FDI and it becomes the second largest industrial sector which attracted FDI. Above all, FDI in garment industries is currently the most promising investment sector in Myanmar. Although Myanmar's economy is largely led by the agricultural industry, FDI in this sector is very small.

### 5.3 Problems of FDI in Myanmar

#### 5.3.1 Judicial revision

Although the Foreign Investment Law of 1988 was significant in opening the door to FDI inflow in Myanmar, it provided only a basic framework for foreign enterprises to establish business entities in the country and the Law contains a certain amount of imperfections. For instance,

<sup>1</sup> For details refer to the report written by the Trade and Industrial Policy Working Group.

Japanese companies have often been baffled by the inadequacy of administrative litigation rights regarding investment approval that is inherent in articles 30 and 31 of the FDI law<sup>2</sup>. These rights are internationally recognised as the essential requirements for FDI-related businesses. Such kinds of imperfections in the Foreign Investment Law create a myriad of problems at the start-up stage and even during the operational stage for FDI companies in Myanmar.

It has been observed that FDI companies are not receiving a sufficient amount of legal and judicial protection, and there is constant frustration regarding the insufficient level of transparency and the instability of the Myanmar legal system. Also, there appear to be a number of contradictions between the purpose of the FDI Law and the purpose of its enforcement.

FDI is normally a relatively stable business commitment in a recipient country based on the long-term business plans of respective investment entities. FDI firms are thus quite sensitive to the stability and credibility of the country's judicial system which is authorised by the government. Such a system must serve as the fundamental basis and anchorage of the market-oriented economy and the business activities of FDI companies.

### **5.3.2 Instability of the institutional environment**

Other serious and adverse problems concerning foreign direct investment in Myanmar include the unstable institutional and policy settings implemented for FDI. Most noticeable is the sudden power shift in decision-making that occurred in the mid-1990's from the Myanmar Investment Committee (MIC) to the Trade Council (TC), which frustrated many existing FDI companies in the country because it produced unnecessary redundancy in decision-making and added intransparency to the process of policy implementation. Obviously the inclinations of the TC, a higher organ to the MIC, strongly affected the policy-making. It is highly likely that the sudden decline in inflow of approved FDI in 1997 and the sluggish FDI situation ever since was the result of excessive rejections of FDI applications in favour of the TC. Cumbersome complications in FDI management authority in Myanmar are not limited to the MIC/TC relationship but also involve other state agencies, including the Directorate of Investment & Administration (DICA) and the Foreign Capital Evaluation Committee (FCEC). Companies are considerably hampered from entering into business in Myanmar because registration, assessment of investment projects, and final decisions for approval are all processed and implemented by different state agencies.

### **5.3.3 Frequent changes in policy**

Problems continue to be seen even after FDI companies are established. Many existing Japanese FDI companies have suffered from frequent and sudden changes in FDI policies and

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<sup>2</sup> Interviews with Japanese FDI companies which operate their business in Myanmar.

regulations, which sometimes violate the Foreign Investment Law itself. In some cases, the sudden and irrational change of rules or regulations, including industrial standards and gauges, has destroyed entire transactions and investment at FDI companies.

One Japanese company was suddenly informed of a crucial amendment in standards/regulations regarding the production of galvanised steel plating, which ultimately meant that their initially planned and previously approved products no longer were able to comply with the said regulations. And also, products complying with the “new” standard would not meet the demands of the company’s clients whatsoever. As a result of this unreasonable ex-post alteration of the rules, the company’s entire equipment line installed at their Myanmar plant became unusable and ended up going to waste. Such examples show how FDI companies have thus been considerably discouraged from investing in Myanmar and have lost confidence in the nation, and have effectively been withdrawing from business in Myanmar.

It almost appears as if the TC has been trying to bounce out foreign-owned companies from Myanmar.

#### **5.3.4 Underdeveloped financial systems**

Inadequate financial systems and schemes also discourage FDI companies from operating businesses in Myanmar. This includes the monthly cap imposed on the amount of overseas remittance. FDI firms exist to raise money in the receiving state and to transmit their profits back to their home country. Remittances which have been restricted to unreasonably small amounts must be increased to higher levels in order to satisfy the requirement of FDI companies.. These kinds of restrictions clearly reveal the immature state of Myanmar’s financial institutions in terms of foreign exchange control.

Raising working capital and obtaining approval for incremental capital or borrowing increases in kyat are other financial concerns that FDI companies face. There are also monthly caps and restrictions in place for such transactions, which cripples FDI activities. Aside from the problems of these regulations and restrictions, FDI companies are uncomfortable with the fact that Myanmar banks are inexperienced when it comes to credit accommodation based on the feasibility of a business plan. For foreign companies, indirect finance is the only way to raise necessary funds for business in Myanmar since the nation’s stock market is almost negligible. It is thus crucial for FDI activities that the banking system in Myanmar be made more rational and efficient.

#### **5.3.5 Shortage of infrastructure**

In order to attract FDI companies, the provision of basic infrastructure is an inevitable requirement. Myanmar has conventionally invested huge amounts into its irrigation system,

however other infrastructure development has remained relatively shelved. Electricity, water supply, sewage systems, roads, train networks and ports/harbours still continue to be underdeveloped, although airports and some road networks were constructed during the investment boom of the mid-1990's. Other essential types of infrastructure must also be supplied for FDI firms. In Myanmar, 29 Industrial Zones (IZ) already exist, and modern private manufacturing companies and certain State-owned Economic Enterprises (SEEs) have entered such IZs. Despite this, infrastructure within these IZs remains quite poor, and the status of infrastructure development varies from IZ to IZ. Existing FDI companies in the manufacturing sector have located in such IZs because they were unable to find suitable alternatives, and they are actually not satisfied with the quality level of IZs whatsoever. Rehabilitation of existing IZs is immediately necessary in order to subsequently upgrade them to Export-Processing Zones (EPZs), and therefore top priority should be given to infrastructure development of IZs in Myanmar<sup>3</sup>.

## **5.4 Immediate action to be taken**

### **5.4.1 Judicial revision**

Before considering the introduction of new laws/regulations for FDI, thorough revision of the existing Foreign Investment Law is required in order to provide legal consistency and completeness. Existing trade regulations and restrictions, such as import/export licensing, import quotas, and lists of prohibited export items, must be relaxed in favour of FDI companies for the purpose of facilitating their activities in Myanmar. Above all, a clear definition of the role of FDI in Myanmar must be established in the context of the Foreign Investment Law. A lack of confidence and trust in the laws/regulations that are directly applied will cause the inflow of FDI into Myanmar to continue to remain stagnant.

### **5.4.2 Revision of administrative structure**

According to the governing law for FDI, the MIC is designated as the authority for delivering FDI policy and other agencies are supposed to act in line with its decisions. The recent confused situation where the MIC's authority has been weakened and the TC has suddenly been empowered regarding FDI matters is quite unreasonable according to the law. The restructuring of FDI-related organisations and the re-vitalisation of the MIC are critical steps in winning back institutional confidence from FDI firms.

Subsequently, it would be optimal to examine the establishment of a special authoritative body to operate the Export Processing Zones (EPZs) which are likely to be built in the near future to promote export-oriented FDI. Before that, however, Myanmar should focus its efforts

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<sup>3</sup> The definition of an "EPZ" is provided in the following chapter.



on establishing transparent and consistent authority for FDI management by reinforcing coordination capacities with the concerned agencies for FDI.

In any case, improvement of the administrative capabilities of FDI-related authorities must be emphasised. For the stages of policy-making, assessment of investment projects, and the delivering of preliminary/follow-up services for FDI firms, more adequately trained human resources are required.

Public FDI promoting organisations should actively engage in information gathering and the pairing of investment partners. The Ministry of Co-operatives has already been engaged in such activities for co-operatives. Other Ministries related to FDI are also recommended to organise similar public support measures for domestic/foreign firms.

#### **5.4.3 Revision of legal framework**

On-going revision of governing law and certain amendments of orders/notifications are necessary to improve the environment regarding FDI, however, unnecessary frequent policy changes without adequate explanation well in advance should be avoided, since they will only be harmful to FDI firms. And existing regulations, orders and notifications must be reviewed in the context of the Foreign Investment Law.

So far, joint venture partnerships have basically been intermediated between foreign ventures and state-owned enterprises and, in some cases, private firms. But foreign-owned companies should also consider co-operatives when looking for promising new candidates for partnership. Co-operatives in Myanmar have been developed in a unique way, and some of them are, in reality, equivalent to “limited liability companies.” Under the Ministry of Co-operatives there is a specialised public corporation which promotes exports and foreign investment, and its industry promotion policies are much more rational and effective compared with those of other Ministries related to industrial promotion. Thus, in the revision of existing FDI regulations, the role of co-operatives should be reconsidered for the promotion of FDI.

#### **5.4.4 Reforms in financial system**

The financial system as a whole is underdeveloped in Myanmar. The most serious problems in the banking sector in Myanmar are: the insufficient ability to manage overseas remittance based on business performance, and the inability to accommodate companies with loans according to the feasibility assessments of their business plans. It will take a considerable amount of time to review and reconstruct the entire financial system. Immediate necessary reform for FDI promotion should focus on rationalisation of the remittance system and the relaxation/removal of fund-raising restrictions. Regulations on foreign currency/kyat accounts must also be abolished.

If EPZs are able to be established in the future, further financial reforms may be required to open an off-shore banking system etc.

In order to rationalise and upgrade/improve the banking sector in Myanmar, foreign banks in Myanmar should immediately be endowed with the ability to conduct business operations as full-scale financial institutions. Without stimulation and contribution from foreign banks, including their branch offices, the quality of operations at Myanmar banks will continue to remain greatly delayed.

#### **5.4.5 Provision of essential infrastructure**

By selecting several of the best IZs, the government could intensify and concentrate its immediate investment on infrastructure for promotion of FDI. It is usually a sound idea for a government with serious fiscal concerns to utilise a BOI scheme to enable construction of private power plants in IZs, however a BOI scheme requires an established and highly sophisticated financial system beforehand in order to attract foreign private participants. To achieve the earliest rehabilitation of existing IZs in Myanmar, this kind of financial scheme will not be adequate. It is possible for the government of Myanmar to acquire the funds to rehabilitate a single (or possibly two) IZs which are currently the most developed ones.

If IZs are upgraded and improved with careful rehabilitation measures, they could also be subsequently converted into EPZs to promote export-oriented FDI. In many developing countries an appropriate location (generally in a major urban area with suitable transport) of EPZs was one of the most critical factors for EPZ success<sup>4</sup>. But in Myanmar, location is not very crucial for the selection of a specific IZ as an “EPZ” in order to promote FDI, because most of locations of IZs in the country already comply with the requirement. The significant factor is the provision of adequate infrastructure within the zones and proper institutional/policy supports for FDI business.

### **5.5 Concluding remarks**

Other countries in Asia had to wait many years after the initial introduction of FDI in order to enjoy “investment booms.” They also exerted great efforts to adjust the conditions for FDI during the early trial periods in 1970s. They were aware of the importance of FDI in their economies regarding job creation, contribution of export income in gaining foreign currency earnings, and the technological/managerial inputs into domestic industries. But establishing the appropriate environment for FDI was not an easy task.

Vietnam was able to save a certain amount of time in establishing favourable conditions for FDI in comparison with its neighbouring countries. However it still had to struggle with internal

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<sup>4</sup> World Bank, *Export Processing Zones*, Policy and Research Series 20, 1992.

inter-ministry discord and it experienced a large decline in FDI following the Asian Crisis. Investments have already started to return to Vietnam due to the continuous revisions made in FDI law and the streamlining of conditions/regulations which benefit FDI firms.

It is recommended that the government of Myanmar reconsider the recently distorted FDI management system under the TC, and revitalise the MIC in line with the Foreign Investment Law. Removal and amendment of FDI-discouraging regulations/orders must be implemented as soon as possible. Above all, rational and stable FDI policy management is the best measure for winning the confidence of existing and candidate FDI firms in Myanmar.