

JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)
THE GOVERNMENT OF THE UNION OF MYANMAR

Myanmar-Japan Joint Study
for
Economic Structural Adjustment in Myanmar

Trade and Industry Sector

FINAL REPORT
[Summary]

February 2003

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Source: Bank of Japan (for USD – Yen conversion)

PREFACE

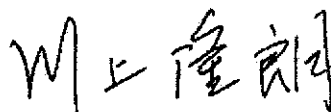
This report describes the results of the study on the Trade and Industry Policy within the framework of the project titled *Myanmar-Japan Joint Study for Economic Structural Adjustment in Myanmar*.

JICA organized a study team led by the Nomura Research Institute, headed by Mr. Kenji Shiino. The study team visited Myanmar eight times between July, 2001 and February 2003 to hold a series of discussions and conduct several field surveys with the kind support of relevant organizations in the country. It should be noted that this joint research was achieved through mutual understanding and close cooperation of Myanmar and Japan's task force members (Leader, Prof. Masahiko Ebashi, Meiji Gakuin University) and the study team.

I hope that this report, including its useful suggestions, will be used, with due consideration to confidential natures of the contents, practically not only by JICA's future aid programmers but also by the Government of Myanmar, organizations, officials and experts concerned to contribute to further development of the Myanmar.

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

February 2003



Takao Kawakami

President

Japan International Cooperation Agency

February 2003

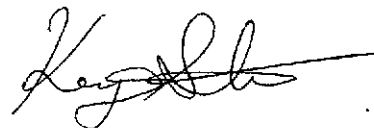
Mr. Takao Kawakami
President
Japan International Cooperation Agency

Letter of Transmittal

We, the members of the JICA Study Team, hereby submit the final report of "Myanmar-Japan Joint Study for Economic Structural Adjustment in Myanmar."

The report sets forth the proposed measures for policy reform in the trade and industry sector, which forms a part of the above-mentioned study. Concretely, we have chosen i) export promotion, ii) the promotion of foreign direct investment and iii) the development of private enterprises (manufacturing) as the priority issues in the trade and industry sector in formulating a long-term industrial vision and industrialization strategy for Myanmar. It presents master plans for export promotion and the promotion of foreign direct investment as well as measures for the development of private enterprises (manufacturing). For the execution of these plans and measures, the study also includes proposals for i) infrastructure development, ii) location of industries, and iii) for the development of the industrial sector, human resources development. In addition, development scenarios by industry are presented for the industries which, in our opinion, Myanmar should nurture as its strategic industries. Since the garment- and footwear-manufacturing industries are judged to be among the most important strategic industries, this study presents master plans for their development. We are convinced that these diverse policy proposals will make significant and important contributions for the promotion of economic structural adjustment, expansion of the roles of private enterprises in manufacturing and the development of a wide range of industrial sectors in Myanmar.

We are deeply indebted to the personnel at Japan International Cooperation Agency, the Ministry of Economy, Trade and Industry and the Ministry of Foreign Affairs in Japan and all members of the trade and industry sector task forces in Japan and Myanmar for their invaluable advice and support. We wish to thank the many researchers in Myanmar who have conducted part of this Myanmar-Japan joint study in their home country.



Mr. Kenji Shiino
Leader
Trade and Industry Sector
Myanmar-Japan Joint Study for
Economic Structural Adjustment in Myanmar

Executive Summary

The Trade and Industry Sector Group (Consulting Group) has conducted various studies (primarily on the industrial sector) in Myanmar and its neighboring countries and discussions and joint studies with task members in Myanmar for the formation of an industrial vision and industrial development strategy (including the location of industries and infrastructure and human resources development for the manufacturing sector) and the preparation of master plans for attracting foreign direct investment (FDI), the development of private manufacturing industries and export promotion, and has arrived at its policy recommendations. The following is a summary of the portion of study conducted by the Consulting Group.

- Endowed with abundant labor and agricultural, forestry and fisheries resources and mineral energy and tourism resources; occupying a strategic location in a high growth region of Asia sharing its borders with giant China and India; and having, as a late-starting developing nation, the possibility of leapfrogging other nations amid global technological innovations, Myanmar has the potential to develop into a major industrial nation in the ASEAN. It is expected that the progress in regional unification as represented in AFTA and plans for a free trade agreement between the ASEAN nations and China will heighten the merit of Myanmar's strategic location.

On the other hand, Myanmar is currently under economic sanctions by the advanced, industrialized nations and the realization of Myanmar's economic potential will depend largely on when and if such sanctions will be lifted. While a number of scenarios are possible, if the sanctions are lifted soon and if the government of Myanmar implements necessary policy reforms, it is possible to draw an industrial vision in which "the status as a newly industrialized nation will come in sight for Myanmar" by 2020. Then, the development of industry will have made progress and it is possible that per capita GDP will have increased to US\$1,500-2,000 from the present US\$200-400 (estimated); the ratio of the industrial sector to GDP will have risen to approximately 35% from the present approximately 10%; and that of manufactured products to total exports will reach 60%.

While the share of the industrial sector in GDP is over 40% in Thailand, Malaysia and Indonesia, that in Myanmar is only approximately 10%. The slow development of the manufacturing sector in Myanmar can be attributed to long vicious cycle, which has resulted from the combination of the effects of domestic policy factors and foreign economic sanctions. The policy factors are characterized by i) the delay in the development of an environment conducive to a market economy, ii) an inward-looking

economic policy which has emphasized import substitution, and iii) inadequate levels of transparency and continuity of policies and efficiency of the government. This report suggests concrete reform measures to correct these shortcomings. They include, for example, phased reform in the so-called export tax of 10% and the launching of an aggressive policy for attracting FDI which is equal to that in the neighboring countries. Prompt policy responses are necessary in a broad range of policies.

- It is especially important to implement priority strategies in stages and change the role of the government in its industrial development strategy to close the gap between the development potential of the economy and the present low level of industrial development in Myanmar. Necessary measures include i) building of a market economy structure that is led by the private sector; ii) outward-looking economic policy that is geared to the promotion of exports and FDI; iii) diversification of the industrial structure; iv) strengthening Myanmar's advantage in the location of industries; v) shifting the role of the government in industrial development to one that will encourage competition among enterprises and adopting a policy that will indirectly support such competition; and vi) the creation of a system that will support the shift of industrial policy framework in the area of knowledge. In the short term (i.e., from 2003 to 2005), phased implementation of such priority strategies as the introduction of FDI, the development of private enterprises, and an improvement of the international balance of payments is suggested.
- Myanmar's strategic industries should be chosen from the perspective of identifying the industries that will propel the industries as a whole, such as "labor-intensive, resource-intensive industries" and "agro-based industries" in which the country already has a comparative advantage, and in terms of the "possibility of utilizing foreign capital" and "raising the industries to higher levels in the medium- and long-term." In the short term, the development of export-oriented industries is important to end the vicious cycle stemming from a foreign exchange shortage. Specifically, such industries include garment- and footwear-manufacturing, assembly of electronic products, mineral resources-related industries and fisheries and wood-processing industries. If the management and technological capabilities are enhanced, food processing also has large growth potential and should be nurtured as a strategic industry. Industrial development should start with simple labor-intensive industries and then identify more advanced, labor-intensive industries, such as electronic parts industry, low-end machinery manufacturing and plastics and material industries as strategic industries. New industries, such as computer software, should also be nurtured.

- The decision-making on and launching of the improvement of the investment environment to attract FDI on a large scale are the sooner the better. The FDI policy to be implemented soon does not necessarily entail large fiscal burden to the government. In the short term, we suggest launching of a series of policies, including the creation of Myanmar Economic Zone Authority (MEZA), which will play the leading role in attracting FDI; enactment of ministerial directives concerning special economic zones (SEZs); and the development of a model SEZ. Since Myanmar does not yet even have export processing zones (EPZs), we may be able to go as far as to say that foreign companies are not yet even contemplating Myanmar as a possible host for their investment. The following six items are policy suggestions which should be implemented as soon as possible.

1. Formulation of a Special Economic Zone Act or ministry directives
2. Early dissolution of disincentive measures
3. Organization of a Myanmar Economic Zone Authority (MEZA, preliminary name)
4. Privatization of electrical power limited to the SEZ
5. Development of SEZ with a one-stop service function
6. Admission to the ASEAN-Japan Center (FDI promotion)

- As typically demonstrated by Vietnam's success in forming its economic foundation and expanding the scale of its economy in recent years through its policy to attract FDI and promote exports, it goes without saying that a dramatic expansion of Myanmar's exports is closely tied to the introduction of FDI. In addition to the issue of the introduction of FDI, a large number of policy priorities and problems exist in Myanmar concerning export promotion. The following six items are the concrete measures which should be taken as soon as possible.

1. Establishment of a government and private export promotion joint committee sponsored by the prime minister.
2. Abolishment of the so-called export tax (commercial tax and income tax) and the provisional introduction of import surcharge and special import surcharge accounts.
3. Opening up exports to the private sector starting with sesame (the steady opening up of restricted export items to the private sector).
4. Abolishment of export and import licenses and the introduction of a "negative list" in exceptional cases.

5. Gradual abolishment of restrictions on dollar imports for the purpose of “trade first,” but not for “exports first” or “imports first” and provisional introduction of a foreign currency allocation system.
 6. The prior introduction of special export processing zones.
- With respect to export promotion, an examination by item shows that there are items that should be opened further to the private sector or that are competitive in export markets and should be newly designated as export promotion items. They include sesame, sesame oil and copper cathodes, just to name a few. The opening of rice and sesame exports to the private sector is likely to dramatically improve Myanmar’s trade balance. The government makes deep interventions in exports by the private sector through the control of exports themselves, price controls and the exchange rate. The government should reduce its intervention, such as the application of inferior exchange rates to the sesame and garment industries and price controls on rice and fish, in the exports of domestic products that are competitive in export markets; enhance export incentives for the private sector; and work to increase exports.
 - The government of Myanmar has been promoting the development of private enterprises since the second half of the 1980s. However, the efforts to promote the development of private enterprises (manufacturing) are facing many problems due to the deterioration of the fiscal balance and foreign exchange revenues resulting from the Asian currency crisis of 1997, requiring further efforts to attain the government’s objectives. Today, with the exception of some large enterprises in the garment, beverage, footwear and wood processing industries, most of private enterprises in Myanmar are small and medium-sized enterprises (SMEs). In the master plans for the development of private (manufacturing) industries, the macro structure (GDP composition, the number of registered enterprises, the scale of enterprises based on the number of employees, etc.) was analyzed through statistical analyses, followed by the identification of micro problems and priorities (power shortages, shortages of raw materials and parts, difficulties in fund-raising, shortages of information, various problems, including the cumbersome export and import system, etc.) through questionnaire and interview surveys. Policy proposals by industry (export-orientation, import substitution, supporting industries, rural industries, etc.) and policy proposals for SMEs (a redefinition of SMEs, the creation of the government bureau for SME promotion, an improvement in company registrations, the enhancement of the functions of chambers of commerce and industry, technological and technical training, measures for the creation of cooperative businesses, measures for industrial land, SME

financing, etc.) were then prepared based on the outcome of these studies. As concrete examples of policy proposals by industry, the study has formulated development strategies for the garment and foot-wear industries.

- With respect to human resources in the industrial sector, which are one of the propellers of industrial development, there are quite a few problems. They include: i) quantitative and qualitative shortages of skilled labor, ii) an absolute shortage of human resources with technological and technical capabilities, iii) a shortage of opportunities for management education for managers of PMIs/SOEs (Private Manufacturing Industries, State Owned Enterprises), and iv) a shortage of business management capabilities. Thus, we suggest the implementation of the following three priority policies.

1. The establishment of Advanced Vocational Training Centers (A-VTC) and accelerated modernization of Vocational Education and Skills Training (VEST)
2. The enhancement of managerial education systems, such as PMIs, for reinforcement of managerial ability
3. The establishment of an Myanmar Industrial Research Center (MIRC) and the creation of an industrial information infrastructure.

The government of Myanmar is advised to adopt as priority policies i) obtaining overseas technological information, ii) attracting FDI, iii) expanding opportunities for exchange with foreign enterprises, iv) enhancement of management education programs for business managers, and iv) a dramatic enhancement of various organizations of private enterprises and the UMFCCL, which serves as their coordinator, and implement such policies as soon as possible.

- Thus far, we have presented policy suggestions centering on export promotion, attracting foreign direct investment and the development of private manufacturing industries as priority measures to end the vicious cycle that is beleaguering Myanmar's economy. Given the present condition of Myanmar's economy, we will present policy suggestions which should be given special notice as emergency recommendations.

<A. Promotion of deregulation and liberalization>

1. Abolish the so-called export tax, excepting some commodities
2. Abolish the export license system

3. Guarantee foreign currency remittance for foreign investors
4. Improve the current unstable condition regarding foreign investors' rights in the legal aspect
5. Abolish the compulsory exchange system with the foreign exchange center rate, which is greatly lower than the market rate, for CMP-based businesses (regarding workers' wages)
6. Improve the transparency and through notification regarding trade and investment
7. Promote simplified, transparent and prompt administrative procedures for the following: New company or business registration, Export and import license issuance, Authorization for direct foreign investment, Approval for capital increases of companies, Customs clearance.
8. Abolish restrictions on direct trade by foreign companies

<B. Creation of special economic zones (SEZs)>

In the present situation, in which even industrial zones in the export processing zone format, not to speak of special economic zones, do not exist in Myanmar, there is very little incentive for foreign companies to invest in the country. We may be able to go as far as to say that Myanmar is not even considered as a host country for a full-fledged foreign direct investment. Economic sanctions by Western countries and other political situations are certainly disincentives for investment, but they are not critical factors in the absence of foreign direct investment in Myanmar. Rather, the deep-rooted perception in foreign countries that “military regime means a lack of peace and order (public security), a lack of transparency in government policies and the absence of investment guarantee for foreign companies,” which can be thought as a partly misguided perception, and the fact that Myanmar does not even have an export processing zone seem to be the critical factors in the absence of FDI. In the intensively competitive business environment revolving around China's strength in production and cost performance, some Asian enterprises' investment behaviors are very business-like. Therefore, it is suggested that the government of Myanmar develop a pilot SEZ and improve the investment environment through the creation of industrial zones. Along with the “availability of abundant, inexpensive labor force,” “the existence of peace and order (public security),” “the pervasive influence of Buddhism and a society of friendly people,” “existence of very few labor disputes” and “the top-down management style and the diligence of workers” should prove to be major attractions for foreign capital.

If the prompt launching of an SEZ development project proves to be difficult, we suggest that Myanmar conduct a preparatory study for attracting foreign capital and a study to find out

the detail conditions for success for Myanmar-model SEZs. It is extremely important to carry out analyses of investment behavior, centering on an analysis of cost competition in the Asian region and an analysis of industrial siting behaviors to choose optimum locations for production for industries, Asian enterprises and product groups which are likely to become potential investors or objects of investment in SEZs in Myanmar. The success of Myanmar's SEZs will depend largely on such studies.

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■ List of Task Force and Consulting Group Members

Chapter 1

Summary and Conclusion

1. Summary and Conclusion

1.1 Characteristics of Economic Policies of Myanmar

In March 1989, Myanmar officially abandoned its socialist economic system and launched a market economy system. However, traditional nationalistic thought and a socialistic controlled economy still remain firmly entrenched as elements in the country's economic policies, which reflects the following trends even at present.

- (1) Priority placed on state-owned enterprises and little emphasis on private sector
- (2) Wariness towards foreign capitals
- (3) Extensive government control over foreign trade and foreign exchange
- (4) State monopoly on foreign trade and domestic sales of important commodities
- (5) State control over lands
- (6) Extensive government intervention in the financial sector
- (7) Government intervention in pricing
- (8) Lack of transparency in policies, laws and regulations

In addition, the nation's "self-sufficient-oriented philosophy" has promoted focusing on state reserves such as food savings and production for import substitution by state-owned enterprises, while disregarding profits gained through international division of labor.

The historical reasons behind such Myanmar's economic policies seem to include: 1) painful experiences such as foreign economic dominance of the country's economy during the colonial era, collapse of domestic industries caused by the free trade system, and the significant disparity in income levels; 2) the need for government control over capital accumulation and redistribution to promote national economic development under the conditions of underdeveloped private capital and domestic markets; and 3) the necessity of establishing a unified nation-state by suppressing armed struggles for ethnic independence and anti-government activities of communist groups. In addition, it is undeniable that international economic sanctions imposed since 1988 have forced the Myanmar government to shift toward an "inward-looking controlled economy."

However, these policies have brought about the following negative effects in Myanmar's economy, hampering it from exhibiting its full economic potential. Therefore, Myanmar needs to free itself from its old controlled-type economy and self-sufficient-oriented philosophy.

- (1) Under-utilized foreign capital and technologies
- (2) Inefficient resource allocation owing to price distortions
- (3) High Expensive transaction costs
- (4) Difficulty in accessing capital goods and raw materials at international prices
- (5) High cost of domestic materials which are monopolized by the state

- (6) Stagnant market entry and exit of private companies
- (7) Inadequate competitive markets
- (8) Inefficient investment
- (9) Repression of entrepreneurship

1.2 Current Stage of the Shift toward Market Economy in Myanmar

It is true that Myanmar's reforms since 1988 aimed at implementing a market economy system have released the economic potential of the private sector and have had a certain effect in introducing foreign capital and technologies. However, the reform process toward market economy, which continued until 1996 as shown in Figure 1-1, was halted during the currency crisis of 1997 in Thailand, and since then Myanmar has been reversing to a controlled economic system.

Figure 1-1 Adopted Measures for Transition to a Market Economy in Myanmar

Area	1987-1990	1991-1996	1997-1999 (Measures after the Asian Crisis)
Price and Exchange Rate Reform	Liberalization of Agricultural Trade (Sept. 1987)	Issuance of FEC (Feb. 1993)	Upward adjustment of Electricity and Oil Prices (June 1999)
		Opening FEC Dealing Center (Dec. 1995)	
		Gradual Depreciation of Exchange Rate for Custom Evaluation (June 1996)	
Fiscal Reform	Introduction of Commercial Tax (Feb. 1990)	Revised Income Tax Law (Feb. 1991)	Upward adjustment of Electricity and Oil Prices (June 1999)
		Gradual Depreciation of Exchange Rate for Custom Evaluation (June 1996)	
		Issuance of Mid-term Bond (Dec. 1993)	
SEE Reform	Issuance of SEE Law and Allowed Private Entry into the Selected SEE Controlled Business (Mar. 1989)	Establishment of Privatization and Evaluation Committee (Jan. 1995)	
	Integration of SEE Account into SFA (Apr. 1989)		
Financial System Reform & Creation of Capital Market	Establishment of Investment Commercial Bank (Sept. 1989)	Issuance of Saving Bank Law and Establishment of Private Banks (Mar. 1992)	Cancellation of Foreign Exchange Dealing for 9 Private Banks (Mar. 1998)
	Issuance of Law on Financial Institution, Central Bank Law, Agricultural Rural Development Bank Law (July 1990)	Issuance of Myanmar Insurance Law (July 1993)	
		Issuance of Mid-term Bond (Dec. 1993)	
		Opening FEC Dealing Center (Dec. 1995)	
		Establishment of Stock Exchange Center (June 1996)	

Area	1987-1990	1991-1996	1997-1999 (Measures after the Asian Crisis)
Development of Private Enterprises	Liberalization of Private International Trade (Oct. 1988)	Issuance of Cottage Industry Promotion Law (Oct. 1991)	
	Permit on Opening Foreign Exchange Account for Private Traders (Jan. 1989)	Issuance of Myanmar Citizen's Investment Law (Oct. 1994)	
	Reopening of UMCCI (Jan. 1989)	Establishment of Industrial Development Committee (July 1995)	
	Issuance of SEE Law and Allowed Private Entry into the Selected SEE Controlled Business (Mar. 1989)		
	Establishment of First Industrial Zone (1989)		
	Issuance of Private Industrial Enterprise Law (Nov. 1990)		
Trade Liberalization	Liberalization of Private Foreign Trade (Oct. 1988)	Boarder Trade Agreement with India (Jan. 1994)	Limitation of Foreign Exchange Remittance Against FEC up to 50,000 US\$ (July 1997)
	Opening of Boarder Trade with China (Nov. 1988)		US\$ Settlement in Boarder Trade (Nov. 1997)
	Permit on Opening Foreign Exchange Account for Private Traders (Jan. 1989)		Imposition of 2% Income Tax on Exports (Dec. 1997)
	Opening of Boarder Trade with Thailand and Bangladesh (Apr-June 1989)		Limitation of List B Items Import up to 20% of Total Imports (Mar. 1998)
	Permit of 100% Foreign Exchange Earnings for Private Traders (Mar. 1990)		Addition of 9 Items in Import Ban List (Mar. 1998)
			Imposition of 10% Export Tax in Boarder Trade (Mar. 1998)
			Imposition of 8% Commercial Tax on Exports (Jan. 1999)
FDI Attraction	Issuance of Foreign Investment Law (Nov. 1988)		
Agriculture Development	Liberalization of Agricultural Trade (Sept. 1987)	Land Lease Permit up to 5000 Acre to the Developer of Reclaimed Land (1992)	Export Permit for Rice Produced in Reclaimed Land up to 50% of the Production (1998)
	Abolition of Planned Cultivate System (1988)		
	A Part Revival of Compulsory Delivery of Rice to the Government (1988)		

Source: Masahiko Ebashi, "Myanmar Economy in Transition", Ritsumeikan Keieigaku, Jan. 2000

Figure 1-2 shows how economic systems have changed in Myanmar, China, and Vietnam during the transition of economies in Asia toward a market economy. The vertical axis shows the degree of ownership of resources by the government and the private sector, and the horizontal axis shows the degree of government intervention in the economy. In this graph the closer you get to the upper-right corner, the more advanced the market economy of the country is. Each country's position is not fixed based on specific quantitative indexes, but

rather on a rough estimation from the viewpoint of the author. The economic system of Myanmar was nearer to a market economy than that of China or Vietnam in 1987 immediately before Myanmar started marketization efforts. Also, domestic private ownership had advanced and government intervention in the economy decreased in the country up until 1996. However, since the Thai currency crisis in July of 1997, the Myanmar government has increased regulations as shown in Table 1-1, and Myanmar reversed to a controlled economic system. In the ownership of resources, offshore natural gas production by the state pushed up its share of the state sector. As a result, the economic system of Myanmar is essentially closer to a socialist controlled-type economy than that of China or Vietnam as of 2002.

One of the direct reasons Myanmar reversed to a controlled economy was the shortage of foreign currency in the country. Another reason seems to be a fear held by top government officials that the government was losing its grip on the economy due to shrinking fiscal revenue and foreign currency earnings of the state during the marketization process.

Looking back on the era of socialism, the state-owned sector had basically controlled all economic activities. During this era, the government set agricultural prices low and brought profits to state-owned enterprises by taking advantage of price differences to secure fiscal revenue and made every investment from state budget. The government also monopolized foreign trade and was solely responsible for managing foreign currency. Furthermore, foreign aid was made available to the government of Myanmar from the mid-1970s.

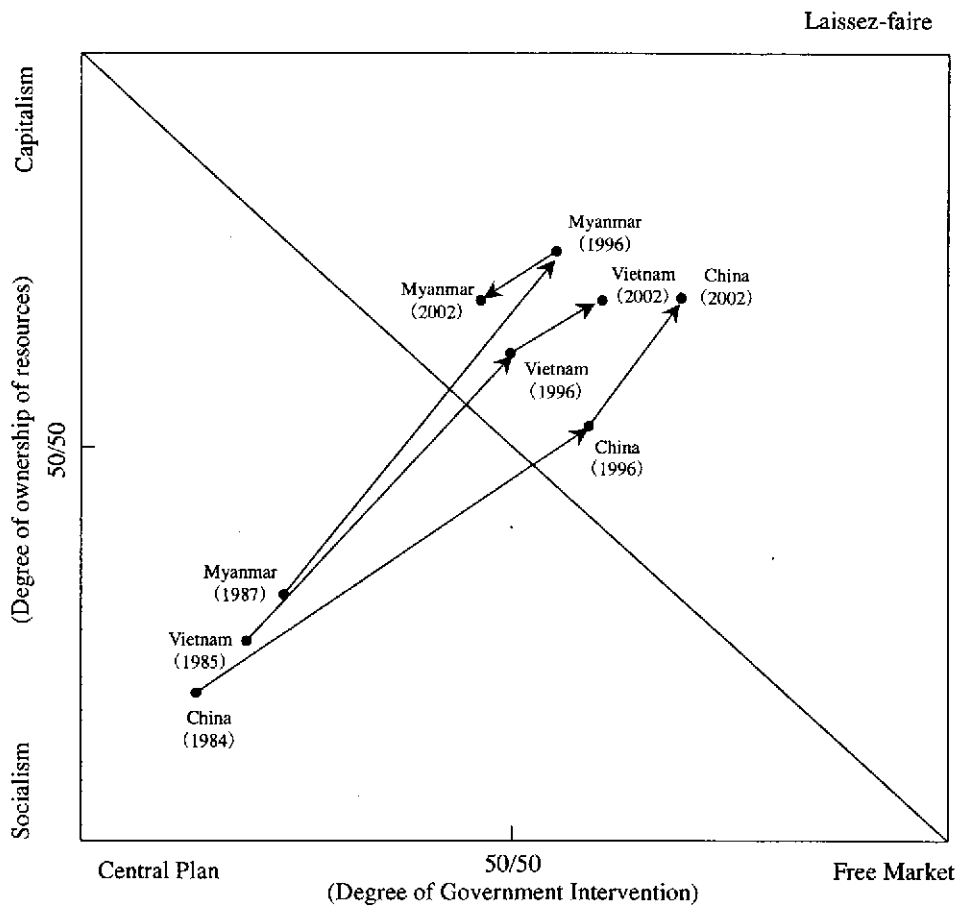
However, the marketization and liberalization policies since the end of 1988 brought about several effects including: 1) price increases in agricultural product prices; 2) the private sector's entry into the market and its development; and 3) competition with imported products. As a result, state-owned enterprises ran into deficits and a capital transfer including foreign currency to the private sector took place. Further, international economic sanctions imposed after the insurrection of 1988 in Myanmar virtually suspended the inflow of foreign aid. Consequently, the fiscal revenue of the state has declined significantly.

Essentially, in order to address such situations, the Myanmar government should have further promoted marketization efforts, including: 1) improvement of the financial system to organize capital in the private sector and direct it toward profitable investment (i.e. financial intermediation function); 2) reform of the tax system (e.g. income tax, land tax, custom duties, etc.) to ensure fiscal revenue to replace income from state-owned enterprises; 3) correction of price distortions by abolishing multiple exchange rates and creation of a competitive environment; 4) restructuring of state-owned enterprises; 5) abolishment of the government monopoly on essential goods; 6) nurturing of private companies; and 7) reform of the administration corresponding to a market economy.

China and Vietnam also temporarily experienced straitened circumstances regarding government finances and foreign currency accumulation during their marketization process. However, as shown in Chart 2, these countries have been addressing such difficult situations by carrying out further marketization efforts. Differing from the situation in both of these countries, there are two additional reasons why Myanmar had to reverse its economic course. First, international economic sanctions have had a substantial impact on Myanmar. China

temporarily faced similar international economic sanctions following the 1989 Tienanmen Incident, however the sanctions were soon relaxed. Also, Vietnam experienced a US-imposed trade embargo, but this was later lifted in February 1994. Second, Myanmar started marketization efforts essentially due to urgency, and it lacked a blueprint for a medium- and long-term strategy toward a market economy. It is difficult to deny the impression that top government officials in Myanmar have been less positive than their counterparts in China and Vietnam in committing to marketization.

Figure 1-2 Degree of Transition to A Market Economy



Source: Made by Masahiko Ebashi

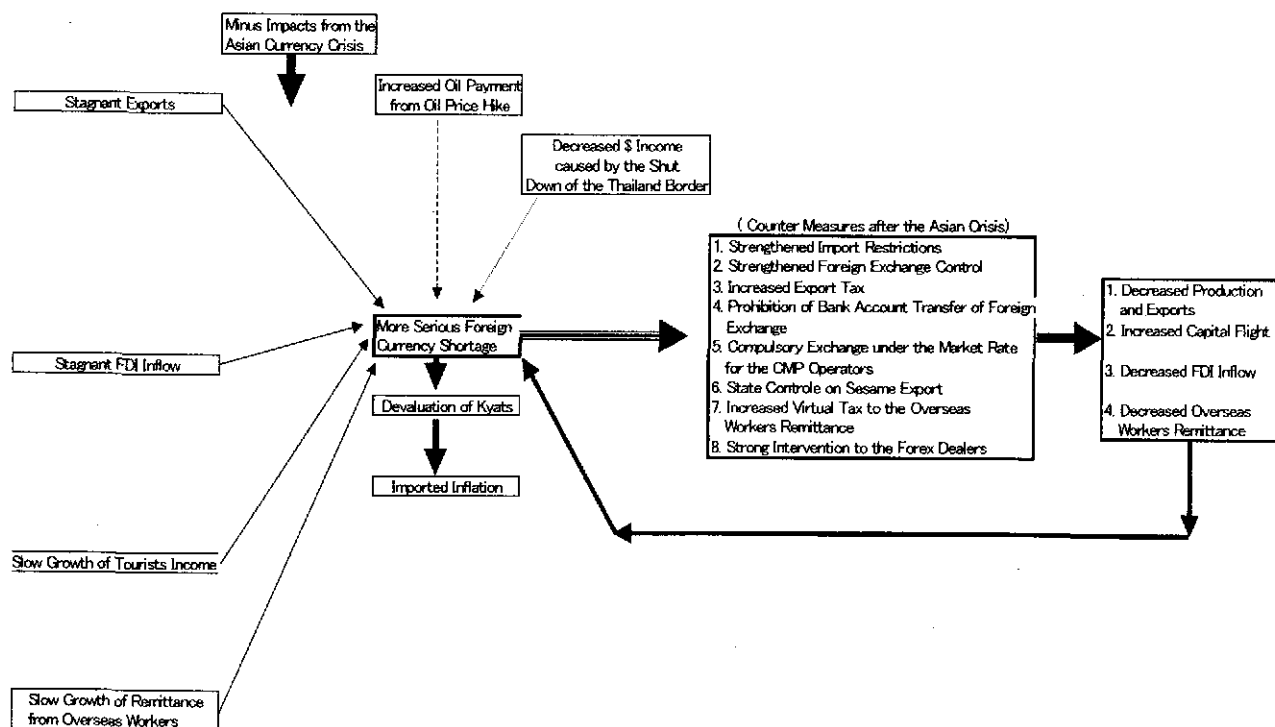
**Table 1-1 Trade & Foreign Exchange Control Measures
after the Asia Crisis Adopted by the Trade Council**

- July, 1997 Limit monthly foreign exchange remittance to max. 50,000 FEC
- Aug. Adoption of "Export First Policy"
- Nov. US\$ settlement for the border trade
- Dec. Imposition of 2% Income tax for the all exports
- Mar. 1998 Limit non-essential goods Imports (List B) to max. 20% of each import transactions
- Mar. Added 9 Items to the list of Import ban items; wine, beer, cigarette, soft drinks, instant noodles, etc..
- Mar. Imposition of 2% service charges on the imported goods for CMP
- Mar. Imposition of 10% charges on the exports for the border trade (later cut to 8%)
- Mar. Cancellation of foreign exchange dealing licenses given to the 9 private banks
 (centralized to the MFTB and MICB)
- Mar. State control on export of sesame
- July Required I/L even for the foreign affiliated companies approved by the MIC
- Aug. Abolition of I/L exemption to the Government Institutions and SEEs
- Nov. Export ban on sesame
- Jan. 1999 Imposition of 8% commercial tax to the all export goods (abolished 5% commercial tax)
- Jan. Limit monthly foreign exchange remittance to max. 30,000 FEC
- Apr. Limit monthly foreign exchange remittance to max. 20,000 FEC
- Aug. 2000 Limit monthly foreign exchange remittance to max. 10,000 FEC
- Aug. Compulsory submission of 40% foreign currency earnings by shrimp export to the Bureau of
 fishery which will be converted into Kyats lower than the market rate.
- Jun. 2001 To dampen the foreign exchange demands by strictly controlled I/L issuance
- Jun. Prohibition of use of bank transferred foreign exchange for import
- Aug. Compulsory submission of foreign currency earnings by CMP exporters to the MFTB or MICB
 The withdrawn FEC will be converted to Kyats under the market rate.
- Mar. Prohibition of direct trade activities by foreign affiliated enterprises
- Sept. 2002 Prohibition of import by foreign remittance (all import became under L/C basis)

Source: Masahiko Ebashi, made from Myanmar "Trade Bulletin" and other news information.

The reverse to a controlled economy has unexpectedly brought about a vicious cycle of foreign currency shortages, financial deficits, depreciation of the kyat, and inflation (see Figure 1-3). Myanmar needs to break out of this pattern as soon as possible by lifting most of the economic control actions that have been implemented since July 1997. Further, Myanmar must immediately resume its interrupted marketization process.

Figure 1-3 Vicious Cycle of Foreign Currency Shortage of Myanmar



Source: Masahiko Ebashi

(Evaluation of Marketization in Myanmar)

In general, marketization in transition economies requires reforms in the areas mentioned below. If we evaluate the current phase of marketization in Myanmar, compared with the other economies in transition, using a five-grade evaluation on eleven items, the following evaluations can be generally made (the number inside the parentheses is the evaluation score).

- 1) Liberalization of Prices (2): A considerable amount of price control and governmental adjustment remains.
- 2) Liberalization of Foreign Exchange and Unification of Exchange Rate (1): Foreign exchange control remains. And multiple exchange rates exist.
- 3) State-owned Enterprise Reform and Privatization (2): Self-supporting accounting system is not introduced. Government investment and subsidies exist. Privatization is limited to only a few small state firms.
- 4) Liberalization of Trade and Investment (2): Extensive export and import control remains. State monopoly on important commodities remains.
- 5) Reform of Banking System (2): Extensive financial restrictions & regulations including interest rates exist. Although private banks are operating, there are no operating foreign banks.

- 6) Reform of Tax System (2): Reforms are not sufficient in corresponding to the market economy, especially regarding value-added tax and agricultural tax, and tax collection systems are not well developed.
- 7) Reform of Administration (2): Reforms are not sufficient in corresponding to a market economy, including areas related to the Ministry of Industry, the Ministry of Commerce, the Ministry of National Planning, and Economic Development.
- 8) Competitive Policy (Prohibition of Monopoly) (2): Laws and policies to promote competition do not exist.
- 9) Creation of Capital Market (2): There are laws related to the establishment of securities exchange and the stock exchange has been opened. There is also a small scale exchange of government bonds, however, the capital market is extremely inadequate.
- 10) Agricultural Reform (3): Rice delivery system by the government, cultivation restriction, government buying price regulations etc. remain in place.
- 11) Improvement of Legal System (3): Legal system reforms are delayed in terms of corresponding to the market economy and the open economy.

As mentioned above, Myanmar's marketization reform is still in its early stages and it is extremely lagging compared to even China and Vietnam. Therefore, Myanmar must further promote marketization reform.

1.3 Macro-economy and Challenges of Trade and Industrial Policies

In order to consider the objectives/challenges of the trade policies in Myanmar, the following need to be confirmed as (1) goals to be achieved by the Myanmar economy, and (2) strategic objectives of the Myanmar economy.

- (1) Goals to be achieved by the Myanmar economy
 - 1) Increased income levels and eradication of poverty via sustainable economic growth
 - 2) Modernization of the economic society
 - 3) Harmonious development among different ethnic groups

- (2) Strategic objectives of the Myanmar economy
 - 1) Stabilization of the macro-economy
 - i) Inflation control
 - ii) Achievement of fiscal balance
 - iii) Improvement of current accounts (international balance of payments)
 - 2) Improvement of the social infrastructure
 - 3) Development of human resources
 - 4) Improvement of the legal system environment
 - 5) Environmental preservation

The following five immediate targets of the trade and industrial policies in Myanmar are expected to achieve the above strategic objectives.

- 1) Improvement of current accounts (international balance of payments)
- 2) Improvement of productivity and investment efficiency
- 3) Strengthening of international competitiveness (especially infrastructure for hardware and software)
- 4) Reduction of poverty through job creation
- 5) Integration into the international economy including ASEAN

Above all, the improvement of current accounts (international balance of payments) is the most important challenge that is ultimately required for macro-economic stability in Myanmar. Figure1-4 is a correlation diagram showing approaches for stabilizing the macro-economy in Myanmar. Inflation control and improvement of balance of payments are indispensable to the macro-economic stability of Myanmar, and they require the reduction of deficit finance, stabilization of exchange rates, promotion of exports, nurturing of private companies, and promotion of foreign direct investment attraction etc. Further, improving the gap between savings and investment gap, encouraging tourism, and promoting remittances from overseas workers are also indispensable to improve the balance of payments.

In this project, we established the following items as immediate challenges of trade and industrial policies in Myanmar. Among others, we gave highest priority to items 2) to 4),

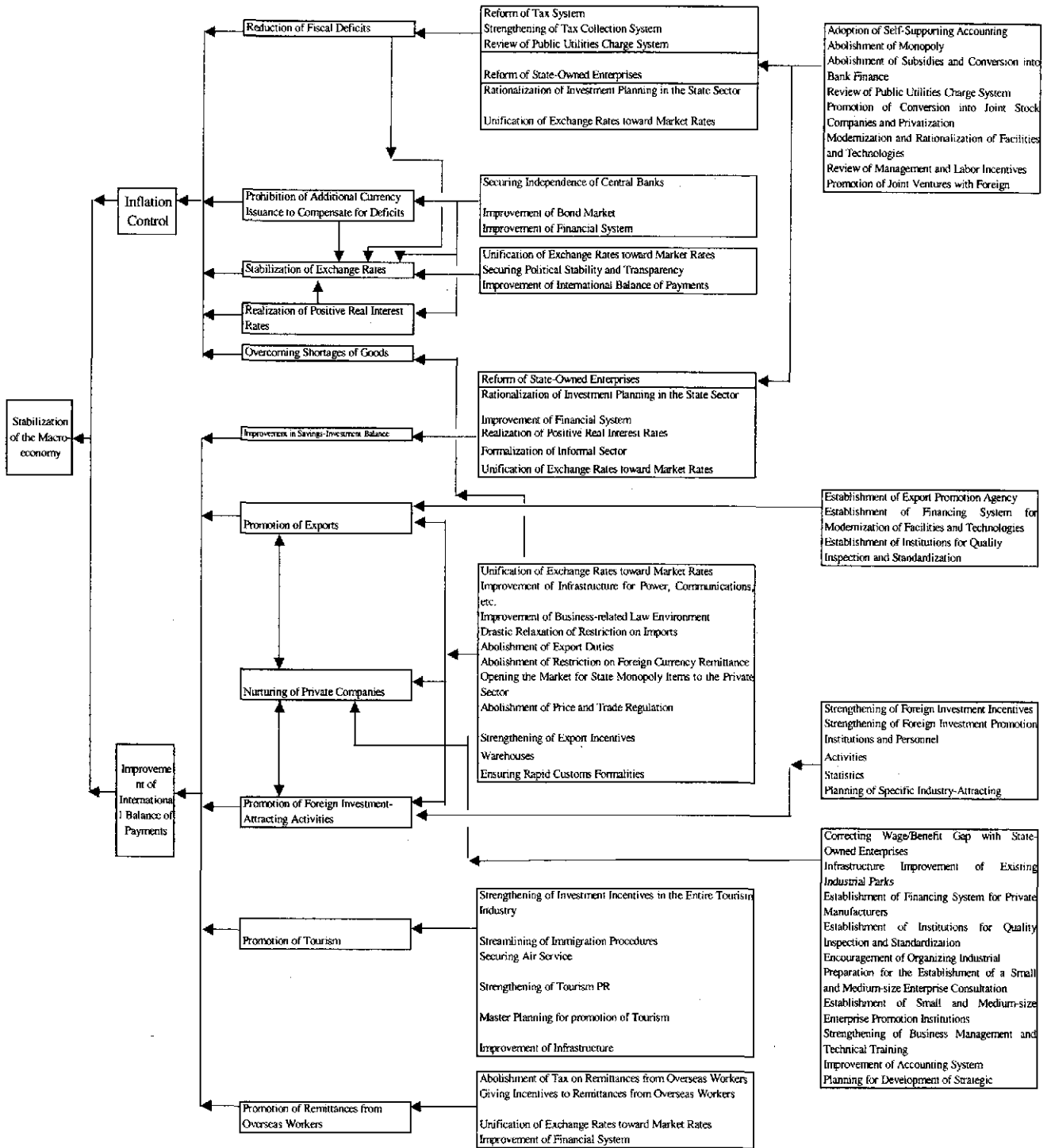
aimed at solving the serious shortage of foreign currency in the country. Then attempted to research the business-related laws indispensable to these challenges and also drew up an industrial vision and development strategy. Also we conducted preliminary research concerning the development of the industrial infrastructures and human resources required for designing such strategy. Although the reform of state-owned enterprises is an important challenge for trade and industrial policies and also an essential area for macro-economic stability, especially with the aim of reducing fiscal deficit, we were not able to cover the subject in our research due to various constraints. If this project continues from next year onward, it is expected that the areas not covered in the current project -- including reform of state-owned enterprises -- will be subsequently researched.

(Immediate challenges of trade and industrial policies in Myanmar)

- * 1) Optimization of resource allocation by designing industrial vision and development strategy
- * 2) Promotion of exports
- * 3) Promotion of foreign direct investment attraction
- * 4) Nurturing of private enterprises (especially manufacturing industries)
- * 5) Improvement of business-related legal environment
- △ 6) Improvement of industrial infrastructures
- △ 7) Human resource development
- 8) Reform of state-owned enterprises
- 9) Promotion of the development of science and technology
- 10) Promotion of tourism
- 11) Promotion of remittances from overseas workers
- 12) Improvement of efficiency and transparency of trade & industry-related administrative services
- 13) Establishment of agency (a think tank) for formulating trade and industrial policies
- 14) Improvement of statistics related to the trade and industry

Note: * means a challenge we began to research in this project, and △ means ones that we conducted preliminary research on in the project.

Figure 1-4 Structural Adjustment of Myanmar Economy: Correlation Diagram of the Industrial/Trade Policies and Macro-economy



Source: Masahiko Ebashi

1.4 Industrial and Trade policies—Recommendations

1.4.1 Industrial Vision and Development Strategy

<Industrial Vision>

Myanmar has great potential to become one of the industrial powers in ASEAN because of its relatively abundant labor force, abundant natural and agricultural, forestry and fishery resources, its strategic location at the center of high growth area in Asia, sharing borders with China, India and others, and the possibility of leapingfrogging in an environment of rapid technological innovation in IT and biotechnology. The moves for regional economic integration such as AFTA and the ASEAN/China FTA agreement should enhance the merits of Myanmar's strategic location. On the other hand, Myanmar is subject to economic sanctions by advanced countries, and the timing of the lifting of the sanctions will alter Myanmar's industrial development potential.

Assuming an early lifting of the sanctions and initiation of necessary economic policy reforms (Scenario 1), Myanmar will accelerate industrial development and Myanmar industry can share a vision of being "on the verge of becoming a newly industrialized economy" in the year 2020. Industrial development, fueled by exports, will make progress—The ratio of manufactured goods to total exports will be 60% or higher; that of exports to GDP will be 40% or higher; and the ratio of manufacturing industry to GDP, which now stands at around 10%, will be around 35%. Per capita GDP will increase from the present US\$200-400 to US\$1,500-2,000. The competitive advantages of Myanmar as an industrial location in human resources, infrastructure, and industrial clusters have reached significantly higher levels, and Myanmar will have a diversified industrial structure, consisting of competitive export industries and efficient domestic market-oriented industries.

Under the assumption that economic sanctions remain for another five to ten years while economic reforms take place (Scenario 2), the level of Myanmar's industrial development in the year 2020 will still be below the average level of Thailand, the Philippines and Indonesia currently. Under the assumption of no substantial economic reforms and no lifting of economic sanctions (Scenario 3), Myanmar's industrial condition will continue to be stagnant and there is a possibility of economic crisis. We do not think Scenario 3 is likely. Our industrial development strategy is based on Scenario 1 and the basic direction of the strategy for Scenario 2 is similar to that for Scenario 1.

<Factors for the Current Low Level of Industrial Development>

At only around 10% the industrial sector's share of GNP in Myanmar is well below that in neighboring Thailand (40%), Malaysia (48%), or Indonesia (43%). Myanmar's stagnant industrialization despite its great potential is caused by a vicious cycle created by developments in the external environment, i.e. the economic sanctions, and domestic policy factors.

The domestic policy developments in relation to Myanmar's industrialization have been

a delay in installing the market economy system, inward looking economic policies, and a lack of transparency and consistency and government efficiency.

With regard to the delay in installing the market economy system, state intervention in industrial activities in the form of price controls, trade restrictions and the SOE system, has weakened the market mechanism. Moreover, since policies favoring SOEs have been in place and the construction of a level playing field with the private enterprises has been delayed, the inefficient SOEs have maintained a high share and the development of potentially more efficient private enterprises has been suppressed. Privatization of SOEs and the reform of SOEs as a preparation stage for privatization have lagged substantially compared with other transition economies such as China.

Among the inward-looking economic policies are policies restricting exports and encouraging imports, such as the 10% export duties, the assessment of import tariffs with exchange rates substantially overvalued against market rates, and multi-layered exchange rates with official rates substantially overvalued against market rates. On the other hand, in reaction to the deteriorating balance of trade condition very strong direct intervention policies to restrict imports such as import controls and foreign exchange quotas have been put in place. Myanmar has not invited FDI (Foreign Direct Investment) as aggressively as neighboring countries have.

The confluence of these policy factors and the economic sanctions has generated a vicious cycle by deteriorating balance of payments and creating a shortage of foreign exchange. In particular, the extremely small inflow of FDI in comparison with neighboring countries has prevented Myanmar from developing viable export industries in the manufacturing sector.

<Industrial Development Strategy>

We will show an industrial development strategy for Myanmar to fill the gap between the *industrial vision and the current industrial structure*. In this process, we take notice of the need to turn the vicious cycle to a virtuous cycle. We believe that Myanmar's industrial development strategy should consist of three dimensions: major thrusts, the changed role of government, and the sequencing of policy applications.

Major Thrusts

The main thrusts of industrial development strategy for Myanmar are fourfold: First, establish a market economy-based industrial system with the private sector leading industrial development. Second, adopt an outward-looking policy framework that promotes exports and FDI with an initial focus on regional markets. Third, diversify the industrial base centered on industries with comparative advantage and enhance accumulation of industrial clusters. And fourth, strengthen Myanmar's competitive advantage as an industrial location through human resource development, infrastructure development, and legal and institutional development.

Marketization of the industrial system is the utmost priority for Myanmar's

industrialization. Direct government involvement in industrial activities such as price controls, import and export controls, and the SOE system should be minimized. The modification of the multiple exchange rate system is crucial to give proper signals to market participants and to reduce the distortions in resource allocation. While privatization should be undertaken as a long-term project, SOE reform should be started immediately to improve the efficiency of management and lighten the fiscal burden. We think it advisable to start with fast privatization of small-scale SOEs. Myanmar should proceed cautiously with the privatization of large and medium SOEs because of the complexity of the problem while strengthening their financial discipline and establishing and pursuing the long-term goal of privatization. As long as there is no level playing field between SOEs and private enterprises, large-scale investments by SOEs should be minimized. Reduction or termination of market protection and fiscal subsidies together with managerial autonomy is necessary. In order to shift the financing of SOEs from market protection and fiscal subsidies to a financial system, a healthy and efficient banking system and capital markets need to be created.

With regard to the outward-looking policies, the major emphasis in the short term should be placed on the export- and FDI-oriented development strategy in view of the fact that Myanmar's current competitive advantages lie in unskilled workers and natural, agricultural, forestry and fishery resources. Since most export industries to attract investment by foreign and domestic enterprises will be in labor-intensive industries, they should contribute substantially to generating employment.

With regard to the enhancement of Myanmar's competitive advantages as an industrial location, the country should strive to upgrade the elements of competitive advantage by increasing the supply of knowledge workers through human resource development, improving the infrastructure, developing the financial system, enhancing competition among enterprises, and supporting the formation of industrial clusters. The government, for example, can support the development of universities and public research institutions to complement technology transfer, develop electricity, transport and communication infrastructure in the area, reduce regulatory impediments to interactions, and invite FDIs in missing links of the clusters.

Changing Role of Government

Our industrial development strategy of market orientation, government needs to implement it with indirect policy measures by avoiding direct intervention and generating market competition. It is necessary to implement privatization and develop legal infrastructure such as competition laws in order to engender competition. Moreover, the government needs to implement comprehensive and flexible policies to upgrade Myanmar's competitive advantages. Government needs to make a fundamental shift of policy framework from the traditional framework of planned economy. It might be useful to establish a policy think tank to support such a wholesale transformation of policy framework. Myanmar may need foreign assistance in the establishment such a new function of government.

Sequential Application of Industrial Development Strategy

We think that the industrial development strategy needs to be applied sequentially to minimize the disruptions in the balance of payments, employment, and inflation. We see three phases: a short-term strategy (from 2003 to 2005), a medium-term strategy (from 2006 to 2010) and a long-term strategy (from 2011 to 2020) to meet the evolving agenda. In this regard, the attraction of FDI and the promotion of private enterprises, particularly the former, should precede reform and privatization of SOEs, in order to generate employment and foreign currency to offset the cost of reform.

The major purpose of the short-term development strategy should be set at reversing the current vicious cycle for a virtuous cycle. We believe this could be done with a twofold strategy of firstly eliminating the bottlenecks in supply of electricity and parts and components and secondly announcing and stating implementation of a policy package containing measures for marketization, outward-orientation, and the transparency and continuity of industry-related policies. A few SEZs should be established to embody the two elements. Moreover, SOE reforms are urgently required. In order to clarify the government's commitment to the new policy framework, it should initiate a reform of government organizations that manage industrial development strategy. That should include specialized organizations for promoting export and FDI. Furthermore, it is desirable to establish a policy think tank early in order to support intellectually the fundamental policy changes and their sequential implementation.

In the medium term, we expect that export-oriented development will gradually be established and foreign exchange constraints will be steadily resolved while there will be substantial increase in employment from FDI and some development of private enterprises. With the increased room to maneuver, it is necessary to consolidate the market economy system by proceeding with privatization. The government should also implement measures to enhance industrial diversification and upgrading by supporting domestic market-oriented industries and supporting industries.

By the time the long-term period starts, the market economy infrastructure should have mostly been established. Competition policy should be effectively implemented to maintain competition among domestic and foreign private firms. Moreover, as foreign exchange constraints should have dissipated, FDI in import substitution industries should also be promoted to diversify the industrial structure. There should be more emphasis on industrial upgrading through human resource development and technology transfer and development.

1.4.2 Strategic Industries and Strategies for Development Based on Comparative Advantages in Myanmar

In this study project an analysis of the actual status of individual industries, except for the garment-manufacturing and footwear industries, or issues related to industry growth strategies, does not fall within the scope of the full-scale study. However, in more practical terms, a rough analysis was carried out on which industries need to be nurtured as strategic

industries for the future or on which industries are more likely to expand and develop. Basically, since each industry is unique, promotional measures need to be tailored specifically to the industry. However, according to the individual industry analysis results, the political policies that are common and important to the major industries are indicated below.

<Reform of the Relationship between SOEs (State owned enterprises) and Private Companies>

- *1 Clarification of the role-sharing relationships between SOEs and private companies and the cooperation and competition viewpoints of both. In parallel with that, expansion of the areas where private companies can operate their businesses. Also, attempts should be made to use the vitality of private companies, which enables them to expand their businesses and management systems based on economic rationality, as a large growth engine for industrial development.
- *2 Even in the industries where SOEs have already become a major driving force, such as agricultural machinery, fertilizers and natural gas, outsourcing to private companies for parts orders and maintenance of facilities is possible. The procurement of facilities, software and engineering from private companies will need to be promoted in order to open up the present closed production system inside the SOEs to the public.

<The Attraction of FDI>

- *3 In the industrial sector, attracting FDI plays an important role in many industries. FDI is essential for the creation of next-generation industrial infrastructure in Myanmar, for example, strengthening the competitiveness of domestic industries (technological and management capabilities), developing industrial personnel, creating new industries and significantly expanding the acquisition of foreign currency. A specialist office that cuts across the boundaries between ministries and agencies should be established and given comprehensive FDI strategy functions as well as responsibility for setting industry-specific solicitation priorities and implementing measures to attract FDI. Urgent measures should be taken, for example, assigning a minister who deals specifically with FDI strategies, without directly taking charge of SOEs.

<Regulatory Reform>

- *4 Looking at each industry, there are regulations everywhere inhibiting the expansion of business activities in private companies, for example, the prohibition of imports of secondhand machinery and the issue of tourist visas. These regulations need to be reformed. (For example, Japanese tourists should be allowed to visit without visas.)

<The Accumulation and Provision of Information and the Formulation of Development Plans for Individual Industries>

- *5 Industries with a higher probability of growing significantly by utilizing comparatively smaller investments, such as the software industry and, particularly, the

export industry, need to be nurtured urgently and given higher priority. Higher priority also needs to be given to the tourism industry, which needs to be urgently expanded to at least a few times its current size in terms of the number of tourists. To accomplish these purposes, the immediate study and setting of priorities for industrial promotion as well as the formulation of an urgent development plan needs to be carried out.

- *6 Not only must there be reinforcement and expansion of competitiveness in the current major industries, but attempts must be made to nurture strategic industries, attract FDI from neighboring Asian countries, analyze possibilities for expansion of exports to Asian and western countries, and formulate strategies for it, accumulate information regarding each industry, provide this information to a wide range of related parties and promote the use of this information. To achieve these purposes, an “Myanmar Industrial Research Center” (preliminary name) possessing a survey function for each industry needs to be established in order to provide industrial information.

The key points from the analysis of individual industries in Myanmar are as shown below. The analysis has become the background to these policies.

The most important perspectives when selecting strategic industries in Myanmar are as follows.

- *1 “Labor-intensive and resource-intensive industries” in which Myanmar enjoys a comparative advantage.
- *2 “Agro-based industries,” assumed to be the core of industrial development even by the government.
- *3 The possibility of utilizing FDI.
- *4 Industry that leads to increasing sophistication over the mid to long term.
- *5 Future improvements in the lives of citizens and the implementation of social infrastructure in Myanmar.

In the short to mid term, it is important to be export oriented in order to break out of the vicious cycle caused by the shortage of foreign currency. Therefore, it is necessary to give priority to nurturing export industries based on comparative advantage or industries which have a higher probability of acquiring foreign currency. Progress with AFTA in the ASEAN countries and the FTA between China and the ASEAN countries will accelerate the restructuring of industries in Myanmar by shifting to comparative advantage industries.

As for labor-intensive industries, in addition to the garment and footwear industries, the assembly-type electronics industry is promising. As for resource-intensive industries, the mineral resource related industries, such as natural gas, copper and gemstone processing, as well as agriculture, forestry and fishery related industries, such as woodworking and fish processing, are promising. Although exporting is difficult with the present management and technological capabilities, the potential for development is also high in food processing. Moreover, apart from the manufacturing industry, a tourism industry based on tourism

resources is also highly important.

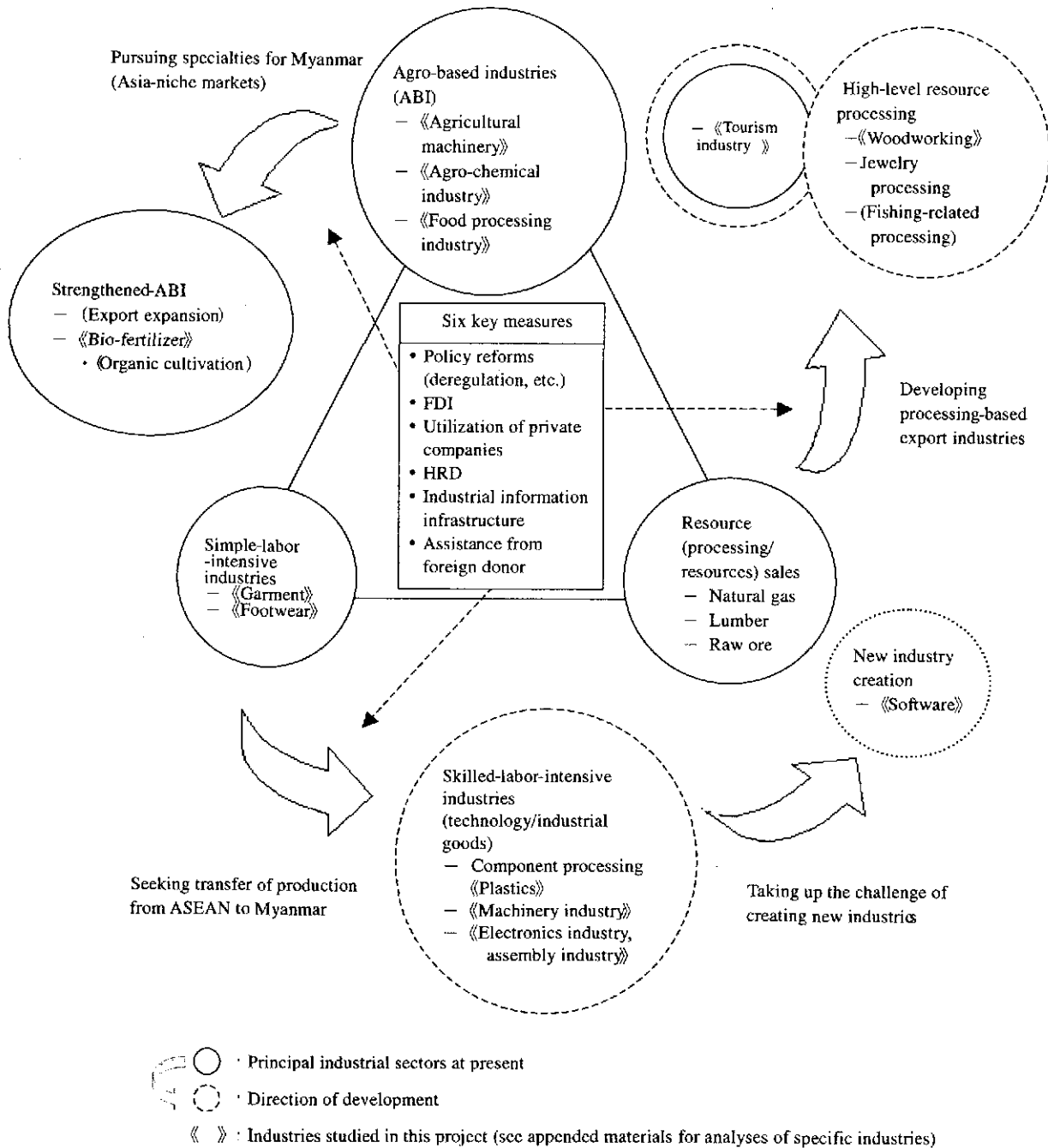
These export industries based on comparative advantage need to be rapidly promoted in the short and mid term by utilizing technological, sales and management capabilities through foreign investment. Foreign investment can be better utilized in the electronics, garment, footwear, natural gas, copper, gemstone processing, fish processing, woodworking, food processing and tourism industries. When utilizing foreign investment in this way, it is important to follow the restructuring trends of industries inside the ASEAN countries and participate in the international production network.

On the other hand, agriculture accounts for a higher percentage of GDP in Myanmar and the comparative advantage of agriculture is potentially high. There is potential for the development of agro-based industries (manufacturing sector), particularly in agricultural machinery, fertilizers, and so forth. In particular, there is a great necessity to develop the agricultural machinery industry as a core part of the machinery sector in Myanmar.

Moreover, if the attraction of FDI and the nurturing of human resources progresses further, the development of skill-intensive industries becoming the future core of the manufacturing industry in Myanmar will be possible, and will in turn lead to technology-intensive industries such as the machinery, electronic parts processing, and electronics and electrical industries. It is possible that the sophistication of these industries will gradually grow over the mid to long term. The plastics industry will have an opportunity to develop because of its role in supporting a wide range of other industries. The software industry will also have the opportunity to develop through the creation of new industries.

Centered on the strategic industries and from the viewpoint of selecting the industries mentioned previously, the orientation of industrial development in Myanmar is as follows.

Figure 1-5 Directions of Industry Development in Myanmar



Source: JICA Study Team

With regard to two or three industries, i.e. the agricultural and fishery related industries (in terms of manufacturing), the software industry and the tourism industry, possibilities for development are provided as examples. (See the separate reference materials for the various individual industry analyses.)

The food processing industry in Myanmar has been strongly characterized as an import-substitute industry up till now. From the perspective of utilizing agricultural and fishery resources in Myanmar, this industry has the potential to grow into an export industry. The conditions necessary for promoting full-scale exports will be the determination of the needs of overseas markets, the introduction of processing know-how and facilities supported by the latest technologies, and the securing of users and sales channels. If these factors are considered, the degree of dependence on foreign currency must inevitably increase. Most of the technology, funds and sales channel issues will be solved by attracting foreign investment. It is desirable that Myanmar pursues active policies towards introducing FDI and implementing business environments in terms of both hardware and software.

The main agro-based industries other than food processing are the fertilizer, agricultural chemical, agricultural machinery and agricultural equipment industries. The production of urea fertilizers is restricted due to the supply of natural gas and plant procurement (investment) and the production of agricultural chemicals requires the procurement of foreign investment and technologies through FDI. The agricultural machinery industry is the core of the present machinery sector and one in which China is rapidly expanding its participation, starting with the supply of engines. The restructuring and expansion of agricultural machinery businesses is important in order to improve the productivity of agriculture and to nurture the machinery sector in Myanmar.

As for the fishery-related industries, the present industrial areas consist of shipbuilding, fish nets, aquaculture of prawns, ice making machinery and refrigerated warehouses. However, they are still at a very basic level. Since the fish catch is restricted due to Myanmar only having about 2,000 offshore fishing vessels of around 100 tons, the acquisition and expansion of shipbuilding capability will be the key to development of these industries. At the same time, since the number of ships is the largest barrier to the expansion of exports, the shipbuilding industry must be nurtured somehow. Some of the ice making machinery is manufactured in Myanmar. However, most of the industrial goods, including refrigerated warehouses, must be imported and there is strong demand by fishing-industry-related parties for domestic manufacture of these items. There is also a high demand for development of a ship repair industry.

The software industry in Myanmar has the potential to expand rapidly. In this industry, the major investment is in human resource development. Investment efficiency is high and the possibility of becoming an export industry is also high. In addition to human resource development, great triggers for industrial development will be the start of marketing development efforts to secure production orders outsourced from overseas, as well as the modernization of computers and communication facilities with the support of foreign governments, for example via ODA.

In the tourism industry, there is an upper limit on the number of seats available on airlines flying into Myanmar, i.e. a maximum of 10,000 seats a week. (At present, 200,000 passengers a year.) However, by setting a mid-term target of attracting one million tourists, which was done in Vietnam in the first half of 90s, foreign currency earnings could potentially be US\$ 400 to 500 million. Compared with the current size of exports from Myanmar, this is a considerable opportunity to acquire foreign currency. It is desirable that a series of measures be implemented immediately, such as improvements in the issue of visas, expansion of the government's efforts to promote tourism, support for package tour development by private companies, and reform of the taxation applicable to tourist companies in order to strengthen their competitiveness.

1.4.3 Policy Proposals Regarding the Accelerated Attraction of Foreign Investment

Investment environments are rapidly being improved in the ASEAN countries with AFTA, and in China, which is attracting large-scale foreign investment. On the other hand, a certain amount of time is needed for introduction of the special economic zone system and implementation of infrastructures. Therefore, the earlier the Myanmar government decides on the introduction of large-scale FDI and begins implementation of the investment environments the better. The government's financial burden is not necessarily large in terms of the FDI measures that need to be promptly implemented. In moving towards the introduction of large-scale foreign investment, a series of policies needs to be implemented immediately, such as the establishment of MEZA, which will be a central player, the formulation of ministry ordinances related to special economic zones (SEZ), and the development of SEZ model districts. The following six policies need to be given particular importance when moving towards the introduction of FDI and implemented immediately.

- 1 Formulation of a Special Economic Zone Act or ministry directives
- 2 Early dissolution of disincentive measures
- 3 Organization of a Myanmar Economic Zone Authority (MEZA, preliminary name)
- 4 Privatization of electrical power limited to the SEZ
- 5 Development of SEZ with a one-stop service function
- 6 Admission to the ASEAN-Japan Center (FDI promotion)

It did seem that FDI in Myanmar was steadily expanding and it actually reached US\$2.8 billion, the amount approved in 1996, supported by the formulation of a law concerning foreign investment in 1988 and the expectation of democratization around the middle of the 1990s. However, due to the slow democratization process and the Asian economic crisis after that, FDI later grew at an extremely slow pace. The cumulative total of approved investments up until fiscal 2000 was US\$7.1 billion, which was only 1.5% of the total of the ASEAN countries (US\$470 billion between 1988 and 2000). Cases of FDI in the manufacturing industry amounted to 40% but most of these were only for the two years, 1996 and 1997.

For the first phase, an attempt needs to be made to attract FDI at the level of the mid 1990s. It has already been proven that FDI has played a significant role in the economic growth of the ASEAN countries through the expansion of exports, the acquisition of foreign currency, the creation of employment and technology transfer. For example, a strong relationship can be seen in each country between export incomes and cumulative FDI, and between GDP per head and cumulative FDI per head. Among the ASEAN countries, both the Philippines and Vietnam, in particular, have populations of a similar size to Myanmar and began implementing full-scale policies to introduce foreign investment during the last half of the 80s. There is an overwhelming difference between Myanmar and these two countries today. There is also the factor that western countries continued their economic sanctions. However, a more fundamental reason is that the implementation of the excellent policies needed to introduce foreign investment or organizational reform of the government, which was seen in the two previously mentioned countries, was missing in Myanmar. Also, as part of this fundamental reason, the minimum investment environments essential for foreign investment were not implemented, such as improvement of the electrical power infrastructure, SEZ development and clarification of related regulations and global business rules.

The goal of Myanmar's industrial vision is to bring its economic standards up to the level of the ASEAN countries. In order to achieve this goal, FDI is essential. In order to attract FDI and use its power to develop the economy, first of all, it is important that the parties responsible for the management of the nation all clearly recognize the necessity of FDI in Myanmar. Secondly, it is essential to implement an investment environment for foreign investment. These two facts need to be pointed out. The reason is that there is a possibility that the economic gap between Myanmar and the other ASEAN countries has become as big as it has simply because the national leaders responsible for economic development in Myanmar did not sufficiently recognize the importance of FDI, and it is conceivable that this could be one of the major reasons for today's economic downturn.

On the other hand, many companies in advanced countries are becoming more active in investing in China, more so than in the ASEAN countries. Competition to attract foreign investment is intensifying among the ASEAN countries. The supply of ODA from Japan and loans from the International Bank and the IMF have been suspended. These are negative overseas factors working against the attraction of foreign investment to Myanmar. However, with the improvement of domestic factors and appropriate strategies for attraction, and while eliciting the comparative advantage of Myanmar represented by its labor and resources, a way of attracting foreign investment will be discovered. Without the active introduction of FDI it is difficult to foresee the economic development of Myanmar to the same level as the other ASEAN countries. According to an analysis of the competitive environment created by surrounding countries and structural changes in the division of labor, processing industries, such as food, timber and garment, and the electronic parts assembly industry, will utilize Myanmar's comparative advantage and there is a high potential for them to actually move there in the short term.

The creation of 400,000 new jobs at 1,500 companies by 2010, and US\$38 billion worth

of exports in 2010, can be targeted if the economic sanctions imposed by western countries are lifted within a few years and there is a remarkable improvement in the investment environment. In the current situation, these figures seem to be extremely high. However, taking into account the potential of Myanmar, the dissolution of factors inhibiting FDI and successful cases in surrounding countries, they are not unachievable.

1.4.4 Policy Proposals Related to the Promotion of Exports

It may not require any further explanation than to simply state the fact that the promotion of exports is an important key to the economic development of Myanmar. The aims of measures to promote exports in Myanmar are the growth of the export industries and economic development through the acquisition of foreign currency in the short term, and the strengthening of competitiveness in the mid and long term.

As can typically be seen by the creation of an economic infrastructure and the expansion of the size of Vietnam's economy due to that government's measures to introduce FDI and promote exports in recent years, no further explanation is required to explain the fact that the promotion of exports in Myanmar is also closely related to the introduction of FDI. Policy proposals in relation to the introduction of FDI are presented in another section. This section summarizes policies related to exports based on the present situation regarding exports in Myanmar, but doesn't include the promotion of exports through the introduction of FDI.

For a start, it is important to announce that the government will promote the liberalization of exports inside and outside the country and send a clear message emphasizing the importance of exports to define the government's basic standpoint. More practically, it is necessary to clarify in principle the liberalization of so-called export activities, reduce the burdens on export industries and remove the disincentives such as export tax, in order to strengthen competitiveness. The government's restrictions need to be reformulated as a system of restrictions based on a "negative list."

The following six practical policies are important and top priority needs to be given to their immediate implementation.

- 1 Establishment of a government and private export promotion joint committee sponsored by the prime minister.
- 2 Abolishment of the so-called export tax (commercial tax and income tax) and the provisional introduction of import surcharge and special import surcharge accounts.
- 3 Opening up exports to the private sector starting with sesame (the steady opening up of restricted export items to the private sector).
- 4 Abolishment of export and import licenses and the introduction of a "negative list" in exceptional cases.
- 5 Gradual abolishment of restrictions on dollar imports for the purpose of "trade first," but not for "exports first" or "imports first" and provisional introduction of a foreign currency allocation system.

■6 The prior introduction of special export processing zones.

The rate of increase in world trade was 6.5% during the 1990s. Trade in Asia was higher at 8.6% and Asia's share of world trade was about 23% to 25% during the period between 1996 and 2000, including the period of economic turmoil caused by the currency crisis in Asia.

Although trade increased in Myanmar by 9.3% every year during the 1990s (according to statistics by the IMF based on US dollars), among the ASEAN-10, three countries in Indochina, Cambodia, Vietnam and Laos, which each has a particularly high cost competitiveness, achieved extremely high growth rates of about 20 to 44%. This shows that if Myanmar implements the environment needed to promote exports, there will be sufficient opportunity to enhance exports.

Due to the "imports first policy," between 1990 and 1991 and between 1995 and 1998 the trade deficit exceeded the total income from exports. This fact typically indicates that the demand for imports in Myanmar is persistent while the development of an import substitute industry is still inadequate. Moreover, a so-called export tax was established and it is considered that the export environment has been deteriorating in recent years. Therefore, it is very likely that the trade deficit is structurally caused. In the 1980s, rice and rice products, timber related products, minerals and beans were the top four items comprising 80% of export products. However, except for beans, which are mainly exported by the private sector, these export percentages have been declining significantly. The decline in exports of items with high export competitiveness, such as rice (currently only state owned enterprises can export it) and sesame was directly related to the deterioration of the trade balance. Of course, it is necessary to make an effort to export new items in the future. However, this fact indicates that reactivating exports for major export products is an extremely important policy issue.

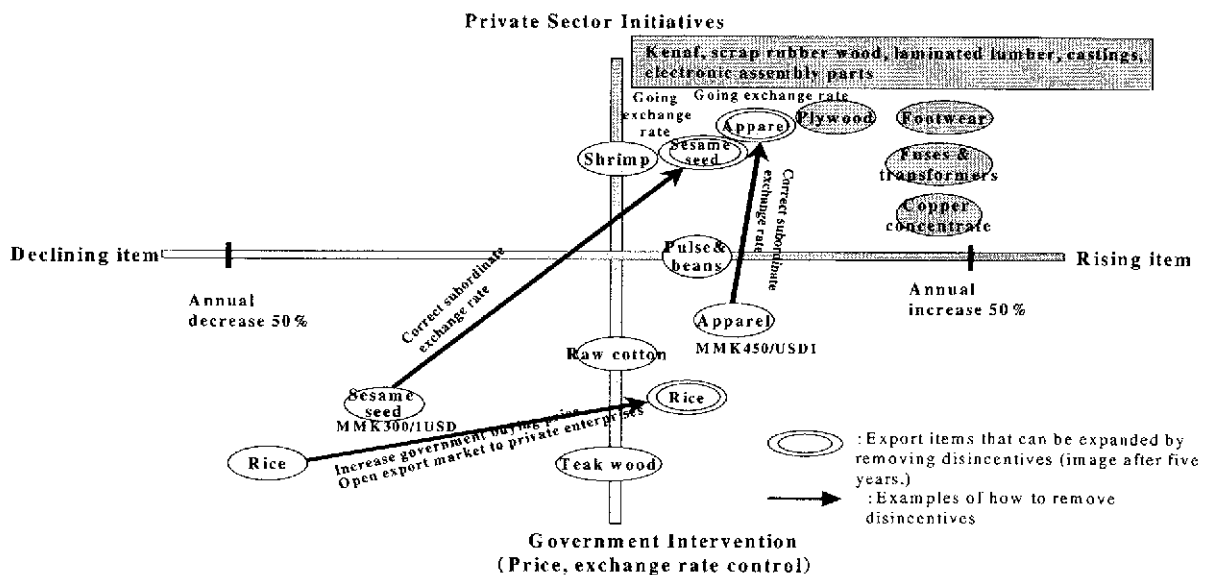
The basic aspects of the present trade policies in Myanmar are the coexistence of the import substitute policy and the export promotion policy, the opening up to the private sector of trade items other than the 32 restricted items, and import restrictions (import approvals limited to the amount of foreign currency gained through exports) placed on the private sector through the "exports first" policy. By opening up items to the private sector, the export turnovers of private companies exceeded those of state owned enterprises between 1994 and 1995. The further opening up of items monopolized by the government and the activation of exports by private companies hold the major key to the expansion of exports from Myanmar.

The largest problems in relation to the expansion of exports by private companies are the loss of export competitiveness caused by the 10% export tax (export tax is the common name, it consists of an 8% commercial tax and a 2% income tax), export restrictions by the government (the existence of restricted items which includes items with export competitiveness, and import quantity restrictions which categorize items into essential and non-essential), frequent and sudden changes to the systems and policies related to exports and imports, and the shortage of human resources knowledgeable about the trade business.

On the other hand, as pointed out in the major proposed items, when considering export

items it can be seen that there are some items which should be more open to the private sector, and some items which should preferably be exported more after identifying the ones with export competitiveness as items recommended for export. At present, there are eight items recommended by the Ministry of Trade including rice and rice products. It is desirable that exporting sesame, sesame oil, copper cathodes, metal casting and kenaf under the leadership of the private sector be recommended. In particular, exports of rice and sesame need to be immediately opened up to the private sector and the trade balance in Myanmar needs to be significantly improved. For example, exports of sesame are restricted in order to produce sesame oil as a substitute for the import of palm oil. If the total amount of sesame were exported, more than US\$120 million in foreign currency could be procured (1999), which is equivalent to 8% of the export income (for the same year). When comparing the manufacturing costs of sesame oil with the import price for palm oil, exports of sesame are economically more beneficial.

Figure 1-6 “Trade-off” Relationship between Private Sector Initiatives and Government Intervention (Myanmar’s Exports to Japan in the Past Five Years)



Source: Japanese Custom Statistics

As seen in the cases of rice and sesame, the government strongly intervenes in exports by the private sector through restrictions on exports themselves, price control and exchange rates. The government needs to reduce its intervention in domestic products with export competitiveness, for example, by not applying subordinated rates to sesame and the garment industry, which is at present a major industry in Myanmar, and by not controlling the price of rice and fish. It also needs to increase export incentives to the private sector and drastically change its policies in relation to exports so that opportunities for exporting major individual items are given maximum utilization.

1.4.5 Nurturing of Private Manufacturers

The government of Myanmar has been promoting the development of private enterprises since the second half of the 1980s. However, the efforts to promote the development of private enterprises (manufacturing) are facing many problems due to the deterioration of the fiscal balance and foreign exchange revenues resulting from the Asian currency crisis of 1997, requiring further efforts to achieve the government's objectives.

In the master plans for the development of private manufacturing enterprises, the macro structure, such as GDP composition, the number of company registrations and the scale of enterprises based on the number of employees, was analyzed through statistical analyses, and micro issues have been identified based on questionnaire and interview surveys. The results of these studies have revealed the following problems and priorities: power shortages, shortages of raw materials and parts, difficulties in fund-raising, shortages of technological information, aging of equipment, shortages of experts, cumbersomeness of and frequent changes in the export and import system, inadequate industrial infrastructure, multiple exchange rates, the 10% tax on export sales, labor practices in favor of employees which are disadvantageous to employers, high costs of doing business and a lack of a level playing field for state-owned enterprises (SOEs) and private enterprises.

An analysis of characteristics of private manufacturing industries is necessary for proposing countermeasures against the problems faced by these industries and measures for their development. The identification of the characteristics of private manufacturing enterprises enables the formulation of an SME policy (or rather a household enterprise policy) that can respond to the problems and priorities faced by household enterprises, which account for the bulk of private manufacturing enterprises. Such measures will help develop a development policy for private manufacturing industries which will also respond to the problems faced of human-tie enterprises and capital-tie enterprises, which are expected to grow in the future, albeit in small numbers. The largest characteristic of private manufacturing enterprises is that in Myanmar, household enterprises, human-tie enterprises and capital-tie enterprises, each of which represents different stages of development, exist side by side. Among the 690 businesses that responded to our questionnaire, 86% were household enterprises, 6% were human-tie enterprises and 8% were capital-tie enterprises, with the household enterprises (personal enterprises) accounting for a dominant share. The same survey has revealed that among all the businesses it covered, sole proprietorship accounted for an overwhelming 75%, with family enterprises accounting for the second largest share with 11%.

Based on this analysis of the characteristics of private manufacturing industries, development measures for these industries have been examined from the five perspectives of export-oriented manufacturing industries, import substitution-type manufacturing industries, the development of supporting industries, the development of rural industries and the promotion of joint ventures with foreign companies. Thus, development measures have been

examined taking into consideration problems and priorities faced by each of these types of industries. The study then formulated measures for the development of SMEs, which correspond to stages of the development of the organizational format of the business. In order to cover enterprises in the three stages of development inclusively, short-, medium- and long-term policy systems have been developed. The study discussed rather in detail the concrete measures that need to be implemented in the short-term in particular. These measures include the redefinition of SMEs, the creation of the SME Development Agency or a Development Bureau, measures for SME registrations, the enhancement of the functions of UMFCFI and human resources development, the creation of technical training centers in industrial zones, the introduction of a system for the sale of state-owned machinery to the private sector, measures for creating cooperative businesses, measures for industrial land and measures for SME financing.

With respect to SME financing, the present status of fund-raising by SMEs and funds supply to SMEs has been analyzed, and an action plan has been proposed to enhance SME financing.

In addition, the study presents concrete examples of policy proposals for the two industries that occupy especially important places as Myanmar's strategic industries. The study has formulated and proposes development strategies for the garment-manufacturing and footwear-manufacturing industries, in which export ratios are particularly high, based on an analysis of the international market environment and measurement of export competitiveness.

1.4.6 Analysis of the Availability of Human Resources and Resulting Proposals

The overall educational plans in Myanmar consist of the Special Four-Year Plan by the MOE (Ministry of Education), which is ongoing, and a new 30-year plan that the government is formulating and for which the content has not yet been released. The JICA study team has *determined nine major issues that are currently facing Myanmar* with regard to human resources in the industrial sector. For example, the lack of numbers and quality of skilled workers who will be a driving force for industrialization, shortages in the total number of technical human resources, the weak infrastructure for technical development, the lack of opportunities for managerial-type education for the managements of PMIs (Private manufacturing industries) and SOEs (State owned enterprises) and insufficient corporate managerial ability within these managements. There are many issues related to human resources that need to be considered when forecasting future industrial development in Myanmar.

Under such circumstances, the following three issues need to be given priority in particular, as urgent measures in terms of industrial development.

- 1 The establishment of Advanced Vocational Training Centers (A-VTC) and accelerated modernization of Vocational Education and Skills Training (VEST)
- 2 The enhancement of managerial education systems, such as PMIs, for reinforcement of managerial ability
- 3 The establishment of an Myanmar Industrial Research Center (MIRC) and the creation of an industrial information infrastructure.

Technological progress is very slow in Myanmar, not only because of shortages in the number and quality of technical human resources but also because, in general, plant facilities are old and there are not many opportunities (in terms of investment) to renew them. It is necessary to create a large trend of activating exchanges with foreign countries, such as the acquisition of overseas technical information, the attraction of FDI, the return of Myanmar students studying overseas and the acquisition of new opportunities for students to study overseas.

One of the other major problems is that there is insufficient corporate managerial ability. Except for a few corporate managements, who are participating in overseas exchanges through imports and exports of raw materials or products, there are few opportunities to acquire advanced management know-how or to receive education related to management inside Myanmar. Although Yangon Institute of Economics and the Union of Myanmar Federation of Chamber of Commerce and Industry (UMFCCI) have courses for corporate management, the scale is still small. It is necessary to expand these courses significantly and improve the quality of the education. Activation of overseas educational exchanges is also an important measure. In Myanmar, even for corporate management, there is no exchange of information regarding success and failure experiences between the managements of companies (except that gained through relatives or trusting friends). Many small and medium-size corporate managements are in fact placed in the situation where they have to learn by trial and error, in the darkness without lights (i.e. information).

In Myanmar, there were 1.64 million workers engaged in the manufacturing industry in '98/'99, 11.4% of the total number of employees. Over the last ten years, this number has hardly increased. This fact indicates that the development of the manufacturing industry has been very slow. Although the 4% unemployment rate is statistically low, there are major problems, such as the mismatching of job types and the lack of employment opportunities in spite of education. For example, about 10,000 skilled workers were nurtured between 1999 and 2000, which is far lower than the targeted number of 320,000 that was supposed to be nurtured in the final five years of the government's 30-year plan. Also, the lack of employment opportunities is typically seen among software engineers. Pursuing employment opportunities and higher benefits, 90% of new university graduate engineers move overseas (to Malaysia, Singapore, etc.). Skilled workers are not often nurtured inside companies. Currently, the Ministry of Labor and the Ministry of industry are mainly operating and

exercising jurisdiction over the Vocational Training Centers (VTC) in Myanmar. However, the VTCs are using educational materials and facilities that are more than 25 years old and they also have serious problems with regard to the quality of instructors.

On the other hand, with regard to technical human resources in Myanmar, high-level engineers are nurtured at universities and so-called “technicians” are nurtured at the GTC (Government Technological College), GTI (Government Technical Institute) and technical high schools. The cumulative total of graduates from the GTC and GTI was about 46,000 between 1997 and 2001. If the number of high-level technical human resources who will play the central role in technology can be identified as the number of university graduate engineers, this is assumed to be 25,000 to 30,000 in total (70 to 80% of whom work for private companies). Moreover, 1/2 to 2/3 of this number are engaged in jobs related to real world technologies and 12,000 to 20,000 engineers are concentrated in the areas of production technology and plant management.

In addition, there is the large question of the abilities of SOE managements. It is claimed that people from the military occupy more than 90% of the MD (Managing Director) /DG (Director General) positions, 60% at the level of director and 40% at the level of manager. The percentage of people from the military in middle management is extremely high. The “Management Training Course” for SOE officials was opened up between 1984 and 1988 and used to be highly regarded. Many senior military officers are from the DSA (Defence Service Academy), including those who have studied economics. Many knowledgeable people have pointed out that even taking these facts into account, it still can’t be said that SOE managements possess the managerial abilities required under a market economy. In particular, the current SOE managements have a negative effect because the military style, top-down method of giving instructions is extreme, and a system for delegation of authority and responsibility has not been built into organizations. For a start, it is necessary to reform the decision-making mechanisms in organizations (decision-making methods, ideal structures for boards of management, etc.), share information inside organizations and innovate the methods for discussion and decision making between divisions.

On the other hand, with regard to the future industrial development of Myanmar, it is at least necessary to be “armed with information,” most importantly industrial information. A Myanmar Industrial Research Center (MIRC) equipped with an industry survey function and an industry information library function needs to be established, developed and expanded as an information center for industrial development.

1.4.7 Measures for the promotion of exports, attracting foreign direct investment and the development of private manufacturing industries: a summary

We have presented an industrial vision and development strategy for Myanmar as well as outlines and major recommendations in Master Plans for export promotion, attracting foreign direct investment and the development of private manufacturing industries. The recommendations can be classified into i) liberalization and deregulation

for the improvement of the business environment in Myanmar and ii) policy support measures necessary for export promotion, attracting foreign direct investment and the development of private manufacturing industries.

As mentioned at the beginning, due to the lingering and strong influence of the controlled economy of the past and the delay in the transition into a market economy, there are many impediments and disincentives in the business environment in Myanmar. Therefore, the environment is very harsh for both domestic and foreign companies. Table 1-2 shows major impediments to business and disincentives by factor which causes them, the order of priority in removing such impediments and the measures for reform. The most frequently cited causes or sources of impediments are foreign exchange and revenue shortages, and inefficiency in administrative systems. Regulations resulting from security concerns, stemming from the viewpoint of governing the nation, are still present in the areas of immigration control, access to overseas information, land use, and the entry of the private enterprises in public services. For expanding exports and the inflow of foreign direct investment and the development of private enterprises, the government of Myanmar needs to remove these impediments and disincentives to business as soon as possible. In particular, there is an urgent need to correct the items that are marked priority No. 1.

Table 1-2 Business Impediments & Disincentives in Myanmar and Its Reform Measures

Contents of Impediments Classified by Its Causes	Priority of Reform	Reform Measures
(Based on the shortage of foreign currency)		
Taxation to the export(US\$ payment)	1	abolish 10% export tax and replace it by 5% import surcharge
Foreign remittance restrictions	1	guarantee foreign remittance for foreign investors
Export & import licensing system	2	abolish export licensing system except for the special items e.g. rice revive one year open general license for the MIC approved project
Various import control measures (NTB)	2	abolish NTB as soon as possible
Compulsory US\$ exchange system under the market value for CMP operators	1	abolish this compulsory US\$ exchange system for CMP operators
State's monopoly or control on important export items	2	open to the private sector for export e.g. rice, teak, jewelry
Dual pricing system (unfavor to the foreigners)	3	promote national treatment within 5years
Difficulty in withdrawing US \$ from the bank	2	improve the current situation
(Based on the under-developed legal system)		
Lack of transparency, delay of notification of trade& investment related regulation	1	improve the transparency, notification process
Insecure foreign investors right in the legal aspect	1	assure foreign investors right in the legal aspect
Delay in obtaining new entry permit and registration for the companies	1	deregulate current regulation and simplify the procedure
(Based on the under-developed financial system)		
Lack of export & import financing service	3	establish export financing scheme
Difficult financial access for the SMEs	2	establish SME financing scheme
Under-developed international settlement & financing services	3	improve the international settlement & financing services
(Based on the under-developed infrastructure)		
Power shortage and its high cost	2	allow private participation by BOT, BOO basis
Under-developed and high cost of international telecommunication	3	allow private participation and encourage competition
(Based on the under-developed administrative system)		
Red-tape in obtaining export & import license	1	simplify the procedure and train the personnel in charge
Red-tape in getting FDI approval	1	simplify the procedure and train the personnel in charge
Red-tape in getting approval of capital increase	1	simplify the procedure and train the personnel in charge
Red-tape in custom clearance	1	simplify the procedure and train the personnel in charge
inefficiency of MIC as an investment service agency	1	laws and regulation which authorize MIC should be strengthened or upgraded
(Based on the so called "national security" reasons)		
Restriction on internet access	1	relaxation of current regulations
Difficulty in obtaining business passport	1	relaxation of current regulations
Complicated immigration procedure to obtain Visa	2	relaxation of current regulations
Restriction on private participation into the public services (IPP, BOT, BOO)	2	relaxation of current regulations
Restriction on land use for factory construction	2	relaxation of current regulations
Restriction of direct trade by foreign enterprises	1	relaxation of current regulations

Source: Source: Task Force of Trade & Industry WG

If the above-mentioned impediments are removed, foreign direct investment will increase, exports will expand, and private enterprises will develop further. However, deregulation and liberalization alone will not make it possible to catch up with other ASEAN nations, where the policy and institutional environment is better than in Myanmar. Therefore, Myanmar needs to take necessary policy support measures for further development. Table 1-3 is a list of major policy support measures, needs for which have been pointed out in this report. It is desirable that the implementation of measures marked priority No. 1 be launched within one to two years and those marked priority No. 2 within three to five years at the most.

Table 1-3 Support Measures to Promote PMI, Exports and FDI Attraction

Area	Main Support Measures	Priority
1. Export Promotion	1-1 Establishment of high level joint export committee	1
	1-2 Establishment of EPZ and Bonded Warehouse	1
	1-3 Provision of export incentives	1
	1-4 Establishment of export financing scheme	2
	1-5 Strengthening trade training function of UMFCCI	2
	1-6 Establishment of trade promotion organization	2
	1-7 Establishment of organization for quality inspection, upgrading including standardization	2
2. FDI Attraction	2-1 Establishment of EPZ or SEZ by BOT, BOO	1
	2-2 Strengthening the authority of MIC as one stop service agency for FDI	1
	2-3 Creation of EZAM(Economic Zone Authority, Myanmar)	1
	2-4 Strengthening FDI promotion activity including joining membership of ASEAN Center, Japan	2
	2-5 Development of human resources for FDI attraction	2
	2-6 Formulation of strategy for attracting specific potential industries	2
	2-7 Improvement of the national economic statistics such as FDI, trade, national income and industrial production	2
3. PMI(SME) Promotion	3-1 Reformation and improvement of existing industrial zones	1
	3-2 Leveling the playing field between the private and SOEs	2
	3-3 Provision of incentives for new investment and investment in the remote area	1
	3-4 Establishment of financing scheme for SMIs	2
	3-5 Establishment of technology training center or common facility for technology upgrading	2
	3-6 Establishment medium-term plan for SME diagnosis consulting system	2
	3-7 Promotion and strengthening of business associations by industries	1
	3-8 Establishment of SME promotion agency/institutions	2
	3-9 Strengthening of technical and industrial management training program	2
	3-10 Formulation of development plan to promote potential strategic industries	2

Source: Task Force of Trade & Industry WG

Dispatch of experts and other support measures

When Myanmar embarks on the first steps toward implementation of these policies, it should seek the assistance of experts in the various fields concerned. This approach is an effective and concrete one that can be efficiently and firmly pursued while surmounting the many obstacles to policy implementation. In addition to using experts from within the country,

use should also be made of Myanmarese who have undergone specialist training and acquired experience in the relevant fields overseas.

A particularly effective strategy would be to send experts to Myanmar from government and public bodies and the private sector in Japan and elsewhere overseas. Below, therefore, we suggest what kinds of experts should be dispatched (i.e. what experts the Myanmar Government should request) to advise on several of the policies proposed in this report. The experts dispatched should consist of teams as well as individuals so as to reap greater benefits from the policies proposed.

Structural reform:

- Reform of electricity system and rates (electricity system and rates system advisers, experts on the economics of electric power)
- Strengthening of industry associations (consultants and present/former managers of chambers of commerce and industry)
- State owned enterprise (SOEs) reform (improvement of management and technology, privatization plans)
- Formulation of development plans by strategic industry (experts on each industry, business strategy experts)
- Reform of labor practices (personnel and labor consultants, labor law experts)
- Reform of customs procedures (customs experts, related information systems engineers)
- Establishment of industrial research center (industry analysts and researchers, industrial information librarians)
- Industry information system development (variety of information on e.g. overseas agricultural markets, export marketing, etc.)
- Creation of SME financing system (SME finance experts)

Development of human resources:

- Improvement of loan screening process for SMEs (bank staff training program experts and consultants)
- Enhancement of SME management skills (seminar series, dispatch of instructors)
- Implementation of government SME policy and support for establishment of programs (experts in SME policy and programs)
- A-VTC (advanced vocational training, advisers, instructors, teaching materials, etc.)
- Practical export training (former/present employees and managers of trading companies and persons with hands-on export education experience, etc.)

- Enhancement of Yangon Institute of Economics MBA program to MBA Business School (business school experts)
- Technical guidance for enterprises locating in industrial zones in Myanmar (machinery repair and mold experts, etc.)

Industrial development:

- Improvement of garment and footwear education programs (establishment of training centers, technical experts)
- Establishment of timber processing technology center and provision of technological guidance (advisers, technology experts)
- Software industry business-matching services (between Japan and Myanmar, etc., business advisers)
- Development of private shipbuilding industry (100-ton vessels, industry advisers, specialist engineers)
- Mineral resources surveying (application of GIS technology, database development experts)
- Establishment of agro-based industrial technology center (Agricultural Machinery, Food Processing)
- The establishment and management of Myanmar Industrial Research Center (MIRC) (Industrial researchers, management consultants)

Special Economic Zone (SEZ) development and attraction of FDI:

- Detailed analysis of FDI demand and promotion of inward FDI (experts in attracting FDI, researchers in related fields)
- Application of BOT model in Myanmar (BOT and legal experts)
- SEZ development (legal experts in foreign investment law, etc., professionals with SEZ experience, marketing strategy experts, consultants, etc.)

Other reforms:

- Establishment of think tank to formulate industry and trade policy (policy analysis and planning experts)

1.4.8 Urgent Recommendations

<A. Promotion of deregulation and liberalization>

It has been stated that deregulation and liberalization for the improvement of the business

environment in Myanmar are essential. The following are the reforms that need to be implemented urgently.

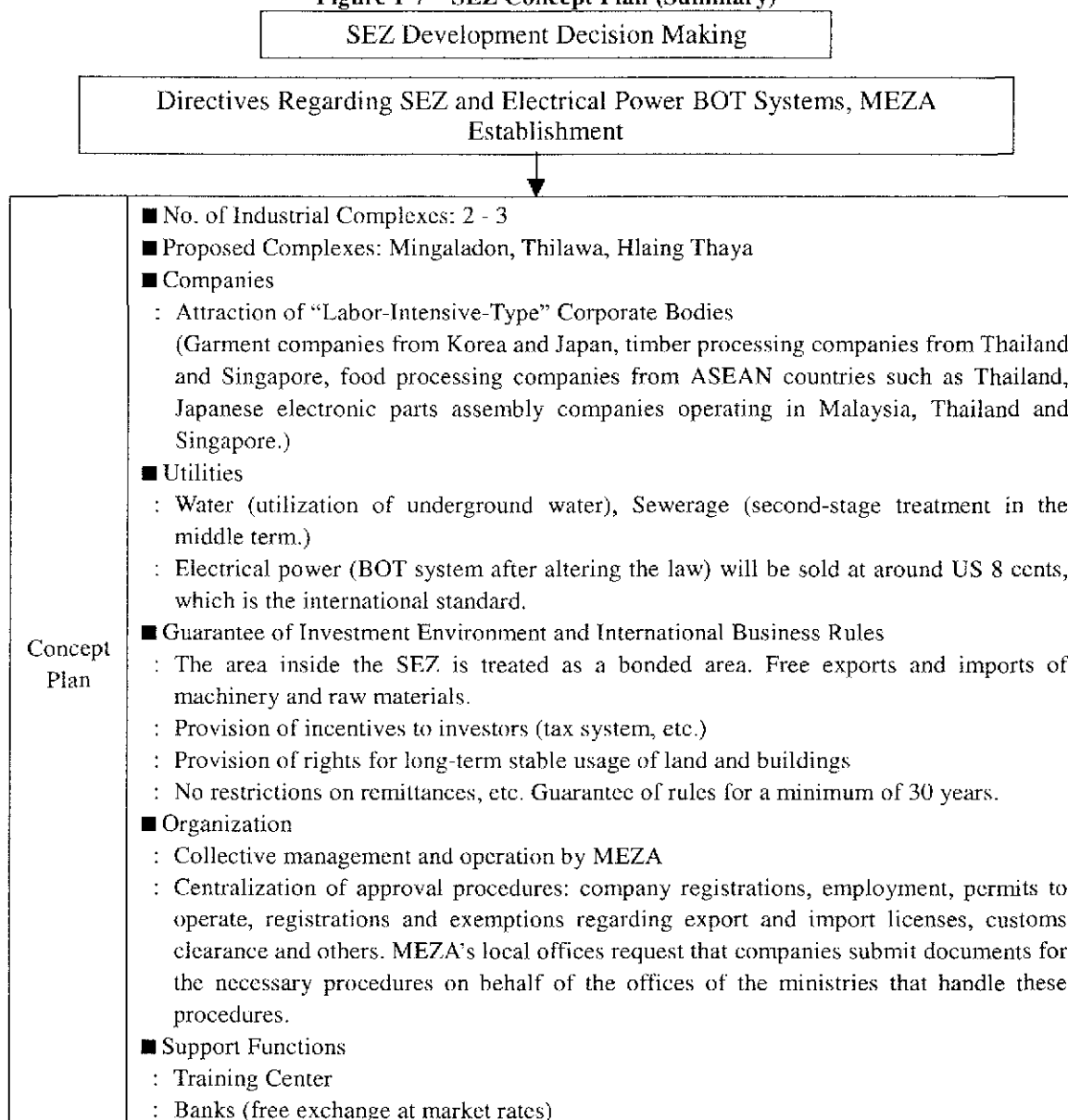
- (1) Abolish the export tax (except for products which were judged to be controlled in light of food security including rice and teak for environmental conservation). Accordingly, if necessary, an import surcharge of 5% (paid in dollars) should be introduced to compensate for the government's loss of foreign currency income by abolishing export tax. A country short on foreign currency should avoid levying penalties on exports. It is more reasonable that the country, taking into account the current trade deficit, should levy taxes on imports. However, it is desirable for the country to lower such surcharge rate in gradual phases and ultimately abolish it as soon as exports expand and the shortage of foreign currency is solved.
- (2) Abolish the export license system
- (3) Guarantee foreign currency remittance for foreign investors
- (4) Improve the current unstable condition regarding foreign investors' rights in the legal aspect
- (5) Abolish the compulsory exchange system with the foreign exchange center rate, which is greatly lower than the market rate, for CMP-based businesses (regarding workers' wages)
- (6) Improve the transparency and through notification regarding trade and investment
- (7) Streamlining, increasing transparency and speed of the following administrative procedures: New registration of companies and businesses, approval of foreign direct investment, approval of capital increases by companies and export and import customs clearance.
- (8) Abolish restrictions on direct trade by foreign companies

<B.The Establishment of Special Economic Zones (SEZ)>

Industrial complexes conform to special economic zone (SEZ) systems, export processing zone (EPZ) systems, specific technological development promotion zone (TPZ) systems, special general industrial zone (GIZ) systems or a system combining all these functions. In Myanmar, there are no industrial complexes in the SEZ or EPZ systems that other Asian countries have successfully adopted and the investment incentives for foreign investment are extremely small. Taking into account the various risks, such as the unstable electrical power supply and the frequent changes in policies, it is difficult to attract FDI under the current conditions.

The SEZ concept plan that Myanmar needs to urgently develop as a pilot project is shown below.

Figure 1-7 SEZ Concept Plan (Summary)



Source: JICA Study Team

The objective of redeveloping two or three candidate industrial zones as SEZs is first and foremost to create a successful model for the introduction of FDI into Myanmar. The aim is to use SEZs to create the conditions for attracting foreign capital into the country. The experience gained and confidence acquired through the success of model SEZs should then be applied in transforming a greater number of industrial zones into SEZs and EPZs.

Critical issues in relation to SEZs are land rental prices and land use terms. The conditions offered need to be attractive in comparison with SEZs and EPZs in neighboring countries. As well as round-the-clock power supplies, it is necessary to guarantee freedom of exchange of dollars at market exchange rates at banks in SEZs, freedom of remittance and bonded zone treatment for SEZs, to provide tax and other incentives to investors, and to

guarantee to investors that these various conditions and rules will be maintained for a minimum of 30 years. There is a need for investment in Myanmar among foreign firms in labor-intensive industries, such as Korean and Japanese firms in the garment industry, ASEAN firms in the food processing industry, Thai firms in the timber-processing industry, and Malaysian firms in the electronic component assembly industry. Inward investment programs should therefore initially focus largely on these industries.

The obstacles presently faced by Myanmar to the proposed development of SEZs and inward investment programs include the problem of development funding, lack of a central coordinating organization, the underdeveloped state of the legal system, and lack of experience. The solutions to these problems need to be clarified through the development of concrete SEZ concepts and feasibility studies. To obtain the necessary development funding, for example, the investment conditions for BOT projects funded by domestic and foreign investors should be urgently developed to attract investment by private enterprises, while at the same time pursuing the use of such sources of finance as foreign government funding. There is already domestic interest in investment in the electricity sector. On the organizational front, the uncoordinated response of the various ministries to SEZs is inefficient and only serves to lower the investment incentive for investors. A single organization with the authority and capacity to manage and administer programs in a coordinated manner should therefore be established. Regarding legislation, the first steps toward the development of SEZs should be taken by issuing directives if enacting laws and ordinances is too time consuming. There have already been a number of successful SEZ projects in China and ASEAN. The officials involved with SEZs in Myanmar need to properly understand the significance of the development of SEZs and study and research successful cases so as to be able to start taking urgent action to create the conditions for the development of SEZs in Myanmar.

<C. Solution for addressing the electric power problem in Myanmar>

The serious shortage of electricity is a major bottleneck hindering industrial development in Myanmar. Therefore, it is indispensable that radical reforms be implemented immediately to solve such shortages of electric power. The following is a tentative solution plan, which basically takes into account the structure of power shortages in Myanmar.

In terms of energy-GDP elasticity, increases in power demand usually considerably exceed the increases in the GDP. However, Myanmar has been unable to make enough investment in power to meet the needs of past growth, which has caused a recent wave of blackouts in the country. One main reason Myanmar was not capable of such investment is associated with past government policies that have held electricity charge extremely low, thereby preventing Myanmar Electric Power Corporation from acquiring enough funds to reinvest. In Myanmar, electricity rates were raised to 1.3 kyat/kwh during FY1995-97 and to 2.5 kyat in FY1998, while the cost of power was at 16 kyat/kwh (approx. US 5 cents) as of the end of 1998. The government subsequently provided state subsidy to cover the balance of 13.5 kyat/kwh, and this reportedly amounted to two billion kyat a month. The financial structure in Myanmar therefore involved a situation where the more the power supply increased, the wider

state fiscal deficits grew; a trend which could not go on forever. The Myanmar government later drastically raised electricity prices to 25 kyat/kwh (about US 8 cents) in June of 1999. However, only those who consumed more than 150 KWH of electricity had to pay such prices; the charge paid by public officials (whose salaries are extremely low) and those who consumed less than 100 KWH were 2.5 kyat/kwh, while those who consumed between 100 KWH and 150 KWH paid 10 kyat/KWH.

The increase in electricity prices to 25 kyat was an adequate enough level to allow private IPPs (Independent Power Producers) to turn a profit, and therefore such private companies began to operate several state power plants in the outskirts of Yangon where they had previously not operated due to procurement problems for diesel oil. Because of their emergence and owing to the effects of energy savings from the increase in electricity prices, blackouts almost totally disappeared in Yangon for a period of about half a year. However, due to subsequent surges in crude oil prices and depreciation of the kyat, the price of 25 kyat became equivalent to two cents when converted to US dollars (as of the end of September 2002). If power costs are estimated to be 5 cents (the value at the end of 1998) then the situation has resulted in a negative margin of 3 cents (36 kyat) per one kwh. Furthermore, ever since the increase in electricity prices was implemented, the number of users who tried to avoid properly paying electricity charges by manipulating their electric meters has increased. As a result, long-term blackouts have once again continued to occur.

It is desirable to raise electricity prices to a profitable level and, at the same time, ensure a steady supply of electricity over broad areas for those who can pay electricity charges. In Myanmar, although farmers have improved their overall standard of living, they do not purchase any products that require electricity due to the lack of availability of electricity. Also, though they save in gold, this does not provide any incentives for improving production levels. If adequate amounts of electricity were supplied, this would enhance incentives for farmers to work harder in order to purchase household electric appliances and other products, which would ultimately improve their productivity. Also the electrification of rural communities will not only significantly transform farmers' way of living, but will also create an enormous demand for industrial products, thereby supporting the industrialization of Myanmar.

Electricity consumers in urban areas receive electricity at extremely low-level prices thanks to subsidies (public officials and employees of state-owned enterprises meanwhile receive further grants from government institutions, basically for free), which somewhat promotes the waste of electricity. Naturally, social policies that help the economically disadvantaged are necessary, however, if the situation is able to be improved so that those who have not paid the increased electricity prices do not readily receive electricity service, then energy conservation can be achieved and this will also stimulate work incentives for people living in urban areas. What needs to be constructed is a sustainable system, which will ensure a steady supply of electricity for those who pay higher electricity prices. This is far better than the current situation, which invites people's frustration and dissatisfaction because the government can not assure the stable electric supply, though the electricity fare remains at very low level.

Since Myanmar cannot expect to receive economic aid from countries other than China and India under the present international economic sanctions, it is essential for Myanmar to attract foreign direct investment and investment from domestic private companies for power generation projects in order to solve the serious shortage of electricity within a short period of time. For that purpose, it is necessary to establish the Build-Operate-Transfer (BOT) law, formally allow foreign capitals to conduct power generation projects based on BOT or BOO (Build-Operate-Own) system, and ensure the conversion of kyat income to dollars. Ahead of such measures, what should be done first is to move the electricity price to a profitable level. If phased and drastic depreciation of the kyat continues, electricity prices in kyat will inevitably fall below cost. If possible, the price system should be improved so that electricity prices are paid by kyat in equivalent dollar amounts (around US 8 cents) and they should fluctuate according to changes in the exchange rate for the kyat.

The Myanmar government has maintained the rates of 2.5 kyat and 10 kyat for some electricity consumers even after they raised electricity prices to the 25 kyat-level, taking into consideration the social effects that such a price increase may cause. Indeed, consideration of the economically disadvantaged is necessary as a transitional measure, however inevitably electricity prices need to be increased in gradual phases so that they more nearly approach the level of power cost. In regard to public officials whose salaries are extremely low, it is more desirable to pay them electricity-related allowances instead of providing nearly free electricity.

The implementation of an electricity price system where charges are paid by kyat in equivalent dollar amounts at first appears to be politically impossible. However in areas that border China and Thailand, electricity prices are being paid by kyat in equivalent yuan and baht amounts (both at around US 10 cents), which are converted at the expensive sum of 120 kyat per one kilowatt hour based on current exchange rates (1 US\$ = 1,200 kyat). According to residents of Muse, Nam Kham and Tachleik, they pay these expensive electricity prices even though they are poor because having electricity is extremely important to them, despite the steep prices.

The Myanmar government believes that blackouts have been mainly caused by factors on the supply side and it therefore plans to construct gas pipelines and hydroelectric power plants. However, they are overlooking the fact that the cause of such blackouts actual lies in the area related to electricity prices. If the state finances are abundant, the Myanmar government could supply inexpensive electricity with subsidies, however indeed their finances are not sufficient. Myanmar government should be bold in taking steps to fundamentally change the electricity price system in order to break out of the vicious circle of low electricity prices, financial pressures, inadequate investment in power generation, electricity shortages and heightened dissatisfaction of the people.

The structure of electricity shortages in Myanmar is common to that of oil supply, railway and river transportation, and air freight, and therefore the price systems of these fields should also be reviewed in a similar way.