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

Executive Summary

March 2003

The Government of
The Union of Myanmar

Japan International
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Foreword

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

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

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

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

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

March 2003

川上隆朗

Takao Kawakami
President
Japan International Cooperation Agency

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A. Supervisory Group Report

Structural Adjustment of the Myanmar Economy: Executive Proposals

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

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

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

I.

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

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

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

In order to ensure that all these activities bear fruit successfully, it is essential for the government of Myanmar to stand ready to supply the necessary professional personnel.

II.

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

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

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

III.

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

IV.

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

V.

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

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

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

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

VI.

Institutional reform on the government's side is urgently needed as a measure to improve the country's export earning capabilities. In this regard it is highly important to increase the transparency of administrative procedures, to minimise official control over the market transactions, and to avoid abrupt changes in policies and regulations. In addition, inviting foreign direct investment is an important way to help both Myanmar's infrastructure and the nation's productive capacity to develop rapidly, as it would bring in foreign currencies, market assistance as well as foreign technology and efficient management. In order to encourage foreign direct investment, it is important to minimise regulatory procedures and to unify the exchange rates. More fundamentally, it would be highly significant to update the nation's legal system and due process, and to revitalise the basic spirit that underlies the relevant laws and make it more effective.

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

VII.

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

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

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

VIII.

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

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

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

IX.

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

X.

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

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

XI.

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

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

XII.

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

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

B. Fiscal and Monetary Policy

Working Group Report

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Acronyms

Banking Sector

ALM	Asset and Liability Management
ASEAN	Association of Southeast Asian Nations
AWB	Asia Wealth Bank
FMWG	Fiscal and Monetary Policy Working Group
HRD	Human Resource Development
IBBM	Institut Bank - Bank Malaysia
ICT	Information and Communication Technology
IT	Information Technology
JICA	The Japan International Cooperation Agency
K	Kyat
MBA	Myanmar Bankers' Association
MEB	The Myanma Economic Bank
ODA	Official Development Assistance
TA	Technical Assistance

Microfinance

BRI	Bank Rakyat Indonesia
CARD	Center for Agriculture and Rural Development
CBI	Capacity Building Initiative
CBO	Community Based Organization
CDRT	The Community Development for Remote Townships
FAO	Food and Agriculture Organization of the UN
GRET	Groupe de Recherche et d'Echanges Technologiques
INGO	International Non Government Organization
K	Kyat
MADB	Myanma Agricultural Development Bank
MFI	Microfinance Institution
MNCC	Myanmar National Credit Council
MMCWA	The Myanmar Mother and Child Welfare Association
MOU	Memorandum of Understanding
NGO	Non Government Organization
PACT	Private Agencies Acting Together
SRG	Self – Reliant Group
TA	Technical Assistance
UNDP	United Nations Development Programme
UNOPS	United Nations Office for Project Services
YMCA	Young Men's Christian Association
YWCA	Young Women's Christian Association

I. The Unification of Exchange Rates[1]

As a whole, the exercise in our Working Group was positive, future-oriented, open-minded, policy-oriented, pro-liberalization, practical, based on mutual-trust, friendly and with sensitivity.

More concretely, some remarkable progress has been made, frankly speaking, more than anticipated.

First, on the unification of exchange rates. It was the most important agenda item. The following is "The agreed Joint Proposal on the unification of exchange rates" submitted jointly by Myanmar and Japan Fiscal and Monetary Working Group to the leaders of Taskforce Team.
(STRICTLY CONFIDENTIAL).

The agreed JOINT PROPOSAL by the Fiscal and Monetary Working Group to Myanmar and Japanese sides. We report that, on the unification of exchange rates in Myanmar, we continued our dialogue in a very low-profiled way over and over again for the last two and a half years and sought to reach an agreement.

On 25 June 2000, on the occasion of the first Workshop, Japanese team presented the Japanese experience of unification recommended by the Young Report after the Second World War. Japanese team proposed to discuss this in a small group. Myanmar side agreed to set up Working Groups.

On the occasion of the second Workshop on 4 December 2000, the Myanmar team submitted a confidential paper on issues and recommendations on Fiscal and Monetary Policies for Structural Adjustment in Myanmar.

On 18 August 2001, we discussed the matter in the Fiscal and Monetary Mini-Workshop based on the paper written by Japanese team.

On 23 November 2001, in his Opening Remarks to the third Workshop, Myanmar side stated that "The Japanese Working Group had made a strong suggestion for the unification of exchange rates in Myanmar. However, we do believe that it is untimely to consider the unification of exchange rates in Myanmar without any social safety net committed by the international and

[1] This article is based on a presentation of Japanese Fiscal and Monetary Working Group at the final workshop in Yangon. The original article is, however, partially modified on JICA's responsibility.

bilateral organizations."

On 21 July 2002, in the Forth Workshop, Japanese team prepared a paper and discussions were made.

We report that our discussions largely converged to the following three points:
First, all agreed to the necessity and importance of the unification of exchange rates.
Second, all agreed that, for the success of the unification, broader range of measures for the stability of the economy should be taken.
Third, from the Myanmar side in particular, the importance of strong foreign reserve was stressed, and it is a prior condition to the unification.

We conclude that, with the objective of the long term stabilization of the macroeconomy of Myanmar, the unification of exchange rates is a must. When and how the exchange rates to be unified have been discussed intensively.

We jointly propose in accordance with this conclusion:
That the Myanmar Government will, at an earliest opportunity possible, unify exchange rate, as a part of the economic policy package, including the intention to reduce budget deficit and modernize national taxation system to raise tax revenue to at least a comparable level with other ASEAN countries relative to GDP,
That, noting the importance of strong position of the foreign reserve in Myanmar, the Government of Japan will take initiative, upon the request made by the Myanmar Government, at an earliest opportunity possible, to embark on governmental level talks among competent authorities on different types of bilateral and multilateral assistance to help achieve the unification, including to explore the possibility of the provision of short-term yen-kyat swap, and a more prompt solution of Myanmar's outstanding arrears with Japan.

We firmly believe that the implementation of our joint proposal by both Governments will give an important signal to the world for further opening and liberalized policy of Myanmar, constitute a crucial step for inviting foreign direct investment, and thus form a basis for policy framework for the prosperity of Myanmar in the 21st century (End of the agreed text).

Second, on microfinance, agreement was made on the joint report with 300 pages, and positive dialogue was made on the implementation of the proposals of the report.

It was not at all foreseen in our initial road map. It was constructively developed in our policy dialogue with a close collaboration of the experts, world wide famous for their 21st century type microfinance model.

Third, on fiscal and monetary policy and system.

In this area, I would like to particularly congratulate that the Myanmar side completed the valuable report titled "Recent Development of Public Finance in Myanmar". It is a confidential paper so, not for public use. It is brief, but very accurate and informative.

A difference of our exercise from the surveillance process by international organizations is ours is not one way talking, but two-way dialogue, so the Myanmar side contributed greatly to the success of our exercise. Reading this report, I strengthened my conviction that the policy subtleness of one country can seldom be understood only by listening to that country's compatriots, not to others.

This document is valuable for two reasons. Firstly, almost all the important problems in this field were covered. Secondly, the policy orientation for the solution was made clear. I highly appreciate that keen awareness on the problem is unequivocally described in this report.

I quote some phrases.

"From early 90's till late 90's budget deficits measured as percentage of GDP remained rather high basically due to much needed infrastructure developments as foreign assistance was negligible in this regard. However, the government is now paying full attention to a significant decline in budget deficit, and accordingly, it is expected that Myanmar will be able to achieve a balanced budget by the year 2005-2006 together with some ASEAN countries. Currently the main objective of the fiscal policy is to help maintain macroeconomic stability. Reduction in public sector deficit is at the core of the government strategy. In order to reduce the budget deficit, the fiscal spending has been thoroughly scrutinized and cubed distinctly, especially for the capital expenditure, which are of nonproductive nature.

The financing of fiscal deficit has relied mainly on borrowing from the Central Bank. However, starting from 1993, the deficit has been financed through the issuance of government treasury bonds. Since 1995, a privatization scheme was initiated, to help reduce the budget deficit, transferring SEEs to the private sector. Further reform measures will take place in coming years to broader tax base and to further strengthen the tax administration, so that mobilization of resources will be promoted.

With a view to promote domestic resource mobilization, a project to establish a securities market in Myanmar started in 1996. In the long run, the development of a securities market will be realized and issuance of government bonds will then be a more effective means of finance as is done in most of the developed countries. Moreover, the current tax system will be replaced by the Value Added Tax System in the future." (End of the quotation)

I once again draw the attention that this policy orientation was recommended neither by Japanese nor by international organizations. This clear message was prepared by our distinguished Working Group members of the Myanmar side.

Overall, we had five main legs in our discussions, first, the exchange rate unification, second, microfinance, third, budget system, forth, modernization of the banking system including the computerization, and fifth, human resource development for banking sector. We need further discussion on the last 2 items. All are very important but very sensitive problems. They are reflected in our final report, sometimes strongly, sometimes exhaustively, and sometimes very elegantly. I hope everybody who reads our final report will perceive our sensitivity on the matters.

My conclusion is I am convinced and strongly encouraged that every member in our Fiscal and Monetary Group shares the value of reform. So I conclude that our undertaking was a constructive and successful intellectual exercise.

Having said these, I sincerely hope that our policy proposal will be materialized through Myanmar's decision making process, because, as Jean Monnet, father of the European integration, once noted, "the final word is always political".

I feel extremely happy to finish our exercise remembering the words Arafat of Palestine said several years ago at the press conference after the meeting invited by President Clinton to Camp David with his counter part of Israel: "Thank you, Thank you, Thank you".

II. Financial Sector

1. Banking Sector Review and Human Resource Development Programme

1.1 Background of the report

The main purpose of this joint study is to identify priority issues and policies on the main financial intermediaries in Myanmar, their managerial improvements and human resource development for banking sector in particular, and thereby contribute to financial sector development that is conducive to a market-oriented economy. Our joint-study team approaches this issue by conducting interviews with financial institutions and analysing existing disclosed documents and data.

To address the issues on the financial sector, it was decided through discussions at the FMWG level that the study led by the Japan Economic Research Institute was to focus primarily on the private sector in the banking business, in consideration of the circumstances on the Myanmar side. Overarching banking sector development issues including state-owned banks were therefore not addressed in a comprehensive manner within this study, although some points are referred to because they are indispensable to the main purpose of the study. Further to the first part of the study on banking sector in Myanmar until July 2002, the second part of the study highlights human resource development of private banks, vital to accelerating development of banking sector in Myanmar.

With the promulgation of the Central Bank of Myanmar Law and the Financial Institutions of Myanmar Law, the government allowed private banks to commence operations in 1992 as part of the banking sector modernisation process. Private banks have been playing increasingly substantial roles in development of the financial sector and the national economy. However, there are still many issues to be considered in order to establish a firm foundation of public trust (by ensuring a sound financial system and improving financial service quality) and contribute to economic growth (by providing capital to real sectors that have higher productivity). Thus, in this report, we will summarise further development of banking sector policies and private-bank management, followed by HRD programme for banking sector with close linkages.

1.2 Measures to be taken into consideration for further development of banking sector in Myanmar

In order to keep momentum in the development of Myanmar's banking sector, policy makers should take into consideration the fact that maintaining public confidence in fundamental commercial banking activities is important. Therefore, ensuring banking system sustainability, improving peoples' access to financial services, and removing impediments to institutions' competitiveness should be emphasised.

1.2.1 Policy measures to build a sounder financial system

Policy measures and managerial improvements for building a sounder financial system
Assurance of the soundness and stability of the financial system is a prerequisite for further banking sector development in Myanmar. However, at a time of rapid expansion of financial services, prudential practices are apt to be deferred for future discussion.

- In order to protect depositors, we recommend that banks disclose their financial statements to the general public and at the same time, develop the sound accounting practice particular to banking sector.
- The Central Bank of Myanmar (CBM) is to take into consideration to establish appropriate prudential norms to be put into actual practice by banks. A typical example is to establish a sounder monitoring and repayment system through introduction of both monthly (or more frequent) repayment and periodical monitoring of the credibility of borrowers in cases where loans are being rolled over. CBM is to take into consideration to examine the quality of assets and real situations of non-performing loans.
- In order to prevent repeated failures, we recommend that banks share amongst themselves periodically their information on delinquent customers and fraud in financial transactions.
- In order to keep financial discipline of banking sector, policy lending should be segregated from commercial banking activities.
- In line with the Control of Money Laundering Law (enacted June 2002), effective actions will be taken against illegal money transactions, with deliberate consideration on ensuring soundness and stability in the financial system.
- The Central Bank of Myanmar is to take into consideration to mandate sound corporate governance in private banks by upgrading the existing establishment norms to reflect international standards. Review of article 3(a) of FIM Law is recommended, specifically looking to require that some private banks be established as shareholding companies. Shareholding companies would provide far sounder financial bases and bank management accountability. In modern market economies, banks must have shareholding company status. Institutions established as limited liability companies should be classified as finance companies.
- CBM is to take into consideration for the need of establishing accounting standards that enable domestic private banks to compete and cooperate with foreign banks on equal financial

bases.

- External auditing and publication of audited results should be compulsory for all financial institutions of relevant size and market presence. Detailed criteria should be set by CBM.

1.2.2 Policy measures to enhance the financial service

Policy measures for enhancing private banks' capacity to provide loans to the small-and-micro enterprise sector, to best serve the real sector productivity growth

- Encourage private banks to improve the access of the small-and-micro enterprise sector to commercial banking services by permitting them to gradually expand their branch networks into local areas, corresponding to the financial capacity of the banks concerned. The criteria for permits for new branches should be rationalised.
- Support institutional capacity building (in financial intermediation) of banks in the course of their expansion from regional to nationwide banks. In parallel with enlarging their customer bases—from only individuals at the community level to also enterprises with wider scopes of business—private banks need to upgrade their bases for making loans from personal connections and mere collateral valuation to creditworthiness and managerial and financial sustainability of enterprises and projects. Human resource development (capacity to both assess borrowers' business plans before providing credit and monitor customer performance after providing credit), will be getting more important in order to minimise credit risk in the banking sector.
- Mobilise longer-term funds by giving customers more incentive to save long term—incentives such as gradual adjustment towards positive interest (in real terms). Banks need to introduce more flexible lending rates, reflecting the individual credit risks of borrowers, in order to encourage more lending to small and micro-businesses.

1.2.3 Policy measures to strengthen the competitiveness

Policy measures for strengthening commercial banks' competitiveness in order to cope with ASEAN regional financial cooperation initiatives and open-up the financial market of Myanmar
In the April 2002 ASEAN Finance Minister Meeting in Yangon, member countries made commitments to further liberalisation of financial services in 2002. The financial crisis in Asia in 1997 and its subsequent impacts highlighted the fact that financial system sustainability is critically dependent on increased competitiveness by domestic financial institutions.

- In order to enhance the competitiveness of commercial banks for the country as a whole, an appropriate division of works among state-owned banks and private banks needs to be reviewed in view of recent rapid progress of private banks' financial services.

- Permission of dealing with foreign exchange business to private banks should also be considered in order to strengthen their business bases in preparation for a gradual shift to full-fledged international banking. Lifting the ban on joint ventures between foreign and domestic banks would facilitate the transfer of know-how to domestic commercial banks from abroad.
- An inter-bank money market and treasury bond secondary market should be established in order to give commercial banks a better environment for liquidity management.
- Financial system stability is reviewed periodically in modern market economies. Assessment of the financial sector in Myanmar cannot be complete without examining its legal framework, focusing on the practice of law. The degree of promotion necessary to induce an efficient discharge of financial obligations should be measured in order to determine policy for further strengthening of the financial market.
- Nowadays, banking laws and regulations governing the legal status, organisation, and operation of banks are becoming uniform worldwide. A comparative study identifying possible differences would help prepare the Myanmar banking sector for modernisation.

1.3 HRD Programme for Banking Sector

1.3.1 The present situation of human resource development in Myanmar

The present situation of ODA

Assistance in human resource development of the banking sector of Myanmar is conducted mainly by ODA; such assistance is difficult to be provided by overseas private financial institutions, as foreign banks firms are facing restrictions in such activities as establishing a joint-venture company or opening a new branch. International bureau of the Ministry of Finance and Revenue is in charge of receiving ODA for financial institutions. In 2002 (as of November 2002), 113 programmes (2822 days in total) have been conducted, either domestically or overseas, by five international institutions and seven countries. More than half of those programmes were conducted by IMF, followed by Japan which provided 21 programmes (572 days in total) including the one conducted jointly with other institutions.

Characteristics of such HRD programmes are:

- Beneficiaries are the Ministry of Finance and Revenue, the Central Bank and State-owned Commercial Banks and availability of such assistance is very limited to private financial institutions.
- The World Bank and the Asian Development Bank have not conducted these HRD programmes for the banking sector and a limited number of countries is providing these

programmes as bilateral technical assistance.

- Very few programmes aim at assisting improvement in institutional capacity of financial institutions systematically through providing trainers' training, as most of training focus mainly on capacity building of officials of financial supervisory agencies.

1.3.2 Recommendations on HRD and technical assistance for banking sector: a sustainable banking sector training programme

We will discuss concretely a banking sector training programme that incorporates trends in banking policies and management, with focus on the following factors: core implementing agencies, targeted trainees, priority subjects, implementing timeframe, recommended courses, and so forth.

Identification of priority areas for the banking sector HRD programme

We will use the following criteria to identify priority areas (those with significant gaps between training and demand) to be addressed by the HRD programme.

1) Urgency of banking sector policies
2) External impact of the training programme (e.g. dissemination of best practices for enhancing financial discipline for banks as a whole)
3) Areas or subjects in which only overseas sources have the know-how
4) Effectiveness and efficiency of training implementation
5) Possible immediate training effects

   Emphasis will be put on trainers training subjects rather than on basic subjects that can be covered in a corresponding course in the future. Trainers can disseminate their knowledge to their colleagues through in-house training (or on-the-job training) in their respective banks. Thus by linking trainers training with in-house training we can expect maximum impact at minimum cost.
6) Possible immediate training effects

Options for implementing banking trainings

In order to implement such trainings, we will examine appropriate modalities. We suggest three options to implement banking trainings.

1) Expected promgrammes by MBA

   Myanmar Banker's Association was established in April 1, 1999 in accordance with the resolution of the Trade Policy Making Council meeting No. 4/99. All private sector banks are constituted as members in the Myanmar Bankers' Association.

   MBA started its first training course in this August. It was not trainers training course.

However, the experience of this course management know-how will be useful to start trainers training course in MBA. The dissemination effect is broad. The merit for using MBA as a training vehicle is that it is easy for member banks to use training course and it meets the purpose of MBA.

Also a new MBA building will be built in 2004 and it will be used not only as a training centre but also as a banking library. Although this contributes to decreasing in the management cost of training course, member banks and training participants will still have to pay additional costs.

When this course is supported by overseas technical assistance, MBA will be able to be the window of ODA. Considering above elements, MBA seems to be a suitable organisation for introducing new trainers training course.

2) Expected programmes by Myanmar-Japan Center for Human Resource Development

The Government of Myanmar and Japan have agreed to establish Myanmar-Japan Center for Human Resource Development (hereinafter the Center) in Yangon for promoting comprehensive human resource development support and exchanges. Their main activities are: conducting business courses, Japanese language course, and cultural and other exchanges. After inception of the Center in 2003, actual implementation of various programmes are expected with the involvement of short-term and long-term experts from Japan prior to the completion of new facilities of the Center in 2005.

Through this undertaking, overall adjustments on the support for HRD from Japan will become easier and recommendations of the ongoing Myanmar –Japan Joint Study for Economic Structural Adjustment will be reflected in the future programmes of Japan Center. Thus the support of HRD for the banking sector will be a promising agenda of the business courses of the Center with the support of Yangon Institute of Economics, considering the importance of the banking sector in the Myanmar economy.

Proposed syllabuses for the course in the Center are basically similar to the trainers training course by the Myanmar Banker's Association mentioned above. However, targeted audiences will be broader than that of MBA, and policy makers and scholars will be included in addition to bankers. Ad-hoc seminars by inviting Japanese and other foreign experts can be more flexibly organised for specific issues of emergency because of the cross-cutting nature of the Center.

3) Expected programmes by an independent training school

Establishing an independent training school is another option. A typical example in ASEAN countries is banking school in Malaysia named "Institut Bank – Bank Malaysia (IBBM)" in Kuala Lumpur. IBBM can be a good future model for training programme and Myanmar can learn many important issues from them.

IBBM is a NPO that was established by banks in Malaysia for concentrating on banking training in 1977. IBBM is governed by a council. The Governor of Central Bank serves a chairman of the council of IBBM. Currently, IBBM has 86 institutional members and about 7,000 individual members. IBBM offers 400-500 training courses a year. Last year, IBBM trained 14,500 people.

From the case of IBBM, we can see that the following aspects are important for successful operation of a banking training school.

- Strong central bank leadership for establishing and operating the institution
- Strong financial support from member banks
- Considerable amount of subsidy out of "the staff training fund"
- Clear targeting of trainees for each subject
- Wide global network of trainers

Framework for developing training programme

1) Recommended methods

When we consider the target trainees for the training programme, we can divide them into three groups: officers and beginners, supervisors and managers, and top management. We recommend that three types of training courses should be designed according to each level of trainees.

Targeted trainees and modalities

Course Type	Targeted trainees	Methods	Duration
A	New employees & officers	General lectures and case study (correspondence course)	Four weeks per course
B	Supervisors & managers (Trainers)	Classified by special areas lectured by overseas experts	Two weeks per course in a specific area
C	Top management	Workshops or seminars on specific subjects Overseas study trip programme	One day or two days per subject One week

2) Recommended subjects and time schedule of the training cources

From the study, we have identified some important areas that are crucial for modernising banking operations and therefore should be focused on the training for bankers. We recommend the following five major areas to be included in the training programme:

- Strategy and management
- Risk management
- International banking and international financial market
- Credit analysis and project evaluation
- Information and communication technology

Please see detailed recommended training courses in the table at the end of this summary.

The following table shows the time schedule and recommended courses.

Course Type	2003	2004	2005	2006	2007
A	MBA general course continues	→	→	→ Correspond-ence course starts	→ →
B	Six urgent courses start	Six urgent courses continue and five additional urgent courses start	Eleven urgent courses continue and five future courses start	Eleven urgent courses and five future courses continue, and five additional future courses start	Total twenty-one courses continue
C		Courses start (Ad hoc seminars)	→	→	→

3) Problems to be solved to implement recommended courses

Main problems are trainers fees, selecting suitable trainers, textbooks and materials (including translation into Myanmar language), strengthening linkage with government organisations such as the Central Bank of Myanmar and the Attorney General, trainers training and linkage with OJT.

1.3.3 Expected technical assistance in HRD of the banking sector

Support for MBA's trainers training programme

MBA seems to be suitable organisation for introducing new trainers training course. Technical

Assistances including Japan to this undertaking are highly recommended in order to establish efficient and effective training programme with a long-term sustainability. Priority will be given to know-how for which there is no domestic source.

Support for the possible HRD programmes for banking sector in Myanmar-Japan Center for Human Resource Development

We recommend to the Center to conduct a banking sector training programme as part of its business course considering the crucial importance of the sector. The possible workshops for banking sector organised by the Center is also expected to provide policy dialogue opportunities between the two countries.

For both cases mentioned above, active interchanges of experts in Japan, Myanmar, and other ASEAN countries should be paid respect in order to make Myanmar counterpart possible to introduce appropriate institutions, HRD programmes and resource persons which are best fit to the Myanmar context.

Dispatch JICA specialists in the subjects of urgent need for conducting a seminar

In the course of the study, Myanmar FMWG and banks requested the study team to conduct a seminar for priority issues with which banks in Myanmar are currently facing. In order to materialise a prompt action for assistance to banking sector HRD, the joint study team has made proposal of this scheme to both Governments. JICA is ready to respond this request with the consensus of the Myanmar Ministries concerned. Through this seminar, the recent private banks' common undertaking will be highlighted for further improvements.

The following three areas are of urgent need among private banks.

- Information and communication technology for banking activities
- Modernisation of payment and fund transfer system
- Micro business loan appraisal

The one-day seminar could be conducted in Yangon in the 1st quarter of 2003 with involvement of JICA short-term experts upon agreement among concerned Ministries concerned. This trial will become an important step stone for long-term assistance schemes mentioned above.

Table: Recommended Training Courses

Areas	Urgent Courses	Future Courses
Strategy and management	Banking marketing and customer satisfaction	
	Branch management	
	Fund transfer	
	Developing supervisory skills	
	Accounting, auditing, and performance evaluation	
Risk management	Compliance	Operational risk management
		Asset and liability management (ALM)
		Liquidity management
International banking and international financial market	International regulations and money laundering law	International trade finance
		Foreign currency exchange
		Derivatives
		International financial market
Credit analysis and project evaluation	Methodologies of corporate analysis	
	Evaluation of SME business plan	
	Credit monitoring	
ICT	ICT and management	Advanced ICT in banking business
		Security in information system
		Database management system

2. Microfinance Development in Myanmar: Towards Sustainable Financial Systems

2.1 Assessment of and basic directions for microfinance in Myanmar, and microfinance institutions and cooperatives

2.1.1 Potential of microfinance in Myanmar

Access to financial services is constrained in Myanmar, both for the corporate sector and for households, resulting in insufficient or inadequate supply of credit and weak mobilisation of domestic savings. Currently, bank and non-bank financial institutions' outreach and capacities to address corporate and individual needs are very limited, and their responsiveness to small economic players is even weaker. As a result, whereas huge demand is observed in the informal financial markets, the constrained institutional capacities on the supply side of financial systems are impeding vigor in economic activities. Above all, a serious worry is the lack of access to credit in rural Myanmar, where about 65 percent of the population resides, as well as among the poor and the potential entrepreneurs who are spread nationwide, including in urban areas.

Having a quarter century history over the world, microfinance is perceived to be an effective instrument for poverty alleviation—as a sustainable financial system by which poor and small economic players can leverage their economic activities and substantially improve the quality of their lives. In Myanmar, the demand for micro-loans was roughly estimated by the UNDP to be US$400 million to US$600 million, suggesting a huge potential benefit, which the sustainable microfinance can bring to hundreds of thousands of poor households if the proper environment were given. Another beneficial aspect of microfinance is that its highly market-friendly approach promotes establishment of sound financial disciplines among borrowers and lenders, which perfectly fits the current policy directions toward successful transition to a market economy in Myanmar.

2.1.2 Rural finance

With the overwhelming proportion of population being in rural areas, development of the rural economy is requisite to accumulation of national wealth in Myanmar. With the exception of Saving and Credit Cooperative Societies engaged in provision of financial services, Myanmar Agricultural Development Bank (MADB), a state-owned bank, is virtually the only major source of institutional credit for small-scale farmers in terms of relative coverage and accessibility. Due to the ever-growing demand for seasonal credit to boost output of paddy and export crops, MADB's mandate and funding priority has been given to farmers over non-farmers. In addition, the scale and impact of MADB loans to farmers are severely limited in comparison with the funding requirements; from the interviews in Shan State, the Dry Zone and the Delta Zone, it was found that only about 5 to 15 percent of women clients of UNDP microfinance projects are able to obtain loans from MADB—through their husbands. Also, geographical constraints in the rural area make provision of financial services very difficult; the remoteness of villages that are reachable only via mountain paths contributes to very high transaction costs. As a result, there is excess demand for capital in the countryside, which is unsolvable by conventional banking. MADB's lending methodology has shifted from village banking to the use of its branch network, which appears to be inadequate for improving farmers' access to financial services. Currently, MADB, yet unfamiliar with microfinance technologies, has not envisaged changing its business scope that is based on traditional agricultural lending.

2.1.3 Informal credit

In general, the majority of the rural and urban poor and small economic players are highly dependent on informal sources of credit for their production inputs and consumption requirements despite the efforts by the government and donors alike to provide alternative sources of credit. Traditional moneylenders in villages give loans at 10 to 15% interest per month if no collateral is given (usually in the form of gold and jewelry) and at 5 to 7% per month if collateral is available.

2.1.4 International and local NGOs involved in microfinance

Microfinance in Myanmar is at an embryonic stage. It is an exogenous phenomenon brought to the country by international NGOs (INGOs) contracted with the UNDP (funding agency) and UNOPS (executing agency) who are interested in using microfinance as part of an overall package for poverty alleviation. However, this situation has not prevented various local organisations or associations and other international NGOs from initiating microcredit projects, some with a savings component.

Currently, there are estimated twenty-three international and local NGOs and projects involved in microfinance in Myanmar. They can be classified into four groups: microfinance INGOs, multipurpose INGOs, local NGOs, and UNDP-assisted projects. The operation of microfinance in these programmes typically comes as a sub-component of a larger intervention by the INGO concerned under agreement with respective line ministries, such as the Ministry of Cooperatives, the Ministry of Health, and the Ministry of Social Welfare. This indicates that no government agency in Myanmar has been designated as the sole entity through which to register a microfinance programme. According to the *inventory survey* and field interviews conducted as part of our microfinance study, NGOs are present in a total of forty townships, excluding the thirty-one townships covered by special UNDP-assisted projects. The coverage represents 12 percent of the total number of 330 townships in Myanmar. All of the programmes target the poor as clients; microfinance INGOs are concentrated in serving the women of rural poor households and other programmes serve both rural and urban poor households. Due to the dominance of three INGO projects, rural women represent 95 percent of the total number of microfinance clients. The major sources of funds are foreign donor grants; some small programmes operate only with internal sources.

The survey captured that the total number of active borrowers of fifteen core institutions is 109,209 and the aggregated loan outstanding is Ks 1.6 billion as of the end of 2001. The savings services are yet limited: less than half of the institutions have adopted compulsory savings and very few have adopted voluntary savings. As to lending methodologies in credit programmes, all of the NGOs surveyed employ the group-lending approach without any tangible collateral, about half of them doing so in combination with individual lending. The loan terms range from 6 months to 20 months, mostly concentrating on 6 months to 12 months. Most of the programmes adopt cost-recovering or market-based interest rates, although some NGOs apply zero or very minimal interest rates due to the concerns for outreach to a larger number of poor households. The loan vary in size but clearly target poor clients: the minimum ranges from Ks 1,500 to Ks 50,000 and the maximum from Ks 50,000 to Ks 300,000.

UNDP/UNOPS-supported projects. The three UNDP/UNOPS-contracted INGOs have provided microcredit and savings services to the poor since 1997: Grameen Trust (up to mid-2002) in three Delta Zone townships, PACT in three Dry Zone townships, and GRET in five Shan State townships. Combined, these three INGOs dominate NGO-operated microfinance in Myanmar, constituting 87 percent of the total outreach. They have a view to institute sustainable microfinance operations in the country. The fact that their geographical coverage is limited, extending to only 3 percent of Myanmar's townships, can be explained by the pilot nature of the projects under the special framework of the overall undertaking agreed by the UNDP and the Myanmar government. However, the cumulative outreach of the three projects, which was 94,724 active borrowers in 1,518 villages as of the end of 2001 (25,102 in the Delta Zone [657 villages]; 49,165 in the Dry Zone [487 villages]; and 20,457 in Shan State [374 villages]), is regarded as nothing less than remarkable, considering that the projects had been operating for only about four years, had covered areas suffering from poor infrastructure and communication facilities (they are some of the poorer areas in Myanmar), and had local staff that lacked experience. The aggregate loan portfolio outstanding at that time was Ks 1,421 million. The three projects have also shown credible performance in outreach of credit delivery; for example, PACT reports that they have been serving an average of 60 percent of the existing households in the villages they cover, which is a surprisingly high penetration ratio. As to savings mobilisation, the three projects are still limited, with a balance in total of Ks 185 million.

Activities served by the three projects are farming (Shan State) and livestock farming (Dry Zone and Delta Zone), trading (Dry Zone) and other non-farming activities (Delta Zone). The three INGOs have a total of 350 staff members. All three projects have demonstrated high repayment rates (99% to 100%) and low portfolio at risk (0% to 1.2%), which are comparable to international best practices. The operational self-sufficiency reportedly ranged from 117 percent to 227 percent and the financial self-sufficiency from 47 percent to 76 percent (assuming a 35% inflation rate) as of the end of 2001, which are good at this stage of development. Field interviews and secondary data indicate that the targeted households perceive the three projects as positive interventions that can bring significant benefits to their economic situation: increases in income, savings, and asset build-up; availability of better food and nutrition to the family; improvement in housing conditions; lesser dependence on moneylenders; and improvement in the clients' quality of life.

Multipurpose INGOs projects. INGOs programmes other than those contracted with UNDP, including World Vision, CARE Myanmar, Save the Children USA, Save the Children UK, and the GRET Chin project, are implementing their own microfinance projects for from 6 months to 7 years. Except for the GRET Chin project, they are yet at the pilot stage or have just begun to expand operations. They are mostly under legal cover by a memorandum of understanding with the ministry supervising activities in their fields. The five INGOs that responded to the *inventory survey* have an aggregate number of ninety staff members involved in microfinance operations, with World Vision having the highest, in the nine townships in the Yangon and Mandalay divisions and Chin State. The aggregate active borrowers were 11,021, out of which the GRET Chin project (6,239) and World Vision (3,728) were dominant, as of the end of 2001. According to the survey, three INGOs report repayment rates from 99.2 percent to 100 percent, one reports a rate of 91.7 percent, and the other 79.9 percent.

The GRET Chin project started in 1995 with village banking methodologies and is now being operated in three townships with a loan portfolio of Ks 70 million. It is worth noting that the project is showing remarkable progress, with an operational self-sufficiency ratio of 98 percent.

Its strong point is the development and strengthening of local community organisations, which has promoted cohesion and solidarity in areas under a very difficult environment. Interviewees reported significant increase in their income and were able to reinvest profits for business expansion. Conversely, the weaknesses of the project are that the value of savings was not inculcated at the start of the programme and that some methodological problems have resulted in difficulties in management and control. The Japanese embassy's Grassroots Fund is currently being put to good use in building the capacities of the local boards and staffs, which is a meaningful intervention in view of weak local capacities in microfinance.

Local NGOs microfinance operations. Mostly registered with the Ministry of Home Affairs, local organisations or associations (YMCA, YWCA, Myanmar Women's Entrepreneur Association, Myanmar Council of Churches, Caritas, Myanmar Baptist Convention, and others) are also involved in microfinance activities for a period of one to eight years in twenty townships of the country. The primary focus of assistance is the poor women. Some try to operate along the key principles of sustainable microfinance, whereas the focus of others remains to be seen. According to the inventory survey, the seven local NGOs reported a total number of forty-seven staff members involved in microfinance programmes. The aggregate number of active borrowers was reportedly 3,464 as of the end of 2001. As to performance, five of the local NGOs are reporting repayment rates of 100 percent or close to 100 percent, whereas the remaining two report 60 percent and 75 percent. The relative efficiency of operations of this group is lower than that of INGOs, which is to be expected considering that some of the local NGOs started programmes only recently.

Other UNDP-assisted projects. Other UNDP-assisted projects include the Community Development Remote Township (CDRT) project, UN Drug Control Program (UNDCP), UN High Commissioner for Refugees (UNHCR) Committee, and the FAO Revolving Fund (up to 2002). CDRT is an integrated project with several components, such as health, education, and water supply, through a self-reliant group (SRG). Operating in ten townships in the border area of Rakhine, Chin, and Kachin, 1,005 SRGs have been formed, covering 15,674 households or 68 percent of the target population. Total savings mobilised amounted to Ks 56.4 million. Each qualified member is given a loan of Ks 20,000 through the SRG. The UNDP provided US$458,658 as capital grants that were then on-lent to the members. According to the UNDP, the SRGs act as a social safety net for the poor by strengthening their social functions and providing flexible loan products based on mobilising small periodic savings. On the other hand, some important tasks remain to be tackled, including a banking or microfinance link for long-term expansion and continuous provision of training to new SRG members. Being still in its infancy, it is too early to access the SRG approach in Myanmar; however, positives would include the promotion of solidarity groups and social bonds, whereas a negative might be the possibility of non-repayment by some borrowers since the loan came from a grant by a donor, which might erode credit discipline among the rest of the members. The fact that SRG members are free to set the loan conditions may create moral hazard in leading to the sustainability of SRG microcredit scheme. Field observations recorded a possible future conflict between the GRET Chin project's cost recovery interest rates and the SRG's zero interest rate scheme.

The FAO Revolving Fund was also supporting the development of communities in Shan State, the Dry Zone, and the Delta Zone but the funding was ceased due to project termination. A notable experiment was the use of private banks as conduits of the funds for self-help groups. An informal tie-up between Kanbowza Bank, a private commercial bank, and the community based organisations (CBO) in the Dry Zone emerged within this project; CBOs borrowed from Kanbowza Bank against their deposits as collateral for re-lending to their members. It is worth noting that, de facto, the CBOs were charging commercial rates.

2.1.5 Saving and Credit Cooperative Societies

The cooperatives' movement in Myanmar originated from the promulgation of India's Co-operative Societies Act in 1904. Primarily it was contemplated as a government-sponsored measure to relieve the agricultural related indebtedness of farmers. In 1992, as political, economic, and social conditions changed, a new cooperative law was enacted to give a wider mandate and freedom to the financial cooperatives. Today, there are reportedly 1,942 functioning Saving and Credit Cooperative Societies in operation with a total membership of 431,000 individuals, forming a sector with significant weight in Myanmar. The total amount of savings held is reportedly Ks 3,851 million and the total amount in loans disbursed is Ks 6,337 million. Official statistics indicate that the aggregate savings and loans have increased by 706 percent and 1,184 percent respectively in the last decade, while the number of cooperative societies and members have declined.

The extensive field research conducted on selected Saving and Credit Cooperative Societies as well as the collection of numerical information through the *inventory survey* illustrate that such societies have a strong potential to become one of the pillars of the microfinance industry in Myanmar, together with the NGO sector. In Myanmar, there are two types of Saving and Credit Cooperative Societies: open- and closed-type memberships. The open type can accept anybody (from all walks of life) whereas the closed type only accept one type of membership and very exclusive (for example, employees only, factory workers only, etc.). The open type societies include small shop owners, vendors, and micro-entrepreneurs as members and are extending financial services on a small scale. According to the records of the Ministry of Cooperatives, as of 2001 there are about 139 open-type Saving and Credit Cooperative Societies, with total membership of 10,097; however, the actual membership number is estimated to be greater than that.

For the purpose of the study, the *inventory survey* was conducted on thirty-four Saving and Credit Cooperative Societies, which represent 24 percent of the sample size. The summary of the findings about institutional characteristics and modalities of the financial services are (i) the thirty-four societies surveyed have, in total, 11,018 members, 7,214 active borrowers, and 10,710 savers, with the Mandalay societies having the farthest outreach; (ii) the average minimum loan ranges from Ks 5,000 to Ks 10,000 per member. Out of the 34 societies, six do not require collateral for loans whereas the rest demand collateral from members in the forms of immovable properties, co-guarantors, or a combination; (iii) the loan duration ranges from one month to four years, with a majority of the programmes (83 percent) being for less than twelve months. Though the interests charged vary from society to society, 71 percent of all the programmes fall into a range from 25% to 60%, which is reasonable for covering the cost of funds and operating costs; (iv) nineteen of the thirty-four societies pay interest earnings on share capital, ranging from 4% to 36% per annum, with four societies paying 18% per annum; and (v) twenty-two societies have five or more board of director members and the remaining societies each have three or four. All of the surveyed societies have full time staff ranging from one to fifteen depending on the size of operations.

Including the findings by extensive field research on nine representative Saving and Credit Cooperative Societies in the Mandalay and Sagaing divisions and Shan State, the following are concluded: (i) the financial landscape for the thirty-four cooperative societies is dominated by nine cooperatives in terms of assets; numbers of members, savers, and borrowers; loan outstanding; savings deposits; and share capital. Of the nine, the Pyin Oo Lwin Market Savings and Credit Society in Mandalay stands out as the best performing and may be in the best financial position to expand into microfinance; (ii) there is a concentration of better performing cooperatives in the Mandalay and Sagaing divisions despite some financial troubles encountered by five cooperatives with significant resources; (iii) cooperatives that operate in township markets are performing better than are cooperatives not similarly situated. Market-based operations are able to capture the fast cash turnover in township markets; and (iv) a notable phenomenon that seems to be unique in Myanmar Credit and Saving Societies is that two cooperative societies have established their own pawnshop businesses (one in the Sagaing division and the other in Shan State), which cater to the poorest sector of the community by accepting collateral of small value, such as old bicycles and appliances. These cooperatives that operate pawnshops perform better in financial terms than do the majority of the Saving and Credit Cooperative Societies.

2.1.6 Banks and pawnshops

At least six private banks, including top-ranking ones, have expressed an interest in being financiers or wholesalers of loans for microfinance operations; some banks have already begun pilot testing. They are all in search of an investment outlet for excess liquidity in the short-term, due to lack of investment opportunities in the traditional credit markets or reluctance to lend to firms in view of non-performing loans. Hence, their interest in microfinance operations is centered on the potential for utilising idle funds. Pawnshops, which are licensed financial entities owned either by the government or the private sector, form a segment of financiers to the poor in Myanmar, with interest rates ranging from 3% to 6% per month. Some of them have also expressed interest in microfinance, and one has drawn funds from private banks to re-lend to farmers.

2.1.7 Key issues affecting the development of microfinance in Myanmar

Interest rate policy. An immediate problem confronting emerging microfinance institutions (MFIs) is the current interest rate policy. Section 61 of the Central Bank Law prescribes maximum level interest rates; the current ceiling is a maximum of 15% on lending, which is considered by many MFIs as impossible for financial sustainability. Currently, three UNDP-contracted microfinance operations and some other INGO projects are *officially* authorised to charge flexible interest rates under special legal cover for their integrated projects; however, the institutionalisation of these projects as well as expansion of other microfinance operations requires flexible financial management in order to be sustainable, more particularly in interest rate setting. Also, private banks that have expressed interest in microfinance would not be able to intervene in microfinance if they are not assured the ability to charge flexible interest rates. Today, the requirement of flexible interest rates for microfinance is well recognised over the world as pre-requisite for development of the microfinance industry, and this is also true in Myanmar.

Legalisation and institutionalisation. The on-going microfinance projects under the support of the UNDP and other international and local NGOs are facing an urgent need for legalisation of entities, only by which they can sustain operations even without special legal cover supported by supervising ministries. The issue of institutionalisation will have to be dealt with through legal action as may be allowed under current Myanmar laws; therefore, an investigation for a permissible legal structure for those projects is indeed an urgent task. Serious study is needed concerning legal paths for lawfully registering NGO MFIs via amendment of the existing law or via policy declaration. If the present legal framework is not able to provide an avenue for the institutionalisation of the INGO projects and other similar projects (including the ones by local associations), it will be important for the government and stakeholders to work together to formulate an appropriate framework.

Localisation. Institutionalisation is separate from, although in some ways linked to, localization. The link between the two issues is the fact that having a legal entity such as a MFI makes a lot of sense if local staff members can effectively participate in its operation. However, localisation should not prevent the benefits to have access to the services and expertise of international experts. Field visits to the three UNDP-contracted projects and interviews with local managers and staff members indicate that those projects are not yet ripe for immediate localisation. Localisation process is desired to take place, but for the time being international experts should continue providing their experiences and expertise and work toward building the capacities of local management, targeting a hand-over in the future.

Implementing capacities of MFIs. Due to the embryonic stage of microfinance in Myanmar, the following weaknesses have been identified in NGO microfinance projects as issues requiring policy measure consideration for further microfinance development: (i) The relative inexperience of local managers and staff members in almost all of the NGO projects brings about insufficient understanding about the corporate governance required in the course of institutionalisation, e.g. the role and functions of boards of directors; (ii) Although the INGOs have been providing training to local staff members, there is an apparent need to conduct systematic training programmes to enhance managerial capacities both at headquarters and at branch levels; at present, expatriate consultants make all key personnel decisions; (iii) A look at the educational background of local staff shows that qualified staff members with financial and accounting disciplines are lacking, whereas financial management is a pressing need to maintain the quality of the loan portfolio and improve the management; (iv) Supporting structure for management, e.g. internal audit, is yet to be formed even in the three INGO projects supported by the UNDP; (v) Personnel issues are now surfacing, including some regarding variation in the scale of salaries among local staff members of the three INGOs; and (vi) The local management has yet to prove a capacity to cope with problems emerging when the number of clients begins to increase and as the operation expands to cover more areas and more clients.

Upgrading indigenous financial systems. The cooperatives sector, particularly the Saving and Credit Cooperative Societies, have a strong potential of becoming one of the pillars of the microfinance industry in Myanmar. However, it must be noted that there also are important challenges ahead that need to be addressed to insure that these societies are able to deliver their services effectively and efficiently to the poor and the micro-entrepreneurs in their community. The challenges include, but not in an exhaustive way: (i) The governance of the board of directors and internal controls are to be enhanced or improved. Also, the external audit by the Ministry of Cooperatives needs to be strengthened; (ii) Since the Saving and Credit Cooperative Societies do not have a standard chart of accounts, the data for the repayment rates, delinquency rates, portfolio at risk and other financial indicators are not too reliable. Different understanding and interpretation of key indicators are prevalent. Bookkeeping systems and financial management need substantial improvement and the development of performance standards is particularly needed; and (iii) A systematic and rigorous human resource development programme for boards of directors and staff in the area of microfinance is a requisite.

2.1.8 Implications from Philippines experiences in microfinance development

After the pursuit of financial reforms in the mid-1980s, the Government of the Philippines adopted the 1991-1998 Medium Term Philippine Development Plan, under which the implementation of market-based financial and credit policies and the increased participation of the private sector in the financial market were emphasised. Among the reform steps, new credit policy prepared a national strategy for microfinance, with a view to address poverty in the country. Since then, the Government of the Philippines has been aggressively working to create an enabling environment and a legal and regulatory framework for the establishment and growth of sustainable MFIs, and thus the country's experiences provide good lessons for Myanmar, as follows.

The government's clear focus on the role of microfinance as an important vehicle for poverty alleviation (as 'Microfinance as a cornerstone in fighting against poverty' in President Arroyo's State of the Nation Address in July 2001) as well as rural development has been a base for policy formation to create an enabling environment. As the coordinating body among the various ministries and implementing agencies, the National Credit Council (NCC) has set out credit policies to rationalise directed credit programmes. Together with the central bank (Banko Sentral Philipinas), NCC carries an important role in promoting microfinance. Another government entity, a wholesale bank (People's Credit and Finance Corporation), has also supported private sector led microfinance. Likewise, the government's overall support is indispensable for microfinance development. As to regulation and supervision of microfinance, the central bank has been taking supportive measures, such as the lifting of the moratorium on the establishment of new banks to allow the entry of new microfinance-oriented thrift banks and rural banks.

Private sector-led microfinance services in the Philippines are provided by three pillars: rural banks and thrift banks, NGOs, and credit cooperatives. Active movements for establishing industry standards and thereby commercialising microfinance are being undertaken. Networking and supporting organisations among the private sector, including the Microfinance Council for NGOs, and confederations and federations of credit cooperatives are very active. These structures are functioning to share information among members, promote best practices and innovative technologies through a number of seminars and workshops, and conduct training to enhance the quality of services and institutional capacities of MFIs.

2.1.9 Lessons from literature survey on worldwide experiences

Many issues that Myanmar faces as its microfinance industry is on the verge of taking off have been shared by other countries in the course of nearly a quarter century history of microfinance development in the world. According to the literature survey on worldwide experiences conducted as part of the study, with a purpose to draw lessons relevant to policy formulation at the current stage of microfinance development in Myanmar, the following are summarised: (i) Step-by-step formalisation of MFIs through a process that begins with legalisation and licensing and progresses to the introduction of explicit regulations is the most appropriate strategy; (ii) The sustainability of microfinance depends on the degree of understanding of microfinance specificities such as risk profiles, which in sum characterised as highly market-oriented approach to the provision of financial access to the poor; (iii) The establishment of sound regulatory environment is a requisite to well balance the growth and stability of the microfinance industry. However, it is impossible to find a 'one-size-fits-all' advice anywhere in the world. To achieve sound regulatory framework, capacity building of policy makers for regulation is a more serious issue than is selection of particular forms of regulation. Over-regulation by insufficient regulatory capacities has brought about serious impediments in many countries' microfinance development. Equally crucial is the appropriate timing for introducing regulations: too early introduction also brings about harmful results; and (iv) As for the mid- or long-term perspective, the integration of MFIs into the formal financial sector appears to be the most effective way to materialise the dual mission of microfinance, i.e., extending the outreach and attaining financial sustainability.

2.2 Road map for microfinance in Myanmar

The *Three pillars* approach. There is a need for a gradualist but coordinated approach to microfinance development. The first step is to craft an overall national strategy on microfinance supported by the government, microfinance institutions, and the donor community. The three pillars of microfinance development in Myanmar can be international NGOs/local NGOs/local association projects, financial cooperatives, and banks interested in microfinance (This manifest can be abbreviated as NGOs–CO-OPs–BANKs. Note that the role of the MADB in microfinance should be carefully assessed in consideration with agriculture policies and institutional capacities). The main goals are to build project implementation capacities, ensure a policy environment conducive to microfinance development, and harness the diverse expertise and resources coming from the donor community to support Myanmar. The emphasis should be on improving the quality of microfinance projects/operations by building the capacities of implementers and concerned government ministries, including the Central Bank of Myanmar and the Ministry of Cooperatives, rather than on an aggressive and rapid expansion of microfinance. Expansion is also necessary, but not at the cost of sacrificing quality of implementation.

2.2.1 Country Action Agenda for Myanmar (CAAM)

A national strategy supported by various stakeholders has to have at its core (1) consistent financial and credit policies; (2) an identification of the critical roles of the stakeholders; and (3) a road map for the development of sustainable microfinance. A sketched proposal for such a road map is as follows: (i) A *goal* is to be defined. It may emphasise the ultimate objective of microfinance as a poverty-reducing instrument or mechanism; (ii) A *vision statement* is then desired, to articulate the collective mission of all public and private entities engaged in microfinance; (iii) *Basic principles* should denote key characteristics that microfinance entails and that should be further pursued in Myanmar, such as *large and deep outreach*, *sustainability*, *client focus*, and *innovation;* (iv) *Strategies* should elaborate core measures to materialise the vision, and hence achieve the goal. Suggested strategies include (a) maintaining a focus on the poor, (b) facilitating an enabling policy, and a legal and regulatory environment, (c) expanding the institutional capacity of MFIs, (d) building an efficient core of microfinance technicians and training centers, (e) promoting sector-wide performance standards, and (f) promoting sustained linkages to commercial capital; (v) *Roles of each player* are to be defined—in particular those of the government. A set of the first steps for the government includes (a) determination of an anchor ministry; (b) establishment of a preparatory microfinance unit and/or working groups in the government, in order to create a legal structure for registering MFIs and crafting policy declaration allowing microfinance players to charge cost-recovering interest rates (that include or take into account the following: cost of funds, administrative cots, risk, and reasonable margin); and (c) preparation for promoting sector-wide performance standards for microfinance, in collaboration with MFIs and other stakeholders; (vi) *Model projects* of NGOs and Saving and Credit Cooperative Societies, being desirable, are to be implemented; and (vii) *The timeframe* for the overall action agenda stated in the above is to be declared. For example, the government may have to complete formal registration of MFIs and policy declaration on a short-term basis (one to two years), whereas establishment of performance standards takes longer (three to six years).

2.2.2 Legal and regulatory framework: pressing needs for legalization of MFIs and adoption of flexible interest rates policy

Whereas the establishment of a regulatory framework for MFIs involves a complicated process that requires careful designing and capacity building in the long term, the legalisation of MFIs is to be resolved immediately to help the microfinance industry to take off in Myanmar. Considering the embryonic state of Myanmar's current microfinance activities, it is very premature to talk of regulation, since the main purpose of regulation is to protect depositors and avoid systemic risk in the financial sector. The social costs of an inappropriate regulatory framework are very high, such as higher transaction costs, limited competition, discouragement of the formalisation of informal microfinance, and weakening of savings mobilisation. Policy makers should focus on the more important concerns: (i) the legalisation of entities as MFIs; (ii) the resolution of policy dilemmas that create uncertainty over the sustainability of microfinance operations; (iii) the capacity building of MFIs and policy makers; and (iv) the facilitation of dialogue between MFIs and policy makers.

Given that special memoranda of understanding between the government and some projects involving microfinance have expiration dates, the question now is whether it is possible to use the current legal framework–Financial Institutions Law, Organization Law, etc.–for the establishment of NGOs and associations that can engage in microfinance. A preliminary review by the study indicates that application of the Financial Institutions Law may be able to immediately clear the path for the entities involved in microfinance to function as legitimate financial institutions, but the MFIs must get exemptions concerning the existing ceiling interest rates and prudential regulations. Another option for the government is to enact a new law allowing the creation of a new category of NGOs for financial service provision. The new law could allow MFIs to function as legitimate intermediaries, charge cost-recovering or flexible interest rates, and engage, perhaps, in a limited deposit-taking activities. With this option, the consequences resulting from limitation of deposit taking as well as potential competition with private banks should be assessed; however, those may not really bring about problems or complaints, since MFIs and banks basically serve different markets.

Saving and Credit Cooperative Societies have no problem in terms of legal registration. As such, the Saving and Credit Cooperative Societies may form the main pillar of microfinance development provided that appropriate capacity building on microfinance is pursued. As regards the interest rates, it seems that the interest rate ceiling imposed under the Money Lenders Act (1945) would not apply to saving and credit cooperative societies. However, to ensure those flexible practices, a policy statement from the government would pave the way for expected involvement of Saving and Credit Cooperative Societies in microfinance without need of changes or amendment of the particular law governing those societies. The second mechanism for cooperative society provision of micro-credits to poor clientele is the establishment and operation of pawnshops that are legally recognised and licensed entities. This is a workable solution, but the ideal situation is for Saving and Credit Cooperative Societies to be directly engaged in microfinance.

2.2.3 Establishment of Myanmar National Credit Council

The development of microfinance involves a wide variety of stakeholders. Relevant agencies for provision of small-scale financial services include associations, NGOs, cooperative societies, pawnshops and banks. The end-users of microfinance are varied: farmers, traders, shop-vendors, and any kind of micro-entrepreneur. Rural as well as urban development by enhanced economic activities and reduced poverty through microfinance are the overarching objectives. These multiple facets of microfinance suggest that policy formulation by the government toward successful microfinance needs a coordinated approach among different ministries and public agencies. Thus, as was shown by the Philippine experiences (see paragraph 26), a governmental coordination body that focuses on creation of favourable policy environment for microfinance merits consideration.

The establishment of a Myanmar National Credit Council (MNCC) to coordinate market-oriented financial and credit policies may be envisaged, with close collaboration with the Ministry of Finance and Revenue and the Central Bank of Myanmar. By monitoring the development process of MFIs and their coalition and the evolution of industry standards, such an MNCC would be able to ensure an exchange of information among the different streams of MFIs (for example, between NGOs and cooperative societies), including their successes and failures, and hence contribute to promotion of performance standards for MFIs.

2.2.4 Microfinance coalition and establishment of performance standards

In a number of countries where the microfinance sector has taken off and flourished, stakeholders have solved the problem of inadequate or asymmetric information on the sector by coming together to form an association composed of practitioners in the field, advocates, regulators and policy makers, and donor agencies. At this stage of microfinance development in Myanmar, there is no institution or agency that functions as a repository of information for microfinance. INGOs have gained considerable experience before coming to Myanmar, while new entrants—that is, local practitioners—have expressed their desire for information on how to deliver microfinance in a cost-effective manner. It is proposed that a network composed of practitioners, advocates, and representatives of relevant government ministries be organised in the country. Depending on the consensus regarding the network's objectives and work programme, its functions may include (i) coordinating capacity-building programmes; (ii) exchanging information and sharing experiences; (iii) sharing performance data of microfinance players, perhaps through publication; (iv) undertaking research projects; and (v) linking up with international networks to build up a wealth of information for the sake of the Myanmar microfinance industry.

To form a microfinance network (or *coalition*), a step by step approach is recommended. At the outset, it will be good to make membership of such a *coalition* as broad-based as possible. The participants belonging to *Capacity Building Initiative*, the three microfinance INGO project members, some financially sound Saving and Credit Cooperative Societies, and some local NGOs and associations could form the core of the network. Government agencies would be able to attend the network's meetings, seminars, and workshops on their own accord as observers, which is optional because those agencies may not be prepared yet for such involvement. At an opportune time, representatives of government agencies should become involved; they would be instrumental in providing future policy and institutional reform support that would benefit the microfinance industry. If the proposed *microfinance unit* in the government were to materialise, then it could be a regular participant in the evolving microfinance network. Thus, the informal group could later on evolve into a formal microfinance network in Myanmar. To ensure continuity of interest and involvement in microfinance activities, there is need to establish a secretariat or small management unit for the microfinance network.

The network's major activities would be (i) identification and agreement on a biding set of core beliefs and principles in the practice of microfinance; (ii) definition of a common work agenda as well as the structure of membership and the operating rules and procedures; (iii) establishment of an accurate database on microfinance practice in Myanmar (its prototype has been initiated as an inventory survey of this study, as seen in Chapter 6); and (iv) formulation and promotion of performance standards for microfinance. It is expected that the members of the network would develop a working attitude of flexibility and proactive social entrepreneurship to advance the interests of both the MFIs and the clients who represent the poor in Myanmar. The activities should be well sequenced to contribute to the establishment of credibility in the microfinance industry in Myanmar.

Performance standards will become an indispensable component of the information infrastructure for microfinance in Myanmar, which is needed for its further growth and development. They can be used for the internal purposes of the management of the organisations concerned as well as by external parties such as donors, the government, and other interested parties to monitor the MFIs and determine what assistance may be needed to improve performance. Performance standards can function as an effective *self-supervisory* tool of the microfinance industry until the capacities of regulators fully develop. The process of formulating the standards is preceded by the formulation and adoption of standard charts of accounts, standard financial reporting formats, etc, which may take a period of time. Training of MFIs and advocacy on the recognition and adoption of performance standards are also needed. Covering those demands, donors will have a crucial role in supporting the establishment of performance standards. As for the standards, they may have two key components: (i) indicators of compliance to administrative requirements and management (such as governance, management, and organisational structure); and (ii) indicators of financial performance (such as portfolio quality, efficiency, stability of operations, and structure of assets). For Saving and Credit Cooperative Societies, the performance standards may have to be separately developed in view of the difference in the operation of those societies vis-à-vis the NGO MFIs.

2.2.5 Microfinance model projects

Currently, the natural limitation imposed by the character of microfinance INGO projects under the UNDP and government's agreement constrains further growth and development of microfinance. Also, given that the presence of international donors that provide funds and technical assistance is scarce, such limitation would seriously hamper development of this emerging sector. It is observed that only the GRET Chin project has initiated a specific microfinance focus without affiliating to any specific humanitarian umbrella. To mainstream microfinance projects in Myanmar, an establishment of *model projects* based on an explicit *financial sustainability approach* is therefore recommended. The opportunity for expansion in a financially sustainable manner by implementing *model projects* would further demonstrate and establish best practices in microfinance in Myanmar.

In order to attain a greater impact on poor communities, it is proposed that pilot *model projects* be initiated in strategic areas. Through field visits and first- and second-hand information on the performance and potential of MFIs and cooperative societies, the proposed strategic areas are the Yangon Division and and the Mandalay/Sagaing Division, based on the following viewpoints: (i) coverage of both urban and rural areas that have a significant number of poor households; (ii) strong presence of local and international organisations that have gained good experience in microfinance and have expressed commitment to the expansion of operations; (iii) ease of monitoring and supervision of the pilot project; (iv) high density of population of poor households; (v) presence of support systems, including training facilities, both from the government and from international organisations; and (vi) openness of practitioners as well as local authorities to implementation or support of microfinance pilot projects.

In Yangon District, it is recommended that the pilot test be implemented by an NGO, which can be selected based on a set of criteria to be jointly determined by the government and a supporting donor. There is an indicative pre-feasibility study of a project targeting the poor in Yangon District that was recently conducted by one of the INGOs. According to this study, the project will be able to sustain its operations by reaching more than 56,000 clients within five years, operational sustainability will be attained by the end of year 2, and financial sustainability by the end of year 3. As an implementer of the pilot project, internationally reputable MFI service providers are strong candidates and there are also possibilities for local NGOs to participate in possible donor support, given their growing outreach and improving performance. Candidates among local NGOs include YWCA, MMCWA, etc.

In the Mandalay and Sagaing Divisions, it is recommended that the pilot project be implemented by selected Saving and Credit Cooperative Societies since they have attained a measure of success in their microfinance operations even without the benefit of training and technical assistance. Field visits and the *inventory survey* have identified the potential of Saving and Credit Cooperative Societies because of their innovativeness in adopting key best practices, such as levying market interest rates; targeting different market sectors; being flexible in repayment terms; providing graduated loan amounts; having trainable management staff, good governance, adequate records and financial bookkeeping systems; and promoting savings mobilisation. Candidates to implement the pilot test may include Shwe Thanlar General Business and Services (Sagaing Division), Pyin Oo Lwin Market Vendors Cooperative Society (Mandalay Division), and Ya Za Soe Saving and Credit Society (Mandalay Division).

2.2.6 Myanmar Microfinance Center of Excellence (MMCE) and capacity building programmes

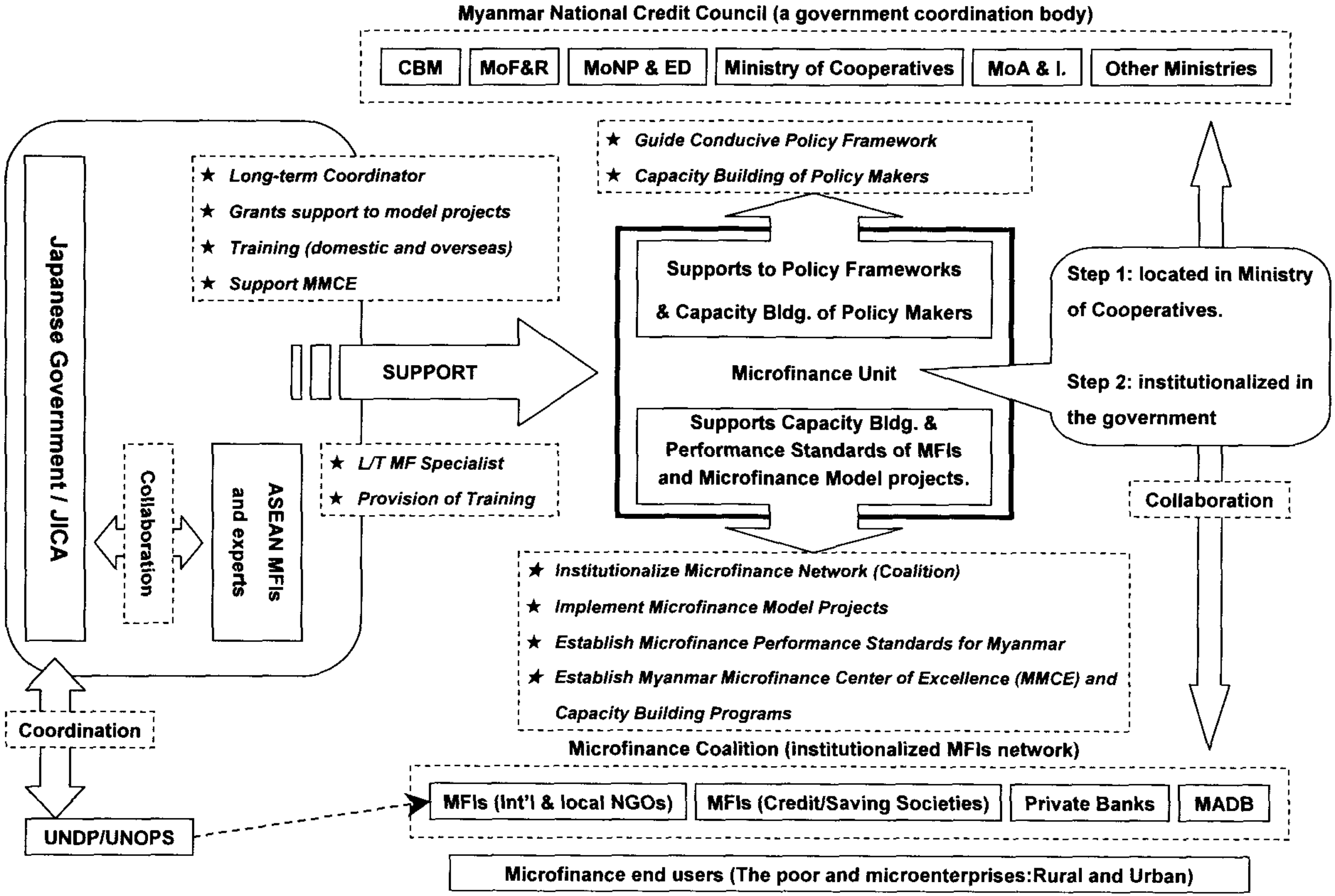
Building the capacities of NGOs, cooperative societies, and other potential players is the key to the growth of the microfinance industry in the country. By so doing, the nascent MFIs can expand their outreach and develop cost-effective, sustainable operations. In this regard, the establishment of a Myanmar Microfinance Center of Excellence (MMCE) as the principal resource center for microfinance promotion and development is recommended. Such an establishment would gather the limited human resources for microfinance in the country (i.e. teachers and trainers) in one place, making efficient use of existing fixed assets (e.g. buildings), and allow the nascent microfinance industry to draw on a common knowledge and skills pool across different sectors. Thus, such an MMCE is envisaged to have economies of both scale and scope in capacity building in microfinance industry. The MMCE would become a focal point in a long-term capacity building programme where international expertise could be made available, even as the center gradually increased the domestic capacity to provide technical assistance to microfinance programmes.

Because an MMCE is a long-term strategy, and establishing one would be an evolutionaly process, a phased approach is recommended. Phase 1 could focus on building the capacities of existing local training institutions through training of local trainers in the field of microfinance as well as improving the existing structure and facilities of the institutions that would be involved. The recommended institutions include *Yangon Cooperative Degree College* and *Sagaing Cooperative Regional College* (SCRC) in the cooperatives sector, the *Capacity Building Initiative* (CBI) in the NGO sector, and the *Myanmar Bankers' Association* (MBA) in the banking sector. The said two cooperative colleges have facilities such as lecture rooms, computers, and dormitories that can accommodate trainees from the cooperatives sector. Moreover, the location of these colleges is strategic relative to the location of the proposed pilot microfinance projects. It must be noted, however, that the existing facilities need to be improved. The current faculty and training staff of the two colleges may have the potential to be teachers and trainers in microfinance, since many of them have at least 10 to 20 years of actual cooperative management experience. However, their knowledge and experience have to be enhanced by exposure to and training in best practices in microfinance. As to the NGO sector, the CBI is a joint project undertaking of international and local NGOs in Myanmar that aims to provide training for Myanmar nationals and use local knowledge and expertise in Myanmar to design and implement more effective development projects. In 2001, the CBI, in its own office, conducted nine trainings, which were attended by 202 participants from thirty-two NGOs. The CBI has strong potential to be developed as the NGOs' training arm for microfinance. As to the training programmes for trainers and practitioners, both basic and advanced management development workshops should be organised through the development of modules. To implement phase 1, it is strongly recommended that a full time microfinance capacity building experts and a core of short-term trainers/experts be mobilised. The capacity building programmes will not only be in the form of formal training but will also offer an exposure programme and study visits to see good practices in different countries.

In phase 2, an MMCE would be established as a joint undertaking by the government and a supporting donor. It is envisioned that the said MMCE would have a distinct personality with a full time staff and trainers composed of academicians, policy makers, faculty members coming from the CBI and the two cooperative colleges, and practitioners. To vest it with formal recognition, it may be advantageous to locate it in an academic setting, e.g., in a university such as the University of Yangon. During the next phase (phase 3), such an MMCE would link with other microfinance institutes in Asia, for example CARD in the Philippines, BRAC in Bangladesh, and BRI in Indonesia, to strengthen it own capabilities and share experiences. It is envisioned that under phase 3 the MMCE would build its internal and international capabilities, and participate in exchanges of faculty members and staff. Publications of training and operations manuals, training kits, case studies, researches about microfinance in the country and experiences of other countries will also be tasked.

Building Sustainable Microfinance Systems in Myanmar

(Proposed Structure of Follow-Up Project from 2003)



3. Financial Behaviour of Private Manufacturing Companies in Myanmar: Implications for Banking Sector Development

As a measure of market-oriented economic development, the Myanmar Government initiated banking and financial reform in June 1990. Three laws were enacted: (1) the Central Bank Law, (2) the Financial Institutions Law, and (3) the Myanmar Agricultural and Rural Development Law. As a result, not only were twenty private banks created but the MSEC (Myanmar Securities Exchange Center), a joint venture between Daiwa Securities and MEB (Myanmar Economic Bank), was established. These measures were certainly a big step toward realising a market-oriented economy, but only up to a certain point.

Numerous other reforms must be implemented in the future to enhance the institutional ability of the banking system as well as the capital market. The main objective of our research is to clarify the current financial environment from the viewpoint of corporate finance and, based on such information, to propose several policy implications for further development of the financial sector.

The banking sector is the core of the financial system in Myanmar. Apart from the banks, there is the Myanmar Securities Exchange Center (MSEC), which is a security company, the Myanmar Small Loan Enterprise (MSLE), which is a non-bank financial institution, and the Myanmar Insurance Corporation (MIC), but these institutions occupy only a marginal position in financial activities in Myanmar.

The initiatives taken since 1992 in financial sector reform are an important element of market-oriented economic reform. Private banks were given authorisation to operate, foreign banks were allowed to open representative offices, and the Myanmar Securities Exchange Center was established. However, private banks are not permitted to transact foreign exchange business because of strict controls under the current severe exchange shortage. Only the MICB and MFTB, both state-owned banks, are authorised to conduct foreign exchange business. Furthermore, foreign banks have not yet been granted branch status and the MSEC currently has only one listing company.

Despite the financial sector reforms, financial intermediation by the banking sector is stagnating, which became apparent while conducting our company financial survey.

There are particular characteristics of the current financial conditions in Myanmar. First, bank loans in general do not play a major role in the corporate finance of private manufacturing companies. The share of bank loans out of total assets is only about 10%. Financial intermediation activities by the banking sector appear to be in a state of inertia. Second, there is a substantial demand for funds in the market. Particular companies actively utilise bank loans as a means of investment, and funds borrowed from the bank account for a fairly high share of total assets. Third, the relationship between accessibility of bank loans and the size of the firm is not linear. Medium-sized firms are more active in bank borrowing than large-sized firms, who use bank loans for their operations and investments. However, they also retain ample self-capital, balancing the optimal combination. Lastly, a firm's accessibility to bank loans is determined mainly by non-economic factors, such as the ethnicity and work history of the owners. The level of education is also significant.

The utilisation of bank loans as a source of funds in Myanmar manufacturing firms is extremely minor and there is great disparity in the usage of bank loans among the firms. The availability of bank loans is largely determined by informal and non-economic factors. In other words, the bank loan market exists in a scattered manner along with the corresponding "scattered social capital". This condition can also be expressed as a market suffering from a broad range of credit rationing.

Observations on both the banking sector and corporate finance obtained through our survey indicate that the main cause of the malfunctioning financial market does not stem from a lack of demand for bank loans. Investment seems substantially active; firms raise funds by various other means for their equipment investment. The most important cause of the wide market failure, is low capacity in financial intermediation, the reasons for which are very complicated. First, a negative real interest rate brings about insatiability of macro economies, which is the most basic factor. Second, various irrational banking regulations, such as the "matching deposit," impede the operational efficiency of the banks. And lastly, the incompleteness of the legal system is a serious obstacle to daily financial transactions.

Policy reforms for banking sector development should be the first priority for solving the problems of corporate financing.

Policy implications

1) Stabilisation of macroeconomy: a precondition for a healthy banking sector
   Macroeconomic stability is a prerequisite for implementing healthy financial intermediary activities for promoting deposits and investments by the private sector.

2) Mobilisation of savings

Without mobilising savings in a big way it is impossible to enhance the intermediary capacity of banks. To do so, financial restraints should be avoided: achieve positive real interest rates by restraining inflation, which is crucial for controlling budgetary deficits.

3) Deregulation of lending activities

The private banks have extremely restricted lending policies. Loans are on a short-term basis only and the lending amount is limited by the value of collateral. Such conservative attitudes of lenders are a result of a rational response to given policy environments such as the "matching deposits" regulation for private banks.

Deregulation of lending practices in various dimensions should be carried out for bank loan market development.

4) Enhancement of intermediary capacity of private banks

Several measures should be considered to enhance the financial intermediary capacity of private banks. First, private banks should be permitted by an independent CBM to grant long-term loans, deal in foreign exchange, clear trade through L/C and extend trade finance to local firms. Second, financial infrastructures, such as computerisation and technical expertise of banking personnel, should be developed.

5) Capital market development

Certain companies have a huge potential as catalysts for further economic development. There are also some that want to be public limited companies. Developing the capital market for Myanmar is an important task and the first step toward achieving this goal is to promulgate the Securities Law.

III. Tax System and Administration in Myanmar

1. General Remarks

Concerning the tax system, a framework and certain items of taxes have already been introduced. A serious problem is that the objectives of the tax system have not been attained through the application of the system. By implementing actions to ensure sufficient security during tax collection, the tax system will become efficient in line with the reality of the country. Specifically, there are many issues to be carefully and thoroughly addressed, including accounting practice, financing functions, and people's awareness of taxes, together with direct assistance from foreign countries.

2. Tax System

By formulating economic policies which correspond to the national targets, and by constructing a consistent taxation policy, a more neutral taxation system will be created. Then, the new system will promote industrial development more effectively than under the current taxation system.

3. Tax Administration

While we conducted our research, we met quite a few tax officials who had adequate basic qualities. As far as they continue to play a central role in tax collection, the future tax administration of Myanmar seems hopeful. Therefore, extensive training should be provided to nurture them to acquire higher-level ability as tax officers, in addition to their adequate basic qualities. To this end, it is suggested that the establishment of educational institutions such as a tax college, as in Japan, should be discussed. Moreover, computers and network construction are indispensable for everyday working, particularly for taxpayer management and administration and for investigations relating to taxation. Technology transfer of software and expertise for the purpose of taxpayer management is therefore required, under cooperation with a foreign government. It is anticipated that more efficient tax administration will be achieved by comprehensively implementing these measures.

4. Summary

Finally, we would like to raise an issue. That is, it is considered that discussions based on analysis, proposals and cooperation regarding the relationship between the government and people in terms of awareness of liability to pay tax and of taxpayer rights are necessary, because these are factors which ultimately influence the taxation system and taxation policies. Also, in Myanmar where most of the national revenues are from the income of state-owned enterprises, the development of a market economy (which is a national target), or the creation of steady progress toward the realisation of a market economy, will provide the basis for introducing a modern taxation system.