

# INTRODUCTORY CHAPTER

## **Economic Reforms in Myanmar: Pathways and Prospects**

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# Introductory Chapter

## Economic Reforms in Myanmar: Pathways and Prospects

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### Abstract

The introductory chapter is intended to provide an overview of the eight chapters written under the auspices of the Bangkok Research Center (BRC). These chapters cover a wide range of issues important to the success of economic reforms and what Myanmar can learn from development experiences of Thailand and Vietnam and other neighboring ASEAN economies. The critical issues at stake are on how to accord policy priorities and policy sequencing to the ongoing economic reforms in Myanmar? First and foremost in a transition process, Myanmar must have macroeconomic stabilization, price and market liberalization and privatization of state enterprises. Policy target must be set to control inflation and to set prices, interest rate and exchange rate in a correct alignment with the supply and demand conditions of the economy. Following successful macroeconomic management, policy makers must be able to mobilize domestic resources and to attract foreign direct investment not only required to build industries but also to transfer skill and technology to Myanmar. In this respect, Myanmar can profit from the success and pitfall from the neighboring countries' experience in managing FDI. It is also equally important to design industrialization strategy that would not exacerbate development disparity among states and regions, and relative inequality among different income groups. Due to the importance of agriculture in providing employment, social safety nets and sources of growth, Myanmar must continue to accord a paramount policy importance in improving agriculture productivity and enhanced allocation of resources to the local government. The existence of Myanmar migrant workers in Thailand provides an attractive policy option to bring back these workers who would be potentially contributing readily to the much needed experienced workers in the manufacturing, service and agriculture sectors in Myanmar. Financial reforms in terms of payment and settlement system should be given policy priority immediately after macroeconomic stabilization. On the contrary, initiating liberalization of financial and banking sectors and capital flows must be carefully scrutinized at much later stages as premature financial sector opening may create instability to the aggregate economy. The chapter on the ASEAN Economic Community provides a comprehensive assessment of the opportunities and challenges facing Myanmar. Ultimately, the implementation of policy

priorities and sequencing of economic reforms is critically dependent on a strong political leadership supported by efficient administration of public bureaucracy

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This research project entitled “Economic Reforms in Myanmar: Pathways and Prospects” is undertaken under the auspices of JETRO Bangkok Research Center (BRC). The objective is to provide a comprehensive analysis of the pathways and prospects of the Myanmar economy following political and economic liberalization initiated by President Thein Sein since March 2011. After decades of economic isolation, Myanmar has initiated a series of gradual and radical changes of economic reforms aimed at accelerating structural change and economic development. On 19 June, 2012, President U Thein Sein declared that the government started this year the Second Phase of reform strategy seeking a 7.7 percent annual average GDP growth based on 2010-2011 market price and a 1.7-fold rise in per capita GDP compared with the base year.

This research project, hopefully, in line with economic reforms mentioned above would help to guide policy makers in charting long-term economic strategy and in navigating short-term economic policy by identifying policy priorities and sequence through economic analysis and lessons learned from the neighbouring ASEAN countries.

With this objective in mind, JETRO Bangkok Research Center (BRC) has commissioned well-established regional researchers to write eight chapters. These chapters cover a wide range of issues important to the success of economic reforms and what Myanmar can learn from Thailand and Vietnam on foreign direct investment (FDI), industrial development, agriculture, production networking and macroeconomic management. The last chapter 8 is written with a view to provide a comprehensive update on opportunities and challenges facing Myanmar in implementing the ASEAN Economic Community (AEC) Blueprint.

Despite two decades of transition from a central planning to a market-oriented economy since 1988, economic transition actually started in March 2011. Three pillars of transition process require macroeconomic stabilization, price and market liberalization and restructuring and privatizing state enterprises. The first priority is to

achieve macroeconomic stabilization and to control inflation. Many transition economies experienced high inflation during the early years of transition as the elimination of controlled prices often resulted in sharp rises in prices. Establishing macroeconomic stability is the first step in gearing an economy for long-term growth. Key elements of sound macroeconomic policies include low and predictable inflation rates, sustainable fiscal positions and a market-based and flexible exchange rate. This must be followed with price and market liberalization. Central planning economies used controlled prices that distorted relative prices and caused inefficient resource allocation. Price and market liberalization is to raise economic efficiencies and enhance economic growth. Restructuring and privatizing state enterprises are to replace the state sector by the private sector as the major source of growth in the economy. The basic problem lies in the transition strategy to put off structural reforms of the state economic enterprises (SEEs). The inefficient operations of the SEEs became a part of the fiscal deficit, and the monetization of the fiscal deficit resulted in macroeconomic instability. Thus, the remaining challenge of the government is to complete the reforms in restructuring the SEEs and consolidating the fiscal balance as well as to build institutional infrastructure. Myanmar can learn from the experiences of reforms in other transitional economies, especially China and Vietnam. Experiences showed that a partial reform produced opportunities for rent-seeking activities, and those who have vested interest in the partial reform obstructed further reforms.

The course of Myanmar's successful economic restructuring can be guided by three complementary development strategies with a focus on regional integration, inclusiveness, and environmental sustainability. The sequencing of the eight chapters contained in this JETRO-BRC research project illustrates key priority areas of policy that Myanmar can consider in moving towards a successful economic transition.

Following macroeconomic stabilization in prices, interest rate and exchange rate, Myanmar economic transition will require substantial investment in physical and social infrastructure, development of human capital and improvement of social services. Therefore effective mobilization of both foreign and domestic savings is vital. The positive and negative effects of foreign direct investment (FDI) were discussed extensively in chapter 3 and 4 in the context of FDI experiences of Vietnam and other ASEAN economies. Myanmar should take note of undesirable side effects of FDI and

recognizes the importance in mobilizing domestic resources through substantial increases in government revenues, developing the domestic financial sector, markets and improve financial intermediation. Vietnam's experience with FDI in the past decades has important implications for Myanmar. Rather than just promoting the volume of FDI, Myanmar should also accord policy priority on technology and human-skill transfer in the process of attracting FDI. Equally important is to attract FDI based on Myanmar's comparative advantage in industrial and trade structures as well as to have FDI approach that incorporates elements of both gradualism and selectivity. Finally, the benefits of FDI can be maximized if the overall policy and economic environment for private sector operations embodies essential elements of stability, transparency and predictability. The opportunities and challenges of FDI in Myanmar are discussed at length in chapter 1, 2, 3 and 4.

Rapid economic growth in ASEAN countries has been propelled by their structural transformation into manufacturing and services activities of increased diversity and complexity. Currently, Myanmar's growth draws largely from exploiting its natural resources (gas, gems and wood), agriculture (legumes and cereals) and fisheries. Further development of its economy, requires widening its base beyond these primary industries while at the same time enhancing the productivity and value-added activities in the primary sector. Based on the present level of technological capability, the abundant of low-cost labour and human capital base, it is logical for Myanmar to start producing and exporting of labour-intensive manufactured goods and low-skilled services through labour-intensive production for the domestic and export markets. As a latecomer in industrialization, Myanmar would not be able to depend on just export-oriented growth strategy as traditional external market conditions have changed since the global financial crisis in 2008-09. Traditional export market of Western economies would not be able to absorb as much exports from emerging economies as in the past. As a result, sources of economic growth must come from a combination of domestic, regional and global demand to sustain demand and growth in Myanmar. Under this new global economic environment, what would be the most appropriate strategy for industrial development for Myanmar? Is it through one or two polar growth strategy? Based on the available data "Two Polar Growth Strategy" in Myanmar (Kudo and Kumagai, 2012) seems possible and appropriate in seeking for high and balanced

development. Two-polar growth strategy refers to having industrial concentration in urban areas (Yangon and Mandalay) and in border areas in which there are potentially high-density of cross-border trade and investment between Myanmar and the neighbouring Thailand, China or India. One polar growth strategy through agglomeration of industries in urban areas provides various externalities arising from of industry, specific labour, parts and components and infrastructure facilities. Such growth strategy adopted by many ASEAN countries in the past has produced rapid economic development. However, there is a distinct trade-off between rapid economic growth and regional income inequality and widening income gap in the urban areas. For any country size and level of development, there is a tipping point that urban concentration and agglomeration of industries beyond this point would be counter productive. Empirical evidence shows that over or under concentration may reduce the rate of economic growth. One polar growth strategy may cause over concentration of industries and reduce the rate of economic growth in the long-run as well exacerbating regional development gap (Rhee, 2012). Two-polar growth strategy that includes both “high” and “balanced” growth (Kudo and Kumagai, 2012) is therefore more appropriate and feasible, given Myanmar’s strategic location of having borders with rapidly growing China and India and the existing industrial bases in Yangon and Mandalay.

Policies aimed for structural changes have been made for supporting the manufacturing and processing sector. Further strategic alignment needs to be implemented in the operation level where the real positive changes can be made. Some “soft policy” initiatives to support industries and create better business environment are equally important as “hard policy” initiatives in industrial development. For example, currently, about 80 per cent of existing industrial zones are underutilized. Therefore, in order to effectively utilize those vacant plots in industrial zones, the management industrial zones should be gradually upgraded to international standards. As a result of decades of policy neglect, Myanmar faces an extensive list of industrial development challenges and the resources required are limited. Prioritizing the development objectives is critical, based on effective cost-benefit analysis and consistent with long-term development objectives. Prioritization will facilitate to identify and sequence reforms and investment so as to maximize resource allocation from domestic and foreign investment.

The importance of agriculture cannot be overemphasized, given Myanmar's geography, climate and population concentration. Agriculture and rural development is consistent with the four pillars of the proposed second phase of reform strategy, i.e. development of agriculture and all round development. Agriculture would serve as one of major sources of economic growth, employment creation and economic and social safety nets in the mid of increased competition due to regionalization and globalization. The issue of agriculture is discussed in Chapter 5 through an analysis of rice policies in Myanmar and in comparison with Vietnam's performance. It was argued that the insufficient public investment in the agriculture sector in Myanmar could be due to lower marginal returns to such investment, which in turn was related to the allocation mechanism of the state budget. Based on past studies, de-centralization of public funds to state and local government would tend to increase marginal returns of agriculture sector. Increasing investment and according policy priority in the agriculture sector would increase productivity on the supply side and purchasing power on the demand side. This chapter provides an analysis and reasons of the stagnant performance of the rice economy in Myanmar in comparison with Vietnam for the last two decades. A repressive price policies and export controls are often blamed as the cause of the stagnant rice production in Myanmar. However, the authors of this chapter argued that the rice prices and the terms of trade of rice producers in Myanmar are neither in worsening trend nor improving trend in Vietnam. This suggests that widening yield gap between the two countries might be attributable to technological change rather than the changes in their rice price policies. The technological progress of rice production depends, to some extent, on the supply of irrigation facilities and high-yielding varieties that, in turn, depends on the quantity and quality of public investment in the agriculture sector. The extent of allocation of fiscal budget for the agriculture sector is higher in Vietnam than in Myanmar. A policy implication for Myanmar is to allocate more agricultural budget to local governments, especially in the area of irrigation development.

The existence of a large number of Myanmar migrant workers in the neighbouring Thailand poses potentially an attractive policy option for policy makers in Myanmar. These migrant workers have been working in Thailand in the agriculture, manufacturing and the service sector and have accumulated valuable skill and experience that would be

in great demand in Myanmar. The Myanmar migrant workers issues were comprehensively analysed in chapter 6 based on a sound theoretical analysis and extensive surveys and interviews by the two authors. Migrants from Myanmar have crossed to work in Thailand, especially in border areas for decades. Given the accelerated economic reforms in Myanmar, an interesting and key question arises whether these skilled and unskilled migrant workers would consider returning home to work? These migrants left Myanmar mostly for economic reasons and some were political refugees from ethnic minorities.

Current political reforms and economic liberalization have created opportunities for these migrants to return home and work in Myanmar. The authors identified that the decision to return home depends on two major conditions: political stability and democratic freedom on one hand and economic opportunities on the other hand. Both groups would consider returning home when they are assured of political stability, not so much driven by political freedom for less-skilled migrant workers. From the surveys, the authors of this chapter identified these migrant workers acquiring skills and experience in construction, agriculture services (hotel and tourism sector) and manufacturing works that are most relevant to economic reform in Myanmar. In addition, the study, argued that bringing back these migrant workers would make income distribution more inclusive as these migrant workers are mostly ethnic minorities and people from poorer regions. This chapter emphasizes the importance of a balanced economic development strategy focusing on inclusiveness of all ethnic groups to participate and benefit. Such economic reforms should be encouraged. In this regard, special economic zones should be promoted in states where there are ongoing ethnic conflicts. In order to enhance a sense of stakeholder among key actors in Myanmar, the United Myanmar Federation of Chamber of Commerce and Industry (UMFCCI) should be consulted intensively on a sustainable basis as UMFCCI has a strategic and an important role in the domestic labour market and in enhancing cooperation with the private sector in neighbouring countries.

A modernized financial system would facilitate effective intermediation of domestic saving to investment and support broad-based growth. Myanmar economy can be considered as a cash-based economy as transaction for business and consumption are made through cash payment. Such a financial and banking system can hardly support a



modern industrial economy. There is a dire need to broaden the financial and banking base and facilitate a functioning credit system for producers and consumers. Myanmar's financial sector is very small and kept under tight control. Private credit is under 25 per cent of GDP and it is below that in most developing ASEAN economies. By comparison, in Vietnam private credit exceed 120 per cent of GDP in 2010. The higher the ratio of private credit to GDP indicates a more efficient utilization of financial resources for production and consumption. Financial issues are discussed in Chapter 7 under "Development of Payment and Settlement". The government has recognized the importance of the financial sector development plan. Financial sector reform and liberalization are under way. These measures are important but to be functioning well and competitive, they need a prudence banking and financial supervision by Myanmar Central Bank. It would be a prudent sequencing financial policy to initially accord priority in the development of payment and settlement systems before further embarking on a more liberalized financial and banking sector that would subject Myanmar's fragile financial sector on external risks and fluctuations. In this case, Myanmar can learn from the mistakes and challenges of other emerging economies in opening up its financial sector too fast prematurely. In this case, it would be wise for Myanmar to carefully consider policy recommendations of International Monetary Fund's 2011 article IV consultation report that was published in May 2012. The importance of timing in financial market opening is critical. In this context, the monetary authority needs to ensure that every requisite policy measure has been taken into consideration. In this respect, setting minimum interest rate on deposit and maximum interest on lending, setting interest rate range which allows banks to determine their rates on deposit and lending freely should be considered. Recent changes in transparency policy of the Central Bank of Myanmar are commendable as it should lead in educating the public on banking and financial products and the risks and benefits involved.

The last chapter on "the ASEAN Economic Community (AEC) Building: Challenges and Opportunities for Myanmar" relates the progress of implementing the AEC Blueprint and the implications to Myanmar economic re-structuring and reforms. Based on various indicators and scorecard measurement, Myanmar's scorecard is relatively low in implementing the AEC Blueprint. Therefore, Myanmar needs

significant efforts to improve on trade facilitation, customs facilitation and integration (National Single Window integration to ASEAN Single Window), standards and conformance, services liberalization, investment liberalization, promotions and facilitation. As the AEC Blueprint is a highly comprehensive initiative, its impact on Myanmar is expected to be wide-ranging. The challenges facing Myanmar in implementing the AEC Blueprint are enormous but the opportunities and benefits would be much more. Economic reforms in Myanmar should be seen in the context of globalization and regional integration in the form of the ASEAN Economic Community. In order to gain the potential benefits and opportunities of the AEC, Myanmar urgently needs to overcome a number of challenges in the form of structural adjustment through the relocation of production factors such as labour, capital, technology and management to maximize economic activities based on dynamic competitive advantage. Of crucial importance during the process of structural adjustment is not to protect excessively the incumbent economic activities that do not have comparative advantage but to meet the necessary adjustment costs by facilitating inter-sectoral or inter-regional mobility of production factors and by designing and implementing effective redistribution policies from those who gain to those who are losing out in relative terms. A case in point can be found in Myanmar's internal struggle among different vested interest groups in revising the newly approved Foreign Investment Law. Another challenge for Myanmar to implement the AEC Blueprint is the limitation in capacity in terms of infrastructure, institutions, rules and regulations, human resources, technology and financing capacity. Without adequate infrastructure such as roads, ports, airports, power plants, industrial estates and management capability, it is difficult for Myanmar to take full advantage of its comparative advantage such as abundant labour, natural resources and strategic location being the connecting node of emerging economic powers of China and India. The limited institutional capacity also results in lacking of reliable information and statistical data to base policy response to cope with the rapidly changing environment towards the establishment of the ASEAN Economic Community.

As a result of credible political liberalization and economic reforms, Myanmar can now expect wider and deeper opportunities of external resources in the form of official financial and technical assistance and foreign investment to fill the gaps. In the

context of the AEC, the adoption of Master Plan of ASEAN Connectivity, ASEAN Infrastructure Development Fund and various land, railways and sea connectivity plans between and among ASEAN Member States provides Myanmar with important economic opportunities to benefit from its strategic location.

All in all, Myanmar historic move to a market economy is very timely as it is happening against the backdrop of ASEAN integration toward one economic community in 2015. Indeed, as a “late-comer” in economic development, Myanmar can benefit from many lessons of its neighbour’s development experiences, especially to avoid the social instability resulting from widening income gaps and environmental degradation they suffered. Despite rapid economic growth in some established ASEAN countries, environment damage occurs, poverty persists and relative income inequality on the basis of different groups and regions widen. The trend of rising inequality in ASEAN is worrisome to policy makers. Therefore, enhancing the inclusiveness of Myanmar’s grow is vital to maintain a strong growth dynamics in the long run. Various studies have indicated that widening income inequality can adversely affect growth performance by having a negative impact on political stability, social cohesion, human capital formation, especially for Myanmar which is still struggling to manage ethnic conflicts in some of its States.

As agriculture and tourism hold potential rapid growth, it is imperative for Myanmar to design growth along environmentally sustainable manner. As a resource-rich country, Myanmar is indeed well positioned to set its course of growth that is environmentally friendly, resilient and dynamic and inclusive. As Myanmar integrates into the global economy, it faces a number of key risks that require careful monetary and fiscal management, particularly in the realm of reserve management and exchange rate stability. Myanmar can learn from Vietnam’s mistake in managing its exchange rate, financial and banking pitfalls, and consequently in controlling inflation. A stable and sustainable development critically requires a constantly changing equilibrium in the real and financial sectors, demand and supply side of the economy.

On final notes of Myanmar’s economic reforms, expediting public sector reform is critically required as its public sector is over-extended and inefficient. The organization and governance structure is weak, leaving it open to mismanagement of staff and resources as well of rent-seeking activities by public servants. Even with

optimum programs and policies in place, the lack of transparency and accountability in decision-making often leads to poor design of public programs and hence poor delivery of public service as mandated in the new economic regime and strongly supported by President Thein Sein, including the establishment of reliable statistics and improvement of statistical system as a roadmap of good governance and people-centered development pathway.

Ultimately, the success of economic reforms will depend on calibrating the implementation of economic reform to domestic political and economic circumstances. As physical, human resources and institutions are limited, policy priority and sequencing are critically vital to the success of planning, managing and implementing Myanmar's transition economy. The more successful in implementing economic reforms, the more policy space for the government to initiating and implementing more vigorous and wide-ranging political and economic reforms in subsequent stages.

The pathways for Myanmar's economic reforms have been discussed and identified and the prospects are clear. Notwithstanding, reform process would not easy as the effective implementation of policy priorities and proper sequencing critically dependent on a strong political leadership buttressed by gradually improving human capital resources and administrative efficacy strengthened by institutional and regulatory reforms.

## References

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