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THE MYANMAR ECONOMY: TOUGH CHOICES

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Global Economy
and Development
at BROOKINGS

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Abstract:

The new Government of Myanmar has astonished the world since it took office at the end of March 2011 by the pace and scope of policy changes it has introduced in a country that has underperformed most other Asian countries for decades. Not a single analyst inside or outside Myanmar before President Thein Sein's inaugural address predicted the changes that many now label "breathtaking." The global policy community and the media have focused heavily on the political changes and challenges, giving less attention to the economic changes and challenges than they probably deserve. This paper focuses on 21 high-priority economic issues facing the Thein Sein administration in mid-2012.

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OVERVIEW

… We must turn to national industrialization to transform [the] country into a developed, rich one with a lot of employment opportunities and high per capita income.

…We have to ensure [a] proper market economy designed to reduce the economic gap between the rich and the poor and [the] development gap between urban and rural areas.

—President Thein Sein, Inaugural Address, March 30, 2011

When the global economy is still instable, when our nation has not had the economic sanctions lifted and when our domestic businesses have not been strong enough with lack of competitiveness, we have had to prioritize the prompt issuance of work business licenses and export/import licenses with a view to enabling our citizens to do business easily and conveniently. …

The national development strategy of our government is not aimed at developing a class or a community but aimed at developing every aspect of all walks of life, all classes or all the people of the Myanmar polity. …

—President Thein Sein, Speech to the National Parliament, March 1, 2012

In its first 63 years as an independent nation, Myanmar (Burma) went from being Southeast Asia's brightest hope (in 1948) to its biggest embarrassment, through three distinct periods of uninspired or misguided governance.[3]

From 1948 to 1958, the country was a parliamentary democracy based on a U.K.-inspired constitution. From 1962 to 1988, the country was ruled by General Ne Win, who followed a socialist path featuring nationalization, isolation and repression.

From 1992 to 2011, the country was ruled by General Than Shwe, who restored a market-based economy, strengthened the balance of payments by exporting natural gas to Thailand and moved the country along a seven-step roadmap to a "discipline-flourishing democracy." At the same time, he kept Aung San Suu Kyi under house arrest, drew global condemnation and sanctions from Western nations for gross human rights abuses and continued to wage war against the country's ethnic minorities.

Pursuant to the 2008 constitution, approved in a national referendum that fell far short of global standards, the country's first multiparty election in more than two generations was held in November 2010. Although this election was neither free nor fair, it produced a new government on March 30, 2011. Led by President Thein Sein, this government has ended many of the repressive policies of the past and has started to pursue broad-based and sustainable economic growth.

On the political front, the Thein Sein government initiated a dialogue with Aung San Suu Kyi that enabled her party, the National League for Democracy (NLD), to win 43 of the 45 seats filled in the by-elections held on April 1, 2012, including a seat for Aung San Suu Kyi in the lower chamber of the national legislature. The government has released hundreds of political prisoners, granted a high degree of press freedom, taken steps to find a peaceful resolution to the conflict with ethnic minorities and improved relations with other countries to the point where most sanctions have been dropped or suspended.

On the economic front, the Thein Sein government has abandoned the official exchange rate of the kyat fixed at 8.5057 to the SDR since 1977 in favor of a floating market rate. It is taking steps to build a sound banking system, has reduced some of the heavy transaction costs impeding international trade and has suspended construction of the Myitsone Dam in Kachin State because of its potentially adverse environmental and social impacts.

The pace of the ongoing transition to a democratic political system and market-based economy in the first year of President Thein Sein's five-year term has been breathtaking. The current level of engagement with Myanmar by the diplomatic community, official aid agencies, international NGOs and private investors is already phenomenal and seems far from peaking.

Based on the country's economic trends of the past year, Myanmar may achieve Vietnam's current level of development in less than 10 years. My judgment, however, is that Thein Sein's administration will not be able to maintain this pace. Until now, the administration has been harvesting low-hanging fruit. Rapid political, social and economic progress in the years ahead will depend on successfully resolving a large number of challenging policy issues. The aim in this paper is to highlight the main economic issues facing the administration.

Readers should not look for policy recommendations. Thein Sein's government is being swamped with recommendations from outsiders, and I prefer not to add to the deluge. Instead, I aim to encourage a public debate within Myanmar that will lead to better policy choices and economic outcomes and to help observers outside Myanmar get a better understanding of the issues and options.

Another caveat is that many economists treat policy options in black and white terms: They are only right or wrong. In contrast, the approach taken here assumes that better outcomes can be achieved when policymakers and policytakers understand that every economic policy option has pros and cons, produces winners and losers, and yields unintended consequences. Instead of examining two or three issues in great detail, this paper examines 21 policy issues more broadly. But policy options are inherently complex: Alongside and within each of the 21 issues are a myriad of other fateful choices that are not addressed.

In addition, only a host of good policy measures working in tandem can create 5-6 percent sustainable economic growth for the Myanmar economy. Thus, if 50 good measures are required, as many as 35 or 40 may have to be implemented successfully before a "tipping point" is reached and impacts become mutually reinforcing.[4]

While this paper focuses on policy issues, it is important not to overlook the huge impact the policymaking *process* has on the choices that are made. Throughout the first year of President Thein Sein's administration, process has both enabled and hindered progress. On the positive side, the process has helped the government understand the central importance of the exchange rate and to move with impressive speed on this front. Also, a labor law has been passed that could help avoid labor problems as the economy becomes more industrialized. And no really bad decisions stand out in other economic policy areas. On the negative side, weaknesses in the policymaking process have delayed the adoption of measures in the agriculture sector to raise farmer incomes, an essential step in a country where 70 percent of the population is rural. Furthermore, natural resource extraction continues at an unsustainable and even counterproductive rate. For the most part, policy decisions are being made largely in a non-transparent, top-down, discretionary manner as was the practice in previous governments.

To its credit, the Thein Sein government has sponsored and supported a series of workshops and conferences on a wide range of economic issues. These events, which are strongly favored by the donor community, have been helpful in raising public awareness of the issues and moving toward a social consensus on how to approach them. There is some risk, however, that key decision makers are spending too much time in these public discussions. Recent "needs assessments" and "scoping missions" being undertaken by most donors individually are another distraction from the crucial functions of policy analysis, policy presentation and policy implementation.

Another positive step in identifying strong economic policy options was the Thein Sein administration's creation of the Myanmar Development Resource Institute (MDRI) and its three separate centers: the Center for Economic and Social Development, the Center for Strategic and International Studies and the Center for Legal Affairs. The MDRI serves as an independent source of policy analysis for the government. The Institute is also expected to play an important role in informing the public about policy issues and in training policymakers and policy analysts.

In May 2012, President Thein also announced the formation of a National Economic and Social Advisory Council, which includes union-level and region-level ministers and prominent personalities from the private sector. Indicative of much of the confusion in Myanmar today, however, as of mid-August, no clear description of the mandate of the council or its membership was available in the English language. There is anecdotal evidence that this council will play an important role in reaching a broad social consensus on contentious issues, especially those related to foreign aid and foreign investment.

THE MYANMAR ECONOMY AT THE END OF THE 2011/12 FISCAL YEAR

An insurmountable problem in assessing the performance of the Myanmar economy at any point in the past 50 years is the absence of reliable data. The assessments put forward here rely heavily on estimates or guesswork. For example, estimates of Myanmar's current population range from below 50 million to above 60 million. Happily, it looks as though this uncertainty will be resolved in 2014 because the Thein Sein government has announced its intention to conduct a census in that year and is receiving assistance from the United Nations and other organizations to ensure that it meets global standards. The government is also getting a lot of donor assistance to improve statistics in other areas.

Among the various assessments produced by public and private sector bodies, international economists and the leading media especially value the annual Article IV consultation reports produced by the IMF staff. In the case of Myanmar, however, none of these reports had been made public until this year. Although the vast majority of IMF member countries now permit their Article IV consultation reports to be published, Myanmar was among the small group that opted to limit distribution to the IMF's governors. To its credit, Thein Sein's administration authorized the IMF to release the staff report on its 2011 consultations. These consultations were concluded in Myanmar in January 2012 and the staff report was posted on the IMF's Web site in May.[5]

Highlights of the consultation report include the following:

- **The main macroeconomic variables:** GDP growth picked up in the 2010/11 budget year to 5.3 percent from 5.1 percent the previous year. Inflation declined to 6.4 percent in October 2011 from a year earlier mainly due to lower food prices and less deficit monetization. Gross international reserves rose to $6.1 billion (equivalent to about nine months of imports).
- **The macroeconomic outlook:** GDP growth is projected to be 5.5 percent in the 2011/12 budget year and 6 percent in 2012/13. Inflation is projected to be 4.2 percent in 2011/12 and 5.8 percent in 2012/13.
- **The main risks:** The downside risk to these projections is mainly a drop in regional demand for Myanmar's exports. The upside risk comes from easing of FDI restrictions, domestic credit expansion and progress toward exchange rate unification.
- **Macroeconomic overview:** "Myanmar could become the next economic frontier in Asia if, with appropriate reforms, it can turn its rich natural resources, young labor force, and proximity to some of the most dynamic economies, to its advantage. Delivering on these expectations with inclusive and sustainable growth should start with ensuring macroeconomic stability. This process is already under way with plans to unify the exchange rate and lift exchange restrictions, and should be supported by establishing a consistent monetary policy framework and improving public financial management."
- **Structural overview:** "Modernizing Myanmar's economy will be a process of removing impediments to growth by enhancing the business and investment climate, encouraging financial sector development, and further liberalizing trade and foreign direct investment. Economic development remains essential for reducing poverty and building human capital."
- **Exchange rate unification:** "The CBM [Central Bank of Myanmar] should be granted a standing authorization to use and manage international reserves. The authorities should prepare to end the 'export first' policy and accept their Article VIII obligations."
- **Establishing a monetary policy framework:** "A consistent monetary policy framework is a necessary complement to reforms of the exchange rate regime. The level of interest rates appears appropriate in light of the economic outlook."
- **Fiscal management:** "Stopping deficit monetization remains essential to contain inflationary pressures. The first budget discussion in the new parliament provides a historic opportunity to redefine fiscal priorities. Expanding tax bases would generate more revenues for development spending. In light of increasing reliance on natural resource-based revenues, a broadly balanced medium-term budget appears appropriate. The adoption of a managed float would increase transparency of SEEs' [state economic enterprises] performance and should guide their reform."
- **Financial sector policies:** "Expediting financial sector modernization is essential to facilitate development and prepare the sector for the ASEAN Economic Community. Financial liberalization

should be complemented with a stronger regulatory and supervisory framework."

- **Other issues:** "Lifting agricultural productivity remains essential for rural development. Recent efforts to support private sector development are welcome and should go further." "Capacity building is essential to improve data quality and coverage. Resolving external arrears would bolster the government's engagement with the international community."

The general approach to the individual issues discussed in this paper has two objectives. One is to do no harm. The other is to strengthen the foundations for sustainable and inclusive economic progress.

MACROECONOMIC ISSUES

Fiscal Policy

Issue #1: What will be the fiscal balance objective for the 2013/14 fiscal year?

The government's fiscal balance over the past 20 years has been generally negative. Moreover, the deficits have been mostly financed by borrowing from the central bank that has been inflationary. The IMF has projected the deficit for the last fiscal year (2011/12), based on a budget inherited from the previous government, to be 5.5 percent of GDP.[6]

The first budget plan produced by the Thein Sein government was for 2012/13. It is not comparable to prior budgets because hard-currency revenues and expenditures are included using an accounting rate (close to the retail market at the Money Changer Counters) of kyat 800 per U.S. dollar instead of the official rate that prevailed before April 1, 2012 of kyat 8.5057 per SDR (equivalent to kyat 5-6 per USD in 2011). This budget plan had a deficit of 4.6 percent of GDP, still largely financed by the central bank. Against a projected GDP growth rate of 6.0 percent, the deficit in the budget plan is not worrisome. However, there is no track record of budget performance that offers any assurance that the planned deficit is realistic. Based on regional experience, the *actual* deficit could be much larger because expenditures have been grossly underestimated or revenues have been grossly overestimated. On the other hand, the deficit could be smaller because the ministries and agencies have had difficulty spending their allocations. (The odds of underestimating revenues appear low.)

In the second half of 2012, the Thein Sein government will need to issue guidance to its ministries and agencies for preparing the 2013/14 budget plan and establish an overall balance in this context. This choice will be an important indicator of Myanmar's macroeconomic management, but it will be difficult to set because of uncertainty about the costs of hosting the Southeast Asian Games at the end of 2013 and the series of Association of Southeast Asian Nations (ASEAN) meetings, including the East Asia Summit, during 2014 (a consequence of chairing ASEAN). The IMF has projected a deficit of 2.9 percent of GDP, but these events may create a larger deficit. At the same time, there is a risk that heavy spending in 2013/14 and 2014/15 will establish spending patterns that are difficult to ratchet back in subsequent years, especially approaching the national election in November 2015.

Issue #2: What steps will be taken to increase the tax yield, including both the structure of taxation and the administration of tax collection?

The Myanmar government's main source of revenue in recent years has been the export of natural gas to Thailand. Another major source has been taxes on domestic and international trade. Land is taxed lightly and taxes on corporate and personal income generate a negligible amount of revenue.

Having low rates of taxation is one way for late starters to catch up with more economically advanced countries. One of the major constraints on economic progress in the future, however, will be the level of government revenue. Raising revenue rapidly by taxing the growing exploitation of natural resources may be possible, but could be a risky strategy. Initial steps taken by Thein Sein's administration to introduce well-targeted tax measures will be a crucial part of building the foundations for sustainable growth. Success will depend not only on the measures but also how effectively those measures are enforced.

Issue #3: To what extent will revenue transparency be improved, especially related to natural resource extraction?

A widely held view is that a large portion of Myanmar's hard currency earnings from natural resource exports is siphoned off into the pockets of powerful people. The credibility of Thein Sein's administration, both domestically and across the donor community, will depend greatly on how quickly it moves to show that these earnings are going into the budget. Myanmar is the kind of country that can benefit greatly from participation in the Extractive Industries Transparency Initiative (EITI), and President Thein Sein went on record in July favoring participation. It could be difficult in the near term, however, to overcome resistance from vested interests to meeting the EITI's standards.

More generally, while the Thein Sein administration has gone much further than its predecessors in disclosing budget details, these disclosures have been largely limited to the legislature.[7] It must be assumed that there are substantial off-budget revenues and expenditures in the public sector. An important part of transparency will be bringing these transactions progressively into the budget.

Issue #4: How will the allocation of expenditures improve, especially among the agriculture, education and health sectors?

The 2012/13 budget has been widely viewed as an improvement over its predecessors because of the increase in shares allocated to the education and health ministries; however, these increases were easy wins given the paltry amounts allocated to these sectors in the past. A better test of the Thein Sein administration's development strategy will be how efficiently the budgeted amounts for education and health in the current fiscal year are spent and how these allocations are adjusted in the 2013/14 budget. Other important tests will be how the allocations for agriculture and defense are adjusted.

Issue #5: Will steps be taken to create a sovereign wealth fund?

Myanmar's gas exports to Thailand already generate more hard currency earnings than the country can absorb efficiently. In 2013, China will begin to make payments for gas from the Shwe fields and transit fees for the oil and gas pipelines to Yunnan province. Thailand will begin paying for gas from the Zawtika field as well. As a result, the government's "excess" hard currency earnings will increase substantially. Without careful management, this excess can lead to a number of problems including unproductive investment and inflation.[8]

One step adopted by a number of countries in a similar situation is to create a "sovereign wealth fund." Such a fund can be used not only to stabilize revenues to the budget (as world prices, and hence export earnings, rise and fall) but also to ensure that some portion of the revenue from exploiting non-renewable resources is saved for the benefit of future generations instead of being entirely consumed now. The IMF recommended consideration of a sovereign wealth fund in its 2010 Article IV consultation. Steps towards the creation of such a fund could strengthen domestic support for the government's program and give foreign donors a reason to be more generous.

Monetary Policy

Issue #6: What further steps will be taken to enable the Central Bank of Myanmar to implement monetary policy?

The Myanmar population has little faith in the kyat due to the three demonetizations between 1964 and 1987 and high rates of inflation over the past 20 years. Increasing the availability of high and low denomination notes may be a simple step to restore faith in Myanmar's currency. The shortage of high denomination notes means that many transactions are settled with stacks of kyat 1000 notes.[9] The shortage of low denomination notes means that sellers round up what would be a competitive price and consumers are short-changed.

Myanmar has had no monetary policy framework or objectives because it lacks the necessary instruments and institutions. With advice from the IMF, the Central Bank of Myanmar (CBM) is in the process of creating an interbank money market. Next steps will include broadening and deepening the market, opening a discount window in the CBM and developing a government securities market.

More fundamentally, the CBM exists as a department within the Ministry of Finance and Revenue and lacks the operational autonomy required to manage monetary policy in a modern market economy. The Thein Sein government is getting advice from the IMF on the preparation of a new Central Bank Law. Timely passage of the law, its content, and how rapidly the CBM builds the capacity to carry out central bank functions will be important indicators of progress. Three crucial functions of the CBM will be to establish an efficient payment system, effectively supervise and regulate the banking system, and manage the country's foreign exchange reserves.

The Exchange Rate System

Issue #7: How rapidly will the exchange rate system be unified and restrictions removed on currency convertibility for current account transactions?

The single most important economic policy measure adopted by the Thein Sein Government so far (and by far) was the abandonment of the grossly overvalued official exchange rate in effect since 1977 and the move to a managed float on April 1, 2012. The IMF provided essential technical advice in preparing for this move, which was preceded in October 2011 by licensing 17 private banks to open "money changer counters" for retail transactions.

The April 1 move is one of many steps required to have a unified exchange rate and achieve Article VIII status in the IMF. This status means that all restrictions on the purchase and sale of foreign exchange for the export and import of goods and services have been removed, which is an obligation for the country as a member of the ASEAN Economic Community. Other countries, like China and Vietnam, have needed two years or more to achieve Article VIII status from similar starting points. Because the country is hosting the Southeast Asian Games at the end of 2013 and a series of ASEAN-related meetings in 2014, Myanmar will be under considerable pressure to move quickly.

While, the most obvious "losers" from exchange rate unification are the state economic enterprises (SEEs) that have been able to obtain hard currency at the official rate for their imports, other, less visible, losers exist. For the affected SEEs, the change will lead to operating losses that can be offset by transitional subsidies from the budget. For the other losers, some of whom are politically powerful, the government will need to find other means of compensation to avoid adverse consequences.

THE PRIMARY PRODUCT SECTORS

Issue #8: What steps will be taken to raise agriculture sector productivity and rural sector household incomes?

Seventy percent of Myanmar's population lives in rural townships where livelihoods depend greatly on agricultural production. The agriculture sector, the most productive in Asia on the eve of World War II, is far from regaining that level of performance. Moreover, in May 2008, a large section of Myanmar's rice-producing delta region was devastated by Cyclone Nargis, the worst on record. This disaster was followed by severe drought conditions in the Dry Zone that continue today. Absent some visible progress in the second year of Thein Sein's administration to boost the agriculture sector, the potential for social unrest is likely to escalate rapidly.

Boosting agriculture productivity to ASEAN-average levels will require improvements in almost every area: land ownership, crop credit, floor prices, extension services, research, infrastructure, etc. From its first day, the Thein Sein administration has placed a high priority on the agriculture sector by convening well-publicized policy workshops and mandating improvements in inputs or outputs. At the one-year mark, however, the impact of these actions is minimal in terms of production, exports or farmer incomes. While crop credit was doubled in the 2011/12 budget year and will be again in 2012/13, the base level was so low that these increases can only have a marginal impact on output. Recent reports indicate that paddy prices are lower this year than last, suggesting that the dry season harvest will be smaller. Also, there is anecdotal evidence that over-indebted farmers are losing their land to creditors. In addition, although the new "rice-specialized companies" have been the main source of rising rice exports, their business models do not appear to be sustainable.

Within Asia, Myanmar has a distinct comparative advantage in agriculture production because its soil has been least damaged by overuse of agricultural chemicals and other unsustainable practices. It has the potential of being the main source of organic food for all of Asia. Exploiting this potential, however, will require exceptionally disciplined policies by the government in the face of powerful market pressures as the country opens up to foreign trade and investment. At the same time, the benefits for smallholder agriculture and household incomes of exploiting this potential are exceptionally large.

Issue #9: What will be the impact of the new land laws?

Land ownership and control is a crucial issue for the agriculture sector but also well beyond it in connection with urbanization, infrastructure projects and industrial agriculture, among others. Two land laws were passed in the legislative session that ended in early May: one on farmland and the other on vacant, fallow and virgin land. Both have been criticized for potentially contributing to land alienation.

Issue #10: What measures will be introduced to slow down the over-exploitation of forestry and mining resources and promote sustainable production of fisheries?

The "resource curse" in the case of Myanmar has been most visible in connection with oil and gas production and timber extraction. It is possible, however, that a wide range of mineral and gem mining projects is doing more damage to both the environment and people's livelihoods. Jadeite mining in particular seems to be out of control. The government is holding three "gem auctions" a year, featuring jadeite, rubies and pearls. In recent years, each auction has yielded gross sales on the order of $1 billion and some more than $2 billion. The macroeconomic impacts of more intensive resource extraction can only be adverse in the short term, including pressure on the exchange rate to appreciate (a phenomenon associated with "Dutch disease"). The major mineral mining operations are extracting coal, copper and gold. Smaller operations are extracting iron, lead, limestone and zinc. Foreign investor interest in Myanmar's mining sector appears to be intense. The steps that Thein Sein's administration takes to manage this interest for the good of the nation will require considerable courage because of the vested interests involved, especially the military and certain ethnic minorities.

Timber extraction has been carried out at an unsustainable pace for 20 years. Most of the timber exported is undervalued or smuggled, depriving the country of revenues that could support improvements in areas such as health, education and infrastructure. Similarly, if the administration would like to capture more of the value of timber extraction, it will need to overcome powerful vested interests.

The marine fishery resources of Myanmar, by contrast, appear to be underexploited, at least by the Myanmar fishing fleet. It is likely, however, that poaching of fish in Myanmar waters by foreign fleets already represents a serious threat to future production.

THE ENERGY SECTOR

Issue #11: What steps will be taken to shift the distribution of natural gas and hydropower production away from exports toward domestic consumption?

The previous Than Shwe government introduced a policy of systematically exploiting Myanmar's natural resources for sale to neighboring countries, beginning with natural gas exports to Thailand in the late 1990s and then expanding to electricity exports to Thailand and China from hydroelectric dams. Part of the motivation for this policy was to obtain foreign exchange needed to maintain order and modernize the economy.

Despite the severe shortage of electric power across the country, less than 15 percent of extracted gas was consumed domestically when the Thein Sein government came to power in March 2011. The administration has taken some steps to shift the output mix in favor of domestic consumption, but a substantial improvement in the mix would require the renegotiation of contracts, which entails some risks.[10] With foreign exchange reserves already above a comfortable level, the benefits of exporting more power appear low relative to the benefits of exploiting the country's natural sources of energy to provide a sufficient and reliable supply of electricity to most of the country's households and industry.

In Myanmar, as in most other countries, the pricing of electricity, gasoline and other fuels is a sensitive social issue. Under its new democratic political system, there will almost certainly be pressures to under-price electricity, but the experience of other ASEAN partners (notably Indonesia) may help the government avoid the pitfalls of doing so.

THE FINANCIAL SECTOR

Issue #12: What steps will be taken to strengthen the banking system and accelerate the move from a cash economy to a banked economy?

The banking system in Myanmar, consisting of four state-owned banks and 19 private banks, is by far the weakest and least developed in Southeast Asia. It will not be possible to build a competitive economy and raise standards of living in Myanmar without a sound and efficient banking system. However, in achieving this goal, the country faces two challenges despite several helpful policy measures adopted in the past year. First, public trust in the banking system remains low because of three past demonetizations and the serious banking crisis in 2003. Second, Western-imposed financial sanctions have prevented Myanmar banks from conducting normal international financial transactions, including letters of credit and credit card payments. The U.S. government suspended sanctions in this area in July and most other countries have suspended equivalent sanctions. The benefits for the Myanmar population as a whole of lifting these sanctions are exceptionally large.

Most of the private banks are working overtime to modernize their services by introducing electronic banking and installing ATMs in convenient locations. They are constrained, however, by existing regulations issued by the CBM, and the CBM is not staffed up to regulate and supervise banks up to ASEAN standards. An early challenge for the banks will be to begin moving cash transactions (perhaps starting with payrolls) into the banking system.[11]

The evolving role of the four state-owned banks promises to be a major policy challenge. In particular, the Myanmar Foreign Trade Bank and the Myanmar Economic Bank may resist giving up certain functions to the CBM, which will require a monopoly on those functions to operate successfully as a central bank. The Myanmar Agriculture and Development Bank has the potential of playing a major role in agriculture sector development, but a set of policy and institutional improvements—as sketched out in the IMF Article IV consultation report and other assessments—will have to be implemented to achieve this goal.

Issue #13: When and to what extent will foreign banks be allowed to establish in Myanmar?

No foreign banks are operating in Myanmar, primarily because Western sanctions have made it impossible to carry out a profitable international banking business within the country, but also because domestic banking regulations are so restrictive. Nevertheless, more than a dozen foreign banks—mostly from Singapore and other Asian nations—have representative offices in Yangon. Foreign banks clearly have an interest in beginning operations in Myanmar, and domestic banks, naturally, are not enthusiastic about the entry of foreign banks. The IMF staff report on its 2011 Article IV consultations notes that “joint ventures with foreign financial institutions would expedite the transfer of technology before the ASEAN financial integration in 2015.” An even less threatening (for the domestic banks) move would be to encourage twinning arrangements between domestic and foreign banks as a step toward joint ventures.[12]

Under the ASEAN Comprehensive Agreement signed in 2009, Myanmar is committed to opening up its financial services sector in 2015 to banks headquartered in its ASEAN partners, and jockeying for early entry has already begun. The selections by the Thein Sein government and the transparency of the process will be good indicators of Myanmar's future economic prospects. Opening the door too soon and too widely could be counterproductive.

INFRASTRUCTURE

Issue #14: What steps will be taken to promote financially sound and socially beneficial investment in transportation and communications infrastructure?

Astonishingly, Myanmar is unconnected to any of its five neighboring countries by a single railroad or highway. Plans for Asian connectivity, strongly promoted by the Asian Development Bank (ADB), have existed for years. East-west and north-south transportation (and development) corridors have been selected that include Myanmar, and other countries have completed large sections of these corridors. Construction on highway connections to India, China and Thailand is currently underway. The Thein Sein government has reached agreement with the Chinese government on a railroad link and has initiated discussions with the Laotian government on a bridge across the Mekong. These new connections have the potential of transforming the Myanmar economy in a relatively short period of time.[13]

The policy challenge is how to finance construction of the basic transportation network required to connect Myanmar efficiently to its natural markets in Asia. Japan promised substantial funding for infrastructure projects in April 2012, and the ADB may provide financing following clearance of Myanmar's outstanding payment arrears, which could be done as early as the end of 2012. The World Bank may also be able to provide funding, but is unlikely to make commitments until 2013. For every infrastructure project, Myanmar will look to private sources of financing, but the risks of making mistakes in this aspect of project implementation—e.g., budget subsidies that are either too little or too big—are considerable.

The communications sector offers one of the biggest opportunities Myanmar has to leapfrog in the process of developing its economy. At the moment, the country's telephone and Internet penetration are among the lowest in the world. The power of mobile telephony, including mobile banking, to fuel economic growth in low-income countries has been demonstrated clearly in recent years. The battle for licenses has already begun and the state-owned monopoly, Myanmar Post and Telecommunications (MPT), has been resisting the entry of private providers offering to sell mobile phone access at substantially lower rates. Hopefully the Thein Sein administration will avoid some of the horrendous mistakes made in nearby countries as it proceeds to auction and allocate licenses for use of its communications spectrum.

Like its mobile telephony, Myanmar's Internet access is decidedly low and currently hinders major economic progress in Myanmar. When the Thein Sein government came to power, Myanmar's Internet access was limited to a single gateway to the global fiber optic network and 1GB per second of bandwidth. At the same time, the government blocked access to many Web sites. While the Thein Sein's administration unblocked most Web sites early in its tenure, it had not as of mid-2012 eased the constraint on access to the global fiber optic network. As a consequence, easy Internet access was unavailable for most businesses and almost all universities. For a country as spacious and populated as Myanmar, three gateways and 10GB per second of bandwidth would be considered minimal today, something on the order of 25GB per second will be needed to handle comfortably the Southeast Asian Games at the end of 2013, and perhaps as much as

100GB per second will be required for the East Asia Summit in 2014. If Internet access has not improved significantly by the end of 2012, it will be interpreted as evidence that Thein Sein's administration has been too weak to overcome resistance from the military (which is concerned about political stability) and from the bureaucracy that controls the existing access.

Issue #15: What amendments to the Special Economic Zone (SEZ) Law and the Dawei SEZ Law will be made to encourage efficient investment and job creation through these vehicles?

In January 2011, shortly before yielding power to Thein Sein's administration, the Than Shwe government promulgated a Special Economic Zone Law and a similar law specifically for the Dawei Deep Seaport Project awarded to the Ital-Thai Development Public Company Ltd in November 2010. Near the beginning of 2012, Thein Sein's administration made known its intention to amend these laws, presumably to make them more consistent with its strategy of broad-based economic growth.

The administration faces two important issues in regard to SEZs. The narrower issue is what to do with the Dawei Deep Seaport Project. Officials cite three reasons for its behind-schedule implementation: Ital-Thai's financial weakness and questionable competence as a port manager; a lack of core investors in large operations like refineries, steel mills and power plants; and the emergence of an alternative, and possibly superior, location for the SEZ. In particular, several years ago the Than Shwe government built a seaport at Thilawa (Myanmar International Terminals Thilawa) near the mouth of the Yangon River, about 25 kilometers from the city of Yangon, and awarded port operations to Hong Kong's Hutchinson Port Holdings. A partially developed industrial zone exists next to this seaport. Some infrastructure experts have argued that the Dawei Deep Seaport Project should be deferred until the Thilawa port and related industrial zone are operating at full capacity.

The broader issue is the trade-off between improving the business climate as a whole and creating specific "enclaves" where business conditions are more favorable. It appears that Thein Sein's administration is committed to promoting a number of SEZs, but there is some risk that it will create too many SEZs and give them too many explicit or implicit subsidies.

STATE-OWNED ENTERPRISES

Issue #16: Which state economic enterprises will remain in the public sector, which will be privatized quickly, and how will privatization be undertaken?

In the final few years of the Than Shwe government, a significant number of state assets were privatized, mostly in nontransparent deals. The assets included land and buildings as well as SEEs. The Thein Sein government has signaled that it will pursue a relatively ambitious privatization strategy, and the Industry Minister is on record as saying he would like to privatize all of the state economic enterprises controlled by his ministry. The government has also announced its intention to adopt a more transparent and competitive privatization process.

The elephants in this room are three SEEs: Myanmar Oil and Gas Enterprise (MOGE), Myanmar Post and Telecommunications (MPT), and Myanmar Electric Power Enterprise (MEPE). In each case, ending their monopolies and inviting competition on a level playing field is a valid alternative to privatization.

A more complicated challenge is what to do with the business enterprises under two holding companies controlled by military interests: the Union of Myanmar Economic Holdings (UMEH) and the Myanmar Economic Corporation (MEC). These enterprises have benefited from special access to licenses, foreign exchange and bank financing, but they are not generally considered to be SEEs even though they have been largely capitalized by organs of the state.

PRIVATE SECTOR DEVELOPMENT

Issue #17: What steps will be taken to improve the business climate and enhance private sector job creation?

Myanmar has been rated as having one of the worst business climates in the world because of—among other problems—political instability, miserable macroeconomic management, a next-to-useless banking system, inadequate infrastructure, a terrible education system and a myriad of administrative obstacles that contribute to high transaction costs.

Thein Sein's administration recognizes the importance of improving the business climate and has taken steps to improve it. For example, the administration reduced the export tax to offset a sharp appreciation of the market exchange rate and ended monopolies on the import of gasoline and palm oil. The Ministry of Commerce has sharply reduced the time and expense required to obtain trade licenses and is easing the process of registering new businesses. Both the Ministry of Commerce and the Republic of the Union of Myanmar Federation of Chambers of Commerce and Industry (RUMFCCI) have made the promotion of small and medium enterprises (SME) a high priority.

The RUMFCCI has more than 20,000 member companies and accounts for the bulk of the private sector's output of goods and services. Defunct under the 1962-88 socialist regime, the RUMFCCI was resurrected in 1989 and, until 2011, existed as an agency of the Ministry of Commerce, with membership being a requirement for obtaining international trade licenses. Simultaneously with the inauguration of the Thein Sein government, the RUMFCCI elected its president for the first time and is now in the process of becoming the leading independent voice of the business community. The major business cronies of the former Than Shwe regime do not play an active role in the activities of the RUMFCCI, most likely to avoid constant criticism.

Another important business group, the Myanmar Business Executives Association (MBEA), was formed by graduates of the Executive MBA Program at the Yangon Institute of Economics. It was allowed at the beginning of 2012 to formally register as an NGO after operating for several years as an informal group, and it is perhaps the best hope for the private sector's future success. In 2007, the MBEA established a Business Capacity Building Center that aspires to bring global best practice to business training in Myanmar.

INTERNATIONAL TRADE AND INVESTMENT

Issue #18: Which restrictions on international trade will be removed next?

Myanmar's international trade has been highly restricted for decades by a wide range of administrative measures on both transactions and payments. In particular, an "export first" policy limits access to foreign exchange for imports to companies that have earned foreign exchange from exports. The unfriendly banking system and the customs valuation policy have driven a substantial body of international payments into the informal "hundee" system. Compounding these restrictions are the financial sanctions imposed by Western countries that force many importers to pay suppliers from offshore accounts (mostly in Singapore), adding significantly to their costs. While Thein Sein's administration has been exploring and gradually adopting a number of measures to eliminate or reduce trade restrictions, these have not yet had a macroeconomic impact. One exception is a car import program that was introduced primarily as a measure to relieve pressure on the exchange rate to appreciate.

The business community is deeply concerned about the looming initiation of the ASEAN Economic Community in 2015 to which the Than Shwe government committed in 2007. Under the "Blueprint" adopted at that time, all restrictions on trade and investment among ASEAN partners are to be eliminated by 2015, although "special and differential treatment" has been extended to the four "newer member states" (Cambodia, Laos, Myanmar and Vietnam). The business community fears that domestic companies will not be able to compete with duty-free imports from other ASEAN countries, leading to widespread company failures and social distress. However, some restrictions allowable under ASEAN rules may mitigate the impact of a wave of ASEAN-origin imports and the feared surge may not materialize for a variety of internal and external reasons.

Issue #19: What are the main issues in the new Foreign Investment Law and how will they be resolved?

Early on, the Thein Sein administration sought enactment of a new Foreign Investment Law (FIL) to replace the 1988 one. Toward the end of 2011, the Ministry of Finance and Revenue drafted and submitted a new FIL to the legislature. After some amendments by the lower chamber of the legislature, the upper chamber was unable to complete its consideration of the amended bill before the legislative session ended in May 2012. However, there have been reports that passage of the new FIL is a top priority for the session of the legislature beginning in August 2012.

The uncertainties surrounding the status of this law and the process of enacting it are symptomatic of two major challenges for Thein Sein's administration: transparency and decision making. It is difficult to reconcile the democratic spirit of this administration with the reality that the text of the initial draft law was not made public, that there was no public discussion of the issues when the draft was deemed to be flawed, and that the administration has declined to explain clearly the timetable for the law's enactment. Remarkably, on July 15, 2012, the administration began publishing in the state gazette the text of all draft laws submitted to the legislature.

Myanmar faces two fundamental issues in passing a sound foreign investment law. First, no other ASEAN country has a separate foreign investment law. They all address foreign investment in the context of general investment laws, basically granting to foreign investors "national treatment," a global best practice. Second, best practice even when there is a separate foreign investment law is to include a "negative list," a list of sectors or sub-sectors in which there is presumption *against* entry. The text of the law that was circulating in January did not have a negative list, only a general proscription against investments that would damage the society, the environment, etc.

It remains to be seen how important this new law will be to foreign investors contemplating entry into Myanmar in the near term. After all, the existing law has not been an obstacle to the tens of billions of dollars of foreign investment approved by the Government of Myanmar over the past 20 years. At the same time, the ambiguous status of the new law is raising red flags and casting doubt on both the Thein Sein administration's commitment to build a modern market economy and its ability to prevail over influential groups expected to be losers in such an effort.

More broadly, if it has not already started, the Thein Sein government can expect to be invited by a swarm of non-ASEAN countries to enter into negotiations on bilateral investment treaties. Here is one area that it can treat as a low priority. The benefits in the near term are likely to be small and the costs of diverting the attention of policymakers from more pressing matters may be substantial.

MULTILATERAL, BILATERAL AND INTERNATIONAL NGO AID

Issue #20: What steps will be taken to channel foreign aid in useful directions?

It is conceivable that the biggest economic problem facing the Thein Sein government today is the tidal wave of visitors it is experiencing. Tourists are not the problem. The list of problematic visitors is led by diplomats, aid agency representatives, international NGO representatives and business executives. The leading edge of this tidal wave was visible even before the November 2010 election and the release of Aung San Suu Kyi from house arrest. It was unmistakable at the end of 2011 when it became difficult to find a hotel room in Yangon, and leading hotels started refusing to renew leases for companies that had been loyal clients for years and reneging on contracts with travel agents for accommodating tour groups. Following the seating of Aung San Suu Kyi and the other elected NLD representatives in the legislature after the April 1 by-elections, it must be assumed that the tidal wave will swell through most of the remaining months of 2012.

Aid agency representatives, in particular, create heavy administrative burdens on the government. However, at a donor conference in Mandalay in mid-May, participants agreed to respect the guidelines that emerged from last year's High-Level Forum on Aid Effectiveness in Busan, South Korea. This agreement could substantially ease the burden.

The worst impact of the tidal wave of visitors is on the small number of Myanmar policy officials, ministers and director generals. These officials are spending large chunks of every work day meeting with foreign visitors, leaving insufficient time for good policy decisions and even less time for effective policy implementation. This kind of adverse impact has been seen in a number of other countries (e.g., Cambodia).

Issue #21: What steps will be taken to clear Myanmar's arrears to foreign creditors?

As a "least developed" developing country (LLDC), by OECD standards, most development assistance to Myanmar should be provided in the form of grants. However, for some projects (especially revenue-generating infrastructure projects) loan financing is more appropriate and will be available on highly concessional terms. The problem is that Myanmar has outstanding payment arrears with its major multilateral and bilateral donors, and new loans from these donors cannot be extended until these arrears have been cleared.

The 2011 IMF Article IV consultation report puts the level of arrears at the end of the 2010/11 budget year at $5.4 billion. Happily for Myanmar, the biggest slice of these arrears—$3.9 billion owed to Japanese agencies—was largely cleared by an exceptional action by the Japanese government in the context of President Thein Sein's visit to Tokyo in April 2012. This is only a temporary fix, however, because international practice is to provide permanent debt relief on official loans through negotiations in the Paris Club of creditors. The next biggest slices are owed to the Asian Development Bank ($407 million) and the World Bank ($351 million). In these cases, international practice is to clear arrears on loans through bridging operations that involve no write-offs.

While Myanmar's arrears problem is not particularly complex compared to other countries, its solution will require time and skillful negotiation by Myanmar officials. Given its status as an LLDC and the optimism surrounding its current transition, officials can make a case for generous write-offs for Myanmar's arrears and remaining payments on old aid loans—as much as 80 percent—both through the Paris Club for bilateral loans and through the Multilateral Debt Reduction Initiative (MDRI) for multilateral loans. However, write-offs of this kind depend on the results of a joint "debt sustainability analysis" by the IMF and World Bank showing that the country's debt is unsustainable. The 2011 IMF Article IV consultation report is accompanied by a preliminary debt sustainability analysis that finds only "a moderate risk of debt distress," a finding that will make it harder for Myanmar to obtain generous write-offs of debt.

ENDNOTES

1. This paper draws on a draft prepared for the International Academic Symposium "Myanmar in Reform 2012," June 18–20, 2012, convened by the Faculty of Social Sciences, University of Hong Kong and the Center for Myanmar Studies, Yunnan University. The draft was co-authored by Lex Rieffel and Khin Maung Nyo, Senior Research Fellow at the Centre for Economic and Social Development in the Myanmar Development Resource Institute.
2. Much of the material in this paper comes from conversations Lex Rieffel had in Myanmar between November 2011 and April 2012 when he was working as a foreign advisor for the Union of Myanmar Federation of Chambers of Commerce and Industry.
3. On June 18, 1989, the ruling military council changed the country's English name from Burma to Myanmar as part of a sweeping change in the Romanized spelling of place names to conform to their corresponding indigenous pronunciation.
4. Because of this tipping point phenomenon, there are strategic advantages to under promising and over performing, especially in the early stages of an economic development program. Setting targets and then falling short of meeting them has a corrosive effect on policymakers, on households and businesses and on foreign donors.
5. http://www.imf.org/external/pubs/cat/longres.aspx?sk=25889.0. As a complement to the Article IV report, the IMF staff also produced and distributed to the IMF's governors a "Selected Issues" report. Unfortunately, this report will not be posted on the IMF's Web site.
6. The fiscal year is from April 1 to March 31.
7. The IMF staff report on the 2011 Article IV consultation does not even include a budget breakdown by sector or ministry.
8. There were press reports in early June 2012 about a government decision to open 23 offshore blocks for oil and gas exploration and development. If true, this suggests that the pressures to over-exploit remain too great for the government to control.
9. Kyat 10,000 notes were introduced in June 2012. Before then, the largest denomination note was kyat 5,000.
10. The government is also reported to be in the process of leasing new gas turbines from GE and repairing others in order to meet rising domestic demand. Juliet Shwe Gaung and Win Ko Ko Latt in *The Myanmar Times*, Volume 32, No. 625, 7—13 May 2012.
11. There were press reports in early June 2012 that debit cards would be introduced before the end of the month.
12. In June 2012, a press report stated that Japan's Sumitomo Mitsui Bank is providing technical expertise to the Kanbawza Bank.
13. Some aspects of this transformation will not be beneficial. For example, infectious diseases and harmful plant and animal species will cross borders more freely.

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