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Industrial Policy Reform in Myanmar

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About the Author

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Introduction

Myanmar faces fundamental choices about its economic future when the sanctions are lifted, and many of these choices will be present even if some of the sanctions remain. There is no technical reason why Myanmar cannot achieve a GDP growth rate of 8 percent a year or more for several decades. If the country did achieve a growth rate of that magnitude, the standard of living of its people would double over the next decade and increase four-fold over the next two decades. Poverty would fall dramatically, first in the more developed regions and then nationwide. In the most recent two decades, in contrast, Myanmar's electric power consumption suggests that GDP growth per capita has at best been negligible and may even have been negative.[1] Furthermore, while there has been some uptick in the GDP growth rate during the most recent two or three years, that growth has been driven by large discoveries of oil and gas together with Chinese related investments of US$3-4 billion a year that have generated revenue for the government but little employment or income for most Myanmar people.

What stands in the way of the potential for sustained high growth that directly involves and benefits the Myanmar people is not the crisis in the world economy. It is not a lack of natural and human resources within Myanmar. And it is not even primarily the existence of sanctions. Instead, it is Myanmar governments over the past decades that have made decisions with respect to how the economy was organized and managed that have had the effect of stifling growth. Going forward Myanmar's government and people can make a series of changes that will lead to accelerated industrial growth combined with improvements in agriculture and services that will transform the society within one or two decades. Or Myanmar can make a choice to continue many of its current policies and instead rely on the discovery of more rich natural resources, notably oil and gas, the more energetic exploitation of its other natural resources, and the politically and socially hazardous emergence of a principally foreign-owned plantation sector. This latter strategy might produce growth higher than is presently the case, but over time slow growth or outright stagnation will return. Furthermore this growth will provide benefits to the Myanmar people only if the royalties and rents generated for the government are spent wisely, which to date has often not been the case.

[1] See Appraising the Post-Sanctions Prospects for Myanmar's Economy: Choosing the Right Path, January 2012; available at http://ash.harvard.edu/extension/ash/docs/appraising.pdf. That draft paper is a work in progress. Its final version will incorporate this and other papers.

If Myanmar is to achieve a sustainable high rate of GDP growth, therefore, there is no alternative to having a robust industrial strategy. All countries of any size[2] from England in the eighteenth century to Japan in the early twentieth century to China today that have achieved growth raising them to middle income and then high income status did so by focusing during the first decades of this growth on industry. Similarly South Korea and Taiwan's periods of near double digit GDP growth in the 1960s through the 1980s was made possible primarily through the rapid growth of industry in general and manufacturing in particular. In the discussion that follows we will attempt to spell out what a successful industrialization strategy for Myanmar would entail. Successful industrialization, it will be argued, involves a series of choices that only Myanmar itself can make.

Choices Have to be Made

It is the sense of our group[3] from meetings with a number of government ministers and business leaders that there is a clear recognition among many that fundamental change is needed, but no consensus or clear understanding of what specific measures are needed to effect change. Does the country want to transform itself over the next two or more decades, or does it want to continue with policies that generate large rents for a few people, but few benefits for the rest? If Myanmar is to transform its economy so that it can increase the average income of its citizens by several-fold and provide meaningful employment for millions, including the many skilled and semi-skilled workers who have left the country, there is no real alternative to an effective industrial development strategy. No such strategy exists at present, however, and creating one presents some unusual as well as some conventional challenges. The conventional challenges involve maintaining an appropriate exchange rate, building adequate infrastructure, removing many regulatory barriers (and making the regulations that remain in place transparent), improving the human resource base, and providing finance for productive enterprises. The unusual challenges relate to the special role in the economy played by the Myanmar military and the state more broadly, Myanmar's longstanding hostility toward and fear of foreign domination, the fragile and sometimes hostile relations between the state and some of Myanmar's ethnic groups, and the large and increasing role that China and Chinese products are playing in the Myanmar economy. This essay will start with the conventional challenges and then move on to the unconventional ones.

[2] Very tiny countries such as Brunei or Kuwait can raise themselves up to high income status relying solely on natural resources, mainly petroleum, but no country with 50 million or more people can do so.

[3] The group visiting in March consisted of nine experts working on various topics and geographic areas. This paper takes advantage of their observations as well as the interviews with Myanmar officials and business people.

1. *Past growth has been slow, narrowly distributed and reliant on depleting natural resources*

Myanmar in 2012 is largely dependent for foreign exchange resources on the export of natural resource products, notably oil and gas but also gems and teak. Thus Myanmar faces the standard problem of natural-resource rich countries: when natural resource prices are high, foreign exchange flows in and drives up the exchange rate, making it difficult for both factories and farms to compete with foreign imports. This puts many factories out of business and lowers the income of farmers[4]. Myanmar will not always be rich in natural resources—it is only "rich" in natural resources today because it has so little else to export. In addition, incomes are very low, and when incomes rise several-fold Myanmar will probably consume most of the oil and gas that it produces and may even become an importer. At current rates the tropical hardwood teak forests will soon be exhausted and Myanmar like Thailand will no longer be a supplier of teak to the world. Myanmar has now floated its currency, and so deliberate efforts by the government to maintain an overvalued rate need no longer be a serious problem. But the effect of market forces at present has much the same effect of overvaluing the rate. The large influx of foreign exchange to buy primary products, and hence market pressure to revalue upward the Kyat, has been further increased by large-scale Chinese investments. This problem of the overvalued exchange rate is, in a technical sense, easy to solve. The government can deliberately devalue its currency, as Indonesia did under similar circumstances in 1978. Whether this is also easy to do politically is beyond the scope of this short essay, but devaluation in the 20-30% range does not appear to present a major political problem for the government.

2. *The economy suffers from poor and unclear regulation and state/military economic domination*

Removing regulatory barriers is essential, but it is also necessary to ensure that the regulations that remain in place are transparent. Myanmar today is riddled with rules and regulations, and the officials administering them have a high degree of discretion in whether and how they enforce these rules and regulations. A business thus cannot even be sure just which rules and regulations apply to its situation. No doubt many regulations conflict with other regulations, making it necessary for a business to fail to comply with some of them. Today, however, excess regulation is trumped by an even larger problem. Most of Myanmar's industry is owned and controlled by either the military or the non-military parts of the government. The only major exceptions are rice milling, which is mainly private, and scattered private firms in industries

[4] This is currently a severe problem at the managed float of about 800 kyat to the dollar. Restoring profitability to agriculture and manufactured exports requires a currency depreciation and maturity and fiscal restraint.

otherwise dominated by state or military firms. These state and military firms operate according to their own rules or lack thereof, and most lose money or would be seen as losing money if conventional accounting rules were used.

This combination of excessive or unknown and arbitrary regulation and government ownership and control of most industrial enterprises discourages people in the private sector from even trying to further the development of Myanmar's industrial sector. It is also a major source of small-scale corruption and no doubt in some cases of large scale corruption. Equally seriously from an economic efficiency view, having to rely on the discretionary decisions of a myriad of officials is a source of much delay in getting needed authorizations. That delay alone can be a cause of business failure.

When this excessive regulation and lack of regulatory transparency is combined with industry run by military and other government officials who operate by their own rules or are not subject to any rules, it is no surprise that Myanmar ranks far down Transparency International's Corruption Perception Index at 180th out of a possible 182 countries (see Table 1). This is an index of perceptions of businessmen and other informed people and not necessarily reflections of reality, but whether they are reality or not, this is not a perception that a country wants others to have if it hopes to attract substantial foreign direct investment from countries other than China and Thailand (which ranked 75th and 80th respectively on the Transparency International list in 2011). The World Bank does not even make estimates for Myanmar in its indexes concerning the ease of doing business (though it will begin to do so soon), but indexes of corruption and of ease of doing business tend to be highly correlated. A complementary index of governance, also prepared by the World Bank, places Myanmar's governance in 2010 among the worst of any country in the world. (See http://info.worldbank.org/governance/wgi/sc_country.asp) Even if the ratings were doubled for 2012, the ratings would still be only similar to North Korea's!

Table 1: Transparency International Corruption Perception Index

Year	Myanmar Ranking	Countries Tied with or Below Myanmar
2011	180 out of 182	Afghanistan, North Korea, Somalia
2010	176 out of 178	Afghanistan, Somalia
2009	178 out of 180	Afghanistan, Somalia
2008	178 out of 180	Iraq, Somalia
2007	179 out of 179	Somalia
2006	160 out of 163	Guinea, Iraq, Haiti

2005	155 out of 158	Haiti, Turkmenistan, Bangladesh, Chad
2004	142 out of 145	Chad, Nigeria, Bangladesh, Haiti
2003	129 out of 133	Paraguay, Haiti, Nigeria, Bangladesh

Source: Transparency International on line (http://www.transparency.org/policy_research/surveys_indices/cpi)

Doing something about excessive regulations and the discretionary implementation of those regulations is easier said than done, although Myanmar has apparently eased many restrictions on imports as its foreign exchange situation has strengthened. The members of our group that traveled to the Chinese border at Muse, for example, learned there that customs procedures had improved considerably in recent years, and one heard similar comments from factories in Yangon.

There is typically a rationale for each regulation that is, on the surface, plausible. More importantly, there are people in power that depend on the existence of those regulations to generate added income and even to justify the existence of their jobs. Trained economists will have no trouble understanding why one has to get rid of these regulations, but others will have to be convinced. Often the most effective way to convince high officials of the need for deregulation is to do a systematic cost-benefit analysis of each type of regulation. The typical justification for a regulation, notably the case with restrictions on trade, is that those restrictions create jobs. Advocates of protection to justify this approach point to factories that employ hundreds or even thousands of people whose jobs depend on such protection. In actual fact, however, the jobs in high cost protected enterprises often cost hundreds of thousands of dollars each; money that is paid ultimately by consumers and producers that purchase these high cost and high priced products. Removing these protective barriers can typically create far more jobs at a much lower cost. Cost benefit analysis can show concretely just what these alternative approaches cost per job created. If Myanmar is to begin a process of deregulation, no doubt either economists within the country will have to be trained in practical cost benefit methods or economists will have to be brought in from outside the country to do this analysis. Long before that, however, there would have to be a willingness of senior political leaders to even consider deregulation. Businessmen might lobby the leaders they know, but that assumes that the businessmen with ties to the political leaders would have an interest in deregulation—too often the opposite is the case. Foreign investors or potential foreign investors are more apt to be a constituency for deregulation, but foreign direct investment is discussed at greater length below.

Finally, the problem is not just one of deregulation. Military and "crony" companies apparently are involved in practices to stifle competition and gain control of particular markets that would be illegal in most countries. There thus need to be rules that prohibit such practices, and these rules need to be enforced. Without a switch to more competitive firms, growth will be narrow and slow and FDI will be limited[5].

3. *Infrastructure costs and quality are among the worst in ASEAN*

Good infrastructure is critical to a successful industrialization drive. The key infrastructure items are reliable and reasonably priced electric power and good transport facilities. What this means in practice is that most of Myanmar's industry, particularly that involved in the export of manufactures, is for the foreseeable future likely to be located in or around Yangon. Items produced for the domestic market such as furniture may locate in places like Mandalay, where they are closer to their raw material (tropical hard wood) and to some of their customers. Internal transport over any distance, however, is very expensive. Our group learned, for example, that it cost $2000 to ship a container from the Thai border to Yangon but only $500 to ship the same container the longer distance to Bangkok. Even for Yangon, however, current infrastructure is not adequate. There are serious electric power shortages in Yangon, and the port currently handling most shipments is clearly inadequate. For Yangon, however, as contrasted to the rest of the country, these infrastructure problems can be readily solved. New thermal power plants can be built quickly and the capacity of existing ones brought up to full capacity, provided that some of Myanmar's rich gas resources are allocated to supplying these plants[6]. There is also a modern port already built near the city, but it is currently underutilized. The potential large investments in a new port far south of the city are not necessary or desirable since the cost would be large and the location is so far from Yangon that substantial costs would be involved transporting the goods between the port and the city.

4. *The Myanmar market for manufactures is small*

Furthermore, Myanmar's domestic market for most consumer items is quite small. If Myanmar's exchange-rate calculated GDP is around US$25 billion (PPP GDP is not appropriate for estimating the size of the market), and if food makes up 60% of average household expenditure, then the market for consumer manufactures of all kinds is likely to be only about

[5] The article "Myanmar's army and the economy: The road up from Mandalay", *The Economist*, April 21-27, 2012, further illustrates this point. (Accessed April 24, 2012, http://www.economist.com/node/21553091)
[6] Current natural gas prices mean that electricity sold to customers, even after the recent 33% electricity price hike, is sold for less than the cost of production. Most companies would gladly pay more for a reliable supply of power that was much less costly than diesel-generated electricity, which costs nearly forty cents a kWh.

$5 billion.[7] Expenditure on manufactures used for investment projects (cement, steel, machinery, etc.) would amount to perhaps another $5 billion, excluding oil and gas exploration projects. What this means in practice is that any industry that is subject to increasing returns to scale either would have to develop early on a capacity to export a substantial part of its production or would have to operate at an inefficient scale and with high costs behind protective barriers. In South Korea, for example, the Pohang Iron and Steel Mill (POSCO) was designed from the outset in the early 1970s to produce more steel than the domestic market could absorb at the time thus making it necessary for it to export steel early on or operate at a smaller scale with much higher costs. At the time starting with a smaller scale steel plant would also have meant lower efficiency and thus high steel costs for all domestic users. Given the high cost of internal transport in Myanmar, most of these exporting industries would have to be located near Yangon's port.

Not all consumer manufactures, however, have large economies of scale, and many of these could no doubt be produced in Myanmar (various plastic goods, for example). But then the question becomes whether firms producing such goods could compete with cheap but reasonably good quality (for the price) imports from China. China exports these products at competitive prices all over the world including Myanmar, and the northern half of Myanmar is closer to Yunnan, China, (physically and in transport-cost terms) than it is to Yangon. Mandalay does produce a few items that are special to the area, such as cut gems and various local handicrafts, but it is mostly a commercial (and tourist) center through which trade from China passes. One industry that could be and sometimes is located outside of the Yangon area is cement, since cost of transport is a major part of the cost of getting cement to where it is being used. Certain food processing industries (rice milling for example) also require locations near to the sources of their raw material.

5. *The role for industrial zones is limited*

There is talk in Myanmar of locating industrial zones (18 in all) in various rural or small-town areas, notably in the minority regions. There probably are a few "industries" that could successfully be located in such areas, but very few. Using the rural small-scale industry program of China in the 1970s as a guide, one could conceivably locate a simple farm machinery operation in such a location if there were electricity available. This could be a repair facility with some metalworking capacity to make simple replacement parts or simple tools (although China mass produces such tools at costs that would be hard for rural industries in

[7] Because we do not have reliable data on either total GDP or its breakdown, these figures are subject to a wide margin for error, but no plausible calculations would produce a market of, say, $10 billion for consumer manufactures in Myanmar.

Myanmar to match). Food processing is also something that has been done locally for centuries, but much of that can hardly be classified as industry. An industrial zone on the Thai border might also attract a few firms that want to use cheap Myanmar labor to export into Thailand. Myanmar's inadequate infrastructure means that there would appear to be no prospect at all of locating industries in industrial zones in more remote regions to produce consumer or producer goods for the national market, let alone for export.

Creating industrial zones may be worthwhile in some of the 18 areas and could be worthwhile in all 18 if the costs of the related infrastructure were kept to a minimum. There may well be some symbolic or political value to building remote industrial zones, but what is really needed is more comprehensive investments in roads and power throughout the states and divisions. Major investments in these industrial zones, however, are not likely to be a major vehicle for bringing substantial industrial development to remote regions anytime during the next decade and thus should be avoided. Small initial investments could be expanded if some of the zones proved successful in attracting significant interest.

Much of this infrastructure investment, whether for industrial zones or for improved transport and electricity will no doubt be undertaken by government agencies. This is one of many reasons why the government budget needs to be unified with all government expenditures in the budget, and that the resulting budget needs to be transparent. In the absence of a unified and transparent budget, it will be impossible to ensure that infrastructure projects will be carried out efficiently.[8]

6. *Improved education will be critical*

A sustainable industrial development program requires a steady improvement in the skill levels of the labor force and increasing numbers of managers, marketers, engineers and the like. However, the first stages of industrialization can make effective use of unskilled labor with limited education. In these first stages, industries typically include garments, shoes, toys, and various electronic assembly items. The managers in these early stages typically come from companies based in Korea or Taiwan, with marketing and design located in these countries. These companies may produce for companies such as Nike that provide design and marketing. The in-country value added in these enterprises is initially small as a share of export value, but

[8] It needs to be emphasized here that we are talking about unification and transparency of the budget of the central government and not a consolidation of state and division budgets into the central budget. It would be especially undesirable if the state and division budgets were included in the central budget in a way that further squeezed the resources going to the states and divisions. State and division budgets also need to be transparent and carefully monitored to avoid waste and misallocation but they also need to be well enough funded to meet the many local needs that are not likely to be provided from the central government budget.

they do employ a great many people. China was and to a degree still is where many of these kinds of products are made, but labor costs in China are rising and companies that export these kinds of products have gone to countries such as Vietnam and Bangladesh. There is no reason why companies would not be willing to move to Myanmar. For products for the North American and European Union markets sanctions would have to be lifted, and that is likely to happen.

Once a country begins to move up the industrial ladder, however, there needs to be a steady improvement in the skills of the labor force and increasing numbers of managers, engineers, and marketers. In the 1950s through the 1970s and perhaps the 1980s Myanmar was arguably well positioned to supply these higher-skilled personnel. Since then, however, the education system at all levels has deteriorated. At the lowest level of skills there is now a minimal level of functional literacy in the country, and there are limits on the degree to which industries can use illiterate workers. Half of those who enter primary school do not stay through the full five years, and then only about 60% of those who do stay go on to complete middle school. Those that do make it to the university have often found the universities closed and the quality of the teaching to be generally quite poor. The military has its own education system for itself and its families, but the quality of this system is unknown to this analyst.

Many Myanmar people go abroad, but it is not known how many of those receive educations abroad or how many are likely to return home at some point in the future. Right now there are simply too few jobs in Myanmar for most of the skilled people abroad, and many Myanmar people—particularly in the 25- to 60-year-old group—have family situations that make return difficult. However, there is a belief that most Myanmar people would prefer to return if they could find meaningful employment and their family situations (children well along in school, etc.) did not make return too difficult. Included among Myanmar residents abroad are large numbers with engineering and other technical skills.

Even if many of those with technical skills return, however, there is no substitute for a major upgrading of the country's education system at all levels and particularly at the tertiary level. There are groups trying to do this, but there is a long way to go.

7. *Improved banking and financial intermediation is needed*

If private (or public) businesses are to get started and to expand, they need capital well beyond what can be supplied by individuals or families. But Myanmar's banking system at present supplies only short-term credit for trade and not much of that. Total private credit extended by the country's banks comes to only 5% of GDP, a miniscule figure. When one does see an active bank, such as observed by our group on the road from Mandalay to Muse, the main purpose of that bank is apparently to handle remittances. Much of what the banks do is to finance the government by buying government bonds in amounts far greater than their credit to private business. This practice needs to stop. Total domestic bank credit in 2010 was only about a quarter of GDP, but most of it went to the government.

The above are problems that are common to many countries, and the solutions are relatively straightforward. To be sure, some of the solutions (deregulation) are difficult to implement, others require substantial funding (infrastructure), and still others take time (improving and expanding education). Finding the right sequencing, priority, and feasibility of these reforms will in itself be very challenging.

Special Issues Applying to Myanmar

There are also issues that, while not unique to Myanmar, are less common among developing economies. These issues complicate some of the standard solutions that might be proposed to get industrialization--and rapid development more generally--started.

(a) One such problem is that the military itself runs huge industrial conglomerates (notably the Myanmar Economic Holdings Corporation and the Myanmar Economic Corporation) employing hundreds of thousands of workers. In addition, most of the other industrial enterprises of any size are state-owned. In 2008 there were 794 such enterprises, up from 624 such enterprises in 1988.[9] The only exceptions to this pattern of state ownership are rice milling, and there is some indication that sugar mills will be privatized. The government's monthly economic indicators publication lists only the output of state enterprises. For the rest, there is scattered private ownership, but most industrial sectors are completely dominated by one form or another of state ownership.

This state takeover of industry is a legacy in part of Burmese Way to Socialism under Ne Win, but the current way in which these industries are run has little to do with socialism or central planning. The industries are run by individual ministries or by such military units as the quartermaster corps. There does not seem to be much if any coordination among the different "owners" of Myanmar's state enterprises. Furthermore, most of these enterprises are making losses and so presumably are a drain on resources rather than contributors to GDP. Those that do report making profits are widely believed to do so through questionable accounting practices. In some cases, in what may or may not

[9] David Steinberg, *Burma/Myanmar: What Everyone Needs to Know*, (Oxford: Oxford University Press, 2010) pp. 163 and 171.

be an extreme example, the factories themselves have been closed down, and the enterprises in question are simply used as a vehicle to import the product, e.g. steel. Prior to the unification of the exchange rate at the market price, imported steel purchased by one former state steel mill was paid for in Kyat at the extraordinary exchange rate of 6.4 Kyat to the USA dollar, while the market rate was 100 to 200 times as high! Where the money from these transactions goes – whether to individuals or to fund the military – is unknown to this analyst.

(b) In a sense this situation is not unlike that of Vietnam, where heavy industry is state-owned and the state is run by the Communist Party, although the situation in Myanmar is far worse than in Vietnam. The result in Vietnam is a heavy industry sector that is very inefficient and a drag on the rest of the economy. That, however, does not have to be the case. China was in a similar situation in the early to mid-1990s, but Premier Zhu Rongji used his country's ambition to join the World Trade Organization as a vehicle for forcing China's state enterprises to become internationally competitive. Even before China joined the WTO, its Premier used the prospect of joining to force state-owned enterprise to shed some 30 million surplus workers, but in reality the situation in Myanmar is much worse than China's was. In Vietnam and China state control of various industries does not preclude coordination among different industries and their investment programs either by the Party or by the government offices that used to be called the state planning commissions. Myanmar has a planning ministry, but there is little evidence that it has any control over the various state and military owned firms other than those that might be directly under its authority.

As long as this situation prevails, there is virtually no prospect for a successful industrialization drive in Myanmar. Domestic private businesses certainly cannot compete with these state and military industries, given that the latter often have monopoly rights over their markets or benefit from other barriers to competition from the private sector. Foreign investors would certainly be unwilling to compete in this context, given that most such investors can go elsewhere. It is thus no accident that most foreign investors concentrate their energies on the natural resource sectors, mainly oil and gas. There is also much foreign investment, mainly from China, in the more remote northern regions, where investors can take advantage of the lack of rules or the lack of enforcement of rules over everything from land ownership to protection of the environment.

(c) Another feature of the Myanmar situation is that the country has a long established desire to have Myanmar businesses run by Myanmar people and not by foreigners. In important ways this is a legacy of the era of British colonialism, in which much of the economy fell into the hands of Indian immigrants; a major step of the Ne Win government was to expel these Indians. At present there are few Indian-run businesses, but much of the business in the country is run by Chinese, both local Chinese who are citizens of Myanmar and Chinese from China. Those from China include many that are in the country on private business, but they also include large Chinese state-owned firms such as the China National Offshore Oil Company (CNOOC). Chinese firms are also building a large number of dams on rivers in the north of the country, and most of the power from these dams will be shipped to China. The suspension of work on the Myitsone Dam gives some indication of the sensitivity of many of these efforts, and some believe that Myanmar's recent interest in attracting more investment from ASEAN, the West and Japan is partly due to the worry in the government as well as among many Myanmar people about excessive Chinese domination of businesses in the country.

Given the lack of Myanmar experience with the efficient running of industrial and many other kinds of enterprises, any industrialization drive would need to rely more heavily on foreign investors to provide the necessary management and technical skills at least for the next two or three decades. Many countries, notably China but also Singapore and others, have discovered that having foreign ownership of local enterprises does not need to mean loss of control to foreigners over industrialization and development more generally. It is not clear that the Myanmar government currently has the confidence to believe that it can make sure that foreign involvement serves Myanmar's interest. Given the limited experience with modern enterprise development and the enormous size, wealth, and power of its northern neighbor, that is an understandable concern. If the recent decision to postpone the Myanmar Industrial Development Ministry (MIDM) project is sustained, however, that is one indication that the country is capable of controlling foreign investment that is not directed to the real needs of the Myanmar economy. The MIDM project was financed by a $4 billion loan from China and was designed to produce heavy machinery that was well beyond Myanmar's current capacity, not unlike Indonesia's very wasteful and ultimately unsuccessful attempt to develop commercial aircraft. The issue of loss of control, however, is not just a problem with Chinese investments since large investments from ASEAN neighbors are also in prospect, although these neighbors do not have the global clout of China[10].

[10] The 2005 book, Theodore Moran, Edward Graham, and Magnus Blomstrom. Editors, *Does FDI Promote Development?* (Washington: Peterson Institute for international Economics and Global Center for Development,

Myanmar Cannot Imitate South Korea

Given the situation described above, if Myanmar wants to increase its overall economic growth rate through industrialization, there are not many options open to the country. Basically the country must move to create a functioning market system to govern the development of industry (and modern services such as tourism). Government regulatory oversight over those activities should be minimal. An activist state-led industrial policy on, say, the model of South Korea or China today is completely unrealistic. The ministries responsible for the economy (and most other ministries appear to have their hand in the economy in one way or another) simply lack the capacity to efficiently manage that approach to development. The only real choices are outright divestiture of almost all state- and military-run enterprises to private owners who will try to reorganize them and run them at a profit. Alternatively, some state and military industries could remain under government ownership but mainly in fields where the private sector is not likely to enter in the short run. Examples of such manufacturing and service industries could include those producing weapons and ammunition or service firms set up to directly support military operations. Even truck assembly plants might remain for a time under military control if the military was itself the main user of the output. It will be some time before Myanmar is able to be internationally competitive in the manufacture of trucks and the military may have security reasons for maintaining an in country capacity in this area. The private sector should meet most of its trucking requirements through imports.

Large parts of the economy would therefore have to be reserved for the private sector—that is industries attached to the military or other government ministries would be excluded since they could not be counted on to operate on a level playing field with the private sector. This would include all labor-intensive consumer goods (textiles, shoes, toys, electronic assembly, etc.). It would also increasingly include many producer-goods industries such as cement, steel, etc. Loss-making state enterprises that cannot be reformed and made profitable using conventional accounting practices should be closed.

For some of these issues involving divestiture of ownership by the military and the government, there will no doubt need to be a well thought out transition process. Studies will have to be done to determine which enterprises should be closed outright and which may need

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2005), found that the benefits of FDI for the receiving country depended on the sector to which FDI was directed and the policies pertaining to that sector. In general, export-oriented manufacturing did the most good for a receiving country's economy, while manufacturing in protected sectors and extractive investments were the least promising. Indeed, they were on balance sometimes harmful if the terms of investment were poor or the taxes collected were poorly used. See http://www.iie.com/publications/briefs/bk-fdi.pdf for a summary of these findings.

restructuring before being put on the market. For those that are designated for privatization, there is the question of privatization to whom and on what terms. Are foreign companies allowed to bid, will credit be made available to domestic groups that may want to bid, etc.? Before government and military divestiture of some or all of the enterprises under their jurisdiction, the new rules governing the divested enterprises will have to be decided and written and, where necessary, independent regulatory agencies or offices of government set up and personnel trained to enforce those new rules. For enterprises that remain under government control, what (transparent) rules should govern their behavior? This process will not be completed in a few months or even a year given the complexities of these problems and of the many stakeholder interests involved in Myanmar. Dragging out this process over many years, however, is a formula for limited reform and slow growth.

Immediate and Longer Run Steps

While there is thus a need for a transition that could take several years even if there were a clear political consensus to act, there are steps Myanmar can and needs to take immediately to generate rapid industrial development, and they are as follows:

1. The currency must be devalued by at least 20-30 percent from the current 800 kyat range to a range closer to 1,000. Myanmar has taken the first important steps by having the exchange rate float and move with market forces and by eliminating the old "official" Kyat 6.4: US$ 1.00 exchange rate, but market forces need to be modified by government steps to make sure that the exchange rate returns to levels at which industry can compete internationally and farmers do not face severely depressed prices for their crops.

2. Most state and military industries that are making losses and cannot be made profitable easily should be closed. The remainder should be turned over to professional managers and be made to face competition on a level playing field. Many of these will be easy to identify. Other more complicated cases will take longer.

3. A process of removing unnecessary regulations that inhibit the start-up and operation of businesses should begin immediately, and the regulations that are needed should be transparent and fairly and efficiently administered.

4. The government budget should be made transparent, and **<u>all</u>** government expenditures, including all expenditures by the military, should be included in the budget. Even if the share of military spending in the budget is high, it should be transparent and voted on by Parliament.

5. Laws needed to attract foreign direct investment in industry need to be written and published (this process has already begun) and a one-stop shop should be set up to handle all procedures connected with the registration of new foreign enterprises. A similar institution or institutions should be set up to enforce the regulations that are written.

6. Investment to ensure a reliable source of electric power first in Yangon and then in as much of the rest of the country as feasible should begin immediately, using either public or private sources. Prices for electricity should cover the full costs of efficient generation and delivery.

7. Road check-points and other similar barriers should be removed except where there is a compelling security need. Major road improvements need to be made so that the costs of transport can be reduced, without overloading trucks in a way that destroys the roads. (Enforcing weight limits does raise trucking charges, but saves more in road repairs.)

Over the longer run, the government and private sources need to take steps to:

1. Radically improve the quality of education at all levels by ensuring that all children finish primary school, that a large and rising share go on to secondary school. Secondary education must be geared to the needs of the economy, and high-quality universities free from political interference must be rebuilt.

2. Facilitate the return of Myanmar people resident abroad, particularly those with needed skills—recognizing that the most important step will be to accelerate GDP and industrial growth and thus provide jobs to the skilled returnees. South Korea provides a good example of other measures that can facilitate the return process. In the 1960s and 1970s the Korean government created major research institutions such as the Korean Institute of Science and Technology (KIST) and the Korea Development Institute (KDI). These institutes paid high salaries by the Korean standards of that time and were explicitly designed to attract back to Korea scientists, engineers, and economists who were living abroad in the United States and Germany.

3. Comprehensively overhaul the banking system so that it is in a position to make longer-term loans to new businesses and is able to grow relative to the economy. A better and larger financial sector is needed.

Final Thoughts on Industry, Agriculture and the States and Divisions

This discussion of industrial policy is primarily oriented toward steps to accelerate Myanmar's rate of growth of GDP. A high growth rate of GDP based on the rapid development of industry over the long run is also the most effective way to deal with poverty. Over the short and intermediate run, however, industrialization will have a limited impact on poverty in Myanmar. The reason is that the first stages of an industrialization drive are likely to be concentrated around Yangon and most of those who get the better paying skilled jobs will be residents of Yangon or returnees from Thailand, Singapore and beyond. Unskilled jobs will go to rural migrants, but many of them initially are likely to come from nearby rural areas that are not as poor as the areas of the country far from Yangon and populated by the country's large minority populations.

Thus on humanitarian grounds and because of the need to demonstrate positive changes in the minority areas in order to maintain peace, there needs to be a major effort to show economic progress in the poor rural areas in general and in the minority areas in particular. Industrial parks and industrialization in these areas more generally are not likely to be an effective answer to this challenge, at least not any time soon. What is needed are steps that will increase agricultural productivity and related services. Devaluation of the Kyat is the least expensive and quickest way to help these areas in the short run. Eliminating the various tolls and security checks along the roads would also lower transport costs and make it easier to produce higher-value agricultural products for urban and foreign markets (rubber, coffee, etc.). Investing in major road improvements would be even more important, and rural electrification would also make a substantial difference. Industrial parks, as suggested above, will have only a limited impact even in the longer run. Industry does not generally locate in remote areas even in countries such as China that have had a very successful experience with rural small- and medium-scale industries. Those rural industries in China tend to cluster near the many large cities and not in remote or mountainous areas.