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Myanmar: Negotiating Nation Building
A Path to Unity and Progress

Prepared for

Proximity Designs | Myanmar

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This research paper was written by David Dapice (David_Dapice@harvard.edu), of the Ash Center for Democratic Governance and Innovation at the John F. Kennedy School of Government, Harvard University, following a trip to Myanmar from March10-22, 2012. *The views expressed herein are the author's alone and do not necessarily reflect those of Proximity, the Government of the Union of Myanmar, or Harvard University.* Funding for the study was provided by the Royal Norwegian Government. This study, along with other recent Ash-Proximity reports on Myanmar, is posted at http://www.ash.harvard.edu/Home/Programs/Institute-for-Asia/Publications/Occasional-Papers

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Background

There is an immense challenge facing the leadership in Myanmar. They have to negotiate a nation and to reform the basic assumptions and processes that have ruled for the past decades. They need to make the new system more representative, more inclusive, less favorable to a narrow group of businessmen and government or army officials and more broadly successful. The new system has to give minority groups a reason to want to be part of the new nation. That means not only creating new sources of growth and wealth, but also making rules that ensure the benefits go to many more than the relatively narrow groups who have largely benefitted in the past. The technical adjustments needed in the exchange rate, the financial system, taxing and spending, infrastructure investments and competition policy will all ultimately be judged on the ability of the policy package to create the conditions for national unity and progress. The government needs to have a vision of this goal and how the pieces fit together. Getting it to work in a shaky world economy with new and still evolving institutions is a huge challenge. But for those who have seen the past clearly for what it was, there can be no doubt that moving forward together is better than going back or staying put.

The task is daunting. Myanmar is facing a shaky global economy just as it is opening up and moving to more transparent economic management. For years, the GDP data have been very questionable; the government budget has remained unpublished and trade data obscured by large unrecorded cross-border trade. Now, economic managers have to determine where the economy is, what its main problems are and what the priorities are for policy makers.

One way of fixing the current situation in Myanmar is to first establish where it is starting from by comparing it in various dimensions with its neighbors. This paper does that, using the latest consistent available data. It examines health, migration flows, electricity use, private credit, real exchange rates and governance, among other variables, taken mainly from the World Bank. It finds that in many cases Myanmar is far below nations such as Bangladesh and Cambodia, much less Indonesia or Vietnam. There are reasons for this choice of comparator nations. Cambodia, while rapidly growing now, underwent traumatic revolution and slaughter under an extremist government in the 1980's and even now has low governance scores and poor social indicators. Bangladesh is a low lying country subject to frequent natural disasters and unstable politics. It has managed 5-6% GDP growth since 1990 but has high levels of landlessness and poverty. Comparing Myanmar to these countries is setting a very modest standard. More ambitious, but not wildly ambitious, are the comparisons to Vietnam and Indonesia. Both are much more successful nations with a longer record of success. All are in the neighborhood of

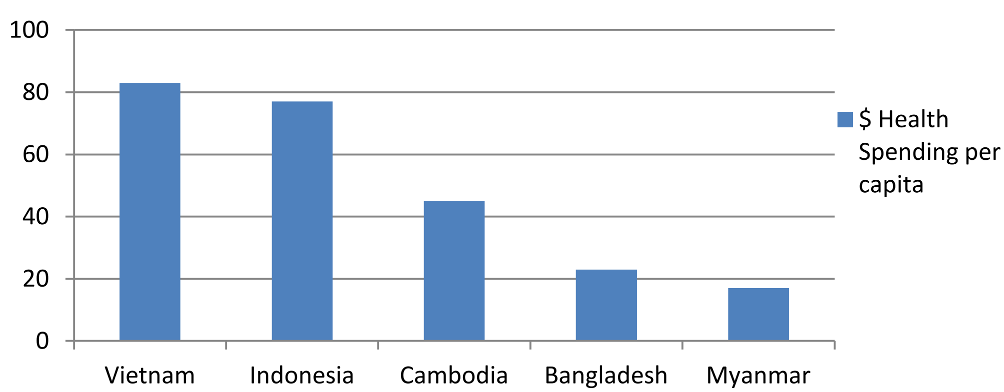
Myanmar and reasonably close in terms of income per capita, rice agriculture and (Bangladesh aside) membership in ASEAN. Given Myanmar's previous leadership role in Southeast Asia, these comparisons are fair. The comparative data will be followed by some analysis and then a summary of strategic choices facing Myanmar.

Human Health and Population Movement

1. *Health spending and mortality*

There are few things as basic as life and death. Myanmar is unique in the low amount of money it spends on health and it also fares poorly on a critical health outcome – mortality of children under five years of age.[1] Note in the two graphs below that higher spending is associated with lower mortality in the nations in this sample. But having Myanmar just spending more is probably not the answer – its public health spending is now very low and it takes time to build up the personnel, expertise and policies to use more money effectively. Even so, every government has some responsibility to create conditions so that its citizens can enjoy a normal and mostly healthy life. Myanmar has failed to do that and one priority is to begin to achieve that goal. For those who argue that the dollars per capita spent should be adjusted for income per capita, it is worth noting that the IMF has estimated the exchange-rate (not PPP) income per capita of Myanmar at over $1000 per capita – the same as Vietnam and well above that of Bangladesh or Cambodia. It is quite possible that the IMF estimate is generous, but even so, Bangladesh has a mortality rate well below Myanmar's and a lower GDP per capita and a higher amount of health spending per capita.

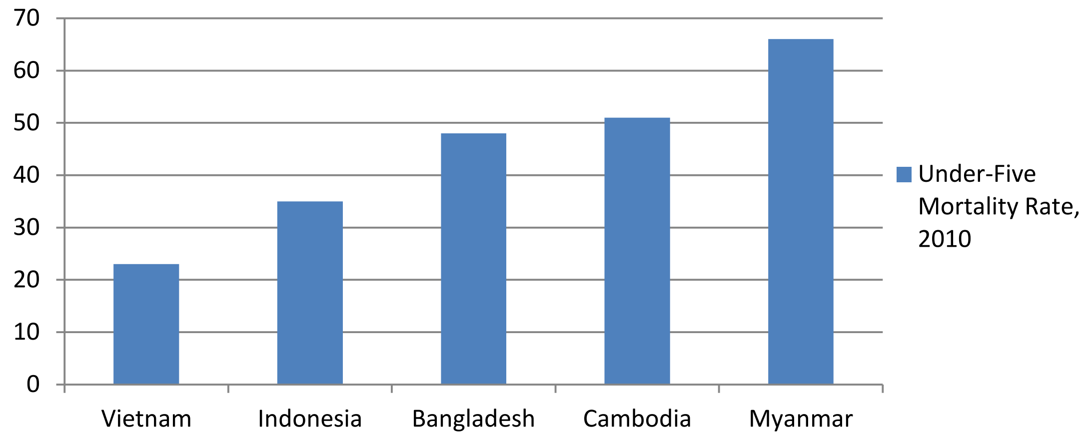
Graph 1: $ Health spending per capita, 2010



Source: World Bank, http://data.worldbank.org/data-catalog/world-development-indicators, accessed 5/23/2012.

[1] In 1990, Myanmar had a lower under-five mortality rate (112 per 1000) than Bangladesh (143) or Cambodia (121), and it was only 31% higher than Indonesia (85). Now it is lowest of all and 89% above the Indonesian level. It has made the least progress.

Graph 2: Under-five mortality rate, 2010

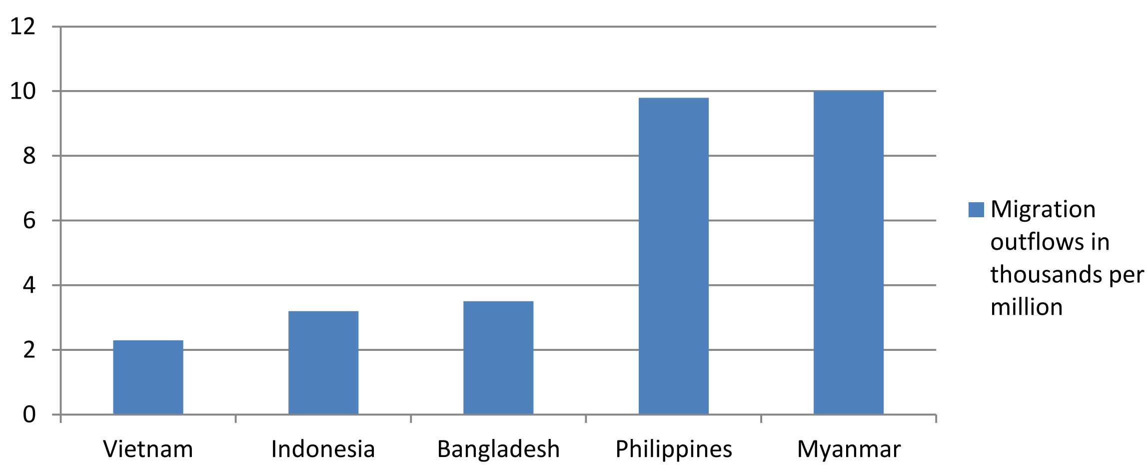


Source: World Bank, http://data.worldbank.org/data-catalog/world-development-indicators, accessed May 23, 2012.

2. *Migration Rates*

If an economic system fails to create wealth and jobs, people often leave it if they can. They do not do so lightly. Host nations often fail to provide legal safeguards for migrant workers. They may even be illegal and subject to expulsion. This can be used as a threat by employers to underpay migrant workers. Because there is such a disadvantage to abandoning one's village, family, language and friends there has to be a strong incentive to leave. In the graph below, the Philippines – a high migration country – was substituted for Cambodia, a country with very few people leaving.

Graph 3: Migration Flows (2005-10) in Thousands per Million People



Source: 2011 World Development Indicators, Tables 2.1 and 6.18; Myanmar data may be understated.

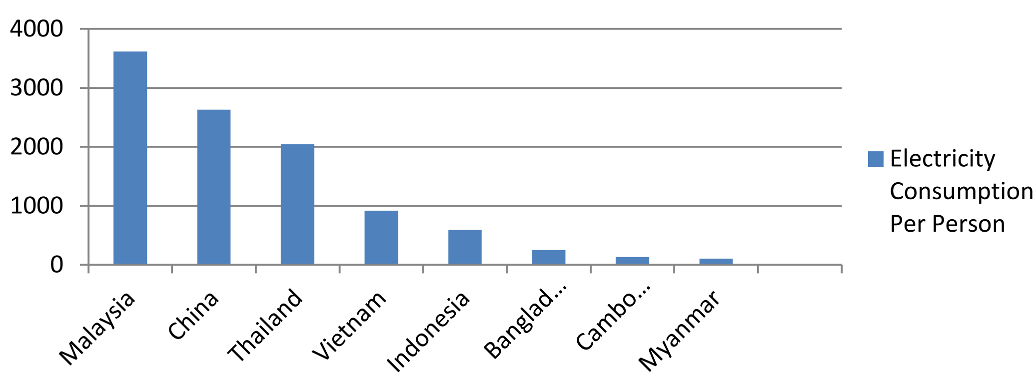
This graph shows that ten thousand workers per million left Myanmar from 2005 to 2010, according to World Bank data. This is probably low, for two million alone are thought to work in Thailand. These workers include not only rubber tappers or construction workers but also educated and skilled engineers and other higher-level workers. The Philippines, a perennial under-performer in ASEAN, is noted for its dysfunctional politics and slow growth. It has exported about 20% of its workforce and relies on $ 20 billion a year in remittances from them to keep its economy afloat. That Myanmar actually has a higher relative estimated migrant flow suggests just how inadequate job opportunities have been. A nation that has trouble keeping its own people is not succeeding. (North Korea tries to deny its citizens a right to leave, but it is properly regarded as a complete failure.)

Infrastructure

1. *Electricity production and connection*

A modern economy runs on electricity. Telecommunications, lighting, industrial machinery and food storage – and air conditioning – all rely on it. Myanmar has less electricity per person than Cambodia or Bangladesh. It has less than a quarter of its population connected, when even Indonesia with its thousands of islands and chronic underinvestment had 72% connected by 2011. It is true that from 2009 to 2011, electricity output in Myanmar has jumped by 50%. However, with little improvement in generating capacity, the system is stressed and prone to blackouts which are themselves the source of widespread protests. Moreover, the plan is to invest an inadequate amount in hydroelectricity that itself is subject to dry season shortfalls. There is no realistic plan to provide reliable and adequate electricity – and demand will grow nearly twice as fast as real GDP. These shortages will short-circuit growth. The only (bad) alternatives are using expensive and polluting diesel generators or costly extra hydro capacity.

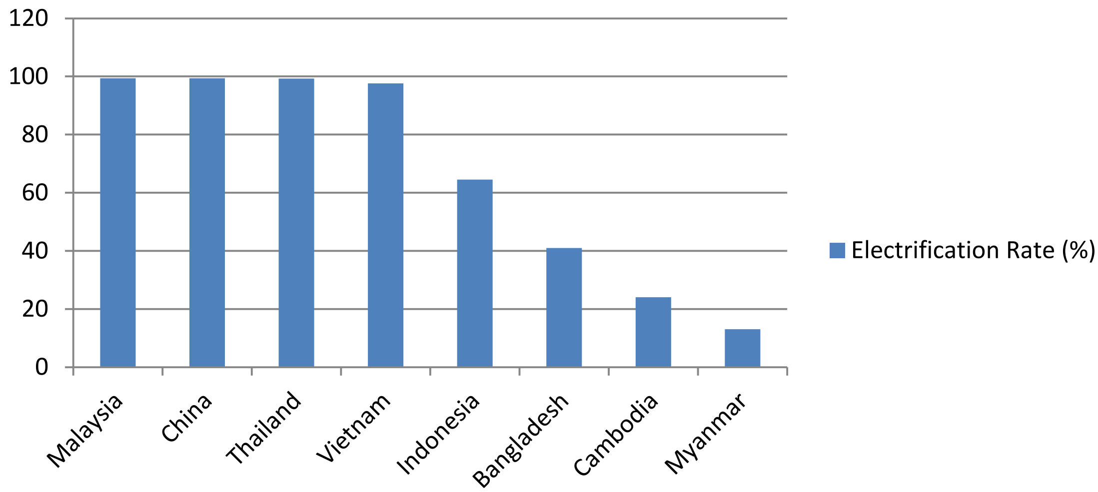
Graph 4: Electricity Consumption in kWh per capita, 2009 or 2011



Note: The per capita electricity numbers for Cambodia and Myanmar in this graph are for 2011, not for 2009.

Source: World Bank data web site. 2009 is the most recent year available for all nations. Myanmar for 2011 is from the December 2011 "Selected Monthly Economic Indicators"; Cambodia is from newspaper reports.

Graph 5: Share of Population Connected to Electricity in 2009



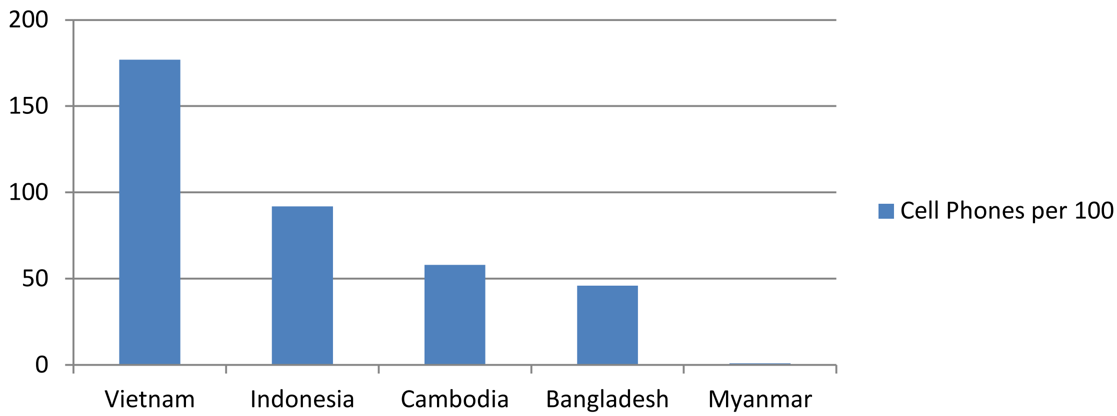
Source: Connectivity from the International Energy Agency; Reports are that by 2011, Myanmar's connectivity rose to 22%.

It is one thing to be behind because of past priorities, policies and mistakes. It is another not to have a plan to rectify these mistakes. Myanmar has plentiful gas reserves but it has no plans to use these to create reliable supplies of base load power for its economy. Splitting up electric power into two ministries, one responsible for thermal and one for hydro makes it even harder to produce a unified and sensible investment plan to deal with these acute shortages.

2. *Telecommunications*

Cell phones have become an important tool for communicating economic information, scheduling meetings and negotiating prices. They are as important to economic life as water is to farmers. A long standing policy has restricted these phones to a very few in Myanmar and recent (and very welcome) reductions in prices still leave Myanmar far behind its neighbors. The graph below shows the number of cell phones (or sim cards used in phones) per 100 people as of 2010. The figure for Vietnam (177 phones per 100) is correct – people buy more than one sim card for their telephone to take advantage of special offers or discounts. The number for Myanmar, of just 1 per 100, shows the distance that had to be made up. However, changing the telecoms policy can result in very rapid growth in cell phone use. Some public investments in cell phone towers may be needed in rural areas, but on the whole, this is one area where it is possible to move fast at a low cost to the public budget. People will pay enough to support cell phone use and expansion. Vietnam in 2000 also had only 1 phone per 100 people, so reforms can create rapid progress.

Graph 6: Cell phones per 100 population, 2010



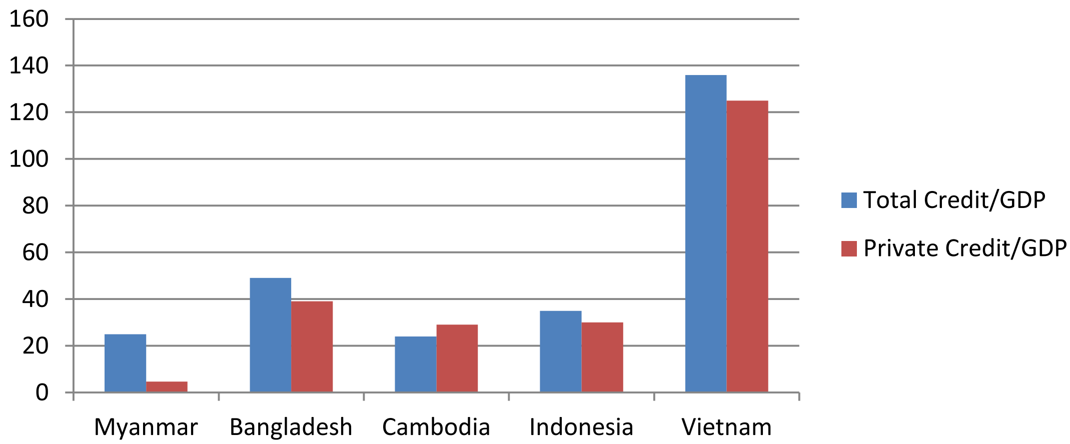
Source: World Bank data bank, http://data.worldbank.org/data-catalog/world-development-indicators, accessed May 23, 12.

Finance and Exchange Rates

1. *Private credit*

Countries grow mainly because households and firms grow. They invest, adopt new technologies, and add capital equipment. Doing this, or just getting working capital for normal production, can either be financed from cash on hand or from loans. Most countries have a banking system that provides finance for both investments and for working capital. If bank loans are not available it is hard to compete or to expand or to add jobs that pay well. Myanmar for a long time had a "Burmese path to socialism" which meant that only state enterprises had access to significant resources. Even now, larger companies are either state owned or military-based firms. Some firms have bought or been given (for example, in return for building the new capital) land or state or military assets but retain close connections to the government or army. In any case, these firms are not often highly efficient – many are reputed to be losing money. Competition is needed to create efficient firms, but bank loans are a key source of growth for competitive firms. It turns out that Myanmar is unique in the limited amount of private credit it provides.

Graph 7: Total and Private Credit as a Percentage of GDP in 2010



Source: ADB Key Indicators 2011. The Cambodian entry is correct – government is negative, so private credit is more than total.

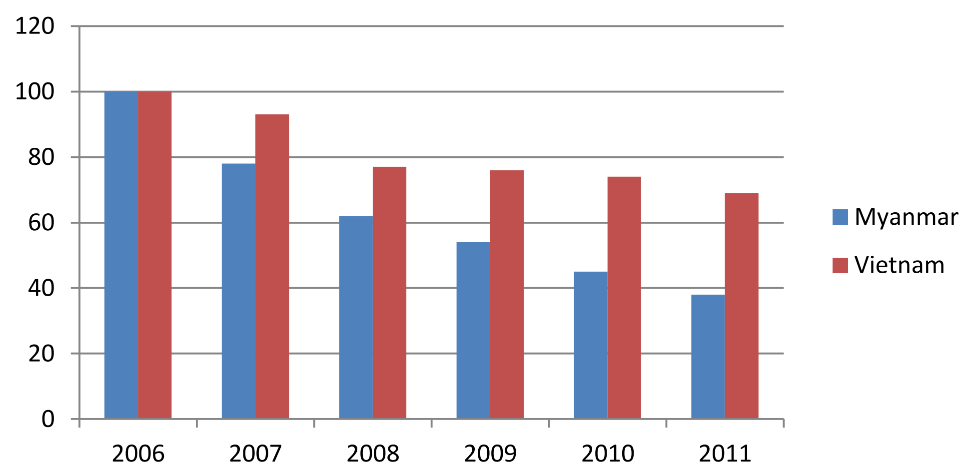
Private credit to GDP in Myanmar in 2010 was estimated by the ADB at about 5%. The IMF projection for 2012/13 is 12%. Even this much higher estimate would leave Myanmar at a third of the relative level of Bangladesh and half compared to Cambodia. The reason for the relatively low level of lending is two-fold. First, there is not a lot of money in the entire banking system. Interest rates on deposits are often below inflation; and there is fear that another currency "reform" might take away even the value of currency held, much less bank accounts. Second, most of what is in the system is directed to buying government bonds. Presumably this is one way to finance what have been large fiscal deficits. Most citizens prefer holding foreign exchange, gold or land to local currency. Until there is some confidence that the currency and banks are safe, these attitudes may be hard to change.

There is an informal credit system. It has no legal protection and has to deal with the likelihood that borrowers will be unable or unwilling to repay. Thus, informal loans are often quite expensive. Normal rural loans without collateral are typically 10% a month or more. If there is collateral, the rate might drop to as low as 5% a month. However, sometimes these loans require repayment at harvest time when crop prices are low and profit to the farmer is minimal. Thus, the effective interest rate can be higher even than the stated interest rate. Lower cost loans from the government agricultural bank are typically limited in amount and seldom tailored to the cash flow needs of borrowers.

2. The Real Exchange Rate

While the kyat to dollar ratio has moved from about 1300 to 800 kyat to the dollar since 2007, inflation in Myanmar has been rather high. Normally, a high inflation rate means the currency will weaken, or there would be more kyat needed to buy one dollar. In the following graph, the real (inflation adjusted) exchange rates are shown for Vietnam and Myanmar for 2006 to 2011. Both have a significant real appreciation of their currency – that is, it takes fewer kyat or dong to buy one dollar. Dollar inflation is ignored in this graph, but it was low and similar for both countries. (The index is set for 2006 = 100)

Graph 8: Index of Real Exchange Rates for Myanmar and Vietnam (Lower is more appreciated)



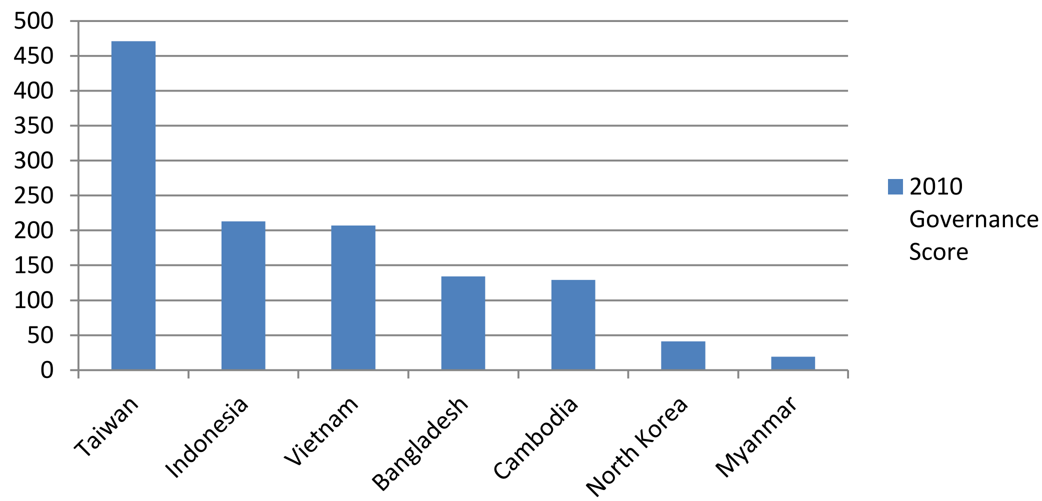
Source: ADB Key Indicators 2011. (www.adb.org/key-indicators/2011/coutry-tables) and Economist Intelligence Unit, Myanmar and Vietnam Country Reports, May 2012.

The graph tells us that Vietnam's farms and factories faced a real appreciation of 31% while Myanmar's producers faced an astonishing 62% real appreciation – or twice as much. In this period Vietnam had huge and productive investments in irrigation and research to help farmers lower their costs. They had billions of dollars in FDI in manufacturing so that costs of factory production fell. These productivity improvements help to offset the real exchange rate appreciation. There was no such offset in Myanmar for a **much** larger movement of the kyat. ***Imagine being a producer and facing a 62% decline in the price of your product with no change in costs!*** That is, in effect, what happened in Myanmar from 2006 to 2011. (Again, modest dollar inflation is ignored, but the net impact is huge.) The appreciation of the real exchange rate has depressed profitability and incomes in agriculture and manufacturing. This is because imports compete with domestic production and exports earn less real kyat per dollar's worth of sales. This impact depresses job growth, exports, productive investment and incomes.

Governance

The World Bank has gathered governance data on most countries including Myanmar since 1996. The dimensions of governance are voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption. Each of these is scored as a percentile from 1 to 100. (A score of 100 for each indicator is the highest; the highest score for all six would be 600. Taiwan's 2010 score is 471.) The following graph gives 2010 governance scores for Myanmar and other nations.

Graph 9: 2010 Governance Score



Source: World Bank data bank, accessed May 23, 2012

Now, governance has improved in Myanmar since 2010 so this graph is too pessimistic. Even so, even if we doubled the 2010 rating, the total would still be very low. This is important, for it suggests that the government has a limited ability to accomplish manyy complicated and difficult things. Feedback loops to allow for fine tuning of demanding government programs may not work very well. Legal institutions may not operate reliably to control corruption or abuses. Of course, it is possible to make progress. But old habits that are ingrained do not always change quickly.[2]

[2] A related World Bank survey called "Doing Business" looks at business conditions in most nations by surveying investors. However, Myanmar had been so isolated that no data were collected through 2011. The 2012 data will include Myanmar and, when available, should provide an unbiased picture of how regulation and other policies influence the business environment compared to other countries. Questions in the survey relate to ability to get

Analysis

The data collected here and other evident facts are conclusive. Myanmar's old system produced violence, disunion and relative poverty. The army felt it needed 400 to 500 thousand soldiers with no external enemies. Untold billions of dollars were extracted or borrowed to fund the internal wars which also crushed broader social and economic development. More children died (as a percent of their numbers) in Myanmar than in poverty-stricken Bangladesh. Less electricity was produced per person than in Cambodia, a broken country for years with no electric system except local diesel generators. The exchange rate was mismanaged and private loans were all but unavailable. Governance scores were half of North Korea's.[3] This is where the nation is starting from. But where can it go now and how?

The first point is that a way must be found to create a real peace, not just a temporary cease fire. If there is conflict, large amounts will be spent on the military instead of infrastructure or social investments. Cronies with ties to officials or the military aside, few will invest much because of the insecurity. Furthermore, the insecurity depresses job creation and increases tensions. For example, right now, there are plans for massive hydroelectric investment in the Kachin state. These projects displace tens of thousands and provide little or nothing for the local population. It makes no sense to base hopes for increased electricity supplies or the export of power on a strategy that will produce more conflict. Either a way has to be found to make the hydroelectric investments attractive to the Kachin or other ways to generate electricity have to be found. (With ample natural gas supplies, this would not be difficult and might even be preferable on technical grounds. Other possibilities involving renegotiation of dam projects with China are also an option.[4]) Jobs have to be created for the demobilized soldiers or else they will again return to extorting money and trading drugs. Peace in the "periphery" of Myanmar is needed to create conditions so that the center can develop.

The second point is that both agricultural and industrial development is needed. Agriculture suffers from an overvalued exchange rate and a long period of under-investment in research, extension, seed development, irrigation and other rural infrastructure. Rural loans, while recently on the increase, are problematic due to low

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electricity and telecommunications, ability to incorporate, get a loan, hire and fire workers, export and import and settle legal disputes.

[3] The high educational rates claimed by Myanmar need to be ground tested. In India, claims of 74% "Census literacy" were found to be wildly inflated when functional literacy was tested by an NGO – the real number was a third as high. A similar effort is needed in Myanmar.

[4] See:"Electricity in Myanmar: The Missing Perquisite for Development" by Professor David Dapice, May 2012.

prices (the exchange rate again) and high costs of freight and ports. If the exchange rate and other problems remain, credit alone will not be a cure-all. For industry, the exchange rate is also weighing heavily, but a lack of reliable electricity, poorly trained workers, and high costs of freight and regulation all conspire to reduce the viability of local business. When visiting the Thai border earlier this year, we learned that a 20 foot container cost $400 to go from Myawaddy to Bangkok but $2000 to go from Myawaddy to Yangon! With such transport costs (including tolls and informal payments) there is little chance of manufactured goods for export being produced anywhere but Yangon and few chances of a factory being able to sell into a national market.[5] Successful development of Yangon infrastructure would accelerate labor-intensive and export-oriented FDI – though the likely slow down in both Europe and China will make such development more difficult.

Third, there has to be a two-pronged attempt at improving education and skill building while also attracting back some of the workers who have left, especially but not only the educated ones. First, there should be an honest assessment of how much is actually taught. Can “literate” people read the instructions on a pesticide can or medicine bottle? If not, what kinds of training are needed to get their skills up to a level that is useful? What skills will factories need? Can the government and the investors cooperate to create training that is aimed at developing skills in short supply? This was done in Penang, Malaysia and helped to promote growth in the electronics industry. It could certainly be done in Yangon as well. At the university level, use of overseas Burmese and visiting professors should help fill short-term gaps. Longer term, more study overseas and use of cooperation arrangements with foreign universities could add key skills and develop capacity. But it is likely, in spite of reported high enrollment ratios, that considerable time and attention will be needed, along with some money, to improve the educational system.

Fourth, there has to be a shift in mentality and orientation from a view that the state or military has rights and citizens have obligations to a more balanced approach. The situation with regard to land ownership, especially in states that have shifting cultivation, is illustrative of this. The unclear legal status of this land means that huge tracts can be taken for large investors in plantations, mines or hydroelectric development because nobody “owns” the land. This favors the influential and displaces the ordinary farmer. A modern economy cannot work when only a tiny minority has the capital and legal right to invest with some confidence while others struggle to live. This alienates most people who either leave the country altogether or passively (and sometimes actively) resist

[5] These and other points are developed in a paper by Professor Dwight Perkins, “Industrial Policy Reform in Myanmar,” April 2012.

government initiatives. All nations have eminent domain, where land can be taken for public use – a road or public building for example, with fair compensation paid for the land taken. In Myanmar, much larger amounts of land are being taken by investors who are very much private and compensation is modest or less. This exacerbates the divide between the connected businesses and the overwhelming majority of people.

In general, this struggle over land rules is representative of the challenge facing the new government in Myanmar. Without progress to extend opportunity and create more inclusive growth, pressures and counter-pressures would build and the new result would be no more satisfactory than in the past.

Can Elite Groups Enlarge into a Broad Coalition?

Reform requires reformers. For reformers to have enough influence to change policies there has to be a critical mass of interested parties who agree on direction. Broadly speaking, there are two choices for Myanmar. One (bad) choice is a reinvention of the past with the military siphoning off a large share of mineral and other natural resource revenues while leaving the parliament and government to deal with the ethnic and democracy groups and residual resources. This dualism would be fatal for there would be no incentive for real peace if resource grabs in the ethnic areas (including land, hydroelectricity, jade, gems and timber) resulted in further displacement and impoverishment of local peoples. A divided nation would continue low level conflicts and the military would use foreign investors to extract resources and take their generous share. This would increase the influence of foreign interests and weaken the ability of the nation to maintain real independence.

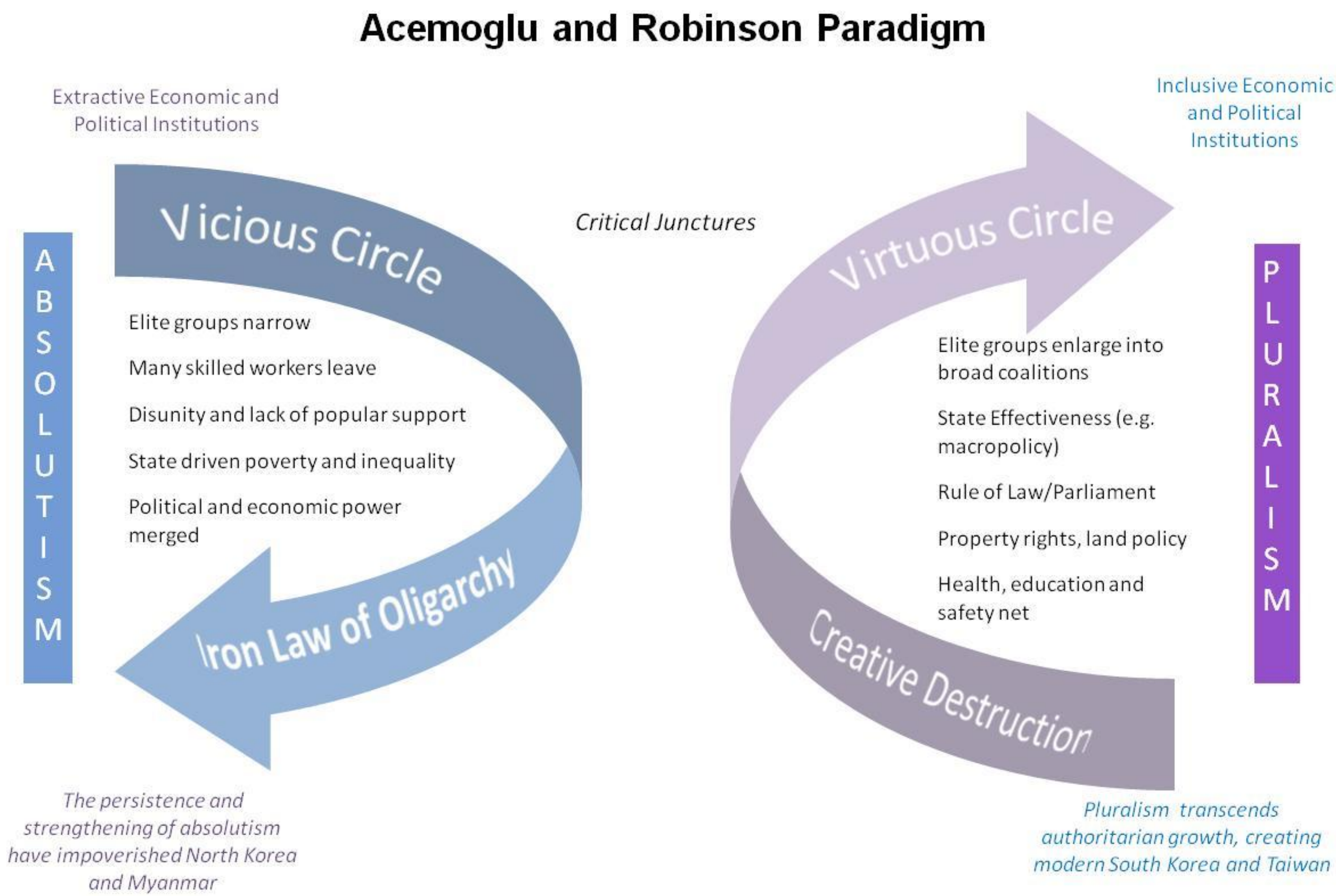
The second option is a far better one. It would not be easy to organize, but by unifying a diverse group of interests it could move away from the extraction, violence and poverty of the past. It would have to include reform minded elements in the government and parliament, democracy forces (including the NLD and '88 Generation), nationalist military officers who want national development, progressive industry and business interests including "good" cronies, and ethnic groups. These groups could insist – perhaps with foreign help – on a real federal budget in which all revenues and expenditures are included – and more is spent on infrastructure, health and education and less on military hardware and operations. It would move towards the creation of a genuine political culture in which compromise and negotiation replaces giving "necessary orders." If such a coalition can be constructed and made to work, a steady expansion of economic and social opportunity will give more and more people a reason to want to be a part of

Myanmar. Those who have already left or might leave would return or stay in this scenario. However, getting these sometimes conflicting groups to cooperate is tough – it is a narrow bridge to a better future.

Myanmar is now at a critical juncture. As the figure on the next page suggests, things could go either way. To use the paradigm of "Why Nations Fail" by Acemoglu and Robinson, the first choice would lead to a vicious circle in which narrow elite groups capture most benefits of growth and political and economic concentration of power increases. Poverty and inequality would remain or even increase and those with skills would stay away or leave. This is not the future Myanmar wants, though based on history it is perhaps the more likely path. The right hand alternative is the opposite path. It involves a broad and inclusive coalition increasing property rights, the rule of law, state effectiveness and opportunities. This is the path that South Korea and Taiwan took – fostering broad based economic and social improvements that enlarged the middle class and eventually created the basis for a well-functioning democracy. The task in Myanmar is far more complicated, starts from a lower level and takes place during a less favorable world economic climate, but it is still possible.

Professor J.S. Furnivall, a noted scholar living in Burma, writing in the 1930's in "An Introduction to the Political Economy of Burma" stated: "If, as is but too probable, the obstacles prove insurmountable (to constructing a unified society and economy)….after a period of anarchy more or less prolonged, our descendents may find Burma a Province of China." This is unlikely to be the future, if only because China is content to extract resources without territorial expansion. However, if national unity eludes this generation, it is likely that there will be very limited degrees of freedom going forward. These stakes are very high.

Graph 10: The Acemoglu and Robinson Paradigm



Appendix One: About the author and the research partners

David Dapice is a professor at Tufts University and a leading expert on the economic development of Southeast Asia and has worked extensively in Indonesia, Thailand, Cambodia and Vietnam. He was principal advisor to the Indonesian Ministry of Finance when this country enjoyed its period of rapid growth. He has studied the Vietnamese economy since the late 1980s, with a particular emphasis on macroeconomic issues, public investment policy, and regional development. Professor Dapice is also the principal economist and researcher associated with the Ash Center's research paper series on Myanmar.

The Ash Center at the Harvard Kennedy School is dedicated to studying development and democratic governance in very different situations, including "hard countries" such as Vietnam, Indonesia and Myanmar. The approach taken is to understand the political economy of reform, not just the technical economics, and to explore the connections between politics and institutional development to help address social and economic problems. www.ash.harvard.edu

Proximity Designs is a non-profit social enterprise operating in Myanmar designing, manufacturing, and marketing innovative products and services that improved the well-being of struggling rural families. Through its sales force in 9 states and divisions, across the Delta, Central Dry Zone, and Shan Hills, Proximity has excellent insight into local conditions, and experiments with participatory governance in the countryside. www.proximitydesigns.org

This combination of local knowledge at Proximity and on-the-ground economic and political analysis of the Ash Center has produced a series of studies that are deeper and more nuanced than many typically seen.