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Report No. 72458-MM

INTERNATIONAL DEVELOPMENT ASSOCIATION

AND

INTERNATIONAL FINANCE CORPORATION

INTERIM STRATEGY NOTE

FOR

THE REPUBLIC OF THE UNION OF MYANMAR

FOR THE PERIOD FY13-14

30 October 2012

**Southeast Asia Country Management Unit
East Asia and Pacific Region
International Development Association
International Finance Corporation**

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CURRENCY EQUIVALENTS

(Exchange Rate Effective as of August 31, 2012)

Currency Unit = Myanmar Kyat (MMK)

US\$1.00 = MMK 872

Fiscal Year: April 1 – March 31

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank	NMSP	New Mon State Party
ASEAN	Association of South-East Asian Nations	PEFA	Public Expenditure and Financial Accountability Assessment
CAS	Country Assistance Strategy	PER	Public Expenditure Review
ICA	Investment Climate Assessment	PFM	Public Financial Management
ICT	Information and communications technology	PGAE	Partnership Group on Aid Effectiveness
IDA	International Development Association	QSEM	Qualitative Social and Economic Monitoring
IFC	International Finance Corporation	SIM	Social Impact Monitoring
IMF	International Monetary Fund	SOE	State-owned enterprise
ISN	Interim Strategy Note	SPF	State and Peacebuilding Fund
KIO	Kachin Independence Organization	UN	United Nations
KNPP	Karen National Progressive Party	UNDP	United Nations Development Program
KNU	Karen National Union	UNFPA	United Nations Fund for Population Activities
LIFT	Livelihoods and Food Security Trust Fund	UNICEF	United Nations Children's Fund
MICS	Multiple Indicator Cluster Survey	UNODC	United Nations Office on Drugs and Crime
MIGA	Multilateral Investment Guarantee Agency	UWSA	United Wa State Army
MMK	Myanmar Kyat	WBG	World Bank Group
NGO	Non-governmental organization	WDR	World Development Report
NLD	National League for Democracy	WFP	World Food Programme

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ACKNOWLEDGMENTS

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THE REPUBLIC OF THE UNION OF MYANMAR

INTERIM STRATEGY NOTE

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I. INTRODUCTION AND RATIONALE

1. **Myanmar is embarking on a triple transition: from an authoritarian military system to democratic governance; from a centrally-directed economy to market-oriented reforms; and from 60 years of conflict to peace in the border areas.** These transitions offer hope to the people of Myanmar for better, safer and more productive lives and represent an opportunity for the country to resume its place as one of the most dynamic economies in Asia (see Box 1).

2. **If successful, these transitions together present a chance for Myanmar's transformation, but in unfolding simultaneously they also pose the risk that setbacks in any one of these realms will affect the others.** Each of these transitions is complex and on their own would challenge the capacity of most states. The strategy of the World Bank Group (WBG) at this early stage of re-engagement will thus focus on programs that can support the success of these three transitions, promote poverty reduction, and pave the way for the resumption of a full country program. These criteria guide the selectivity in the engagements proposed here, to ensure a focused approach that yields tangible results in a context of limited capacity.

3. **The WBG's re-engagement is taking place after an absence from the country spanning more than two decades, with Myanmar in arrears to IDA, and in the context of a very limited knowledge base.** The proposed Interim Strategy Note (ISN) covers an 18 month period, during which the WBG will work with the Myanmar government to clear the country's arrears to IDA, which as of August 2012 stood at \$406.5 million. The process of IDA arrears clearance will take place in parallel and be closely coordinated with Myanmar's clearance of arrears to the Asian Development Bank and other creditors.

4. **As preparations for arrears clearance continue, an urgent government priority critical to the success of Myanmar's triple transition – moving from top-down decision making to participatory approaches and bottom up planning – may be financed out of a pre-arrears clearance grant.** The proposed grant, which is being presented to the Board for consideration at the same time as this ISN, would finance urgent infrastructure and community needs at the village level (for example small scale irrigation, rehabilitation of schools and health centers, construction of rural access roads), using a community-driven approach in which communities in partnership with local authorities identify, plan and implement their development priorities. This would deliver tangible results, contribute to poverty reduction and inclusive growth, and support the government's emphasis on shifting to a bottom-up planning approach. In line with the government's focus on inclusive growth IFC will also present to the Board for consideration at the same time as this ISN a proposed investment in ACLEDA PLC, a Cambodian microfinance company, in support of its planned entry into Myanmar.

II. COUNTRY CONTEXT AND KEY DEVELOPMENT CHALLENGES

Recent Political and Security Developments

5. **Myanmar, a country with a population estimated at up to 60 million people, enjoys a favorable geographic location with an extensive coastline along the Andaman Sea, fertile land, and a rich endowment of natural resources,** including fisheries, forests, natural gas and

hydropower potential, and precious stones and minerals. As the largest country in mainland Southeast Asia, Myanmar has one of the lowest population densities in the region, with significant agricultural potential. Its geographic location at the intersection of China and India, two of the world's most dynamic economies, leave it well positioned to resume its traditional role as a regional trading hub.

6. **Embarking on these transitions, Myanmar is leaving behind decades of isolation, fragility, and conflict,** which began with armed insurgencies in the border areas soon after independence that eventually led to an army coup by General Ne Win in 1962, who pursued an isolationist “Burmese path to socialism” that included a nationalization of the economy and a severing of linkages with the outside world. While some of the country's self-imposed isolation ended following Ne Win's resignation in 1988, the government's suppression of the political opposition at that time made it the target of a broad range of Western sanctions. Despite intermittent attempts to forge peace with armed ethnic groups (notably a series of ceasefires in the late 1980s and early 1990s) and tentative efforts at economic reform and political opening (including Myanmar's accession to ASEAN in 1997 and a limited opening towards foreign investment), the country's potential has been held back by poor governance.

Box 1: Myanmar in History

During the late 19th and early 20th century, Burma's (now Myanmar's) economy was one the fastest growing and most advanced economies in all of Asia. Modern transportation and communications infrastructure, as well as the expansion of banking services facilitated a dramatic rise of major export industries, and by the 1920s companies such as Burmah Oil (the parent company of British Petroleum) were amongst the biggest in the world. Rangoon became one of the greatest trading ports in the East and millions of immigrants flocked to Burma in search of new opportunities. Its university had few regional rivals and its civil service and judiciary included hundreds of Burmese educated at Oxford and Cambridge. Visiting in the 1920s, Somerset Maugham wrote that a drive around Rangoon was barely distinguishable from a drive around Shanghai or Honolulu.

There was however a dark side to Burma's growth. The economy was almost entirely dependent on the export of a few primary commodities – rice, timber and oil – with profits in the hands of a few mainly Scottish firms. Easy credit had fueled the agricultural boom but the collapse of paddy prices during the Depression impoverished millions, leading to a widespread agrarian revolt as well as bloody communal riots.

Then came the Second World War and the near complete destruction of Burma's infrastructure and the leveling of every city and town other than Rangoon, followed almost immediately by the civil war and armed conflicts that have yet to end. A new nationalism combined with a deep distrust of global capitalism.

But until the early 1960s there was still a sense that Burma's economy was one of the more dynamic in the region. Rangoon remained as modern a city as Bangkok and was a key aviation and commercial hub for southeast Asia. Lee Kuan Yew famously visited just after Singapore's independence to ask the country's leaders for economic advice. But with the start of army rule in 1962 and decades of self-imposed isolation, Burma's days as a promising Asian star were soon over, with the country eventually being designated as a least-developed country in 1987.

Contributed by Thant Myint-U, historian and author of *Where China Meets India: Burma and the New Crossroads of Asia*

7. **However, the administration of President Thein Sein, brought to office following elections in 2010, has signaled its intent to chart a new direction for the country.** In his inaugural address in March 2011, President Thein Sein reached out to long-time critics of the former regime, urging that differences be put aside in order to work together for the good of the country, including through national reconciliation, good governance, and economic development.

8. **As part of this process, the Thein Sein administration has undertaken far-reaching moves towards political reconciliation with opposition groups.** The release from house arrest of Aung San Suu Kyi in November 2010 was followed by large-scale releases of political prisoners (including in May and October 2011 and January and September 2012) and the welcoming back of members of the Myanmar Diaspora, including prominent critics of the government. The government resumed a previously stalled dialogue with Aung San Suu Kyi that led to a historic meeting between President Thein Sein and Aung San Suu Kyi in August 2011 and the re-registration of her National League for Democracy (NLD) as a legal political party. Following parliamentary by-elections on 1 April 2012, the NLD became the largest opposition party in parliament, with Aung San Suu Kyi and 42 other NLD delegates taking their parliamentary seats in May 2012.

9. **These high-profile political developments have been accompanied by less reported but equally tangible changes in people's everyday lives, in particular increased civil and political freedoms.** Changes in the national legal framework allowed the formation of trade unions and public gatherings for the first time in 20 years. More broadly, an increased freedom of expression, including a new media law which reduces media and internet censorship, led to new public discussions of previously taboo topics such as poverty and corruption.

10. **Finally, the government has embarked on an important process of reconciliation with ethnic minorities, reaching ceasefires with several armed groups and renewing ceasefires that had come under strain,** including with the United Wa State Army (UWSA), the Karen National Union (KNU), Karenni National People's Party (KNPP) and the New Mon State Party (NMSP). The ceasefire with the KNU was particularly noteworthy in that it brought to an end Myanmar's (and the world's) longest-running civil conflict, spanning some six decades. Although conflict continues between the government and the Kachin Independence Organization (KIO) in Kachin State and the existing ceasefires remain fragile, progress is being made towards moving from a cessation of hostilities towards addressing grievances. The President's establishment of a Peacemaking Committee chaired by himself has signaled the priority his government accords this process, and provides an overarching structure to the peace negotiations with different actors.

Recent Economic Developments

11. **In President Thein Sein's March 2011 inaugural speech to parliament, he outlined economic reform as a key priority of his government.** Since then, the government has implemented a series of reforms to remove economic distortions. Among the most significant of these was the floating on 1 April 2012 of the Myanmar kyat, an important first step in abolishing a multiple exchange rate regime that had been identified by successive IMF Article IV missions as a key constraint on the economy. The value of the kyat is now based on a managed float, with the exchange rate set at Kt818:US\$1 from 1 April and allowed to fluctuate slightly on a daily basis, as opposed to the previous official rate of Kt6:US\$1.

12. **Other reforms have included a sizeable increase in state pensions, a series of tax reforms, and changes of regulations** to ease the cost and time for importing vehicles (significantly reducing transport costs, especially for small and medium enterprises). In particular, the profit tax has been abolished and consumption tax rates (which previously ranged from 5 to 90 percent) lowered to 5 percent for most goods, as a prelude for transitioning to a

value-added tax. The government has also rationalized personal income tax bands and brought public officials into the tax net. As a step towards decentralization, state and regional budgets have been established. The state-owned telecommunications company has lowered prices for mobile phones and introduced cheaper, (albeit still expensive) pre-paid SIM card services.

13. **Notably, the government decided to suspend work on several large, controversial development projects, in particular the Myitsone dam on the Irrawaddy river and a coal-fired power plant in Dawei, on Myanmar's southern coastline.** Both of these projects faced widespread public opposition and if implemented were likely to have significant social and environmental impacts – factors that the government cited in its decisions to suspend these projects and subject them to further review.

14. **In a nationally-televised speech in June 2012, President Thein announced a “second wave” of economic reforms aimed at developing the private sector.** New laws on foreign direct investment and telecommunications are currently either in the drafting stage or being considered by Parliament. The government is also undertaking a review of the financial sector, including regulations related to microfinance and private banks, to promote access to finance and create an environment conducive to job creation for both men and women and the development of non-extractive industry sectors in the economy. In a similar vein, the government is considering the establishment of a number of special economic zones to promote manufacturing.

15. **However, given the scope and complexity of these reforms, there is concern about the government's capacity both to draft and implement them.** In many cases, decisions made now (for example on land administration, foreign direct investment, the banking sector and telecommunications) will have significant long-term impacts, yet there is concern about the speed at which new legislation is being drafted and the legislative process itself, which thus far has not been widely consultative with key stakeholders nor informed by international examples and practices. Many of the new laws and regulations have emerged as a surprise to the industries affected, affecting compliance and limiting wider buy-in. Similarly, the process of opening up Myanmar's economy holds great potential, but is fraught with risk. Being able to benefit from Myanmar's natural resource wealth, or promoting regional integration to capitalize on Myanmar's strategic location in a dynamic neighborhood, will depend on building capacity for developing and implementing policy responses.

16. **On the macroeconomic side, higher fiscal spending before the elections, growth in commodity exports and investment has underpinned a reasonable growth performance.** GDP growth is estimated to have been 5.3 percent in 2010/11 and is projected at 6.25 percent for 2012/13, in part due to improved business confidence following the suspension of sanctions and economic reform momentum, notwithstanding a worsening external environment. Inflation has been on a downward trend due to the decrease in commodity prices and a shift from monetization of the fiscal deficit to bond financing and is forecast at 5.8 percent. The fiscal deficit peaked in 2010/11 at 6 percent and is projected to have fallen in 2011/12 to 5.5 percent. Going forward, revenues are expected to increase significantly as a result of using the managed float exchange rate for public sector exports including natural gas, and increased production in a major new gas field. The 2012/13 budget allocated a very significant increase in expenditure on health and education, albeit from very low levels. With the recent liberalization of car imports and plans to lift exchange restrictions, the current account deficit is projected to increase to about 4.5 percent of GDP. International reserves are expected to remain comfortable at about \$7.9 billion

(equivalent to 8½ months of imports) in FY2012/13, mainly due to higher expected foreign inflows.

17. **Myanmar has significant arrears on its public and publicly-guaranteed debt, currently estimated at \$10.6 billion.** The authorities have expressed their commitment to clear these arrears and normalize relations with Myanmar's creditors. While multilateral discussions on modalities for arrears clearance have begun, these are still at a preliminary stage. Discussions have also begun at the Paris Club to explore a coordinated approach to arrears clearance. Further, Myanmar went into arrears only for countries and institutions that stopped making new loans, but appears to have continued to service debt to creditors that have been willing to make new loans, some of which were on non-concessional terms and could have a negative impact on the risk of debt distress. A strong macroeconomic policy framework will therefore be essential to ensure macroeconomic stability as the authorities implement economy-wide reforms and undertake a comprehensive plan to clear their arrears.

Poverty and Human Development

18. **Myanmar is one of the poorest countries in East Asia, with an estimated GDP per capita of between \$500-\$800, and a poverty headcount of 26 percent.** The country's GDP is estimated at \$40 billion. About 75 percent of the population has no access to electricity, and almost half of roads are not passable during the monsoon season. Telecommunications and internet access is also very limited, and while reliable social indicators are limited, they point to widespread needs. For example, Myanmar has high levels of under-nutrition, among the highest in the region: 23 percent of children under five are underweight and 35 percent stunted.

19. **A key limitation in understanding the development challenges in Myanmar is the lack of accurate and consistent data, especially at the national level.** Confounding statistics give at best a partial picture of the country, especially given the diversity across the country. The last national census took place in 1983, and population figures used today range from 48 to 61 million, with an estimated 3 million people living abroad. Similarly, there are divergent data on indicators from economic growth and national income to health and education outcomes.

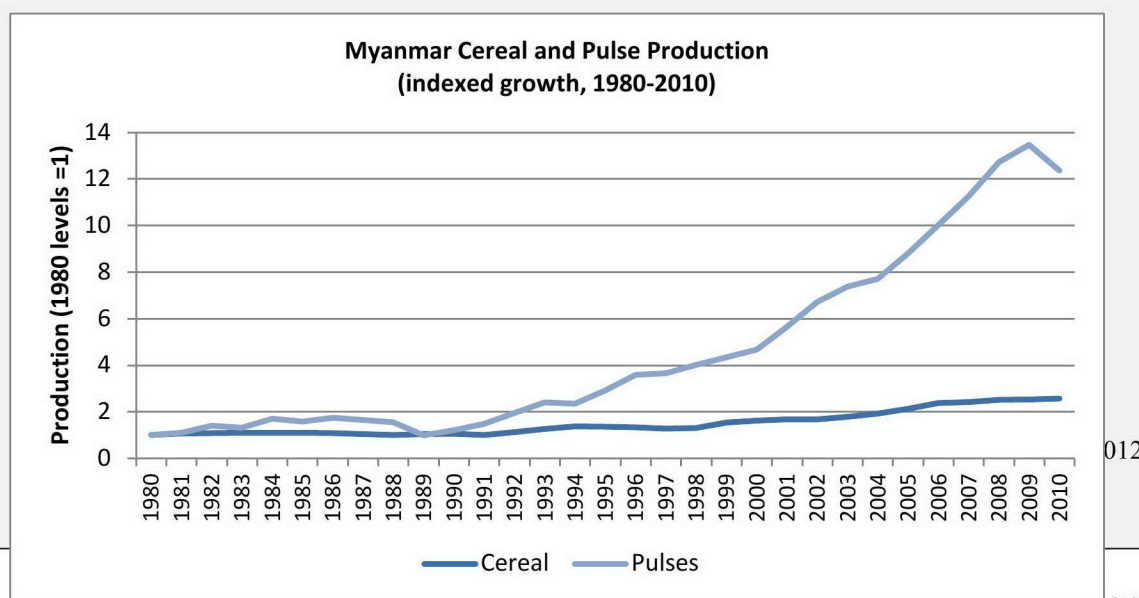
20. **While much of recent economic growth has been in extractive industries (in particular mining and natural gas), it is the agriculture sector that accounts for the largest share of the economy, generating 43% of GDP.** The sector generates about 54% of employment and provides livelihoods for more than 70% of the population, but is characterized by a number of constraints, including limited irrigation, little value added agro-processing capacity, and widespread indebtedness in rural communities. The government's agricultural policy has attempted to ensure food security at the national level (as opposed to household food security), and to maintain low prices for staples consumed in urban areas. This has led to restrictions in land use and rice production requirements for farmers, prescriptive use of rice seed, extension systems focused on meeting rice production targets, a marketing system dominated by state actors, and inconsistent export decisions. However, the sector holds great potential, with appropriate liberalization of the rice sector one example of reform that could generate significant economic benefits in the short-term (see Box 2). Other interventions to increase agricultural productivity include technology transfer, extension services, and animal disease control.

21. **The development of the domestic private sector in services and manufacturing will be critical to Myanmar's future economic growth.** Myanmar has good potential for

diversifying into a range of non-primary activities, including tourism, telecommunications, garments, manufacturing, construction and banking. In addition, Myanmar has significant potential to further develop its ties with its regional neighbors and ASEAN and could benefit from wider regional integration to broaden its own economic base beyond primary industries.

Box 2: Myanmar's Agricultural Potential

Once the world's largest exporter of rice, Myanmar has enormous agricultural potential, which could provide a significant economic boost to the country's large rural population, and contribute to addressing regional food security. The agricultural sector today is held back by a wide range of factors, some of which will require a sustained engagement to resolve. Yet the example of beans and pulses shows the potential impact of relatively simple regulatory reforms: since the government in 1988 liberalized the trade in beans and pulses, removing price controls and lowering restrictions on exports, production has increased more than 12-fold.



22. **Migration has been an important coping mechanism, especially for the rural poor.** Migration is taking place both seasonally (with farmers seeking labor during the off-season in urban areas) and semi-permanently (domestically from rural to urban areas, and internationally, in particular to Thailand and Malaysia). Estimates suggest that as many as three million Myanmar migrants currently live abroad, and while their remittances provide an important safety net, the absence of legal migration mechanisms frequently exposes migrants to risks of trafficking and maltreatment.

23. **Two rounds of UNDP-supported household surveys¹ (in 2005 and 2009) paint a picture of falling poverty,** from 32 percent in 2005 to 26 percent in 2009. The data also highlights significant differences in poverty across geographical areas of the country, with rural poverty (at 29 percent) considerably higher than urban poverty (at 16 percent). However, caution is urged in the interpretation of data, since the surveys did not include populations in parts of the

¹ Integrated Household Living Conditions Surveys of 2005 and 2009

border areas, potentially masking large pockets of poverty and skewing final results. Moreover, proxies of poverty show a mixed picture: while caloric intake and ownership of small assets have increased as one would expect when poverty is falling, the share of food in consumption has been rising rather than falling for the poorest three quintiles.

24. Lack of access to and the poor state of existing infrastructure are major impediments for the provision of basic health and education services, and for economic development.

About 75 percent of the population has no access to electricity, and the consumption of electricity (about 160 kWh per capita) is one of the lowest in the world – twenty times less than the world average. Furthermore, the existing power infrastructure can meet only about half of current demand, resulting in frequent blackouts and rationing of electricity supply. In many areas, access to drinking water is a challenge. Myanmar's transport sector is under-developed for a country of its size, population, and potential. Road density for ASEAN overall is about 11km per 1,000 people, while Myanmar's is about 2km per 1,000 people.² Telecommunications and internet access is also very limited, with teledensity at only 7.5% and only 1% of the population using the internet.

25. Myanmar is prone to natural disasters and vulnerable to the effects of climate change. The coastal regions are exposed to cyclones, tropical storms and tsunamis, while the hilly regions are exposed to landslides. Rainfall-induced flooding is a recurring phenomenon across the country, and – except for Tanintharyi Region – the whole country is at risk from earthquakes. Cyclone Nargis, which hit the Ayeyarwady Delta in May 2008 and left an estimated 138,000 people dead with a further 2.4 million people affected, was by far the largest natural disaster in the country's recent history. There have since been frequent small to medium scale natural disasters including floods, landslides, heat waves and earthquakes. The government is placing high priority on further strengthening disaster risk reduction efforts, including through the Myanmar Action Plan for Disaster Risk Reduction.

Gender

26. A national plan to enhance gender equality and empower women is underway, but the capacity to implement the plan is limited. The 2008 Constitution grants equal rights, opportunities and legal protection to all citizens, and Myanmar is a signatory to the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW). The Ministry of Social Welfare, Relief and Resettlement, and the Myanmar National Commission on Women's Affairs oversee the implementation of CEDAW. In addition, the government is developing a National Strategic Plan for the Advancement of Women (NSPAW) 2012-2021 which includes 12 key activity areas along the lines of the Beijing Platform of Action. While the government is working on enhancing women's status and protection, there is a need to enhance public perceptions of the importance of gender equality in development, and to strengthen the capacity of national institutions to effectively implement CEDAW and the proposed NSPAW.

27. In the overall data-poor environment in Myanmar, few reliable gender-disaggregated indicators are available, making it difficult to assess gender-based vulnerabilities. The 2011 UNDP Human Development Report ranked Myanmar at 96 among 146 countries in the area of gender equality, measured by the Gender Inequality Index which primarily assesses reproductive health, empowerment and economic activity. Challenges still

² See also *Myanmar in Transition: Opportunities and Challenges*. Asian Development Bank, August 2012.

persist across issues of human development, economic opportunity and voice. For example, the maternal mortality rate is high, ranging from 360-380 per 100,000 live births; women's participation in the labor market is low at 63.1% compared to 85.1% for men; and women make up only 4% of members of parliament.

Governance

28. **Decades of underinvestment have taken a toll on public institutions and the civil service.** The reach of government and its ability to provide services, in particular in rural areas, remains limited. Health, education, and agricultural extension services all suffer from having been underfunded for extended periods of time. Salaries of many civil servants – in particular at the lower levels of the bureaucracy and those in rural areas – are often insufficient to cover living costs, although the FY2012/13 budget (following a heated debate in Parliament) provided a significant raise to civil servants. Partly as a result of these limitations, households have relatively high out-of-pocket costs to access public health and education services (a 2007 survey showed out of pocket expenditures accounting for 92 percent of total spending on health). A lack of funds to cover the cost of transportation has in many cases confined agricultural extension workers to the areas they can reach easily.

29. **Corporate governance of larger companies and financial institutions is limited as most are closely held by families, small groups, and the military.** Cronyism and capture have been significant features of the economy, with firms close to the government undertaking public investment projects in return for concessions and/or access to natural resources. In addition, accounting and auditing are weak across the board and enforcement of regulations is uneven, including unequal treatment among state-owned enterprises (or those with close links to the state) and private firms. Finally, a substantial portion of economic activity in Myanmar is informal, with small and medium-sized enterprises accounting for over 90 percent of the country's enterprises.

30. **Poor regulations, a lack of enforcement, and extractive investment have also done significant harm to Myanmar's environment.** Once considered the last frontier of biodiversity and with a long tradition of sound forest management practices, Myanmar today is facing the results of extensive deforestation as a result of both increased commercial logging and illegal logging activities, particularly in border areas. This has led to soil erosion, landslides, and decreased soil fertility, depriving many families of their traditional sources of income. Similarly, overfishing, including by foreign vessels, is endangering the livelihoods of fishing villages.

31. **With the ongoing spate of reforms, many aspects of governance at the central level have improved, both in terms of civil rights as well as economic governance.** The government has made concerted efforts to improve transparency, with the national budget being presented and debated in Parliament for the first time in 2012 (leading to significant cuts in the Executive's proposal), and subsequently published in national newspapers. The government has established a Finance Commission and undertaken a significant de-concentration of budgeting and planning functions, including a move towards more bottom-up planning and budgeting. Myanmar also has a semi-independent Auditor General whose purview spans the entire public sector. Restrictions on media have been lifted, leading to greater coverage of sensitive topics, including corruption.

32. **Recent reforms have aimed to address a range of serious human rights issues,** including on forced labor, the absence of an independent judiciary, natural resource exploitation and land grabs. In addition to these problems, the legacy of conflict and limited control by the central government have given rise to opium cultivation in parts of the country, particularly Shan and Kachin States, with Myanmar in 2012 ranking as the world's second-largest producer of opium, after Afghanistan. Following an extended decline, opium cultivation has increased significantly since 2005. In addition, the framework for stopping money laundering is inadequate.

33. **Despite recent efforts by government at the central level, corruption remains a problem,** both at the local level in people's daily lives (with ad-hoc fees required for many interactions with government) and at the institutional level, in particular in areas of natural resource management and public investment. Myanmar has a vertically integrated judicial system, with the Supreme Court serving as the country's highest court, and a number of high courts as original and appellate chambers for each region and state. Corruption is reportedly widespread with payments required to expedite hearings, influence judicial decisions, evade arrest, and improve prison conditions. Inconsistent application of laws due to corruption and other institutional reasons affects not just business and investor confidence, but also ordinary citizens' perceptions about state effectiveness and legitimacy. Ethnic minorities, including in central Myanmar, are particularly affected by these as they experience greater difficulty in renewing their documents and more scrutiny of their legal status by local officials.

34. **While formal government structures and authorities are predominantly top-down (and in many cases quite divorced from the realities facing local populations) as a result of a long history of military governance, governance at the local level offers more entry points for accountability, with a sophisticated set of both formal and informal institutions.** Notably, despite being nominated by the township authorities, the formal village leadership is responsive to the community, in part due to the informal involvement of elders in village governance, creating a system of checks and balances. This system is imperfect and impacted by local factors, including ethnic and religious differences, but does offer a surprisingly effective feedback and accountability mechanism for local populations. These interactions between formal and informal institutions could provide a useful basis for engagement on core issues, including service delivery, especially if coupled with new approaches to strengthen the voices of the poor.

35. **Social cohesion remains strong in Myanmar, and has been an essential part of the safety net as a way for households to cope with external shocks.** In the wake of Cyclone Nargis, local populations were the first responders, and a wide variety of informal social networks exist that provide a range of support, from financial help for poor families, to education and board for children, to free funeral services. Religious institutions of all faiths as well as ethnic associations play a critical role in this network, along with closely-knit communities in rural Myanmar and neighborhoods in urban areas. In addition, remittances from Myanmar migrants abroad have provided an important buffer for families against shocks. Nevertheless, recent localized instances of communal violence including in northern Rakhine State indicate the need to address continuing societal fault lines.

Myanmar's Development Strategy

36. **The government is working on a five-year development plan, which will cover the term of the government (2011-2015).** The plan focuses on four objectives: (i) agricultural development; (ii) balanced growth among regions and states; (iii) inclusive growth; and (iv) quality statistics. These objectives are in turn translated into further operational detail, for example with a “Rural Poverty Alleviation and Development Framework” identifying eight tasks covering a broad agenda for rural development, including developing the agricultural production sectors, developing micro saving and credit enterprises, rural energy, and social and economic development of rural areas.

37. **In a move away from traditional top-down planning driven by quantitative output targets, a process is underway to develop a national “Framework for Economic and Social Reform” that would supplement the five-year plan** to give coherence to the government’s reform effort, including on sequencing and overall objectives. In a significant break from past practice, the government has worked closely with stakeholder groups in developing this framework, consulting with the private sector, independent think tanks and experts, and drawing on international expertise, including through the formation of a National Economic and Social Advisory Council to advise the President. The Government has established a Planning Commission to guide medium-to-long term economic planning and development in the country, headed by the President and comprising chief ministers from all regions and states (with each region/state and sectoral ministry having been asked to develop specific development plans). In addition, the government has begun to develop an architecture to support development cooperation (see box 3). Given these ongoing efforts by government to prioritize reform efforts, the proposed WBG program intentionally retains flexibility to respond to requests that may emerge, especially with analytical and advisory services.

38. **Finally, relevant Ministries are developing plans to support Myanmar’s participation in regional integration under the ASEAN Economic Community 2015 initiative and in preparation for Myanmar’s chairmanship of ASEAN in 2014.** Myanmar is actively collaborating with other ASEAN countries in the establishment of a Regional Power Coordination Center in the Greater Mekong Sub-region (GMS) and fostering of regional energy trade, areas in which the ADB is planning to provide support as part of their GMS program.

Box 3: Experiences in Development Cooperation

The Myanmar government is in the process of setting up structures to manage foreign aid and engage with development partners, including the Foreign Aid Management Central Committee which brings together relevant ministries under the leadership of the President. International experience in development cooperation highlights the types of challenges that a country like Myanmar, with little prior experience in the coordination of a diverse development partner community is likely to face. While national ownership of the development process is fundamental, global experience shows that it can be undermined by (i) too many uncoordinated offers of support, resulting in fragmented and stand alone initiatives from development partners; (ii) lack of transparency in management of development finance, including when resources flow off budget or bypass crucial elements of the government systems; and (iii) transaction costs imposed on stretched government structures.

In a context of weak capacity, it is particularly important for development cooperation to support the strengthening of institutions and avoid a range of practices that in other countries have tended to undermine institutional development, including (i) brain drain of the best civil servants to development partner financed structures, (ii) salary top-ups or payments to government officials outside government norms which create distortions and unsustainable practices for the rest of the administration, and (iii) multiplication of project specific and separate implementation structures. Some of these practices might be well-intended for short term

quick delivery of results but in the long term undermine the ability of institutions to deliver services and design and implement policies.

These lessons learned and principles have been captured in the “Busan Partnership for Effective Development Cooperation” and have been discussed in the context of a development partner workshop in Mandalay in May 2012. These discussions also identified emerging good practices in various sectors in Myanmar (in education, public financial management, peace building and health) which could be promoted in the future.

III. REVIEW OF THE WBG’S PAST ENGAGEMENT

39. **Myanmar became a member of the International Bank for Development and Reconstruction in 1952, the International Finance Corporation in 1956, and the International Development Association in 1962.** The Bank’s first project in Myanmar was approved in May 1956, supporting the Government’s rehabilitation and modernization of the railway (damaged during World War II) and inland water transport sectors. There have been a total of 35 projects in Myanmar, although the Bank has approved no new lending since 1987. In 1998, the Government went into arrears to IDA but has remained a member. In the period since 1987, the Bank has supported only one project in Myanmar, the “Avian Influenza Support” project financed by the Avian and Human Influenza European Union trust fund and implemented through Food and Agriculture Organization, which was closed in 2011. IFC has not had any engagement in Myanmar to date.

40. **Even in the absence of ongoing operations in Myanmar, Bank staff continued to accompany the Fund on its annual Article IV missions to Myanmar,** and Myanmar continued to attend the Bank’s Annual Meetings, providing opportunities for occasional contact.

41. **Following the devastation of Cyclone Nargis, which killed an estimated 130,000 people, the World Bank provided technical support to ASEAN to conduct, jointly with the Government and the United Nations, the Post-Nargis Joint Assessment which outlined damages caused by the cyclone and priorities for recovery.** As part of this effort, the Bank also supported Social Impact Monitoring (SIM) in the affected areas to assess both the impact of the cyclone and of post-disaster assistance on local communities. At the request of development partners, the World Bank built on the SIM work to provide monitoring and analysis for the multi-donor livelihoods trust fund (LIFT) on a fee-based services agreement. This Qualitative Social and Economic Monitoring (QSEM) is scheduled to continue until January 2015.

IV. WBG INTERIM STRATEGY

Strategic Foundations

42. **The aim of this Interim Strategy Note is to support the Myanmar government in the country’s current triple transition – from an authoritarian military system to democratic governance, from a centrally-directed economy to market-oriented reforms, and from conflict to peace in the border areas – for the benefit of the people of Myanmar.** In so doing, the ISN draws on the WBG’s experience in other countries, and the findings of the 2011 World Development Report on *Conflict, Security and Development*, in particular in its emphasis on a continuous effort on transforming institutions and building confidence. At the same time, the ISN

aims to lay the foundation for the resumption of a full country program, including by supporting diagnostic work to build a shared understanding of key development challenges facing the country.

43. **The ISN will thus focus on three pillars: the first aimed at supporting government's efforts to transform institutions to allow them to deliver for citizens; the second at building confidence in the ongoing reform process; and the third focused on preparing the way for the resumption of a full country program.** Each is outlined in some detail below, though given the early stages of the Bank Group's re-engagement with Myanmar, adjustments within each pillar are likely to be needed during the course of the ISN. Gender aspects will be integrated in the analytical and operation work of the three pillars to deepen the understanding of gender issues in Myanmar as well as improve gender equality and empower women.

44. **The engagement of the World Bank Group will be important since Myanmar needs not only technical support in terms of policy assessments and advice, but also implementation support that goes beyond technical assistance,** including on improving management of public finances, competitive procurement, transparent management of resources and assessments with regard to social and environmental safeguards for investment projects. At the same time, it will be important to maintain selectivity and focus in the WBG's re-engagement given capacity constraints at all levels of government and limited absorptive capacity. The focus of initial engagements is thus on those areas that support the government's priority reforms, are in areas where the WBG has a comparative advantage, and have a significant impact on poverty reduction.

Objectives and Programs

Pillar 1: Transforming Institutions

45. **To effectively manage and sustain Myanmar's triple transition, it will be critical to support national efforts to rebuild and transform Myanmar's institutions to equip them to successfully mediate competing demands, steer an increasingly complex economy, and navigate the country on its development path.** To this end, activities under the ISN will focus on policy advice and capacity building, as well as technical assistance and investment to support the development of domestic institutions, including in the public and private sectors. To improve economic governance and create the conditions for future economic growth and job creation, the focus of this work will be on two areas: (i) public financial management, to enable the government to articulate an effective development plan and link budgets to policy priorities; and (ii) private sector development, to promote broad-based economic growth and job creation in line with the government's priorities, including increasing access to finance for rural and urban microfinance borrowers and SMEs.

46. **Firstly, in the public sector, diagnostic work will identify key priority areas for reform, with technical support for capacity building to be designed accordingly.** This work has begun with a Public Expenditure and Financial Accountability Assessment (PEFA) to provide a snapshot of the condition of Myanmar's public expenditure, procurement and financial accountability systems. Since there is no recent history of development partner engagement on PFM reform (other than by the IMF under the Article IV discussions and a recent mission on

government financial statistics), little understanding of the status of the government's PFM reform agenda, no prior diagnostic work, and no existing process of engagement on PFM between government and donors, the proposed output will be deeper than is sometimes the case for PEFA assessments. The PEFA is expected to be completed in mid-FY13.

47. **After the PEFA provides an initial diagnostic of the strengths and weaknesses of the PFM system, a Public Expenditure Review (PER) will provide an assessment of government public expenditure patterns and policy.** The PER will analyze the broad patterns of public expenditure by functional and economic classification and benchmark expenditure patterns to relevant comparators. The report will also follow up on the PEFA assessment through selective analysis of the public financial management system and elaboration of a possible PFM reform strategy, including a set of priority reform recommendations. The PER will complement the aggregate analysis of expenditure patterns with sectoral analyses that use expenditure analysis as an entry into a more in-depth understanding of government policy and capacity. While the initial choice of topics and sectors will inevitably be selective (with an initial focus on health and education, and at an appropriate time on revenue policy and administration), the PER can be programmatic to allow a continued engagement and coverage of topics and sectors. Completion of the first phase of the PER is expected in early FY14.

48. **Finally, beyond these longer-term pieces of analytical work, the WBG will support a flexible, demand-driven program of knowledge support for government in areas of macroeconomic and public sector management.** This could include just-in-time policy notes, shorter diagnostic pieces, south-south exchanges to benefit from the lessons learned in other economic transitions in the region and beyond, and workshops and seminars to discuss emerging economic issues.

49. **Secondly, in the private sector, generating broad-based patterns of growth, including among small and medium enterprises (SMEs) and in the non-extractive sector will be important for job creation and for sustaining the reform momentum in Myanmar.** The policy environment for private businesses, in particular domestic small and medium-sized enterprises, is a serious challenge to their start-up, operation, and expansion. Private businesses in Myanmar face significant challenges, including policy uncertainties, outdated and unclear regulations, limited protection of property rights, high levels of perceived corruption, unequal treatment among state owned enterprises (SOEs) and private sector firms, and high costs registering and licensing (it costs the equivalent of 70 percent of per capita income to register a business, which is the highest in the world for starting a business). Myanmar also compares poorly to its neighbors in terms of electricity consumption, road networks, telecommunications and internet connectivity, and financial market development. Although the private sector makes up the majority of economic output, the government is a direct participant in many key areas of the economy. Economic reforms currently underway, including reform of state-owned enterprises and opening up to external investors will be important to support the development of a more inclusive, market-oriented, and private sector-led economy.

50. **Attracting investments as well as enhancing competitiveness of domestic firms will require addressing these constraints.** An Investment Climate Assessment (ICA) will be undertaken together with IFC to develop a better understanding of these complex constraints, based on a survey of firms as well as an analysis of the policy and regulatory climate. The ICA will analyze the constraints that micro- and SME size firms face in Myanmar, including on starting and closing a business, accessing permits, registering property, enforcing contracts, taxes,

trade matters, labor, investor protection, and access to finance. The ICA will then provide recommendations for reforms. This work will run through FY13-4 (although IFC assessments of legal and regulatory issues could lead to earlier opportunities to support the reform program) and will be followed by a program of support for implementation of business environment reforms, including on improving labor and environmental standards. The Bank and IFC will also consider supporting business environment reforms identified during the ICA preparation period.

51. Finally, the financial sector will be critical in order for Myanmar to achieve long-term, broad-based economic growth. Myanmar has some of the lowest levels of penetration of financial services in the world with the ratio of domestic credit to GDP at 4.7% – the lowest of all 159 countries for which data was available. The formal financial system consists of 19 very small-scale, closely held banks, four state-owned banks, and a small number of microfinance institutions. As a result, access to formal financial services has been extremely limited and the economy is being largely run on a cash basis. Significant unmet demand for financing remains, and in the absence of formal financial services, the population in both urban and rural areas turns to informal lenders, paying interest rates of up to 20% a month. The financial sector’s legal and supervisory structure is weak and the system is vulnerable to abuse for different purposes.

52. Support envisaged during the ISN aims at developing a stable, well-functioning financial system that improves access to finance and banking through four elements: (i) a reform plan for developing the financial sector in a systematic way (“master plan”); (ii) building an adequate legal and regulatory framework for the financial sector; (iii) enhancing supervision of the financial system, including developing a crisis preparedness framework; and (iv) establishing a well-functioning financial sector infrastructure and payments systems. In addition, together with the Bank, IFC will support the development of banking services to SMEs through policy support and capacity building of financial institutions. The Financial Sector Development Program is expected to run from FY13-14, with complementary activities expected to continue thereafter.

53. In addition, given the challenges small and micro-level firms and households have in accessing formal financial services, support will be provided by both the Bank and IFC to develop the microfinance sector. The Financial Inclusion for National Development (FIND) program is designed to enhance the framework and capacity for microfinance in Myanmar and will support the Myanmar Microfinance Supervisory Enterprise (MSE), the newly formed regulatory and supervisory body for the microfinance industry. Assistance will focus on (i) institution building for microfinance supervision; (ii) capacity building for MSE staff; and (iii) financial literacy and awareness building for existing and potential microfinance clients. This program will be implemented in collaboration with IFC and other development partners. In addition to the proposed investment in ACLEDA PLC, IFC will also identify opportunities for providing technical assistance to support the development of microfinance in Myanmar. The FIND program will run through FY14, with follow-on activities to continue thereafter.

54. Beyond these specific plans for supporting the transformation of institutions, the WBG’s overall engagement aims to build government capacity and strengthen institutions, including by working together on project design and through WBG implementation support. The experience of working with a range of government departments in the design of the proposed community-driven development operation provides a useful example in this regard, with line ministries keen to learn from current thinking and experiences in this area and developing options for applying these lessons in the Myanmar context.

55. **A key goal of supporting institutional transformation is to improve public sector governance in Myanmar.** The proposed analytical work will help government identify the priorities in this regard, marking important first steps in what will inevitably be a long-term process. These changes will be important both for service delivery and for promoting growth: Myanmar will need investment capital to develop its economy and support inclusive growth, and will benefit from the WBG's support for improving the business environment to ensure a fair and transparent environment for foreign and domestic investors. Encouragingly, the Myanmar government has announced its intention to join the Extractive Industries Transparency Initiative (EITI) which aims to bring together government, private companies, and civil society to ensure the transparent and proper use of revenues from natural resources. Given Myanmar's wealth of natural resources, this is an important and welcome step, and the WBG will work with the government and EITI partners to identify any support that it may be able to provide in this regard.

Pillar 2: Building Confidence

56. **Global experience has shown that even in the fastest reformers, transforming institutions takes time. The second pillar of the ISN thus aims at building confidence in the ability of the ongoing reform process to generate benefits for the people by delivering visible interim results from the longer-term changes underway,** recognizing that building confidence is an ongoing process rather than a one-off event. This pillar encompasses three sets of activities: support to the peace process; support to civil society; and supporting quick wins that deliver tangible results to the population.

57. **The first set of activities under this pillar will aim to support the peace process in ethnic minority areas through community-driven development programs to promote the economic and social recovery of conflict-affected communities.** This will benefit populations affected by conflict (who are among the poorest of the poor in Myanmar) and help sustain ceasefires and the government's peace initiative by generating a peace dividend, drawing on the Bank's experience with CDD programs in post-conflict settings, including in Indonesia (Aceh), the Philippines (Mindanao) and Afghanistan. Focused initially on a small set of pilot areas with implementation through experienced local community-based organizations, interventions will be coupled with a robust monitoring and evaluation effort (covering both WBG and other donor interventions) to identify lessons learned for potential expansion and scaling up, as well as possible direct support to the newly established Myanmar Peace Center. These interventions will take place in close coordination with other donors and in support of the Myanmar Peace Initiative led by the Government, with Norway playing a lead donor and facilitating role, at the request of the government. Given the urgent nature of this intervention, this activity will be financed out of Bank-administered trust funds that allow for the use of funds in countries in arrears (i.e. the State and Peacebuilding Fund, and the Korea Trust Fund for Economic and Peace-building Transitions), and could thus proceed even before arrears are cleared.

58. **A second set of activities will support a strengthened role for civil society to engage with government at all levels, including at the local level and on service provision, to strengthen social accountability.** In the context of Myanmar's transition, new stakeholder groups and spaces for dialogue have emerged, including members of parliament and political parties, women and youth groups, labor groups, and independent media. Activities will focus on re-establishing links between civil society and communities with local institutions and authorities, drawing on expertise from the WBG in areas of social accountability and that of regional networks such as the Associated Network for Social Accountability (ANSA). In addition, the

WBG will make public and disseminate the outcomes of diagnostic and analytical work to inform a substantive debate of key issues facing the country.

59. **A third set of activities will focus on identifying and realizing activities with quick and tangible impacts for communities across a range of sectors.** These could include ICT reform, policy work on agricultural productivity, and IFC work on supporting private sector development and access to finance. This would also include the proposed pre-arrears clearance grant financing for a community-driven development approach. This project, which is being presented to the Board for its consideration at the same time as this ISN, aims to enable rural communities to benefit from improved access to and use of basic infrastructure and services through a people-centered approach by financing community-identified rural infrastructure investments (for example small scale irrigation, rehabilitation of schools and health centers, construction of rural access roads) and strengthening the capacity of communities in partnership with local authorities to effectively identify, plan and implement their development priorities. This would both deliver immediate visible results across the country, create jobs, contribute to poverty reduction and inclusive growth, and support the government's emphasis on shifting to a bottom-up planning approach, including by providing a model that could later be scaled up by government or in cooperation with other donors. The project will emphasize gender considerations, requiring 50% of village committee members to be women, allocating at least one sub-project per village tract annually to directly respond to women's priorities; and ensuring that women working on sub-projects receive equal pay for equal work.

60. **In addition to delivering visible results to build the public's confidence in the reform process, these early interventions and others envisaged as part of the ISN can also help build confidence of government in the reform process and contributions of development partners.** The experience of working together holds the potential to build (i) confidence of government in the ability of development partners to support the government's reform agenda, after a period in which most external assistance to the country circumvented government in support of parallel systems; (ii) confidence of wider parts of government in the benefits of the reform agenda, including through south-south exchanges to offer government officials an opportunity to learn from other countries' experiences; and (iii) confidence of government in engaging with a wider group of stakeholders in decision-making and implementation, as a departure from traditional top-down, centralized decision-making and to increase transparency and accountability.

Pillar 3: Preparing for the Road Ahead

61. **The third pillar of the ISN focuses on preparing for the resumption of a full WBG country program in Myanmar, including arrears clearance to enable Myanmar to access IDA resources.** At this time, the Bank expects that the arrears clearance process will take place in coordination with the Asian Development Bank, in keeping with the *pari passu* principle and in accordance with established arrears clearance principles. A DPO will be extended to Myanmar to support the government's reform program aimed at ensuring macroeconomic stability, improving public financial management and creating a conducive investment climate. Such an operation would be one off and its proceeds would be used to support Myanmar's foreign exchange needs, including those associated with IDA arrears clearance.

62. **Prior to any subsequent investments, financial management and procurement assessments would be undertaken to determine the robustness of government systems, and any necessary additional measures.** Any project financing would build up gradually to develop

familiarity with and confidence in fiduciary systems. The focus initially will be on basic services and strengthening public sector systems given that most donor funds have traditionally bypassed government and public systems.

63. The WBG will continue during the ISN period an intensive effort of conducting analytical and diagnostic work to build its knowledge base of key development issues facing the country. As part of the coordination with the ADB, the WBG assessments will primarily focus on economic diagnostics, while the ADB will carry out assessments in other sectors (including infrastructure, trade, and connectivity), with results of the assessments shared across the two institutions. Beyond these specific areas of engagement, the WBG will look at possible support to the 2014 national census, which the government is carrying out together with the UN Fund for Population Activities (UNFPA). To better assess the baseline and progress on a range of human development indicators, the WBG will undertake some additional work itself, and collaborate on other pieces with partners, including on a proposed gender situation analysis which is being carried out in collaboration among Government, UN agencies, and civil society on key priority areas of the National Strategic Plan for the Advancement of Women (NSPAW) to better understand gender-based vulnerabilities in Myanmar. The WBG will contribute to the Gender Situation Analysis and consider shorter, just-in-time policy notes, including by drawing on the findings of the 2012 World Development Report on Gender Equality and Development. All work will aim at building the understanding not only of the WBG, but also of government, civil society, development partners, and other stakeholders.

64. In addition, given the data limitations noted above and in line with the government's national development plan, a nationally representative household expenditure survey will be undertaken during the ISN period to provide government and its partners with better and more detailed information on the extent of poverty and its determinants. Such data can help government better understand the well being and vulnerability of the population; and better guide donors' support in strengthening basic services. This work, which will include gender-disaggregated data, will build on previous household surveys carried out in 2004/05 and 2009/10 and will be carried out with the Planning Department of the Ministry of National Planning and Economic Development and in collaboration with the Central Statistical Organization. This task involves surveying thousands of households across the country to better understand and quantify the economic well-being of the Myanmar population.

65. Beyond this analytical work, the Bank will consider possible catalytic engagement in other sectors. This could potentially include agriculture, health, education, transport, ICT, and/or water resource management, depending on government priorities, opportunities, and needs. In addition, as government progresses in developing its national reform framework, the WBG will stand ready to provide technical support to key institutions involved in the reform process, including to the development of a Poverty Reduction Strategy Paper based on reliable data and broad consultation. Given the country's acute shortage of investment against rapidly increasing infrastructure demand, the WBG could start its engagement in infrastructure by addressing emergency rehabilitation needs in coordination with other development partners. A government request in this regard has been support for the rehabilitation of its electricity generation and distribution network, which is both a key constraint on economic growth and a rising source of popular frustration.

66. In keeping with its emphasis on both selectivity and donor coordination, the ISN proposes only limited engagements in the social sector, in particular on health and

education, given that these are areas with high interest by other development partners. In health, seven international donors have just established a \$300 million “Three Millennium Development Goal” Fund (3MDG Fund) for the period 2012-2016. Building on the \$138 million Three Diseases Fund (2007-2012), the 3MDG Fund expands the scope of support beyond the three diseases of HIV/AIDS, TB, and malaria to encompass maternal and child health.³ Similarly, in the education sector donors are supporting a four year “Myanmar Quality Basic Education Programme” (QBEP), with commitments likely to be in the range of \$60-80 million for the period 2012-15. The Bank will provide technical support to these sectors in areas where it has a comparative advantage, including through a sectoral focus on health and education in the public expenditure review. Further engagements in these areas may follow as needs and gaps in external support become more clear.

Implementing the ISN

67. **One key uncertainty for the program outlined here is how quickly progress can be made on clearing Myanmar’s arrears to IDA (which stood at \$406.5m as of 31 August 2012).** Reconciliation of these arrears is expected to be completed shortly and a joint debt sustainability analysis being undertaken with the IMF to determine Myanmar’s level of debt distress is nearing completion. Discussions have also been held with various parties on how Myanmar could be supported to clear these arrears. Arrears clearance is critical to make new IDA resources available to Myanmar to meet the country’s development needs.

68. **Myanmar qualifies for exceptional reengagement allocations from IDA.** The allocation for FY13 is \$407 million, and the indicative allocation for FY14 is \$165 million.⁴ In addition, if approved by the Board, an IDA pre-arrears clearance grant of about \$80 million would be available to Myanmar before arrears are cleared to fund urgent priorities in the government’s reform effort, namely the community-driven development project, described under Pillar 2. The total amount of IDA support is sufficient to support both a one-time DPO post arrears clearance, as well as additional investment projects.

69. **To balance the large needs in Myanmar with the constraints imposed by a limited knowledge base, the ISN proposes a relatively large analytical program (composed of both short policy notes and longer-term diagnostics), and a relatively smaller set of perhaps four operations.** The first, if approved by the Board, would be an exceptional pre-arrears clearance grant available to Myanmar before arrears are cleared to fund urgent priorities in the government’s reform effort, namely the community-driven development project, described under Pillar 2. This could be followed later in the ISN period by an emergency electricity or irrigation rehabilitation project, and projects to support public sector management to improve the linkages between budgeting and planning for improved service delivery, and reform of the financial sector to address constraints related to access to finance, with IFC considering additional support to microfinance. IFC’s proposed first investment in microfinance, with ACLEDA PLC to support its entry into Myanmar with an option to convert into the equity of ACLEDA PLC’s Myanmar subsidiary once arrears are cleared, will be presented in parallel with this ISN. Each of these operations would meet the criteria of supporting priority reforms sought by the government,

³ The seven donors are Australia, Denmark, the Netherlands, Norway, Sweden, the UK, and the EU.

⁴ As agreed during IDA15, countries re-engaging with IDA after a prolonged period of inactivity on the basis of a strong transitional plan with concerted donor support are eligible for exceptional allocations for a period of two years, plus three years of phase-out to PBA norms.

contributing to inclusive growth and poverty reduction, and drawing on the comparative advantage of the WBG vis-à-vis other donors. Depending on the outcomes of fiduciary assessments, special implementing arrangements may be needed, with the Bank's recent Avian Flu project in Myanmar providing some relevant experience in this regard

70. **While the timing of lending operations will depend on arrears clearance, WBG support for Myanmar's transition and implementation of this ISN can begin even before arrears are cleared.** Diagnostic work undertaken with support from donors, technical assistance in the regulatory reform process, and initial financing for programs from trust funds all offer the possibility of important support in this first stage of WBG re-engagement. In addition, IFC expects to engage in some high-impact investment projects (for example in the area of microfinance or telecommunications) in parallel with arrears clearance. As arrears clearance proceeds and IDA resources become available, these initial activities will provide useful experience for expanding WBG support.

71. **Effective implementation of the program outlined here will require a scaled up country presence and team.** Preparations for this have begun, including the appointment of a World Bank Country Manager and an IFC Resident Representative, opening of an office in Yangon, and preparations for the opening of an office in Nay Pyi Taw. Going forward, the Bank will review staffing needs and determine the appropriate balance of presence between Nay Pyi Taw and Yangon.

72. **Across all activities, the WBG will seek to work as a group,** collaborating closely in particular with IFC either through joint work (for example in the case of the Investment Climate Assessment and the access to finance work) or complementary activities. IFC's initial assessments will focus on the investment climate, the financial sector and infrastructure, with possible advisory and investment services engagements to follow depending on developments. While Myanmar is not yet a member of MIGA, the government has announced its intent to join MIGA, and MIGA is in discussions with the government on the process for this.

Partnerships

73. **The large needs and complex operating context in Myanmar make coordination with other development partners essential, especially given the WBG's extended absence from the country and limited government capacity.** In keeping with the Paris Principles, the Accra Agenda for Action and the Busan Declaration, the program proposed here is based on close consultations with development partners and focuses on areas where the WBG has a comparative advantage. Over the last years, the WBG has built close relationships with key development partners in Myanmar, both through the support to ASEAN following Cyclone Nargis, the support to the LIFT livelihoods trust fund, and the fee-based services work on economic diagnostics being undertaken in support of development partners. Following a donor retreat in Mandalay in May 2012, the WBG is willing to play a leadership role along with other DPs on a shared basis. In addition, the WBG will continue to serve as a technical expert on the board of the Multi-Donor Trust Fund for Livelihoods and Food Security (LIFT) and has been requested to provide technical inputs into the health sector by serving on the board of an ongoing multi-donor trust fund, and in education, by providing technical inputs into an education sector review.

74. **In the implementation of this ISN, the WBG will continue this close cooperation with development partners, including with the ADB and the IMF.** The initial office of the WBG in

Myanmar will be co-located with the ADB, and regular consultations at the working level, supplemented by high-level consultations of senior management of both institutions (most recently in May 2012 in Manila) aim to ensure close coordination and complementarity in work programs. This will extend to the process for arrears clearance, in keeping with the *pari passu* principle of treatment for multilateral debt. Close coordination continues with the IMF, including on sharing information and coordinating missions.

75. The WBG will also maintain a close relationship with ASEAN, building on the technical cooperation in Myanmar following Cyclone Nargis, and the ongoing technical work by the WBG in support of the ASEAN integration agenda. As Myanmar prepares for the ASEAN chair in 2014, the WBG will work with ASEAN to support Myanmar's efforts to live up to key commitments under the integration initiative.

76. Finally, the WBG will continue to work closely with bilateral development partners. Australia and the UK are already providing financing for some of the proposed diagnostic work on a fee-for-services basis, and the WBG is engaging with other partners, including Myanmar's regional neighbors, to identify opportunities for collaboration. More broadly, the WBG aims for its analytical work to serve as a public good to inform the plans of both government, civil society, private sector and development partners, and is committed to making public and disseminating (including in Myanmar language to the extent feasible) the final products of all analytical work. The process of collaborating with civil society and government in disseminating and discussing the Bank Group's work will in and of itself also promote openness and dialogue in support of the transition.

V. RISKS

77. The current government-led reform process is dynamic and far reaching. This presents an important opportunity for Myanmar to address long-standing development challenges, and the WBG is committed to assist Myanmar in seizing this opportunity. At the same time, the scale and pace of reforms also pose a unique set of risks that need to be recognized in program design. Beyond specific risks inherent in eventual operations, this ISN identifies five key country-level risks.

78. First, the continued fragility of reforms. Reforms remain largely driven and enabled by a consensus among key individuals, notably among them President Thein Sein on the government side and Aung San Suu Kyi on the side of the opposition. It is unclear whether the reform process could be sustained beyond the direct and active involvement of these very few key players. In addition, there is a risk of an emergence of alliances of vested interests seeking to disrupt the reform process. Myanmar's future depends on the nature of compromises reached between multiple stakeholders with often incompatible interests. In the run up to the 2015 elections, current reforms may be seen as a threat to those that benefited from previous arrangements, including protected access to government and market opportunities. Finally, there is a risk to reforms from increased domestic tension as new openness allows for previously suppressed grievances – including by ethnic and religious groups – to surface. The ISN thus aims to support a move from individuals to institutions, including a focus on strengthening and working through government systems, and supporting civil society and processes that can help to reconnect the population with government authorities, especially at the local level.

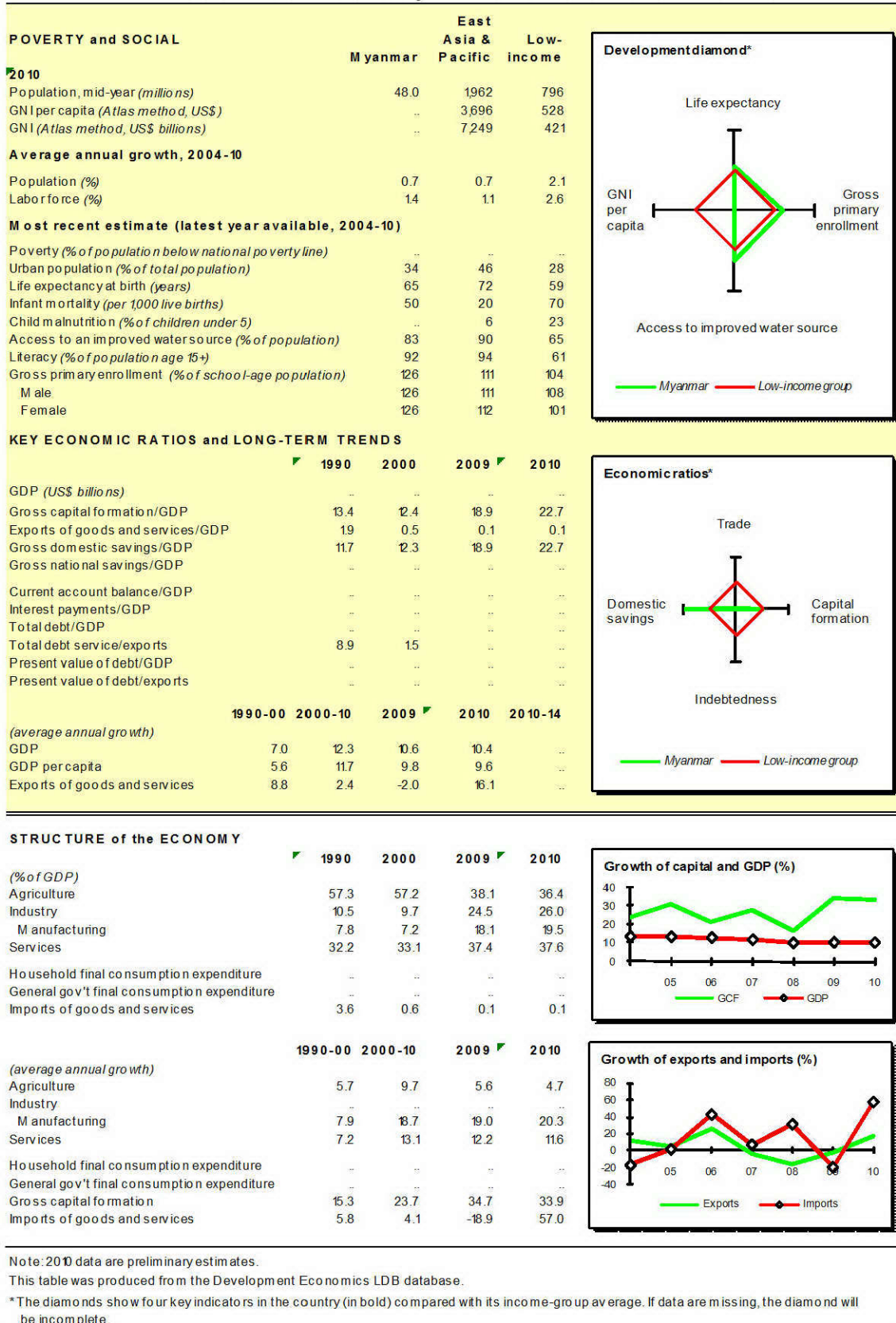
79. **Second, the risk of a resumption of conflict.** While the government's peace initiative has gotten off to a promising start, it remains in its early stages, and conflict continues in Kachin State. A wider return to conflict remains a possibility, and indeed the conflict in Kachin State – which follows a ceasefire that lasted some 17 years – provides a cautionary lesson that this process will require active and sustained engagement. In addition, the situation in northern Rakhine State remains intractable. The WBG's activities under this ISN thus include specific efforts to promote peace, including by generating a tangible peace dividend for conflict-affected communities.

80. **Third, the WBG is beginning activities in an uncertain operating environment.** After two decades of absence from Myanmar, there is a need to build an understanding both among the WBG of the Myanmar context, and among Myanmar counterparts of modalities of working with the WBG. In addition, the rapid scale-up of international assistance to Myanmar poses donor coordination challenges to prevent draining government capacity, the provision of inconsistent advice, or the introduction of economic distortions. For that reason, the strategy proposed here focuses on moving gradually, scaling up as knowledge and experience expand, and investing in coordination with development partners to identify respective areas of comparative advantage.

81. **Fourth, there is a risk of rising expectations leading to popular frustration and disillusionment.** While the government's reform agenda is ambitious, it will take time for Myanmar to catch up with some of its neighbors. As noted above, limited data mean that the scope of the reform tasks are not yet fully understood, but already there have been early signs of discontent (including demonstrations over power outages in urban centers and a series of factory strikes). The WBG will thus focus actively on communicating its work and expected results to a wide range of stakeholders, including government, civil society, and private sector, to manage expectations and explain what progress is being made.

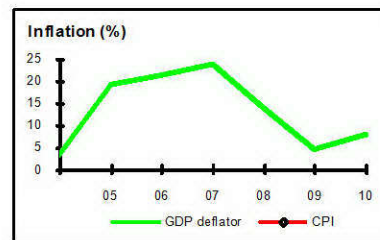
82. **Finally, there remain risks of government overreach in the reform agenda in the context of limited capacity, leading to a suboptimal reform program or economic mismanagement.** In recent months, new institutional mechanisms for planning and budgeting have been put in place and are evolving, alongside a new exchange rate regime, new tax rates, new banking regulations, and new foreign investment laws. The agenda is thus massive, and capacity limited, making the system vulnerable to internal and external shocks, including the possible resumption of rapid inflation, sudden exchange rate volatility, or another financial crisis. Given the limited monitoring and implementation capacity to maintain macro-economic stability or respond to shocks, it will be important to work with government to quickly develop an understanding of the macroeconomic and financial sectors and assist the government in building stronger monitoring, policy and crisis response capacities.

Annex 1: Myanmar at a Glance



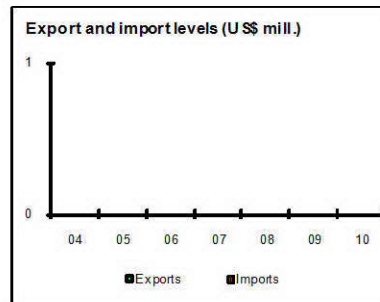
PRICES and GOVERNMENT FINANCE

	1990	2000	2009	2010
Domestic prices				
(% change)				
Consumer prices	17.6	15.6	..	..
Implicit GDP deflator	18.5	2.5	4.9	8.2
Government finance				
(% of GDP, includes current grants)				
Current revenue	25.5	..	..	..
Current budget balance	0.0	..	..	..
Overall surplus/deficit	0.0	..	..	..



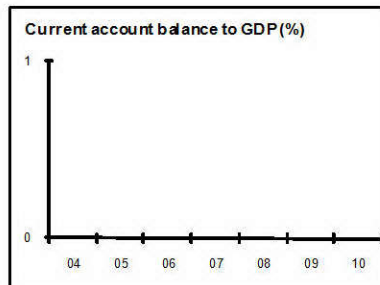
TRADE

	1990	2000	2009	2010
(US\$ millions)				
Total exports (fob)	897	..	..	..
Timber	184	..	..	..
Rice	77	..	..	..
Manufactures	..	..	..	..
Total imports (cif)	1832	..	..	..
Food	..	..	..	..
Fuel and energy	5	..	..	..
Capital goods	..	..	..	..
Export price index (2000=100)	..	..	..	..
Import price index (2000=100)	..	..	..	..
Terms of trade (2000=100)	..	..	..	..



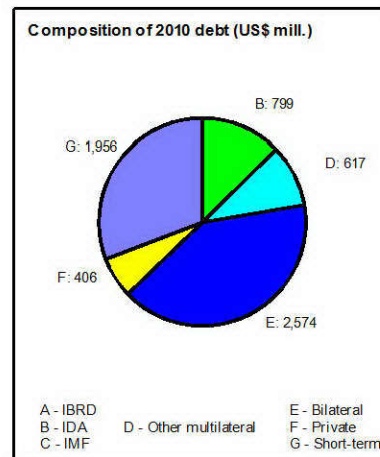
BALANCE of PAYMENTS

	1990	2000	2009	2010
(US\$ millions)				
Exports of goods and services	1279	..	..	..
Imports of goods and services	2,103	..	..	..
Resource balance	-824	..	..	..
Net income	-52	..	..	..
Net current transfers	..	..	..	..
Current account balance	-416	..	..	..
Financing items (net)	371	..	..	..
Changes in net reserves	45	..	..	..
Memo:				
Reserves including gold (US\$ millions)	..	269	..	..
Conversion rate (DEC, local/US\$)	..	..	..	..



EXTERNAL DEBT and RESOURCE FLOWS

	1990	2000	2009	2010
(US\$ millions)				
Total debt outstanding and disbursed	4,695	5,975	8,186	6,352
IBRD	0	0	0	0
IDA	716	684	777	799
Total debt service	60	36	29	687
IBRD	0	0	0	0
IDA	9	0	0	0
Composition of net resource flows				
Official grants	37	45	322	339
Official creditors	86	10	-9	-104
Private creditors	-8	-17	0	-546
Foreign direct investment (net inflows)	163	258	323	756
Portfolio equity (net inflows)	0	0	0	0
World Bank program				
Commitments	0	0	0	0
Disbursements	57	0	0	0
Principal repayments	3	0	0	0
Net flows	53	0	0	0
Interest payments	5	0	0	0
Net transfers	48	0	0	0



Note: This table was produced from the Development Economics LDB database.

3/29/12

Annex 2: Myanmar Indicative Activities FY13-14

Thematic Area	Activity	Instrument and funding	Time Frame
Pillar 1: Transforming Institutions			
Analytical and diagnostic work	Public Expenditure and Financial Accountability Assessment (PEFA)		Ongoing until mid-FY13
	Public Expenditure Review (PER)		First phase completed by early FY14
	Investment Climate Assessment (ICA)		FY13 through FY14
	Financial sector master plan, legal reform, and supervision strengthening		FY13 through FY14
	Knowledge support on economic transition		Mid FY13 through FY14
Operations and lending	Possible PFM and/or financial sector support project	tbd (IDA)	FY14
	IFC support for microfinance	tbd	tbd
Pillar 2: Building Confidence			
Analytical and diagnostic work	Agricultural productivity policy work		Late FY14
	Policy advice for ICT reform		Mid-FY13
Operations and lending	National CDD project	\$80m (IDA pre-arrears clearance grant)	Mid-FY13
	Support to peace process (CDD support to communities, M&E system)	\$7m (tbd; trust fund)	Late FY13
	Support to civil society to promote social accountability	\$tbd (trust fund)	Late FY13
	Possible emergency power rehabilitation project	tbd (IDA)	FY14
Pillar 3: Preparing for the Road Ahead			
Analytical and diagnostic work	Household survey		Late FY13
	Gender assessment and policy notes		Mid-FY13 through FY14
	Qualitative M&E services for livelihoods trust fund		Ongoing through mid-FY15
Operations and lending	Development policy operation	\$410m (IDA)	Mid-FY13

Annex 3: Development Coordination Matrix (preliminary, as of September 2012)⁵

Sectors	International Financial Institutions	Multilateral Institutions and UN System	Bilateral Donors	
Agriculture, livelihoods and community driven development <i>A Livelihood and Food Security Trust (LIFT) has been the main vehicle for development partner coordination</i>	ADB WB	FAO, UNDP, UNODC, WFP	LIFT donors AusAID European Union Netherlands Sweden UK (DFID) Other donors Japan (JICA) Norway Israel	Denmark France (AFD) New Zealand Switzerland USAID Korea (KOICA) Germany Italy
Health <i>A 3-Disease fund and its successor 3 MDG, as well as the Myanmar Country Coordination Mechanism (CCM) have been the main vehicle for development partner coordination</i>	WB	Global Fund UNOPS, WHO, UNICEF, UNAIDS, UNFPA	3 MDG donors AusAID European Union Norway UK (DFID) Other donors France (AFD) Korea (KOICA) Germany Switzerland (SDC)	Denmark Netherlands Sweden Japan (JICA) USAID Israel
Education <i>A Multi Donor Trust Fund (MDEF) and an Education Sector review (underway) have been the main vehicle for development partner coordination</i>	ADB WB	UNICEF, UNESCO	MDEF donors: AusAID European Union Other donors Germany (GIZ) Korea (KOICA) France	Denmark UK (DFID) Japan (JICA) Norway Israel
Public sector management	ADB IMF WB		AusAID	UK (DFID)
Trade and regional integration	ADB WB		AusAID	
Transport	ADB		Japan (JICA)	Korea (KOICA)
Energy	ADB WB		Japan	
ICT	WB		Korea	
Environment and disaster risk reduction	ADB	UNDP UNHabitat OCHA	Germany European Union	Japan Korea
Financial and private sector development, including microfinance	ADB IMF WB IFC	UNCDF, UNDP-PACT	Germany (GIZ) AusAID Thailand Singapore LIFT (see above)	UK (DFID) JICA Malaysia
Support to peace process <i>The Myanmar Peace Support initiative (MPSI) has been the main vehicle for development partner coordination</i>	WB	UN	Norway (Lead donor) AusAID Denmark Japan Switzerland USAID	Canada European Union Sweden UK (DFID)

⁵ Given the dynamic development assistance landscape in Myanmar, information in this matrix – which is based on inputs compiled from publicly available information and information provided by donors, and covers only a selection of key sectors – is likely to continue to change. A more in-depth description of development partner support to Myanmar is available via the Partnership Group for Aid Effectiveness, a secretariat for a group of donors in Myanmar.

Annex 4: Summary of Consultations

Given that this ISN marks the formal reengagement of the World Bank after an absence spanning more than two decades, the themes and messages of the ISN have been the subject of wide-ranging consultations with a broad group of stakeholders. This included discussions with government (both bilaterally with line ministries, as well as with the Foreign Aid Management Working Committee and the President's National Economic and Social Advisory Council), as well as a series of consultations with a broad range of stakeholders inside and outside Myanmar. Between June and September, consultations took place in Yangon with domestic civil society, local and international NGOs operating in Myanmar, development partners, the UN Country Team in Myanmar, and representatives of the Myanmar private sector. In addition, consultations with advocacy and civil society groups based outside of Myanmar took place in September in both Chiang Mai, Thailand and Washington DC. Written comments were received by Human Rights Watch, the Bank Information Center, and the Conflict Risk Network, in addition to an open letter to the World Bank Board of Directors concerning the ISN signed by a group of civil society organizations working on Myanmar. Finally, to extend our outreach and promote public understanding of the WBG's activities, a two-page summary of the draft ISN was posted on the World Bank's website in both English and Myanmar language.

Key themes emerging from the consultations included:

- **Broad support for the Bank's re-engagement and the analysis presented and program proposed in the ISN**, including on the triple transition, three pillars of engagement, and country risks.
- **An emphasis on the need to address capacity constraints at all levels and across sectors**, with many consultations highlighting this as potentially the binding constraint in successfully implementing the government's reform program.
- **Keen interest and many questions about how the World Bank Group works**, in part as a function of the WBG's extended absence from the country, including on financing, knowledge transfer, project design and implementation support, safeguards, procurement and financial management standards.
- **Diverse views on priority engagement areas**. While stakeholders welcomed the proposed areas of engagement, some urged us to consider increased involvement in key sectors, including health, education, agriculture, and infrastructure and public sector governance.
- **An emphasis on the need to support government not only in implementation of reforms, but also in prioritization and design**.
- **Some concerns, particularly by human rights groups, about providing too much support to government given the incomplete nature of the transitions underway**. While stakeholders broadly welcomed the WBG's re-engagement, some raised concerns about providing too much support to government, and suggested the need to continue to press for governance reforms and remain alert to ongoing concerns, including on conflict, governance and human rights.

We believe that the proposed program is fully responsive to these concerns. At the same time, the consultations raised issues that will be important to continue to address during the ISN implementation period, and we plan to continue consulting with stakeholders regularly over the next 18 months to ensure that our engagement benefits from as wide a range of views as possible.

