Inclusive Growth Diagnostic – Myanmar

Produced by the Department for International Development (DFID)

Myanmar Country Office

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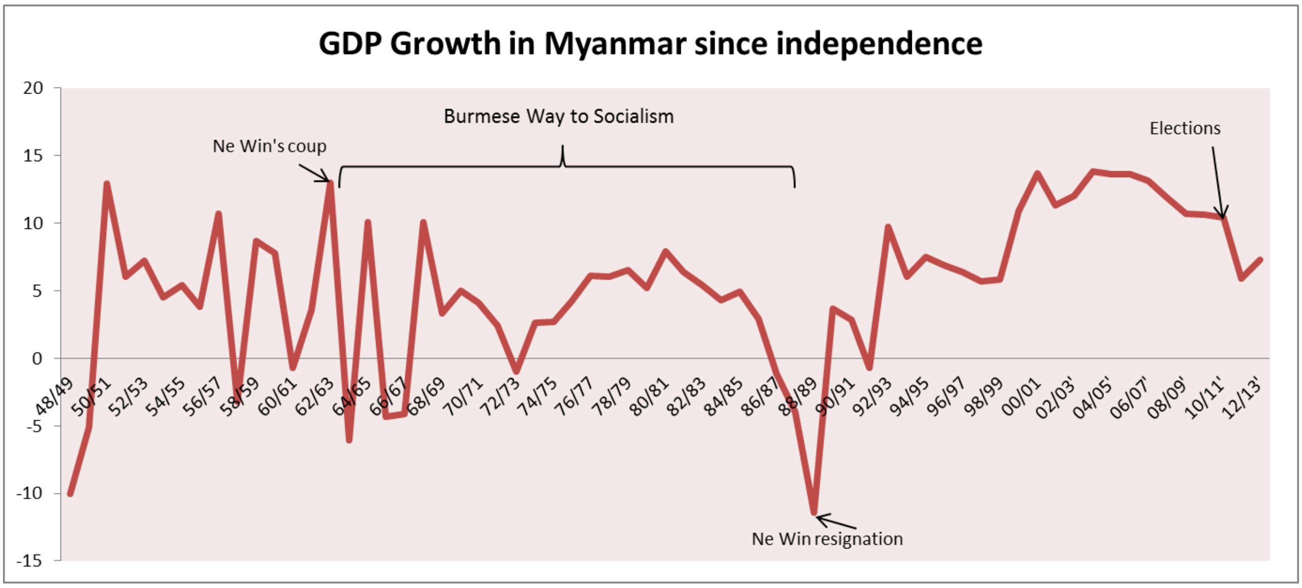
Setting the Context:

1. **Myanmar should be rich. Its abundant natural resources and its strategic location mean that it is ideally suited to access the region's economic giants.** Forty percent of the world's population live in countries that border Myanmar.[i] Myanmar's opening up in the last few years has the potential to link it to the vast economies of India, China and South-East Asia. If this is well managed, Myanmar could become an important player in regional trade and become more integrated into Asia's growing manufacturing value chains.

2. **But Myanmar is poor - one of the poorest countries in Southeast Asia – largely due to decades of economic mismanagement, conflict and international isolation under military dictatorship**. It has a population and landmass close to that of Spain, but an economy 4% of the size, closer in size to Luxembourg's. Contrast that with the early 20th Century when Myanmar's income per head was larger than that of China or South Korea. Following independence from British control in 1948, Myanmar went down a path of civil war, military dictatorship and state dominance of the economy. The economic and political institutions that were created as Myanmar experimented with socialism were over time captured by a narrow elite – the military generals and their "cronies" – with little interest in the welfare of the populace. Over the years, Myanmar's population has become deskilled and less educated compared with its neighbours, and some of the former key sectors, like agriculture, are now mostly unable to compete with its neighbours. The borders that it shares with the regional economic giants are often mired in conflict or hard to access due to difficult geography. The result is that today 37% of people live in poverty;[1] its Human Development Index ranking is 150/186; infant mortality is 44.8 per 1,000 live births; 35% of children are stunted; and many adults are under-employed. Over one million people have been displaced by conflict, inter-communal violence and the abuse of human rights.

Figure 1: GDP Growth in Myanmar since independence[ii]



3. **In 2011, Myanmar's Government initiated a reform process that offers the first real hope for peace and prosperity in 60 years.** On the back of an election (neither free nor fair) a new quasi-civilian government came in to power in 2011. Although this returned many former generals to senior government positions, Government launched its ambitious political and economic reforms. Among them, a commitment to free and fair elections in 2015, free press, exchange rate unification, the signing of a national ceasefire agreement and a commitment to free trade.

[1] UNDP, in the original Integrated Household Living Standards Survey (2010) estimated the poverty rate to be 26%, whereas a World Bank study, which revisited the data in 2014, put the poverty rate at 37%. The Government still uses the figure of 26%.

4. **The trajectory of reform is not clear-cut. There are major challenges and even reverses in some reform areas.** There is a concerning situation for the Rohingya in Rakhine, many of whom remain in internally displaced camps and/or subject to discriminatory policies and an erosion of citizenship rights. There has been a sharp rise in armed conflict in some of the 'ethnic' areas despite the signing of a national ceasefire agreement. An escalation in protests around new laws in education and the intrusive religious protection bills[2] has seen an increase in the jailing of protestors and journalists. And while Government has maintained its commitment to free and fair elections for end 2015, these themselves may add more uncertainty to the future of the reform process.

5. **Even within the uncertain political, economic and social context, Burma is likely to grow overall.** The rate of economic growth is encouraging, estimated to have risen above 8% in 13/14 and 14/15, largely due to natural gas exports and extractives.[iii] Per capita GDP is expected to go above $1,200 this year.[3] Credible sources predict that Myanmar could see its economy triple or quadruple in size over the next decade – with the right policy choices.[4]

6. **It is less certain what the pace, sustainability and inclusiveness of this growth will be.** For example, the accentuation of an enclave economy with a high growth centre in Mandalay, Naypyitaw and Yangon surrounded by a low growth periphery is a real possibility. The average person in the ethnic States has been largely excluded from Myanmar's growth to date, despite these regions possessing much of the mineral and natural wealth. In addition there are signs that Myanmar's economy may be overheating and is becoming increasingly vulnerable to macroeconomic imbalances.[5]

7. **Reform is possible but it will take time, and setbacks should be expected.** Within this context, DFID needs to embrace and respond to the significant challenges ahead now. The reform process still constitutes the best possible chance the country has ever had to reduce poverty. Long-term sustainable change will take decades but real improvements will be possible in the interim. Engaging now while the political window is open with grant financing and technical expertise behind a country led framework will help shape both the long-term change and encourage the best possible outcomes for the poor along the way.

Structure

8. This paper sets out the most important constraints to inclusive economic growth in Myanmar. It builds on DFID Burma's Country Poverty Reduction Diagnostic (CPRD) which identified the opportunity to use aid in a transformational way to support reformers for poverty reduction.[6]

9. A major challenge for this exercise is the quality of data. Much of the economic data is outdated and comes from 2001-2010, a period of time renowned for data inaccuracies and inflated figures.[iv] Other socio-economic data is equally weak and we know little about the remote parts of the country or the parts of the country under the control of ethnic armed groups. These factors make it hard to precisely determine what the most binding constraints to inclusive growth are or how to prioritise the ones we have identified. This should be at the forefront of people's minds when considering the conclusions this exercise draws.

10. Section 1 takes a look at the causes behind current growth patterns while Section 2 looks to the sectoral opportunities for inclusive growth, taking particular note of agriculture and the opportunity presented to Burma from being in the region it is. Sections 3 and 4 review the technical, political and institutional constraints to inclusive growth, and section 5 concentrates on the rationale of the DFID portfolio – now and our future direction.

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[2] Some of the new religious protection bills grant the State the right to regulate the right of women to have children, and with whom, and what their religion will be.

[3] This partly increased from previous estimates due to lower than expected population figures from the recent census

[4] This would be consistent with current growth rates of 7-8%.

[5] See IMF Article IV for a fuller discussion of these issues

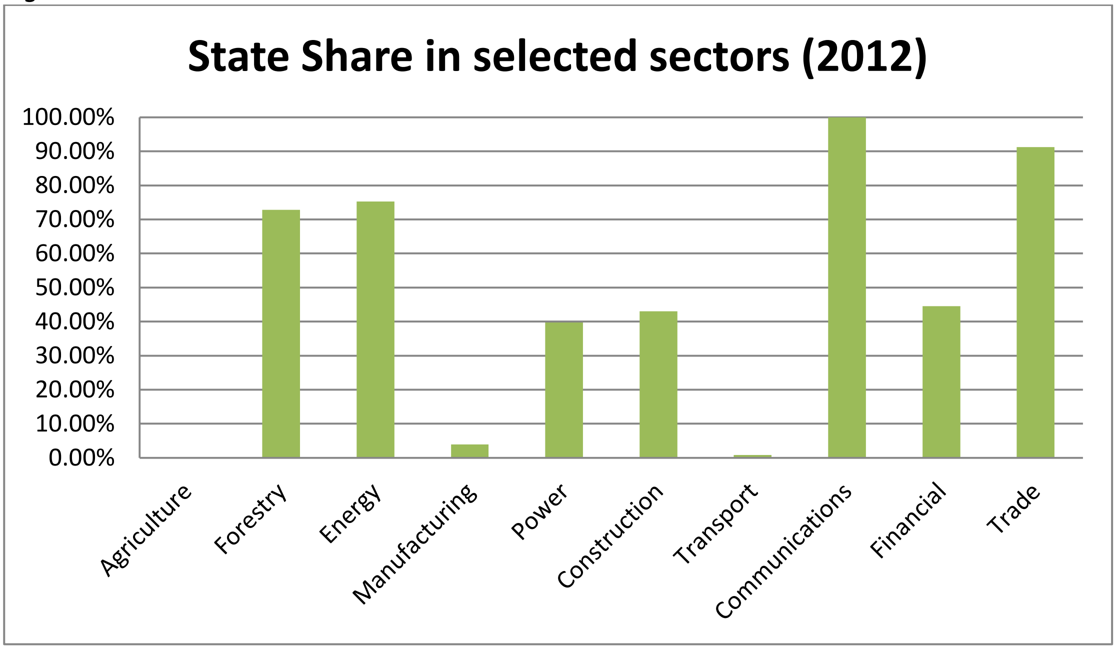
[6] This study is more narrowly focused than the CPRD, focusing on inclusive economic growth. It does not consider in detail other important issues linked to poverty reduction in Myanmar such as humanitarian assistance, conflict resolution and basic service delivery which remain DFID priorities.

Section 1: What has driven Myanmar's currently observed pattern of growth?

11. **Myanmar's past economic mismanagement forms the foundation for the pattern of growth we observe today**. Before July 2013, the Central Bank's only role was to print money to finance public spending. Exchange rate policy was characterised by the military regime's abuse of the discrepancies between the multiple exchange rates. The budget, with 44% of revenues off-budget[v], was an exercise in fiction. Trade was overregulated, corrupt and damaged by sanctions. It was only revenues from Myanmar's rich natural gas sector that enabled it to avoid complete economic ruin. Direct state involvement in the economy suppressed competition, stifled innovation, increased corruption and led to opaque rules and regulations. The result is a business environment characterised by pervasive risk and uncertainty, low levels of investment, low productivity and minimal diversification.

12. **This has left an economy dominated by state economic enterprises (SEEs), cronies and a large informal and often illegal sector.** The exact size of the SEE sector is not known, by donors or the Ministry of Finance. Best estimates suggest the 42 SEEs now account for between 7% and 15% of GDP[7] [vi] and two thirds of all public sector revenues.[vii] Most of the state's economic development expenditure (about 9% of GDP), which should be providing the public goods designed to create a competitive economic environment, actually goes through SEEs.[viii] The SEEs have enjoyed generous subsidies[8] and dominate some major sectors such as energy (see figure 2) though their dominance overall has been falling following liberalisations and as other sectors have taken off. We know less about military-owned enterprises but we know they have major economic interests in sectors such as mining, alcohol, cigarettes and transport. The cronies have used their close ties with the military and government to access natural resources, import licences and monopolies. This group is well placed to take advantage of Myanmar's opening up because of the assets they own and the capital at their disposal. Myanmar is the second largest poppy-producing country in the world, and has significant production of methamphetamine and other synthetic narcotics, many leaving through the notorious Golden Triangle. Most people have been excluded from participating in the economy and many small and medium sized enterprises (SMEs) keep themselves small enough to stay under the radar.

Figure 2 State Share in selected sectors[ix]



[7] This is down from about 31% in the late 1980's

[8] The rules for SEEs on receiving subsidies have changed. Profitable SEEs no longer receive direct state subsidies to finance operational expenses or capital expenses, though unprofitable SEEs can still receive such support. It is possible that SEEs receive indirect subsidies through other means such as better prices for goods and services procured from other SEEs or possibly favourable treatment in the acquisition of licences or fixed assets. We do not know enough about SEEs to conclude definitively.

13. **The extractives sector has dominated economic growth**. These sectors, in particular gas, have boomed and dominate exports. They have enjoyed the lion's share of Foreign Direct Investment (FDI) alongside energy (between 83% and 98%) in recent years.[x] Poor government policy has left the agricultural sector with productivity levels at around 50% of the rest of South-East Asia. The garments sector enjoyed a boom in the late 1990's and early 2000's but it lost its major export market (the US) with the onset of sanctions. The latest available figures[9] (2012) put agriculture, livestock and fisheries at 31% of GDP, Industry at 29% and services at 41%.[xi] Other estimates put agriculture's share as high as 40%. Industry and services are growing above 7% whilst agriculture is growing at 4.5% (see figure3).[xii] Official GDP statistics suggest that the service sector is now the lead driver of growth. Figure 4 shows that its contribution to GDP growth rose from 3.4% in 2011/12 to 4.2% in 2014/15. Part of this is due to strong communications growth following telecoms liberalisation and growth in the transportation sector off the back of rising imports and exports. But it may also reflect spill-overs from growth in the illicit and unreported sectors of the economy (such as illicit jade production) into the licit sector.

Figure 3: Sector Shares in Myanmar[xiii]

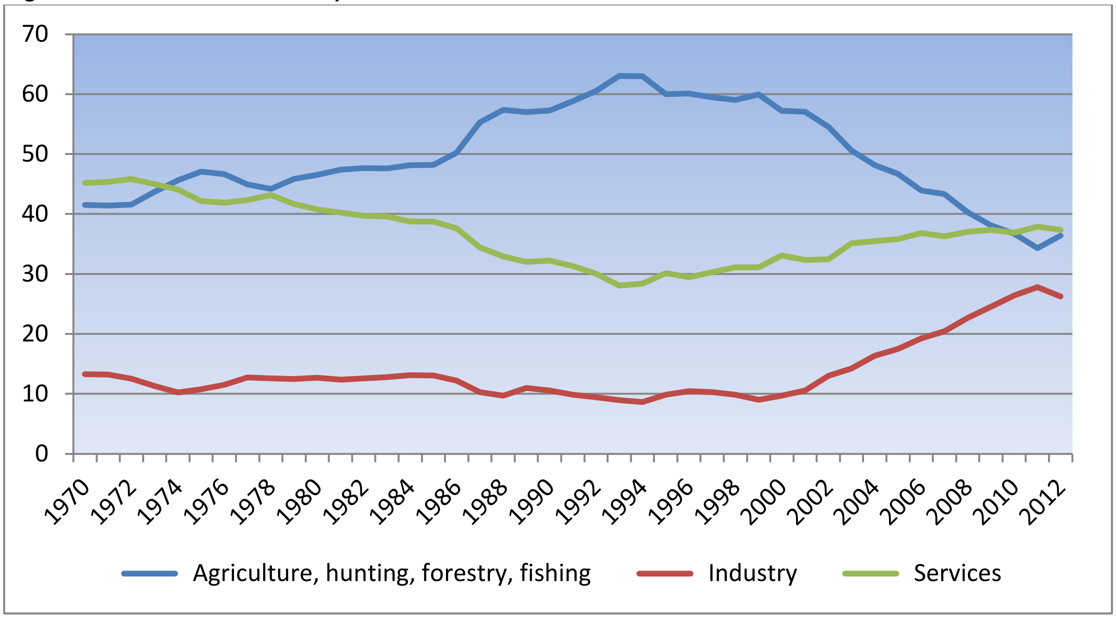


Figure 4: Sector Contribution to Real GDP Growth[xiv]

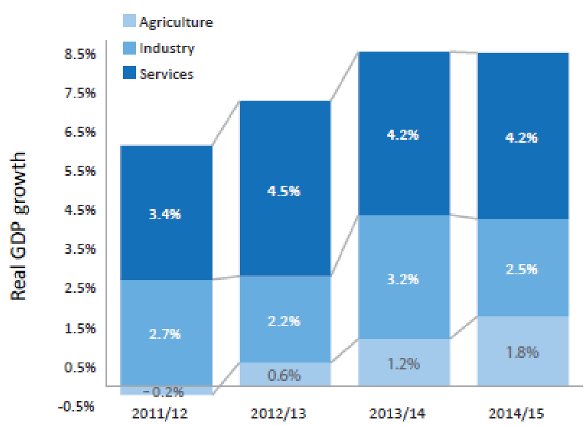
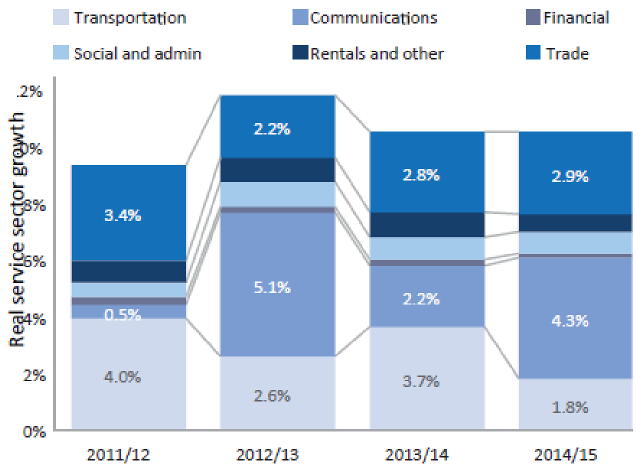


Figure 5: Contribution to Service Sector Growth (%)



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[9] There are major question marks over the accuracy of some of these figures, particularly as the 2012 figures reflect a major increase of the manufacturing sector as a share of GDP from 10% of the economy in 2003 to 17% in 2009 which appears unlikely.

14. **Significant economic reforms have been initiated since 2011 although much of this has been undoing past policies**. Myanmar's multiple exchange rates have been unified; its Central Bank is independent; it has normalised its relationship with all creditors; most sanctions have been lifted; public sector revenues doubled from 11/12-13/14[xv] along with improving revenue transparency; a number of reforms have aimed to attract private investment – in 2014/15 a staggering 45 reforms were made to regulation around starting a business[xvi]; some of the most distortionary economic privileges (such as restrictive export and import licenses and tax exemptions for SEEs) have been removed; some of the state monopolies have been dismantled; and it is set to join the Association of South East Asian Nations (ASEAN) Free Trade Area.

15. **Myanmar's macroeconomic indicators have generally been solid in the past few years though risks have risen considerably in the past 12 months and this will pose challenges in the near future.** Inflation was around 6% in 13/14 but is expected to rise above 7% this year and accelerate further to double digits next year.[xvii][xviii] The exchange rate has weakened in recent months; worryingly its reserves are below 3 months of imports; it is at low risk of debt distress[10] [xix] though its full liabilities are unclear; and its underlying fiscal deficit (once one-off payments are taken out) is over 5% of GDP this year and falling gas prices and weaker SEE performance will continue to increase fiscal pressures.[xx] The continued financing of part of this deficit by the Central Bank contributes to the inflationary pressures mentioned above. The current account deficit widened to over 6% of GDP reflecting a rising trade deficit and mainly financed by FDI, new loans and a one-off mobile phone licence payment.[xxi] Aid flows are increasing but are still relatively small.[11] Portfolio flows are non-existent. Estimates suggest that remittances are in the billions but are not well captured by official data.[12] Although investments have reached regional averages, Myanmar still suffers from decades of underinvestment.[xxii]

16. **Myanmar has historically underperformed on trade.** Sanctions contributed to Myanmar's trade being focused almost entirely (90%) in the immediate sub-region with Thailand, China and India its main partners (see figure 4). It is one of the least open countries in the world[xxiii] and trade makes up 55% of GDP[xxiv] which compares poorly to the LDC average of 64.4% and to its neighbour Thailand (150%). Natural resources, particularly gas, dominate its exports (see figure 5). In spite of its advantageous location, Myanmar is not yet well-placed to take advantage or to compete against other ASEAN countries, three of which place in the top 26 of the Doing Business rankings.[13] The former government's trade policy was not progressive: until recently it placed tariffs on exports and enabled the military to monopolise the acquisition of trade licences.

[10] Total public debt is 32% of GDP and external debt is 14% of GDP

[11] Total ODA disbursements to Myanmar increased from $504 million in 2012 to $3935 million in 2013. This represents an increase of 681% but this was largely due to debt write-offs (e.g. Japan on its own wrote off $3110m). 2013 is the latest year for which we have figures. See OECD database.

[12] 82% of the remittances surveyed by the International Organisation for Migration flowed through informal channels

[13] Singapore (1st), Malaysia (18th) and Thailand (26th)

Figure 6: Make-up of export destinations in 2012 (first chart) and 2002 (second chart)[xxv]

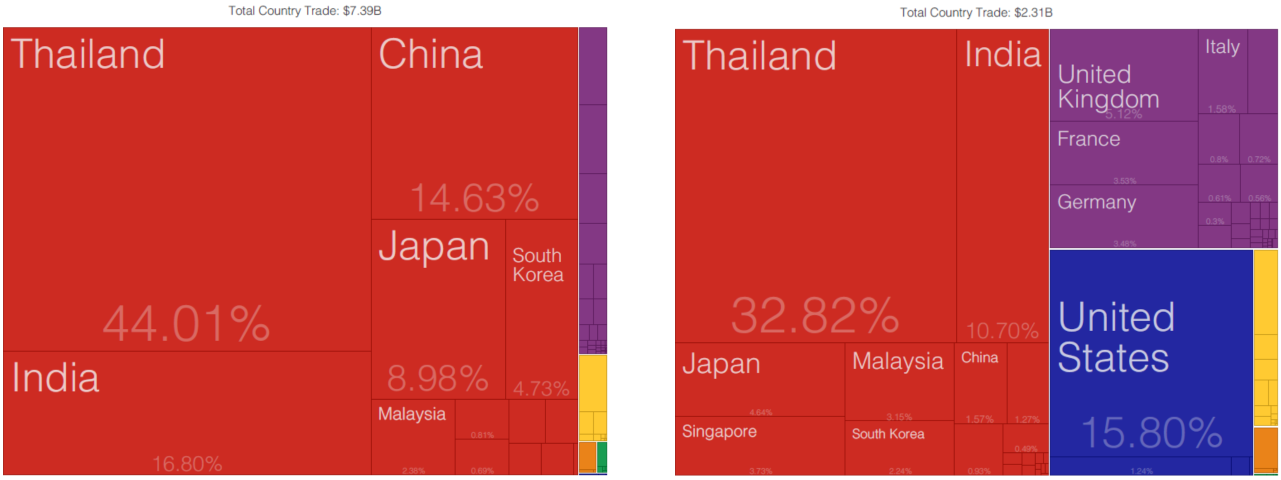
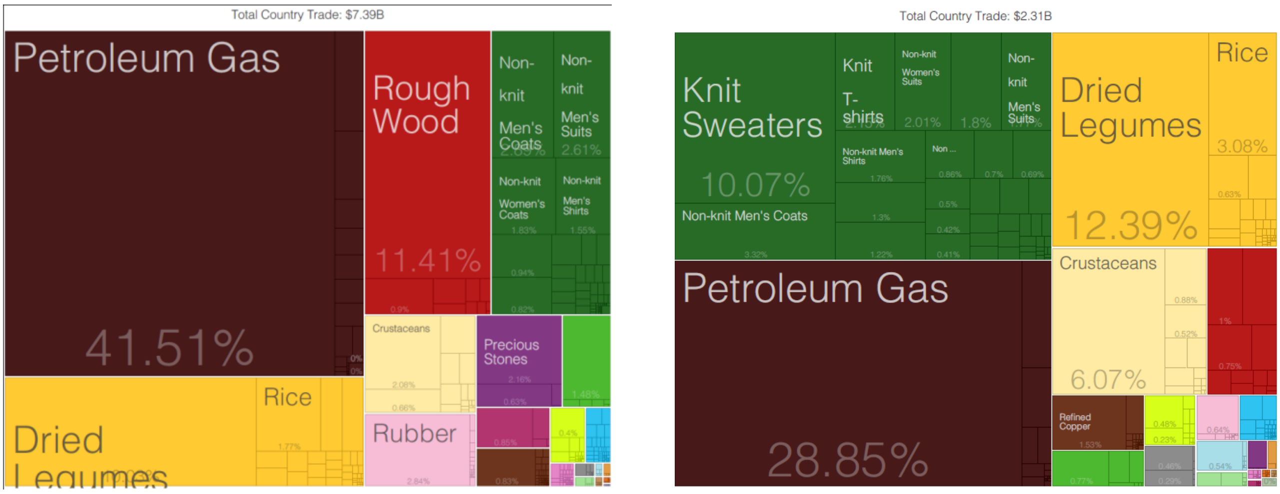


Figure 7: Make-up of exports in 2012 (first chart - total $7.4bn) and 2002 (second chart - total $2.3bn)[xxvi]



17. **Myanmar has a large young population.** Burma's population is 51.4 million.[14] The labour force is 31 million and 40% of the working age population is under the age of 30.[xxvii] It has 80% labour market participation, the second highest in Asia after Cambodia.[xxviii] Despite these favourable demographics, 74% of employment is informal and, whilst unemployment at 2.5% is low, underemployment at 38% is high.[xxix] Officially 1.5 million people have emigrated for work, but some reports put this at 4.7 million (almost 10% of the population).[xxx] Internal migration is even more important. Just over 50% of the workforce is in agriculture, 36% in services and 12% in industry. Wages in Myanmar are amongst the lowest in the region.[xxxi] The introduction of a minimum wage recently will have consequences which are as yet uncertain.

18. **Recent growth is above 8% and is expected to stay there in the near future.** This has been driven by its expanding gas sector and other natural resources such as gems and jade. Construction and real estate are also booming, fuelled by foreign currency from natural resources and from illegal trade in border regions. This growth is unlikely to have been inclusive particularly in the absence of strong public expenditure. Rising FDI approvals into the labour-intensive manufacturing sector suggest this sector could drive future growth and inclusion.

[14] Before the 2014 census population data was widely disputed and estimates ranged from 45 million to 65 million people.

19. **At 37%, poverty is high with major differences between groups and regions.**[xxxii] There is also a large group of people living just above the poverty line suggesting a high vulnerability to shocks. Myanmar has 7 regions and 7 states, more than 135 officially recognised ethnic groups and 108 linguistic groups.[15] Myanmar's Gini Coefficient is 30% (2010) though data is weak. This is relatively high but lower than Vietnam (35%) and China (40%).[xxxiii] There is considerable inter-regional inequality. Parts of the country are extremely poor such as Rakhine and Chin, with poverty rates above 70%.[xxxiv] These drastic differences can only partly be explained by their remoteness. The World Bank characterises poverty in three groups.[xxxv] The first group is the traditional poor largely concentrated in rural areas and highly dependent on subsistence agriculture for their livelihoods. The second group is the transitional poor based in urban or peri-urban areas who have moved away from traditional rural livelihoods but are now working as low-skilled casual labourers. The final group is the excluded who cannot access opportunities for other reasons such as their ethnicity, their geography or their sex – in some cases the government has systematically excluded specific groups from participating in the economy, most notably the Rohingya population in Rakhine State but also other ethnic groups and many Bamar people. Conflict is also a major driver and the regions affected by conflict have higher poverty rates than those unaffected – 40% compared to 22%.[16] [xxxvi]

20. **Women are underrepresented and disadvantaged throughout the economy.** Women occupy 6% of parliamentary seats, much lower than regional levels of 15%.[xxxvii] Although women make up roughly 50% of employment in state administrative organisations, they only make up 20-30% of leadership positions.[xxxviii] They make up more than 60% of employees in large firms, however less than 30% of owners or managers – only Bangladesh and Sri Lanka have lower proportions in the region.[xxxix] While women achieve higher levels of education than men when they have access to formal education, they find it harder to enter the labour market.[xl] They are often paid less than men.[17] [xli] Gendered norms direct women to fulfil traditional expectations which limit their opportunities for participation in economic and public life. Other barriers include: a lack of formal education; a perceived lack of skills/abilities; a lack of time/money; the reluctance of husband/family; non-acceptance by the community; and security.[xlii] Women are generally disadvantaged in rural areas and, especially when separated or divorced, are often excluded from village social life and decision-making.[xliii] It is mainly men who move in search of work, but poor and landless women also migrate for work, often taking their children with them and often more vulnerable to exploitation.

21. **Myanmar is one of the ten most vulnerable countries to climate change.**[18] [xliv] It is threatened by sea level rises [19] in its coastal and delta areas and by drought in its dry zone. Climate change will reduce agricultural productivity in the absence of a concerted adapted response. Vulnerability to climate change is compounded by low resilience and weak institutions. People in the coastal zone are directly at risk from physical impacts, but also to economic impacts through damage to agriculture and fisheries. The highly productive delta and low-lying coastal areas will not only be exposed to increased temperatures, erratic rainfall, droughts and floods, but also to increased salinity, coastal erosion, and inundation. Without an appropriate response, crop yields are likely to fall, and crop failures due to extreme weather likely to increase; land losses due to sea level rise will cause displacement; and pests and opportunistic species will thrive.[20] [xlv]

[15] It is divided into 64 districts, 324 townships and 65,148 villages.

[16] This is based on a comparison between the coastal and hilly regions (40%) and the dry and delta zones (22%)

[17] QSEM3 documents differences between men and women's wages (Ky 2,000 vs Ky 1,500) but QSEM4 suggests there is little difference between wage rates for the same tasks. Another study suggests that women receive 61% of the amount received by men for the same work.

[18] Yangon has been rated as the fourth most vulnerable city in the world.

[19] One estimate suggests that those at risk from sea level rise (measured as the probability that an individual resides in a zone threatened by storm surges) will increase from 2.8 million to 4.6 million in Myanmar by 2050

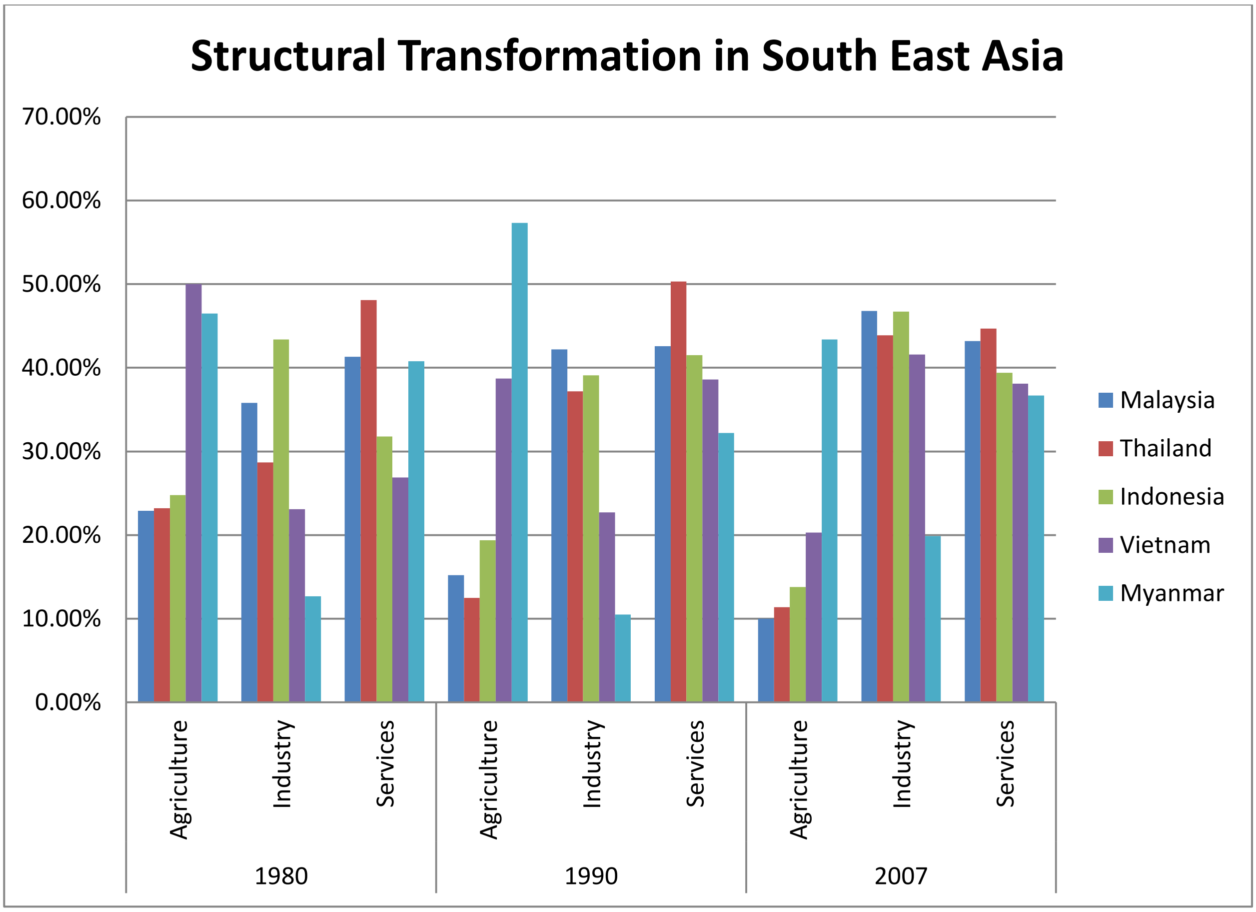
[20] Estimates for loss of agricultural productivity in Southern Asia suggest rice yields will be reduced by 14% and wheat by 46% with potential increases in child malnutrition of 14% in 2050.

Section 2: Sectoral Opportunities for Inclusive and Transformational Growth:

How will Myanmar grow?

22. **The sectoral re-allocation of labour away from agriculture and into more productive sectors is a feature of the high growth economies of Southeast Asia.** This is manifested in agriculture's share of GDP declining towards 10% compared with industry and services contributions growing to around 40% (see figure 6).[xlvi] Vietnam is a good example: Its share of agriculture in GDP fell from 50% to 20%. This reallocation of labour away from agriculture is thought to have contributed to around a third of Vietnam's overall productivity growth between 1990 and 2008. This doesn't mean forgetting about agriculture – productivity in the agricultural sector in Vietnam grew by 3.5% annually over the same period, thus contributing to, but not being the major driver of economic growth.[xlvii] The movement of labour away from agriculture drives growth because productivity is higher in other sectors. For example, in 2008, Malaysia's non-agricultural output per worker was 26 times that of its agricultural sector, Thailand's 13 times, and the Philippines' 3 times. [xlviii]

Figure 8: Structural Transformation in South East Asia[xlix]



23. **In order to achieve sustained high growth, Myanmar needs to create the conditions that attract labour and resources into more productive sectors as well as raising productivity in agriculture.** In Myanmar agriculture still accounts for 30-40% of GDP with productivity well below that of industry and services. An increase in productivity across all sectors, and a concomitant reallocation of labour and capital into higher productivity sectors is a prerequisite for growth. There has been no discernible trend toward this[l] though there are hints at a (slow) transformation underway post-2011. Even without this inter-sectoral reallocation of labour and capital, Myanmar can still maintain high growth rates primarily from the gas sector and extractives. There is a risk that such growth would mask the lack of reform in other parts of the economy.

Major sectors:

24. **Agriculture is a major sector for Myanmar's economy but productivity is low**, contributing 15% of Myanmar's export earnings, and employing 50-65% of the labour force. Rice is the staple crop and a significant export commodity. Like most crops, productivity is well below regional averages. Some sectors such as beans and pulses (making up 12% of exports)[li] have managed to thrive away from government interference. Agriculture is mostly dominated by small-holders and landless seasonal agricultural labourers (50% of the rural population is landless) and is characterised by low quality inputs (and outputs). Productivity throughout the sector is seriously constrained by the minimal provision of public goods, such as extension, training, education and technology transfer.[21] [lii] Lack of affordable credit has left farmers and those in the wider rural economy undercapitalised and unable to invest or in debt-traps.

25. **Agriculture is the most important sector for poverty reduction** because it provides the majority of livelihoods in Myanmar. The rural share of poverty is around 82%.[liii] One in four people in rural areas cannot get enough to eat and one in three children are stunted.

26. **Myanmar's agriculture has high potential if it gets the right investment and technical know-how.** Estimates point to a further 5.7 million hectares of cultivatable land, and abundant fresh water resources (more than twice that available to Bangladesh, Vietnam and Thailand).[liv] It has relatively low utilisation rates of chemical inputs – a good basis for a sustainable agricultural sector.[lv] With strong commercialisation, better business services and more integrated supply chains, there is a real opportunity for farmers to start climbing the value ladder from the current mix of low quality products (dominated by low quality rice) to higher quality rice, fish, vegetables, fruits, livestock and other products that may create more employment and higher value per hectare.

27. **Myanmar has abundant extractive natural resources.** It ranks 41st in the world for proven reserves of natural gas and 78th for proven reserves of crude oil. However it is relatively unexplored and new discoveries are anticipated. Gas accounts for 40% of exports.[lvi] Myanmar is rich in jade, rubies, sapphires and limestone; copper, lead, zinc, tungsten, gold, coal and barite and fairly rich in antimony, silver, nickel, gypsum, iron and manganese.[lvii] It accounts for over 90% of the global rubies trade and is the largest source of jade. Gas, wood, gems, jade and minerals, make up 60% of formally recorded exports (around 10% of GDP). Informally, the jade sector alone is thought to make up 16% of GDP (2011) and credible analysts suggest this could much higher again, almost as much as half of GDP.[lviii]

28. **Extractives, in particular mining, have been a major driver of conflict in the ethnic areas** because of a lack of formal revenue sharing agreements with the central government. Furthermore, social and environmental safeguards are unclear and largely unimplemented.

29. **The formal extractives sector is dominated by large SEEs in oil, gas and timber and military SEEs in mining** and was characterised by corruption, especially in the pre-2011 period when the multiple exchange rate system allowed the syphoning off of much of these revenues from the budget. It is still characterised by large illicit and underreported production and corruption, particularly in the extremely opaque mining sector. This combined with little public expenditure deriving from extractives, and poor service delivery, means that very few people have benefited from Myanmar's natural wealth. Today the sector remains opaque. Myanmar ranks the lowest in terms of resource governance of the 58 natural resource rich countries surveyed by Revenue Watch Institute in 2014.

30. **There is cause for some optimism in the extractive sector but vested interests make deep reform difficult.** More (but far from all) of the revenues from the gas sector, contributed largely by the SEE Myanmar Oil and Gas Enterprise (MOGE), have been brought on-budget[22]. The tenders in oil and gas have also brought in a strong list of international companies that should improve governance in the sector. The government is committed to the Extractives Industries Transparency Initiative (EITI) and other mechanisms

[21] Bangladesh and Vietnam, with similar productivity potential in their delta regions have yields that are 66% and 114% higher respectively.

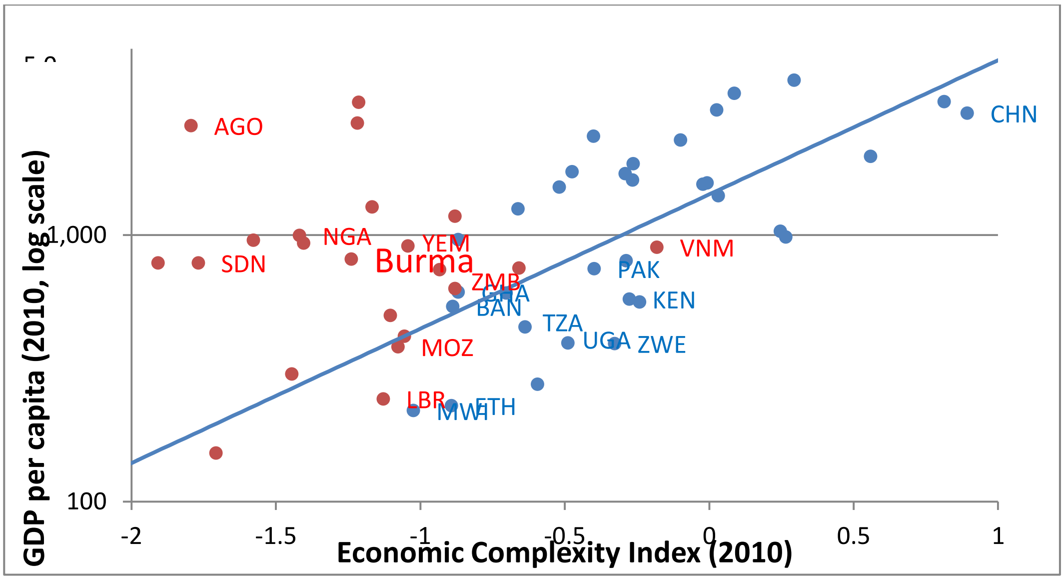
[22] MOGEs' contributions to the national budget are based on the same principle as other SEEs. This means 25% of net profits as taxes and another 20% of net profits as a contribution are made.

to better manage revenues from this sector.[23] If this trend is maintained, the prospects for the sector and the broader economy are more positive[24] [lix] though strong vested interests are likely to prevent an overly inclusive (and hence positive) scenario from unfolding.[lx] It is likely that reform in the jade and gemstones sector will be much more difficult and more complex, particularly given the likely participation of powerful groups including the military, the armed groups and actors in China.

31. **Myanmar has a small and highly concentrated export sector, with garments and tourism as arguably the most promising manufacturing and services sectors respectively.** Myanmar was both a founding member of the General Agreement on Tariffs and Trade and the World Trade Organisation, and a full member of ASEAN since 1997. Exports only amount to $9.4 billion compared with $229 billion for Thailand, $227 billion for Malaysia and $114 billion for Vietnam.[lxi] Prior to sanctions, Europe and the United States were both significant markets, particularly for garments. After sanctions, Myanmar's exports became concentrated on Thailand, China and India. It now ranks amongst the least diversified, in terms of export markets, in the region, alongside Cambodia.[lxii] Falling exports of shrimps and prawns and garments have been replaced by natural gas, beans and pulses as well as semi-precious stones.[lxiii] Exports of services increased by roughly 30% from 2005 to 2011, much of this from tourism and services related to manufacturing.[lxiv] A lot of trade eludes statistics because it is illegal, particularly in border areas. The lack of border policies around such trade makes it much harder to increase the value added around border trade – it is much harder to identify policies to increase value addition on timber for example if a large part of the timber is illegally exported.

32. **Myanmar has a lower level of complexity in its export make-up than countries at similar levels of income** (see figure 7).[25] Myanmar has some potential to move into sectors with higher levels of technological sophistication such as agricultural products, wood products, clothing and footwear, but its experience of export diversification (both in terms of products and destinations) is very poor. Most of its export growth is made up of exports of existing products to existing markets. New product growth is almost entirely negligible. The probability of a new export relationship surviving into its second year for Myanmar is 46%, falling to 18% for above three years.[lxv] This compares with 66% and 44% respectively for China. This can mostly be attributed to poor export quality.[26]

Figure 9: Myanmar (labelled Burma)'s position on the economic complexity index[lxvi]



[23] Recent options include a Sovereign Wealth Fund. Given that the country is running fiscal deficits above 5%, it is not clear that it this is the most sensible of policy options but the commitment to transparency and accountability this would bring is important

[24] Estimates suggest that, by 2030, the energy and mining sector could contribute $21.7 billion to GDP and employ 250,000 people.

[25] Commodity exports and largely unprocessed natural resources dominate exports. These products are not normally associated with high knowledge spillovers or linkages to other production.

[26] Poor quality can refer to product quality but also price quality, distribution, etc.

33. **The lifting of sanctions, the re-instatement of Myanmar to EU Generalised System of Preferences (GSP) and its joining of the ASEAN Free Trade Area could enable Myanmar to take advantage of its borders with Bangladesh, China, India, Laos, and Thailand**. It is also a member of ASEAN-level agreements on trade in goods, services, investment and other areas of the ASEAN Economic Community. It is a signatory of the five ASEAN+1 agreements with Australia-New Zealand, China, India, Japan and the Republic of Korea. In 2013 it signed a Trade and Investment Framework Agreement with the US and we might expect this trading relationship to become closer (and recover the lost ground from when the US received almost 27% of Myanmar exports in 2000) if the reforms in Myanmar continue. The same is true of the EU which removed its sanctions in 2013 and the reinstatement of GSP has now enabled Myanmar to have duty and quota free access to the EU for all products except arms.

34. **Despite the opportunity provided by its geographical location, many of the areas bordering China, India and Southeast Asia are mired in conflict or are geographically remote.** The next section will explore some of the soft and hard infrastructure gaps that Myanmar needs to fill to make best use of its trading opportunities. Overcoming these infrastructure gaps will be much more challenging in conflict-affected or remote areas.

35. **SMEs are an important part of the domestic economy and a priority for the government.** SMEs (defined here as businesses with less than 100 workers[27]) make up 97% of companies in Myanmar.[lxvii] Of the SMEs registered as of 2012, 63% were in food processing and beverages, 7.6% in construction, 4.4% in metal and petroleum products, and 6.6% in garments and 4% in consumer goods. SMEs are a priority focus area for the government. The government has created an SME Central Development Committee, chaired by the President, and are in the final stages of an SME law. The Small and Medium Industrial Development Bank (SMIDB) has been operational since 1996 with the specific aim to improve access to finance for SMEs – but truly resolving this problem will require much deeper reform of the financial sector (discussed in section 3).

36. **Trade integration provides both an opportunity and a risk (through increased competition) for many SMEs.** The development of industrial zones[28] [lxviii] since the 1990s provides opportunities for SMEs to develop clusters which open windows to make efficiency gains and to increase technology spillovers. The planned Special Economic Zones (SEZs) may also provide further opportunities for cluster development but also bring major risks, particularly on land. The development of economic corridors through increased trade links also provides similar opportunities.

Sectors with major potential:

37. The Asian Development Bank (ADB) identified agricultural commodities, clothing and footwear as the most promising sectors, followed by a number of primary commodities.[lxix] The National Export Strategy[lxx] identified seven sectors as priority sectors for export based on their capacity to contribute to export growth, socio-economic development goals and employment creation through their current and potential export performance. These are outlined in a bit more detail below. Other sectors might include pharmaceuticals, corn/maize, gems, car-parts, construction and potentially others.

- **Rice:** Formerly a top producer, Myanmar now accounts for 1.8% of world trade. Rice has high potential for socio-economic impact and the global market conditions are also favourable as demand increased by 18% since 2010, with Indonesia and China being the world's biggest rice importers.[lxxi]
- **Beans and Pulses:** Myanmar is one of the largest cultivators in the world increasing its harvests by 221% since 2002. Sector yields are well above world averages (13,237 hg/ha compared to 9,077 hg/ha) but further productivity gains appear possible (through mechanisation) and there may be potential to move into processing (only 5-10% of beans and pulses are subject to any processing in Myanmar). 74% of shipments go to India but sub-sector production in oilseeds sees exports going to Japan, China and Taipei.[lxxii]

[27] There are additional characteristics defining SMEs in Myanmar including that it must have less than 50 horse power of installed power, annual production capacity of less than 10 million Kyat and an investment amount of less than 5 million Kyat.

[28] SMEs already dominate industrial zones with small sized firms make up 57.5% of the tenants in industrial zones, medium-sized make up 24.3% and large make up 17.3%.

- **Fisheries:** It employs roughly 3-4 million people and is an important part of protein in the local diet. Myanmar has abundant water resources and the total catch of freshwater and marine fish almost tripled between 2002 and 2011. Less than half of the exporters in the sector have access to processing and cold storage facilities which appears to be the major constraint to the sector.[lxxiii]
- **Forestry:** It accounts for 1% of GDP with 100 wood-based industries and an SEE (the Myanmar Timber Enterprise). It accounts for 12% of Myanmar's exports and Myanmar is the world's leading exporter of tropical hardwood logs. There is limited processed wood and one of the biggest constraints is the inability to comply with the standards and certification requirements of developed markets.[lxxiv] In April 2014, Myanmar banned the export of virgin teak in an attempt to strengthen the local milling industry. The illegal export of timber is one of the pretexts through which the current conflict in Kachin is justified and funded.
- **Rubber:** It employs roughly 350,000-400,000 workers and smallholders constitute 90% of total producers, mostly producing unsmoked sheets. It primarily exports natural rubber (90%) and imports manufactured rubber products, giving the country an overall trade deficit in rubber. It is a small player globally ranking 13th in the world. Global prices have fallen by some 40% between 2011 and 2013.[lxxv]
- **Garments:** It was the highest export item in 2000. It remains the main manufacturing industry with over 200 factories. It offers significant job opportunities, particularly for women, and export-oriented production. Its current export markets are Japan and South Korea but the sector expects a large increase in demand from the US and EU but it will need to upgrade logistics, improve power supply and infrastructure and ensure compliance with international labour standards.[lxxvi]
- **Tourism:** It enjoys vast forestry reserves, snow-capped mountains and pristine beaches coupled with a rich cultural heritage. It has great potential and the ADB predicts that tourist arrivals could increase sevenfold to 7.5 million in 2020 and generate revenues of $10 billion (a 14-fold increase in revenue). It has the potential to be a major driver of job creation already employing over 700,000 people directly, possibly rising to 1.4 million by 2020. Indirect employment will be significantly higher.[lxxvii]

Table 2.1: Tapping into Asia's Supply Chains

The global economic centre of gravity is (re)orientating itself towards Asia. Asia is currently the fastest growing region in the world and under optimistic scenarios Asia's GDP could reach 50% of world output by 2050.[lxxviii] Many countries, such as China, face considerable economic challenges but there is cause for some optimism: catch-up growth episodes have only just begun in some countries and Asia's place as the factory of the world is expected to solidify.[lxxix] While Chinese wages have grown by an average of 12% a year and some firms are re-locating production, much of this production (and the FDI that supports it) is likely to remain in Asia. ASEAN's close proximity and its improving enabling environments makes it an increasingly attractive alternative. FDI into ASEAN (as a share of global FDI) rose from 11% in 2000 to 25% in 2013. Much of this supports the geographic unbundling of Asia's manufacturing supply chains (with Asia now accounting for 50% of world trade in intermediate inputs, up from 14% in 2000) but an increasing share is designed to provide consumption goods for Asia and its rising middle class.[lxxx]

With Asia's population ageing and growing at a slower rate, migration within Asia is likely to become increasingly important. Average education levels are also improving but with large gaps between countries in the skills of their workforces. Asia is home to 30 million migrant workers and this is expected to rise. Of most relevance for Myanmar are the changing patterns of migration in ASEAN. In 1990 60% of migrants from ASEAN migrated out of the region while in 2013 70%, some 6.5 million migrated within ASEAN, though unofficial migration could make this even larger. Myanmar dominates ASEAN migration flows with the majority migrating into Thailand. Many ethnic groups now have a well-established diaspora and networks within Thailand that makes future migration easier. This trend has the potential to upskill Myanmar workers and to continue the inflow of remittances.

These changes may have important implications for Myanmar's comparative advantage relative to its Asian neighbours. In simple terms, Myanmar is a relatively low skilled, labour abundant, resource rich but capital scarce country. It could find itself in a position where it is able to capture a share of the regional supply chain in low skilled manufactured goods. While many countries in the region are already well connected into these supply chains, their labour is becoming increasingly skilled and therefore increasingly seeking employment out of low skilled sectors. Firms (whether foreign or local) may identify a particular part of a low skilled supply chain that suits Myanmar's comparative advantage. The factors that make this more likely are beginning to take place as Myanmar increases infrastructure investment and becomes increasingly connected into a regional trading block.

Yet we must be careful not to oversell the opportunities. China remains surprisingly competitive in low skilled manufacturing such as garments, in spite of rising wages.[lxxxi] And other ASEAN countries, such as Indonesia, Cambodia and Laos similarly have low wages, improving business environments and rapid infrastructure investment. Rents from Burma's large extractive sector risk pushing up costs of production. Furthermore the scope for the manufacturing export sector to pull large numbers of people into more productive employment is falling. Manufacturing is becoming increasingly automated in China and there is scope to do more - China has 30 robots per 10,000 workers compared to 323 in Japan.[lxxxii]

Section 3: What factors constrain inclusive growth?

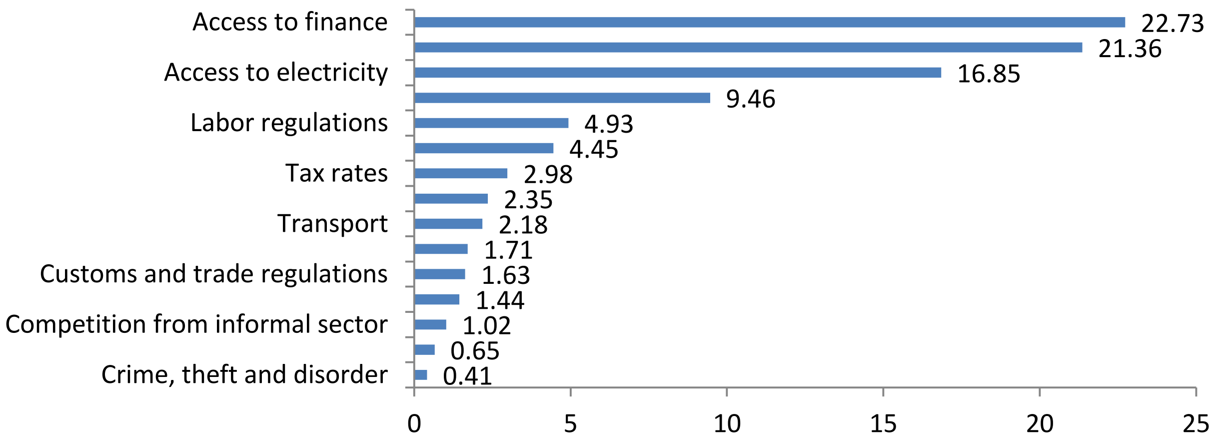
38. **The evidence shows that growth is characterised by increasing productivity and a shift in the allocation of resources (including labour) away from agriculture and into new and existing higher productivity sectors. This in turn requires investment and risk-taking.** For example, it means domestic and foreign entrepreneurs establishing lines of credit, international companies moving operations to within country, or at the micro level, it might be about an individual forgoing current earnings in order to develop a new skill or qualification or a decision to migrate to where job opportunities are better. In fact, it will require a combination of these things and much more. Underlining all of these decisions that will form the basis for Myanmar's economic transformation is the ability for these decision-makers to compete fairly to profit from the risks they take and investments they make. This section explores the factors that constrain such decisions and therefore that act as impediments to inclusive economic growth.

39. **The constraints to boosting growth vary by region and are considerable when we get to the ethnic states. What works in one place does not necessarily translate to another.** For example, changing policies or laws in Naypyitaw may have limited impact on inclusive growth in a state or region not under government control. We can expect that the more limited control the central government has over the state or region the less likely we are to see any positive impact from policy changes made in the centre. In addition efforts at easing these constraints might boost growth without necessarily increasing inclusive growth. For example increasing access to finance may boost credit for the most economically viable sectors, which may be in non-inclusive extractives. It is necessary to understand the specific factors preventing poor people from benefitting from the easing of the constraint. We will not cover this in depth here but will consider it in our interventions.

Cross-cutting constraints:

40. **Myanmar is one of the worst places in the world to invest or do business.** The World Economic Forum's Global Competitiveness Index ranks Myanmar 134th of 144 countries (2014/15).[lxxxiii] The Heritage Foundation's Economic Freedom Index places Myanmar 162nd out of 178th but 40th out of 41 in the East Asia Pacific Region (2014).[lxxxiv] The World Bank's Doing Business Report for 2015 ranks Myanmar 167th out of 189, the lowest in a competitive East Asia Pacific Region,[lxxxv] ranking 160 for setting up a business and 187th for enforcing contracts. Firms identified access to finance (23%); access to land (21%); access to electricity (17%); and access to skills (9%) as the biggest obstacles to business in the non-rural economy according to the Enterprise Survey (2015) – (See figure 8). The results vary depending on the size of the firm with large firms identifying electricity as the biggest obstacle (46%); medium firms identifying land (25%); and all firms identifying finance as one of the top three constraints.[29] [lxxxvi] As the Enterprise Survey only focused on the non-rural economy, constraints may differ in rural areas. This reinforces the need to understand the constraints in different states and regions as flagged above.

Figure 10: Share of firms identifying issue as the main obstacle to the firms' success in Myanmar[lxxxvii]



[29] A previous survey from 2012 showed electricity as the biggest factor followed by political instability, corruption, foreign sanctions and skills.

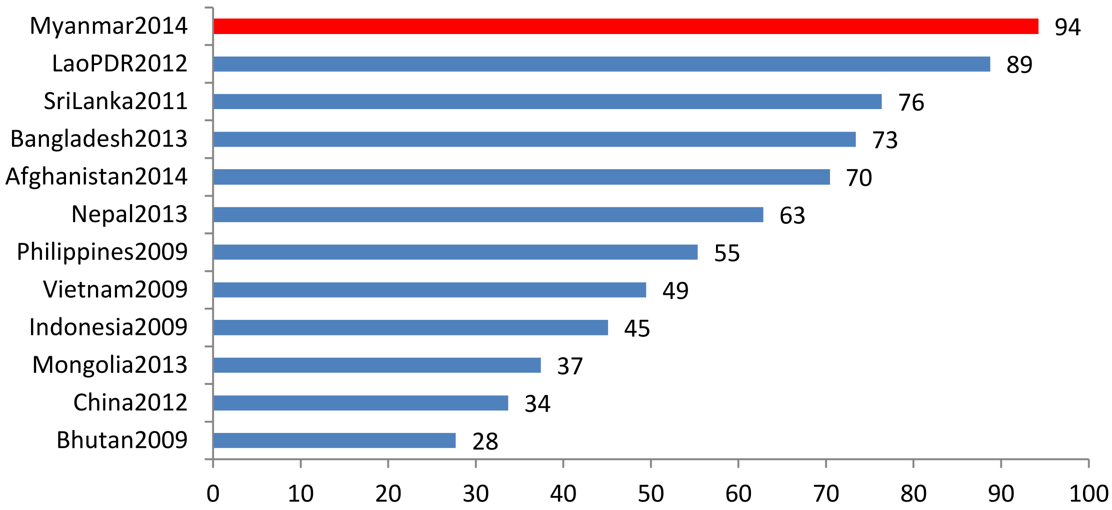
41. **Access to affordable finance is a binding constraint: removing the barriers here could have relatively quick returns.** Private sector credit is low at 14.9% of GDP (2013).[30] 87% of firms use their own funds for working capital needs, much higher than in comparator countries.[lxxxviii] Only 27% of firms purchase or sell on credit compared with 94% in China, 84% in the Philippines and 70% in Sri Lanka and Vietnam.[lxxxix] Only 30% of firms have a bank account, only 7% have a line of credit and only 4% applied for credit in the last year, the lowest levels amongst peers by some distance, and smaller firms are the least likely in each case.[xc] [31] SMEs identify complex procedures, unfavourable interest rates and strict collateral rules as the main reasons for not applying for loans. Other financial services such as insurance are also restricted and underused. In spite of the recent granting of limited licences to nine foreign banks and the opportunities created by the expansion of mobile telephony, reform in the sector has been slow.[32] This is because of a strong domestic lobby concerned about competition and a nervous new regulator with memories of the domestic financial crisis in 2003. The result is that many of the regulations currently in place are by their nature restrictive and protective and do not support the expansion of the sector: an interest rate cap of 13% per year limits the willingness of banks to lend to SMEs; private banks can only provide loans for one year with some extension up to two years which all but eliminates investment loans; and restrictive collateral requirements mean that banks can only accept land as collateral. The rural finance sector is even more underdeveloped with major shortages in formal credit and high farmer indebtedness. [xci]

42. **Landlessness, insecurity of tenure and land prices are binding constraints but reform is unlikely to deliver results quickly.** All land is owned by the state although companies and individuals enjoy a certain degree of ownership in three ways: freehold;[33] grant, lease, license;[34] and agricultural land.[35] Security over tenure is a major problem. Land grabs are cited as a major factor prohibiting the return of populations displaced by conflict for example – although it is not exclusive to these areas. Recent policy changes[36] including the draft national land use policy, the over-arching framework for land and natural resource governance – have been criticised for not adequately addressing gender equality, customary land tenure, land reclassifications, independent land dispute procedures and Government issued large-scale land concessions. The existence of multiple government bodies (and Ethnic Armed Groups) with responsibilities for land; 73 laws, amendments, orders and regulations defining the land tenure system; and a weak institutional structure for handling disputes makes for a complicated and insecure system. The presence of a wide variety of different customary laws further complicates the picture and there can often be difficult tensions between customary practices and objectives around inclusion, for example the ability of women to inherit land. The Doing Business Survey (2014) states that it takes an average of 113 days to register land compared to 25 days and 2 days in Indonesia and Thailand respectively.[xcii] Firms in the industrial sector are more likely to own their land than those in the services sector, presumably due to industrial zones. Additionally, access to land is a major problem in large urban areas, because of rising prices.[37] [xciii] Land reforms are long-term processes requiring ongoing political will and engagement with the public to maximise legitimacy.

[30] This does actually constitute a vast expansion from 5.1% in 2010.
[31] 82% of large firms report that they use either personal loans or a combination of personal and business loans to finance business activities
[32] Other important reforms include the preparation for credit bureau and the foundations for a stock market (due in 2015). The microfinance sector has expanded significantly since the introduction of the microfinance law in 2011 with over 200 institutions being offered licences; a reach of almost 900,000 clients; and an increase in loan size.
[33] Freehold is the is the exception rather than the norm, exists in big cities, does not require the payment of land revenue and enables land to be both transferable and inheritable
[34] Grant, lease, license is where the Government awards the use of the land for periods of 10, 30 or 90 years, land is transferrable, land revenue must be paid and the Government can reacquire the land
[35] Agricultural land is where land use right (based on the Farmland Act 2012) can be sold, mortgaged, leased, exchanged or donated, land use is limited however there are almost no regulations enabling the processing or implementation of this act
[36] The Farmland Act 2012 and the Vacant, Fallow and Virgin Lands Management Law 2012
[37] 25% of firms based in Yangon cited land as a major constraint whilst only 2% in Monywa did.

43. **Poor infrastructure, especially electric power supply, is a binding constraint. Taking the necessary decisions to ease this constraint could be done quickly though the benefits could take some time to materialise.** 94% of firms suffer from power outages, by far the highest in the region (see figure 9).[xciv] It takes a full year to get an electricity connection and only 5% of firms apply for one.[xcv] Manufacturing firms are the worst affected.[38] [xcvi] Myanmar has access to abundant hydropower potential and natural gas resources, as well as renewable energy potential. Past policy of exporting energy resources to earn foreign currency, particularly to China and Thailand, has been a major blocker to increasing supply. This makes the planned increase of the share of gas going to the domestic market in 2017 important.[39] Myanmar has the lowest tariffs in the region[xcvii] which costs the government $190 million per year[xcviii] and these (rising) costs would be a major blocker to expanded supply. Its transport network is undeveloped with road density being amongst the lowest in the region[40xcix] . Access to mobiles and the internet are still low, but have shown rapid improvement following liberalisation.[41] [c] Financing the infrastructure funding gap, estimated to be as much as $80 billion to 2030, will be another important challenge, requiring significant private sector involvement.[ci]

Figure 11: The number of firms experiencing power outages[cii]



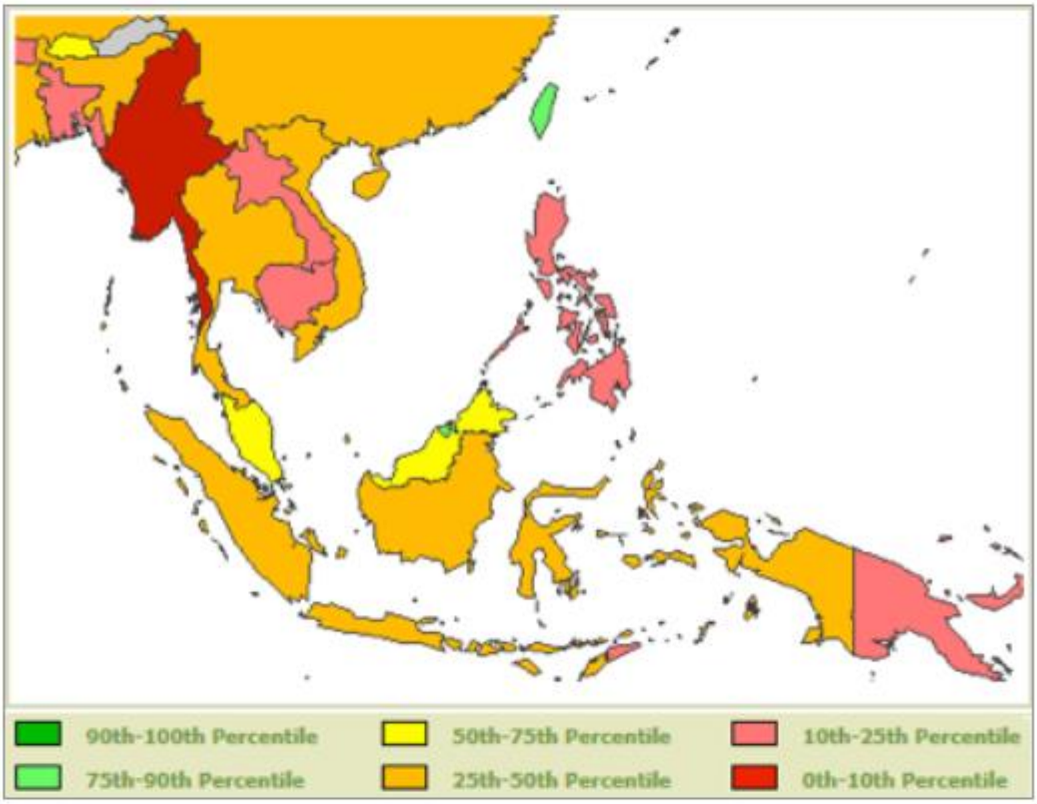
44. **The lack of skilled workers is not a binding constraint across all sectors but the shortage of skills is a symptom of deeper problems in the education sector which will eventually prevent inclusive growth.** The education sector in Myanmar has been weakened by decades of underinvestment and deliberate neglect. Although once an intellectual leader in Asia, the Myanmar education system is now characterised by low learning outcomes, high rates of drop outs and inequality. The system fails to deliver enough people who can read, write and apply critical thinking[42], rendering many unemployable in modern industries or unable to take full advantage of vocational training opportunities. This affects future productivity, deters prospective investors (despite low wages) and undermines inclusive growth. A number of firm surveys[ciii] have identified this as important, particularly for SMEs and firms in the services sectors. Manufacturing was also identified as a sector that suffers but Myanmar firms in this sector are also amongst the least likely in the region to invest in training for their workers.[civ] It is unlikely that the shortage of skills will be a constraint in all sectors – agriculture will still use unskilled labour for example.

45. **Government's involvement in the economy has complicated regulation, stifled competition and restricted trade, creating a binding constraint in many sectors. There will be opportunities to deliver**

[38] 31% of manufacturing firms state that access to electricity is their biggest obstacle.
[39] This is planned for the new off-shore gas fields due to start production in 2017
[40] Burma's road density is 148,690 km as of 2012 with only 38.9% of the total network paved.
[41] 18 months since liberalisation 39% of the population aged 15-65 now owns a mobile and sim (the proportion of poor people is similar) and 63% of those owned a smart phone with 3G facilities more gradually expanding beyond the main urban centres.
[42] Fewer than 10% of children complete secondary education, and only about half complete primary education

returns by easing some of the constraints in this space. It is difficult for firms to enter and exit markets in Myanmar which ranks last in the Doing Business survey for starting a business.[43] [cv] Firm entry is governed by at least half a dozen laws[44] and therefore many firms choose to remain informal.[45] [cvi] There are 15 different types of taxes and duties collected by seven different departments and the incidence of corruption is high (see figure 10).[46] Private firms are only given the opportunity to bid for state contracts if the SEE sector cannot deliver.[47] The result is that only 2% of private firms have attempted to win a government contract which is the lowest in the region.[48] [cvii] Trade is hampered by excessive and outdated government regulations and compliance procedures. The result is long waiting times for a trade licence (15 days) and a high proportion (more than 50%) of firms paying bribes.[cviii] The trade competiveness index in infrastructure ranks Myanmar 141st out of 148 countries. These high fixed costs to doing business are particularly hard on SMEs but also act as a deterrent to foreign firms who decide to go elsewhere.[49] These firms are also the ones most likely to innovate and diversify which makes this particularly worrying. The government has initiated important reforms in this area but there is much more to do.

Figure 12: Control of Corruption[cix]



[43] It takes 11 procedures, 72 days and costs 156% of income per capita to start a business. The minimum capital requirement for setting up a business is $150,000 for infrastructure and manufacturing compared to at least 90 countries globally that have no paid-in capital requirements.

[44] This varies depending on the sector, the location and whether the investor is foreign or local

[45] Firms state the main reasons as being: the fear of government interference; the opaqueness of the regulatory process; the lack of coordination between Government Agencies (leading to inconsistent requirements) and the lack of benefits to registration as the main reasons.

[46] This is confirmed by other surveys such as Transparency International's Corruption Perception Index which ranks Myanmar 157th of 177 countries in 2013

[47] There is no central procurement law and much discretion is given to individual ministries in this area. There is no legal requirement that they must use procurement from SEEs first but they may do so if they choose.

[48] This is less than half of the proportion of Bangladesh and Indonesia, the next two lowest.

[49] Foreign firms also have their own set of challenges to deal with in particular a nervous domestic firm lobby in some sectors; the difficulties of transferring funds in and out of Burma; the difficult of making equity investments into domestic firms; the lack of clarity (and delays) around Myanmar Investment Commission approval; opaque arbitration processes; and other restrictions such as the difficulties around the acquisition of land and being excluded from certain sectors.

46. **Macroeconomic factors pose major risks to inclusive growth. This will continue to be a major cause for concern in the near future, particularly as Myanmar does not yet possess the levers it needs to manage such risks.** Many of the macroeconomic fundamentals have been stable in the past few years (strong growth, stable inflation, sustainable debt levels, etc.) but vulnerability was always high because of a poor macroeconomic policy environment. The poor macroeconomic policy environment has been the focus of reform as evidenced by the unification of the multiple exchange rates; the granting of independence to the Central Bank; and reforms that have happened through the government's Public Financial Management modernisation strategy. However macroeconomic reforms are still at a relatively early stage and the underlying vulnerabilities in the system have begun to have real impacts in the past 12 months, as described in paragraph 15 above. The main institutions responsible for managing these risks; the Ministries of Finance, National Planning and Economic Development and the Central Bank, have been systematically weakened by decades of military rule and macroeconomic manipulation. They also oversee a highly fragmented system where they often have to fulfil different policy objectives (such as the Central Bank's financing of part of the deficit) or where they do not have full control over public sector decision-making in key areas (such as in taking on public debt where many parts of government can secure loans with unclear levels of supervision from the Ministry of Finance). These institutions may therefore struggle to enforce the macroeconomic discipline required on other parts of government. These institutions have also been strengthened in recent years[50] but this will need to continue. Parliament's active challenge to the executive may also be important in helping these institutions control the fragmented system to enforce macroeconomic discipline as evidenced by the role it has already played in lowering external debt and reducing budgetary expenditures for example.

47. **The government will need to pay particular attention to fiscal management if it is to create the fiscal space necessary to support inclusive economic growth without risking macroeconomic instability.** Extractives will remain an important source of government revenue for the foreseeable future but this reliance creates its own fiscal and macroeconomic risks. More money is now going into basic services[51] (though coming from a low base), but public investment in economic development is still dominated by SEEs and defence accounts for the largest share of the budget. The increases to basic services also happened at a time when revenues were rising and continued increases (which are needed) will be much harder and more keenly contested if gas prices fall. Myanmar's small revenue base means the government is highly reliant on gas revenues. When combined with undeveloped financial markets preventing good value government borrowing, this explains their use of Central Bank financing of the deficit, which creates the inflationary and exchange rate pressures that the government needs to avoid. Furthermore the government's growing fiscal liabilities through the expansion of subsidised lending[52] are a major cause for concern. With budget deficits of above 5%, its reserves making up less than 3 months of imports, one of the lowest tax/GDP ratios in the world, falling gas prices[53] and a large SEE sector placing liabilities on the government books, the government can ill-afford fiscal indiscipline.[54] Control over fiscal discipline is fragmented however, with line ministries and SEEs seemingly free to secure loans, sign Public Private Partnerships and launch large public procurements with little oversight from the Ministry of Finance. If these reforms are prioritised, Myanmar's gas revenues (even with falling prices) and growing revenue base, if managed well, should provide Myanmar with the fiscal space it needs. Revenues will increase as reforms continue but also as other sources of finance become available to Myanmar, for example through financial markets or through donor financing. However the

[50] The Central Bank became operationally independent in July 2013; and the Ministry of Finance has a much strengthened mandate on the national budget process and its oversight of medium term fiscal sustainability.

[51] Based on DFID analysis of budgets from 2010/11 to 2013/14, the budget for health has increased sevenfold and the budget for education has tripled since 2011

[52] This amounted to $800 million in 2014 made up of $100m through the Myanmar Agriculture Development Bank and $700m through the Ministry of Cooperatives, the latter borrowed from the China EXIM Bank

[53] If gas prices followed IMF World Economic Outlook oil price projections (3% decline per annum), public expenditures would need to decline by 5% in 2020/21 to maintain its current budget deficits – this analysis if from chapter 3, page 19 of the forthcoming Public Expenditure Review by the World Bank

[54] Recent government language on the creation of more policy banks as conduits for subsidised state lending is worrying, particularly as this would be throwing precious public finances at a problem that probably requires regulatory reform.

promise of future revenues often makes fiscal discipline difficult, and this increasing revenue will need to come alongside the reform discussed above.[55]

48. **Freedom to migrate safely is important both for inclusion and economic transformation and could emerge as a potential constraint in some areas.** Accurate figures on internal migration are unavailable but it is considered larger than external migration – almost 10% of the population by some estimates. Internal migration is important as a facilitator of economic inclusion and a major source of income for those residing in rural households. Most rural households have members that are permanently, temporarily, or seasonally migrating. It is also a characteristic of economic transformation – people moving out of own account farming into the wider rural economy, and further afield to urban areas (and abroad) – increasing income and driving the economy forward. External migration is also an important contribution to Myanmar's growth – especially in the ethnic areas bordering Thailand. Annual remittances are estimated at $8 billion annually with $4 billion flowing into Karen State alone.[cx] There is some evidence that migration is also helping incomes converge across national space – people have migrated out of the Dry Zone in to Karen state, where wages are higher, to fill the void left by the Karen migrants. Given 83% of these flows are sent through unofficial channels, enabling the financial sector to facilitate this formally could be an important reform, as is putting in place the public goods in the ethnic regions that could help boost inclusive growth in situ. Anecdotal evidence suggests that remittances are consumed rather than invested.[cxi] However, continued restrictions on the freedom of movement, particularly in light of increased restrictions in Thailand, could have major negative consequences, especially for those regions that have looked to Thailand as the hub of economic opportunity.

49. **Myanmar is vulnerable to a number of shocks and risks – it is not well-placed to manage many of them.** Myanmar is one of the ten most vulnerable countries to climate change. It is also vulnerable to economic risks such as its overdependence on neighbouring markets for trade, leaving it exposed to regional downturns; and commodity price volatility, particularly in the gas sector. There are also risks that accompany increased growth such as the capability of Myanmar's cities to handle increased pressure arising from rural to urban migration; possible trade-offs between growth and environmental and social objectives; and the sustainability of natural resource extraction. The Government has limited capacity to handle such issues and there is relatively little public awareness of such issues and how to address them.

Sector-specific constraints:

50. **Many of the constraints identified above will constitute binding constraints to agriculture's development.** Access to skills might be one exception as the agricultural sector is likely to need unskilled labour in the short-term. A shortage of skills and particularly basic education are however important constraints to movements out of on-farm activity to off-farm activities and jobs in urban areas which may have a stronger demand for basic skills. Another exception is macroeconomic conditions which are not currently constraining the sector however the risks are high and memories are fresh from the exchange rate appreciation of 2012 and 2013 that significantly squeezed agricultural exports.[56] Sector studies largely confirm the importance of the cross-cutting constraints we identified including: skills improvement; access to credit; protection of investors; paying taxes; infrastructure; competition; trading across borders; enforcing contracts; and resolving insolvency.[cxii] As trailed in section 2, investments in public goods such as better seeds, extension services and irrigation will be important if the sector is to capitalise on the productivity and quality gains that investment could achieve.[57] [cxiii]

51. **The sector's ability to adapt to climate change will be central to its prospects.** As detailed in section 1, there are considerable risks to the sector arising from climate change. Myanmar will need to be well

[55] Development partners will need to be careful if they move towards budget support that they don't undermine the incentives to pursue reforms that strengthen the ability of the macroeconomic setting institutions to enforce macroeconomic discipline

[56] This lead to a number of the business associations representing farmers lobbying the government not to let the Kyat strengthen beyond 900 Kyat to the dollar. It did strengthen to under 900 Kyat to the dollar before returning to weaker levels in 2013/14.

[57] Low mechanisation and productivity (only 16% of households used tillers or tractors in comparison to 70% in Vietnam) and production quality is low, for example 88% of 2012 exports contained 25% or more broken grains.

prepared at all levels from the provision of public goods such as cyclone shelters or research, to the provision to appropriately targeted services such as insurance and to the preparedness and resilience of households.

52. **Access to finance, access to infrastructure, overcomplicated regulations and the lack of freedom to compete are probably the biggest constraints to manufacturing and tradable services.** Section 2 highlighted Myanmar's historical inability to create and develop export sectors and resolving some of these constraints will be central to doing that. As with agriculture, macroeconomics remains a risk that could quickly undermine progress made on other constraints. A lack of access to skills could also emerge as a constraint to the development of some sectors particularly if Myanmar can move to higher value exports.

53. **Strengthened trade institutions and a more careful approach to import tariffs may help overcome many of the challenges the manufacturing sector is facing.** An export promotion agency could be a good way to help firms capitalise on increased market access. Trade Support Institutions are weak and characterised by a duplication of functions and relatively few providing key services such as research, financing or packaging support.[cxiv] Although average import tariffs are small, significant peaks are put on certain products, in particular the imports of raw materials and intermediate products acting as a deterrent to prospective producers in search of inputs.[cxv]

54. **A more targeted FDI strategy addressing key investor concerns might enable Myanmar to grab parts of the global manufacturing supply chain. Myanmar**'s low wages, large working population and strategic location should enable it to attract part of the labour-intensive supply chain, such as in garments. If Myanmar could successfully overcome some of the global challenges faced in such sectors, it could benefit. For example, in garments, were it to safeguard worker conditions, establish less adversarial industrial relations and pursue other responsible business goals, it would be seen favourably by investors looking to manage these risks in their supply chains.

55. **Myanmar's natural resource wealth has the potential both to support and to damage the country's growth and development.** International experience points to the dangers of using the prospect of continued extractive revenues growth to borrow now to accelerate investment. This borrowing can lead to absorption capacity constraints; put upward pressure on exchange rates (making diversification more difficult); and threaten debt sustainability. Success in managing revenues from extractives will be significant in enabling higher value agriculture production and manufacturing. The sector also poses major risks to conflict as described elsewhere. There are important issues to consider around environmental sustainability, in particular deforestation and unrestricted and unregulated mining activities. Rising emissions and waste, expanding hydropower development and water pollution all pose additional risks. There are difficult economic trade-offs that the country is not yet well-placed to manage.

Section 4: What political or institutional factors enable constraints to persist?

Myanmar Pre-Reforms:

56. **Myanmar has never been united under its current borders.** Its infrastructure was devastated by World War II. The institutions inherited from colonial rule were not fit for purpose. The politicians that took over upon independence in 1948 were weakened by the assassinations of some of the county's most experienced leaders[58], and were unable to follow up on commitments to a federal system and a Union of Burma made at the 1947 Panglong Conference. This failure underlies the multiple tensions and conflict that have followed.

57. **Military control increased exclusion and weakened institutions.** The conflict formed the pretext for the strongest institution in the country, the military, to take power (once in 1958 and again more permanently in 1962). The military systematically weakened civilian institutions and introduced disastrous economic policies. It imposed a Bamar-Buddhist identity to try and control the large and ethnically, linguistically and culturally diverse country. The result was that economic power became concentrated in the hands of a small Bamar political-military male elite. Powerful individuals dominated decision-making, using patronage networks and state institutions to exert control over economic assets. Constant churn and jockeying for position led to multiple sources of authority within government and competition between ministries. The ethnic states and regions, where the legitimacy of the military government was non-existent, developed their own institutions and their own economic relationships.

The Reform Process

58. **Despite recent reforms in a number of areas, the system left by the military government still dominates.** In addition to the economic reforms outlined previously, there have been changes in a number of other areas: Freedoms of Assembly and of Association have been introduced; political prisoners have been released; the National League for Democracy (NLD) and Aung San Suu Kyi (ASSK) are participating in the political process; the 2008 Constitution has given more power to State and Regional governments; ceasefires have been signed with most of the major Ethnic Armed Groups; and civil society has been better able to engage the government and the private sector. In spite of this, much of the picture outlined at the start of this section is still relevant. While reforms are changing the formal rules of the game, systems do not change quickly. Much of the legacy of the past 70 years will remain central to the growth narrative for the near-term.

59. **A large scale reversal of reforms is unlikely but the endpoint of reforms is unclear.** The military launched reforms from a position of strength and not weakness. Reforms are thought to have emerged for a number reasons: an unwillingness to be too dependent on China (particularly as sanctions forced Myanmar closer to China); the widening economic gap between Myanmar and its neighbours; and the desire of former leaders to retire in such a way to prevent the emergence of a new all-powerful leader (and the threat such a leader would pose to them).[cxvi] These factors remain important today, making it unlikely that we will see a major reversal of reforms. There are many gaps in our understanding about the dynamics that led to these reforms and why major groups have allowed them to continue. This includes how decisions are made in the military or the Ethnic Armed Groups, and what the objectives of these groups are.

60. **The risks to the reform process are significant.** The peace process has not yet made the transition into full scale political dialogue though this is not a reform where we should expect quick results. This does run-up against the rhetoric of quick wins of the leaders of the reform process and the risk that policy reform on contentious issues such as natural resource revenues disrupts the peace process is real. Inter-communal violence flared in mid-2012 in Rakhine State, leading to smaller outbreaks in other parts of the country, and the emergence of a Buddhist nationalist movement. In some cases the violence had all the hallmarks of well-organised and systematic violence with reports of at least tacit support from local authorities and facilitation by the media. Countering discrimination and hate speech in the run up to the election is politically sensitive, and likely to prove unpopular in the polls. The elections in 2015 also pose the risk that the losers may not accept the results, or that a new government does not command support amongst the elite, the bureaucracy

[58] Including independence hero Aung San, the father of Aung San Suu Kyi

or the military, making it impossible for them to govern. Unequal or exclusive economic progress, a risk in an economy where natural resources are so important, will have unavoidable social consequences. Even good inclusive growth policies may struggle to halt unequal economic progress in the short-run. There is also a risk that particular groups continue to face systematic exclusion from economic activity, political participation and access to state services, hampering poverty reduction efforts and posing risks to stability.

61. **But the reforms still constitute the best opportunity Myanmar has ever had for peace, stability and prosperity.** The reforms show that Myanmar is opening up, with power and opportunities being broadened out, albeit slowly, beyond the previously dominant groups. The reforms provide an opportunity to resolve existing conflicts and pursue a sustainable route out of poverty. Myanmar's future direction will be the outcome of negotiation, at least between the powerful groups (including the NLD and the Ethnic Armed Groups), rather than the outcome of the views of a military dictator as previously.

The Key Economic Actors and the Distribution of Power:

62. **Power is exclusive but not wholly dominated by the state and its close allies.** The reform process has begun to challenge the long-standing balance of power and, in doing so, has enabled the emergence of a range of new contests especially among the ethnic armed groups – though not exclusively so as outlined in the table below:

Table 4.1: Key Actors in Myanmar

The State: The State has reduced its direct involvement in the economy but it is still engaged in many key sectors. Many powerful public bodies and SEEs at Union, and State and Regional levels are used to being able to pursue their own economic interests unimpeded. This creates a conflict between them and the President's stated objective of people-centred development. Reforming such a system will take considerable political capital and will give rise to considerable risks, with the privatisation of state assets for example.
The Cabinet: Getting different ministries to work together to achieve a policy objective is extremely difficult. There are strategic national objectives and reform plans but there is no overarching strategy that binds all state institutions together and serves as a basis for the prioritisation of public resources. Policy reform is still driven by individuals. Technocratic ministries have traditionally been weak. This presents a major challenge in getting other ministries, some which wield significant power, to fulfil newly mandated roles or requirements put forward by the reform process.
The Military: Military-owned companies are still central economic players but are less dominant than they were a decade ago with the removal of some of their monopolies and benefits. The military still enjoys considerable political power with 25% of seats reserved for military MPs in the Union, and State and Regional parliaments and with the Commander in Chief overseeing three of the most powerful ministries.
The Cronies: Although they made significant profits in the past, they are no longer guaranteed economic dominance through connections with the military and political elites. They enjoy vast wealth and retain significant influence over some policy makers. This means they will be important drivers of the economic direction Myanmar takes and cannot be ignored. They are well-placed to benefit from economic reform if they can avoid their past business investments being investigated.
The Political Elite: Still dominant in the Union Solidarity and Development Party (USDP), they could gain from the opening up of the economy to regional opportunities. The high probability of an NLD victory in the forthcoming elections may reduce their direct influence. This remains highly dependent on how the elections play out and the USDP response to defeat.
The Opposition: The NLD re-entered politics in 2012 winning 43 of 44 available seats in the by-elections. It is well primed to win a free and fair election in 2015 but would face both extremely high populist expectations and significant hurdles to its ability to govern. There are also 12 ethnic parties represented in the Union parliament and it is expected that they will target State and Regional level parliaments in 2015.
The Ethnic Armed Groups: There are 17 significant armed groups with considerable differences in size, strength and relationship with the Union Government. They vary in terms of the control they exert and the support they receive from civilians. Their approach to economic development is also different. Some have been operating natural resource-dominated economies at the expense of local populations. Others are concerned over the risks that development might bring.
The Buddhist Sangha: Although it is supposed to remain outside of politics, the high regard in which much of the population hold monks mean that they can have political influence. A number of prominent monks have become important in recent years, most significantly as the face of Buddhist Nationalism. Even though the rhetoric of such monks is not supported

uniformly by the Sangha, it has given momentum to the rise of Buddhist Nationalism and associated inter-communal violence, which pose major risks to the reform process and stability of the country.

Civil society: Political space and new found freedoms has led to a resurgent civil society. This has led to some major change, most notably the suspension of the Myitsone Dam. There has been a darker side to some of these freedoms manifested in an increase in hate speech targeting Muslim communities, and linked to the inter-communal violence that resurfaced in 2012. It is likely that civil society can continue to extend the role they play in the developing public policy.

Uncivil society: Six decades of conflict have enabled organised criminal gangs, militias, networks and protection rackets engaged in illicit trade, extortion and violence to flourish benefitting from the war economies in Burma's borders. These groups can and do disrupt and distort Myanmar's economic and political reform processes.

International Investors and Enterprises: The Chinese became the biggest investors in Myanmar during western sanctions; much of this investment is in the extractives sector and some of it in the ethnic states and regions. There is growing investment coming from Japan, Korea, India and Thailand and other parts of ASEAN. These countries and China will be crucial in the future; particularly if they choose to move some of the labour intensive parts of their supply chains to Myanmar. Western interest and influence is growing but is confined to sectors that are relatively transparent.

SMEs: They have not been well represented in unions, business associations or federations representing business groups. The development of SMEs is a stated priority of the government and the opposition; finding a way to capitalise on this will be important for economic development.

New Voices: We could see an emergence of new groups and voices demanding reform. One example is emerging business leaders who may demand fairer competition and an equal access to opportunities. We might also see the emergence of new leaders and senior policymakers after the new elections including in the States and Regions. Another possible example is multi-stakeholder groups spanning government, business and civil society who could become powerful groups should they speak and act with a single voice.

What political and institutional factors need to be addressed to ease the constraints to inclusive growth?

63. **Myanmar will need to find a way to overcome the various conflicts in the country and minority groups, particularly ethnic groups, will need to benefit from reforms.** Continued conflict and inter-communal violence will significantly undermine inclusive growth in the affected regions by stifling investment and reducing job opportunities. In addition, it may hamper growth in other parts of the country, particularly because many of the conflict-affected areas are border areas and form the basis for Myanmar's trading opportunities. Continued conflict or risk of conflict will make it difficult to make the necessary investments in infrastructure needed to capitalise on trade. Resolving many of the conflicts won't be easy due to the depth of distrust and because there are many powerful groups that benefit from the war economy through informal and illegal trade. Ethnic groups that dominate these areas must be convinced that the reform process benefits them. For that to happen, the outcome of the political dialogue and negotiations will need to be reflected in new laws, policies, and likely amendments to the constitution.

64. **Reforms must continue and the reformers must be sought out and supported.** For Myanmar to move towards a more sustainable and higher growth path in which more and more people and groups are able to participate, it will require continued effort to formulate, implement and institutionalise effective policies to respond to existing and emerging constraints. Assuming reforms (such as decentralisation or the peace process) continue, new decision-makers and policymakers will emerge across the system. Identifying and supporting champions of reform in government, opposition, business, civil society, ethnic areas and at the State and Regional level and supporting them is likely to generate high returns.

65. **Reforms must be institutionalised, public sector capacity must be strengthened and policy coherence needs to be built.** Many of the reforms have been forced to by-pass government systems avoiding the problematic incumbent institutions.[59] Whilst this is probably an effective approach in terms of making an individual reform happen, it puts the sustainability of the reform at risk and fails to institutionalise and embed the reforms. Public institutions must then develop their ability to implement, monitor and further

[59] A notable example of this approach is the President's Office's use of the Myanmar Development Resource Institution (MDRI) as a delivery mechanism for many of their signature reform priorities such as the EITI.

improve reforms. It might not be possible to develop an overarching whole of government strategy that genuinely serves as a basis of prioritisation. However it may be possible to start building policy coherence by supporting efforts that require cross-ministerial cooperation.

66. **The Government and the military need to prove that they can work in the public interest and set the groundwork for an improved social contract. This will need to be matched by increased capacity of citizens and civil society to constructively hold government to account.** Trust will take a long time to build – especially for the minority ethnic groups who have been marginalised, persecuted or attacked militarily. However there are ways that the Government can both build this trust and start to generate a growth dividend. It can start introducing competition into previously state-dominated areas. It can build on more positive recent interactions with civil society in policy development and legislative reform.

67. **Elite capture seriously undermines both the competitiveness of important sectors and equitable access to growth enhancing services and assets thus proving to be major blockers to the easing of the constraints identified.** The government, the military, cronies and ethnic armed groups have important economic interests across a range of sectors. This involvement often has a detrimental effect on competition in these sectors resulting in monopolies or oligopolies functioning as cartels. The same groups often dominate the access to assets (such as land) or services (such as finance). In some cases this is done formally by controlling the right to issue a land-use permit or informally by using political connections to block reform in a sector. The result is that, a growth enhancing service (for example finance) is almost exclusively available to these elite groups. This acts as a serious deterrent to increased economic activity.

The political economy of the technical constraints to inclusive growth (summarised in table 49):

68. **The institutions responsible for macroeconomic policy don't have all the levers they need to control a fragmented system and there are interests that benefit from this fragmentation.** Economic reforms have significantly disabled the primary channels through which the main macroeconomic institutions were manipulated by the former regime. The reforms have given these institutions a stronger framework through which to pursue better macroeconomic policy. However these reforms propose to weaken the ability of other parts of the public sector to exercise fiscal autonomy, in particular SEEs and powerful line ministries. The strength of these actors is such that, even if the formal rules change, the macroeconomic institutions will struggle to enforce new policy on this fragmented system. Reforms related to decentralisation have implications for macroeconomic management and we do not yet fully understand the implications of these reforms. This may create both opportunities and risks, by bringing in a new set of actors and changing the rules of the game.

69. **Despite some initial progress and high level political support, there remain considerable vested interests that make true reform to the financial sector very difficult**. Financial regulation still suffers from the memory of the domestic financial crisis in 2003 and the policy responses to this have remained in place. Responsibility for financial regulation is also spread over the Ministry of Finance and the Central Bank, adding to the complexity. There is an argument to be made that these restrictions are supported by well established businesses and those within Myanmar who already have access to capital, as a means of suppressing new firm entry and competition. To compound these issues, there is also a strong domestic banking lobby that is nervous about foreign competition in the financial sector. Reforms designed to enable foreign banks to provide loans were blocked at the last minute limiting foreign banks role to wholesale banking. State sponsored Policy Banks are currently being touted as an alternative means to increase access to credit but won't address the underlying constraint. They risk limiting the reform space and creating a new set of interests opposed to wider financial sector reform. All this is likely to mean that reform will be relatively slow. In spite of this, improved donor coordination with the Central Bank combined with a strong existing relationship with the Ministry of Finance may provide an entry point to this very complicated space.

70. **High level commitment explains initial progress in infrastructure, but continued reform will be challenging, particularly in conflict-affected areas.** Most public expenditure is channelled through SEEs who may be more likely to pursue their own interests over serving wider public interests. In energy, the presence of multiple plans[cxvii] owned by multiple ministries poses challenges. However there is clear political will to

improve electricity access and, initial progress (moving access from 30-50%), should be feasible. Moving access above 50% in a manner that does not drain public finances (electricity generation is priced below cost) will require considerable political commitment. In transport, the division of responsibilities across different ministries makes coordination difficult though there is a coordinating group with a proposed national transportation plan. The presence of strong private sector firms in the telecommunications sector should provide significant opportunities in this space and may be a driver for continued reform and growth. In terms of the physical infrastructure needed for trade, there is political commitment but many of the individual projects (particularly SEZs) have come up against major challenges and would probably continue to do so, especially where there is limited consultation with local communities. Trade infrastructure is much more difficult in conflict-affected regions. Building a better road to a neighbouring economy sounds like an economic win-win but in fact might be perceived as facilitating the advancement of the army and be resisted by the local groups.

71. **Progress on land reform will be extremely complicated given the number of actors involved and any progress will require ongoing political commitment from all sides.** There are multiple government bodies and Ethnic Armed Groups involved in the management of this issue in different areas and at different levels which massively complicates progress. It is further complicated by land grabs, which brings in powerful vested interests with close connections to elites. Possible tensions between land reform and customary laws add yet more complexity.

72. **Strong commitment to education reform and increased government expenditure could be undermined by a set of contentious issues and broader political capture in the run up to elections.** There is widespread recognition of the need for education reform in Myanmar and the ongoing development of a 5 year National Education Sector Plan sets out a pathway for broad based reform. The increasingly politicised National Education Law amendment process however highlights the risk that reform could be derailed by contentious issues associated with moving from a unitary to multi-ethnic state (e.g. language of instruction, decentralisation, curriculum, role of ethnic education departments) as well as the risk of broader political capture due to education's strong symbolic role in state failure and political repression.

73. **Broad-based progress on creating a more level playing field for businesses will be extremely difficult but there will be opportunities within sectors or on particular issues.** Economy-wide progress on improving regulation and increasing competition will come up against significant vested interests, particularly because of the involvement of the state and military in so many different sectors. However making progress on specific issues, in specific sectors or by strengthening the institutions responsible for overseeing competition may be possible on a case-by-case basis. High-level trade reform will be possible because of the political momentum created by ASEAN and the various associated agreements. Deeper reforms, such as customs reform, are more likely to come up against specific vested interests.

74. **Sectoral engagements will be subject to their own specific political economy considerations**. These will be dynamic and will vary in different sub-sectors and in different regions. Any interventions targeting a specific sector or region will require a more detailed analysis of these issues.

Summary of Political Economy of Technical Constraints

Constraint	Binding (sector)	Politically Feasible	Will space close	Timing of benefits
Macroeconomic Policy	Has become binding with high risk for all sectors and for inclusion.	Partial progress feasible but politically challenging to stop deficit financing.	Yes	Both Short and Long-term
Access to finance	Binding (all sectors)	Partial progress feasible	There is a risk that space closes further but also possibility that we will see renewed openness and reform.	Both
Infrastructure (esp. Electric Power)	Binding (all sectors)	Yes but multiple plans and responsible ministries makes it difficult and in some cases conflict-related issues (such as road transport).	Unlikely to see space close across all areas but strong likelihood that space closes on specific issues (e.g. electricity tariff or road transport in conflict-affected areas)	Long-term
Land	Binding (most sectors but not for large firms (in particular elites) or firms in industrial zones)	Uncertain due to the large number of actors involved	Uncertain (space has to clearly open first)	Some opportunity for short-term benefits but reforms likely to take a long time
Skills	Not binding in all sectors	Yes, though risk of political capture particularly in run up to election.	The current window for structural reform in the education sector will likely close.	Long-term
Government involvement in economy and impact on competition, regulation and trade	Binding (most sectors) Corruption & Cronyism Tariff System, Inland Road Connectivity, Trade Financing	Partial progress in certain sectors feasible but there will be specific sectors where reform will be blocked by powerful vested interests.	Likely to see continued reform momentum on ASEAN Economic Community commitments and in certain sectors but appetite for broader reform and for reform in some sectors may diminish depending on political will and vested interests	Both

Section 5: Current Economic Development portfolio and potential future direction:

75. **The obstacles to inclusive growth are technical, political and institutional – and in some of the peripheral and mountainous areas, also physical.**[60] As assessed in section 3, the main technical constraints include access to finance, land, infrastructure, macroeconomic stability, skills and weak regulation and competition. Section 4 pointed to the political and institutional factors that need to be addressed for inclusive growth - conflict, the slowing pace of reforms which shakes confidence, low capacity and unaccountable public sector, and the elite's domination of key economic sectors, services and assets. These analyses shape DFID's approach to inclusive growth in Myanmar (and the principles underpinning our approach) as laid out in this final section.

76. **The time to act is now. The current reforms offer the first real hope in sixty years to for peace and inclusive economic growth.** Although the political window for radical reform is slowing or closing in some areas, the continued commitment to the 2015 election, the peace process and decentralisation will mean that some space to act will remain open over the next few years.

77. **But change will be gradual and we should anticipate setbacks.** The political and economic drivers of the current system are deeply rooted and do not lend themselves to rapid change. Continuous engagement from development partners to respond to opportunities and overcome setbacks will be necessary to deliver the long-term gradual change required.

78. **Myanmar should prioritise reforms that lead to economic structural transformation – a reduction in the share of production of agriculture in the economy and a corresponding rise in manufacturing and services**. In support of this transformation, Myanmar needs to prioritise macroeconomic management and stability; remove barriers to new private businesses; promote competition and foster innovation; reform the sectors with export potential; and manage the risks to growth. On their own, these will not be sufficient for inclusive growth. Myanmar also needs to make progress on the political and institutional factors that form the context as identified in section 4.

79. **Structural transformation will require a fundamental change in the government's approach to the economy**. Government will need to shift away from its dominant role in key sectors to creating the right market conditions for private firms to lead. This involves a major change in the mind-set of politicians and the civil service – moving from being a self-interested economic agent to being the regulator. And it will likely take time for the private sector to trust the Government as a regulator prioritising country interests over vested interests. A rapid reduction of government investment before the private sector is ready to step in could be negative. Similarly, selling-off government assets too early could result in elite capture.

80. **These transformations will not necessarily result in inclusion on their own – especially for those classes and ethnic groups excluded to date.** Most opportunities now are in the agricultural sector (the most important sector for spreading growth in the short-run) and the rural non-farm economy. In time, the share of employment in agriculture will fall and a parallel rise in the number of jobs in the wider rural economy and urban areas should see increased migration from rural to urban areas. Government will need to create the conditions that facilitate safe migration – guarding against the extremes of trafficking – but also extending access to essential basic services. Supporting, facilitating and monitoring safe outmigration to other countries is essential given that around 10% of the country works abroad (legally and illegally). Not everyone can or will move out of agriculture even at the same time as they remain on marginal land. Government will need to help this group 'hang in' in the agricultural sector, helping increase food security and resilience through targeted and well managed safety nets. Continued conflict and ethnic and religious exclusion also means that some groups may be actively excluded from this growth process without more direct efforts to ensure their inclusion. For example, in some areas of Rahkine the Rohingya are prohibited from traveling to areas such as Yangon where they might access economic opportunities. There is a risk that such exclusion results in a cycle of exclusion and instability.

[60] Some of the regions are highly mountainous, sparsely populated and isolated from major travel routes and markets. The cost of delivering public goods and services in such areas is prohibitive. Here we might expect outmigration to be a more realistic goal in helping incomes converge across national space.

81. In laying out our approach, we have developed principles to underpin our progression. DFID will be:

- **Ambitious and work according to our comparative advantage**. We will prioritise our engagement based on where we have the comparative advantage and capacity to help deliver transformational change.
- **Delivering our support as part of a coherent HMG position.** This includes synergy with our existing programmes, other DFID programmes led from the UK and regional teams, broader UK Government (FCO and UKTI) work, and work conducted by international banks and institutions with which the UK has a shareholding (for example the World Bank and Asian Development Bank).
- **Focused on reform and inclusion** – not just in economic development, but also in democratic governance, peace-building, gender, civil society strengthening and basic service delivery. Work in these areas may also create direct opportunities to enhance inclusive growth – the work on peace-building for example may create opportunities to increase inclusive growth in previously marginalised areas.
- **Flexible and innovative.** DFID will retain flexibility to quickly respond to political openings on reforms and new and innovative partnerships that may unlock the surest path to reform. This might be direct engagements with companies on responsible investment; strategic partnerships with Thailand, China and India to boost inclusive growth; or identifying new reformers that may emerge after the 2015 election who we can support to deliver important reforms. We will be flexible to adopt different approaches in our interventions – for example working on regulatory reform within a specific sector might be more feasible than trying to improve regulations across all sectors.
- **Continuously challenge our assumptions and be practical in our goals.** The operating environment in Myanmar is characterised by uncertainty. There are a lot of unknowns and the context is dynamic. This will require a careful approach with regular challenge of our initial assumptions and strong political economy analysis. Careful sequencing will be important as it will rarely be possible or desirable to move straight to best practice in such a complex environment with relatively weak capacity and vested interests. We are open to helping reformers edge forward in ways that improves the situation but does not necessarily move to the gold standard straight away.
- **Prioritising aid effectiveness and sustainability.** We will coordinate and demand strong coordination from donors and implementing partners. We will ensure that our interventions support institutional reform and increase accountability to citizens for better services. DFID will use opportunities to develop local capacity by using local suppliers of local systems where possible.
- **Guided by conflict sensitivity and ensure we do not leave people behind.**

DFID's economic development portfolio:

82. To respond to the analysis in the diagnostic – the culmination of our thinking since the reforms began in 2011, our portfolio is focused as follows:

- **Stepping Up:** Increasing agricultural productivity and supporting smallholders who can to step up to commercialisation in agriculture. This should include supporting the emergence of high potential export sectors in the agriculture space (such as the beans and pulses sector).
- **Job creation, improving skills and stepping out:** Support the emergence of job-creating sectors where the opportunity for productivity (and therefore wage) growth is higher. This includes promising sectors in the rural non-farm economy (such as agri-processing) as well as non-agricultural services (such as tourism) and manufacturing sectors (such as garments). Specifically we are supporting rural households to 'step out' of own account farming' into the wider rural economy and through migration. At the core of our support are skills development and certification, migrant rights, financial inclusion, social protection and nutrition support. We are also working with the government and non-state actors to prioritise the education sector reforms most fundamental to delivering the critical skills required by Myanmar's future labour force. We will also explore how to ensure that Myanmar's cities are best able to cope with the increasing urbanisation.
- **Boosting business for shared prosperity:** Promote increased competition and innovation in the private sector by trying to remove the biggest constraints to strong export-led growth. This includes improving investment regulation, policy and implementation; addressing key constraints to financial sector

development; improving the financing of infrastructure and shared services; finding ways to help Myanmar realise its trade potential; promoting more responsible business; and identifying ways to ensure that the benefits of growth are more widely shared.

- **Better public expenditure:** Strengthen the government's ability to direct its public expenditure to the right areas including increasing and improving the quality of its economic development expenditure and expenditure allocated to basic services and social safety nets.
- **Managing the risks to growth and hanging in:** Help Myanmar manage the major risks that it faces, all of which have major implications for economic growth. These include its exposure to natural disasters, its vulnerability to shifting weather patterns, rising demand for food, the environmental risks that surround its increased economic growth, its concentration on a small number of trade partners and its subsequent exposure to downturns in regional economies and its vulnerability to falling gas prices. Through our livelihoods work we will seek to support those who are not in a position to step up or step out in agriculture to ensure that they can hang in by maintaining a focus on food security, improved nutrition and social safety nets. In short, we will strengthen their resilience and build their capability to step out over time.

83. Before 2012, DFID's economic development work was confined to working on livelihoods and food security with small holder farmers in cyclone affected areas. The easing of sanctions in 2012 enabled us for the first time to work more closely with the Government and with the private sector and we have been progressively shaping our work around the areas identified above to respond to this. We have taken the following steps:

- **Improved the evidence base for our interventions** by funding a number of studies such as the Investment Climate Assessment and the Public Expenditure and Financial Accountability assessment, using these studies as a way of incentivising the entry of International Financial Institutions (which were only able to formally enter in January 2013).[61] We will need to continue to deepen our knowledge in other areas such as sector-specific political economy analysis; deepening our understanding of how to boost inclusive growth in the peripheral regions; and how Myanmar can best benefit from regional economic shifts and dynamics.
- **Experimented with interventions around inclusive and responsible business** through the Centre for Responsible Business and the Business Innovation Facility.
- **Supported reformers in the Government to deliver important reforms** in areas that overlap with our own priorities such as the Extractives Industries Transparency Initiative and on Public Private Partnership work in the electric power sector.
- **Reshaped existing programmes to have a much stronger focus on economic transformation**, for example on rural economic development through the Livelihoods and Food Security Trust Fund (LIFT).
- **Initiated or begun initiating long-term programming.** In some cases we have the right mechanisms in place such as on Public Financial Management. In other cases we have had to reshape existing mechanisms (as in rural economic development as stated above) and in other cases we are developing new programmes to create the right mechanisms to respond such as on private sector development.
- **Planned for exit and a sustainable legacy through leveraging public and private capital.** We have moved away from projects focused on reach and results to an approach where our programmes on the ground are linked into our policy advocacy with Government, donors and the private sector and are part of a system that generates evidence and uses that evidence to advance reform. This approach to policy reform and evidence is at the heart of our work with LIFT.

84. We will explore how we can boost inclusive growth through the work DFID is doing on peace building and education. Our primary instruments however are the following programmes:

[61] IFIs were unable to set up a programme prior to January 2013 as Burma was in arrears on its debt to these institutions. These arrears were cleared in January 2013.

- *Livelihoods and Food Security Trust Fund and International Climate Facility* (£100m over 4 years and business case planned for completion in November 2015).
- *Business for Shared Prosperity* (business case £50m over 5 years, part of which has been approved) and the *Business Innovation Facility* (live business case of £4.9m over 5 years).
- *Improving the management of public finances for the benefit of the people* (£20m over 5 years up until 2019).
- *PIDG InfraCo Asia* (£19m over 5 years – through the PSD PIDG business case).
- *South Asia Regional Trade Integration Programme* (managed out of the India Regional Office with a total pot of more than £500m and the business case is forthcoming).

[i] Myanmar's moment: Unique opportunities, major challenges. McKinsey, June 2013
[ii] U Myint, "GDP Growth Rates: Myanmar and Selected Asian Countries", presented at National Workshops for Economic Development of Myanmar, Naypyitaw, August 2011 and U Myint, "Myanmar's GDP growth and investment: lessons from a historical perspective", in Monique Skidmore and Trevor Wilson, eds., Dictatorship, Disorder and Decline in Myanmar (Canberra: ANU E Press, 2008), pp. 51–60 combined with recent data from IMF Review of Staff Monitored Programme in January 2014 and the IMF Article IV Statistical Annex in 2010
[iii] IMF Article IV Consultation for Myanmar, October 2014
[iv] U Myint, "GDP Growth Rates: Myanmar and Selected Asian Countries", presented at National Workshops for Economic Development of Myanmar, Naypyitaw, August 2011 and U Myint, "Myanmar's GDP growth and investment: lessons from a historical perspective", in Monique Skidmore and Trevor Wilson, eds., Dictatorship, Disorder and Decline in Myanmar (Canberra: ANU E Press, 2008), pp. 51–60
[v] Public Expenditure and Financial Accountability Performance Report, May 2013
[vi] Conceptualising Public Sector Reform, The Asia Foundation, 2015, and forthcoming in Myanmar Public Expenditure Review (2015) produced by the World Bank Group
[vii] Conceptualising Public Sector Reform, The Asia Foundation, 2015
[viii] Ibid
[ix] Presentation made by the Budget Department in the Ministry of Finance in March 2014
[x] Unlocking the Potential, Country Diagnostic Study, ADB March 2014
[xi] Myanmar: Unlocking the Potential, Country Diagnostic Study, ADB March 2014
[xii] Ibid
[xiii] UNCTAD Data base
[xiv] GoM and WB estimates in Myanmar Economic Monitor, October 2015 World Bank Group
[xv] Forthcoming in Myanmar Public Expenditure Review produced by the World Bank Group
[xvi] Doing Business Report (2016), World Bank Group
[xvii] The Asian Development Outlook 2015 "Financing Asia's Future Growth", 24 March 2015.
[xviii] IMF Article IV Consultation for Myanmar, September 2015
http://www.imf.org/external/pubs/ft/scr/2015/cr15267.pdf
[xix] IMF Debt Sustainability Analysis accompanying the IMF Article IV Consultation for Myanmar, October 2014
[xx] IMF Article IV Consultation for Myanmar, September 2015, IMF Article IV Consultation for Myanmar, October 2014 and The Asian Development Outlook 2015 "Financing Asia's Future Growth", 24 March 2015.
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