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# Myanmar on the Move: An Overview of Recent Developments

Lex Rieffel

**Abstract:** This paper examines the remarkable political transition underway in Myanmar/Burma since the inauguration of President Thein Sein at the end of March 2011. It begins with the historical background and the political context and then addresses the main features of the economy, highlighting current performance, major reforms, and key issues. It concludes by characterising the progress to date as verging on the miraculous, while stressing that future progress is highly uncertain. The next two years leading up to a national election in 2015 are unlikely to be as easy as the past two. Outsiders can be most helpful by giving senior officials more space to concentrate on policy formulation and implantation.

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**Keywords:** Myanmar, Burma, economy, reforms

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# 1 Introduction

You might call it a reverse coup. In March 2011, former general Thein Sein was sworn in as the president of Myanmar's first elected government in almost 50 years. His inaugural address astonished experts both inside and outside the country by sketching out a vision of democratic rule and economic management that represented a 180-degree turn from the preceding decades of military rule.

President Thein Sein further confounded sceptics and critics by actually taking concrete steps toward achieving this vision. The two most dramatic steps in 2011 were initiating a dialogue in August with opposition leader Aung San Suu Kyi that led to her election to a seat in the legislature six months later, and suspending construction in September of a dam at the head of the Ayeyarwady River designed to supply electricity to Yunnan Province in China.

The most dramatic steps in 2012 are not as easy to select, but the one most likely to top the list of any economist is abandoning (on 1 April) the country's grossly overvalued official exchange rate and adopting a market-based exchange rate system. These policy reforms and many others produced a tsunami of foreign visitors to initiate aid programs and reap the early fruits of an improved investment climate.

The future of Myanmar would be rosy except for a number of deeply rooted legacies dating back to its first day of independence on 4 January 1948. It is easy to foresee rapid economic growth and rising standards of living as long as the reform momentum continues. It is more likely, however, that the momentum will falter due to problems from two sources. The most obvious source is the ethnic differences that have plagued the country since independence will remain unresolved. The other source is a collection of vested interests that could become more adept at preserving their advantaged positions and fending off competition from both internal and foreign sources.

# 2 The Economic Legacy

Myanmar's pre-independence starting point is important to keep in mind.<sup>1</sup> On the eve of World War II, the British colony of Burma stood out for

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1 Three basic works on the Myanmar economy are Myat Thein 2004, Tin Maung Maung Than 2007, and Fujita, Mieno, and Okamoto 2009. In *Fierce Dragons*, Sean Turnell (2009), an economic historian, has written about the key role played by the Chettiar business community in the developing, before World War II, Burma's Irrawaddy Delta into the world's leading source of rice exports. He also analyses the

being the world's biggest rice exporter and for having an educated elite that was among the finest in Asia. The physical destruction of Burma's industry and infrastructure by the Japanese army and then by the advancing Allied Forces was massive. Aung San – the father of Aung San Suu Kyi – emerged from the war with a group of army officers trained in Japan to lead the fight for independence from Britain. One of the first tragedies suffered by the Myanmar nation was his assassination (along with six other leaders) barely six months before Myanmar became formally independent.<sup>2</sup>

From 1948 to 1958, Myanmar was governed by the majority party in a parliament elected under a constitution conforming to the democratic standards of the day. The government was relatively stable but increasingly dysfunctional. It was immediately challenged by dual insurgencies: communists in the Burman heartland and ethnic separatists in the mountainous borderlands. The army was eventually (at the end of the 1980s) able to crush the communist insurgency, but the ethnic insurgencies remain unsettled. The economy slowly recovered from the wartime devastation but internal conflicts and misguided policies kept employment and incomes well below potential levels.<sup>3</sup>

When a national election in 1960 failed to produce a more effective government, army chief of staff General Ne Win seized power and began 50 years of military rule. He moved rapidly to pursue a socialist path, nationalising most of the industrial sector and closing the country to outside influences. He presided over a steady decline of Myanmar's economy. In 1987, Myanmar was designated by the United Nations as one of the world's least developed countries.

Economic misery was at the heart of the popular uprising that ended Ne Win's rule in 1988. The junta that displaced him promptly abandoned socialism in favour of market-based growth, and called for multi-party national elections in 1990. Aung San Suu Kyi, married to a British academic and living in England, happened to be visiting her ill mother at the time of the uprising and became the leader of the main anti-military party: the National League for Democracy (NLD). Contrary to the expectations of the

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banking crisis that Myanmar suffered in 2002, and a successful microfinance scheme initiated by an international NGO.

2 Thant Myint-U's *River of Lost Footsteps* is an excellent introduction to Myanmar.

3 Burma's economic development in the 1950s was based on the "Pyidawtha Plan". At the heart of this plan was an 840-page report produced by a team of American engineers and the noted economist Robert R. Nathan and delivered to the government in 1953. The definitive study of the development and implementation of the plan was written by one of the team members, Louis Walinsky and published in 1962: *Economic Development in Burma 1951-1960*. Walinsky 1962.

junta, the NLD won 80 per cent of the seats, but the junta opted to retain power. General Than Shwe emerged as the supreme leader in 1992 and ruled with a heavy hand for the next 19 years.

An economic renaissance in the first half of the 1990s went flat in the second half as the regime's suppression of internal dissent – especially keeping Aung San Suu Kyi under house arrest – and its constant military actions directed at a number of ethnic minorities prompted most Western democracies to impose political and economic sanctions against Myanmar. In the wake of the 1997–98 financial crises in Asia, the Myanmar economy was grinding to a halt when it was revived by a windfall of foreign exchange from natural gas exports to Thailand.

In the first decade of the 21<sup>st</sup> century, Western sanctions intensified, especially after an organised attack on Aung San Suu Kyi in 2003 and the suppression of a monk-led uprising in September 2007. The economy grew modestly on the strength of natural resource extraction, but the bulk of the population experienced little improvement in their standard of living.

### 3 The New Political Scene

The singular feature of the political transition that began in 2011 is that it was initiated by General Than Shwe based on a seven-step roadmap to a “discipline-flourishing democracy” announced in 2004.<sup>4</sup> Key steps were a referendum in May 2008 to approve a new quasi-democratic constitution, a national election in November 2010 that was neither free nor fair, and the selection of retired General Thein Sein – prime minister in the previous government – as President.<sup>5</sup> In response to the reforms introduced by President Thein Sein after his inauguration on 30 March 2011, the Western sanctions have been lifted or suspended, aid donors have rushed in to support the country's political and economic transition, and a swarm of foreign in-

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4 An “insider's” perspective on the political transition can be found in Kyaw Yin Hlaing 2012. An “outsider's” perspective can be found in Osnos 2012.

5 The edited volume by Rieffel (2010b) includes perspectives on Myanmar on the eve of the 2010 elections from two prominent Myanmar political analysts, two Chinese analysts, and others from ASEAN, Australia, India, Singapore, Thailand, and the United States. It also contains the statement by U.S. Department of State Assistant Secretary of State for East Asia and the Pacific before a congressional committee in October 2009, outlining the Obama Administration's new policy of “pragmatic engagement” toward Myanmar.

vestors has been taking advantage of every opportunity to advance their business interests.<sup>6</sup>

In the months since the Thein Sein government took office, improvements in the political scene have been astonishingly positive. At the heart of these improvements has been a kind of partnership between President Thein Sein and Aung San Suu Kyi. The NLD had refused to participate in the November 2010 election because it deemed the 2008 constitution to be flawed and illegitimate. President Thein Sein, however, was able to provide enough assurances about his commitment to democratic rule to enable the NLD to compete in a by-election held in April 2012 to fill empty seats in the legislature. The NLD won 43 of the 45 open seats, and Daw Suu Kyi was elected by a landslide in one of the constituencies.

A Thein Sein–Suu Kyi duumvirate might be a winning formula for good governance, but there are competing forces and pressures that make the political outlook highly uncertain. To begin with, the legislature – led by speaker of the lower chamber U Shwe Mann – is shaping up as an independent source of power. It eagerly amends legislation proposed by the government and many of these amendments appear to benefit special interests more than the population as a whole. The 2008 Constitution mandates a new election in 2015, and as this date approaches both the NLD and majority government-sponsored party (Union Solidarity and Development Party–USDP) are likely to become factionalised and increasingly disinclined to cooperate (for the role of civil society in the recent elections, see Lidauer 2012). The 2008 Constitution also reserves a quarter of the seats in the two houses of the legislature for military appointees. So far, these appointees have shown a surprising degree of independence, but how this faction will evolve is hard to predict. It is even possible that the Constitution will be amended before the 2015 election to shrink or eliminate the military seats.

The existential challenge for the Thein Sein government, however, is making peace with the ethnic minorities. New ceasefire agreements have been concluded with all but one of the armed ethnic groups. It is hard to imagine sustainable economic growth in Myanmar until a durable ceasefire is concluded with the Kachin Independence Army and a peace agreement with the ethnic minorities as a group – presumably including amendments to the 2008 Constitution – is ratified. Given the blood that has been shed and the

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6 David I. Steinberg (2010) is a useful guide to Myanmar's political evolution since independence in 1948.

grievances that have accumulated since independence, the difficulty of achieving this outcome cannot be exaggerated.<sup>7</sup>

Another daunting political challenge is resolving the fate of the Rohingya people residing in Rakhine State, which is stretched along the Indian Ocean coast from the border with Bangladesh. This Muslim group, numbering an estimated 800,000, has been stateless for decades despite inhabiting the area for generations. In two episodes of serious communal violence in Rakhine State in 2012, more than 100,000 Rohingya people lost their homes. Most are living in refugee camps. The Rohingya problem has the potential of destabilising the government and disrupting the normalisation of Myanmar's relations with the rest of the world.<sup>8</sup>

The best news on the political front is the ability of the population at large to enjoy the freedoms that have been denied them for fifty years and that have been enjoyed to an increasing degree by their Asian neighbours. While a number of political prisoners have not yet been released and some dissidents have been arrested, the government has stopped censoring the press and exiled activists have been invited back. It is this new freedom from fear that above all makes people optimistic that the reforms ushered in by the Thein Sein government will not be reversed.<sup>9</sup>

## 4 Macro-economic Policies and Performance

It can be said that there was no macro-economic management in Myanmar from the end of the parliamentary government in 1958 until the inauguration of the Thein Sein government in March 2011.<sup>10</sup> To its credit, the government has embraced the concept of macro-economic management, following in the footsteps of its East Asian neighbours, and has called upon the

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7 For background on the ethnic issue, see Callahan 2007 and Zaw Oo and Min Win 2007. For an examination of winners and losers in the peace process in mid-2012, see South 2012.

8 The political strains at the end of 2012 are analysed in great detail in International Crisis Group 2012a.

9 The military continues to play a major role in the political system and the economy. Redefining the military's authorities and functions is a crucial challenge for the government that goes beyond the scope of this article.

10 Rieffel (2010a) provides an overview of the Myanmar economy at the beginning of 2010, focusing on key policy challenges for the government. A more recent overview is provided in International Crisis Group 2012b. Twenty-one high-priority economic issues facing the Thein Sein government in mid-2012 are examined in Rieffel 2012. Many of the statements and judgments in the following paragraphs are based on personal observations and conversations with knowledgeable interlocutors in Myanmar between January 2010 and January 2013.

International Monetary Fund for help in building the necessary human and institutional capacities.<sup>11</sup>

The Thein Sein government inherited a multiple exchange rate system with one of the world's most overvalued official exchange rates. Before the end of 2011, IMF experts were working with the government to introduce a new exchange rate system. On 1 April 2012, Myanmar introduced a market-based exchange rate, and steps are now being taken to move to full current account convertibility, possibly before the end of 2013.

The balance of payments remains strong, benefitting from the high global oil prices used as benchmarks for Myanmar's natural gas exports to Thailand, along with substantial foreign exchange earnings from gem sales and other agricultural and natural resource exports. Upward pressure on the exchange rate has been heavy and is expected to continue as foreign currency receipts rise from investment, tourism, foreign aid, etc.

A large cloud hanging over Myanmar's balance of payments was a stock of payment arrears, on the order of 11 billion USD at the end of 2012, mostly on official loans from Japan. Arrears to the Asian Development Bank (517 million USD) and the World Bank (436 million USD) were especially problematical because they could not be written off as arrears to bilateral official and commercial bank creditors can be. Again to the credit of the Thein Sein government, but also to the Governments of Japan and Norway, a "bridging" operation was carried out in January 2013 that paid down these arrears, enabling the two multilateral agencies to resume normal lending to Myanmar. At the same time, an agreement was reached with bilateral creditor agencies in the Paris Club to cancel and reschedule most of Myanmar's other arrears.<sup>12</sup>

Improvements in fiscal policy seem to be materialising more rapidly than improvements in monetary policy. Myanmar has run chronic fiscal deficits monetised by the central bank and fuelling significant inflation. A key step toward fiscal sanity was taken in 2011 when the Thein Sein government decided to use a market exchange rate for the hard currency components of receipts and expenditures in its 2012/2013 budget instead of the 100-times overvalued official rate. The composition of the 2012/2013 budget was also shifted significantly in a pro-growth direction. The World Bank is now undertaking a Public Expenditure and Financial Accountability As-

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11 The first IMF report on Myanmar released to the public and posted on the IMF website was the staff report on the 2011 Article IV consultations with Myanmar: International Monetary Fund 2012. A second report, on the Myanmar government's program of economic and financial policies in 2012, which will be monitored by the staff, was posted in January 2013: International Monetary Fund 2013.

12 The Paris Club press release can be found at <[www.clubdeparis.org/](http://www.clubdeparis.org/)>.



essment (PEFA) and a Public Expenditure Review (PER), which have the potential of yielding a quantum improvement in fiscal policy (World Bank 2012a).

Another significant development in this area is the Thein Sein government's commitment to participate in the Extractive Industries Transparency Initiative (EITI) and the concrete steps it has taken to do so. This effort to show how revenue derived from resource extraction goes to finance socially beneficial activities could help to transform Myanmar's resource curse into a blessing.

The problem with monetary policy is that the Central Bank of Myanmar lacks the legal authority, the institutional capacity, and the essential instruments to conduct effective monetary policy. The weakness of the banking system and the super-shallow capital market are also handicaps. The IMF's technical guidance is focused in this area. A new central bank law is expected early in 2013 and a rudimentary money market may exist by the end of the year.

Two important caveats about the macro-economy are in order. First, the statistical base is thin and unreliable.<sup>13</sup> Even the population of the country is uncertain, with estimates ranging from 48 to 62 million people. Virtually all existing economic data should be taken with a grain of salt. Second, a great deal of economic activity in Myanmar is unrecorded. Much of this is "legitimate" border trade, but the illegal component (narcotics, smuggled timber and wildlife, human trafficking, etc.) is large enough to have a macro-economic impact.

With these caveats, the latest estimates from the IMF and the World Bank for the basic economic indicators are as follows: GDP growth of 6.3 per cent in fiscal year 2012/2013 (ending 31 March), inflation of 6.1 per cent, and a fiscal deficit of 5.3 per cent of GDP. Foreign exchange reserves were adequate at around 5 billion USD (four months of imports) at the end of 2012. The ADB estimate of GDP per capita was 857 USD in 2011, the lowest in East Asia.<sup>14</sup>

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13 The World Bank website includes the following statement: "Comparable country data for Myanmar can't be provided at this time. The World Bank and other agencies are re-engaging with the Myanmar government and will support Myanmar in its effort to address the scarcity of reliable data for the country."

14 The latest reports on the Myanmar economy from the Asian Development Bank, the World Bank, and the IMF are listed in the references.

## 5 Infrastructure

One of the most astonishing facts about the economy of Myanmar is that it lacks a single highway or railroad connection with any of its five neighbouring countries. Asian “connectivity” has been a regional preoccupation for decades, with major corridors to and through Myanmar well studied and laid out. The previous government prided itself for its infrastructure investments, but these were largely in the form of scattered roads, bridges, and dams motivated more by political objectives than economic ones. Outstanding examples are the new capital of Naypyitaw and the 220-mile highway connecting Yangon to Naypyitaw.

In the years ahead, the long-stalled plans for transportation infrastructure are expected to proceed on a fast track, with a good amount of donor assistance and in a public-private partnership framework (ERIA 2012). Airport expansions are already underway in anticipation of the Southeast Asian Games and the ASEAN/East Asia Summits that Myanmar will be hosting at the end of 2013 and in 2014 respectively. An important decision was made in 2012 to prioritise the development of the Thilawa Port and Special Economic Zone on the edge of Yangon, with the help of Japan. Two other major port and economic zone projects initiated by the previous government have started but the pace of their development is less clear. One is at Dawei, directly West of Bangkok, which started as a concession granted to a Thai construction company but may go forward as a Japan-led venture. The other – led by China – is at Kyaukphyu near the border with Bangladesh where the pipeline from a major offshore gas field makes landfall and where the parallel gas and crude oil pipelines to Yunnan Province in China, now nearing completion, begin.

Arguably the most important infrastructure improvements in the next few years will be in the electric power sector. Myanmar is one of the least electrified countries in Asia. Large investments in hydropower during the past two decades have been undertaken to export power to China and Thailand, with less than 20 per cent of the output used domestically. The Thein Sein government understands the urgency of expanding capacity for rural and industrial electric consumption as well as urban consumption and has taken a number of important steps to meet the demand. An important policy challenge for the government will be avoiding the subsidies that voters and special interests are likely to seek (see Asian Development Bank 2012d and Dapice 2012).

The IT sector is where some of the earliest gains may be realised. Mobile phone penetration was under 10 per cent when the Thein Sein government took office and the goal of achieving 80 per cent penetration by the end of 2015 may be within reach (Government of Myanmar 2012). The

government and the private banks also appear to understand the power of mobile banking and are working to put reliable systems in place quickly. Internet access, sharply constrained by the previous government, has been improved greatly during the past year and the policy objective is to build capacity sufficient to meet the rapidly increasing demand.

Looping back to hydro-electric power, one of the biggest stories in 2011 was President Thein Sein's decision to suspend construction on the Myitsone Dam at the head of the Ayeyarwady River. It was part of a complex of dams to supply electricity to Yunnan Province agreed to by the previous government with the China Power Investment Corporation. It was controversial for at least six reasons: non-transparency, minimal electricity supply to the domestic market, forcible displacement of residents, predominant use of Chinese labour, adverse environmental impacts, and disrespect of local cultural heritage. The symbolism of the suspension, in terms of rebalancing Myanmar's relations with China and responding to civil society concerns, was great.<sup>15</sup>

## 6 Agriculture

Sixty to seventy per cent of Myanmar's population lives in rural areas and is dependent on agriculture. Productivity in this sector is low by Asian standards, but Myanmar does have one advantage here. Unlike its neighbouring countries, its croplands have not yet been damaged by overuse of chemicals (fertiliser, pesticides, herbicides). It will not be easy, however, to preserve this advantage (see Asian Development Bank 2012c).

Policy weakness may be the most severe in this area. Land tenure is a huge problem despite the passage of two new land laws under the Thein Sein government. Land alienation is occurring at a rate that is probably not socially sustainable. It is driven by rich and powerful interests seeking easy gains from commercial agriculture and urbanisation. It is enabled by the absence of an effective land registration system, lax enforcement, and the absence of a trusted dispute resolution process. Newspapers and journals in Myanmar are constantly publishing stories about new or ongoing "land grabbing" cases. One of these cases, or a combination, could become a socially explosive issue.

Experience elsewhere has highlighted the key role of government-sponsored agricultural credit programs in raising productivity. Myanmar has

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15 Volume 31, Number 1 (2012) of the *Journal of Current Southeast Asian Affairs* has six articles on China–Myanmar relations, see <<http://hup.sub.uni-hamburg.de/giga/jsaa/issue/view/77>>.

never had an effective program and the Thein Sein government does not seem to be moving aggressively to put one in place. More troubling, the Agriculture Ministry is more oriented toward achieving production targets than raising rural incomes by freeing farmers from existing constraints and supporting them with useful technical advice. The minister is considered to be a major obstacle to essential reforms.

Myanmar has the potential to once again be the world's leading rice exporter, but it is moving slowly to develop this potential and it may not be the best objective in the long term. Another macro concern in the agriculture sector is the unsustainable rate of deforestation, not only to export timber but also to create rubber and palm oil plantations. In the fisheries sub-sector, substantial wealth is being depleted through poaching by foreign fleets because the Myanmar navy does not have the capacity to stop them.

## 7 Oil and Gas and Minerals

Myanmar's resource curse is most severe in these sectors. Its oil resources were an objective of the Japanese army in World War II, but rent-seeking behaviour was not a problem in this area until Myanmar began exporting natural gas to Thailand from an offshore field in 1998. A second field in the same general area (west of Dawei) came on stream shortly thereafter, and gas from a third field is due to start flowing in 2013 through a second pipeline to Thailand.

As mentioned above, a separate offshore field near the border to Bangladesh will begin exporting gas to Yunnan Province before the end of 2013 through a pipeline cutting across the heart of Myanmar. Foreign investors have lined up to initiate new exploration and development ventures (both oil and gas, off shore and on shore), and the Thein Sein government is accommodating this demand, perhaps more than can be justified from a long-term development perspective.

The Thein Sein government has also been more supportive of mining sector development than may be economically wise or socially tolerable. Auctions of jadeite, sold almost exclusively to Chinese buyers, have been held two to three times a year, with some reporting sales in excess of 1 billion USD. Myanmar is a major source of rubies, mostly smuggled into Thailand. Mineral resources include coal and gold, but extend well beyond to others being exploited and yet to be exploited.

The current headline-grabbing extractive project is a copper mine in Sagaing Region undertaken as a joint venture between a military-affiliated Chinese company and one of the two major holding companies created by the Myanmar military. Residents have been protesting an expansion of the

project, with growing support from civil society generally. In November 2012, a police action against protesting monks seriously injured dozens of them and prompted the legislature to create a commission of inquiry led by Aung San Suu Kyi.<sup>16</sup> How this episode plays out will be an indication of how soon Myanmar can overcome its resource curse. One solution could be nationalisation of the project followed by the formation of a joint venture with a new foreign partner through a highly transparent process.

## 8 Manufacturing and Services

Myanmar's manufacturing sector is a mix of problems and opportunities. The problems are of four kinds. First, the high ground is occupied by state-owned enterprises, enterprises not considered state-owned but controlled by the military, and enterprises created by the cronies/proxies of the previous government. Together these represent the bulk of the vested interests in the economy. Second, the Western sanctions that began biting after 1997 took the steam out of the market euphoria at the beginning of the 1990s and made investment in manufacturing for export unattractive. At the same time, manufacturing for the domestic market was losing its appeal due to low incomes and poor growth prospects. The garment industry in particular was decimated when sanctions were tightened in 2003. Thousands of garment workers (mostly women) lost their jobs. Third, neither the banking system nor the capital market is capable of providing financing on reasonable terms for unconnected entrepreneurs. Fourth, exceedingly high land prices are offsetting much of the advantage of Myanmar's low-wage labour.

The opportunities grow out of these problems. The Thein Sein government is committed to privatising the state-owned enterprise sector both to improve competitiveness and to reduce its drag on the budget.<sup>17</sup> With sanctions largely suspended or lifted, the garment industry is stirring and could create thousands of new jobs within a couple of years because the skills already exist in the labour force and the export market is familiar. Financing will remain a problem in the short term, but the Myanmar Investment Commission has a mandate to encourage labour-intensive foreign investment and capital is plentiful in Asia. Another noteworthy development is the enactment of a Labor Law in March 2012 that has been viewed positively by both employers and workers.

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16 Most recent developments of this kind are described accurately and comprehensively in the weekly editions of *The Myanmar Times*, available at <[www.mmtimes.com/](http://www.mmtimes.com/)>.

17 References to current commitments of the government are mostly drawn from Government of Myanmar 2012.

Three of the service sub-sectors are worth mentioning. The financial sub-sector is by far the most important. At the start of the Thein Sein government, it hardly deserved the name. The historical legacy, including three demonetisations and a full-blown banking crisis in 2002, had destroyed public trust in banks. As a result, Myanmar still has a cash economy and even that is hampered by a scarcity of small notes and large notes. Myanmar banks were disconnected from much of the international financial system due to the Western sanctions, and a large portion of the country's international financial transactions were handled in the informal "hundi" system.

Most of Myanmar's nineteen private banks have moved aggressively over the past two years toward the goal of becoming domestically and internationally competitive. In particular, a handful of them have reached the point of having ATMs linked to the Visa- and MasterCard systems as well as equivalent Japanese and Chinese systems. These banks are also becoming competitive in offering remittance services for the millions of Myanmar workers in Thailand and elsewhere in Southeast Asia. They are working closely and rapidly with the Central Bank of Myanmar to build a modern payment system, a money market, and an exchange rate system. Wholesale and retail lending is still sharply constrained by regulations and equity capital. Steps have been taken by several banks to create partnerships with foreign banks, mostly from within the region. The government is expected to allow the formation of joint venture banks within a year or two but to hold off at least until 2016 the entry of foreign banks. The two main policy challenges in this area are building capacity in the Central Bank of Myanmar to regulate and supervise the banking system and restructuring the four state-owned banks so that they contribute meaningfully to economic growth.

Myanmar has had a nascent capital market for more than a decade. The previous government started issuing government bonds to curtail the monetisation of the fiscal deficit but building a government securities market will take several years. There is a lot of talk about revving up the stock exchange, which has long been the object of assistance from Japan, but it will take even longer for it to become an engine of growth.

The tourism sub-sector is booming. Hotels in Yangon have more than tripled the price of rooms since March 2011 in response to an extreme shortage. The main tourist destinations of Bagan, Mandalay, and Inle Lake are having difficulty coping with the influx of visitors. Numerous hotel and resort projects have been announced with ground being broken every week if not every couple of days. New airlines have been formed. The government is even considering opening its land borders for tourist entry, which have been closed for the past 50 years.

The construction sub-sector has been buoyant for almost a decade, propelled by building Naypyitaw and then by Chinese investments that spilled over into high-income housing in Yangon and Mandalay. Long-term growth prospects in this sub-sector are superb. The binding constraints in the near term will be the exorbitant cost of land (due to market imperfections, not basic scarcity), limited bank financing, and shortages of construction materials and skilled labour.

## 9 The Social Sectors

The greatest tragedy in Myanmar after the unresolved ethnic conflicts is the decimation of the education sector during the decades of military rule when students were viewed as a threat to political stability instead of a source of future prosperity. The Thein Sein government is giving a high priority to rebuilding the sector, even seeking to produce university graduates matching ASEAN norms by 2015. Two sources of optimism are rapid growth in private education at all levels and the plans of foreign donors to provide substantial financial resources and expertise for improving the education system.

The health sector also declined steadily over the past 50 years, although the growth of private health services after 1988 compensated for some of the decline in public health services. The Thein Sein government has sharply increased the budget allocation for the health sector from a pitifully low level. Some relatively rapid gains in indicators like infant and maternal mortality may be possible as foreign donors focus on the major weaknesses and foreign investment in medical services accelerates.

The rise of civil society since 1990, accelerating after Cyclone Nargis in 2008, is another source of optimism. As donor agencies and international NGOs have been given more scope for operating inside Myanmar, civil society has benefited more from capacity building activities than the government has. And civil society organisations have focused their programs on sectors where government programs have been weakest, including health, education, and rural development.

## 10 Foreign Trade and Investment

Although the Thein Sein government has removed numerous impediments to trade, many remain. Early moves by the government were ending key import monopolies (e.g., palm oil) and authorising a sharp increase in car imports to help soak up the inflows of foreign currency making the exchange rate appreciate to the point that exports were becoming uncompetitive. With Myanmar committed to free trade in 2015 with its partners in the

ASEAN Economic Community, the government is taking steps to rationalise the trade regime as best it can against resistance from vested interests.

The Thein Sein government was committed from the beginning to encouraging foreign investment, and attached a high priority to the passage of a new Foreign Investment Law (Bissinger 2012). The initial draft law, submitted to the legislature near the end of 2011, was highly controversial. It was sent back to the legislature by the President twice to remove protectionist elements before he signed it in November 2012. The flow of investment in the next few years, however, is not likely to be influenced much by the new law. More important determinants will be the action taken by the Myanmar Investment Commission on specific projects, the speed of infrastructure improvements (especially electricity and ports), the evolution of the financial system, and creating socially acceptable procedures for land acquisition.<sup>18</sup>

Another key driver of investment will be the role of Myanmar's large diaspora. It consists of two distinct segments: More than 100,000 skilled professionals scattered around the world, and as many as three million semi- and unskilled workers in Southeast Asia, mostly in Thailand and largely undocumented. Already skilled professionals are returning in significant numbers to test the waters, taking advantage of family connections and language ability. While they have the potential of transforming the economy, the existing business elite may prefer to collaborate with foreign partners rather than with members of the diaspora.

## 11 Foreign Aid

The arrears clearing operation at the beginning of 2013 will produce a gigantic statistical flow of aid to Myanmar. This will have a positive catalytic effect on both donor assistance and foreign investment but will not be a good indicator of future flows of aid to Myanmar. Aid flows from Western donors will be constrained for the next two to three years by lingering concerns about funding government programs and projects and by their relatively cumbersome procedures. By contrast, flows of aid from Asian donors, principally Japan but also Korea, China, and India, are likely to expand rapidly and in aggregate exceed aid flows from Western donors.

It is too soon to say whether foreign aid to Myanmar will be a curse or a blessing (Rieffel and Fox 2013). The Western donors stopped giving aid to the Myanmar government a decade ago because of its miserable human

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18 The sensitive issue of investment in Myanmar's borderlands is addressed in Transnational Institute 2013.



rights record. A low level of humanitarian assistance was maintained until Cyclone Nargis struck in 2008 when the previous government was shamed into opening the door for more disaster relief and recovery assistance. The aid flows gradually eased during the next three years and then became buoyant in the second half of 2011 as the reforms of the Thein Sein government gained credibility. In the past year, the government has been swamped with visitors from multilateral aid agencies, bilateral aid agencies, and international NGOs. Combined with visiting politicians, corporate executives, journalists, etc. seeking meetings with senior government officials, it is clear that these visits leave insufficient time for senior officials to formulate and implement essential policy adjustments.

While official aid flows are likely to accelerate in the months ahead, they will undoubtedly add up to only a fraction of the private capital flows. Consequently the beneficial impact of the aid flows will depend on three factors. First is the extent to which they help the government adopt and implement policies that foster sustainable and inclusive growth and direct flows of private capital away from unsustainable resource exploitation toward productive, labour-intensive activities. Second is the extent to which they align with the government's priorities and avoid the duplication and burdensome features of aid programs that have earned a bad reputation in other countries. Third is the extent to which they help build human and institutional capacity, not only in the public sector in the short term but in the education system in the long term.

To its credit, the Thein Sein government has done a credible job of developing a respectable national planning process and procedures for managing foreign aid. The First Myanmar Development Cooperation Forum was held in mid-January 2013 in Naypyitaw. It was well attended by donor agencies, and included representatives of international NGOs and the private sector. A draft *Framework for Economic and Social Reforms* was presented by the government as a basis for aligning donor programs with the government's development priorities (Government of Myanmar 2012). Furthermore, the Naypyitaw Accord for Effective Development Cooperation was adopted by acclamation. It contains commitments by the Myanmar government and by its "development partners" (donors) designed to ensure country ownership of the development process and avoid many of the problems that have undermined the effectiveness of foreign aid to other countries in the past.

## 12 Summing Up

The single best word to sum up the outlook is: uncertain. The primary source of uncertainty in the short term is the success or failure of the gov-

ernment's efforts to find a durable resolution of the conflict between the Burman majority and the ethnic minorities. Close behind is the success or failure of Myanmar's quasi-democratic system, which will face a crucial test in the 2015 national election.

A great source of uncertainty in the medium term is whether the government will be able to avoid the massive and unsustainable resource extraction that threatens to undermine living standards for future generations. Two other sources are the resistance of vested interests to essential reforms and social turmoil if the economic dividends expected by the population do not materialise quickly enough.

There are no good precedents for the kind of political and economic transformation that Myanmar is undertaking. What the Thein Sein government is attempting is a social experiment as ambitious as the one launched by Deng Xiaoping in China in 1979, although obviously on a smaller scale. Thirty-odd years ago, the global economy was favourable and the Chinese experiment took full advantage of this situation. The global economy is distinctly less favourable today. For example, the kind of export-led growth strategy that worked so well in other East Asian countries may not be a winner for Myanmar. On the other hand, the growth prospects of Myanmar's Asian neighbours are considerably better than those of the United States and Europe, which should work to Myanmar's advantage – as long as global threats such as climate change do not become spoilers.

It is incontestable that Myanmar is “on the move”. The progress made by the Thein Sein government since March 2011 verges on the spectacular. However, it will require a miracle for Myanmar's political and economic transitions to avoid major bumps over the next three years. What outsiders can do now to improve the odds for such a miracle is to give the government some breathing room: more time to concentrate on policy formulation and implementation, less unsolicited advice on what to do, and more encouragement of efforts by the people of Myanmar to pursue their own course toward a just and prosperous society.

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