ISSN 0219-3213

2014 #10

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ESTABLISHING INFRASTRUCTURE PROJECTS: PRIORITIES FOR MYANMAR'S INDUSTRIAL DEVELOPMENT — PART II: THE ROLE OF THE STATE

STUART LARKIN

ISEAS Publishing
INSTITUTE OF SOUTHEAST ASIAN STUDIES

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Published by: ISEAS Publishing
Institute of Southeast Asian Studies
30 Heng Mui Keng Terrace
Pasir Panjang, Singapore 119614
publish@iseas.edu.sg http://bookshop.iseas.edu.sg

ISEAS Library Cataloguing-in-Publication Data

Larkin, Stuart Paul.
Establishing Infrastructure Projects : Priorities for Myanmar's Industrial Development. Part II, The Role of the State.
(Trends in Southeast Asia, 0219-3213 ; TRS 10/14)
1. Infrastructure (Economics)—Myanmar—Government policy.
2. Industrialization—Myanmar.
3. Industrial policy—Myanmar.
I. Title.
II. Series: Trends in Southeast Asia ; TRS 10/14.
DS501 I59T no. 10(2014) 2014

ISBN 978-981-4620-22-2 (soft cover)
ISBN 978-981-4620-23-9 (e-book, PDF)

Typeset by Superskill Graphics Pte Ltd
Printed in Singapore by Mainland Press Pte Ltd

FOREWORD

The economic, political, strategic and cultural dynamism in Southeast Asia has gained added relevance in recent years with the spectacular rise of giant economies in East and South Asia. This has drawn greater attention to the region and to the enhanced role it now plays in international relations and global economics.

The sustained effort made by Southeast Asian nations since 1967 towards a peaceful and gradual integration of their economies has had indubitable success, and perhaps as a consequence of this, most of these countries are undergoing deep political and social changes domestically and are constructing innovative solutions to meet new international challenges. Big Power tensions continue to be played out in the neighbourhood despite the tradition of neutrality exercised by the Association of Southeast Asian Nations (ASEAN).

The **Trends in Southeast Asia** series acts as a platform for serious analyses by selected authors who are experts in their fields. It is aimed at encouraging policy makers and scholars to contemplate the diversity and dynamism of this exciting region.

THE EDITORS

Establishing Infrastructure Projects: Priorities for Myanmar's Industrial Development — Part II: The Role of the State

By Stuart Larkin

EXECUTIVE SUMMARY

- The issue of establishing infrastructure projects for Myanmar's industrial development is addressed in two parts. Part I focuses on the role of the private sector, how Myanmar's conglomerates can take the lead on infrastructure development with financing from the new China-led multilateral development banks. Part II focuses on the role of the state. The government needs to work closely with the conglomerates and also adopt measures and policies that will facilitate this model of infrastructure development.
- For sustainable, inclusive and high rates of economic growth Myanmar needs to diversify from its dependence on agriculture and the resource sectors and target labour-intensive manufacturing exports for growth which harbours the prospect of being able to climb the technology ladder. It needs infrastructure investment to be competitive.
- Washington consensus policies with their emphasis on improving governance and market liberalization may only intensify the political economy dynamics of the resource curse and be insufficient to bring about a transformation in the economy's structure to manufacturing exports.
- The more interventionist approach associated with the developmental state, which is characterized by collaborative state business relations and which the successful Asian economies have adopted, offers a better model for Myanmar to follow.

- More specifically, the executive should work closely with the tycoons, and their conglomerates, to establish a pipeline of "shovel-ready" infrastructure projects, assigning the necessary concessions, in timely preparation for exciting new sources of project finance.
- The two new China-led multilateral development banks – New Development Bank (NDB), (the "BRICS bank"), and the Asian Infrastructure Investment Bank (AIIB) – will both focus on infrastructure finance. Their loan covenants will not contain non-economic conditionalities.
- These new sources of financing could minimize political pushback resulting from fears of China's rapid rise since (i) the loan recipients will be Special Purpose Vehicles (SPVs) wholly owned or majority controlled by Myanmar conglomerates and (ii) though China-led these new institutions are multilateral.
- The government should match its collaboration with the tycoons on specific project development with a sharpened focus on improving governance as it pertains to the provision of international project financing. This includes paying attention to the legal and regulatory environment and perhaps drafting specific project finance and SPV laws and also addressing land issues.
- Infrastructure concessions where the project promoter is responsible for land acquisition are not generally considered "bankable" by international financial institutions so it is best that the government accepts responsibility for land acquisition through exercise of its rights under eminent domain.
- Some farmers who lose their land to infrastructure projects could be compensated with fallow and virgin lands taken back from agribusinesses that have acquired such lands but have failed to invest. This solution avoids the thorny problem of how to set financial compensation related to land valuations escalated by the speculative prospect of infrastructure investment.
- The currency needs to be depreciated to a level that is stable and competitive, i.e. consistent with export growth and reserves accumulation, so that it is underpinned for the duration of foreign currency denominated project loans as well as realistic for spurring export-led growth.

- Industrial policies need to be developed so that Myanmar integrates with the world economy in a way that promotes its own industrialization and technological advancement.

Establishing Infrastructure Projects: Priorities for Myanmar's Industrial Development — Part II: The Role of the State

By Stuart Larkin[1]

INTRODUCTION

As a late industrializer Myanmar is faced with a very competitive global market that for market entry requires a minimum infrastructure threshold to enter the game. Involving the private sector in the provision of public goods – in so-called public private partnerships (PPPs) – brings efficiency gains. In the telecommunications sector where market fundamentals and potential are clear foreign companies have successfully tendered for GSM licenses. However, in other infrastructure sectors such as power generation and transportation where economic parameters are less clearly defined and where local knowledge is at a premium, foreign companies are struggling and there is a compelling case for the local conglomerates to play a leading role. While Thein Sein has courted foreign investors, there is little debate, much less a consensus, on the role of the state in industrial development.

The Western donors (including Japan[2]) and the international financial institutions (IFIs) have engaged the Thein Sein government with a "Washington consensus" type agenda that stresses good governance

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[2] Japan is an important source of development capital. The Abenomics monetary expansion can greatly benefit Myanmar since it involves a substantial boost to overseas investment spending by Japan's well-connected conglomerates who work closely with JICA and other government agencies. Stimulus to Japan's

and market liberalization.[3] Thein Sein has already largely achieved his two main goals: legitimacy for his new government and the lifting of sanctions. But he is also seeking to reduce dependence on China and attract investment from Western (and Japanese) multinational corporations (MNCs). The USA also wishes to see less Chinese influence in Myanmar but is also holding out for stronger democratic gains which are on the cards. The US Specially Designated Nationals (SDNs) blacklist of many of Myanmar's tycoons is matched by Thein Sein's own aloofness from the tycoons who he may feel are tainted by their association with the military regime.

Thein Sein and the donors confidently predict the attainment of middle income status by 2030 even though liberalization could intensify the resource curse and market-oriented policies may be insufficient to bring about structural change in the economy. The more interventionist approach of the "developmental state" associated with the successful economies in Asia offers a better prospect. The executive needs to work closely with the country's tycoons, and their large conglomerates, to take the lead on infrastructure development, an approach now viable with the two new China-led multilateral development banks – New Development Bank (NDB) (BRICS) and the Asian Infrastructure Investment Bank (AIIB) – focused on infrastructure finance. However, Myanmar has to demonstrate that it has a series of "bankable" projects ready to go in order to justify their attention. The president and the tycoons need to work closely together to identify projects and allocate concessions. With Myanmar's conglomerates as recipients of loans from multilateral institutions, albeit China-led, political pushback over China's rapid rise can be minimized.

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domestic economy may be circuitous via repatriated profits but it can be good for Myanmar. Also Japan can easily understand a Myanmar that adopts the developmental state model since it is akin to its own. But Myanmar must be patient with Japan's alignment to the dysfunctional US policy position on Myanmar due to Japan's dependence on the US defence umbrella.

[3] See my paper "Myanmar: Between Economic Miracle and Myth", *ISEAS Perspective*, 11 July 2014.

Apart from initiating effective collaboration between the state and business on infrastructure project formulation, (the public sector on its own would take too long), the state must also prepare the governance environment as far as possible to facilitate international project lending. While this involves fostering general improvements in governance it also involves focusing on those aspects of governance that most closely pertain to project finance including the legal and regulatory environment and attention to land issues. Adjustment to a stable and competitive exchange rate is also a necessary adjunct, and industrial policies can also be complementary to the focus on establishing the new infrastructure project pipeline.

ROLE OF THE STATE IN MYANMAR'S INDUSTRIAL DEVELOPMENT

The "Developmental State"

Like early development in Northeast Asia, the most successful economic and industrial performances in Southeast Asia were generated by policies that promoted the rapid development of internationally competitive labour-intensive industries: Dwight H. Perkins (2013).[4] Even before identifying how best to establish international competitiveness it is necessary to consider what role the state should play in bringing about the necessary transformation of the economy. Socialism in Myanmar under Ne Win 1962-88 had long since been discredited but the hybrid market economy introduced under the military government 1988-2011 had at best only limited success with industrialization, and the economy remains dominated by agriculture and the resource sectors. Many economists attribute the remarkable performance of the East Asian economies to the role of their state, rather than (or in addition to) that of market forces. The model is woven from various threads – macroeconomic management and stability, a competent bureaucracy, symbiotic state-business relations,

[4] Perkins, Dwight H., *East Asian Development: Foundation and Strategies*, 2013; p. 119.

publicly controlled financing for development, industrial policy in a broad sense, etc. – which are closely related to the state.

The concept of the developmental state is based on the assumed role of the state in facilitating the structural transition from a primitive/agrarian to a modern/manufacturing society. The developmental state is meant to play the social engineering role (i.e. the role of restructuring the national economic system) for promoting long term (industrial) development. Industrial policy, the core of the developmental state's policy actions, is to nurture a competitive and dynamic manufacturing sector, or industrialization in short.

The manufacturing sector has a special role to play in growth due to its greater scope of generating high levels of productivity (particularly at early stages of development) and externalities, (Weiss, 2011). Evans (1995) argues that the main objective of the developmental state is to encourage a country's production structure to move it up to higher rungs on the industrial ladder, thereby occupying better niches higher up, in the global division of labour. The developmental state is also committed to resolving conflicts in the on-going process of restructuring as it tends to induce winners and losers, ensuring that the benefits are widely shared, (Chang 1996). The state is expected to facilitate the process of restructuring, ideally in such a way that would not adversely affect efficiency and productivity (UNCTAD, 2009). The developmental state is also understood to be identified with its actual achievement of economic growth, since its legitimacy stems from the significant improvement in standards of living for a broad cross-section of society.

The Asian developmental state is associated with the types of economic policies followed by East Asian states in the second half of the twentieth century. And is often related to Johnson's seminal analysis (1982) of Japan's industrial policy. The Asian developmental state has two institutional attributes: (i) the competent bureaucracy of a pilot agency dedicated to devising and implementing a planned process of economic development and (ii) "embedded autonomy" to describe the ideal relationship between the developmental state and the indigenous business sector. According to Johnson, the successful developmental state needs to be sufficiently embedded in society so that it can achieve its development objectives by acting through "social infrastructure", but not so close to business that it risks "capture" by particular interests.

A "Weberian bureaucracy", one characterized by meritocratic recruitment and promotion, career service, and reasonable pay and prestige, (Evans 1997), can mitigate against the tendency for state business relations to degenerate into unproductive, rent seeking activity. In a Weberian bureaucracy officials' self-interest is firmly anchored in institutional goals and not easily diverted to private ends. Promotion by merit criteria is a key feature. Entrepreneurs invest in lobbying only if they perceive a reasonable probability of success. If meritocratic procedures for promotion insulate bureaucrats from lobbying, then the probabilities fall, and rent seeking ceases to be a profitable alternative to productive investment (Tollison and Congleton 1995). State business collaboration is insulation not isolation. President Thein Sein is addressing the issue of corruption in the civil service but Myanmar is still some way from having a Weberian bureaucracy. Civil service reform is a priority but it is a long term program. However, this is not to say that productive collaboration cannot still occur.

Under the developmental state model the president needs to forcibly align the interests of the state with those of its most powerful tycoons. Rather than merely pursuing short term profits such as in cement, consumer credit and real estate, the tycoons are directed into activities that serve the nation's development goals, such as undertaking difficult and complex infrastructure projects. The US Specially Designated Nationals (SDNs) blacklist of many of Myanmar's leading tycoons is therefore a direct and calculated assault by the USA on Myanmar's developmental state. Senior General Than Shwe tried to promote the careers of these tycoons in order to create large conglomerates as "national champions" but unfortunately his "brainwaves" were translated into action without much discussion, let alone feasibility analyses, and so the development dividends yielded were at best marginal. Since the tycoons still made money in spite of the lack of reciprocity in the arrangements, with the Myanmar state and citizens left short-changed, there have been charges of "crony capitalism". But this should be seen as a failure of politics rather than of entrepreneurship. In spite of the change in regime type the USA still seeks to punish the tycoons, and by extension undermine Myanmar's developmental state. The Washington Consensus, and neoliberalism, as the framework for governance and economic development is then applied by the donors to Myanmar uncontested. Although US goals are not clear, this strategy could damage development prospects in Myanmar were it not for 2015 election prospects for a change in president and availability of development financing from the new China-led multilateral development banks.

Thein Sein, who was Prime Minister for five years under Senior General Than Shwe's developmental state, has wholeheartedly embraced the Washington Consensus-type agenda the Western donors have brought with them in their re-engagement with Myanmar.[5] And the tycoons have been left out in the cold with Thein Sein apparently also regarding them as "cronies". Within the context of seeking to reduce dependence on China, Thein Sein has courted FDI from Western MNCs while discouraging FDI from Chinese SOEs. Chinese FDI has indeed trailed off – between April 2013 and January 2014 Chinese investment in Myanmar was only US$46 million[6] – but US FDI since Washington lifted most of its sanctions in 2012 is a mere US$243 million.[7] This has raised serious questions over whether Thein Sein's major policy shift has been wise.

For development economists, the Washington Consensus is inadequate in at least three ways. First, its focus on the rate of economic growth without regard to its distributional consequences, placing reliance on the "trickle down" effect for poverty reduction which is uncertain. Second, its denial of market failures (including imperfect market competition, necessity of public goods, positive and negative externalities resulting from production and consumption etc.) which are part of everyday experience is unhelpful considering they have long been identified as the principal justification for state intervention. Third, it contains the notion that a single set of policies can be the most appropriate in all economies

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[5] See Stuart Larkin, op. cit.

[6] Mahtani, Shibani, "China Rocks Myanmar's Diplomatic Boat", *Wall Street Journal*, 10 May 2014, http://online.wsj.com/news/articles/SB10001424052702304655304579552963238417846

[7] *Irrawaddy, The*, "US investment in Burma Remains Modest Since Sanctions Were Lifted", 20 September 2014, http://www.irrawaddy.org/business/irrawaddy-business-roundup-september-20-2014.html

regardless of their stage of development (or for that matter their historical or cultural setting).

What can most usefully be drawn from Walt Rostow's classic work The Stages of Economic Growth: A Non-communist Manifesto (1960) is that there are two quite distinct stages in the development of economies. The first stage can be described as the "economics of development" requiring nurture, protection and competition and, the second, the "economics of efficiency" requiring less state intervention, more deregulation, freer markets, and a closer focus on near term profit.[8] This suggests Myanmar can benefit more from a developmental state approach currently and from a Washington Consensus approach when it has attained a higher income level.

From these two stages it can be drawn that Myanmar may suffer deleterious consequences from an "opening up" and liberalization that is too rapid. Giving freer rein to unfettered market forces intensified by deregulation, trade and investment liberalization may exacerbate pre-existing "resource curse" dynamics.[9] Such policies may encourage the private sector to focus on oil and gas and mining, real estate and the consumer sectors rather than bring about structural change necessary to establish export-led labour-intensive manufacturing industry which offers greater prospects for development based on climbing the technology ladder. Resource exports don't create much employment and put upward pressure on the exchange rate that renders manufacturing exports uncompetitive in a phenomena known as Dutch Disease. Consumer imports can displace local firms and result in a trade deficit, (which ballooned to US$2.6 billion in 2013/14 compared to US$100 million the year before[10]), and real estate is notorious for its boom-bust cycle.[11] With no reason to assume that a more open economy driven by

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[8] Joe Studwell, *How Asia Works: Success and Failure in the World's Most Dynamic Region*, 2013.

[9] Stuart Larkin, op. cit.

[10] Selected Monthly Economic Indicators (Online), CSO, www.csostat.gov.mm/s01MA02.htm

[11] In meetings in Yangon during the first week of September no businessmen said they had friends who *weren't* engaged in the real estate business.

the private sector pursuing short term profits will bring about structural change in the economy a more interventionist state is desirable.

State Business Relations and Infrastructure Development

Successful strategies pursued by East Asian economies suggest an active role for the state in the early stages of a country's economic development but the Washington Consensus presumes that when business and the state have close congenial relationships, democratic ideals, economic efficiency, and social welfare will suffer. Poorly paid officials cannot defend the public good when engaged with entrepreneurs with a keen appreciation of self-interest, flexible scruples, and vast resources. Rent seekers are wasteful because they both squander rents captured and invest more resources in pursuit of them whereas eliminating rents allows business to concentrate its efforts on market competition and allocative efficiency.

But while market oriented reforms can eliminate some points of potential collusion between business and government they do not eliminate contact altogether. And the process of reform creates new rents, e.g privatization opportunities. And the road to markets is easier to negotiate if business actively cooperates. Generally, economic policy is improved if informed by the needs of the private sector. Furthermore, market failures in natural monopolies, finance, and public utilities clearly signal the need for government regulations and bureaucrats to administer them. So it's a question of how best to manage state business relations. Successful East Asian states have found ways that business and the state can collaborate with positive outcomes rather than collude (with negative outcomes).

Infrastructure investment that supports competitiveness for manufacturing exports, such as in power generation and transportation, is a priority for Myanmar's industrial development. Before addressing the kind of collaboration between government and the private sector in Myanmar that would hasten the necessary establishment of a pipeline of "shovel-ready" infrastructure projects, it is useful to first consider the benefits of state-business collaboration in the more general context. These are the information exchange, reciprocity, credibility and trust which contribute to better policies and their subsequent adjustment, and encourage businesses to make productive use of government assistance.

An increased flow of accurate, reliable information between business and the government is the first potential benefit of close relations. Policies that fit industrial and economic reality will be more credible. Also, the flow of information from government to business on sectoral markets, export opportunities, labour market conditions etc. and other issues that affect investment planning – both formal and informal – help business to perform better. Business associations are crucial conduits of exchange of information in both directions. Transparency is a mechanism to remove information from the hands of those who might manipulate it. Transparency in government decision making through dissemination of decision rules and criteria can reduce political uncertainty for investors. Transparency in business operations can reduce greatly the costs of government monitoring.

Because the free exchange of information is regularly enlisted in the pursuit of private gain at the expense of the public good there is a need for reciprocity: this means that in direct exchange for a concession or subsidies, the state exacts certain performance standards from firms. Performance standards that are clear and measurable reduce opportunities to manipulate information. Disciplining should not be too costly because punishing only a few firms signals government intentions and establishes credibility. Government credibility reduces a major source of political uncertainty. Political uncertainty has a high cost of postponed or foregone private investment. Problems of credibility constitute the major obstacle to a better growth performance of many LDCs (Aymo Brunetti and Beatrice Weder, 1994).

States in developing countries have come increasingly to rely on private economic agents to execute the changes that policy makers want. This is particularly evident in infrastructure development where governments have drawn on public private partnerships (PPPs). Credibility allows officials to count on the private sector for effective implementation. Credibility depends on many factors such as the type of policy, flows of information, the reputations of officials associated with the measure, the degree of institutionalization of the rules and agencies involved, and the political backing of the government adopting the policy. Strong constitutions, democratic checks and balances and the rule of law can help but in many policies intended to promote economic transformation discretion is likely to continue to be the rule. Here interactions between government and business, especially repeated interactions that generate trust, can have a positive impact on credibility. For the appropriate balance policy makers must adjust policies in ways necessary to respond to new conditions without abandoning the policy itself.

Effective collaboration between entrepreneurs and officials implies mutual dependence or vulnerability. Credibility and trust are crucial in managing this mutual dependence. Trust is “extremely efficient and makes the whole economy work better” (Arrow, 1974). In LDCs the lack of trust between economic agents can inhibit all types of beneficial exchanges and retard overall development (Leff, 1986). “High trust systems are more competitive”, (Soskice, 1991). Trust in state business relations is a more specific, calculated contingent phenomena where protagonists on each side expect those on the other side not to betray them, (Oliver Williamson, 1995). Trust between business and government elites can reduce transaction and monitoring costs, diminish uncertainty, lengthen time horizons, and thereby increase investment.

Trust between officials and entrepreneurs can reduce political uncertainty and increase the flow of long term, low cost investment. Informal trust may substitute for property rights. Trust increases the voluntary exchange of information, makes reciprocity more likely even without active monitoring and disciplining, and generally reduces uncertainty and increases credibility on all sides. Trust is costly and time consuming to construct and easy to destroy. Trust in the narrow sense, depends on friendships, contacts, and common sense and thus is sensitive to changes in personnel. Trust between bureaucrats depends on the length of their interaction, both past and expected, as they become predictable to one another.

When the state is a coherent corporate body, rather than a collection “of individual maximizers masquerading as organizations in pursuit of the common good, … dense ties with the business community can become vehicles for the construction of joint public-private projects in pursuit of economic transformation” (Evans, 1997). While improving state capacity is an on-going long term project, to create the Weberian bureaucracy, charismatic political leadership can play a very important role in mobilizing the varying agencies and departments of government to pull in the same direction in the common cause of national development.

Upon the president's authority, the government needs to make available to the conglomerates some of the master plans and project information for the nation's infrastructure development that has been generated by both domestic and foreign public sector agencies. No one's interest is served by the conglomerates' having to commission research already undertaken. The conglomerates can engage outside sources of additional advice and expertise in the evaluation of such plans and their further refinement, which is a significant cost for them to incur and one they will undertake only if they are insulated from the risk of subsequent competitive tender for the relevant concession. And the conglomerates can in turn confer and develop their ideas and interests with the government departments concerned. This whole exercise requires considerable trust – since the tycoons will not want to share project information with bureaucrats who may divulge details to their rivals – but the state planners must receive input from the private sector if their plans are to be informed by economic reality.

If the president, or other procurement authorities of the state, are to award infrastructure concessions to the tycoons without a fully transparent process of public competitive tender then the issues of trust and reciprocity become paramount. The tycoon escapes the uncertainties and ambiguities associated with evaluating tender documents that are less than fully comprehensive, (due to the complexities and many "unknowns" integral to most major projects), and avoids the risk of overpaying for a concession that occurs in a competitive process, but reciprocity and trust are essential in the relationship with the power-holder. The power-holder must trust the tycoon to deliver what he says he will and while the tycoon makes private profits the state must still receive "value for money" in the provision of public goods and services by the concession-protected private business. The tycoon must be credible to the power-holder and trust in the relationship is essential. For a developmental outcome it is of course also necessary that the power-holder genuinely holds development goals, and is publicly held to account for this, otherwise his relationship with the tycoons can too easily degenerate into rent seeking collusion. So it is extremely important that power-holders build trust with the general public.

The process of developing all of the infrastructure plans solely within the public sector and then offering some of them out to the private sector by competitive tender is time consuming and inefficient. The current challenge requires a sense of urgency so that a pipeline of "shovel-ready" projects can be created in time for the launch of lending operations by the two new China-led MDBs, otherwise the initial flurry of loans will go to other countries in the region who are better prepared, like Thailand and India. And Myanmar will have missed yet another opportunity for accelerated development.

Democracy and Development

There is no body of empirical evidence that positively or negatively correlates democratic development with economic development.[12] Many Asian states have been authoritarian to a degree, especially at the earlier stages of their development, but the extent that this is causal of their economic success, or otherwise, is unproven. The authoritarianism is possibly due to the historically-based attitude of Asian paternalism but in any event Myanmar is in many ways in uncharted waters. It is hoped that Myanmar's transition to democracy will produce more capable political leadership and improved governance but this is not a certainty.

One challenge is that the country is now on a five-year electoral cycle whereas effective economic planning for a LDC should be on a considerably longer timeframe. Myanmar's politicians are currently focused on constitutional matters and neither of the two main political parties, the National League for Democracy, (NLD), and the Union Solidarity Development Party, (USDP), have set out their views on economic policy. These are the issues that most concern the general public and yet they are not yet offered a differentiated choice.

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[12] For a review of some of the literature, see Julian Wucherfennig, "Modernization and Democracy: Theories and Evidence Revisited", ETH Zurich Centre for Comparative and International Studies, *Living Reviews in Democracy*, Vol. 1, 2009.

There is always the risk that politicians will want to keep voters in the dark on economic policies and instead play "identity" politics and pander to the prejudices of the general population. Populism is also a very real risk whereby politicians will promise "quick fixes" to improving living standards rather than lay the sound foundations necessary for long term economic growth. The greatest risk to economic development in Myanmar is that politicians will be overly sensitive to the fickle winds of public opinion and will not be prepared to take the tough decisions necessary for economic transformation when they may incur short term unpopularity. If the politicians don't educate the electorate about the need for making informed choices then structural change will not occur, resource curse dynamics will be unaddressed, the gap between rich and poor will widen and only superficial sporadic benefits will be delivered to people in accordance with the electoral cycle, and the high expectations that people hold from democracy will not be delivered.

The three key aspects for economic development involve what may be unpopular political choices in the short term: (i) the government working with the tycoons (often dismissed as "cronies"); (ii) tapping sources of finance from China (when many regard China as a threat rather than as an opportunity; and, (iii) depreciating the currency when it may initially result in an inflationary surge. But in terms of the immediate challenge, it is not only necessary for big business to work closely with the state, led by the president, but also that the government focuses its efforts on improving governance and capacity in those areas that most closely pertain to infrastructure development – reducing risks for foreign financiers and more generally those that help get difficult infrastructure projects off the ground – such as the legal and regulatory environment for project finance and land issues.

IMPROVING THE LEGAL AND REGULATORY ENVIRONMENT

The Enabling Environment

The enabling environment refers to the whole collective of government regulations and institutions that facilitate the operation of business and the economy. It includes basic institutions such as government, rule of law, and efficient capital and labour markets. It also includes the ability of the government to create consensus and the ability to help people who fall through the cracks in the system. General governance standards have an important bearing on the enabling environment, in particular the transparency and predictability of policy formulation and implementation and the degree to which the government consents to being held accountable. The current government have made considerable efforts to improve the enabling environment, for example, in reducing the length of time that it takes to register a new company, or in combating corruption, but much more needs to be done.

Certainly as far as accessing international sources of debt finance is concerned, some of the governance issues that the government needs to address can be identified by the country risk factors perceived by the international bond markets contained in the International Country Risk Guide (ICRG) at the time of issuance (PRS Group 2013):[13]

(i) Political risk. Together with the economic and financial risk ratings, the political risk rating is one of the major components of the ICRG composite country risk rating. The overall risk political risk rating aggregates 12 component factors, including government stability, socioeconomic conditions and the three factors mentioned below – corruption, bureaucratic quality and contract viability/ expropriation

(ii) Corruption. Within the system "…. distorts the economic and financial environment; it reduces the efficiency of government and business by enabling people to assume positions of power through patronage rather than ability; and … it introduces an inherent instability into the political process" (p. 4)

(iii) Bureaucratic quality. "The institutional strength and quality of the bureaucracy is a shock absorber that tends to minimize revisions of policy when governments change…. In these low-risk countries, the bureaucracy tends to be somewhat autonomous from political pressure …" (p. 7).

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[13] Ehlers, Torsten, Frank Packer and Eli Remolona, "Infrastructure and Corporate Bond Markets in Asia", chapter in *Financial Flows and Infrastructure Financing*, Alexandra Heath and Matthew Read (ed.), Reserve Bank of Australia, 2014.

(iv) Contract viability/expropriation risk. Risk of unilateral contract modification, cancellation or outright expropriation.

For each measure a higher value reflects lower risk. It is the quality of bureaucracy that is the most consistently highly correlated with the sovereign rating. Contract viability/expropriation risk, political risk and quality of the bureaucracy are country characteristics that are highly likely to influence the infrastructure bond rating.

Public Governance of Public-Private Partnerships

The government can benefit in a number of ways from involving the private sector in infrastructure development in so-called public private partnerships (PPPs). The advantages are (i) fiscal optimization as the financing responsibility for construction is shifted to the private sector, (ii) process efficiency with tighter contracting and increased rigour of execution, and (iii) reduced performance risk since constructing and operating are passed to the private sector. However, there are additional complexities when the private sector becomes involved, particularly in reconciling the private sector's pursuit of private profit with the government's duty to safeguard the public interest. A set of principles for the public governance of PPPs published by the Organization for Economic Cooperation and Development (OECD) can be usefully drawn on here.[14]

The government needs to establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities. The president needs to ensure public awareness of the relative costs, benefits and risks of PPPs and there should be active consultation with stakeholders and end users should also be involved in defining the project. The procurement authorities should be entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability. All regulation must be clear, transparent and enforced.

[14] For details, see OECD, "Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships", May 2012.

In sum, the government needs to take appropriate steps to ensure that PPPs are affordable, represent value for money and are transparently treated in the budget process. Given that PPPs may come to constitute a significant part of Myanmar's infrastructure solution it is important they are met by strong public institutions and that it is recognized that democracy and the rule of law depend upon and require sound regulatory frameworks, notably relating to fiscal sustainability. PPPs can become a prominent method for delivering key public services transparently and prudently in Myanmar but only insofar as the right institutional capacities and processes are in place. But good governance is not only necessary for safeguarding the public interest – it is also important for attracting foreign financing.

Importance of the Legal and Regulatory Framework

Since investors, lenders and those operating within the market (advisors, constructors and operators) can choose between jurisdictions and projects the government of Myanmar needs to focus on improving the legal and regulatory environment. To foster a business friendly environment for infrastructure development the government needs to minimize uncertainty and maximize transparency and predictability in the general conduct of policy. The government needs to reduce unnecessary legal and regulatory impediments to the smooth functioning of infrastructure markets and at the same time create a robust regulatory framework.

There is a need for new legislation that addresses specific infrastructure issues within a comprehensive framework, such as how to regulate project finance, to establish onshore Special Purpose Vehicles (SPVs) to hold infrastructure concessions and define special waivers on capital controls to enable international debt service and repayment of principal. There is also the need to rationalize existing overlapping and contradictory laws that pertain to areas of broader concern such as land issues and creditors' rights and insolvency. Attention also needs to be paid to contract issues such as enforcement, dispute resolution and legal certainty. The overall objective is to reduce the risks borne by the numerous different participants of PPPs in order to attract larger funding sizes at lower cost and promote successful project execution and operations.

The Pyithu Hluttaw Commission for Assessment of Legal Affairs and Special Issues, a committee of Parliament which is already reviewing existing laws for revision or annulment, could usefully explore the case for passing laws specific to project finance and SPVs that would underpin the complex contractual arrangements necessary for the international financing of the nation's infrastructure development. Multilateral and bilateral donors and the global professional services firms are useful sources of advice.

Creditors' Rights and Insolvency Systems

International project finance still sits within the overall credit governance environment. Effective creditor rights and insolvency systems promote commercial confidence by enabling market participants and stakeholders to more accurately price, manage, and resolve the risks of default and non-performance. The extension of credit is predicated on repayment, and its costs are influenced by the risks and potential for default, as well as the associated costs and delays of recovery. Effective creditor rights and insolvency systems also facilitate prompt resolutions and recovery. Attracting loans and investment requires that repayment risks be reasonable and manageable. Systems of credit protection, resolution and enforcement are also necessary: collateral without reliable enforcement affords little genuine protection.

Myanmar's transition to a modern credit-based economy requires (i) predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency and (ii) a sound insolvency system. Commerce is a system of commercial relationships predicated on express or implied contractual agreements between an enterprise and a wide range of creditors and constituencies. Rights governing those relationships and the procedures for enforcing rights have not changed much. Those rights enable parties to rely on contractual agreements, thus fostering confidence that fuels investment, lending and commerce. Conversely uncertainty about the enforceability of contractual rights increase the cost of credit to compensate for the increased risk of non-performance.

The legal framework for creditor rights includes mechanisms that provide efficient, transparent and reliable methods for recovering debt, including seizure and sale of immovable and movable assets, as well as the sale or collection of intangible assets such as debt owed to the debtor by third parties. A creditor's ability to take possession of a debtor's property and to sell it to satisfy the debt is the simplest most effective means of ensuring prompt payment. A legal framework for secured lending provides for the creation, recognition and enforcement of security interests in all types of assets, including land which is by far the most common form of collateral. There is plenty of scope in Myanmar for rationalization of the laws that relate to these areas. There is also a need for a clear corporate insolvency process which includes a framework for cross-border insolvencies with recognition of foreign proceedings. Legal support for a broad range of activities such as debt write-offs, reschedulings, restructurings and debt-equity conversions is needed. For resolution of a failed undertaking, a collective process for adjusting the rights and interests of a variety of stakeholders is needed. The policies and interests which must be balanced include governmental and political objectives, cultural and social concerns, and economic and commercial interests. Confidence in such a framework significantly reduces risks for would-be participants and so facilitates financing.

LAND ACQUISITION FOR INFRASTRUCTURE DEVELOPMENT

Land Issues

All large projects for infrastructure and industrial development involve land acquisition and if the right policies and laws are not in place the project promoter bears increased risk of incurring expensive delays in land agglomeration or of not getting the project off the ground at all. If inadequate compensation and rehabilitation and resettlement (R&R) dominate the discourse, especially now when civil society organizations (CSOs) can take up the cause of displaced communities and give them voice through a now uncensored social and mainstream media, the project promoter faces possibly intense reputation risk as well as financial uncertainty. Infrastructure concessions where the project promoter is responsible for land acquisition are not generally considered "bankable" by international financial institutions so it is best that the government accepts responsibility for land acquisition through exercise of its rights under eminent domain. However, land is crucial to all citizens and project land acquisition can only be considered within the broader context of land issues as a whole.

Though some foreign investment in the energy and extractive sectors has been tied to contentious land issues it is the acquisition of agricultural land by local businessmen, most recently with the intention of "flipping it" to foreign agribusiness investors, that has aroused controversy over alleged "land grabbing". The practice is not new but has come to the fore with Thein Sein's more open style of government and the country's opening up. The Ministry of Agriculture and Irrigation's (MoAI) 30-year (2000-30) Master Plan for the Agricultural Sector aims to convert 10 million acres of fallow and virgin land to agricultural production and the acquisition of land by corporate and private entities has grown rapidly in line with this policy. By 2001, the state had allocated over 1 million acres to about 100 enterprises and associations and by 2011 204 national companies had obtained roughly 2 million acres.[15] But more than 70 per cent of these private holdings have never been developed and often the cultivators who already occupy the land are allowed to continue farming on an annual basis. But in anticipation of a flood of foreign investors private firms are beginning to reassert ownership over these increasingly valuable plots and seek to evict "squatters" and begin development projects.[16] Quite apart from the lawfulness and fairness of this land acquisition, and the procedures for land titling, transfer of ownership, classification, change of use etc., it is necessary to examine (albeit briefly) agricultural policy and the issue of household farming versus plantations (or corporate agribusiness).

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[15] USAID Country Profile, "Property Rights and Resource Governance: Burma", 2013, citing Woods 2011 and Landesa 2013.

[16] Kyaw Kyaw, "Land Reform Key to Burma's Future", *The Diplomat*, 25 August 2012.

Myanmar's infrastructure (and heavy industrial) development is essential for establishing export competitiveness for labour intensive manufacturing exports – central to overall economic development – and it is paramount that the government is seen as an "honest broker" in land issues, that it prioritizes these projects, and that it does not squander public goodwill on land acquisition for agribusiness projects of dubious economic benefit and which threaten social stability, just to satisfy the greed of a few hundred well-connected businessmen and corrupt public officials.

Household Farming versus Plantations

Myanmar has a total land area of 677,000 sq. km consisting of 330 townships and 64,817 villages.[17] More than two thirds of the population live in rural areas and have livelihoods in or closely related to agriculture. Hence land policies, and particularly those pertaining to agricultural land, are of fundamental importance to the social fabric (and stability) of the nation. In fact, as an exclusively domestic preserve the governing elite's conduct of land issues is a fundamental test of its overall responsiveness to the peoples' needs, whether there is a development imperative or whether the elite solely serves its own constituency of the rich and powerful.

Labour intensive farming produces the highest yields which in turn created consumer demand for basic locally produced manufactures while the relatively equal social structure created an "equality of opportunity" that served industrialization well. The evidence from so many countries shows farm yields per hectare are in inverse proportion to farm size.[18] This is because the labour intensive gardening approach gets the most

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[17] Soe Lwin, Deputy Director General, Department of Rural Development, Ministry of Border Affairs, "Urban Development in Myanmar", presented at UNHabitat seminar 2012.

[18] Michael Lipton, "Towards a Theory of Land Reform", in David Lehmann (ed.), *Agrarian Reform and Agrarian Reformism*, Faber & Faber, 1974. He provides a long list of studies to support this assertion. As cited by Joe Studwell, *How Asia Works: Success and Failure in the World's Most Dynamic Region*, 2013.

out of the land.[19] Where labour is cheap, or unpriced in the case of family labour, as in Myanmar, household agriculture makes the most sense. Even in the case of "cash crops" such as sugar, bananas, rubber and palm oil claims to scale economies by plantations are suspect and constraints on small farms can be easily overcome. Even palm oil yields are very sensitive to labour input.[20] The important scale economies are to be found in processing and marketing and this important "infrastructure" is necessary to the success of household farming anywhere (and plantations have no unique capability in these activities).

Myanmar's businessmen have not been successful in agribusiness, going back to the failed land reclamation projects in the delta for rice cultivation in the mid-1990s.[21] As absent city dwellers they cannot control the inputs such as seed and fertilizer, nor the harvest, which can be sold off in local markets by dishonest labourers and it is hard to attract good managers to rural areas with substandard or non-existent health and education provision for their families. Foreign agribusiness investors may be intoxicated by the country's great agricultural potential but few have so far invested. Also, they may be put off by the controversies generated by land acquisition and the adverse publicity such disputes can attract, and of the risk of resultant political intervention. Can they really succeed where local businessmen have failed? So if Myanmar businessmen have substantial rural land holdings who's ownership is contested, that they make zero or low returns on these investments and that they cannot "flip them" to foreign investors for a quick profit, it may be that the government may want to encourage them to divest and then such land can be offered in compensation to farmers who have to be relocated following land acquisition for essential infrastructure

[19] See Joe Studwell, op. cit., for examples of time-consuming interventions that raise the yields of family farms so much.

[20] Joe Studwell, ibid.

[21] They hadn't really expected to make money on these "policy projects" but in a *quid pro quo* they gained from opportunities elsewhere such as obtaining import licenses.

development[22]. The government too may wish to focus on addressing the problem of increasing landlessness in rural areas, and of strengthening land tenure security and other policy matters that promote household agriculture. This will strengthen the social and economic fabric of the countryside and reduce resistance and conflict when land really must be expropriated for the greater good.

Recently Enacted Land Legislation

Recently enacted land laws replace the system established during the socialist period and officially reintroduces the concept of private ownership as land tenure rights can be sold, traded or mortgaged. But the mechanisms for realizing this scheme are not all in place, creating dangers of local-level land grabbing and corruption. Poor farmers are exposed to the temptation to sell their use rights for short term gain which makes them vulnerable to speculators and large scale corporate agriculture interests. Unclear registration procedures and the lack of guidance on how LUCs are issued, asymmetry regarding access to local officials and relevant information for future land values may all disadvantage smallholders. Farmers could also lose their land because they lack proper documentation. The laws do not acknowledge or legitimize common customary and informal practices for governing and transferring land. Pre-existing cultivators of VFV lands can be seen as squatters and deprived of their use rights and many of the lands awarded to agribusiness companies are of this category so the laws can be used to provide legal cover for land grabbing.

Unsurprisingly, land grabbing has become a major issue in Myanmar. The majority of the 1,700 complaints the National Human Rights Commission received in its first six months of operation were related to land grabs. A commission on agriculture formed in 2012 by the National Democratic Force received 4,000 complaints of lands grabs and

[22] The granting of fallow and virgin lands to agribusinesses carries a government claw-back clause that can be invoked in the event of non-investment within a pre-specified period.

dispossession in the first few months of investigation. The cross-party Land Acquisition Investigation Committee has received more than 2,000 complaints since 2012.[23] The Thein Sein government has responded to the high level of land-related disputes by announcing a review of the recent legislation and by establishing two new committees. The Land Allotment and Utilization Scrutiny Committee, headed by the Ministry of Environmental Conservation and Forestry is assessing how land is classified, how it is being used and how it should be allotted and used. The Land Acquisition Scrutiny Commission is tasked with reviewing government land acquisition going as far back as twenty years: what rules were followed, whether compensation was paid, the purpose of such projects and how they were subsequently executed. However, it is not empowered for dispute resolution and the information collected will be to inform parliament's legislative reform initiatives.

Need for a Comprehensive Land Law and Policy

The body of law governing land in Myanmar is expansive, complex, and characterized by vague, conflicting and overlapping provisions. One survey in 2009 found at least 73 active laws, amendments, orders and regulations bearing on housing, land and property (HLP) rights and ambiguity and confusion in land laws remain following the 2012 statutes. (Displacement Solutions 2012; Leckie and Simperingham 2009). For example, there are at least 12 categories of land classification: freehold, grant, agricultural, garden, grazing, culturable, fallow and waste, forest, town, village, cantonment and monastery (UN Habitat, 2010). Clearly there is a need for a new comprehensive land law and policy.

The government recognizes the need for a holistic approach to land management, tenure security and land conflict resolution. Policies and laws need to be properly harmonized with one another, processes need to be clear and easy to understand, and access to information and citizen inclusion in decision making processes should be identified

[23] Henley, Giles, "Case Study on Land in Burma, Evidence on Demand", March 2014.

as rights enshrined in the law. There needs to be adequate protection of smallholder rights, improvements made to land titling procedures and legal recognition of customary land use. A nationwide system of land classification/zoning based on participatory land use planning at national, state/regional, district, township and ward/village level should be adopted. A clear mechanism for reclassifying areas of land to match their actual use and protect existing land tenure claims of rural farmers should also be established.[24]

But of greatest relevance to infrastructure project development, it is necessary to bring compulsory acquisition policies in line with international best practices. The 1894 land Acquisition Act remains the primary law governing compulsory acquisitions through invoking the "eminent domain" provision which empowers the state and its associated agencies to acquire land by using the public purpose clause even in the case of private companies. Ambiguity in definition of whether for public purposes or for businesses purposes leaves landholders vulnerable to losing their land through arbitrary processes. The Act sets out the procedures for objections to acquisition, for the temporary occupation of land and for the acquisition of land for corporations. It includes the required notice to be given, the method of valuation of land, court processes and appeals including for taking possession. It requires the authorities to provide compensation to the original owners of the land but in practice this often falls short of basic minimum standards. Some of these issues are expanded upon below.

Land Acquisition for Infrastructure Projects

Land acquisition is essential for the country's infrastructure development but it is almost always contentious with conflict often centring over the issue of compensation and rehabilitation and resettlement (R&R). The

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[24] This summary of recommendations is drawn from the Food Security Working Group's Land Core Group, "Legal Review of Recently Enacted Farmland Law and Vacant, Fallow and Virgin Lands Management Law: Improving the Legal and Policy Frameworks Relating to Land Management in Myanmar", November 2012.

stakeholders are the government, private sector and civil society (usually representing the interests of farmers) and to avoid conflict the general public must have confidence in the method and process. It needs to be clear the circumstances under which the government can compulsorily acquire land by invoking "eminent domain" for the public purpose. When the private sector is involved, the question arises of when land is acquired for public purpose and when for private profit. Perhaps there can be a sliding scale: where public purpose is strongest "eminent domain" powers can be stronger. Where the public purpose is less directly served but yet the project is important there could be a system where the majority of land holders have a greater say in whether land is acquired or not.

To facilitate large infrastructure projects of clear national purpose it is best for the government to take responsibility for land acquisition and incorporate it into the concession agreement to be awarded to the project promoter but there should be some modality for ensuring that the minimum possible amount of land is acquired. Processes for negotiation, determining compensation, arbitration etc. must be transparent and the government must be considered an honest broker. Compensating displaced farmers with other agricultural land (perhaps fallow and virgin land recovered from companies that have failed to develop it) is preferable but cash offers or other forms of compensation like equity options or rehabilitation jobs can be used provided it is fair. The scope of compensation can also extend to promoting cultural facilities, educational infrastructure and other key amenities to win peoples' support. There must also be compensation for those who may not own land but will also be disadvantaged by the project – such as landless agricultural workers, non-agricultural workers, forest dwellers, tenants or share croppers etc. Effective communication with affected people can go a long way in settling many of their queries and apprehensions. And R&R is crucial for persuading most of the landholders to agree to part with their land. It should be treated as a rights based entitlement scheme and not as a welfare scheme. Most of all, people should have the trust that everything will be done for them properly and transparently.

In order to speed up the project development there may be instances where the project promoter is advising the government agency on project design and even working alongside the authorities at the time of land acquisition, actively inputting into the process. Where this happens the project promoter must be mindful of the sensitivities of the local population. Stinginess in the level of compensation can quite easily lead to delays, the cost of which can easily outweigh the paying of adequate compensation at the outset. The government must carefully select which project promoters it wishes to work with since its own reputation and electoral prospects can be damaged by an association with greedy and unscrupulous entrepreneurs. The tycoons selected to undertake the important infrastructure projects will be the ones that have demonstrated the ability to upgrade the level of their game for operations in the post-military world.

INDUSTRIAL AND EXCHANGE RATE POLICIES

The Need for a Stable and Competitive Exchange Rate

Thein Sein’s government can be commended for unifying multiple exchange rates early in the administration but the single unified rate has been fairly consistently strong due mainly to strong resource exports, particularly natural gas but also jade and timber, and ODA and FDI inflows. High deposit rates in local banks and a “red hot” real estate market may be attracting unofficial capital inflows as well. The strong exchange rate and the almost complete abandonment of administrative controls on imports has caused the trade deficit to dramatically escalate to US$2.6 billion in 2013/14 from US$100 million the year before and a US$100 million surplus the year before that.[25]

A downward adjustment in the exchange rate is necessary for a return to trade surplus and a restoration of export competitiveness. Touching a record low of Kt1,300/US$1 in 2003 the Kyat then steadily appreciated. It was Kt1,100/US$1 in 2005 and reached Kt800/US$1 in 2012 but it has since stabilized off the top at around Kt970/US$1. Over this period Myanmar has had much higher inflation than its trading partners. Dapice and Vallely (2014) argued that a full adjustment to the real exchange

[25] Selected Monthly Economic Indicators (Online), op. cit.

rate of 2005 would imply an exchange rate now of Kt1,500 or Kt1,600/US$1, although they concede that real improvements in infrastructure or reduced trade barriers would allow a more modest adjustment to Kt1,100 or Kt1,200/US$1.[26]

Price signals are an important determinant of resource allocation in the economy and the exchange rate is the "mother of all prices", fixing Myanmar's prices relative to the global economy. The strong exchange rate excessively encourages imports, and has resulted in displacing local producers as well as making exports uncompetitive. If the Myanmar government aspires to transforming the economy into one driven by labour-intensive manufacturing exports it will be necessary to depreciate the exchange rate and peg it at a lower rate. Managing the currency depreciation by the Central Bank of Myanmar purchasing US dollars – whether funded by Kyat monetary creation or Treasury bond sales – can be undertaken by a small team of technocrats. The longer the necessary adjustment is postponed then the tougher the subsequent adjustment will be later.

The objective is to get "prices right" in the economy so that the right allocative signals are sent. If imported inputs for infrastructure become more expensive as a result from depreciation then local materials will be used more and domestic investment in building materials, e.g. cement plants, will be stimulated. Imported rice milling equipment would cost more but the investment should be evaluated in the light of processing higher rice quantities due to stimulated external demand. The effect on garments would be positive. The price of imported sewing machines for garments start-ups would increase but the effect would be negligible as this is a labour intensive and not a capital intensive industry. The garments sector operates on a CMP (cut, make and pack) basis, where there are no F.O.B. imports and exports, and the garments maker is paid a fee for his services. A currency depreciation will make those fees lower relative to competitors in Bangladesh and Indonesia, for example, or else result in a higher Kyat remitted income. A currency depreciation will

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[26] Dapice and Vallely, "Choosing Survival: Finding a Way to Overcome Current Economic and Political Quagmires in Myanmar", Harvard Kennedy School, 12 March 2014.

stimulate export industries, which is the whole point. Diesel and gasoline and electricity prices would have to go up. In the case of electricity the tariff has to be set at a rate that supports investment so that increased demand (and wider coverage) can always be met. Subsidies only promote wasteful over-consumption and it is best that local energy supplies reflect their true cost with reference to the global markets and with Myanmar developing competitiveness in export industries with sound costing.

Regarding the provision of infrastructure that is financed from abroad – such as Myanmar's tycoons securing project finance from the new China-led MDBs – it is important that the exchange rate is pegged and that it remains stable for many years, to cover loan durations. Insuring against currency risk is often expensive. Project loans extended will be denominated in foreign currency, most likely RMB or US dollars, and both debt service and repayment of capital will be in these hard currencies. If the Kyat suddenly depreciates the cost of debt service and repayment relative to the kyat-denominated locally collected tariffs will become prohibitive and debt default will result. To protect the project promoters and to reduce risk to the lenders, and to give peace of mind to the government who would inevitably become involved if all these big infrastructure projects went belly up, it is necessary that the local currency is pitched at a level in line with economic fundamentals including the attainment of trade surpluses consistent with sustainable export competitiveness and accumulation of foreign exchange reserves. The right level for the Kyat must be established at the outset.

Industrial Policy

The Industrial Policy (IP) of a country is its official strategic effort to encourage the development and growth of the manufacturing sector of the economy. The government takes measures aimed at improving the competitiveness and capabilities of domestic firms and promoting structural transformation. A country's infrastructure is normally considered as part of the manufacturing sector, with usually a key role in IP. Industrial policies are sector specific, unlike broader macroeconomic policies; they are interventionist as opposed to laissez-faire economics. IP is associated with the developmental state rather than with the

Washington consensus. The rapid growth of the East Asian economies, or the newly industrialized economies (NIEs), has been associated with active IPs that selectively promoted manufacturing and facilitated technology transfer and industrial upgrading.

The prevailing philosophy and international rules that govern trade and development that facilitate globalization are not particularly conducive to the industrialization and development of developing countries. The dominant economic philosophy has moved against government intervention in the economy. The need for IP has increased because the international market has become increasingly more concentrated; global production, international trade and technology have become more and more dominated by MNCs; technological changes have accelerated and production has become more knowledge-intensive. Meanwhile the policy space of developing countries has shrunk due to the dominant views of the orthodoxy propagated by WTO rules and the international financial institutions' (IFIs) and bilateral donors' loan conditionalities. But the two new China-led MDBs could help restore balance and will most likely give a much more sympathetic hearing to the developmental state and its formulations for IP.

But the historical record for IPs is mixed, with every great success story touted being matched by a fiasco somewhere else. The argument against IP rests on the limits of state capacity, with its attendant risk of political capture of IPs, which may be more harmful than market failures. Economists argue that developing countries should focus on their comparative advantage by promoting mostly resource- and labour-intensive industries. But some countries, like Bangladesh, then fail to ascend the technology ladder. And so the argument emerges that developing countries should supplement their development of industries where they have existing comparative advantage by targeting a few carefully selected industries that would generally be considered beyond the country's current technological level, ones that offer higher productivity but which may only become competitive in the longer term. The common sense solution is that a pragmatic rather than an ideological position be taken.

In Myanmar's case, the most pressing area to address for competitiveness is infrastructure and this is less contentious since the state must by necessity play a key role in the provision of public goods and services but the IP concept is still relevant because of the efficiency gains that can result by having the private sector collaborating with the state. The current and future backbone of the industrial sector consists of SMEs which one hopes will grow to become major corporations. However, as SMEs their role in infrastructure development, or indeed in “heavy” industry, is precluded. Thus it is only Myanmar’s largest conglomerates that have a role to play in the country’s infrastructure development, in working with the government and foreign financiers. But that is not to say that benefits do not cascade down to smaller firms in the form of subcontracts during the construction phase and in just being able to access the infrastructure in the operational phases. In this way, the conglomerates, led by the tycoons, provide benefits to the multitude of SMEs to grow rapidly. In particular, the infrastructure upgrade should be directed at enabling SMEs to be export competitive. Politicians must explain this to the general population so that the granting of infrastructure concessions are not just seen as “sweetheart deals” to further enrich the tycoons. The development dividend is paramount.

Capital intensive “heavy industries” such as petrochemicals and iron and steel require a minimum scale of investment far beyond the capabilities of individual or even collectives of SMEs. Heavy industries are building block industries that can significantly contribute to the export competitiveness of SMEs by producing useful local sources of essential inputs. Heavy industries, unlike the infrastructure sectors which are solely domestic in character, can target exports. The introduction of this criteria to heavy industry projects, where public subsidy is involved, can be a useful safeguard against “white elephant” large-scale industrial projects. The domestic market size would initially be too small to support such large scale investment and the inclusion of export sales in the project model supports feasibility while instilling the need for operational discipline in line with international standards. From the government’s point of view, export performance is easier to measure, more transparent and harder to distort than goals such as technological development or increases in productivity.

Attention needs to focus on power generation and transportation. Enabled by the infrastructure upgrade, and in some industries facilitated by “anchor FDI” from MNCs, SMEs can target exports for growth in labour-intensive industries, and endeavour to climb the technology ladder. Within the context of regional specialization, this is known as the “flying geese” pattern of development which is long established in Asia. In industries like steel and petrochemicals it may make sense for a local conglomerate to work with a MNC as a strategic investor. If the local conglomerate is enjoying some forms of protection or subsidy then the state must ensure that the country as a whole benefits from a strong development dividend from the undertaking. There should be clear performance criteria established and sanctions for failure.

Foreign investors have a key role to play in fostering industrial development but the state must be alert to which forms are beneficial. “Anchor FDI” by MNCs can form the basis of new industries whereby local SMEs can assume a growing role in component supply. Automotive is the classic example of this type of industrial investment. But the government must be very wary of “displacement FDI” whereby MNCs serve no more of a useful purpose than to displace local firms. MNCs are adept at using “transfer pricing” and “brand licensing” to minimize onshore profits that are exposed to taxation and they know no loyalty to any nation-state. As countries “race to the bottom” to provide the greatest incentives, the MNCs play one off against another and are masters in avoiding technology transfer. They often have little interest in making their in-country activities more knowledge intensive and they pull out at short notice if things don’t go their way. The government must monitor MNC activities and differentiate them, and develop the most effective ways of engagement. Just as with the local conglomerates, the agents of the developmental state must harness the activities of MNCs to advance national development.

A major risk for Myanmar is if the political economy of the “resource curse” is not fundamentally addressed and industrial policies merely become another tool for the elite and for well-connected people to extract rents. Having politicians who are genuinely committed to development and nation building is paramount and a consistent and relentless drive to improve governance and the standards of public accountability is necessary. Observing a few basic principles while developing industrial policies can help.

The importance of instilling “export discipline” as a central principle cannot be over-estimated. A company that is successfully selling its goods into the international market, where competition is stiff, must be doing something right, and can be worthy of subsidy. The demands of the international market forces firms to constantly upgrade both the technology in the product and the technology involved in the manufacturing process. Conversely, protecting domestic market consumption does not encourage investment in new technologies. Rather than attempting to pick winners, the state needs to constantly weed out losers, especially where subsidies are involved. Successful firms need to be subsidized for more rapid growth, not the unsuccessful ones. Subsidy abusers need to be punished. The state can fashion policies and directives so that bank lending is directed at firms that can demonstrate export success to facilitate their rapid growth, including trade finance. In general, the finance sector should be kept on a tight leash. The banks need to be encouraged to lend to industrial firms, especially exporters, when they may find easier short term profits are to be had from domestic consumer credit. Banks are also easily distracted to real estate lending that contributes less to the country’s development. The successful Asian economies are based on export-led growth and exports are often *not* the lowest hanging fruit.

Industrial policy is a complex subject and the devil is in the detail. The government needs to study each sector of the economy, including those sectors that don’t exist yet but it should have, and formulate a sector strategy, assigning a relative weight to the overall importance of each sector according to its assessed prospects. The sector studies should include an audit of the existing firms (both local and foreign), the role that foreign investors might play, the case for protection or subsidies, direction of bank credit etc. With sustained effort over time, the policies of the nation can help guide the total strategic effort of the country and influence the development of different sectors and create a stronger portfolio of national industry.

CONCLUSION

For Myanmar's policy decision makers a blind act of faith in free markets alone to deliver the prosperity that the country seeks – the Washington consensus model – is unlikely to be sufficient to bring about the structural change in the economy necessary to bring about sustained development. The more interventionist approach characterized by the developmental state, with its long pedigree among successful Asian economies, is far more likely to deliver the necessary results. For Myanmar the formula is the president works closely with the conglomerates to establish a pipeline of "shovel-ready" projects, with the necessary concessions assigned, in time to tap the new China-led multilateral development banks in their initial splurge of project lending.

Of course, Myanmar cannot really influence whether China will develop a strong execution capability in multilateral development banking with its entirely different *modus operandi* from China's prior experience which is limited to its national policy banks. The China Development Bank is entirely staffed by Chinese people and its enormous success can be largely attributed to the exceptional talents of a single individual, Chen Yuan. However, there are still good reasons to feel confident China will succeed with its future international financial expansion, itself a defining quality of it becoming a great global power. But Myanmar should not shift all its hope over to China again, but instead rebalance. Myanmar must seek good economic relations with all of its development partners. Japan is a major potential source of development capital, particularly in the context of its rivalry with China, and in due course the Western powers will acquire a better grasp of Myanmar's needs and come on board to a greater extent.

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TRS10/14

ISBN 978-981-4620-22-2

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