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From the Desk of...

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Can Myanmar reform its economy? Hans Vriens, an expert on public policy issues in Asia and working closely on Myanmar investment issues, sounds a cautious note as the country attempts to shake off its past and fulfill its potential.

Now that the US and the EU have suspended sanctions against Myanmar, many companies are exploring investment into a country they were forced to leave half a century ago. It was in 1962 that General Ne Win staged a coup closed the borders, nationalized the economy and kicked a several hundred thousand Indians out of the country – many of them entrepreneurs and shop keepers.

Myanmar is the final frontier in Southeast Asia. It seems almost a stampede to enter first into this country with 60 million inhabitants. The aspiring investors are in for a tough ride. Yangon has the most challenging investment climate in Asia, with the exception of North Korea!

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There is hope. One year into a dazzling political transformation, Naypyidaw has embarked on overhauling its mismanaged economy. Parliament is working on a new investment law. Two land laws were recently passed by a surprisingly active and reformist parliament. The President has already introduced a realistic exchange rate, signed the “Labour Organization Law”, that provides the right to strike and form labour unions and a law on Special Economic Zones (SEZ). The government thinks these zones will play a similarly important role in its economic development the way Shenzhen did in China.

During his first year in office, President Thein Sein -- formerly the no. 4 general in the junta of ex-strongman, Tan Shwe -– surprised everybody with a number of bold political initiatives. He succeeded in bringing Aung San Suu Kyi into the political process, he successfully concluded peace agreements with 11 ethnic groups and a new effort to sign a peace agreement with the Kachin in the north is underway. Real peace with the ethnic minorities had been illusive ever since independence in 1948. And for the first time the government talks about previously taboo subjects, like widespread “poverty” and “underdevelopment”.

Myanmar’s economy is tragically mismanaged. For 50 years it has been run by generals who were trained to fight ethnic minorities and to mistrust civilians, let alone economists. Civilians were banned from the government and even from advisory positions. The often bizarre economic policies of General Ne Win and General Tan Shwe made Myanmar the poorest country in Asia, with the exception of North Korea.

Reliable data about the Myanmar economy are scarce. For example, according to official government statistics Myanmar appears to be the fastest growing economy in Asia, with an average GDP growth of 12% over the last 12 years, a rate that would have tripled per capita income. But the story of electricity production tells a different story; electricity output often grows 1.5 to 2 times as fast as GDP per capita income levels. However, electricity consumption per capita grew on average only 2.7% a year. In other words, the economy was actually stagnating.

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Just how backward is the economy? A visit to the main branch of one of the major banks is illustrative; People are unloading a small truck parked in front of the bank. Workers carry big bags on their backs into the branch. Inside, the bags of cash are deposited. Behind the counter, piles of cash stacked up to the ceiling are being counted and recounted. It looks more like a paper factory than a bank. This is what is euphemistically called a cash-based economy. By law, banks in Myanmar provide virtually no credit facilities to farmers, or mortgages, or consumer credit, or credit cards -- as a result of US sanctions. Most overseas transactions are handled in Singapore, which acts like an off-shore banking platform for Myanmar and using the informal hundi system.

The economy is a textbook example of mismanagement: the exchange rate is overvalued, electricity prices are highly subsidized, rice exports are controlled and sometimes banned, infrastructure is poor, public sector salaries are very low, there are too many price controls and all kinds of import and export licenses, and even export taxes.

The government runs chronic budget deficits. In part because it receives such a small share of GDP in tax revenue – only about 3.5%.The Central Bank has printed the short fall every year, though this will soon no longer be necessary. Myanmar is becoming a quasi petro state thanks to large offshore gas fields which are being developed. Total and Chevron are already exporting over USD 3 billion in natural gas to Thailand each year. Next year the Shwe gas field will come on stream and its natural gas will be pumped through a pipeline which is currently being built straight through to the Chinese province of Yunnan. In 2015 another big offshore gas field will start exporting to Thailand. Two years ago twelve new oil and gas investments were approved, worth USD 10.8 billion. In 2011 another ten offshore blocks were auctioned off.

The gas boom is bad news for manufacturing and agriculture. As a result of the massive increase in gas and jade exports, Myanmar is suffering from the Dutch disease in which it causes the national currency the Kyat to appreciate -- since 2008 it has risen from 1400 to 820 to the US Dollar. This happened despite continued money-printing by the central bank, high inflation and no visible gains in workers' productivity.

Despite this, the manufacturing sector represents one of the most promising areas for growth and for foreign direct investment, which the government is so keen to attract, especially from the developed world. This is to counter balance the weight of Chinese companies which have been the dominant foreign investors in Myanmar over the last few years.

Low labour costs are a significant advantage, a difference exacerbated by rapidly rising wages now in Thailand and China. Wages are low by regional standards, with unskilled labourers making 1500-2000 Kyat a day (USD 1.80 to 2.42 at the current exchange rate). A number of Thai textile manufacturers have already announced they are moving their factories to Yangon.

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Myanmar's agricultural sector has a history of productivity, hailing back to the British era when Burma was the world's leading rice exporter. However, decades of poor government policies, including an artificially low fixed domestic rice price, resulted in stagnation in rice production. Agriculture is critically important as it is where most people find employment out of a total work force of 30 million, most of them in the informal sector. Yet again, an overvalued exchange rate, an almost complete lack of credit and high inflation (currently running at 10%) has decreased the real prices of many agricultural products by 50% over the last five years, significantly impoverishing those who work and live on the land.

Investors are lining up to try to understand what opportunities exist in Southeast Asia's second largest country – in terms of size – now that it is suddenly 'open for business'. This is a cautionary tale. It will take brave political decisions by the government to significantly improve the investment climate and create a level playing field for foreign investors.

About Hans Vriens and The Insight Bureau

Hans W. Vriens is a political and economic analyst and founder of V&P in Singapore. His firm set up an office in Yangon earlier this year. www.insightbureau.com/HansVriens.html

Hans is one of the leading independent advisors on public policy in the Asia Pacific region, with almost 20 years of experience following the political shifts taking place across a number of key countries. Based in Singapore, he has been counsel to chief executives and board members on market entry strategy, regulatory affairs and managing sensitive issues across Asia. He has particularly strong experience in Southeast Asia, China and India. Hans frequently provides background briefings to visiting executives to help them understand political, economic, cultural and business developments in the region. He is able to provide unique and frank analysis thanks to the many research and consultancy projects he has led for leading multinationals and governments around Asia over recent years.