SUPPORTING ECONOMIC TRANSFORMATION

BRIEFING PAPER

Foreign direct investment and economic transformation in Myanmar

Stephen Gelb

June 2017

Key messages

- Foreign direct investment in labour-intensive activities such as garment exports and mass housing should be actively promoted from China and elsewhere, to enhance economic transformation in Myanmar.
- Over and above increased investment in these sectors, significant expansion of training is needed to address shortages of high-level skills, such as those of managers and technicians.
- Complementary reforms in finance and trade policy are urgently needed to realise the transformative impact of both foreign and domestic investment.

The issue

Myanmar's new democratic government must address high poverty rates – 25.6% of the population of 54 million are poor, average per capita income is $4,882[1] – while managing a complex political situation: the military retains significant formal political power while rebel groups still contest large parts of the country. Natural resource exports (oil/gas, wood, precious stones) have driven strong growth in recent years, but 60% of the population works in agriculture, and economic transformation is crucial to sustain growth and reducing poverty.

Foreign direct investment (FDI) – especially from China[2] – has been important for natural resource exports, but has sparked social conflict. Our recent paper (Gelb et al., 2017) explores the potential for FDI, including from China, to contribute positively to economic transformation and poverty-reducing growth, focusing mainly on garments and construction. Garments is a labour-intensive export-oriented sector; construction is also labour-intensive, and improved low-cost housing and infrastructure provision lowers costs for other sectors.

[1] Poverty data from Asian Development Bank; income data from World Bank World Development Indicators.
[2] In value terms, China is the largest foreign investor in Myanmar, and power and oil/gas are the largest sectors. Data provided by the Myanmar Department of Investment and Company Administration.

Foreign direct investment in garments

FDI in the Myanmar garments sector has been significant, if measured by the number of entries rather than their value.[3] In mid-2015, about 55% of officially registered garment firms in Myanmar were known to be fully or partly foreign-owned, with about 25% of the foreign firms from China and 17% from Hong Kong.[4] Many recent entrants, especially from China, have set up operations in Myanmar in a 'joint' entry decision with key customers – which are often global corporations in branded clothing or retail, or their first-tier suppliers. Many locally owned firms also have foreign owners, though such 'fronting' is inefficient from a policy perspective. Foreign-linked firms supply almost all garment exports, and these have risen rapidly in recent years, especially since EU sanctions were lifted in 2012. Export growth is likely to continue as US sanctions were lifted in 2016.

The industry is a major job creator, with about 200,000 employed in total in mid-2015[5] – about a quarter in Chinese and Hong Kong firms. Labour

[3] Average investment value for garment firms is around $2.5 million, much smaller than for power or oil/gas projects.
[4] 29% were from Korea and 12% from Japan. Data provided by the Myanmar Garment Manufacturers Association.
[5] Average factory size in Myanmar garments is about 700 workers, slightly more than in Bangladesh, which is about 550. Data provided by the Myanmar Garment Manufacturers Association.

turnover is very high, but it is lower and working conditions are better in exporting (i.e. foreign-owned) firms.[6] But foreign-owned firms have very few local managers, reflecting Myanmar's shortage of high-level skills. Beyond jobs and exports, foreign-owned garment firms have generated few other benefits (linkages or spillovers) in Myanmar.

Foreign direct investment in construction and infrastructure

Foreign-led construction projects focus on infrastructure and commercial and high-end residential developments. Chinese state-owned firms are prominent, winning infrastructure contracts even since the 2011 suspension of the controversial hydroelectric dam project. Foreign investors in construction require local joint venture (JV) partners. This offers a lucrative new rent source to Myanmar's large family-owned conglomerates, which have benefited from natural resource exports. There is some evidence of improvements in local JV partners' efficiency and capabilities. However, this may raise infrastructure costs, and there is a trade-off between such 'enterprise development' spillovers and benefits to downstream firms of cheaper and improved infrastructure.

Publicly funded low-income housing projects – from which foreign firms have been excluded – are potentially very significant for economic transformation, because they would lower urban real wages. There is also considerable informal foreign entry – via 'fronting' by local businesspeople – in smaller urban residential construction. This reflects a scarcity of small and mid-sized local firms, and also points to lax enforcement of planning regulations and construction standards. Serious technical and management skills shortages affect projects of all sizes, and a significant share of construction materials need to be imported (40% of cement, for example).

Policy suggestions

Economic transformation and creation of urban industrial jobs in Myanmar would be enhanced by substantial increases in both garment exports and construction of mass housing, as government policy recognises. But Myanmar cannot meet its target in either sector (or in construction materials) without substantial numbers of new mid-size firms. Since competitive local firms have not emerged in large numbers, more FDI is essential in both sectors, and China is the most likely source, given its economic size and geographic proximity. Although Myanmar has liberalised and modernised entry procedures for foreign investors in recent years, entry restrictions (such as JV requirements in several sectors) and cumbersome procedures remain, which simply discourages transparent formal entry by foreign firms. Myanmar should further ease entry and undertake active investment promotion in garments (and other labour-intensive exports such as footwear) and in low-income housing construction. Entry of Chinese and other foreign garment assemblers could also be encouraged through engagement with buying firms, especially global retail or apparel corporations.

A central factor in the scarcity of competitive local firms – and therefore the need for FDI – is the shortage of entrepreneurial, management and technical skills: high-level skills are a more binding constraint than shop-floor production skills. One short- to medium-term measure to address this constraint is 'labour circulation': the movement of skilled employees (foreign and local) from foreign firms to existing and new local firms. Entrepreneur support policies should be made available to foreigners, together with outreach to the Myanmar diaspora. In the longer term, Myanmar should follow the Bangladesh example, where tertiary education institutes dedicated to the garment industry increased the supply of managers and high-skill technicians in the industry.

Financial sector and trade policy reforms are needed as complementary measures to support transformative economic growth. Garment exporters need to be able to access currently unavailable trade credit, and the existing distinction between CMP (cut-make-package) and FOB (free-on-board) producers allowing tariff-free fabric imports only to the former, is meaningless and should be scrapped. In construction, the residential mortgage market is in its infancy and its growth should be accelerated, while public rental housing developments should be considered.

This briefing paper is drawn from **Gelb, S., Calabrese, L. and Tang, X. (2017) *Foreign direct investment and economic transformation in Myanmar.* Supporting Economic Transformation paper. London: Overseas Development Institute.** Full references can be found in this paper.

[6] See Tanaka, M. (2017), Exporting Sweatshops? Evidence from Myanmar. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2938903