SUPPORTING ECONOMIC TRANSFORMATION

FOREIGN DIRECT INVESTMENT AND ECONOMIC TRANSFORMATION IN MYANMAR – THE ROLE OF THE GARMENT SECTOR

Event report

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INTRODUCTION

On 14 March 2017, the Overseas Development Institute (ODI)'s Supporting Economic Transformation (SET) programme held a workshop in Yangon to explore questions around the role of the garment sector in supporting economic transformation in Myanmar, including: what role does the garment sector play in promoting exports, employment and the transfer of skills in Myanmar? How does foreign investment contribute to Myanmar's garment sector? And how can foreign investment, from China and other countries, further contribute to economic transformation in Myanmar?

The meeting was attended by the UK Department for International Development (DFID), Pyoe Pin, SMART Myanmar, the Business Innovation Facility, the DaNa facility, Envisage and a leading European retailer.

The discussion was centred around the findings of the newly published SET report, *'Foreign direct investment and economic transformation in Myanmar'*. The SET team working on Myanmar includes Stephen Gelb and Linda Calabrese (both ODI) and Xiaoyang Tang (Carnegie-Tsinghua Center for Global Policy).

The report looks at foreign direct investment (FDI) in Myanmar, with a focus on Chinese investment, to assess how it contributes to economic transformation in four sectors: agriculture, construction, garments and tourism. Approximately 40 firms were interviewed in both Myanmar and China to assess the extent to which these firms have generated employment, enhanced skills and other spillover effects that can promote economic growth and transformation. The report presents the findings of these interviews, together with interviews with other stakeholders and much secondary evidence, and makes policy recommendations for the Government of Myanmar, the private sector and development partners.

The event started with a presentation of the paper, followed by a discussion among participants.

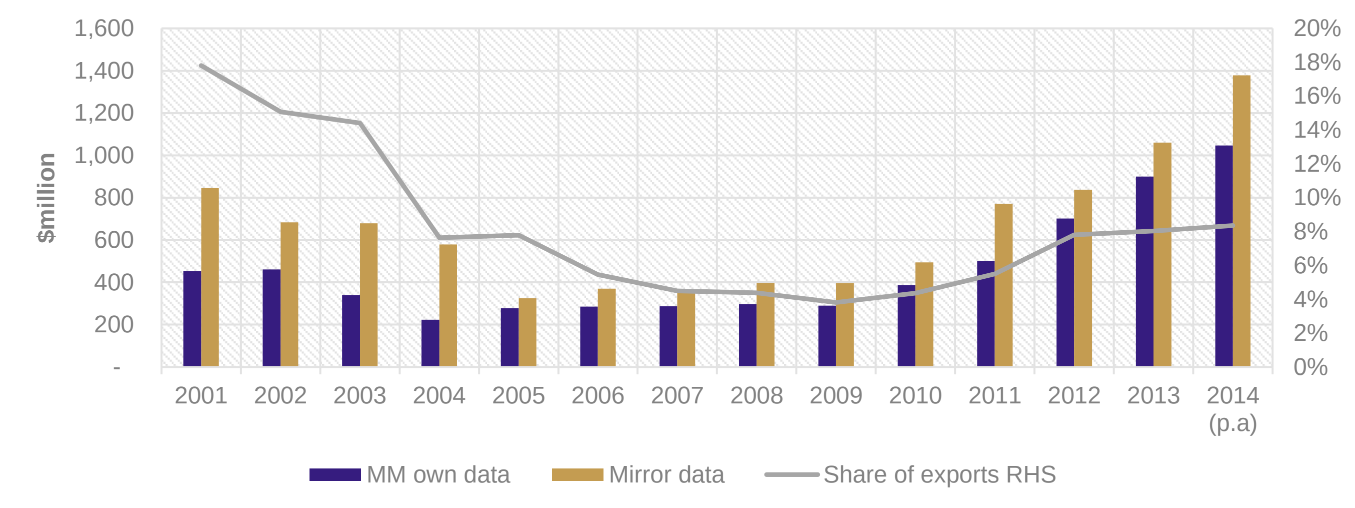
PRESENTATION

Stephen Gelb, Principal Research Fellow and Private Sector Development Team Leader, ODI

Trade in garments

Trade data show that the performance of Myanmar's garment exports has evolved considerably in recent years, as shown in Figure 1 (which shows a striking difference between Myanmar's own data and mirror data). In the early 2000s, garments were the main export from Myanmar, supplying the United States (US) and the European Union (EU). With the introduction of US sanctions in 2003, the sector was hit: exports declined substantially, especially those directed to the US and EU. Market growth in Japan and South Korea partially offset this decline, and since then sector exports have again increased, especially since the relaxation and eventual elimination of sanctions by the EU and then the US. This is evidenced by the entry and later expansion of European garment value chain lead firms, together with their Chinese suppliers, into Myanmar to establish export platforms into Europe.

Figure 1: Myanmar garment and textile exports, own and mirror data



Sources: Own data from MMSIS and Myanmar Customs Department. Mirror data from UN Comtrade. Share of exports is for own data.

Foreign direct investment

The SET project analysed FDI data from different sources, which are often inconsistent. In the last decade, the manufacturing sector as a whole has seen foreign investment materialised in around 500 projects worth 5 billion USD. China is the biggest investor by value, with 31% of the total value of foreign investment in manufacturing, followed by Singapore – but it is possible that many investments from China and other countries use Singapore as a 'front'. This 'fronting' is very common, not only in Myanmar but in many other countries.

Chinese investment in manufacturing is relatively recent, and it has been intensifying since the transition.

Garment sector structure at firm level

The history of the garment sector in Myanmar offers many interesting insights, including:

- The centrality of Asian FDI; in the early 1990s, producers from South Korea and Japan set up affiliates in Myanmar. Many people then left these firms to set up their own companies in Myanmar. This process of 'labour circulation' is crucial for the garment sector.
- Crony companies played an important role in the development of Myanmar's garment sector. One key foreign entry was Daewoo, a South Korean firm, which created a joint venture with the United Myanmar Economic Holdings Limited (UMEHL), a military company set up to undertake light manufacturing in the case of UMEHL. When this collapsed in 1997, many of its staff went on to set up their own firms.
- Interest in the garment sector was motivated by the fact that the sector offered access to foreign exchange at a time when this was not readily available.
- The distinction between domestic and foreign firms is blurred in many cases. There are many example of firms that are registered as domestic but have some sort of collaboration with foreign investors, and firms that are registered as joint ventures but are effectively managed by foreigners.
- The export market is dominated by foreign or partly-foreign firms. This long record of engagement with foreign companies has allowed Myanmar to develop strong capabilities but makes Free-On-Board (FOB) or 'original equipment manufacturer' production less likely for domestic firms.

The tendencies we see today in the garment sector are the following:

- The presence of global value chains (GVCs) shapes the sector. The decision to invest in a country (in this case, Myanmar) is often taken jointly by the lead buyer (usually a retailer or clothing brand), and the 'original equipment manufacturer' (OEM), i.e. the producer (often from China or elsewhere in Asia).
- The domestic affiliates often have very little authority to decide what to produce and when, as they work on orders and receive precise instructions and inputs to fulfil them. These firms often lack the capital, network and skills to enter the market autonomously.
- The distinction between Cut-Make-Pack (CMP) and FOB production that defines the sector in Myanmar has its origin in the need to acquire foreign exchange in a closed market, as the Myanmar market was until 2012. Regardless of its origin, the lack of foreign exchange makes it more difficult for Myanmar firms to operate as OEMs for large brands.

Firms' interviews and findings

The interviews conducted with approximately 40 firms in Myanmar and China provided insights on the motivation of firms' entry into Myanmar, the quality of the operating environment and transformative impact of these firms:

- Labour productivity in Myanmar is lower than in China. This is, however, offset by the lower labour costs, which make it still profitable to produce in Myanmar.
- The quality of energy, water and transport infrastructure in Myanmar is poor and creates additional costs for firms. So far, these costs have been offset by lower labour costs, but this might not be the case in the future.
- Myanmar workers can produce high-quality garments, and are easily trainable. This may be due to the country's long experience with producing garments.
- In terms of managerial skills, Myanmar has a gap. Most foreign firms resort to hiring foreign managers, and find it difficult to substitute these with local managers.
- Finance and foreign exchange challenges exist for all firms, but domestic firms are disproportionately affected by these as they cannot access foreign exchange and capital to operate their business.
- Trade facilitation remains an issue for firms.
- The garment sector has contributed to economic transformation in Myanmar in several ways: it has generated employment (200,000 workers but the industry is growing fast), technical skills development and exports. Gaps still exist, especially in managerial skills and entrepreneurialism.

Policy recommendations

In order to achieve the targets set out by the National Export Strategy, the Myanmar garment sector needs to grow considerably. It should treble the number of factories and double the size of the factories (from the current average of 500 workers to 1,000). It is difficult to achieve this growth with domestic resources only, and therefore foreign investment will still be necessary.

To further enable this growth, the following policy options could be taken on board by the Myanmar Government, the private sector and development partners:

- The sector needs more entrepreneurial and managerial skills. In the short term, these can be mainly found in three ways:
    - Through FDI, which is likely to be in the form of Chinese outward investment because China dominates global garment assembly.
        - This requires increased engagement with European and US lead firms, to encourage them to support their OEMs to invest in Myanmar.
        - This can also be promoted through Chinese outward investment promotion agencies. Similar programmes already exist elsewhere, such as the Partnership for Investment and Growth in Africa (PIGA, supported by DFID).
    - Through 'labour circulation' of skilled labour, that is movement of managers and technicians across factories, from foreign-owned to locally-owned firms.
    - By incentivising Myanmar diaspora to return and/or invest in the country.
- In the longer term, the domestic supply of entrepreneurs can and should be increased. This requires the creation of training institutions at scale to train workers with technical, engineering and managerial skills. Workers can also be trained in an institute, or through ad-hoc programmes set up by the firms themselves.
- Land and infrastructure issues need to be resolved. In particular, both hard and soft infrastructure needs to be improved to ensure Myanmar's sector is competitive with those of other nations. One mechanism could be improving existing industrial parks.
- Policy changes:
    - The distinction between CMP and FOB production needs to be eliminated, but this is not enough.
    - In order to enable the creation of domestic OEMs, the trade credit system needs to be improved to allow producers in Myanmar to access trade credit.
    - Financial systems need to be developed to operate the trade credit system.

DISCUSSION

We record here comments made by participants, without attribution to individuals.

Labour, skills and diaspora

- Skill transfer is crucial, but to date the Government has provided limited support to ensure it takes place. There are legal requirements for skills transfer in the special economic zone (SEZ), but not for other investment. Monitoring and enforcing the skills transfer requirements in the SEZ will be challenging.
- Similarly, incentivising the Myanmar diaspora to develop the garment sector is a good idea, but the Government should become actively involved to promote and advertise these initiatives.
- A participant remarked that at this stage, firms might not be committing to skills transfer as they are prioritising other issues, such as infrastructure. Firms might still be testing the ground in Myanmar, and committing to do skill transfer only when the investment is more secure.
- Communication problems between foreign management and domestic workers are frequent. Cultural differences are common in the work environment, and this makes it even more important to develop a class of domestic managers who can manage firms but also have a good understanding of the cultural context.

Role of lead firms in foreign firms' entry

- The participants recognised the role of lead buyers, and of the joint decision between lead buyers and OEMs, have been driving forces in the garment sector in Myanmar.
- One participant remarked that there have been instances where a more independent approach was taken. Several foreign investors (especially smaller firms) set up shop in Myanmar without any buyer commitment. SMART Myanmar has worked to put these in touch with buyers, when possible.

There are also other independent approaches, for example, one OEM just moved to Myanmar hoping to gain contracts from a large lead firm.

Myanmar's policy environment

- Government support for the garment sector is currently quite limited, and the policy and monitoring framework is unclear. Growth is mostly driven by FDI.
- One participant remarked that foreign firms value predictability. This does not need to be in form of policies and legal frameworks as indication by the government will suffice. Unfortunately, the Government in Myanmar is not providing any certainty, and this can discourage some investors. Opportunities for foreign investment still exist because domestic firms remain unable to access international customers. However, to encourage further investment the Myanmar Government should show its intention to support the sector by providing infrastructure, skills development, etc. Similarly, to promote the growth of the sector outside Yangon, signals by the government are necessary.
- The Myanmar Ministry of Trade monitors the sector rather than facilitating investment. Therefore, the policies and strategies that are available and that could drive the development of the sector are not adequately implemented.
- Some of the policy measures that are necessary to the development of the sector (trade finance reforms, for example) have been widely discussed and are mentioned in key policy documents, but are not implemented.

National Export Strategy

- Participants agreed that the National Export Strategy's objectives for the garment sector are ambitious. While the sector is currently growing, buyers move fast, and if they find another location that offers better conditions, they will relocate. Myanmar has a window of opportunity of a few years before buyers may decide to move if conditions have not improved.
- The sector is growing and firm size is increasing. In the period 2014-2016, average firm size increased from 500 to 750 workers. Therefore, it is not impossible that the factory size could double.

Infrastructure

- Garment firms in Myanmar pay an 'infrastructure premium' due to the lack of good-quality infrastructure. However, this has recently improved. Energy supply and price have improved and firms make less use of generators. A participant observed that more reliable electricity has encouraged some foreign firms to bring in more sophisticated machinery.

Automation in the garment sector

- A participant remarked that a recent study by the International Labour Office highlighted the role of automation in South-East Asia. This could be restricting the window of opportunity for light manufacturing in countries with low labour costs. Does this jeopardise the opportunities to develop the garment sector in Myanmar?

- However, it was noted that in the garment sector globally the levels of automation are still low, and it is not clear when these technologies will become cheap enough to replace workers. It is unlikely that Myanmar will be negatively affected by this in the coming decades. However, some operations could be automated.
- An expert also noted that increased automation will take time, as firms may not immediately catch up with new technologies.

Future research

Participants expressed their interested in further research in the following areas:

- How do we ensure that this sector expands outside Yangon?
- Is there any successful experience in manufacturing in strategic areas, for example close to the border with Thailand, where diaspora is concentrated?
- Given the shift of manufacturing activities within China (from east to west), what is the impact on Myanmar?

SET is an applied research and advisory programme at the ODI, funded by DFID. The programme's reports, dialogue sessions and events cover four dimensions of a country's experience in economic transformation: (i) what is happening? (ii) why is it happening? (iii) what should be done? and (iv) how to make it happen. For more information, visit set.odi.org.