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FOREIGN DIRECT INVESTMENT AND ECONOMIC TRANSFORMATION IN MYANMAR

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Note: Throughout this document, we follow UN practice in referring to ‘Myanmar’ rather than ‘Burma’.

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EXECUTIVE SUMMARY

This study assesses the potential for foreign direct investment (FDI) to contribute to Myanmar's economic transformation, by raising productivity and growth. The study focuses on four sectors – agriculture and agro-processing, garments, construction and tourism – selected for their significance for both transformation and FDI in Myanmar, particularly FDI from China.

The paper begins with a brief review demonstrating that economic transformation over the past two decades has been limited, though data limitations make it difficult to reach firm conclusions. The sectoral composition of output has shifted, as agriculture's contribution has dropped from over 40% in 1997 to below 30% in 2014, while industry (manufacturing, construction, mining and extractives, and utilities) doubled from around 15% of gross domestic product (GDP) to around 30%, manufacturing alone going from less than 10% to over 20%. Agriculture's employment share is still largest, but has dropped from over 60% to 40% between 1991 and 2013, but much of the labour was absorbed by low-productivity services, and manufacturing is still very low at about 10%.

The review of trade and investment looks at overall performance, as well as in the four selected sectors, and at relations with China. Exports have grown especially into China, but are dominated by extractives (particularly natural gas and precious stones). Promising growth of garment exports in the 1990s was interrupted by sanctions, but exports have begun to recover as these have been relaxed since 2012. FDI performance has similarly been poor and dominated by natural resources (extractives) and infrastructure (hydropower), with China the largest source. Garment export potential has raised manufacturing FDI since 2012. The trade and investment regimes are still undergoing liberalisation to encourage entry.

Forty firms in the selected industries were interviewed, of which 31 were Chinese investors. Motivations for entry were predictable, including low-wage unskilled labour to support garment exports to European and US markets, domestic infrastructure and real estate projects in construction, and domestic market share in rice seeds and rice processing firms with rice output supplying both the domestic market and growing Chinese exports. The paper emphasises firms' interactions with each other: Chinese garment firms' entry is largely motivated by the choice of Myanmar as a location by their customers (often large Western retail or clothing brands), while construction and agro-processing firms have been required to have local joint venture partners, which usually have been part of the well-connected family-owned conglomerates that dominate Myanmar business.

The firm interviews – and much other evidence – suggest the Chinese firms are fairly satisfied with their performance in Myanmar, and with the productivity of low-skilled Myanmar labour (adjusted for wages). The Chinese and non-Chinese firms are not very different with respect to their main concerns: the quality of infrastructure (energy and transport particularly) and trade facilitation; the quality of local employees in higher-level managerial and technical positions; the limited breadth of the financial system, including the narrow scope of financial and foreign exchange instruments; and the unpredictability or absence of regulation.

The paper reviews in some detail the foreign presence in each of the four sectors and its impact on economic transformation. Significant positive effects include employment and exports in garments, local enterprise development and downstream user costs in construction (and infrastructure), and exports, technology transfer and product market competition in agriculture and agro-processing, where indirect Chinese investment (via a large EXIM Bank loan) is supporting farmer liquidity and mechanisation.

The paper makes a number of policy recommendations for UK DFID, starting with general concerns.

- a. Support public and private policy dialogue, which is remarkably sparse, and which will help develop a culture where burden-sharing and trade-offs between different interests become visible.
- b. Address the severe shortage of high-level skills (entrepreneurial, management and technical) through multiple approaches:
 - i. Set up post-secondary institutions at scale to focus on these skill areas.

- ii. Support ‘labour circulation’ to enable skilled and experienced employees of foreign firms in Myanmar to set up their own enterprises, via mechanisms to assist access to finance and land.
- iii. Use similar mechanisms to attract diaspora entrepreneurs back to Myanmar.
- c. Promote collective action by businesses:
 - i. Support clustering through the regeneration and expansion of industrial parks (the special economic zones not being sufficient), focusing especially on ‘soft’ institutional infrastructure in these areas, while partnering with other donors better placed to support ‘hard’ infrastructure.
 - ii. Support the upgrading of business associations and their ability to engage in policy dialogue, by training at scale in organisational and negotiation skills.
- d. Support reforms in the financial and energy sectors to improve the quantity and quality of provision and lower its cost, including liberalisation of foreign exchange access.
- e. Support efforts to improve economic statistics and training in regulatory skills.

On the different sectors, the paper recommends, over and above the sector-specific adaptation of the general recommendations:

- a. Garment sector:
 - i. Support significant increases in firm entry from China and other Asian source countries, through ‘trilateral’ investment and trade promotion – (Myanmar/China/UK and Europe) – including a focus on the lead (buying) firms in the value chains (retail and brand owners).
 - ii. Encourage the immediate elimination of the CMP/FOB distinction in the Myanmar tax structure, and support the introduction of back-to-back letters of credit and bonded warehouses (as advocated by the industry), by assisting with training and systems development in customs and banking.
- b. Tourism:
 - i. Focus on high-level skills development by assisting with training institution development.
- c. Construction:
 - i. Focus on urban low-cost housing development by supporting entry by Chinese construction companies, both large and small.
 - ii. Develop regulatory capabilities for tendering, construction safety and housing product quality.
- d. Agriculture:
 - i. Scale up existing interventions in financial system leasing capacity for mechanisation and irrigation equipment, in investment promotion to encourage foreign entry into rice seed production and rice processing and in efficiency improvements and cost reductions in rice export infrastructure.

ACRONYMS

CMP	Cut-Make-Pack
CSO	Central Statistical Organisation
DICA	Directorate of Investment and Company Administration
DTT	Double Taxation Treaty
FDI	Foreign Direct Investment
FIL	Foreign Investment Law
FOB	Free on Board
GDP	Gross Domestic Product
GNI	Gross National Income
GVC	Global Value Chain
ITC	International Trade Centre
JV	Joint Venture
IPA	Investment Promotion Agency
MEC	Myanmar Economic Commission
MGMA	Myanmar Garments Manufacturers Association
MIC	Myanmar Investment Commission
MMK	Myanmar kyat
MMSIS	Myanmar Statistical Information System
MOFCOM	Ministry of Commerce, People's Republic of China
NLD	National League for Democracy
OBM	Own brand manufacturer
OECD	Organisation for Economic Co-operation and Development
OEM	Original Equipment Manufacturer
PRC	People's Republic of China
SEE	State-owned Economic Enterprise (referring to Myanmar enterprises)
SET	Supporting Economic Transformation
SEZ	Special Economic Zone
SOE	State Owned Enterprises (referring to Chinese and other countries' enterprises)
UMEHL	Union of Myanmar Economic Holdings Limited
UNCTAD	United Nations Conference on Trade and Development
USDP	Union Solidarity and Development Party

1 INTRODUCTION

Structural economic transformation is an aspect of the economic growth process which reflects the reallocation of resources (especially labour) from less productive to more productive activities, as well as changes in the composition of output and higher average productivity in the economy as a whole. Reallocation can occur either from low productivity to higher productivity sectors, for example from subsistence agriculture to manufacturing, or from less productive to more productive activities within the same sector, such as from less mechanised to more mechanised production techniques within manufacturing or within agriculture. Economic transformation raises the growth rate in the short term, but also enhances the sustainability of growth in per capita incomes over time. Structural economic transformation driven by a shift of resources into secondary industry has long been seen as the key to economic development of low-income countries, because secondary industry offers arguably greater potential than agriculture or (most) services sectors for stronger productivity growth as a result of capital-intensive production, for technological progress, for agglomeration and scale economies, and for linkages and spillovers between firms and sub-sectors.¹ Indeed, with the possible and partial exception of India where IT services have been important, there are arguably no economic development success stories of the past 75 years in which secondary industry, and manufacturing in particular, has not been central.

Looking across countries, manufacturing productivity levels converge ‘unconditionally’, in other words the manufacturing productivity level in developing countries tends to catch up to its level in developed countries (Rodrik, 2013). Increased productivity in agriculture and services are also part of structural transformation. Rising productivity linked to mechanisation and commercialisation of farming contributes to growth directly, and also lowers the cost of food for urban workers and consumers which supports industrial expansion. Both manufacturing and commercial agriculture depend heavily on a wide range of services inputs, so that lower costs and improved quality of the latter can have substantial downstream growth and transformation impacts. Structural transformation also involves changes in demand composition, especially in exports, away from unprocessed primary commodities towards manufactured goods and processed natural resources. The shift in sectoral ‘labour allocation’, that is, employment patterns, at the heart of structural transformation is increasingly seen as the key to sustainable poverty reduction, since it raises household incomes and enables accumulation of human capital, so lowering vulnerability.

This study examines Myanmar’s economic transformation over the past two decades, and its potential for further transformation in the future. Agriculture’s share of Myanmar’s gross domestic product (GDP) has dropped from 60% in 1991 to 27.9% in 2014, but this does not necessarily mean that there has been extensive transformation: 42% of the workforce is still found in agriculture and the sector remains largely unmechanised. Over 25% of workers are in trade, which remains overwhelmingly informal, with low-productivity activities. This suggests that structural transformation has been limited, notwithstanding strong GDP growth since 2007/8, averaging 5.8% per annum.² Myanmar’s gross national income (GNI) per capita in 2014 was \$1270,³ which was above its regional neighbours Cambodia (\$1020) and Bangladesh (\$1080) but below Laos (\$1660), India (\$1570) and the average of sub-Saharan African developing countries (\$1637).⁴

As detailed in Section 2 below, China has been Myanmar’s largest international economic partner for trade and investment over the past 15 years, and has itself undergone very rapid economic transformation with associated employment creation and poverty reduction over the past 30 years. This has been linked with the rapid expansion of the manufacturing sector in China, including garments and other export-oriented light manufacturing supplied to industrialised-country markets, as well as the construction and engineering

¹ For more discussion on economic transformation, see McMillan et al. (2015). The classic references are Chenery et al (1986), and Lewis (1954).

² This average growth rate is based on International Monetary Fund (IMF) staff estimates of real GDP growth: see tables of Selected Economic Indicators, Article IV Consultations, 2011, 2013 and 2015, available at <http://www.imf.org/external/country/mmmr/>.

³ World Development Indicators (WDI), current US\$, Atlas method.

⁴ This average excludes South Africa.

sectors with development in transport and energy infrastructure and urban housing. But China is now shifting into a new phase of economic growth involving rises in domestic wages and in the share of domestic consumption in aggregate demand relative to exports and fixed investment. This is contributing to a shift in China's export-oriented labour-intensive light manufacturing from the coastal regions to new locations both inside and outside China, and to an increase in outward investment in other sectors, including construction and engineering. Both the latter sectors are central to the Chinese government's foreign economic policy strategy articulated as the 'Belt and Road Initiative', in which Myanmar is of great significance, given its geographical location between western China and the Bay of Bengal and Indian Ocean.

But several large Chinese investment projects in Myanmar have been politically and socially controversial, as has been the extensive informal natural resource extraction and trading activities undertaken by Chinese businesses. In the past five years, this has contributed to political tension over China's role in Myanmar – both within Myanmar and between the two countries – however, as its much larger neighbour and with its own global stature increasing, China remains very influential in Myanmar's economic and geo-political situation. The ongoing political transition in Myanmar, together with the continued economic growth transition in China, provides a promising context for investment from China to have significant beneficial impacts on economic transformation in Myanmar. This paper examines this possibility.

This study focusses on foreign direct investment (FDI), in particular from China, and in particular into four sub-sectors with the potential to accelerate economic transformation in Myanmar, namely: garment manufacturing; agriculture and agro-processing; construction; and tourism. Three of the four sub-sectors – garment manufacturing, construction and tourism – are in secondary industry, and garments, tourism and agro-processing (partially) are export-oriented. Garments, construction and tourism are all labour-intensive, and have the potential to provide extensive employment opportunities for people moving out of subsistence agriculture, which also helps to create a workforce able to undertake standardised factory-type work. Though these activities may not be high productivity in international comparative terms, they are high productivity in the context of Myanmar's current economic structure, and particularly relative to subsistence agriculture which still employs 40% of the workforce. For this reason, this study also examines the expansion of commercial agriculture and agro-processing, which are higher productivity activities than subsistence agriculture and also contribute in potentially significant ways to economic transformation through lower prices for domestic food and through increased exports. The construction sector's impact on transformation is both direct and indirect, the latter via forward linkages relating to the provision of housing and improvement of infrastructure, that is, lower input costs for other sectors.

We begin in Section 2 with a discussion of the broad context of economic transformation in Myanmar, including an examination of changes in the sectoral composition of output, employment and trade, focusing on both the Myanmar economy as a whole, and on the four sub-sectors of primary interest in this paper. This section also discusses FDI into Myanmar, looking at historical patterns of inward investment by sector and source country, and the ongoing reforms in the investment environment in an effort to improve the country's historically poor performance in attracting foreign capital. The discussion in this section makes extensive use of both official Myanmar data as well as 'mirror' data from its trade and investment partners.

To examine whether investment from China into Myanmar could benefit economic transformation, we interviewed 32 Chinese firms and ten non-Chinese firms already operating in the four selected sub-sectors in Myanmar. The objective was to understand the firms' motivations for investing in Myanmar, their perceptions of the business environment and their impact on Myanmar's economy. Section 3 presents the findings from the firm interviews in the context of the overall trajectory of each sector, which provides a basis for discussion in Section 4 of possible policy options for various stakeholders – the Myanmar government, the Chinese government and Myanmar's other development partners – to enhance economic transformation through growth of these activities. Section 5 discusses the political economy context for the formulation and implementation of policy options looking at both Myanmar's political transition and its relationship with China.

2 GROWTH, TRANSFORMATION, TRADE AND INVESTMENT IN MYANMAR: AN OVERVIEW

This section takes stock of economic transformation in Myanmar in recent decades, looking first at changes in the production structure and at productivity across sectors, before turning to trade and finally to FDI. We draw on a wide range of secondary data sources including DFID's Inclusive Growth Diagnostic (2015) and SET's own data portal.⁵ Although it has improved recently since the Myanmar Central Statistical Organisation (CSO) introduced the Myanmar Statistical Information Service (MMSIS), both data availability and quality in Myanmar remain very uneven, especially at the sectoral level, which is a severe limitation on what can be said with confidence about economic transformation.⁶

Illustrative of the data challenges, there is considerable uncertainty even about the overall size of Myanmar's economy, as measured by GDP. Table 1 reports estimates of GDP presented by the Myanmar government.

Table 1: Alternative estimates of Myanmar's GDP, 2012/13–2014/15

			CSO Myanmar	IMF	WDI
2014/15	Nominal	MMK trillion	65.44	-	-
		US\$ billion	65.25	63.1	64.33
2013/14	Real	MMK trillion	48.88	54.7	-
		US\$ billion	-	56.7	-
2012/13	Nominal	MMK trillion	51.26	47.7	-
		US\$ billion	-	55.6	74.69

According to the CSO, Myanmar's nominal (current price) GDP was Myanmar Kyat (MMK) 65.44 trillion in the fiscal year (FY) 2014/15, equivalent to United States (US) \$65.25 billion converted using IMF exchange rates.⁷ The IMF's own projection of nominal GDP for FY2014/15 was US\$63.1 billion, which is 3.3% smaller than the CSO's figure,⁸ while the World Bank's WDI report nominal GDP for FY2014/15 of \$64.33 billion, 1.4% lower than the CSO. Similar disparities are found in earlier years, and for both nominal and real measures.⁹

As noted above (and taking the data at face value), based on a population of 53.4 m. the GNI per capita in 2014 was \$1270 according to the World Bank (Atlas method). This income level is higher than Cambodia and Bangladesh but below Laos, India and the average for sub-Saharan Africa (excluding South Africa). Note that the IMF reports per capita income as \$1112 per capita (IMF, 2015a).

Given the uncertainties about the GDP data, both real or nominal, growth rates calculated using the data should be treated with extreme caution. Nonetheless, we report here that according to the UN data for

⁵ <http://set.odi.org/data-portal/>. Explanation of the methodology and use of data are provided in te Velde and Kennan (2015).

⁶ See <http://www.mmsis.gov.mm/>, which provides better quality data than the CSO's original site <http://www.csostat.gov.mm/>.

⁷ See www.mmsis.gov.mm, which reports official data compiled by the CSO. This figure was published on 18 August 2015. Myanmar's national accounts present data for the fiscal year, running from 1 April to 31 March: for example, FY2014/15 starts on April 1 2014. The exchange rate used here is \$1 = MMK997.18, the average monthly rate over FY2014/15 from www.imf.org. The IMF estimate of real GDP for FY 2013/14 is MMK54,699 billion, or \$56.7 billion, equivalent to \$1112 per capita (IMF, 2015a).

⁸ IMF (2015a: Table 1a) published a few weeks after the MMSIS figure for FY2014/15.

⁹ Exchange rate differences probably account for part of this disparity: the IMF reports the average US\$ exchange rate for the MMK to have been 640.65 for 2012 (end-2012 855.00) and 933.57 for 2013 (end of year 988.00).

gross value added (GVA) (used across countries for the SET data portal), aggregate economic growth in Myanmar averaged a scarcely credible 9.7% *per annum* between 1991 and 2013, with the rate remaining above 10% persistently between 1999 and 2010. As noted above, the IMF reports growth of 5.8% on average for the years 2007/08 to 2013/14.

2.1 Sectoral composition of output in Myanmar

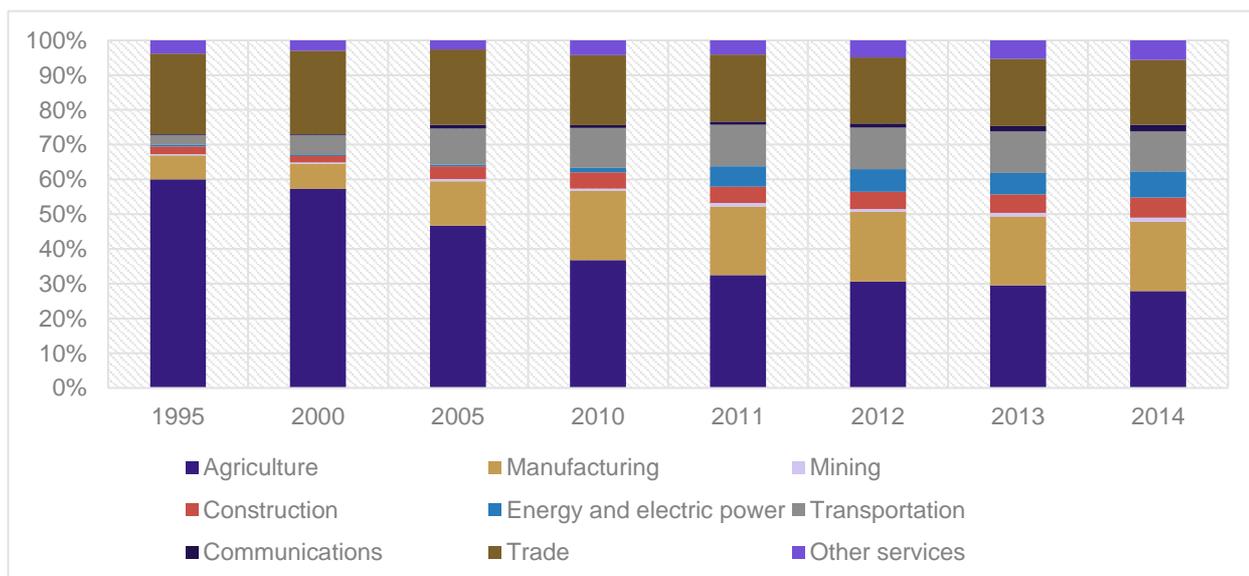
This section discusses shifts in the sectoral composition of output in Myanmar, using CSO data, before looking at shifts in the sectoral composition of employment using data from the ILO.

As shown in Figure 1, in 2014 nearly 28% of value added came from agriculture, with 20% from manufacturing, 7.3% from mining and extractives (mainly natural gas), and just under 6% from construction. The remaining 39% came from the services sector, with a surprisingly large share of 14.8% contributed by infrastructure services: transport and communication.

There are alternative estimates of the size of the mining/extractives sector, based on different information on resource exports. The IMF reports a figure of \$3.6 billion of natural gas exports in 2012/13 (provided by the SOE Myanmar Oil and Gas Enterprise, MOGE), equal to 6.47% of its estimate of nominal GDP for that year of \$55.6 billion, and reportedly 70% of all exports (IMF, 2015a, b). This is not significantly different from the CSO estimate of mining’s share of output. In contrast however, a recent unofficial report suggested that jade output, based on mirror data of Myanmar exports reported as imports by its trading partners, was at least \$31 billion for 2014 (Global Witness, 2015a). The report went on to argue that this was not accounted for in the GDP data, notwithstanding that it was ‘official’ output in the sense that the foreign trade was regulated and measured by public agencies. Adding this amount to officially measured output would significantly raise both the GDP whether reported by the Myanmar government or multilateral organisations, and also raise significantly the share of mining relative to those of other sectors.

Nonetheless, taking the official data at face value, it is evident that the composition of the economy has changed considerably over time, as Figure 1 shows. Agriculture’s contribution to GDP has dropped dramatically since 1995, while the industrial sector (including manufacturing, mining and construction) has quadrupled its share. The manufacturing share alone has nearly trebled from 1995 to 2014.

Figure 1: Value added by each sector as share of GDP, selected years

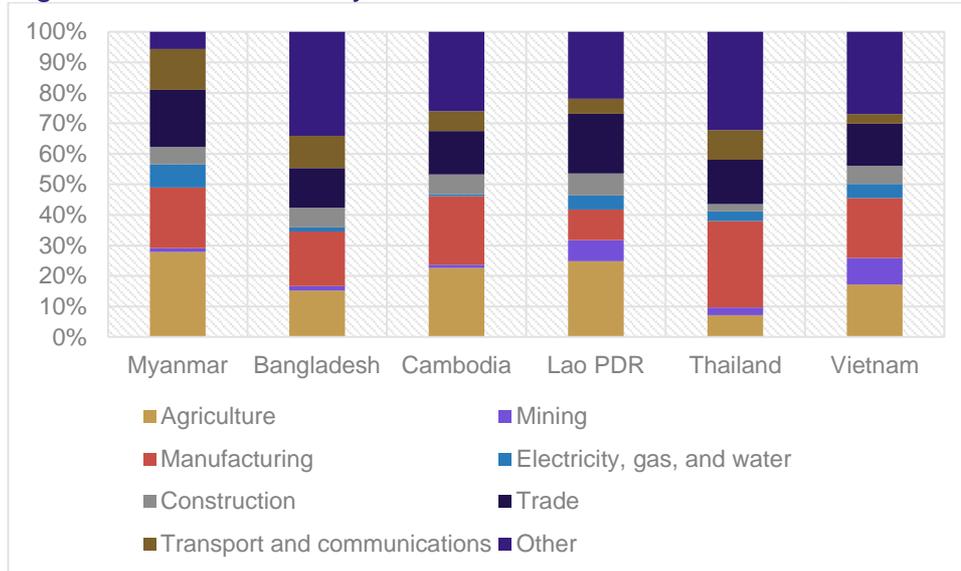


Source: CSO, MMSIS.

Compared to the other countries in the region, Myanmar’s economy relies heavily on agriculture despite the drop in the sector’s share (Figure 2). The contribution of manufacturing to GDP is in line with

neighbouring countries, but higher than developing countries in sub-Saharan Africa where the share of value added of manufacturing averaged 11.2% of GDP in 2014 (World Bank, WDI).¹⁰

Figure 2: Value added by each sector as share of the GDP, selected countries, 2014



Source: CSO MMSIS; Asian Development Bank, Key economic indicators 2015.

2.2 Employment and productivity levels

Turning now to employment, the total Myanmar workforce – people aged 15 to 64 years old – was 32.98 million in 2014 according to the latest population census (Ministry of Immigration and Population, 2015). The census indicates that 21.2 million were employed and only 900,000 unemployed, with the remainder of the workforce – 10 m. people – in unpaid and subsistence work.¹¹ The World Bank and International Labour Organization (ILO) both label the latter categories as ‘employed’, and their figures for total labour force and unemployment broadly correspond with those of the Myanmar government.

Employment projections using a model compiled by the ILO World Economic and Social Outlook (WESO) suggest that employment rose from 19.59 m. in 1991 to 30.42 m. in 2013. According to this analysis, agricultural activities remain the largest occupation, though the share of the population working in agriculture dropped from more than 66% in 1991 to 42% in 2013, with the absolute number of agricultural workers peaking at 14.99 m. in 2000 and dropping to 12.79 m. by 2013.¹²

The manufacturing share of employment remains low, though it increased from 7.1% in 1991 to just over 10% in 2013. This is in line with most other countries in the region, using data from the same dataset: employment in manufacturing ranged from 10.7% in Cambodia to 14% in Vietnam in 2013, though in Lao PDR, less than 2% of the workforce was in manufacturing. The ILO WESO dataset reports a very low share of employment in the mining sector of less than 1%, almost certainly an underestimate given the sector’s share of output.

The ILO WESO data suggests that manufacturing sector employment growth was 3.9% *per annum* between 1991 and 2013, with employment rising from 1.4 m. to 3.2 m. people. Construction sector employment grew from 217,000 workers in 1991 to 1.77 m. in 2013.

¹⁰ African countries, however, may or may not exhibit the same degree of underestimation of their extractives sector.

¹¹ For a full explanation see: <http://laborsta.ilo.org/applv8/data/c2e.html>

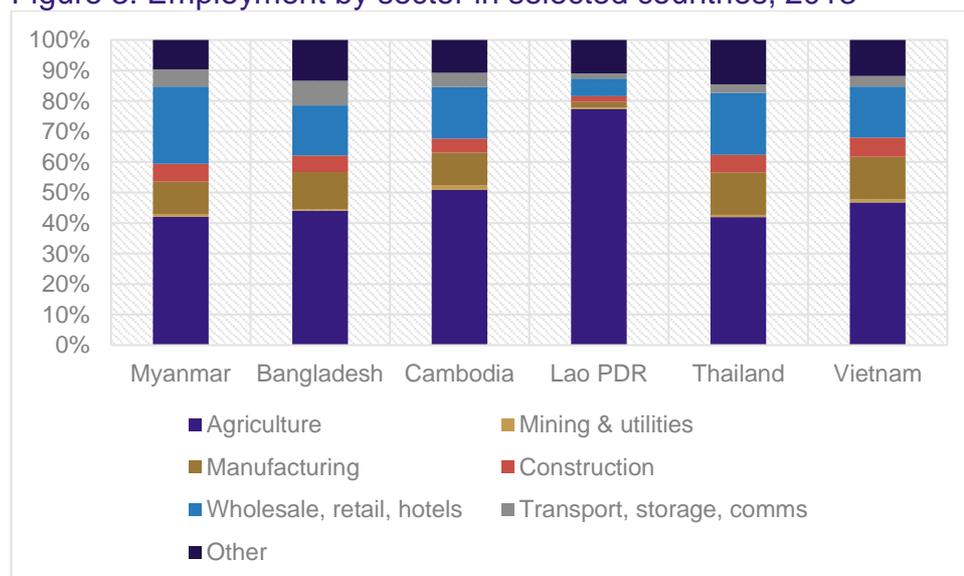
¹² Note that it is not clear how agricultural employment is defined in this dataset.

Table 2: Employment by sector (%)

Sector	1991	2000	2005	2010	2013
Agriculture	66.3	60.4	52.8	45.7	42.0
Mining and utilities	0.6	0.8	0.9	0.9	0.9
Manufacturing	7.1	8.6	9.7	10.1	10.6
Construction	1.1	2.4	3.7	4.9	5.8
Wholesale, retail, hotels	17.2	18.9	21.4	24.1	25.4
Transport, storage, comms	2.4	2.9	4.2	5.3	5.6
Other (incl. gas/electricity)	5.3	6.2	7.4	9.1	9.6
Total	100	100	100	100	100

Source: ILO WESO supporting dataset.

Figure 3: Employment by sector in selected countries, 2013



Source: ILO WESO supporting data set as compiled by the SET data portal.

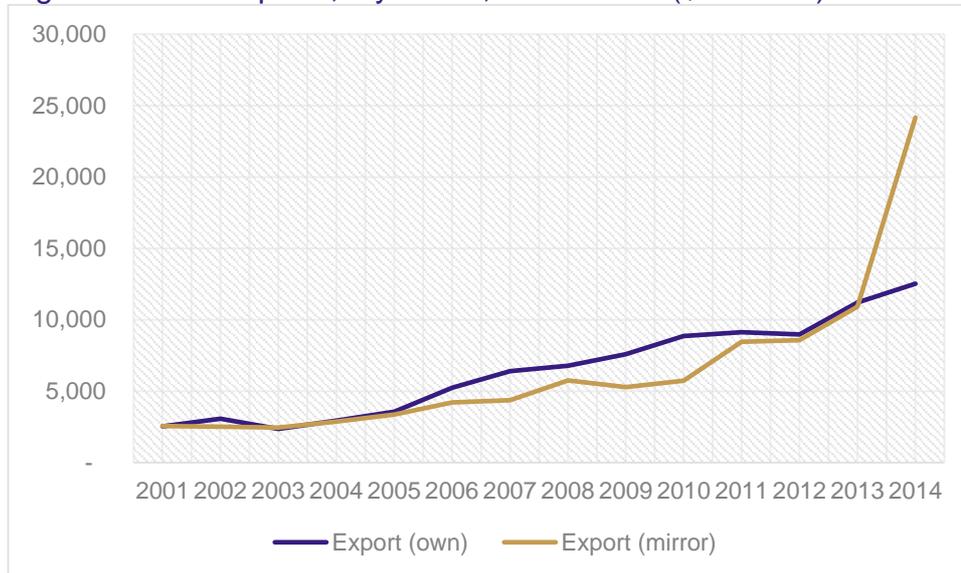
The SET dataset examines labour productivity using United Nations (UN) data on output and ILO WESO data on employment. The resulting estimates of growth of labour productivity for Myanmar are not credible, but are reported here for completeness. For the economy as a whole, productivity growth was 7.4% between 1991 and 2013, with the manufacturing sector increasing its productivity by 10.7% and agriculture by 7.3%, even though the latter sector remains largely unmechanised. The data suggests that annual manufacturing productivity growth between 2003 and 2010 was a barely credible 17.4% and that it slowed to 4.7% per year since 2010. Unfortunately, better quality data at sector level is not available, meaning that firm estimates of labour productivity are not possible.

2.3 Trade relations

As with all its economic data, Myanmar's trade data is idiosyncratic, partial and inconsistent over time, so that international comparisons can be difficult. For example, official data distinguishes between sea and air trade, on one hand, and overland ('border') trade on the other, and may exclude overland trade in some

(sensitive) items. In addition, there is a very high level of illicit and unrecorded trade in key commodities, which may comprise very significant shares of total trade, as illustrated by the mirror estimates of jade exports cited above. In this section and the next, therefore, we examine in turn exports and imports using *both* own data from official Myanmar sources, as well as mirror data from Myanmar's trading partners.¹³

Figure 4: Total exports, Myanmar, 2001–2014 (\$ millions)



Source: Own data from the MMSIS. Mirror data from UN Comtrade, as compiled by the *Atlas of Economic Complexity* (for 2001-2010) and the *International Trade Centre* (2011-2014).

Exports have increased more than tenfold in value from \$820 m. in 1993 to around \$10 billion in 2013, and over \$12 billion in 2014, according to own data. The mirror data follow a very similar pattern up to 2013, but there is a sizable disparity for 2014, which is accounted for by jade being underreported in the own (Myanmar) data: the Myanmar customs department reported jade exports for May 2014 to April 2015 as \$1.02 billion (AHK German Delegation in Myanmar, 2016), while Chinese data reports \$12.3 billion jade imports for 2014 from Myanmar.¹⁴

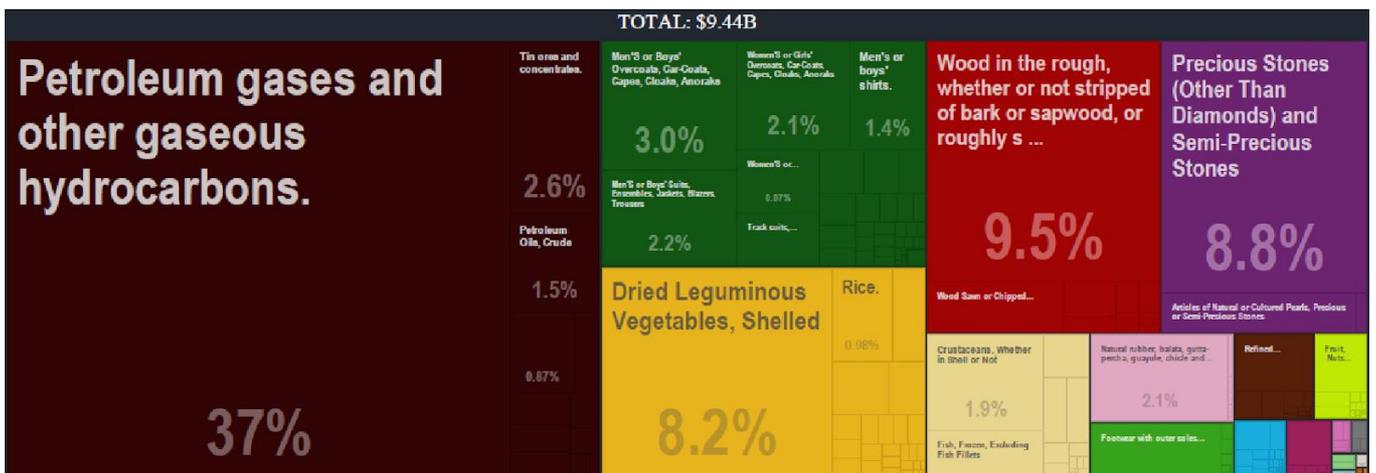
Looking at Myanmar own data, the overall export increase since the 1990s can largely be attributed to natural gas exports, which grew from zero in 1999 to almost \$2.4 billion in 2010, more than a quarter of total exports in that year (MIT Observatory of Economic Complexity), and then more than doubled to \$5.18 billion in 2014/15 (AHK German Delegation in Myanmar, 2016). With the opening of the pipeline pumping gas from Kyaukphyu in Myanmar to Yunnan Province in China in July 2013,¹⁵ natural gas has become the largest export by value, with other natural resources and semi-processed commodities also prominent, including wood/timber and precious stones. Manufacturing exports in 2013 were less than 15% of the total, four-fifths of which – 12% of total exports – were in garments, as discussed further below. It is worth mentioning here that export taxes of 10% were levied on all until 2011, when they were reduced to 2%, for all commodities except oil and gas (85 and 5%), wood (50%) and gems (30%) (WTO, 2014). The export regime was further reformed in 2013, with many commodities no longer requiring licences.

¹³ Mirror data can itself be problematic, as the number of reporting trade partner countries may vary over time, and the quality of reported data may vary across partners.

¹⁴ Global Witness (2015a) asserts the true figure to be about \$31 billion, about 2.5 times the figure reported by China. The *South China Morning Post* reported a Myanmar official figure for jade exports of \$540 m.

¹⁵ An adjacent oil pipeline began pumping from February 2015.

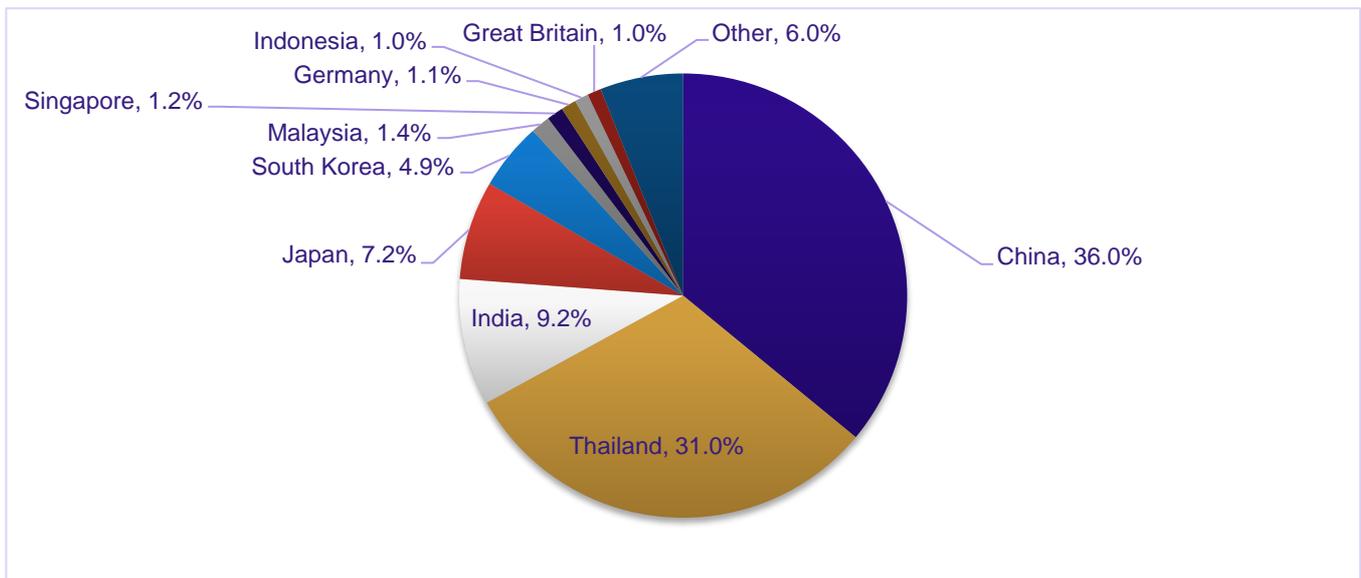
Figure 5: Composition of Myanmar exports, 2013



Source: MIT Observatory of Economic Complexity.

Turning to trading partners, Figure 6 below shows the major export markets for 2014, using mirror data. Myanmar trades to a very large extent with other Asian countries. Myanmar’s own data shows a very similar picture, with 95% of exports going to Asia, and over 70% to Thailand and China alone. Below we discuss in more detail exports in garments, agricultural products and tourism (the latter not included in the data shown here). In all three, Asian markets remain dominant, but in garments and tourism, European and North American markets are growing fast since the relaxation of sanctions.

Figure 6: Myanmar export markets, 2014

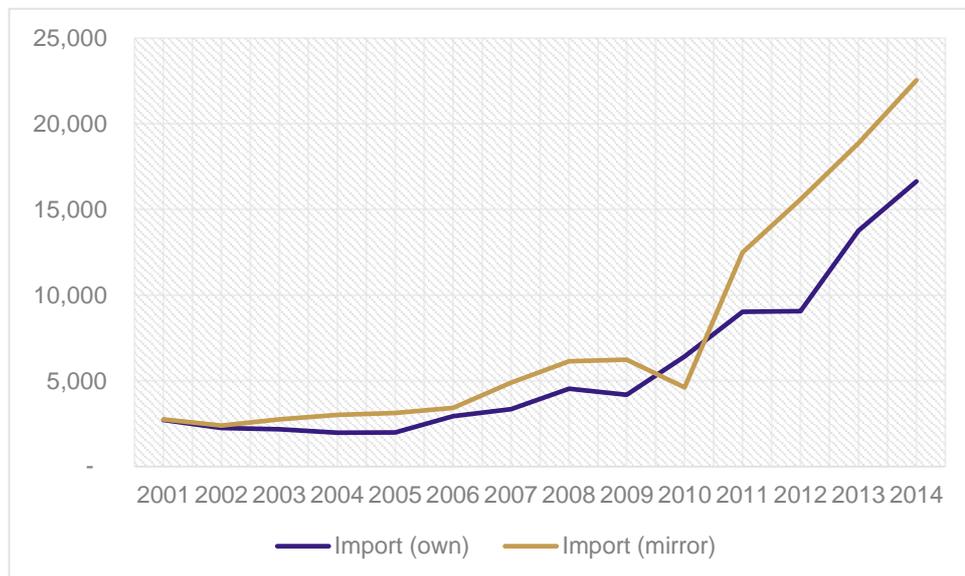


Source: Observatory for Economic Complexity based on UN Comtrade.

Figure 7 compares own and mirror data on imports, showing significant disparities between the two sets of data since 2011, the point at which total imports began to grow much more rapidly. As a result, the own data and mirror data give differing perspectives on Myanmar’s trade balance over the period, as shown in Figures 8 and 9, between which – it should be noted – the scales on the vertical axis differ quite significantly. The own data in Figure 8 suggest a fairly sizable trade surplus between 2003 and 2010, with a growing deficit thereafter. In contrast, the mirror data in Figure 9 suggest trade was balanced up to 2010, followed by a deficit for three years before trade again became balanced in 2014, and at a much higher absolute level than in the own data. The contrast between Figure 8 and Figure 9 is noteworthy, as it suggests Myanmar trade data is an unreliable guide for trade and balance of payments policy, as well as for customs revenues. There is little pattern to the discrepancies between the own (Figure 8) and mirror

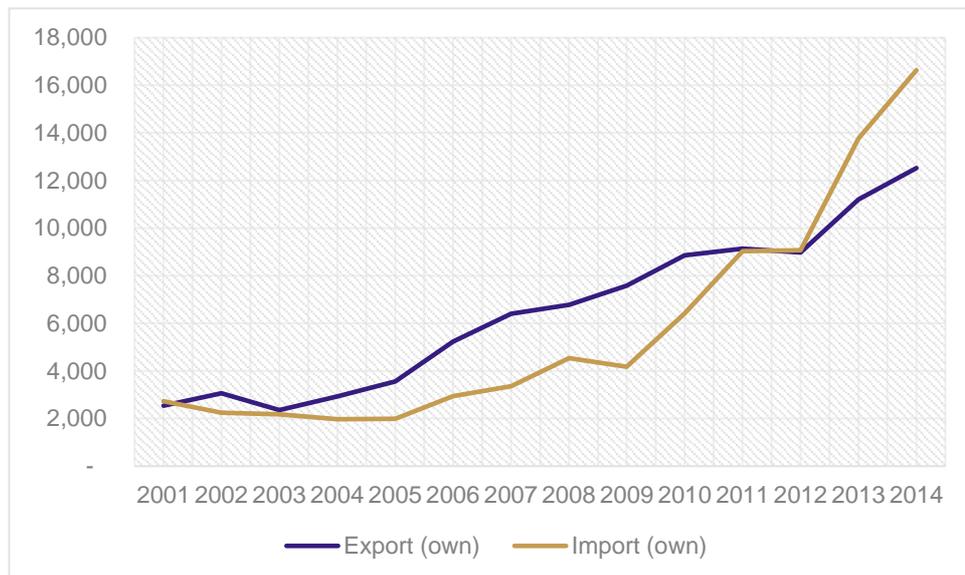
(Figure 9) data, though in many years since 2001, the own data is higher on both the import and the export side, which may suggest that misinvoicing has been used to channel funds out of Myanmar.

Figure 7: Total imports, Myanmar, 2001–2014 (\$ millions)



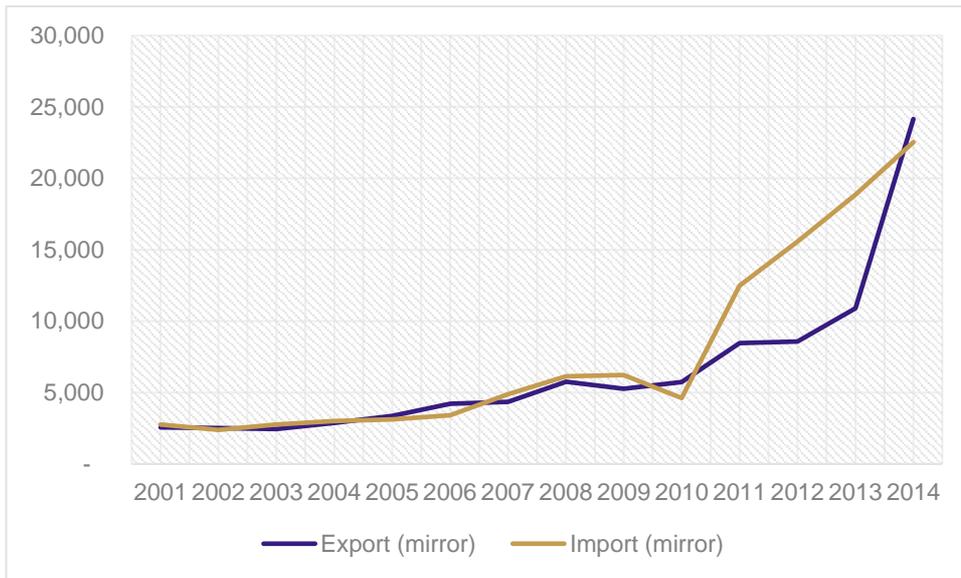
Source: Own data from the MMSIS. Mirror data from UN Comtrade, as compiled by the Atlas of Economic Complexity (for 2001-2010) and the International Trade Centre (2011-2014).

Figure 8: Total exports and imports, own Myanmar data, 2001–2014 (\$ millions)



Source: CSO, MMSIS.

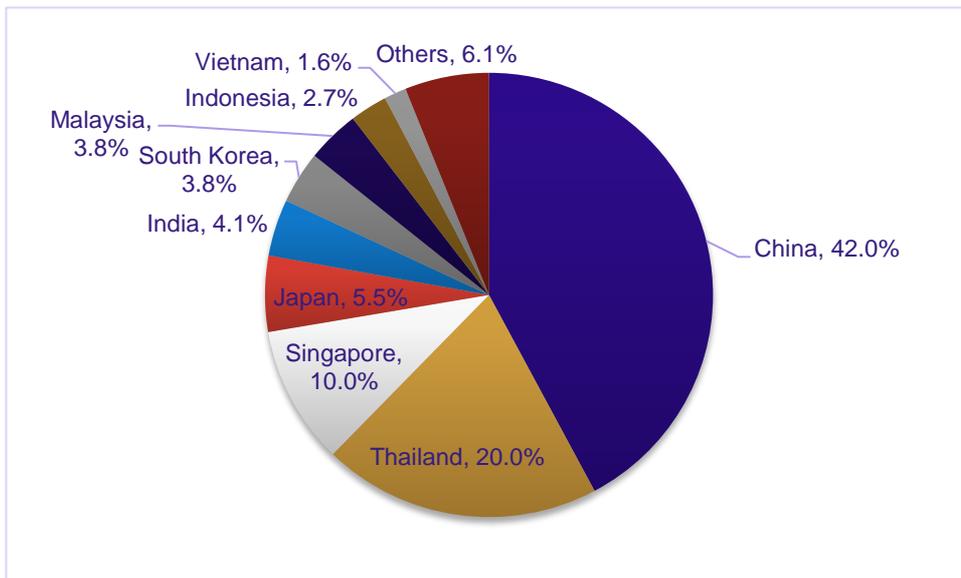
Figure 9: Total exports and imports, mirror data, 2001–2014 (\$ millions)



Source: UN Comtrade.

Figure 10 shows imports by source country, and as with exports, the overwhelming majority of imports come from Asia, with China and Thailand being the two largest sources followed by Singapore.

Figure 10: Myanmar top import sources, 2014



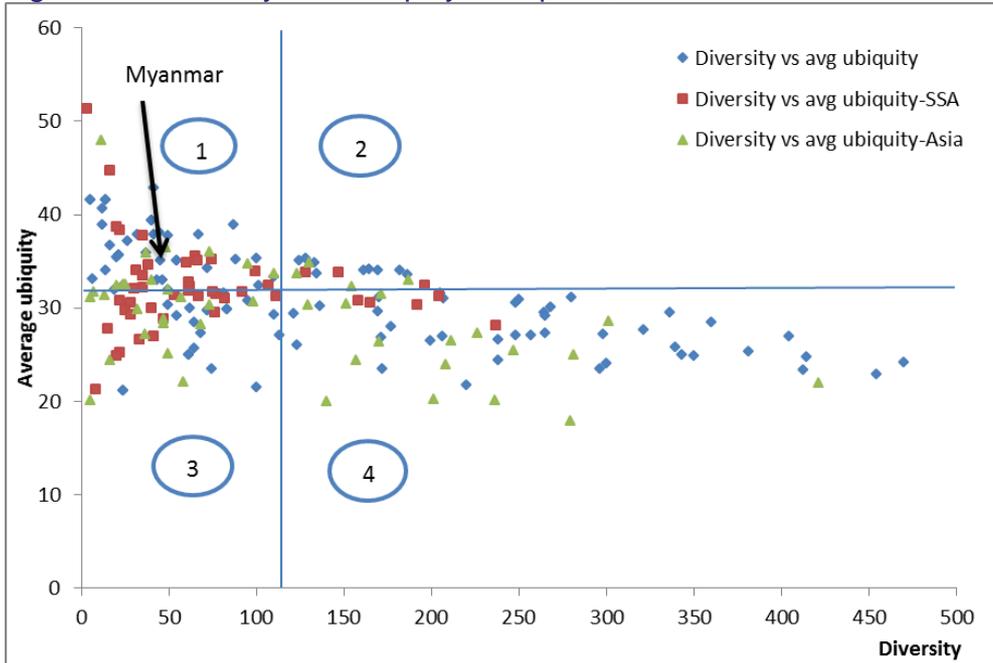
Source: Observatory for Economic Complexity based on UN Comtrade.

2.3.1 Trade diversification

Looking at Myanmar’s exports in comparative perspective reinforces the view that diversification of production is low and exports are mostly standardised products, that is, the country produces a limited range of products exported by many other countries. Figure 11 below plots the position of countries in relation to export product diversity of a country and export market ubiquity of a product. Product diversity refers to the range of products exported by a country, while market ubiquity refers to the number of competitor countries faced by a country in its export markets, or equivalently, the number of countries exporting a particular product (Hausmann and Hidalgo, 2010; Hausmann et al., 2014). The expected diversity-ubiquity relationship across national economies is negative: greater export diversity is associated on average with lower ubiquity. Both diversity and ubiquity reflect a country’s capabilities, diversity directly

and ubiquity inversely, so that Myanmar and other quadrant (1) countries have low capabilities. Industrialised countries are in the lower right quadrant (4).

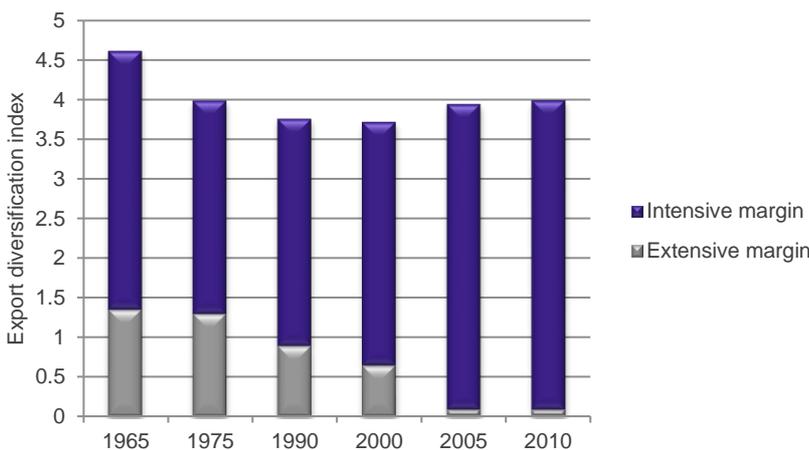
Figure 11: Diversity and ubiquity of exports, 2012



Source: SET computations <http://set.odi.org/>

Another perspective comes from the IMF’s economic diversification index, which distinguishes between extensive diversification (increases in the number of export products or partners) and intensive diversification (more equal distribution of exports among existing products or partners) (IMF, 2014). An increase in the index reflects *lower* diversification. Figure 12 below shows that Myanmar’s index has *increased* since 2000, reinforcing the conclusion based on the Hausmann-Hidalgo index, that the country has low capabilities. Myanmar’s extensive margin has decreased somewhat, while its intensive margin has increased, indicating more concentration of existing export products.

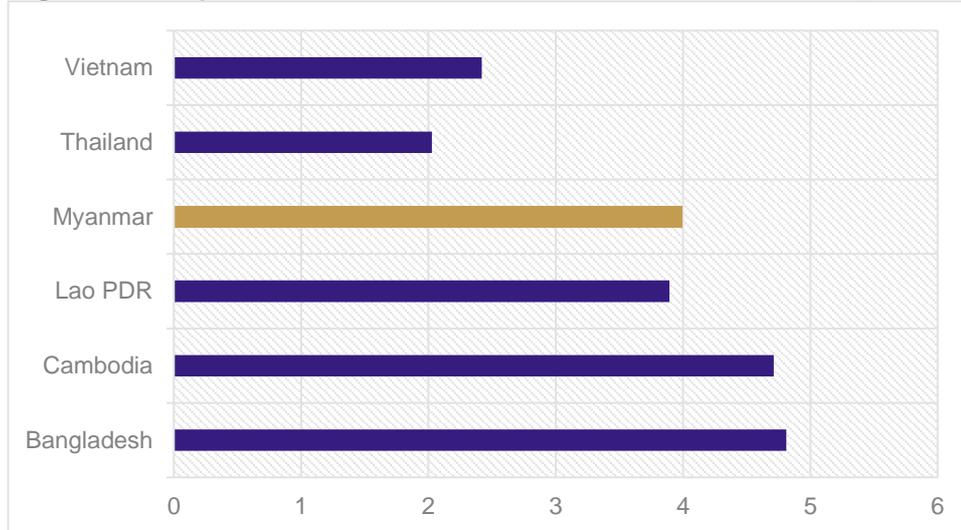
Figure 12: Myanmar export diversification index



Source: DFID-IMF Diversification Toolkit (<http://www.imf.org/external/np/res/dfidimf/diversification.htm>): Export Diversification Database as compiled by the SET data portal.

Figure 13 compares Myanmar with a set of south-east Asian competitors and Bangladesh, relative to which it performs reasonably well, though the usual *caveat* regarding data quality applies to Myanmar and some of the comparators alike.

Figure 13: Export diversification index for selected countries, 2010



Note: A lower index indicates higher diversification.

Source: DFID–IMF Diversification Toolkit (<http://www.imf.org/external/np/res/dfidimf/diversification.htm>): Export Diversification Database.

2.3.2 Trade in selected sectors

We look more directly now at trade in the selected sectors – garments, tourism and agriculture – to highlight the potential for export growth in these sectors that would in turn contribute to overall growth and economic transformation. Construction is not included as it is not an export sector.¹⁶

2.3.2.1 Garments

Garments is one of the few manufacturing sectors where Myanmar is part of global value chains.¹⁷ During the 1990s, exports to the US and the European Union (EU) grew considerably (Figure 14), and in fact garments had become the country's main export by 2000, at which time natural gas exports had not yet begun. Estimates of garment exports as a share of total exports in 2000 vary from 30% (OECD, 2014) to almost 40% (Kudo, 2005), compared with 2.5% in 1990. Garment exports – 65% of which were supplied by locally-owned private firms and 20% by foreign-owned (Kudo, 2012a)¹⁸ – grew in the 1990s despite suspension from the Generalised System of Preferences (GSP) by the US in 1989 and by the EU in 1997, but began to drop from 2000 in the expectation of US sanctions. At that time, 50% of Myanmar's garment exports went to the US, and 40% to the EU.

When sanctions were imposed in 2003, garments still provided over 20% of total Myanmar exports, but its share then fell away steeply to just over 7.5 % in 2013 (Kudo, 2005, 2012a; OECD, 2014). Sanctions and the absence of preferences led to substantial numbers of garment factory closures. Figure 15 shows the effect of sanctions on exports to the US and the EU market. Exports to the US fell from \$435 m. in 2001 to zero in 2004, and although exports to the EU rose from \$399 m. in 2001 to \$527 m. in 2004, they then dropped to below \$200 m. by 2009.¹⁹ The markets in Japan and South Korea partially offset these falls, rising from close to zero in 2001 to over \$300 m. by 2010. Garment exports have trebled in value terms since 2010, and risen strongly as a share of total Myanmar exports (Figure 14). This has been driven by continued export growth into the Asian markets, the relaxation of sanctions by the US in 2012, and the EU's restoration of the GSP preference in July 2013, since when the EU market has recovered strongly. 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, as will be discussed in detail below. The US restored Myanmar's GSP status in September 2016, which might yield similar positive effects on garment exports (AFP and Barron, 2016).

¹⁶ Construction equipment and intermediate inputs are of course imported, but are not identified in the trade data as imports of the sector.

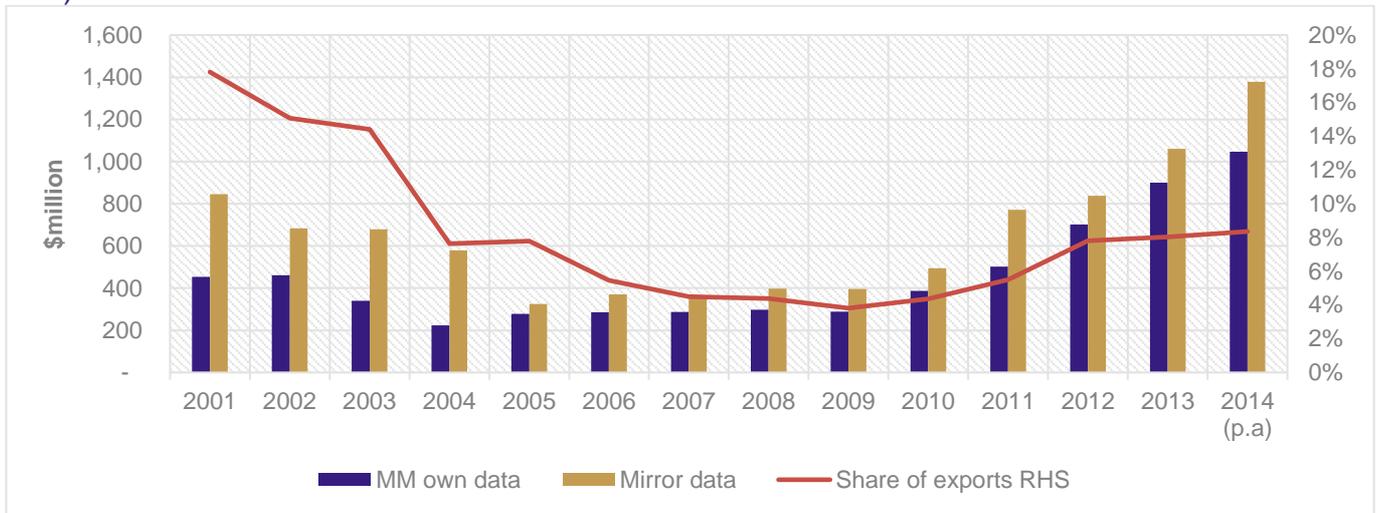
¹⁷ Useful introductions to global value chains in the garment sector are Gereffi and Memedovic (2003) and Staritz (2011).

¹⁸ The remaining 15% was supplied by state and military-linked firms, including the Union of Myanmar Economic Holdings (UMEHL).

¹⁹ The EU market was likely also affected by the threat of consumer action against Myanmar products, provoked by the US ban (Kudo, 2013).

In 2012, the EU took 16% of Myanmar garment exports, with Japan taking 50% and Korea 33% (International Labour Organisation [ILO], 2015). Myanmar own data consistently present much lower garment exports than the importing countries mirror data. Figure 14 suggests \$1.05 billion of garment exports in 2014 according to Myanmar Customs, while UN Comtrade data (using trading partners' imports) suggest a much larger figure of \$1.38 billion in 2014 and \$1.56 billion in 2015 (see Figures 14 and 15). In 2015, 37% of exports went to the Japanese market, 25% to South Korea, and 34.6% to the EU, with 2.7% to the US (ILO, 2015). It is likely that the US and EU shares will increase substantially in the medium-term as the US market grows following the entry of US firms such as The Gap in 2014, and the restoration of GSP preferences on October 7 2016, as President Obama promised when meeting Aung San Suu Kyi in September 2016). The decline caused by sanctions, and the potential for future growth is illustrated by the fact that, in 2000, Myanmar garment exports to the US were eight times the value of those of Vietnam, but in 2012, Vietnam's total garment exports to the world market amounted to twenty times those of Myanmar.

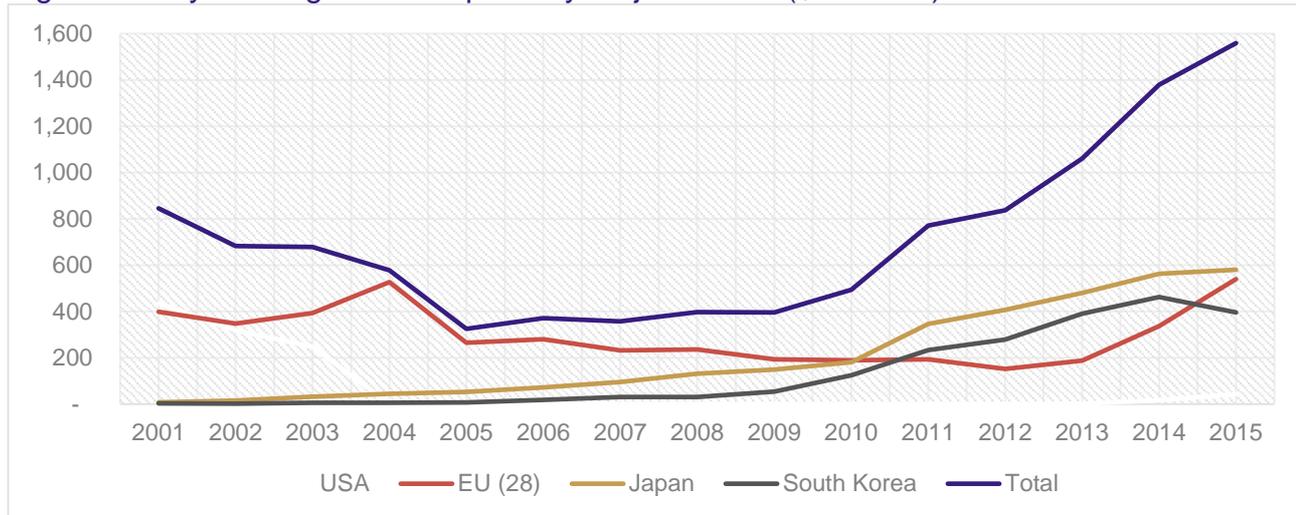
Figure 14: Export of textile and textile articles (\$ millions) (LH axis); share of total exports (RH axis)



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

The global apparel market is highly segmented by product type as well as by quality, and there is a common view that Myanmar's export presence during the past decade in the Japanese and Korean markets – where consumers emphasise quality more heavily than in the EU and US – has contributed to significant improvement in production capabilities in the country. One illustration of this is the recent change in the composition of garment exports: in 2013, 93% of exports were wovens which had preferential access to the Japanese market, but as demand from the EU increased, there has been an increase in exports of knits, which in 2014 comprised 18.7% of exports. Knits are more difficult to work with than wovens, requiring specific skills from technical staff and production workers, as well as different machines than wovens.

Figure 15: Myanmar garment exports by major market (\$ millions)



Note: This graph only includes garment exports (HS codes 61 and 62).

Source: UN Comtrade, mirror data.

2.3.2.2 Tourism

Tourism (entry by foreign visitors) is a services export which contributes to economic transformation through various channels, including the increased demand for low-skilled labour and the opportunities offered to enterprises in the tourism 'value chain' resulting from tourism growth. Both of these (direct and indirect) effects of tourism growth on economic transformation are particularly strong where tourist attractions are based on natural resources (for example, beaches and coastal areas, mountains, game parks) or on historical-cultural sites in remote or rural locations. Productivity is increased and transformation enhanced as people in these areas are drawn out of subsistence activities into waged work, and as markets are created for local enterprises in services (e.g. cleaning, catering and entertainment) and manufacturing (e.g. handicrafts). Infrastructure built in these areas can serve to catalyse economic activity beyond tourism (reflecting an induced effect of tourism growth). Growth in city-based tourism also of course has considerable potential for low-skill job creation, and especially to draw low-skill labour in informal enterprises into more formal, higher productivity activities and markets.

Official data on foreign tourism into Myanmar is collected and published by the Ministry of Hotels and Tourism (MHT, various years), and also published by the UN World Tourism Organisation (UNWTO).²⁰ The ministry classifies visitors according to point of entry: air/sea (to Yangon, Mandalay and Naypyidaw) or land (border gateways), with the latter accounting for roughly two-thirds of total entries.²¹ The ministry data suggest that 97% of overland entrants are from Thailand (MHT, 2015), most of whom stay for less than one day (ibid: 6).

Tourism inflows and export receipts have increased significantly since 2011, due to both relaxed land border entry restrictions as well as the changed US and EU diplomatic stance towards Myanmar. Between 2006 and 2010, total international visitors to the country averaged 725,000 per annum, generating just over \$80 m. in receipts annually, equivalent to 1.33% of total exports on average over the five year period (WDI). In 2013 (the most recent available MHT/UNWTO data for tourism export receipts), the number of foreign visitors had trebled from the 2006-10 average: there were 2.04 m. visitors – 900,000 entering via air/sea, and 1.4 m. overland – generating \$934 m. in tourism export receipts, or 8.3% of total exports. By 2015 the number of foreign visitors had doubled to 4.7 m., of which 1.3 m. entered by air or sea (MHT, 2015). Estimates produced by the WTTC (2016) suggest tourism export receipts in 2015 amounted to

²⁰ See UNWTO (2015) using data from the Myanmar Ministry of Hotels and Tourism. The same data is presented in World Bank, WDI. The World Trade and Tourism Council (WTTC) presents different data based on estimates by Oxford Economics Ltd, and using concepts from the Tourism Satellite Accounts project of the UN, OECD and UNWTO (WTTC, 2016).

²¹ Some international tourism data does not classify visitors staying for less than 24 hours as tourists. However UNWTO, WDI and WTTC all include overland entrants in their 'tourists' data.

\$1.89 billion (\$1.2 billion in 2014), equivalent to 12.8% of total Myanmar exports (2013: 5.1% of total exports, 2014: 9.5%). In sum, tourism is an export sector of rapidly growing importance for Myanmar.

By far the majority of foreign visitors entering Myanmar are from Thailand, which provided 74.5% of the 2015 total, comprising 15.7% of the total 1.3 million air/sea entrants in addition to almost all overland entrants (MHT, 2015). The EU contributed 16.1% of air/sea entrants, and North America and Oceania (Australia/New Zealand) a further 9.2%.

Chinese visitors comprised 148 000 (11.4%) 2015 air/sea entrants, the second largest source country after Thailand. China formally closed its south west borders with Myanmar, Vietnam and Laos in 2005, due to the rise in cross-border gambling, drug-running, and kidnapping and other criminal activities, and re-opened them only at the end of 2013 (Gokunming, 2013). It is evident that both licit and illicit border trade in goods, and thus also border-crossing, continued despite the closure. Despite the re-opened borders, land border crossing between China and Myanmar may still be largely unofficial and unrecorded. Myanmar tourist data report land crossings by 'gateway', but do not explicitly identify the neighbouring country of each gateway. Officially recorded land entrants to the "Northern" border gateway in 2015 were only 69 739, while those to the "North-eastern" gateway were considerably larger at 674 901 (MHT, 2015). It is unclear which of these refers to the border post between Ruili (Yunnan Province, China) and Muse (Shan State, Myanmar).²²

2.3.2.3 Agriculture

In the 1920s, Myanmar exported on average 2638 million metric tons of rice annually, and though annual exports in the 1960s were only 46% of this level, it is a remarkable fact that during that decade Myanmar was the world's leading rice exporter. Subsequent government limitations on rice exports tied to food security concerns cut exports, and during the 1990s average annual exports by volume were down to 244 000 tons, only 20% of the 1960s level (World Bank & LIFT, 2014).

These are telling statistics, given the significance of agriculture in both overall output and employment and that rice comprises 43% of total agricultural output (FAO, 2013). It is of great significance therefore that (sea-borne) rice exports began to revive from 2009 when the export regime began to be liberalised, and grew rapidly from 2011 when further trade deregulation allowed transport of rice to the Chinese border and lowered export taxes. Border (overland) rice trade with China increased from zero to 684 000 tons in 2012 and 747 000 tons in 2013 (World Bank & LIFT, 2014), and total rice exports have continued to rise, reaching 1.365 million tons in FY 2014/15 (Xinhua, 2016).

Despite much higher transport costs for overland rice exports to China compared to sea trade²³, the landed cost of Myanmar rice in China is well below the wholesale price of Chinese domestic rice, because of rising production costs in China and price supports provided to Chinese farmers for income distributional reasons. Despite the growth of Myanmar rice exports to China over the past 5 years, significant uncertainties remain. Though the rice was allowed into its market, China regarded Myanmar border rice as below health and safety standards (and the trade was unrecorded in Chinese trade data). This is partly due to Myanmar's outdated milling capacity and transport infrastructure. Negotiations between the two governments began in late 2014 – notwithstanding the tensions in Myanmar-China relations connected with the Myitsone Dam and other large infrastructure and mining projects – over rice quality inspection procedures and licensing of Myanmar processing facilities (McLaughlin, 2015). An MoU was signed in February 2015 but new procedures and market arrangements are apparently not yet fully implemented.

Rice is not Myanmar's only significant export crop. Exports of pulses – a less important food crop in Myanmar – were liberalised in 1988, and Myanmar is now the world's 2nd largest exporter of pulses²⁴,

²² It is unclear whether there is a border crossing between Myitkyina (Akchin State, Myanmar) and Tengchong (Yunnan Province, China), which Myanmar and Chinese citizens can use. Foreigners are restricted to Muse-Ruili.

²³ Land and sea transport costs are \$75-100 and \$30-35 per ton respectively (World Bank & LIFT, 2014), though

²⁴ Pulses (dry beans) are Myanmar's 3rd largest food product by value, contributing \$1.26 billion to GDP in 2012, compared with \$7.13 billion from rice and \$1.54 billion from chicken (FAOSTAT, 2013). Pulse exports in 2012 were about one-fifth of output.

which were worth \$237 million in export receipts in FY 2012 (Raitzer et al., 2015). After 2013, pulse exports no longer needed a license (though rice export licensing continued).

In summary, in all three sectors discussed here, there is considerable potential for export growth which would contribute substantially to overall economic growth, productivity growth and structural transformation. But in all three sectors, investment is needed to make export growth possible, both in productive capacity in the sectors themselves – in the case of agriculture, both farming and agro-processing (milling and logistics) – and in transport and energy infrastructure.

2.4 China–Myanmar trade

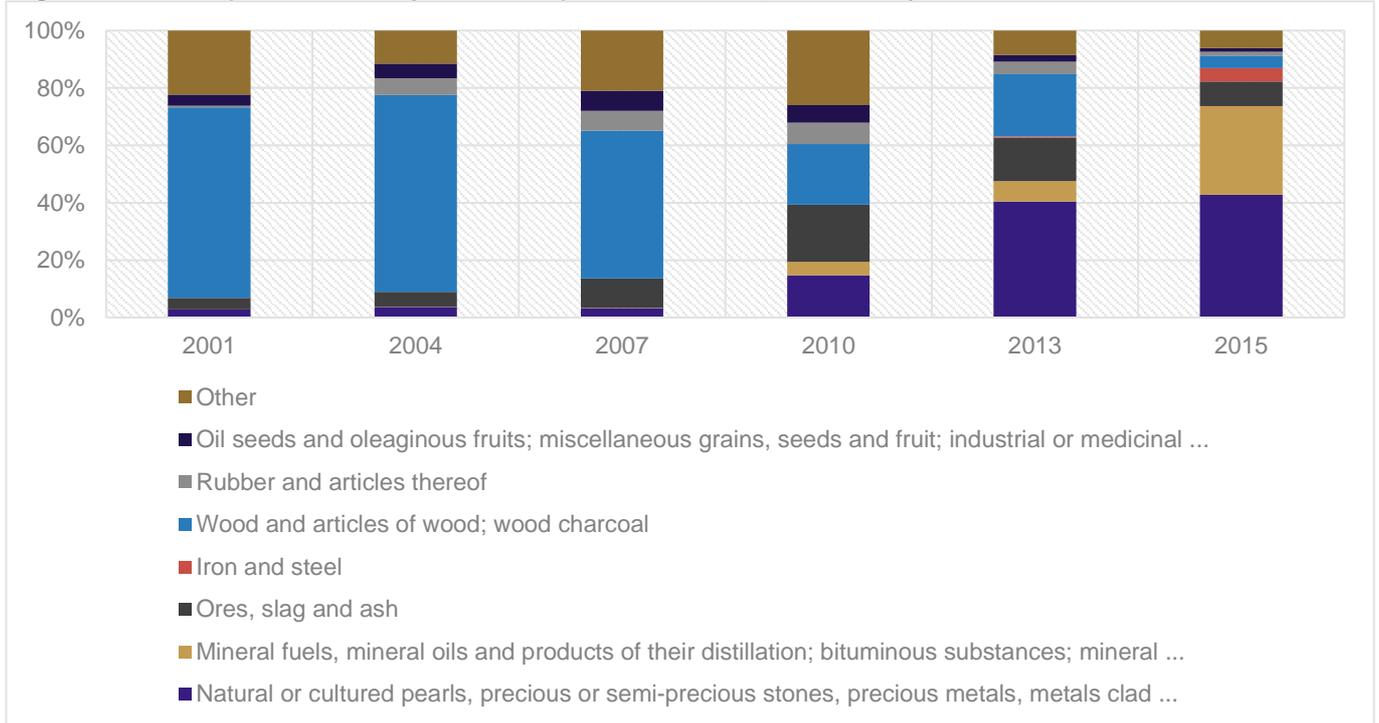
Figures 6 and 10 above illustrate that China is Myanmar's largest trading partner, in total and in each of imports and exports. Myanmar's own data suggests that it runs a (small) trade deficit with China, with imports having grown from \$2.72 billion in 2012 to \$5.02 billion in 2014 (an increase of 85%) though exports grew even faster, from \$2.24 billion to \$4.7 billion (an increase of 109%), implying a deficit in 2014 of \$0.35 billion, with bilateral trade just below \$10 billion. Because Myanmar data showing the composition of imports and exports by country is unavailable, in this section we look in more detail at trade between the two countries, relying primarily on Chinese mirror data, which suggests that trade in both directions is much larger than does Myanmar data.²⁵ Recalling that Chinese data includes imports of jade and excludes imports of rice from Myanmar,²⁶ Myanmar's exports to China (according to Chinese data) grew from \$134 million in 2001 to \$15 billion in 2014. Trade still overwhelmingly comprises resource-based commodities with little domestic value addition in Myanmar. Figure 17 shows Myanmar-China trade with and without precious and semi-precious stones.²⁷ The two figures are striking because their orders of magnitude (reflected in the vertical axis scale) are completely different and because the direction of the trade balance is reversed. There were major increases in exports to China in 2010 and again in 2014. Reasons for the 2010 increase are unclear, while Figure 16 indicates that the 2014 increase was largely due to a reported increase in 'pearls & precious stones' from just over \$1 billion to \$12 billion. Gas exports to China via the Kyaukphyu pipeline began midway through 2013, but have been only 25% or less of the pipeline's capacity (The Irrawaddy July 31 2014; interfaxenergy.com March 9 2016).

²⁵ As a result, the data cited in this section are not directly comparable with Figures 6 and 10.

²⁶ The Myanmar data includes rice but excludes jade.

²⁷ This has been calculated subtracting products with HS code 7103 from the total imports and exports. In HS version 2012, HS code 7103 corresponds to precious and semi-precious stones. Jade corresponds to 710399 (precious and semi-precious stones, other), and it is therefore included in this category.

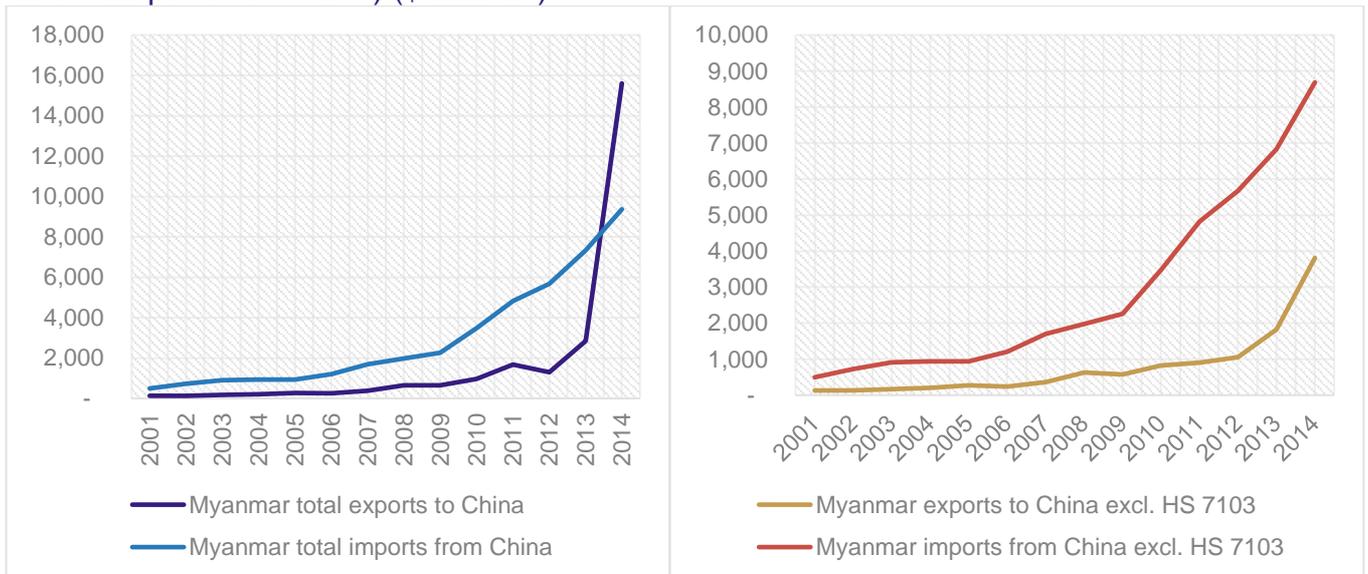
Figure 16: Composition of Myanmar exports to China, selected years



Note: This graph uses mirror data, that is data on Chinese import from Myanmar rather than data on Myanmar exports to China.
 Source: International Trade Centre Trade Map.

Myanmar's imports from China have increased steadily from less than \$500 million in 2001, reaching about \$9.5 billion in 2014. The left chart in Figure 17 suggests a substantial bilateral trade surplus for Myanmar of about \$4.5 billion (around \$3.5 billion in 2013), in contrast to the small deficit reflected in Myanmar own data. Assuming the Chinese data are accurate, an FDI flow from China into Myanmar would partially offset this surplus.

Figure 17: Myanmar imports from and exports to China, with and without HS 7103 (precious and semi-precious stones) (\$ millions)

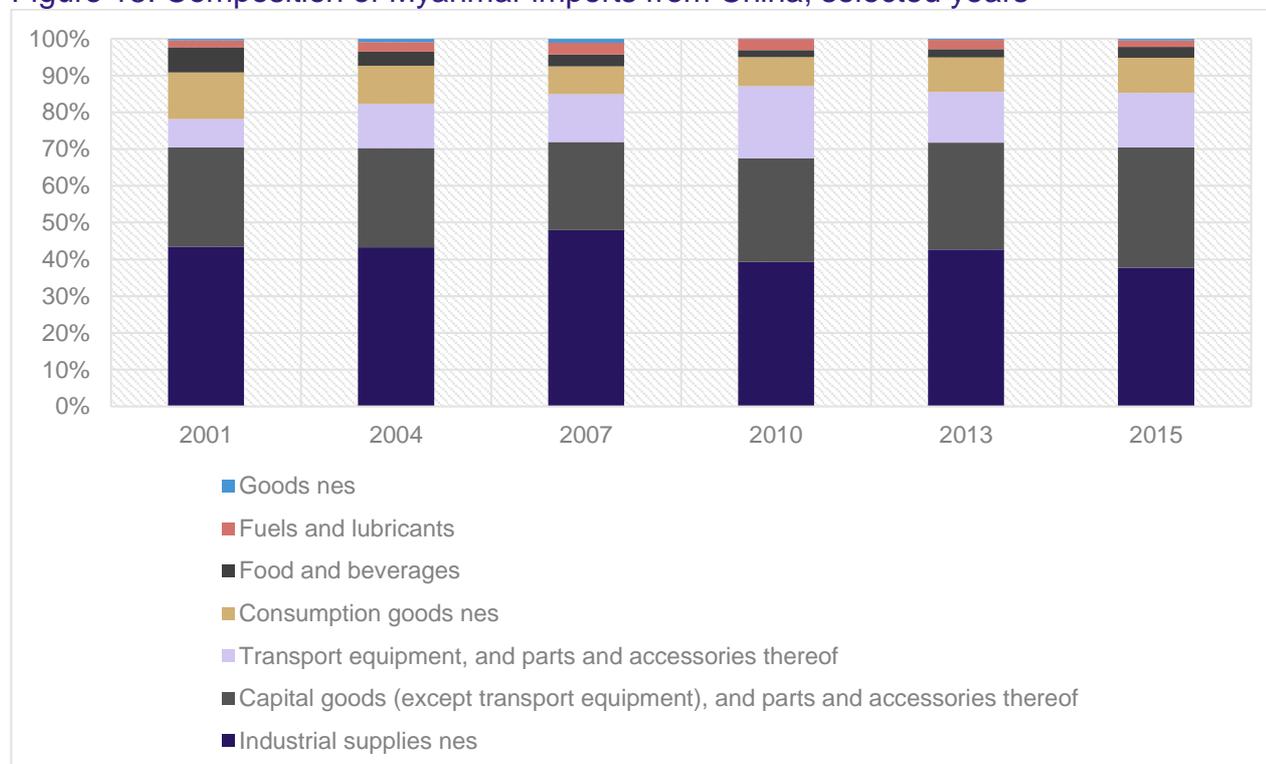


Note: These graphs use mirror data.
 Source: International Trade Centre Trade Map.

In thinking about the role of trade in economic transformation, it is important to consider imports as well as exports, because of the role of imported equipment in expanding productive capacity in industry, business services and commercial agriculture, as well as the significance of imported intermediate inputs. Imports

from China are particularly important given that they are likely to be priced below those from other suppliers and to be favoured by Chinese investors. Figure 18 shows that the composition of Myanmar's imports from China reflects large shares of equipment (including vehicles, electrical equipment and machinery) and of inputs into production, including cotton and artificial fabric for use in the Myanmar garments sector. Imports of consumer goods are a small proportion of the total.

Figure 18: Composition of Myanmar imports from China, selected years



Source: UN Comtrade. Nes = not elsewhere specified.

Looking at Myanmar's imports from China at the 6-digit HS level provides a clearer picture of their transformational potential. Table A1 in the Annex shows the top 20 imports from China in 2014, constituting about 40% of total imports from China, based on Chinese data for exports to Myanmar. Precious stones and artefacts made with precious stones account for over 12% of total Myanmar imports from China, for reasons that are unclear. More relevant is that the table shows that in 2014 Myanmar imported \$680 million in textiles, fabrics and yarn from China, which was over 60% of Myanmar's total imports of these products amounting to \$1.1 billion.²⁸ Garment exports from Myanmar in the same year came to just over US\$1 billion, suggesting (if the data are correct) that Myanmar ran a trade deficit for the sector. During 2013-15, approximately 62% of fabric and yarn imports to Myanmar came from China including 68% of knitted fabrics, 53% of cotton fabrics, and 79% of artificial fabrics.

The table underlines the importance of Chinese transport machinery and vehicles, which are considerably cheaper than western models and therefore more accessible to farmers and other small producers. Not evident in the table, but important according to some of the agriculture sector experts we interviewed, is Chinese agricultural machinery and irrigation equipment.

2.5 Foreign direct investment in Myanmar

This section provides a broad overview on foreign direct investment trends and patterns, its regulation, and its potential impact on economic transformation.

²⁸ This is based on HS categories 52/54/55/60, and taken from the ITC database.

2.5.1 Legal and institutional framework for foreign investment

The Myanmar government began to seek foreign investment in 1988, when a Foreign Investment Law (FIL) was first enacted in 1988. The reform programme of the Thein Sein government after 2011 was intended in large part to attract more FDI, and a revised FIL was introduced in 2012.^{29, 30} Although the 2012 FIL considerably liberalised the prior foreign investment regime, in 2014 Myanmar still had more statutory restrictions than any other country except China, as measured by the OECD's FDI Regulatory Restrictiveness Index (OECD, 2014, p33). The 2012 FIL required all foreign investments to be individually approved by the Myanmar Investment Commission (MIC), which then comprised ministers and deputy ministers with the Directorate of Investment and Company Administration (DICA) as its secretariat. The 2012 FIL provided foreign investors the right to lease land for 50 years (renewable up to 70 years) and to remit capital and profits (PWC, 2015). The FIL law also provided for incentives to all MIC-approved foreign investors, including income tax exemption for the first five years and import duties exemption.³¹ The MIC's approval depended on its evaluation of the domestic economic impact of the investment, taking into account employment and living standards, value added, and imports of capital equipment. The law also specified employment quotas with all unskilled labour required to be local from the outset, and the share of local skilled labour rising to reach 75% by the fifth year of operation. Regulations published in 2013 and 2014 specified activities either entirely prohibited to foreigners or allowed only via joint ventures (JVs) with citizens, in which the maximum shareholding by foreigners was 80%, as well as activities which require additional permission, usually from the relevant sector's ministry.³² In unusual sequencing, the 2012 FIL was followed (rather than preceded) by a Myanmar Citizen's Investment Law passed in 2013 and providing the same benefits to local firms.

In 2014, the government began to work on a new investment law, intended not only to further liberalise the investment regime but also address the redundancy of two distinct investment laws. A draft consolidated investment law was published in early 2015, and a revised draft in early 2016, under the auspices of the UDSP government.³³ The new investment law was finally approved in October 2016 and will come into force on April 1 2017, replacing the 2012 FIL and the Myanmar Citizen Investment Law.³⁴

The new law aims to simplify and streamline the investment screening and approval process and liberalise the entry conditions, both intended to attract more foreign investment as well as promoting domestic investment. The MIC's composition and powers are changed, making it an autonomous body appointed by the President with the possibility of private sector members. Together with limited decentralisation of investment approval power to regional state governments following legislation passed in late 2015, the scope of projects requiring MIC approval – that is approval at central government level – is narrowed, to include only projects in five categories: 'strategic'; above a capital investment threshold; significant impact on environment or local communities; using state-owned land or buildings; or otherwise designated to require submission to the MIC.³⁵ Beyond these categories, which will be further detailed in the rules

²⁹ The 2012 FIL is available at <http://www.dica.gov.mm/sites/dica.gov.mm/files/document-files/foreigninvestmentlaw.pdf>.

³⁰ Registration and operation of companies in Myanmar is based on the Myanmar Companies Act (1914), currently under revision. Many smaller companies do not register (interviews, April 2016). Foreign companies registering under the Act are required to have share capital above a threshold of \$150,000 in manufacturing and \$50,000 in services, and to obtain a 5-year renewable 'permit to trade' from the Directorate of Investment and Company Administration (DICA).

³¹ MIC approval is distinct from the DICA trading permit.

³² See MIC Notifications No. 1/2013 and No. 11/2013, updated in No. 49/2014.

³³ The 2nd draft of 24 February 2015 in English is available at <http://www.burmalibrary.org/docs21/2015-Myanmar-Investment-Bill-V2-24-02-2015.pdf>, with explanatory notes available at

http://ingoforummyanmar.org/sites/ingoforummyanmar.org/files/attachments/MYANMAR_INVESTMENT_LAW_-_Draft_V2_EXPLANATORY_NOTE-9.3.2015.pdf. A 3rd draft of 13 January 2016 in Myanmar language only is available at: <http://dica.gov.mm.x-aas.net/>. The DICA D-G indicated in interviews in April 2016 that the new Law was drafted with the assistance of the IFC and the EU, and also was influenced by the OECD (OECD, 2014).

³⁴ An unofficial translation of the new law, which is expected to come into force on 1 April 2017, is available on the website of the Directorate for Investment and Company Administration (DICA). See: http://www.dica.gov.mm/sites/dica.gov.mm/files/document-files/unofficial_translation_mil_20161019-e.pdf. See also <http://www.gibsondunn.com/publications/Pages/Myanmar-New-Investment-Law.aspx>

³⁵ This is in contrast with the 2012 FIL, where MIC approval was required for all business seeking to receive incentives.

accompanying the law which will be published in early 2017, state and regional investment commissions will be able to issue investment permits.

The new law also classifies investment applications into prohibited, restricted, and promoted activities or sectors. The first, prohibited, category, includes investments with negative impacts on environment, biodiversity, traditional culture and customs, and public health, as well as national security, under some circumstances. These categories are fairly standard in investment law in other countries. Restricted activities include four sub-categories: (i) limited to government; (ii) limited to domestic investors; (iii) requiring JVs with domestic investors; and (iv) subject to approval of the relevant ministry. The restricted sectors within each category will be listed in the rules once published, no doubt after negotiation with various ministries over the details of category (iv), and possibly also wider political negotiations including domestic businesses over categories (ii) and (iii). The scope of restrictions has been considerably narrowed since the 2012 FIL was passed, and it remains to be seen if the lists published in 2017 further reduce the number of sectors or activities, and so further liberalise Myanmar's investment regime. Finally promoted activities and sectors are included for the first time in the law, though there is no indication there what mechanisms will be used to promote the identified sectors.³⁶

The new law proposes a different structure of tax incentives than the 2012 law, no longer offering incentives to all investors but only to those investing in specified activities and specified regions, with income tax reductions of three, five or seven years available in different regions distinguished by their level of development, with longer exemptions in less developed regions. The interaction between the use of tax incentives to promote investments on a regional basis and the specification of promoted sectors is not clarified in the law itself. But in media interviews at the time of the new law's passing, the DICA DG implied that only the promoted sectors would get income tax exemptions in the designated areas. The sectors he mentioned included labour-intensive manufacturing, infrastructure, agriculture and agro-processing (de Carteret, 2016).

A very important liberalisation step is that foreign firms can now lease land for 50 years, with two renewals for ten years each, rather than requiring annual rental permits from DICA.³⁷ Import rebates remain on inputs used to produce exports and on all machinery imports. Skilled labour quotas are dropped, a further significant liberalisation measure.³⁸

The new investment law moves well beyond the 2012 FIL in strengthening investment protection standards, aiming to meet 'internationally acceptable' levels for national treatment (meaning foreign investors will be treated identically to domestic investors); for 'most favoured nation' treatment (meaning foreign investors from all home countries will be treated identically to each other); for fair and equitable treatment (meaning no arbitrary adjustment of an investment's circumstances after entry); for expropriation (only with good cause and with appropriate compensation); and for dispute settlement mechanisms.³⁹ The law allows repatriation of profits (dividends) and of invested funds through the capital account, as well as services payments through the current account to parent companies such as royalties, and licensing or management fees.

Investors are required to interact closely with the MIC/DICA both before and after investment approval. MIC/DICA may seek feedback from line ministries and other authorities, where relevant, and may ask for

³⁶ The 2015 draft law included a liberalisation 'ratchet', indicating that once an activity or sector was opened, that is, excluded from the list of activities requiring approval, it could not later be restricted, that is, added to the list of excluded activities. This feature is missing from the law as passed in 2016.

³⁷ According to a note recently released by DICA, the process of endorsement for land should be clear and simple, and only assess the proposed use of the land rather than the entire investment project (DICA, 2016). The endorsement only exempts investors from the restriction imposed under the Transfer of Immoveable Property Restriction Act (1987) which limits leases to foreigners to 1 year. When receiving the endorsement, foreign investors are still bound by all other requirements applied when leasing land (DICA, 2016).

³⁸ This information is based on an interview with the DICA DG in April 2016.

³⁹ Myanmar has signed ten Bilateral Investment Treaties, of which five have entered into force, including one with China (UNCTAD Investment Policy Hub; Bonnitca, 2014). As a member of the Association of South-East Asian Nations (ASEAN) Myanmar is party to twelve ASEAN treaties (Bonnitca, 2014).

revisions to investment proposals. Once an investment is in operation, the investor is required to submit quarterly and annual reports to DICA covering financial and other aspects of performance, including foreign procurement of equipment and intermediate inputs.⁴⁰ Where performance is not in line with the approved plans, the investor can be asked to account for the variance and to address it. Operations are subject to visits by DICA inspectors and potentially to fines or other penalties (interviews with DG DICA, January and April 2016).

FDI in Myanmar is subject to further regulation by a number of other laws and agencies over and above the 2012 FIL. Firstly, the State-owned Economic Enterprise (SEE) Law (1989) limits a set of activities to government provision, though licenses can be issued to foreign investors. The (positive) list for government provision includes banking, insurance, telecoms, electrical power generation, petroleum and natural gas, teak, jade and precious stones. Liberalisation has begun in some of these: in 2014, nine licenses were issued to banks from six countries, and a further four banks were awarded licences in early 2016 (McLaughlin, 2015b; Channel News Asia, 2016)⁴¹, though foreign banks' services are limited to corporate wholesale banking for foreign investors. Mobile telecoms licences were issued to two foreign companies in 2013, which had an immediate impact on equipment and service prices for users when they began operating in late 2014.⁴² In capital-intensive sectors such as infrastructure (energy and transport), insurance and mining, there are requirements to include local firms in JVs or consortia, which had provided significant opportunities to 'crony' businesses close to the military and/or USDP government.

Secondly, as noted above, MIC approval in many activities is contingent on approval from line ministries or other government agencies, who can set conditions for investments in their area of jurisdiction, involving entry and/or ownership thresholds, or specified local partners or other JV requirements, including partnership with the ministry or agency itself.

Thirdly, three Special Economic Zones (SEZs) in Myanmar have been specified, which are subject to a separate law and administrative approval process.⁴³ The Myanmar Special Economic Zones Law (originally passed in 2011 but revised in 2014) provides more attractive incentives than the 2012 FIL, with investment approval decentralised to each SEZ's managing agency, rather than by the MIC. Incentives vary slightly across categories of business, but include income tax exemption for five to seven years, land rental for up to 75 years, import and export trade without licences, and with some exemptions from duties, and capital and profits repatriation. But only one of the three SEZs, Thilawa near Yangon (being developed with the Japanese government) is currently operational, with the first phase completed and a few investors producing. Transport links with Yangon are still under construction and Thilawa is not a deep-sea port, limiting the types of activities that can be located there. Dawei in the south (a joint project with the Thai government) and Kyaukphyu in Rakhine State (being developed with China) are still under development. A tender to develop the latter was awarded at the end of 2015 to a consortium led by CITIC, a large Chinese construction SOE. However, there has been substantial opposition to the SEZ from many civil society groups, on the grounds of potential economic and environmental damage in the area or simply that Chinese investment in large infrastructure projects is unacceptable.⁴⁴

Fourthly, although the FIL addresses land ownership and leasing by foreign investors, it is also worth mentioning that in 2012 two new land ownership laws were passed – the Vacant, Fallow and Virgin Lands Management Law (VFV Law) and the Farmland Law – which affect investment in the agriculture sector specifically. Land ownership formally rests with the state, but these laws were intended to create land

⁴⁰ This suggests that a wealth of data exists about foreign investment entry and performance over a long period of time (as far back as 1994-95), but this unfortunately remains unpublished, and perhaps also unprocessed.

⁴¹ Banks from the home countries of the first round awardees were not eligible to apply in the second round. With the exception of the ANZ Bank, all licences awarded thus far have been to Asian banks.

⁴² See Jason Motlagh, When a SIM Card Goes From \$2,000 to \$1.50, Bloomberg.com, 29 September 2014.

⁴³ There are also 19 industrial zones (with 7 more planned) which specify industrial activity locations, but do not offer any incentives over and above the FIL.

⁴⁴ See Global Risk Insights, Risks loom for Myanmar's Kyaukphyu Economic Zone, 26 January 2016, <http://globalriskinsights.com/2016/01/risks-loom-for-myanmars-kyaukphyu>.

markets based on 'land use certificates' issued and administered by a new Farmland Administration Body, and to increase productive use of unused land. Not surprisingly, the new laws have been politically contentious, as has the National Land Use Policy process initiated in connection with their implementation, and which released its report in early 2016. The new policy commits Myanmar to consultative processes and protection of human rights and the environment in future land transfer processes, especially where relocation of communities is involved (Henley, 2014).

Fifthly, official business associations also play an important role in the regulatory framework affecting investment. In most sectors the associations have been set up largely by government. For example, the Myanmar Garment Manufacturers Association (MGMA) was established by the Ministry of Home Affairs in 2002 and is now attached to the Ministry of Commerce. As discussed further below, MGMA endorsement as a 'CMP' producer is required for garment manufacturers to receive licenses from the Ministry of Commerce which allow them to import fabric and other inputs, so that the MGMA is *de facto* screening entry of foreign producers. Similar considerations about entry barriers posed by the regulatory role of officially-sponsored business associations apply in the tourism sector. The Myanmar Hoteliers Association 'was set up under the close supervision of the Ministry of Hotels and Tourism in line with the permission of the Head of State', while the Union of Myanmar Travel Association (UMTA) 'was formed under the supervision of the Ministry of Hotels & Tourism in year 2002'.⁴⁵ These organisations and nine others in the tourism sector comprise the Myanmar Tourism Federation. According to our informant interviews (April 2016), it is 'compulsory' to be a member of the relevant MTF affiliate if a firm wishes to be registered as a company by the Ministry of Hotels, with registration in turn required to carry out many aspects of business operations. For example, only registered hotels can accept foreign tourists, while less formal unregistered guest houses may accommodate only Myanmar citizens. This means that low-cost establishments catering to informal business visitors from China and Thailand (together the vast majority of tourism entries to Myanmar) are encouraged to remain informal, unregistered and unregulated on fiscal or health and safety issues.

In addition to its investment regulation role, DICA is also responsible for investment facilitation and promotion, and the collection of investment statistics. Amongst these functions, the focus of DICA's reform and modernisation strategy thus far has been on the first of these, investment facilitation, where the aim has been to streamline the process of investment approvals and improve its efficiency.⁴⁶ A 'one-stop shop' service was introduced in Yangon in 2013, and the goals now are to cut approval time to one day there, and to establish DICA branch offices in the states, starting in Mandalay, aiming eventually to establish state-level one-stop shops. A further goal is to 'educate' local investors to register and formalise their activities (interviews with DG DICA, January and April 2016).

As the foreign banking license process illustrates, diversifying foreign investment source countries is another priority. But investment promotion is not yet a very well-developed function at DICA: fewer than 10% of its 350 staff are engaged in this activity, though Myanmar does have nine economic attachés at its embassies around the world, including one in the US and one at the EU in Brussels.⁴⁷ Myanmar's investment promotion strategy relies heavily on its image as a new investment destination offering untapped opportunities, which perhaps encourages a 'herd' or 'gold rush' attitude amongst potential investors, which might limit the sustainability of the process. Some effort is put into trade fairs, both in investment source countries and in Myanmar itself.⁴⁸ There is reportedly very little explicit effort put into investment promotion in China, mainly because Chinese investors need little encouragement. Chinese delegations come regularly to Yangon and regional expos in Myanmar, and DICA participates in ASEAN trade expos within China.

⁴⁵ See <http://www.myanmarhotelier.org/index.php/en/about-mha> and <http://www.umtanut.org>.

⁴⁶ Prior to 2011, the MIC appears to have had the power only to recommend approval, with endorsement required from the Trade Council and then the Cabinet. The 2012 Law empowered the MIC to make the decision.

⁴⁷ The others are all in Asia: Japan, Thailand, China, Hong Kong, Singapore, India, Korea.

⁴⁸ The DG DICA mentioned going to the annual ASEAN fair in China seven times, and referred explicitly to the business fair in Mandalay in October 2015, which attracted 400 participants, though it is not clear how many were potential foreign investors rather than local businesses and bureaucrats, business associations, foreign consultants and the like (ODI interview, April 2016).

2.5.2 FDI performance in Myanmar

This section looks at FDI overall, before turning to focus specifically on FDI in the four selected sub-sectors, and FDI relations with China. We start however with a discussion of Myanmar's official FDI data. Data on investment, which is collected by DICA, is limited and what is available is often weak quality, though there are signs of improvement in recent years.⁴⁹ DICA is the source of Myanmar FDI data reported by UNCTAD, the standard source of internationally comparative FDI data.⁵⁰

2.5.2.1 FDI data issues⁵¹

We discuss here the severe challenges relating to FDI data published by DICA. It should be noted at the outset that DICA's data only includes investment approved by the Myanmar Investment Commission (of which DICA is the Secretariat). There is an unknown amount of other (formal) FDI in Myanmar which has been approved by other government ministries, public agencies or state officials. In addition, many foreign investors may enter 'informally' as 'shadow' partners of local businesses, to avoid identification as foreign businesses by tax or other authorities, or by customers or local communities. While much of the unrecorded investment is probably in natural resource-related sectors (extractives, agriculture and forestry), our interviews with Chinese firms suggest it is also common for smaller investments in urban and industrial settings, particularly since the post-2011 upsurge of popular hostility to Chinese firms.

Turning to the data published by DICA, FDI flow data is presented in two categories: the 'approved' amount of 'permitted' enterprises, and the 'approved' amount of 'existing' enterprises. The latter refers to approved investment which has subsequently been realised, in the sense of actually entering the country, not necessarily in the same year as it was approved. Stocks in the DICA data are cumulative flows. There is a gap between the two flow measures – very large in some years – which is a source of considerable confusion about Myanmar's FDI data. A similar gap is found in many developing countries, and in principle may be explained by several factors. While still deliberating on their ultimate location choice, firms may seek approval in several countries for a single investment project under consideration, so that some investment approved by a country is never realised. Firms may also postpone or cancel a planned investment for which approval has already been received, due to changed economic or business conditions. There may be a gap between 'flow' (annual) measures of approved and existing investment, but not between 'stock' (cumulative) measures. For example, where the FDI 'market' is 'thin' so that inflows are relatively small (as in Myanmar), one or two large projects (such as in infrastructure or extractive industries) involving multi-year construction periods may dominate the 'approved' flow data for any given year, whereas the related 'existing' investment flow may be spread over several years, contributing to a large approved-actual investment gap in flow terms. But as approved projects are completed, the gap in stock terms will decline and eventually disappear. Another issue is that approved project values may include contributions from domestic partners in JVs (or other domestic financing), while existing investment inflows would exclude that domestically-financed component. This latter factor may be particularly pronounced where – as in Myanmar historically – there is a shortage of foreign exchange and consequent tight regulation of access to this crucial resource, so that local contributions substitute for FDI inflows enabling domestic partners to access forex. The respective contribution of these factors (or perhaps others, such as misreporting) in explaining the gap in historic FDI data in Myanmar is not clear, but the

⁴⁹ The DICA data is published on www.dica.gov.mm and also by the Central Statistical Organisation (CSO) (www.csostat.gov.mm). An EU-ASEAN project is assisting DICA to improve data quality (Gilmore, 2016), and the DICA DG indicated that assistance is also being received from Japan (presumably JICA), (ODI interview, April 2016).

⁵⁰ For DICA as UNCTAD's data source, see Methodological note, page 37, in UNCTAD, 2015. For UNCTAD's FDI data, see www.unctadstat.org.

⁵¹ For discussion of FDI data in Myanmar, see OECD (2014, p 53) and Bissinger (2012). Bissinger (2016) provides annual data – obtained from DICA – for existing investment in total and by sector, which is not publicly available on the official websites. He shows an even larger gap with approved investment than does DICA's official data, reflecting significantly lower existing investment. He reports total cumulative existing investment up to March 2015 of \$21.227 billion, less than half DICA's figure of \$46.391 billion. In 2005-6, according to Bissinger (2016), over \$6 billion was approved but actual FDI inflow was only \$236 million, less than 4% of the approved figure. According to UNCTAD, inflow in 2005-06 was \$724 m. Over the period 2005-06 to 2014-15, DICA approved \$46.456 billion (502 projects), while Bissinger shows realised investment by value amounting to only 35% of this figure, that is, \$16.337 billion. His figures are of the same order of magnitude as those of UNCTAD, but DICA argue that the UNCTAD data are partial. It is unclear why they don't provide UNCTAD with more accurate data.

third of these factors – large lumpy projects – undoubtedly played a role, and the fourth – access to forex – may well have been significant also.

In the DICA data, the gap in stock (or cumulative flow) terms is smaller than it appears when flows for only one or two extreme years are considered. The OECD, whose data (2014, 53) appears to vary from UNCTAD's⁵², reports that in 2005-6, over \$6 billion was approved while existing (realised) FDI inflows were only \$236 million (less than 4% of approved), while in 2010-11, \$20 billion was approved, while existing (realised) inflows were a mere \$1.3 billion (6.5% of approved). These two years had particularly high approvals linked to large infrastructure projects, and thus very large approved:realised gaps in flow terms. But for most other years between 1989 and 2012, the gap is in fact much smaller, and even, in three of the eight years between 2005 and 2012, negative – realised investment was in fact larger than approvals in those three years. For the full eight-year period 2005-2012, the OECD data suggest that realised inflows are only about 16% of approved investments, a gap of 84%, but excluding the two 'outlier' years with very high approvals, the cumulative realised flows are about 72% of approvals, a gap of only 28%.

Furthermore, the stock gap has slowly shrunk, as projects which are very large shares of FDI stocks, have been completed. Table 3 presents DICA's official figures for cumulative (stock) investments in the permitted and existing categories since October 2013. As the table shows, in late 2013 the gap was 21%, that is, existing (realised) investment (as reported by DICA) was 79% of approvals, but by mid-2016, the share of existing investment had steadily increased to 84% of approvals, a gap of 16%. A gap of this dimension may be considered not to be a major problem.

Table 3: Permitted vs. existing investment, stock (cumulative flow total since 1989)

Date	DICA Permitted \$m	DICA Existing \$m	Gap (% of permitted)	UNCTAD Stock \$m
Oct 31 2013	42.95	33.8	21.2	16.7*
June 30 2014	46.7	36.65	21.5	-
Dec 31 2014	52.8	42.8	19.0	17.65
June 30 2015	56.6	46.3	18.2	-
Dec 31 2015	59.15	48.9	17.4	20.48
June 30 2016	63.7	53.35	16.3	-

* As of 31 Dec 2013.

Source: DICA, UNCTAD (www.unctadstat.org)

Nonetheless, Myanmar's FDI data quality problems remain of concern. Table 3 also shows a very large 'gap' between DICA 'existing' (realised) data and UNCTAD data, much larger than that between DICA's 'permitted' (approved) and 'existing' (realised) FDI. This is confusing given that DICA is the source of UNCTAD's Myanmar data. The DICA Director-General (ODI interview, April 2016) explains the gap between DICA's data for 'existing' investment and the UNCTAD data as resulting from the fact that DICA's 'existing' investment includes both the value of imported equipment (obtained from the Ministry of Commerce's Customs Department) and the value of finance brought into Myanmar by foreign direct investors (obtained from the Central Bank of Myanmar's foreign exchange transactions), whereas UNCTAD's data reflects only the latter, that is, foreign exchange (cash) transactions by foreign investors, presumably for working capital and investment in building construction. Why UNCTAD only publishes data for forex transactions is unclear, since its data is supplied by DICA (rather than the Central Bank of

⁵² Though UNCTAD is given as a source for the OECD chart (2014, 53).

Myanmar or the CSO). Nonetheless, DICA will from later in 2017 publish data for actual FDI inflows rather than for 'approved' amounts of 'permitted' and 'existing' enterprises.⁵³

The poor quality of FDI data is all the more surprising as DICA obtains foreign investors' balance sheets, quarterly and annually, which it uses to compare investors' approved proposals with their ongoing performance. Based on these reports, DICA may require investors to account for any variance from the approved plan, or to shift performance to meet the plan. DICA at present does not use this (potentially very rich) data in compiling its own FDI statistics. A potentially valuable but low-cost intervention would be to enhance DICA's data processing capabilities to enable incorporation of reported data in its FDI statistics, which would be useful in its investment promotion activities as well as investment regulation and monitoring.⁵⁴ Giving DICA the authority to obtain data on *all* FDI in Myanmar would evidently also be essential for improvement in FDI statistics.

2.5.2.2 Recent FDI trends⁵⁵

There is broad agreement that Myanmar's overall performance in attracting FDI since it opened up to foreign investment in 1988 has been poor, for both economic and political reasons (OECD 2014, World Bank 2014). FDI from East Asia did begin to enter in the early 1990s but the incipient improvement was halted by the Asian financial crisis in 1997-98. Around the same time sanctions on new investments were imposed by the US⁵⁶, which had removed Myanmar from the GSP scheme in 1989. The EU suspended Myanmar from the GSP in 1997, with US trade sanctions following in 2003. These restrictions affected not only trade with the US firms but also investment by (US and European) firms planning to export goods produced or assembled in Asia to the west, with the garment industry especially being affected, as discussed above. 'Approved' investment into Myanmar was boosted from 2003 by Chinese (and Thai) resource-seeking projects initiated in the power and extractives sectors, where investments are 'lumpy', consisting of a few very large projects. But their implementation has been uneven, so that actual inflows may have been far lower than what was approved.⁵⁷ Western sanctions have progressively been eased since mid 2012 when the US lifted its investment ban (and which was followed by the May 2013 visit by President Thein Sein to the US during which the US-Myanmar Trade and Investment Framework Agreement was signed).

There has been improved investment performance since, both in the value of aggregate inflows, and in the number of foreign investment project approvals, particularly in manufacturing, which can be taken as an indication of renewed and stronger investor interest.

Figure 19 provides a comparison between DICA and UNCTAD FDI flow data. Figure 20 shows inward FDI stocks and flows since 2000 according to UNCTAD data.⁵⁸ The two figures together demonstrate clearly the inconsistencies between alternative presentations of Myanmar FDI data, by the government and by UNCTAD, but each illustrates the unevenness and overall poor performance of the country in attracting FDI. It is clear though that performance has begun to improve since the lifting of sanctions.

⁵³ Interview with DICA officials, Yangon, March 2017.

⁵⁴ In interviews with DICA management in April 2016, we were informed that DICA is receiving assistance from the Japanese government in the area of FDI monitoring and data processing, though details are unclear. An EU-ASEAN project (www.compass.asean.org) is assisting DICA to improve its FDI statistics quality (Gilmore, 2016), and it is hoped a new company registry to be completed by end-2017 will allow a census of foreign investors to be carried out in the course of 2018.

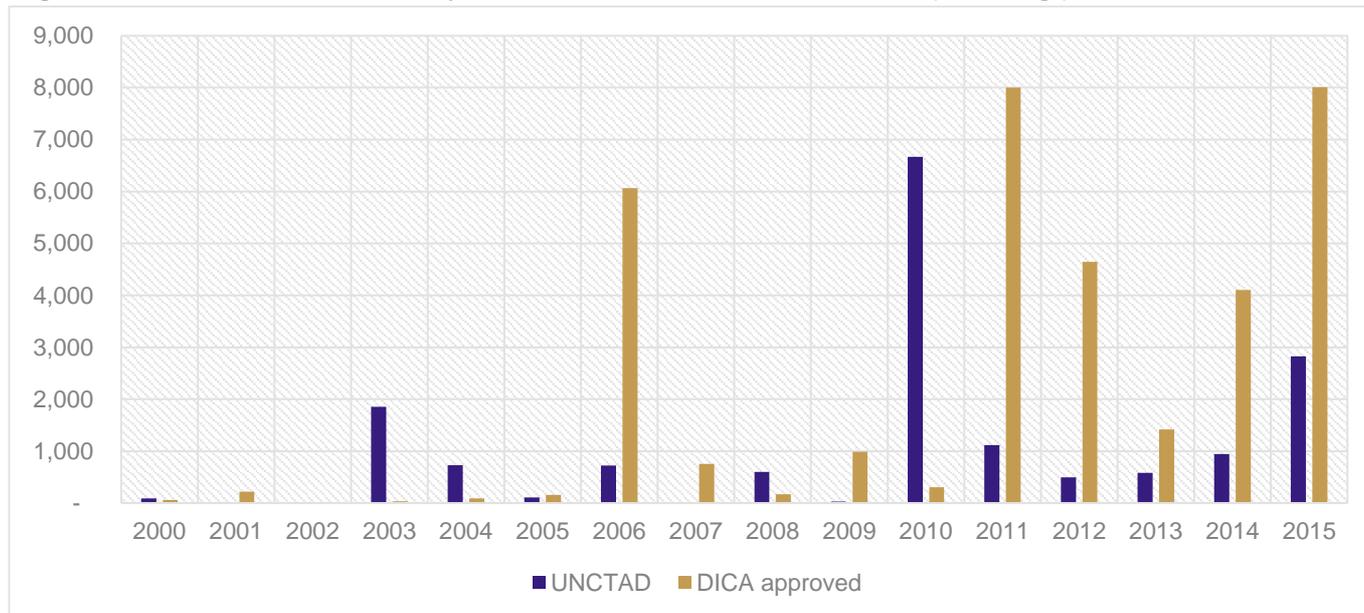
⁵⁵ The discussion in this section uses all three FDI data series: DICA permitted, DICA existing, and UNCTAD.

⁵⁶ The US allowed firms already present in 1997 to remain.

⁵⁷ Though DICA's idiosyncratic approach to collecting data about actual investment inflows implies that it cannot be concluded with certainty.

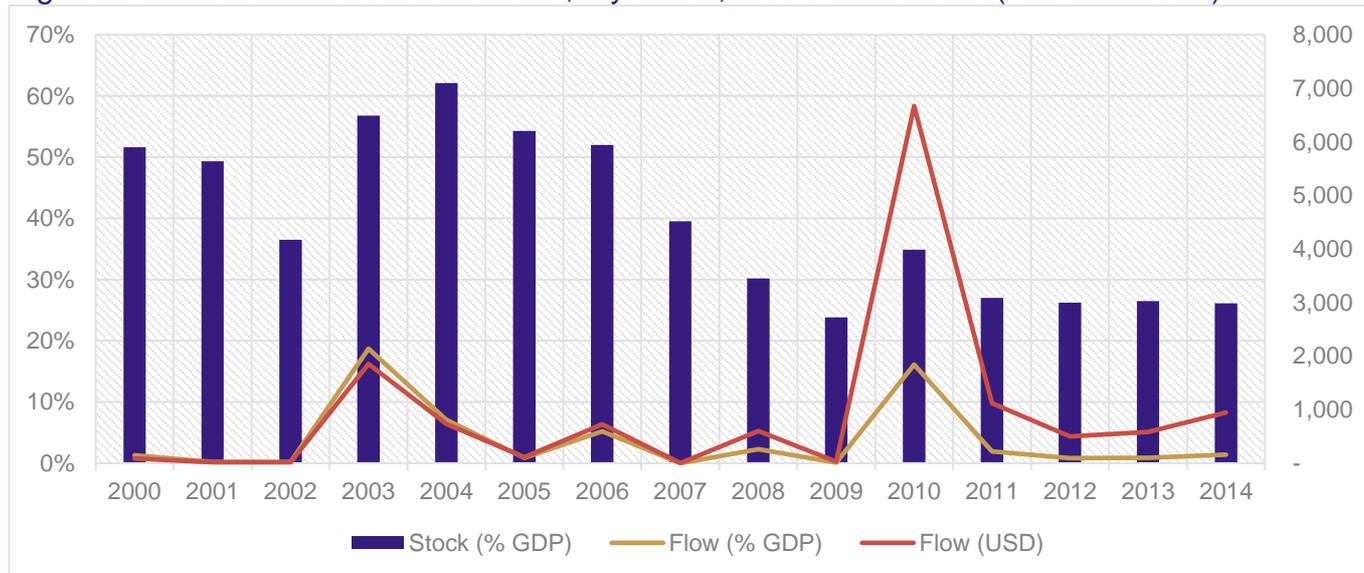
⁵⁸ The figure uses UNCTAD's reported GDP figures to calculate FDI as a share of GDP, but UNCTAD's estimated GDP is significantly larger than that of the IMF or World Bank presented above.

Figure 19: Inward FDI flows, Myanmar, 2000/01–2014/15, DICA ('existing') vs UNCTAD



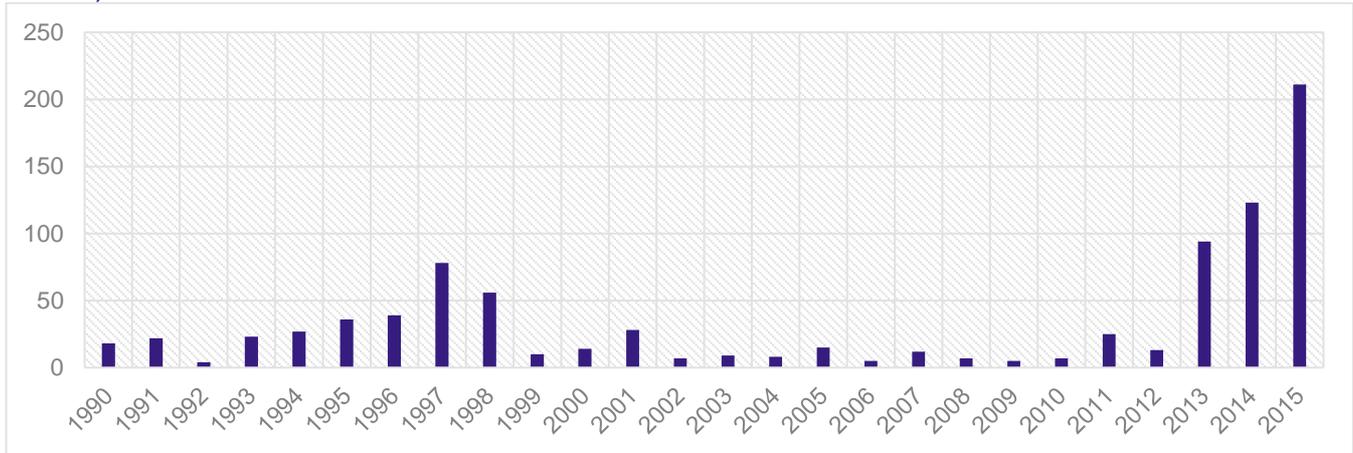
Source: DICA; UNCTAD Stat. The DICA data is for 'existing' (realised) inflows.

Figure 20: Inward FDI stocks and flows, Myanmar, 2000/01–2014/15 (UNCTAD data)



Source: UNCTAD Stat.

Figure 21: FDI entry to Myanmar, no. of projects per annum, 1989/90–2014/15 (FY ending 31 March)

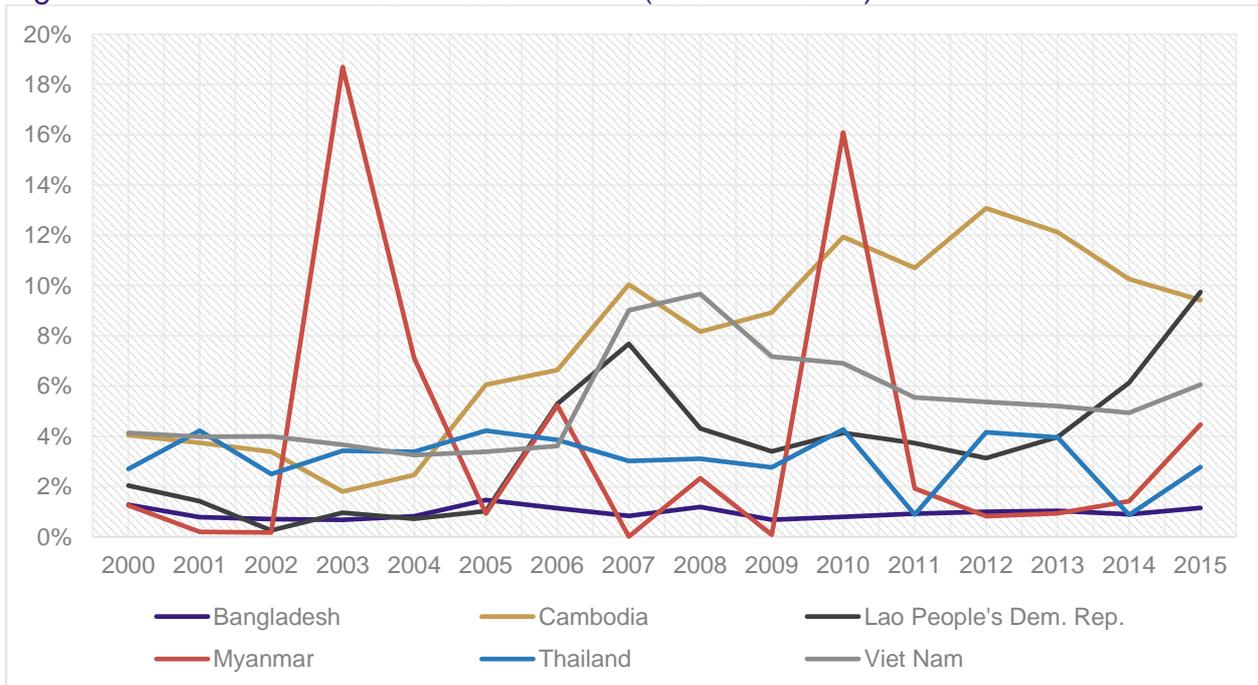


Source: DICA.

Figure 21 shows the number of foreign investment projects approved by DICA each year, and gives some idea of the fluctuation of foreign investor interest in Myanmar over time. Over the period 1989/90 to 2014/15, a total of 896 projects were approved. The six-year period 1992/93 to 1997/98 saw 259 projects (29% of the total) approved. During the following 12 years of sanctions between 1998 and 2011, only 165 projects in total (14 on average per annum) were approved, though some of these were very large investments by value, as the previous two figures showed. With new interest in Myanmar’s economy after the lifting of sanctions, the number of approved projects rose ten-fold to 142 per annum, 428 in total, during the three years since 2012 (Bissinger, 2016; OECD, 2014).

Figure 22 uses UNCTAD data to compare Myanmar with three other South-East Asian economies and Bangladesh. Leaving aside the issue of data quality, except for the short-lived ‘peaks’ associated with lumpy investments in 2003 and 2010, flows into Myanmar are below those in comparator countries, and also seem to be more volatile than those of its neighbours.

Figure 22: Inward FDI for selected countries (% of own GDP)



Source: UNCTAD Stat.

Since mid-2014, DICA has provided cumulative data for sector and home country distributions for both permitted and existing investment. Given all the caveats discussed, this data should be used with caution. Notwithstanding, Table 4 provides the sector breakdown for approved and realised investments since 1989, showing that about two thirds of projects by value were in oil/gas and power, a share which rose to over 75% for 2005-2015. The manufacturing sector's share is only 10.3% of total approved investment by value since 1989, and only 8.3% since 2005. But perhaps more significant for this report is the *number* of projects approved: manufacturing has provided two thirds of projects realised over the period since 1988/89 (Table 4), and 73% since 2012. The average size of manufacturing projects approved between 2005 and 2015 was just over \$10 million, compared with an average size of \$92.5 million for all sectors.

Table 4: Foreign investment by sector, cumulative 1988/89–2014/15, DICA data

	Sector	Permitted (approved)				Existing (realised)				Existing as % of permitted	
		Number projects	%	Value (\$m)	%	Number projects	%	Value (\$m)	%	Number projects	Value
1	Agriculture	17	1.6	243	0.4	14	1.8	214	0.4	82.4	88.1
2	Livestock/Fish	34	3.3	453	0.8	16	2.1	193	0.4	47.1	42.6
3	Mining	70	6.8	2871	4.9	10	1.3	2341	4.8	14.3	81.5
4	Manufacturing	585	56.6	6245	10.6	493	65.0	5012	10.3	84.3	80.3
5	Power	9	0.9	19372	32.7	8	1.1	13341	27.3	88.9	68.9
6	Oil & Gas	151	14.6	19642	33.2	93	12.3	18718	38.3	61.6	95.3
7	Construction	2	0.2	38	0.1	n.a.	-	n.a.	-	-	-
8	Transport/Comms	29	2.8	4753	8.0	20	2.6	4577	9.4	69.0	96.3
9	Hotel & Tourism	58	5.6	2271	3.8	42	5.5	2010	4.1	72.4	88.5
10	Real Estate	32	3.1	2517	4.3	20	2.6	1736	3.6	62.5	69.0
11	Industrial Estate	4	0.4	203	0.3	3	0.4	189	0.4	75.0	93.1
12	Other services	42	4.1	545	0.9	40	5.3	529	1.1	95.2	97.1
13	TOTAL	1033	100	59153	100	759	100	48863	100	73.5	82.6

Source: DICA data and statistics (2015)

Table 5 provides the source country distribution for approved and realised investments since 1989, with countries ranked by value of realised investment. Though providing only about 12% of the number of realised projects, China provides the largest share of the value of realised investment with 31.3%, and together with Hong Kong SAR, accounts for 46% of the total value. Hong Kong is known to be the source of finance for some of the large Chinese investments in Myanmar. The approved:realised gap is not significant for China or most other source countries, though it is large for Thailand and Malaysia. The UK is the fifth-largest home country for approved investment since 1989, and the only non-Asian country in the top seven on the list, but the UK data in this table includes the British Overseas Territories, the British Virgin Islands and the Cayman Islands. Both of these, like Hong Kong, are significant destinations for

Chinese outward FDI.⁵⁹ An unknown proportion of this Chinese investment is thought to move on to third countries, so that the UK data in Table 5 may in fact include some investment that is ultimately Chinese.

Table 5: Top foreign investment source countries, cumulative 1988/89–2014/15, DICA data

	Country	Permitted (approved)				Existing (realised)				Existing % of permitted	
		No of projects	%	Value (\$m)	%	No of projects	%	Value (\$m)	%	No of projects	Value
1	China	115	11.1	15418	26.1	90	11.9	15274	31.3	78.3	99.1
2	Singapore	189	18.3	11818	20.0	153	20.2	11480	23.5	81.0	97.1
3	Hong Kong	117	11.3	7272	12.3	99	13.0	7176	14.7	84.6	98.7
4	UK*	82	7.9	4059	6.9	48	6.3	3407	7.0	58.5	83.9
5	South Korea	122	11.8	3396	5.7	108	14.2	3324	6.8	88.5	97.9
6	Thailand	90	8.7	10352	17.5	51	6.7	3217	6.6	56.7	31.1
7	Malaysia	52	5.0	1663	2.8	25	3.3	1065	2.2	48.1	64.0
8	Netherlands	13	1.3	982	1.7	10	1.3	747	1.5	76.9	76.1
9	India	22	2.1	731	1.2	21	2.8	726	1.5	95.5	99.3
10	Viet Nam	10	1.0	691	1.2	10	1.3	692	1.4	100	100
11	Japan	83	8.0	609	1.0	72	9.5	506	1.0	86.7	83.1
12	France	4	0.4	542	0.9	3	0.4	538	1.1	75.0	99.3
13	TOTAL Top 12	899	87.0	57533	97.3	690	90.9	48152	98.5	76.8	83.7
14	TOTAL Overall	1033	100	59153	100	759	100	48863	100	73.5	82.6

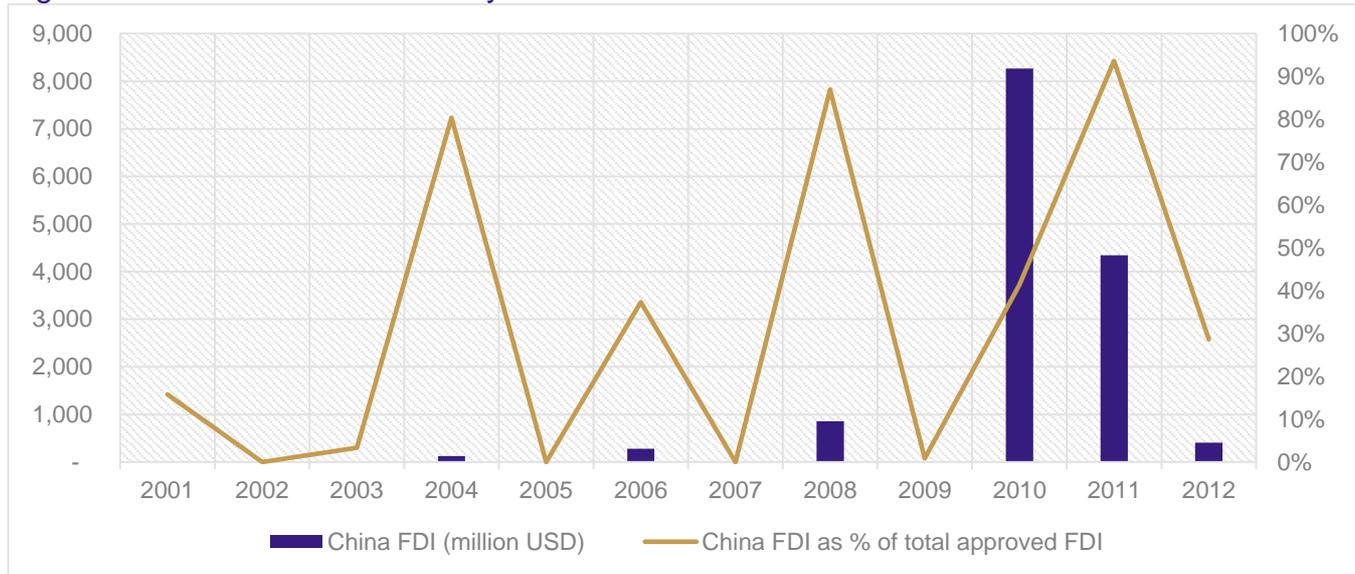
Source: DICA data and statistics (2015). * UK includes British Virgin Islands and Cayman Islands.

2.5.2.3 FDI from CHINA

Over the full period 1989 to 2015, China is the largest home country amongst realised (existing) investments, as shown in Table 5, and together with Hong Kong accounts for almost half of realised investment. Approved investment from China rose from just above zero in 2003 to nearly \$15.5 billion by 2015, of which 93% was in power, oil and gas, and mining, and none in manufacturing (DICA, 2016, Bissinger 2016). Figure 23 shows the lumpiness of approved Chinese investments in Myanmar, with large projects approved in 2010-2011. The large Chinese hydro-power projects, oriented to supplying energy needs in western China, are well known. There are also substantial Chinese projects in mining and oil and gas pipelines, though non-Chinese foreign investors also participate in the gas sector.

⁵⁹ In 2014, 58% by value of Chinese outward direct investment flows for the year went to Hong Kong, and 7.1% (\$8.76 billion) to the British Virgin Islands and Cayman Islands, (MOFCOM, 2014). Much of these funds may have flowed back into China, a process known as 'round tripping'.

Figure 23: China FDI inflows to Myanmar



Note: data are on an approval basis.

Source: UNCTAD Bilateral FDI statistics, based on data from the Central Statistical Organisation, Ministry of Finance and Economic Planning.

The data for Chinese FDI in Myanmar is not surprisingly also plagued by data problems. As of 2012, the stock of approved investment from China was \$9.6 billion investment according to DICA, but official Chinese investment data showed FDI stocks in Myanmar of \$3.1 billion at end-2012, with \$0.75 billion in flows to Myanmar in 2012 alone (MOFCOM, 2014). By 2015, the gap between Myanmar stock data and Chinese 'mirror' data had grown: DICA showed \$15.42 billion in approved investment from China and \$15.27 b. in realised data (a tiny gap as Table 5 above shows), while the FDI stock reported by MOFCOM had increased only to \$3.93 b, with total reported flows from China to Myanmar in 2013-2014 of about \$819 m.

It is also noteworthy that Bissinger (2012) estimates (using unpublished DICA data) that realised investment from China into Myanmar was a mere \$0.82 billion, less than 10% of approvals reported by DICA, and about a quarter of the stock figure reported by MOFCOM. One possible explanation is that much of the planned and approved Chinese power projects have not materialised. Another factor may be that much Chinese activity in Myanmar up to 2012 was linked to the military and neither subject to formal investment approval procedures nor recorded (Callahan, 2012). A third explanation is that much Chinese investment is not recorded as coming from China. Firm interviews in Myanmar for this paper suggested that many (private) Chinese investments in Myanmar may not be recorded as Chinese, due to routing via third countries such as Singapore or Malaysia, or via tax havens such as the Caribbean British Overseas Territories. Small private investments may not be recorded as foreign-owned at all, due to formal ownership by local Myanmar 'fronts'. As noted, these practices are widespread, either for tax or related reasons within China or Myanmar, or to present a non-Chinese 'image' within Myanmar. Interviews with Chinese investors suggested that some have the perception that FDI approval applications from Chinese investors are subject to greater scrutiny than those from elsewhere since the 2011 Myitsone Dam suspension and the associated deterioration of China-Myanmar relations in the public realm. The DICA data, as processed by Bissinger (2016), lists only a single Chinese investment in manufacturing (all sub-sectors) since 1989, but in the garments sub-sector alone, the Myanmar Garment Manufacturers Association (MGMA) listed 44 Chinese firms (including firms with some sort of Chinese participation) in its membership of 342 companies up to December 2015. Additionally, MGMA has 32 companies from Hong Kong and 9 Taiwanese companies among its members.

The value of approved investment since 2005 for the four sub-sectors of interest – agriculture and agro-processing, construction and civil engineering, garments and tourism – is shown in Table 6. As would be expected, the garment projects are very small in value terms relative to other manufacturing projects –the average size of manufacturing projects listed in Table 4 is around \$10 m. compared to just over \$2 m. for the garment projects. The other light manufacturing projects in Table 6 are also below the overall

manufacturing average of the projects listed in Table 4. Nonetheless, these investments are important for economic transformation because of their labour-intensity and employment-creating potential, raising the productivity of labour they employ compared to the previous activities of those workers (in household enterprises and/or subsistence agriculture).

Table 6: Existing investments in selected sub-sectors, 2005–2015

Sector	Value of approved investment, \$ million	Value of approved investment as % of all approved investments	Average size of project, \$ million*	Number of projects	Number of projects as % of all projects
Garments	410	0.9%	2.47	166	32.7%
Other light manufacturing (shoes, wigs etc.)	332	0.7%	8.74	38	7.5%
Construction (including infrastructure & real estate development)	2,410	5.0%	141.75	17	3.4%
Agriculture	446	0.9%	27.84	16	3.2%
Agro-processing	353	0.7%	19.63	18	3.5%
Tourism & related	904	1.9%	53.20	17	3.4%
Total all sectors	47,999	-	94.67	507	-

Source: Authors' estimates based on dataset of existing investment provided to ODI by DICA, for period 1989 to February 2015, supplemented by ODI research to identify some missing source countries from other public information.

Focusing on the approved Chinese investment presented in the DICA database (Table 7), the largest number of approved projects is in garments and related and in other manufacturing, though the projects are small (average \$2.2 million and ranging from \$0.36 million to \$10 million). Oil and gas and energy projects reflect the opposite, of course, with a few very large projects.⁶⁰

⁶⁰ It should be noted that the total of approved Chinese in Table 7 is \$19.899 billion, which is different from (and much larger than) the figure reported in Table 5 (\$15.418 billion). Both figures come from DICA, and the reason for the discrepancy is unclear.

Table 7: Chinese investment approved by DICA, 1989–2015

Sector	Value of approved investment, \$ million	Value of approved investment as % of all approved Chinese investments	Average size of project, \$ million	Number of approved projects	Number of projects as % of all Chinese projects
Agroprocessing	6.67	0.0%	2.22	3	3.6%
Garment and associated industries	80.78	0.4%	1.92	42	50.6%
Other manufacturing	1,283.96	6.5%	91.71	14	16.9%
Mining	910.84	4.6%	113.85	8	9.6%
Oil and gas	4,554.05	22.9%	506.01	9	10.8%
Power	12,843.72	64.6%	3,210.93	4	4.8%
Tourism	12.14	0.1%	6.07	2	2.4%
Transport	199.50	1.0%	199.5	1	1.2%
Total all sectors	19,891.64	-	239.66	83	-

Note: These data are drawn from a dataset covering the period 1989-2015; the first recorded Chinese investment in the dataset is in 1994.

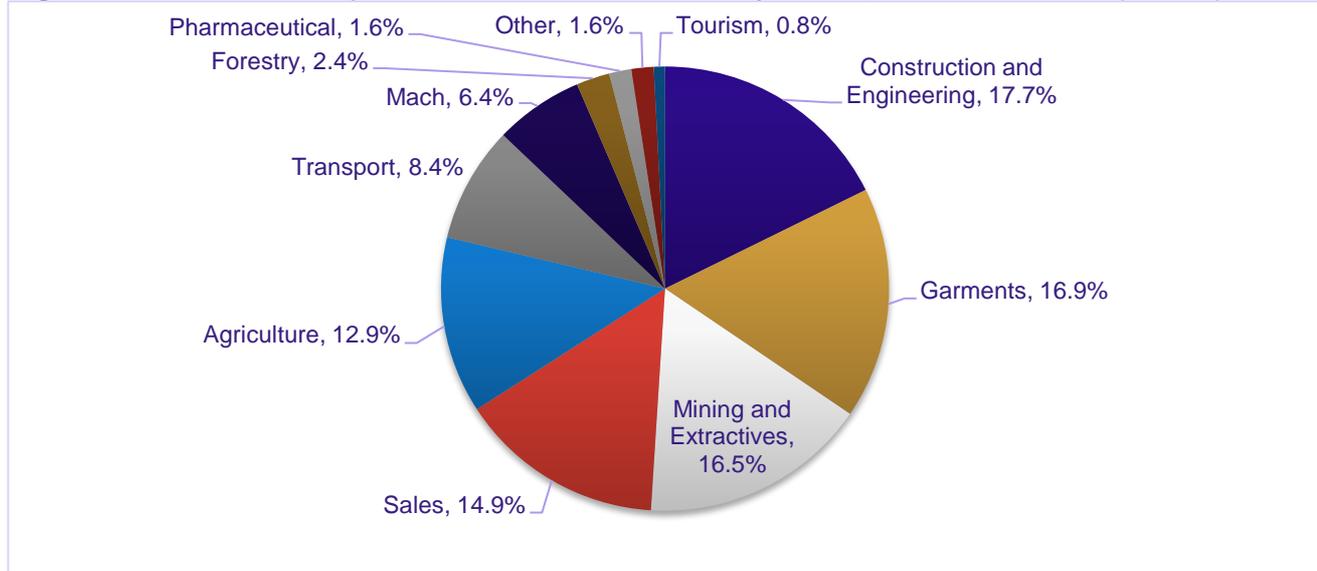
Source: Authors' estimates based on dataset of existing investment provided to ODI by DICA, for period 1989 to February 2015, supplemented by ODI research to identify some missing source countries from other public information.

The DICA firm-level dataset of approved investments offers an indication of the importance of Chinese investments in each sector. In terms of approved investments for the period 1989-2005, China was the third largest investor in garments with over \$80 million approved investments (preceded by Hong Kong and South Korea) and the largest investor in the manufacturing sector with \$1,284 million invested, with nearly double the value of investments of the second largest investor (Japan with \$727 million) (authors' calculations on the DICA dataset). China also had the largest number of approved investments (*ibid.*).

Our research for this paper also examined the firm-level register of outward Chinese FDI projects maintained by the Chinese Ministry of Commerce (MOFCOM), which includes 249 investments in Myanmar approved as outward FDI by the Chinese authorities.⁶¹ Figure 24 shows the sectoral composition of the 249 approved projects, based on our inspection of company websites. There is a fairly even spread of projects between construction and engineering, garments, mining and extractives, and agriculture, as well as 'sales', indicating companies that were not (yet) investing in Myanmar but had offices seeking investment or export opportunities.

⁶¹ The list does not identify which projects have been realised, as distinct from approved.

Figure 24: Sectoral composition of Chinese FDI to Myanmar, number of firms (n=249)



Source: Chinese Ministry of Commerce listing, authors' analysis.

The MOFCOM list also identifies location by province of the company head office within China. These are widely dispersed with 27 of 34 provinces or provincial-level administrative units represented, but the largest share (18%) comes unsurprisingly from Yunnan, the western province bordering Myanmar, followed by 'national' firms, State-Owned Enterprises (SOEs) owned by the central government (17%). We were not able to identify entry dates for the firms on the MOFCOM list, but a similar exercise carried out elsewhere identified 170 Chinese investments in Myanmar, of which only 20% had entered before 2008, and 34% between 2009 and 2011. Almost half – 47% – had entered in 2012 and 2013 (JETRO, 2014).

2.6 Concluding remarks on transformation, trade and FDI

This section has reviewed the evidence for economic transformation in Myanmar in the past 25 years, evidence which must be understood in the light of the poor quality of publicly available data, even compared to other developing countries. Although industry and services have increased their shares of GDP, and labour has moved out of agriculture, the extent of structural transformation since 1990 has been very limited. This supports the view of Myint (2012), based on a longer time horizon from 1970. Though international trade has risen in value, mostly due to natural resource exports, there has been little diversification in its composition, and arguably even a decline in this respect. FDI in value terms has risen strongly, but has been driven mainly by projects in oil and gas, mining and hydropower, and so contributed little to transformation.

But as the country's political transition from military rule has proceeded since 2011, the picture has changed and much more encouraging conclusions regarding transformation are possible. Industrial output and employment shares have grown rapidly, while the structure of both trade and investment reflect a shift in emphasis towards more transformative activity. As we have noted, manufacturing exports have increased rapidly through this later period, with garment exports in particular growing fast since the lifting of US sanctions and the restoration of the EU's GSP preferences. With the US GSP preferences also now restored as of late 2016, further export growth can be expected in this and possibly other light manufacturing activities. As also noted, the number of investment projects in manufacturing has increased substantially in the recent period, which is a more significant indicator from the perspective of economic transformation and employment creation of low-skill jobs than the value of investment inflows. As the immediately preceding discussion underlined, a growing Chinese presence in Myanmar manufacturing, particularly in light manufacturing for export, has been one major contributing factor in the stronger performance on economic transformation since 2011 than during the preceding two decades. The growth of tourist arrivals into Myanmar (including from Europe) and the increase in rice exports to China – both also associated with the economic and political liberalisation since 2011 – are further suggestions of the rising pace of economic transformation.

3 FOREIGN INVESTMENT IN MYANMAR: INSIGHTS FROM FIRMS AND SECTORS

This section discusses the potential of foreign investors to contribute to economic transformation in Myanmar, focusing mainly on the four selected sectors and mainly on Chinese firms, though FDI from other home economies is also discussed. This paper focusses on China because of its significance as an investment and trade partner for Myanmar, its significance as a global manufacturing economy (and the close linkages between manufacturing and transformation), its growing role as an outward investor in manufacturing as well as natural resource-linked activities, and its regional significance in south-east Asian economics and security.

We discuss in the first sub-section foreign firms' motivations for investing in Myanmar and aspects of the entry process. We then turn to firms' activities in Myanmar and perceptions of their operating environment and their own performance, which impact upon the attractiveness of Myanmar as an investment destination. The third sub-section examines foreign firms' impact on economic transformation and the potential for this impact to be enhanced. In each sub-section, we discuss the four sectors in turn: garments, tourism, construction and agro-processing.

Throughout the discussion, we draw extensively on firm interviews carried out for this study in both Yangon and in Beijing and Kunming, the capital of Yunnan province in China, which borders Myanmar. We interviewed 31 Chinese firms and nine non-Chinese firms, a total of 40 firms, for this study. The Chinese firms were largely identified from the MOFCOM list of 249 Chinese investors into Myanmar, though some other firms, especially in the garment sector, were identified during fieldwork in Yangon, and these included firms that were not 'from' the People's Republic of China (PRC), but are owned by the wider Chinese diaspora outside the PRC. The fluidity of the meaning of 'Chinese firm' because of the very large and active diaspora is an important feature of Chinese investment in Myanmar (and elsewhere) to which we will return below.

Twenty-four firms were interviewed at the Myanmar operations, of which seven were also interviewed at their head offices in China. Another seven firms were interviewed only at their head office in China. All the non-Chinese firms were interviewed only in Yangon. Interviews of the firms used a prepared questionnaire. There are too few firms, especially within the individual sectors, to develop a rigorous and credible statistical analysis of the questionnaire data. The discussion below also draws on wider insights and information yielded during the interviews with the firms, as well as 22 other stakeholder interviews in Myanmar, including the Director General of DICA, officials at four business associations, and 17 staff of donor organisations or independent consultants and experts. These discussions were less structured, and did not use a pre-defined questionnaire.

Table 8 presents the breakdown of firms interviewed by sector, which were defined more broadly than in the formal ISIC classification codes used for national accounting and in the data analysis in Section 2 above. Garments is defined to include footwear, and we interviewed a large footwear producer selling exclusively into the domestic market. Tourism ranges from small travel agents and tour operators to large hotels (the firm interviewed is owned by a Myanmar national but managed by a Western firm). Construction as defined here includes real estate and property developers, large infrastructure project developers and operators and manufacturers of construction materials. Agriculture sector interviews included producers of inputs (seeds, fertiliser) as well as agro-processors. The 'Other' sector in the table includes five firms outside the four selected focus sectors who were willing to be interviewed, including one each in security services, pharmaceuticals and thermal materials, and two machinery producers, one supplying the furniture industry and the other sewing machines. The 31 Chinese firms included both state-owned firms – about half the firms in construction, and one each in tourism and agriculture – as well as privately-owned firms, including all the garment firms.

Table 8: Breakdown of Chinese firms interviewed

	Garments	Tourism	Construction	Agriculture	Other	Total
Chinese affiliates	7	2	10 (5)	3 (2)	3	25
Head offices in China	-	1	2	2	2	7
Non-Chinese	4	4	2	-	-	10
Total interviewed	11	7	14	5	5	42

Source: ODI firm interviews, Dec 2015-Jan 2016

Note: a. Numbers in brackets indicate firms interviewed both in Myanmar and also at head office in China.

b. The total is 42 rather than 40 because two firms are double-counted, due to being involved in two sectors: one Chinese firm in construction and tourism, and one non-Chinese firm in garments and tourism.

3.1 Motivations for Entry, the entry process and market structure

As will become clear below, identifying and counting foreign investment in Myanmar is not much easier when looking at firms than at the aggregate level, as discussed above. The DICA and MOFCOM data both suggest that the majority of investment by value and the majority of Chinese firms entered Myanmar after 2008. The Chinese firms interviewed were willing to tell us when they entered Myanmar: in our small sample, about one quarter of the firms had been in Myanmar well over ten years, but the rate of entry had increased since 2012. However, firms were predictably much less willing to share with us details of their ownership shares and registered status in Myanmar. Several firms, across all sectors, referred to the hostility from the Myanmar public towards Chinese firms, indicating that this led them to route their entry via a third country, often Singapore or Malaysia, a process that raises transaction costs of both entry and operation. Other firms indicated they had local JV partners, which may have been required for registration because they were entering a restricted activity such as agriculture (foreigners cannot buy land outright and are restricted to long-term leases), or may have been motivated by a desire to present a 'Burmese image', or because only local partners could get access to essential resources, such as urban land for a factory. Chinese firms may often be registered as local firms in the name of the Myanmar partners, or simply be unregistered. One implication for this study is that we do not focus only on firms explicitly identified as Chinese (itself a fluid label since it often refers to the diaspora beyond the PRC), or even only on foreign firms, since the lines are blurred between these categories and domestic Myanmar firms.

Firm motivations for entry are laid out in Table 9, and consistent with what would be expected, they broadly separate along sectoral lines into market-seeking and resource-seeking investments. Market-seeking investments, which included almost all the construction/infrastructure firms, aim to provide their services or sell their products in the host domestic market and sometimes also regional markets, whereas resource-seeking investments aim to acquire natural resources unavailable in their home economies for export back home (the agriculture firms), or to use resources that are available at a lower cost in the host country (such as low-skill labour), for export back to the home economy or to third markets.^{62 63}

It is also important to point out that firms' investment decisions depend not only on 'pull' factors in the investment destination, but also on 'push' factors in the home country motivating outward investment, amongst which interviewees mentioned VAT rebates for fabric exports from China (garment firms), and the stagnation of real estate prices in China (property development and construction firms).

⁶² A third commonly-cited motive for investment is efficiency-seeking, which aims to take advantage of specific conditions in the host market, such as the potential to exploit economies of scale. Like resource-seeking investment, the focus is on costs and supply of production inputs, as distinct from the demand side focus of market-seeking investments. Some analysts identify labour cost/supply motives as efficiency-seeking, and restrict resource-seeking to *natural* resources. A fourth motive for investment is strategic asset-seeking, where companies wish to acquire an asset (often another company – supplier, customer or competitor) to advance its own global strategy. This does not seem relevant to Chinese firms entering Myanmar.

⁶³ Note that natural resource-seeking investment in extractives and oil and gas was explicitly excluded from the study, and interviews were not sought with firms in these activities.

Table 9: Motivations for entry by Chinese firms

	Garments	Tourism	Construction	Agriculture	Other	Total
Market-seeking (within Myanmar)	1		10	1	5	17
Cheap labour resource-seeking (export platform to OECD)	5					5
Natural resource-seeking (export to China)			1	2**		3
Services exports to China		3				3
Unknown	1		1	2		4
Total companies interviewed	7	3	12	5	5	32

Source: ODI firm interviews, Dec 2015-Jan 2016. ** Turnover for one company is 20% in Myanmar and 70% in China, with 10% elsewhere. Note that one firm is double-counted as it is active in two sectors in Myanmar.

We elaborate on the Chinese and other foreign firms' presence in each the four selected sectors of the Myanmar economy, including entry and activities in the domestic Myanmar market or global market, for market- and resource-seeking firms respectively.

(i) Garments (including footwear): The number of garment producers in Myanmar has increased rapidly since the easing of sanctions began in 2012, and entry by Chinese firms has largely been in this period. The December 2015 MGMA membership list contains 342 entries, of which 44 are identified as from China, as well as 32 from Hong Kong and 9 from Taiwan.⁶⁴ A claim by one of our informants, which we were unable to verify, was that 18 of twenty foreign-owned shoe factories producing for export in Myanmar were from China and Taiwan, with the largest of these employing 10,000 workers. Several European brands, including H&M, C&A, Marks and Spencer, Adidas, and Lidl, have begun to source from Myanmar since the reinstatement of the GSP by the EU, with several of their pre-existing suppliers from China establishing Myanmar operations as part of this process, as discussed below. So far, only one US brand, The Gap, has entered Myanmar, but more can be expected since the US reinstated GSP for Myanmar in September 2016. Asian OEM (original equipment manufacturer) producers have also entered, such as Bogart Lingerie, a Hong Kong firm with factories in Beijing and Guangdong, which has set up three factories in Myanmar since 2013 and planned to employ a total of 5,000 workers in Myanmar by end 2016, producing for Victoria's Secret and Elle (Barrie, 2016).⁶⁵ We have identified one Chinese OBM producer, Sumec, which entered Myanmar in a joint venture with Lat War, a domestic garment producer established in 1999 which subsequently diversified into power, pulp and paper and property development, and employs 2000 people producing garments under contract for Asian and European brands (Cryer, 2016). The Sumec-Lat War JV was agreed in August 2014, with MIC approval granted in August 2016, and plans to eventually employ 5000 workers in Yangon. Sumec is part of a Chinese conglomerate, originally in engineering which entered garments and textiles only in 1998, and established its own brands in the Chinese market from 2006. Though it has invested elsewhere in other activities, Myanmar appears to be its first international garment production operation, and it reports that it chose Myanmar ahead of Cambodia and Bangladesh (Sumec, 2016).

⁶⁴ The ILO mentions 210 factories in 2015 (ILO, 2015), and SMART, which works closely with MGMA, mentions 350 exporting factories with 230,000 workers in Oct 2015 (SMART, 2015).

⁶⁵ The Korean OEM Panko announced in August 2016 that it was establishing a 202-hectare complex at a cost of US\$30 – 50 million in Yangon, together with the local firm Olympus Asia Development Group (which is possibly part of the Shwe Taung group, owned by a family with close links to the military in the past, the Aung Naing family, which is the name of Olympus' Singapore-educated MD). The Panko complex will produce some of its own inputs in Myanmar, including buttons. It will begin operations in three years, and will create a claimed 40,000 to 60,000 jobs. Panko has developed a similar garment complex in Cambodia (Myat Noe Oo, 2016).

Production in the Myanmar garment sector comprises almost exclusively cut-make-package (CMP) production operations, meaning that the firms are contracted to assemble products based on designs and patterns, and using fabric and other inputs, supplied by the contractor. As already discussed above, the main sector-specific entry requirement is for firms to register as either CMP (cut-make-package) or FOB (free on board) producers with the MGMA, which was set up by the government in 2002 with a regulatory rather than associational function.⁶⁶ The CMP producers obtain tax exemption on import duties for imported fabric and other inputs used to produce exports, while producers registered as FOB do not receive exemption.⁶⁷ Unsurprisingly, no producers are registered as FOB (MGMA, 2016), and this requirement does not seem to be a meaningful obstacle in practice to foreign entry. Notwithstanding this, much policy discussion around the sector is concerned with the need to eliminate this distinction, as – the argument runs – the absence of tax exemption is a significant obstacle to the industry in Myanmar, and especially domestic-owned producers, ‘graduating’ from simple clothing assembly sub-contracting operations (CMP) to more complex activities including input sourcing, marketing and obtaining of orders and even clothing design, which are understood as FOB functions. This policy stance is notwithstanding the common observation that many Myanmar firms, while classified as CMP, are in fact already doing FOB.

To understand foreign entry into the Myanmar sector, however, it is important to spell out the structure of the global value chain (GVC) since the entry decision of resource-seeking firms in the sector (seeking low-wage unskilled labour) is very closely linked to the strategies and location choices of the firms they supply within GVCs.

A ‘triangular’ business model is common in value chains in the garments (and also other consumer goods light manufacturing industries, such as footwear). In the triangular model, a ‘GVC lead firm’, most of which are buying firms such as retailers or brand owners in industrialised country markets (US, Japan or EU), contracts an original equipment manufacturer (OEM) supplier, most of whom are based in Asia, to fill an order based on a design supplied by the lead firm. Shares of the overall order are allocated to several CMP (cut-make-package) operations, usually in different countries, by the OEM producer, which may own some or all of the CMP operations. In GVCs led by Japanese buying companies, the lead firm generally undertakes its own OEM activities, and may also undertake some or all CMP activities.⁶⁸ The OEM sources fabric and all other inputs, usually in China or elsewhere in Asia, and supplies these to the CMP operations. The latter assemble the products and ship them direct to the final customer, which is the lead firm where the order originated. The CMP firms receive payment direct from the OEM contractor for the assembly of the product, but – importantly for Myanmar – this payment does not generally include the cost of the material inputs to be assembled, which are usually imported to the CMP’s economy. The OEM retains title to the inputs and its payment to the CMP firm comprises only the latter’s domestic overhead costs, plus its value added, comprising wages plus a very small profit margin, over which even independent CMP firms have very little bargaining power. Where the CMP operations are subsidiaries of OEMs, as in the case of most Chinese-owned CMP garment firms in Myanmar, they have very limited independent decision-making scope, whether to increase turnover (and concomitantly value added within Myanmar) by seeking orders, to raise margins or to expand their activities beyond CMP. Indeed, one of our interviewees confirmed that the Myanmar managers of Asian OEMs (Japanese and Korean as well as Chinese) had ‘no idea’ of the value of the OEM firm’s orders from its own customers, with the Myanmar operation’s working capital restricted to its responsibility for paying wages and local overheads (all in local currency). Even independently-owned CMP firms are to a considerable extent ‘captive’ suppliers of the OEMs that provide their market. OEM firms are themselves tied to their lead firm customers, though a single OEM is likely to supply more than one lead firm.

⁶⁶ The MGMA is part of UMFCCI, and remains government-linked, though increasingly independent. Its limited associational capacities are illustrated by the recent emergence of several smaller more localised groupings to address labour-management conflicts in the industry.

⁶⁷ All exporters pay a 2% advance income tax. This was lowered from 10% in 2011, partly to offset the strong appreciation of the exchange rate at that time.

⁶⁸ This difference in organisational strategy and risk management – ‘externalisation’ of OEM by the US and EU lead firms, versus ‘internalisation’ by Japanese and Korean lead firms – has implications for formal FDI data, as the latter are likely to involve much larger cross-border investment than the former.

The links amongst firms within the GVCs underline both the centrality of foreign firms for the expansion in developing countries of sectors dominated by buyer-led GVCs, such as garments and footwear, as well as the interdependence of production location and market choices by firms operating within a single GVC. Firms' choices are not made independently of each other, least of all by CMP suppliers, but nor by lead firms or OEMs.⁶⁹ A lead firm is unlikely to enter a new country unless it has persuaded (or pressured) its OEMs to enter as well. In interviews in Yangon, both European lead firms and Chinese CMP producers confirmed that their own initial entry decision was 'joint' in this sense between the two types of firm.

Lead firms need to consider concerns of their own customers, so that irrespective of whether they or 'their' OEM own an operation or not, they need to be sure that any operation which is new within their value chain meets social and environmental standards in their own markets, as well as quality standards. For this reason, EU and US lead firms (which do not undertake OEM activities themselves) set up small offices in new countries with (mostly expat) staff who work with new supplying operations of OEM suppliers, who themselves may be investors setting up the new operations as (internalised) subsidiaries which they own, or may sub-contract independent producers already operating within the new location. Through monitoring and training, the expat staff regulate the local CMP producers in their value chain, both those owned by OEMs and independents. This standard pattern is already evident in Myanmar, followed for example by The Gap and by European lead firms we interviewed. The Gap is working in Myanmar with two Korean firms with whom they have worked for 'many years', though it is not clear whether the Korean OEMs themselves entered Myanmar only when The Gap decided to source from Myanmar or whether they were already operating in Myanmar before that (The Gap, 2014). Another EU-based lead firm, H&M, which recently began to source in Myanmar had 12 staff in-country working with 13 suppliers when we interviewed them in early 2016. All the suppliers were affiliates of Chinese firms with whom H&M has been working for five to ten years, and whose entry into Myanmar was part of a joint decision with the lead firm. Today (early 2017), H&M has 37 suppliers in Myanmar, indicative of the growth potential of the sector. Interestingly, while the initial decision to enter the Myanmar market was jointly taken by the lead firm and its suppliers, subsequent expansion into the Myanmar market was a spontaneous choice by the OEMs, many of which expanded their operations in the country.⁷⁰ Though changing production cost conditions in China were probably part of the reason for the shift of activity of both the lead firm and its Chinese suppliers from their original location in China, the EU's restoration of GSP was certainly a major contributing factor to their entry into Myanmar rather than elsewhere in China or into another low-income country. With the US GSP preferences now also restored, further entry of US firms (with Chinese suppliers) in addition to The Gap can be expected.

But new entries into Myanmar by multinational lead firms and their Chinese (or other foreign) suppliers are possible because the industry in Myanmar already has some fundamental capabilities. Thus, it is useful to trace briefly the historical trajectory of Myanmar's garment sector.⁷¹ Garment sectors in poor countries generally start with CMP activity which, as discussed, is closely linked to foreign firms' presence. Some firms in the domestic economy may later graduate to OEM; that is, they may develop the capabilities and market linkages to obtain orders and to source raw materials, as well as to access credit and foreign exchange necessary to finance OEM activity. With these capabilities as well as an entrepreneurial appetite for risk, they are able to begin OEM via their own CMP operations as well as sub-contracting other CMP producers. Later, some of these OEM firms may 'graduate' further into OBM (own brand manufacturer). As in other low income countries such as Bangladesh or Lesotho, the sector's expansion in Myanmar since the early 1990s, shortly after the military takeover, has been tightly linked with foreign investment and foreign management more generally, mostly driven by Asian OEMs who began to establish their own CMP operations in the country from that time. During the 1990s, and before US sanctions were imposed in 2003, the sector became a significant exporter, as seen above. One key foreign entry was that of

⁶⁹ Decisions by firms operating interdependently within a single GVC are also of course impacted by the unequal distribution of power within the GVC. See Gereffi et al (2005).

⁷⁰ The lead firm has stated that they intend to work more with domestic producers and have no intention of actively promoting entry of new foreign OEMs.

⁷¹ This account relies heavily on the work of Kudo, especially Kudo (2013).

Daewoo, the Korean firm, which created a JV with UMEHL (United Myanmar Economic Holdings Limited), one of the two firms set up by Myanmar's military at that time to undertake economic activity, light manufacturing in the case of UMEHL. The Daewoo/UMEHL JV set up in 1990 became a significant exporter to the US as well as Japan – its exports to Japan in 2007 alone accounted for about 8% of Myanmar's garment exports for the year (Kudo, 2013). Even more important was that many of Daewoo's expatriate staff left the firm, especially after its partial collapse and restructuring in the wake of the 1997 Asian crisis, and set up their own garment firms in Myanmar.^{72 73} After 1995, foreign OEM firms invested from Hong Kong and elsewhere in Asia, while Taiwanese OEM firms established linkages with domestic firms in which the Taiwanese supplied finance, machinery and managers, and procured orders and inputs.⁷⁴ It is unclear why the Taiwanese OEMs did not take formal equity ownership positions in their Myanmar associate firms. But this practice continued for many years – one Chinese-owned firm that we interviewed began in Myanmar in much this way in 2004, with loan finance and equipment from a Taiwanese backer who had been the employer of one of the Chinese partners.

Apparently most Myanmar producers, even those apparently locally-owned, continued to have foreign management influence and possibly ownership, even if this was not always visible: about 80% of firms were foreign-owned or managed according to a veteran Korean manager in the Myanmar industry interviewed in 2006 (Kudo 2012), while the MGMA vice chair suggested in 2013 that only 20% of all garment manufactures in Myanmar were 'really' locally owned, implying 80% had formal or informal foreign ownership (CBI 2013). This implies that actual equity ownership by foreign firms was not the norm: in his survey in 2006, Kudo identified 45 foreign-affiliated firms, equivalent to only 31% of the 145 firms in his sample (the sample in turn comprising 90% of the 165 firms then operating in Myanmar according to the MGMA). Of the 45 foreign firms identified by Kudo, 17 were from Korea, 13 from Hong Kong, three each from Singapore and Thailand and two from Japan. There were at that time no firms directly from China (PRC), though it is quite possible that some of the foreign firms were in fact Chinese firms entering via third countries. Interestingly, no firms identified themselves as Taiwanese either, notwithstanding Kudo's own argument about the latter's significant influence – through non-equity links – in the sector's development (Kudo, 2013).

Foreign-linked firms have dominated exports, not surprisingly: in 2007, one third of Myanmar's garment exports went to Japan, and a detailed analysis showed that 95% of these exports were provided by firms with foreign linkages (Kudo 2012), and that exporting was highly concentrated: 10 biggest exporters supplied 80% of the exports to Japan (Kudo 2013). The decline in garment exports in the wake of US import sanctions in 2003 led to many firm closures, but it is unclear how many of these were foreign withdrawals. In 2012, estimates based on MGMA data suggested that 84% of exports from 'very large' firms (over 900 workers) came from 17 firms with (known) foreign equity involvement, including nine wholly-owned foreign subsidiaries (which supplied 42% of exports), seven JVs with private Myanmar partners (supplying 26% of exports), and the Daewoo/UMEHL JV supplying 16% of exports (Pyoe Pin, 2012). The remaining 16% of exports were supplied by seven very large local Myanmar firms. The latter group may well have had hidden foreign ownership or influence, along the lines of the Taiwanese presence just discussed. In addition, according to Pyoe Pin (2012), there were then 100 registered firms in the MGMA with between 100 and 900 workers, who were apparently not exporting (though their ownership status as foreign or local is not spelled out). This picture of the industry's structure is suggestive of Myanmar's potential for OEM at that time, a few years ago. That the majority of existing CMP exporters in Myanmar were *already* affiliated with 'parent' Asian OEM firms (who may or may not have been formal

⁷² Daewoo is also the firm that was crucial in supplying the skills enabling its Bangladeshi employees to set up garment firms that became the core of the industry in that country, although that process occurred in the 1970s.

⁷³ According to Kudo (2013), in the early 1990s (soon after the establishment of the military government) and notwithstanding the apparent liberalisation of foreign investment in 1988, only JVs with state or military companies were possible in practice. Thus a group of Hong Kong firms established JVs with MTI (Myanmar Textile Industry, a state-owned enterprise) in the early 1990s. The *de facto* investment regime opened up by 1995 to allow independent entry to garment firms, so the MTI-linked JVs were all dissolved by 2005, though it is possible that they left a legacy of production management skills through managers who stayed in Myanmar moving to other garment producers.

⁷⁴ At this time in the late 1990s, Asian OEM firms were looking globally for 'quota' under the Multi Fibre Agreement, and CMP production was highly valued in countries such as Myanmar and Lesotho, which had unfilled export access to developed country markets. Diversification of production locations was also driven by risk management strategies.

equity owners) implies that Myanmar-based CMP exporters would be very unlikely to become independent OEMs themselves, though it is important to point out that some of their (skilled) employees might be able to do this by setting up their own firms.

Some recent Chinese entrants into the garment sector are affiliates of foreign-based OEM firms. Indeed, this foreign base is crucial for the profitability of the Myanmar affiliate, according to one of our informants, who claimed that '75-80%' of Chinese firms' Myanmar-linked profit is from trading activities related to input sourcing, since the firms obtain not only preferential prices on all inputs from China but also a VAT rebate in China on fabric sourced there. Even if the claim is exaggerated, the implication is that assembly activity in Myanmar is in fact not highly profitable *per se*. According to observers, profitability in Myanmar is below that in Bangladesh, even though foreign-owned CMPs price below what they would in their home country. Preferential market access in the EU, and now also the US, through GSP status is crucial to firms' viability, particularly because lead times are lengthened by the absence of local inputs (CBI, 2013).⁷⁵

The garment firms interviewed, including a small number of firms which are not Chinese, reported that no employees in Myanmar had quit to set up independent firms, a crucial mechanism in the evolution of the industry elsewhere. One or two interviewees did suggest that domestically-owned CMP producers were sometimes sub-contracted by foreign CMPs already in Myanmar, when the latter had capacity constraints and had difficulty in meeting delivery schedules. But this reinforces the lack of (international) market linkages of the Myanmar CMP firms.

The role of domestic owners in the garment industry's origins may have been primarily to provide what might be labelled 'regulatory resources' and access to factor markets, that is, to enable foreign firms to overcome obstacles to entry into, and operation in, Myanmar, and to facilitate access to labour, land and the banking system, which would have been essential to convert foreign currency export earnings. UMEHL and MTI (the state-owned enterprise) were self-evidently able to provide these resources as distinct from production expertise, and other local business partners possibly offered similar benefits. According to Kudo (2013), many local firms started in the 1990s because their owners – through mechanisms unknown – had acquired land holdings in designated industrial areas, on which they were later required to build factories or to lose the asset. The garment sector both offered factories that were relatively cheap to construct and a ready supply of potential foreign operating partners. After the MGMA was set up in 2002, Myanmar partners could perhaps play a useful role in managing administrative interactions with government through this official body, whose board consists only of Myanmar citizens.

This brief historical background underlines three points which remain relevant today for the expansion of the Myanmar sector. First, the garment sector has not been immune from the practices which contributed to early accumulation by 'cronies' in other sectors in Myanmar. In garments these practices were reflected first in the presence of UMEHL (and MTI) in the garment sector itself, and secondly in the leverage provided to smaller beneficiaries by the government, in the form of (industrial) land concessions which enabled these individuals to enter the industry, by making them attractive as JV partners for foreign companies or 'fronting' for foreign individuals, and by allowing them to access capital and foreign exchange. Second, the line between local and foreign firms is heavily blurred so that simply looking at formal equity ownership and FDI approvals is not sufficient to understand the role of foreign companies. And third, the production location decisions are interdependent across the value chain and this has been the case throughout the sector's development in Myanmar, as elsewhere, so that the entry of Myanmar garment firms into OEM will depend in large measure on the decisions and interventions of foreign firms.

What appears as a perverse policy incentive, the confusing CMP-FOB distinction where the tax exemption appears to be provided to the 'wrong' group, that is, provided to CMP producers rather than to FOB, can be better understood once it is put into historical perspective and its origins understood.⁷⁶ The triangular model in the garment industry described above is evidently very trade-intensive, on both import and export

⁷⁵ Although one Yangon-based US lawyer suggested the impact on Myanmar's garment exports to the US would be minimal (Consult Myanmar, 2016a).

⁷⁶ This paragraph draws on Kudo's (2005, 2012) invaluable work on the historical emergence of the garment industry in Myanmar.

sides, and therefore trade finance is crucial. OEM firms must not only have international business linkages to obtain orders and source inputs, but they must also have access to foreign exchange to finance input purchases which they provide to sub-contractors, in effect financing part of the latter's working capital. The origins of the CMP-FOB distinction lie in the era of extreme forex shortages in Myanmar, also characterised by a very wide gap between official and unofficial exchange rates. The distinction in the garment sector was a mechanism to ration foreign exchange within Myanmar to the benefit of others in Myanmar seeking access to scarce foreign exchange. The CMP-FOB was not intended to address the capabilities and market activities of Myanmar garment producers, but in fact to limit their demand for forex to purchase inputs abroad while at the same time enabling them to export and earn scarce forex for the country. Declaring their export earnings at the official rate for export tax purposes would also enable the CMP producers to benefit from the gap between official and 'black' exchange rates.⁷⁷ In effect by providing 'free' fabric and other inputs to Myanmar CMP producers, the OEMs were supplementing the economy's forex supply and enabling the garment sector to be a net provider of forex to the country, while also economising on the CMP producers' working capital needs, since companies also were required to hold the equivalent of their import value on deposit (Pyoe Pin, 2102).⁷⁸ FOB producers in contrast would need access to foreign exchange for imports, and would have to channel most of their earnings back through the domestic banking system, and would have to operate their trade in both directions at the official exchange rate. The CMP registration system and the import tax rebate, together with export taxes, the Myanmar affiliates of foreign OEMs were forced to pay some taxes in Myanmar and to channel small amounts of forex through the Myanmar banking system. These additional costs were minor however, and the foreign exchange restrictions and exchange rate disparity were not a big problem for OEM networks based outside Myanmar. But the forex restrictions and exchange rate 'gap' almost entirely ruled out Myanmar-based OEMs. The CMP-FOB distinction has become archaic and redundant as the forex restrictions have been relaxed and the exchange rate gap has disappeared since 2012. Myanmar no longer faces a tight forex constraint, so that nobody benefits now from the garment sector distinction. But even though most individual garment producers manage their business so that they do not pay higher costs resulting from the distinction, the garment sector overall pays a cost in the sense that the distinction hampers the potential for expansion of OEM activity. With the shifting priority to employment creation and export promotion, the CMP-FOB should be scrapped immediately. But this discussion also underlines that, as MGMA (2016) and others argue, scrapping the CMP-FOB distinction is not sufficient to enable OEM activity in Myanmar: what is also needed is liberalisation and deregulation of credit and foreign exchange access in Myanmar, as well as modernisation of the procedures in the credit and forex markets to lower transaction costs.

(ii) Tourism: As discussed above, Myanmar's international leisure tourist market has grown rapidly since 2011, reflected in an annual growth rate of 'air/sea' arrivals into Myanmar of 33% (mainly at Yangon airport), driven by political liberalisation.⁷⁹ Strong market growth is expected to continue, with planned international arrivals to double between 2016 and 2020 by the government's Tourism Master Plan (MHT, 2013). Growth hotel development in Myanmar has been very rapid: in 2010, the MHT reported 23,454 rooms in 'hotels, motels and guesthouses'⁸⁰ in the country, in 691 establishments, of which 7,658 rooms were in Yangon in 181 establishments. In 2015, these figures had about doubled, with 49,946 rooms in 1,279 establishments nationally, of which 15,424 were in Yangon in 324 establishments.⁸¹

Foreign involvement in the hotel sector has grown rapidly through the period, though this is not fully apparent in the official Myanmar Tourism Statistics (MHT, various years). In 2010, there were 31 existing foreign invested hotels, and 5 under construction, and by 2015, this had risen only to 34 foreign invested hotels, with another 11 under construction and 3 more MIC-approved. Singapore topped the list of home

⁷⁷ Typically, the regulations also provided opportunities for rent-seeking by allowing limited access to forex for equipment imports, including vehicles, which ostensibly for use in the business, were generally sold on at highly inflated prices.

⁷⁸ It is not known if this requirement is still in place.

⁷⁹ As well as specific events such as Myanmar's hosting of the South East Asian games in 2013, which created a need to increase the number of hotel rooms by 7%.

⁸⁰ The data does not distinguish between these categories. Officially, only registered hotels can accept foreigners.

⁸¹ Accommodation in Mandalay also doubled: in 2010, 3,035 rooms in 72 establishments; in 2015, 6,788 rooms in 168 establishments.

country investors with \$600m invested in the sector, with Hong Kong fourth with \$77m. However, foreign involvement in the international hotel industry often (indeed usually) involves not direct investment by international corporations, but management contracts to brand and operate hotels owned by other investors, who are often local. Most international hotel brands have entered Myanmar in this fashion, including Accor (Novotel brand), Melia, Kempinski, Daewoo, Shangri-La, Best Western, Pullman and Hilton. Hotel construction in Naypyidaw appears to have been largely locally financed by conglomerate businesses with close links to government officials. These firms have a significant stake⁸² in the ongoing expansion of upmarket tourist hotels in Yangon, which is expected to continue as 5,000 new rooms in upmarket hotels are brought onstream between 2016 and 2018 (JLL, 2016).

Based on public information, there is Chinese involvement in only two major hotels.⁸³ The first is Wyndham Hotels, the very large US group (owning Ramada, Days Inn, Howard Johnson and other brands) that entered in 2015 to establish a hotel in the Kantharyar Centre at Kandawgyi Lake in Yangon. This was in partnership with a local property consortium (AMCD), which provided the land, and with Shining Star Investment, a Chinese hotel investor originating in Kunming, Yunnan Province but now operating out of Hong Kong (www.sinyaoo.com), which presumably provided the finance. Secondly, it was reported in 2013 that a joint venture of Chinese and British Virgin Islands companies (the latter almost certainly also Chinese) had received MIC approval to build a hotel and serviced apartment complex in Yangon, though this project's implementation remains unconfirmed.

In looking at the Chinese presence in the tourism sector, we need to distinguish between on the one hand formal large-scale FDI where there appears to be limited Chinese presence, and on the other hand small and often informal firms owned and/or run by Chinese nationals who have migrated to Myanmar, or by Myanmar citizens of Chinese ethnic origin (part of the Chinese diaspora), where there appears to be substantial activity, linked to the large number of Chinese visitors in Myanmar. The seven firms in this sector interviewed for this study are all small and owned either by Burmese nationals who are ethnic Chinese, or by long-term Chinese immigrants, so that they cannot be considered FDI in the conventional sense. In interviews with these firms and with expert informants, reference was made to 'dozens' of small 'tour operators' focusing on the Chinese visitor market, and to 'many' low-end motels run by Chinese entrepreneurs and catering primarily to Chinese visitors, who prefer to purchase food, accommodation and local transport from (ethnic) Chinese providers, according to several interviewees.

The claims of a substantial informal Chinese presence in the supply of low-cost tourist services is supported by arrival data showing a significant Chinese visitor market, which almost certainly spends a small amount *per capita* – nearly 150,000 air arrivals in 2015, 11.4% of the total, and more than treble the 2010 figure (MHT, various years), as well as an indeterminate number entering over land (see discussion above). The Myanmar government has made efforts to promote the country as a destination for both Chinese leisure tourists and for hotel investors, including advertising on Chinese TV, participating in travel expos and official policy dialogues, and bringing Chinese travel agencies to Myanmar on 'look-see' visits. (Qin Zhongwei 2013; Maw 2013; Anon 2014). However, only 123 of 5,630 licensed tour guides in 2015 in Myanmar were Chinese-speaking (MHT, various years). The distribution of Chinese visitors between leisure and business motivations is unknown, but is probably skewed towards the latter: tourism industry experts talked of 'many thousands' of travellers entering over land for 'informal trade', and often travelling as far as Mandalay, more than a day's journey from the border, indicating there is demand for accommodation and other services. This could change: one Chinese informant claimed to have signed a contract with a Chinese travel agency to organise tours for 10,000 Chinese visitors through 2016. Market information in this segment of the tourism market flows freely via Chinese social media such as WeChat, on which service providers rely for advertising, but which they also use to provide information on business opportunities in Myanmar as well as on personal security risks facing Chinese individuals. The Chinese

⁸² They include Zaykabar, whose chair is patron of Myanmar Hoteliers Association (part of the Myanmar Tourism Federation set up by the Ministry in 2012 as the umbrella association in the industry with regulatory powers over private firms) The MHA is part of the Myanmar Tourism Federation set up by the Ministry in 2012 as an umbrella association with regulatory powers over private firms) as well as Dagon International, Yuzana, Htoo Group and Max Myanmar. The Spanish chain Melia's Yangon hotel is Vietnam-financed.

⁸³ There were reports that a Chinese investor, Toener, was involved in the Golden City development involving the Uni Global Power company of Singapore and Marriott Hotels, but this was strongly denied by Uni Global (Consult Myanmar, 2016b).

tourism firms are truly entrepreneurial and innovative, often engaging in multiple activities, such as combining tour operating with property broking and development, or with gemstone trading.

In sum, the tourism sector has not been a major focus for Chinese investment until now, but there is considerable potential, especially if the Chinese leisure tourism market can be grown. This will depend partly on the development of a more benign image of China amongst the Myanmar population.

(iii) Construction: As with the tourism sector, in looking at foreign investment in construction and infrastructure and the Chinese presence in particular, we should distinguish between formal large-scale FDI undertaking large infrastructure projects as well as major residential and commercial projects, on one hand, and on the other, medium-size but often informal firms owned and/or run by Chinese migrants or members of the Chinese diaspora, doing smaller commercial or residential projects.

The largest construction projects naturally involve infrastructure expansion. Infrastructure upgrading and expansion supported by these big projects are a prerequisite for economic transformation, even if they do not reflect transformation in their own structure, being generally capital intensive and not focused on enterprise development through backward linkages in their own supply chains. But their key impact is in their forward linkages, that is through provision of higher quality and lower cost infrastructure services to a wider network. In this sense, they reflect a policy dilemma in that they often incur social costs and contribute to environmental damage and political instability, but at the same time enable other enterprises and producers to raise their productivity, so contributing to job creation and poverty reduction, though these benefits are not inevitable.

As the aggregate FDI data above shows, Chinese firms have been at the forefront, and as is also very well known, have been involved in some of the largest and most controversial infrastructure projects in Myanmar, particularly in dams for hydroelectricity generation. This is not the place to explore this issue, but it is important for a comprehensive understanding of the Chinese FDI presence in the sector and in the Myanmar economy, to note that the Chinese SOE CPIC (now SPIC) not only undertook the Myitsone Dam, suspended by then-President Thein Sein in September 2011, but also was in various stages of development of another seven dam projects. Furthermore, at least three other Chinese construction SOEs and four engineering companies have been involved in six other dam projects (PWC, 2013).⁸⁴ Since many of these are 40-year BOT projects for which construction has been started and in some cases completed, the substantial Chinese presence in hydropower will remain for the long term.⁸⁵ In September 2016 it was reported that the Myanmar Ministry of Electricity and Energy was reviewing 49 hydro projects approved by the previous government, of which 31 were Chinese investments involving as many as 11 Chinese companies (Myint and Slodkowski, 2016).⁸⁶ ⁸⁷ Of the 49 projects, 12 were to be financed from domestic sources, but the rest require FDI, and new Chinese FDI into Myanmar hydro will require some agreement on Myitsone.

Chinese firms have dominated hydropower construction since 2000: in one listing of 24 operating hydropower stations in Myanmar, only 4 were identified as being operated by Chinese firms (the majority are operated by the Ministry), but each of the 21 commissioned since 2000 had Chinese suppliers for transmission and generation equipment, and/or for EPC (engineering, procurement and construction) services (www.industcards.com, 2015). Chinese electrical equipment suppliers have also been critical, for example the Chinese subsidiary of Japanese corporation Toshiba won the contract in March 2015 to supply generation and turbine equipment to the 308 MW Upper Yeywa Dam being constructed by Zhejiang

⁸⁴ Swiss, German and British engineering companies are also mentioned by PWC (2013).

⁸⁵ The Burma Rivers Network lists 27 Chinese SOEs as investors in Myanmar hydropower projects (<http://www.burmariversnetwork.org>).

⁸⁶ In December 2015, the Ministry of Electrical Power (as then called) had identified 46 hydro projects of which only 7 were at the implementation (construction) phase, the rest being at earlier stages of development and hence easier or cheaper to halt or revise (MOEP, 2015).

⁸⁷ This is a separate exercise from the State Commission established in August 2016 to review dam construction on the Irrawaddy River, the former being concerned to address issues relating to Myanmar's energy supply, and the latter concerned with political, social and environmental issues.

Orient Engineering for the energy ministry (Consult Myanmar 2015), while China State Grid Corporation has exported equipment to the Chinese-built hydropower projects. Chinese firms are also involved in energy projects other than hydropower, for example UREC (Union Resources and Engineering Company) started to build a 500 MW gas-fired plant in May 2016 which will supply electricity to Yangon and the Thilawa SEZ from mid-2018.⁸⁸ Datang and China State Grid, which have both had some involvement in hydropower projects, indicated in interviews that they are now actively involved in other generation and transmission projects in Myanmar (including extending the grid), while awaiting developments in the hydropower sector.

Chinese firms are also heavily involved in transport infrastructure development. The China National Petroleum Corporation (CNPC)-led oil and gas pipeline between Kyaukphyu in Myanmar and Kunming in Yunnan province is also a controversial project. But it is noteworthy that (as with many Chinese-led infrastructure projects) the pipeline's construction had started in November 2009, and continued notwithstanding the Myitsone suspension two years later, with gas transport beginning in July 2013 and oil in February 2015.⁸⁹ The gas pipeline was constructed by CNPC with Indian and Korean companies but the oil pipe was, perhaps significantly, built by CNPC alone. China Harbour Engineering (CHEC) was part of the winning consortium for Yangon airport awarded in 2013, having been involved in the development of Naypyidaw Airport in 2009. CHEC is also part of the consortium comprising five Chinese and one Thai company led by the Chinese SOE CITIC which won the contract in December 2015 to develop the Kyaukphyu SEZ and port, a project that has also met much public opposition. The China Road and Bridge Company won a tender in July 2016 to build two sections of road in the Greater Mekong Subregion, the first project awarded by the Myanmar government to a Chinese company since the NLD took power in April 2016. The road is to be financed by the Asian Development Bank (www.chinadaily.com.cn, 8 July 2016). Finally, Chinese telecoms equipment firms ZTE and Huawei, neither an SOE, are both prominent in Myanmar, supplying hardware and services to the three mobile network operators.

All these projects also require local investors,⁹⁰ which means that foreign firms enter JVs inevitably with 'the large family-owned diversified conglomerates' that dominate the construction sector (OBG, 2014). Construction activity was crucial to the creation of the conglomerates, as these families used their links with military leaders as leverage in getting projects during two construction booms. The first was during the 1990s and the second when Naypyidaw was built after 2002, on the basis of private financing of public buildings in exchange for concessions and licences in other activities. A third boom is underway, fuelled by post-2011 liberalisation and the influx of foreign capital to the country, which has driven up demand for high-rise upmarket buildings to accommodate foreign companies and their expatriate employees, and their consumer service needs. Several of the upmarket hotels mentioned in the previous section are located in new residential and shopping complexes, each involving (claimed) investment of hundreds of millions of dollars, and collectively representing a major increase in the value of FDI inflows into Myanmar. Yangon is a very fast growing property market, with rental rates now third highest in the world. A new Condominium Law was passed in early 2016 allowing foreigners to purchase apartments under certain restrictions, and this may raise building standards and will certainly stimulate increased supply of residential construction in this market segment.

The family-owned conglomerates have been major beneficiaries of the current property boom, their incumbent positions in the construction sector and urban land market (and foreign investment regulations requiring JVs with local partners) providing them with new sources of economic rent. An unsystematic examination of the boom suggests that it is being driven by foreign finance from Asia together with foreign construction service providers (planning, engineering, architecture, design) from high-income locations, including Singapore and Hong Kong as well as OECD countries. The latter are playing a central role in the face of Myanmar's serious skills shortages: there are only 260 engineers able to supervise high rise construction, for example (OBG, 2016).

⁸⁸ Formed by a merger of two Yunnan companies in 2009, UREC itself reports its involvement in 22 hydropower projects in Myanmar, including the Panglaung and Shweli projects, the latter being the first Chinese BOT contract in Myanmar, with a 40 year contract (www.urec.com.cn).

⁸⁹ The pipeline was approved in China in April 2007, and agreed with Myanmar in November 2008.

⁹⁰ Construction of the Kyaukphyu SEZ is an exception, as SEZ's are regulated by the SEZ Law.

Private Chinese companies are involved in the boom, too, both as property developers in partnership with local conglomerates, and as construction contractors. The \$110m Kantharyar Centre development by Shining Star Investments has already been mentioned above, and involves apartment blocks and shopping centres as well as the Wyndham Hotel. Toener Investments is a Hunan-based corporation developing two upmarket residential/shopping complexes in Yangon, Kanbae Towers and Riverfront Gardens.⁹¹ The \$300 million Dagon City complex involving Marga Landmark, a Hong Kong firm, was forced to shift its location further from the Shwedagon Pagoda for heritage reasons. The China State Construction Engineering Corporation, an SOE, is building another major complex at the Polo Club, also to include a hotel, and where the land is owned by the Myanmar Economic Corporation, which like UMEHL is a military-controlled conglomerate. Smaller Chinese firms are also involved as subcontractors, such as a foundation engineering firm interviewed for this study, which is working with Shining Star Investments, and suggested that their advantage lay in ‘asset specific technology’, meaning their ability as a Chinese firm to work with Chinese architects and construction engineers.

Large upmarket residential/commercial complexes do have positive effects for economic transformation in their construction, and to a lesser extent in their use once complete, in the sense that they offer large numbers of jobs (though probably far fewer than export-oriented light manufacturing) for low-skill, low-wage workers, whose productivity is higher in these activities than in household agriculture or informal urban services, which might be their next best alternative occupation. However, expansion of low-cost and affordable housing⁹² offers an even more directly transformational activity within the construction sector, for which there is already very substantial need but which is certain to increase even more rapidly to the extent that economic transformation such as garment sector growth, is successful. Even without successful transformation, there is a dire need for improved urban housing: estimates suggest an annual influx of 300,000 people into Yangon in the next decade. Not surprisingly, ‘affordable’ housing delivery up to 2010 was insignificant, with only 55,000 units built in the preceding 20 years. The issue continued to have low priority for the USDP civilian government, reflecting the limited political weight of the urban poor and working class – in 2013, the national government targeted building 100,000 units at a cost of less than \$25,000 each, but only 23,000 units were planned for the 2013-15 period, while at the beginning of 2015 the Yangon region announced plans for 18,000 new units over two years. All these numbers are well below needs, while the price per unit of those actually delivered are extremely high at \$50,000-60,000 per apartment. This underlines again the trade off between rents to the construction sector and the needs of transformation. The new NLD government has promised to build 180,000 affordable housing units in an unspecified time frame.⁹³

Very little direct information on low cost and affordable housing construction is available, but it would appear that family-owned, diversified conglomerates dominate here too: a recent tender for 15,000 units was awarded to one such firm, but other bidders identified publicly of a similar sort (Tun, 2016). Tender regulations appear to favour large firms and therefore the conglomerates: bidders have to put up the money in advance, and are paid tardily by government, so that working capital demands are very high, while ‘secondary trade’ in construction permits is common, raising costs and lowering quality of the final product (Consult Myanmar, 2016c).

There have been repeated promises, most recently in mid 2016 from the government that it will take the apparently obvious step of allowing foreign firms to enter the low-cost and affordable housing market, from which they are currently barred (Consult Myanmar, 2016c). Reports in both mid 2013 and mid 2015 suggested this step would happen at those dates, without action being forthcoming on either occasion, but the NLD government may implement the policy. In fact, many small private Chinese construction firms appear to already be operating informally in Yangon and the rest of the country. Informants referred to a loosely organised association of 100 small and medium (ethnic) Chinese construction firms and property

⁹¹ It has also been identified in some reports as leading the Golden City development, but this appears to be wrong.

⁹² These categories appear to be distinguished in Myanmar policy.

⁹³ Though another report suggested that the Ministry of Construction (as distinct from Housing) ‘plans to build 1 million housing units across 81 cities between 2012 and 2031’.

developers in Myanmar, engaged in building projects such as low-rise apartment blocks.⁹⁴ It was argued that domestic building techniques and regulatory capability in this market segment of the construction sector, including on health and safety, were very outdated due to the lack of information flow from abroad over many decades, and that Chinese firms are already undertaking on-the-job training of locals in skilled occupations in the sector. The formalisation of foreign entry into this market segment would evidently attract a greater number of small private firms from China and perhaps elsewhere in South-East Asia and strongly expand the delivery of adequate low-income housing. The housing sector needs further investigation, and we return to this below.

Finally, we look very briefly at construction input markets, which have predictably been dominated by incumbents, the local conglomerates, but foreign firms are now entering as JV partners. A JV to produce prefabricated concrete was set up in 2013 by High Tech Concrete Technology (HTCT), a subsidiary of the Shwe Taung conglomerate, and a large Singapore cement producer, Tiong Seng. At least two Chinese firms have also entered cement production in Myanmar, Anhui Conch investing to refurbish an existing plant in Mandalay in November 2014, and the CITIC with the Thai company Siam Cement in December 2013. One of our own informants was a medium-sized steel construction material producer, which initially entered the Myanmar market via exports in 2011, following with an investment to set up a local production facility in 2014. The firm employs ethnic Chinese local managers, and several hundred local workers.

(iv) Agriculture and agro-processing: The economic transformation story in agriculture is primarily about rice. Rice is Myanmar's primary crop amounting to 43% of total agricultural production by value (FAO 2013), though the usual data caveats need to be applied even more strongly to agriculture sector data. The US Department of Agriculture argues that rice output is in fact only half the Myanmar government figure (Raitzer et al., 2015). This implies that, rather than being relatively high, rice yields are very low, indeed the second lowest in the south-east Asia region. Low productivity is also linked to low mechanisation rates, with only 16% of farms having land preparation machinery and only 15% threshing machinery, compared with rates of 70% and 84% respectively in Vietnam, and low irrigation rates, with only 20% of land irrigated, and 80% of rainfall coming in the monsoon season. Up to 2011, farmers were forced to grow rice, but crop choice has since been freed up.

Increased productivity across the rice value chain, growing as well as upstream and downstream segments, would have important positive impacts on growth and transformation elsewhere in the economy, given the centrality of rice in Myanmar diets, comprising '25 percent of the consumption of richer (presumably urban) households and 50 percent of the consumption of poorer households' (World Bank and LIFT 2014).⁹⁵

There are many issues that need to be addressed to raise productivity in Myanmar rice production and in its agriculture more generally.⁹⁶ Here we focus only on the presence of Chinese firms and Chinese markets in the sector. As discussed above, Myanmar's rice export trade has begun to revive as a result of deregulation of exports starting in 2003, but more significantly due to the liberalisation of the export licensing and rice transport regimes after 2009, allowing all registered traders to export, and lowering export taxes. Overland exports to China have risen rapidly to about 55% of Myanmar's total rice exports by 2014/15. This is despite the Chinese authorities' health and safety concerns, which are now regulated and subject to safety inspections under the terms of an agreement signed in early 2015. Under that agreement, the Myanmar Rice Federation (MRF) regulates exports to China in collaboration with the China Cereals, Oils and Foodstuffs Corporation SOE (COFCO), including registering local companies allowed to participate, who must meet Chinese health standards. An initial nine Myanmar companies were selected to participate in the trade, with ten more added later. The agreement on rice, like many others reached despite the supposed standoff between the two countries over hydropower dams suspension, also stands

⁹⁴ See also Consult Myanmar 2014, Illegitimate Chinese companies hog housing projects in Myanmar.

⁹⁵ The percentages probably refer to calorie intake rather than consumption expenditure on food or in total.

⁹⁶ For overviews, see Raitzer et al, 2015; World Bank and LIFT 2014; and OECD 2014b.

in contrast to the inability of the two countries to agree on how to manage the teak and other wood trade between them.

Chinese demand for imported rice from Myanmar is expected to grow in the medium term, and this would be supported by quality improvements in the value chain segments upstream and downstream of growing. A major problem has been the lack of investment in these segments, resulting in low seed quality (because farmers are forced to provide their own seeds but most do not have adequate storage for this) and in high wastage rates due to antiquated milling and processing equipment, much of which dates back to the 1960s, and results in about 15-20% quality and quantity losses during milling (World Bank and LIFT, 2014). Foreign investment has begun to enter Myanmar's rice milling industry, with a Chinese SOE CAMC Engineering establishing in early 2015 a JV to mill 200 tonnes per day in partnership with the Myanmar Rice Millers Association. Half of the mill's capacity is to be exported to China. Rice mill JVs have also been set up by Myanmar companies with French, Thai and Japanese partners, the latter involving Mitsui and MAPCO, the Myanmar Agricultural Processing Company, a State Economic Enterprise designated a Special Agricultural Development Company.⁹⁷

Chinese firms are currently attempting to establish rice seed production in Myanmar, which is more profitable than rice farming and may improve quality of rice including for export. A CAMCE subsidiary is involved in rice seed production in Myanmar, as is another (private) Chinese firm based in Yunnan, the latter in partnership with the Burmese Institute of Agricultural Science.

Perhaps the most important Chinese contribution to agricultural productivity in Myanmar has been in the form of indirect, rather than direct, investment. The Chinese EXIM bank has made a loan of \$700 million to Myanmar in three tranches, in 2013, 2015 and 2016 respectively, to provide small loans to farmers through agricultural cooperatives, intended to support working capital needs as well as mechanisation. This loan has provoked considerable political controversy in Myanmar, due to concerns over farmers' ability to repay without borrowing from informal moneylenders at usurious rates, and indeed over the government's ability to repay in the face of exchange rate depreciation. This is notwithstanding the wide recognition that credit constraints are a major reason for poor agricultural performance. The LIFT multi-donor trust fund has established a credit guarantee scheme to support farmers' access to loans and lease financing for mechanisation in partnership with Yoma Bank (a domestic bank part of a family-owned conglomerate). But at this stage the LIFT project's scale is dwarfed by the EXIM loan. Much of the farm equipment purchased through these instruments is imported from China, and produced by companies such as Dongfeng.

A second arena of Chinese investment into Myanmar agriculture, much more controversial but mentioned here for completeness, has been plantation crop promotion, mainly rubber, under the Chinese government's opium substitution programme. This began in the 1990s, but was provided with significant new resources in 2006. The entry of farmers from Yunnan province has been supported by official subsidies, tax waivers and quotas for imports back to China, financed by a national government fund but administered by provincial officials. It is argued that the push into rubber has been partly motivated by the rise in demand in China associated with the rising demand for tyres. By 2009, there were reportedly almost 200 Chinese-run plantations in Myanmar. Perspectives differ on whether this has been successful in ending opium cultivation and raising agricultural productivity (Cao Yin and Guo Anfei, 2012), or whether the entry of Chinese businesses has fuelled pre-existing political and social tensions in the areas where it has happened (Global Witness, 2015b; Kramer and Woods, 2012). One Yunnan rubber plantation firm which was interviewed but had apparently almost entirely withdrawn from Myanmar due to political instability and security risks in the region, preferring to focus on its holdings in Laos.

⁹⁷ The head of MAPCO, Chit Khine, is also the head of the MRF, and head of a large family-owned conglomerate (Eden Group).

3.1 Perceptions of the operating environment in Myanmar

We asked the Chinese firms them whether they were satisfied with their performance, that is, whether firm profitability and growth and productivity levels had met the expectations they had when they entered Myanmar. The clear majority in all sectors bar construction indicated that they were satisfied, though one firm – a furniture producer – had abandoned its plan to shift from exporting to Myanmar to begin production there. Of the 16 firms who answered the question as to whether they had plans to expand their activities in Myanmar, 14 indicated that they did have such plans. In the construction sector, the picture was much more mixed, with half of the firms (six of twelve) expressing dissatisfaction with their performance, though for at least one, the reason was linked to the political suspension of its infrastructure project.

The views about the operating environment that firms expressed during interviews are presented below. In general, the interviews confirmed widely-expressed concerns about the Myanmar operating environment, though the evidence for this consensus in many reports and interviews by private and public agencies is not repeated here.

(i) Labour: Several firms, especially in construction, referred to the impact on costs and timely delivery of job restrictions requiring them to hire a specified proportion of local employees, which they claimed had negative productivity implications. Collectively, the construction firms rated labour quality as somewhat unsatisfactory, though labour cost was more satisfactory. The views of the telecoms firms on their local employees' skill levels are relatively positive in relation to basic tasks, and optimistic about their ability to improve those skills via training and experience, as mentioned above.

Construction firms indicated that the productivity of Myanmar labour was about half that of Chinese workers. In contrast, the garment firms suggested that Myanmar shop-floor workers are only about one-third as productive as Chinese workers, while earning one-quarter of the wage, so that unit labour costs in Myanmar are lower than in China. A rise in wages could shift this equation, however, and firms are concerned that rising labour demand in the sector would raise wages. Some also mentioned the 2015 minimum wage legislation as reinforcing upward wage pressures, though it remains to be seen to what extent this legislation can or will be enforced. Many firms were reported in 2009/10 as complaining that the labour cost discount in Myanmar relative to other locations was not large enough to offset the infrastructure cost premium, though the Kyat's depreciation since then would have impacted favourably on their cost structure.

The telecommunications firms undertake extensive training of their Myanmar employees, who comprise two-thirds of their labour force, even though Chinese employees, familiar with the company's technology and systems, are still doing the more technically sophisticated tasks. Some construction firms made the same point about 'asset specificity' in justifying their use of skilled Chinese labour. Following their global practice, Huawei set up an academy in the Thanlyin University of Science and Technology in Yangon, which was reported as the 147th globally,⁹⁸ and claimed to have trained 5,000 people globally during 2015 (Anon, 2016). ZTE reportedly send local staff to China for training. Both telecoms firms expressed optimism that skills development among the Myanmar workforce would in the medium term 'graduate' from being able to install equipment to doing testing, adjustment and maintenance.

In our interviews, firms also expressed concern about very high labour turnover rates, which underlines the importance of productivity improvement by workers over time as a result of formal training and supervision in production. This applies even to low-skill workers on a garment factory floor, who cannot be easily replaced at no cost, particularly some short-term loss in productivity. As a result, employers need to accommodate increased wage demands to some extent. Furthermore, Myanmar garment workers appear to have basic underlying skills, and firms in this sector also are positive about their ability to develop specific production skills. The literacy rate is 90% amongst women, which is on a par with China and Vietnam and higher than Cambodia (65%) and Bangladesh (52%). The lingerie OBM Bogart, which has opened three factories in the country since 2013 and employs 5,000 workers, claims it started producing

⁹⁸ These are called HAINA academies (Huawei Authorized Information, Network Academy).

its technically most challenging items in Myanmar immediately after entry, and speaks very highly of the 'workmanship' of its workers, and their emphasis on product quality rather than quantity of output (Barrie, 2016). This suggests that firms are satisfied with workers whom they have trained, and this was explicitly indicated by one of our informants who noted that training in Myanmar was 'quite easy' compared to Africa where he had previously worked, with the suggestion that only one week was spent training local shop-floor workers, though this was not entirely credible. This firm brought in twenty Chinese technicians for training and supervision.

(ii) Local management and JV partners: Interviewees were not positive about the quality of local managers, and this is reinforced by other evidence. One interviewee, a non-Chinese investor operating in both the tourism and business services sectors, referred to poor decision-making and low levels of financial management and marketing skills. A telling view of local management capability is the implication of a divergence between the expatriate and local management in The Gap's two Myanmar suppliers, even though both suppliers are Korean-owned firms with which The Gap has worked for many years in other locations. Many of the Chinese firms employed expatriate or ethnic Chinese locals as managers, though unfortunately we did not explore this issue systematically. The only Myanmar manager we spoke to in the garment industry indicated that he knew of no other local managers in Chinese-owned firms in the industry. He himself has worked for many years in the Cambodia operation of his current employer, a Hong Kong-based OEM, starting on the shop floor, though he had acquired a BA degree before leaving Yangon. He himself is sometimes part of his firm's team negotiating with buyers in Hong Kong.

Firms in agriculture and in construction and property development, as well as in some aspects of tourism, are required to enter JVs with local partners. No firm was explicitly negative about this in our interviews, apparently seeing it as (part of) the cost of doing business in Myanmar. For Chinese firms, it is a familiar issue that has been a central feature of China's own development trajectory since the 1980s, and is in many ways crucial to the country's acquisition of technology and technological capabilities. Many of the SOEs and larger private firms now present in Myanmar have themselves established JVs in China as (then) junior partners with OECD country firms. As with labour skills, the Chinese firms were positive about local partners' willingness and ability to learn, while making clear that local Myanmar partners did not undertake more advanced technical tasks.⁹⁹

(iii) Quality: Firms' views diverged between garments and construction. The former were, on the whole, very satisfied, as reflected in Bogart's strategy, which echoes one expert informant's view that Myanmar is on the second tier globally in terms of garment production quality, above African countries such as Lesotho, Madagascar or Ethiopia. As a lingerie manufacturer, Bogart may also be an important example of improvement in Myanmar's quality levels, as in the past local CMP producers focused on men's clothing, which involves less frequent style changes and lower delivery pressure than women's. In fact, 90% of output is in the men's clothing category, according to the Myanmar government's export strategy (Ministry of Commerce, 2015, page 9), and an earlier assessment had suggested that Myanmar had 'failed' in women's clothing (Kudo, 2013), but this may be changing.

In contrast to garments, views of production quality in construction were less positive. As noted above, one Chinese firm interviewed expressed concerns about building safety and also about the limited capacity in the country to regulate it. This reflects the skills shortages amongst high-skill occupations, also mentioned above. On the other hand, two Chinese construction firms complained about quality standards, which imposed the use of 'western' technology rather than Chinese, including in the scoring of tenders. This raised costs, they noted, without increasing quality, and there were suggestions of a cultural barrier, which could hamper activities of smaller Chinese firms into this sector, if regulation of smaller projects increases.

⁹⁹ The local partner in the ill-fated Myitsone Dam is AsiaWorld, one of Myanmar's largest conglomerates. It was responsible there for tasks such as low-income housing construction for displaced populations, which was part of the 'CSR' activities.

(iv) Infrastructure: Chinese firms in all sectors pointed to the low quality of Myanmar infrastructure as a significant challenge in their ongoing operations, echoing views expressed in surveys and media reports by firms from other FDI source countries.

All the infrastructure firms we interviewed rated transport as unsatisfactory in all three dimensions: supply, cost and quality. Transport is also a challenge in the agriculture sector, not surprisingly, as rural transport networks are less extensive and of lower quality. Several firms in the garments and related sector mentioned transport difficulties for imports and exports, with high freight charges due to the small scale of the industry, compared with competitor countries. In his systematic survey in 2006 of garment producers, Kudo suggested that road transport from Yangon to Bangkok was quickest, but the small volumes, as well as the issues of vehicle maintenance and security risk, resulted in the cost being three times that of sea transport (Kudo, 2013). This research needs to be updated but nonetheless underlines the potential benefits of road corridor construction currently being planned.

Electricity is perhaps an even more severe problem, with frequent outages especially in the dry season.¹⁰⁰ The garment firms rated electricity quality worse than its supply or price, with several complaining of power interruptions, though these varied widely depending on precise location in and around Yangon: some talked of two or three outages per month, others of 20 outages per day. Several of the firms, across all sectors, had their own generators and regarded this as normal, which is common in developing countries and is usually factored into cost structures, but raises costs nonetheless. An earlier estimate suggested that energy contributed about 15-20% of total local costs in garments, which of course excludes material inputs, but is still startlingly high (Kudo, 2013). The garment firms also referred to the difficulties of access to quality water supplies.

An important if predictable point emerging from interviews with garment producers was that the influx of new firms into the industry in recent years has increased pressure on both infrastructure and labour costs. Transport congestion was worse than it had been. One important feature of this was the lack of adequate housing for workers close to work and the consequent need for employers to arrange passenger transport. As already discussed, lack of low cost housing is a more general challenge in Yangon.

(v) Land and rents: Several firms complained of high rents for offices and factories in and around Yangon, and a shortage of supply, as discussed above.

(vi) Finance and foreign exchange access: There are deep and well-known problems in the financial system and the foreign exchange market, which seriously hamper financial access for domestic firms and have limited access of European and US firms, but are perhaps a less crippling problem for Chinese firms. One interviewee in construction affirmed that obtaining forex via the black market is the only option, but was relatively sanguine about this. In the garment sector, the inability of Myanmar firms to access appropriate trade finance (such as back to back letters of credit) is identified as a major barrier to their entry to OEM activity, and while this is probably true, it appears not to be the most pressing constraint, in the sense that resolving this problem would not immediately lead to large numbers of these firms entering new lines of activities or accessing new markets. In agriculture, input 'wholesaling' activities, directed at the upgrading of seed usage, access to irrigation and the use of machinery via leasing by co-operatives and similar farmers' groups, have been prevented or made more difficult by forex market difficulties and the lack of depth and breadth in the domestic financial system.

Many interviewees, both foreign investors and experts, implied that Myanmar businesses had little appetite for risk so that borrowing was very low. Risk aversion may be a reflection of an entrepreneurial culture that is not vigorous, but more likely may simply reflect a general business climate which is heavily regulated and characterised by many entry barriers, and a financial system characterised by excessive controls and high costs for borrowers, both borrowing terms and transaction costs.

¹⁰⁰ Electricity supply outages are highly seasonal, and occur more often in the dry season when the hydropower plants cannot generate at full capacity because of the lack of water (ADB, 2012).

(vii) Legal and trade regulation: The majority of firms complained of difficulties and restrictions related to their entry. Chinese firms are not very different from western firms in this respect, though more recent entrants confirmed that the process had been shortened since 2012 from 6-7 months to 3-4 months.

Construction firms all had more specific concerns about the Myanmar regulatory and policy environment, including about the unpredictability of price regulation and arbitrary awards of tenders, and associated property market volatility. These concerns are common to all foreign investors, rather than being specific to Chinese firms. It is worth recalling that the joint bid for a mobile telecoms licence by ChinaMobile & Vodafone was dropped, which the two firms argued was due to the low expected return resulting from the uncertain regulatory environment as well as a lack of infrastructure (phone towers).

Several firms in the garments and related sector mentioned the difficulties posed by trade facilitation, that is, customs regulatory and administrative requirements, which are a serious problem for light manufacturing export platform activities such as garments and footwear, which are also heavily import-dependent. Like the garments sector, agricultural and agro-processing firms rely on imported inputs such as fertilisers and seeds, and these remain tightly regulated. Export procedural costs and the state monopoly in port loading adds a regulatory burden to already high transport costs, and makes Myanmar's exports considerably less competitive. For example, port processing charges for agricultural exports amount to \$8.50 per ton in Myanmar versus \$0.05 per ton in Vietnam (WB and LIFT, 2014).

3.2 Impact of Chinese firms on economic transformation in Myanmar

Combining the discussion of the aggregate data in Section 2 above with the interviews with firms, it is evident that Chinese investment has several significant impacts on economic transformation in Myanmar, and we discuss these for each of the four sectors in turn.

Table 10 below provides an initial indicative summary of these effects, though our conclusions are naturally tentative, given the small sample of firms. The rows identify a number of potential transformative impacts of inward investment, in three groups. First is the direct and short run effects in terms of increases in employment and exports. The second group is the indirect effects relating to transfer within the foreign affiliate of knowledge embodied in skills and technology. The third group is the indirect spillover impact on firms other than the foreign investor itself. Spillovers can be of two types: (i) within the firm's value chain, via backward linkages contributing to local enterprise development, or via forward linkages in the form of lowered user input costs; or (ii) through the markets in which the firms buys and sells, either via more intense competition in domestic product markets resulting from entry, with potential positive effects on productivity as firms respond, or via more intense competition in domestic labour markets resulting from increased labour demand, which by raising wages could lead to further efforts by firms to raise productivity. The second and third groups of effects are important for sustaining economic transformation over time through ongoing improvements in productivity. The table identifies positive impact to date of Chinese investment on the transformation variable with one or two '+' signs, depending on the perceived strength of the impact. The absence of any impact where one might be expected on *a priori* grounds is indicated by an 'N' (for neutral), while a minus sign ('-') indicates a channel where no impact is expected, for example, the garments sector is not likely to lower user costs downstream.

Table 10: Impact of Chinese firms on economic transformation (n = 31)

		Garments	Tourism	Construction	Agriculture	Other
Direct short-run macroeconomic impact	Employment	++	N	+	(N)	++
	Exports	++	+	-	++	N
Cross-border knowledge flows within firm	Skills transfer	+	N/+	+	++	+
	Technology transfer	N	-	++	++	+
Spillovers: within the value chain, or via product or labour markets	Upstream linkages: enterprise development	N	N	+	N	DK
	Downstream linkages: lowered user costs	-	-	++	+	DK
	Enhanced competition in product markets	-	+	+	++	+
	Enhanced competition in labour markets	++	-	+	N	N
	<i>Number of firms</i>	7	3	12	4	5

Source: ODI firm interviews, Dec 2015-Jan 2016.

Note: + = moderate positive effect; ++ = stronger positive effect; N = no effect; - = no effect likely; DK = don't know.

3.2.1 Garments

Employment shifts into manufacturing are the single most important indicator of transformation in economies where employment remains dominated by agriculture, as in Myanmar. The transformative impact is not simply higher paid and more productive work for many people, but also the creation and development of an industrial workforce that did not exist before. The garment industry provides significant numbers of jobs, and there can be little doubt that the growing Chinese presence (which is itself part of a more general move into Myanmar by global actors in the system) has been important in that. The average labour force for the seven firms interviewed (including one footwear firm selling to the domestic market) was over 900, of whom women comprised over 90%. One of our informants also reported that women comprised 70% of managers and supervisors in the industry. The dataset available to us from the MGMA (to which all firms are required to belong) suggests the total number of employees in the industry is about 196,000,¹⁰¹ or around 0.9% of the employed national labour force estimated at 21.2 million. Of these, more than 50,000 workers, roughly a quarter of the total, are employed in firms with Chinese or Hong Kong ownership, which amounts to nearly 100 firms. As already mentioned above, there is also reportedly a small group of 20 footwear exporters of Chinese or Taiwanese provenance, of which the largest has (reportedly) 10,000 workers. It is also worth emphasising that garment sector wages doubled between 2004 and 2008, and doubled again between 2008 and 2013 (the latter increase after labour strikes). While of course problematic for individual firms, especially in the short term, since wages account for about half of total costs, with material inputs excluded, in the longer run rising labour costs can stimulate a drive by firms to seek productivity increases through innovating, that is, beginning new activities and products which they themselves did not undertake previously.

But linkages and spillovers to the Myanmar economy from firms in the sector have to date been very limited beyond the direct employment and export effects. The industry relies almost entirely on imported inputs, with some firms sourcing thread and packaging in Myanmar, while a hang tag and label factory was established in 2015. Capabilities of firms have improved, reflected in some firms moving from wovens to knits, a shift which can be attributed to entry by foreign firms. As discussed, there appear to be very few Myanmar-owned and -operated firms directly undertaking export-processing activities, and informants suggested that no former employees of foreign-owned firms have set themselves up independently. This

¹⁰¹ SMART Myanmar 2015 provides an estimate (also from MGMA) of 230,000 workers in the industry, 17% higher.

had happened in the late 1990s, as we have seen, but that experience has apparently not been repeated, which was ascribed to an inability to access capital.

In the view of the Yangon-based staff of the European lead firm we interviewed, the country is ‘not yet ready’ for FOB production, the main constraints being skills, infrastructure and access to credit. They also expressed concern about the legal and regulatory environment, especially social standards and human rights, and environmental challenges, all of which are of primary concern to the customers of European (and US) retailers and therefore monitored across their supply chains.

It is perhaps too early to reach definitive conclusions about the sector’s future in Myanmar. It does appear likely that it will grow along the same lines as it is currently structured, that is through further entry of new CMP operations and growth in scale of those already present. A 2015 McKinsey analysis on the garments sector reported that 30 of 40 industry leaders placed Myanmar in their selection of the three main ‘sourcing destinations’ up to 2020, after Bangladesh and Vietnam. The recently announced entry by Korean firm Panko (discussed above) seems to reinforce this point. The question is whether the sector can expand not only ‘extensively’, that is along the same lines as currently, but also ‘intensively’, expanding the scope of existing operations to new segments and activities upstream or downstream in the value chain, which would contribute to the emergence of an ‘ecosystem’ for the sector in Myanmar. Significantly, Panko plans possible input production in Myanmar. It is also interesting that Myanmar has a very small upmarket indigenous fashion design sub-sector, which is slowly developing international linkages and presence of its own, based on the ‘fusion’ of local fabric and traditional dress with European style. At this point, it seems to operate completely independently of the foreign-owned CMP sector, but its potential significance is not necessarily whether it actively links up with the latter, but rather in the fact that it suggests design and marketing capabilities do exist in Myanmar (which is not the case in some other garment CMP hubs globally), implying perhaps that there is potential for more such capabilities to be developed and harnessed to larger-scale production.

3.2.2 Tourism

Like garments, tourism is an export activity, but the actual export earnings to the host country are somewhat limited in the case of tourism because destinations are concentrated and leakages of revenue to foreign service providers such as airlines and hotels are very high, perhaps as high as 70-80%. In the tourism sector, the most important direct impact of Chinese investment appears to be through providing an export market for Myanmar through the relatively large and growing flow of visitors from China. Much of this flow of visitors (though it is unclear how much) supports trade and investment between China and Myanmar. It is not clear how much the small informal Chinese firms’ hotel and tour operating activities are currently contributing to employment and skills development in Myanmar.¹⁰²

At the top end of the market, Western chains are operating hotels, a few of which have been financed and/or constructed by Chinese companies, and increases in employment and especially skills are hard to attribute in any simple way to Chinese entry. The impacts on economic transformation are very similar to those in garments. The large Myanmar-owned, Western-managed hotel that we interviewed provides 500 low- and semi-skilled direct jobs with associated training and skills transfer, while higher-skill jobs are filled by Myanmar returnees or by foreigners. Goods to be used in the hotel are almost entirely imported, while services are internalised by the hotel rather than outsourced to local firms. This was argued as due to the poor quality and high prices of Myanmar products, but it should be noted that this is fairly standard practice in most locations by hotel chains seeking to protect their brands, which rest heavily on quality.

Also similar to garments, it is perhaps premature to conclude that the impact on economic transformation of the expansion of upmarket tourism in Myanmar will be very limited. As other countries have shown, there is great potential in the industry for ‘labour circulation’, that is, for skilled employees (both local and foreign) to move from middle management or senior technical positions in foreign-owned firms to senior

¹⁰² One non-Chinese foreign tour operator informed us of some spillover into micro-enterprise development: one of their guides opened their own tourism business outside Yangon to work with the travel agent but also with other clients, while the tour operator provided a loan to a second former employee, who used it to buy a car and set up their own tourist taxi business.

management in domestically-owned firms including starting their own firms in the local economy. Labour circulation as part of enterprise development depend also on credit availability and financial system development, and capital requirements are of course a much more significant constraint in the tourism sector than in garments.

3.2.3 Construction

We found evidence of substantial and diverse impacts from the construction sector, covering most of the transformative variables, and particularly those in the second and third groups which could contribute to sustaining transformation over time. The most important effect is in the form of forward linkages, that is, the availability of improved infrastructure services to users, which can help overcome some of the major constraints facing firms. Direct employment effects are primarily at the construction stage for large projects. The firms we interviewed had medium-sized labour forces (50-150 employees) but would be indirectly responsible for far more employment creation when undertaking projects.

The construction firms interviewed all had a significant minority of Chinese workers in their Myanmar labour force. This is common for Chinese firms in the sector in other developing countries, for example in many countries in Africa, and is in many cases a consequence of skills shortages in the domestic labour force,¹⁰³ and the benefits of ‘asset specificity’, that is, the need for workers to be familiar with technical equipment used by or being installed by the contractors to ensure downstream efficiency and/or safety. To this extent the need for imported skilled labour is dictated by cost considerations including future risk management, and is part of the wider trade-off in construction and infrastructure between indirect transformative impacts through effectively meeting downstream user needs at low cost and with high quality service versus direct transformative impacts such as job creation, enterprise development and skills transfer in the firm’s own activities, especially those relating to the project construction phase.

There is potential for enterprise development in the construction sector, notwithstanding the rent-seeking origins of domestically-owned firms in the sector. The foreign telecoms firms that have entered Myanmar’s mobile phone sector reportedly do very little local procurement. One firm (perhaps we should say ‘only’ one firm) reported that its local JV partner had actively sought benefits from technology and skills transfer within the partnership. Further research on this issue would be valuable, especially given their role in technology transfer from Western firms in China’s own industrialisation.

3.2.4 Agriculture and agro-processing

This sector needs further investigation, and we discuss it very briefly. Here we leave aside any evaluation of the transformative impact of investment in rubber or other crops via the controversial opium substitution programme, which is necessary to fully evaluate the Chinese and other FDI presence in both agriculture and processing. The agriculture column in Table 8 should be read as concerned only with the rice value chain. Its fairly positive picture of the impact on transformation is a reflection more of potential than of realised change, as Chinese and other foreign entry is at a very early stage in this activity. But the Chinese presence as described above is focused on three of the key factors constraining an increase in productivity across the rice value chain: seed quality, milling, and finance for mechanisation and irrigation equipment. Thus the potential impact – subject to the need to scale up, as well as the assumption that the Chinese firms will in fact achieve their own market objectives – is very significant on skills and technology transfer through greater financial access for small farmers, which will contribute to increased yields together with seed quality improvement. The potential impact is also significant on efficiency improvements and increased competition in downstream processing, which together with higher yields, should raise export values substantially.

¹⁰³ As discussed above, the telecommunications firms undertake extensive training of their Myanmar employees.

3.3 Concluding remarks

This section has shown that the motivations for Chinese firms to enter Myanmar are in broad terms similar to those of investors from elsewhere. In other words, some firms – in garments – enter to make use of Myanmar’s low wage low-skill labour to produce for export to third markets, while other firms – in construction – are looking to sell in the growing domestic market within Myanmar. Firms in the rice value chain have entered to benefit from the growth in the export market to China in particular, though they themselves may not be direct exporters. In the same way, Chinese firms’ concerns about the Myanmar operating environment are similar to those of other firms, focussing especially on poor regulation and poor infrastructure.

In addition to their direct contributions to employment and exports, our interviews suggest that Chinese firms are enhancing economic transformation and higher productivity through the expansion of the garment and agricultural export (rice) sectors, in which they are playing an increasingly important role together with other foreign firms. In construction, Chinese firms are contributing to lower downstream user costs as well as to enterprise development and productivity increases of other firms within their own value chains. In garments, agriculture (rice production) and construction, Chinese firms are contributing to technology and skills transfer into Myanmar. There is little evidence of significant impact of Chinese investors in the tourism sector, though there is potential for expansion especially in the mid-level and lower market segments.

Enhancing the transformation impact requires scaling up foreign investment, from China but also from other source countries. The specificity of each sector is underlined by the detailed discussion above. In garments, the entry of foreign investment and their impact on economic transformation emerges from joint activities by firms within a value chain. In construction, the other sector with significant Chinese presence, the key consideration in relation to economic transformation is the trade-off between the direct transformation effects resulting from the sector’s expansion and the induced effects of expansion downstream on the users of the installations produced by the sector. Where the output comprises upmarket housing, shopping centres and hotels, the former effect is naturally dominant, but where the output is infrastructure installations or low income housing, the latter is more likely.

4 TOWARDS POLICIES FOR ECONOMIC TRANSFORMATION

This section discusses possible policies for Myanmar to enhance economic transformation in the four selected sectors with an emphasis on the potential benefits of FDI from China and elsewhere. The discussion is in a different mode than the previous sections, in that ideas and options are sketched out in very broad terms in order to be suggestive and even provocative. Needless to say, all proposals need further refinement and assessment of their viability, but they are presented with the intention of contributing to policy debate in Myanmar.

The NLD government has made one major public statement on the economic policy in July 2016, which provides a useful outline of its broad thinking as well as some positive pointers about a focus on economic transformation.¹⁰⁴ Overall, the policy statement aims for more broad-based development and nation-building as the overarching objectives. It continues and reinforces the ‘pro-market’ liberalisation of policy under the USDP government, while perhaps suggesting a less ‘pro-business’ policy stance (that is, less favourable towards incumbents) than before. FDI is the specific focus of the seventh point of the twelve-point statement, with lower investor risk the main emphasis, while the sixth point on job creation contains at least an implicit reference to industrialisation, in referring to the special economic zones.¹⁰⁵ The same point also refers to the need for migrants to return from abroad, an important issue that we take up below. The first point of the twelve is concerned with national reconciliation, and explicitly mentions the EITI, while point 2 is focused on competition and the need to limit monopolies. The priority given to these two points can be taken as a signal of concern about the economic power of the ‘cronies’. The new government seems clear in its intention to alter future sources of ‘economic rents’ in Myanmar towards productivity and efficiency and to encourage their use to raise growth, as reflected in Aung San Suu Kyi’s comments to the country’s ‘top taxpayers’ (read: cronies) in October 2016 (Naing Zaw, 2016).¹⁰⁶ The NLD policy statement also explicitly addresses reform of the financial sector and in energy and other infrastructure, both of which are of course crucial for transformation, as evident from the discussion above.

The challenge remains of course to formulate and implement specific policies reflecting the broad goals and directions spelled out. The previous government (often with support from development cooperation partners) had prepared detailed economic policy documents across many issues, the status of which under the new government is not entirely clear (at least to a remote observer). It is likely that these will have to be revised in line with the new government’s priorities, and this process will likely be drawn-out and uneven. The new government (and the NLD party) will have to maintain a careful balance in this exercise between, on one hand, decentralisation to ministries and departments to enable efficient and effective policy formulation and implementation, and on the other hand, some degree of centralisation to ensure coherence and alignment with government’s broad objectives. This will be a particular challenge in Myanmar where decision-making has been extremely hierarchical under the various authoritarian governments of the past five decades, so that heavily centralised decision-making has become the norm in government and in political parties also. There is also a wider challenge to create the conditions for democratic economic policy formulation in the society: building the capacity of interest groups to engage in economic policy debate, building policy analytical capacity in universities and think tanks, and increasing economic literacy amongst journalists as well as in the wider public. Though there is progress in all of these areas, there is much still to be done.

¹⁰⁴ These comments rely on the summary of the NLD government’s economic policy document in Aye Thidar Kyaw (2016), which provides a summary of the policy statement issued (in Burmese only) by the government on July 29 2016. Of course there are many policy-oriented grey documents that are not systematically discussed here, produced by the World Bank, the IMF, the OECD, the Asian Development Bank, the International Trade Centre, UN ESCAP, and the Myanmar government (generally supported by one or more donor agencies).

¹⁰⁵ Though the SEZ policy is to some extent limited in scale, and is also ‘stuck’ with only one in progress and the construction of a second only recently awarded to a contractor.

¹⁰⁶ Aung San Suu Kyi said ‘she was not against some citizens getting rich, as long as they did so “fairly.” Regarding tycoons who made fortunes exploiting links with Burma’s repressive military rulers—helping to finance their rule in turn—she said, “We can’t mend the past. But I would like to request that they act fairly at present.”

Business associations are one important set of interest group organisations where capacity building is urgent. These should transform from quasi-official regulatory agencies to organisations that can provide a foundation for collective action by businesses on policy, labour relations, and local infrastructure. Improved negotiation capabilities and corporate governance practices are an essential part of the necessary shift. A start has of course been made on this, as shown by the MGMA already having evolved away from its narrow origins, but the endemic problems in Myanmar of managerial capabilities and technical skills seem to apply as much to sector associations as to their individual member firms.

A crucial requirement for broad public engagement in economic policy formulation and effective policy evaluation is the production of reliable and consistent economic statistics, without which policy is, if not impossible, at least a risky guessing game. Government in Myanmar collects vast amounts of data, but published data is limited, and often inconsistent and erratic, as has been emphasised in the discussion above. Training of a new cadre of public sector statisticians is urgently needed.¹⁰⁷

A further overarching issue relates to the foreign exchange market and trade finance, which as discussed above in relation to garments, has been critical in shaping the trade and investment regimes. The removal of sanctions is now completed, and reform in this sphere is urgent, including the building of networks between domestic and foreign banks.¹⁰⁸

We turn now to sector-specific policy recommendations for the garments, tourism and construction and infrastructure sectors, some of which will be applicable more broadly, in other sectors. Insofar as agriculture and agro-processing, we have little to add to the discussion above which indicated that appropriate policies are already in process of implementation, including the development of leasing capacity in the banking system to support farm mechanisation and irrigation, the entry of foreign investors into rice seed production and rice processing to modernise and expand capacity, and the liberalisation and joint regulation of the rice trade with China. The policy priority should be on scaling up these interventions to raise rice output, in all of which foreign investors can make essential contributions. In addition, the monetary transaction costs and time required for exports can be lowered with improvements in both transport efficiency and trade facilitation administrative processes.

4.1 Sector-specific policies

4.1.1 Garments

This section argues that growth in the garment sector and related light manufacturing activities depends on the expansion of the pool of entrepreneurial and management skills in Myanmar, which can be addressed by dedicated large-scale training institution, by FDI promotion which takes account of the global value chain's structure, by promoting skilled employees in foreign firms already in Myanmar to undertake their own start-ups, and by encouraging diaspora returnees.

There are already detailed policies for the garment sector: a national export strategy (NES) for garments (Ministry of Commerce, 2015) and an industry association strategy paper (MGMA, 2015). In interviews, sector experts emphasised the reform of trade taxes, in particular scrapping the CMP/FOB categories and associated tax exemptions, which are identified as the central obstacles to sector growth. They also emphasise the urgent introduction of 'back to back' letters of credit and bonded warehouses for imported inputs for export processing. The garments NES sets targets for 2020 of \$12 billion exports and 1.5 million new jobs, which are very ambitious given the 2014 levels of \$1.0 - 1.4 billion exports and 200 000 – 230 000 workers. The targets imply the industry should grow to about eight times its size within six years, which

¹⁰⁷ The beginnings of this appear to be underway, as evidenced by the MMSIS website which has been supported by KOICA, though it is not known to what extent this focuses on production of national accounts data, while statistical capacity development at DICA is being supported by JICA.

¹⁰⁸ US banks did not (it seems) start to do business with Myanmar despite US sanctions on financial transactions being lifted in 2012, and despite four Myanmar banks being licensed by US regulators in February 2013 to undertake transactions with US firms. These steps did allow US companies to use letters of credit in Myanmar and to transfer funds for trade and investment, but difficulties remain, forcing firms to register in Singapore.

seems unlikely in such a short time frame. Nonetheless, progress towards achieving it depends on the emergence of a full 'ecosystem' in Myanmar's garment sector, and the policy challenge now is to put in place some of the foundations of such a system. We consider in turn issues in the sector relating to entrepreneurship and management, labour, land and infrastructure, and intermediate inputs. Several of the points already made in this section are evidently of most direct relevance to the garment sector, and will not be repeated at length below.

Looking first at entrepreneurship and management, it is useful to remember that the NES exports and employment targets (or even a more modest achievement) implies an increase of several multiples in the number of establishments (factories) from its current level of about 300, and consequently also a very large increase in the number of senior managers within the industry. In Bangladesh, where garment exports grew about four times as high between 1995/96 and 2007/08, from \$2.55 billion to \$10.7 billion, the number of establishments (factories) and the number of workers both doubled, while establishment labour force size stayed roughly constant (around 550 workers).¹⁰⁹ Incidentally, this implied that export value per worker and export value per factory also doubled. Even if labour force size per establishment in Myanmar does not follow the Bangladeshi pattern of staying constant but instead doubles, Myanmar will still need 500-600 new garment factories and perhaps 60-75% of that number of new entries (assuming many firms will operate multiple establishments) to meet the NES targets. This rough estimate underlines that entrepreneurship and management are a significant constraint on the sector's growth, perhaps the most pressing constraint, and illustrates the scale of the investment promotion task in meeting the NES target.

High-level skills including entrepreneurialism (an organisational culture encouraging individuals to take risks and make decisions), management capabilities and technical capabilities appear to be in general shortage in Myanmar, not only in the garment sector. This is perhaps not surprising after more than five decades of authoritarian rule, heavy regulation and top-down decision-making across state institutions. Notwithstanding that there are 127,000 formal businesses and 620,000 informal enterprises (OECD, 2014b, vol.1), the *rate* of entrepreneurship is low: these numbers are low relatively, when compared with Thailand and Vietnam, and they are low in absolute terms too: only 720 (0.5%) of the formal enterprises are larger than 100 workers. This further underlines a scarcity of management capabilities, since 100 workers is roughly the threshold where owner-managers need to delegate many line functions to managers. The scarcity of managerial capabilities within Myanmar was underlined in our interviews by the Burmese manager of a Chinese clothing CMP, who suggested that he (a diaspora returnee) was unique, as he knew of 'no other' local managers in foreign firms in the garment industry in Yangon. The figure cited earlier for qualified construction engineers – only 260 nationally – is equally suggestive of the dearth of technical skills.

Successful economic transformation depends upon the start-up and growth of large numbers of businesses, many of them necessarily large, each needing not only an owner-entrepreneur but also groups of managers and of engineers. This begs the question: where will these people come from to enable Myanmar's transformation? This suggests that a long-term and large-scale process of high-level skills development is urgent. Point eight of the NLD document addresses education and skills, but apparently does not explicitly mention high-level skills. In the garment industry, there are many existing 'NGO-type' initiatives working with small numbers of small locally-owned firms and/or running short capacity-building courses. These organisations are doing valuable work, but are simply not sufficient in scope or scale. Developing an 'ecosystem' of organisations for the sector requires building (or expanding) large tertiary level formal education and training institutions dedicated to the garment sector (or at least labour-intensive light manufacturing) which can undertake the provision of both generic management and business skills combined with sector-specific technical and engineering skills to young people. Such institutions can also promote new approaches to entrepreneurship (identifying and grasping opportunities) and (re-) train people already in the workforce.¹¹⁰ This should start as soon as possible, as it will necessarily be a long-

¹⁰⁹ Average factory workforce size in Bangladesh seems somewhat smaller than in Myanmar, interestingly, with the latter around 700 workers per factory.

¹¹⁰ This should include English language training, as this is essential for modern business practice.

term process with positive benefits some way off, and it should be considered independently of the expansion of basic secondary education, which is undoubtedly also necessary.

The Bangladesh experience is instructive in this regard: a Bangladesh Institute of Fashion and Technology (BIFT) was established by the industry association in 1999 with donor assistance¹¹¹, about 20 years after the sector began to grow rapidly. By 2010, the BIFT was self-financing and graduates around 1,300 students annually, up to Master's degrees. There is also a textile engineering college, and a range of private universities that have established textiles departments, and the government department responsible for textiles runs about 50 post-graduate technical training institutions (Fernandez-Stark et al, 2011). There does not appear to be a strong design element in the Bangladesh array of institutions, but in Myanmar, as noted earlier, the presence of a small luxury fashion design sector may provide a 'kernel' of domestic capabilities that could grow if complemented by an overlapping range of education and training institutions. Training programmes in technical and managerial areas could include internship programmes supported by donor funds and buyer CSR funds, which could even enable opportunities to work in foreign-run operations in Myanmar or in the industry in other Asian countries, including China. International experience and exposure is essential for young trainees and enables them to begin building networks within the industry.

The rough calculation above of the need for new firm entry into the industry shows that the need for entry into the industry cannot be met by an increase in the supply of domestic entrepreneurs alone, so that FDI is essential, together with 'labour circulation'. Looking first at FDI, the major source of producer operations to enter Myanmar is almost certain to be China, given its dominance in global garment assembly activities. Garment assembly firms from other countries are entering Myanmar, but from the discussion above, their numbers are evidently smaller than entries from China, although political sensitivities mean that many Chinese garment firms have not identified themselves as Chinese, in neither their formal entry registration nor in their daily activities in Myanmar (though they are surely recognised 'on the street' as Chinese). The 'under the radar' entry of Chinese firms across all sectors is illustrated by the low numbers of FDI approvals and existing investments from China in the DICA database – only 90 indicated in the aggregate published data in Table 5 (and 83 in the firm-level database, as per Table 6). As already discussed, the role of western and Japanese buying firms – brands and retailers – is crucial in the decision process relating to entry of foreign garment assemblers and OEM producers. These buying firms are in effect doing investment promotion, and enterprise development: they provide assurance of a market, indirectly enable financial assistance and working capital by facilitating input procurement, and actively support product quality improvement. In addition, they select the firms that will receive these forms of support, and their support is withdrawn in the face of poor performance. This suggests that formal investment promotion efforts should engage with lead firms in value chains (especially those based in the UK and the EU), as well as with Asian OEMs, assemblers and component producers.

New models of investment and trade promotion are emerging to take account of the triangular structure of global value chains in industries like garments, footwear¹¹² and other light manufacturing.¹¹³ These models encourage co-operation between public investment promotion agencies of large developing countries (China, India) and those of low-income or lower middle-income countries (to date in Africa) to facilitate the re-location of production, especially product assembly, from the former to the latter, promoting trade and investment between the two countries as well as to third markets in OECD countries. Engagement with GVC lead firms in OECD countries is also recognised as a necessary part of the model. These models seem to fit the Myanmar context well, even if they imply competition in some sense with existing efforts to promote trade investment into Africa. DICA should be encouraged to interact with trade and investment promotion agencies in China as well as with GVC lead firms and Chinese OEMs and assemblers in the garment industry. DICA officials suggest that they have not actively pursued Chinese investors up until now, possibly because of the wider political sensitivities around China-Myanmar relations. Consideration

¹¹¹ BIFT received support from the IFC, EU and ADB as well as four bilateral agencies, including UK DFID.

¹¹² Capital costs in footwear are about four times as much as in apparel (Kudo 2009).

¹¹³ These efforts are being supported by DFID and by the International Trade Centre, a UN agency in Geneva.

would be worth giving to the benefits of discriminating between industries and sectors, and engaging more actively on sectors with greater transformational potential from inward investment. Indeed such a careful selection of sectors appears to have been the approach to developing a regulatory framework to enable increasing rice exports from Myanmar to China.

The rough calculation above of the numbers of new firm entries needed in the garment sector also shows the importance of labour circulation, that is, the movement of managers and technicians from positions as senior employees in firms owned by others, into domestic start-up businesses of their own. This may enable a single foreign entrant to 'spawn' several new producers in the industry, as employees leave to run their own start-ups. Even if the latter are assemblers (CMP producers), as they are likely to be initially, they will be crucial to industry expansion along the 'extensive margin'. But these producers are likely to have international experience and networks, since they have worked previously in foreign investors. Thus there will be potential for (some of) them to expand along the 'intensive margin', that is, increasing the scope of their activities by entering value chain segments beyond CMP garment assembly.

Labour circulation has been crucial to the emergence of the very large and in many ways successful garment industry in Bangladesh, which some actors in Myanmar's garment industry see (correctly) as a 'role model' for their own. Furthermore, as discussed above, it was also important in the 'first' (1990s) emergence of the industry in Myanmar, though these origins of the industry in Myanmar are little known, and the subsequent fortunes of these firms also unknown. It has been important in industry development in many other successful examples, not least in China's own development, but also including tourism (hotels) in many countries. The 'source' firms in the domestic economy – those which the new entrepreneurs leave to undertake their own start-ups – are often foreign investors, and (skilled) labour circulation is an important mechanism for technology and knowledge transfer, including business models, marketing skills and customer relations, supply chain and labour management, and so on, from abroad to new enterprises in the domestic economy.

A third broad policy suggestion therefore is to establish or extend start-up firm support schemes that are available to new entrepreneurs who have left employment at foreign firms in Myanmar, especially to assist access to factor markets (capital and finance, labour and land). This access will complement the information the new entrepreneurs are likely to already have, relating to intermediate input and product markets and about production processes. This support should, it hardly needs saying, be provided to both Myanmar and foreign citizens already working in Myanmar, whether they are working for local or foreign enterprises. Support should be conditional on meeting specified targets, for exports where appropriate, such as in garments or footwear, or for approved domestic output, such as in low-cost housing construction. Finally, the support should be provided at a level which would allow entrepreneurs to establish sufficiently large firms to be competitive immediately, for example, garment firms able to employ 500 to 1,000 workers at the outset. Applicants would have to demonstrate they have the capabilities to manage an independent firm, including market knowledge and networks.

Fourthly in regard to entrepreneur and management capabilities, there should be a concerted effort to attract – with incentives similar to those provided to new start-ups by entrepreneurs already in Myanmar – émigré and diaspora Burmese back to Myanmar to set up businesses and to bring the business skills acquired abroad into the Myanmar economy. There is a large Myanmar diaspora – perhaps as large as 5.5 million (OECD, 2014b, vol. 2, p131) though the official government figure is only 514 000 – though the proportion of high-skilled or well-educated amongst them is not clear. An initiative to assess the potential contribution of the diaspora would be worthwhile, which should go beyond remittances to explore its role in economic transformation, that is, potential investment mechanisms to attract diaspora pools of finance and especially knowledge back into Myanmar.

Turning now to lower skill labour categories, buying firms also need to be encouraged, perhaps via tax incentives in their home countries, to engage via their CSR activities with industry training institutions in Myanmar, as and when these are established. The buyers' presence in Myanmar, related to the development of standards for product quality, as well as social, labour and environmental rights, is itself

an important element of an evolving industry ecosystem.¹¹⁴ Training for shop-floor workers is obviously very important, and is undertaken by firms directly, though the need for collective processes across firms should also be investigated.

Sector policy on land and infrastructure should focus on support for clustering of garment firms in industrial zones, going beyond the three (or perhaps only two) SEZs currently underway, and as discussed below, perhaps exploring the expansion of the existing industrial parks (in number, in size and in efficiency), through cooperation between donors and the Myanmar government. The benefits of clustering and agglomeration are widely understood in Myanmar. These benefits are in some sense essential to the growth of light manufacturing industries to drive economic transformation, in part because clustering is a necessary (if not sufficient) condition for the evolution of a business and institutional 'ecosystem' in a sector, that is, the growth of a group of firms and support agencies with sufficient scope and scale to be a low-cost source of specific skills, services and information for the industry in that area. The emergence of an ecosystem would be part of the process through which the Myanmar garment sector broke into OEM activities.

Attention in Myanmar seems very heavily focused on the SEZs, of which there are only three, and two of these have not yet begun construction. The Kyaukphyu SEZ is, it seems, proceeding notwithstanding past controversies, and point 6 in the NLD's economic policy statement indicates that SEZs are a priority. But the two (or possibly three) SEZs are hardly sufficient to meet the need for clustering. Much more attention should be focused on the industrial parks, of which a much larger number already exist but in almost all cases are apparently not functioning optimally and are poorly located for import and export activity (OECD, 2014b, vol. 2, p 79). These zones should be upgraded and expanded in number, including enabling them to provide 'pre-competitive' public goods, such as skills training for semi-skilled labour (machine operatives and construction site workers, for example) or trade facilitation services or worker housing, and enabling them to address difficulties with local level infrastructure such as roads and water. It would seem that Asian businesses and public agencies are active in this arena in establishing privately-run industrial park, such as the Korean Panko development mentioned above, or the Japanese Mitsui-led development of the Mingaladon zone which was set up in the 1990s. But these examples need to be multiplied, starting with regeneration of the existing zones and policy towards them: the management of the zones is decentralised, which is helpful, but there are no common standards or central oversight, which is not helpful. There is a need not only for the expansion and upgrading of 'hard' infrastructure in the zones, but also for 'soft' infrastructure (trade facilitation, labour regulation and even financial services). Chinese SOE firms are already contracted to construct the Kyaukphyu SEZ and would certainly be an option to undertake the construction elements of industrial park refurbishment and expansion. Political issues would have to be addressed, though, both because of the political controversy over Kyaukphyu as well as because there are local firms already present in the industrial zones, mainly doing small-scale manufacturing for the domestic market. With that caveat, this seems to offer a mechanism for exploring the potential cooperation between development partners with complementary expertise and capabilities, on one hand in civil engineering and construction such as China, and on the other hand in institutional development and regulation such as the UK.

Finally, in relation to intermediate inputs, the issues of trade facilitation and trade credit are central. Bonded warehousing and back-to-back letters of credit are identified by SMART Myanmar experts, working with the MGMA as the major issue to open the sector's growth potential. Interestingly, the National Export Strategy for garments, issued by the Ministry of Commerce, suggests that these issues are a 'level 3' (low) priority. While not likely to be a panacea, it is true that these reforms would be valuable, and are easy in principle, being 'stroke of the pen' changes to the regulatory framework that could be implemented by government without direct financial cost. Systems development and training in the customs service and in banks would then be necessary, of course, so the changes would take time to become fully effective. Despite the apparent consensus in their favour, it appears that they have not been introduced, and engagement with appropriate officials, including at the central bank, might assist in moving the process forward.

¹¹⁴ And indeed the same applies to the NGOs that monitor and help to enforce acceptable production practices.

4.1.2 Tourism

As discussed above, there is increasing foreign presence in the tourism sector in the form of international chains operating upmarket hotels, though the latter are mostly owned by local conglomerates, sometimes together with investors from elsewhere in Asia, including a small number from China. These hotels are in many cases part of larger commercial complexes that also include residential apartments and shopping facilities, so that in formal terms, the FDI in hotels in this segment is better considered as part of the construction and real estate sector. As a consequence, we will not offer here detailed policy prescriptions for the tourism sector.

Three general points can be made about tourism, however. The first is to investigate more systematically the presence of a 'missing middle' in hotel and tourist services providers, that is, the absence of a substantial market segment priced *between* luxury upmarket hotels and small guesthouses and informal tour operators, which is indicated by anecdotal evidence and casual observation. If a shortage of mid-price hotels and tourism establishment is evident, the 'binding constraint' on these firms may well be, as in the garment sector, the scarcity of entrepreneurial and management capabilities, coupled with lack of access to finance. This motivates a policy approach along similar lines, focusing on increasing the supply of managers, encouraging an increase in labour circulation and in provision of high-level skills training. Also of relevance is the need to work with the international hotel chains, the equivalent in this sector of buying firms in the garment industry.

The second point, which is related, is to remove the distinction between hotels and guesthouses, at least insofar as the distinction restricts guesthouses to accommodating only Myanmar citizens. The reason for this is not clear, but may well have been related to price discrimination between the two types of guest, or perhaps more likely to access to the formal foreign exchange market. Given the large numbers of Chinese (and Thai) overland entrants into Myanmar (as reflected in official MHT data), its main effect is likely to be that all or most of their expenditure remains unrecorded and in the informal sector. Eliminating the restriction may be a step towards changing that, and increasing formalisation of tourism activities.¹¹⁵

Finally, further efforts could be made in relation to 'market development', that is, to attract more Chinese leisure tourists to visit Myanmar. As noted above, some initiatives have been undertaken in recent years, notwithstanding possible anti-Chinese sentiment in Myanmar. It is unclear how much success they have achieved. The number of Chinese visitors arriving at Yangon and other airports trebled between 2010 and 2015, but remains very low at about 150,000. According to the China Tourism Research Institute, travel agencies organised just below 12 million visitors to foreign countries, with Thailand the leading destination receiving 17% of these, or around 2 million visitors. Even taking account of possible statistical inaccuracy, this suggests that there is considerable potential for growth in Chinese leisure tourism to Myanmar.

4.1.3 Construction and infrastructure

The first set of issues here concerns low-cost housing, of which there is a severe shortage throughout the country but especially in Yangon. Estimates vary but historic delivery rates appear to be 10% or less of the need, while costs (or market prices) for new apartments are extremely high. A focus on provision of mass low-cost housing would support economic transformation, both directly, in raising productivity and increasing employment within the construction sector itself, as well as indirectly, in lowering housing costs for low-wage workers in other sectors, and hence limiting upward pressure on the real wage. More research is needed to fully understand this segment of the market, but it seems that the large local construction companies have limited interest in this activity, perhaps because potential returns (economic rents) are less attractive than in other, more upmarket, housing and commercial real estate segments. Smaller domestic companies appear to have limited capacity to address the need, at least to do so at appropriate prices. The issue of scarcity of high-level entrepreneurial, management and skills, applies as strongly in construction as in the garments and tourism sector, and there is a similar need for training institutes.

¹¹⁵ In a previous version of this paper, it was suggested that efforts be made to formalise the Chinese informal presence in the sector by getting Chinese tour operators and accommodation providers to register their enterprises. Here we pull back from that argument, as it is likely to be difficult and risky process, and should not be a priority in addressing the already very complex situation of Chinese firms' presence in Myanmar.

This opens up opportunities in principle for foreign, including Chinese, medium-sized construction companies, who can provide efficient production at scale, as our interviews suggest. The Myanmar government has (again) indicated it will allow foreign investors into the sector, and this needs to be encouraged as a matter of urgency, and should focus on both large and small entrants. It was not clear in the July 2016 announcement concerning entry of foreign construction firms into low-income housing whether the foreign firms would be required to enter JVs with local partners. Further foreign entry into production of construction inputs should be strongly encouraged, for example into cement production, where it has already begun. It is likely that domestic capacity to produce inputs will not grow fast enough even with foreign entry, so that imported inputs will be necessary, with China likely being the major source. Consideration should be given to tax incentives for imported equipment to be used in low-cost housing construction, though monitoring would be a problem.

Opening up the sector to encourage small, currently informal, foreign companies to register and hence bid for work would help to increase the supply of housing, though it would need to be accompanied by a significant improvement in regulation of low-cost housing, covering tender processes, and monitoring of delivery in relation to both construction safety and to product quality. A valuable intervention could be made by donor agencies in supporting skills and institutional development in all three areas, and this should be further investigated.

It must be recognised that a wave of Chinese firms' entering into low-cost housing construction, particularly smaller firms, may spark popular protest. Opposition to the Chinese presence has not occurred in the garment sector, but many firms may obscure their nationality, and they do not need to participate in public tendering processes. Signals from political leaders about the urgency of achieving public housing goals by all available means would be helpful.

An important pointer in relation to this issue may be the recent award by the government of a construction contract to a Chinese company for the first time since the political transition in April 2016, when the China Road and Bridge Company (CRBC) won the tender to build two sections of road along the East-West Economic Corridor, a contract worth about \$500 million. Significantly, this project is to be financed by the Asian Development Bank (Nan and Shuiyu, 2016). It is not known whether CRBC is required to work with a local JV partner, but this seems likely.

Turning to large infrastructure issues, the requirement for foreign contractors to have JV partners is perhaps the critical policy issue facing infrastructure construction, as it poses in sharp form the trade-off between the direct and indirect benefits of infrastructure for economic transformation. On one hand, there are the positive effects for downstream users – on cost, quantity (network expansion) and quality (reliability) – of improved infrastructure in energy, transport and water, which come from rapid, efficient and low-cost delivery of effective networks. But on the other hand, there are potentially significant indirect transformation benefits, in the form of skills and technology transfer to local participants in infrastructure construction, including employees of infrastructure firms, JV partners, and construction input suppliers, though possibly at a price in terms of cost and delivery. Where the infrastructure 'gap' is large – where existing installations are most inadequate relative to current and future demand – the potential downstream impacts are likely to greatly outweigh any potential skills/technology transfer or enterprise development benefits, and the latter should be forgone in many projects in favour of more rapid and lower-cost network expansion, by giving lower priority to JV and related performance requirements for transferring benefits to local partners and participants, and instead allowing foreign contractors to carry out the project at lowest cost. In principle, the evaluation of where and when to impose local content requirements of this sort is probably best done on an individual project basis, especially for large projects.

But any attempt to limit local participation is likely to run up against political economy realities in Myanmar. The domestic conglomerates are the incumbents in infrastructure sectors, and are already accessing considerable rents from these sectors, which are to a large extent replacing (and are probably much larger than) rents from import licences for restricted products and supplementing continuing sources of rents from natural resource exports.

Requiring foreign investors to enter JVs is not an inherent problem, as the Chinese experience itself reminds us: through JVs, domestic firms in China upgraded their capabilities for both production and for technology innovation, in partnerships with foreign entrants. The context is crucial, however: in China, the transfer of technology and related capabilities was achieved primarily in the manufacturing industry, rather than in infrastructure, where the risks and social costs (downstream) are higher. Equally relevant, there was pressure on Chinese firms to use JVs to develop their capabilities, rather than seeing them simply as opportunities for rent acquisition. The pressure came from Chinese state agencies – the owner of the Chinese JV partners was often a provincial or city government, which prioritised the national drive for economic growth – which competed with each other intensely in domestic goods and factor markets competition. In this context, enterprises recognised that their long-term survival (and the career prospects of their managers) depended in part on developing their productive capabilities to sustain their future growth.

In Myanmar, the context is quite different and the potential is much smaller for JV requirements to have similar positive technology upgrading and learning effects as they did in China. Neither the state nor market competition currently create particularly powerful pressures on firms, especially not on the large family-owned conglomerates that have already achieved incumbency in infrastructure, finance, real estate and construction and some other sectors, as a result of capital accumulated through their earlier access to natural resource- and import licence-based rents. In the rush of FDI entering Myanmar since 2011, the size of the conglomerates has given many of them preferred status as JV partners for entering foreign corporates, both western and Asian (including Korean and Japanese), which in a path-dependent process has then further entrenched their position as incumbents across multiple sectors and their economic power as a group, notwithstanding individual differences amongst them.¹¹⁶

The conglomerates – as a group, though there may be exceptions – are therefore likely to deeply oppose any moves to limit the application of existing JV requirements, just as they opposed the full liberalisation of foreign firm entry in the passage of the Foreign Investment Law in 2012, and forced JV requirements into the legislation, in the process delaying passage for six months (Petty and Tun, 2012). Their overt political influence now is less than it was then, but they surely retain some ‘veto power’ over policies, which may be sufficient to obstruct reforms that threaten to exclude their access to rents.¹¹⁷ But while rolling back restrictions on JV requirements for future foreign investment in construction is important to enhance speed and efficiency of delivery, it will not on its own increase the efficiency of conglomerates’ ongoing activities in construction. Similar considerations apply in other sectors including finance. There is a need to develop competition policy mechanisms and contestable market structures so as to create incentives and pressures on the conglomerates to achieve this.

¹¹⁶ It is noteworthy that even large projects funded by western donors, such as LIFT, are forced to work with the groups, for example in microloan and equipment leasing schemes which have no alternative but to partner with conglomerate-owned banks, as the only available institutions with both licences and delivery systems.

¹¹⁷ Though the new investment law was passed in October 2016, the implementing regulations, for example listing activities where 100% foreign ownership is not allowed, are not yet public and are promised only for March 2017.

5 CONCLUDING REMARKS: THE POLITICAL ECONOMY OF FOREIGN INVESTMENT AND ECONOMIC TRANSFORMATION IN MYANMAR

Rather than summarising the paper – which is done in the Executive Summary – the concluding remarks in this section very briefly discuss crucial political economy issues related to economic transformation in Myanmar. Two central questions are considered: is there a coalition of interest groups in Myanmar favouring economic transformation and can provide political support for appropriate policies? And secondly is there a role in supporting economic transformation for China.

5.1 Interest groups and economic transformation

There is not a strong interest group coalition favouring structural economic transformation in Myanmar, albeit that structural change may be in the interests of the majority of the population. Notwithstanding the dominance of the military within Myanmar's political system (and it retains formal explicit veto power over many issues), Myanmar has a weak state, which has not been able to secure its own territory and borders and establish its authority over society, for example in relation to mobilising financial resources. And notwithstanding the broad political support for the NLD, Myanmar has a 'thin' society, in the sense that organisations of economic interest groups (such as industrial workers, farmers, small business owners, and even ordinary soldiers) appear to be small and not well organised, so that their ability to influence political and policy processes is limited.

The key interest group in relation to economic transformation is of course business, and Myanmar has a bifurcated business class. On one hand, there are a very large number of small businesses with limited productive capacity and little political influence through their business associations which are rather weak, as noted above. On the other hand, there are a small number of large businesses with some productive capabilities which may not be internationally competitive, but with well-honed abilities to capture rents generated from the country's resource-linked international trade and from cross-border monetary flows. Of course, this group ('the cronies') are much less dependent on the military and its linked political parties than they were before political and economic liberalisation began under the Thein Sein government. Today, they are increasingly linked to foreign corporations – not only Chinese, but across a range of foreign countries¹¹⁸ – and governments which have turned to them as partners in the past few years, in the absence of suitable other local candidates. Local partners are legally required in many instances, but also necessary to access land or to deliver services in the domestic market. These constraints will shift in the wake of the 2016 Investment Law and may over time lead to changes, but it is important that the conglomerates have already established these incumbency positions.

As a result, these groups have already moved quite far along the road of generating new sources of rent (that is, sharing in the profits of foreign investors into Myanmar and the rapid growth resulting) instead of the natural resource-based exports and the import licences that were their original source of wealth accumulation. A recent debate within the international community concerned with Myanmar focussed on the issue of whether the cronies should be 'allowed' to participate in the economy once democracy was fully achieved, and when and which sanctions should be lifted (see for example, Freeman, 2015). Those opposing crony participation argued on moral grounds that their history of support for, and benefit from, the military, ought to mean that they lost access to economic participation. Those in favour of their participation argued that they were the only domestically-owned businesses with the size to carry out certain tasks, such as infrastructure development, and goals such as poverty reduction would be delayed if they were excluded. In one sense, this debate is *passé*; even as the debate proceeded, foreign corporations from OECD countries (Europe, the US and Asia), as well as from China, were following their own market-seeking logic on entry into Myanmar and making deals with one or other crony, the cronies as a group being 'the only game in town' from the entrants' perspective. Their incumbency in key

¹¹⁸ This is demonstrated by a scan of their interests. See for example Min and Kudo, 2014, as well as numerous news reports over the period.

infrastructure sectors, including banking, energy, transport and real estate, provides them with capital and leverage to enter new activities and sectors, creating their characteristic conglomerate structure. This reflects the path dependent nature of incumbency, which leads to its reinforcement over time and increasing economic power over time, increasing in absolute terms but also relative to other domestic businesses that remain smaller and less influential.

In other words, even though it may be desirable, it is too late to shift the cronies from their dominance of economic power in Myanmar, and they remain part of the 'political settlement' shaping economic outcomes in broad terms, notwithstanding the change of government in April 2016. The cronies may have lost many direct clients in the political arena as a result of the USDP losing the November 2015 election so badly, but that does not mean they have lost political influence entirely. They are not of course a unitary homogenous group, and some had already started developing links with the NLD prior to the 2015 election, though little is known publicly about these links. Whatever the cronies' direct links with the NLD may be, the NLD leadership recognises the realities of power in Myanmar. This was illustrated by Aung San Suu Kyi's approach to the Letpadaung mine commission in 2012, where rather than pursuing the popular option of cancelling the project, she called for its reform and restructuring to partially address the interests of both the Chinese investors and the Myanmar military. In similar fashion, the NLD has acknowledged that the conglomerates need to be worked with, rather than directly opposed, because they retain considerable 'veto power' over policy. In the meeting between the government and the top taxpayers (read: cronies) in October 2016, Aung San Suu Kyi indicated that the sources of crony capital in the past would not be questioned – it was their future stance that was of concern and this should be 'fair' and they should 'contribute to others', that is, contribute to broad-based development (Naing Zaw, 2016).

The view here is that the cronies will not 'spontaneously' shift the basis of their activities from seeking rents via 'deals' (increasingly with foreign investors) to seeking profits through efficiency, innovation and competition. Since JV requirements have become an increasingly significant source of rents for these businesses, the expected March 2017 publication of the list of sectors and activities requiring JVs under the new Investment Law of October 2016 will be a very significant signal of their political and policy influence. It would be surprising if the cronies acceded to a substantial downscaling of this list, but if the government does significantly shorten that list, it would suggest the cronies' have less power than suggested here. The opening up of longer-term leasehold to foreign investors, now enshrined in the new law, does remove (or at least restrict) one important source of access for domestic businesses to 'deals' with foreign investors.

The question is therefore what can be done to ensure that their activities advance transformation, rather than obstruct it? Regulatory mechanisms, including both carrot and stick, are required and there are two possibilities: either state regulation or private regulation. As regards the former, competition policy and anti-monopoly sentiment is a major priority – point 2 – in the NLD's economic policy statement, and this emphasis is praiseworthy. Competition policy will take a considerable time to become effective as it will require not only legislation but also the establishment of implementing and enforcement institutions. The challenge is that where they are part of a weak state such as Myanmar's, in an economy with scarce high-level skills, new regulatory institutions are often prone to 'capture' by powerful private actors subject to regulation, and to hollowing out as their most capable staff are hired by private corporations.

If the alternative of private regulation, through market linkages, is to work, the disciplining pressure must come from outside Myanmar, that is, via foreign firms investing in the country. When a foreign firm is a customer of a domestic producer (which may itself be foreign-owned), the foreign customer is able to impose technical and quality standards on their products and their production processes. Lead firms in garments, for example, require standards from their suppliers, including efficiency but also issues such as labour and environmental standards, which in the long run will reinforce economic transformation. However, a market discipline mechanism in the sense of pressure to enhance productivity cannot easily be applied in a situation where the market linkage between the two firms is the reverse, that is, the foreign firm is a partner (or supplier) of the domestic firm, rather than a customer, such as in construction or real estate development. In those cases, it is probably necessary to rely on domestic firms facing competition from foreign firms. But the current regulations around JVs make it less common that domestic firms would face foreign firms directly in product markets, that is, outside of the context of foreign-domestic JV

partnerships. More reflection is required here as to how foreign investors might elicit interest in learning and technology transfer from their Myanmar partners.

5.2 A potential role for China in promoting economic transformation in Myanmar

Another avenue worth exploring – in relation to China in particular – is whether there is a potential role for foreign investors' own (home) government to support a shift from deal-based rents to transformational efficiency and productivity improvement on the part of the foreign investors' Myanmar partners. As discussed above, in China's own history, JVs were a crucial mechanism for technology and knowledge transfer and for productivity improvement by Chinese corporations, which were under pressure from the state agencies which owned them. Can this process be adapted to support upgrading in Chinese firms' JV partners? And more generally, is there any scope for official Chinese facilitation of economic transformation in Myanmar through the medium of Chinese FDI into the country?

Two considerations are relevant: the Chinese government's approach to outward investing firms, and the wider context of China-Myanmar relations. The Chinese government very actively promotes outward investment, and interacts closely with Chinese firms, especially state-owned enterprises (owned at national, provincial or local government level), operating abroad. Since about 2011, there has been a shift in Chinese policy towards increasing pressure from on outward investing companies to be more socially responsible in their investments decisions and the behaviour of foreign operations. This has been driven by social tensions and difficulties in several host countries triggered by Chinese firms' presence, and in some instances, by the ill-judged actions of individual managers of Chinese operations (Heng, 2015). Tensions have arisen in several African countries, though Zambia is the best-known example. Events in Myanmar around the large Chinese projects may well also have contributed to the shift in thinking.¹¹⁹ Chinese officials recognise that it is not possible for their government simply to 'instruct' outward investing firms to act more responsibly, and that, just as in western corporations, a change in thinking is required within these firms to change management attitudes. It is also true that socially responsible investment is not always take to imply productivity enhancement and improved efficiency within a firm's core business. Nonetheless, some degree of pressure will be brought to bear, and it is more likely that this change in policy stance on the issue will be taken on board more thoroughly and more rapidly, in state-owned enterprises than by private firms. It is worth remembering that Chinese investors in Myanmar's infrastructure construction sector are largely SOEs, both national and sub-national government owners. Chinese firms in the garment sector are of course private rather than state-owned, as are most potential medium-sized construction firms looking to enter low-income housing construction (though there may be large construction SOEs with an interest in the latter activity). But as mentioned above, there is a small but growing initiative underway in China in which official investment promotion agencies are engaging with small private light manufacturers to facilitate their outward investment into developing countries in Africa, and this provides a model and some lessons.¹²⁰

Turning to China-Myanmar relations, it has been suggested above that there has been less tension in recent years than is recognised by many commentators, who focus rather narrowly on one or two specific issues, notably the suspension of the Myitsone Dam in 2011. While that was undoubtedly a major incident, its disruptive effect on overall bilateral relations has perhaps been overstated. It is striking that construction of the gas and oil pipeline continued after the dam's suspension, so that gas began to flow in 2013 and oil flows commenced in 2015. In 2015 the two countries negotiated a memorandum of understanding regarding rice trade between them, and China's EXIM Bank extended its (three-tranche) loan to support microcredit to Myanmar's small farmers, which had been put in place in 2013. Also noted earlier was the award to a Chinese SOE of a road construction contract by the NLD government in August 2016. In the same month, NLD leader Aung San Suu Kyi was welcomed in Beijing by Chinese President Xi Jinping,

¹¹⁹ See Heng (2015). Dr Heng is affiliated with a MOFCOM agency. The first two case studies in her book are the Myitsone Dam and the Myanmar oil and gas pipeline.

¹²⁰ Information on the PIGA (Partnership for Investment and Growth in Africa) project at www.intracen.org.

with their joint statement affirming *inter alia* that China was “willing to continue to provide assistance for Myanmar’s economic and social development[including] specific measures to support Myanmar’s efforts in livelihood improvement” while Myanmar was “willing to strengthen cooperation with the Chinese government, [and] further enhance trade and investment”. Taken together, these processes do not suggest a breakdown of relations between Chinese and Myanmar authorities.

The Chinese authorities (at national and provincial levels) have supported modernisation in Myanmar via major projects such as the pipeline and the hydro dams, or the opium substitution and agricultural credit programmes, albeit all of these have also promoted China’s own interests. Simultaneously, ‘China’ has allowed modernisation to be undermined by informal deals in logging and jade, and also in agriculture and the opium substitution programme (which is riddled with contradictions; Campbell, 2013). What this underlines is that there are multiple Chinese interests in Myanmar, both public and private, with the private interests impacting on the official ones. As a first cut, we should distinguish between China’s national interests, on one hand, and provincial/regional interests in Yunnan province, on the other, so as to recognise that these are neither identical nor simply ‘directed’ out of Beijing. Yunnan officials have some degree of autonomy from Beijing, as well as some distinct concerns.

China’s national interests relating to Myanmar include creating leverage for Myanmar to participate in the Belt and Road process,¹²¹ and trying to limit US influence within Myanmar, are largely matters for Beijing rather than Kunming (Yunnan’s capital). Included in the former are Imports from or through Myanmar of energy and food, both key concerns for China’s national security. Provincial interests in Yunnan, in contrast, include natural resource trade, especially in gemstones (jade) and wood, and increasingly also in rice, as well as agricultural investments in Myanmar linked with the opium substitution programme. These address specific private interests based in the province but trade taxes are important for provincial fiscal revenues. The national government in Beijing has supported the opium substitution programme politically and financially, but the drug trade and associated criminality are primarily Yunnan concerns, since they carry the risk of spilling over into social instability in the province. Similarly, ethnically-based political instability and conflict in Myanmar is more of a Yunnan concern. As a result, we should not expect to see a unitary homogenous actor with a single set of interests nor complete coherence and consistency over time in ‘China’s’ approach to, and actions on, Myanmar. It is more useful to consider how the different elements and interests in China’s approach have evolved over time. It can be tentatively suggested that the national government’s concerns in relation to Myanmar have become more dominant, as suggested by the agreement over rice exports from Myanmar to China as well as the (less successful) efforts to regulate teak exports. The pressure for investors to act more responsibly, coming from the national government, also aligns with increasing regulatory oversight of relations between the two countries.

This – and the carefully calibrated approach it has taken towards relations with the new NLD government – suggests that, rather than focussing on the short-term, China’s national government takes a long-term view of stability in Myanmar, favouring conditions that will enhance this, including the extension of the Myanmar state’s authority over the country’s territory through a secure and permanent peace agreement, and the enhancement of the state’s fiscal capabilities through more effective collection of tax and other revenues, including mineral rents. From this perspective, the significance attached to the Extractive Industries Transparency Initiative (EITI) in the NLD’s economic policy statement of July 2016 is reinforced by China’s support for EITI, requiring its outward investors to adhere to EITI reporting standards.

All these considerations suggest that official Chinese support may be possible for outward investors to support economic transformation in Myanmar, both to encourage domestic conglomerates to benefit from technology transfer from foreign partners and identify productivity improvement as a basis for profitability, and to encourage garment and other light manufacturing firms to locate operations in Myanmar. Further reflection is needed to define possible instruments and modalities to achieve these objectives. In addition to possible lessons from the PIGA process mentioned above, a concrete step to open more specific

¹²¹ Though it is commonly called the ‘One Belt, One Road’ initiative, Chinese officials insist it should properly be called ‘Belt and Road’ because it involves multiple land and sea routes.

dialogue about FDI flows between the two countries might be the discussion of the merits of renewing the bilateral investment treaty originally signed in 2001 between the two countries given the change of regime in Myanmar, or alternatively establishing a double taxation treaty (DTT) between Myanmar and China, which does not exist, even though China has 99 DTTs including with Laos, Vietnam and Bangladesh.¹²² Discussions around such treaties could offer an opportunity for a high-level but focussed engagement between the two countries on the importance of FDI between them for growth and transformation in Myanmar, as well as for China's wider concerns in its international economic questions of transformation, while also providing (public) reassurances on these issues. It may be argued that the possibility for this to happen is still some way off, as resolution of outstanding issues such as the Myitsone Dam suspension would need to occur first. Yet as noted above, agreements on narrowly-defined and bounded issues such as the rice trade, and project awards such as the road section of the East-West Corridor, have proceeded nonetheless, so that a DTT may similarly be possible, and in the process act as a legitimacy-building exercise.

¹²² Myanmar has DTT with the following countries: India, Singapore, United Kingdom, Laos, South Korea, Vietnam, Malaysia, Thailand; and it also negotiating DTTs with Indonesia and Bangladesh.

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Interviews

For the preparation of this work, several organisations were interviewed in Myanmar. The list is provided below. These organisations are not responsible for the views expressed in this paper, which are of the authors alone.

- Asian Development Bank
- British Myanmar Chamber of Commerce
- Building Markets Yangon
- Business Innovation Facility
- Directorate of Investment and Company Administration
- European Union
- International Finance Corporation
- International Labour Office
- International Growth Centre
- Italian Embassy
- Japan International Cooperation Agency
- Livelihoods and Food Security Trust Fund
- Myanmar Centre for Responsible Business
- Myanmar Thilawa SEZ Holdings
- Pyoe Pin
- SMART Myanmar.

ANNEX: MYANMAR'S IMPORTS FROM CHINA

Table A1: Top 20 imports, 6-digit level, 2014

Product Code	Product Description	Value (US\$ '000)	Share of total imports from China
852520	Transmission apparatus, for radiotechnology	750,594	8.01%
710310	Precious/semi-precious stones (o/t diamonds)	685,736	7.32%
711620	Art. of precious or semi-precious stones	453,379	4.84%
722830	Bars & rods, alloy steel, o/t stainless	422,948	4.52%
871120	Motorcycles with reciprocating pistons	409,076	4.37%
271000	Petroleum oils, etc, (excl. crude);	218,566	2.33%
870422	Diesel powered trucks with a GVW ex	145,099	1.55%
551219	Printed, dyed or coloured woven fab	138,418	1.48%
721070	Flat rolled prod, i/nas, painted, varn	131,960	1.41%
060299	Other live plants, nes	127,000	1.36%
722870	Angles, shapes and sections, as, o/	102,482	1.09%
840890	Engines, diesel nes	94,779	1.01%
721049	Flat rolled prod, i/nas, plated or	89,135	0.95%
851782	Telegraphic apparatus, nes	84,431	0.90%
630140	Blankets (excl. electric blankets),	73,944	0.79%
851740	Apparatus, for carrier-current line	73,256	0.78%
722540	Flat rolled prod, as, o/t stainless	68,026	0.73%
401120	New pneumatic tyres, of rubber of a	67,630	0.72%
852190	Video recording or reproducing apparatus	62,441	0.67%
600293	Weft knits or crocheted fabrics of	60,993	0.65%

Note: this table uses mirror data, that is data on Chinese exports to Myanmar rather than data on Myanmar imports from China. Nes = not elsewhere specified.

Source: International Trade Centre Trade Map.