OECD Development Pathways

Multi-dimensional Review of Myanmar

VOLUME 2. IN-DEPTH ANALYSIS AND RECOMMENDATIONS

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Myanmar faces a crucial few years ahead. The country is undergoing a significant political and economic transformation and the decisions of the coming years will lay the foundations for many years if not decades to come. Gaining the momentum for development is even more crucial as Myanmar’s population will start ageing soon. Before that happens, Myanmar must seize the demographic window of opportunity through bold, effective reforms. Fortunately, Myanmar can benefit from the economic dynamism of its region and tap into the growth pole of emerging Asia.

To succeed, Myanmar must reach a more rapid, sustainable and equitable development trajectory. This requires a transformation of the economy from an agrarian base reliant on small scale agriculture at present towards a broad range of modern activities. Building up the right skills in the workforce will be essential to support this structural transformation. A lack of skilled workers is already a constraint on the economy which will only become more acute as the country modernises if the right policies are not put in place. Realisation of Myanmar’s transformation will also depend upon how effectively the country can mobilise and allocate the vast financial resources needed to support its development targets. In all these areas, the institutions and policy frameworks need to be strengthened if Myanmar’s ambitious reform goals are to be met.

This report is the second volume of the OECD’s Multi-dimensional Review of Myanmar. It follows the Initial Assessment published in July 2013 which identified the key challenges to development in Myanmar through a broad diagnostic assessment across a wide range of policy areas. This second volume provides an in-depth analysis of those key challenges and develops a series of policy recommendations to overcome them. The recommendations were developed through an inclusive process which involved extensive consultations with Myanmar government officials and with the academic, business and international donor communities based in the country. The OECD, UNESCAP and UMFCCI Myanmar Business Survey 2014, which gathered information from over 3000 firms from every state and region in the country, also provided an invaluable source of data and information. The review process will conclude with a final phase which will seek to support the Government of Myanmar’s efforts in implementing policy recommendations.

Policy recommendations

- Foster agricultural value chains that generate links to complementary non-agricultural services and inputs to kick-start a structural transformation towards a more manufacturing and service-based economy.
- Align education and skills policies to the needs of the labour market, allocating greater resources to technical and vocational education and training (TVET) and putting in place incentives for workplace training.
- Strengthen the capabilities of the formal financial system to mobilise and allocate resources through the careful liberalisation of the banking sector and broadening the facilities to provide financial services, especially to
the rural sector. This needs to be backed up by a longer-term process of institutional development of financial institutions, markets, regulation and supervision.

**Structural transformation towards a modern economy: upgrading agriculture, manufacturing and services**

Countries that have achieved structural transformation towards a modern economy show that broad-based agricultural transformation has been a prerequisite and catalyst for industrial development. It (a) provides affordable food, (b) drives up incomes of farmers enabling them to become consumers of industrial goods and services, and (c) frees up labour for industrial and urban jobs and savings for investments. Kick-starting Myanmar’s structural transformation therefore depends on modernising agriculture and reaping the opportunities offered by neighbouring markets for food products. With the right support and the agricultural “engine” in place manufacturing and services can become the sustainable drivers of Myanmar’s growth.

**Modernising the agricultural sector**

Myanmar’s well-endowed agricultural sector has the potential to become a major agri-food producer and trade hub in the region if it can increase its productivity and modernise. *Fostering value chains that generate linkages to complementary non-agricultural services and inputs* at each stage of the chain from input supplier to producer to consumer could provide the impetus to modernise the sector. In addition, the development of value chains will help to build linkages to complementary non-agricultural activities and assist in initiating a structural transformation towards a more manufacturing and service-based economy.

Myanmar’s agricultural sector has considerable opportunities for expansion and diversification but faces structural constraints. The sector accounts for nearly 32% of GDP and 20% of export earnings. Its share of employment, at 60%, is much higher. The gap between employment and output shares in agriculture reflects low labour productivity that translates into low agricultural incomes. Indeed, agricultural income per capita is about USD 200 per year, the lowest among its Asian neighbours, and most farms are subsistence-level holdings, with over 50% of farms being less than five acres (two hectares) (Figure 1). Raising incomes in rural areas will require increased agricultural productivity. Rice is Myanmar’s main crop but rice productivity is low and its output has been growing more slowly than that of other crops.
Improving the performance of agricultural value chains and integrating Myanmar’s over 2 million commercial smallholders (those with 2-20 hectares) into them can provide a way to harness emerging demand-driven market opportunities to modernise the agriculture sector, improve its performance and raise agricultural/rural incomes. The value-chain approach generates linkages to complementary non-agricultural services and inputs at each stage of the chain from input supplier to producer to consumer that can ignite the wider process of the transformation in the rural economy. These complementary inputs and activities add value to the product and include a wide range of services such as processing, transportation, technical assistance, marketing and logistics and the provision of inputs ranging from chemicals to machinery. Locating these activities in rural areas near production generates investment, employment and income opportunities leading to further growth. These can stimulate the flow of labour to the non-agricultural sector and thus also improve overall labour productivity in agriculture. The mango value chain provides an example for improving access of Myanmar fruit and vegetables to global markets. Indeed, expansion of fruit and vegetable exports are well known for creating links to non-agricultural services and inputs and thus opportunities for the growth of SMEs in rural areas.

Research and innovation as well as extension services can help overcome the outdated methods of farming that are holding Myanmar’s agriculture back. Notably, limited funding for R&D for varieties adapted to local conditions has meant that production and distribution of high quality seeds has not been able to keep up with needs of the agriculture sector. Greater public investment in agricultural R&D in this area will be fundamental to increasing productivity and to promoting innovation in agriculture. Expanding agricultural extension services and farmer education
can also help spread modern farming practices and improve productivity. There are numerous ways to extend the quantity and quality of extension services to farmers, including: continual training for extension professionals; strengthening the links between agricultural research and extension services; expanding the delivery of technical information and training as well as weather warnings and market price data through the Internet, radio and smart phones; expanding the use of village-based approaches with local leader formulas, such as farmer-to-farmer approaches in the transfer of knowledge and skills; using co-payment schemes for specific types of technical assistance; adopting public-private approaches in the provision of extension services with government oversight.

Contract farming can provide incentives for modernisation and help increase productivity and incomes among smallholders. Contracts with large exporting firms can incorporate small farmers into markets where ensuring quality, safety and delivery volumes for buyers are important. Contracts provide for acquisition of inputs through credit, for technical assistance and for a guaranteed price at harvest, thus relaxing the constraints the typical farmer faces in these areas. Myanmar already makes use of contract farming through some 58 Rice Specialisation Companies (RSCs). However, because rice is a generic product with no specific quality attributes it may not be well suited to contract farming. There are however opportunities for contract farming in the fruit and vegetables sector, where quality and safety requirements need to be ensured all along the chain. From a public policy perspective, there is a role for government to support the establishment of contract farming where smallholders are involved. For example, the government could promote industry associations that bring together producers and farmers to discuss strategies and market opportunities. Ensuring a transparent legal framework for contracts between farmers and agribusiness also needs to be considered as the sector develops.

Many of Myanmar’s crops could potentially be exported but inadequate infrastructure hampers progress. The physical structures and facilities needed at an economy-wide level, including electricity supplies, telecommunications systems and transportation facilities such as roads, ports and airports need to be upgraded. These constraints are particularly severe in rural areas where production occurs. Producers and traders are often obliged to substitute lack of public infrastructure with private, higher-cost solutions, such as fuel-based generators in place of national electricity supplies, which lowers profits and dampens incentives for investment.

Exports are also constrained by the institutions, laws and policies governing the sector. The most binding and pervasive constraint on exports is the lack of an adequate financial system. A robust financial system – encompassing banking, microfinance, and insurance services – for the agricultural sector as well as for the wider rural economy is needed to take advantage of market opportunities,
foreign and domestic, that are likely to develop in the near future. In addition, **resolving ambiguity in land tenure and production rights should improve production incentives.** Security of land tenure and freedom in crop choice are two of the most important unresolved issues. Other constraints include insufficient government food safety inspection services, which increase production risks and limit access to international markets, and the lack of government support to explore new market opportunities, which limits market entry potential in relation to competitors. The government could consider setting up a special portal for agri-food products to disseminate information on importing country food safety regulations and market information to facilitate trade.

Myanmar has the potential to expand its range of agricultural export products and destinations. Myanmar’s National Export Strategy (NES) has identified a number of priority sectors including rice, fish and crustaceans, pulses, beans and oilseeds, with rubber as an emerging priority sector. To develop a strategic plan to activate Myanmar’s potential value chains in these sectors will require not only in-depth analysis of their production potential and market opportunities, but also the identification of trade capacity needs. Building on Myanmar’s NES, several candidates for further value chain development can be identified, in particular: fruits and vegetables and fish/crustaceans, which can integrate smallholders to markets for high value products; and rice, because of its widespread production and opportunities for upgrading.

**Developing the manufacturing sector**

Myanmar’s manufacturing sector is growing from a small base that is anchored in agriculture. While the share of value-added of the manufacturing sector has increased over the last decade, Myanmar is still an agrarian country, with a manufacturing share of only 26% even compared with its neighbouring countries Viet Nam and Thailand, which reach close to 40%. Food and beverage production strongly dominates the private manufacturing sector in Myanmar, followed by the construction materials, apparel and metal/mineral sectors (Figure 2).

The private manufacturing sector is growing, but state-owned enterprises still play a dominant role. Although their number has been declining rapidly, they still play a large role in various sub-sectors covering almost all key manufacturing classifications, but particularly heavy metal products, construction materials, food and beverages, apparel, industrial raw materials, personal goods, and printing and publishing. According to the Central Statistical Organisation (CSO), there were 639 state-owned enterprises operating in the manufacturing sector at the end of FY 2011/12.
The manufacturing sector has shown some positive signs of development following various development strategies coupled with the reforms since 2011. Since the present reform process began, both domestic and foreign investors have changed their attitudes and behaviour toward business opportunities in Myanmar, with domestic investment and FDI shifting towards the manufacturing sector, which now is the top-ranked sector among all economic activities (followed by hotels and tourism and then transport and communications and power).

The government of Myanmar has been particularly focused on developing its manufacturing sector following the example of the export- and FDI-led development strategy which a number of Myanmar’s neighbours have undertaken in the past decades. The government has implemented new investment laws and made plans to develop other key legal frameworks such as the SME and industry laws and the intellectual property law. Additionally, the government is promoting the development of industrial zones and special economic zones as one of the main industrialisation strategies to enhance trade and investment in the manufacturing sector. Such measures are intended to build the capacity of the manufacturing sector; to promote FDI into the sector; to enhance the competitiveness of SME manufacturers; and to promote exports of manufactured goods. The government has been active in developing policy frameworks, institutions and linkages with the manufacturers.

However, the Myanmar Business Survey showed that manufacturers in Myanmar face several key constraints. Among the 34 choices of major obstacles to the current operations of surveyed manufacturers (ranging from infrastructure issues to human and institutional capital), corruption was identified most frequently as a very severe obstacle (Figure 3). Other serious obstacles to firms’ current operations are lack of technology and access to land and office space. In addition, SMEs in particular face a regulatory burden that often overstretches their capacity.
In view of these findings, more effective government intervention is needed to enhance the competitiveness of the manufacturing sector. For example, **creating and enforcing a fair and transparent legal and regulatory regime** for manufacturers could help to tackle corruption. A clear contract policy for public (and private) procurements with manufacturers and an e-procurement system would be important to have. In addition, **implementing a streamlined institutional framework for the development of science and technology and putting in place better skills systems** could help to improve access to technology and workforce skills (see next section on education and skills). Policy measures to support SMEs specifically and a nation-wide strategic plan for the development of SEZs and industrial zones could also help overcome constraints in infrastructure and access to suitable land.

Lastly, given the importance of SMEs in the manufacturing sector, policy measures which help to foster the growth of SMEs will be crucial to the development of the manufacturing sector overall. As access to finance is a key constraint, **an SME development fund could be a tool to enhance access to finance for SMEs**. Countries such as India, Japan and Malaysia have developed SME funds, or apex SME banks, and provided various financial services to the SME sector. While continued emphasis should be placed on the development and strengthening of the capabilities of the financial system to allocate financial resources, a dedicated SME fund could bridge the financing gap in the meantime. This could be done in co-operation with international development agencies that want to channel funding to manufacturing SMEs. The key success factor of an SME fund is to develop comprehensive risk management skills, improving information transparency. **An SME development agency could be tasked with assessing the costs and benefits of specific laws/regulations and eradicating unnecessary roadblocks**. The agency could also be tasked with setting up “single-window” SME service centres which could handle all business registrations, licensing, permits and tax collection in streamlined, simplified and transparent procedures and disseminate regulatory, financial, technical and market information to the manufacturers, in co-operation with other relevant ministries, financial institutions and business associations.
Seizing opportunities in the services sector

The services sector will play an important role in Myanmar’s transition to a modern economy from one now reliant on agriculture. Growth in the services sector is likely to outpace that of the economy as a whole in Myanmar, as this sector benefits disproportionately from rising incomes and the resulting demand from wealthier consumers for more personal and social services such as education and healthcare. Services increasingly contribute to economic development indirectly by improving the quality and efficiency of goods production and directly in high-productivity modern services such as finance, business and ICT.

The services sector retains room for considerable expansion in Myanmar for several reasons. First, the share of total GDP of the services sector remains comparatively low. Between 1990 and 2011, the value added of the services sector increased from 34% to 42.9% of GDP, respectively, and from 31% to 39.5% of total employment, respectively. In spite of gradual increases in the contribution of the services sector to Myanmar’s economy, its share of total value added remains low in international comparisons, even considering Myanmar’s level of development (Figure 4).

Figure 4. Myanmar’s services share of GDP is somewhat low for its income level
Percent of GDP in services versus the log of GDP in USD per capita, 2012

Note: The services sector excludes utilities. 

Second, in low-income countries such as Myanmar, limited domestic demand makes tradable services, such as tourism, particularly important growth drivers. For example, international tourism receipts received by Myanmar nearly tripled in the past three years, from USD 0.32 billion in 2011 to 0.93 billion in 2013. However, the constraint from domestic demand and a lack of openness to trade have impeded the growth of the services exports. Despite accounting for about 2.6% of the overall GDP of the Association of Southeast Asian Nations (ASEAN), Myanmar accounts for
only 0.26% of the value of the region’s services exports. Services exports have been declining in Myanmar as both a percent of GDP and of world services exports, though both show recent signs of improvement. For the most part, services in Myanmar are highly isolated from international competition. Although improvements are being made, notably through the ASEAN Framework Agreement on Services, Myanmar is ranked 121st out of 148 countries on the GATS Commitment Index.

The transport and logistics and tourism sectors have particularly high potential to grow, to create jobs and to produce beneficial spillovers for the rest of the economy. Myanmar has a strategic location for growing the transport and logistics sectors, given its location between the two emerging giants of China and India and its access to the Indian Ocean via the Bay of Bengal. In addition, the present reform process and relaxed international sanctions should help to boost the growth in the tourism industry.

In particular, policies should harness the growth potential of the transport and logistics and tourism sectors. To enhance the transport and logistics sector, reforms and additional public investment are needed, with priority on regulatory reforms, education and training programmes, and the upgrading and expansion of road networks. Indeed, the improvement of domestic transportation systems – both long-distance and within destinations – is also critical for growing the tourism sector. Tourism policies should also focus on developing popular locations to manage increased numbers of visitors and promoting more balanced tourism.

**Filling the skills gap in Myanmar**

Building up the right skills in the workforce will be essential to support Myanmar’s structural transformation. Firms in the country identify a lack of skilled workers as a serious or very serious obstacle to their operations. This constraint could become even more acute as the country undergoes economic modernisation if the right skills policies are not put in place.

As the Initial Assessment revealed, time is of the essence. Myanmar’s population will start ageing soon so there is a risk that the country could get old before it gets rich if the momentum for development is not seized now. The size of Myanmar’s potential workforce (people aged 15-64) will be fairly stable at around 40 million until 2035, after which it will begin to fall and the dependency ratio will rise as the population ages. While investing in basic education remains important, the investment will take time – a generation – to bear fruit, whereas Myanmar needs to develop the right skills in a much shorter timeframe. This builds a strong case for a policy focus on training and retraining for adults. This is especially important given Myanmar’s “lost generation” of people now of working age who suffered from reduced education opportunities and the deteriorating quality of education under the previous regime.
Policy makers need to focus attention on developing relevant skills, removing any barriers which prevent people from actively contributing their skills to the labour market, and ensuring that people's skills are utilised effectively, all underpinned by a strong policy framework for skills.

**Developing relevant skills**

High drop-out rates are holding back the development of higher level skills beyond basic literacy and numeracy. It will be important to **address the financial and other non-financial barriers to access to education** that keep enrolment and completion rates from improving more quickly. Barriers include care or work responsibilities that children may have outside of school, the physical distance children need to travel to school (especially secondary schools), the language of instruction for children for whom Myanmar language is not their mother tongue, and inadequate provision of services for children with disabilities.

Education quality is also jeopardised by insufficient teacher training. As teacher quality is an important school factor influencing student achievement, increasing the quality and duration of teacher training will be an important policy goal. **Selection criteria for teacher training colleges and institutes could be used to ensure that competent and motivated candidates enter teacher training; more flexible entry pathways into the teaching profession could also help.** For example, introducing the option of a two-year teacher training course for university graduates of other disciplines would open up an additional entry point into the profession.

Many of the jobs likely to be created as Myanmar industrialises will require strong technical and vocational skills, but technical and vocational education and training (TVET) is currently very limited, with just 0.5% of upper secondary students enrolled in TVET (Figure 5). **More and better technical and vocational education** would better serve the needs of Myanmar’s modernising economy and would provide more useful skills to the large numbers of students who do not reach higher education. **Including workplace training and ensuring that TVET teachers keep up-to-date with modern industry standards will be important quality aspects.**
Figure 5. Secondary technical and vocational education and training (TVET) is limited in Myanmar

Technical/vocational enrolment at the upper secondary level as % of total enrolment in upper secondary

Note: Upper secondary education corresponds to the final stage of secondary education. Data are for 2012 except for Myanmar (academic year 2013/14) and Indonesia (2011).

Activating skills supply

Few people in Myanmar are identified as inactive, but there are concerns about unemployment and high emigration rates. While labour force participation rates are generally high, there are signs that unemployment, in particular youth unemployment, is a growing concern. In addition, up to 5.5 million Myanmar nationals work abroad (Figure 6). This diaspora represents a huge skills pool which could potentially contribute to Myanmar’s economy. Effective polices will be needed to encourage “brain circulation” and avoid the problem of “brain drain”. The best way to prevent brain drain is to provide incentives to stay, including by improving local labour-market conditions, rather than by imposing coercive measures to prevent emigration.
Figure 6. Around 10% of Myanmar’s population is estimated to live abroad

Emigration rates (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Emigration Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Myanmar</td>
<td>10</td>
</tr>
<tr>
<td>Philippines</td>
<td>4</td>
</tr>
<tr>
<td>India</td>
<td>1</td>
</tr>
<tr>
<td>China</td>
<td>1</td>
</tr>
</tbody>
</table>

Note: Myanmar data based on 2009 estimates; China, India and Philippines figures refer to 2005-06.


Migrants’ apparent preference to return to their traditional home would argue for a focus on creating jobs in rural areas, through an agricultural value chain approach that generates linkages with complementary services and inputs (generally) in the non-agricultural sector. The government could also consider targeted services to help returning workers reintegrate into local labour markets.

Putting skills to effective use

Young people are often not “work ready” by the time they complete their initial education, or even after graduation from university, and workers instead tend to acquire skills “on the job”. Employers' investment in formal training to maintain, develop or increase workers’ knowledge and skills is however very limited: over half of all firms do not spend anything on training for employees.

Myanmar could strengthen employment services, in particular by providing job-matching services and training to meet employers’ needs. Government schemes, especially for individuals with low levels of skills, are necessary to solve the problem of under-skilling in the labour force and to achieve an optimal match between workers’ skills and job requirements. This will be especially important in sectors where firms may be unwilling to provide training if their employees are likely to leave for a competitor, which in Myanmar is particularly the case in the fisheries sector and the hotels and tourism sector, among others (Figure 7).
The effective utilisation of skills is also hampered by difficult school to work transitions. Students face difficulties in making this transition due to the design of the current matriculation system and a lack of reliable information on the employment and earning prospects of different career options. Facilitating school to work transitions through reform of the simple pass/fail matriculation system, evidence-based careers advice services and strong partnerships between schools, universities, employment services and employers would also help better utilisation of skills.

Finally, efforts should be made to fully establish the national qualifications framework (NQF) that is currently under construction as soon as possible, as being able to identify people's skills accurately helps ensure that those skills are used effectively. Myanmar could consider establishing a Recognition of Prior Learning programme which would be recognised within the NQF to help those individuals who have never had, or who do not have, the opportunity to access formal learning.

Strengthening the policy framework for the skills system

The framework for policy making, both for the formal education sector and for wider skills policy, is complex and a large number of ministries have responsibility for education or training programmes. Effective policy making is also hindered by a lack of accurate information and data, and limited engagement with social partners.
In order to reduce complexity and enhance the coherence of policy making, the government could consider consolidating operational responsibility for education and training (both general and TVET) into a smaller number of ministries. Systematically gathering and publishing data and other information about evolving skills demand would support evidence-based policy making that is more responsive to labour market demand. Introducing institutionalised arrangements – such as advisory councils – to include social partners in designing and implementing skills policy would also help ensure that education and training programmes are relevant to the needs of business and the wider economy.

Providing the financial resources to support development

Realisation of Myanmar’s potential will depend upon how effectively the country can mobilise and allocate the financial resources to support its development needs. The conditions also need to be created for the development and strengthening of the capabilities of the financial system to allocate savings, provide financial instruments and services to meet the needs of the population, and support effective functioning of markets. Myanmar’s authorities have made impressive beginnings on achieving these priorities. The challenge now is to sustain an ongoing process of reforms to ensure that the provision of financial resources not only keeps up with but helps to catalyse the country’s overall development.

Mobilising resources for development

Myanmar’s ambitious development plans will require financial resources on a considerably larger scale than have been available during the pre-reform decades. Although it is difficult to estimate the size of these needs, they could amount to as much as an additional 5-10% of GDP on average over the next two decades. Achievement of the growth targets implied by the country’s development objectives (which are comparable to those attained by other developing Asian countries in the early stages of their take-off) could require capital investment averaging between 21% and 28% of gross domestic (GDP) annually over the next two decades, and rising over time to reach as much as 30-40% of GDP by 2035 (Table 1).

In order to meet these funding needs, Myanmar will have to tap all available sources of financial inflows, domestic as well as external. Inflows from external sources – mainly official development assistance (ODA) and foreign direct investment (FDI) – are expected to surge in response to the lifting of sanctions and are likely to be especially important in financing development through the remainder of this decade. However domestic sources, from government revenues and private savings, will have to supply the bulk of development finance, and they will need to increase significantly over time, particularly as the initial surge from external sources recedes.
### Table 1. Assessment of investment needs in Myanmar until 2035, based on two scenarios

<table>
<thead>
<tr>
<th>Scenario 1 – constant ICOR</th>
<th>Scenario 2 – increasing ICOR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth in Myanmar until 2035: 6.5%</strong></td>
<td></td>
</tr>
<tr>
<td>Investment share, average over 2013-35</td>
<td>27.30%</td>
</tr>
<tr>
<td>Investment share reached in 2035</td>
<td>37.00%</td>
</tr>
<tr>
<td><strong>Growth in Myanmar until 2035: 7.5%</strong></td>
<td></td>
</tr>
<tr>
<td>Investment share, average over 2013-35</td>
<td>28.90%</td>
</tr>
<tr>
<td>Investment share reached in 2035</td>
<td>40.00%</td>
</tr>
<tr>
<td><strong>Growth in Myanmar until 2035: 8.5%</strong></td>
<td></td>
</tr>
<tr>
<td>Investment share, average over 2013-35</td>
<td>30.40%</td>
</tr>
<tr>
<td>Investment share reached in 2035</td>
<td>43.00%</td>
</tr>
</tbody>
</table>

Notes: Investment share in 2012 was around 16.7%. In both scenarios, GDP growth rates are assumed to be constant over the period 2012-35. Scenario 1 assumes a constant incremental capital to output ratio (ICOR) while scenario 2 assumes an increasing ICOR. Estimates are given for three average annual GDP growth rates of: 6.5%, 7.5% and 8.5%. In the first scenario, Myanmar reaches the capital stock per capita corresponding to the level of GDP per capita attained by China in 2003 if its GDP grows at an average annual rate of 6.5%; and reaches the capital stock per capita required to attain China’s per-capita GDP in 2005 and 2007, respectively, with GDP growth of 7.5% and 8.5%, respectively.

The second scenario assumes that the ICOR, which measures the marginal amount of investment necessary for an economy to generate an additional unit of GDP in Myanmar increases progressively from 1.2 in 2004 (calculated as a ten-years moving average) to 4.5 in 2035 (closer to current levels in other Asian economies). The ICOR is currently low in Myanmar, reflecting the relative scarcity of capital, and the corresponding average return on investments is relatively high. However, the ICOR is expected to increase as capital efficiency decreases along with capital accumulation. Given the projected efficiency trends in investment and the projected output, the corresponding investment amounts are derived for each year until 2035, and the investment shares until 2035.


Financial resources from external sources, mainly ODA and FDI but also a small portion of remittances from Myanmar citizens working abroad, are likely to be particularly important in the medium-term. The total FDI, ODA and official remittances in 2012 was USD 2.7 billion (about 4.5% of GDP). However, given the expected increases in ODA and FDI following the lifting of sanctions and political and economic reforms, flows from these sources and a large unofficial component of remittances could rise to as much as USD 7.3 billion over the medium-term, or 13.2% of GDP. This level is comparable to some other Asian neighbours (for instance, in 2011, FDI, ODA and remittances represented 14.5% of GDP in Cambodia, 14.5% in Viet Nam and 9.7% in Lao PDR) and suggests that the figure is realistic. This analysis indicates that external sources could provide as much as one-quarter to one-third of Myanmar’s financing needs for development through at least the remainder of this decade. However, ODA and FDI flows are unlikely to be sustained at such a level.
indefinitely: as development proceeds and the most productive foreign investments are exhausted, the flows are likely to recede.

In the longer term, the bulk of the financial resources to support development will come from government revenues and domestic savings. Both sources have been depressed by excessive regulation and other legacies of the pre-reform system and will need to rise substantially. Government revenues, especially tax revenues, are exceptionally low compared to other Asian developing countries. Available revenues for spending on development, social, and other general government purposes amounted to 9.1% of GDP in fiscal year FY 2012/13 (Figure 8). Gross national savings (GDP less final consumption expenditure) has risen significantly since 2010, to an estimated rate of about 24.5% of GDP in 2012 from 15.8% in 2009, but is still short of the levels of 30% or more attained by Viet Nam and most other rapidly growing ASEAN economies.

Figure 8. Total revenues and taxes in Myanmar are comparatively low in relation to GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Revenue</th>
<th>Tax Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Myanmar</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>25</td>
<td>25</td>
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<td>Indonesia</td>
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<td>Bangladesh</td>
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<tr>
<td>China</td>
<td>60</td>
<td>60</td>
</tr>
<tr>
<td>India</td>
<td>70</td>
<td>70</td>
</tr>
</tbody>
</table>

1. Tax and other non-tax revenues plus transfers from SOEs.


Natural resource revenues will fill part of the gap but tax revenues need to rise substantially, to at least 10% of GDP over the medium term, possibly even more. The projected natural resource revenues could account for more than one-third of total available government revenues over the medium-term if the ratio of revenues from taxes and SOE transfers remain at their FY 2012/13 level. Natural resource revenues, particularly those from energy sources, can be highly volatile owing to fluctuations in their international prices and hence are more difficult to predict and more prone to lead to unexpected declines in overall government revenue and increases in the budget deficit. Government revenues from natural resources need...
to be effectively gathered and managed. If tax revenues do not rise, Myanmar risks becoming overly-dependent on natural resources to finance government spending.

Tax revenues could be raised through reforms to the tax system and tax structure and improved tax compliance. Currently, there are only 200,000 registered taxpayers in the entire country, amounting to only 0.4% of the population. While there is some scope to raise revenues by increasing tax rates in some areas, much will have to come through improved collection. Tax collection and compliance are limited by weaknesses in tax administration. In addition to gradually increasing commercial tax rates and improving collection of all taxes, reforms in three other areas are likely to have an important bearing on success in raising overall revenues available for development and other government objectives. The thorough reform of the tax system in Myanmar should also help facilitate introduction or expansion of other taxes that would not only help boost revenues but also in some cases would help promote other development goals. These include property taxes and environmental taxes, which although levied to some degree, could probably be expanded.

Revenues need not only to be increased but the tax and other revenue-raising mechanisms need to become more efficient to provide incentives to foster private sector development and to avoid excessive distortions and costs to the economy. Myanmar authorities have recognised the need both to increase the overall ratio of tax revenues to GDP and to improve the efficiency of the tax structure and the tax administration. A major tax reform took effect in FY 2012/13 that represents a good beginning toward these goals. The success of reforms to increase government revenues will also require restraint and careful targeting of subsidies and tax preferences for investment and other purposes. Myanmar has also introduced an array of tax holidays, exemptions and other preferences to attract foreign investment. Although these preferences appear roughly comparable overall to those applied in other Asian developing economics, care will need to be taken to ensure that such preferences are carefully designed to be as cost-effective as possible.

Allocating resources

Increasing tax revenues needs to be accompanied by an ongoing process of public financial management (PFM) reform to improve government capabilities to ensure that revenues are allocated in line with development and other priorities, that public services are delivered efficiently, and that fiscal soundness and stability are maintained. Improvement in the effectiveness with which development resources are allocated will be as important as success in increasing their mobilisation. Effective allocation of development resources will require strengthening of a wide range of institutions in Myanmar that are at present underdeveloped or weak. These include institutions shaping the way in which government revenues are raised and allocated; the capacities of the financial system; and, more broadly, the institutional arrangements for effective functioning of markets and businesses. The present
Extensive efforts to strengthen public financial management are underway. Myanmar’s government has begun a programme of PFM reforms to improve the effectiveness with which expenditures are allocated, financed and managed. The reforms taken so far have already yielded some significant accomplishments, especially in making the budget process more transparent to the public and more accountable to its elected representatives. Further reforms to budgeting processes will be necessary to address weaknesses. Recent reforms have established more systematic and open formal procedures for formulation, review, and discussion of the budgets of the Union and (now) the states/regions, but most of the earlier underlying procedures, standards and arrangements remain. Important weaknesses in the budget process include weak linkages between national development plan objectives and the budget process; lack of comprehensiveness and transparency in the budget; weak control of overall budget outcomes; inadequacies in rules and procedures necessary for effective public services delivery; and limited (although improving) capabilities for external audit and public scrutiny and accountability. Most of the weaknesses are common to most developing countries and are substantially a reflection of the early stage of development of their institutions.

Spending on social needs is low because the budget is not fully aligned with development priorities. Public spending on health and education by Myanmar amounted to 0.8% and 1.5% of GDP, respectively, in the FY 2012/13 budget (Figure 9). The limited spending on health, education and other social areas contrasts with the relatively high level of need for services. This is especially evident in indicators of health, such as life expectancy, infant mortality and per-capita expenditures on health.

A fiscal federalism framework has been established under the 2008 constitution, but implementation is so far limited compared to other federal states. According to official statistics, Myanmar states and regions together accounted for 4.7% of total government revenues and 6.7% of total expenditures in FY 2012/13. The degree of fiscal decentralisation in Myanmar measured by these figures is well below that of most other developing countries in the Asian region, as well as that of federal countries in the OECD (Table 2). Going forward, Myanmar faces important choices about how to further develop and elaborate the fiscal federal system.
Figure 9. Public spending on health and education is low

Education and health expenditure ratio to real GDP and to total expenditure (in %)

A. Education (in 2011)

B. Health (in 2012)

1. The allocation for education in FY 2012/13 budget rose to 1.5% of GDP and to 1.8% in the FY 2013/14 budget.
2. The allocation for health was raised to 0.8% of GDP in the FY 2012/13 budget and to 0.9% of GDP in the 2013/budget.
* Data are in 2010.

Table 2. Sub-national share of government revenues and expenditure

<table>
<thead>
<tr>
<th></th>
<th>Revenue</th>
<th>Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>55.3</td>
<td>66.5</td>
</tr>
<tr>
<td>Germany</td>
<td>34.9</td>
<td>38.7</td>
</tr>
<tr>
<td>Mexico</td>
<td>9.6</td>
<td>45.3</td>
</tr>
<tr>
<td>United States</td>
<td>45.4</td>
<td>47.3</td>
</tr>
<tr>
<td>Korea</td>
<td>15.7</td>
<td>43.3</td>
</tr>
<tr>
<td>China1</td>
<td>58.6</td>
<td>82.0</td>
</tr>
<tr>
<td>India2</td>
<td>49.5</td>
<td>41.1</td>
</tr>
<tr>
<td>Indonesia3</td>
<td>12.2</td>
<td>19.0</td>
</tr>
<tr>
<td>Malaysia4</td>
<td>11.4</td>
<td>10.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>15.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Myanmar5</td>
<td>4.5</td>
<td>6.7</td>
</tr>
</tbody>
</table>

5. Myanmar CSO, data for FY 2012

Sources: See notes above.

Transforming the financial system to support Myanmar’s development

The most important determinant of Myanmar’s success in mobilising the financial resources for its development will be the capabilities of the financial system. The key challenge for Myanmar authorities will be to ensure that financial system development proceeds rapidly enough to support overall economic development rather than to constrain it. Given Myanmar’s early stage of development, it is not surprising that the key elements of the financial system are at present quite limited. The government has given top priority to improving the financial system and has taken an impressive number of steps since 2010 toward providing the legal and regulatory frameworks necessary to foster its development.

Strengthening and developing the capabilities of the formal financial system will involve extending its outreach into the economy, improving the efficiency with which domestic savings are allocated, and providing a wider range of products and services to serve the needs of the population. This will require a long-term process of institutional development of financial institutions, financial markets, and financial regulation and supervision. However, liberalisation of the banking sector and substantial improvements in its capabilities and the broadening of facilities to provide financial services to the rural sector within the medium term are particularly urgent. These reforms are likely to be important keys to the success of Myanmar’s overall development plans.
Development of the rural financial system, in particular, will be critical. Of all the segments of the Myanmar economy, the rural sector is the most underserved by the formal financial system. Only about 2.5% of total loans go to the rural sector, even though it accounts for 30% of GDP and two-thirds of employment. The rural population has considerably less access to formal financial services than the population in urban areas and some segments, such as landless farmers, are effectively cut off from such services.

Myanmar authorities consequently face a number of important decisions, including about the basic structure of the banking system, the sequencing of liberalisation, the development of rural finance and microfinance, and the strengthening of supervisory institutions. Authorities are likely to have greatest success by concentrating on fostering a sustained process of institutional development to improve the capabilities of financial institutions and markets and the supporting legal and regulatory frameworks and infrastructure. Direct government interventions, such as loan subsidies or other preferential lending, may be appropriate in certain cases but need to be carefully targeted in scope and duration lest they interfere with the institutional development process.

Myanmar’s financial system is at a very early stage of development, characterised by a near-complete dominance of commercial banks, which account for nearly all the assets of the formal financial system, the near absence of formal financial markets, and a very limited array of financial instruments and services. The limitations of the Myanmar financial system are manifest in an exceptionally low penetration of financial services and products into the economy: less than one-fifth of the population has access to formal financial services.

Several features of the banking system impair its ability to effectively gather and allocate financial resources. These include factors that limit the incentives and capabilities of state-owned and other government-affiliated banks to operate as prudentially sound commercial entities; weaknesses in the structure of the private and semi-government banks (PSGB) segment, notably the small scale and narrow scope of many of the banks; and regulatory restrictions. The traditional commercial banking services provided by the banking sector are comparatively limited relative to their overall asset size and in relation to the policy functions they carry out for the government.

Some regulations are very stringent, including the officially specified rates for bank deposit and lending rates, as well as strict collateral requirements. The conservative lending practices have resulted in a fairly low rate of loan default, but the practices have also contributed to the limited access to formal credit by much of the private sector. Regulations have also sharply constrained the ability of banks to extend their services more broadly into the economy. The interaction between the structural limitations of the banking system and restrictive regulation has impaired the banking system’s effectiveness in meeting the financial needs of the population. Improvement of the effectiveness of the banking will require significant relaxation.
of bank regulations in certain areas in the near term as well as the beginning of reforms to convert the state-owned banks into more effective commercial entities. As competition increases, the PSGB sector may also need to undergo some restructuring. Authorities also face important choices about the pace and scope of opening to foreign bank participation in the domestic market.

In addition, financial regulatory responsibilities will need to be clarified. Myanmar’s formal financial regulatory structure is fairly well defined but somewhat fragmented and departs in some important respects from international practices. In practice, particular segments of the financial institutions sector are subject to more than one government entity and in some cases regulatory agencies also have commercial functions.

The very early stage of financial market development in Myanmar is not surprising given that there were virtually no formal financial markets prior to 2011. Financial and capital market development needs to focus first on interbank and bond markets. Stock market development in Myanmar should be regarded as a longer-term project whose benefits will be manifest gradually; linking it to that of the ASEAN region could overcome domestic limits to market scale. Stock markets need to be fairly well developed and supported by extensive infrastructure, strong regulatory/supervisory capabilities and a relatively large scale if their benefits are to be realised.

Sustaining reforms

Myanmar has embarked on the path of reform with a breath-taking pace and is making impressive progress in many domains. Nevertheless, it will be crucial to sustain this drive in order to establish institutions that are conducive to development outcomes and to improve the conditions for development and well-being of its citizens.

Successful structural reforms of the kind just beginning in Myanmar take time and require sound leadership to win consent for the changes. Policy design needs to be underpinned by solid research and analysis, and appropriate institutions are needed to make the transition from decision to implementation. Experiences from other countries show that successful reforms often require several attempts and that effective communication with voters and stakeholders throughout the reform process is essential in order persuade them of the need for reform and, in particular, to communicate the costs of non-reform.

To this end, the third and final phase of the Multi-dimensional Country Review will support Myanmar’s reform efforts through guidance on implementation of the key policy recommendations developed in the present report.
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Multi-dimensional Review of Myanmar

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