

Myanmar: Selected Issues



MYANMAR

SELECTED ISSUES

March 2018

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Approved By
**Asia and Pacific
Department**

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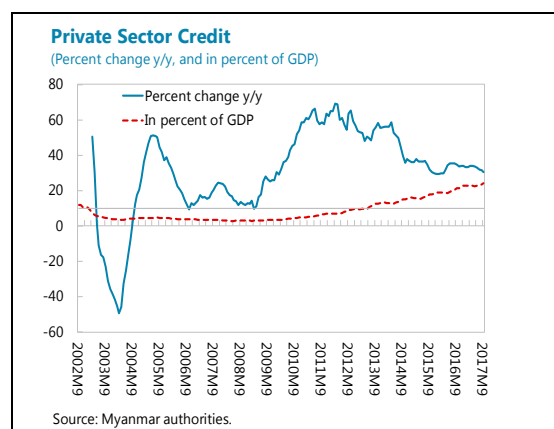
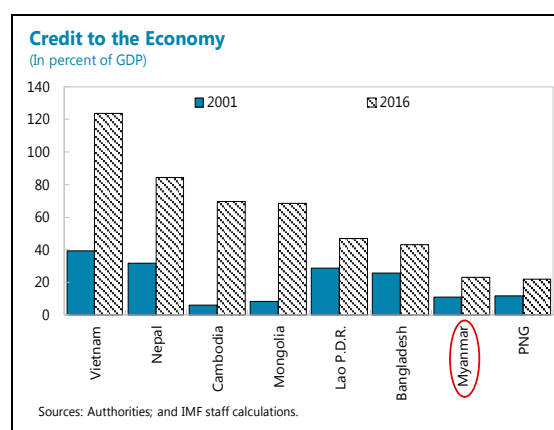
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BANKING SECTOR DEVELOPMENTS¹

Latent banking sector risks are surfacing, following a period of rapid credit growth and as banks adjust to updated financial regulations. Over time banks will need to enhance their credit risk management, and reduce the over-reliance on collateral values to safeguard lending. A banking system action plan has been developed, to enhance the banking system's resilience, as well as strengthen the supervisory and resolution framework. The ongoing overhaul of the prudential framework and financial sector reforms will strengthen the banking sector and its role in supporting the economy.

A. Background

1. Myanmar's banking system has grown significantly in recent years, but remains relatively small. Credit to the private sector started to surge in 2009, peaking at nearly 70 percent per annum, amid strong optimism that built as Myanmar moved towards its recent reform period. In part, rapid private credit growth was an outcome of fiscal dominance, which drove an accommodative monetary policy stance and an expansion in reserve money. The rudimentary bank supervision and unchecked growth in reserve money fueled credit growth to a relatively narrow customer base. However, strong credit growth also reflected the small base of private sector credit, and low development of preceding years. Myanmar experienced a banking crisis in 2003 (Box 1), and a decade passed before private sector credit as a share of GDP recovered to its modest pre-crisis level, of just over 10 percent. More recently, credit growth has started to moderate, against a background of banks' adjustment to new prudential regulations. Nonetheless, credit growth remained rapid at 27 percent (y/y) in September 2017. The ratio of loan assets to GDP is relatively low, at around 40 percent, and private sector credit to GDP is currently around 25 percent of GDP (September 2017).



2. The banking sector is comprised of state-owned banks (SOBs), domestic private banks, and foreign bank branches (FBBs). Myanmar has four SOBs, 24 private banks, and 13 FBBs. In addition, five more private banks are in the process of being licensed by the Central Bank of

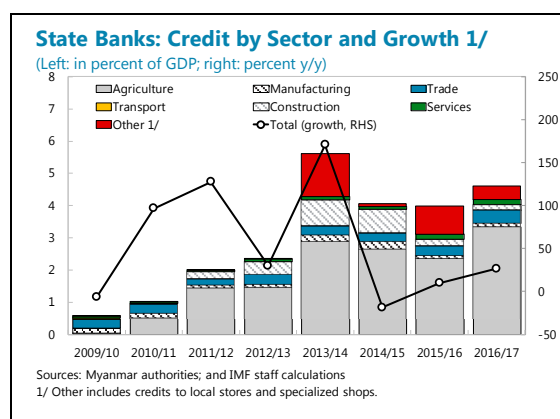
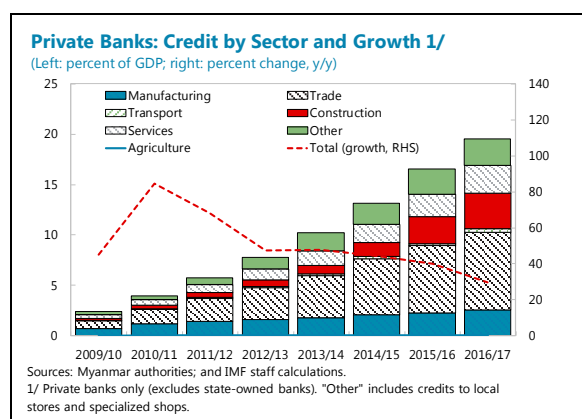
¹ Prepared by Leni Hunter.

Myanmar (CBM). Private banks account for more than half of banking system assets (Text Table), and the largest six private banks hold around 80 percent of private bank assets (as of March 2017). Several small private banks are “policy banks” that are sponsored by a line ministry with private sector contributions. They take deposits and extend loans, but tend to have a narrow focus for lending (e.g., tourism, construction, and agriculture).² Risks in policy banks could create contingent liability risks for government.

Myanmar: Structure of the Banking System as of March 2017
In Kyat billions

	Number	Branches	Total Deposits	% of System	Total Assets	% of System	Total Loans	% of System
State owned Banks	4	516	9,979	28%	17,347	36%	2,234	12%
Private Banks	24	1520	23,324	66%	26,889	55%	16,155	86%
Foreign Bank Branches	13	13	2,120	6%	4,597	9%	327	2%
Total banking system			35,424		48,834		18,716	
In percent of GDP			44%		61%		23%	

Source: Myanmar authorities.



3. Once-dominant SOBs remain systemically important, but have a smaller share of banking system assets and deposits.³ From 1963 to 1990, Myanmar’s banking system was completely state owned, and SOB dominance of the banking system has extended to relatively recent times.⁴ The SOBs undertake quasi-fiscal operations through subsidized lending, mainly to the

² See Myanmar Article IV Staff Report 2015, Box 4.

³ The state-owned banks are Myanma Economic Bank (MEB), Myanma Foreign Trade Bank (MFTB), Myanma Agricultural and Development Bank (MADB), and Myanma Investment and Commercial Bank (MICB).

⁴ The Financial Institutions of Myanmar Law (FIML) 1990 allowed for the creation of private banks, for the first time since all private banks were nationalized as ‘Peoples’ Banks’ in 1963. The People’s Banks were merged into a single bank in 1970. This single bank was divided into four separate banks by the Bank Law of 1975: the forerunners of today’s CBM, MEB, MADB and MFTB. See Turnell, 2009.

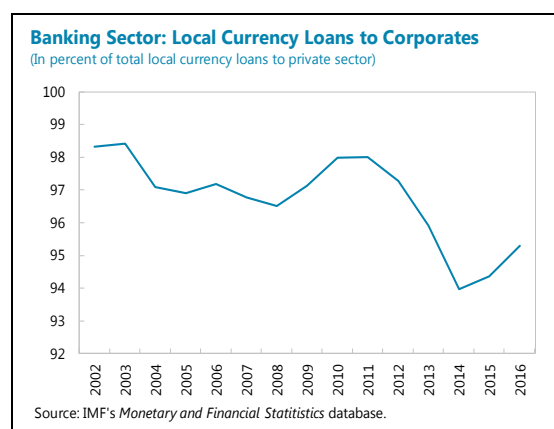
state and the agricultural sector (a major employer and source of household income⁵). They also offer conventional banking products, which puts them in competition with the private banks. Although the SOBs' market share of lending has declined (Text Table), concerns remain that the SOBs crowd out private bank lending in some niche areas (e.g., in agriculture).⁶ Subsidized lending and other inefficiencies have eroded profitability and led to losses in SOBs. The authorities have embarked on an SOB restructuring program with World Bank assistance, which aims to reduce fiscal risks to the government from the SOBs and improve the overall competitiveness of the banking sector.

4. FBBs were licensed to operate in Myanmar in 2015 and 2016, subject to restrictions.

FBBs have largely offered services to foreign companies in Myanmar, due to restrictions intended to limit competition with the still-developing domestic banks. For example, a prohibition on paying interest on kyat deposits means that FBBs have limited access to kyat deposit funding, which in turn restricts their ability to lend in kyat. However, foreign banks are permitted to lend locally in partnership with a domestic bank, and more recently the CBM has eased restrictions by allowing foreign banks to provide trade finance to exporting firms. Although the foreign banks have been small in terms of asset size, they hold a disproportionate share of the banking system's capital.

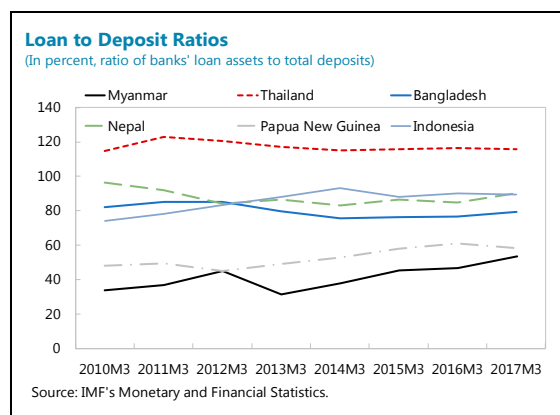
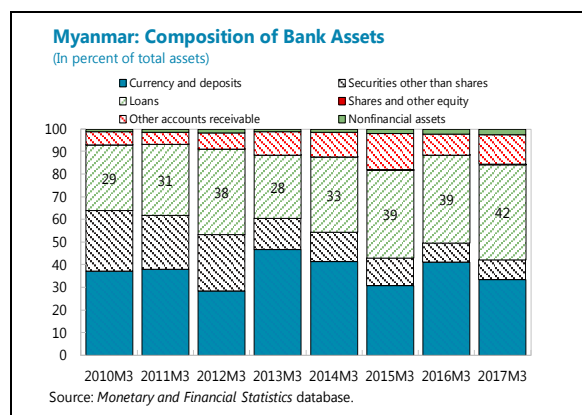
5. Lending is a relatively small share of total assets; most private bank lending is to corporate borrowers.

Domestic banks are largely deposit-funded, and take deposits and lend mainly in domestic currency. Partly for this reason, FX mismatch in the aggregate data is low, though this may mask larger net open positions in some individual banks. Aggregate loan-to-deposit ratios are also relatively low, reflecting difficulty in deposit transformation in some banks, including SOBs. Private bank lending is primarily in the form of corporate overdrafts, in the trade, construction, services, and manufacturing sectors. Around 95 percent of private sector lending is to business, suggesting that among other things collateral requirements have been a hurdle to smaller borrowers. Households and SMEs have relied heavily on credit from nonbank and informal lenders, at significantly higher interest rates.

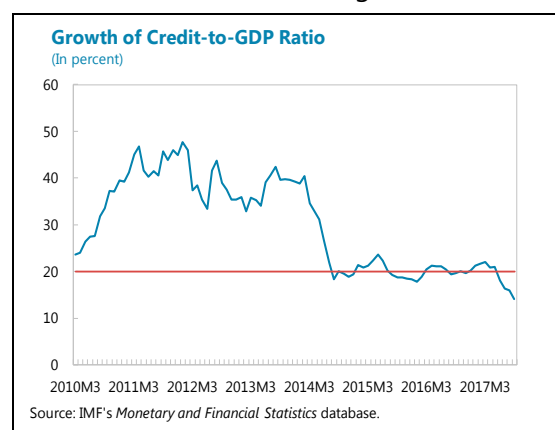


⁵ Agriculture accounted for around 50 percent of employment in 2015. See Ministry of Labor, Immigration and Population, Myanmar, 2016.

⁶ As noted in World Bank (2016).



6. Given recent moderation in credit growth, evidence of a credit “boom” is mixed. Credit booms occur in periods of excessively fast credit growth, and have been used as an indicator of potential risks to financial stability and growth. The risk of a “bad boom”, that leads to low growth or ends in crisis, increases when the starting point level of credit to GDP is high, or when the boom is of long duration⁷. Not all credit booms are “bad booms”—some booms can reflect genuine credit deepening, particularly in developing countries. Credit booms are often evaluated using credit gaps (deviation of credit from an estimated trend), but these can be difficult to use when trend credit growth is not stable, as is likely to be the case in Myanmar given ongoing structural change. Following Dell’Ariccia, et. al. (2012) we therefore define a credit boom as occurring when the credit to GDP ratio grows faster than 20 percent per annum.⁸ While this definition points to a credit boom between 2010-2014, more recent data is less indicative of a credit boom. Nonetheless, vigilance is required given the strength of credit growth in recent years and data limitations.



7. Regardless of whether a credit boom is identified, banking system fragilities have developed.⁹ Much credit growth has been in the form of one-year overdrafts secured on real estate and fixed assets, to a relatively limited pool of borrowers, and continuously rolled over. This reflects requirements that lending must be collateralized by real estate or other immovable assets, and have a maximum contractual maturity of one year (unless offset by matching long-term deposits). In addition, the lending interest rate is capped at 13 percent, and deposit rates are subject to floors of

⁷ Dabla-Norris, et. al. (2015).

⁸ Dell’Ariccia et.al. (2012) also define a credit boom to occur when credit to GDP ratio is at least 1.5 standard deviations above trend, and annual growth of credit to GDP is greater 10 percent.

⁹ Extensive controls on the banks are not new—a series of controls and restrictions, including on interest rates and deposits, were imposed following the nationalization of private banks in 1963 (Turnell, 2009).

6 percent and 8 percent for call and term deposits, and a cap of 10 percent.¹⁰ These lending practices increased banks' exposure to property values, while potentially obscuring risks. Controls have restricted banks' ability to price risk, and may have hindered the development of risk management capabilities. In addition, by limiting profitability, interest controls have likely acted as a deterrent to capital accumulation in the banks. Several banks are part of large conglomerates with extensive commercial interests, adding to related party and large exposure concerns. Limited data is available for prudential supervision, and accounting and auditing practices need to be improved.¹¹

8. As noted in previous Staff Reports, the banking system is undercapitalized. The banking system capitalization is low even under current NPL loss recognition levels, and the CBM is working with banks to bring loan classification and capital levels up to the requirements of the 2016 Financial Institutions Law (FIL).

B. The Evolving Regulatory Environment

9. Progress is being made towards financial system reform, and supervisory capacity is improving. The 2013 Central Bank Law provided for the establishment of an autonomous CBM, enabling the CBM to move from the Ministry of Finance. The law provides the CBM a clear mandate for price and financial stability, with authority for monetary policy, and the licensing, supervision and regulation of banks. Strengthening of the foreign currency system and monetary policy framework have been key achievements. Dissemination of financial sector data has improved. Efforts are also being made to build banking supervision capacity, with progress on strengthening onsite and off-site supervision with Fund TA. However, the supervision function remains at a relatively early stage and is under-resourced, albeit with the recruitment of additional staff in late 2017. Supervisory resources will be further challenged by the licensing process for five new domestic banks.

10. The passage of the FIL was a major step forward in financial regulation. Four key regulations to support implementation of the FIL were released on July 7, 2017, pertaining to capital adequacy, large exposures, asset classification and provisioning, and liquidity requirements. The CBM also issued a directive on credit risk management (March 2017), and a directive that allows for the restructuring of viable overdrafts to term loans of up to 3 years, incorporating regular payments of interest and principal (November 2017). The authorities intend to allow unsecured lending where adequate risk management frameworks are in place, with a proposed interest rate cap of 16 percent. Under the new regulations, minimum capital adequacy ratio requirements are 4 percent for tier 1 capital, and 8 percent for regulatory capital. Large exposures are limited to no more than 20 percent of core bank capital, and all overdraft loans must be cleared each year for a period of two consecutive weeks.

¹⁰ The call deposit floor is set by the Myanmar Bankers' Association.

¹¹ As noted in the 2017 Article IV Staff Report, FSI indicators have been published for the first time, but the system-wide measures mask significant differences among banking groups and the NPL data does not conform to international standards.

11. The new regulations should be implemented in a manner that supports financial stability and deepening. The four regulations issued in July 2017 come into effect at varying times: the liquidity requirement and large exposure limit were effective July 7, 2017; however, the minimum capital requirement, and the asset classification and provisioning requirements, came into effect following a 6-month transition period. Banks were also given three years from July 7, 2017 to phase in their provisioning needs. Where applicable, banks will submit conversion plans (for large exposures, overdraft transformation) to lay out how they intend to come into compliance with the new regulations, and capital improvement plans where necessary. A key short-term challenge will be to restructure viable overdrafts into term loans, and wind down large exposures in an orderly manner that avoids a credit crunch or excessive property price correction. Recapitalization needs will need to be reassessed, as banks submit their overdraft and large exposure conversion plans, and recognize losses as loans become overdue. The CBM will need to carefully handle compliance on a bank-by-bank basis, eschewing general forbearance.

12. A banking system action plan (BSAP) has been developed in collaboration with the World Bank. In order to deliver the benefits of the new regulations the BSAP provides a transition plan to strengthen credit risk management, provisioning and capital. It encourages a phased conversion of overdrafts to risk-based term lending, and further supervisory capacity building, including on resolution frameworks. The BSAP will feed into the broader financial system development strategy that was developed with IMF and WB TA and adopted in 2013. It will also draw on other development plans to ensure a coordinated approach across development partners. Key recommendations from the BSAP are briefly discussed below.

- **Issue remaining regulations and key directives as soon as possible.** These include regulations on related party transactions (including new reporting requirements), external auditors (including requirements to use IFRS), and directives on substantial interest, and fit and proper criteria, and Boards of Directors.
- **Strengthen credit risk management in banks.** Further supervisory guidance on credit risk management is recommended. This guidance should require banks to develop and implement robust credit policies, processes and controls, including underwriting practices with affordability assessments for all loans through cash flow analysis. It should also restrict new loans with a maturity of greater than one year to those that are fully amortized (i.e., with both principal and interest repayments).
- **Move ahead with restructuring of SOBs.** As noted in the Staff Report, following the review of diagnostic reports with World Bank assistance, key tasks will relate to requiring state-owned banks to submit plans for remedial actions, with associated timeframes and follow-up action plans to ensure compliance.
- **Build supervisory capacity, including on recovery and resolution frameworks.** This includes resourcing the function at the CBM to develop contingency plans for bank recovery and resolution, and enabling lender of last resort operations to solvent banks while avoiding public sector bailouts.

- **Increase bank capital.** Banks with capital shortfalls will need to be brought into compliance with the new regulations within realistic timeframes, or face penalties. Gradual interest rate liberalization will help banks better price credit risks and raise capital through improved profitability. Capital can also be injected through foreign minority equity investments, following amendments to the Companies Act.
- **Carefully liberalize constraints on the banks.** The CBM should continue financial sector and interest rate liberalization at a pace commensurate with the CBM's capacity to regulate and supervise. The CBM intends to allow banks to lend unsecured where adequate risk management is in place, and have issued a directive to permit foreign banks to provide retail export financing services. Lifting of the tiered interest rate caps should be carried out in a gradual manner, and foreign banks' domestic lending activities liberalized once the domestic banks are in a stronger and more competitive footing. Gradual interest rate liberalization will assist with improving monetary policy framework, by enabling the operation of the interest rate channel.

C. Summary

13. The banking sector is in a period of adjustment, following strong credit growth and improvements in bank regulation. Latent banking sector risks are being addressed in the context of an ongoing overhaul of the regulatory and supervisory framework, which will strengthen the banking sector over time. Despite its small size, banking sector fragilities may pose risks to broader macroeconomic stability, as demonstrated by the 2003 crisis (Box). New regulations need to be implemented in a manner that supports financial stability and deepening – with realistic time frames for compliance, while avoiding general forbearance. At the same time, further development of supervision capacity is urgently needed. Over the medium term, gradual liberalization of banking system controls will be part of a move towards risk-based (as opposed to collateral-based) lending.

Box 1. The 2003 Banking Crisis

Accounts of the bank crisis primarily attribute the crisis trigger to the collapse of ‘informal finance companies’ in 2002.¹ These companies offered high rates of return (in excess of the bank deposit rate ceiling), but engaged in highly speculative investments and were described as “little more... than ponzi schemes” (Turnell 2009). At the same time, financial system confidence was weakened by rumors, including of large-scale deposit withdrawals in the wake of new anti-money laundering legislation, a political scandal linked to one of the large banks, and others. These events were followed by heavy deposit withdrawals from five large private banks, that turned into a systemic deposit run.

Initial actions taken by the banks and the CBM in response to the crisis were unsuccessful. In February the banks started to limit deposit withdrawals and attempted to recall loans. The loan recalls aimed at 20 percent to 50 percent repayment of outstanding balances, with a central bank-endorsed timetable for repayment (Turnell 2009). Although the CBM attempted to quell the crisis through providing public reassurance and liquidity support (February 21), the crisis continued.

Anecdotal reports suggest a severe macroeconomic impact.² At the time of the crisis, the banking system was small, private banks were still relatively new, and credit penetration and use of bank accounts was low. Despite these factors, the economic impact of the crisis according to anecdotal reports in the literature and media was severe. Lack of access to deposits prevented firms from making payments to employees and suppliers, with cascading effects. At the same time, loan recalls led to asset fire sales. Beyond the immediate impacts, the crisis has had long-term effects on confidence in the banks. As noted above, recovery in the ratio of private sector credit to GDP has taken several years.

¹ This box primarily draws on Turnell 2003, 2009, as well as contemporary media reports.

² For example, the 2003 Economist magazine article “Kyatastrophe: A bank run in Myanmar” <http://www.economist.com/node/1650080>.

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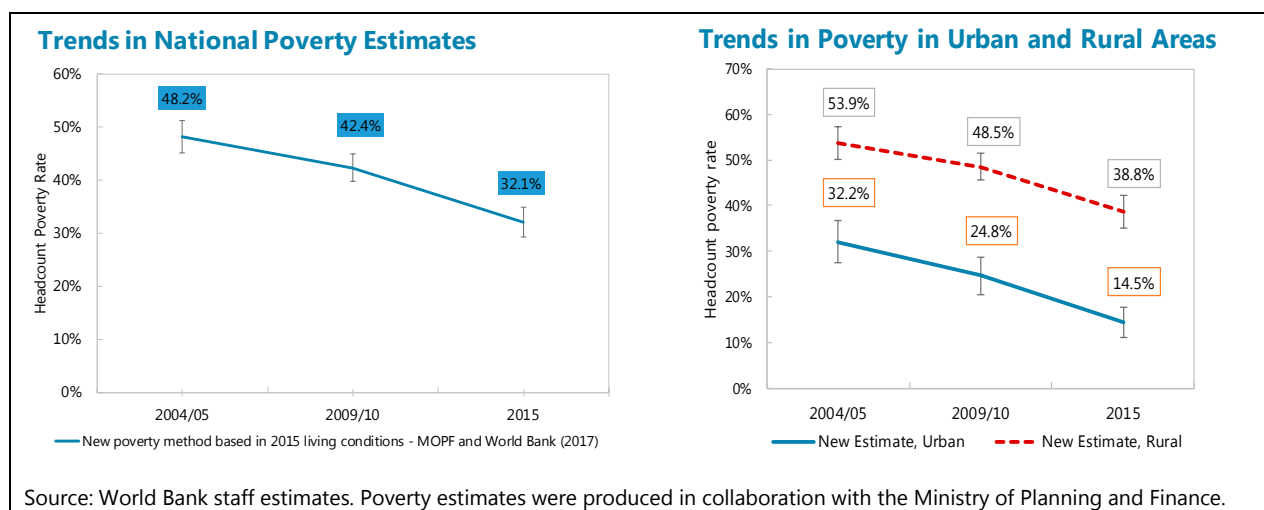
POVERTY DYNAMICS AND SUSTAINABLE DEVELOPMENT GOALS (SDGS)¹

Myanmar has achieved impressive poverty reduction over the last decade. However, disparities across urban-rural areas have widened contributing to higher levels of inequality, although the level of inequality remains moderate compared to regional peers. Causes of poverty are multifaceted including a weaker productive and financial assets base, and inadequate access to social services. Going forward, implementation of a second wave of reforms focused on financial reforms and inclusion as well as raising public spending on infrastructure, education and health through enhanced revenue mobilization and external financing would help to achieve the SDGs.

A. Poverty Dynamics

1. Myanmar has made impressive progress in its poverty alleviation over the last decade.

Poverty declined by 33 percent between 2004/05 and 2015, from 48.1 percent to 32.1 percent, based on the national poverty line benchmarked to 2015 living conditions (Ministry of Planning and Finance, (MOPF) and the World Bank, 2017).² This impressive poverty reduction was strongest in the post-2011 liberalization phase, highlighting the inclusive growth impact of the first wave of reforms in Myanmar (see IMF 2014 and World Bank 2015). The poverty reduction was mirrored in a 31 percent or 2.8 percent annual rise in household expenditures, using the new welfare aggregate. Other indicators of living standards, such as the ownership of motorcycles and televisions, have also risen over time.

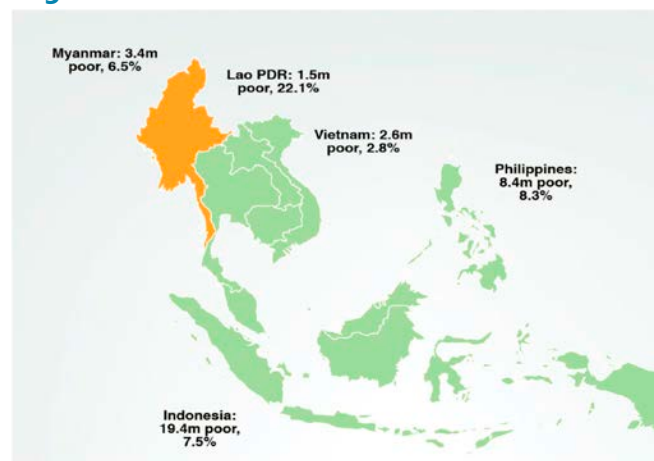


¹ Prepared by Reena Badiani-Magnusson, Senior Economist, World Bank, Yasuhisa Ojima, IMF Resident Representative in Myanmar, with contributions from Maximilien Queyranne (IMF), Ryan Wu (IMF), UNICEF and UNDP. The section on poverty dynamics relies heavily on "An Analysis of Poverty in Myanmar: Part 02 Poverty Profile" by the Ministry of Planning and Finance and World Bank.

² Previous estimates of national poverty based on the Integrated Household Living Conditions Assessment (2017) show a similar trend reduction in poverty.

2. **The internationally comparable extreme poverty rate is comparable to that of regional peers.** Using an internationally comparable poverty line, an estimated 6.5 percent of people in Myanmar were poor in 2015. Myanmar’s extreme poverty rate is relatively low given its GDP per capita. From a regional perspective, the poverty rates are higher than those seen in Vietnam but lower than those seen in Indonesia and the Philippines at the same point in time.

Regional Chart



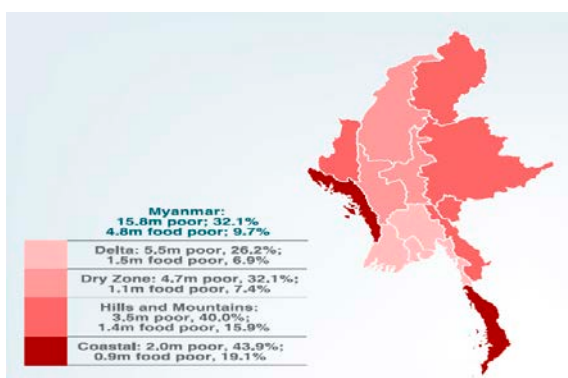
Sources: Ministry of Planning and Finance (MoPF); and World Bank.

B. Regional Disparities

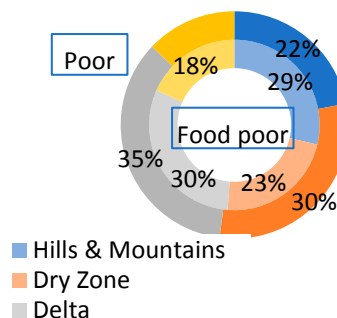
3. **Urban areas have seen faster growth in household welfare, and a sharper decline in poverty in percentage point terms.** Both rural and urban poverty have declined, with urban poverty falling from 24.8 percent in 2009/10 to 14.5 percent in 2015, and rural poverty falling from 48.5 percent to 38.8 percent over the same period. The more rapid decline in urban, relative to rural, poverty is mirrored in sectoral growth figures, which show a more rapid rate of growth in manufacturing and services than in the agricultural sector over the same period. Rising welfare in urban areas has been accompanied by an expansion in asset ownership.

4. **Poverty is overwhelmingly rural.** The headcount rate is higher in rural areas than in urban areas, at 38.8 percent compared to 14.5 percent. With 87 percent of the poor living in farms and villages, the text figures below visualize the headcount rate of poverty in urban and rural Myanmar, and across the agro-ecological zones, and show the share of poor in these areas. The majority of the poor and the majority of people in Myanmar are found in rural areas.

Poverty Headcount by Urban/Rural Status and Agro-zone



Share of Poor and Food Poor in Urban/Rural Areas and by Agro-zone



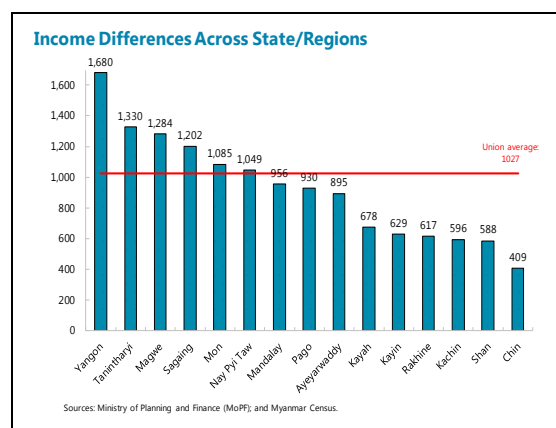
Sources: Ministry of Planning and Finance (MoPF); and World Bank.

5. There is extensive variation in the rate of poverty across agro-ecological zones. The Myanmar Poverty and Living Conditions survey cannot produce estimates of poverty at the state or region level, but instead can be used to assess poverty at the agro-zone level.³ The headcount rate of poverty is highest in the Coastal and Hills and Mountains area, at 43.9 percent and 40 percent respectively. These areas have the highest poverty intensity and severity indexes, consistent with the substantial food poverty also recorded in these areas. The headcount rate of poverty is lower in the Delta, at 26.2 percent, and the same as the national average in the Dry Zone, at 32.1 percent. Though the Delta and Dry Zone have lower poverty rates, 65 percent of the poor in Myanmar live in these areas due to the high population density of these areas.

6. Poverty in the Coastal and Hills and Mountains areas is deeper and more severe than in the other agro-ecological zones. This can be seen through the higher shares of food poor living in these areas, as well as through measures that capture the severity of poverty, such as the poverty gap.⁴ The deprivations seen in the Coastal and Hills and Mountains areas are also seen in a number of other indicators.

7. Most measures of inequality have risen since economic liberalization, albeit from a relatively low base. Households at the top 90th percentile have seen faster consumption growth than those at the bottom 10th and the median household. The share of total expenditures going to the bottom 20 percent and to the bottom 40 percent has declined since 2009/10. The gini coefficient of inequality is estimated to be 0.35 in 2015. The rise in inequality is noteworthy but unsurprising, as individuals with better education and more capital benefited more from the early liberalizations and reforms. While living standards in rural areas have seen substantial improvements, the changes have been more limited than those seen in Myanmar's cities and towns.

8. Income differences across State/Regions in Myanmar are substantial and coincide with rural-urban divide on poverty. Per capita GDP ranges from 1.7 million Kyat per capita in Yangon, by far the richest Region, to 400,000 Kyat in Chin (see the text figure right). This is reflective of some important features of the economy including: the concentration of natural resources (with mining in Tanintharyi and Magwe), the lower GDP per capita of states affected by conflicts and the relative high income of all the central dry area (Magwe, Sagaing,



³ The Hills and Mountainous zone includes: Kayah, Kayin, Shan, Kachin and Chin. The Delta zone includes: Bago, Mon, Ayeeyarwady. The Dry zone includes: Sagaing, Magwe, Mandalay and Nay Pyi Taw. The Coastal zone includes Rakhine and Taninthayi.

⁴ Note that the standard error of poverty estimates in Coastal areas is considerable, likely reflecting the substantial diversity of its regions. Although poverty in Coastal areas is estimated to be higher than in the Hills and Mountains, due to high standard errors the difference between the two zones is not statistically significant.

Mandalay, Bago). The high poverty regions seem to be associated with rural and conflict-affected dimension.

C. Vulnerabilities and Causes of Poverty

9. Despite improvements in living conditions, there are many individuals whose consumption patterns place them just above the poverty line. Individuals are near-poor or vulnerable to poverty if there is a nonnegligible chance that they could fall into poverty. This is captured by looking at the population that lies within 20 percent of the poverty line. Although the fraction of poor and near-poor has declined over time, from 61.9 percent in 2004/05 to 55.6 percent in 2009/10 using the new poverty measure, 46 percent of the population continued to live under the near-poor line in 2015. Thus, the bottom 40 percent of Myanmar's population continues to be either poor or very vulnerable to falling into poverty. Moreover, beyond facing a substantial risk of absolute poverty, this group has limited access to basic services such as electricity, health care, and improved water and sanitation.

10. Vulnerability to exogenous shocks and low financial inclusion constraints poverty reduction. Households prone to shocks take actions that affect their ability to bounce back and escape poverty, including cutting back on their investments, selling core productive assets, and withdrawing children from school. Poorer households have more limited recourse to formal credit or relatives that can help them to weather large shocks, leading to households taking out high interest loans that they may struggle to pay back. A fifth of all households in Myanmar are estimated to be heavily indebted and nearly one in five households has taken out a loan to cover basic food needs.

11. Causes of the poverty are multifaceted. Firstly, poor households have a weaker productive and financial asset base. Secondly, poor households are less integrated into the formal economy and possess fewer formal claims to possessions and entitlements. Thirdly, poor households are less likely to own land, are more likely to rent land in and to cultivate smaller plots. Fourthly, poorer households are disproportionately concentrated in agriculture, either as casual laborers or as small holder farmers, and tend to be less diversified in their activities.

12. Educational outcomes have shown some signs of improvement in recent decades, but key challenges remain:

- **Dropout rates remain high in secondary education.** Education completion has increased across generations. Among those who were 60 years of age and above in 2015, just under half (47 percent) reported not having completed any formal education. The share of individuals who have completed primary schooling increased from 45 percent among those aged 50 years and over (born in or before 1960) to 48 percent for those aged 35-39 years (born in 1975-1979). In addition, while attending lower-secondary school was previously the privilege of a few, it has become a possibility for nearly half of individuals in more recent generations. The fraction of individuals who enroll in and complete lower-secondary and upper-secondary has risen across generations. There, however, continues to be substantial dropout between primary and lower-secondary school and, even among those who start lower-secondary. Children typically start

falling behind at lower-secondary school, and drop out towards the end of lower-secondary. Costs—both direct and indirect—are the main reasons given for discontinuing school.

- **There is still significant diversity at the regional level**, despite the improvements in educational attainment among generations. According to Census figures, the percentage of the population aged 15 to 24 who had never attended any educational level varies substantially across states and regions. The gap in the non-attendance rates for those aged 15 to 24 years in 2014 is nearly 25 percentage points between the state with the highest prevalence of non-attendance (Shan State) and the region with the lowest (Yangon).

13. The health sector is also key to reap the full benefit of the expected demographic dividend in coming years, while wrestling with the following key challenges:

- **High infant mortality.** Out of every 100 children born in Myanmar, 6.2 die before their first birthday and 7.2 before their fifth. Children from poor households are more likely to live in nutritious food scarce environments and in households with unimproved water and sanitation infrastructure, with implications for their physical and mental growth potential. The effects of such childhood poverty and stunting can be devastating and long-lasting, limiting physical and cognitive development, with subsequent effects on labor market outcomes.
- **Low protection against health-related shocks with sizable redistributive and economic impact.** Health treatments are costly and almost exclusively out-of-pocket, placing a large burden on households, particularly the poorest who have more difficulty affording appropriate treatment. Sixteen percent of households in the sample survey face catastrophic health care expenditures, accounting for more than 10 percent of total welfare. This has a large impact on labor force participation and productivity, as 4 percent of labor days are lost due to sickness.

D. Strategies to Achieve the SDGs

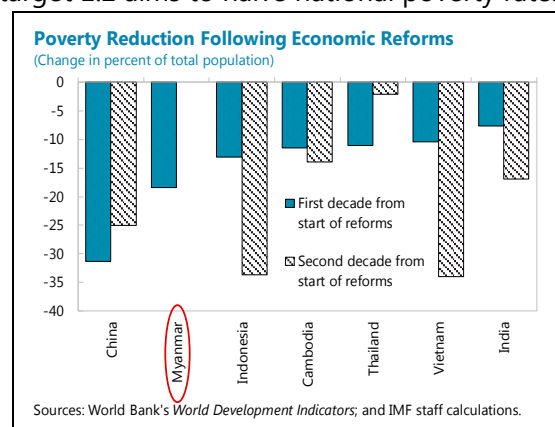
14. Achieving the SDGs will require sustaining the growth takeoff and making growth more inclusive, through a second wave of reforms and investments in human and physical capital. Myanmar's initial economic liberalization led to an impressive growth take-off and poverty reduction. The pace of poverty reduction in the last decade was comparable to the successful economic liberalization episodes in the region. Cross country experience suggests the need to implement a second wave of reforms to sustain the growth momentum and poverty reduction in the next decade or two. The multi-faceted causes of the poverty in Myanmar highlighted above indicates the need for mutually reinforcing policies and investments that would help achieve the SDGs in poverty/inequality and social dimensions. In particular, a scaling up of investments in infrastructure and human capital would boost more inclusive growth and job creation including by addressing regional disparities.

15. The government is laying the foundations of a path focused on implementing policies to achieve the SDGs and monitoring progress. The new administration's development agenda is people centered: the Twelve Point Economic Policies focus on inclusive and sustainable

development, supporting the implementation of the SDGs. However, challenges remain in identifying spending needs and developing an overarching economic roadmap building on the numerous sectoral and regional plans. For Myanmar, increased private sector consultation and development of a structured and strategic medium-term development plan with a fiscal framework, would help to provide strategic direction and facilitate reform implementation. Good progress has been made in developing a monitoring framework for SDGs with the “Baseline Report: Measuring Myanmar’s Starting Point for the Sustainable Development Goals.”

16. A deeper focus on the extreme poor would leave Myanmar well placed to make a substantial dent in the SDG related to poverty but would need to address regional disparities to ensure no one is left behind. Sustainable Development Goal 1 is to “end poverty in all its forms everywhere” and has two specific poverty reduction targets. One target (SDG 1.1) talks of eradicating extreme poverty by 2030, based on a globally comparable notion of extreme poverty. The international poverty line was updated in 2015 to \$1.90 a day in 2011 prices, and only 6.5 percent of people were below the extreme poverty rate in 2015. While Myanmar’s recent growth episodes has contributed to sustained consumption growth for average households and for those around the poverty line, for the bottom decile growth appears to have been more limited. Indeed, in rural areas, the evidence suggests no clear improvements over time for these populations. In order to reach SDG 1.1, policies need to be orientated towards a sustained rise in incomes of the lowest decile of the population. This requires a focus on poverty in the Coastal and Hills regions, including conflict zones, where most of the extreme poor live.

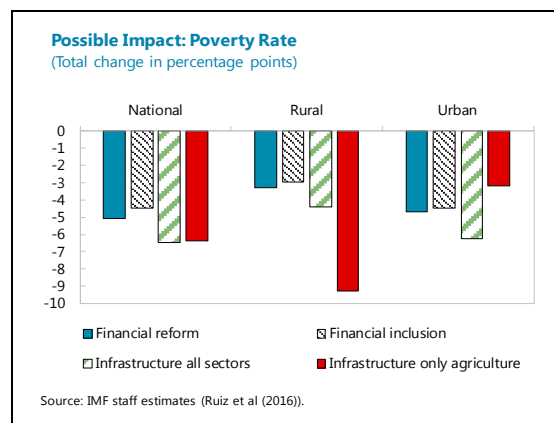
17. Halving the national poverty rate would require a second wave of catalytic reforms particularly narrowing the rural-urban divide. SDG target 1.2 aims to halve national poverty rates in all its dimensions between 2015 and 2030. This implies about a 16-percentage-point reduction of the 2015 national poverty rate from 32.1 percent to 16 percent by 2030. An even larger reduction in poverty would be required in rural areas given the higher poverty incidence. A number of fast growing Asian emerging markets (e.g., China, Indonesia and Vietnam, see the text chart) have achieved such rates of poverty reduction in the second decade of liberalization through a new wave of reforms. A dynamic stochastic general equilibrium (DSGE) model calibrated to Myanmar’s macroeconomic trends and distributional features of household data show that a combination of reforms could help achieve SDG 1.2.



18. Financial reforms and inclusion coupled with an infrastructure push particularly focused on the agriculture sector would have the strongest impact (IMF, 2017)⁵. Financial reforms

particularly interest rate liberalization over the medium term outlined in chapter 2 would raise savings and investment through prudent credit expansion, leading to a faster industrial sector and a sharper decline in poverty in urban areas. If this process were to be accompanied by financial inclusion reforms, access to finance in rural areas and farm income would also rise (see text figure). Using revenue generated by financial reforms and broadening the tax base to increase investment in

infrastructure can further boost growth, and reduce poverty and nationwide inequality. Investment in infrastructure that benefits all economic sectors has a larger positive impact on economic activity, but investing in rural infrastructure leads to a better distributional outcome for the country as a whole. The combination of a second wave of reforms in the financial sector and a revenue-based scaling up of infrastructure particularly in agriculture would allow a cumulative reduction in poverty to achieve SDG 1.2.⁶



19. Undernourishment and malnutrition during childhood is a particularly concern for achieving SDG 2 in Myanmar (CSO 2017 and UNDP, 2017). Goal 2 seeks sustainable solutions to end hunger in all its forms by 2030 and to achieve food security. While undernourishment and malnutrition during childhood in South-East Asia is below the World level, the prevalence of undernourishment in Myanmar (14.2 percent) was above the global average over the period 2014 to 2016. According to the Myanmar 2015–16 Demographic and Health Survey (DHS), the prevalence of stunting among children under 5 years is 29.2 percent, a huge cost felt in terms of cognitive abilities and human capital development of future youth.

20. Reducing maternal mortality, deaths of newborn and children under 5 years of age is the first target under Goal 3 and is of importance in Myanmar. The maternal mortality ratio, under-five mortality rate and the neonatal mortality rate in 2015 were higher in Myanmar compared to the regional average (CSO 2017). In 2015–16, just over 60% of births were attended by skilled birth attendance highlighting the challenge at hand in improving child and maternal health outcomes.

⁵ Macroeconomic and Distributional Implications of Financial Reforms in Myanmar, in Myanmar Selected Issues Paper, IMF Country Report 17/31.

⁶ The Systematic Country Diagnostic (SCD) of the World Bank was published in 2014 and highlighted Myanmar's priorities of: (1) raising incomes in rural communities; (2) increasing universal access to basic services such as health care, education, water and sanitation, and electricity; (3) and improving investment climate for private sector led growth and good jobs.

21. Myanmar's population is largely literate but a lot needs to be done to ensure that all people have access to quality education and lifelong learning opportunities (Goal 4). The Labor Force Survey (2015) indicates that almost 89.6 percent of the population was literate (men at 92.3 percent and women at 87.3 percent). However, only a quarter (22.4 percent) of youth between 15 and 24 years old participated in formal, non-formal education and training in 2015. When looking at adults, the participation falls to 0.5 percent. While enrollment and completion of secondary schooling have increased, the drop out ratio remains high at the secondary level with uneven quality and access across regions.

22. To achieve the SDGs in social sectors, Myanmar will also need to sharply increase public spending on education, health and social protection (see Box 1).

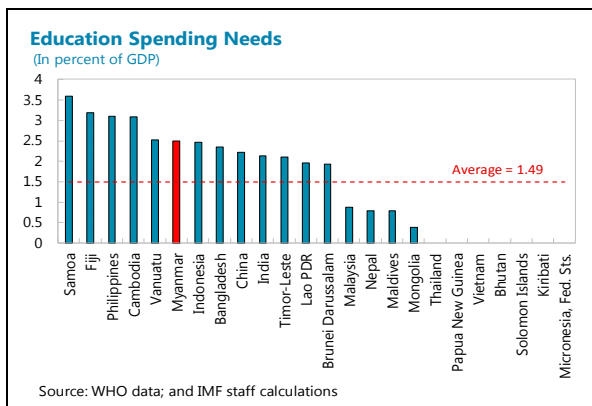
23. Pilot areas of Fund and SDGs. The Fund has been recently stepping up its efforts to monitor new SDGs-related macro-critical issues (e.g., gender equality, inclusive growth, and climate change) as pilot areas, and is closely working with development partners including WB, UNDP and UNICEF.

- **Gender equality.** Goal 5 aims to empower women and girls to reach their full potential, which requires equal opportunities to those of men and boys, with eliminating all forms of discrimination and violence against them. Gender gaps in education achievements at secondary and tertiary levels and entrance to public sector jobs are minimal for Myanmar's level of income. In addition, the incidence of violence against women by husbands and proportion of teenage marriages is relatively low in Myanmar (1 young woman 15–19 out of 8 was married in 2015–16). However, the proportion of seats held by women in national parliament was much lower in Myanmar compared to regional and global averages in 2016. On average, daily earnings of men were 1,300 Kyats higher than the daily earnings of women (CSO and UNDP, 2017). While equality between men and women is itself an important development goal, raising female labor participation and land ownership would boost growth and inclusion.
- **Inclusive growth.** Goal 8 focuses on sustained and inclusive economic growth, which is a prerequisite for sustainable development. As highlighted in the previous section, a second wave of reforms focused on financial reforms elaborated in Chapter 2 and financial inclusion (Box 2) would have the largest impact on supporting inclusive growth. Financial inclusion policies aimed at increasing general credit access for agriculture and SMEs would also help achieve the respective SDG. Policies to improve infrastructure can amplify the positive impact of financial reforms and inclusion. Moreover, investing in rural infrastructure leads to a better distributional outcome and a larger reduction of the Gini coefficient (IMF 2017).
- **Climate change.** Goal 13 aims to strengthen resilience and adaptive capacity to climate-related hazards and natural disasters. On average, around 27 persons per 100,000 people were killed and missing due to natural disasters every year over the period 2006–2015. Natural disasters also generated a direct economic loss of 1.82 percent of GDP every year, on average over the same period. The policy response of governments to past natural disasters was more limited compared with other developing Asian countries (IMF 2017). To more effectively mitigate the impact of climate-related disasters, Myanmar needs to enhance preparedness and response ability through addressing weaknesses in ex-ante resilience and ex-post adaptive capacity.

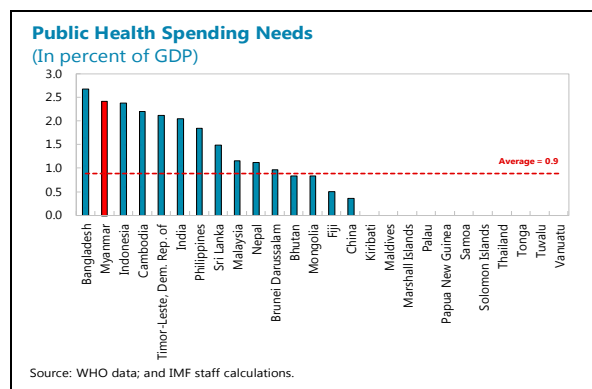
Box 1. Estimating Spending Needs to Achieve the Education and Health SDGs

Budget allocations to social sectors have increased significantly from 2012/13 as a share of total spending (from 8.2 percent to 12.8 percent).¹ However, achieving the SDGs by 2030 will require further expenditure rebalancing toward and additional financing to social sectors (education, health, and social protection). There is also a need for continued focus on spending efficiency. To estimate spending needs, we calculate spending increases to reach average levels of best performing countries along various outcome dimensions related to SDGs.

Education spending needs for 25 Emerging and Developing Asia (EDA) countries are calculated as the additional spending required to attain a near 100 percent enrolment in primary and secondary education.² On average, it is estimated that EDA countries would require an additional 1.5 percent of GDP in education spending. Myanmar is estimated to have much larger spending needs at 2.5 percent of GDP.



Public health spending needs for EDA countries are calculated as the additional public expenditure needed to catch up with spending observed among best performers for a series of indicators that capture basic health outcomes and services coverage.³ Reference expenditure is calculated as average public spending among the best five performers for each indicator.⁴ Per this approach, EDA countries would require 0.9 percent of GDP in public health spending, while Myanmar would need additional 2.4 percent of GDP.



The authorities made progress towards establishing strategies for financing development outcomes.⁵ In addition to raising domestic revenues and increasing foreign direct investment, Myanmar should aim at mobilizing official concessional financing and accelerating project annual disbursement rates which stand on average at 6 percent.⁶

¹ Source: IMF staff estimates

² These figures are based on the average per pupil spending among peer countries with near 100 percent enrolment with adjustments for country demographics.

³ Coverage of antiretroviral therapy among people living with HIV, antenatal and delivery care coverage, neonatal mortality rate, infant mortality rate, and under-five mortality rate.

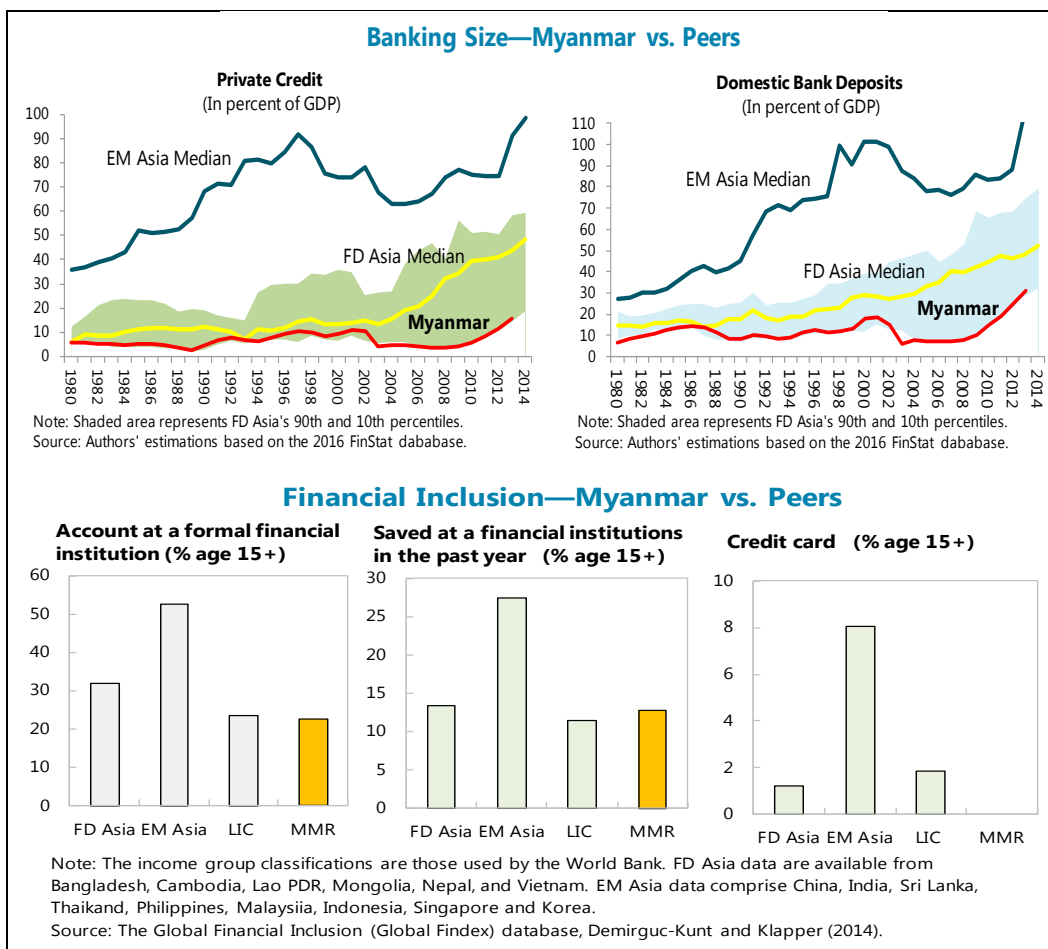
⁴ Public spending needs are computed for each country as the difference (if positive) with respect to reference expenditure. An aggregate indicator is obtained considering as reference average spending among best performers across all five indicators.

⁵ UNDP, Report on Financing Development Outcomes in Myanmar through the Establishment of an Integrated National Financing Framework, August 2017.

⁶ Work Bank Group, Myanmar Public Expenditure Review 2017: Fiscal Space for Economic Growth.

Box 2. Financial Inclusion in Myanmar

Myanmar’s financial sector is still underdeveloped with financial inclusion also lagging its peers. Although both private credit and deposits in the banking system have grown gradually following a sharp decline in the 2003 banking crisis, they remain low compared with other frontier and developing Asia (FD Asia) countries and far below emerging Asia (EM Asia).¹ Financial inclusion in Myanmar is also limited with account ownership at regulated financial institutions, savings and credit card ownership falling below its peers.

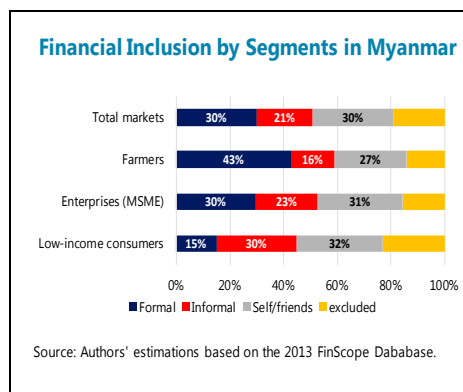


Myanmar population is thinly served by financial services with uneven access and a high reliance on informal means owing to several constraints. Finscope (2013) indicates that 30 percent of adults use regulated financial services but only 6 percent of the adults use more than one service. There is also uneven access to financial services with the banks' branch network disproportionately benefitting urban areas such as Yangon. Also, farmers though still underserved, have better access to formal financial services (at 43 percent) compared to MSMEs (at 30 percent) and general households (see Figure 3 below). The limited ability to borrow from formal financial institutions is in part due to: i) a narrow collateral base (mainly land and buildings); ii) an inadequate credit guarantee system; iii) the limited availability of financial products (e.g., fractional term loans, leasing and factoring finance); and iv) underdeveloped risk management skills (e.g., premature credit-scoring system).

¹ Frontier and developing Asia (FD Asia includes Bangladesh, Bhutan, Cambodia, Lao P.D.R., Maldives, Mongolia, Myanmar, Nepal, Papua New Guinea, Sri Lanka, Timor-Leste, and Vietnam (IMF, 2015). Emerging Asia (EM Asia) includes other ASEAN countries (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand), China, Hong Kong, Korea, India, and Sri Lanka.

Box 2. Financial Inclusion in Myanmar (concluded)

The Myanmar government has made financial inclusion an integral part of its inclusive growth strategy and has undertaken several initiatives to support it including the 2011 microfinance business law and the Financial Inclusion Road Map (FIRM). The 2011 law set the stage for the development of the microfinance sector, expected to fill credit gaps particularly in the agriculture and small and micro enterprises. Subsequently, several regulations pertaining to MFIs were passed in 2016 and 2017. Also, the government launched the Financial Inclusion Road Map (FIRM) in 2015 aiming to bring the population into the formal financial market with access to modern financial products and services. The roadmap sets out several targets on the access to financial services by 2020 (Table).

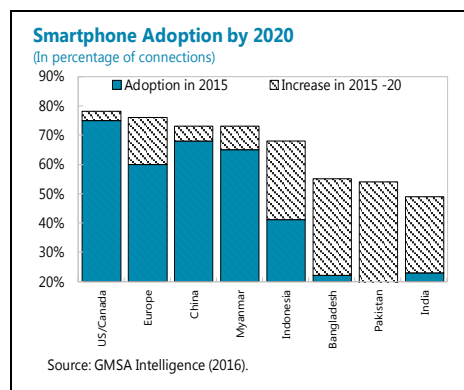


	Size (mil)	Access in 2014	Target in 2020
Agriculture (farmers)	12.1	43%	51%
MSME (Micro, Small and Medium Enterprise)	7.2	30%	40%
Low income household	7.5	15%	28%
Other	13.0	27%	36%
Total	39.8	30%	40%

Source: Myanmar authorities (2015).

Recognizing the impediments to financial inclusion, Myanmar has prioritized mobile banking to facilitate financial inclusion. CBM formulated a basic regulatory framework in 2013 (bank-based model) to allow technology service providers, financial service providers, and mobile network operators to partner with banks in the provision of financial services. A 2016 Regulation on Mobile Financial Services (non-bank-based model) is to provide payments and financial services using mobile technology infrastructure, including kyat-denominated cash-in and cash-out transactions, money transfers and domestic payments. The regulation permits mobile network operators (MNOs) to offer those services through their own platforms, with ensuring interoperability, agents network (without exclusivity), KYC and customer due diligence (CDD), and customer protection.

Myanmar's rapidly expanding usage of mobile phones—especially for smart-phones—holds the potential to allow the country to "leapfrog" in financial inclusion and financial development. With dramatic declines in the cost of telecommunication and rapid smartphone penetration, including in rural areas, Myanmar hopes that it will be able to bypass—at least to a significant degree—traditional modes of financial services delivery and accelerate financial inclusion. However, it is unclear how far a country can "leapfrog" without the support of physical infrastructure, such as networks of bank branches, road and electricity distribution, as well as a solid banking system.



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INTEGRATING INTO THE GLOBAL VALUE CHAINS¹

Myanmar is not well integrated into the global value chains (GVCs), and is still the least open economy in ASEAN. Further integration into GVCs will allow Myanmar to reap the gains from its geographical proximity to the world's growth engines, and benefit from the demographic dividend and competitive wages. The integration into GVCs will also help Myanmar achieve inclusive growth and reduce poverty.

A. Background

1. International trade has become increasingly dominated by global value chains (GVCs).

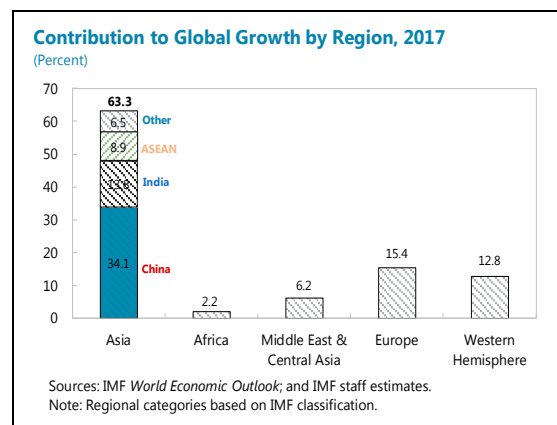
Thanks to improved logistics and technology, production across borders has been broken into components. Countries can specialize in the production of specific parts and components, rather than entire final goods. This allows them focus on the stage at which they have comparative advantages, and gradually move up the value chain and diversify exports.

2. Integration into GVCs can help Myanmar catch up and achieve inclusive growth.

Myanmar's economy is undergoing a profound transformation with the ongoing economic liberalization. However, the country has not been well integrated into GVCs, and is still the least open economy in ASEAN. Further integration into the global value chains will allow Myanmar to reap the gains from its geographical proximity to the world's growth engines (China, India, and rest of ASEAN), and benefit from the demographic dividend and competitive wages thanks to its young and literate labor force. The integration will also help Myanmar achieve inclusive growth, if the benefits from trade are shared among a broader populace through job creation and structural transformation.

3. The paper is organized as follows. Section

A starts with the role of GVC participation for convergence and the role of FDI, then section B examines where Myanmar stands in GVCs. After that we look at the experience from Cambodia and Vietnam regarding their participation in GVCs and FDI (Section C). Section D discusses how to further integrate Myanmar into GVCs, and section E presents the case for deepening regional integration. Section F concludes the paper with a summary of policy implications.



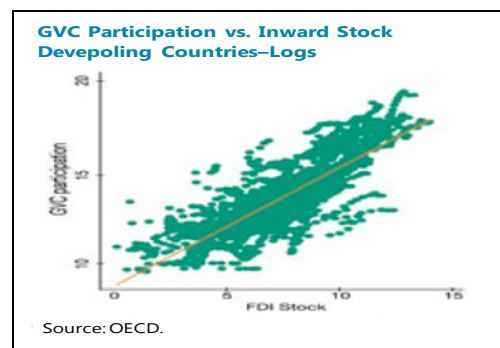
B. GVC Participation and the Role of FDI

4. GVC participation is conducive to convergence and productivity growth. The early stages of GVC participation typically involve labor intensive low-value-added activities.

¹ Prepared by Yiqun Wu.

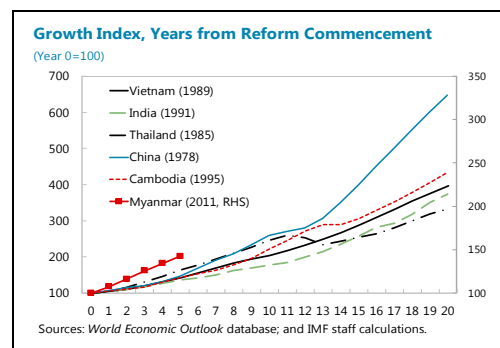
Upon reaching higher levels of development, there is the possibility to specialize in higher value-added tasks. Experiences from developing countries show that when entering global production networks, they usually play a role in lower value-added activities. But with access to investment, knowledge and technology, over time these countries gain from positive spillovers in productivity growth and skills upgrading, and move up to higher value-added activities. GVC participation facilitates the convergence of low income countries towards the global economic frontier (OECD 2013).

5. FDI is a major driver of GVC participation, playing an important role in the creation of global production networks. OECD (2013) identifies FDI as a key enabler for low-income countries to link into global value chains, which supports growth and technological upgrading. Empirical data has showed a strong correlation between FDI and GVC participation in developing countries. The presence of foreign firms can help countries move into higher-value production, enhance human capital, and support technology diffusion.

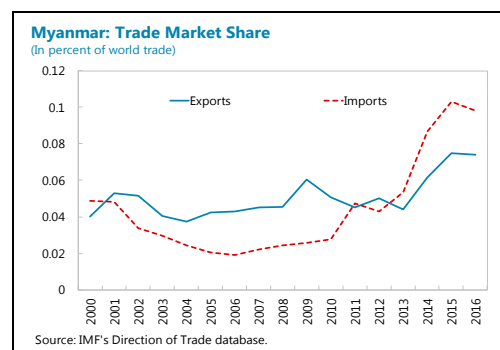


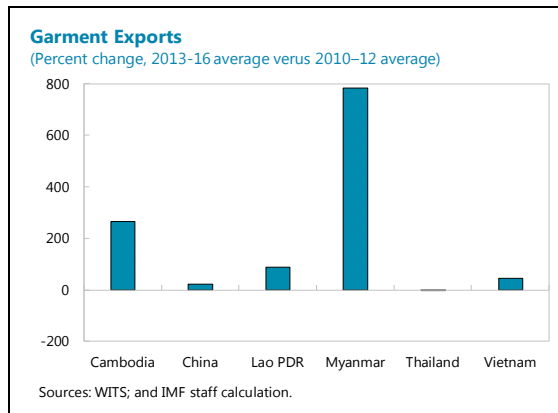
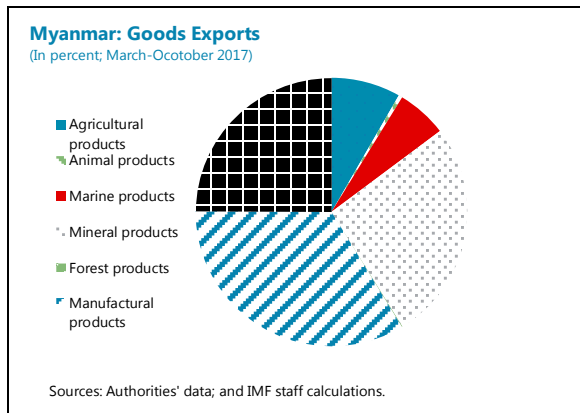
C. Where Myanmar Stands in Global Value Chains

6. The initial phase of reform in Myanmar saw strong economic expansion in comparison with regional reform efforts, supported by an early surge in FDI. Since 2011, when Myanmar introduced a series of political and economic reforms, the country has grown rapidly at 7.57 percent per year, which is among the fastest growth rates in the region.

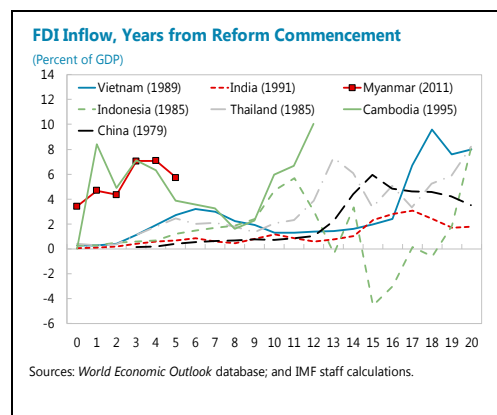


7. Myanmar is gaining market share in global trade, albeit from a low base. With the economic liberalization at the beginning of this decade, trade volumes soared by an average of near 30 percent per year in 2010/11–2013/11, and continued recording double-digit growth in 2013/14–2014/15. The exports composition has evolved with manufactured products comprising the largest portion of exports in 2016/17, accounting for one third of total exports. In particular, the garments industry has developed rapidly and become a significant export sector. The government has looked to boost value-added exports by formulating a five-year strategy, targeting a threefold expansion in value-exports by 2021/22. On the import side, manufactured goods, including machinery and transport equipment, has accounted for the bulk of imports.

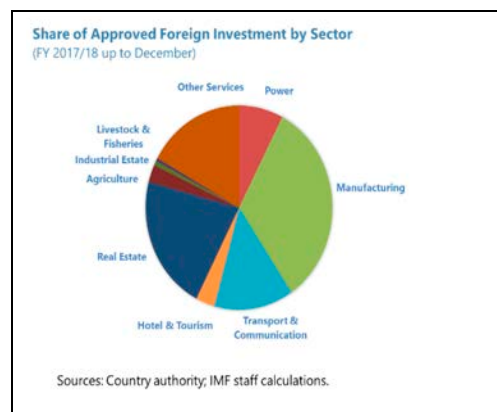




8. Myanmar’s growth takeoff has been largely reliant on FDI. Since 2011, Myanmar has seen a large amount of FDI flowing into the country. China has been the biggest FDI contributor, providing US\$18.0 billion to the country since 2005, following by Singapore and Hong Kong SAR. FDI were largely directed into oil and gas as well as manufacturing sectors.² The oil and gas sector has received the most FDI, amounting to US\$22.4 billion as of early 2017. The new Investment Law³, together with the new Companies Act, is expected to provide a boost for foreign investment in Myanmar.



9. Special Economic Zones (SEZs) in Myanmar has played an important role in jumpstarting manufacturing activity. Many countries including China, Bangladesh, Cambodia, and Vietnam have a similar approach to attract FDIs. In January 2014, Myanmar’s Parliament passed the Special Economic Zone Law that provides a legal framework for the SEZs. Several SEZs have been initiated or proposed: Thilawa SEZ, Dawei SEZ, Kyauk Phyu SEZ, and Sittwe SEZ. In Thilawa SEZ, as of late 2016, over 70 companies across 14 countries have contracted with total investment of more than US\$ 700 million. Almost half of investors are from Japan. The SEZ has hosted industries both for export and for domestic markets. The Dawei SEZ (with expected total



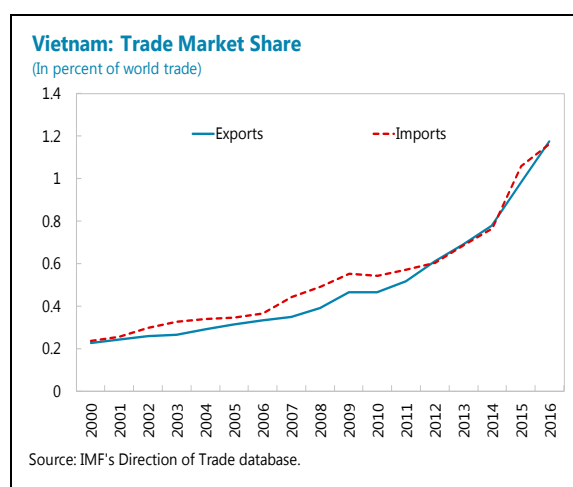
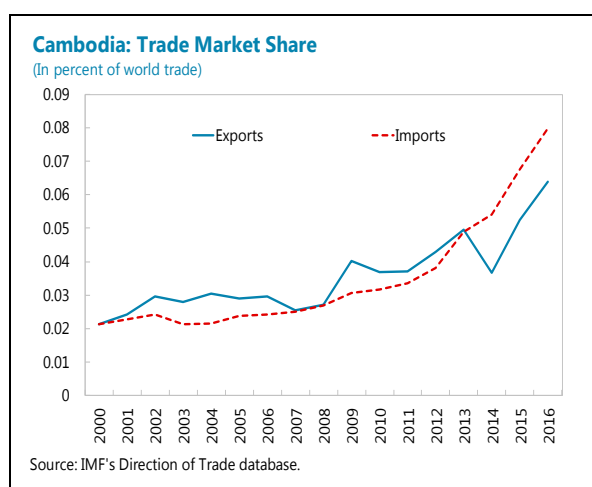
² With declining gas prices over the past few years, both export earnings from gas exports and FDI inflows into the sector have been slowing down.

³ The new law combined and replaced the overlapping foreign investment and Myanmar citizen’s investment laws, and simplified the investment process.

costs of US\$10 billion) was initiated in 2008, but was postponed in 2013 due to financing constraint. It is expected to be resumed in 2018 with the assistance of international development partners.

D. Experiences from Cambodia and Vietnam⁴

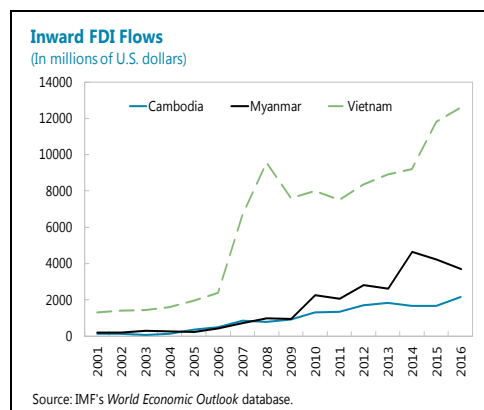
10. The frontiers of global production networks have been continuously pushed out into developing countries, including Cambodia and Vietnam. These two countries have grown rapidly as buyers and sellers in global trade, and extensive margins of their exports and imports have been significantly increased in recent years. In these two countries, foreign value-added in exports grew substantially since mid-1990s, with very high FVA in non-commodity sectors such as electronics, apparel and footwear, and machinery and equipment. These goods lend themselves to supply chain trade as their assembly process can be broken into a series of components.



11. Vietnam and Cambodia are increasingly integrated with Chinese supply chains. Their trade links with China have grown rapidly, and China has become an important supplier of goods to Cambodia and Vietnam. In Cambodia, fabric and other textile materials accounted for about 60 percent of imports from China. In Vietnam, imports from China are predominantly investment goods (machinery, equipment, and steel) and intermediate inputs (electronic components and fabric). As China moves up the value chain, its low-end, labor intensive exports have started to taper off. Preliminary findings show that low-income Asia has been among the main beneficiaries of China's exit from low-end exports (IMF, 2015a).

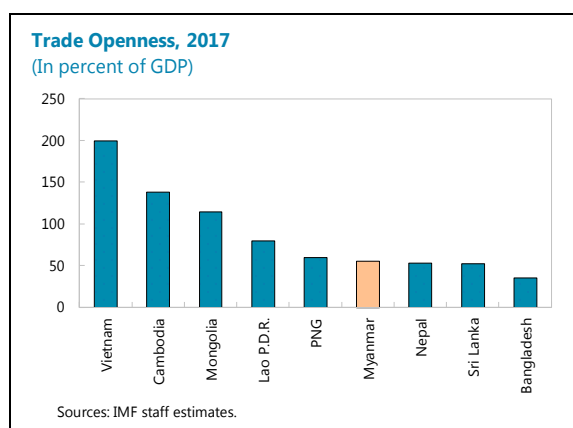
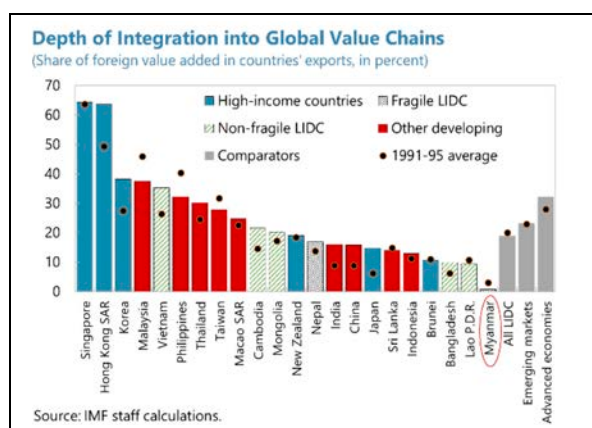
⁴ This section is based on IMF (2015a).

12. FDI has played a crucial role in Cambodia and Vietnam. In Cambodia, the garment industry with the contribution of nearly one-tenth of GDP, is the major recipient of FDI inflows, accounting for a quarter of the total FDI stock (UNCTAD 2013). This FDI-driven sector has become a major source of employment and income, generating more than 70 percent of export revenues, and 27 percent of manufacturing employment. In Vietnam, FDI at times approached 10 percent of GDP and foreign companies account for close to 70 percent of exports, mostly in electronics manufacturing and apparel (IMF 2015a). FDI has played a central role in transforming Vietnam from exporting mainly commodities to exporting a diversified set of products.



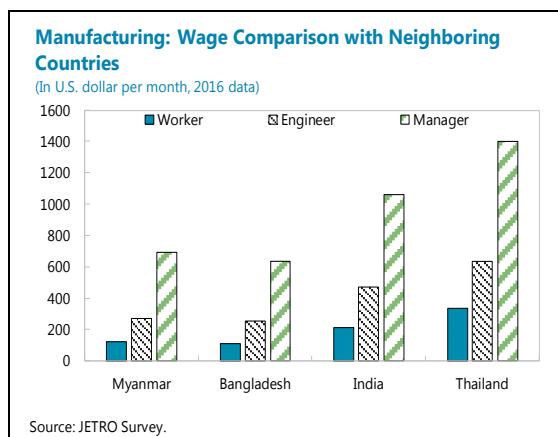
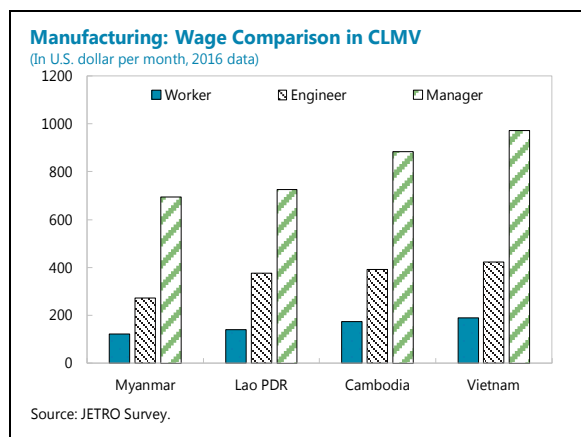
E. Myanmar's Further Integration into GVCs Based on Cross-Country Lessons

13. Myanmar has not been well integrated into GVCs. Although trade is growing, Myanmar is not yet as open as its neighbors. The country's trade openness ratio, at 37 of GDP as of 2017, is much lower than that of most other Asian low-income countries. Exports are highly concentrated within a small set of products, and also in terms of trading partners.



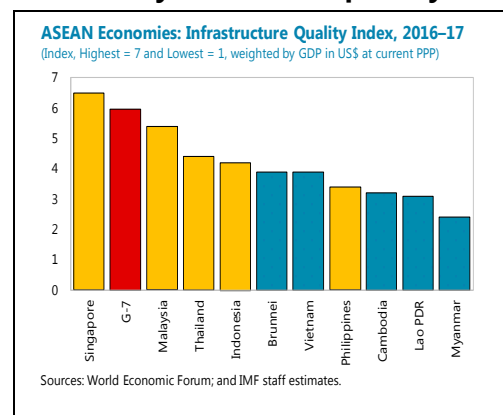
14. Labor cost is low in Myanmar, but infrastructure and other costs of doing business factors are crucial. Compared with other Asian countries that are ageing fast (IMF 2017a), Myanmar still enjoys demographic dividend. It has a significantly large youth population: the median age is 27 and about 55 percent are under the age of 30. Despite the low expenditure on education, Myanmar has a fairly literate labor force: the 2014 consensus reported nearly 90 percent of those aged 15 and over could read and write (higher than 73 percent to 80 percent in regional peers). The wage survey conducted by the Japan External Trade Organization (JETRO) shows that Myanmar still has wage competitiveness over Vietnam and Cambodia, and other garment producing countries (chart). Although low wages were indeed found to be correlated with rising market share in labor-intensive goods, it alone would not allow Myanmar to take full advantage of new trade opportunities.

Infrastructure and institution factors are vital. Cross-country panel regressions show that openness, infrastructure, education, and governance, all contribute positively toward export market share at all levels of technology sophistication (IMF 2015).⁵



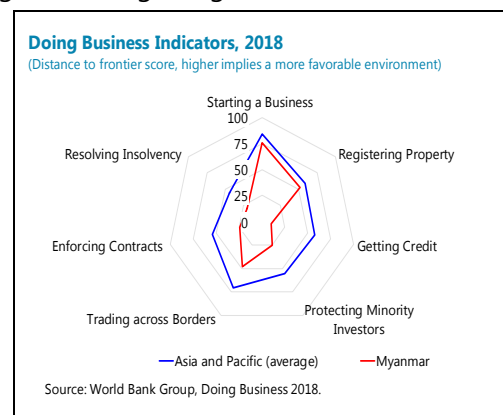
15. Improving infrastructure, particularly for transport and electricity, should be a priority

in Myanmar. Myanmar still lags in infrastructure. It is ranked low in the overall logistics performance index by the World Bank and urgently needs infrastructure development, especially in the areas of transport and electricity generation. A McKinsey report in 2013 estimated that Myanmar would need US\$320 billion to build basic infrastructure and the infrastructure sector would grow from US\$10.5 billion in 2010 to US\$48.8 billion in 2030 (McKinsey 2013).



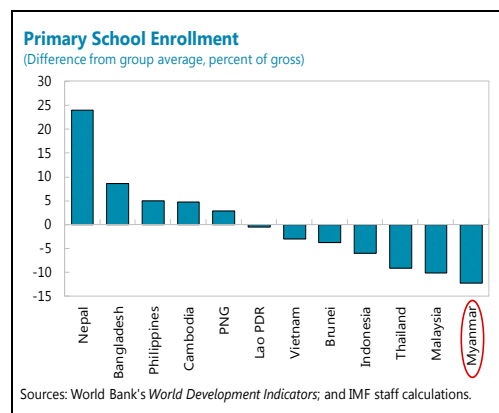
16. Open and competitive business climate will help Myanmar maximize gains and spread benefits of economic reform.

The World Bank’s Doing Business Ranking places Myanmar at 167 out of 189 countries. Myanmar ranks behind its regional peers in the ease of enforcing contract, getting credit and trading across borders. Indeed, the country performs poorly in most areas in the life cycle of a business. Other business surveys also suggest that weak domestic supply chains and poor access to electricity, transport services and affordable financing and corruption are the major impediments to investment. Stable and transparent business conditions, based on political and social stability and sound legal and institutional frameworks, are particularly important for Myanmar and will contribute to its greater GVC participation.



⁵ For Vietnam, a growing skilled yet inexpensive labor force, strong infrastructure, and liberalized trade helped attract FDI despite relatively low scores on competitiveness measures.

17. Human capital must be developed. This is a priority that will eventually position Myanmar to move upstream in GVCs. Despite recent increases, government spending on health and education remains low compared with other low-income countries (IMF 2018). Increases in investment in these sectors with corresponding improvement in technical and vocational skills would help strengthen Myanmar’s competitiveness. The low access to education will also limit participation in the digital economy and industries/services of the future.

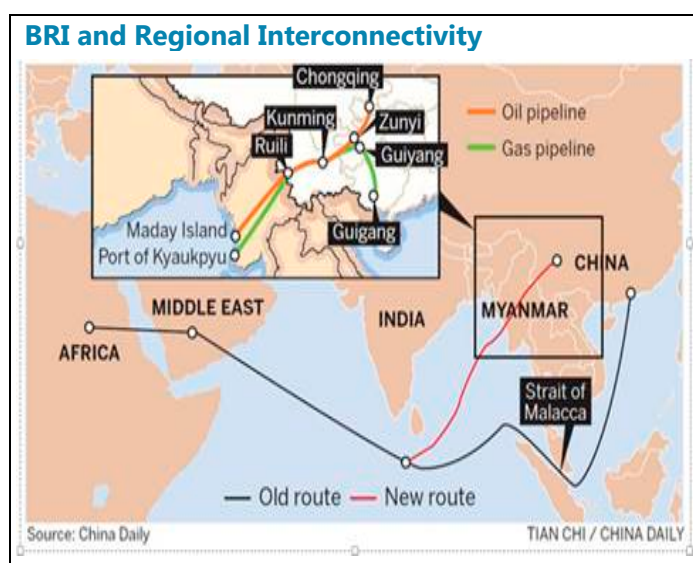


F. Regional Integration and Myanmar’s GVC Participation

18. Regional integration will facilitate Myanmar’s participation in regional and global value chains. Asia is the main growth engine of the world, contributing a majority of the global growth. “Factory Asia”, with its strong participation in global production, is the most dynamic area in the global value chains (IMF 2015). Myanmar, spanning a vital geographic area, has a unique position of gaining from geographical proximity with China, India, and other fast-growing ASEAN countries. Indeed, those countries that Myanmar shares borders with, account for one fifth of global economic size and two fifths of global population. Further integration with regional economies would help Myanmar play a more active role in the worldwide production network.

19. The connectivity-oriented BRI is poised to reshape GVCs. China launched the BRI in 2013, and the number of countries now engaged in the BRI has reached nearly 70. The BRI will increase the flows of goods, capital and human skills, with focus areas including infrastructure development and trade facilitation, financial connectivity and integration, policy coordination, joint research, and people-to-people exchange. Cumulative investment is expected to reach \$1 trillion within a decade.

20. Myanmar’s participation in the BRI will facilitate its integration into GVCs. Myanmar has advantages of bridging China's southwestern gate with the Indian Ocean on the overland trajectory, and of locating on the main point for trade transitions on the marine route. The BRI offers Myanmar new opportunities to address infrastructure needs, strengthen regional economic and financial connectivity, and support diversification and employment. Current projects include the US\$2.45 billion oil and gas pipeline (the first phase was completed and went into operation in

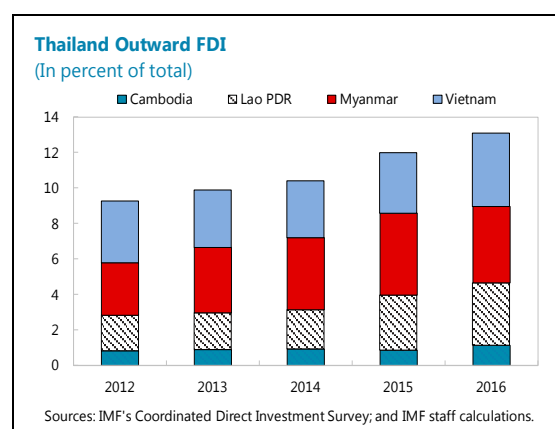


April 2017), which links PetroChina's Kunming refinery with the Bay of Bengal; a US\$7.2 billion deep-sea port of Kyauk Pyu (under negotiation); and a US\$2.3 billion Industrial zone (the development began in early 2016).

21. Myanmar is India's gateway to southeast Asia and ASEAN. India is the fifth largest trading partner and the tenth largest investor of Myanmar.⁶ These two neighboring countries share a long land border well as a maritime boundary in the Bay of Bengal. Indeed, Myanmar provides landlocked northeast India with an outlet to the sea. The two countries are seeking to enhance road, sea and air connectivity, including direct shipping lines, direct air connectivity, and new border trade points to bolster trade across the land border. The US\$ 120 Million Sittwe port was financed by India, and the feasibility studies to establish the Sittwe SEZ are under preparation.

22. Regional integration between the CLMV and other ASEAN countries has proceeded at a fast pace in the last decade. The ASEAN Economic Community (AEC) has facilitated integration among ASEAN countries. A recent ASEAN 2025 blueprint further promoted a dynamic integration process in the next decade from various perspectives, including trade, investment, and migration. The CLMV has played an increasingly significant role in intra-regional trade and trade outside the region. In 2014, the CLMV accounted for 10.4 percent of total intra-ASEAN trade, an increase from 7.6 percent in 2007. For extra-ASEAN trade, the CLMV accounted for 15.2 percent in 2014, up from just 8.0 percent in 2007. Myanmar's efforts to implement its commitments under the AEC initiative will greatly facilitate its integration into regional production networks and global supply chains.

23. Economic links between Thailand and Myanmar has been stepped up. Thailand's exports and imports market share in CLMV countries increased rapidly. Thailand has been playing an increasingly active role in promoting investment integration with the CLMV, with more than 10 percent of outward FDI destined to these countries. Thailand is developing its Eastern Economic Corridor (EEC) into a leading regional economic zone. A major focus of the EEC is to improve existing connectivity, including creating sea routes from Thailand's eastern seaboard to Myanmar's Dawei deep-sea port project. Myanmar is also building an SEZ surrounding the Dawei port, which is expected to generate up to 65,000 new jobs on completion.



⁶ Bilateral trade grew to US\$ 2.18 billion in 2016/17. Approved investment from India reached US\$ 740.64 million as of mid-2017, mostly in the oil and gas sector.

G. Conclusions

24. Myanmar needs to integrate itself further in the global value chains. With the new government's export-promoting strategy and ASEAN countries' regional integration initiatives, Myanmar's participation in GVCs could support diversification and employment.

25. Integration into global value chains can be engines of inclusiveness and poverty reduction. Diversification into manufacturing, market-oriented agriculture and trade in services would help deduce over-reliance on natural-resource industries that often offer few employment but provoke social tensions. However, key policy and structural reforms will be required to share benefits from trade among a broader populace. Improving rural access to finance (including trade finance) and providing support to local economic activities would help leveraging trade to underpin inclusive growth and poverty reduction. Improvement in infrastructure can amplify the positive impact on inclusive growth (World Bank 2016; IMF, 2017b).

26. However, fiscal risks need to be closely monitored. To capitalize on the opportunities from further regional integration and connectivity, infrastructure projects should be well designed and managed with fiscal risks fully recognized.

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