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Harnessing FDI and Enabling Myanmar's Business Environment

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As its economy opens, Myanmar needs to fully benefit from foreign investment to secure its economic growth. But while FDI inflows into Myanmar have burgeoned, a significant challenge remains to create an environment in which the benefits of FDI are maximized and translate into sustainable economic development. Phyu Phyu Mar outlines some of the necessary steps and actions the government and other stakeholders should take to create a better enabling environment for FDI.

With a population of over 50 million, a promising internal market, and rich in natural resources, Myanmar's favorable endowments make it an increasingly attractive destination for foreign investment. It is furthermore located at the crossroads between the growing economies of Bangladesh, China, India, Laos, and Thailand.

More foreigners are coming into the country, new hotels of all sizes and capacities are being built, major airlines are flying to Yangon, international conferences are being held, and representative offices and businesses opened—all of which are testament to the fact that the international business community increasingly recognizes the opportunities present in Myanmar.

Whereas in the fiscal year 2009-10, FDI-inflows amounted to only US$ 329.6 million, in 2014-15 Myanmar received $ 8.1 billion in net-FDI inflows.[1] For 2015-2016, the Myanmar Investment Commission has prioritized maintaining these high inflows, setting a modest target of attracting a further $ 6 billion.[2]

At the same time as foreign investment is increasing, the reform of Myanmar's business environment is proceeding at a remarkable pace and is occurring in the context of political reform, national reconciliation, and the transition to a capitalist economy. According to Article 35 of the Myanmar Constitution, an indication of the high-level commitment to economic reform, Myanmar shall strive

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to implement a market-based economy. One of the supportive directives is to harness technical know-how and investment from sources both inside the country as well as from abroad. However, in spite of such objectives and the economic reforms underway, the question of whether increased FDI flows will benefit Myanmar in the long term is still an open one.

This paper argues that the benefits of FDI, among others the transfer of know-how and human resource development, will not be conferred automatically. In order for FDI to be harnesed more effectively, the government of Myanmar with the assistance of other actors is required to undertake necessary measures, which include improving macroeconomic stability and creating a business enabling environment. Failure to do so will jeopardize the sustainability of Myanmar's economic development. Before outlining the necessary measures to be taken, I first provide a background to Myanmar's economic "reintegration" and the pitfalls and opportunities FDI presents for the country.

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Breaking Out of Isolation

After the Burma Socialist Programme Party seized power in 1962, Myanmar saw a decline in its economic power, from being the most advanced economy in Southeast Asia to becoming one of the least developed countries in the region. In 1987, the country was included on the List of Least Developed Countries by the United Nations. During this period, Myanmar not only closed its doors to foreign trade and investment, but it also nationalized or expelled all foreign businesses; many local private business activities were also nationalized. The establishment of a command economy and international economic isolation effectively thwarted and reversed the economic momentum from prior decades.

The first attempts at economic reintegration and revival were initiated by the then caretaker government of the State Law and Order Restoration Council (SLORC). On November 30, 1988, the Union of Myanmar Foreign Investment Law was enacted. The law aimed to promote exports, explore for and utilize natural resources, acquire foreign technology, create more employment opportunities, and facilitate regional development. The Myanmar economy subsequently boomed between 1989 and 1999, with GDP per capita growing at an average rate of 3.9 percent per year [ed. the accuracy of this figure is disputed].[3] However, a combination of factors such as the Asian Financial Crisis, the government's inability to implement crucial policy reforms, as well as external pressure and international sanctions, led to recession and a retraction of foreign investment from the West. During this difficult period, China moved quickly into Myanmar and invested heavily in oil and gas pipelines, hydropower dams, and mining projects. This investment continued into the 2000s: between 2008 and 2011, China invested approximately US$ 12 billion.[4]

Almost five decades after Myanmar closed its doors to the world, the new government of the Republic of the Union of Myanmar has initiated a fervent attempt to reintegrate with the global economy. This has, moreover, occurred in conjunction with a transition towards a more inclusive political system. In particular, the Myanmar government has recognized the importance of FDI as a tool to achieve economic development. Accordingly, rapid and crucial reforms were undertaken within two years after the civilian government under President U Thein Sein came to power in 2011.

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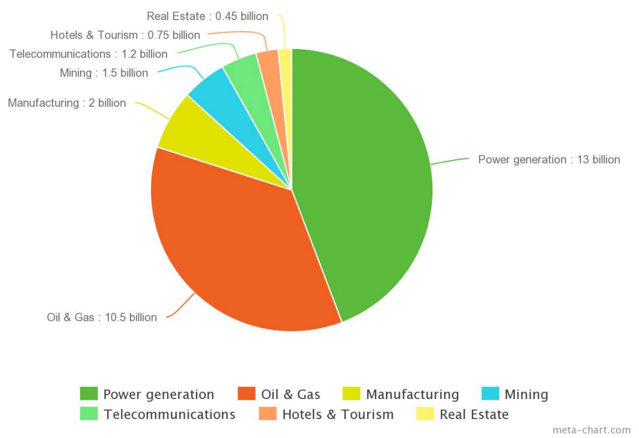
The new Foreign Investment Law was enacted in 2012, and a managed float exchange rate system was introduced; this allows the Myanmar Kyat (MMK) to devaluate enough in order to attract FDI and promote exports. The new investment law is more elaborate in many areas compared with the legislation previously in place, and includes regulation of areas such as profit repatriation, property rights, and ownership structures. Subsequent foreign investment rules, issued in 2013, further classify the types of investments which can be undertaken, and the environmental and social impacts of investment are also treated.

Figure 1. FDI by Sector in US$, 2010-2014



Data compiled from the Directorate of Investment and Company Administration of Myanmar.

As a result of these measures, foreign investment has since soared. By 2014, according to the Directorate of Investment and Company Administration (DICA), Myanmar's aggregate foreign investment had exceeded US$ 49 billion.[5] As the next section illustrates, however, effectively harnessing the positive benefits of FDI remains a significant challenge.

Harnessing FDI: Pitfalls and Opportunities

Much research has gone into analyzing the impact of FDI on developing countries with scholars identifying both negative and positive effects on the host country. Proponents argue that FDI accrues many benefits. These include: transfer of technical know-how and development of human resources, integration into the global economy, the promotion of competition, organizational development, industrial restructuring, and so on. In spite of this, such benefits are not conferred automatically or equally, with the challenge being to manage FDI in a way that propels the entire economy forward to close the gap with developed countries. Myanmar is no exception in this regard. How such effects (and their shortcomings) apply to the situation in Myanmar is examined below.

Diversifying FDI

According to DICA data, FDI inflow into Myanmar between 2010 and 2014 was dominated by investment in the power generation and natural resource sectors (see Figure 1 opposite), with lesser amounts invested in manufacturing, telecommunications, and tourism.[6] Whereas the Myanmar government receives revenue from these sectors, which can contribute to government investment in infrastructural improvement, education, and health, sustaining Myanmar's growth will only be realized if investment can be diversified towards other sectors such as infrastructure, agriculture, manufacturing, and services. Indeed, the consequences of the overconcentration of FDI in natural resources and power generation are well encapsulated by the so-called resource curse. By comparison, neighboring countries such as Vietnam receive much more FDI in their manufacturing, real estate, and construction sectors, and for these countries the longer-term viability of job creation and technology transfer associated with FDI appears more favorable than is currently the case for Myanmar.

Transfers of Technological Know-how and Human Resource Development

Investors in Myanmar are finding it difficult to recruit sufficiently qualified employees. This is especially the case regarding Chinese investments, which have mainly been concentrated in the natural resource sector. It is well reported that a large percentage of the workforce is of Chinese extraction and that the use of local Myanmar labor is limited. Unless this is addressed, the transfer of technical know-how will be restricted and new skills and working practices will not be disseminated to the Myanmar workforce. This is especially the case in terms of fostering managerial expertise with the capacity to drive change and technological reform among local Myanmar firms.

Integration into the Global Economy

Interaction with the global economy increases as multinational corporations and foreign companies become established. International trade grows, and so does the incentive to comply with international standards, rules, and regulations. This is something often sought after by Myanmar's own businesses, and entities such as Myanmar's Chambers of Commerce have been active in lobbying the government to more vigorously promote adherence to international standards. One outcome of this was Myanmar's accession to the New York Arbitration Convention in 2013 (which requires Myanmar to adhere to international standards of arbitration), an action which will help further Myanmar's economic integration and facilitate greater international trade by making the country more attractive and reliable for investors.

Promoting Competition among Local Firms

FDI increases competition in the local market in a variety of ways, thereby benefiting consumers as well as promoting technological innovation and investment in human capital. This effect can clearly be seen in the telecommunications sector where the entry of Ooredoo and Telenor dramatically reduced the cost of telecom services for consumers.[7] However, in the case of other sectors, increased competition may result in the closure of local firms. This is especially true of the manufacturing and the financial sectors where Myanmar firms are not ready to compete against international players and may face difficulties.

"Investors in Myanmar are finding it difficult to recruit sufficiently qualified employees."

Organizational Development and Restructuring

Multinational organizations carrying out FDI often act as a force for institutional changes in the host country. Moreover, their active participation in policy formation and contacts with the government in areas such as industry standards can serve to promote policies supporting increased efficiency and economic growth.[8] FDI also plays an important role in promoting private-public partnership through joint ventures with the government. However, it is also necessary for the government to keep up with the rapid changes taking place in the business environment. In the case of Myanmar, capacity issues for the regulatory authorities clearly exist. In the insurance sector, for example, regulations have barely changed two years after allowing foreign representative offices to open. Despite the best efforts by foreign companies and the World Bank to encourage this, little regulatory reform has been implemented in Myanmar during the past two years.[9] The same symptom can be seen across all government ministries.

In sum, Myanmar has not sufficiently leveraged the opportunities afforded by FDI and faces a number of important pitfalls. In particular, it is clear that Myanmar's business environment is not yet ready to derive full benefit from FDI inflows. As a result, it is incumbent on the government to not only focus on the scale of FDI, but also on creating a broader enabling environment for FDI. How this can be achieved is examined next.

Creating an Enabling Environment for FDI

In an OECD report on FDI published in 2002, several categories are outlined where reforms are needed in order for the full benefits of FDI to be derived by host countries. These are: macroeconomic stability, the quality of financial intermediation, an improved business enabling environment, and upgrading relevant infrastructure.[10] Also important is that Myanmar move from "extractive" economic institutions to inclusive ones that create the incentives and opportunities necessary to harness the energy, creativity, and entrepreneurship in society. All of these contribute to creating a broader "enabling" environment for maximizing the opportunities presented by the currently high FDI inflows. The main factors are examined in turn below.

Macroeconomic Stability

In the long run, Myanmar's economic goal should be to achieve its economic potential by growing at a sustained rate over a long period of time. Maintaining a proper investment climate is necessary to foster this steady economic growth. To do so, macroeconomic stability and inclusive growth are a necessity. The government should prioritize developing strategies and carrying out reforms which aim to reduce fluctuations and increase the employment and income opportunities across all levels of society.

There are several macroeconomic reforms that can be undertaken to help achieve this, notable among which is giving more autonomy to the Central Bank of Myanmar. Although much has been done to make the Central Bank independent during this government, there is also much more to do when it comes to capacity building and targeting inflation. Capacity building for the Central Bank is one of the necessary long-term strategic priorities for the Myanmar government and international development organizations. After decades of operating in a restricted economic environment, the skills and knowledge of central bankers should be upgraded in order to make them more ready to manage the economic challenges of an ever more complex world. Priority should be given to train the next generation of central bankers who will manage the country's monetary policy in the coming decades.

Maintaining low and stable inflation is furthermore vital for boosting the confidence of foreigners and locals in the economy and economic policy alike. Although inflation in Myanmar is somewhat high, the Central Bank of Myanmar has been able to maintain a relatively stable inflation rate of around 7 percent. However, it remains to be seen if Myanmar can maintain stable inflation amid a widening trade deficit and an increasing reliance on imports. The priority of monetary policy moving forward should be making sure inflation does not get out of control and erode the credibility for Myanmar's new economic policies.

Creating a Business Enabling Environment

The Myanmar government has a vital role to play in creating an enabling environment that allows private sector activities to flourish. According to the Asian Development Bank, such an environment entails "the availability of public goods and services required by businesses, a functioning finance system, the efficient and transparent regulation and taxation of private enterprises, and the development of a healthy workforce through investments in education and health."[11]

One of the critical factors for improving the business enabling environment in Myanmar is understanding the existing constraints, removing these, closing the gap between regulation and stakeholders' needs, and also improving administrative support mechanisms. Currently, the Myanmar government is undertaking several initiatives in order to lift constraints and improve administration, which include: setting up one-stop-service centers to make registration processes for Small and medium-sized enterprises (SMEs) easier, introducing e-licensing systems for export and import businesses, and further reducing administrative barriers for trade operations.

In spite of the above, Myanmar's previous socialist government left a legacy of many special permits and quotas that is proving hard to unravel. Myanmar ranks 177 out of 189 countries according to the World Bank's most recent "Ease of Doing Business" Index. This illustrates that the barriers for doing business in Myanmar have not been sufficiently eased through regulatory reforms. According to the same index, Myanmar ranks even lower, in 189th place, when it comes to starting a business, with the barriers in terms of number of procedures, time, and cost being prohibitively high.[12]

This system has created a situation where Myanmar businesses are comfortable with informal markets and networks. According to the Myanmar Enterprise Survey conducted in 2014, many Myanmar companies do not find corruption and making extraordinary payments to be constraints.[13] Instead, company executives regard entertaining government officials and securing permits as a critical success factor for business, and not as a dubious practice indicative of corruption.

Table 1. Ease of Doing Business Ranking in Selected Asian Countries, 2014-15*

	2014	2015
Malaysia	20	18
Thailand	28	26
Vietnam	72	78
China	93	90
Lao PDR	155	148
Myanmar	**178**	**177**

* Out of 189 countries surveyed with 1 being the easiest, 189 the most difficult. Myanmar was included in the rankings for the first time in 2014. Source: World Bank, Doing Business.

In the effort to successfully reform, Myanmar must recognize the existence and magnitude of the informal barriers currently existing, and design policies which will do more to move the market away from the informal sphere and into the formal and regulated sphere. Outdated regulations[14] cause inefficiencies, corruption, and restrict investment. Policy makers should focus their initiatives on developing policies and frameworks which will be beneficial to Myanmar's business environment as a whole. International firms can contribute to this by working together with the local business community and sharing best practices and by promoting good governance and transparency within the government. The local business community should also endeavor to try to address these issues internally by interacting more with the government. In turn, the government should make it easier for the private sector to address their concerns.

Some such efforts are already underway. The International Momentary Fund is collaborating with the Union of Myanmar Federation of the Chambers of Commerce and Industry to host the Myanmar Business Forum bi-annually where local business associations address industry experts and work together with relevant regulating authorities to iron out prevailing issues. Outstanding issues are then presented at the plenary forum of which President U Thein Sein is chair. Such efforts are integral to bridging the divide and encouraging dialogue between the private sector and regulators, and as such, should be further strengthened.

"Barriers for doing business in Myanmar have not been sufficiently eased through regulatory reforms."

Upgrading Infrastructure

Strategic investment in infrastructure is very important for achieving inclusive economic growth and for an economy to fully benefit from FDI. Without such infrastructure, some communities will be left out of the development driven by FDI, something which may later create social inequality and lead to potential instability.

KEY POINTS

- The increase in FDI does not necessarily reflect that Myanmar will be able to fully harness the economic benefits from foreign investments.
- A lack of regulatory reform and diversification of investments as well as limited transfer of technical know-how serve to impede the benefits of FDI.
- For FDI to be beneficial for Myanmar, it is important for the financial market to be developed, human resource capacity needs to be at a level where technology transfers can take place, and the country needs to have a better business enabling investment climate.
- Despite being prevalent, businesses in Myanmar do not find corruption a major constraint. As the country shifts towards more inclusive institutions, it is necessary to recognize the existence and magnitude of informal barriers.
- Integrating with international standards and agreements will enhance the confidence of international companies and allow Myanmar firms to better engage in international business transactions.

An Asian Development Bank study in 2012 argued that the Myanmar government should focus its efforts on developing soft infrastructure and promoting private-public partnership.[15] In fact, in order to efficiently develop hard, that is physical, infrastructure, the governance, policy, and administrative aspects of infrastructural development are important. It is within the government's immediate power to improve these elements. Once in place, better infrastructure would not only help create an environment for better business but also become a foundation for advancing non-infrastructure related development.

Private sector initiative in infrastructural development is important for improving efficiency. However, the government should build private-public partnerships on the foundations of good governance and transparency. Again, the government must build up its administrative capabilities and improve decision-making in order to optimize the benefits of better infrastructure for the country as a whole.

Leveraging MNCs and Development Aid

In the sections above, I have stressed the importance of capacity-building for government and regulators. With such great interest in FDI in Myanmar among the international business community, the Myanmar government has a unique opportunity to leverage the current situation by engaging with international development organizations in collaboration with multinational corporations (MNCs).

MNCs not only have influence in their home countries, but they also have extensive experience in regulation and policymaking in the different markets they operate in. The Myanmar government should capitalize on this by persuading MNCs to coordinate activities with development aid agencies in their home countries. By doing so, aid projects carried out in Myanmar can target bottlenecks, have high returns, and contribute more to the kind of capacity building that is sorely needed by carrying out projects focused, for example, on training and education.

Conclusion

In sum, it can be clearly seen that FDI is having a positive impact on the Myanmar economy and that there is political will to go in the right direction. Indeed, the Myanmar government has successfully focused on attracting more FDI in the past three years. However, more needs to be done to reinforce the framework for long-term economic and social reforms which will better leverage the benefits of FDI. Therefore, for Myanmar to more fully benefit from FDI, decision-makers need to be aware that the perceived benefits from FDI will not be fully realized if the local environment is not ready to receive such investments. The government should thus focus on creating an enabling environment where Myanmar can more effectively harness FDI. The government cannot achieve this alone and must collaborate with the local private sector as well as multinational companies and international donors to strengthen the overall business climate.

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[14] Many laws and regulations vital to the business environment such as company act, land administration, taxation, arbitration, and contract enforcement are outdated and are in need of review.
[15] Soft infrastructure includes rules and regulations governing the use and functioning of physical infrastructure. See: Asian Development Bank, Infrastructure for Supporting Inclusive Growth and Poverty Reduction in Asia, May 2012, http://www.adb.org/sites/default/files/publication/29823/infrastructure-supporting-inclusive-growth.pdf

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