

Burma's Economy 2008: Current Situation and Prospects for Reform

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...we shall restrict the use of the term economic development to widespread, widely shared, sustainable economic growth accompanied by significant structural change in production patterns and in economic and political institutions and by generalized improvement in living standards. This definition distinguishes economic development from economic growth that is narrowly based; dualistic in production and distribution; cyclical; grounded in the exploitation of natural resources; and unaccompanied by systematic changes in production structure, institutional development or improvement in the living standards of the poor.

(Adelman and Morris 1997)

Introduction

Defined in the ways above, 'economic development' is not a process that is currently taking place in Burma. Indeed, and notwithstanding the windfall gains from natural gas exports that are currently accruing, present day Burma is perhaps best described as an 'un-developing' country, as the modest gains made in the early 1990s are steadily wound back. In 2008, and in the immediate period ahead, some growth in GDP will be apparent, but this will largely be the result of the gas windfalls that otherwise mask an economy that is regressing in every important respect.

This paper will present the current state of Burma's economy, and explore the reforms that will be necessary should sudden political change take place. Such proposed reforms are limited to those required in a short to medium term horizon to stabilize the macro-economy and lay the foundations for future growth. Longer term structural changes are also necessary if Burma is to begin to 'catch up' to the relative prosperity of its neighbours and erstwhile peers, but these are noted simply in passing. Nevertheless, and even according to this shorter horizon, profound changes to Burma's *political* economy will be necessary for any real gains in the socio-economic circumstances of its people. It will also be apparent from what follows that economic reform in Burma will require

changes that are not limited to macroeconomic policies (fiscal consolidation, exchange rate unification, interest rate liberalization, and so on), but which also includes fundamental institutional reform that will embrace the application of:

- effective property rights;
- basic freedoms (including at least an approximation of the rule of law);¹
- basic functioning infrastructure;
- government policy-making that is rational, consistent and informed by a reasonably honest and efficient civil service;
- market opening policies, including the removal of remaining restrictions on private enterprise;
- openness to foreign trade and investment.

It is scarcely conceivable that such elements will be adopted by Burma's current leaders, which as a consequence raises the question of the country's political trajectory. The restrictions on enterprise imposed by Burma's ruling junta, the self-styled 'State Peace and Development Council' (SPDC), are precisely the means of its economic power and, unreconstructed, it is unlikely to 'do a China' by relaxing economic control while maintaining its grip on political power. Accordingly, there is a presumption in this paper that the reforms outlined will be those applied by a *new* government in Burma, ideally democratically elected, but at the very least one that is interested in pursuing genuine economic development in its truest sense.

As always in the context of Burma, an important caveat must be entered with respect to all that follows regarding data. Burma's official economic statistics are unreliable, incomplete, internally contradictory and frequently subject to dramatic revision. In the below, therefore, care has been taken in assembling and filtering data that common sense and a requisite knowledge of Burma's political economy allows to be plausible. Such care is most manifestly necessary with that limited data made public by the *Myanmar*

¹ The recognition of the rights to property, and the extension of these rights with others to constitute the 'rule of law', represent the core of those 'good institutions' for which there is general consensus amongst economists as being necessary for sustainable economic growth and development. Property rights and the rule of law encourage higher investment (the indispensable variable in the experience of countries that have achieved transformational growth) by granting individuals the fruits of their labour and enterprise. Security of property, and the confidence that others will abide by known and credible rules, are the vital ingredients to exchange itself (simply the formal transfer of property rights when all is said and done), market prices, and rational economic calculation. An enormous literature asserting the importance of property rights and the rule of law has emerged in recent years, much of it empirical, which includes (amongst the most convincing accounts); Acemoglu and Johnson (2005), Besley (1995), Bardhan (2005), Easterly (2001), Rigobon and Rodrik (2005), Rodrik, *et.al.* (2004).

Closely aligned with property rights and the rule of law are the various attributes that allow for political participation and 'voice'. These attributes, which include basic civil liberties, freedom of the press and various democratic rights of association and mobilization, help protect the individual against the risk of arbitrary property expropriation, mitigate against corruption, encourage policy stability, social trust and higher investment in health, education and human capital formation generally. As with property rights and the rule of law, a substantial literature has grown up on the importance of voice and accountability in economic development, including; Barro (1996), Besley and Burgess (2002), Brown and Hunter (2004), Brunetti and Weder (2003), Halperin, *et.al.*, (2005), Lederman, *et.al.*, (2005), Rodrik (2000), Sen (2000).

Central Statistical Organisation (MCSO), but it is likewise exercised with respect to that produced by the IMF, Asian Development Bank (ADB), the UN and other international agencies. The IMF's *Article IV Consultation Report* for 2007 is one of a number of important sources used in this paper, but we do not shy away from disputing the data or conclusions of this and other documents when warranted.

I. Burma's Economy 2008: A Snapshot

The current dire state of Burma's economy is the product of forty-five years of inept economic management under the SPDC and its predecessors. Burma's military apparatus has for decades claimed a dominant share of the country's output, while it has simultaneously dismantled, blocked and undermined basic market institutions. There are no effective property rights in Burma, contract enforcement is non-existent, and macroeconomic policy-making is arbitrary, erratic and ill-informed. The SPDC spends vastly in excess of its revenue and, like many such regimes throughout history, resorts to 'printing money' to finance its expenditure. Accelerating inflation and monetary chaos have been the predictable consequences. Burma's currency, the *kyat*, is widely distrusted and trades via a variety of exchange rates. Most of Burma's leading corporations are owned by serving and retired military officers, and the country is judged by *Transparency International* as the second-most corrupt in the world.² Critical sectors of Burma's economy are starved of resources. Burma spends a mere 1.4 per cent of GDP on health and education, less than half that spent by the next poorest member of ASEAN, and Burma is the only country in the region whose defence budget is greater than that of health and education combined (Selth 2002, p.135). This lack of spending on health and education has had grave consequences. According to UNICEF, Burma's health system is the 'second-worst in the world' after Sierra Leone, and the country has become a hub from which communicable diseases such as HIV/AIDS, elephantiasis and avian influenza spread though the region. Meanwhile, Burma's education system has degraded to such an extent that illiteracy in rural areas is now twice as common as it was in the era when the country was a British colony. Only a quarter of Burmese children complete primary school, and secondary school has become the preserve of children of the (relatively) well-off. Universities (when they are allowed to open), almost exclusively belong to the 'connected' elite (Council on Foreign Relations 2003).

The SPDC's economic mismanagement means that, even from non-sanctioning countries, Burma attracts little in the way of foreign investment. What does enter is strongly concentrated in the gas and oil sectors, and other extractive industries. Little employment is generated from such investments, and there is little in the way of technology or skill transfer. In 2008 Burma's per-capita GDP, measured at the market exchange rate, will amount to only around \$US290. Over 70 per cent of this income will be spent on food, by far the highest proportion so devoted in the region, and a significant indicator of the slim margin of survival that is the current lot of the average person in Burma (IMF 2007). A survey undertaken jointly by the UNDP and Burma's own *Central Statistical*

² 'First' place went to Somalia. *Transparency International's Corruption Perception Index 2007* is available online at <http://www.transparency.org/policy_research/surveys_indices/cpi/2007>.

Organisation found that over 30 per cent of the population had incomes below that necessary to provide for basic food and other needs, a ratio that rose to over 50 per cent in non-Burman states and regions (UNDP 2006).

The primitive state of Burma's economy, notwithstanding the SPDC's decade-long claim of double digit growth rates, is revealed in its structural make-up. Dominated by agriculture and extractive industries, the share of manufacturing and services in GDP (the critical indicators of countries that have truly achieved transformational growth), remain extraordinarily small. Table 1 lays bare Burma's economic structure, as juxtaposed to its better-performing peers and neighbours:

Table 1: Sectoral Structure of Burma's Economy
Contribution to GDP (%)

Sector	Burma	China	Thailand	Vietnam	Cambodia	Bangladesh
Agriculture, Livestock, Fishing and Forestry	47	13	10	21	33	19
Manufacturing and Processing	13	42	35	21	22	16
Services: Trade, Communications, Finance	27	40	46	38	38	55

Source: ADB (2007).

It is Burma's internal political-economy that has denied the country access to the international economy, and from the potential gains from the international division of labour so effectively exploited by its neighbours in ASEAN and by countries such as China. Many of Burma's peers are not liberal democracies, but most are governed by rulers that at least recognise that their own advantage grows with that of their country's economy. The ruling regimes of these countries are not above behaving in predatory ways, but in this there is usually subtlety enough such that they avoid killing the economy 'host'. There is no such subtlety in Burma. The ruling regime has little understanding of the dynamics of a market economy, and mistakes the building of roads, bridges, dams and other physical infrastructure as constituting 'economic development' in themselves. Burma's state is almost wholly predatory, and is not so much parasitic of its host as all-consuming. If in other countries ruling regimes behave occasionally as racketeers in skimming a 'cut' from prosperous business, then Burma's is more like a looter – destroying what it can neither create nor understand.

II. Necessary Reforms for Short to Medium Term Turnaround

a) Fiscal Consolidation

The excessive demands of the ‘state’ on Burma’s productive capacity is the country’s most pressing economic problem. Indeed, it is the singular fact that drives all of Burma’s other macroeconomic maladies – from the loss of monetary control via money ‘financed’ budget deficits, the divergent official and unofficial exchange rates, the financially repressing interest rate controls, to the rapacity of the Burmese army (*Tatmadaw*) in the countryside. As can be seen in Table 2 below, the consequence of Burma’s chronic budget deficits is an equally habitual resort to the printing press to finance them:

Table 2: State Share of Burma’s Financial Resources
Selected Indicators (kyat millions)

Year	Central Bank Lending to Government	Commercial Bank Lending to Government	Commercial Bank Lending to Private Sector	Public Holdings of Government Bonds
1999	331,425	12,460	188,149	378
2000	447,581	36,159	266,466	463
2001	675,040	40,985	416,176	504
2002	892,581	43,248	608,401	563
2003	1,262,588	35,546	341,547	544
2004	1,686,341	89,217	428,391	505
2005	2,165,154	100,358	570,924	463
2006*	2,593,246	120,513	596,298	419

**As at end-September. Source IMF (2008)*

In recent times the SPDC has sought to improve its collection of taxes, especially those levied on various commodities, services and in the form of customs duties. Regarding the latter, especially significant have been the moves (in 2004 and 2006) to levy duties according to an exchange rate (now set at K1,250:\$US1) that is much more in line with that applying in the (informal economy) market. Income taxes have likewise been increased in recent years, particularly those applied to the employees of private enterprise, and to the earnings of foreign-owned firms. Yet, notwithstanding these moves, in 2006/07 total tax revenues amounted to K676,742 – or a mere 26 per cent of the financing provided to the state by the Central Bank of Myanmar (CBM) by the 3rd quarter of that year alone. Such tax revenues likewise amounted for a little less than 4 per cent of GDP. By way of comparison, according to a recent survey by the IMF, the average tax-take in developing countries is around 18 per cent of GDP (Tanzi and Zee 2001, p.3).

Under current arrangements, the foreign exchange revenues Burma is accumulating via its exports of natural gas are making next to no impact on the country’s fiscal accounts. The reason for this is simple – Burma’s gas earnings are recorded in the country’s state finances at their ‘official’ (exchange rate) *kyat* value. As shall be explored later, the

official exchange rate of the *kyat* (at around K6:\$US1) over-values the currency by around 150–200 times its market value. This dualism imposes other great costs on Burma's economy, but critical here is that the use of the official exchange rate to convert the country's gas earnings into *kyat* dramatically underplays their true (potential) contribution to state finances. Recorded at the official rate, Burma's gas earnings for 2006/07 of \$US1.25 billion amounted to a mere 0.6 per cent of budget receipts.³ By dramatic contrast, if the same US dollar earnings were recorded at the market exchange rate (at that time around K1,200:\$US1) their contribution would more than double total receipts, which would more or less eliminate the country's fiscal deficit. That this is not done is yet another revealing episode of the chronic macroeconomic mismanagement that inflicts Burma, as well as the SPDC's priorities. The 'missing' gas earnings that effectively go unrecorded in Burma's public accounts show up instead in the country's foreign reserves, where doubtless they are earmarked for the sort of imprudent capital spending projects such as those that will be outlined below.

Of course, on the other side of Burma's small tax and other revenues is the state's anything but small spending. Dominated by the demands of the *Tatmadaw* as well as Burma's (profoundly inefficient) state-owned enterprises, together these absorb an estimated 80 per cent of total state spending, and many multiples of the tiny sums devoted to health and education (0.5 and 0.9 per cent of GDP respectively). Burma's fiscal deficit currently exceeds 11 per cent of GDP (IMF 2007, p.8).

As is readily apparent from Table 2, in the absence of sufficient tax revenue, Burma's state expenditure is 'financed' by the simple and highly destructive expedient of mandating the CBM to 'print money' according to the volume required. This finance from the CBM dwarfs that made available by the banking system to the private sector – from which the only hope for meaningful economic development in Burma will emerge. Notwithstanding the recent tax increases, moreover, the necessity for CBM financing seems to be increasing. In 2005, the latest (full) year for which we have data, central bank funding of the government rose by K478.8 billion, up an extraordinary 28.4 per cent on the previous year. Meanwhile, in the six months to September 2006 the central bank lent an *additional* K428.1 billion, an increase of 19.8 per cent on the full-year total for 2005, and clearly illustrating that Burma's public finances are continuing to deteriorate. The IMF (2007, p.8) concurs, while also noting that the country's budget deficit is the highest in the region. Burma's 'money printing' is the primary driver of inflation in the country which, currently at around 50 per cent per annum, is likewise the highest in Southeast Asia.⁴

...Reform

Given its roots into just about all other economic problems facing Burma, substantially reducing the country's fiscal deficit (and modifying its financing) must be a first-order

³ Data derived from IMF (2007, p.9).

⁴ Inflation is a slippery concept in Burma since the prices of goods and services differ markedly around the country, with especially acute price divergences between rural and urban areas. Of course, 'inflation' is also often disguised by the unavailability of goods in many places, and by other market distortions.

priority for any new, or genuinely reforming, government. As noted at the top of this paper, real and effective reform of Burma's economy requires profound political transformation – but this central fact is also allied to what will be necessary for getting the country's fiscal house in order. The reason for this is simple: it is precisely Burma's current political arrangements and the 'policies' they inspire (the huge and expensive military apparatus, the grandiose and irrational capital spending schemes, the keeping of the gas revenues 'off balance sheet', and so on) that are at the heart of the country's chronic deficits. The transfer of political power away from the current version of Burma's military regime *should* allow for the following:

- The reduction in the personnel numbers of Burma's military. Currently numbering around 350–400,000, the *Tatmadaw* is the largest armed force in Southeast Asia by personnel. It is far larger than is necessary for Burma's external security, which is to highlight the obvious: that the *Tatmadaw* is configured according to the SPDC's need to stifle internal opposition and to run a military-dominated state. A new government enjoying a popular mandate cannot be without a defence or security force, but it will not need to be anything like its current size. Slimming down the *Tatmadaw* will not only be a substantial political virtue, it will also moderate the single most significant recurrent item in the budget too.

Of course, too rapid a reduction in the personnel numbers of the *Tatmadaw* will pose its own problems – but these are tempered by the following considerations: Firstly, the process of slimming down the *Tatmadaw* should be a process over time rather than a single dramatic event, and in the interim the armed forces can be employed in genuine infrastructure maintenance and construction. Secondly, there will likely be substantial *voluntary* movements of individuals out of the *Tatmadaw* come political change. Many Burmese soldiers are reluctant recruits, and many others (especially in higher ranks) take commissions in recognition that the armed forces are the surest route into business and economic security. Remove the latter incentive, and with a growing economy negating the *Tatmadaw* as the only source of a secure meal-ticket, and its ranks will likely thin considerably. Thirdly, and notwithstanding the vast imposition that military spending imposes on Burma's budget, the *Tatmadaw* is already filled with individuals who are underpaid, given insufficient food and equipment, and who are all too often left to fend for themselves through expropriations from farmers and others (a 'policy' formalized in the *Tatmadaw's* 'Self Reliance Program').⁵ In short, it is difficult to conceive that troops released from Burma's armed forces can do more damage to the country's economy or society than they already do in uniform.

- The expenses of the *Tatmadaw* constitute the most serious recurrent drain on Burma's finances, but these are matched by an almost equally persistent

⁵ For details of the *Tatmadaw's* Self-Reliance Program, see 'Myanmar army document spotlights low morale', *Jane's Defence Weekly*, March 27, 2007.

pattern of capital spending projects of highly dubious merit. Such projects are usually undertaken at the whim of senior members of the SPDC, and are subject to little or no bureaucratic oversight or assessment. Examples of such projects are, alas, legion in Burma's modern economic history, but some especially egregious recent fancies include:

- The creation of Naypyidaw, Burma's new administrative capital. This project, whose astrological/numerological aspects have become a particular fascination, has been estimated by the IMF (2007, p.8) to have cost around 2.4 per cent of Burma's GDP in 2005/06, with ongoing costs of similar magnitudes in subsequent and coming years. Such estimates are likely to understate Naypyidaw's true costs to Burma, moreover, given the widespread reports of forced labour on the project, and the fact that much work on the capital was (and is being) undertaken by private firms at below cost in exchange for other concessions in Burma's highly-controlled economy.
- The decision (announced in May 2007) to purchase a nuclear reactor from Russia at a cost mooted to be between \$US300–500 million (2–3.5 per cent of GDP).⁶
- The SPDC's ambitious plan (announced in May 2006) of replacing the bulk of Burma's imports of diesel fuel with locally-produced bio-diesel derived from the 'physic nut' (*jatropha curcas*). The plan determines that some 7 million acres be devoted to planting *jatropha*, with every cultivator with more than an acre of land being required to sow at least 200 *jatropha* bushes. How *jatropha* will be converted into bio-diesel has not yet been determined, since Burma lacks anything like the capacity to refine 'physic nuts' into useable fuel.⁷
- The construction of the Yadanabon 'Cyber City' on the outskirts of Maymyo (Pyin Oo Lwin). The costs of this project are unknown, but its worth in a country in which internet access is greatly restricted (Yadanabon was closed down several times during the unrest of August-October 2007), and where electricity supplies are highly unreliable, may be open to some doubt.

Whilst poor decision-making with respect to large 'public' investments is not confined to authoritarian regimes, it is almost universal amongst them, and a

⁶ According to information supplied privately to the author, new doubts have emerged over the reactor purchase, even though several hundred Burmese technicians are currently training in Russia. If indeed the reactor purchase fails to go ahead, it will be but the latest stumble in what has become a very much stop-go saga. But for more on the background on Burma and the nuclear question, see Selth (2007).

⁷ For more on Burma's *jatropha* campaign, see 'First Myanmar *jatropha* harvest ready after 2006 planting campaign', *Biofuels Digest*, March 12, 2008, available online at <<http://biofuelsdigest.com/blog2/2008/03/12/first-myanmar-jatropha-harvest-ready-after-2006-planting-campaign/>> (accessed April 10, 2008).

direct outcome of a system that allows no checks and balances, no transparency, and no accountability. A new political order in Burma, which included a reasonable portion of each of these latter virtues (and best guaranteed through representative democracy in concert with the rule of law), would at the very least limit the worst of such whimsical decision-making. The fiscal space made available in the place of that spent on new capitals, nuclear reactors and cybercities might instead be spent on more mundane, if infinitely more valuable, critical infrastructure.

- A change in political regime in Burma will also allow for a reduction in the funds siphoned off by the country's notoriously inefficient state-owned enterprises (SOEs). In contrast to the situation in China post-1987, and other countries in the region (such as Vietnam), Burma's SOE's have not transformed into entrepreneurial entities aiming to serve the market or maximize profits. Instead, they constitute valuable patronage vehicles for the SPDC and, in this guise, accumulated collective losses that (in 2006/07) absorbed over 23 per cent of all tax revenue. According to the IMF's (2007, p.27) projections, this will rise to 29 per cent in this current (2007/08) financial year.

Such then are some of the *cost* savings that might be expected in the wake of fundamental reform of Burma's political economy. Gains might also be expected on the revenue side:

- As noted above, at present the substantial foreign exchange revenues accruing from Burma's gas exports do not impact (except in a trivial way) on the country's internal finances. As shall be discussed later, future arrangements for Burma's gas windfalls might call upon the creation of various institutions to best use them – but, for an interim 'reconstruction' period, such funds will prove invaluable in the financing of much needed infrastructure, and for at least as much needed spending in areas such as health and education. Properly brought to book (and correctly weighted according to the *kyat's* market exchange rate), Burma's gas earnings would more than double the projections of useable government revenue for 2006/07 (IMF 2007, p.9).
- Unifying Burma's multiple exchange rates (more on which below) would bring about an improvement in Burma's fiscal position in two ways: Firstly, it would eliminate the ability of SOEs and regime-connected individuals to access foreign exchange at the 'official' exchange rate – a practice that currently imposes a substantial (if understandably difficult to quantify) cost to the government budget. Secondly, it would finalise the moves begun in 2004 of fully levying customs duties against import values calculated at the *kyat's* market exchange rate. The IMF estimates that unifying Burma's exchange rates would bring about an improvement of Burma's fiscal position of 3–5 per cent of GDP (IMF 2007, p.17).

- Difficult to quantify, but a government apparatus that functions according to some broad mandate, and incorporating a gradually professionalized civil service, is likely to collect greater tax revenues than one in which tax evasion and corruption is accepted by regime supporters and opponents alike. In a similar vein, but out to the medium term and beyond, a genuinely reform-minded government in Burma would be in the position of being able to pursue a number of innovative tax options that have been applied in other transition economies in recent years. One of these, particularly suitable for countries (such as Burma) without much in the way of a tradition of income tax, is the ‘flat’ tax adopted by a number of east European countries as well as Russia. Though the time frame since the introduction of such taxes is too short for any definitive empirical verdict, the results thus far suggest they deliver greater tax revenues through improved compliance, a strengthening of the macroeconomic stabilization effects of fiscal policy and, perhaps surprisingly, improved progressivity of the tax system (primarily via the improved compliance).⁸

b) Unifying Burma’s Exchange Rates

To external observers, the most obvious manifestation of Burma’s macroeconomic troubles are its dual, and highly diverging, exchange rates. Formally rigidly fixed against the IMF’s Special Drawing Rights, but in practice against the US dollar at a rate of approximately K6:\$US1, Burma’s ‘official’ exchange rate has not borne much relation to reality for some time.

The only exchange rate that matters in Burma (except, as noted above, for those few well-connected individuals and SOEs able to access the official rate) is the ‘market’ exchange rate as determined daily, informally, according to demand and supply. Currently this rate stands at around K1,000:\$US1, one hundred and fifty times below the official standard. Wild swings in the market value of the *kyat* are reasonably frequent, to which the SPDC’s counter is invariably to order the arrest of those dealing in it.

In addition to its sometimes unruly fluctuations, the unofficial exchange value of the *kyat* has been in secular decline for some time, and in this it acts as something of a barometer of Burma’s macro-economy. Table 3 below records the *kyat*’s declining market value vis-à-vis the US dollar over the last decade:

Table 3: Indicative (Unofficial) Exchange Rates, *kyat*/\$US1

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008*
350	500	650	960	900	1,000	1,300	1,450	1,300	1,000

**As at March.*

⁸ For an introduction to the impacts of flat income taxes in transition economies, see Keen, Kim and Varsanao (2006).

Reforming (unifying) Burma's divergent exchange rates must be an immediate priority of any reforming government. Apart from painting an image rightly associated with the most chaotic of economies, Burma's dual exchange rate apparatus imposes costs. Creating an obvious incentive for corruption (for those able to buy dollars at the official rate, and sell at the market rate) and an impediment to foreign investment, the dual exchange rates cost existing businesses within Burma seeking to export or import (who are forced to inhabit a 'grey' area of legal vulnerability), and those generally needing official approval in some form. All up, the IMF (2007, p.16) estimates that economic losses associated with the inefficiencies of Burma's divergent exchange rates amount to as much as 5–10 per cent of the country's GDP.

Fortunately, this aspect of economic reform can be quite quickly and easily implemented since, in essence, unifying Burma's exchange rates simply requires abandoning the unrealistic official rate and allowing the *kyat* to legally trade at its market value. Formally, this means the adoption of a 'floating' exchange rate for Burma (of the sort prevalent in many countries throughout the world, developing and developed alike). This author agrees with the IMF (2007, p.16) that, in any immediate reform period, a floating exchange rate is preferable for Burma to a reconfigured fixed or 'pegged' rate. This reasoning is based on:

- (i) Burma will possess insufficient foreign exchange reserves with which to 'defend' a fixed or pegged exchange rate for some time. The country will accrue greater foreign reserves in the future from the ongoing sales of gas and other commodities but, maintaining a prudent and permanent buffer aside, these will be better applied to critical health, education and other infrastructure needs.
- (ii) A new government in Burma will need time to win policy credibility. This increases the dangers that a fixed exchange rate will need to be defended by fiscal or monetary policy instruments, robbing them of alternative uses and distracting the government generally.
- (iii) It would be extremely difficult, in the initial reform period, to decide upon a rate the *kyat* could be fixed *at*. Decades of a dual exchange rate system, coupled with an economy finding its feet as well as new trading partners (in the likelihood that sanctions will be lifted against a new genuinely reforming government), means that the information we have already in informing what an 'equilibrium' exchange rate might be for Burma will quickly become obsolete. Allowing the market to decide the rate would, at the very least, yield further information throughout the transition period, while avoiding the consequences of setting an exchange rate that was too high (damaging Burma's trade prospects), or too low (encouraging inflation).
- (iv) Likewise, and before even determining the exchange *rate*, is the difficulty in deciding which foreign currency to peg *to*. Ideally, countries should peg

to a currency in which the largest share of their trade is denominated (insulating their main exports and imports from exchange rate volatility of the peg currency), and one that is relatively stable, widely accepted internationally, and issued by a country without high inflation or other chronic monetary problems. In Burma's case it is difficult to know, in the short run, which currencies could fulfill all of these criteria. The US dollar is by far the most widely accepted currency internationally, is issued by a country with low inflation and general monetary stability, but is at the moment beset by substantial exchange rate volatility. Nor, of course, is the United States Burma's largest trading partner (even though many of Burma's current and prospective exports are usually priced in US dollars in world markets). Thailand and China are currently Burma's most important trading partners (though they may not remain so post-political change), but their currencies are not completely tradeable (China), are subject to periodic volatility (Thailand), and are underpinned by national monetary systems that are 'fragile' and inflation-prone (both). Fixing Burma's exchange rate must await, at the very least, a greater feel for whom the country will be doing business with in the years ahead.

- (v) A fixed exchange rate would require active management by the CBM which, especially in the early reform period, will be confronted by numerous tasks that will greatly tax its capacities. Providing assistance to the central bank, especially in the provision of training, would be one area in which the international community (especially other central banks and the multilateral financial institutions) could render meaningful and effective assistance.
- (vi) Finally, and as noted by the IMF (2007, p.16), such necessary debates as would come with a decision to fix could rob an economic reform process of momentum – precisely at the time a (newly-installed) government is most likely to have the goodwill to push other difficult reforms through.

Of course, the decision to allow Burma's currency to float during the transition period does not close-off other options at a later date – at which time many of the issues noted above will likely have been resolved. This could include Burma's adoption of a currency-board arrangement to essentially 'import' fiscal discipline and monetary stability should these remain wanting. Burma had a currency-board in the early years of independence, and it is a device championed by a number of scholars of the country.⁹

c) The External Sector

The one bright spot with respect to Burma's economy in recent years has been the apparent turnaround in the country's external sector. In place of the chronic deficits that hitherto have been a characteristic have emerged persistent surpluses – and along with them swelling foreign exchange reserves. Table 4 below reveals the broad picture:

⁹ See, for instance, Khin Maung Kyi *et.al.* (2000).

Table 4: Burma's External Sector – Selected Indicators (\$US millions)

Year	Goods Exports	Goods Imports	Current Account Balance
2000	1,661.6	2,165.4	-211.7
2001	2,521.8	2,443.7	-153.5
2002	2,421.1	2,022.1	96.6
2003	2,709.7	1,911.6	-19.3
2004	2,926.6	1,998.7	111.5
2005	3,787.8	1,759.4	587.7
2006	4,554.7	2,343.4	802.0
2007*	1,556.8	774.9	428.6

*As at end-1st Quarter. Source: IMF (2008)

Meanwhile Tables 5 and 6 present the changing pattern of Burma's trade according to the country source of its exports and imports;

Table 5: Burma's Exports by Source (kyat millions)

	China	Hong Kong	India	Singapore	Thailand	USA
2003-04	1343.2	475.5	2166.5	786.0	4676.1	582.7
2004-05	1658.8	656.1	1956.3	807.3	7219.2	1.5
2005-06	2125.2	1488.1	2841.6	1532.7	7868.6	0.8
2006-07	3530.4	2316.6	4217.2	1047.9	13,533.8	19.9
2007-08*	2452.3	2455.2	2775.9	1507.6	10,753.0	6.3

*ie, as at November 2007. Source: M CSO (2008)

Table 6: Burma's Imports by Source (kyat millions)

	China	Japan	India	Singapore	Thailand	USA
2003-04	2816.8	1579.3	652.4	4048.0	1143.3	141.7
2004-05	2819.0	920.4	480.1	3471.5	1054.2	165.7
2005-06	2716.0	610.7	465.2	3240.2	1376.2	478.4
2006-07	4185.8	896.3	916.5	5928.0	1749.4	248.1
2007-08*	3553.5	829.1	676.9	2293.0	1743.1	85.6

*ie, as at November 2007. Source: MCSO (2008)

...while Table 7 likewise reveals a changing story, this time according to the type of commodities that Burma is exporting to the world;

Table 7: Composition of Exports (Kyat millions)

Export Type	2003-04	2004-05	2005-06	2006-07	2007-08*
Gas	3,478	5,812	6,235	11,676	9,835
Teak and other Woods	2,149	2,776	2,750	2,939	2,023
Pulses and Beans	1,731	1,283	1,875	3,497	2,443
Garments and Textiles	1,965	1,238	1,586	1,602	1,025
Rice	130	180	214	18	31
Total Private Sector	7,838	7,228	9,313	11,887	8,051
Total State Sector	6,281	9,469	11,333	18,139	15,695

Total	14,119	16,697	20,646	30,026	23,746
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** April-November. Source: EIU (2008), MCSO (2008)*

Burma's trade turnaround is apparent in each of the tables above, but they also uncover a more nuanced picture than that of unambiguous success. Examining Table 4, for instance, exposes that much of the turnaround in Burma's current account position in recent years (up to the last two) owes as much to falling imports as it does to increasing exports. This is problematic. Imports, of consumption goods, intermediate goods, capital goods and, with each of these, concomitant ideas and 'know how' – are critical to economic development. We would also expect that a country experiencing strong growth to demand more imports as its people become richer and its economy more complex. That this has not been the case in Burma is troubling for what it implies for the future and, perhaps it is needless to say, offers something of a devastating critique of the phenomenal growth rates claimed by the SPDC over the last decade.

Tables 5 and 6 meanwhile are of interest in what they reveal of the changing relative importance of Burma's trading partners. Changes that are driven (more on which below) by the changing composition of Burma's exports, they reveal:

- The growing importance of China (including Hong Kong).
- The growing dependence upon Thailand (and natural gas) as the principal market for Burma's exports.
- The still-strong importance, albeit declining in relative terms, of Singapore.
- The declining importance of Japan as a source of imports (largely in favour of China).
- The near-absence of Western countries – both as sources of imports, and as markets for Burma's exports.

Table 7 on the other hand reveals the success of Burma's pulse and beans exports, largely as a consequence of the absence of state intervention in the production and marketing of this crop. The heavy-hand of the state elsewhere is also very apparent, with just over 60 per cent of all of Burma's exports in 2006/07 being undertaken via the state and the SOEs. Although Burma imposes relatively low formal tariffs, non-tariff and non-formal trade barriers are substantial. Export and import licences are required for the movement of most commodities in and out of Burma, the issuing of which usually come under the remit of the Trade Committee of the SPDC, and its head (the second in-command of the junta), Vice Senior-General Maung Aye. Other barriers include restrictions on the repatriation of profits, the many impositions on foreigners working for international firms, and the various limits upon access to foreign exchange.

Of course, the 'elephant in the room' with respect to Burma's exports is the country's emergence as a major regional supplier of natural gas. Gas exports comprised nearly 40

per cent of Burma's exports by value in 2006/07. Table 8 below reveals that it is a mixture of both rising gas prices as well as increases in export volumes that are behind the growth of the sector:

Table 8: Burma's Gas Exports, Earnings and International Reserves

<i>Year</i>	<i>Gas Export Volumes (million cubic metres)</i>	<i>Gas Price (\$US per million Btu)¹⁰</i>	<i>Balance of Payments (\$US m)</i>	<i>Reserves (\$USm)</i>
2003-04	5,664.4	4.98	541	781
2004-05	9,501.1	7.43	929	873
2005-06	9,138.5	7.31	1,547	1,026
2006-07	13,028.3	8.45	2,226	2,039
2007-08	10,326.8*	9.41	2,355**	3,307**

* *ie, April–November 2007. Source: MCSO (2008), IMF (2007).*

** *Projection*

Burma's gas exports come courtesy of its possession of large, and exploitable, fields of natural gas offshore in the Gulf of Martaban and in the Bay of Bengal. Cumulatively, these fields have confirmed recoverable reserves of around 540 billion cubic metres – enough, at current prices and rates of production, to bring in annually around \$US2 billion for the next 30 to 40 years.¹¹ Two of the fields, the so-called Yadana ('jewel') fields off Mouttama, and the Yetagun ('valiant banner') fields off Burma's Tanintharyi coast, came on stream in 1988 and 2000 respectively, and it these that are the overwhelming source of Burma's current gas deliveries.¹² Yadana was a joint venture between Burma's state-owned energy company, the Myanmar Oil and Gas Enterprise (MOGE), in partnership with Total Oil (of France, which manages the project), Unocal (now Chevron, United States) and PTT Exploration and Production ('PTTE', Thailand). The Yetagun fields were developed by MOGE, Premier Oil (UK), and Nippon Oil (Japan) (Tin Maung Maung Than 2005, p.265). The primary customer of the output from the Yadana and Yetagun fields is (as noted above) Thailand which, in stark contrast to the historical relationship, now runs a substantial trade deficit with Burma as a consequence (of just over \$US2 billion in 2006/07).¹³

¹⁰ Prices are a composite of those applying to the delivery of natural gas to a number of countries and regions. Gas export prices are typically quoted in 'British Thermal Units' (Btu's), a measure that accounts for both volume and energy intensity. Though there are other complications that must be taken into account in particular contexts, one Btu is equivalent to approximately 28 million cubic metres of gas.

¹¹ British Petroleum, *BP Statistical Review of World Energy, June 2007*, <<http://www.bp.com/statisticalreview/>>, accessed March 27, 2008.

¹² For more on the background to the development of these fields, and Burma's energy policies more generally, see Tin Maung Maung Than (2005, pp.257-292).

¹³ Burma's trade statistics suffer from the general unreliability of data in Burma, but the situation is exacerbated here by the under-reporting of imports in order to avoid customs duties. Military imports are likewise certain to be under-reported while certain categories of exports – notably of narcotics – are completely invisible. These latest numbers derive from the MCSO, and were reported by Ye Lwin and Kyaw Thu, 'Government Dominates Foreign Trade as Gas Sales Pump Up Exports', *The Myanmar Times*, June 4-10, 2007, <<http://www.mmtimes.com>>.

Over the next few years the export of gas from Yadana and Yetagun will be joined by that from new fields off Burma's coast in the Bay of Bengal. These fields, the most lucrative of which are collectively known as the 'Shwe' ('gold') fields, have roughly the same gas reserves present (an estimated 200–240 million cubic metres) as discovered at the Yadana and Yetagun reservoirs.¹⁴ The Shwe fields were explored and developed by a consortium that comprised MOGE, together with South Korea's Daewoo Corporation, the Korean Gas Corporation, the Gas Authority of India Limited, and India's Oil and Natural Gas Corporation.

The ultimate customer of the gas actually *delivered* from Burma's Shwe fields will be China – which in 2007 'won' a fiercely contested bidding war against India and South Korea. This result provoked consternation in South Korea and India at the time, not least because China's reported bid of \$US4.28 per million Btu was below that of India's offer of \$US4.76.¹⁵ China's Yunnan Province will be the recipient of the gas, courtesy of a 2,400km pipeline that will come ashore near the port of Sittwe (via a facility at nearby Ramree Island), and run more or less the length of Burma into Yunnan. With little in the way of labour or environmental considerations to get in the way, construction of the Shwe pipeline can be completed relatively quickly (two to three years). As matters currently stand, however, a delay seems likely in the project, with a senior Yunnan official recently stating with respect to the pipeline that '*whether*, when and how to build it are yet to be decided' (emphasis added).¹⁶ In the light of this, it is now likely that the first Shwe gas (and its revenue) will not flow until at least 2011.

Since the dramatic announcements of substantial gas reserves in the Shwe fields, scarcely a week passes without further announcements of gas discoveries off Burma's coast. Many of these are doubtful. Recent claims by MOGE of a new and vast field in the Gulf of Martaban for instance (of over 240 billion cubic metres – marginally larger than the Shwe fields), have been discounted.¹⁷ Whilst it is likely that significant and thus far undiscovered gas reserves *do* exist off Burma, there equally seems much to suggest that the SPDC (and MOGE in particular) are engaged in a substantial 'talking up' of the country's gas business. Their hyperbolic claims highlight the extent to which Burma's energy sector is currently buoyed by possibly irrational sentiment. By nature commodity markets are extraordinarily volatile, and Burma as a consequence is now acutely vulnerable to changes in sentiment, and clearly to any downturn in gas prices.

¹⁴ Estimates of the size of the Shwe fields vary, but those here refer to *confirmed* gas reserves according to British Petroleum's *BP Statistical Review of World Energy*, *op.cit.*

¹⁵ Anupama Airy, 'Myanmar Prefers China as Gas Buyer', *Financial Express*, May 29, 2007, <<http://www.financialexpress.com>>.

¹⁶ The official was Bai Enpai, Secretary of the Yunnan Provincial Committee of the Chinese Communist Party. The statement, which was made on March 8, 2008 caused widespread astonishment given the conventional wisdom that the pipeline was a 'done deal'. Bai Enpai's comments were reported by China's Xinhua News Agency, <www.xinhuanet.com/english/>.

¹⁷ Principally, by Thailand's PTTE, which acknowledges a likely 70 billion cubic metres. See Ye Lwin and Kyaw Thu, 'Government Dominates Foreign Trade as Gas Sales Pump Up Exports', *The Myanmar Times*, *op.cit.*

*d) The Banking Sector*¹⁸

Precluded from much in the way of access to international funds, and without a functioning stock market, bond market, or any of the usual financing vehicles available to firms in most countries, formal finance for private enterprise in Burma is limited to that made available by the country's banks. But Burma's banks are in dire straights. Bank lending in Burma has recovered *somewhat* since the 2003 banking crisis (more on which below), but it remains pitifully meagre. In 2006 total funds lent by the banks was only around 20 per cent of that provided by the CBM to the state. Of course, as can be seen from the data in Table 2 earlier, a substantial component of commercial bank lending (more than 20 percent of the funds they provided to the private sector) also made its way to the government. Burma's banking sector, in fact, scarcely performs an intermediation function, for which the fault once more lies in excessive state interference – in this case in the form of heavy-handed and inappropriate regulation. There are many examples of this, but representative are restrictions imposed on Burma's banks that 'cap' the interest rates they can charge on loans, and pay on deposits, at 17 and 12 percent respectively.¹⁹ Such rates, well below even the most optimistic estimates of Burma's inflation rate, reward neither saver nor lender. The low-levels of voluntary saving in Burma, and the inadequate lending to the private sector, are the entirely predictable consequences.²⁰ Burma's domestic savings rate of 12.7 per cent of GDP (2006/07) is far lower than that required to support the formation of capital necessary for transformational growth. Burma's saving rate compares highly unfavourably to its ASEAN partners (Singapore has a savings rate of 49 per cent, Malaysia 43 per cent, Thailand 29 per cent and Indonesia 26 per cent), and even countries such as Bangladesh and Cambodia (20 and 14 per cent respectively) (ADB 2007).

...A non-Functional Sector

Crowding out by the state is the most important and pernicious of the maladies affecting private sector finance in Burma, but it is by no means the only one. Burma's financial system is in other ways dysfunctional – a situation that was spectacularly revealed in the country's 2003 banking crisis. A much under-reported event internationally, the collapse of Burma's leading banks in 2003 brought about at least two years of negative economic growth (notwithstanding the official GDP numbers), and reduced Burma for a time to a near-barter economy.²¹

Burma's 2003 banking crisis was triggered by the collapse of a series of informal finance companies which were little more than 'ponzi' or 'pyramid' schemes. The existence of

¹⁸ For a full review of Burma's financial sector and its present failure but potential future, see Turnell (2008).

¹⁹ For more on the regulations distorting the functions of banks in Burma, see Turnell (2006, 2008).

²⁰ In June 2007 the essentially moribund state of Burma's banks was underlined by an announcement from the central bank that places limits on the amount of deposits that banks can accept. The imposition of these limits, stipulating a ceiling on new deposits of K3 million per customer, per week, is an implicit recognition that the banks can find few profitable lending opportunities. See Shah Paung, 'Burma's Private Banks Limit Deposits to Stay Alive', *The Irrawaddy*, July 26, 2007, <<http://www.irrawaddy.org/>>.

²¹ For a comprehensive analysis of Burma's 2003 financial crisis, see Turnell (2003).

such schemes, which promised those Burmese with money with a hedge against the country's chronic inflation, was itself a sure sign of a malfunctioning financial system. Through the failure of these schemes, and both via specific links and simple 'contagion', the crisis quickly extended into the country's private banking sector. Subsequent 'runs' on the banks stripped them of reserves and prompted the adoption of measures to restrict deposit withdrawals. In the panic a flight to cash led to a shortage of the *kyat*, and a liquidity crisis. Liquidity support, had it been rapidly and appropriately supplied by the CBM could have limited the contagion. The CBM, however, failed miserably in the crisis and its support was both too little and too late. Burma's private banks, which superficially had appeared to be performing strongly before the crisis (but more on which below), were irreparably damaged. As can be seen from Table 2, recovery from the damage to Burma's banking sector has been slow. Most significantly, bank lending to the private sector has yet to regain the levels prevailing before the crisis.

Even before the 2003 events, however, Burma's banking system did little to provide the finance desperately needed by truly *productive* private enterprise, and loans to businesses *unconnected* either to the banks or to the government were both expensive and hard to come by. Surveys of Burmese business owners conducted by the author reveal that the private banks are generally wary of lending to new enterprises that can offer little in the way of collateral. Meanwhile, for those that can put up collateral, the requirements are steep – a 'rule of thumb' adopted by many of the banks being a demand for fixed asset collateral of around 200 per cent of the value of a loan.²² Such collateral can really only be offered by 'connected' borrowers within larger business groups, and/or parties with links to government and military enterprises. These same surveys reveal that unconnected borrowers are also typically asked to pay hefty 'establishment fees' for loans. Such fees function as recompense for the 'capped' interest rates charged by the banks, but they also have the effect of greatly increasing costs to borrowers. The fees are sometimes informal by way of simple bribes paid to individual loan officers – but they are also often imposed with the full connivance of the management of the banks.²³

The high collateral requirements and other loan costs has created a situation in Burma in which what little lending has been undertaken by the private banks is predominantly to enterprises and individuals who are able to generate both high and quick returns. Such enterprises tend to be those engaged in highly speculative activities – in particular, hotel and real estate speculation, gold trading, jade mining, fishing and logging concessions and (for a brief period), garment factories. It has also been the case that an extra 'return' could be gained if the borrowers were so-called 'leaders of national races', many of whom enjoy extra privileges by way of special access to high-yielding natural resource

²² These interviews were conducted by the author across 2006-2007 in the United States, Singapore, Thailand as well as in Burma itself (remotely, via various secure channels). See also May Thander Win, 'Banks claim a solid recovery', *The Myanmar Times*, July 31-August 6, 2006, <<http://www.mmmtimes.com>>.

²³ This assertion is based on interviews with borrowers from the banks by the author.

sectors.²⁴ Of course, sometimes a bank will partner especially well-connected individuals on no terms at all – writing off their contribution as ‘political insurance’.²⁵

Burmese enterprises generating returns in the medium to long term, such as manufacturers, receive little bank finance. According to a Japanese survey of 167 small to medium manufacturing enterprises (SMEs) in 2006, most rely upon ‘self-financing’, and on funds available from friends and family, rather than bank loans.²⁶ This is true even for working capital and trade (supplier) finance, which sets the experience in Burma apart from that commonly observed for SMEs in other countries. The survey also drew attention to the fact that most of Burma’s new banks are at the centre of conglomerates and, in this context, demonstrate a bias in their lending to related entities. Such ‘connected’ lending has many causes – but not least as a vehicle to ‘cope with default’ in a scenario in which ‘the function of law in Myanmar seems to be very limited’ (Mieno 2006, p.158).

Beyond self-financing, informal moneylenders remain for many enterprises their only source of capital. The ubiquity of the moneylender in Burma is time honoured, and the emergence of formal private banks in the 1990s did little to dent their importance. Especially dominant is *ne pyan toh* (‘one-day lending’), usually provided to market traders by moneylenders (often women) according to a common formula of an 80 *kyat* loan in the morning, and a (somewhat usurious) 100 *Kyat* repayment the same evening. As necessary as such finance might be, its cost is not at all conducive to stepping up the scale of the economic activity it funds, or in allowing the establishment of formal businesses that might be viable in the long run.

Rural Finance

Of all the ‘real’ sector activities repressed by Burma’s dysfunctional financial system, no situation is more acute, or its repercussions so dire, as in agriculture. For reasons as unfathomable as they are destructive, Burma’s commercial banks are forbidden to lend to agriculturalists for cultivation. In their place as formal credit providers there is the state-owned ‘Myanmar Agricultural Development Bank’ (MADB) – the institution that is meant to be the sole provider of rural credit in Burma, but whose own modest objective of providing finance to meet just ‘30 percent’ of a cultivators production costs is internal recognition of its severe limitations. In fact, in practice the MADB has fallen well-short of meeting even this modest target. Average loans to paddy cultivators (80 percent of all MADB lending is to such farmers) were between K2,000 to K8,000 per acre of paddy in

²⁴ Many of these leaders were those who had made ceasefire agreements between the groups they represented, and the SLORC/SPDC. For more, see Bruce Hawke, ‘Burmese Banking: The Yangon Laundromats Burnout Explained’, *The Irrawaddy* 12:4 (April 2004), pp.17-21.

²⁵ One of the most damaging issues surrounding Burma’s banks are the widespread accusations that they are engaged in laundering the substantial money generated through Burma’s narcotics trade. For more on this see Sean Turnell, ‘Burma’s Economic Prospects’, US Senate Foreign Relations Committee, US-Burma Relations, One Hundred and Ninth Congress, March 29, 2006, <<http://www.senate.gov/~foreign/hearings/2006/hr060329p.html>>.

²⁶ This survey was conducted by Fumiharu Mieno, and its results reported in Mieno (2006). See also Myat Thein (2004).

2004 (the latest year for which we have anything like reasonable data), against cultivation costs of the same crop of around K60,000 (FAO 2004, p.3). The roughly 90 percent financing ‘gap’ is met via recourse to the moneylender, and by simply going without. MADB claimed to have 1.2 million borrowers in 2004 (down from 1.7 million in 1999), or 17 percent of all rural households (FAO 2004, p.6). These numbers are the latest publicly available on the operations of the MADB, but it is certain that since the FAO’s field survey in 2004 the situation for the MADB has only declined further. Indeed, information provided by the author suggests that, in 2008, the MADB is making next to no loans at all, and is operationally moribund.²⁷

A significant reason for the MADB’s parsimony (and its current parlous state generally) is that the bank itself is desperately short of funds – indeed, it has been ‘decapitalising’ over recent years. As its primary source of funds the MADB claims 2 million depositors, but in fact it attracts little in the way of actual deposits (a mere K4.6 billion in 2004) (FAO 2004, p.25). Deposits in the MADB are inhibited by many of the same restrictions imposed on other banks in Burma, including those on the interest rates the bank can pay. But in addition to these, and even more damaging, has been a policy in place since 2003 that greatly restricts the ability of depositors to withdraw their deposits (FAO 2004, p.2).

In 2004 the MADB’s capital stood at just K1.2 billion, an extraordinarily small financial platform upon which to pursue the functions of a country-wide bank with over two hundred branches and engaged in a form of lending with strong covariant risks (FAO 2004, p.5).²⁸ The MADB desperately needs an injection of capital, but the only policy towards it of late in this context is a most destructive order that compels the bank to pay the government a dividend of 25 percent of its annual profits. Unfortunately, such profits that might be claimed by the MADB are surely entirely fictitious. Since 1991 the bank has been forbidden from writing off bad debts, and claims as a result a 100 per cent repayment rate (FAO 2004, p.10). This figure may be compared to an annual provision against bad debts by Thailand’s ‘Bank for Agriculture and Agricultural Cooperatives’ (Thailand’s ‘equivalent’ of the MADB) of around 15 per cent of its portfolio.²⁹

The lack of finance imposes heavy costs on Burmese agriculture in terms of productivity, and certainly inhibits the ability of cultivators to move to more capital intensive modes of production. Even fertilizer is beyond the reach for most borrowers reliant upon MADB loans, one consequence of which is that fertilizer is now seldom used in Burma – a phenomenon that has the effect of reducing agricultural yields, and income, all round.

Reforms

Creating a properly-functioning financial system in Burma will take time, but it will be vital to the country’s future economic prosperity. Amongst the first steps that will be necessary in reforming (or, more accurately, reconstructing) this system include:

²⁷ This assessment is supported by that of the UNDP (2006).

²⁸ Agricultural lending is especially risky because seasonal factors tend to impact upon all borrowers simultaneously.

²⁹ Bank for Agriculture and Agricultural Cooperatives, <<http://www.baac.or.tha>>, accessed March 5, 2008.

- i. Assessing the condition of the state-owned banks. This will include identifying what will likely be the high proportion of their lending that is ‘non performing’ (in arrears and/or in complete default), and their recapitalisation to ensure short-term solvency. In the short to medium term decisions should be made as to whether some of the state-owned banks are necessary at all, whereupon they could be prepared for merger, sale or closure. The state-owned Myanmar Investment and Commercial Bank (MICB) and Myanmar Foreign Trade Bank (MFTB) are both prime targets for closure, while the broader-based Myanmar Economic Bank (MEB) for restructuring and eventual privatization. The MADB needs to be restructured, and eventually rolled into a new umbrella institution incorporating microfinance as well as more standard rural finance methodologies and products. In this Indonesia’s ‘Bank Rakyat Indonesia’ (BRI), and especially its renowned ‘unit desas’ (village banking) system, could be usefully studied.³⁰
- ii. The application of best-practice banking regulation and supervision. On paper Burma adheres to the so-called Basel Accords, but in practice bank regulation is corrupt, ad-hoc and almost entirely ineffectual. Implementation is thus the key issue, and it is one for which the assistance of international financial institutions would be both valuable and readily forthcoming.
- iii. Closely related to the above is the reformation of the CBM which, in both its microeconomic (regulatory) and macroeconomic functions has lost almost all credibility. At the core of the CBM remain some good and talented staff, but credibility is everything to a central bank and, as such, top to bottom restructuring of the institution will be necessary. It is critical that a reformed central bank for Burma (which might include a change of name – a revival of ‘Bank of Burma?’) enjoys formal operational independence from the government of the day.
- iv. Burma has restrictions on the activities of private banks that do nothing for prudence or efficiency whilst greatly inhibiting sectoral development. These restrictions, which include limits on branch numbers, products offered, deposits accepted and loans granted, should be removed as soon as possible.
- v. The foreign-exchange monopolies of the MFTB, MICB and MEB should be abolished, and surviving private banks should be authorised to deal in foreign exchange.
- vi. Burma’s financial sector should be opened to internationally-respected foreign banks. This is a way for Burma to ‘import’ into its financial system new skills, technologies, competition, as well as access to international capital. Such foreign banks would also

³⁰ A large literature has grown up to examine BRI’s success. For an introduction, however, see ADB (2000).

- facilitate foreign direct investment in Burma (as well as trade), through their provision of necessary international banking services not easily provided by indigenous institutions in the short term.
- vii. Financial repression in Burma, which is the outcome of the caps on lending and deposit interest rates, should come to an end by the immediate abandoning of these caps.
 - viii. Given all of the above, a Burma in genuine transition to a rule-based market economy would be ripe for the benefits promised by 'microfinance'. Indeed, three large microfinance schemes are already operated by the UNDP in Burma (and many others by various NGOs). These show considerable promise, but are held back from achieving their potential under the SPDC – which refuses to grant microfinance legal recognition, and other protections necessary for the creation of formal financial institutions of the type Burma needs.³¹

e) Agriculture

The problems in accessing finance are unfortunately just a subset of the many difficulties facing Burma's cultivators and farmers. Transformational reform is unavoidable in the medium to longer term, but in the transition phase the removal of the market distortions that continue under the SPDC will be critical. Especially significant in this regard are the various export restrictions, production controls, and procurement orders from the military that continue to dominate the agricultural landscape in Burma (despite the ending of centralized compulsory procurement in 2003). Burma's recent success as an exporter of beans and pulses (for which it is now the second largest exporter in the world) demonstrates that its agriculturalists react strongly and quickly to legitimate market signals. The trade in beans and pulses was liberalised a decade ago, in great contrast to that for most other commodities, which continue to suffer all manner of interference. The conclusion of the FAO, following its 2004 agricultural sector review of Burma, was unequivocal:

Were markets to be truly liberalised (and directed production eliminated) there is little doubt that Myanmar would see a substantial and far reaching change in cropping patterns over the next decade...Farmers and exporters would rapidly respond to areas where Myanmar has a competitive advantage, as they have already done for pulses... Export earnings would rise substantially, more than compensating for increased imports of commodities for which the country has no competitive advantage...Farm incomes would rise and national growth would be accelerated (FAO 2004, p.161).

But lifting the restrictions and limitations on trade will not be sufficient to restore Burma's degraded agricultural sector. Under the SPDC and its predecessors, Burma's rural areas have been chronically neglected. Rural infrastructure in almost all its forms

³¹ Microfinance can play (and has played in other countries and circumstances) a significant part in stimulating employment in the private sector – and from which hope for Burma's economic future must reside. For an exploration of microfinance in Burma, and its promise, see Turnell (2005, 2008).

has collapsed. Many villages are without viable roads to connect them to national (or even regional) markets, fertilizer is unavailable in many locations, irrigation systems have silted up, seeds, pesticides, pumps and other apparatus are largely absent, and fuel of all varieties (with the qualified exception of animal manure) is often beyond financial reach. Market liberalization will solve some of these maladies but, in the short to medium-run, Burma's agricultural sector will require substantial public expenditure and investment, especially on roads, bridges, irrigation, power generation and distribution, as well as on environmental and resource management systems. Such public investments will be necessary to support a sector in which private sector involvement should be otherwise dominant, and a reforming government in Burma should look to various 'public-private' partnership schemes that have been important forms of infrastructure provision in the region. That said, public funds of some magnitude will need to be committed, for which the financial resources made available from Burma's gas exports might be most profitably employed (more on which below).

One of the most significant barriers to the improvement of Burma's agricultural sector is that all rural land in the country is formally owned by the state.³² Individuals are eligible for 30-year inheritable *use* rights on rural land, with such rights determined by village-level land committees (with the permission of similar regional committees), but land cannot legally be transferred between unrelated individuals. This also means that land cannot be used as collateral on loans. More broadly, the lack of land title denies the Burmese cultivator the incentive, and security, to invest or otherwise improve their farms. Of course, the practice of the SPDC (as well as elements of the *Tatmadaw* independently in the field) to engage in arbitrary land confiscation only makes an impossible situation worse.³³ According to the FAO (2004, p.159), the ability to buy and sell title over land is a seminal economic 'right', the provision of which for Burmese agriculture is the 'key to sector development'.

Giving Burmese cultivators title over their lands should be a first order priority of any genuinely reforming government. This will not be easy, and there will be many pitfalls and (even more certainly) disputes along the way, especially with respect to determining original ownership on lands subject to past confiscation. Nevertheless, such land reform will be critical to Burma's future. In this task, however, reformers in Burma need not reinvent the wheel, since the whole question of land title in transition scenarios is something that a great many former socialist countries have had to grapple with in the last two decades. Burma can gain from the lessons of these experiences, some of the most important of which include;

- The recognition and application of local knowledge as to the basis of the claims of individuals and families to land.

³² For an overview of the importance of land ownership forms and economic development, see World Bank (2003). That the right to private ownership in land might also aid in the promotion of sustainable natural resource management, see Cattaneo (2001).

³³ The issue of land confiscation, rural landlessness, and other afflictions imposed on Burma's cultivators by their government is splendidly, if depressingly, detailed in Hudson-Rodd and Sein Htay (2008).

- The need for full public participation, through legislative transparency and public awareness campaigns, of new land tenure arrangements.
- Subsequent legislation that is clear, and transparently enforced through independent processes, including specialist courts.
- The need to complement land-titling with other reforms (some implicit in the above), of creating efficient and independent judicial systems, reforming financial laws and regulations, installing bankruptcy and foreclosure laws, and so on.
- Ensuring that formal laws are consistent with the complexities of local social and cultural values.³⁴

f) 'Gas' and its discontents

As noted above, Burma is now earning substantial revenues from the sale of natural gas from its offshore deposits. Such earnings, which will rise to around \$US2 billion per annum in the years ahead, offer the *opportunity* to change the economic 'conversation' in Burma. Yet, also as noted above, Burma's gas earnings are already causing problems. Almost invisible in the country's public accounts, so far they seem to be earmarked for the type of wasteful and grandiose spending projects that have been a characteristic of Burma's military regimes for nearly five decades. In short, Burma's earnings from its natural gas exports seem primed to visit upon the country a 'resources curse'.

Known under a myriad of labels, the notion of a 'resources curse' refers to the seeming paradox of abundant natural resources in a country, and yet its simultaneous economic underperformance.³⁵ Initially the idea was founded on the observed harmful effects on the manufacturing sector of real exchange rate increases via booming commodity exports (the so-called 'Dutch disease'), but in recent times attention has turned to two other avenues via which the possession of lucrative natural resources can undermine economic development. The first and most simple of these relates to the importation of volatility. Natural resource and commodity exports typically provide highly volatile earnings, the cause of which is an amalgam of fluctuating prices, sometimes unpredictable rates of resource extraction, and variability in the timing of payments to states by project partners. In the case of Burma and its gas, thus far price volatility has been in the country's favour, but it will not forever remain so. Meanwhile, a close examination of Burma's gas earnings month by month does indeed show substantial 'lumpiness' in payment timing.³⁶ If a country possesses a sophisticated domestic financial system, and/or has access to

³⁴ The author recognises that this list is both far from comprehensive, and more than usually subject to the difficulties of translating abstract ideas into workable solutions. For an introduction into both the potential and complexities of land title, the enormously influential work of the Peruvian economist, Hernando de Soto, is little bettered. It can be sampled at the Institute for Liberty and Democracy, <<http://ild.org.pe/en/home>>, but for a more comprehensive statement, see de Soto (2000). Once more for an examination of all of these issues in the context of Burma, see Hudson-Rodd and Sein Htay (2008).

³⁵ The first example of a resources curse was probably that flowing from the negative effects on 16th century Spain of the influx of precious metals from the New World. The modern label for the phenomenon seems to have its origins in Auty (1993).

³⁶ See, for instance, the 'export of major commodities' pages of the MCSO, <<http://www.csostat.gov.mm/>>.

international financial markets, such volatility can be quite easily dealt with through hedging, futures and forwards contracts, and other instruments. In the absence of these, and accordingly of relevance to Burma, volatility otherwise can lead to 'boom-bust' cycles in the macro-economy.

But the avenue through which a resources curse might operate that has become a particular focus of late relates to the ways in which resource windfalls can undermine good governance, democracy, the rule of law – and other attributes and institutions conducive to economic growth. Resource revenues, being easy to distribute to well connected insiders and others can promote corruption, the under investment in human capital, and allow governments the wherewithal to be unresponsive to the needs of their (often non-tax paying) citizenry. Simultaneously, such revenues also increase the incentives to attain (and retain) political power, from which the extraction of economic 'rents' becomes the vehicle for wealth and prosperity for those able to access them – at the expense of enterprise and other virtues which otherwise might determine national wealth creation. Meanwhile, the creation of an effective democratic state itself is undermined, in favour of a political apparatus favouring repression, the doling out of rewards for regime loyalty and the creation of self-celebrating 'prestige' projects that unfortunately litter much of the developing world. Of course, all of the above are present in Burma today.

Efforts by a number of countries to mitigate against resources curse effects have spawned a number of innovative devices and institutions. At one extreme (long-employed by the US state of Alaska for instance) are 'Revenue Distribution Funds' (RDFs), which seek to avoid the governance-eroding symptoms of resource windfalls by channelling them directly to the populace, thereby eliminating profligate government spending by simply by-passing the state altogether. But whilst RDFs stop wasteful government consumption, they do not necessarily finance higher levels of investment, since such revenues can simply be used for private consumption too. Depending upon circumstance this might be no bad thing, but for developing countries such as Burma, what is vital is capital accumulation – for growth and development generally, but also to offset what is in essence the depreciation of the country's 'naturally-endowed capital' via the sale of its energy resources.

Of greater interest as a device for resource-curse mitigation than RDFs then, especially in the context of developing and transition countries, are so-called 'Natural Resource Funds' (NRFs), whose function is to insulate state finances from the unpredictability and volatility of resource revenues by providing a vehicle in which to 'save' and invest these revenues in productive ways. Stabilisation funds have been employed in many countries, most inspired by Norway's extraordinarily successful 'State Petroleum Fund' which was created in 1990 to manage that country's windfall gains from its North Sea oil. Similar stabilisation funds have subsequently been established in Azerbaijan, Kazakhstan, Papua New Guinea, Venezuela and, most recently, in East Timor.

Unfortunately, however, and with the possible exception of the last case (for which the jury is still out), NRFs have proved a severe disappointment. The reason for this is

simple, and it boils down to the lesson that, to be successful, NRFs need more or less the same ‘good governance’ as that generally required to avoid a resources curse in the first place. Whatever the legal safeguards, in practice NRFs have proved no less susceptible to manipulation, mismanagement, and outright government plundering than national budgets generally.³⁷ The sobering reality is that stabilisation funds seem only to be viable in countries (demonstrably such as Norway) that do not need them.

For a country such as Burma then, and assuming a genuinely reform-minded government, the best way to avoid a resources curse will not be to establish new institutions such as RDFs or NRFs (at least not in the immediate or transition period, even though both might be usefully employed in the longer-term). Rather, for Burma a better alternative will be to channel the gas revenues into core private sector-*complementing* public investment. Such investment, which includes spending on basic infrastructure (roads, power generation, water and irrigation, ports and airports), as well as on health, education, and the institutions that establish and uphold property rights and the rule of law, are underprovided by the private sector – even as they are integral to its success. In this form, public investment constitutes true capital formation. Resource windfalls such as Burma’s gas earnings are converted into long-term *physical* assets that perform the same ‘saving’ function as the financial assets of an NRF, but which are arguably more necessary in countries such as Burma in which truly-productive public investment is largely absent.³⁸

Of course, prudence and oversight must accompany programs of public investment, lest such spending be channelled (as it is at present in Burma) into wasteful projects or those that simply line the pockets of government-connected contractors. Various devices can help insure this, however, not least via the creation of a truly independent oversight body to review and, where necessary, cap public spending. Transition economies (and especially those with weak institutional traditions such as Burma) are likely to find it difficult to establish bodies truly independent of the government of the day. One possible solution, consistent with another institutional reform noted in these pages, would be to locate public spending oversight within a reconstituted central bank.³⁹ Uniquely not reliant on the state for the financing of its own operations, a constitutionally independent central bank is also ideally placed to best consider the macroeconomic impact of both resource revenues and the public spending they might allow. Finally, and in recognition of the universal truth that ‘sunshine’ is correctly regarded as the best disinfectant, accompanying any oversight mechanisms must be transparency and the widespread dissemination of information – the seeds of better practice from which much might grow.⁴⁰

³⁷ The most significant recent example of this is the case of Chad, whose NRF (the *Collège de Contrôle*) was undermined when, in 2005, the government simply rewrote the fund’s laws of establishment to gain access to its accumulated revenues. For more on this episode, see Bell and Fario (2007, pp.301-301).

³⁸ For more on this strategy, see the excellent contributions to the resource curse literature of Sachs (2007), and Humphreys and Sandbu (2007).

³⁹ Central banks play a critical role in the oversight of the NRFs and other resource revenue schemes of East Timor, Norway, and Sao Tome and Principe (Bell and Fario 2007, pp.295–297).

⁴⁰ In this context too, a transition Burma could usefully apply the standards set out in the UK-instigated ‘Extractive Industries Transparency Initiative’ (EITI). Details of this increasingly important international

Conclusion

Laying the foundations of a market-centred and rule based economy will be key to the success of any transition strategy to lift Burma from its present 'least-developed' purgatory. This will not likely be achieved under Burma's current military rulers, who for nearly five decades have eschewed the market and sound policy, while they have wantonly undermined critical institutions. With a genuinely reforming government in place that is accountable, reasonable, predictable in its policy-making, and protective of the rights of the individual under impersonal law, Burma's future need not be bleak. Such a government will face immense challenges in any transition, not least as presented by resources revenues that may break or make the country. The hour is late, but with change cometh hope.

body can be found at <<http://eitransparency.org/node>>. For a general overview of the critical importance of transparency in avoiding a resources curse, see Humphreys, Sachs and Stiglitz (2007), *passim*.

APPENDIX

Burma's Economy: Some Data Projections

The table below presents Burma's economy as at the end of financial-year 2006-07 (ie, April 2007), and as projected for the next five years to 2011-12. All data are the author's calculations based on underlying numbers, projections and estimates of the IMF (2007, 2008), the Asian Development Bank (ADB, 2007), the CIA (2008), filtered figures from the MCSO and other, confidential, sources. The projected numbers are, of course, highly vulnerable to various assumptions regarding both Burma's and global economic circumstances. For instance, the growth estimates below are slightly lower than those projected by the IMF (2007), primarily as a consequence of a slowing global economy and greater costs imposed by the persistence of higher energy prices (especially of imported diesel) than may have been anticipated just a year ago.

Burma's Economy
Selected Indicators and Projections 2006/07–2011/12

	2006– 07	2007– 08	2008– 09	2009– 10	2010– 11	2011– 12
GDP (\$US million)	14,455	15,178	15,709	16,259	16,893	16,244
Real GDP Growth (%)	4.5	5.0	3.5	3.5	3.9	4.0
Per-capita GDP (\$US)	289	297	301	305	311	316
Per-capita GDP growth (%)	2.4	3.4	1.0	1.0	1.0	1.0
Per-capita GDP (PPP)	1,472	1,546	1,601	1,657	1,721	1,790
Growth of Agricultural Output (%)	3.0	3.1	2.2	2.2	2.2	2.3
Growth of Industrial/Energy Output (%)	22.0	9.7	7.0	7.0	7.1	7.5
Growth of Trade and Services Output (%)	5.0	6.0	4.5	4.5	4.5	4.7
Balance of Payments (\$US million)	700	1,000	750	450	250	100
Net Fiscal Imbalance (% GDP)	-4.3	-3.9	-3.0	-3.0	-3.5	-3.0

Some comments:

Firstly, it is striking that even projected forward five years, per capita GDP in Burma will likely remain below \$US1 per day. This result I believe is quite robust, whatever the likely trajectory of the US dollar over the period. I conservatively assume in the calculations above, for instance, a population for Burma of 50 million. This compares to the CIA's (2008) low (too low?) estimate of 47.8 million, and the probably exaggerated 56.5 million calculation of the ADB (2007). Most Burma observers assume a population in the range of 50-54 million. Taking the mid-point of this range lowers my per capita GDP number to \$US278 for 2006/07, with commensurate falls for the projections

thereafter. All of these GDP numbers are calculated using a *kyat*/\$US exchange rate that is a heavily market-weighted amalgam (92 and 8 per cent respectively, following the lead of the IMF [2007]) of Burma's official and unofficial exchange rates (more on which below). Calculating purchasing-power parities (PPP) for Burma, which attempts to adjust income to relative costs of living in different countries is, not surprisingly, extraordinarily difficult and subject to many more complicating assumptions (see Bradford 2004). My estimate of per capita GDP based on PPP of \$US1,472 is lower than the CIA's \$US1,900, which in my view overstates Burma's GDP growth over the last few years. Thailand's per capita GDP on PPP terms is around \$8,000 (CIA 2008).

Likewise notable is the contribution to Burma's GDP of net exports, driven by the country's expanding sales to Thailand and (at the end of the five-year projection) to China. Indeed, this is the near exclusive driver of economic growth in Burma, and to a great extent masks the near-stagnation of the country apparent just about everywhere else.

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