Burma's Economic Prospects

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by

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Overview

According to official statistics released by Burma's ruling military regime, the self-styled 'State Peace and Development Council' (SPDC), Burma's economy grew by an astonishing 12.2 per cent in 2005. Beating even the previous year's stellar performance of 12.0 per cent, and coupled with double-digit growth all the way back to 1999, by these measures Burma is the fastest-growing economy in the world. What's more, Burma achieved this astonishing growth using less energy, less material resources and, in the middle of it all, while negotiating a banking and financial crisis that was as serious as any in history. Truly, a miracle economy indeed.

It is, alas, also a fantasy economy. Under the SPDC, the *real* Burma is a wasteland of missed opportunity, exploitation and direst poverty. More realistic numbers of Burma's economic performance calculated by Burma Economic Watch show that far from stellar growth, Burma's economy actually shrank in 2003 and 2004. In 2005 Burma will likely have returned to growth, but at a rather more modest 2 to 3 per cent. Similar growth can be expected for the coming year. None of this growth, however, has anything to do with improved economic fundamentals, but with the windfall gains accruing to the state from the rising demand for Burma's exports of natural gas.

The real Burma is one of the poorest countries in Southeast Asia. Only 50 years ago, it was one of the wealthiest. The dramatic turnaround of Burma's fortunes is the product of a state apparatus that for decades has claimed the largest portion of the country's output, while simultaneously and deliberately dismantling, blocking and undermining basic market institutions. The excessive hand of the state, which for many years was wedded to

a peculiar form of socialism, has manifested itself in a number of maladies that are the direct cause of Burma's current disarray. These include:

> The suppression of the fundamental economic institutions – effective property rights, contract enforcement, the measures that define the 'rules of the game' for efficient economic transactions – that history tells us are necessary for sustainable long-term growth.
> Macroeconomic policy-making that is arbitrary, often contradictory and ill-informed.
> A regime claim to Burma's real resources that greatly exceeds its ability to raise revenue through taxation. As a consequence, like many such regimes around the world and throughout history, it resorts to the printing press to 'finance' its expenditure. Inflation and monetary chaos have been the predictable consequences.
> A currency, and a financial system, that is widely distrusted. People in Burma store their 'wealth' in devices designed as a hedge against inflation and uncertainty. As a result, financial intermediation is underdeveloped and the allocation of capital is distorted.
> Rent-seeking through state apparatus that offers the surest route to prosperity, at the expense of enterprise. Burma's leading corporations are mostly owned and operated by serving and retired military officers. Corruption is endemic.
> Important sectors of Burma's economy that are starved of resources. Negligible spending on education and health have eroded human capital formation, and reduced economic opportunities. Agriculture, which provides the livelihood for the overwhelming majority of the Burmese people, is chronically (and, often deliberately) starved of critical inputs.
> Economic mismanagement by the regime that means that Burma attracts little in the way of foreign investment. What does arrive 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. All of the revenues from Burma's exports of gas and oil are accrued by the regime.
> At a micro-level, the almost complete stifling of economic innovation by the military regime. Whenever there has occurred enterprise development in particular sectors, these are 'shaken-down' for kickbacks of various kinds – usually they are threatened with expropriation and even nationalisation.

Such then are some of the broad factors that inform Burma's current economic circumstances. Below we will detail more closely specific sectors of Burma's economy, their current condition, and immediate prospects.

Economic Growth

In February 2006, Burma's Minister of National Planning and Economic Development, Soe Tha, announced that his country's growth rate for 2005 would be 12.2 per cent.[1] This topped even 2004's strong growth of 12.0 per cent, and made Burma (certain small oil producing countries excepted), the fastest growing economy in the world.

Table 1: *Claimed* Annual GDP Growth Rates (% p.a.), Burma, 1999-2004

1999	2000	2001	2002	2003	2004	2005
10.9	13.7	11.3	10.0	10.6	12.0	12.2

Source: ADB (2004 and 2005).

If only it were true...

Stating anything definitive with respect to economic growth in Burma is fraught with the difficulties pertaining to a country in which the official statistics are notoriously unreliable (even deliberately mis-stated), and collecting data otherwise is difficult. Burma does not publish national accounts statistics, and the only growth data that is made available is that which accompanies ministerial statements such as the one above. Nevertheless, we can be sure that economic growth in Burma is well below the Minister's claims. His boast is greatly at odds with even the most cursory glance at the economic circumstances on the ground in Burma, circumstances which point to ever deeper levels of poverty for the average citizen, and of an economy that at worst is on the verge of collapse, and at best cycles through bare subsistence.

More substantially, however, we can dispute the Minister's claims through various *proxy* measures and indicators of economic growth. For instance, if Burma was truly growing along the lines claimed by the SPDC, one would expect to see it using more productive resources – energy, land, labour, capital, and so on. We do not see this. Indeed, as the Asian Development Bank (2005:30) notes, electricity usage in Burma actually *fell* by 32.4 per cent across 2004-05. Amongst other indicators – in the same period cement output fell 8.5 per cent, sugar production fell by 2 per cent, and credit extended to the private sector (Table 3 below) was only fitfully recovering from its collapse the year before. In 2005 it is likely that manufacturing as a whole contracted – not a result one would expect to see (the sector contributes just over 10 per cent of GDP) for an economy growing in double-digits (EIU 2006:18). In addition to these 'internal' proxies, however, if Burma was actually growing at the rates claimed by the SPDC, we would also presume to see certain patterns in its economy that history tells us to expect of rapidly growing economies (Bradford 2004). We should see less reliance on agriculture, greater reliance on industry, and even the emergence of services. Of course, these are long-term patterns, but shorter-term trends are generally at least consistent with them in countries that truly have enjoyed high growth (and for which the Asian 'tiger' economies and China are

[1] Minister quoted in *The Myanmar Times,* vol.16, no.305, 20-26 February 2006.

exemplary). Burma displays none of these structural dynamics. Indeed, as demonstrated by Bradford (2004), agriculture has assumed a greater role in Burma's economy in recent years. In short, either the military regime's claimed economic growth numbers are greatly at odds with reality, or the country has truly found a unique path to economic prosperity.

An alternative set of growth numbers (Table 2 below), more consistent with our critique here (and with Burma's recent economic history), have been estimated by the Economist Intelligence Unit (EIU 2006):

Table 2: Economic Growth Estimates (EIU)
(% p.a.)

2001	2002	2003	2004	2005	2006
5.3	5.3	-2.0	-2.7	2.9	1.9

As can be seen from the estimates above, moderate economic growth returned to Burma in 2005 and this will likely continue through 2006. Such growth is in no way reflective of any bout of economic reform in the country, but instead is driven by the increasing global demand for energy which has pushed up the price of natural gas. Burma currently exports natural gas only to Thailand in sizeable quantities, but new projects are currently being brought on stream via a series of deals with Chinese, Indian and South Korean investors. Increasing gas prices and export volumes caused Burma's trade balance to turn positive in 2005 (EIU estimate: 4.4% of GDP), and it was this contribution that was responsible for the country's estimated positive rate of economic growth overall. Contributions from agriculture remain flat (despite relatively good harvests), whilst other sectors of the economy – manufacturing, transport, services, tourism – are likely to detract from economic growth. These sectors face particular downside risks in 2006, ranging from further disastrous policy choices by the military regime, high oil prices, potential avian influenza outbreaks, political unrest at home and abroad (especially Thailand), capricious policy changes, consumer boycotts, and so on.

Macroeconomic Policy

Fiscal Policy

Macroeconomic policy-making in Burma is coloured by one overwhelming fact – the irresistible demand of the state upon the country's real output. This demand far exceeds the state's ability to raise taxation revenue, and accordingly has led to a situation in which the state 'finances' its spending by the simple expedient of selling its bonds to the central bank. This policy (in economics parlance, 'printing money') distorts every other aspect of policy-making in Burma. Fiscal policy is simply concerned with the raising and spending of funds, monetary policy likewise with keeping interest rates sufficiently low (as shall be examined, negative in real terms) to minimise financing costs. Neither plays a counter-cyclical or developmental role, and both seriously blunt the functioning of the market economy.

Table 3 below illustrates the financial demands of the state in Burma on the country's financial system.

Table 3: 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*	2,065,038	74,693	559,555	**457

**As at end-October, **As at end-January*
Sources: IMF (2006), Myanmar Central Statistical Office (MCSO 2006)

As can be seen from Table 3, the demands of the state upon Burma's financial resources swamps all others. Central bank lending to the government is the favoured device for financing government expenditure. Yet, as can also be seen from the data above, the state is also a borrower from Burma's (nominally) commercial banks. The latter provides the private sector with little more than a quarter of the funds that Burma's financial system provides to the central government. The small amount of government bonds held by the general public, an infinitesimal proportion (substantially less than one per cent) of the bonds sold to the central bank, is indicative of the lack of confidence the citizens have in such state-created financial assets.

In recent years the SPDC has introduced dramatic increases in the taxes it levies. Customs duties alone rose by over 400 per cent in 2004/05 (due to a mix of increases in tax rates, and exchange rate formulae – more on which below). Notwithstanding this, total central government tax revenue in fiscal year 2004/05 came to just K278,024 million (EIU 2006:17). The SPDC does not publish data on its spending, but given that *new* advances to the regime from the central bank came to K378,697 million in roughly the same period, it is reasonable to assume that taxes account for little more than 40 per cent of government spending.

Monetary Policy

Monetary policy in Burma is formally the responsibility of the Central Bank of Myanmar (CBM). However, a number of factors determine that it is incapable of yielding any

influence over monetary conditions in Burma.[2] The first and most simple of these factors is that Burma has in place interest rate controls that cap lending rates at 15 per cent per annum, and do not allow deposit rates to fall below 9.5 per cent per annum. These rates, and the rate at which the CBM will provide funds to the commercial banks (the so-called 'CBM rate', currently at 10 per cent), have not changed for a number of years (Turnell 2006). Given that Burma's inflation rate was (conservatively) put at just over 20 per cent in 2005, this implies that 'real' interest rates in Burma have been substantially negative (EIU 2006:5). The motivation of the regime for locking in such rates (which result in substantial distortions in capital allocation), is to minimise the interest rates paid on government debt. Currently, three and five-year Burmese government bonds have fixed-yields of 8.5 and 9.0 per cent respectively (MCSO 2006). In common with other countries with an underdeveloped financial system (on which, more below), the CBM is likewise unable to employ devices (open market operations, rediscount facilities, repurchase agreements) that are part of the standard tool box of central banks. The distrust of Burma's currency, the *Kyat,* has created parallel (black-market) foreign currency spheres in Burma, and these are also beyond the influence of the CBM. Finally, it perhaps goes without saying that the CBM does not enjoy operational independence from the state, and accordingly has no credibility beyond it.

Exchange Rate

Burma has a fixed-exchange rate policy that officially links the *Kyat* to the US Dollar at the grossly-inappropriate rate of K6:$US1.[3] This official rate, however, is just one of a number of exchange rates applicable to Burma's currency. The most important of these rates, and the only one relevant to the people 'on the street' in Burma, is the 'black market' or 'unofficial' rate. Currently this rate stands at around K1,160:$US1, nearly two hundred times below the official standard promulgated by the regime. This rate is, of course, subject to daily, even hourly, fluctuation according to the perceptions of the country's prospects. Wild swings in the unofficial rate are reasonably frequent, to which the SPDC's counter, instead of engaging in meaningful currency reform, is invariably to order the rounding up of a cohort of 'usual suspect' foreign exchange dealers. As a consequence of the United States' highly effective sanctions imposed on Burma, the SPDC has employed various coercive measures to try to discourage the use of the US dollar, and in favour of the Euro, the Singapore dollar, the Thai Baht and the Yen. These measures have had only limited success, and the US dollar remains a highly-prized store of value (especially, in this context, 'new' $US100 bills).[4]

In addition to its sometimes wild fluctuations, the unofficial 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

[2] Not that, under the present regime, the CBM would be allowed any real power anyway. This fact was dramatically revealed during the 2002/03 banking crisis, when the CBM was sidelined in favour of an obscure brigade commander in the (unsuccessful) attempts to manage matters (Turnell 2003).
[3] Technically, the *Kyat* is fixed to the IMF's 'Special Drawing Rights' at a rate of K1:SDR8.5085 – which yields are more or less constant K6:$US1.
[4] The author can confirm that the $US also remains the favoured medium through which larger Burmese businesses continue to conduct their activities.

macroeconomy under the military regime. Table 4 below records its declining value vis-à-vis the US dollar over the last decade:

Table 4: Indicative (Unofficial) Exchange Rates
***Kyat*/$US1**

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
240	340	350	500	650	960	900	1,000	1,300	1,160*

**As at March*
Source: Burma Economic Watch.

In addition to the 'official' and 'unofficial' exchange rates there are other, 'semi-official', rates that apply depending on the counterparties and circumstances. For instance, a rate of K450:$US1 currently applies for all funds brought into Burma by UN agencies and international NGOs.[5] This rate, when enforced, means that such organisations provide the SPDC with foreign exchange effectively at less than 'half-price' (the organisations are likewise compelled to conduct their foreign exchange operations via the state-owned Myanmar Foreign Trade Bank). This same exchange rate applies, for the purposes of excise calculation, to many exporters and importers in Burma (regardless of the rate they actually conduct their business in).

The regime's multiple and divergent exchange rates are the public face of Burma's macroeconomic malaise. They also provide for extraordinary opportunities for corruption. It is clear, for instance, that having access to foreign currency at anything close to the official exchange rate presents the recipient with the potential of immediate windfall gains. Reforming and unifying Burma's exchange rate regimes, which almost certainly should mean allowing the *Kyat* to 'float', should be a first-order priority in any future reform program. Unfortunately, such a reform program is unlikely from a regime that is clearly the existing system's leading beneficiary.

'Capricious' Policy Making

One of the most damaging features of macroeconomic policy-making in Burma (of all types), is that it is often made in ways that to observers appears highly capricious, arbitrary, selective and even simply irrational. Examples of such decision-making are legion, of which the following are but a small but indicative recent sample:

> In October 2005, the SPDC suddenly announces an eight-fold increase in the retail price of gasoline.
> In 2004, in order to stem rising domestic prices, the SPDC announces a ban on rice exports. Just a year earlier the SPDC had brought in measures designed to substantially liberalise the avenues through which rice producers could export.
> Various announcements through 2005 that exporters/importers in Burma were to henceforth use the Euro rather than the $US in their transactions.
> The (numerous) changes to tax and duty levies on commodities.

[5] Information provided to the author by an official, but confidential, source. This matter has been subsequently reported in the press (Parker and Yeni 2006).

Reflexive cycles of relaxation/restriction on border trade.
Sudden arrests and purges of regime insiders when, occasionally, they call attention to the regime's follies and incompetence. Legal procedure scarcely matters in Burma, but 'economic crime' is the usual charge.
The sudden announcement in 2005 that Burma's administrative capital would relocate from Rangoon to Pyinmana. Not strictly an economic decision, but there is little to suggest that the economic dislocation costs of the move were seriously entertained.

External Sector

Trade

As noted in the overview, it is only from the external sector that any growth in Burma's economy is apparent, or likely. Driven by rising gas export prices *and* volumes, and augmented by a precipitous decline in imports (more on which below), Burma recorded a trade surplus in 2004 of over $US900 million. For the first three months of 2005, the latest data publicly available, the surplus in this item stood at nearly $US470 million (IMF 2006). With gas prices rising across 2005 and greater volumes likely to have been shipped, a large trade surplus just in excess of $US1 billion for the year as a whole is expected. For 2006 this trend will almost certainly continue, with the EIU (2006:5) predicting an annual trade surplus of $US1.2 billion. It will be noted from Table 5 below, however, that imports in Burma have been falling in recent years. This seems unlikely to continue for much longer, especially as Burma imports required infrastructure to develop the new gas fields that have been the subject of recent deals. Table 5 also reveals that, to a considerable extent, Burma's trade surpluses are offset by deficits in services and in income payments – all of which diminish the overall surplus on current account. This trend likewise will continue into the future – driven by the repatriation of profits by the (largely foreign) firms investing in Burma's energy sector.

Table 5: Burma's External Sector
Selected Indicators
($US millions)

Year	Goods Exports	Goods Imports	Current Account Balance
1999	1,293.9	2,181.3	-284.7
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*	836.6	364.5	296.6

**As at end-1st Quarter, Source: IMF (2006)*

Table 6 below reveals the source of Burma's exports, and illustrates the dominance of gas exports over other items. The *growth* of gas exports is also dramatically revealed – their value exceeding that of the whole of 2004 by the end of the first quarter 2005. So far most of this gas is sourced from the existing Yadana and Yetagun fields (the product of which is exported to Thailand), but this will shortly be joined by gas piped from sites soon to come on stream, including that of the (offshore) Korean/Indian/Burmese ventures in Rakhine State. From Table 6 we can also see that the vast bulk of Burma's exports are from extractive industries of various types. Worryingly, as the EIU (2006:24) notes, exports of Burmese teak are likely to be substantially understated when one considers the pervasiveness of 'illegal' logging in the country. Burma's exports of garments and textiles have substantially contracted over the last two years, overwhelmingly a function of the ending of the Multi-Fibre Agreement that has seen China increase its share of the global garment industry, at the expense of smaller-scale players such as Burma (Turnell 2006).

Table 6: Composition of Exports
(*Kyat* millions)

Export Type	2002	2003	2004	2005 (at end-April)
Gas	4,247	5,919	3,334[6]	3,461
Teak and other Woods	1,880	1,874	2,149	810
Pulses	1,898	1,744	1,407	503
Garments and Textiles	2,985	2,973	1,298	368
Shrimp and Fish Products	829	829	1,003	230
Metal and Ore	288	288	503	220
Rice	754	754	112	90
Rubber	76	89	81	61

Source: EIU (2004, 2005, 2006), MCSO (2006)

Investment

Burma is not a large recipient of foreign direct investment (FDI). The country is regarded as a highly risky destination for foreign investment, and a difficult location to do business. In a recent report on economic freedom, the Washington-based Heritage Foundation ranked Burma third from the bottom (in front of only Iran and North Korea) with regard to restrictions on business activity. According to the Foundation, 'pervasive corruption, non-existent rule of law, arbitrary policy-making, and tight restrictions on imports and exports all make Burma an unattractive investment destination and have severely restrained economic growth' (Miles, O'Grady and Holmes 2006:125).

As can be seen from Table 7, FDI in Burma is overwhelmingly directed to the gas and oil sectors. Very little FDI makes its way to industry, and even less to agriculture (which has

[6] This figure, based on Burmese official data, is lower than that suggested by Thai import data. Accordingly, it probably understates Burma's gas exports in 2004.

received FDI of a mere $US34.4 million since the 'opening' of Burma 17 years ago).[7] In terms of source country, the traditional largest investors, Singapore and Thailand, have in recent times been overshadowed by China. This trend is likely to continue, albeit with China joined by greater investment in Burma's gas sector by Indian and Korean investors.

Thailand's role as an investor in Burma has eroded in relative terms as noted, but it remains a pervasive influence on Burma's economy nonetheless. One recent investment project with far-reaching implications is a joint venture agreement with Burma (signed in 2005) to construct four large dams on the Salween River. The dams are designed to provide hydro-electricity for Thailand, and foreign income for Burma. Unfortunately, however, the externalities of the project are far from benign. The dams are located in a region of Burma populated by Karen, Karenni and Shan – three of the largest of Burma's ethnic groups, and amongst the most economically marginalised. Such groups have greatly suffered in the past during the construction of various infrastructure projects in Burma, and one can only fear that they are likely to do so again. The United States' Congress has itself found that the military regime's actions against these ethnic groups constitutes a form of 'ethnic cleaning'. Like so many of the regime's 'big ticket' development projects, this one shows all the signs of being a disaster in the making (Akimoto 2004).

Table 7: Foreign Direct Investment Flows
Sector and Source
($US millions)

	2003	2004	2005 (as at end-April)
Sector			
Gas and Oil	44.0	54.3	142.6
Real Estate	-	-	31.3
Mining	3.4	1.5	6.0
Manufacturing	13.2	2.8	3.5
Transport	-	30.0	-
Agriculture & Fisheries	26.4	2.6	-
Source Country			
China (incl. Hong Kong)	12.9	2.8	126.6
Thailand	-	22.0	29.0
Japan	-	-	2.7
Malaysia	62.2	-	-
South Korea	0.3	34.9	-

[7] This figure for agricultural investment, which is consistent with other sources, was rather surprisingly reported in the Rangoon-based *Weekly Eleven News* in December 2005. The report was reproduced the same month in the online edition of *The Irrawaddy,* http://www.irrawaddy.org.

United Kingdom	-	27.0	-

Source: EIU (2004, 2005, 2006)

Foreign Exchange Reserves

Table 8: Foreign Exchange Reserves
Selected Countries
$US millions

Year	Burma	Thailand	Cambodia	South Korea	Vietnam
1999	265	34,063	393	73,987	3,326
2000	223	32.016	502	96,131	3,417
2001	400	32,355	587	102,753	3,675
2002	470	38,046	776	121,345	4,121
2003	550	41,077	815	155,284	6,224
2004	672	48,664	943	198,997	7,042
2005*	774	50,728	939	210,317	8,602

* *End 1st Quarter, Source: IMF (2006)*

Burma's trade surpluses and (to a lesser degree) the flows of FDI, have swelled the country's official foreign exchange reserves – from $US 265 million in 1999, to over $US 774 million today (Table 8 above). The latter number, however, is still very low by global or even regional standards. Table 8 contains a sample of countries that, for a variety of reasons, Burma might be compared to. It can be seen that Burma has, by some margin, the lowest level of reserves 'comfort', even when compared to tiny and poor Cambodia. Of course, Burma's foreign assets must also be set against its foreign *liabilities*. These currently stand at around $US 7 billion (or around 14 times the size of the country's reserves), and consist for the most part of defaulted loans to the World Bank and other multilateral lenders (IMF 2006).

Monetary and Financial Sector

Burma's financial system, a mix of state-owned institutions, 17 surviving 'privately-owned' banks of varying degrees of health, and a dominant informal sector, is failing to meet the country's need for capital.[8] As noted in Table 3 earlier, the largest claimant on credit creation in Burma is the state. Private sector trade and industry in Burma can access *some* credit from the private banks, but the macroeconomic instability of the country means much of this is of a short-term nature only, and concentrated in such inflation-hedging sectors as real estate and precious metal and stone trading. Long-term credit for industrial development is almost completely non-existent. Personal credit in Burma is available from formal financial institutions for a handful of well-connected cronies of the regime, but for the average person in Burma 'credit' is supplied by friends,

[8] Determining what is 'private' or not is difficult in Burma – a country where business can scarcely escape the clutches of the regime.

relatives or, less agreeably, the local moneylender – for time immemorial a ubiquitous presence in the country (Turnell 2006). For agriculturalists in Burma the availability of credit is especially dire. According to a recent UN agency survey, 80 per cent of Burma's agriculturalists are without access to formal credit of any kind.[9]

To an uninformed observer, it must have seemed possible at the dawn of 2002 to entertain some optimism with regard to the financial system in Burma, particularly with respect to the private banks. These had emerged only since 1990, and the implementation of certain financial-sector reforms (principally the 'Financial Institutions of Myanmar Law' and the 'Central Bank of Myanmar Law'). By 2002 the private banks appeared to be growing strongly and, amongst the largest of them, the creation of a degree of trust and even 'brand recognition' seemed apparent. Beneath the surface, however, all was not well. Burma's interest rate restrictions imposed by the regime (noted above) greatly hampered the private banks in traditional intermediation (taking in deposits and making loans), forcing them into activities of high risk and questionable legitimacy. That said, some of the private banks had been established in the first instance precisely to conduct and disguise unorthodox and criminal activity (regarding the latter, the laundering of narcotics money especially), while others were little more than corporate 'cash boxes' for various entities connected with the regime. In 2002, however, all of this bubbled to the surface as a financial crisis engulfed Burma.

At the centre of Burma's 2002/03 financial crisis was a banking collapse that was almost archetypal of such phenomena. However, the crisis did not begin in the banks. Rather, it began, in late 2002, with a series of failures amongst what were known in Burma as 'private finance companies' – in effect, 'institutions' that were for the most part little more than gambling syndicates and 'ponzi' schemes.[10] Though these firms were not legally authorised deposit-taking institutions, they presented a tempting investment opportunity for Burmese seeking a non-negative return on their funds.[11] Such temptation had an irrational side in promised rates of returns typical of ponzi schemes, but there was a rational aspect to it as well since, as noted, the rates the banks could pay on deposits was effectively 'capped' at 9.5 per cent. In 2002 inflation was estimated to be in excess of 55 per cent per annum, meaning that putting money in the bank was a (certain) losing proposition in real terms (IMF 2006).

The crisis in Burma's private finance companies quickly spread to the private banks – a contagion perhaps unremarkable given the country's history of periodic monetary and financial crises under military rule. Long lines of anxious depositors formed outside the banks, a phenomenon that rapidly swelled into a classic 'bank run'. From this moment on, the response of the relevant monetary authorities in Burma (principally the CBM) was

[9] Information confidentially supplied to the author by the agency concerned. Of course, even if more credit was available it would make little difference to the circumstances of Burma's farmers in the absence of other reforms – notably the exit of the regime from its incessant meddling and demands on the rural sector. Making credit alone more accessible raises the risk of simply making Burma's farmers more indebted.

[10] For a detailed account of Burma's 2003 banking crisis, see Turnell (2003). Ponzi schemes pay extremely high returns to their members out of the capital of *new* members. They must ultimately fail when the supply of new members dries up.

[11] That is, these schemes were not authorised under *The Financial Institutions of Myanmar Law* (1990).

almost wholly destructive. Late and inadequate liquidity support to the banks by the CBM was overwhelmingly negated by the imposition of ‘withdrawal limits’ on depositors that escalated into an outright denial of depositors of access to their money. Even worse, loans were ‘recalled’ with little consideration given to capacity to repay. More potent breaches of ‘trust’ in banking would be difficult to imagine. With a full-scale banking crisis now in play, there followed the usual symptoms of such events – bank closures and insolvencies, a flight to ‘cash’, the creation of a ‘secondary market’ in frozen deposits, the cessation of lending, the stopping of remittances and transfers, and other maladies destructive of monetary institutions. By mid-2003 the private banks had essentially ceased to function. In 2004 selected banks reopened, some of the largest closed completely (including the Asia Wealth Bank and the Myanmar Mayflower Bank, then the largest and third largest respectively of Burma’s private banks), and a weak recovery began.

Table 9: Selected Financial Indicators
(*Kyat* millions)

Year	Demand Deposits	Time, Savings and Foreign Currency Deposits	Money + Quasi Money (M2)
1999	72,707	216,549	562,224
2000	119,746	335,574	800,542
2001	206,349	450,560	1,151,713
2002	290,520	541,307	1,550,778
2003	82,948	386,298	1,572,402
2004	139,880	594,169	2,081,824
2005*	164,855	693,465	2,536,861

**As at end 1st Quarter*
Source: IMF (2006) and MCSO (2006).

Table 9 above reveals the progress thus far of this anaemic recovery. As can be seen, both demand as well as less-liquid deposits have bounced back, though the former are still below the levels of late 2002. Taken together, in 2005 total bank deposits of K858,320 million were a mere 33.8 per cent of the total money supply (M2) – indicating, as of course did the data on *lending* in Table 3 earlier, that the state remains by far the dominant actor in Burma’s financial sector.

Of course, the data in Table 9 can also be profitably employed to once more critique the SPDC’s growth claims in recent years. For instance, the regime boasted that Burma’s economy grew a vigorous 10.2 per cent in 2003 – a year in which new lending to the private sector ceased, loans financing existing activities were recalled and all the measures of private monetary assets declined dramatically. If matters were not serious they could be laughable. According to the SPDC, Burma can not only grow strongly without the increased use of energy and other ‘real’ factors of production – it can also do it seemingly without money.

Agriculture

Burma remains an overwhelmingly agricultural country. Agriculture accounts for around 57 per cent of Burma's GDP and engages over 70 per cent of its labour force (UNDP 2003). Nevertheless, for many years it has been a sector of profound neglect and routine exploitation by the Burmese government. Critical inputs such as fertiliser are unavailable to most farmers at prices they can afford, and over 80 per cent of Burma's land under cultivation lacks irrigation of any form (Dapice 2003, EIU 2006:22). As noted earlier, credit from formal institutions is unavailable to most farmers in Burma, and at present less than 3 per cent of bank lending in Burma is extended to agriculture. Inexplicably, the private banks are *forbidden* to lend for farming. Meanwhile, recent experiments in microfinance under the auspices of the UNDP are moving towards failure in ways sadly familiar to such interventions (Turnell 2005).

In 2003, Burma's military regime made great noises about liberalising the trade in rice, internally and externally. In practice, however, great interference by the state in the basic decisions taken by farmers – what, how and how much to produce – has continued unabated. Of course, in many areas of Burma a final blow is the exactions of Burma's military forces, the *Tatmadaw,* forced by the country's strained finances to 'live off the land' (Vicary 2003, 2004).

In recent years the SPDC has adopted a number of programs designed to increase the amount of land under cultivation in Burma. Such efforts, which include the so-called 'summer paddy program', and various schemes designed to reclaim land in the Irrawaddy Delta, have invariably failed to achieve their desired outcomes because of the lack of critical inputs noted above. Farmers without sufficient fertiliser to prepare new fields, or without credit to allow the construction of dykes, fences and other land improvements, have been unable to make effective the exhortations for more 'extensive' production (Okamoto *et.al.,* 2003, Thawnghmung 2004).

The end result of these 'supply-side' problems, caused by the regime's inability to avoid interfering in the basic decisions taken by farmers, is that Burma's agricultural sector, once the jewel of its economy (the famed 'rice bowl' of the British Empire) is operating well-below potential. Indeed, it is likely that the production of Burma's great staple, rice, is lagging behind even the country's population growth rate – bringing with it then the likelihood that in recent years hunger has been increasing (Dapice 2003, Aung Din Taylor 2002, Vicary 2004).[12]

Money Laundering

The shadow of money laundering continues to linger over Burma's financial sector, and Burma remains one of only two countries (the other is Nigeria) to be deemed a 'non-cooperative' jurisdiction with respect to money-laundering by the Financial Action Task

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[12] Also, information privately supplied to the author.

Force (FATF).[13] FATF, an associate body of the Organisation for Economic Cooperation and Development (OECD), is the world's premier agency for dealing with money-laundering globally. Burma has been named as a non-cooperating country in each of FATF's annual reports since the organisation's inception in 1998. Some progress has been made on the surface – Burma now has legislation designed to counter money-laundering for instance – but the problem, as is so often the case with respect to laws in Burma, is enforcement.[14] As yet it is simply not credible that Burma's military rulers are serious about eliminating a problem that they themselves are implicated in.

The acute concern with respect to money-laundering in Burma is that the country remains one of the world's largest producers of illicit drugs. Burma is, indeed, the second largest producer in the world of illegal opium, and it is the single largest producer in Southeast Asia of methamphetamines (Department of State 2005). Down the years a number of financial institutions in Burma have been identified as money launderers, and in 2003 two of the countries largest banks, the Asia Wealth Bank and the Myanmar Mayflower Bank, were publicly identified as such by the United States Treasury (an unprecedented move). According to the Treasury, the banks were;

> …controlled by and used to facilitate money lending for such groups as the United Wa State Army - among the most notorious drug trafficking organizations in Southeast Asia. The Burmese government has failed to take any regulatory or enforcement action against these financial institutions, despite their well-known criminal links.[15]

In addition to the specific naming of these two specific banks, however, and consistent with the FATF declarations on Burma, the US Treasury also announced that Burma *as a jurisdiction* was of 'primary money laundering concern'. As such, the Treasury Secretary was authorised (under Section 311 of the USA Patriot Act[16]), in collaboration with the US State Department, Department of Justice and various financial regulators, to direct financial institutions in the US to take 'special measures' against Burma's banks.[17] Such measures 'range from enhanced recordkeeping or reporting requirements to a requirement to terminate correspondent banking relationships with the designated entit[ies]'. In the case of the Burma ruling specifically:

> The designation of Burma is intended to deny Burmese financial institutions access to the U.S. financial system through correspondent accounts. Thus, the proposed rule would prohibit U.S. financial institutions from establishing or maintaining any correspondent account for, or on behalf of, a Burmese financial institution. This prohibition would extend to any correspondent account maintained by a U.S. financial institution for any foreign bank if the account is

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[13] This finding, re-stated in FATF's annual report for 2005, was confirmed most recently at a plenary meeting of FATF held in Cape Town in February 2006 (FATF 2006).
[14] The legislation concerned is the 'Law to Control Money and Property Obtained by Illegal Means', promulgated on 17 June 2002. For a review of the Law and its deficiencies, see Turnell (2004).
[15] This ruling is set out in the *Federal Register,* vol.68, no.227, Tuesday, November 25, 2003, pp.66305-66311.
[16] 'Providing Appropriate Tools Required to Intercept and Obstruct Terrorism' (PATRIOT) Act, 2003.
[17] The *Federal Register, op.cit.*

> used by the foreign bank to provide a Burmese financial institution indirect access to the U.S. financial system. In such a case, the U.S. financial system would be required to ensure that the account no longer is used to provide such access, including, if necessary, terminating the correspondent relationship.[18]

In addition to the United States, many other countries (and individual financial institutions) have placed limitations on financial sector linkages with Burma out of money laundering concerns. A particularly notable example of which was the decision taken by the Bank of China, in January 2006, to terminate all $US business with both the state-owned Myanmar Foreign Trade Bank and Myanmar Investment and Commercial Bank (Ye Lwin 2006).

<u>Economic Sanctions</u>

Broadly speaking, there is no *a priori* case, either for or against, the efficacy of economic sanctions in delivering desired objectives. History yields instances where economic sanctions have failed to deliver all the changes desired, but it is also replete with examples where they have proved decisive. Whether or not economic sanctions will be useful depend on circumstances and context – of the target country, and of the countries imposing sanctions.

Of course, in Burma's case the most important 'context' to be considered is that the country's democracy movement, the representatives who won 82 per cent of the seats in the country's last parliamentary election in 1990, continue to call for them. Gainsaying such a call might rightly be considered as somewhat presumptuous. Nevertheless, of concern in these pages are the *economics* of the matter. Here too, however, the answer is, in the view of the present writer, unequivocal. As shall be examined below, economic sanctions are necessary in Burma to help dislodge the real obstacle to the country's economic development. This obstacle, the regime that has been oppressing the country for four decades, has never given any hint that it can engage in meaningful economic reform.

Burma is presently subject to economic sanctions from a number of countries. The most rigorous economic sanctions on Burma, however, are imposed by the European Union and the United States. Under the so-called 'Common Position' of European Union Foreign Ministers, member countries ban EU investment in state-owned enterprises (broadly-defined), effectively veto lending to Burma by agencies such as the World Bank and IMF, preclude travel to the EU by SPDC officials and their families, and freeze European assets held by the same officials and family members.[19] The United States' sanctions are authorised under the 'Burmese Freedom and Democracy Act' of 2003, and

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[18] *ibid.*

[19] As an example of the 'broad' definition of 'state-owned enterprise', is the EU ban on dealings with companies associated with Burmese-military controlled entities such as Union of Myanmar Economic Holdings. Two of Burma's banks, Innwa Bank and Myawaddy Bank, have been caught in this particular net. It should be noted that material support to Burma from both the World Bank and IMF would be on hold for reasons unconnected to sanctions – given that the country is currently in default on its loans from these institutions.

indirectly via measures to control money laundering (noted above, and captured under Section 311 of the Patriot Act). The United States goes one step further than the EU, by imposing a ban on *imports* from Burma. Other countries, including New Zealand, Canada and others, impose various restrictions on their activities in and/or with Burma, most concerned with aid allocation, the activities of Burmese financial institutions, and travel by members of the regime.

Unlike some other sanctions regimes, EU and United States' sanctions on Burma are carefully calibrated so as not to block critical exports to the country of food, medicine and similar essential supplies.

All of the above said, sanctions alone are not going to bring about the change required in Burma, but in the view of this author they are a critically important component of a multi-faceted strategy that must contain 'sticks' as well as 'carrots'. This support for sanctions is based on the following propositions:

> The existing sanctions on Burma are well-targeted. Certainly, it *is* true that a small number of Burmese workers have lost their jobs because of sanctions, mostly in the garments industry. Such numbers affected, however, are an infinitesimal proportion of Burma's population, the vast bulk of whom have no contact whatsoever with the traded goods sector. Moreover, an important simultaneous development to the levying of sanctions – to wit, the ending, on 1 January 2005, of the Multi-Fibre Agreement on Textiles (MFAT) – would have meant that the few jobs that were lost from sanctions would almost certainly have been lost anyway. The MFAT had previously limited the exports of various textile categories by assigning countries 'quotas' of the principal textile consuming markets. The effect of the MFAT above all was to thus artificially limit the exports of China (by a large margin the cheapest producer) in all sorts of textile categories. The lifting of these quotas caused the long-expected surge in China's exports, and a whole host of 'marginal' exporters such as Burma, who were previously viable principally because of the quota system, to lose market share. In short – even without sanctions, Burma's garment-exporting industry would have greatly contracted. Of course, the proof of this can be seen in the dramatic fall in Burma's garment exports *beyond* the United States – a consequence not of sanctions, but the 'squeeze' imposed by China (Turnell 2006).
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> It is the elite of Burma's economy, instead, who are most affected by the sanctions thus far imposed on the country. A sizeable number of this elite are 'connected' with the ruling regime in Burma, and a high proportion are personally related to the members of the SPDC itself. Sanctions are likely to contribute to a successful policy when the relevant incentives of important groups are consistent with the change desired. The sanctions currently imposed upon Burma, by the EU but most effectively by the United States, seem to meet this requirement.

Burma's poverty is solely a consequence of the policies of the military regime that has ruled the country for four decades. Poverty in Burma (in a nation unusually blessed with natural resources) is the result of a political-economy that has been consciously shaped by a regime in ways that are not conducive to growth. Stated simply, the military regime has actively undermined and prevented the development of the institutions that history tells us are necessary for growth. Such institutions include;

- secure property rights (including of the person) which encourages saving, investment, innovation, entrepreneurship;
- a stable and responsive government – not necessarily democratic, but a government that acts according to rules rather than individual caprice, and which will address at least the primary concerns of the populace;
- relatively honest government – the market is the venue for trading, rather than the state;
- limited government – keeping the state's claim on the nation's surplus to merely that required to fulfil a consensus of 'reasonable' functions;
- a primacy of rationality and reason in national decision-making.[20]

It takes but a moment's reflection to conclude that Burma enjoys scarcely any of these attributes. Burma's problems manifestly *did not* and *do not* come from the sanctions that countries impose upon it. Overwhelmingly, Burma's economic problems are home-grown, but they require fundamental political reform to solve. The efficacy of particular measures in bringing about such fundamental reform – whether sanctions or any other device – should be the criteria against which judgements are made.

It is the case, at the time of writing, that sanctions combined with increased diplomatic activity under Secretary Rice at the UN Security Council, are having an impact. Equally important, the Burmese Freedom and Democracy Act of 2003, as well as the subsequent efforts to refer Burma to the UN Security Council, have stirred Burma's neighbours into doing something about a country that imposes all sorts of problems on *them* (from narcotics and people trafficking, to the flows of refugees across their borders). In 2005 the countries of the Association for South East Asian Nations (ASEAN), undertook a number of measures designed to bring about change in Burma – including; pressuring Burma to relinquish its 'turn' to chair ASEAN, appointing a number of special ASEAN delegates to meet with Burma's leaders and promote dialogue, calls for political reform and the release of political prisoners by the highest ASEAN bodies, and so on. Beyond ASEAN, at the United Nations and in approaches to Burma even

[20] A similar list, to which the author is indebted, is provided by the eminent economic historian David Landes in his 1998 book, *The Wealth and Poverty of Nations* (1998:217-218)

from countries such as China and India, change does seem to be 'in the air'. Rewarding Burma through the *removal* of sanctions, despite its leaders' recalcitrance *yet* at the moment that pressures upon them seem to be building, is surely ill-advised.

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