

**THE MACROECONOMICS OF POVERTY REDUCTION:  
THE CASE STUDY OF MYANMAR**

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# EXECUTIVE SUMMARY

## 1. THE FACTS

1.1. The UNDP's Regional Bureau for Asia-Pacific has undertaken a regional programme on the macroeconomics of Poverty Reduction. The programme aims at reviving discussion on integrating poverty reduction objectives into national economic policy making and general socio-economic development strategies. Thus it seeks to present policy options and institutional means to foster more pro-poor stabilization, economic restructuring and growth. Under this programme a number of case study reports on the macroeconomics of poverty reduction have been prepared for a number of countries to form the basis of understanding the efforts and experiences of pro-poor growth in the Asia Pacific. This study is a sequel to these researches to prepare a policy oriented report on the linkages between economic policies and poverty reduction in Myanmar by addressing macroeconomic, adjustment and complementary policies.

1.2. Myanmar, in a rare coincidence, stands between the South and Southeast Asian countries with respect to geographical location, poverty situation and social developments. With nearly 27 percent of the population below the poverty line, Myanmar at the eastern tip of the Indian peninsula is better off than the South Asian Countries save Sri Lanka and worse off than most of the Southeast Asian countries. With regard to social developments like schooling and health facilities etc. also Myanmar holds a dividing position between these two groups of countries. This static view of Myanmar's poverty is one part of the story. Another very important part is what is happening to poverty over time.

1.3. Myanmar's poverty has deteriorated. The deterioration has ensued from the worsening of rural poverty, poverty of the country being basically a rural phenomenon.

1.4. Myanmar has had social developments skewed towards negative directions. Excepting the gender development index, which is the result of female advancement in various fields, all other social indicators exhibit deterioration in recent years. These indicators include enrolment in primary and secondary education, fertility rate, and maternal as well as infant mortality rates.

1.5. On the economic front too Myanmar has not done well. Economic growth seems to have been moderate though official data claim high growth rate. The impact of growth on the condition of living of the poor in particular is undermined as growth has been accompanied by considerable instability and high inflation. The poverty impact of growth is further undermined due to the worsening of social developments mentioned thus making growth removed from being broad-based. Furthermore, the inclusiveness of growth is hampered by the existence of poor infrastructure and communication facilities, high regional disparity and excessive spatial concentration in the primate city—the restrictive factors so far as the participation of labour in economic activities is concerned.

1.6. The instability of growth is caused mainly due to fluctuation in agricultural growth – the major contributor to the overall growth. Whereas perpetuation of public debt of high order, result of large fiscal imbalance, by means of borrowing from the central bank has prompted the government to follow cheap money policy that has given rise to high level of monetization of the economy fueling the inflationary trend.

1.7. Myanmar's external and internal balances are symptomatic of a straining macro-economy. The current account deficit and its counterpart, the saving- investment gap,

disappear at the beginning of the century. This happens at a very low level of savings and investment and a strained balance of payments with vulnerable foreign exchange reserves.

1.8. The government's budgetary capability to address poverty has declined. The budget deficit of about 5 percent per annum is indeed high for a country with low level of GDP growing at a moderate rate. Due to the non-availability of external assistance and low revenue effort, the government turns to belt-tightening such that public expenditure falls precariously. Worse still, capital expenditure mostly bears the burden of the budget crunch.

The distributive norm is violated in the sectoral allocation of resources. Defense expenditure takes the bigger chunk than that of agriculture and forestry, industry and mine, and education and health combined. On the revenue side insufficient tax effort has been the order all along the line.

1.9. The state owned enterprises (SOEs) notwithstanding their considerable influence on the economy through the supply of vital inputs, services and employment are loss making concerns and preempting public resources to impose heavy burden on the thin exchequer.

1.10. The pro-poor orientation of Myanmar's financial markets is at a very low ebb. Outside the bank and non-bank financial institutions the micro-finance system could not develop to a reasonable level partly due to inappropriate price policy.

The financial markets are undiversified and inefficient: the level of monetization is high and the level and trend of broad money balances and private sector credit reflecting savings and credit intermediation are depressing. Negative real interest rate indicative of market fragmentation, and high intermediation cost symbolized in the high interest rate spread have been the order of the financial system. In the background of the highly undeveloped financial markets are the absence of adequate financial infrastructure and prevalence of a repressed financial system.

1.11. Myanmar's external sector, barring the development assistance and FDI, has expanded considerably. The imbalance in the current account of the balance of payments has been narrowed down and ultimately wiped out. This is done at the cost of imports the brunt of which is borne by capital imports: capital goods imports as percent of total imports has fallen drastically. The terms of trade is being deteriorated. The weakening of the terms of trade owes largely to the perpetuation of the distorted exchange rate regime and also to Myanmar being an exporter of primary products because generally primary goods are more instable in the international market. Myanmar does not appear to have made gain in export specialization in primary or any other commodity groups.

The fixed exchange rate regime inhibit poverty alleviation by discouraging the employment-oriented agro-based exports. Also the absence of a more liberalised current account of the balance of payments is trade restricting.

1.12. Agriculture remains the lifeline of Myanmar's economy in respect of its contribution to GDP, exports and employment generation. Thus this sector turns out to be the most important sector for the promotion of growth and poverty reduction. But this key sector has been left to the vagaries of nature and has not yet been modernized and thus has been the main source of the instability of growth.

The level of industrialization is very low and so also is the extent of manufacturing exports. Agro-based, and food and beverage products constitute the main manufacturing items. The economy does not show up structural transformation – production structure has been more or less the same over several decades.

1.13. Regulatory constraints are pervasive in Myanmar's various macroeconomic policy frameworks and institutional arrangements. The process of liberalisation and functioning of the markets are constrained by many debilitating regulations.

1.14. Beginning in 1988 Myanmar started liberalizing its various sectors in favour of market economy. As a result, the private sector participation in economic activities and the consequent contribution to GDP has gone up to some extent. Due to the lack of proper investment climate— physical and socio—political - the volume of FDI is very low and development assistance is not forthcoming. The benefit of liberalization has been of little consequence to the poorer section of the population because liberalization has been slow and lopsided and there is lack or absence of policy framework and institutional arrangement for taking care of the poor.

## 2. CONCLUSIONS

The main conclusions of this study are as follows:

- In the face of deteriorating poverty situation, poverty reduction in Myanmar remains a challenging task.
- Recent economic growth, moderate or whatsoever, lacks pro-poor orientation. Acceleration of growth and institution of pro-poor growth remains a daunting task.
- The government's financial capacity to address poverty has significantly declined. The case for greater revenue mobilisation is very strong.

Public expenditures and policies are not tuned to the distributive norm. There is a strong case for reallocation of expenditures to improve enabling conditions.

- The pro-poor orientation of the financial system is too weak. There is a strong case to strengthen the system from the point of view of poverty reduction.

The financial markets are highly underdeveloped and repressed and too weak to deliver the services needed in a liberalized system. There is a strong case to strengthen the financial system.

- Persistence of various regulatory restrictions on trade, investment, foreign exchange market and others has given rise to distortions and inefficiency besides anti-poor developments. The case of reforms in these areas is very strong.
- The resource constraint of the country is accentuated partly due to the non-availability of external resources. There is a case for improving the investment and socio-political climate for external resource mobilization.
- Absence of a definitive sectoral strategy has meant that the employment-oriented agriculture has not made a headway and industrialization is yet to pick up. The case for integrating the development of agriculture and industry with the former as the lead sector is very strong.
- High regional inequality and urban concentration persist in Myanmar. These are anti-poor phenomena. In this milieu the emergence of regional growth centres and secondary cities is important for addressing poverty. Because this would help dispersal of population and economic activity nearer to where the vast majority of the poor reside.

### 3. RECOMMENDATIONS

A stable growth with low inflation is conducive particularly to the poor and the common people. Most importantly for poverty reduction growth has to be broad-based and inclusive. In order that economic growth has these qualifications, the following recommendations are in order.

#### 3.1. Restoring Fiscal Capability to Address Poverty

The need for early and firm budget balancing should be a prime objective of fiscal capability to address poverty. The level of Myanmar's government revenue is too low to support government's needed policies and programmes for restoring macroeconomic stability and realizing a good record of human development for the alleviation of poverty. Raising the revenue-GDP ratio to a two-digit level – 10 percent of GDP – should construe an important target to be accomplished stepwise. Both the tax and non-tax revenues can be increased for this purpose. In the first step, measures should be taken to raise revenue to 7.0 to 8.0 percent of GDP. This amount was accomplished in the past and is considered potential amount in the short run. In the second step, additional revenue to the tune of 2 to 3 percent of GDP should be attempted.

Two-prong reform measures are suggested to realize the revenue target:

- Reform of tax policy will include (i) valuing imports and exports at or near the market exchange rate to be determined as part of a broader exchange rate reform discussed later, and (ii) strengthening the tax administration to enhance its performance, reduce corruption and increase compliance on the part of the tax payers. In this respect, the recommendations of the 13th Technical Conference of the Commonwealth Association of Tax Administrators may be considered.

#### 3.2. Enhancing Pro-poor Bias of Public Expenditure

Adequate government expenditure with a bias towards social sectors meets efficiency and equity considerations, "crowded in" private sector investment and promotes pro-poor growth. It is recommended that fiscal reforms be geared to accomplish the following:

- About 3 to 4 percent of GDP be spent on the social sectors giving education the highest priority.
- The institutions responsible for implementation of the expenditures be strengthened to improve service delivery.

#### 3.3. Reforming SOEs for Crowding in of the Public Sector

Large deficits of the state owned enterprises have meant direct implications for government finance – monetization of public debt and rising inflationary pressure. Two broad approaches to the reform of the public sector enterprises are suggested:

- Rehabilitation involving adoption of policies to affect the competitive environment within which the enterprise can operate. Also steps for restructuring of the management and improvement of the accounting procedure are important in this regard. No new SOE should be established.
- Privatization process should be pursued seriously. To this effect, some 600 enterprises of 18 different ministries nominated for privatization since 1995 (San Thein 2003) should be considered for action.

### **3.4. Reforming the Financial System for Addressing Poverty**

From the viewpoint of poverty reduction, there is a need of reforms of the financial sector for mobilizing resources to empower the poor, small farmers and small businesses. To attain this the following are suggested:

- Special provision should be made for making credit available to small farmers and small businesses from the public and private banks.
- Special provision be made for providing micro-credit to rural households from the public and private banks.
- Attention be given to the development of micro-finance institutions.
- Steps to be taken for the establishment of the central bank's authority over the financial markets.
- Adequate legal framework for enforcing contracts, commercial autonomy of bank management and institution of credible and transparent accounting should be ensured.

### **3.5. Reforming the External Sector**

There is a strong case for the external sector policy reform in the areas of exchange rate regime, current account of the balance of payments and trade barriers. Policy reform should be geared to:

- Replacement of the fixed exchange rate regime by a "managed" floating system until the foreign exchange market can accommodate the floating system.
- Replacement of the present restricted current account of the balance of payments by one with convertibility of the kyat.
- Sharply limiting the trade barriers such as import licensing in the first place for subsequent elimination of other restrictive ones.

It is advisable to create an adjustment fund to cater for the need of absorbing unforeseen shocks.

### **3.6. Formulating Sectoral Strategy**

Myanmar presents a case for having a sectoral development strategy in harmony with the poverty reduction and overall development policies. The sectoral policy requires that agriculture be given topmost priority with the following suggestions:

- For modernizing the agriculture farmers are needed to be encouraged, by credit facility and input supplies etc, to use modern inputs. In this connection, increased private sector participation in the sale and distribution of inputs such as fertilizer, pesticides and water etc. is necessary.
- The government should pass law to issue land rights to farmers so that it can be used as collateral for loans and it can be sold/purchased. At the same time it has to make legislation to limit firm size.

- Village level approaches to raise rural incomes including integrated agro-forestry, woodlots, fish or shrimp ponds, livestock raising and development of crafts etc needs to be geared up.

### **3.7. Promoting Export-Oriented Strategy for Poverty Reduction**

To promote export-oriented strategy, emphasis should be given on the integration of agricultural development and industrialization. To this end, attention is to be given to:

- Intensification of efforts for development of agro-based industries. There is a need to identify the potential enterprises.
- Promoting the rural and traditional SMEs by focusing particularly on the improvement of product quality and design. Also SMEs be encouraged for international subcontracting especially with the ASEAN member countries.

### **3.8. Spatial Development for Poverty Alleviation**

Myanmar presents a case for the development of secondary cities within the framework of policy for the reduction of regional inequality. For this, attention is required to be given to

- Developing regional growth centres and secondary cities.

### **3.9. Doing Away with the Restrictive Regulations**

It is necessary to free various markets from the clutches of debilitating regulations. Some of these are

- Barriers to open trade in agricultural commodities.
- Restriction on opening bank branches in the rural area and ban on extending banking hours beyond the normal working hour, etc.

### **3.10. Attracting External Resources for Poverty Alleviation**

It is important to supplement the domestic means by external resources. For this it is necessary to

- Make the investment as well as socio-political climate congenial for attracting FDI and development assistance.

### **3.11. Pacing and Sequencing of Reforms**

Export promotion strategy be pursued keeping in view Myanmar's position in the development process. Rather than taking hasty decisions, it should follow what is called "crossing the river while feeling the stone" principle. For example, in agriculture, restrictions on non-staples should be removed first. Also import restriction on agricultural inputs such as fertilizer and pesticides be removed followed by similar steps to the imports of inputs for agro-based industries and then to imported inputs for ISI's. Sudden withdrawal of protection could mean undesirable consequences in respect of employment and poverty.