Post-Communist Economies, 2013
Vol. 25, No. 3, 357–370, http://dx.doi.org/10.1080/14631377.2013.813141

Myanmar's two decades of partial transition to a market economy: a negative legacy for the new government

Koji Kubo*

Institute of Developing Economies (IDE-JETRO), Chiba, Japan

(*Received 24 January 2013; final version received 4 April 2013*)

Despite more than two decades of transition from a centrally planned to a market-oriented economy, Myanmar's economic transition is still only partly complete. The government's initial strategy for dealing with the swelling deficits of the state economic enterprises (SEEs) was to put them under direct control in order to scrutinise their expenditure. This policy change postponed restructuring and exacerbated the soft budget constraint problem of the SEEs. While the installation of a new government in March 2011 has increased prospects for economic development, sustainable growth still requires full-scale structural reform of the SEEs and institutional infrastructure building. Myanmar can learn from the gradual approaches to economic transition in China and Vietnam, where partial reforms weakened further impetus for reforms.

The installation of a new government in March 2011 has increased Myanmar's prospects for economic growth and integration into the international economy. However, the economic conditions inherited by the new government are less than ideal. In 2011 gross domestic product (GDP) per capita was USD 856.8, and foreign trade per capita was USD 330.3, both of which are the lowest among the members of the Association of Southeast Asian Nations (ASEAN).[1]

From 1962 to 1988 Myanmar (then Burma) pursued the 'Burmese way to socialism', a variant of central planning with self-imposed isolation from the international economy. While Myanmar never had a communist government, it had most of the elements of a Soviet-type planned economy. Analogously, Myanmar faced challenges that were common in transition economies, including macroeconomic stabilisation, price and market liberalisation, restructuring of state enterprises and institutional infrastructure building.[2] More than two decades have passed since 1988, when the former junta announced the transition to a market-oriented economy. Owing to the peculiar transition strategy, however, it can be considered only partly complete.

This article explores this economic transition. Although the Myanmar economy was sometimes analysed from the viewpoint of transition economies in the 1990s (Cook 1995, Rana 1995, World Bank 1995, Tun Wai 1996), it has seldom been discussed from this viewpoint in the 2000s owing to a lack of information. This article aims to profile the challenges faced by the new government that are particular to transition economies.

The article is organised as follows. The first section outlines the transition strategy of the former military junta. The next two sections describe the salient features of the public and private sectors respectively under Myanmar's transition. The following section

*Email: koji_kubo@ide-jetro.org

outlines remaining challenges that the new government must deal with in the transition process. The final section summarises the analysis and offers some concluding remarks.

The Myanmar way to transition to a market economy

Until 1988, under the government led by the Burma Socialist Programme Party (BSPP), Myanmar (Burma) pursued the Burmese way to socialism, a variant of central planning.[3] The industrial and services sectors were wholly under the control of the central planning office, although they accounted for a minor share of GDP, around 21.7%, as in other transition economies in Southeast Asia (Rana 1995). The agricultural sector, which accounted for the bulk of economic activity, was never collectivised but the marketing of the principle agricultural commodities was monopolised by the state under the state procurement and distribution system. Foreign trade was monopolised by the state. Nonetheless, smuggling was considered pervasive (Tin Soe and Fisher 1990).

Myanmar started its transition to a market economy during the economic turmoil of the late 1980s. Before the transition the real GDP growth rate was negative for three years in a row, and it recorded −11.4% in 1988 (World Bank 1995). To counteract the economic downturn, in September 1987 the BSPP government announced the abolition of the state procurement and distribution of rice, which led to an immediate jump in the price of rice. To combat inflation, the government demonetised large-denomination banknotes in September 1987. The demonetisation invalidated 57% of the currency in circulation. The rise in the price of rice and the demonetisation led to a nationwide anti-government movement in August 1988. Under these circumstances the military staged a *coup d'état* in September 1988, seizing power from the BSPP. The military established the State Law and Order Restoration Council (SLORC) and announced the abandonment of the Burmese way to socialism, aiming to revitalise the economy. The military junta remained in office until March 2011 and implemented its peculiar transition strategy.[4]

The transition strategy of the military junta emphasised the creation of new private firms and activities as opposed to state enterprise reform. The government liberalised the domestic marketing of agricultural commodities but resumed the procurement and distribution system for rice, though on a smaller scale than before. The government also allowed private firms to enter the industrial, commercial and foreign trade sectors, while the State Economic Enterprise Law instituted in March 1989 designated 12 commodities for monopolisation by state economic enterprises (SEEs). These included teakwood, minerals, petroleum and natural gas and precious stones and pearls.

The junta recognised the inefficiency of existing state enterprises. Under the BSPP regime, SEEs took loans from the Myanma Economic Bank (MEB), one of the state banks, and maintained revolving funds outside the centrally controlled budget. These loans resulted in a large accumulation of debt. The outstanding loans from the MEB to the SEEs swelled from 9% of GDP in 1978 to 61% in 1988. Furthermore, the source of funds for loans to the SEEs was mostly Central Bank lending to the MEB. In fact, by printing money, the Central Bank had been lending to the SEEs indirectly through the MEB.[5]

The most striking feature of the state enterprise reform was the inclusion, starting in the fiscal year 1990, of SEE financing within the state budget. This allowed the government to scrutinise SEE expenditure more carefully. The government also banned bank loans to the SEEs and instead created the State Fund Account (SFA) within the state budget, from which all financing of the SEEs was provided. Under this system SEEs surrendered all surpluses, if any, to the SFA and the SFA covered all deficits, if any, of the

SEEs. Thus the SEEs were no longer accountable for their losses or profits. In fact, the introduction of the SFA exacerbated the soft budget constraint problem of the SEEs.

Another salient feature of the reform was that the central planning of production and distribution and the use of price controls in the public sector remained intact. Official prices of SEE products were controlled by either their parent ministries or the Cabinet, depending on the importance of the product. Strategic products whose prices were determined by the Cabinet included petroleum and vehicles. In a sense, the official exchange rate for foreign currency remained the most significant officially controlled price. The official exchange rate had been fixed at 8.50847 kyat per IMF special drawing right (SDR) since 1977, and it had never been devalued until April 2012. Because the SEEs often traded with each other, the use of the controlled price resulted in cross-subsidies, masking the economic performance of individual SEEs.

As a consequence of this transition strategy, two resource allocation systems stood side by side in Myanmar: central planning of the state sector and the market-oriented economy of the private sector.

Public sector in transition

In 1990 the overall public sector share of GDP was 22%, and the total employment in SEEs was 312,000 (World Bank 1995, pp. 52–53). The operations of the Myanmar SEEs have been diverse. They included large-scale monopolistic operations such as electric power generation and supply, railways and the post and telecommunications. They also included operations such as textiles and foodstuffs where there was competition with the private sector and with imported goods. Table 1 summarises the consolidated non-financial public sector operations for selected fiscal years. The term 'Consolidated accounts' used in the table refers to the consolidated accounts of the central government and the SEEs.

Although the SEEs appear to have accounted for a large portion of the fiscal deficit, it is difficult to determine the exact size of their deficits. On the one hand, the SEEs contributed financially to the Union Government through monetary transfers. In 2007 such transfers from SEEs surpassed their overall deficit. On the other hand, the World Bank

Table 1. Summary of consolidated non-financial public sector operations.

Fiscal year	1992	1997	2002	2007
	Unit: Kyats, billion			
Union Government				
Revenue	n.a.	88	281	1722
Tax revenue	*12.6*	*46*	*107*	*902*
Transfers from SEEs	*5.0*	*27*	*75*	*686*
Expenditure	n.a.	98	352	2059
Overall balance	−7.1	−10	−71	−337
State Economic Enterprises				
Receipts	n.a.	185	445	2265
Expenditure	n.a.	232	576	2704
Overall balance	−5.8	−47	−131	−439
Consolidated Accounts				
Overall balance	−12.9	−57	−202	−776
Overall balance (% of GDP)	−5.2	−5.1	−3.6	−3.3

Note: n.a. = data not available. Sources: World Bank (1995), IMF (2001, 2009).

(1995, pp. 56–58) argued that there were implicit subsidies from the Union Government to the SEEs embedded in the provision of electricity and petroleum products at subsidised prices as well as interest subsidies on investment grants. The World Bank considered that, when these subsidies were taken into account, the SEEs were still responsible for approximately 20%–50% of the fiscal deficit in the early 1990s.[6] Thus the deficits of the Union Government and the SEEs are difficult to disaggregate with precision.

The most important feature of Myanmar's transition was the worsening of the soft budget constraint problem embedded in the state budget system. The budget system was divided into the local currency (Myanmar kyat) budget and foreign exchange budget. The remainder of this section presents the details of the budget system.[7]

Kyat budget

Both SEEs and ministerial departments received financing from and surrendered all revenue to the SFA. A diagram of the state budget system is presented in Figure 1. It shows that the SFA as well as the current accounts of the SEEs and the Union Government was at the MEB; the MEB played the role of cashier for the public sector.

The SFA created a more centralised budget system for the state sector than that used prior to 1988. The SEEs had to obtain approval from the Ministry of Finance and Revenue for both capital and current expenditure. After approval, the budget of individual SEEs was disbursed to their current accounts at the MEB. In addition, SEEs were not allowed to dispose of their revenue freely; they had to surrender it to the SFA. Thus the budget disbursed imposed an effective ceiling on SEE expenditure.

The SFA exacerbated the soft budget constraint problem of the SEEs. In terms of cash flow, the SEEs surrendered revenue in their current account to the SFA. In terms of profit and loss, if a SEE happened to make a profit, its transfer to the SFA was registered as an income tax and contribution to the Union Government. In contrast, a SEE's deficit was recorded as a net transfer from the Union Government to the SEE. That deficit was already financed with the budget disbursed from the SFA, and the Union Government was liable for the remaining debt. From the standpoint of the SEEs, their deficit did not remain their debt. Thus, although the budget system did not allow the SEEs autonomy in their expenditure, neither did it hold them accountable for poor performance.[8]

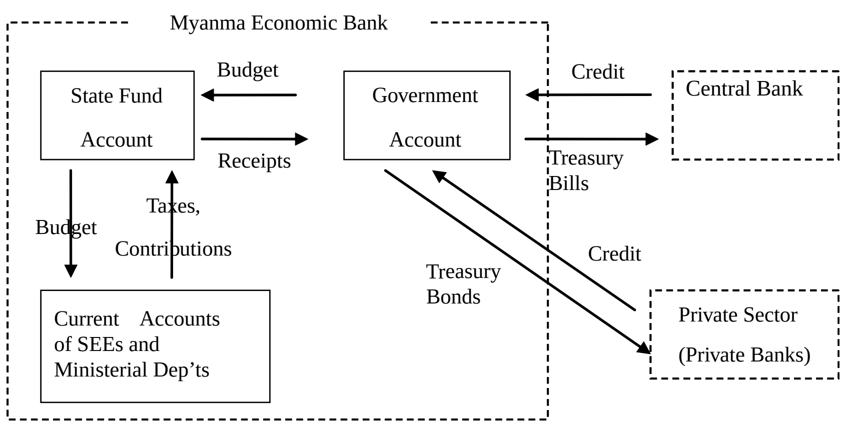

Figure 1. State budget system and monetisation of the fiscal deficit. Source: Author.

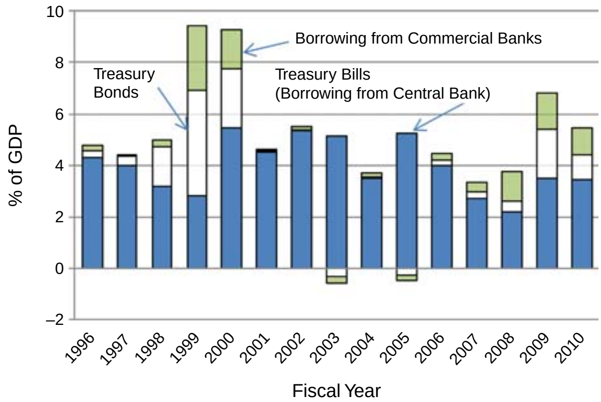

Figure 2. Financing of fiscal deficit, 1996–2010. Notes: 'Treasury Bonds' refers to the net sales of treasury bonds (total sales minus discharged). 'Borrowing from Central Bank' is calculated as the balance between the Central Bank's claims on the government at the end of the current fiscal year compared with the end of the previous fiscal year. 'Borrowing from Commercial Banks' is calculated from the balance sheet data of the consolidated deposit money banks. Sources: *International financial statistics* CD-ROM, IMF; IMF (various issues); *Selected monthly economic indicators*, Central Statistical Organization (CSO), Myanmar; *Statistical yearbook*, CSO, Myanmar; *Key indicators for Asia and the Pacific 2012*, Asian Development Bank.

The next question is how the Union Government financed deficits in the SFA. The Union Government employed both treasury bills and treasury bonds to finance the SFA, with the former the main tool. The Central Bank accepted treasury bills and, in exchange for them, printed and injected money into the Union Government. The Union Government used the receipts from the SFA to discharge the treasury bills. If the revenue from the SFA fell short of budget expenditure, it mostly resulted in the accumulation of outstanding treasury bills. This is the process of monetising fiscal deficit, where the deficit of the SEEs was financed primarily by the Central Bank through the SFA.

The strong dependence on monetisation to finance the fiscal deficit is evident in Figure 2, which shows changes in the Central Bank's claims on the Union Government, changes in commercial banks' claims on the Union Government, and the net sales of treasury bonds in terms of percentage of GDP. Given that the size of the fiscal deficit had been around 5% of GDP, the figure indicates that the Central Bank financed the bulk of the fiscal deficit. As will be shown later, such monetisation of fiscal deficit undermined macroeconomic stability.

Foreign exchange budget

The budget system collected and allocated foreign exchange within the public sector separately from the kyat budget. The foreign exchange budget and kyat budget were not convertible; a SEE which had a surplus in its kyat budget could not convert it into the foreign exchange budget. For individual expenditure in foreign currency, the SEEs had to obtain a foreign exchange permit (FE permit) from the Ministry of Finance and Revenue in addition to authorisation from their respective parent ministries. Once an FE permit was issued, the government credited foreign exchange to the SEE's account at another state bank, the Myanma Foreign Trade Bank (MFTB) and subsequently debited the equivalent kyat amount at the official exchange rate from the SEE's account at the MEB. In this way, foreign exchange was rationed to the SEEs at the official exchange rate.

Furthermore, the SEEs were not permitted to dispose of their own foreign currency revenue but had to surrender all such revenue to the MFTB. When the SEEs surrendered their foreign currency revenue, the equivalent amount of kyat at the official exchange rate was then credited to their current accounts at the MEB.

Thus the foreign exchange budget was more strictly controlled than the kyat budget so there was little scope for rent seeking among the SEEs despite the large gap between the official and parallel exchange rates. Moreover, the SEEs were not profit-oriented entities in the first place.

These strict controls were a reaction to a shortage of foreign exchange during the 1990s. As shown in Table 2, the trade balance of the state sector had been in deficit until the Myanmar Oil and Gas Enterprise, an SEE, began exporting natural gas in 2000. Major export items of the SEEs included natural gas and timber, and the foreign exchange revenues from these exports were allocated mainly for imports of fuel oil.

The use of the overvalued official exchange rate complicated the management of the state budget. The disparity between the official exchange rate and the parallel market rate once reached 24,200% in September 2007, where the official and parallel exchange rates of the Myanmar kyat vis-à-vis the US dollar were 5.6303 and 1369 respectively. The foreign exchange revenue of the SEEs was converted into kyat at the official exchange rate, thus overvaluing the kyat by a factor of more than 100 compared with the parallel exchange rate in the 2000s. Thus the trade surplus, if any, would be undervalued and would not contribute much to the state budget in nominal kyat terms. According to an estimate by Kubo (2011), devaluation of the official exchange rate to the level of the parallel rate would have turned the government's fiscal deficit into a surplus for 2008.

Table 2. Trade by sector, 1995–2011.

	Private sector		Public sector			Total	
				Exports			
Fiscal year	Imports	Exports	Imports All goods	All goods	*Natural gas*	Imports	Exports
	Unit: USD million						
1995	1236	477	596	418	*0*	1832	895
1996	1559	605	434	323	*0*	1993	928
1997	1645	770	663	266	*0*	2309	1036
1998	1820	745	882	337	*1*	2702	1082
1999	1833	1109	773	325	*5*	2605	1433
2000	1857	1380	463	581	*171*	2321	1961
2001	1777	1333	958	1216	*632*	2734	2549
2002	1786	1653	511	1422	*912*	2297	3075
2003	1532	1308	703	1048	*580*	2235	2356
2004	1354	1262	626	1653	*1015*	1979	2915
2005	1368	1603	614	1951	*1073*	1982	3554
2006	1804	2068	1125	3155	*2031*	2928	5223
2007	2443	2369	903	4044	*2532*	3347	6413
2008	2592	2480	1971	4313	*2384*	4563	6793
2009	2806	3087	1381	4443	*2906*	4186	7530
2010	4623	3502	1781	5354	*2515*	6404	8856
2011	6611	4073	2421	5056	*3493*	9032	9129

Note: Myanmar's Central Statistical Organisation reports the value of imports in kyat, which is converted into US dollars at the official exchange rate. Source: Selected monthly economic indicators, CSO, Myanmar.

Private sector in transition

This section evaluates three aspects of Myanmar's transition to a market economy in relation to the private sector: macroeconomic stability, market liberalisation and institutional infrastructure.

Macroeconomic stability

Monetisation of fiscal deficits led to excess money supply, which is considered to have then brought about high inflation (Turnell 2011). Figure 3 summarises the rate of inflation per annum, as well as year-on-year changes in the money supply and retail rice price. The inflation rate refers to the consumer price index (CPI) and money supply indicates the sum of money and quasi-money. The negative growth in money supply in early 1988 was due to the demonetisation in September 1987. Rice is the staple food in Myanmar, and expenditure on rice accounted for 30.1% of the total expenditure of an average household in 1989, and 18.3% in 2006; rice had a higher weight than any other item in the CPI.[9] It can therefore be concluded that the changes in the retail rice price partially translated into inflation. Two observations can be made on Figure 3.

First, the dynamics of inflation were largely the result of changes in rice prices. There were several sources of rice price fluctuations. One is the liberalisation of the domestic rice market in 1989. Although monthly data are not available, the annual data show that the rice price index increased from 100 in 1986 to 112 (1987), 191 (1988) and 339 (1989) before falling to 266 in 1990, implying that the rice price overshot its equilibrium after the liberalisation of domestic marketing (Fujita and Okamoto 2009). Export controls on rice also exacerbated the fluctuation; owing to tight controls on rice exports, a good harvest would result in a collapse of the price, as occurred in 2000. In fact, the retail rice price in real terms fluctuated more than the export price did, indicating that domestic factors were the dominant sources of price fluctuations as opposed to international market factors.

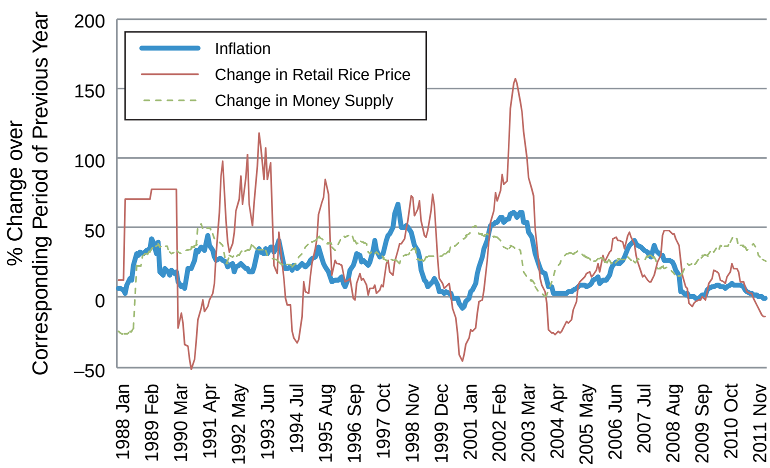

Figure 3. Inflation and changes in retail rice price and money supply, January 1988–March 2012. Note: As monthly retail rice price data are not available from January 1988 to April 1990, the changes in the rice price calculated with the annual averages for fiscal years 1987 to 1989 are interpolated in this figure. Sources: *International financial statistics* CD-ROM, International Monetary Fund (IMF); *Selected monthly economic indicators*, CSO, Myanmar.

Second, the inflation rate did not exceed double digits during the initial transition process as it did in other transition economies such as Vietnam. The retail rice price increased by 70% in 1988 and 77% in 1989. The CPI-based inflation remained below 50% in these years, whereas the average annual inflation rate for the entire period from 1988 to 2012 was 22.4%.

While the correlation between inflation and changes in the money supply is modest in Figure 3, inflation might be partially attributable to the excess money supply. Kubo (2007) confirmed a co-integration relationship between the money supply (money plus quasi-money: M2) and the price level (CPI), suggesting that inflation was related to the growth in the money supply over the long run. Fischer *et al.* (2002) argued that the short-run dynamics of the price level are often dominated by various shocks but that in the long run there is a stable relationship between the price level and the money supply in developing countries with high inflation. Their argument applies to Myanmar. The averages of annual inflation rate, changes in the retail rice price and changes in money supply for the period from April 1990 to March 2012 were close to each other at 22.4%, 25.6% and 31.5% respectively.

High inflation imposed an inflation tax on the private sector's holdings of domestic currency. For an inflation tax, the currency in circulation is equivalent to the tax base, and the inflation rate is equivalent to the tax rate. For example, in the fiscal year 2001, the currency in circulation was 18.7% of GDP and the average inflation rate was 34.6%, so that the inflation tax was equivalent to 6.5% ($=$ 18.7% $\times$ 34.6%) of GDP. High inflation was a factor that depressed private sector growth.

Market liberalisation

The government allowed the operation of private firms but they were subject to various forms of intervention. The most extensive intervention was observed in the foreign exchange market and foreign trade. After 1989 the official exchange rate for foreign currency was applied only in the public sector and not in the private sector. When external trade in the private sector was legalised in 1988 private exporters were permitted to retain only 60% of the foreign exchange they earned from exports; 40% had to be surrendered to the government at the official exchange rate. In 1989 the retention rate was raised to 100% but exporters were subject to a 10% export tax paid in foreign currency.[10] Since then there has been no surrender requirement on export earnings for the private sector or on foreign exchange allocation to private importers, so the foreign exchange market became divided between the public and private sectors (World Bank 1995, Hori and Wong 2013, IMF 2012).

If the foreign exchange transactions in the private sector were all in the parallel market, how was the parallel market exchange rate determined? Because the foreign exchange regulations prohibited the people of Myanmar from holding foreign currency, private exporters were required to deposit their export earnings as foreign currency deposits (FCDs) at state banks.[11] While the government did not permit FCD holders to withdraw their deposits in foreign currency,[12] the government tolerated domestic account transfers of FCDs. Thus, exporters were able to transfer FCDs to buyers' accounts and receive payments in kyat. In this way FCDs were traded in negotiated transactions between exporters and importers at competitive prices. Apart from FCDs, illicit holding of foreign currency was also tolerated and widespread.[13] Both FCDs and illicitly held foreign currency were traded in the parallel market.

The gap between the official and parallel market exchange rates did not itself directly distort the economic activity of the private sector. Since private exporters were permitted to retain export earnings as FCDs, the gap between the two exchange rates did not impose an effective tax on exporters, unlike the dual exchange rate regimes in other countries. At the same time, the gap did not function as a subsidy to private importers because they were not allocated any foreign exchange. Therefore, in Myanmar's segmented foreign exchange market, the official exchange rate had scarcely any impact on the private sector.

On top of these foreign exchange regulations there were strict regulations on foreign trade. Both imports and exports required government licences for every shipment. Issuance of import licences for vehicles was restrictive, which distorted the price of vehicles. Furthermore, in the face of a surge in private imports, in July 1997 the government conditioned issuance of import licences on licence applicants having sufficient FCDs at state banks to cover the import bills. This regulation is often referred to as the 'export first and import later' policy, or simply the 'export first' policy. As a result, two distinctive types of foreign exchange transactions emerged within the private sector as illustrated in Figure 4. One was the buying and selling of FCDs. FCDs were export earnings after the deduction of export taxes, and could be used to obtain import licences. The other was the buying and selling of illicitly held foreign exchange, which could not be used for import licences.

Growth in private imports was constrained by the amount of private exports after the enforcement of the 'export first' policy was strengthened in 2002. Table 2 shows that the trade balance of the private sector was more or less even from 2002 to 2009. This implies that the demand for imports in excess of the available FCDs was channelled to the black market. In fact, the large discrepancies between official Myanmar import data and the corresponding data of trade-partner countries suggest that smuggling made up a large portion of foreign trade. In 2009 the government expanded the categories of export earnings eligible for import licences to include foreign currency incomes from services such as local hotels and tourism. This helped private imports to surpass private exports in 2010 and 2011. In any case, it is evident that the tight controls on private imports, especially the 'export first' policy, had distorted the foreign trade in the private sector.

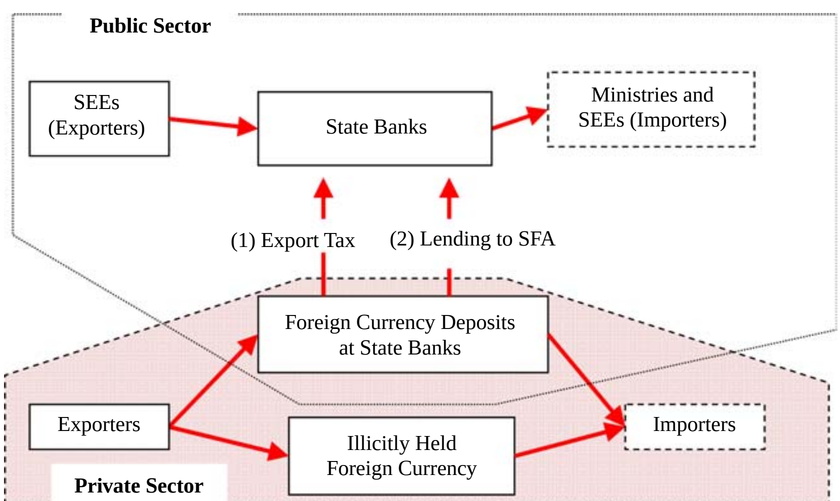

Figure 4. Foreign exchange linkage between public and private sectors. Note: SEEs and SFA refer to state economic enterprises and the State Fund Account, respectively. Source: Author.

Regardless of the segmentation of the foreign exchange market, why did the government maintain the restrictive controls on foreign exchange and foreign trade of the private sector? Figure 4 hints at the answer. The two linkages between the public and private sectors[14] may be the rationale for the government's strict administrative controls. First, export taxes were collected from the private sector in foreign currency. This became a part of the government's fiscal revenue, and was allocated within the public sector through the state budget system. Second, state banks were able to channel the FCDs of the private sector to the state budget as loans. The tight controls compelled exporters to deposit export earnings in state banks, which allowed the government to collect export taxes as well as temporarily borrow from them.

Institutional infrastructure

Weak development of institutional infrastructure was manifested in the underdevelopment of the banking system. The banking system is a key piece of institutional infrastructure for shifting resource allocation from a centrally planned to a market-oriented system. Some macroeconomic indicators in Figure 5 confirm the underdevelopment of the banking system.

The high ratio of currency to money supply indicates the dependence of the Myanmar economy on cash as opposed to bank deposits. This ratio was 63% in 1995, improved to 43% in 2002 and worsened to 70% after the banking crisis in 2003. In 2010 it was 51%. For reference, the ratio was 13% in Indonesia (2010), 16% in the Philippines (2007), 9% in Thailand (2010) and 14% in Vietnam (2010). Myanmar's ratio of currency to money supply is the highest among Southeast Asian economies.

The trend of the currency to money supply ratio was dominated by the development of private banks in the case of Myanmar. The Financial Institutions of Myanmar Law, enacted in July 1990, permitted private commercial banks. The first licence for a private bank was granted in May 1992, and overall 20 private banks had obtained banking licences

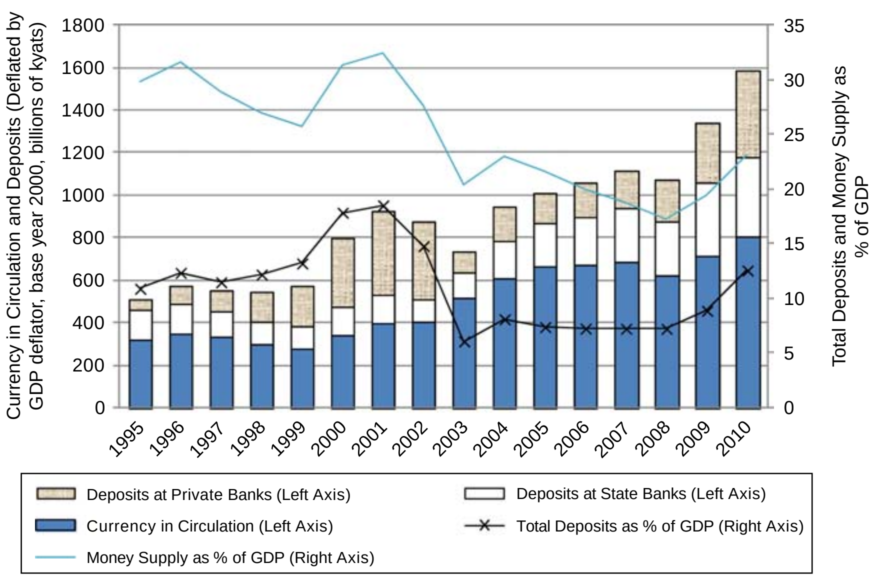

Figure 5. Indices of financial sector development, 1995–2010. Sources: *International financial statistics*, IMF; *Statistical yearbook*, CSO, Myanmar.

by May 1997. Because they offered more convenient banking services than the state banks did, the total deposits of private banks surpassed the overall deposits of the four state banks as early as 1998. Private banks developed resiliently until 2002. However, six major private banks faced contagious bank runs in February 2003, and the total deposits of the private banks fell from K 645 billion to K 216 billion during 2003.

This banking crisis was symptomatic of the underdeveloped institutional infrastructure. The root problem was the depositors' weak confidence in banks, which was mainly a result of insufficient disclosure of banks' financial condition and weak supervisory capacity of the financial authorities (Turnell 2003). In this environment the collapse of pyramid-scheme illicit financial companies triggered panicked withdrawals of deposits at the largest private bank. Liquidity assistance from the Central Bank was both too little and too late and only exacerbated the bank run, setting off a chain reaction that led to contagious bank runs at other major private banks.

Challenges for the new government

The new government inherited the incomplete transition to a market economy from the former military junta. The economic structure of the public and private sectors described above remained mostly unchanged in 2012. There are at least four remaining challenges for the new government.

The first challenge is reform of the SEE system. This has been slow even when compared with the gradual approach of other transition economies in East Asia. The integration of the SEEs into the state budget through the SFA worsened the soft budget constraint problem. To contain the deficits of the SEEs, it is essential to abolish central planning of the prices, production and distribution of the goods and services that SEEs provide. The necessary reforms include separation of the SEEs from the state budget as well as abolition of price controls. These reforms will harden the soft budget constraints and allow the SEEs to integrate into the market-oriented economy of the private sector.

In February 2011, just before the change of government from the military junta, there was a fire sale of state assets, including factories owned by SEEs. This could be viewed as a bold step toward privatisation, but there are also concerns that the main purpose of the fire sale was to transfer blue-chip state assets to cronies of the military junta, leaving the new government with a larger financial burden.

Separating the SEEs from the state budget is not the end of restructuring. Henceforth they will need to raise working capital and investment finance from the market or their own resources. The soft budget constraint problem could thus re-emerge in the form of weak financial discipline on the part of the SEEs as well as their lenders. Should the SEEs become financially distressed, they could seek assistance from the government *ex post*; this gives less incentive for the SEEs to improve operations *ex ante*. Banks may also expect the government to bail out their non-performing loans to the SEEs, and may therefore lend to the SEEs without scrutinising the economic viability of projects. The experiences of other transition economies, particularly Vietnam, show that this form of soft budget constraint can cause problems for state enterprises undergoing restructuring (Unteroberdoerster 2004). This is a major concern in the transition process, and Myanmar can learn from the experience of Vietnam.

Second, price and market liberalisation is only partly complete. For example, both exports and imports of the private sector are still subject to licensing. The new government has undertaken several bold reforms in foreign exchange and foreign trade. One is the move from the fixed exchange rate system to a managed float system in April 2012. Others include the abolition of the 'export first' policy in April 2012 and the deregulation of car imports in May 2012. The new government aims to obtain IMF Article VIII status of current account liberalisation in 2013.

It should be noted, however, that the introduction of the managed float system and the devaluation of the official exchange rate have had only a relatively minor impact on the private sector. First, since the private sector did not use the official exchange rate, its devaluation had less effect there. Second, the Central Bank reference exchange rate was introduced in April 2012 to guide the price of foreign exchange transactions in the banking sector. Since formal transactions in the banking sector are subject to restrictions such as documentation of sources or use of foreign exchange, black market transactions in foreign exchange are still pervasive. The restrictions separate the Central Bank from the black market, so that the Central Bank does not lead the black market rate but rather follows it. Third, the SEEs are still under the control of the state budget system and they are not yet integrated into the foreign exchange market. Thus unification of the foreign exchange market remains a challenge for the new government.

Compared with the introduction of the managed float system, the abolition of the 'export first' policy and the deregulation of car imports are more substantial. Issuance of import licences was formerly at the discretion of the military junta. The tight import control distorted the price, with car import licences yielding large rents which were often shared between the junta and its business wing, the Union of Myanmar Economic Holdings Limited (UMEHL). The new government succeeded in the deregulation of car imports, along with the abolition of the 'export first' policy, which stimulated private imports. Since Myanmar is facing severe appreciation of the local currency against major foreign currencies (IMF 2012), a rise in imports would serve as a favourable countermeasure for alleviating currency appreciation.

The improved foreign exchange position of the government has also given impetus to liberalising foreign exchange and foreign trade. Exploration for and export of natural gas has brought the government large amounts of export revenue, which has led to the accumulation of foreign reserves. This should allow the government to unify the foreign exchange market more comfortably without resorting to quantitative controls.

Third, macroeconomic stabilisation is still incomplete. Monetisation of fiscal deficits has been routine. The shortage of fiscal revenue remains a major obstacle to fiscal consolidation. Inefficient performance of SEEs is considered one of the major sources of fiscal deficits. The controlled prices, including the grossly overvalued official exchange rate, masked the true financial position of the state sector. In this regard, the move to the managed float system in April 2012 is expected to help clarify the financial position of the consolidated state sector as well as the individual SEEs.

Fourth, institutional infrastructure building has scarcely begun. The resumption in January 2011 of parliament, which had been suspended under the military junta, was an important development in the political economy dimension. Although the military-backed party accounts for the majority of seats, parliament has begun to examine the fiscal budget as well as to consider legislation such as the Foreign Investment Law. The resumption of parliament could speed up the reform of governance of the public sector.

Concluding remarks

More than two decades have passed since Myanmar's military junta announced the transition from the Burmese way to socialism to a market-oriented economy. This article sheds some light on the economic transition in Myanmar, which has seldom been examined in the recent literature owing to the scarcity of information on the Myanmar economy. Investigation of the past transition processes clarifies the remaining challenges for the new government.

This article shows that Myanmar is lagging far behind in its reforms compared with the transition economies of China and Vietnam, two countries well known for their gradual approaches to state enterprise restructuring. The delay spans all of the following principle elements of transition processes; macroeconomic stabilisation, price and market liberalisation, restructuring of state enterprises and institutional infrastructure building.

The root problem lies in the transition strategy's slow approach to structural reform of the state economic enterprises (SEEs). The government attempted to counteract the swelling deficits of the SEEs by integrating them into the State fund account (SFA) under the state budget and scrutinising their expenditure while at the same time maintaining controls on the prices, production and distribution of the goods and services supplied by the SEEs. This policy change exacerbated the soft budget constraint problem of the SEEs: their inefficient operations became a part of the fiscal deficit and monetisation of fiscal deficits resulted in macroeconomic instability.

Although the government permitted new private firms and activities, the private sector has been subject to a high inflation tax, pervasive economic restrictions and meagre institutional infrastructure. Economic restrictions included tight import controls, which distorted relative prices and brought in economic rents to the former junta and its cronies. The meagre institutional infrastructure was manifested in the underdevelopment of the banking sector: the major private banks collapsed in a contagious bank run in February 2003 partly due to the weak financial regulatory framework.

Thus the remaining challenge for the new government is to complete the reforms in restructuring the SEEs and to consolidate the fiscal balance, as well as to build institutional infrastructure. Myanmar can learn from the experiences of reforms in other transition economies, especially China and Vietnam, which followed the gradual approach in the reform of state enterprises. There is a concern that partial reform could produce opportunities for rent seeking, and those who have vested interests in the partial reform could obstruct further reforms.

Acknowledgements

The author would like to express his deepest gratitude to former senior officials of the Ministry of Finance and Revenue, Myanmar, for informative discussions, and to Shin'ichi Watanabe for valuable suggestions. Any remaining errors and omissions are the sole responsibility of the author.

Notes

1. These figures are calculated from the data in Asian Development Bank (2012).
2. See IMF (2000) for a review of major elements in the transition processes from a centrally planned to a market-based economy.
3. Myat Thein (2004) offers a detailed description of the 'Burmese way to socialism'.
4. The junta changed its name to the State Peace and Development Council in November 1997.
5. While MEB loans to SEEs equalled 61% of GDP, savings in the banking sector came to only 11.3% of GDP in 1988.
6. Such estimates are not available for the fiscal deficit in recent years.
7. The information on the budget system is based on the facts before 2009. Since then there may have been some changes in the system.
8. Apart from centrally planned production, some SEEs undertook consignment production for private firms or entered into joint ventures with foreign firms. However, the profits (in a joint venture, the SEE's portion of the profits) were also transferred to the SFA.

9. These figures are from *Statistical yearbook*, Central Statistical Organization (CSO), Myanmar.
10. The export tax was reduced in September 2011.
11. At times foreign currency deposits at private banks were also permitted.
12. Starting in February 1993 the government introduced foreign exchange certificates (FECs). Since then it has been possible for FCD holders to withdraw in FECs and to sell these for kyat in the parallel market.
13. These include proceeds from smuggling and remittances from people working outside the country.
14. In addition to these two, there is another linkage. Some SEEs and ministerial departments procured imported goods from private importers using their kyat budget. Government allocation of foreign exchange is concentrated in a small number of SEEs that have regular expenditure in foreign currency. Foreign exchange was not always allocated for one-off purchases of imported machines, in which case they were procured through the kyat budget from private importers. Such official procurement through private importers, when a large sum, may have a depreciating effect on the parallel exchange rate.

References

Asian Development Bank (ADB), 2012. *Myanmar in transition: opportunities and challenges*. Manila: Asian Development Bank.

Cook, P., 1995. Privatization and private sector development in a transitional economy: the case of Myanmar. *In*: P. Cook and F. Nixson, eds. *The move to the market?: trade and industry policy reform in transitional economies*. London: Macmillan Press.

Fischer, S., Sahay, R. and Vegh, C.A., 2002. Modern hyper- and high inflations. *Journal of economic literature*, 40 (3), 837–880.

Fujita, K. and Okamoto, I., 2009. Overview of agricultural policies and the development in Myanmar. *In*: K. Fujita, F. Mieno and I. Okamoto, eds. *The economic transition in Myanmar after 1988: market economy versus state control*. Singapore: Kyoto University Press and NUS Press.

Hori, M. and Wong, Y.C., 2013. Efficiency costs of Myanmar's multiple exchange rate regime. *Journal of international trade and economic development*, 22 (2), 209–233.

International Monetary Fund (IMF), 2000. Transition: experience and policy issues. *In*: *World economic outlook*. Washington, DC: International Monetary Fund.

International Monetary Fund (IMF), 2001. Myanmar: statistical appendix. *IMF country report,* no. 01/18. Washington, DC: International Monetary Fund.

International Monetary Fund (IMF), 2009. Myanmar: staff report for the 2008 Article IV Consultation. Unpublished document. Washington, DC: International Monetary Fund.

International Monetary Fund (IMF), 2012. Myanmar: staff report for the 2011 Article IV Consultation. *IMF country report,* no. 12/104. Washington, DC: International Monetary Fund.

Kubo, K., 2007. Determinants of parallel exchange rate in Myanmar. *ASEAN economic bulletin*, 24 (3), 289–304.

Kubo, K., 2011. Natural gas export revenue, fiscal balance and inflation in Myanmar. *ASEAN economic bulletin*, 28 (3), 374–387.

Myat Thein, 2004. *Economic development of Myanmar*. Singapore: Institute of Southeast Asian Studies.

Rana, P.B., 1995. Reform strategies in transitional economies: lessons from Asia. *World development*, 23 (7), 1157–1169.

Tin Soe and Fisher, B.S., 1990. An economic analysis of Burmese rice price policies. *In*: Mya Than and J.L.H. Tan, eds. *Myanmar dilemmas and options*. Singapore: Institute of Southeast Asian Studies, 117–166.

Tun Wai, 1996. Myanmar. *In*: P.B. Rana and N. Hamid, eds. *From centrally planned to market economies: the Asian approach, volume 3. Lao PDR, Myanmar and Vietnam*. Hong Kong: Oxford University Press.

Turnell, S., 2003. Myanmar's banking crisis. *ASEAN economic bulletin*, 20 (3), 272–282.

Turnell, S., 2011. Fundamentals of Myanmar's macroeconomy: a political economy perspective. *Asian economic policy review*, 6 (1), 136–153.

Unteroberdoerster, O., 2004. Banking reform in the lower Mekong countries. *IMF policy discussion paper,* no. 04/5. Washington, DC: International Monetary Fund.

World Bank, 1995. Myanmar: policies for sustaining economic reform. *Report,* no. 14062-BA. Washington, DC: World Bank.