Burma's Economic Prospects and Challenges[1]
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The Burmese economy continues to grow very slowly. According to some estimates, real GDP increased by 1.1% in FY2008/2009 (April-March) and will grow at 1.0% in FY2009/2010. Growth is then expected to accelerate to 3.1% in FY 2010/2011, still a much slower pace than those of other Asian economies. Official data are much higher than those of external observers. For example, they show GDP growth averaging 13% since 2000.

The economy remains heavily dependent on agriculture and extractive industries. Agriculture accounts for about half of GDP. Approximately two-thirds of Burma's population live in rural areas and work as small farmers or laborers. Agricultural recommendations from the IMF were proposed to liberalize output and input markets, increase efficiency in the use of the country's water resources, improve land tenure security and access, and develop infrastructure. The government has verbally concurred with the necessity of such reforms. Some action has been taken, such as drastically reducing marketing and production controls, and ending the requirement that farmers sell rice to the government yearly at less than half market price.

Domestic and foreign investment is likely to remain low. Because of an unfavorable business climate plagued with pervasive bureaucratic controls, lack of transparency, and poor infrastructure, both domestic and foreign private investment will remain low, although some foreign direct investment (FDI) (mostly from China) will be available in the extractive and hydroelectric sectors. Compounding the depressive effects of the poor business environment is a financial system that is underdeveloped and weighed down by burdensome and restrictive regulations that limit deposits and lending.

Private consumption is insufficient to substantially contribute to GDP growth. It remains weak because incomes are low and price instability results in excessive precautionary saving. The current decline in commodity prices and falling remittances from overseas Burmese workers are likely to further depress consumption in the short-term.

Cyclone Nargis had a significant impact on the economy. On March 3, 2008, Cyclone Nargis hit the Irrawaddy river delta in the south as well as some industrial areas around the former capital Rangoon. In June 2008, the total cost of the cyclone's impact was estimated at 20% of GDP (about $4 billion at the market exchange rate). Small-scale farming and fishing, in

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particular, suffered severe damage. Donor assistance will likely cover most reconstruction costs although some funds were set aside by the government.

Burma has a complex currency regime. There is an official exchange rate, a government-sanctioned market exchange rate, used for external transactions, and an exchange rate used in the parallel market. The highly unrealistic official exchange rate has been pegged to the International Monetary Funds' Special Drawing Rate (IMF SDRs) since 1977, and was equivalent to 5.6 Kyat per $1 in November 2008. It is primarily used by the government and state-owned enterprises, and to report financial statistics.

The government-sanctioned market exchange rate works through the issuance of government foreign exchange certificates and appreciated in August from 1,100 Kyat per $1 to 1,000 Kyat per $1. It is believed to be roughly in line with macroeconomic fundamentals (neither over- nor under-valued). The parallel market exchange rate is close to the government-sanctioned rate although it charges a premium over it. According to multilateral donors, a unified exchange rate would increase investment and risk-taking, reduce price distortions, and instill confidence in foreign investors and donors.

External accounts continue to post surpluses but they will be smaller. The current account surplus is expected to decline slightly from 2.6% of GDP in FY2009/2010 to 2.3% of GDP in FY2010/2011. Exports from the gas and mining sectors are the main contributors to Burma's favorable international trade position. However, Thailand (the destination of Burma's natural gas exports) will limit its imports due to its own economic downturn. Declining commodity prices also will negatively affect Burma's trade balance, including in the typically robust mining sector. There will continue to be imports of capital equipment due to cyclone reconstruction work and the development of oil and hydropower projects.

Trade is still heavily regulated. Burma has a complex and restrictive trade regime. While import tariffs have been reduced in accordance with the Association of South East Nations' (ASEAN) Common Effective Preferential Tariff (CEPT) scheme, non-tariff barriers (such as trade licensing) and export restrictions remain in place. Complex and non-transparent customs valuation and regulations discourage trade and hinder the growth of the private sector.

International trade with Burma is influenced by the diverging political positions of its trading partners. Burma faces tough international sanctions that are likely to further reduce the demand for its exports. US restrictions on gem trade were tightened in mid-2008, and the EU has implemented sanctions on trade in gems, timber and precious stones since 2007. However, Asian countries constitute Burma's largest export partners, and they (including ASEAN) continue to adopt a very apolitical approach to conducting trade with Burma. China and India, for example, continue to be a strong source of demand for Burmese natural resources and pulses (legumes).

The performance of state-owned enterprises has recently improved. In April 2009, industries such as natural gas, crude oil, cement, paper, and cotton yarn recorded increases in output for the first time in 12 months. Natural gas is Burma's primary export commodity, and output in the sector rose by 11.1%. In the mining sector performance has been mixed although jade output rose by 11.7%. Despite these improvements, projected unfavorable short-term export trends are likely to affect the performance of state enterprises in these sectors.

The government is unable to raise enough revenue to cover its expenses. In April, tax revenue (income, commodity, services, and commercial taxes) and customs duty revenue fell drastically. Tax revenue in FY2008/2009 had increased due to measures taken to combat evasion, and the government has stated its commitment to do more in this regard. However, the revenue base is small. The IMF has advised the government to privatize loss-making state-owned enterprises and to allow the others to operate on a commercial basis. Moderate progress in this respect has been recorded with the privatization of some state enterprises providing and processing inputs to the agricultural sector.

The government has been running large deficits primarily financed by the Central Bank. Although data on public expenditures and the budget are scarce, the government is estimated to run large a large fiscal deficit that increased in 2008. In its latest Article IV consultation, the IMF estimated that the fiscal deficit amounted to 3.4 % of GDP in FY2008/2009. The government budget deficit is projected to be 4.5% of GDP in FY2009/2010 and 4.8% of GDP in FY2009/2010. The government also borrows from the domestic private sector, although to a much smaller extent. A large proportion of government spending is devoted to the military and to serving a small elite closely connected with the army. Spending on health and education is low.

The government's borrowing limits the ability of the Central Bank to conduct monetary policy. The Central Bank's monetary policy tools are geared towards facilitating government expenditures instead of correcting the economy's overall trajectory. The Central Bank holds down interest rates in order to keep borrowing costs low for the government and raised them only once in the past five years. Because of the high inflation rate, real interest rates are negative, which makes lending unattractive and is another cause of low economic activity.

Inflation is high. The IMF estimates consumer price inflation to have been as high as 30% on average between 2007 and 2008. The Economist Intelligence Unit (EIU) estimate for 2008 is 26.8%. Government fiscal deficits financed by the Central Bank have strongly contributed to broad money growth and inflation. However, high food prices and increases in administered prices (such as for diesel, gasoline, and natural gas canisters) have also played a role. Food prices are likely to fall in FY2009/2010 and pull inflation rates down. However, Central Bank continued financing of government deficits will limit control of the money supply and inflation, which is projected to be 11.2% in 2010. High inflation rates also risk eroding competitiveness due to their influence on the real exchange rate.

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