

Institutional Challenges Facing Economic Development in Myanmar: A Case Study

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Submitted 10 September 2014; accepted in final form 24 November 2014

Abstract

The New Institutional Economics (NIE) school of thought suggests that institutions are necessary for economic efficiency and are the primary cause of economic development. After a half-century of isolation under the military rule, Myanmar is experiencing major political and economic reforms. This paper gives a descriptive overview of Myanmar's current institutional environment from the perspective of NIE. The study finds that Myanmar's economic development potential is widely recognized; however, the poor quality of its institutions remains one of its biggest challenges. Major institutional challenges such as a centralized political structure, concentration of resources and business in the hands of the military, cronyism, bribery and other forms of corruption, ineffective and outdated bureaucratic structures and policies, and an underdeveloped banking system remain as obstacles in the developmental process. Myanmar's rapid economic progress in the years ahead will depend on how the large number of challenges regarding policy issues will be resolved. Thus, this study's primary purpose includes examining and analyzing Myanmar's current institutional environment as well as providing suggestions and policy recommendations for beneficial economic development.

Keywords: *economic development, institution, Myanmar, new institutional economics*

1. Introduction

More than five decades of military rule has left Myanmar with very weak institutions and capabilities, posing several challenges to the current transformation process. Major institutional challenges around the concentration of power in the hands of the military, monopolization of the resources and business, bribery and other forms of corruption, ineffective and outdated bureaucratic structures and policies, and underdeveloped public services and the banking system are obstacles to development. The New Institutional Economic school of thought suggests that institutions are necessary for economic efficiency, which is the primary cause of economic development. Therefore, institutional quality is important since a country's prosperity and economic development rely on its institutional environment. Myanmar's rapid economic progress in the years ahead will depend on how its numerous challenges regarding policy issues will be resolved.

This study's first objective is to review the New Institutional Economics (hereafter NIE) theory to gain a better understanding of the importance of institutions in national economic development. A second objective is to overview, examine and analyze the current political and economic institutions necessary for Myanmar's economic development, based on the NIE concept. This study also aims to provide policy implications regarding the institutional environment needed for prosperous economic development in Myanmar.

Therefore, results from this study can contribute to the country's development by providing a descriptive case study with concrete examination and thorough analysis of the institutional environment during Myanmar's current transitional period, relying on the NIE's general insights. This study's outcome and analysis will help guide and inform government policies to promote economic development. This paper examines the current institutional environment and addresses the problems in Myanmar's institutions that are necessary for economic development. To that end, the study provides the implications of effecting institutional changes for a smoother transition and economic prosperity in Myanmar. It is hoped that the outcome and analysis the study generates will help guide and inform government policies to promote beneficial economic development.

2. Literature Review

The NIE school of thought is a vast and relatively new multidisciplinary field that includes aspects of economics, sociology, history, political science, business organization, and law. It combines and extends the two economics theories of the original, or old, institutional economics and neo-classical economics. The NIE acknowledges the important role of institutions (assumption of old institutional economics), particularly institutions within the framework of neoclassical economics. Considering the insight of this theory, some linkages can be drawn to provide a connection between economic development and structural changes needed for Myanmar, which may require a huge reform effort to support economic development as well as cope with upcoming challenges brought about by the implementation of ASEAN Economic Community in late 2015.

2.1 Theoretical background

The NIE is built around the works particularly advocated by Douglas North (1990, 2005) and Oliver Williamson (1975). The term NIE was introduced by Williamson in his paper focusing on transaction costs. It has since become a standard term that classifies a diverse group of economists who share a common intellectual ground: institutions matter, the relationship between institutional structure and economic behavior requires attention, and the determinants of institutions can be analyzed with the aid of economic theory (Richter, 2005). NIE provides a new way of analyzing economic phenomena. It explains the determinants of institutions and their evolution over time, and it evaluates their impact on economic performance, efficiency, and distribution.

Thus, NIE is a useful framework that could help determine the types of institutions needed (either formal or informal) to improve Myanmar's economic performance. Therefore, based on NIE's concepts and general hypothesis, this paper examines the current institutional environment in Myanmar and intends to provide analysis and recommendations.

Based on North's definition, it is commonly agreed that "institutions are made up of formal rules (political systems, constitutions, laws governing contracts, property rights, organizations, product information, taxes, tariffs, regulation of banks, etc.), informal constraints (culture, norms of behavior, customs, values, traditions, sanctions, religions, etc.), and their enforcement characteristics; and they establish the rules of the game of a society" (North, 1990). More formally, institutions are humanly devised constraints that structure political, economic, and social interactions.

NIE suggests that in market exchanges there exist transaction costs comprising the cost of information as well as the cost of protecting rights and policing and enforcing agreements. Thus the existing cost in transactions due to imperfect information or uncertainty leads to the creation of both formal and informal institutions. Wiggins and Davis (2006) stated that these institutions evolve in response to the uncertainty, risk and information costs associated with living and transacting in an imperfect world. In turn, this leads to lower transaction costs and reduced uncertainty between market exchanges, both of which affect economic performance as a whole.

2.2 What kind of institutions promote growth and how?

North (1990) stated that institutions that evolve to lower transaction costs are key to economic performance. However, NIE suggests that due to path dependency, no single strategy for institutional design exists for all countries. Nevertheless, much NIE literature and many NIE economists have suggested fundamental institutional elements and designs that could enhance economic performance and foster development.

According to Milo (2007), only efficient institutions promote growth. Milo posits that countries need two distinct and not necessarily complementary sets of institutions to meet the challenges of development:

- 1) those that promote exchange by lowering transaction costs and promoting trust (contracts and contract enforcement mechanisms, commercial norms and rules, and habits and beliefs favoring shared values and the accumulation of human capital), and
- 2) those that induce the state to protect rather than expropriate private property (constitutions, electoral rules, laws governing speech, and legal and civic norms).

These types of institutions encourage individuals to engage in productive activities by providing appropriate incentives and establishing a stable structure of human interactions, thus reducing uncertainty.

Similarly, in Rato's (2006) essay "Building Better Institutions", good institutions are those that adopt policy frameworks that accept several broad principles. First, the private sector is recognized as the main actor on the economic stage, with the state stepping in to provide appropriate regulation of markets. The second principle states that a good institution should have a commitment to protecting property rights and creating an environment in which innovation can thrive. Third, the rule of law prevails, and corruption is not tolerated in either the public or private sectors; and fourth, there is a stable macroeconomic environment, reflected in low inflation and a sustainable fiscal position (Rato, 2006).

2.3 How do institutions affect economic performance?

According to Wiggins and Davis (2006), the previously proposed types of institutions help determine the economic growth by potentially affecting three factors: investment, technical innovation and economic organization. Owners of capital are more likely to invest when property rights are secure. If it is easy to trade, obtain credit, retain a reasonable share of the profits (i.e., without excessive taxation) and ensure against risk, then investment is encouraged. Investment may also be stimulated when establishing companies or more informal economic groups is a relatively straightforward task.

Institutions help promote technical innovation by securing intellectual property rights, which is likely to promote private investment in research and development of innovation. Consequently, when institutions facilitate transactions and co-operation among individuals and thus build trust, whether in formal companies or less formal co-operatives, an economic organization is likely to be more effective and efficient, delivering the benefits of specialization and economies of scale where they apply.

In summary, NIE theory takes into account the profound effect of institutions on economic interaction as it acknowledges that legal, political, social and cultural institutions affect an economy's performance. The NIE's central hypothesis is that institutions (formal and informal) are crucial and the first determinant of economic performance. Overall, the NIE demonstrates that institutional quality as measured by bureaucratic efficiency, absence of corruption, protection of property rights and the rule of law is important for growth. Thus, it is suggested that the kinds of institutions that matter are those that protect property rights (a constitution, the rule of law), and lower transaction costs (promoting trust, contract and contract enforcement mechanism, stable macroeconomic, and an absence of corruption).

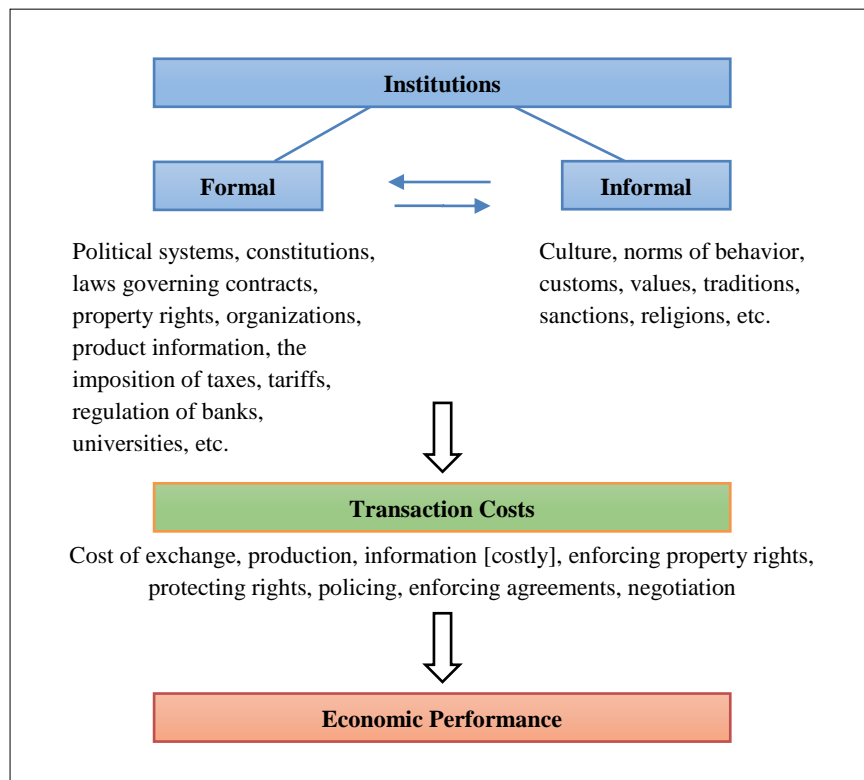


Figure 1 NIE Model and its Application

3. NIE Application in the case of Myanmar

As described in the above framework, “institutions” lead to better “economic performance”. The transaction cost is an intervening variable between institutions and economic performance, which is causally affected by institutions and itself affects economic performance. However, this study does not aim to discern the relationship between these variables, but the theoretical framework is constructed and variables are identified as a means to provide a descriptive theory that establishes the overall framework.

This study is, therefore, a descriptive case study research paper that includes a description and examination of the current institutions necessary for Myanmar’s economic development. The study uses both quantitative and qualitative data collection methods, which required a web-based review of existing reports, journals, news, articles, opinions, official publications and documents for content analysis. The study also uses quantitative methods to indicate the level of institutional environment (governance quality, the degree to which protection of property rights exists, political atmosphere, etc.) through application of several economic development indicators (such as the Freedom Index, Regulatory Efficiency, Good Governance indicators, Rule of Law) provided by several international organization such as The World Bank.

The information is from primary documents, secondary statistical data and tertiary sources. Regarding the data collection process, both tertiary and secondary sources are used to make textual analysis. The study mainly is in a descriptive style and mixes analysis methods in that it uses both qualitative and quantitative methods. The paper is outlined in a deductive style: it begins with a brief discussion on general theories (especially NIE) provided by several scholars. It then applies the theoretical framework and existing economic development indicators to focus on an analysis of the specific case study of Myanmar.

Even though institutions include both formal and informal constraints, this study only focuses on examining the formal institutions (political systems, constitutions, laws governing contracts, property rights, organizations, the imposition of taxes, tariffs, regulation of banks, etc.). Informal constraints such as culture, norms and traditions require a study of history, thus needing a large amount of time. Therefore, this paper focuses only on the formal rules/institutions needed to examine the institutional environment via information, data and indicators that can be collected in a relatively short time period.

4. Examination and Findings

Considering the NIE perspective, we have examined the institutional atmosphere using several indicators. To examine the quality of formal institutions in Myanmar as suggested by some institutional economists, we rely on several indicators and indexes, such as the Index of Economic Freedom on Myanmar by The Heritage Foundation, six key governance indicators of Myanmar from The World Bank, and the Economic Freedom of the World by the Fraser Institute.

The following are the summary figures that indicate Myanmar’s institutional quality, economic freedom, governance quality and other aspects related to its economic institutional environment (North refers to the polity, judiciary, laws of contract and property).

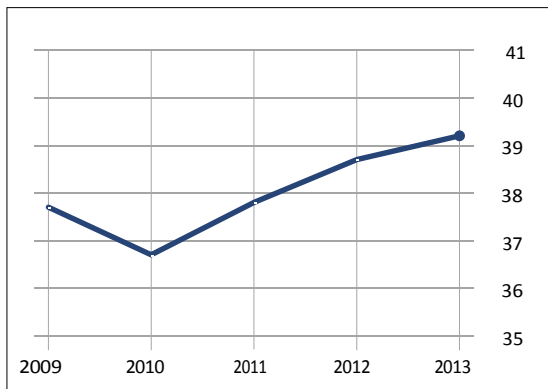


Figure 2 Index of Economic Freedom

Source: The Heritage Foundation/Wall Street Journal, 2013

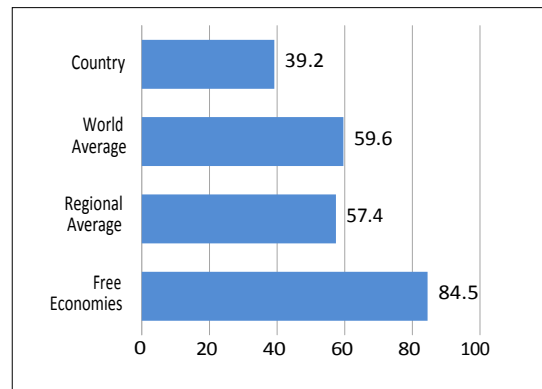


Figure 3 Country Comparisons

Myanmar’s economic freedom score is 39.2, 0.5 point higher than in 2012, thus rendering its economy the 172nd freest in the 2013 *Index* out of 177 countries rated. According to the Heritage Foundation this is due to improvements in reducing corruption and increasing monetary freedom. The country is ranked 40 out of 41 countries in the Asia-Pacific region, and thus its overall score is much lower than the regional average.

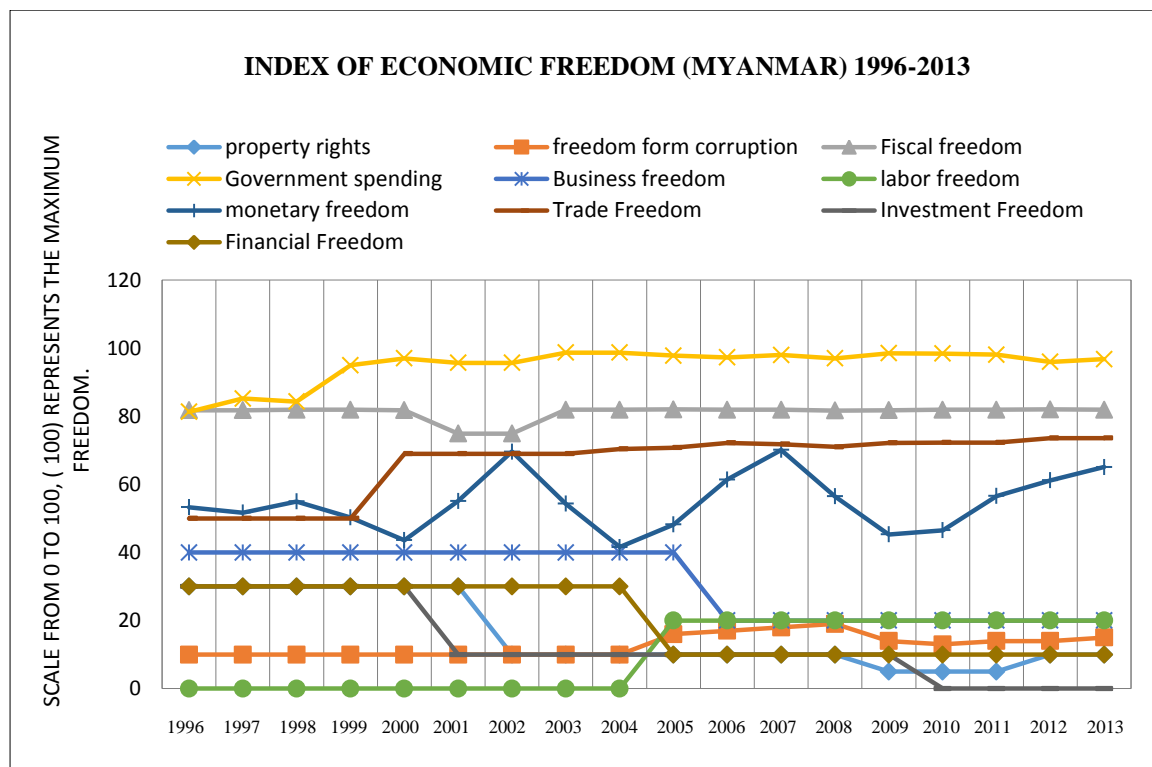


Figure 4 Summary of the Index of Economic Freedom on Myanmar

Source: The Heritage Foundation/Wall Street Journal (2013) and author’s summary on the Index of Economic Freedom on Myanmar from raw data.

The index measures 10 components of economic freedom on a scale of 0 to 100, whereby 100 represents maximum freedom, from 1996 to 2013. Overall, private property is not protected in Myanmar. Corruption remains a serious problem, and compared with the rest of the world Myanmar falls among nations with the highest levels of repression.

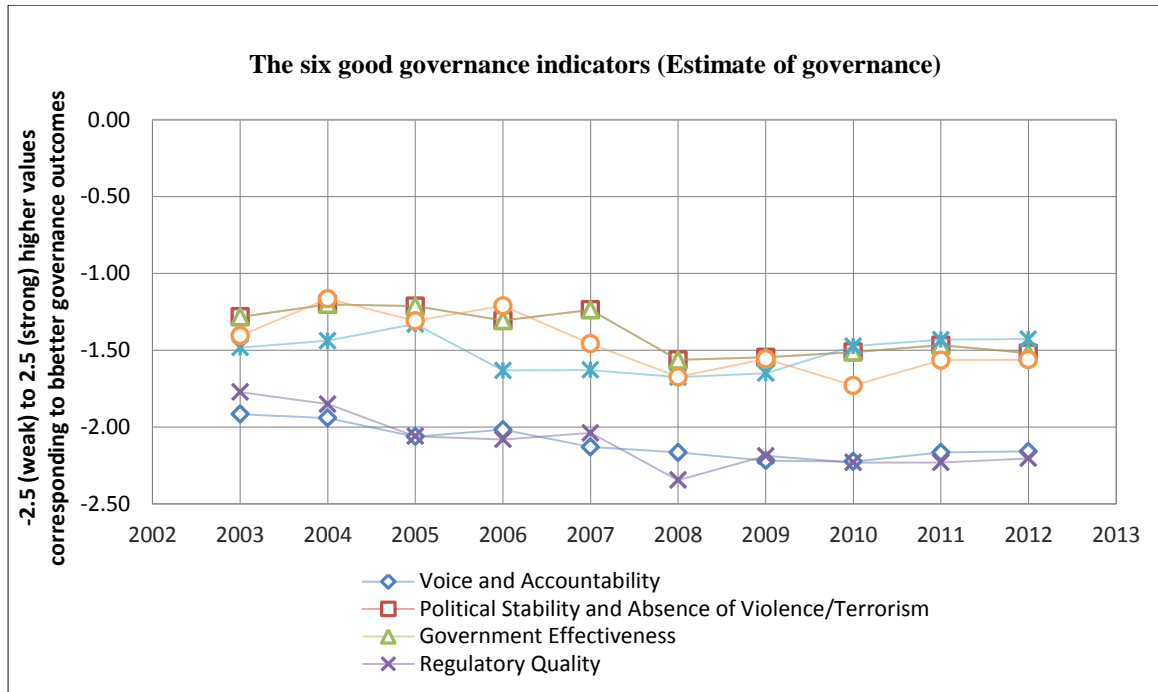


Figure 5 Summary of Myanmar six governance indicators

Source: The World Bank Group (2013) and author’s summary of Worldwide Governance Indicators on Myanmar.

Overall, comparing Myanmar’s six good governance measures over time, from 2008 we see slight drops in all perceptions. Thus, this figure confirms some weakening in Myanmar’s institutional quality in recent years.

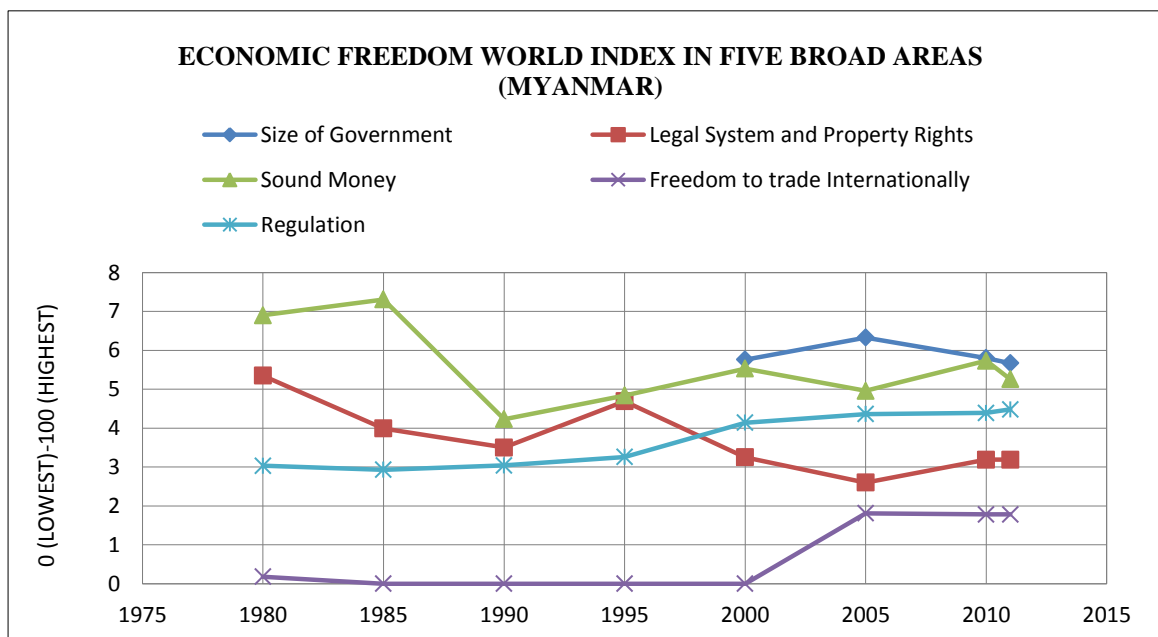


Figure 6 The Economic Freedom Index (EFW)

Source: The Fraser Institute’s EFW 2013 annual report and author’s summary of Myanmar Economic Freedom based on the data provided by the Fraser Institute annual report.

EFW studies have found that countries with institutions and policies more consistent with economic freedom have higher investment rates, rapid economic growth, higher income levels, and a more rapid reduction in poverty rates. However, the above EFW figures show a continuous lack of freedom in the five broad areas across three decades in Myanmar.

In summary, the above measures of the Economic Freedom Index, the Economic Freedom of the World and the Good Governance Indicators provide statistical measurement regarding several aspects of institutional quality, economic freedom and governance quality. These indicators enable us to have some general ideas on the overall aspects of institutional quality, economic freedom, governance quality and other aspects related to Myanmar's economic institutional environment (North refers to the polity, judiciary, laws of contract and property). Most indicators reveal that Myanmar's overall institutional quality remains low.

Furthermore, the study examines Myanmar's current institutional environment by looking at its polity, governance systems, rule of law, transparency, property rules, judiciary system and banking system, which all help determine economic performance. Riffle states that Myanmar has been rated as having one of the world's worst business climates and that its miserable macroeconomic management, a virtually useless banking system, inadequate infrastructure and several administrative obstacles contribute to high transaction costs, which contradicts the suggestions of the NIE that suggest better and proper institutional structures would to lower transaction costs, which in turn would aid economic development.

The examination indicates that shortcomings in Myanmar's institutional environment. Thus, the necessary institutions have not been established and existing ones operate ineffectively. With the problem of centralized political systems, concentration of resources in the hands of the military and its cronies, corruption, the absence of the rule of law, underdeveloped legal and regulatory frameworks, a lack of independent legislative and judicial systems, vague and unclear interpretation of laws that fail to provide legal and economical certainty as well as the protection of property rights and contracts, and weakness in economic institutions such as underdeveloped financial institutions all pose challenges to efficient economic performance. Several aspects of Myanmar's institutional environment remain poor, obviously creating an unfavorable environment for economic development.

NIE posits that a nation's institutional environment (polity, judiciary, laws of contract and property rules, and policies that define the conditions under which business occurs) is the first determinant of economic performance. Accordingly, fostering Myanmar's economic development would require a process of removing impediments to growth by enhancing its institutions. According to NIE, only the right kind of institutions can create the potential to boost a country's economic development.

One of the main obstacles to improving institutions in Myanmar concerns the judicial branch: it remains weak due to the military's influence and the way legal and judiciary bodies are structured according to the nation's constitution. Due to an incomplete regulatory framework and underdeveloped institutions, Myanmar's rule of law is weak. A lack of clear laws, regulations and enforcement mechanisms worsen corruption, provide virtually no transparency and discourage investment and economic activities.

5. Discussion and Policy Recommendations

According to NIE, the type of institutions that foster economic growth require formal rules that clearly define property rights to the goods or services that can be exchanged, promote trust and respect for the rule of law, and finally enforce rights and laws as objectively and fairly as possible. NIE economist Yeager suggests that for markets to exist and perform well, at least six criteria must be in place, including good information for consumers, a stable and trusted monetary system, legitimate and secure ownership of property rights, and access to an impartial legal system for both buyers and sellers (Boliari, 2007).

However, due to past experience of three currency demonetizations, people have lost trust in the Central Bank of Myanmar regarding its currency, the kyat. Moreover, the banking system is outdated and underdeveloped. Property rights are unprotected because of vaguely stated, outdated laws and regulations and an ineffective judicial system. Thus, Kim, Neo and Oeni (2012) state that regulatory and legislative restrictions with the lack of capacity within Myanmar's institutions may limit its ability to cope with the influx of foreign investment. Though Myanmar's legislative framework for investment is being revised, there are concerns about the effectiveness of the rule of law to implement this.

Thus, to create a decent institutional environment for economic development, the transformation of the role of military together with the eradication of corruption and the establishment of rule of law are the most urgent priorities for the reform that Myanmar's leaders should carry out. The policies of decentralization, investment support and policy initiatives that are designed to level the playing field and protect the rights of people and business entities are needed for local and international businesses to grow and prosper in Myanmar. Capacity building of the parliament and judiciary system is also needed. The banking sector needs to be reformed and upgraded to create a more favorable investment climate. All these issues should be addressed intensively and efficiently.

The current flawed constitution and weak rule of law are the primary cause of several problems such as corruption, the lack of transparency and protection of property rights, and the monopolization of resources and business by the military and its cronies. Thus to achieve prosperity in Myanmar, there needs to be: a) a constitutional amendment for allocation of power, b) protection of property rights, c) the rule of law with an impartial judicial system, and d) a trusted monetary system.

a) Constitutional amendment for allocation of power

This study principally posits that the amendment of the constitution would allow Myanmar to obtain a proper solution to the aforementioned problems and help achieve economic prosperity. To create a business-friendly climate, attract foreign investment, and promote innovation and trust by reducing corruption and strengthening transparency, there needs to be a reduction in the domination of the military and its monopolization of resources and businesses. The allocation of power, opportunities and resources should not be monopolized and concentrated in the hands of a small group of people, but fairly distributed. Thus, a change in the country's power structure and constitutional amendment is essential. Once the constitution is amended and power is re-structured and equally distributed, corruption and a lack of transparency will be diminished.

b) Protection of property rights

The NIE suggests that strong property rights institutions and various legal institutions comprise some of the key trade and development-facilitating institutions (Nugent, 2008). Thus, the government should develop rules and regulations that doesn't favor cronies, but rather promote the fair conduct of business among all parties. The government should also establish clear policies and laws addressing the protection of property rights for all citizens as well as for foreign investors, and give primary importance to further liberalizing trade and foreign direct investment.

c) Strong financial institutions and trusted monetary system

The banking system is extremely underdeveloped and isolated from the international financial infrastructure. It will be impossible to build a competitive economy and raise living standards in Myanmar without a sound and efficient banking system. A process of ensuring macroeconomic stability; encouraging financial sector development, such as modernizing the banking system; and establishing a consistent monetary policy framework are also crucial for economic development. Additionally, due to past experience, public trust in Myanmar's currency and banking system remains low. Advocates of NIE, North and Yeager, state that to have well-functioning markets that drives economic development, institutions must promote trust. Overall, there needs to be changes in monetary policies to regain trust in the currency and approaches in renewing the banking system (private banks as well as state-owned banks) to make transactions easier and up to international standards in order to create a friendly environment for investment and business essential to economic growth.

d) Improved judiciary capacity and rules and regulations

The current problem of dependent and structural disconnects in Myanmar's judicial system and courts render them incapable of delivering justice fairly and establishing the rule of law. Moreover, several rules and regulations are out of date; therefore, they are irrelevant and are unenforceable. In short, the enforcement of regulations needs to be strengthened, several policies and laws revised, and judicial systems and courts restructured and enhanced in their capacity so as to help build a friendly business atmosphere that attracts foreign investment and promotes free markets.

e) The role of international communities

Myanmar, together with donor countries and private and foreign investors, can collaborate to enhance the quality of the institutions across all sectors. Assistance can be provided via capacity building and training of personnel in regulatory agencies and financial institutions and provide the technological support and capital assistance. Foreign donors and investors as well as local firms could seek several opportunities and benefit from Myanmar's rich and abundant natural resources and young labor force while assisting and contributing to Myanmar's reformation process. A prosperous future in Myanmar needs enhancement and reformations in all sectors of the institutional environment: the polity, constitution, judiciary, contract law, property rights, and policies that define the conditions under which business occurs. It is hoped that the conclusions and analysis in this study will help inform government policies on promoting investment, productivity and economic growth through institutional reformations and changes.

Institutions (both formal and informal) are the first determinant of economic development. Thus, one of the constraints and limitation of this study is its inability to focus on analyzing the informal institutions or the unwritten constraints (such as social, culture, norms of behavior, customs, values, traditions, sanctions, and religion) due to limited time and length. The study thus focuses its examination and analysis on formal institutions and written rules including political systems, constitutions, and laws governing contracts, property rights, organizations, and banking regulation. Hence, this paper suggests further study on the informal constraints (such as social norms, culture, religion and history) to gain a better and fuller understanding of the current economic phenomena and provides more substantive recommendations for economic development in Myanmar.

Despite large numbers of theoretical studies as well as case studies and analysis of the importance of institutions on economic development under the perspective of the NIE, no single study examines Myanmar using the framework of institutional economic theory. The IMF Myanmar country report (2014) comments that if key institutional constraints are addressed the country's outlook is bright. Given Myanmar's significant economic potential, appropriate institutions and policies to manage the economy and supervise the financial system need to be built rapidly to achieve sustained growth and prosperity; thus, more academic study and research on Myanmar's institutions for economic development is needed.

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