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CONTENTS

The Influential Determinants of FDI Inflow in Myanmar

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Abstract

Many different factors affect the volume and distribution of FDI in developing countries around the world. Many researchers have found that the primary determinants of major FDI inflows include political stability, favorable tax and subsidy policies, the existence of an appropriate business environment, better administrative procedures and a low level of corruption. Inward FDI stock in Myanmar is much lower than that of neighboring countries. The government has initiated a broad range of reforms to open its economy to foreign trade and investment. The economic scholar point out that if Myanmar chooses the right national development strategy, enhances open trade and investment strategies and learns from economies with similar experiences, the country can catch up to its neighbors and partners in the region. Some economic experts point out that government promotions to attract FDI are irrespective of the realization of an investment boom in the country.

Key Words: FDI, Trade policy, economic growth

I. Introduction

Other things remaining the same, the effectiveness of FDI policy in any country may be gauged by examining the trends in foreign investment approvals and actual inflow. A great deal of evidence shows that FDI has contributed significantly to the economic and industrial development of ASEAN economies. FDI flows are often accompanied by valuable resources such as technology, organizational capability, managerial skills, and marketing know-how. In the last two decades, the involvement of developing countries in international trade has increased while FDI has expanded rapidly as capital inflows.

Many different factors affect the volume and distribution of FDI in developing countries around the world. Many researchers have found that the primary determinants of major FDI inflows include political stability, favorable tax and subsidy policies, the existence of an

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appropriate business environment, better administrative procedures and a low level of corruption. Since globalization, the world economy has been characterized by increased integration and ties between countries in which foreign direct investment (FDI) constitutes a business phenomenon of vital importance and frequency. FDI contributes to the improvement of macroeconomic outcomes of host countries and from there it can enhance a nation's economic growth.

According to international reports, Myanmar is one of the most difficult markets in the world in which to operate a business even though the government is implementing political and economic reforms aimed at promoting the country's participation in the global economy. Like other ASEAN countries, Myanmar has built its development strategy on export-led development based partly on FDI. However, FDI has played less of a role in Myanmar than other countries in the region. Previously, due to the impact of economic sanctions, potential investors from many OECD countries did not consider Myanmar as a location for investments. Myanmar experienced the largest economic impact among the countries in the Mekong region. Myanmar has a large amount of economic potential from the benefits of economic integration and infrastructure development in the Mekong region.

Most of the investment that Myanmar has received has gone to natural resource sectors with only a negligible role for foreign investors in manufacturing or services (OECD Investment Report, 2014). Nowadays, the Democratic government is adopting an open-door policy and favors creating economic opportunities to build a modern developed nation. The objective of this paper is to point out the influential determinants of FDI inflow in Myanmar using the current economy as a case study. This study is made up of the following four sections; exploring some perspectives from previous literature, current FDI trends in Myanmar, the influential determinants of FDI in Myanmar, and FDI policy implications.

II. Previous literature review

Previous studies have focused on the pull factors, features of the host countries that attract or deter FDI inflows, but foreign investment is not attracted to less developed countries except in cases with cheap labor or abundant raw materials. There has been a proliferation of policy-oriented studies seeking to make a country's investment climate more attractive to both foreign and local investors. Foreign direct investment contributes to the development of many countries by improving infrastructure, transferring technical skills, raising entrepreneurial abilities and elevating financial resources regarding both government revenue and foreign exchange.

Many researchers have analyzed FDI and foreign trade with the different points of view. This study mainly points out the determinants of FDI in developing countries. In previous studies, the determinants of FDI have generally fallen into three categories; a focus on core factors influencing the decision to invest in a country or industry, a more macro-oriented functional relationship between FDI and possible determinants, and finally, why FDI is preferred to other forms of investment based on different resource allocation decisions. When analyzing the main determinants of FDI, country-specific characteristics are widely accepted, especially for factors related to the host country market.

FDI analysis is often based on either horizontal foreign direct investment or vertical foreign direct investment. Horizontal foreign direct investment is often done by multinational corporations which replicate their production processes in foreign facilities located near large customer bases. Vertical foreign direct investment is based on the theory of comparative advantage and it is one of the fastest-growing types of FDI into developing countries from developed countries. Vertical FDI requires a substantial fixed cost investment in a foreign affiliate in a country with the appropriate characteristics (Krugman, Obstfeld & Melitz, 2012).

A nation's chance of attracting and receiving FDI depends on the development of the host country's infrastructure and institutions by making efforts at fundamental reform.

Yousaf, Hussain & Ahmad (2003) analyzed the volume and determinants of FDI in a sample of 15 developing countries. The FDI flow into developing countries took various paths and its volume was modest at the beginning of the 1980s but has tended to rise in subsequent years. Ferris, S.P., Thompson, G.R. & Valsan, C. (1997) analyze FDI in Guyana in Latin America and pointed out the important determinants of FDI compared with 11 other Latin American countries. Goldberg & Kolstad (1995) analyzed exchange rate variability and demand uncertainty and explored the implications of short-term exchange rate variability for FDI flows.

Real exchange rate variability influences the location of production facilities for risk-averse parent companies and fixed productive factors. Yu-Chen & Santanu (2011) studied the relationship between labor cost and FDI in India, specifically the effects of foreign-owned firms paying higher wages than their domestic counterparts.

III. The Current Foreign Direct Investment Situation in Myanmar

Myanmar is the second largest country in Southeast Asia, and the 12th most populous country in all of Asia. With 55% of people under the age of 30, Myanmar's population is well positioned to capitalize on an expansion of the economy. Although the international record on natural resource-based exports as a means of promoting economic development is unsure, Myanmar's natural resource exports can play a vital role in development, and a well-regulated resource sector can generate high growth in income, investment, and trade while laying a foundation for the diversification of exports and domestic activity over time.

After the Democratic government came into power in 2011, the United States, Japan, and ASEAN have started to seek ways to invest in Myanmar. According to data from the Asian Development Bank (ADB), the country's GDP expanded by 8.5% in 2014-15, and the government estimated 2015-16 GDP growth at 9-10%. In 2016, GDP reached US$62.6 billion. Thirty years ago, there was very little foreign investment and Myanmar only engaged in small international trade. On November 30, 2015, the Directorate of Investment and Company Administration (DICA) stated that the total amount of FDI from 1988 to November 2015 had reached US$58.2 billion, including manufacturing enterprises and oil and gas companies which were responsible for one-third of the total investment, at US$19.6 billion. However, this amount has seen a significant drop after FDI reached a peak in 2014.

After adopting a liberalization policy, the government continues to open the economy to attract FDI and enhance trade. "Liberalization is a key word here right now. We have grown rapidly in recent years, and we expect to see increased economic activity for the foreseeable future", said U Aung Naing Oo, secretary of the Myanmar Investment Commission (MIC) and director-general of the Directorate of Investment and Company Administration (DICA).

IV. The influential determinants of FDI in Myanmar

Previous studies have focused on the pull factors, features of the host countries that attract or deter FDI inflows, but foreign investment is not attracted to less developed countries except in cases with cheap labor or abundant raw materials. FDI may be one key element for the development of Myanmar in the future. The government has initiated a broad range of reforms to open its economy to foreign trade and investment. Myanmar has a rich natural resources base, a young labor force and a strategic geographic location between the two economics giants India and China and stands to benefit from greater global and regional economic integration, including its membership in ASEAN. Many different factors affect the volume and distribution of FDI in developing countries around the world.

4.1. Myanmar Investment Law

The government released a draft of the Myanmar Investment Law in February 2015 which had been in the works since 2014 and was ratified by Parliament in 2016. The new law replaced both the 2012 Foreign Investment Law and the Myanmar Citizens Investment Law of 2013 with comprehensive legislation aimed at bringing all investment regulations under one framework. The objective of this law was to develop responsible investment business which does not cause harm to the natural environment employs human resources, has a high production function for services, trading, technology, agriculture, livestock and industrial sectors. According to the Myanmar Investment Law, the MIC will also evaluate all investment permit applications according to specific key factors including whether the investment will result in a significant level of domestic employment, if the economic activity will involve the import and use of heavy equipment or advanced technology, how much economic activity will be added to the domestic economy and the degree that the economic activity will uplift the living standards of Myanmar’s citizens.

4.2. Current Financial sector

Financial sector development is still at an early stage in Myanmar. It remains firmly underdeveloped and repressed, with financial intermediation almost entirely dominated by an unsophisticated banking sector. The government has prepared a financial sector roadmap to foster financial development with a new foreign exchange management law. There are further plans to open the banking industry to foreign participation, and developing the capital market with the launch of a stock exchange in 2016. Moreover, the Central Bank established a regular liberalization program to allow the entry of private domestic banks and the establishment of representative offices for private foreign banks.

In 2012, the Foreign Exchange Management Law was adopted, and it allows both locals and foreigners to deal with foreign currency in Myanmar. According to this law, it requires all foreign exchange transactions to occur through banks that have been authorized by the Central Bank of Myanmar to deal in foreign exchange. As such, foreign investors may now open foreign currency accounts at authorized banks within Myanmar and maintain these accounts abroad, as well as remit foreign currency abroad, subject to the approval of the relevant government authorities. As foreign exchange is absorbed and spent in the economy, the real exchange rate could appreciate, reducing the competitiveness of Myanmar's trade-exposed firms and sectors. Currently, Myanmar faces the devaluation of the kyat, and the exchange rate of the kyat with the US dollar is weaker than previous.

4.3. Special Economic Zones

The term Special Economic Zone (SEZ) is used to describe the delineated geographic areas within which have a different legal and regulatory regime relating to business and trading activities.(Responsible Investment in Myanmar, 2017). Nowadays, SEZs are powerfully linked to national economic development plans, and are a base for innovation and new institutions for market economy success. A growing percentage of inward investment has gone towards Myanmar's new special economic zones. SEZs play a central role in Myanmar's efforts to attract investment and to promote competitive semi-manufactured and manufactured goods with significant local value addition. If the SEZs become successful, they will continue to be a high priority target for the government as a means to attract foreign investment.

Table (1) Thilawa SEZ Investment (by Sector)

Sector	2017-2018		
	Amount	Value (US$mil)	%
Manufacturing	6	185	74
Trade		47	19
Real Estate		8	3
Transport and Supporting		7.48	3
Services		1.35	0.5
Total		248.6	100

Source: Directorate of Investment and Company Administration in Myanmar

By September 2015, during the first phase of Thilawa SEZ, launched in 2013, 48 firms had signed contracts to set up operations in Thilawa, with many of those companies involved in garment manufacturing. The second SEZ is in Dawei, situated in southern Myanmar, with another SEZ in Kyaukphyu, in the state of Arakan, and both projects have begun to attract interest from foreign corporations. SEZs offer a variety of investment opportunities for foreign investors.

Table (1) shows the sectoral FDI inflow in Thilawa SEZ in FY 2017-2018. The foreign direct investment entered in the manufacturing sector was the largest with 74% of all investment. Currently in the Thilawa SEZ, Japan is the largest investor, contributing 33% of all investment in 2017-2018.

4.4. Labor Utilization

According to the 2014 Myanmar Census, 65.6% of the population is of working age (15 - 64 years old). This population is well educated, with a high literacy rate of 93% and wide spread basic competency in English. As a labor abundant country, Myanmar has the comparative advantage of lower labor cost in attracting FDI to export-oriented labor-intensive sectors. There is growing evidence that factors such as the right to collective bargaining, worker safety, education, due process and a commitment to ethical, social and environmental norms provide an attractive and sustainable environment for investment. Although Myanmar's rank in basic literacy rate is high, education and labor skills need to improve in order to attract more FDI.

With the influx of FDI into Myanmar, the government need to confirm the positive effects of creating employment and needs to check whether workers have the ability to absorb and work with standardized technologies. At the same time, technology education and vocational training are crucial for human resource development. As the condition of the Greater Mekong Sub-region (GMS) East-West Economic Corridor and the Three Pagoda Pass Road are improved, and labor costs in Thailand rise, there is a chance for more labor-intensive industry to be relocated to Myanmar. However, the current infrastructures in these locations for investors are still limited.

Table (2) shows the employment opportunities in Myanmar from Investment Enterprises (2011-2012 to 2017-2018). The availability of adequately skilled labor is crucial for attracting firms engaged in export-oriented FDI. U Maung Nanda Aung, the executive director of Heritage Capital Investment, points out the challenge of finding skilled labor in Myanmar, and that the education level is low compared with the rest of the world. However, currently, employment opportunities are increasing compared due to higher FDI inflow. In the modern global investment climate, investors confer importance to labor and environmental standards, corporate governance, and political stability.

Table (2) Employment Opportunities from Investment Enterprises (2011-2012 to 2017-2018)

Fiscal Year	Foreign investment Enterprises		Nationality' investment Enterprise		Total	
	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign
2011/12	6814	465	9015	160	15829	625
2012/13	62412	719	18871	198	81283	917
2013/14	77597	1373	17269	187	94866	1560
2014/15	115500	2587	12626	134	128126	2721
2015/16	94922	2341	29418	238	124340	2579
2016/17	65830	2019	9743	145	75573	2164
2017/18	78146	1964	12612	281	90758	2245
Total	501221	11468	109554	1343	610775	12811

Source: Directorate of Investment and Company Administration in Myanmar

4.5. Infrastructure Development

Good infrastructure is not only a driver of FDI inflow, but also a pre-requisite for positive spillovers from FDI onto the host country's economy. If a country's infrastructure is sufficient, the country will have spillover benefits from FDI and attain a higher level of growth. Therefore, especially for developing countries, the larger the investment in infrastructure, the greater the FDI inflows can lead to even faster growth.

Table (3) List of existing Infrastructure Enterprises under the Foreign Investment Law

Sector	*No.*	*Investment Amount (US$ millions)*	*Percent (%)*
Power	14	14,685.1	63.6
Transport (Air)	2	666.2	2.9
Transport (Port)	9	527.1	2.3
Telecommunications	22	7,076.4	30.6
Transport (Road)	1	143.2	0.6
FDI Infrastructure Projects	**48**	**23,098**	**100**
FDI Total Projects		**61,276**	
% of FDI total Projects			**37.7**

Source: Directorate of Investment and Company Administration in Myanmar

The lack of infrastructure in Myanmar is an important obstacle to meeting the needs of society and to enterprise and economic development. The openness for FDI should be considered with the capacity of the macro economy and the location of Myanmar, compared with other ASEAN countries in various indicators of investment climates. A huge obstacle to attracting investment in the manufacturing sector is insufficient power, communications, roads, railways, bridges and ports. The government has stated that its investment priorities include the construction of road and rail networks, power plants, water treatment plants industrial parks and special economic zones (SEZ) to meet the demand for new infrastructure.

Although logistics infrastructure is an important factor for investment, Myanmar's current logistic infrastructure is poorer than other countries. The government is building physical roads to becoming Asia’s “crossroads” through investments. Recently, the Oxford Business Group issued of The Report: Myanmar 2018, which states that Myanmar is expected to require at least US$60 billion of new investment over the next 15 to 20 years to fulfill the country’s rapid urbanization and massive infrastructure agenda set by the Ministry of Transport and Communication in September 2017. The government’s emphasis on establishing effective national and international supply chains for future economic growth, improvements in infrastructure (particularly power infrastructure, road, rail, air, and ports) have the highest priority in order to attract FDI. Limited infrastructure capacity is also a major issue hindering the promotion of industrial activities. Table (3) shows a list of infrastructure enterprises and their existing value of investment as approved by the Foreign Investment Law.

FDI in hydroelectric power plants is permitted as a joint venture or build-operate-transfer (BOT) scheme. The Ministry of Construction seeks to encourage private sector investment in infrastructure development and uses BOT projects or joint ventures for the constructions of roads, inland cargo depots, ports, and airports. The government is conducting various infrastructural projects under BOT or other Public Private Partnerships (PPP) agreements with investors from the private sector.

4.6. Tax Exemption

Tax exemption is an influential factor for attracting FDI to a host country. From the spillover effects of the introduction of new technologies and the enhancement of human capital (skills), FDI can positively affect domestic income and policymakers frequently re-examine their tax rules to ensure the attractiveness of FDI. Moreover, governments should constantly check the competitiveness of their tax environment for FDI, but ensure that an appropriate share of domestic tax is collected from multinationals.

Some previous studies have found that FDI was becoming increasingly sensitive to taxation and the long-run impact of corporate tax reform is one uncertainty of how tax factors into FDI decisions, including what investors consider to be favorable tax rates. Similar to comparisons regarding location and market size, foreign investors normally compare tax burdens in different locations. It should be noted that a low tax burden alone cannot compensate for a largely weak or unattractive FDI environment. However, tax incentives can be a major factor in investment location decisions for some foreign investors, especially, export-oriented companies.

Employees of companies incorporated in Myanmar and established under the foreign investment law are treated as residents and their income is taxed at a rate of 25%. Commercial tax is payable on goods that are imported or produced in Myanmar as well as trading sales and services. Recently, as the next step to promote and invite FDI, the current government is preparing many incentive schemes and policies to attract multi-national enterprises with promulgation of a new foreign investment law established in October 2016. Under the new Foreign Investment Law, the government will give income tax exemptions in designated zones. Zone 1 is the least developed region and will have an exemption for seven years. Zone 2 is a moderately developed region and will have an exemption for five years. Zone 3 is an adequately developed region and will have an exemption for three years. The government may also allow more favorable exemptions and relief for locations where Myanmar citizen-owned businesses are operated or for other investor economic activities.

4.7. Trade Policy Issues

Appropriate trade policies are not only predictable, consistent and transparent, but lower the risks for investors, which is particularly important for foreign firms. Empirical researchers point out that if trade policies are unpredictable, FDI will be lower. Another problem is trade-related infrastructure shortages for exports. These trade facilitation challenges are compounded by broad investment climate weaknesses, especially those affecting small to medium size businesses and entrepreneurs, with difficulties in access to finance to support export-oriented activities and capacity challenges in trade promotion institutions.

The previous government enacted the New Export and Import Law of September 2012, aiming to align Myanmar's trade policy with international rules and regulations, as well as promoting trade facilitation. Concerning the trade facilitation measures, the Ministry of Commerce is responsible for monitoring export and import license applications. However, the institutional, infrastructure and capacity challenges mentioned earlier are key impediments to Myanmar benefitting from trade development schemes, such as the Generalized System of Preferences (GSP) benefits reissued by the EU in July 2013 and the US in 2016. Since 2012, many of the previous trade sanctions have been lifted. An important trade policy and export promotion strategy was launched in March 2015 called NEX 2015-19, which was created in cooperation with the World Trade Organization. It is a road map to supporting workable, diversified economic development through trade. In line with this policy, the government started a 12-point economic strategy in July 2016 and set its trade policy objectives.

V. Policy Implications

Recently, a new trend in FDI of shifting investments from the natural resource and energy sectors to the manufacturing sector has improved FDI growth, but Myanmar's FDI is still not on a level comparable to neighboring countries. Inward FDI stock in Myanmar is much lower than that of neighboring countries. Some authors point out that if Myanmar chooses the right national development strategy, enhances open trade and investment strategies and learns from economies with similar experiences, the country can catch up to its neighbors and partners in the region. Some economic experts point out that government promotions to attract FDI are irrespective of the realization of an investment boom in the country. Facilitating labor intensive manufacturing and the accompanying support service activities would further raise trade, investment and income-earning opportunities as well as attract further foreign investment critical to transforming Myanmar’s economy. Likewise, the country’ success in getting the benefits from foreign direct investment will allow infrastructure development and better institutions through trade and investment liberalization.

Although the government is supporting value-added activities, exports continue to be heavily concentrated in raw materials such as natural gas, gems and other minerals with much of the incoming investment going to these areas in recent years. However, the government transactions rules and regulations have some weakness. Domestic reforms are necessary to build international confidence in the growth of commercial and investment ties with Myanmar and to lift the country’s trade and growth potential. Recent economic, political and social restructuring changes offer better reasons for investment since the party led by Daw Aung San Suu Kyi gained power in 2016. Effective public investment, policy-making and power sharing are fundamental to sustainable trade-oriented growth, the development of the capacities and welfare of Myanmar’s people and the peace and political settlement necessary to sustain growth in the long term.

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