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Preparing Myanmar's garment sector for a potential suspension of EU trade preferences

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Executive summary

This policy note discusses strategies for Myanmar to prepare its garment sector for a potential suspension of the tariff-free, quota-free access to the EU market that it presently enjoys as a 'Least Developed Country' (LDC) under the EU's Generalized System of Preferences (GSP). Myanmar's tariff-free and/or quota-free access to key markets like the EU, as well as its low cost of labour, effectively compensate for numerous constraints associated with producing garments in Myanmar. Foreign-owned producers will need to be convinced that these constraints have been greatly reduced if they are to remain in Myanmar once it loses its LDC trade privileges. The story is similar for domestic-owned firms, except that it is harder for them to flee to another country; unfortunately, this means they are more likely to go out of business in this scenario.

Myanmar's garment sector has experienced considerable growth over the past decade, in large part due to the EU's reinstatement of Myanmar to its GSP. This is evident from the parallel expansion in the number of new garment exporters in the country over the same period combined with the fact that for a majority of these new companies the EU was the destination of their first shipment. Although the variety of garment products exported from Myanmar has increased over the same period, there is no indication of significant product upgrading taking place as well. However, Myanmar should adopt a cautious approach to product upgrading for the time being. The ability to produce more sophisticated goods will grow in importance as national income and wage levels rise.

An international firm's choice of where to locate its manufacturing is motivated by profit maximisation. The decision often hinges on where unit labour costs are relatively lowest. However, low wages do not automatically lead to low unit labour costs; labour productivity plays an equally important role. The empirical literature has identified a number of sector attributes which are beneficial for labour productivity. These include: a high degree of competition between firms; openness to trade; better management quality within firms; and healthy industrial relations. In addition, the minimum wage should be revised periodically based on a process of collective bargaining between firms and unions.

Bangladesh offers some useful lessons from the experiences of its own garment sector as well as the policies it has adopted to promote its garment exports. Notably, Bangladesh introduced a scheme for commercial banks to provide back-to-back letters of credit for its garment exporters, as well as bonded warehouse facilities which allow imported inputs to be cleared through customs against export orders without paying any duty. Although both Bangladesh and Myanmar are heavily reliant on raw material imports for their garment industries, it is not clear whether efforts to promote domestic textile production would be particularly advantageous for their garment exports, given the enormous economies of scale enjoyed by China in textile production. We also note that compliance is a key consideration for overseas buyers of garments in Bangladesh, and can expect it to hold similar importance in the Myanmar context as well.

In terms of anticipating the impact of a suspension, we can look to when the Myanmar garment industry previously had its privileged EU trading status revoked, in 1996. Initially, the US market served as a cushion of sorts, as Myanmar suppliers still benefitted from quota-free access to the US market for most garment products. However, the US eventually imposed sanctions on Myanmar in 2003. The effects of the 2003 sanctions were severe. While large firms were able to maintain their operations, medium-sized firms were forced to lay off much of their workforce. Factories that had parent companies in other markets (e.g. Japan, South Korea), or foreign affiliation more generally, fared considerably better than their purely domestic counterparts. Small domestic firms were the worst-hit of all.

We can only speculate on whether a similar pattern of events will play out if the EU decides to suspend Myanmar's GSP status again. However, the policy issues discussed in this note can and should be addressed as soon as possible, regardless of the EU's decision. A significant reason for this is that Myanmar is already on track to graduate from LDC status, and lose the trade preferences it receives as a result of this classification, within this decade. As such, the growth of the sector should not depend on LDC benefits even in the relatively short term.

Policy recommendations

To increase labour productivity:

1. Introduce measures to increase competition in the garment sector and enforce competition law. Studies show that increased competition can lead to higher average productivity levels.

    a. Enhance the capacity of the Myanmar Competition Commission, which is charged with enforcing the Myanmar Competition Law 2015. In addition, re-examine the decision to include government representatives in the commission's membership who are also responsible for regulating market entry.

    b. Set up an online database of Myanmar garment suppliers aimed at foreign buyers, with some facility for verified buyers to leave reviews.

2. Look into policies aimed at improving managerial capital, which may involve supplementing the National Education Strategy Policy with a skills strategy that reflects the managerial (as well as other) needs of industry in Myanmar.

3. Employers and unions should engage in collective bargaining to set the base minimum wage level. In addition, employers should agree on the structure of skill premiums above the base wage.

4. Work closely with the Confederation of Trade Unions in Myanmar to recognise and respond to grievances and in the settlement of disputes. Ensure that workers are not discriminated against for participation in a trade union.

To address specific barriers to garment exports:

5. Remove the requirement for garment manufacturers to obtain a recommendation letter or registration certificate from a relevant ministry/department in order to export (even if no export license is required).

6. Look into policy measures that can expand access to back-to-back letters of credit for Myanmar garment exporters, such as a scheme for national banks to offer these.

7. Support a transition to a bonded warehouse system for export-oriented inputs rather than the import duty drawback system which is currently in use.

8. Extend the import duty exemption available to cut-make-pack exporters to free-on-board exporters of garments as well.

To understand and address Myanmar's overall trade costs:

9. Conduct a survey to identify the most prevalent barriers to greater utilisation of trade preferences in Myanmar.

10. Improve the efficiency of customs procedures and trade infrastructure more generally.

    a. Conduct further research to identify existing customs bottlenecks.

    b. Conduct an investigation into the factors that place upward pressure on transport costs in the country.

Introduction

This policy note discusses strategies for Myanmar to prepare its garment sector for a potential suspension of the tariff-free, quota-free access to the EU market that it presently enjoys as a 'Least Developed Country' (LDC) under the EU's Generalized System of Preferences (GSP). It is important to note from the outset, however, that the discussion concerns policy issues that can and should be addressed as soon as possible, regardless of the EU's decision on this matter. A significant reason for this is that Myanmar is already on track to graduate from LDC status, and lose the trade preferences it receives as a result of this classification, within this decade. As such, the growth of the sector should not depend on LDC benefits even in the relatively short term.

As we will see, Myanmar's tariff-free and/or quota-free access to key markets like the EU, as well as its low cost of labour, effectively compensate for numerous constraints associated with producing garments in Myanmar. Foreign-owned producers will need to be convinced that these constraints have been greatly reduced if they are to remain in Myanmar once it loses its LDC trade privileges (regardless of whether it is the result of a suspension or LDC graduation). The story is similar for domestic-owned firms, except that it is harder for them to flee to another country; unfortunately, this means they are more likely to go out of business in this scenario.

Background

Since the early 2010s, Myanmar's garment sector[1] has risen to international prominence on the back of political and economic reforms and, at the same time, an easing of international sanctions. In particular, Myanmar's renewed status as a beneficiary of the EU GSP in July 2013, coupled with the expansion of Chinese investment in the sector, has allowed Myanmar garments to gain significant ground in EU markets (El-Shahat and di Canossa, 2018; Lin, 2019). Moreover, the US added Myanmar to its GSP in November 2016, under which most garment exports enjoy low tariffs – specifically, most-favoured nation (MFN) rates (EuroCham Myanmar, 2019).

As it stands, the industry is dominated by the "cut-make-pack" (CMP) pricing model, which corresponds to the bottom rung of the global garments value chain. Under CMP, all raw materials are imported, with the role of Myanmar factories restricted to assembling the products only. The CMP model results in the Myanmar factory retaining only a small share of the product's value. In addition, these factories are at risk of being replaced by manufacturers in other low-cost countries. The next step up the chain is the "free-on-board" (FOB) system, under which the Myanmar factory is responsible for the entire production process, including procurement of raw materials, and is therefore less easily replaced (El-Shahat and di Canossa, 2018; EuroCham Myanmar, 2019; SMART Myanmar, 2015).

Another challenge for the sector as it currently stands is that it remains beholden to overseas policymakers and their willingness to support preferential trade agreements (PTAs) with Myanmar (Freeman, 2019). This represents a glaring source of vulnerability – one that was brought to public attention when the EU announced in October 2018 that it is considering a suspension of Myanmar's status as a beneficiary of the bloc's 'Everything But Arms' (EBA) initiative – part of its GSP – under which Myanmar enjoys tariff-free and quota-free access to EU markets for all sectors but arms. Such a move has the potential to stifle the growth potential of Myanmar's garment industry and cause considerable job losses (Lwin, 2018). It is important to note that Myanmar's garment sector has experienced withdrawals of trade preferences in the past. Notably, the EU suspended Myanmar's GSP status in 1996 and the US imposed trade sanctions in 2003 (Freeman, 2019).

More recently, the COVID-19 pandemic has caused severe disruption to Myanmar's garment sector, through both demand and supply-side shocks (e.g. cancellations of EU orders and difficulty obtaining inputs from China, respectively). However, there are early indications that this is a temporary blow, as reports emerge of previously cancelled orders being revived again along with continuing investor interest in the sector (Htwe, 2020). A 2020 Fitch Solutions report predicts a return to strong growth in the sector (Liu, 2020).

Indeed, there are good reasons to remain optimistic about the future of Myanmar's garment industry. Notable among these is the ongoing US-China trade war. Newly imposed tariffs as a result of the trade

[1] For the purposes of this note, the garment sector corresponds to the two-digit HS codes 61 and 62.

war have served to accelerate an already-ongoing shift in low-cost garment manufacturing out of China (EuroCham Myanmar, 2019; Liu, 2020). Myanmar – with its low cost of labour, favourable market access (notably, EU GSP) and ability to manufacture relatively more complex garments compared with other countries in the region – is well-placed to attract these businesses.

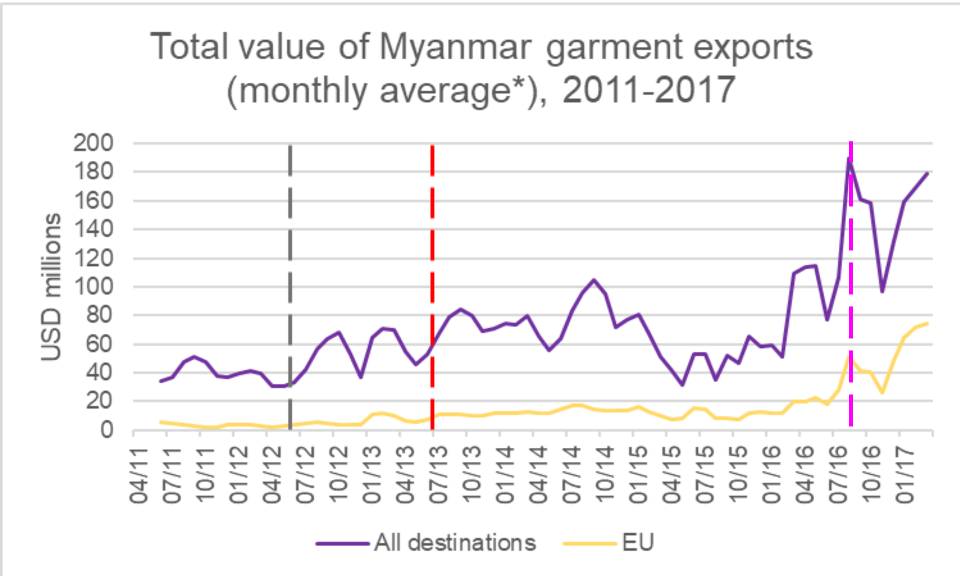
Structure

We start with an overview of the main trends in Myanmar garment exports up until 2017/2018[2]. This is followed by discussions regarding the regional competitiveness of the sector and the domestic policy context. We then take stock with a SWOT analysis of the sector, before homing in on the threat of a suspension of Myanmar's EU GSP status. We conclude with policy recommendations.

Trends in Myanmar garment exports

The rapid growth of Myanmar garment exports over the past decade is clear from Figure 1, which marks out the points at which Myanmar regained its preferential trading status with the EU and the US. These developments contributed to garment export revenues reaching USD 534 million in the first quarter of 2017, of which USD 223.2 million can be attributed to exports to EU markets. Figure 2 depicts a simultaneous increase in the proportion of garment shipments to the EU. The upward trend in exports to EU destinations also, for the most part, extends to CMP sectors other than garments, as can be seen in Table 1.

Figure 1

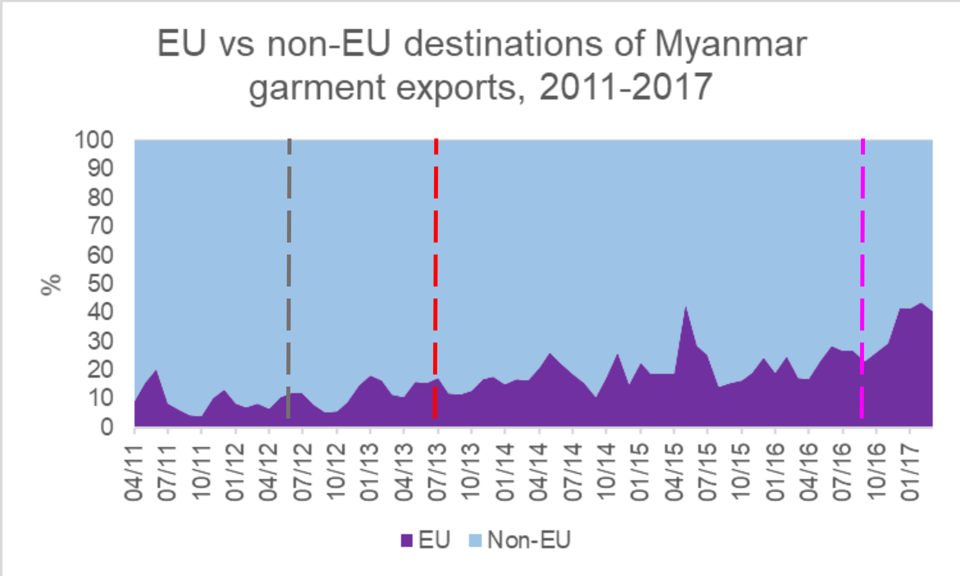


Source: Author's representation using data from the Department of Trade.

Notes: * refers to a three-month moving average. The red line marks the month that the EU reinstated its GSP for Myanmar. The grey line marks the month from which the EU GSP took retroactive effect. The pink line marks the month that the US reinstated its GSP for Myanmar.

[2] We do not have access to transaction-level export data beyond this period.

Figure 2



Source: Author's representation using data from the Department of Trade.

Notes: The red line marks the month that the EU reinstated its GSP for Myanmar. The grey line marks the month from which the EU GSP took retroactive effect. The pink line marks the month that the US reinstated its GSP for Myanmar.

Table 1: Value of CMP Exports to the EU (USD millions), 2016-2018

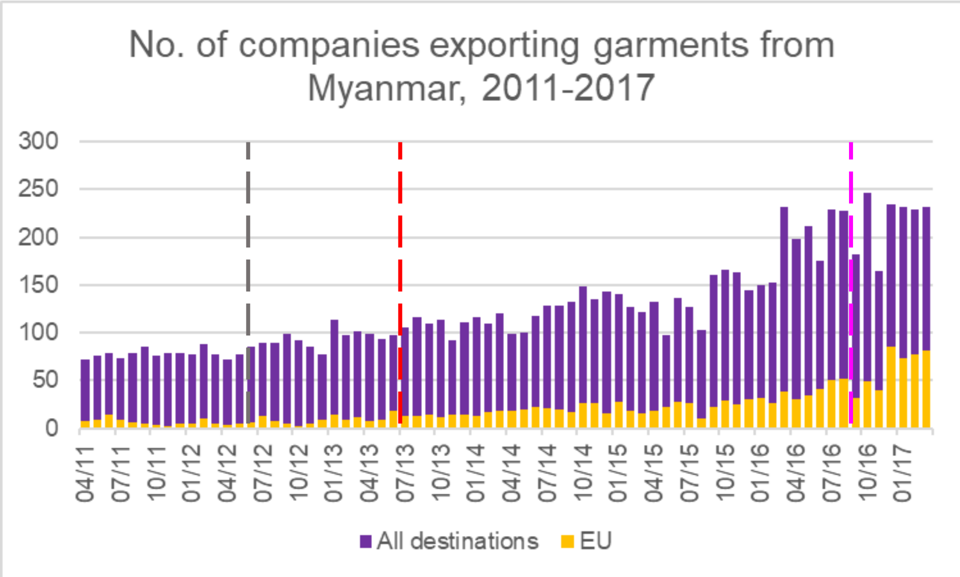
Product	2016/2017	2017/2018	2018*
Bags	6.52	17.11	17.32
Cameras and related accessories	8.36	16.86	7.61
Electronic devices and related accessories	0.90	1.02	1.60
Fish and fish products	0.00	0.00	0.02
Other marine products	0.00	0.00	0.00
Footwear	39.92	77.81	58.75
Garments	493.49	1038.57	988.30
Gloves	0.36	2.58	2.34
Hats	2.79	2.81	2.66
Others	22.72	10.67	8.13

Source: Author's representation using data from the Department of Trade.

Notes: * indicates that the data covers April to September only.

A parallel expansion is observed in the number of companies exporting garments, with an increase in the number of companies serving EU markets in particular (see Figure 3). Myanmar's reinstatement into the EU's GSP appears to have attracted many of these new entrants; 77.8% of the first shipments of these new companies were to the EU. The average size of garment factories has also increased over this period, with an average of 750 employees in 2016, up from 400 in 2014, and this appears to be related to increases in foreign ownership as well as the number of firms engaged in export, as both characteristics are found to be associated with larger firm size (El-Shahat and di Canossa, 2018).

Figure 3



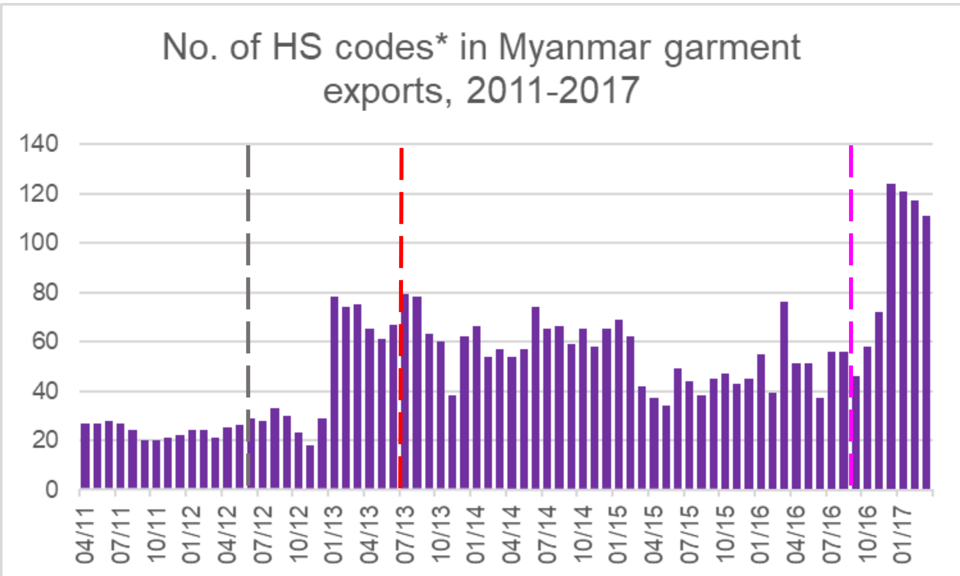
Source: Author's representation using data from the Department of Trade.

Notes: The red line marks the month that the EU reinstated its GSP for Myanmar. The grey line marks the month from which the EU GSP took retroactive effect. The pink line marks the month that the US reinstated its GSP for Myanmar.

Product diversification and complexity

This past decade has also seen a dramatic increase in the number of different garment products that are exported from Myanmar, as depicted in Figure 4. A staggering 89.6% of first shipments of these new HS codes were to an EU destination. However, there is no indication that Myanmar garment exports have increased in average complexity over the same period (see Figure 5). The complexity of a product captures the variety and level of knowhow required to produce it (Center for International Development, 2019).

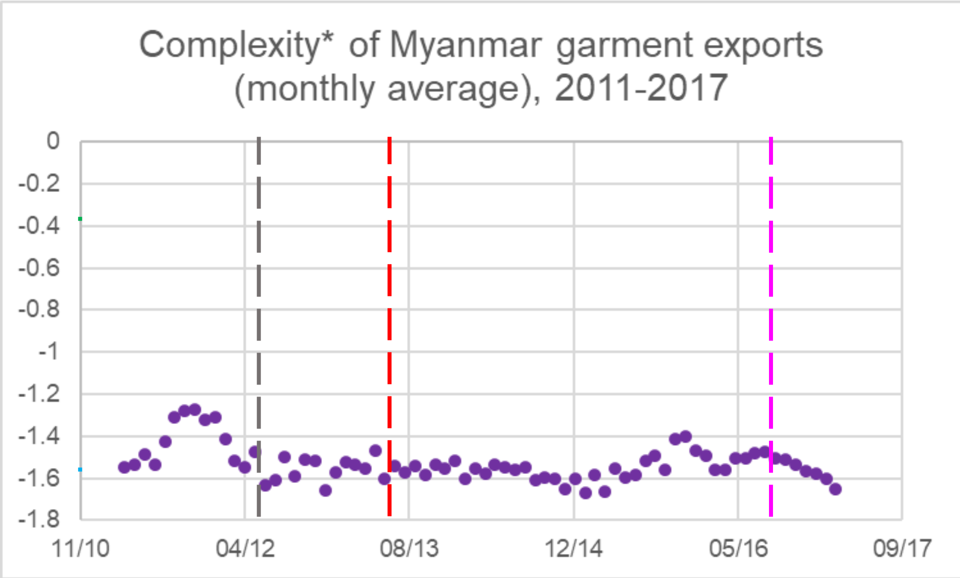
Figure 4



Source: Author's representation using data from the Department of Trade.

Notes: * refers to HS6 codes. The red line marks the month that the EU reinstated its GSP for Myanmar. The grey line marks the month from which the EU GSP took retroactive effect. The pink line marks the month that the US reinstated its GSP for Myanmar.

Figure 5

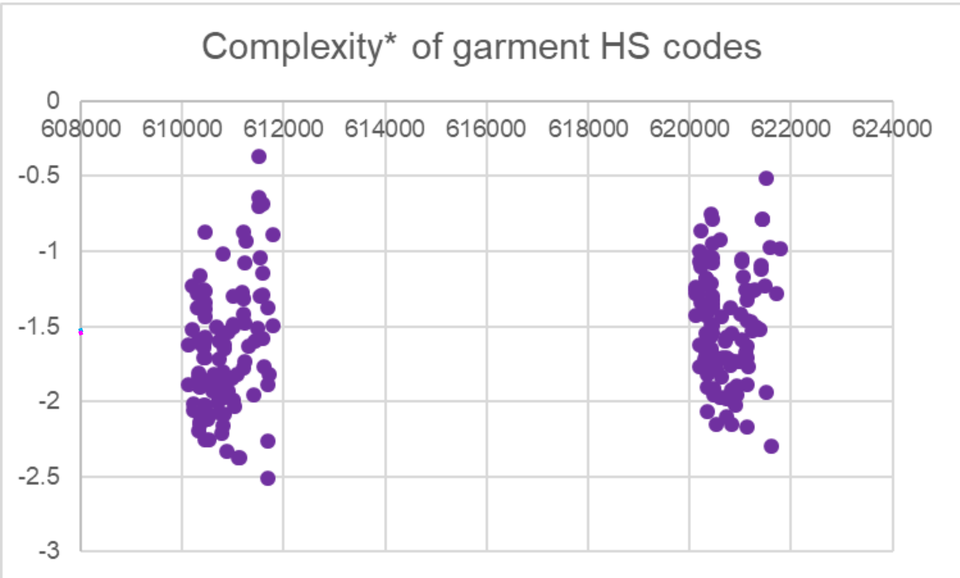


Sources: Author's representation using data from the Department of Trade and The Observatory of Economic Complexity.

Notes: * refers to the 2017 Product Complexity Index for HS6 codes. The dashed red line marks the month that the EU reinstated its GSP for Myanmar. The dashed grey line marks the month from which the EU GSP took retroactive effect. The dashed pink line marks the month that the US reinstated its GSP for Myanmar. The solid blue line represents the average complexity of all garment HS6 codes. The solid green line corresponds to the most complex garment product.

There is, in principle, scope for Myanmar to produce more complex garment products ("product upgrading"). Figure 6 depicts a scatterplot of product complexity for garment HS codes, with both the Myanmar and overall average scores marked out for reference. It is clear that there are several products (both 61 and 62 codes) with complexity scores above the Myanmar average that could potentially be produced, or in greater quantities where they are already produced, in the country.

Figure 6



Sources: Author's representation using data from the Department of Trade and The Observatory of Economic Complexity.

Notes: * refers to the 2017 Product Complexity Index for HS6 codes. The pink line represents the average complexity of all garment HS6 codes. The blue line corresponds to the average complexity of Myanmar garment exports.

Product complexity can have implications for sector resilience, as complex goods tend to be less substitutable and firms that produce them may experience less volatility as a result (Maggioni et al., 2016). This argument suggests that Myanmar could attempt to shift its garment production towards more complex items in order to reduce the vulnerability of the sector, since there are fewer countries where these items are produced and, therefore, buyers can source from in the event of Myanmar being suspended or graduating from its trade privileges.

However, as noted by Woodruff (2014), mistakes tend to be punished more harshly when a product is relatively more complex to produce. In particular, labour efficiency may take on even greater importance in complex manufacturing involving capital-intensive processes, as that efficiency is also leveraged with capital. Relatedly, product quality tends to be more sensitive to mistakes at higher levels of complexity – for example, the consequences of faulty wiring in a piece of machinery are likely to be more severe than those of a loose button on a single piece of clothing. As such, Myanmar should adopt a cautious approach to product upgrading for the time being. Based on China's experience, the ability to produce more sophisticated goods will grow in importance as national income and wage levels rise (and, as a consequence, manufacturers of less complex goods are priced out of the international market).

Regional competitiveness

An international firm's choice of where to locate its manufacturing is driven by the desire to maximise profits. In particular, the decision often hinges on where unit labour costs are relatively lowest. As capital is more internationally mobile than labour, the cost of raising capital locally is typically less of a consideration. Likewise, the cost of land, although it may be significant, tends to contribute less than labour to the overall cost of manufacturing (Lipschitz and Schadler, 2019). As such, unit labour costs are an important metric for assessing Myanmar's relative competitiveness as a garment manufacturing hub.

The following equation breaks down a country's unit labour cost into its components:

$$ULC = \frac{W}{PROD}$$

where W is the hourly wage rate and $PROD$ is the amount of output produced by each worker per hour (i.e. labour productivity).

From the above, it is clear that low wages do not automatically lead to low unit labour costs and that labour productivity plays an equally important role. In terms of what determines labour productivity, a range of factors, typically encapsulated by the term "total factor productivity" (TFP), are likely to contribute. Table 2 lists determinants of TFP that empirical research is in agreement on and which Myanmar policymakers should be aware of. Some proposed determinants of productivity, such as the level of human capital, have produced conflicting evidence so far. These have been left out of Table 2, along with determinants of productivity at the level of an individual firm that do not call for government intervention (e.g. incentive pay and human resource management practices more generally).

Table 2: Policy Implications of Determinants of TFP

Determinant of TFP	Evidence	Policy implications
Competition	Syverson (2004) finds that the level of competition between US concrete producers is strongly associated with higher levels of average productivity. The geographical density of concrete producers is used as an indicator of the level of competition, given the homogenous nature of the product. Syverson (2007) observes that this effect leads to lower average prices as well.	These studies suggest that measures to increase competition in Myanmar's garment sector may lead to higher productivity and, by extension, lower unit labour costs. This would serve to at least partly offset the cost increase associated with a loss of trade preferences.

Trade	As noted by Syverson (2011), there is strong evidence that international trade subjects domestic firms to more intense competition and can result in a "weeding out" of less productive firms.	Remove the requirement for garment manufacturers to obtain a recommendation letter or registration certificate from a relevant ministry/department in order to export (even if no export license is required). Although safeguarding the reputation of Myanmar's garment sector can be seen as a responsibility of the state, removing these barriers is unlikely to lead to entrant firms exporting lower-quality output. The reason is that, similar to Macchiavello and Morjaria (2015), incumbent firms in these markets are likely to have longstanding relationships with foreign buyers, and so they should not see their reputation significantly affected. Instead, in order to bolster the reputation of the sector, the government could consider setting up an online platform for verified buyers to give feedback on their purchases from Myanmar exporters. This would address the problem of information asymmetry, which can lead to degeneration in product quality (Akerlof, 1970).
Management quality	Bloom et al. (2013) find that the adoption of modern management practices by Indian textile firms leads to a 17% average increase in productivity and corresponding increases in profitability within the first year. These effects turned out to be persistent when a follow-up study was conducted eight years later (Bloom et al., 2018). Bloom and Van Reenen (2007) observe similar results in a set of developed economies, and also note that poor management practices tend to be more prevalent in markets that are less competitive and in family-owned firms where ownership is passed down to the eldest son. Another recent study (Adhvaryu, Kala and Nishadham, 2016) suggests that good managers are better able to deal with shocks to worker productivity.	Policy interventions aimed at promoting modern management practices are potentially very cost-effective. These can include policies to increase competition and improve the rule of law. Such policies, by increasing the risk of being forced out of the market for poorly managed firms, are likely to incentivise better management. Policies aimed at improving managerial capital should also be considered.
Labour relations	Krueger and Mas (2004) show that a period of labour strife affecting a tire factory in Illinois contributed to a higher incidence of defective tires being produced. Mas (2008) finds evidence of reduced quality of production in facilities manufacturing construction equipment where workers were affected by an extended contract dispute. Quality can be thought of as a part of revenue-based productivity, so these	Supporting unionisation both in general as well as specifically to promote worker participation in wage-setting, responding to grievances and the settlement of disputes is likely to improve revenue-based productivity.

	studies suggest that labour unrest can have a negative impact on TFP.	

Sources: Adhvaryu, Kala and Nishadham (2016); Akerlof (1970); Bloom and Van Reenen (2007); Bloom et al. (2013); Bloom et al. (2018); Krueger and Mas (2004); Macchiavello and Morjaria (2015); Mas (2008); Syverson (2004); Syverson (2007); Syverson (2011)

Naturally, we would expect productivity to evolve over time and also for inflation to occur. These are both factors which affect the profitability and, therefore, regional competitiveness of a sector. Many countries use minimum wage legislation to ensure workers receive decent pay. However, as there is a trade-off between higher pay and profitability, the minimum wage can also be used to influence firms' profits. In fact, to keep the rate of profit similar over time in spite of changes in productivity and inflation, the minimum wage should be revised periodically to reflect nominal labour productivity, as captured by nominal GDP per worker. The fact that this is a nominal measure allows us to account for inflation and not just (real) productivity. We can expect a minimum wage that is roughly proportional to labour productivity to emerge from a process of collective bargaining between firms and unions.

PTAs also play an important role in determining a country's relative competitiveness as a supplier of garments. To see this, consider the following. Suppose it costs more to ship a garment from producer country A to consumer market C than it does from producer country B, because country B enjoys a PTA with country C exempting import tariffs. For the country A producer to secure orders from the country C consumer, this additional cost would need to be absorbed in some way by the country A producer, such as by accepting a lower contract price, thus reducing his/her profit margin. As a result, garment manufacturers would prefer to locate in country B rather than country A, expecting a higher return on their investment there, all other things being equal.

With that being said, tariffs are just one of the many costs of trading internationally; there are a number of less-visible trade costs that are also important for Myanmar's attractiveness as a hub for garment exports. We discuss some of these issues on p. 11.

Case study: Comparisons with Bangladesh

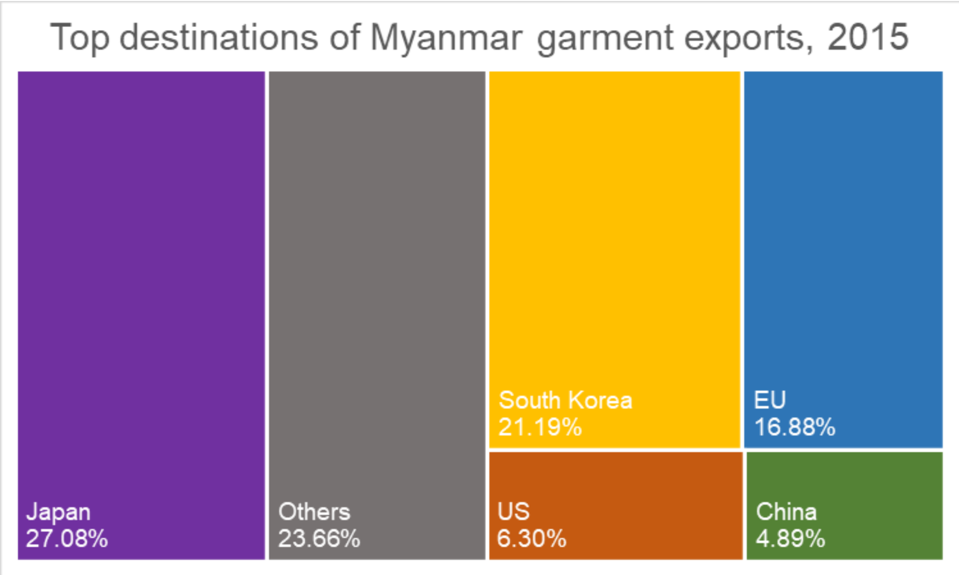
Myanmar faces stiff competition from its neighbour Bangladesh in exporting garments to the EU. For comparison, Bangladesh exported USD 17.9 billion in clothing to the EU in 2019, whereas Myanmar exported USD 2.7 billion in clothing to the EU in the same year (European Commission, 2020a; European Commission, 2020b).[3] As per Figures 7 and 8, EU markets accounted for 16.9% of Myanmar garments exports in 2015[4], compared with 57.4% in the case of Bangladesh. Note that Bangladesh also benefits from tariff-free access to the EU.

When Bangladesh's garment industry first rapidly expanded, in the 1970s and 1980s, it attracted foreign investment because of its unused quota under the Multi Fibre Arrangement[5].[6] At the same time, domestic investment was encouraged through the introduction of two particularly helpful export

[3] We define "clothing" in this context using the Standard International Trade Classification.
[4] Which is the most recent year for which we have this information.
[5] The Multi Fibre Arrangement governed world trade in textiles and garments from 1974 to 1995. Under this framework, countries were allowed to, either unilaterally or bilaterally, impose quotas on textile and garment imports that were considered damaging to their domestic industries (World Trade Organization, 2020b).
[6] Myanmar enjoyed a similar advantage under this framework, as it received no quotas from the EU and the US only imposed quotas on six woven items (Kudo, 2008).

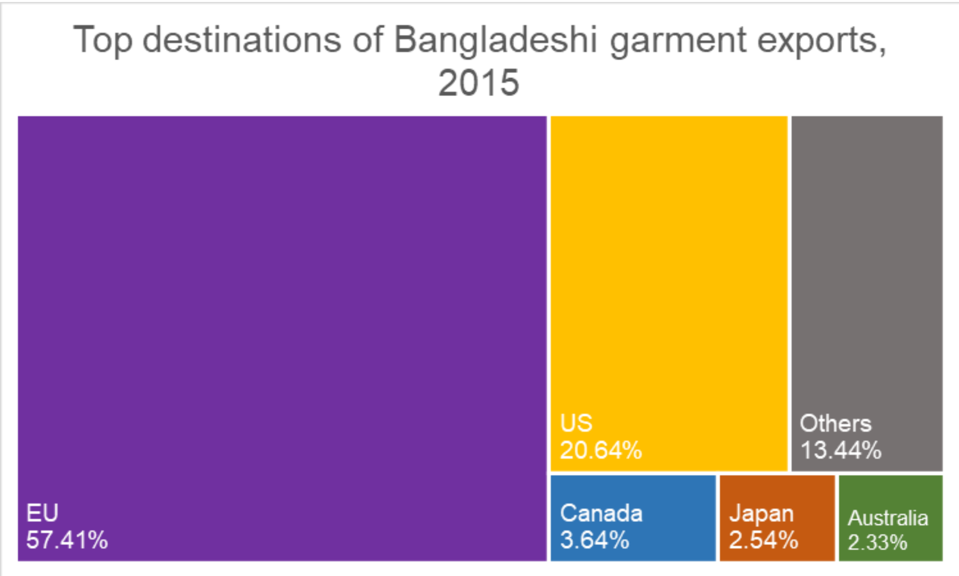
promotion policies. The first was a scheme for commercial banks to provide back-to-back letters of credit. The second was the provision of bonded warehouse facilities which allowed imported inputs to be cleared through customs against export orders without paying any duty (Yunus and Yamagata, 2012).

Figure 7



Source: Author’s representation using data from the Department of Trade.

Figure 8



Source: Author’s representation using data from the World Bank.

Note: Garments are represented by the ‘Textiles and Clothing’ product category used in the World Integrated Trade Solution database.

The range of trade financing options available in Myanmar has been improved by recent measures that allow foreign banks in the country to provide trade finance (Aung, 2018). However, back-to-back letters of credit are still not offered by national banks in Myanmar (International Finance Corporation, 2020). On the bonded warehouse front, steps are being taken in Myanmar to institute such a system, which should gradually replace the duty drawback system that Myanmar currently has in place (Myanmar Times, 2019).

In both Myanmar as well as Bangladesh, there remains a dependence on imported raw materials for garment manufacturing. This is not ideal in that it increases lead times for suppliers and also subjects them to currency risk. However, as noted by El-Shahat and di Canossa (2018), sufficiently developing the native textile industry to overcome this dependence is both time and capital intensive. It is also not clear whether efforts to promote Myanmar's textile industry would enable it to compete with the likes of China, which enjoys enormous economies of scale in textile production.

Reportedly, Myanmar's many years of experience exporting garments to Japan and Korea have conferred to it relatively high levels of workmanship and the ability to manufacture somewhat more complex products than its regional competitors (Centre for the Promotion of Imports from developing countries, 2018; Myanmar Garment Manufacturers Association, 2019).[7] Moreover, Myanmar enjoys the lowest cost of labour in the region – either on par with or lower than that of Bangladesh (Liu, 2020). These factors, in combination, suggest that Myanmar's unit labour costs are likely to be low. Nevertheless, the country should remain wary of losing any such advantage.

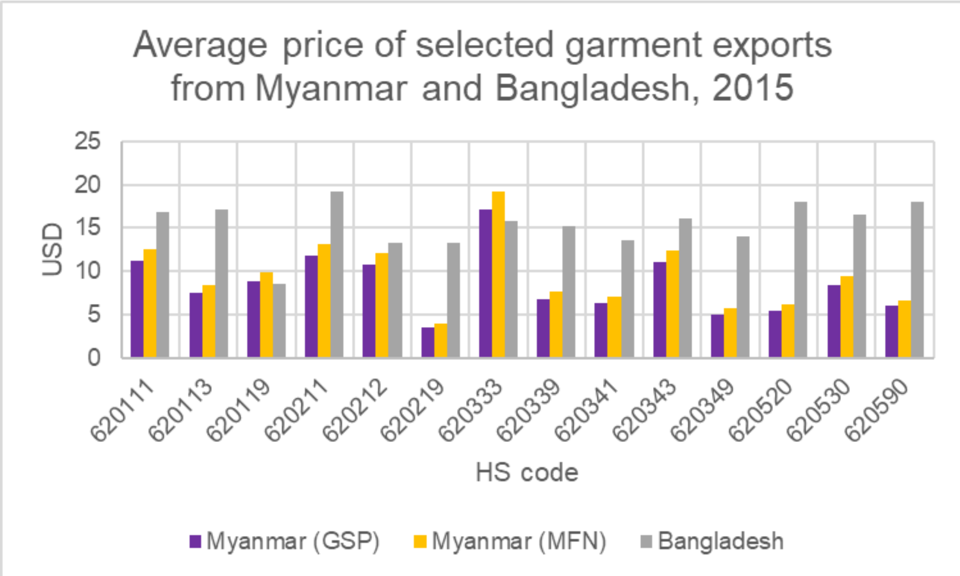
It is important to note that violations of labour rights conventions, including freedom of association and the right to organise, are grounds for a country's suspension from the EU's GSP scheme. As such, there is a strong case for supporting and encouraging unionisation, as well as healthy industrial relations more generally, in Myanmar, in order to manage this risk and, in so doing, avoid attracting tariffs on Myanmar exports to the EU. Refer to Table 2 for some empirical evidence that suggests industrial relations are also important for productivity, which is another cost-reducing factor. Furthermore, it should be assumed that reputational risks such as these can be a critical consideration in international buyers' decisions to source from one country over another. Indeed, a 2011 McKinsey survey of Western buyers of Bangladeshi garments found compliance to be their second-biggest concern when sourcing from the country.

Furthermore, Myanmar's continued status as a beneficiary of PTAs such as the EU GSP may be critical for its garment industry to remain competitive and yet profitable. Data from 2015[8] shows that the country benefits from lower prices than Bangladesh for a number of its main garment export items to the EU. This can be seen from Figure 9, which compares average price levels for major garment export items[9]. A suspension of Myanmar's EU GSP status could result in the country losing such an advantage, as Myanmar exporters would go from facing zero to MFN tariffs. Although this is not the case for any of the items in Figure 9 for which Myanmar enjoyed a price advantage over Bangladesh to begin with, the risk of this scenario remains and, bearing in mind that Figure 9 depicts price levels in 2015, may even be higher today. It is, however, worth noting that Bangladesh is in the same situation as Myanmar with respect to its prospects for graduation from LDC status and thus may lose its privileges under the EBA scheme as early as 2027 (UN DESA, 2020)

Also suggesting that GSP privileges offer some critical advantage to Myanmar suppliers, one study found that 46% of a non-representative sample of 69 garment firms in the country reported making use of some form of GSP, with the majority of these being foreign-owned (Lin et al., 2018). That is not to suggest that firms that currently do not make use of a GSP scheme do not stand to gain from doing so, as underutilisation of trade preferences can arise due to any number of reasons, including rules of origin requirements, the administrative costs of using these channels or just a lack of information.[10] A survey of Myanmar exporters to identify the most common barriers to utilisation of trade preferences may be helpful for designing policies to increase uptake in these instances.

[7] Though, of course, with scope for manufacturing products that are even more complex, as seen in Figure 6.
[8] Which is the most recent year for which we have this information.
[9] For which data is available.
[10] Myanmar currently receives preferential market access under the following PTAs: ASEAN and ASEAN+1 agreements; GSP schemes (Australia, Belarus, Canada, the EU, Iceland, Japan, New Zealand, Norway, Russia, Switzerland and the US); South Korea's preferential tariff system; India's Duty Free Tariff Preference Scheme; and China's duty-free, quota-free scheme (Thu, 2016).

Figure 9



Source: Author's representation using data from the UN and the World Trade Organization.
Note: Refer to the Appendix for product descriptions corresponding to these HS codes.

Improving the efficiency of customs procedures and trade infrastructure more generally should be seen as being just as important for the country's overall competitiveness as its access to trade privileges. Myanmar exporters presently incur significant unobserved costs in the form of lengthy waiting times for accessing containers and customs clearance, with 42% and 29%, respectively, of garment firms in one survey citing these issues as the main challenge when exporting from Myanmar (Lin et al., 2018). This is consistent with the findings of Khandelwal and Teachout (2016), who use a gravity model to demonstrate that Myanmar has significantly higher unobserved trade costs than its neighbouring countries, including Bangladesh.[11] In addition to waiting times, high transport costs may be a significant contributor to these unobserved costs. However, this would be a topic that requires further research before specific policy recommendations can be made.[12]

The domestic policy context

A number of policy developments over the past several years have improved Myanmar's attractiveness as a hub for CMP exports (see Box 1).

Box 1: Relevant policy developments over the past five years

The Myanmar Investment Law 2016 was introduced. Notable policies promulgated under this law include the following:

- A foreign investor is allowed to conduct business in Myanmar as a: (1) 100% foreign-owned entity in permitted sectors, including garments; and (2) a joint venture with foreign, local or government entities.
- Tax incentives are granted for investments in promoted subsectors, of which many fall under the garments sector.

[11] Although Bangladesh is also found to have above-average unobserved trade costs (Khandelwal and Teachout, 2016).
[12] In particular, we would need to estimate the extent to which transport costs are actually high in Myanmar and then understand what the primary causes of the high costs are. We would see a need for different policies depending on the causes we identify. For example, market deregulation may be the answer if the transport sector turns out to be heavily cartelised but not so if the root of the problem is low-quality roads.

The Myanmar Companies Law 2017 was introduced. Notable policies promulgated under this law include the following:

- Companies can be registered online through Myanmar Companies Online, reducing red tape for new businesses.
- A company is still regarded as a “Myanmar company” if its foreign shareholdings are less than 35%, in which case notification to the Directorate of Investment and Company Administration (DICA) is not required.

Policy developments pertaining to labour include the following:

- Enactment of the Payment of Wages Act 2016, which ensures that wages are paid regularly and specifies the conditions under which lawful deductions can be made.
- In May 2018, the daily minimum wage was revised from MMK 3,600 to MMK 4,800. A new revision is due to occur in 2020.
- In September 2018, Myanmar signed a memorandum of understanding with the International Labour Organization for implementing its first Decent Work Country Programme for the period 2018-2022.
- Enactment of the Occupational Safety and Health Law 2019, which holds factories legally responsible for ensuring a range of health and safety as well as welfare measures.

Sources: EuroCham Myanmar (2019); Larive International (2018); SMART Myanmar (2020)

Box 2: The investment approval process in Myanmar

The Myanmar Investment Law 2016 has simplified the procedure for foreign investment in Myanmar. Under this law, certain categories of investment require a Myanmar Investment Commission (MIC) permit. Investments that do not fall in this category but seek the right to use land and/or any reliefs or exemptions also require an investment endorsement, from the MIC or a state/region investment committee. MIC, rather than region/state investment committee, endorsement is required for investments of more than USD 5 million as well as for any that need ministerial approval.

The following table outlines the process for obtaining an investment approval.

Step	MIC permit	MIC endorsement	Region/state investment committee endorsement
1	Seek information from DICA	Seek information from DICA	Seek information from DICA
2	Buy, fill in and submit Form (2) to DICA	Buy, fill in and submit Form (4-A) to DICA	Buy, fill in and submit Form (4-B) to region/state DICA office
3	Attend Proposal Assessment Team meeting and give presentation	Review by DICA	Review by region/state DICA office
4	Attend MIC meeting and give presentation	Review by MIC	Attend region/state investment committee meeting and give presentation
5	Receive decision and, if approved, pick up permit	Receive decision and, if approved, pick up endorsement	Receive decision and, if approved, pick up endorsement

Source: Directorate of Investment and Company Administration (2018)

<u>Sector strategies</u>

The two main strategic frameworks guiding the development of Myanmar's garment sector are the National Export Strategy (NES) of the Ministry of Commerce, and the 10-year roadmap of the Myanmar Garment Manufacturers Association (MGMA).

Box 3: The 2015-2019 NES for textiles and garments

The NES for textiles and garments stresses job creation and economic development, and is essentially composed of five strategic objectives:

1. Production mode: The transition from the CMP mode of manufacturing to the FOB mode, for greater profitability.
2. Volume: The ramping up of production volume for the current portfolio of exported products, for sector growth and higher firm revenues.
3. Quality: Establishment of industry-wide quality standards and their attainment by a large majority of the sector's firms, for higher margins and access to more markets.
4. Knit products: Development of capacity for production of knit garments, for access to more markets and value chain development.
5. Design: Development of design capacity, for higher margins and value chain development.

Source: Ministry of Commerce (2015)

Box 4: The MGMA's 2015-2024 sector strategy

With a stated ambition of becoming Myanmar's highest revenue-earning industry, and one that can assure its workers a high quality of life, the MGMA orients its sector strategy around six objectives:

1. Improve the competitive advantage of the Myanmar garment industry
2. Ensure that full social compliance and social dialogue is practised at all levels of the industry
3. Build an apparel training sector that supports the industry as it develops
4. To build the image, position and brand of the Myanmar garment industry
5. To inform policy change which improves the enabling environment for positive sustainable growth of the textile and garment sector
6. Increase the service potential of trade associations

Source: Myanmar Garment Manufacturers Association (2015)

SWOT analysis

We can summarise the main strengths, weaknesses, opportunities and threats pertaining to Myanmar's garment sector as follows.

Strengths	Weaknesses	Opportunities	Threats
LDC status and related preferntial access to major markets (e.g. EU, US)	Dominance of the CMP pricing model (only a small share of the product value goes to the Myanmar factory)	Strong investor interest and potential to attract low-cost garment manufacturing from China (including in the context of the US-China trade war)	Potential suspensions and/or graduation from trade preferences
Low cost of labour compared with regional competitors	Relatively high incidence of disruptive industrial disputes	Potential for greater utilisation of trade preferences	Reliance on imported raw materials exposes the country to global supply chain shocks (as during the COVID-19 pandemic)
High levels of workmanship and ability to manufacture relatively complex garment items compared with regional competitors	Red tape associated with export and import license regime and generally high unobserved trade costs	Graduation from LDC status may be an opportunity for the garment sector to continue growth if enough constraints are addressed	Any medium to long-term negative implications of the COVID-19 shock
A number of investment-friendly policies (e.g. 100% foreign ownership, online company registration)	A shortage of experienced domestic managers		Potential for political volatility and/or social unrest
Occupational Safety and Health Law 2019 shows the government takes compliance seriously (enforcement will be key)			

The potential impact of a suspension of EU GSP

According to the Myanmar Garment Manufacturers Association (2019), when the Myanmar garment industry had its privileged EU trading status revoked in 1996, the US market served as a cushion of sorts, as Myanmar suppliers still benefitted from quota-free access to the US market for most garment products. However, this provided only temporary respite, since Myanmar exports to the US were banned following the passing of the Burmese Freedom and Democracy Act in 2003.

The effects of the 2003 sanctions were severe. According to Kudo (2008), there was a drastic decline in the CMP charges received by Myanmar suppliers, as buyers took advantage of factories' desperation to maintain their workforce and machines. In very general terms, large firms were able to maintain their operations, while medium-sized firms were forced to lay off much of their workforce. Factories that had parent companies in other markets (e.g. Japan, South Korea), or foreign affiliation more generally, fared considerably better than their purely domestic counterparts. Small domestic firms were the worst-hit of all.

Whether we are likely to see a repeat of these patterns is uncertain, and any forecast is ultimately only as reliable as the assumptions of the underlying economic model. Notably, whether a removal of the EU GSP for Myanmar will result in dramatically lower garment export volumes will depend crucially on the sensitivity of international buyers of Myanmar garments to changes in price – a parameter known as the price elasticity of import demand. A high sensitivity of buyers to price changes would imply a more severe impact from a GSP suspension, whereas the reverse would imply a much more muted impact.

Another source of uncertainty is the extent to which Myanmar will be able to successfully divert its garment exports to other countries, which would undoubtedly soften the blow. This is far from certain. For example, assuming the EU does decide to suspend Myanmar's GSP status, there is a possibility that the US could follow suit, resulting in one less market for Myanmar's EU exporters to turn to in response to the suspension. While it is very difficult to speculate on the most likely US response at this time, it would be reasonable to expect that major Asian markets, such as Japan and South Korea, would remain open to Myanmar imports, as was the case following the 2003 sanctions. If that turns out to be the case, we may once again see smaller firms and those without parent companies in these markets going out of business.

Box 5: A case study of Cambodia's recent (partial) GSP suspension

In February 2020, the EU announced a partial withdrawal of Cambodia's trade privileges under the EU's EBA scheme, to be effective from 12 August 2020. More specifically, the EU will be withdrawing Cambodia's tariff-free access for selected products, including some garment and footwear items. The affected tariff lines correspond to roughly 20%, or EUR 1 billion, of Cambodia's annual exports to the EU. According to the EU's official statement, this decision was motivated by "[t]he duration, scale and impact of Cambodia's violations of the rights to political participation and to the freedoms of expression and association".

As the suspension has only just taken effect, we must turn to forecasts in order to assess the impact of such a move. One forecast, produced by the World Bank (2019), predicts a decline of between 8.7% to 10.4% in Cambodian garment export volumes as a result of losing tariff-free access to EU markets for all garment products (as opposed to the partial suspension that was eventually the EU's course of action). According to another set of forecasts, Cambodia's garment, textile and footwear exports could shrink by around 13.4% in the purely hypothetical scenario that no diversion of affected exports to alternative destinations is possible. In the more realistic scenario where trade diversion is possible, the estimated decline is limited to 11.8% (Talaengsatya and Varachotisate, 2019).

Source: European Commission (2020c); Talaengsatya and Varachotisate (2019); World Bank (2019)

Box 6: The implications of LDC graduation versus GSP suspension

Myanmar has already met the UN criteria for graduating from 'Least Developed Country' (LDC) status for the first time in 2018 and thus may be able to graduate as early as 2024. Once Myanmar graduates, and after a three-year transition period (i.e. not before 2027), the country would lose its tariff-free, quota-free access to the EU as well as any preferential treatment it receives from other countries by virtue of this classification.

There are two main differences between losing preferential access to the EU because of a suspension as opposed to graduating from LDC status. The first is the fact that a suspension will take effect with a much shorter transition period (most likely six months, based on Cambodia's experience) than the three-year transition period following graduation from LDC status. The second is that in the case of a suspension Myanmar would also not be eligible for the standard EU GSP, whereas in the case of a graduation it will only lose its eligibility for the EBA scheme. The difference between the EU's standard GSP and their EBA scheme is that the former assures a partial or full removal of tariffs for two-thirds of tariff lines (with the remaining tariff lines subject to MFN rates), whereas the EBA scheme guarantees zero tariffs (and no quotas) for all products except for arms and ammunitions.

Source: European Commission (2020d); UN DESA (2020)

Conclusions and policy recommendations

In a sense, Myanmar's garment sector is able to display the levels of growth we have seen in recent years because its strengths (and opportunities) outweigh its weaknesses (and threats) in the eyes of buyers and investors. For the sector to continue this trajectory, it is essential that enough of these weaknesses are addressed in the next five or so years that the loss of LDC status – a key "strength" of the sector – does not alter this view on the part of buyers and investors. To this end, we recommend exploring the following policy options. Some of these are specific policy proposals that can be taken up as soon as possible; others are general and call for further investigation before a specific policy change can be proposed. Please also note that these recommendations are equally supportive of both domestic and foreign-owned garment manufacturing in Myanmar.

To increase labour productivity:

1. Introduce measures to increase competition in the garment sector and enforce competition law. Studies show that increased competition can lead to higher average productivity levels.

a. One option is to explore measures to enhance the capacity of the Myanmar Competition Commission, which is charged with enforcing the Myanmar Competition Law 2015. In addition, the decision to include government representatives in the commission's membership who are also, in their separate duties, responsible for regulating market entry should be re-examined, as it makes the commission prone to conflicts of interest.

b. Another measure which could promote competition (and is relatively easier to implement) is to set up an online database of Myanmar garment suppliers aimed at foreign buyers, with some facility for verified buyers to leave reviews.

2. Look into policies aimed at improving managerial capital. This may involve supplementing the National Education Strategy Policy with a skills strategy that reflects the managerial (as well as other) needs of industry in Myanmar. In this context, the language skills of domestic managers should not be overlooked – managers who are proficient in Chinese as well as Myanmar are in particularly high demand in the garment sector.

3. Support and encourage both worker (union) and employer participation in wage-setting, so as to more fully account for the positive as well as potential negative impacts of raising the minimum wage. To put this into practice, employers and unions should engage in collective bargaining to set the base minimum wage level. In addition, employers should agree on the structure of skill premiums above the base wage, with the aim of stimulating higher worker productivity.[13]

4. Work closely with the Confederation of Trade Unions in Myanmar to recognise and respond to grievances and in the settlement of disputes, so as to minimise incidents of labour unrest. For this to be effective, the country's Arbitration Council needs to ensure workers are not discriminated against for participation in a trade union.

To address specific barriers to garment exports:

5. Remove the requirement for garment manufacturers to obtain a recommendation letter or registration certificate from a relevant ministry/department in order to export (even if no export license is required). This policy should be pursued in tandem with recommendation 1b above, so as to promote high-quality exports from Myanmar.

6. Look into policy measures that can expand access to back-to-back letters of credit for Myanmar garment exporters. This could take the form of a scheme for national banks to offer these.

7. Support a transition to a bonded warehouse system for export-oriented inputs rather than the import duty drawback system which is currently in use.

8. Extend the import duty exemption available to CMP exporters to FOB exporters of garments as well. The current system creates a distortion against value chain upgrading for firms that may otherwise be keen to do so.

To understand and address Myanmar's overall trade costs:

9. Conduct a survey to identify the most prevalent barriers to greater utilisation of trade preferences in Myanmar in order to design specific policies to increase utilisation.

10. Improve the efficiency of customs procedures and trade infrastructure more generally.

    a. Conduct further research to identify existing customs bottlenecks, as a first step to developing specific solutions.

[13] An ongoing IGC study has observed that the wage premiums currently received by workers who upgrade their skill levels may not be high enough to incentivise participation in off-the-job trainings, such as those provided by the MGMA.

b. Conduct an investigation into the factors that place upward pressure on transport costs in the country. This would be helpful for devising policies to reduce overall trade costs.

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Appendix: HS Codes in Figure 9

HS code	Product description
620111	Coats; men's or boys', overcoats, raincoats, car-coats, capes, cloaks and similar articles, of wool or fine animal hair, other than those of heading no. 6203 (not knitted or crocheted)
620113	Coats; men's or boys', overcoats, raincoats, car-coats, capes, cloaks and similar articles, of man-made fibres, other than those of heading no. 6203 (not knitted or crocheted)
620119	Coats; men's or boys', overcoats, raincoats, car-coats, capes, cloaks and similar articles, of textile materials (other than wool or fine animal hair, cotton or man-made fibres), other than those of heading no. 6203 (not knitted or crocheted)
620211	Coats; women's or girls', overcoats, raincoats, car-coats, capes, cloaks and similar articles, of wool or fine animal hair, other than those of heading no. 6204 (not knitted or crocheted)
620212	Coats; women's or girls', overcoats, raincoats, car-coats, capes, cloaks and similar articles, of cotton, other than those of heading no. 6204 (not knitted or crocheted)
620219	Coats; women's or girls', overcoats, raincoats, car-coats, capes, cloaks and similar articles, of textile materials (other than wool or fine animal hair, cotton or man-made fibres), other than those of heading no. 6204 (not knitted or crocheted)
620333	Jackets and blazers; men's or boys', of synthetic fibres (not knitted or crocheted)
620339	Jackets and blazers; men's or boys', of textile materials n.e.c. in item no. 6203.3 (not knitted or crocheted)
620341	Trousers, bib and brace overalls, breeches and shorts; men's or boys', of wool or fine animal hair (not knitted or crocheted)
620343	Trousers, bib and brace overalls, breeches and shorts; men's or boys', of synthetic fibres (not knitted or crocheted)
620349	Trousers, bib and brace overalls, breeches and shorts; men's or boys', of textile materials (other than wool, fine animal hair, cotton or synthetic fibres), (not knitted or crocheted)
620520	Shirts; men's or boys', of cotton (not knitted or crocheted)
620530	Shirts; men's or boys', of man-made fibres (not knitted or crocheted)
620590	Shirts; men's or boys', of textile materials n.e.c. in heading no. 6205 (not knitted or crocheted)

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