

## **Cross-cutting Issues and Organizational Arrangements for Industrialization**

In the Context of Broadening the Policy Scope in Ethiopia\*

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The policy scope of Ethiopia is expanding. In the last few years the Government of Ethiopia has studied the possibility and desirability of broadening the policy scope for industrialization, and it is now ready to put this idea into practice. The policy change will be incorporated in PASDEP 2011-2015, which is the national five-year development plan currently under preparation. The broadening of policy scope is also recommended by a number of foreign experts<sup>1</sup>.

Ethiopia's vision for industrialization is Agricultural Development Led Industrialization (ADLI). ADLI has been concretized in a series of documents such as *An Economic Development Strategy for Ethiopia* (1994), *Rural Development Policies, Strategies and Instruments* (2001), *Industrial Development Strategy* (2002), *Sustainable Development and Poverty Reduction Program* (SDPRP) 2002/03-2004/05, and *A Plan for Accelerated and Sustained Development to End Poverty* (PASDEP) 2005/06-2009/10. ADLI is an industrialization strategy in which agriculture plays a key role in preparing various conditions for full-fledged industrialization through the provision of industrial materials, consumption goods (mainly food), demand for industrial goods, labor supply, and foreign exchange. The transformation of small subsistence farming into commercial agriculture is at the center of this strategy.

ADLI shifted from the formulation stage to serious implementation around 2002-2003. In the last several years, the Government of Ethiopia has concentrated limited human and financial resources on a small number of export-oriented priority industries. These industries, such as leather and leather products, textile and garment, food processing, and floriculture, were given generous incentives and high policy attention. Among these, floriculture, which was not included in the original list of priority industries, has recorded the fastest growth in output and export, followed by leather and leather products—albeit from very low bases. Meanwhile, the results of the other two priority industries were less spectacular. The Government has also

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<sup>1</sup> Joseph Stiglitz (Columbia University), Dani Rodrik (Harvard University), and Justin Linn (World Bank chief economist) are said to have advised in this way. Among them, Rodrik's note for Ethiopia calls for the following revisions: (i) broadening policy scope to include more sectors; (ii) supporting "new" activities for Ethiopia rather than exports; (iii) recognition that mistakes are both unavoidable and necessary; (iv) broadening the list of policy instruments; (v) giving incentives and subsidies to "pioneers" only and not emulators; and (vi) enhancement of lines of communication and coordination with the private sector (Rodrik, 2008). For more on ADLI and the policy shift, see K. Ohno (2009b).

actively mobilized donor assistance for these industries in the drafting of master plans, strengthening industrial human skills, leveling up of technology, establishing research and training centers, marketing and business matching, enhancing business associations, and so on. Important tools of industrial policy, such as benchmarking, business process re-engineering (BPR), pilot projects and subsequent dissemination, and public-private partnership, have been learned and implemented. More recently, *kaizen* has been added to the policy toolkit.

In all fairness, it can be said that Ethiopia in the last several years has made good progress in early industrialization and can now take up the next round of challenges. Admittedly, past performance has not been perfect and a number of unresolved issues remain. For example, the expected emergence of competitive local firms has been slow and inter-ministerial coordination is far from effective. But the Government feels that enough has been learned about the tools, roadmaps and pitfalls of industrialization so that policy space can be enlarged as it formulates the development strategy for the next five years. More specifically, Ethiopia from now on will support not just selected export-oriented industries but also other industries that mainly supply domestic markets such as steel, cement, glass, metal processing, chemicals, and pharmaceuticals. In other words, parallel promotion of exports and import substitution is about to begin.

The GRIPS policy dialogue team strongly supports the expansion of policy scope of Ethiopia accompanied by enhanced policy capability. This is in line with Dynamic Capacity Development, the idea we put forward in another paper that internal capabilities should be selectively and strategically built up to attain concrete industrial objectives rather than generally and randomly (Ohno and Ohno, 2008). It should be emphasized that causality between policy capability and policy scope is mutual. Ethiopia can expand its policy space because its policy capability has improved but setting new policy goals in turn will require a further upgrading of policy capability.

It is in this context that the authors wish to raise some cross-cutting issues and discuss organizational arrangements in industrialization for the review of the Ethiopian authorities. Broader policy space opens up greater opportunities but it also increases the risks of miscalculation, political capture, wasted resources, and macroeconomic instability. Policy makers should be fully aware of these risks in advance and take proper precautions in charting the new policy course. We will conduct this policy dialogue primarily from the perspective of high performing East Asia where pro-active industrial policy is widely accepted and practiced. This does not mean, however, that East Asian good practices are always relevant in Ethiopia. The validity of each argument from East Asia must be carefully examined, with modifications if necessary, before applying to the Ethiopian soil.

In the formulation of industrialization strategy, the largest difference between Ethiopia and high performing East Asia—especially Southeast Asian economies—is the existence in the latter of large inflows of

manufacturing FDI which generate strong demand for quality, skills, logistics, institutions, infrastructure services, and the like, in the national economy which determines the kind of policy needed for further industrialization. But such demand for local capability by FDI firms is largely absent in Ethiopia. Export orientation does expose local industries to global competition, but export alone does not produce such strong and broad pressure for local excellence.

Below we present a number of cross-cutting issues and organizational arrangements as a checklist to stimulate discussion among policy makers. When concrete ideas and cases are offered, they are meant to be references and initial suggestions rather than final recommendations. Our discussion covers the existing export-oriented priority industries as well as the proposed import substitution industries which are located in or near the urban center. Rural industrialization, a topic of great importance in ADLI, is beyond the scope of the present paper.

**Part I. Cross-cutting Issues**

In this part, we address six issues that may become important as Ethiopia’s policy capability is raised and its policy scope is enlarged. Each issue contains a few sub-issues which are summarized in a box.

**1. Policy framework and structure**

- 1-a. Ethiopia has an industrial vision but strategy, action plan, and review remain incomplete.
- 1-b. The industrial chapter of the next PASDEP, and the five-year industrial implementation plan to be prepared by MOTI, should state clearly the direction of industrialization strategy in the next five years.
- 1-c. All three levels of industrial policy (general, responsive, pro-active) should be strengthened.

Industrialization strategy should have the layered structure that runs from general to specific and from long-term to short-term. These layers are normally called vision, strategy, and action plan. The vision is a long-term goal often expressed in a slogan such as “becoming an industrialized country by 2020” or “attaining middle income by 2025.” The strategy, also called the master plan or the roadmap, is a document that typically covers the next three to five years and contains policy principles, priority sectors, time tables, policy instruments, and so on, to give details on the road to achieve the vision. The action plan is a list or a matrix of concrete actions that must be taken typically within one to three years with clear designation of action content, performance criteria, deadlines, and responsible organizations. Furthermore, a review mechanism (“monitoring and evaluation”) must be installed to ensure implementation and facilitate necessary adjustments. Review may take various forms including commissioned reports by external experts, a high-level government committee, and formal or informal internal review by the ministry in charge.

In Ethiopia, ADLI sets the fundamental direction and the Industrial Development Strategy (2002) states key principles such as private sector initiative, export orientation, strong state guidance, and so forth, and specifies priority sectors. Together, ADLI and IDS stipulate the basics of industrialization strategy that can remain valid for a long time beyond the five-year cycle of PASDEP. These correspond to the “vision” and part of the “strategy” mentioned above. Meanwhile, industrial master plans have been compiled for the priority industries. Quality and structure of these master plans differ greatly—partly because they reflect distinct characteristics of each sector but mostly because they were commissioned to different donors with different methodologies. For action plan and review, the monthly Export Steering Committee and MOTI’s regular contacts with the business community (business associations and individual enterprises) are the instruments for monitoring implementation, identifying problems and coming up with solutions.

ADLI and IDS are comprehensive and flexible enough to accommodate most policy shifts and therefore can continue to guide industrialization for a decade or two to come. What is required additionally is the statement of policy elaborations and adjustments which become necessary every few to several years, such as the proposed introduction of import substitution, due to changing circumstances and rising policy capability. Instead of drafting an overall industrial master plan separately, we suggest that the industrial chapter of the next PASDEP and the five-year industrial implementation plan, which will be prepared by MOTI after the approval of the next PASDEP, should serve this purpose. To do this, the content of both documents must coincide, with the one being the executive summary of the other, and must be based on the discussion and agreement of all main stakeholders in advance. This means that such stakeholder meetings should be held frequently between now and the completion of the five-year implementation plan. The industrial chapter of the current PASDEP, as it is written, is not strategic enough to set the medium-term policy direction.

Over time, the master plans of priority industries should be drafted (if missing) or revised (if they already exist) by imposing minimum common orientation and minimum common structure that reflect the overall direction of ADLI, IDS and PASDEP but allowing sufficient room for the unique features of each sector<sup>2</sup>. Given the limited human and financial resource and donor support, the number of master plans should be relatively small and perhaps should not exceed ten. They should be drafted for the existing export-oriented industries as well as the proposed import substitution industries.

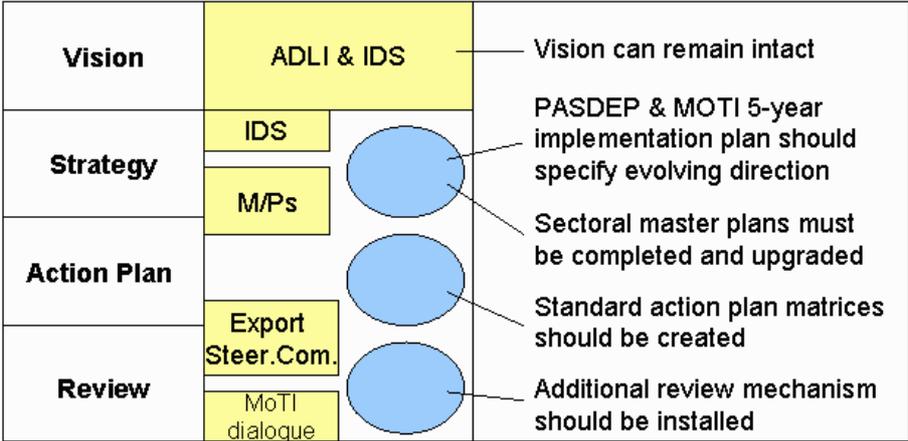
To strengthen action plans and review, the current works by the Export Steering Committee and MOTI’s regular interaction with priority industries should be supplemented by the compilation of standard action plan matrices for each priority industry which contain actions, sub-actions, performance criteria, deadlines and designation of responsible organizations. These matrices may be attached to the sectoral master plan or

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<sup>2</sup> The existing master plans for leather and leather products (assisted by UNIDO) and textile and garment (assisted by China), for example, have very different style and structure. It is suggested that the Government should be involved more deeply in the initial design of industrial master plans so the minimum level of conformity is ensured. At the same time, requiring all master plans to have the same chapter structure, as practiced in Vietnam, is going too far in imposing uniformity.

produced separately from the master plan<sup>3</sup>. Moreover, there should be a formal mechanism to regularly review and adjust the implementation of these action plan matrices. For this reason, the action plan and the review mechanism should be created simultaneously as inseparable and mutually dependent policy tools. Possible enhancement of Ethiopian industrial policy structure is summarized in Figure 1.

**Figure 1. Possible Enhancement of Industrial Policy Structure**



Industrialization strategy should properly address three aspects. The first is the establishment of a stable, transparent and business-friendly environment for domestic and foreign investors (i.e., cutting red tapes and leveling the playing field). The second is ensuring quick response to the requirements of the business community. Whenever there is a need or a problem, the government should act promptly to supply what is needed or remove what is impeding business activities. Ethiopia has already made significant progress in these two areas by implementing business process re-engineering (BPR) aggressively in every ministry and agency. However, these aspects are still basic and passive. The third aspect of industrialization strategy is the creation of dynamic comparative advantage in which pro-active policy makers generate new industrial strengths and guide investors towards new activities under close coordination with private partners (PPP) but without necessarily waiting for their move. Such pro-active anticipation and creation of dynamic comparative advantage is commonly practiced in East Asia but may remain controversial among Western donors. The disagreement arises from the fundamentally different views about the role of government vis-à-vis the market in economic development. We believe that pro-activeness is essential for the effectiveness of industrialization strategy, but it requires deeper knowledge and higher policy capability than the other two. The industrialization strategy of Ethiopia, consisting of the MOTI’s industrial implementation plan and sectoral master plans, should enhance all these aspects, especially the last.

**2. Past review and future evaluation**

<sup>3</sup> The standard action matrix format can be seen in the automotive industry action matrices of Thailand and the Triangle of Hope action plan matrices of Zambia (for improving investment climate). The former are incorporated in the automotive master plan while the latter are produced as a separate document submitted to the Government at regular intervals.

2-a. There should be an *ex post* review of export industry promotion.

2-b. There should be *ex ante* analyses of proposed import substitution industrialization.

As Ethiopia expands its policy scope from a few export-oriented industries to the inclusion of import substitution industries, there is a need to review the past and evaluate the future as soon as practically possible in formulating industrial policy orientation for 2011-2015. Review here is different from the reviewing mechanism of action plans mentioned above.

In the last several years, Ethiopia targeted its human and financial resources to the promotion of a small number of export-oriented priority industries. Promotion tools included cheap land, preference in taxes and import duties, bank loans, foreign exchange allocation, research and testing facilities, training programs, close consultation with businesses, quick trouble-shooting, and concentrated use of ODA for these purposes. The result of this generous policy package should be assessed before Ethiopia takes the next bold step in industrialization strategy. It is essential to document what has been offered to promote these industries and what progress has been made in industrial performance. It is also necessary to numerically compare the explicit and implicit costs of promotion relative to the direct and indirect benefits that accrued to the national economy. Although precise determination of these costs and benefits may be difficult, best estimates should be produced with available information and data. Studies should be conducted for leather and leather products, textile and garment, and floriculture. For food processing, one or two concrete farm products may be selected for this purpose.

At the same time, there should be preliminary studies of import substitution industries which will be promoted during the next PASDEP cycle. For each industry, there should be assessment of domestic situation, global and regional trends, Ethiopia's potentials, hurdles and pitfalls to be overcome, and possible strategic orientation for promoting the industry.

We propose these studies, which should be completed within a few to several months, to help deepen industrial policy debate in Ethiopia and draft the industrial chapter of the next PASDEP. They should also be used as preliminary inputs to the subsequent drafting or revision of sectoral master plans and the feasibility studies to be conducted for import substitution industries (see next section). Since the preparation of master plans and feasibility studies will take time, these studies should be used to start policy debate as soon as possible.

Both of these studies—past review and future evaluation—should ideally be commissioned to independent and neutral Ethiopian researchers outside the Government. For each industry, a medium-sized report should be submitted to the Government and should also be circulated openly and widely. These reports may be published in one collected volume. The reports should be neither too theoretical nor too narrative. They

should be sufficiently analytical and contain concrete numbers and estimates.

MOTI should cooperate with the drafting process of these studies by supplying data and information, but it should not take the lead in determining the content. First, MOTI is too occupied with existing workload. Second, the self-assessment of industrial policies by MOTI is not nearly as convincing as the assessment of respectable outsiders. Third, evaluation of industrial policies by Ethiopian researchers at universities and research institutes, rather than government officials or foreign experts, will contribute to the strengthening of local research capability and the building of constructive relationship between the Government and the Academia (as we see in Tanzania, for example). The Ethiopian Government needs to foster its ties with local academics to strengthen its own capacity to design and implement industrialization strategies in the future. Assistance by donors and foreign experts may be sought if necessary, but again they should not dominate the outcome of the report.

### **3. Time dimension of industrial promotion**

- 3-1. Industrial promotion must always be temporary with pre-announced graduation schedule.
- 3-2. Time-bound support measures should be available to all producers, whether pioneers or copycats.
- 3-3. A long-term liberalization roadmap should be prepared in anticipation of WTO accession.

Industrialization strategy must balance the requirement of international integration with the requirement of local industry promotion. Policy makers must give proper weights to liberalization and integration vis-à-vis the amount and duration of support to local firms so that the policy package as a whole generates strong incentive for producers to work hard rather than shut down their factories or resort to political lobbying. Opening the country without regards to domestic private capability is suicidal. Protecting local industries without the prospect of graduation is equally disastrous. Striking the balance between international competition pressure and local industry promotion is a delicate matter whose concrete solution must be discovered for each industry in each country.

Another fact about industrialization strategy is its temporary nature. Industrial promotion can never be permanent—if it is it means that the policy has failed. Priority industries may receive generous assistance for a time but not forever. The typical duration of intensive promotion is several years but it may be shorter or longer depending on the case. Promotion must end when it becomes clear that the industry has succeeded in gaining international competitiveness or that it has failed—in either case additional support cannot be justified. Ideally, the duration of industrial promotion should be pre-announced and strategically linked to the internationally committed liberalization schedule of that industry. Promotion must be terminated when the time comes regardless of success or failure of that industry. As Prof. Rodrik remarks, the Government must accept the fact that mistakes are unavoidable in industrial policy and that not all supported industries can be winners (see footnote 1).

Previously, Japan and Korea adopted the infant industry promotion strategy in which temporary tariff protection shielded domestic firms until they gained international competitiveness. In the world of the early 21st century, however, latecomer countries are no longer allowed to use heavy protection to promote domestic industries. This does not mean that industrial promotion is no longer possible, but it does mean that promotion must take a different form. There exist a large number of measures for strengthening industrial capability without violating any international commitments—such as education and training, technology transfer, public-private partnership, SME promotion, development finance, efficient logistics and distribution, industrial estates, FDI marketing, and reliable power and transport. None of the policy measures we discuss violates WTO or any other international rules.

In Ethiopia a few export-oriented industries have enjoyed incentives and subsidies in the last several years. In addition, MOTI has worked very closely with industry associations and individual firms in the priority industries to assess business strategies, report monthly exports, mobilize donors' assistance, conduct benchmarking, trouble-shoot problems, and so on. Young officials in the Textile and Leather Development Center of MOTI, who routinely visit member firms in these sectors, seem to know the ins-and-outs of strategies and problems of individual firms. In the early stage of industrialization such intensive public support and guidance is laudable. But at some point, perhaps relatively soon, private firms must graduate from this heavy dose of guidance and assistance and make their own business decisions at their own cost and risk. Technical and financial aid from the Government and donors should be reduced in appropriate steps. The (revised) master plans of these industries should have a chapter to discuss such graduation.

One related issue raised by Prof. Rodrik is how to allocate industrial support measures among producers. He argues that incentives and subsidies should be given only to “pioneers” who start “new activities” (in the context of Ethiopia) but not emulators who follow pioneers without taking risks themselves.

The key developmental question that a prospective investor needs to be asked before granting him incentives is not whether his project is export-oriented, but whether it is new to the Ethiopian economy—either a product not previously produced in Ethiopia or a significant technological upgrading of an existing product... It is the pioneer firms that bear the cost of discovery—can a particular activity operate profitably in Ethiopian conditions?—and of putting Ethiopia on the global radar screen of investors. So it is they who need the subsidy, and not the followers who simply emulate the success—if success is what they experienced—of the pioneers. Crudely put, the (rhetorical) question is whether the 91st firm investing in flowers still needs a tax break. (Rodrik, 2008, pp.6-7)

While this argument may have some theoretical merit, we do not think it is practical or fair. In reality it is administratively impossible to determine who is pioneering and who is not. Mere order does not tell us the amount of new value created or new risks taken, because the tenth investor may well be crucial rather than the first. If support is given only to the first  $x$  investors, this will spawn distorted incentive to go first and

exclude others regardless of whether the first movers have proper managerial and technical capability. Such a race for initial privilege is called *license hunting* and encourages rent seeking and cartelization. The Ethiopian Government does not have the capacity to rank firms according to the amount of value created, and even if it did it should not waste its precious time and human resource for such ranking.

Industrial promotion measures must be available to all producers that satisfy the announced criteria defining eligible activities whether they are the first investor or the 91st. As argued above, support measures must be time-bound and phased out after a number of pre-specified years. But while these measures last, all eligible producers should be able to access them. In fact, this is the only administratively manageable and politically acceptable way of conducting industrial promotion in a low-income developing country. If further selection is desired, support may be linked to some readily recognizable performance criteria (such as output or export volume) so that competition among producers may be engendered. However, this type of industrial policy is a fairly advanced one and should not be attempted by a government without high capability, transparency, sufficient toolkit, and strong trust and constructive cooperation with the business community.

In the medium to long run, there should be an overall industrial master plan (in addition to those for individual sectors) with mutually consistent industrial promotion schedule and international integration schedule. The timing of WTO entry must also be an integral part of this roadmap. Negotiations for WTO accession are very complex and time consuming. Moreover, large existing members of WTO tend to impose unreasonable opening conditions which they themselves do not abide by on small new members. As a result, most negotiating governments become too pre-occupied with document preparation, legal adjustments, diplomatic battle, and the like, and forget about building linkage between industrialization strategy and integration strategy. But this is a big mistake. Trade liberalization with a deadline is a challenge as well as an opportunity for industrial promotion. To effectively cope with this challenge and opportunity and make WTO accession meaningful for national development, there must be a clear roadmap for industrial promotion in advance.

The literature on the order of economic liberalization informs us that there is a proper sequence of liberalization that must be followed to avoid macroeconomic crisis. Liberalization must start with domestic markets such as local goods, services and labor. Then it must be followed by the liberalization of domestic finance. Capital-account liberalization must come at the end when all domestic markets are liberated and function reasonably well (McKinnon, 1993). Another important lesson from the developing world is that resilience of the real-sector economy such as growth potential, structural diversity and regional integration can greatly enhance the capacity of the national economy to withstand global shocks under integration. Ethiopia's liberalization schedule must have a proper macroeconomic sequence and must be synchronized with the progress of its industrialization strategy.

#### 4. Import substitution

4-1. Import substitution must avoid the risks of *policy misjudgment* and *political capture*.

4-2. Technical details are key to the success of import substitution. A high-quality feasibility study (F/S) or master plan should be prepared for each import substitution industry to be promoted.

As Ethiopia embarks on import substitution, we would like to draw the attention of Ethiopian authorities to its well-known risks. All arguments in the previous section regarding the temporary nature of promotion apply to import substitution. In addition, even greater precaution must be taken because import substitution is a more risky policy area than export promotion.

Import substitution is more risky than export promotion because the Ethiopian Government can regulate domestic markets more easily than global markets. It can restrict entry, use subsidies and taxes that affect prices and profits, and introduce standards for quality, safety, environment, and so on, that also influence business outcome. While exporters can hardly lobby for larger overseas markets or higher commodity prices, producers that sell domestically can often ask the government to do something about their plight. To the extent that the government has policy instruments to directly affect domestic markets, import substitution is more subject to *policy misjudgment* and *political capture* than export promotion. And this is precisely why neoclassical economists dislike import substitution. Although import substitution may be a beautiful idea theoretically, they contend that it cannot be implemented effectively because (i) the government does not know the right industries to promote; and (ii) the policy will surely be captured by political interest groups. Anne Krueger, the former World Bank chief economist and the champion of trade liberalization, states:

The problem with the [infant industry] argument, as a basis for policy, is that it fails to provide any guidance as to how to distinguish between an infant that will grow up and a would-be producer seeking protection because it is privately profitable... The infant industry argument also is an excellent example of a theory that is nonoperational because criteria for bureaucrats to identify cases have not been put forward (Krueger, 1997, p.12)

No matter how careful economists are, special interests always will seize their research results in supporting their own objectives. And, no matter how sophisticated and careful research findings are, there always will be politicians formulating, and non-economists administering, policies. (*ibid*, p.19)

Today the neoclassical ideology is no longer dominant as before and few would support Krueger's extreme pessimism over the capacity and intention of the government. Furthermore, as mentioned above, industrial promotion in our age is conducted with an array of WTO-consistent policy instruments rather than high tariffs and non-tariff barriers. Even so, the risks highlighted by Krueger are real and should not be ignored. Where we should differ from Krueger is the policy conclusion. We know that both market and government are imperfect. The fact that bureaucrats may not know the selection criteria and policy may be hijacked by

rent seekers should not lead us to entirely abandon import substitution. We should proceed with utmost care to avoid these obvious risks. Policy capability is not given but can be improved over time.

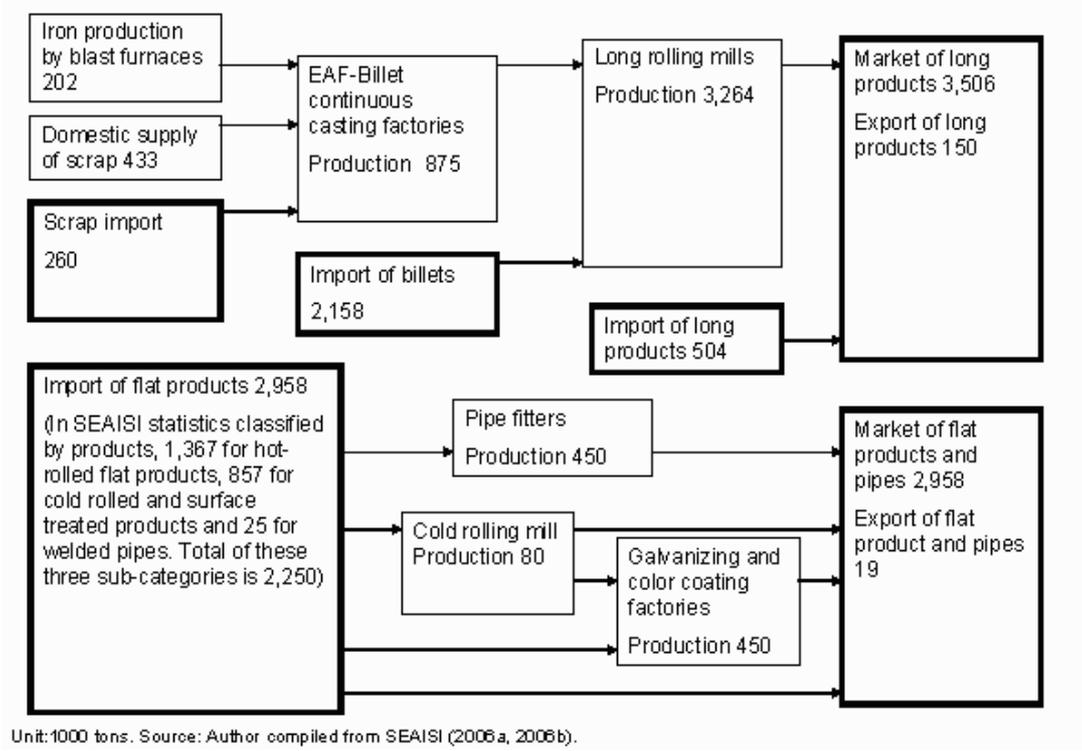
Policy misjudgment must be minimized by sufficient learning in advance and readiness to give up failed support in actual implementation. Ethiopia should study the nitty-gritty of each targeted import substitution industry to reduce expectable risks and wastes prior to the approval of concrete projects or promotion measures. A good feasibility study (F/S) should be conducted and a good master plan should be prepared by experienced experts for each targeted import substitution industry. Political capture must be prevented by strong leadership that punishes rent seeking and encourages value creation. Democratic developmentalism (DD), the political regime adopted by the Ethiopian Government for national development, aims to institutionalize precisely such a policy orientation. As long as this policy direction is firmly in place, Ethiopian economic policy is less likely to be captured into endless protection of inefficient industries.

Take the steel industry, for example. It is widely known that promoting the steel industry in latecomer countries is not an easy task (Kawabata, 2007). The steel industry consists of a wide range of activities from the cottage industry of long bar rolling with primitive technology to integrated steel mills with gigantic scale and frontline technology. Production is broadly divided into long steel and flat steel, each with many upstream and downstream processes. Each process in turn can be performed by various technologies and equipments with certain merits and demerits. The market is subdivided into high quality, medium quality and low quality products, each requiring different investments and technologies. The quality of raw materials (iron ore, cokes, scrap metal, etc.) largely determines the quality of output, while transport and logistics determine cost competitiveness. The demand size relative to efficient equipment capacity, the state of competition, and world business cycles are crucial determinants of profitability. Reduction of operational waste and down-time also contributes greatly to high yield and low cost. Environmental concern must be addressed as a matter of high priority. The role of government differs from one process to another, and should diminish over time as private firms grow and become competitive.

In such a complex industry, financial outcome depends crucially on the right choice of details—technology, production capacity, equipment type, input procurement, mill location, forward and backward linkage, factory management, training, targeted markets and customers, timing of investment, taxes and tariffs, finance, and so on. In Vietnam, for example, the nation's first modern flat cold rolling mill in Phu My could not supply to FDI customers such as Sanyo, Honda and Yamaha because it did not have the right equipment for surface treatment and marketing was insufficient to meet customer needs. Hoa Phat, a local private business group, purchased a cheap electrical furnace from China to produce billets (intermediate input for steel bars and wire rods) but it later found out that the furnace capacity was too small for efficient operation and cost reduction. An enormous amount of money can be wasted and bankruptcies can soar if these technical details are not set right.

Before Ethiopia begins to promote the steel industry, the current status of the domestic steel market should be grasped with respect to material flows (input-output relations among processes), quality and technology, market segmentation, transport and logistics, operational efficiency, and so on. The compilation of a material flow chart, as shown in Figure 2 for Vietnam, is the very first step for this purpose. In many latecomer countries experiencing construction booms, demand for construction steel (bars, wire rods, galvanized flat steel) is very strong while domestic supply is limited. While a few rolling mills may spontaneously emerge, the import bill for billets and finished construction steel surges. In the early stage, the steel industry should develop from long steel to flat steel, from downstream to upstream, and from low quality to medium quality. Another lesson from East Asia is the importance of steel market intermediaries, such as “coil centers” for flat steel and steel bar processors for long steel, in creating an efficient supply chain of the industry.

**Figure 2. Material Flows of the Vietnamese Iron and Steel Industry, 2005**



Source: Kawabata (2007), p.9.

The government should not invest directly in production facilities but manage markets and private investors (both local and FDI) to minimize inappropriate investments, cope with external shocks, and stabilize the market as much as possible (the global steel market is inherently unstable so it is impossible to eliminate all shocks and fluctuations). The history of the steel industry shows that private investments cannot always be regarded as efficient or environment-friendly. Many mistakes can be made in large and indivisible investments in steel. Oftentimes, too many investments are made with too small size and unwanted technology to overcrowd the market and damage environment. The government must acquire sufficient

capability to monitor and regulate private investments in the early stage of steel development.

The above is just a sketch of some of the problems in steel industry promotion. Full details must be given in a thick F/S report or a master plan prepared by experienced steel experts. The same can also be said for any import substitution industry other than steel. If a full F/S or a master plan takes too much time, a preliminary study should be organized as a starter as suggested in Section 2 above<sup>4</sup>.

## 5. Industrial clusters and corridors

5-1. There are many definitions of industrial clusters and corridors. Applicability of each to Ethiopia should be carefully examined.

5-2. The idea that related projects and programs should be implemented collectively in certain geographical areas is useful in building agro food parks and other industrial zones.

The concept of *industrial cluster*, as practiced in policy formulation, can be classified into several different approaches:

(i) Innovation through interaction between top-level researchers and businesses—proximity of high tech firms and top-level research institutes or universities, under an effective local leader, is expected to generate new products or even a new industry. Michael Porter’s cluster approach and the industrial cluster initiative of Japan’s Ministry of Trade, Economy and Industry (METI) belong to this category. Commercialization of advanced technology is anticipated. Silicon Valley in California and Zhongguancun in Beijing are typical examples.

(ii) Agglomeration of related firms for effective inter-industry linkage—producers with input-output relations, such as buyers-sellers and assemblers-part suppliers, gather to enjoy efficient trading, information sharing, and sharing of input and output markets. Kuchiki (2007)’s “flow chart approach” is an attempt by policy makers to establish an industrial park, provide local capability and infrastructure services, and invite an anchor firm and a multitude of suppliers. To succeed, this approach must be accompanied by incentives, training, FDI marketing, FDI-local firm linkage, technology transfer, and so on.

(iii) Concentration of small producers belonging to the same industry—this kind of clusters, consisting of small and family enterprises, often emerge spontaneously in both urban and rural areas. Trade villages specializing in shoe making, ceramic production, etc. are such examples. According to Sonobe and Otsuka (2006), these clusters typically evolve in three stages: initiation, quantitative expansion, and productivity breakthrough.

(iv) A broad definition of industry which includes supporting industries and supporting services—in the cluster-based industrial development strategy in Malaysia’s Industrial Master Plan 1996-2005

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<sup>4</sup> MOTI created the master plans (the “strategic plan” and the “business plan”) for chemicals (mainly soap and detergent) and pharmaceuticals in 2007. Strategic studies and documents also exist for cement and paper and pulp. Drafting was done by Ethiopian experts with occasional help from the German ECBP program. Our team is in the process of obtaining and evaluating these documents.

(IMP2), an industrial cluster is defined to be “an agglomeration of inter-linked or related activities comprising industries, suppliers, critical supporting business services, requisite infrastructure and institutions” (IMP2, p.23). This is a functional agglomeration which may not be necessarily located in one small geographical space.

(v) An industrial estate—sometimes the term industrial cluster is used synonymously with an industrial estate (an industrial park, a special economic zone, an export processing zone, etc), a delineated area with rental plots and necessary infrastructure which is developed and operated by a private or state-owned management company<sup>5</sup>.

The related concept of *industrial corridor* also has different meanings:

(vi) Building international transport infrastructure—this typically involves the construction of a road which usually connects hinterland and landlocked countries with a sea port. Development programs and private investments may follow the construction of such a road, but not always.

(vii) Asian Industrial Corridor Initiative—the Japanese METI is launching an initiative to create new cross-border industrial regions in Southeast Asia and India by consciously combining transport infrastructure with other policy components such as public-private partnership, efficient logistics, human resource development, electronic trading, speedy customs clearance, etc. in comprehensive regional development planning.

(viii) Food processing industry zones—in Ethiopia, the term *growth corridor* is used as an idea to link agro-ecological potentials with infrastructure and markets, including the building of several industrial zones specializing in food processing in rural areas or near local cities.

Since industrial clusters and corridors have many definitions, the user of these terms should be careful not to mix different meanings. Some of them are useful for Ethiopia’s industrial development but not others. (i) and (vii) are too advanced for Ethiopia’s reality. (ii) can serve as a reference in building industrial zones to receive FDI firms, but perhaps in a smaller scale than in East Asia. (iii) is useful in formulating SME policy. (vi) gives another entirely different perspective on development along a transport corridor such as the Djibouti-Addis Ababa highway.

In Ethiopia, the establishment of integrated agro food parks, proposed in the food processing master plan draft, may take advantage of some of these concepts selectively. The idea that regional development must integrate all related programs by different ministries and donors into an organic whole is a sound one. Policy coordination required for this initiative should be provided jointly by MOTI and MOARD.

The concept(s) of industrial clusters and industrial corridors most useful for Ethiopia’s development strategy should be identified, modified (if necessary), and integrated into the next PASDEP. Industrial estates for local investors and those aimed at inviting FDI generally require different conditions. While both

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<sup>5</sup> In Vietnam, the term *cum cong nghiep*, which translates as industrial cluster, means a small industrial park without boundary fences. This terminology is creating confusion when Vietnamese officials and researchers discuss industrial cluster-based development strategies.

may commonly require good administration, land preparation, access road, power, water, and reliable labor supply, local investors may need more managerial, technical and financial support while harnessing FDI dynamism may require strategic FDI marketing, an appropriate incentive package, quick and low-cost access to global markets, and so on. Specific requirements also differ from one industry to another and even from one FDI firm to another. A development strategy should be drafted with these different requirements in mind.

**6. SME promotion**

- 6-1. SME promotion should clarify targeted firms and activities.
- 6-2. SME promotion policy with clear targets and based on relevant international experiences should be created and strengthened as the key component of industrialization strategy.

SME promotion is a very popular industrial policy tool around the world but its content and results differ greatly across countries. Most countries produce little result because they fail to identify proper goals and lack concrete knowledge of how to conduct effective promotion. Ethiopia’s SME policy also remains underdeveloped. Its goal must be re-defined with clarity and concreteness and its policy instruments and mechanism must be strengthened by learning selectively from successful countries.

The objectives of SME policy can be broadly divided into the generation of income and job opportunities for the general population (poverty reduction) and the selective support of excellent SMEs to become creators of internal value and competitors in global markets (competitiveness). Both of these objectives are important and may be pursued in parallel, but the goals, strategies and instruments they require are significantly different and should not be mixed.

In Japan where both large enterprises and SMEs are historically well developed, the purpose of SME policy in the post WW2 period shifted gradually from the protection of SMEs against exploitation by large parent firms to the encouragement of innovation by SMEs as a source of global competitiveness. Japanese policy instruments and mechanisms are highly complex, combining multiple channels for PPP, participatory policy making (“deliberation councils”), technical assistance, financial support, repeated consultation, and so on. Probably this model is too difficult for most developing countries to adopt initially.

In Malaysia and Thailand, where the economy is highly industrialized but dominated by FDI firms in electronics, automobile and other machinery industries, the main policy goal is to increase internal value and replace foreigners with local managers, engineers and designers. SME promotion is at the core of this strategy, together with R&D, education, technology transfer, national brand creation, etc. The Small and Medium Industries Development Corporation (SMIDEC), the lead agency for SME promotion in Malaysia, has a large number of grant and loan programs for SMEs that implement concrete and verifiable activities

to improve productivity and expand business. Although different from the Japanese approach and institutionally much simpler, we consider the Malaysian programs as one of the best SME policy packages in the world. They are clearly aimed at boosting international competitiveness and not poverty reduction.

**Table 1. Malaysia’s SME Support Programs**

(Small and Medium Industries Development Corporation)

Eligibility	Enterprises with more than 60% local capital, with annual sales less than RM25m, employees less than 150.
Grants	Provided for industrial linkage, business planning, product and process improvement, logistic services, overseas marketing, obtaining quality certification, improved packaging, design, labeling, halal products, etc.
Soft loans	Provided for factory relocation, ICT, etc.
Selection	“Concept papers” submitted by enterprises are evaluated by SMIDEC within 14 days and benefits disbursed within 20 working days.
Monitoring	Proposed actions are monitored after 3, 6 and 12 months, and benefits may be withdrawn if they are not implemented.
Industrial Linkage Program	Database of 18,000 companies; annual matchmaking events with the participation of over 250 local suppliers and MNCs; pioneer status with 100% tax exemption for five years and other tax privileges.

Source: K. Ohno, ed. (2006), *Industrial Policy Formulation in Thailand, Malaysia and Japan*, Vietnam Development Forum, Publishing House of Social Labor, Hanoi. Also see [www.smidec.gov.my/index.jsp](http://www.smidec.gov.my/index.jsp).

In a poor agricultural country where industrial development remains primitive and FDI absorption is limited, SME promotion covers virtually the entire industrialization strategy because almost all producers are micro or small. The term SME promotion may be too broad and ambiguous for such a country. Goals, targeted firms, and policy instruments for such promotion must be realistic and relevant to the local situation, and must be quite different from those in more advanced countries.

Ethiopia’s SME policy needs to target both poverty reduction and international competitiveness. These two directions are in principle separable, and should be drafted and implemented as different strategies. The first package, which should be available to all eligible enterprises in urban or rural areas, must provide general support such as elementary management, technology, accounting, information, marketing, etc. The second package should be designed more strategically and offered conditionally only to those enterprises that demonstrate willingness and potential to excel, with an appropriate monitoring mechanism. It is necessary to re-define and re-classify SME promotion into separate policy components whose responsibilities should be assigned to different organizations (ministries and agencies). For each, legal and policy frameworks, executing and supporting organizations, industrial human resource development, management and technology assistance, finance, and enterprise matching and marketing should be clarified.

At present, FeMSEDA's workshop programs are mainly directed at nationwide poverty reduction while the works conducted at the Textile and Leather Development Center, the Leather and Leather Products Technology Institute (LLPTI), and the Textile and Apparel Institute (TAI), with donor assistance, are directed at producing excellence.

## **Part II. Organizational Arrangements**

Part II gives concrete examples of organizational arrangements and related policy instruments in selected countries in East Asia—Japan, South Korea, Malaysia and Thailand. Different countries adopted different organizational solutions to facilitate industrial policy making. The type of leadership and its effective alliance with the technocrat team were crucial determinants of each country's organizational arrangements. Special attention will be paid to the two closely related issues of *inter-ministerial coordination* and *stakeholder involvement*. We will also examine how these countries executed high-priority programs. While these examples may not be transferred directly to Ethiopia because of different backgrounds, it is hoped that they will provide concrete suggestions about organizational arrangements from which Ethiopia can selectively adopt.

### **1. Leadership and the technocrat team**

One of the key ingredients of the “East Asian Miracle” was alliance between the leader and the technocrat team (Campos and Root 1996, Ohno and Shimamura 2007). In all of the countries examined here, though with varying degrees of success, there were (i) a visionary leadership which led long-term national development, (ii) a team of competent economic technocrats responsible for economic policy making and implementation, and (iii) institutionalization of inter-ministerial coordination and government-business partnership. Central coordination mechanisms were created in the government machinery for formulating, implementing and monitoring development policies (Kondo 2005).

It is also important to note that high-performing economies in East Asia did not possess strong institutional bases at the beginning of their rapid development. Capability and institutions were strengthened during (and not before) their high growth periods. East Asian experiences confirm that state-building is a dynamic process in which the government has to build up industrial policy capability through focused hands-on efforts in the process of industrialization.

There were significant country variations in leadership type, functions of the technocrat team, and approaches to the sharing of development and industrial visions. Table 2 summarizes these differences among Japan, South Korea, Malaysia, and Thailand in their respective high growth periods.

**Table 2. Alliance between Leadership and Technocrat Team in East Asia**

	Leadership Type	Technocrat Teams	Development & Industrial Vision Formulation
Japan (late 50s-70s)	Organizational leadership	MOF, EPA, MITI (super-ministry for industrial policy)	Economic and physical plans for vision sharing; industry-specific policies
S. Korea (60s-70s)	Strong personal leadership	EPB (super-ministry)	5-year plans and plans for targeted industries
Malaysia (80s-90s)	Strong personal leadership	Prime Minister's Dept. esp., EPU (super-ministry)	Vision 2020, 5-year plans; and Industrial Master Plans (IMP)
Thailand (80s)	Organizational leadership	Core macro-economic agencies (no super-ministry)	5-year plans; no industry-wide plan (except after financial crisis)

South Korea and Malaysia had strong *personal leadership*. President Park Chung-hee of South Korea (in power 1961-79) and Prime Minister Mahathir bin Mohamad of Malaysia (in power 1981-2003) were charismatic leaders. They imposed national goals, exercised strong control, and became the driving force of national development and institutional building. The Economic Planning Board (EPB) of South Korea and the Prime Minister's Department (the Economic Planning Unit (EPU) in particular) of Malaysia functioned as super-ministries to centrally coordinate the formulation, implementation and monitoring of vision documents and development plans. These super-ministries were technocratic arms to realize leaders' visions.

By contrast, *organizational leadership* was salient in Japan and Thailand. There was no charismatic leader who ruled for a long time and there was no single super-ministry in either country. A number of key economic ministries and agencies worked closely together to formulate the vision in collaboration with political leaders, which was concretized into various plans and policy measures. In Japan, economic technocrats and businesses shared the idea of industrial catch-up based on economic nationalism. While a number of economic ministries participated in policy making, the Ministry of International Trade and Industry (MITI) played the lead role in coordinating and supporting private sector activities. In Thailand, linkage between macroeconomic agencies and real-sector line ministries was relatively weak, preventing the formulation of effective industrialization strategies. However, close coordination among core macroeconomic agencies provided a stable economic environment conducive for promoting private-sector led growth<sup>6</sup>.

Regardless of such variations in leadership, the governments of successful East Asian economies

<sup>6</sup> Organizational leadership refers to "mission-driven control" by powerful groups or organizations, in contrast to "goal-oriented control" by a charismatic figure (Kondo 2005). In Thailand, the Thaksin administration (2001-06) introduced a charismatic top-down approach based on new public management, but this short period was generally considered an exceptional case in the political history of Thailand.

institutionalized government-business interactions for information sharing and policy coordination (Weiss 1998, Weiss and Hobson 1995, Kondo 2005). This created large flows of high-quality information between the government and businesses and enabled effective management of policy networks, which together contributed to the building of mutual confidence, credible commitments, and predictability between the public and private sector. Moreover, the nature and intensity of government-business coordination has evolved over time as the private sector improved its capability (see section 3 for Korea's HCI drive).

## **2. Mechanisms for inter-ministerial coordination and stakeholder involvement**

Industrial development has multi-sectoral dimensions, involving not only industrialization strategy in the narrow sense but also agriculture (inputs and markets), infrastructure, skill development, science and technology, environment, and so forth. Moreover, unlike the social or infrastructure sector, the industry sector is not public-expenditure intensive. Since private agents are the main counterpart of industrial strategy making, consideration must be given to not only budget allocation but also providing incentives and the regulatory framework conducive to business activities<sup>7</sup>. For these reasons, effective industrial policy formulation and implementation requires: (i) inter-agency coordination mechanisms; (ii) constructive and continuous contacts with businesses; and (iii) mechanisms to frequently review and flexibly adjust policy implementation.

Not all East Asian governments had industry-wide policies or overall industrial master plans. Regardless of the existence of such documents, the governments of successful economies all devised centralized mechanisms for inter-ministerial coordination and instruments for government-business partnership for industrial policymaking and implementation. They included deliberation councils, steering committees at the national or sectoral level, working groups, special task forces, government-business forums, and industry-specific or function-specific institutes. The following accounts give concrete examples of organizational arrangements and instruments adopted by selected East Asian countries.

### *2-1. Japan: MITI and the use of deliberation councils in a bottom-up approach*

Japanese economic ministries in the late 1950s to the 1970s included the Economic Planning Agency (EPA) under the Prime Minister's Office, the Ministry of Finance (MOF), and the Ministry of International Trade and Industry (MITI, currently the Ministry of Economy, Trade and Industry) which collectively assumed the primary role in formulating medium- and long-term national visions and economic plans. In addition, the EPA and, subsequently, the Land Agency (established in 1974) under the Prime Minister's Office formulated spatial plans which included corridors, industrial zones, and land and regional development

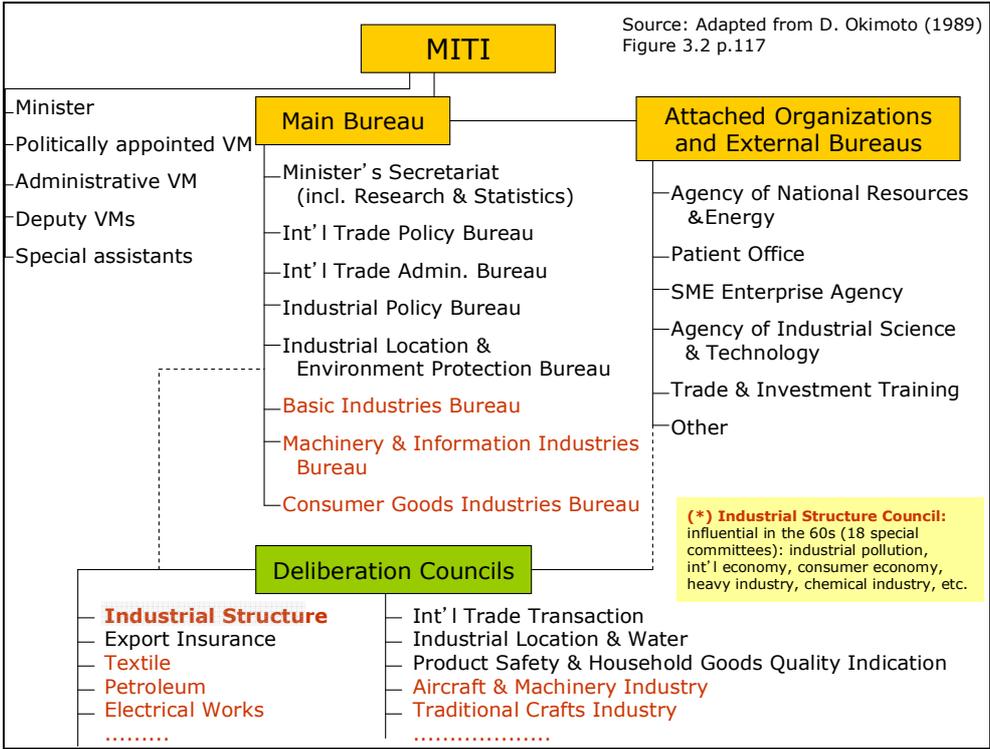
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<sup>7</sup> This applies to the productive sector in general, including agriculture. Based on similar analogies, Mick Foster, proponent for Sector-Wide Approach (SWAp) and new aid modalities such as budget support, pool fund, and so on, recognizes the difficulty in introducing agricultural SWAp in Sub-Saharan Africa compared with SWAp in the health and education sectors (Foster, et. al. 2001).

plans. Responsible ministries or agencies organized deliberation councils whose members consisted of representatives from other ministry officials, business leaders, experts and academicians. In Japan, deliberation councils functioned as the key instrument for vision making, policy consultation and coordination, and information sharing within and outside the government.

Based on a shared vision and shared policy directions, MITI assumed full responsibility in industrial policy formulation and implementation. According to Okimoto (1989), MITI was the *de facto* super-ministry for industrial policy. Compared to the more fragmented industrial policy making mechanism in the United States, MITI was distinctive in: (i) having very broad jurisdiction over many industrial and functional sectors from small and medium enterprises (SME) to basic industries such as petroleum and steel, international trade, and even environmental protection; and (ii) having both vertical (industry-based) and horizontal (functional or cross-industrial) bureaus (Figure 3).

**Figure 3. Japan: The Structure of the Ministry of International Trade and Industry**

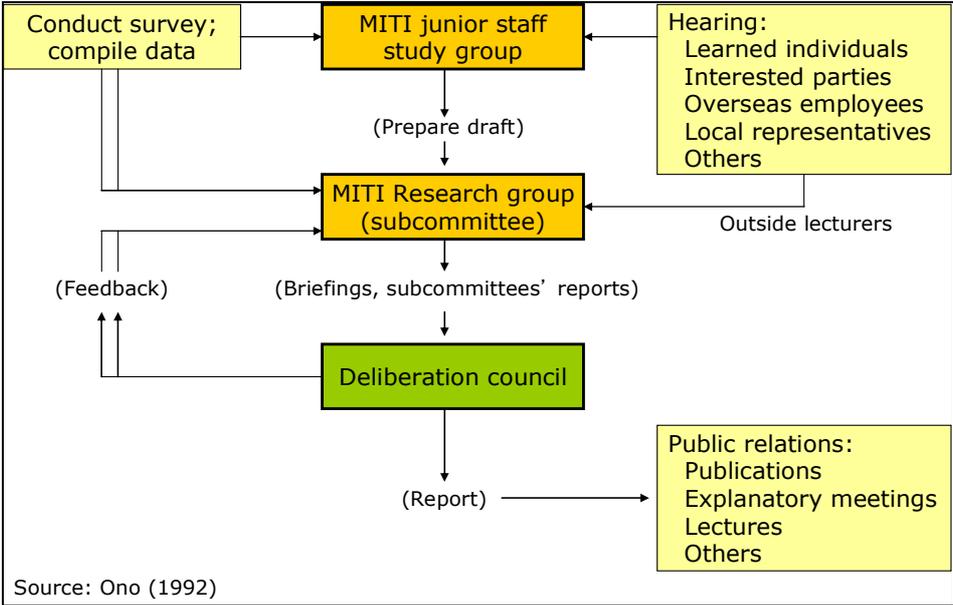


Deliberation councils were extensively used by MITI as a policy making instrument. Deliberation councils were managed by a secretariat staffed by MITI officials. With members from private businesses, deliberation councils provided a forum in which the government and businesses met and discussed policy issues and business trends, promoting consensus-building (World Bank 1993). Moreover, the structure of deliberation councils reflected both vertical and horizontal bureaus within MITI, which contributed to enhancing MITI's capacity to aggregate diverse interests (Okimoto 1989). Among deliberation councils, the Industrial Structure Council, established in 1964, was most influential as it managed the industrial policy in

its entirety by the participation of representatives from the public and private sectors (Johnson 1986). The Industrial Structure Council drafted a vision for industrial policies for each decade. It published the vision of Heavy and Chemical Industry (HCI) in the 1960s, knowledge-intensive industries in the 1970s, creativity and knowledge-based industries in the 1980s, and better quality of life in the 1990s (Kawakita 1991). It also discussed measures to support pioneer industries and ensure the transition of sunset industries.

Japan’s policymaking process was characterized by the bottom-up approach, in which policy formulation started with MITI’s junior officials gathering and analyzing data and information and conducting intensive hearings from various stakeholders, especially the business community (Figure 4). Collected information served as the basic input to subsequent discussions at the subcommittee and the deliberation council which respectively drafted and finalized policy recommendations. Throughout the process, deputy division directors (officials in the mid-thirties) were at the center of communication flows both inside MITI and between MITI and the private sector, and thus had a considerable voice in determining the policy direction (Okimoto 1989).

**Figure 4. Japan: MITI’s Deliberation Council and Policy Formulation (late 1950s-early 1970s)**

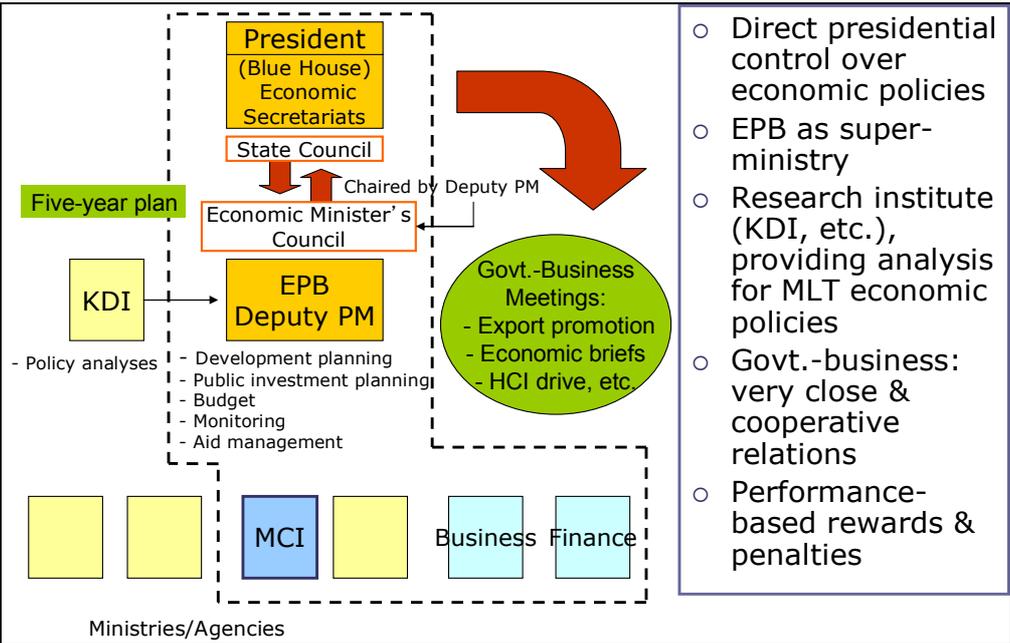


*2-2. South Korea: the super-ministry and the top-down approach*

During the 1960s and the 70s, President Park Chung-hee exercised strong personal leadership. This was a top-down approach to economic policy making, implementation and monitoring (Figure 5). The Economic Planning Board (EPB), created in 1961, was designated as the super-ministry integrating development

planning, budget control, aid management, overall policy coordination, and monitoring<sup>8</sup>. Headed by the Deputy Prime Minister who chaired the Economic Minister’s Council and directly reporting to the President, EPB was above other ministries and agencies. Policy research institutes also played an important role in producing analyses on long-term issues with specialized knowledge and expertise. Among them, the Korean Development Institute (KDI), established in 1971, assisted EPB in formulating medium- and long-term economic policies<sup>9</sup>.

**Figure 5. South Korea: Development Vision and Government-Business Partnership (1960s-70s)**



From the mid 1960s to the early 1980s, a very close and cooperative relationship existed between the government and private businesses. Meetings were held frequently and regularly between leaders of both groups. The Monthly Export Promotion Meeting was particularly important in coordinating the export drive. It was presided over by President Park and attended by selected business association leaders, governors of financial institutions, major export enterprises, and economic ministries. In the meeting, President Park would first be given briefings on the achievement of export targets from every business receiving subsidized policy loans. Second, members discussed problems of specific industries. Third, business members expressed their views on export market trends, and examined the drafts of regulations

<sup>8</sup> EPB combined several strategic functions previously entrusted to different ministries. These included: (i) development planning which was originally with the Ministry of Reconstruction working with USAID in the aftermath of the Korean War; (ii) budget formulation; (iii) collection and evaluation of census and other statistics which was originally assumed by the Ministry of Internal Affairs; and (iv) jurisdiction over the inflow of foreign capital and technology (Kim and Leipziger 1993).

<sup>9</sup> Stimulated by KDI’s success, other ministries also established institutes under their jurisdictions. These included the Korean Education Development Institute (KEDI) in 1972 by the Ministry of Education, the Korean Rural Economics Institute (KREI) in 1978 by the Ministry of Agriculture and Fishery, and the Korean Institute for Human Settlement (KIHS) in 1978 by the Ministry of Construction. By 1992, there were at least 10 policy research institutes in the Korean government (Kim and Leipziger 1993).

and policies. Fourth, based on the opinions of the business community, President Park ordered relevant departments of the ministries to adopt remedial measures. In subsequent meetings, ministries were obliged to report on their actions and industry performance (World Bank 1993, Cheng et. al 1996, Kondo 2005).

To prepare for these meetings, the Ministry of Commerce and Industry (MCI) collected information from individual exporters on a monthly, weekly, and sometimes even daily basis. It also monitored and analyzed market conditions. Moreover, lower-level meetings among middle managers in private industries, middle-level officials in the government, and experts and academicians supplemented the Monthly Export Promotion Meetings. These meetings took place in the form of industrial discussion groups, divided into either functional or sectoral groups depending on the issue (Campos and Root 1996).

President Park also organized the Monthly Economic Briefing. Like the Monthly Export Promotion Meeting, the briefing was attended by the President, EPB, business leaders, and representatives of financial institutions. While the Monthly Export Promotion Meeting focused on devising countermeasures to eliminate impediments to export growth, the Briefing paid more attention to analyzing and monitoring economic performance regarding exports (Kondo 2005).

### *2-3. Malaysia: A super-ministry and multi-layered, inter-ministerial coordination*

Since independence in 1957, the successive Prime Ministers in Malaysia have generally exercised strong leadership, and technocrats have served as the support arm to realize the leader's vision. The organizations responsible for policymaking were mainly in the Prime Minister's Department such as the Economic Planning Unit (EPU), the Implementation and Coordination Unit (ICU), and the Public Service Department (PSD), in addition to the Ministry of Finance (MOF). Especially EPU functioned as the super-ministry, taking a lead in the formulation of long- and medium-term plans and reviews, public investment planning and development budget, as well as aid management.

Malaysia established a multi-layered, inter-ministerial coordination mechanism for each of the planning and implementation functions. The National Planning Council (NPC) was placed at the highest level of decision-making with regard to socio-economic matters. Chaired by the Prime Minister and comprising of key economic ministers, NPC served virtually as the economic committee of the Cabinet. Below NPC was the National Development Planning Committee (NPDC), a working level planning committee chaired by the Chief Secretary to the Government and consisting of the heads of all ministries. EPU acted as the secretariat, and a similar planning setup existed at the state and district levels. The National Action Council (NAC), chaired by the Prime Minister, had the highest authority over the overall implementation and coordination of development strategies. It met regularly with selected government agencies for intensive review of progress and problems of development strategies. ICU served as the secretariat. A similar institutional setup was copied at the state and district levels.

During the period 1971-1985, *Bumiputra* or the New Economic Policy (NEP) was the overriding policy framework in Malaysia<sup>10</sup>. Government-business relationship became somewhat antagonistic because NEP favored the ethnic Malay and the government also established a number of state-owned enterprises. A major breakthrough in industrial policy was made in 1981 when Prime Minister Mahathir took office. Mahathir renovated economic policies and institutional arrangements for strategic government-business relationship. He launched the Look East Policy in 1981 which urged Malaysians to learn from the Japanese and Korean experiences in economic development, the Vision of Malaysia Incorporated in 1983, and Vision 2020 with pro-business orientation in 1991. The Ministry of International Trade and Industry (MITI) of Malaysia formulated the first Industrial Master Plan (IMP1, 1986-95), which laid the foundation for manufacturing to become the leading sector of the economy.

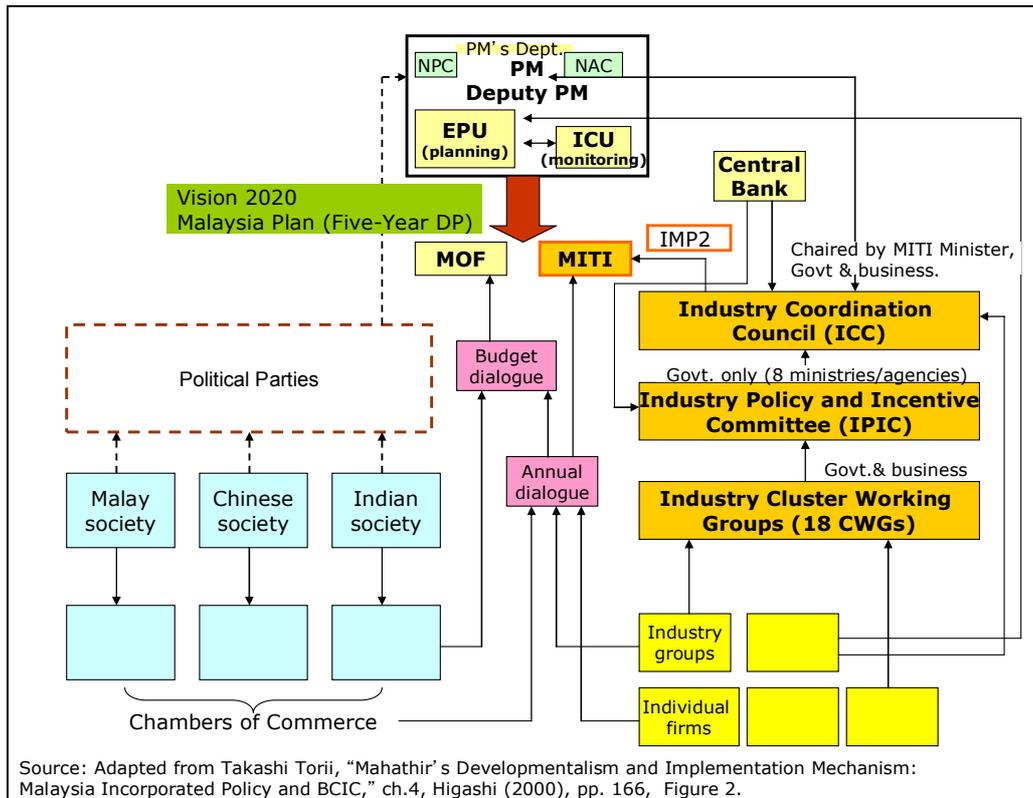
To realize Vision 2020, the second Industrial Master Plan (IMP2, 1996-2005) aimed at improving the competitiveness of manufacturing by broadening and raising its activities along the value chain curve. Its two key thrusts were “manufacturing plus plus” and “cluster-based industrial development” (Ohno 2006). The background paper was prepared by a researcher at the Malaysian Institute of Economic Research (MIER). In preparation for IMP2, Importantly, IMP2 paid greater attention than IMP1 to the institutionalization of policy coordination mechanisms and established the following three-layered bodies (Figure 6):

- (i) The Industrial Coordination Council (ICC), aimed at monitoring the progress of IMP2 and examining problems raised by the subordinate committees. It was chaired by the Minister of the International Trade and Industry and included eight officials from MITI, EPU, MOF, Central Bank, related economic ministries (at the level of permanent secretary), 15 business representatives (Chamber of Commerce, Federations of Malaysian Manufacturers, major industrial associations).
- (ii) The Industrial Policy and Incentive Committee (IPIC), aimed at examining investment promotion policies. IPIC members were limited to economic technocrats (officials from eight ministries and agencies).
- (iii) The Public-Private Cluster Working Group (CWG) and the Strategic Thrust and Initiative Task Force (STITF). The members consisted of both government officials and business representatives. As subordinate groups to IPIC, the former discussed the promotion of 18 targeted sectors in IMP2, while the latter examined policy measures to build up international competitiveness and prepare for economic globalization (Torii 2000, Kondo 2005).

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<sup>10</sup> The NEP (or *Bumiputra* policy) was an affirmative action plan aimed at poverty problems and imbalances among ethnic groups in favor of indigenous Malay. It was formulated in 1971 in response to the 1969 ethnic riot.

**Figure 6. Malaysia: Mechanisms for Industrial Policy Coordination (1991- )**



Source: Adapted from Torii (2000), pp. 166, Figure 2.

Another important instrument to realize Vision 2020 was the Vision of Malaysia Incorporated, which regarded government-business relationship as a firm-type organization. Although announced in the early 1980s, its institutionalization began only in 1991 when Vision 2020 was launched. Similar to IMP2, the Vision of Malaysia Incorporated established multi-layered bodies.

At the highest policy level, the Malaysian Business Council (MBC) was established in 1991 to share problems and information on industrial development among political, government and business leaders. Modeled on Korea's Monthly Export Promotion Meeting, MBC was chaired by the Prime Minister and managed by the Prime Minister's Department. The members included 10 key ministers and 10 officials, 55 business representatives, and some representatives from labor. MBC facilitated direct communication among big businesses, labor, and the Prime Minister. At the working level, the Malaysia Incorporated Officials' Committee was established in 1993. The Committee was chaired by the Chief Cabinet Secretary of the Prime Minister's Department, and the members included government officials, business associations, and business leaders. This was modeled after Japan's government-business relations.

Furthermore, all government branches and federal states were requested to establish government-business councils and annual forums. Although the frequency of their organization varied among agencies, the well-known examples included the annual budget dialogue organized by MOF to seek business opinions

prior to budget formulation, and the annual trade industrial dialogue organized by MITI, which had started even before 1991.

#### *2-4. Thailand: National and sectoral steering committees for Industrial Restructuring Plan*

Unlike the three countries mentioned above, the Thai government traditionally had no industrial sector planning and no industrial targeting strategy (Christiensen et. al 1993). Policies were most effective in maintaining macroeconomic stability which was conducive to trade, investment, and private sector growth. No single super-ministry existed, and until the late 1990s the core macroeconomic agencies—the National Economic and Social Development Board (NESDB), the Bureau of the Budget (BOB), the Fiscal Policy Office (FPO), and the Bank of Thailand (BOT)—collectively exercised strong power and shared responsibilities for economic policymaking.

The Asian financial crisis which erupted in July 1997 prompted the Thai government to conduct a comprehensive industry review. Pressed by the circumstance, the government quickly formulated the Industrial Restructuring Plan (IRP) for enhancing industrial competitiveness with due attention to social conditions. IRP consisted of the Master Plan, the Strategic Plan and the Action Plan for industrial restructuring, and included as its objectives upgrading of labor skills in target industries, supporting small and medium enterprises, relocating high pollution industries, and promoting clean technology. The Ministry of Industry (MOI) was the leading ministry which organized the involvement of various stakeholders such as the public sector, businesses, and academicians. Although IRP was formulated and implemented in the frameworks of structural adjustment loans of the World Bank and the Asian Development Bank, the Thai government took full initiative on the content of the Master Plan, the Strategic Plan and the Action Plan.

The process of IRP formulation involved the following steps (Figure 7).<sup>11</sup> First, MOI reviewed industrial research from several sources, such as the Thailand Development and Research Institute (TDRI) and the Chulalongkorn University, and drafted the guidelines for industrial restructuring in consultation with the agencies concerned. The Cabinet approved the guidelines, and the National Industrial Development Committee was established in September 1997 to supervise and manage the formulation of IRP. The Committee was chaired by the Deputy Prime Minister and managed by MOI with the participation of related ministries, businesses, and academicians. In January 1998, the Industrial Restructuring Master Plan was approved by the Cabinet.

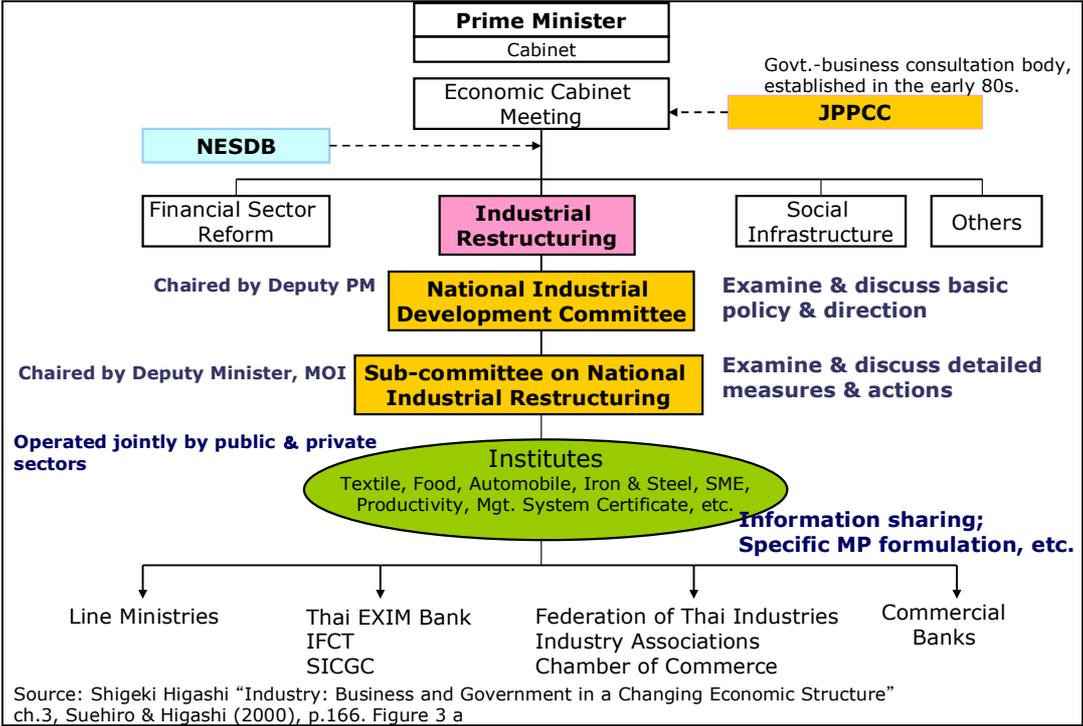
The National Industrial Development Committee appointed a subcommittee to prepare the Strategic Plan and the Action Plan for Industrial Restructuring. The subcommittee was chaired by the Deputy Minister of

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<sup>11</sup> Based on the Industrial Restructuring Plan (1998-2002), the National Industrial Development Committee, unofficial translation by Vibool Chandrangsu as contribution of DEG and the Regional Advisory Service Project.

MOI. The Director General of the Office of Industrial Economics and the representative from the Industrial Promotion Department acted as secretariat and prepared these plans in consultation with the public and private sectors, investment promotion agencies, and academicians. Workshops were held for this purpose. The Strategic Plan, approved by the Cabinet in March 1998, provided a framework for the restructuring of 13 industrial sectors. Guided by this framework, the Action Plan was drafted and approved by the National Industrial Development Committee in June 1998, and subsequently by the Cabinet.

**Figure 7. Thailand: Formulation and Implementation of IRP (after 1997)**



Source: Adapted from Higashi (2000), p.166, Figure 3

Furthermore, ten specialized “institutes” were established to design concrete promotional measures for targeted industries and themes and to cope with problems in the implementation process of IRP. They were operated jointly by the public and private sectors, having their own staff and boards. They acted as a hub of information sharing and consultation between government and businesses, and in some cases formulated industry-specific master plans (e.g., Thai Automobile Master Plan 2002-06). Some institutes originated from the Industry Promotion Department of MOI while others were transformed from different existing agencies or established by donor assistance.

Table 3 shows these ten specialized institutes. They included six industry-specific institutes (textile, food, automobile, electrical and electronics, cane and sugar research, iron and steel) and four thematic institutes (productivity, TVET, management and certificate, SME development).

**Table 3. Thailand: Institutes Created as Part of IRP (as of Oct. 1999)**

Name	Start-up Date	Organizations
Thailand Productivity Institute	June 1995	Originated from MOI industry promotion dept. 20 Board members, 161 staff.
Thai-German Institute	Nov. 1995	Financial cooperation from KfW, GDC. Technical training (CNC, CAM/CAD, etc.), 12 Board members, 79 staff, 5 German experts.
Thailand Textile Institute	June 1997	Based on MOI industry promotion dept. and industry association. 20 Board members, 27 staff.
National Food Institute (NFI)	Oct. 1996	Based on MOI industry promotion dept. and industry association. 20 Board members, 27 staff.
Management Systems Certification Institute (MSCI)	March 1999	Originated from Thai Industrial Standard Institute (TISI). 14 Board members, 55 staff.
Thailand Automotive Institute (TAI)	April 1999	Supporting industry development. 20 Board members, 28 staff
Electrical & Electronics Institute (EEI)	Feb. 1999	Supporting industry development. 29 Board members, 28 staff.
Foundation for Cane & Sugar Research Institute	April 1999	Originated from Cane & Sugar Research Institute. 13 Board members.
Institute for SME Development	June 1999	Modeled on Japan's SME Univ. Operated by Thammasat Univ. in cooperation with 8 local universities. 21 Board members.
The Iron & Steel Institute of Thailand	Dec. 1998 (cabinet approval)	Aimed at joint marketing promotion of four steel companies (oversupply)

Source: Higashi (2000)

### 3. Mechanisms for executing high priority programs

Successful East Asian economies organized special task forces and national committees to plan, implement and monitor high-priority programs. As the examples below show, these task forces and committees were closely supervised by top leaders, and their decisions were often accorded with cabinet-level authority. Secretariat teams were established in relevant ministries and agencies and given the strong authority to manage the entire process and make necessary inter-agency coordination and stakeholder consultation. In many cases, the process combined both top-down and bottom-up approaches, which facilitated the gathering of high-quality information, “fast-track” decision-making, and rapid problem-solving.

#### 3-1. South Korea: Special task forces for Export Drive and HCI drive

As mentioned before, in South Korea, the Export Drive was one of the highest national priorities under the Park administration. The President-chaired Monthly Export Promotion Meetings were held in which the Ministry of Commerce and Industry (MCI) served as the secretariat. The meetings monitored export performance, identified bottlenecks and discussed concrete measures to promote exports. A notable point was that the President imposed rigid performance standards on subsidized businesses under a strict monitoring mechanism. The government and businesses assumed mutual responsibilities. On the one hand, ministries were ordered by the President to take measures and report the results at the next meeting. On the other, businesses were rewarded and penalized according to their export performance; good performing

companies were not only given financial and fiscal incentives but also awarded medals<sup>12</sup>. As explained above, this top-down approach was complemented by a range of bottom-up activities coordinated by MCI with the involvement of businesses, concerned ministries and academicians at the operational level.

The Heavy and Chemical Industry (HCI) Drive was another high-priority program during the period of 1973-79. Under the promotional laws, six strategic industries were targeted including industrial machinery, shipbuilding, electronics, steel, and petrochemicals. The Third Five-Year Plan (1972-76) set specific targets of physical quantities of steel, ships, automobiles, and so on, to be produced by 1980.

To implement this program, the HCI Promotion Committee was established in 1973. Chaired by the President himself, the Committee was given the highest authority equal to the State Council. At the working level, a special task force, called the HCI Planning Team, was established with the membership of high-level economic technocrats from the Economic Secretariat of the Blue House, the Economic Planning Board (EPB), and MCI. Because the HCI Planning Team was headed by the Presidential Secretary of Economic Affairs of the Blue House, the HCI program was entirely under the direct control of the President (Hong 1997). Massive government support, including import protection, tax incentives, and most importantly, preferential access to the credit of the National Investment Fund, was provided to strategic industries.

It must be admitted that the HCI Drive provoked controversy. This was partly because the decision-making was highly centralized at the Blue House and MCI, bypassing the more orthodox mechanism led by EPB. It was also because its large financial and fiscal mobilization forced EPB to make a difficult decision of balancing micro investment planning with macroeconomic management.

The nature of industrial policy making changed significantly under President Chun Doo-hwan (in power 1980-88). A typical example was his semiconductor related policies. In contrast to the promotion effort up until the 1970s, the government focused on formulating guidelines of the industries and refrained from actively pushing policy targets. In addition, most of these policies were demanded by the private sector rather than initiated by the government. When the Basic Plan for the Promotion of the Electronics Industry was prepared, MCI formed a working group with sixteen members including the head of MCI's Electric and Electronics Industry Bureau (secretariat), related ministries, private companies, the Korean Institute of Electronics Technology, and the Electronics Industry Association of Korea (Hong 1997).

### *3-2. Thailand: Cabinet-level and national committees for Eastern Seaboard Development*

The 1980s was the time when Thailand made a leap forward in development by adopting export-oriented

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<sup>12</sup> In the Confucian culture, public recognition by the President has special meaning with high prestige.

industrialization. Prior to this, in the late 1970s the government faced serious balance of payments problems triggered by the oil crises, and the strengthening of industrial competitiveness became an urgent goal for the country. Prime Minister Prem Tinsulanonda (in power 1980-88) took the lead in pushing priority policy agenda and instituted mechanisms for addressing three national priorities: (i) Eastern Seaboard Development; (ii) government-business consultation; and (iii) rural development. All of these were highlighted in the Fifth National Economic and Social Development Plan (1982-86).

For each of the three priority programs, Prime Minister Prem established a national committee under his chairmanship and entrusted the technocrat teams of the National Economic and Social Development Board (NESDB) to plan, coordinate and monitor respective programs. Below, we will examine how these committees were organized and functioned for the two of the national priority programs, (i) and (ii), above.

As Thailand's first forward-looking strategic initiative for an economic take-off, the Eastern Seaboard Development (ESD) program was a flagship regional development program receiving the highest priority in the Fifth and Sixth Development Plans<sup>13</sup>. Located 80 to 200km southeast of Bangkok (the Thai capital), the ESD program had an unprecedented scale with numerous project components in infrastructure development including deep seaports, roads, railways, power and communication, etc; industrial zones; urban development; water resources; and environmental management<sup>14</sup>. It aimed to strengthen international competitiveness by building industrial zones and generate employment outside Bangkok to mitigate concentration.

In late 1980, Prime Minister Prem established special coordination and decision-making mechanisms exclusively for the program. These included: (i) the Eastern Seaboard Development Committee (ESDC), a cabinet-level national committee chaired by the Prime Minister and managed by the Secretary General of NESDB; (ii) sub-committees chaired by the ministers of government organizations in charge; and (iii) the Office of the Eastern Seaboard Development Committee (OESD) within NESDB to act as the secretariat. OESD was headed by the Deputy Secretary General of NESDB.

These mechanisms combined top-down (policy issues) and bottom-up (technical issues) approaches and facilitated both vertical and horizontal coordination. The presence of a cabinet-level committee enabled quick decision-making on priority policy issues (*de facto* "fast track" processes) and strategic use of donor assistance. OESB coordinated the Budget Bureau, the Department of Technical and Economic Cooperation (DTEC), and the Fiscal Policy Office (responsible for loan aid) to work on the details of the budget and aid resource mobilization. In this way, the ESB program was treated as a special program outside the routine

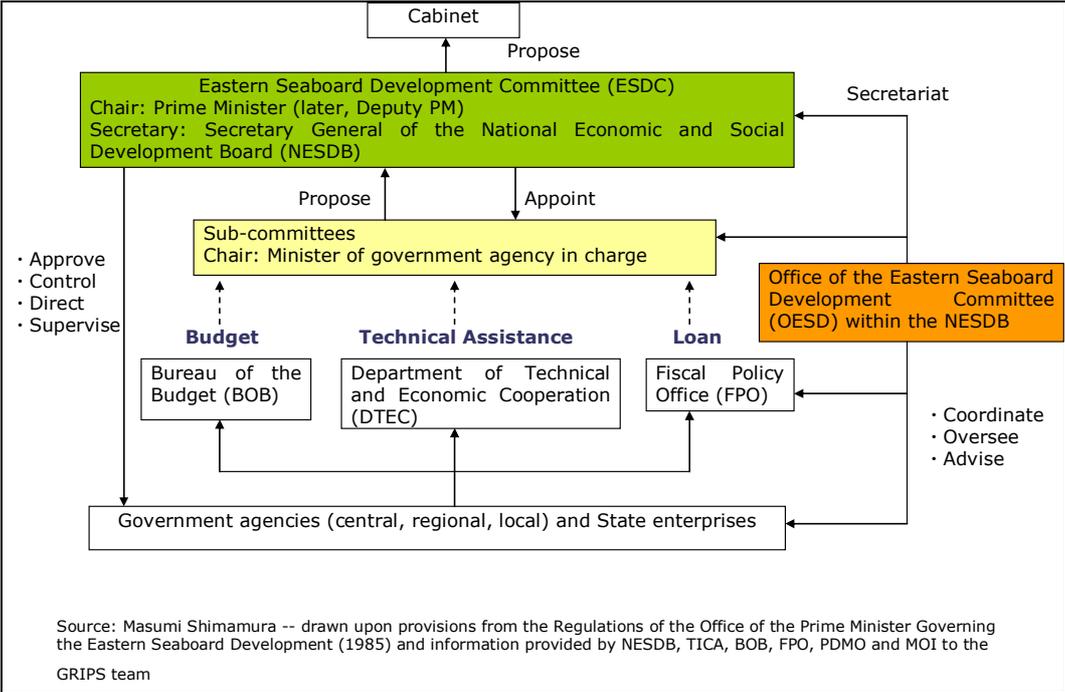
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<sup>13</sup> The Fifth Development Plan had one entire chapter dedicated to the ESD program.

<sup>14</sup> The basic plan for ESD was formulated with the funding of the World Bank. Japan provided wide-ranging assistance including both technical cooperation (master plans, feasibility studies, etc.) and financial cooperation. Regarding the latter, during the period of 1982-1993, Japan financed 16 major infrastructure projects amounting to a total loan commitment of 179 billion yen (via 27 loan agreements). The total public investment for ESB-related infrastructure was estimated at around US\$1.5 billion, which was largely funded by Japanese ODA loans.

policy making channels. The mechanisms also incorporated multi-layered check and balance functions. The NESDB secretariat acted as an influential liaison office to plan and implement the program. Highly motivated and competent technocrats were recruited, many of them being seconded from related ministries and agencies, for this task (Ohno and Shimamura 2007). Figure 6 describes the overall decision-making structure for the ESD program.

**Figure 8. Thailand: Coordination and Decision-making for Eastern Seaboard Development**



The National Joint Public and Private Consultative Committee (JPPCC) was the first formal mechanism for public and private sector collaboration in Thailand. Designating the private sector as the engine of growth, Prime Minister Prem established JPPCC in 1981. Like ESDC, it was chaired by Prime Minister Prem and the Secretary General of NESDB served as the committee secretary. Other members were deputy prime ministers, ministers and deputy ministers of economic ministries, the Governor of the Bank of Thailand, and the Secretary General of the Board of Investment. The private sector was represented by the Thai Chamber of Commerce, the Federation of Thai Industries, and the Thai Bankers Association.

JPPCC differed from the government-business forums in Japan and Korea examined above. Only matters of general interest were discussed, typically, problems that plagued the majority (if not all) of large firms. Nevertheless, because these forums were open to the press, they put pressure on the Prime Minister to respond to the reform proposals put forward by the business community. Through JPPCC, information on the impact of regulations, tax measures, and trade policy on the performance of individual firms as well as the national economy was quickly communicated to officials, helping the government to respond to the problems. Big businesses were incorporated into the policymaking process, especially in the making of

trade policy (Campos and Root 1996).

#### **4. Implications for Ethiopia**

Over the last five years, the Ethiopian government has made impressive achievements in building mechanisms for implementing the Industrial Development Strategy (IDS).

First, the government organized the Monthly Export Steering Committee, chaired by the Prime Minister and managed by MOTI, with the participation of related ministries and agencies, to review export performance and discuss measures to be taken for export promotion.

Second, MOTI regularly organizes sectoral forums with businesses and meets industrial associations (for example, textile and garment, leather and leather products, agro-processing, horticulture) to discuss export targets of respective industrial sectors.

Third, MOTI has built its structure around “priority” industry departments, based on the strategic vision of IDS, and established industry-specific “Development Centers” to act as a hub of formulating and implementing sectoral master plans, monitoring business performance, supporting problem-solving, and preparing reports to the Monthly Export Steering Committee. Furthermore, sector-specific technology and training institutes, especially the Leather and Leather Products Technology Institute (LLPTI) and the Textile and Apparel Institute (TAI), have been established to provide technical advice to firms by mobilizing donor support.

Fourth, Ethiopia has devised instruments to gather information on the problems faced by the private sector. These include dialogues between government and chambers of commerce at both national and local levels; the Private Sector Development (PSD) Hub, located in the Addis Ababa Chamber of Commerce, which conducts research and analyses for private sector development; and the PSD Sector/Technical Working Group which facilitates government-donor aid coordination.

These are laudable achievements in a relatively short period. Nevertheless, as Ethiopia hopes to move up to the next stage of industrial development, continuous efforts are required to build additional policy capability. For this purpose, based on the experiences of East Asia, the Ethiopian Government may consider strengthening the following organizational aspects:

- (i) A mechanism for constantly reviewing and adjusting industry-wide policy. This is particularly important as there are ongoing discussions on the possible expansion of policy scope of IDS or

moving to the “second-generation” of industrial policy<sup>15</sup>. Such a mechanism would also be useful in coping with unexpected shocks, such as a global financial crisis or an acute foreign exchange shortage.

- (ii) A mechanism for involving various stakeholders—not only businesses as has already been done, but also research institutes, experts and academicians. East Asian economies have actively mobilized the knowledge and expertise from experts and researchers outside the government and involved them in the policymaking process through deliberation councils, national and sector committees, institutes, and other informal discussion meetings. As suggested in Part I, Ethiopian experts and researchers may be mobilized for the evaluation of past and future industrial promotion measures, whose results should serve as analytical inputs to the industry chapter of the next PASDEP (see (iv) below).
- (iii) A mechanism for addressing cross-cutting or functional issues, in addition to industry-specific issues. Now that MOTI has made progress in building capacity to respond to industry-specific issues, it may also wish to consider how to address cross-cutting issues—for example, quality and safety standards, international trade policy, and industrial location—and make effective links between these perspectives and industry-specific support. This will become important when the planned *kaizen* program, focusing on selected pilot companies with JICA’s technical cooperation, comes to a scaling-up stage to involve a larger number of firms. Cross-cutting perspectives would also be useful for ensuring methodological uniformity on sectoral master plans.
- (iv) A mechanism for strengthening inter-ministerial coordination, especially among MOTI, MOFED, and MOARD. As noted in Part I, collaboration between MOTI and MOFED is crucial as MOTI prepares the industry chapter of the next PASDEP and, subsequently, the five-year industrial implementation plan. Moreover, since incentive measures have fiscal and financial implications for both export industry promotion and proposed import substitution, MOFED should be involved in the discussion on the possible expansion of industrial policy scope. Furthermore, to promote ADLI, it is vital that MOTI and MOARD work jointly to concretize several concepts related to the agro-industry sector such as “integrated agro food parks” and “growth corridors.” Moreover, ministries and agencies charged with infrastructure development and regional governments should also be involved when necessary. All these can be achieved by strengthening inter-ministerial coordination mechanisms centered around MOTI.

To achieve these organizational goals, it is important to consider how GRIPS-JICA industrial policy dialogue with the Ethiopian authorities may be used for the building of industrial policy capability

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<sup>15</sup> World Bank (2009), *Project Appraisal Document for Ethiopia: Protection of Basic Services Program Phase II Project*, Annex 10: Macroeconomic Assessment and Monitoring Arrangements, p.150.

mentioned in (i)-(iv) above. This is related to the question of how the policy-level forum and the working-level forum (Policy Dialogue Steering Committee) of the bilateral policy dialogue can contribute to the promotion of industrial policy coordination and stakeholder interaction which include both businesses and researchers.

Additionally, it is also useful to consider the following possibilities: (i) whether MOTI's Development Centers can in the future assume the role of managing government-business partnership in respective industrial sectors; (ii) whether to establish functional centers similar to Malaysia's STITF and Thailand's "Institutes"; and (iii) how the experience of inter-ministerial coordination under the Engineering Capacity Building Program should be used to improve the design of an inter-ministerial coordination mechanism.

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