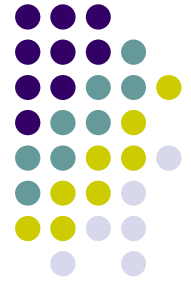


Dynamic Capacity Development in East Asian Industrialization



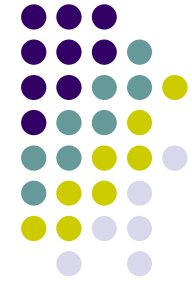
Izumi Ohno & Kenichi Ohno (GRIPS)
Revised Dec. 2008

Menu

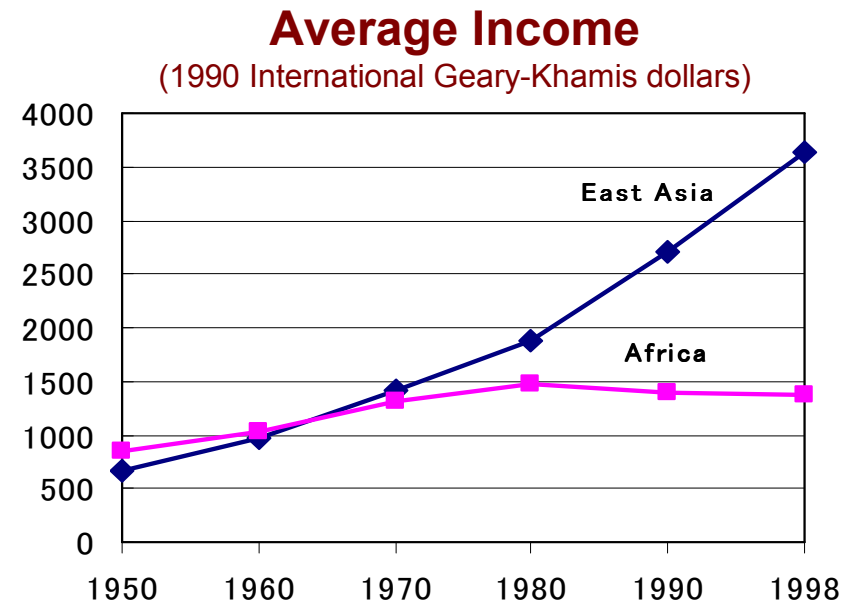


- East Asian miracles and disasters
- Dynamic capacity development
—desirable policies vs. local capability
- Goal orientation
—vision, strategies and concrete actions
- How donors can assist
- Examples from China, Japan, Thailand, Malaysia, Vietnam, El Salvador, Indochina, Mozambique

Diversity in East Asian Performance

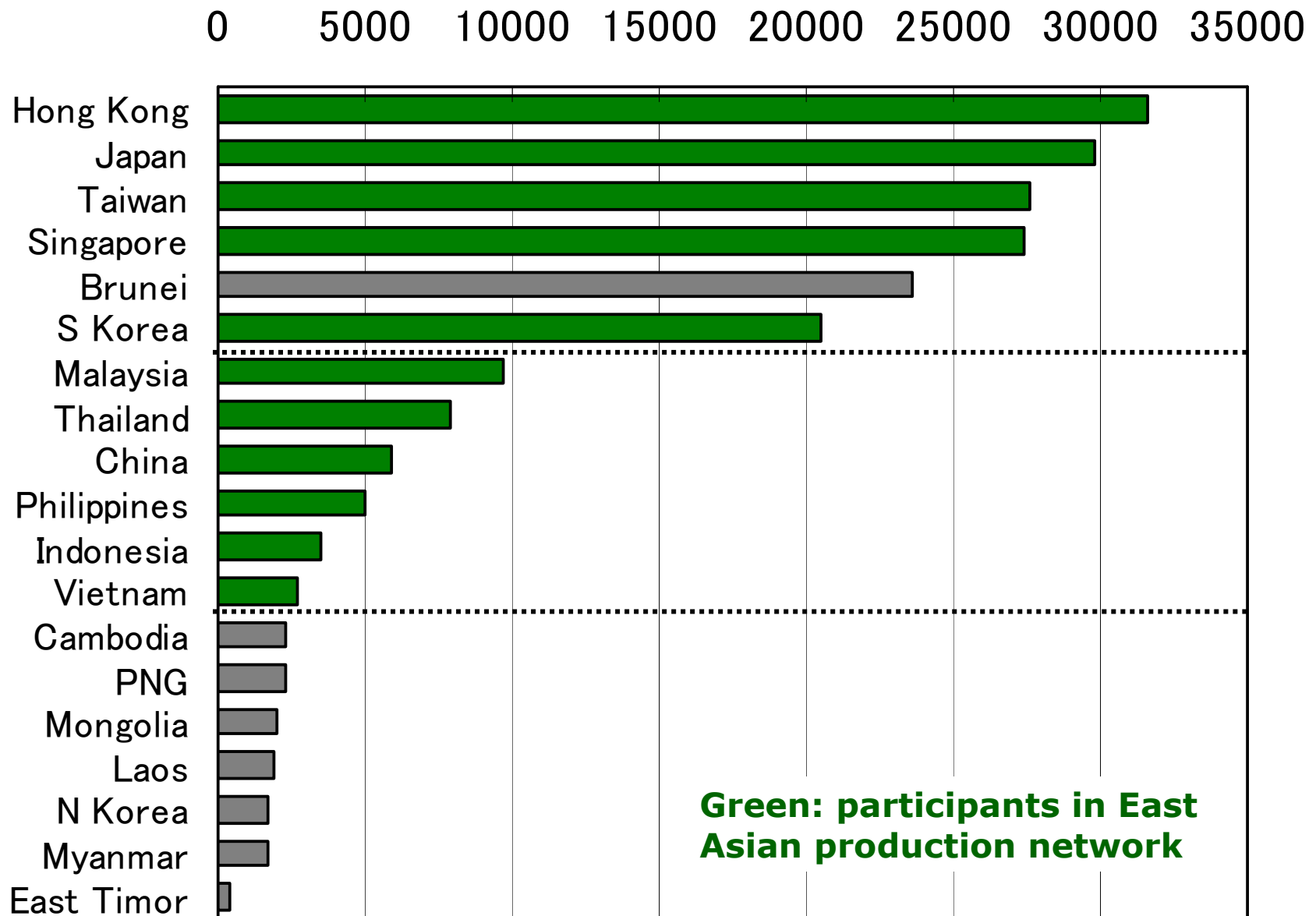


- E. Asia has high growth *on average*, but it contains super-performers as well as disastrous states.
- Winners' bias in studying high performers only; we should compare successes and failures in E. Asia.



Source: Angus Maddison, *The World Economy: A Millennium Perspective*, OECD Development Centre, 2001.

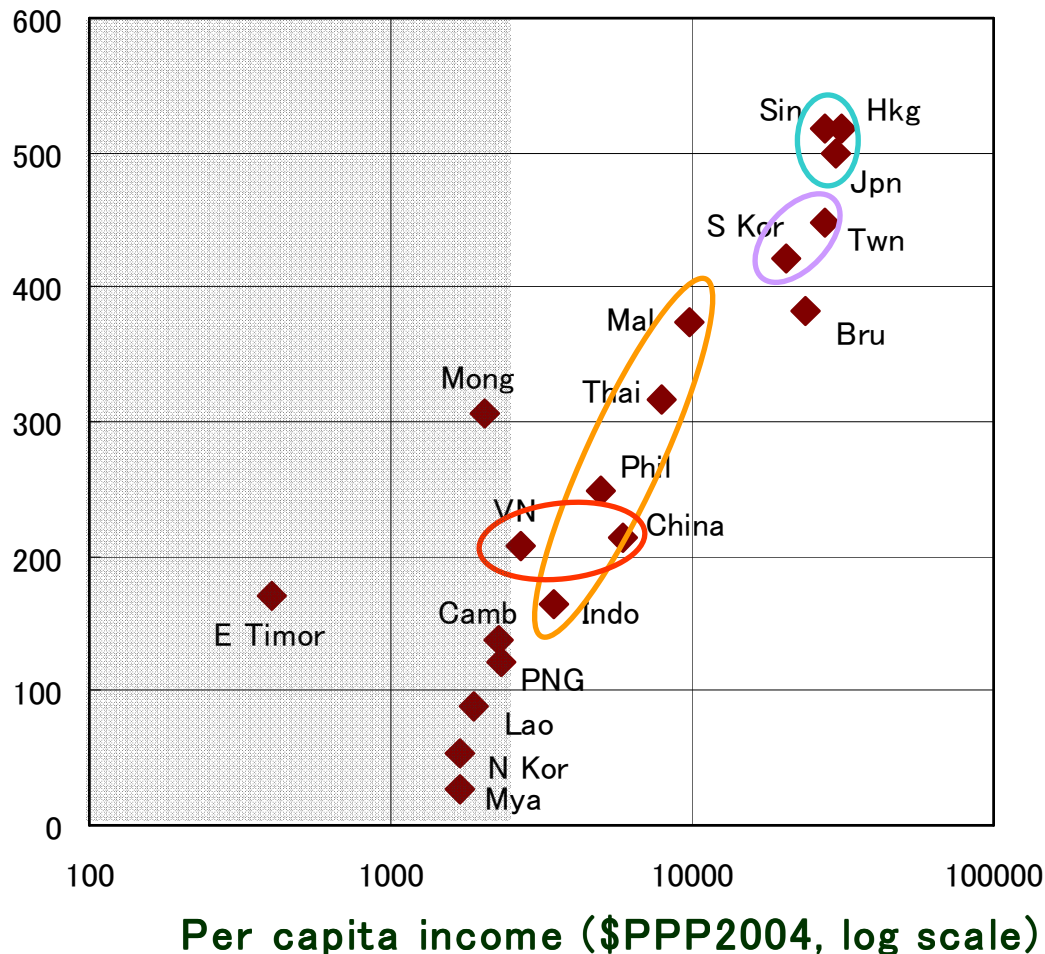
Per Capita GDP in 2004 (\$ PPP) World Bank data



Diversity in Political and Economic Development



Governance, WGI2005



High correlation (0.90) but causality cannot be argued from this diagram

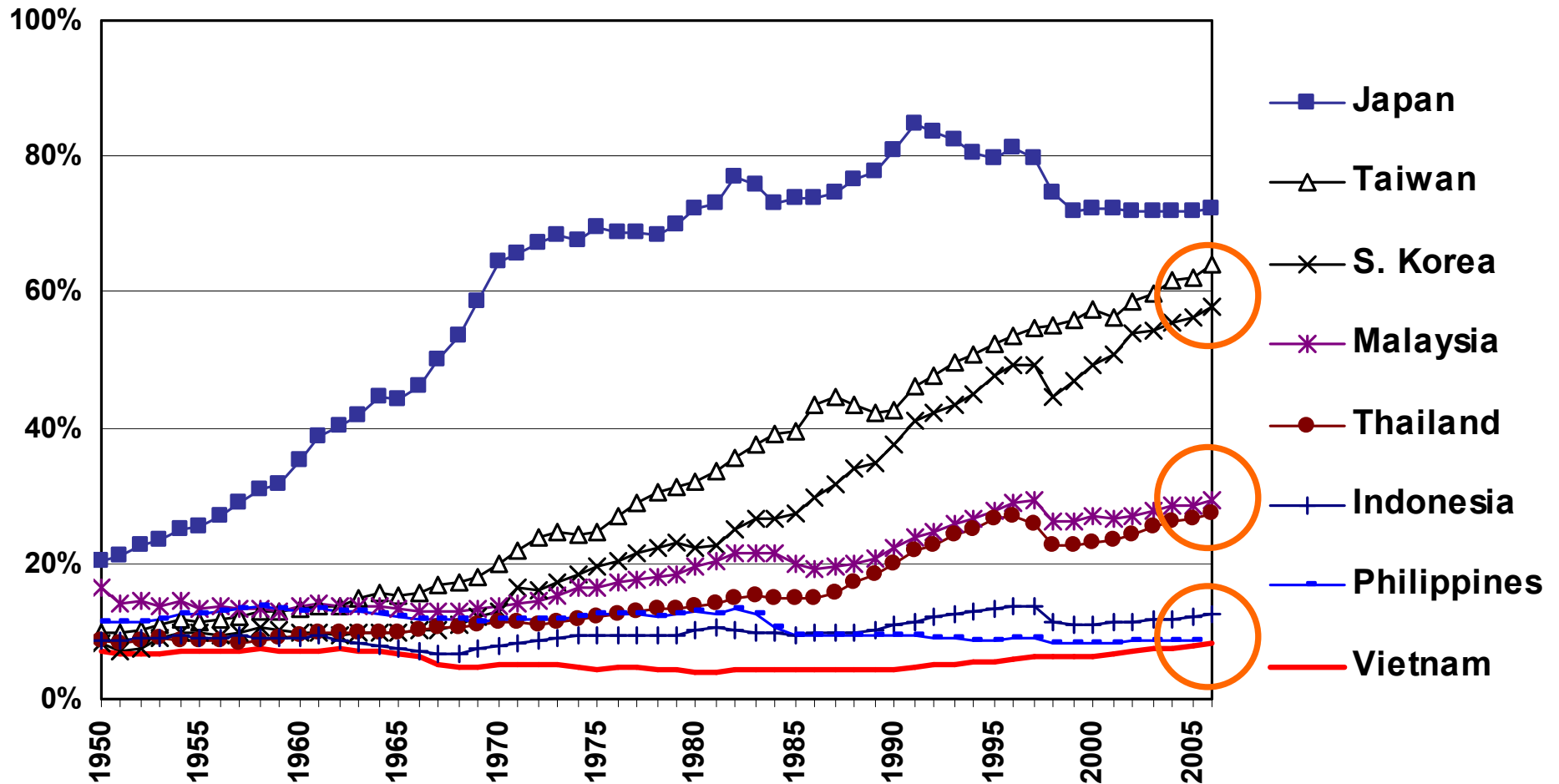
Only circled economies participate in regional dynamism

Sources: Compiled from World Bank, *Worldwide Governance Indicators*, Sep. 2006; and World Bank, *World Development Indicators*, 2006.

Different Speed of Catching Up

Per capita real income relative to US

(Measured by the 1990 international Geary-Khamis dollars)



Sources: Angus Maddison, *The World Economy: A Millennium Perspective*, OECD Development Centre, 2001; the Central Bank of the Republic of China; and IMF *International Financial Statistics* (for updating 1998-2006).

Lazy Workers in Japan (Early 20th Century)



Survey of Industrial Workers, Ministry of Agriculture and Commerce, 1901

- Japanese workers are only half as productive as American workers.
- They stop working when supervisors are not watching.
- Skilled workers are few, and they are often too proud and lazy.
- Job hopping is rampant in comparison with US.
- Japanese workers never save.

➔ Even today's high performers started with low capacity in private and public sectors.

South Korea: Unpromising Place with Inept Institution



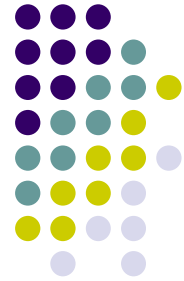
The Lessons of East Asia – Korea, K. Kim & D.M. Leipziger (1993)

- Heavily dependent on US foreign aid for food, fuel and other raw materials, Korea was not seen as a promising place for major investments.
- During the period from 1940 to 1960, the Korean bureaucracy was a kind of spoils system.

The East Asian Miracle, The World Bank (1993)

- At late as 1960, the Korean civil service was widely viewed as a corrupt and inept institution.
- In less than two decades, this view has been dramatically altered. By the late 1970s, the bureaucracy had become one of the most reputable in developing world. How did this come about?

Thailand: Haphazard Planning, Shortage of Qualified Personnel



World Bank Mission Report 1959

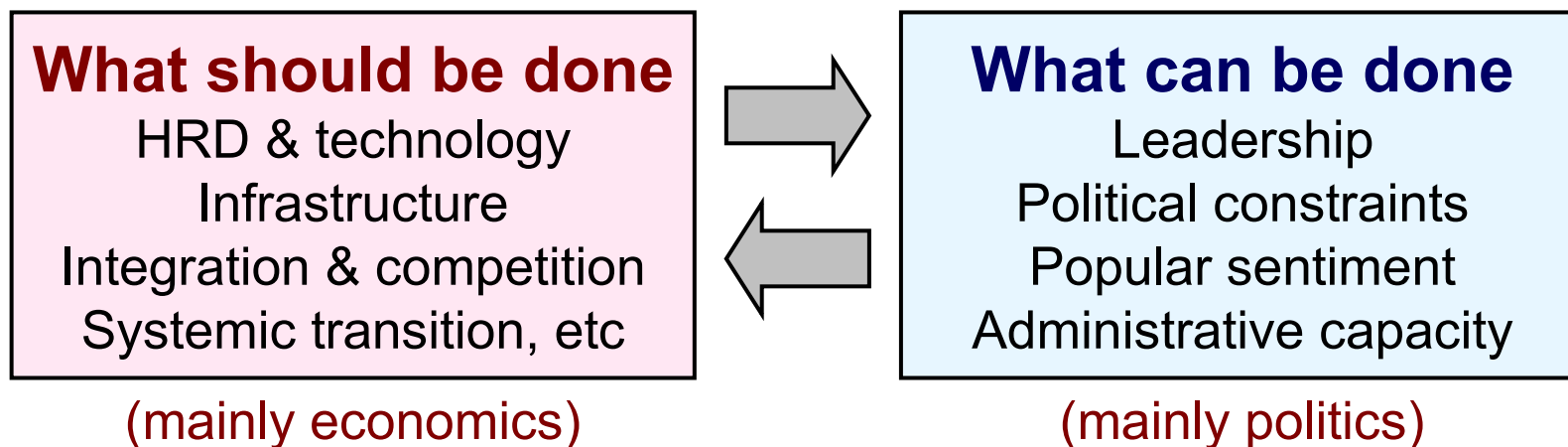
- Investments have been authorized without first trying to find out if they would serve urgent needs, if they would be as productive as other alternatives, or if the particular forms of investment chosen were the best means of attaining their objectives.
- There is a shortage of trained manpower and of managers and administrators qualified by experience to operate industrial concerns and government departments efficiently.
- It will be most difficult, if not impossible, to find suitably trained and sufficiently experienced Thai personnel who can be spared from present assignments to fill all these important senior positions.

Source: *A Public Development Program for Thailand, Report of a Mission organized by the IBRD at the request of the Government of Thailand*, The Johns Hopkins Press, 1959.

Policy Design: Desirability vs. Feasibility



- Development is both a political process and an economic process.



- Each country is unique in *what needs to be done* as well as *what can actually be done*.
- Any policy maker must work with economic and political space simultaneously.



Policy Design (cont.)

- Policy advice without feasibility consideration cannot be implemented—regardless of whether proposed actions are a few or many, common or tailor-made.
Eg. macro conditionality (fiscal & monetary austerity), transitional strategy (big-bang vs. gradualism), external opening, governance, growth diagnostics, etc.
- We need to figure out a policy sequence which is both desirable *and* feasible in each country's context.
- While the government is directly responsible for politics, outsiders can indirectly assist in overcoming political problems.

Good Governance Debate

Worldwide Governance Indicators (Kaufman Index)



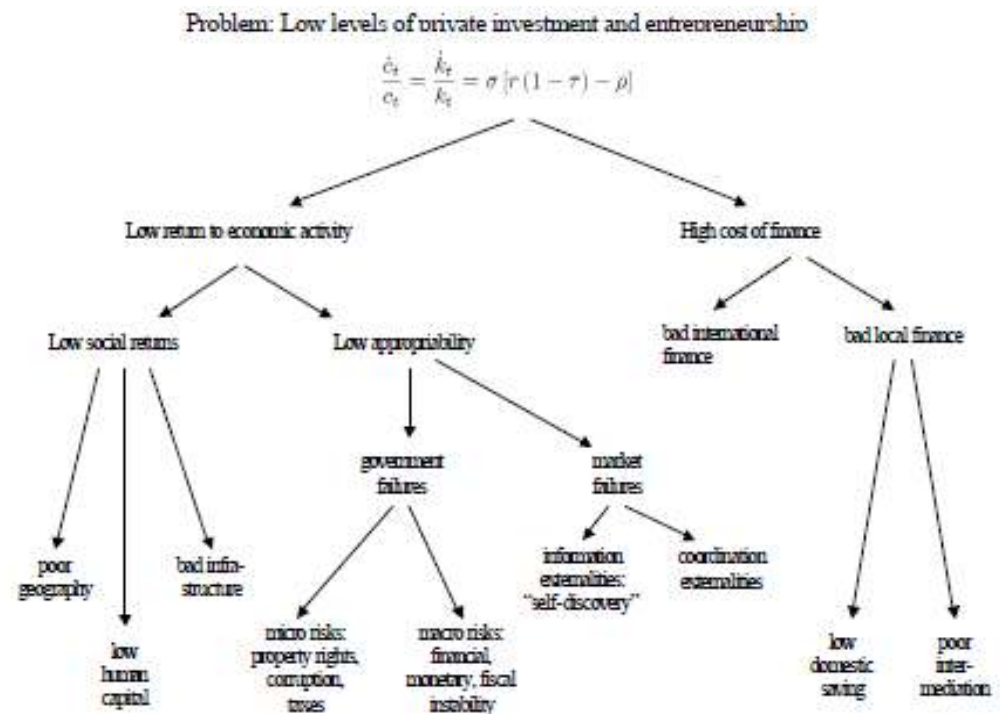
- Causality? (growth ↔ governance)
- Feasibility of a long menu of institutional changes and capacity-building initiatives?
- No guidance on what specifically needs to be done in the real world context:
 - Merilee Grindle: “good enough” governance
 - Mushtaq Khan: “growth-enhancing” governance capability
 - Y. Shimomura: “endogenous” good governance elements
- East Asian high performers did not (do not) score high in Kaufman Index.

Growth Diagnostics (HRV Model)?

Hausmann, Rodrik and Velasco (2005)



- Discover a small number of **most binding constraints** to growth in each country.
- **HRV Tree**—private investment is key to growth; inquiry starts with *low return* or *high cost of finance*, and the causes of each.
- Harvard, WB, DFID, AsDB, IDB etc. are conducting GD in many countries.



Problems with Growth Diagnostics



- Search for desirable policies without considering political/administrative feasibility (a few or many, common or unique – secondary issues).
- Discovery of general weaknesses relative to global norm instead of enhancing the country's unique strengths (do you need to be “average” in all aspects before launching a development strategy?)
- Diagnostics only—no clear mechanism for prescribing concrete actions (the task is left to policy makers).

How to Cope with Economics-Politics Nexus



- **Joint research in economics & political science?**
→ Fine for academics but not much use for policy makers (too abstract for operational use)
- **Policy-capability matching? (WDR97)**
Improve institutions/governance before attempting difficult policies (such as selective industrial policy)
→ Too broad and without focus; difficult to put into practice or mobilize political support
- **Dynamic capacity development**
Improve ability through selective hands-on experience—
clear goals, focused effort, trials and errors, cumulative sense of achievement

More on Dynamic Capacity Development



- Goal orientation: **long-term vision → phased strategies → concrete action plans.**
- Direct most effort to perfecting your strengths rather than correcting your general weaknesses (don't worry too much about Kaufman index or investors' ranking).
- Stop abstract thinking and start concrete action
 - No**—Is industrial policy useful? What is the role of state?
 - Yes**—Let's build this port & industrial zone successfully, etc.
- Achieve successes one by one, and be proud.
- Top leaders: take political risk and responsibility to move things fast forward.

A Comparison of East and West

	East Asian	Traditional
Purpose	Enhance strengths to create competitiveness	Find weaknesses relative to norm, and correct them
Selectivity	Future vision, phased strategies, concrete actions to achieve goals	Improve governance, institutions etc. generally (let market do the rest)
Time frame	Patient; build trust through long-term engagement	Short-term implementation and frequent reviews
Modality	Hands-on experience, less talk or writing	Emphasize framework, monitoring, dissemination



Example: Pragmatism of Deng Xiaoping in China



(In power 1978-97)

- All for production increase rather than fighting for political ideology (cf. Mao, in power 1949-76)
- “*Black Cat or White Cat*” – capitalism (FDI) or socialism (SOEs) does not matter as long as it catches mice (increase production).
- *Special Economic Zones* – creating good business conditions in limited areas to receive investment.
- Trial-and-error and flexible adjustment (“Even try stock market and see”).
- “Some get rich first, others can follow later.”

Example: Latecomer Japan Beats British Textile Industry



1883 Establishment of Cotton Spinning Industry

Target: import substitution of cotton yarn (industrial input)

Actors: Eiichi Shibusawa (super business organizer)

Takeo Yamanobe (engineer studying in UK)

Action: establish **Osaka Spinning Co.** with sufficient scale and technical breakthrough

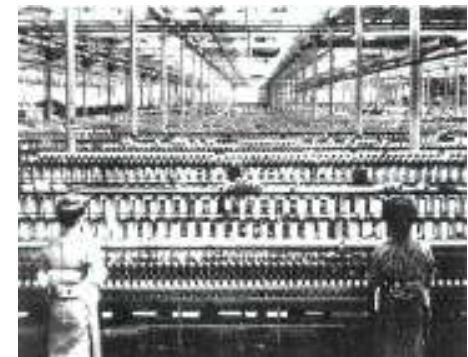
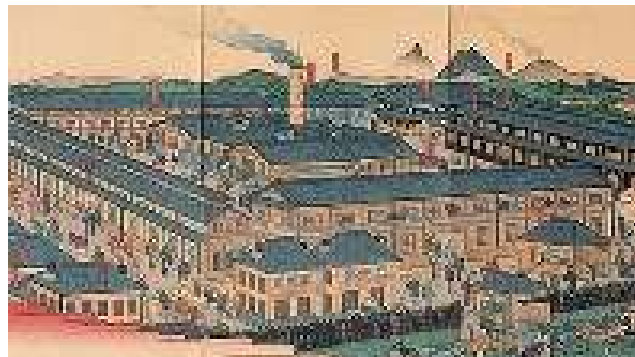
Result: instant success with a large number of followers; Japan overtakes UK as top textile exporter by early 20th century; The City of Osaka is called “Manchester of the Orient”



Shibusawa



Yamanobe



Example: Thai Automotive Master Plan 2002-06



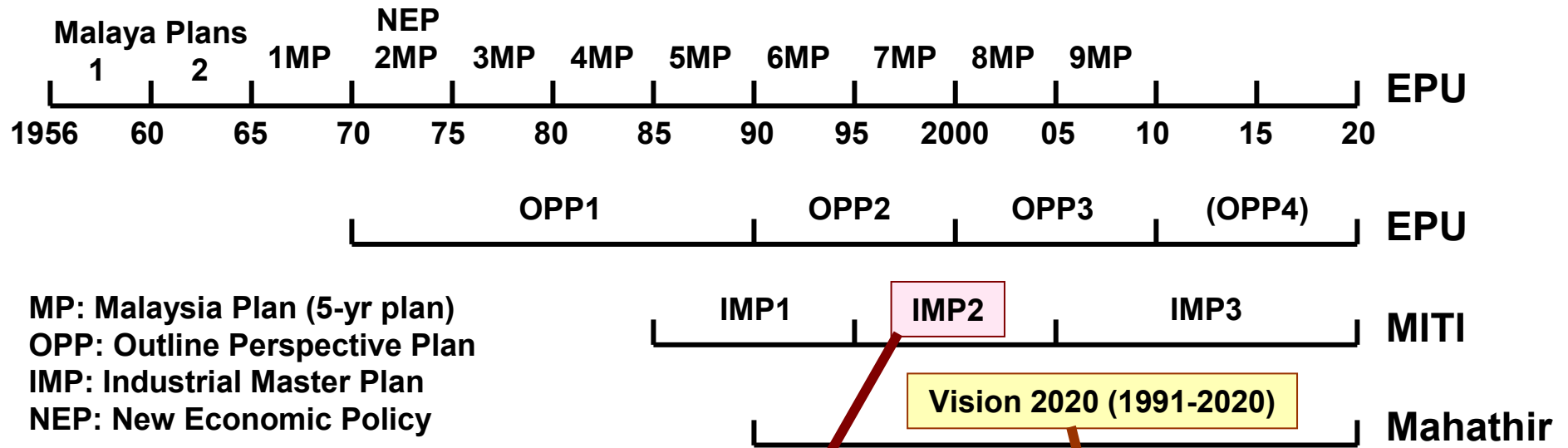
PM Thaksin's Vision: Become "Detroit of Asia"

Targets: produce 1 million cars/year & export 40%
produce 2 million motorcycles/year & export 20%
export high quality parts (>200 billion baht)
localization >60%

Actors: Ministry of Industry, Thai Automotive Institute, FDI producers, local suppliers

Action: 180 pages of policy matrices detailing strategies, actions plans, performance criteria, responsible parties

Result: all targets achieved by 2005, one year ahead of schedule



MP: Malaysia Plan (5-yr plan)
 OPP: Outline Perspective Plan
 IMP: Industrial Master Plan
 NEP: New Economic Policy
 EPU: Economic Planning Unit
 MITI: Ministry of International Trade and Industry

Industrial Master Plan 2 (1996-2005):

- Raising & broadening value chains
- Cluster-based industrial development
- Electronics, textiles, chemicals, resource-based industries, food, transport machinery, materials, machinery & equipment

Become a fully developed country by 2020 featuring:

- National unity
- Confidence
- Democracy
- Moral & ethics
- Tolerance
- Science & technology
- Caring culture
- Economic justice
- Prosperity

Example: Malaysia



How Donors Can Help

- (1) If the country already has valid industrial vision, strategies and action plans, **mobilize aid to realize the existing vision.**
- (2) Engage in **long-term, open-ended policy dialogue** for self-discovery and strategy formulation (preferably followed by specific assistance).
- (3) Build a **core infrastructure** and align aid and investments around it through donor coordination and private-public partnership.

(1) Mobilizing Aid to Realize the Existing National Vision



- Ethiopia's industrial vision (ADLI, Ind. Dev. Strategy) and strategies (Leather M/P, etc) are largely valid and clear.
- Donors should support Ethiopia's vision rather than creating a new one.
- Japan has many aid tools for industrial support:
 - Production and technology management
 - Industrial human resource training
 - Efficient logistics and marketing
 - Infrastructure (esp. transport and power)
 - Regional development planning
 - Creating necessary laws, standards, institutions
 - Removing negative impacts of industrialization

Japan's ODA: Standard Policy Menu for Enhancing Industrial Capability in East Asia

Policy area	Measures
1. Capacity building (for specific firms)	<ul style="list-style-type: none"> - <i>Shindanshi</i> (enterprise evaluation) system - TA for management and technology - Mobilization of current or retired Japanese engineers - Intensive support for limited sectors (e.g., die & mold) - Awards, PR and intense support for excellent local companies
2. Human resource (general or institutional)	<ul style="list-style-type: none"> - Management/technical centers and programs - Mobilization of current or retired Japanese engineers - Alliance between FDI firms and local universities/centers - <i>Monozukuri</i> school (to be upgraded to university) - Meister certification system
3. Finance	<ul style="list-style-type: none"> - Credit guarantee - SME finance institutions - Two-step loans
4. Incentives	<ul style="list-style-type: none"> - Exemption or reduction of taxes and custom duties - Grants or loans for specified actions

Standard Policy Menu (cont.)

5. FDI-local linkage	<ul style="list-style-type: none">- Database and matching service- FDI-vendor linkage program- Parts Industry Association and Business Study Meetings- Trade fairs and reverse trade fairs- Improving logistics
6. FDI marketing	<ul style="list-style-type: none">- Creation of strategic industrial clusters- Industrial parks and rental factories- Efficient logistics and infrastructure- FDI marketing targeted to specific sectors or companies
7. Policy framework	<ul style="list-style-type: none">- Supporting industry master plan- SME law- SME ministry- Business associations and industry-specific institutes- Quality standards and testing centers

Note: This table summarizes Japan's assistance measures to East Asian countries contained in the New Aid Plan for ASEAN (late 1980s to early 1990s), the Mizutani Report for Thailand (1999), the Urata Report for Indonesia (2000), and ongoing discussion for strengthening Vietnam's supporting industries (Ohno, 2008b).

(2) Japan's Policy Dialogue with Developing Countries



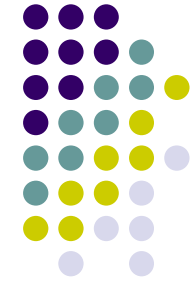
- **Argentina** – Okita Mission 1985-87; 1994-96 (follow up)
- **Vietnam** – Ishikawa Project 1995-2001
- **Thailand** – *Mizutani Report* for upgrading SMEs and supporting industries, 1999
- **Indonesia** – Continuous Government-Business Policy Dialogue; *Urata Report* for SMEs, 2000; Prof. Shiraishi & Asanuma, 2002-04 (post-Asian crisis)
- **Laos** – Prof. Hara for overall development strategy, 2000-05
- **Myanmar** – Prof. Odaka, 1999-2002 (but failed)

Ishikawa Project in Vietnam 1995-2001



- Communist Party General Secretary Do Muoi requested Prof. Shigeru Ishikawa to study the Vietnamese economy. The bilateral project was agreed between two prime ministers.
- JICA mobilized a large number of scholars and consultants. Prof. Ishikawa emphasized the spirit of mutual respect and joint work (and a lot of patience).
- Topics covered: macro, budget & finance, industry, agriculture, trade, SOE reform, Asian financial crisis.
- Continued dialogue—New Miyazawa Plan (1999), Vietnam-Japan Joint Initiative for improving investment climate (2003-).
- Now under preparation—Vietnam-Japan Partnership for Supporting Industry Development.

Ishikawa Project in Vietnam



Vietnam = Transition economy
+ Underdevelopment

Tasks:

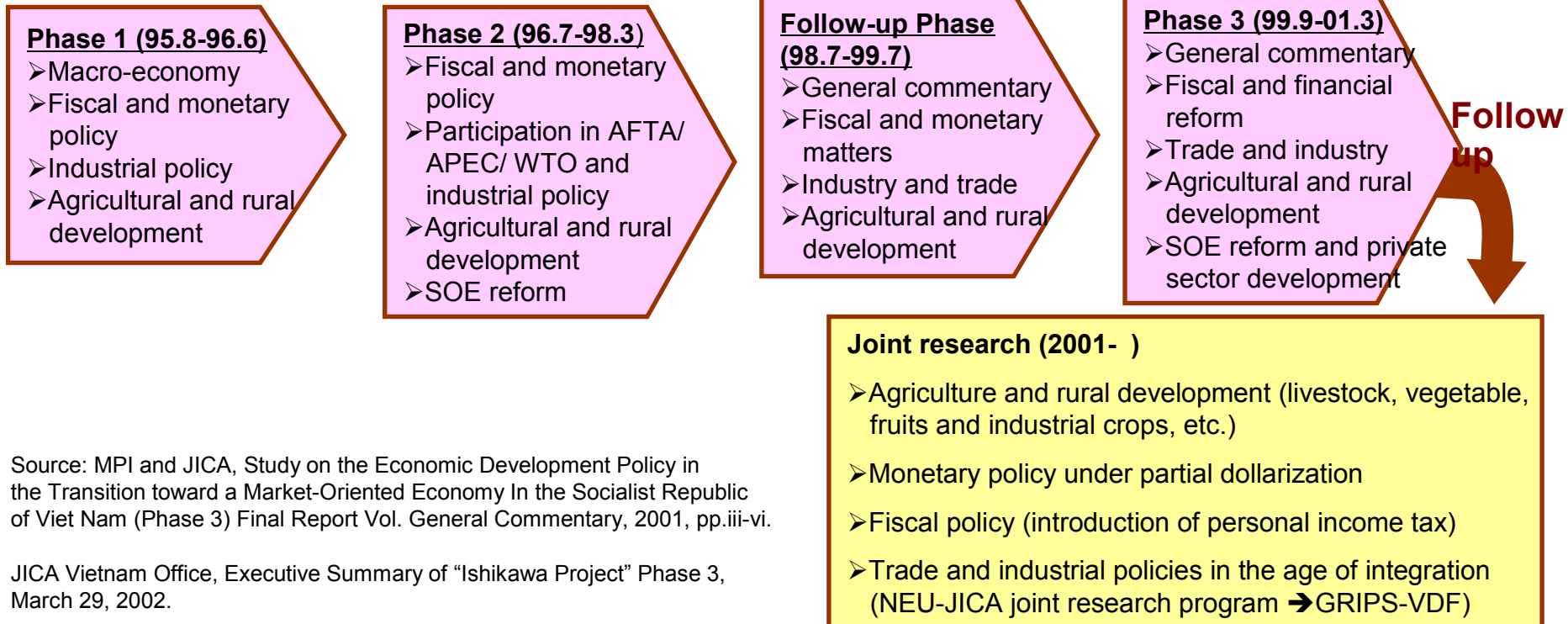
- Macroeconomic stabilization
- Structural adjustment (systemic transition to market economy)
- Long-term development strategy

Advise on the drafting process of the 6th Five-Year Plan

Advice on the implementation issues of the 6th Five-Year Plan, including participation in AFTA/APEC/WTO and industrial policy

Advice on the emerging issues arising from the East Asian crises and the economic integration process

Advice on the formulation of the 7th Five-Year Plan



Source: MPI and JICA, Study on the Economic Development Policy in the Transition toward a Market-Oriented Economy In the Socialist Republic of Viet Nam (Phase 3) Final Report Vol. General Commentary, 2001, pp.iii-vi.

JICA Vietnam Office, Executive Summary of "Ishikawa Project" Phase 3, March 29, 2002.

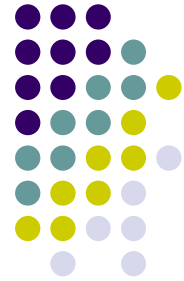
Policy Dialogue in Africa?

The Case of Zambia



- JICA is conducting “Triangle of Hope” Project 2006-09 (improving investment climate), mobilizing a Malaysian expert (ex-MIDA official).
- Task forces organized within GoZ, with the involvement of President
- Investment promotion initiatives – targeted at Malaysia and India
- JICA support to the development of Multi-facility Economic Zone (MFEZ).
- As a next step, Zambia wants Japan to help formulate a long-term industrial strategy.

(3) Japanese Assistance for Core Infrastructure



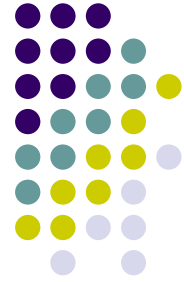
- **Greater Mekong Subregion** – East-West and North-South Corridors for development of Indochina
- **Thailand** – Eastern Seaboard: creation of industrial zones around a port infrastructure
- **Vietnam** – Highway No.5 (Hanoi – Haiphong Port) for FDI attraction (industrial clusters)
- **Cambodia** – Sihanoukville Port, power and telecom networks, special economic zone
- **El Salvador** – La Union Port + regional development
- **Mozambique** (planned) – Nacala Port and Corridor for regional development

El Salvador: Growth Diagnostics vs. Japan's ODA



- **Hausmann-Rodrik Growth Diagnostics 2003:** The largest constraint in El Salvador is the lack of self-discovery caused by market failure (low appropriability). Infrastructure is not a binding constraint.
- **Local Report 2008 (FUSADES):** Our infrastructure is best in Central America and we are already a regional hub, but we can do even better by handling trade more efficiently. This will raise our productivity and competitiveness. For this purpose, infrastructure, especially *La Union Port*, is essential.
- **Japanese ODA in El Salvador:** Upgrade *La Union Port* as key infrastructure. Additional support for social & HRD, productive sectors, Eastern Region development, and regional integration.

The Vision: Strengthening El Salvador's Position as a Regional Transport Hub



- Airport already a regional hub (built by Japan 28 years ago)
- Central American Highway link
- Pacific-Atlantic link via Panama Canal – El Salvador as a regional feeder
- However, La Union Port is low capacity
 - ➔ Build a new port with sufficient capacity and services





Components of Japan's ODA in El Salvador (ongoing)



KEY INFRASTRUCTURE

- Construction of La Union Port
- Rebuilding an old bridge (Honduras border)
- Digital map technology for efficient planning
- Urban development planning for La Union City

Social & Human RD

- MEGATEC La Union (training center)
- Primary schools & math
- Clean water
- Rural electrification
- Solid waste control

Support for Productive Sectors

- SME promotion
- Aquaculture
- Small-scale agriculture
- Reservoirs & irrigation
- Small-scale livestock

Eastern Region Development

- La Union Port
- Plan Puebla Panama
- CAFTA & other FTAs
- Cent. Amer. integration
- M/P for Eastern Region

Greater Mekong Sub-region East-West Economic Corridor



**The Vision for
GMS in
Southeast Asia**
(Source: JBIC)

Nacala Development Corridor

The Case of Mozambique (planned)

Nacala Development Corridor →
(Source: CPI, Govt. of Mozambique)



Regional development around Nacala port and corridor

Conclusion:

East Asian Policy Engagement



- Building new competitiveness from the country's strengths, not correcting general weaknesses.
- Goal-oriented approach—vision, phased strategies, concrete action plans.
- Focus effort strategically—don't waste time in general improvement without clear goals.
- Donor-recipient policy dialogue for trust, knowledge transfer, and strategy formulation.
- Long-term open-ended engagement rather than outcome-based approach with frequent reviews.