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Development Forum Report

Assisting Industrial Transformation in Africa

Japan-Ethiopia Industrial Policy Dialogue Phase II

Japan International Cooperation Agency (JICA)

GRIPS Development Forum

Edited by the GRIPS Development Forum

Contact:
GRIPS Development Forum
National Graduate Institute for Policy Studies
7-22-1 Roppongi, Minato-ku, Tokyo, 106-8677 Japan
Phone: 03-6439-6337
Fax: 03-6439-6010
E-mail: forum@grips.ac.jp
http://www.grips.ac.jp/fourm-e/

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Foreword

This volume contains industrial policy advice and supporting materials prepared by the GRIPS Development Forum (GDF) and the Japan International Cooperation Agency (JICA) in the Second Phase of the Ethiopia-Japan Industrial Policy Dialogue (January 2012-July 2016). A Total of nine regular policy sessions were held in Addis Ababa at three levels: with the Prime Minister, with Ministers and State Ministers, and with officials and experts on the ground where policies were being implemented. These included a series of High Level Forums, organized jointly by the Ethiopian Development Research Institute (EDRI) and JICA, under the chairmanship of H.E. Dr. Newai Gebre-ab, Chief Economic Advisor to the Prime Minister and the Executive Director of EDRI.

Besides these regular sessions, additional meetings were organized with the Prime Minister and his high-level advisors while visiting Japan, many policy letters were exchanged with them, and eight policy research missions were dispatched to third countries. JICA's industrial cooperation projects, including Kaizen and a pilot for champion product creation and country branding, were conducted in parallel with the policy dialogue. This format was basically the same as in the First Phase (June 2009-May 2011) whose records were published earlier from GDF. The present volume contains the highlights of our policy advice at the end of the Second Phase. Compared with the First Phase which mostly focused on general policy methods and East Asian experiences, the Second Phase was more action-oriented and supportive of concrete policy measures initiated by the Ethiopian government.

The Principal authors of this volume were Kenichi Ohno (GDF), Izumi Ohno (GDF), Toru Homma (JICA), and Masaaki Hamada (JICA) in cooperation with other members of JICA team (Keiji Katai, Chigusa Seki, Kimiaki Jin, Kana Fukuda, Emi Kurita, and Deresse Fekadu Nigussie). The authors would like to thank all leaders, officials, researchers, and business people in Ethiopia, Japan, and other countries who provided us with valuable information and views without which our advice would have been less pertinent. Competent support of Akemi Nagashima, Mieko Iizuka, and Yuka Akiyama (GDF) in preparation of this report is deeply appreciated.

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List of Abbreviations

5S	Seiri, Seiton, Seisou, Seiketsu, Shitsuke
A.S.I.A	Alliance for Supporting Industries Association (Thailand)
ADLI	Agricultural Development Led Industrialization
AEO	Authorized Economic Operator
ASEAN	Association of Southeast Asian Nations
ASID	ASEAN Supporting Industry Database
ASYCUDA	Automated System for Customs Data
BOI	Board of Investment (Thailand)
BOT	Build Operate Transfer
BPR	Business Process Re-engineering
BSID	Bureau of Supporting Industries Development (Thailand)
BUILD	BOI Unit for Industrial Linkage Development
CDC	Council for the Development of Cambodia
CIER	Chung-Hua Institution for Economic Research
CMP	Cut-Make-Pack
CSA	Central Statistical Agency of Ethiopia
DBE	Development Bank of Ethiopia
DD	Democratic Developmentalism
DEA	Data Envelopment Analysis
DFID	Department for International Development (UK)
DPST	Domestic Private Sector Transformation
EDRI	Ethiopian Development Research Institute
EFFORT	The Endowment Fund For The Rehabilitation of Tigray
EHDA	Ethiopian Horticulture Development Agency
EIA	Ethiopian Investment Agency
EIC	Ethiopian Investment Commission
EKI	Ethiopian Kaizen Institute
EMI	Ethiopian Management Institute
EPRDF	Ethiopian People's Revolutionary Democratic Front
ERCA	Ethiopian Revenues and Customs Authority
ETB	Ethiopian Birr
EU	European Union

FDI	Foreign Direct Investment
FeMSEDA	Federal Micro and Small Enterprise Development Agency
FY	Fiscal year
GDF	GRIPS Development Forum
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GRIPS	National Graduate Institute for Policy Studies
GTP	Growth and Transformation Plan
GTP II	The Second Growth and Transformation Plan
HLFs	High Level Forums
HR	Human Resource
ICOR	Incremental Capital-Output Ratio
ICT	Information and Communication Technology
IMF	International Monetary Fund
IoT	Internet of Things
IPD	Initiative for Policy Dialogue
IPDC	Industrial Parks Development Corporation
IPP	Independent Power Producer
IPR	Intellectual Property Rights
IZs	Industrial Zones
JBIC	Japan Bank for International Cooperation
JETRO	Japan External Trade Organization
JICA	Japan International Cooperation Agency
J-SMECA	Japan Small and Medium Enterprise Management Consultant Association
KDI	Korean Development Institute
KOTRA	Korea Trade-Investment Promotion Agency
LIDI	Leather Industry Development Institute
LMEs	Large and Medium Enterprises
LPG	Liquefied Petroleum Gas
MATRADE	Malaysia External Trade Development Corporation
METEC	Metals and Engineering Corporation (Ethiopia)
METI	Ministry of Economy, Trade and Industry (Japan)
MIDI	Metals Industry Development Institute

MITI	Ministry of International Trade and Industry (Malaysia)
MLIT	Ministry of Land, Infrastructure, Transport and Tourism (Japan)
MNC	Multinational Corporation
MOA	Ministry of Agriculture
MOEA	Ministry of Economic Affairs (Taiwan)
MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
MOFED	Ministry of Finance and Economic Development (Ethiopia)
MOI	Ministry of Industry
MOTI	Ministry of Trade and Industry (Ethiopia)
MSEs	Micro and Small Enterprises
Nor.	Nominal
NPC	National Planning Commission (Ethiopia)
NPOs	Nonprofit Organizations
ODA	Official Development Assistance
OEM	Original Equipment Manufacturer
OSOS	One Start One Stop
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
PPSEZ	Phnom Penh Special Economic Zone
PSRC	Policy Study and Research Center
QCD	Quality, Cost and Delivery
R&D	Research and Development
RDB	Rwanda Development Board
SCORE	SME Competitiveness Rating for Enhancement (Malaysia)
SFA	Stochastic Frontier Analysis
SME Support	Organization for Small and Medium Enterprises and Regional Innovation
SMEs	Small and Medium Enterprises
SOE	State-owned Enterprise
SPS	Sanitary and Phytosanitary
TAI	Thailand Automotive Institute
TAMA Cluster	Technology Advanced Metropolitan Area Cluster
TFP	Total Factor Productivity
TICAD	Tokyo International Conference on African Development

TIDI	Textile Industry Development Institute
TIER	Taiwan Institute of Economic Research
TNC	Transnational Corporation
TNI	Thai-Nichi Institute of Technology
TPA	Technology Promotion Association (Thailand-Japan)
TVET	Technical and Vocational Education and Training
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
US	United States
USAID	United States Agency for International Development
USD	United States Dollar
VA	Value-added
VMC	Vendors Meet Customers
WTO	World Trade Organization
WW2	World War Two

Preface

This volume contains industrial policy advice and related materials prepared for the Ethiopian government at the time it formulated the Second Growth and Transformation Plan 2015/16-2019/20 (GTP II). The advice and materials were extracted from various forums, meetings, papers, letters, and emails which took place in the course of Ethiopia-Japan Industrial Policy Dialogue (Preparation, 2008-2009; Phase 1, 2009-2011; and Phase 2, 2012-2015). Contents were selected from the viewpoint of current relevance rather than comprehensiveness with addition, updating, and re-prioritization where necessary. Past issues that have already been solved or become obsolete are not included.

During the last seven years, we have witnessed great changes in Ethiopia, a poor African country that grew fast and is emerging as a newly industrializing economy. Ethiopia in 2008, when we started this dialogue, and Ethiopia today are different countries not only in the physical outlook of streets and infrastructure but also in surging foreign direct investment (FDI) and expanding policy scope in support of industrialization. This economic dynamism was primarily the result of aggressive learning and doing by the Ethiopian government. High aspiration, strong commitment, and unrelenting pragmatism of the Ethiopian policy makers from top to bottom are truly remarkable. We praise this policy spirit as well as achievements up to the present.

Nevertheless, this is just a beginning in the long process of industrialization, and the way ahead for Ethiopia will be challenging. Moreover, the path that Ethiopia has chosen to travel, namely, FDI-led industrialization leading to technology transfer and skills upgrading, is a familiar one for East Asia's Flying Geese economies with well-known risks and pitfalls. That is why we would like to conclude Phase 2 of Industrial Policy Dialogue with this document featuring our honest and straightforward proposals and warnings from the perspective of Japanese and East Asian policy makers and analysts. Honesty and straight talk are the attributes strongly requested by the Ethiopian dialogue partners from the start.

This volume covers a wide range of issues raised and discussed by the GRIPS Development Forum (GDF) , the Japan International Cooperation Agency (JICA), and other members of the Ethiopia-Japan bilateral dialogue, as well as national leaders, officials, and experts in many countries in Africa and Asia who offered us valuable insights on industrial policy formulation and execution. We would like to thank them all. Responsibility for the content of this report however rests solely with GDF.

Tokyo, August 2016
GRIPS Development Forum

About Industrial Policy Dialogue

How it began

In 2002, the GRIPS Development Forum (GDF) started visiting African governments in search of an ideal partner for industrial policy dialogue. In Zambia, Tanzania, Ghana, Uganda, and Mozambique, we met presidents and/or economic ministers and permanent secretaries, did limited policy research, and engaged in mini policy dialogue. In the summer of 2008, we were approached by JICA to attend a policy conference in Addis Ababa. Professor Joseph Stiglitz of Columbia University, a Nobel laureate, organized annual African Task Force meetings of the Initiative for Policy Dialogue (IPD), and the next meeting was to be held in Ethiopia. JICA, which financially supported IPD, wanted Japan to contribute intellectually as well. We accepted the offer because we had heard that Ethiopia was serious about industrial policy. But we did not know that Prime Minister Meles Zenawi would attend virtually all sessions of the two-day conference.

We explained East Asian ideas of industrialization in our session and presented our edited book to the Prime Minister. He started to read it during the conference. Chapter 7 of the book was JICA's kaizen assistance in Tunisia.[1] In the following week, Prime Minister Meles invited the Japanese ambassador to his office and requested two-part cooperation from Japan—policy dialogue with GDF and kaizen by JICA. He had heard about kaizen before but did not know that JICA was helping African countries to adopt it. He said, "Please do a kaizen project in Ethiopia just as you did in Tunisia."

In reality, Ethiopia-Japan Industrial Policy Dialogue has been conducted jointly by GDF and JICA (not by GDF alone) at three levels: Prime Minister, Ministers and State Ministers, and officials and experts at the operational level. Policy dialogue sessions were held four times a year during Phase 1 and twice a year during Phase 2 in Addis Ababa. Although the frequency was reduced in Phase 2, our workload was the same or even higher because of increased research at home, letter-writing to the Prime Minister and Ministers, and more frequent policy missions to third countries in Asia

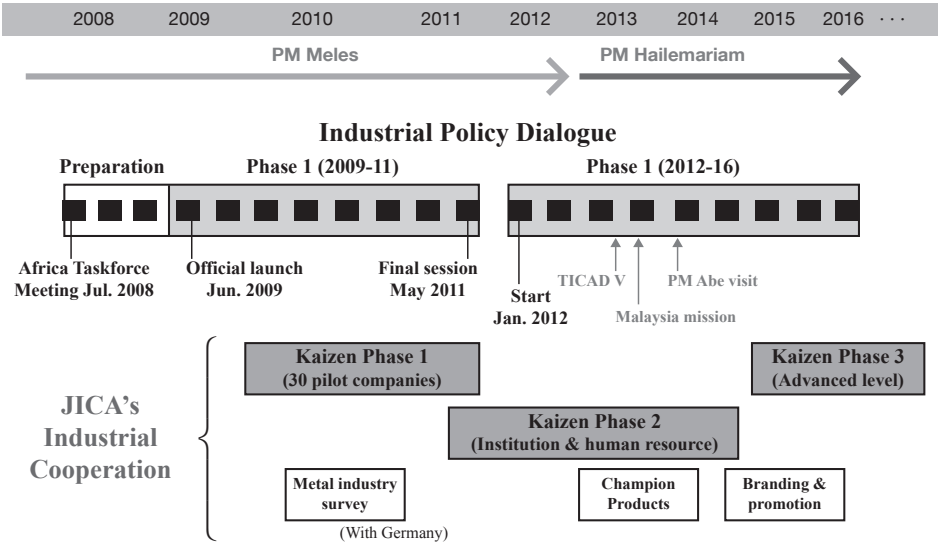
[1] Tsuyoshi Kikuchi, "The Quality and Productivity Improvement Project in Tunisia: A Comparison of Japanese and EU Approaches," ch.7, *Diversity and Complementarity in Development Aid: East Asian Lessons for African Growth,* GRIPS Development Forum, 2008. The book was subsequently updated and published commercially from Routledge in 2013 with the revised title, *Eastern and Western Ideas for African Growth*, where previous ch.7 was renumbered as ch.8.

and Africa. After Prime Minister Meles passed away in 2012, bilateral dialogue was continued by new Prime Minister Hailemariam Desalegn with equal zest and seriousness. We always aimed at building mutual trust, conveying most appropriate lessons for Ethiopia from a broad selection of countries (not just from Japan), and respecting the will and ownership of the Ethiopian government.

Modality and topics

The topics of Industrial Policy Dialogue were selected carefully each time to fit the policy environment and the interests of the Ethiopian government, both of which were rapidly evolving. We refrained from setting a series of agenda a few years in advance. We also did not want to just present our findings or recommendations; we wanted to make sure that what we discussed was closely related to what Ethiopia planned to do, and led to actual policy formulation and improvements. The Ethiopian government does not hesitate to revise policies or introduce new ones when it is convinced of the value of policy advice. We consider it important that Japan offers some (but not necessarily all) of the funding and/or technical expertise needed to carry out proposed policies. This increases the chance of proper implementation as well as the

Figure 1. Industrial Policy Dialogue and Kaizen



Note: Black boxes indicate three-level policy dialogue in Addis Ababa (PM, ministers, operation level).

incentives for both sides to seriously engage in the dialogue. Figure 1 illustrates how Ethiopia-Japan Industrial Policy Dialogue proceeded in parallel with JICA's industrial cooperation, consisting of kaizen and other concrete projects, on the ground.

During 2008-2015, 19 policy discussions were held with the Prime Minister, 18 High Level Forum sessions were conducted in Addis Ababa, and 15 policy research visits to third countries in Asia and Africa by Ethiopian, Japanese, and/or other officials and researchers were organized (not counting mutual visits between Ethiopia and Japan). In addition, there were numerous visits to offices, factories, and project sites, discussions with international organizations and other donors, regional trips inside Ethiopia and Japan, and invited lectures.

We had 10 face-to-face policy meetings with Mr. Meles Zenawi and 11 such sessions with Mr. Hailemariam Desalegn (two of which were when he was Deputy Prime Minister). With both Prime Ministers, discussions were direct, rich, and action-oriented with an average length of 1.5-2.0 hours each. The progress of kaizen and the agenda of High Level Forums were usually reported, but the discussion most often took unexpected turns to new policy initiatives, hot issues at hand, or how bilateral policy action could be accelerated. Prime Ministers sometimes wrote letters to us. In the first year of Phase 1, Mr. Meles sent us two long letters on the developmental philosophy of Ethiopia. He additionally requested GDF to collect English materials on various issues related to industry or East Asia, to which we responded with six information packages.[2] Mr. Hailemariam also asked for policy research papers when we did not send him enough. GDF wrote a total of 17 policy letters to Prime Ministers and other high-level policy dialogue participants.

At the level of Ministers and State Ministers, we organized formal and well-prepared sessions called High Level Forums (HLFs) which consisted of half-day or full-day presentation and discussion in a hotel conference room. HLF agenda were agreed 1-3 months ahead of the session by picking up industrial issues with high policy relevance to the Ethiopian government. We did not choose topics years ahead because situations and policy interests shifted very quickly in Ethiopia, and HLFs aimed at policy impact rather than academic merit. HLFs were usually covered in local TV and news media. Apart from HLFs, parallel seminars were sometimes organized in the

[2] Information packages requested by Mr. Meles were on the Japanese TVET system, rural life improvement programs in East Asia, basic information on steel and metal processing industries, international comparison of industrial policy formulation, historical experiences of foreigner-assisted technology transfer in Japan and Korea, and basic information on the chemical industry.

same day or week to discuss such specific issues as kaizen, champion product creation, and national re-branding (see Appendix Tables for High Level Forum agenda, policy letters, and third country policy missions).

From general to specific

Over the seven years, policy discussions with the Prime Ministers and at HLFs shifted from general principles to specific policy instruments, which was just as we had intended.

In Phase 1, broad issues were discussed such as Democratic Developmentalism (DD) and Agricultural Development Led Industrialization (ADLI), the two principal developmental philosophies of Ethiopia, as well as how East Asian governments drafted and executed industrial policy. It was particularly instructive to hear the details of DD and ADLI from Prime Minister Meles and clarify certain points with him, which provided us with a firm ground for initiating concrete knowledge sharing. Transferability and adjustment of kaizen to Ethiopian soil was another issue we discussed intensely, but deliberation on kaizen gradually moved to the operational level such as the Ethiopian Kaizen Institute (EKI) and the Kaizen Project Coordination Committee as JICA's kaizen cooperation took root. The Growth and Transformation Plan (a five-year plan that stressed growth and industrialization: GTP) was also discussed. The Ethiopian government separately requested an ad hoc survey on the basic metal and metal processing industries in Ethiopia, which was conducted in cooperation with Germany.

In Phase 2, equipped with sufficient knowledge of Ethiopian policy mindset, direction, and weaknesses, the main focus was to selectively introduce concrete policy measures so they would be seriously considered and even actually adopted by the Ethiopian government. It was important to choose a small number of policy measures and produce success rather than try to cover all measures at once but superficially. Candidate policy measures were proposed by both sides. First, to infuse an attitude toward demand orientation and customer satisfaction (not just efficient factory operation), strategic export promotion at the macro level and champion product creation at the micro level were proposed. Japanese, Malaysian, and Thai experts were mobilized for this purpose. A large Ministry of Industry mission headed by a State Minister was sent to Malaysia for two weeks to study strategic FDI attraction in preparation for revising the Investment Proclamation and Regulation. As manufacturing FDI began to

pour into Ethiopia from Turkey, India, China, and other countries, discussion turned to FDI-led industrialization and FDI-linked technology transfer, which are common policy agenda in East Asia. Topics such as industrial zone development and management, labor productivity and wage, one-stop investor service, and handholding were added. Bringing Japanese manufacturing firms to Ethiopia, which we thought was hardly possible a few years back, became a bilateral priority issue.

Following an East Asian path

In this way the situation surrounding the Ethiopian economy has changed from within and without. Ethiopian industrial policy is evolving partly in response to shifting circumstances and partly as an autonomous driving force of economic transformation. Previously we were unsure how the idea of ADLI—using agriculture growth to stimulate full-scale industrial growth—was to be concretized and scaled up in Ethiopia. By now, we are convinced that FDI-led industrialization, whose possibility became apparent several years ago in Ethiopia, will be the way to go forward for a considerable time in the future.

Successes up to now should be credited mainly to the strong political will and aggressive policy learning of the Ethiopian government, which is truly outstanding by the standards of developing countries. International cooperation was also helpful but it could not have been effective without proper policy mindset on the receiving side. Foreigners like us and others should be humble about the size of contribution we have made to this feat. We already know how hard the Ethiopian government worked to promote and incentivize flower growers with Dutch cooperation or to attract the first large integrated textile mill from Turkey. These did not happen by free markets or "self-discovery" of private firms.[3]

When policy discussions reach this stage, we no longer see any substantive difference between Asia and Africa. All nations are different in policy capability as well as social and external circumstances whether they are in Asia or Africa, so Ethiopia's socio-economic uniqueness itself cannot be cited as a differentiating factor. We should recognize the fact that many Asian governments are struggling to implement policy measures which Ethiopia has already adopted or is trying to introduce, such as the

[3] Proactive industrial policy of Ethiopia is documented in Arkebe Oqubay, *Made in Africa: Industrial Policy in Ethiopia*, Oxford University Press, 2015. Chapter 5 is devoted to the analysis of policy-aided development of Ethiopian floriculture.

high-level export coordination committee, strategic FDI and industrial zone policy, sectoral industrial institutes, national kaizen movement, a nationwide technical and vocational education and training (TVET) system, etc. According to our assessment based on ten policy sub-components over thirteen countries, the quality of industrial policy of Ethiopia is superior to that of India, Vietnam, Indonesia, or Cambodia.[4]

This also means that Ethiopia has entered an era in which past and current growth experiences of East Asia—both successes to emulate and failures to avoid—are more directly relevant to its policy formulation. There is no other country on the African Continent to which this statement applies more aptly. For this reason, our policy advice to the Ethiopian government at the end of Phase 2 of Industrial Policy Dialogue, contained in this volume, is essentially East Asian

[4] Kenichi Ohno, "The Quality of Industrial Policy as a Determinant of Middle Income Traps," a paper presented at Singapore Economic Review Conference 2015, Singapore, August 2015.

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Appendix Table 1. Topics Discussed at High Level Forums (Ministerial Level)

	Presentations by Japan or Third Country	Presentations by Ethiopia
<PHASE 1> Session 1 June 2009	(1) JICA's plan for policy dialogue (2) ADLI and future directions for industrial development"	(1) Evaluation of current PASDEP focusing on industrial development and related sectors
Session 2 Sep. 2009	(1) Cross-cutting issues on industrial policy & East Asian policy menu (2) Organizational arrangements for industrial policy formulation (3) SME policies in Japan"	(1) Comments and feedback by the Policy Dialogue Steering Committee on Japanese presentations
Session 3 Nov. 2009	(1) Designing industrial master plans: international comparison (2) Industrial policy direction of Ethiopia: suggestions for PASDEP II	(1) Concept for the industrial chapter of PASDEP II and the formulation plan
Session 4 Mar. 2010	(1) Basic metals and engineering industries: international comparison of policy framework & Ethiopia's case	(1) Draft of industry sector for PASDEP II (2) Overview, contents of PASDEP II draft of chemical subsector
Session 5 July 2010	(1) Result of basic metal and engineering industries firm-level study – parts conducted by MPDC and JICA	(1) Report of kaizen training in Osaka (2) Report of kaizen training in Chub (3) Current status of kaizen project and institutionalization of kaizen
Session 6 Oct. 2010	(1) Singapore's experience with productivity development: internalization, scaling-up, and international cooperation	(1) Contents of industry sector in GTP (2) Singapore's productivity movement and lessons learned
Session 7 Jan. 2011	(1) The making of high priority development strategies: international comparison	(1) Organizational structure of MOI and linkage with other ministries"
Session 8 May 2011	(1) Ethiopia's industrialization under GTP (2) Achievements of Kaizen Project (3) Kaizen movement in Asia & Africa (4) Taiwan: policy drive for innovation	(1) MSE development strategy of Ethiopia (2) Kaizen dissemination plan (3) Botswana's productivity movement and its Implication for Ethiopia
<PHASE 2> Session 1 Jan. 2012	(1) Export orientation: 3 policy directions (2) Export promotion: JICA's experience (3) Export promotion center in Egypt	(1) Export promotion of Ethiopia (2) Assessing Ethiopian investment and export policies
Session 2 Aug. 2012	(1) Results of champion product seminar (2) Export promotion of Malaysia (3) Economic diplomacy in Thailand	(1) Performance of export promotion in Ethiopia (2) Export promotion by foreign mission
Session 3 Jan. 2013	(1) Proactive FDI policy (2) FDI policy experience of Malaysia (3) JICA's assistance in Zambia etc.	(1) FDI inflow into Ethiopia
Session 4 Jul. 2013	(1) JICA's PSD assistance in Indonesia (2) FDI-linked technology transfer	(1) Malaysia's strategic FDI policy (2) Revision of Investment Proclamation
Session 5 Feb. 2014	(1) International comparison of manufacturing performance (2) Handholding programs	(1) Sectoral institutes: roles & performance (2) Kaizen in GTP II and long-term vision
Session 6 Aug. 2014	(1) FDI-led industrialization in East Asia (2) FDI inflow into latecomer Asia	(1) Proposal for key ideas in GTP II (2) Current status of Ethiopian FDI
Session 7 Jan. 2015	(1) Modality & key points of Japanese-run industrial zones in Vietnam & Thailand (2) Industrial zones & foreign currency issues in Myanmar & India	(1) Productivity & competitiveness chapter, industry chapter & kaizen in GTP II
Session 8 Oct. 2015	(1) Remaining industrial issues ahead (2) Industrial zone experience in Cambodia	(1) Discussion on GTP II draft (2) Ethiopian wage & labor productivity survey
Session 9 Jul. 2016 (Preparatory)	(1) Japan's alignment to Industrial objectives of GTP II	(1) Macro issues related to GTP II (2) Industrial Policy of GTP II (3) Hawassa Industrial Park

Appendix Table 2. Policy Letters

(Letters exchanged with high-level leaders; those with substantive policy content only)

No.		Date	To/from	Pages	Main topics
PHASE 1	1	June 9, 2009	From PM Meles	16	Democratic Developmentalism (DD) & Agricultural Development Led Industrialization (ADLI)
	2	July 27, 2009	To PM Meles	9	Agriculture, import-substitution, ADLI
	3	July 30, 2009	From PM Meles	6	Agriculture, proto-industrialization, import substitution, ADLI
	4	Nov. 16, 2009	To PM Meles	3	Master plan structure, energizing private sector, proactive industrial policy
	5	July 13, 2010	To PM Meles	9	Kaizen, metal industry, MSEs
	6	Oct. 29, 2010	To Minister of Industry Mekonnen	5	Formulation of GTP; report on high-level discussion
	7	Dec. 27, 2010	To Minister of Industry Mekonnen	8	Response to the question on how to cope with export firms that do not fulfill their targets
PHASE 2	8	Apr. 30, 2013	From PM Hailemariam	--	Request for meeting in Yokohama (TICAD V) regarding GTP2 & kaizen, via Japanese Embassy
	9	May 27, 2013	To PM Hailemariam	8	Kaizen, GTP2, planning mechanism, think tank (response to PM's inquiry)
	10	Aug. 11, 2013	To PM Hailemariam	10	Vision & industrial strategy in GTP2
	11	Aug. 11, 2013	To high-level participants of IPD	7	Comments on the draft report on Ethiopian Industrial Development
	12	Sep. 2, 2013	From PM Hailemariam	5	Response to Aug. 11 letter; light manufacturing vision, Planning Commission, Competitiveness Council, etc.
	13	Dec. 24, 2013	To PM Hailemariam	4	Light manufacturing vision, FDI data problem, export promotion
	14	Apr. 28, 2014	To PM Hailemariam	11	Data analysis & key issues of large inflow of manufacturing FDI from the viewpoint of East Asia; kaizen, handholding
	15	Sep. 29, 2014	To high-level participants of IPD	17	Issues related to industry, productivity & competitiveness (input to GTP2)
	16	Jan. 26, 2015	To PM Economic Advisor Dr. Arkebe	5	Concrete conditions & requests for inviting Japanese firms (based on bilateral discussion)
	17	Mar. 27, 2015	To PM Hailemariam	18	Comprehensive discussion on industrial issues in GTP2
	18	Nov. 13, 2015	To PM Hailemariam	9	Progress in Japanese Investment Area, remarks on latest GTP2 draft, future of Industrial Policy Dialogue
	19	Jun. 6, 2016	To PM Hailemariam	8	Assessment of GTP2, Japan's alignment with GTP2, Japan's industrial cooperation
	20	Jul. 15, 2016	To PM Hailemariam	3	SME policy documents of Japan, Taiwan and Malaysia attached and explained
	21	Jul. 29, 2016	To PM Hailemariam	6	Proposing schematic presentation of core industrial components of GTP2

Note: It has been customary to copy policy letters to high-level participants in Industrial Policy Dialogue. Page numbers include tables, figures, and appendices. Apart from the correspondence in the table, shorter letters were sent from GDF to PM Meles on July 6 and Dec. 2, 2009.

Appendix Table 3. Third Country Policy Mission

(Missions that produced inputs to Industrial Policy Dialogue)

	No.	Date	Country	Participating Officials & experts				Purpose (other than studying policy formulation & organization)
				Total	Ethiopian	Japanese	Other	
PHASE 1	1	Nov. 2009	Burkina Faso	1	0	1	0	Current status of national productivity movement
	2	Aug/Sep. 2010	Singapore	9	1	4	4	National productivity movement, FDI policy, SME policy, Nanyang Polytechnic
	3	Oct. 2010	Tanzania	2	0	2	0	East African Community (Arusha), MOI & industrial policy
	4	Nov. 2010	Korea	5	1	2	2	Industrial policy, SME policy, ODA strategy
	5	Jan. 2011	Burkina Faso	1	0	1	0	Current status of national productivity movement (follow-up of Nov. 2009 mission)
	6	Feb. 2011	Botswana	1	1	0	0	Current status of national productivity movement
	7	Mar. 2011	Taiwan	5	1	2	2	Technology & RD, science parks & EPZs, SME policy
PHASE 2	8	Aug. 2012	Ghana	8	0	8	0	African Center for Economic Transformation (ACET), industrial & finance policy
	9	Sep. 2012	India	3	0	3	0	National Manuf. Policy, industrial corridor, kaizen
	10	Oct. 2012	Mauritius	3	0	3	0	EPZ & FDI policy, garment & sugar sectors, export promotion, SMEs & HR, kaizen, policy coordination
	11	June 2013	Malaysia	16	11	5	0	FDI, export & industrial park policies as a model for Ethiopia; National Transformation Strategy
	12	June 2014	Indonesia	5	0	3	2	Development planning, policy coordination, new industrial policy, FDI policy, private efforts
	13	Aug. 2014	Rwanda	6	0	6	0	Development planning, Rwanda Development Board, industrial HR, ICT, SEZ
	14	May 2015	Thailand	3	0	3	0	FDI-local firm matching & linkage policy
	15	May 2015	Cambodia	3	0	3	0	Collective policy formulation, new industrial dev. policy, FDI & SEZ policy under CDC, Sihanoukville
	Total participants			71	15	46	10	

Note: As a common topic, most of the policy missions examined industrial policy formulation and implementation including policy procedure and organization. Total number of participants includes double-counting of same individuals. In parallel with Ethiopia-Japan Industrial Policy Dialogue, industrial policies of Vietnam and Mozambique were also studied intensively on other budgets.

Chapter 1

Background and Overview

1-1. Policy evolution

One striking feature of Ethiopian economic landscape is dynamic change in socio-economic situations as well as evolving industrial policy at a speed not frequently observed in other developing countries.

Over the last two-and-half decades under the rule of the Ethiopian People's Revolutionary Democratic Front (EPRDF), national priorities shifted gradually from building of a new nation to the pursuit of industrial excellence. In 1991, when the previous Derg regime was toppled by military force, first tasks of the interim government were restoration of peace and stability, creation of a federal state, drafting of a new constitution, resuscitation of the suppressed private sector, and re-connecting with the outside world for aid and support. Internal political competition, a separation war with Eritrea, and famine and hunger pestered the country. According to Former Prime Minister Meles Zenawi, it was only about 2002-2003 when the Ethiopian government felt that these problems were largely under control and that time had come to turn its main attention to economic development.

Industrial policy also evolved from elementary to more sophisticated. In the 1990s the government prepared developmental ideas but it was unable to put them into concrete practice. Between 1992 and 1994 the concept of Agricultural Development Led Industrialization (ADLI), which looked to agricultural growth as an initiator of structural transformation and a catalyst for full-fledged industrialization, was formulated. From 1995, ADLI served as a key guiding principle for a series of national development plans. Ever since, the Ethiopian government has never abandoned the notion that industrialization must be accompanied by robust agricultural growth.

At the same time, policy makers realized that a strategy of targeting smallholder agriculture in rural areas alone was insufficient to accelerate industrialization. Hoped-for results such as crop diversification, productivity breakthrough, and structural transformation did not visibly occur. In the mid-2000s, the scope of ADLI was considerably broadened to include large-scale commercial agriculture, micro and small enterprise development, large and medium manufacturing, import substitution, and foreign di-

rect investment (FDI) attraction.[1] The industrial chapter of Growth and Transformation Plan (GTP) 2010/11-2014/15 aimed at strengthening large and medium enterprises in eight selected sub-sectors as well as micro and small enterprises (MSEs), and promoting both export and import-substituting industries.

Meanwhile, from around 2009, Ethiopia began to receive export-oriented labor-intensive manufacturing FDI. Arrival of a large integrated textile mill from Turkey was followed by other garment and footwear investments. By now Ethiopia has emerged as a favored destination of light manufacturing processes migrating from countries where labor cost has become too high. To seize this historical opportunity, the government introduced additional policy initiatives. FDI law and regulation were revised, FDI administration was brought to a higher level, the FDI policy mechanism was centralized and strengthened, industrial zones were created, and one-stop investor services began to be prepared.

Another prominent feature of Ethiopian industrial policy is East Asian orientation with strong country ownership. Ethiopia flatly rejects economic neo-liberalism of the Washington institutions, and spends significant time and energy on learning policies from the Orient as well as from Western scholars advocating policy activism. The United Nations Industrial Development Organization (UNIDO), the United Nations Development Programme (UNDP), Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), Italy, and the United States Agency for International Development (USAID) were the donors implementing visible industrial support projects in Ethiopia in 2008, when our policy dialogue began. By now, virtually all development partners—even those with little practical knowledge on the ground—want to participate in the industrial support for Ethiopia. Ethiopia also mobilizes academic research to justify what it does or intends to do. Mr. Meles read economic literature widely, and Mr. Hailemariam is also an avid reader. They consulted renowned foreign economists via meetings, conferences, books and monographs, and even emails. Mr. Meles and Dr. Arkebe, Economic Advisor to the Prime Minister, themselves wrote research books and articles.[2] Mr. Meles once sent young officials to the Korea Development Institute

[1] These "new" elements were already mentioned in the earlier official documents such as *An Economic Development Strategy for Ethiopia* (1994) and *Ethiopian Industrial Development Strategy* (2002). But actual implementation of ADLI up to the mid-2000s emphasized support for smallholder agriculture.

[2] Meles Zenawi, "States and Markets: Neoliberal Limitations and the Case for a Developmental State," ch.5, A. Norman, K. Botchwey, H. Stein, and J. E. Stiglitz, eds, *Good Growth and Governance in Africa: Rethinking Development Strategies*, Initiatives for Policy Dialogue Series, Oxford University Press, 2012; Arkebe Oqubay, *Made in Africa: Industrial Policy in Ethiopia*, Oxford University Press, 2015.

(KDI) School in Seoul to absorb the Korean way. From 2008, regular Industrial Policy Dialogue with Japan has been conducted.

In GTP II, a vision of "Becoming a leading nation in light manufacturing in Africa in particular and in manufacturing in general" has been added to the national visions. This bold statement reflects Ethiopia's aspiration to become the most favored host country of light manufacturing on the Continent. According to Prime Minister Hailemariam, this vision should be interpreted in three parts: by 2025, (i) Ethiopia will be No.1 in Africa in light manufacturing; (ii) Ethiopia will be one of the leading countries in Africa in manufacturing; and (iii) while light manufacturing is highlighted, heavy and/or import substitution industries with large domestic demand will also be promoted. We strongly agree with and support this vision.

To pursue this light manufacturing vision, verifiable performance criteria for "a leading nation in Africa" will become necessary. We propose three-way measurement of Ethiopia's industrial performance—by macro and sectoral numbers, champion products, and industrial human resource. GTP II is expected to carry macro and sectoral targets for 2019/2020 such as the share of manufacturing reaching 8% of Gross Domestic Product (GDP) (currently 4.6%) and manufacturing employment of 750,000 (currently 380,000). These numbers were reduced from those discussed earlier, and we do not know at the time of this writing whether the targeted manufacturing share of export (20%) will be retained in the final version. At any rate, these are reasonable targets and we even suspect attainment of some of these numbers ahead of time—if policy evolution continues in the right direction.

Additionally, Ethiopia should take aim at production of one or two high-quality industrial products (including agro-processed products) with high domestic value and strong global demand. Korea has smart phones, Taiwan excels in electronic components and assembly, and Thailand exports eco-cars, pickup trucks, and their components. At first a global product may be a foreign-brand product (e.g. Original Equipment Manufacturing (OEM) garment and footwear or Rift Valley Wine produced by Castel). But over time, Ethiopia should learn value creation so it can produce Made-in-Ethiopia goods with domestic brands. This may be world premium coffee, high-end fashion garment with ethnic design, electronic components, or any other items. Champion products are not naturally emerging; they are created by deliberate and persistent joint effort by businesses and government.

Another way to prove industrial excellence is through mind-resetting, training,

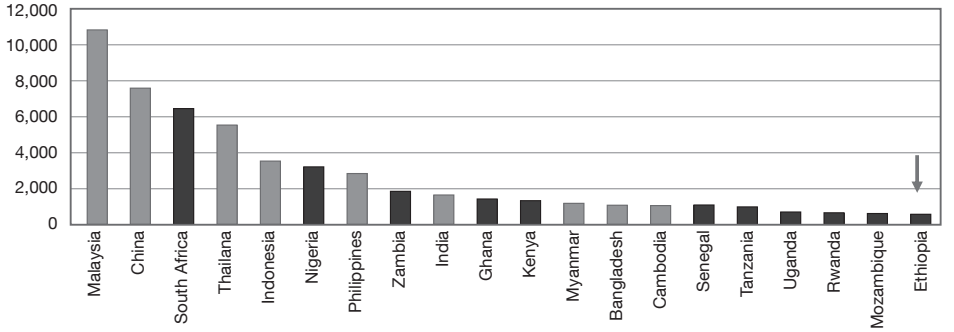
and mobilizing Ethiopian people—managers, engineers, technicians, and workers. Kaizen is already started, and other policy components should be added. Creation of excellent industrial human resource must be backed by national passion and movement, ambitious but realistic targets, globally competitive standards and supporting institutions, matching labor skills with industrial needs, and incentivizing people to stay and improve in their trained fields. When macro-level targets are met through high performance of Ethiopian products and industrial labor, instead of just FDI's activities, Ethiopian industrialization becomes a genuine one. But for this, Ethiopia needs additional policy learning.

1-2. Where Ethiopia stands

Ethiopia is rising fast in per capita income, infrastructure, FDI attraction, manufactured export, policy aspiration, and popular expectation. With new industrial zones, a divided three-lane expressway, new railway lines, construction boom, aggressive expansion of Ethiopian Airlines, flower export, and French wine and strawberry production, any visitor will sense the energy and determination driving this nation, and believe this poor African country will not be so poor in the next five to ten years. But Ethiopia's starting point was very low and high growth up to now has not removed all barriers to development. It is therefore useful to check some basic statistics to ascertain where Ethiopia stands in the developing world. As a starter, Figures 1-1 and 1-2 clearly show that Ethiopia's income and manufacturing sector are still at the bottom range as of 2014. Also, Asian developing economies have much higher manufacturing-to-GDP ratios compared with African peers.

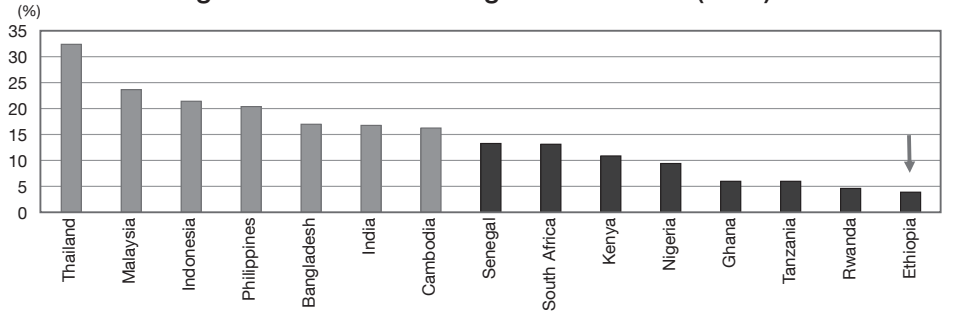
Regarding the cumulative stock of FDI (for all sectors), the United Nations Conference on Trade and Development (UNCTAD) Database reports Ethiopia's stock to be $7.3 billion as of 2014, while FDI data for 1992-2013 made available to us by Ethiopian Investment Agency (EIA) (now Ethiopian Investment Commission: EIC) add up to 411 billion birr—or about $23 billion at the average exchange rate of 18 birr = $1. The wide gap between the two sources may reflect the difference between operational versus registered FDI. Moreover, we believe the quality and consistency of both sources need to be improved significantly. At any rate, they give us at least a rough magnitude of FDI inflows into Ethiopia. Using the UNCTAD data, Figure 1-3 compares Ethiopia's cumulative FDI with other African and Asian nations. Ethiopia has a long way to go to before joining the club of major receivers of manufacturing FDI.

Figure 1-1. Per Capita Income (USD, 2014)



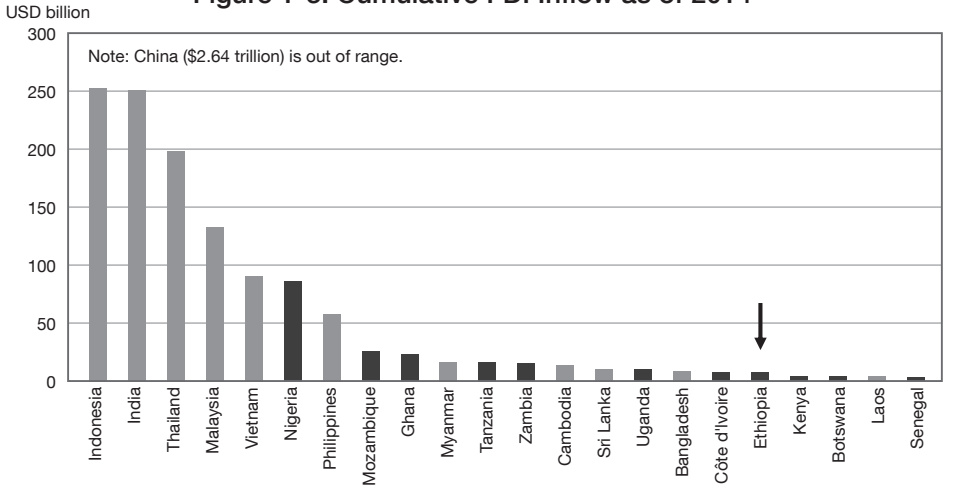
Source: World Bank, World Development Indicator database, accessed Sep.14, 2015.

Figure 1-2. Manufacturing: Share of GDP (2014)



Source: See Figure 1-1.

Figure 1-3. Cumulative FDI Inflow as of 2014

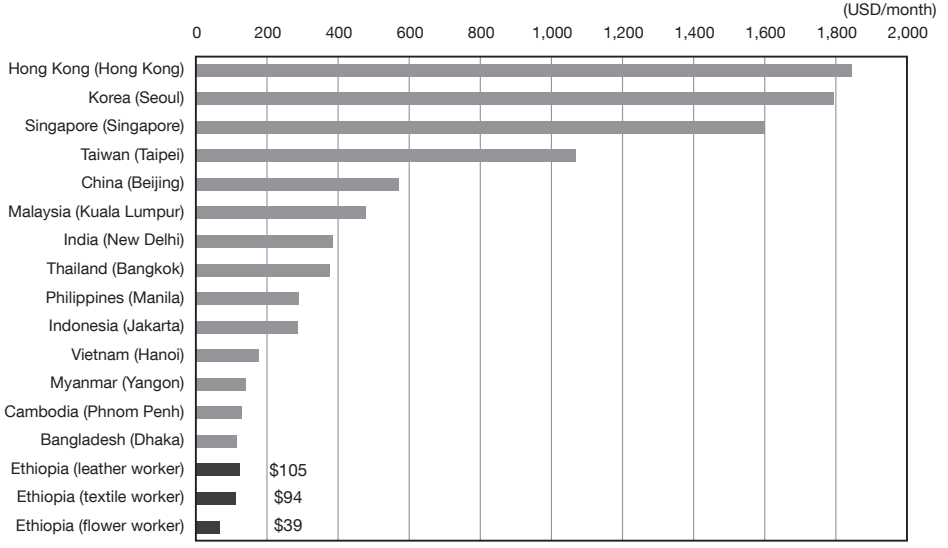


Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).

Regarding monthly wage, unskilled manufacturing wages of China, Malaysia, India, and Thailand are already above $300 as reported in Figure 1-4. At this wage level, no new labor-intensive manufacturing FDI will come, and existing ones start leaving. In fact, many of these countries have an explicit policy to shift to high technology by discouraging simple manufacturing. Monthly wages in Indonesia and Philippines are approaching $300 and Vietnam's urban wage is close to $200. At this wage level, existing labor-intensive processes can stay but not for very long. Wages in Myanmar, Cambodia, and Bangladesh are lower and still suitable for light manufacturing, but they are also on upward trends. In recent several years wages are rising particularly fast in Indonesia, Vietnam, and Cambodia at double digits and sometimes even exceeding 20% annually, while their labor productivity growth is in the range of 2-5% per year only. They are quickly losing labor competitiveness which is a big headache for domestic and foreign investors alike and worries policy makers.

Ethiopia's manufacturing wage is often said to be about $50 per month, which is competitive enough to attract labor-intensive FDI. A recent JICA-commissioned survey by Addis Ababa University researchers (see footnote to Figure 1-4) shows that the

Figure 1-4. Monthly Worker Wage in 2015



Sources: JETRO Annual Survey on Comparison of Investment-related Costs among Major Cities and Areas in Asia, 2015; for Ethiopian data, Ethiopian Inclusive Financial Training and Research Institution, "Basic Empirical Research on Productivity and Wage in Ethiopia," a JICA commissioned study, September 2015.

current Ethiopian monthly wages, including tax and social security contributions and other benefits, are $105 for leather workers, $94 for textile workers, and $39 for flower workers. Wage is not the only factor that attracts FDI, but it is a very important one. If Ethiopia continues to offer reasonable wage and rising labor productivity together with other advantages—political stability, serious policy support, improving business climate, good industrial zones, one-stop service, industrial skills, better connectivity, etc.—inflow of light manufacturing FDI will surely accelerate. Otherwise, it may stall in the middle. Issues of labor productivity and wage will be revisited in later sections as they are critically important for Ethiopia in the coming years.

One of the weakest points about Ethiopia is poor business environment. The World Bank's Doing Business Indicators show that Ethiopia ranks low and its relative position is falling in recent years (currently 132nd among 189). Annual fluctuations in such ranking should not be taken too seriously because what they measure and what the country tries to improve may not match. But the fact remains that Ethiopia's business environment is one of the worst even by the African standard.

Table 1-1. World Bank's Ease of Doing Business Ranking

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Singapore	2	1	1	1	1	1	1	1	1	1
Hong Kong	7	5	4	4	3	2	2	2	2	3
Korea	27	23	30	23	19	16	8	8	7	5
Malaysia	21	25	24	20	23	21	18	12	6	18
Taiwan	35	47	50	61	46	33	25	16	16	19
Thailand	20	18	15	13	12	19	17	18	18	26
Mauritius	23	32	27	24	17	20	23	19	20	28
Japan	10	11	12	12	15	18	20	24	27	29
Rwanda	139	158	150	139	67	58	45	52	32	46
Tunisia	58	80	88	73	69	55	46	50	51	60
Morocco	102	115	129	128	128	114	94	97	87	71
Vietnam	99	104	91	92	93	78	98	99	99	78
China	91	93	83	83	89	79	91	91	96	90
Philippines	113	126	133	140	144	148	136	138	108	95
Egypt	141	165	126	114	106	94	110	109	128	112
Indonesia	115	135	123	129	122	121	129	128	120	114
Ethiopia	101	97	102	116	107	104	111	127	125	132
Cambodia	133	143	145	135	145	147	138	133	137	135
India	116	134	120	122	133	134	132	132	134	142
Bangladesh	65	88	107	110	119	107	122	129	130	173
Myanmar	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	182	177
Total number of countries & areas	155	175	178	181	183	183	183	185	189	189

Source: World Bank Doing Business Report 2006-2015. The survey was initiated in 2004 and began to be published in 2006.

1-3. Three compelling advantages

Regarding why FDI—especially manufacturing FDI—is attracted to some countries but not others, we have the following hypothesis derived from observations on business conditions and industrial policies in a large number of developing and emerging economies. As a first step, compelling factors and supplementary factors should be distinguished.

All business investments are driven primarily by profit motive, and a country must therefore offer at least one irresistible source of business profit in order to become a preferred investment destination. Such profit sources are what we call the *compelling factors* of FDI attraction, which are classified into (i) labor advantage, (ii) large and/or growing domestic demand, and (iii) natural resources. Labor advantage is sub-divided into the case where there is a large supply of cheap labor with reasonable quality (low-end labor advantage) and the case where excellent human capital is available even at high cost (high-end labor advantage). If a country possesses even one of these factors, FDI will come no matter what the other conditions (supplementary factors) may be. If a country has two or all of these factors, the inflow of FDI will be unstoppable.

Supplementary factors are what is normally called "investment climate" (excepting labor aspects) and include (i) political stability, personal security, frequency of crime and terrorism, and the state of corruption, (ii) policy consistency and predictability, (iii) administrative efficiency in business opening and closure, taxation, customs, cross-border trade and remittances, foreign exchange, etc.,[3] (iv) power and logistics, (v) industrial zones, factory sheds, and one-stop investor services, (vi) business finance and foreign exchange, and so on. Improvements in these areas can significantly accelerate FDI inflow *if the country already has at least one compelling factor*, but cannot by themselves alone attract FDI in the absence of compelling factors. This two-step analysis can explain why some countries with smooth business procedure receive little FDI while others with notoriously inefficient, corrupt, and even dangerous business environment receive much.

Singapore is the global business and financial center thanks to its high-end labor advantage. Cambodia and Bangladesh attract light manufacturing FDI due to low-end

[3] The World Bank's Doing Business Indicators cover 11 regulatory areas applicable to SMEs: (i) starting a business, (ii) dealing with construction permits, (iii) getting electricity, (iv) registering property, (v) getting credit, (vi) protecting minority investors, (vii) paying taxes, (viii) trading across borders, (ix) enforcing contracts, (x) resolving insolvency, and (xi) labor market regulation. These collectively cover only part of administrative efficiency, and Doing Business country ranking should be understood as such.

labor advantage despite their inferior Doing Business rankings (worse than Ethiopia). Indonesia, also with poor business conditions, attracts many Japanese firms because it has large domestic demand for cars and other consumer goods and services. In Vietnam, gradual loss of low-end labor advantage (wage increase) is offset by rising domestic demand. Nigeria's attraction is oil and gas plus large domestic demand despite its business risks. Meanwhile, Mozambique, Zambia, Angola, and Namibia attract foreign mining interests but have no other advantage in labor or domestic demand. In one Central Asian republic without any compelling factor, manufacturing FDI does not arrive even though its business climate is open and friendly.

This leads to the following conclusion. Ethiopia attracts light manufacturing FDI in great number because of its low-end labor advantage. This is the compelling reason why Ethiopia can follow the East Asian path of FDI-led industrialization, a condition which few other African countries share. On the other hand, Ethiopia's supplementary conditions are partly positive and partly negative. Political stability, strong will to industrialize, and concrete effort in kaizen, technical and vocational education and training (TVET), industrial support institutes, Development Bank of Ethiopia (DBE) finance, etc. are positive aspects. But other business conditions remain poor even by low-income country standards, such as tax and customs administration, foreign exchange control, non-global standard accounting, etc. Still other areas, such as one-stop service, industrial zones, connectivity to Djibouti and outside world, power supply, etc. show signs of improvement but roads ahead are still long. Ethiopia must jealously guard its low-end labor advantage for a considerable time, while at the same time correct inferior business conditions as quickly as possible to take full advantage of the existing labor advantage.

1-4. The Flying Geese pattern

Ethiopia is beginning to follow a development path similar to that of Southeast Asia. If we look closely, of course there are different aspects unique to Ethiopia just as there are even among Southeast Asian economies. But the key fact that manufacturing FDI is an initial driver of industrialization and structural transformation remains the same. Policy issues that arise from such development also overlap between Ethiopia and East Asia. For that reason, Ethiopia can learn much from East Asia's successes and failures.

East Asia is unique because it has attained economic development through the

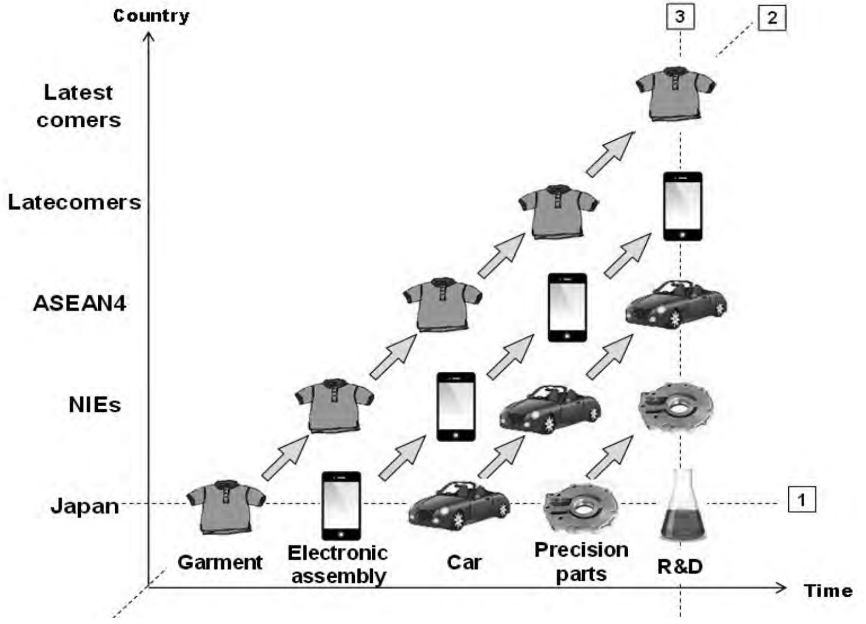
very existence of the East Asian region as a powerful arena for policy learning, production cooperation, and business competition among its member countries, and not by the effort of each country alone. One by one, countries in different development stages accelerated growth by participating in the dynamic production network created by private multinational corporations. Linked by trade and investment and assisted by economic cooperation, an international division of labor with clear order and structure emerged. Industrialization proceeded through geographic widening on the one hand and structural deepening within each country on the other. This supply-side phenomenon is called the Flying Geese pattern, through which East Asia has become the global factory of manufactured goods. No other developing region has such a collective growth mechanism.

For any economy in East Asia, development means jumping into this arena and becoming one crucial link in it, receiving competitive pressure as well as cooperation from neighboring economies, and upgrading industrial capabilities along the technological ladder. Over time, industries are passed from advanced countries to less advanced ones through FDI, so all latecomers crave to absorb as much manufacturing FDI as possible. What drives these countries is a nationalistic urge for industrial excellence by copying good practices of others, and not conditionalities or policy matrices imposed by international organizations.

Figure 1-5 illustrates industry passing within the Flying Geese pattern. If we fix a country (say, Japan), we can observe the transition of main activities along the time axis (direction 1). If we fix a product (say, garment), we can diagonally trace shifting production sites across countries (direction 2). If we fix a time (say, now), geographic distribution of activities within East Asia can be explained (direction 3). While reality is a little more complex than this, the picture can provide a first-approximation story on how order and structure are created in the regional production network.

For long Japan was the leading bird in this configuration, but late starters such as Korea, Taiwan, and China now beat Japan in certain high-tech and electronics sectors. Seeing this, some say that the Flying Geese are now dead, that what we see is random acrobatic flight. However, even with some shifting players, order and structure are still clearly visible in East Asia—except that they are not exactly the same as before. If we allow the possibilities of overtaking and leapfrogging, we can confirm that the Flying Geese are still alive and well. And we believe Ethiopia has just joined this production network at the tail. The Flying Geese are expanding from Asia to Africa.

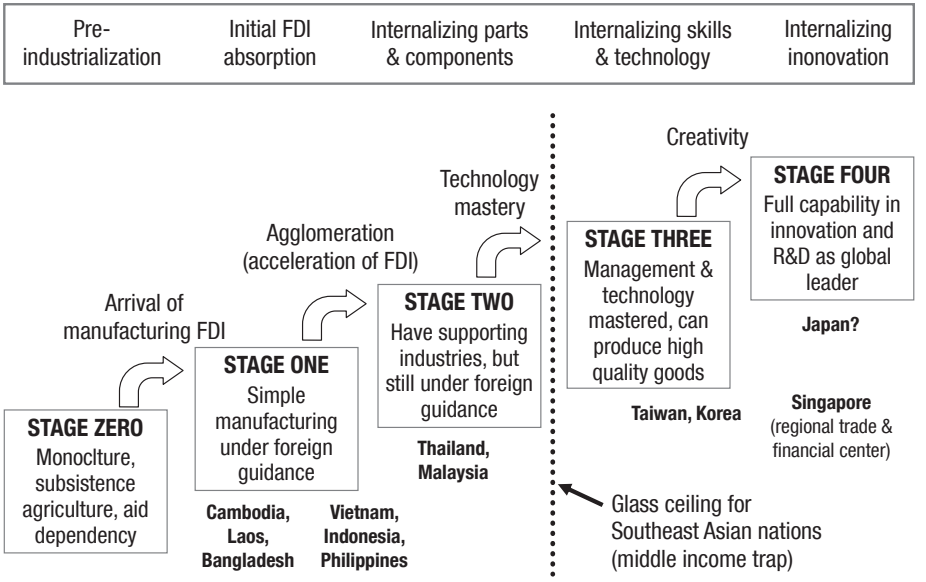
Figure 1-5. Structural Transformation in East Asi



But there is one serious problem in East Asia. Many of the late starters seem trapped in middle income, not reaching high income even in the long run. Figure1-6 shows the steps in catching-up industrialization initiated by FDI attraction, which is typically observed in East Asia.

From the status of monoculture, subsistence agriculture, and aid dependency (Stage 0), a latecomer begins to attract export-oriented labor-intensive manufacturing FDI (Stage 1). At this stage the nation contributes cheap labor and land only while foreigners control management, production, marketing, design, technology, branding, and other value-creating activities. As production volume rises, domestic supply of materials and components emerges, and the nation's industrial base widens a bit—although most value is still created by foreigners (Stage 2). Then, a critical moment arrives when domestic citizens and firms learn value creation, master technology, and replace foreigners. GDP rises dramatically and the nation becomes a leading exporter of high-quality goods (Stage 3). The final stage is innovation—creation of entirely new products and services, and capturing of huge pioneers' gain instead of copying and perfecting what others invented (Stage 4). In this diagram, Ethiopia has just graduated from Stage 0 and entered Stage 1.

Figure 1-6. Stages of FDI-led Industrialization



The only economies in East Asia that have reached Stage 3 or 4 are Japan, Singapore, Taiwan, and Korea. All other economies in the region are unable to go past Stage 2 because of their inability to create value wanted by the global market. To put it another way, the key is internalization of physical inputs, skills and technology, and innovative power in this order. Most countries in Southeast Asia can internalize up to physical inputs but not others. We call this the Glass Ceiling phenomenon between Stage 2 and 3. It is essentially the same as the problem of middle income traps.

1-5. Avoiding a future middle income trap

Some may argue that discussion of middle income traps is too early for Ethiopia which is still a low-income country hoping to reach lower middle income by 2025. But such a view is mistaken. Avoiding a trap is crucial for all countries regardless of income level. Preparation should start before the country is actually trapped—the sooner the action, the better.

Countries with a large inflow of manufacturing FDI (Stage 1) often become complacent because structural transformation (industrialization) is visible in macro and sectoral statistics such as industrial output, the export share of manufacturing, etc. But such industrialization is superficial because transformation is FDI-driven, and because

huge imports of industrial inputs are needed to sustain domestic manufacturing (in East Asia this problem is called the absence of "supporting industries.") With many countries gradually raising income, the threshold of middle income itself has become easier to cross, with 48.4% of countries and territories now classified as "middle income" by the World Bank.[4] Governments should look beyond simple numbers such as these to continuously improve human capital and enhance the competitiveness of domestic enterprises.

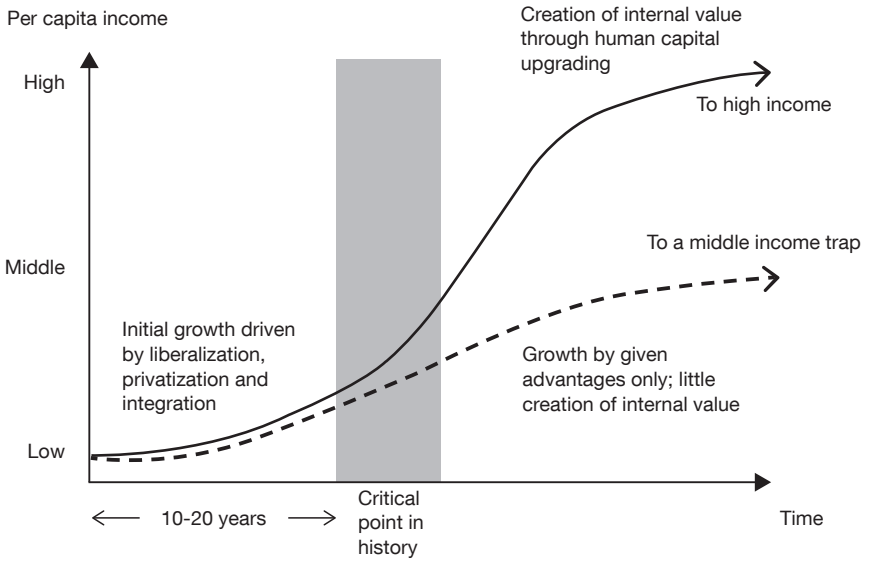
A middle income trap can be defined as a situation where an economy is unable to create value beyond what is delivered by given advantages. Here, given advantages include natural, demographic, and geographical factors as well as external factors such as trade, aid, and FDI. The presence of such advantages often impedes accumulation of knowledge, skills, and technology because of various psychological, political, and economic reasons. The Curse of Natural Resources, also known as the Dutch Disease, is well publicized. But having non-resource advantages can also negatively affect industrialization.

Any country that starts from a very low development level can enjoy rapid growth for a decade or two simply by liberalization, privatization, and integration. However, as one-time freeing effects are exhausted, a critical moment arrives when growth begins to slow. That is when most countries realize that they are trapped. Beyond this point, fast growth can be sustained only if proactive industrial policy is installed to revitalize the private sector. The situation is illustrated in Figure 1-7. Ethiopia is still in the initial stage where fast growth can be realized even with low-quality policy, but it will soon reach a point where policy quality is critical. It is highly advisable to improve industrial policy now rather than later.

We would like to present the hypothesis that the lack of quality in industrial policy is the main cause of a middle income trap. The corollary is that installation of high-quality policy that actively supports value creation by the private sector, beyond just freeing and opening markets, is required to escape the trap. Policy innovation must occur not so much in policy scope—because industrial policy menus are similar across emerging and developing economies—but in how effectively commonly practiced policies are executed in such areas as education and training, small and medium

[4] As of July 2015, the World Bank's income classification has 31 low-income economies (14.4%), 51 lower-middle-income economies (23.7%), 53 upper-middle-income economies (24.7%), and 80 high-income economies (37.2%) with the total of 214 economies.

Figure 1-7. Diverging Growth Paths



enterprises (SMEs), FDI attraction, industrial parks, export promotion, logistics and connectivity, FDI-local firm linkage, etc. This does not mean that other factors such as history, geography, natural resources, and capital inflow are unimportant. These are important and affect growth but they do not critically determine the long-term growth trajectory of a country as policy quality does.

There are three policy areas that need to be improved. First, industrial policy in the narrow sense must be activated to generate and sustain the sources of growth. Second, social problems caused by rapid growth must be dealt with such as income gaps, environmental damage, uncontrolled migration and urbanization, traffic and housing problems, cultural change, and a surge of materialism and corruption. Third, macroeconomic management must be upgraded under financial integration. For Ethiopia at present, the primary objective should be vitalization of growth sources followed by the solution of new social problems. Proper management of financial integration is an important task for the future.

Our assessment of industrial policy quality is given in Table 1-2 for selected Asian and African countries for which we have sufficient knowledge through policy research. Four points are worthy of note even in this small sample.

First, there is a huge gap in industrial policy quality among governments from

excellent to poor. Not all Asian governments have high scores in comparison with proactive African governments such as Mauritius, Ethiopia, and Rwanda.

Second, policy quality and income are positively correlated. In our sample, correlation between industrial policy score and the log of per capita income is 0.815. It should be noted that correlation does not prove causality. However, positive correlation is at least suggestive, and consistent with the hypothesis that poor industrial policy causes a middle income trap.

Third, within each country, sub-component scores are positively correlated. If one policy is bad, others are likely to be also bad. There is a common policy culture within any government that largely determines the effectiveness of all policy measures, with quality variation among them usually small and accidental.

Fourth, no clear relation is detected between policy quality and the possession of natural resources. Resource-rich countries such as Malaysia and Indonesia do not show any outstanding quality in industrial policy. Countries that have excellent industrial policy in our sample, as well as more generally, are often those poorly endowed with natural resources.

In our policy scorecard, Ethiopia has a point average of 3.0 which is worse than Mauritius, Malaysia, and Thailand (all of which are upper middle income countries) but better than Vietnam, Indonesia, India, and Cambodia (all of which have higher income than Ethiopia). I gave Grade B to Ethiopia but it is actually a borderline case between B and C. Within Ethiopia, industrial parks and FDI marketing get relatively high marks but business climate and SME development receive relatively low marks. Ethiopia and Rwanda are outliers in the sense that their industrial policies are much better than the level expected of low income countries. This must be because they are serious learners of industrial policy, especially from East Asia.[5]

[5] For more on policy quality grading, see Kenichi Ohno, "The Quality of Industrial Policy as a Determinant of Middle Income Traps," a paper presented at Singapore Economic Review Conference 2015, Singapore, August 2015.

Table 1-2. International Comparison of Industrial Policy Quality

	Date of research	Evaluation of industrial policy sub-components										Average	Grade	For reference only	
		Industrial human resource	Domestic enterprise development	Business climate	Power and logistics	Export promotion	Strategic FDI marketing	Industrial parks	Supporting industries & FDI-local firm linkage	Productivity, technology & innovation	Standards and testing			Per capita income (WB, 2013, USD)	Doing Business ranking (WB, 2014, among 189 entries)
Singapore	Aug.-Sep. 2010	5	4	5	5	4	5	5	4	5	5	4.7	A+	$55,183	1
Japan	Continuous	5	5	4	5	4	3	3	…	4	5	4.2	A	$46,330	29
Korea	Nov. 2010	5	4	4	5	5	3	4	…	4	5	4.3	A	$25,977	5
Taiwan	Mar. 2011	5	5	5	5	3	4	5	…	5	5	4.7	A+	$22,597	19
Malaysia	2006, 2010, 2013	3	4	4	5	4	5	4	1	4	4	3.8	B	$10,538	18
Mauritius	Oct. 2012	4	4	4	4	4	5	4	3	4	3	3.9	B	$9,478	28
Thailand	2005, 2009, 2013, 2015	3	2	4	4	3	4	4	4	2	4	3.4	B	$5,779	26
Indonesia	Jun. 2014	2	2	2	2	2	3	1	1	1	2	1.8	D	$3,475	114
Vietnam	Continuous since 1995	1.5	1.8	2.0	2.8	1.6	1.7	2.2	1.5	1.4	1.5	1.8	D	$1,910	78
India	Sep. 2012	1	1	1	2	3	1	2	1	1	1	1.4	D	$1,498	142
Cambodia	May 2015	0	1	4	3	1	2	3	0	0	1	1.5	D	$950	135
Rwanda	Aug. 2014	2	2	4	3	3	4	4	2	2	1	2.7	C	$639	46
Ethiopia	Continuous since 2008	3.0	1.9	1.7	3.1	3.9	4.3	4.4	2.0	3.2	2.0	3.0	B-	$505	132

Notes:

1. Evaluation: 0 (non-existent or worse), 1 (little), 2 (some), 3 (moderate), 4 (good), 5 (excellent). For Vietnam and Ethiopia, for which detailed data are available, points are given to the first decimal point.
2. Letter grades: A+ (4.5 or above), A (<4.5), B (<4), C (<3), D (<2), F (<1).
3. Evaluation of policy prepared and implemented by national government only; results obtained by private effort, international cooperation, or external conditions are excluded.
4. It is somewhat difficult to evaluate the policy of a mature economy, such as Japan and Korea, with a large number of industrial policy measures in the past and at present. Grades may differ depending on which measures are evaluated and how much weight is given to past achievements relative to present policies.

Chapter 2

Basic Direction

2-1. FDI-led industrialization

Ways to industrialization are many, and each developing country should choose the path most appropriate for it. In choosing such a path, the aim should be strengthening the competitiveness of domestic firms and citizens, and unique conditions available to the home country should be utilized fully to this end. Guided by this principle, we recommend a five-part industrialization strategy to Ethiopia at this critical juncture of its history. The five policy components are strategic FDI attraction, enterprise capacity building, FDI-local firm linkage, efficient logistics, and industrial human resources, as explained below.

Value creation by Ethiopian people and firms is the key to industrialization with quality. To attain this, there are basically two tracks:

(i) *Direct competition*—strengthening Ethiopian enterprises, independently from foreign partners, for export and/or import substitution which includes, but not limited to, the creation of champion products; [1] and

(ii) *Indirect competition*—strengthening Ethiopian enterprises so they can work effectively with foreign producers and/or buyers as regular business partners thereby attaining high standards and becoming a crucial link in a global value chain.

Both tracks are valid and should be pursued simultaneously (the two-track approach). But for rapid and visible industrial results, the second track has a much greater impact on the nation's output, employment, trade, and structural transformation. Not many developing countries receive light manufacturing FDI in large numbers, the kind of FDI that contributes greatly to early industrialization rather than just mining or real estate projects. Ethiopia is lucky to have such FDI, and this unique advantage should be fully utilized. Thus we propose that FDI-linked technology transfer should be the primary policy goal during GTP II (and possibly GTP III) while fostering autonomous

[1] Even in creating champion products, initial contact with and learning from foreign buyers will be highly beneficial until the producers of champion products improve marketing and technology and become able to expand their global business by their own.

and competitive Ethiopian enterprises is a very important but supplementary goal.

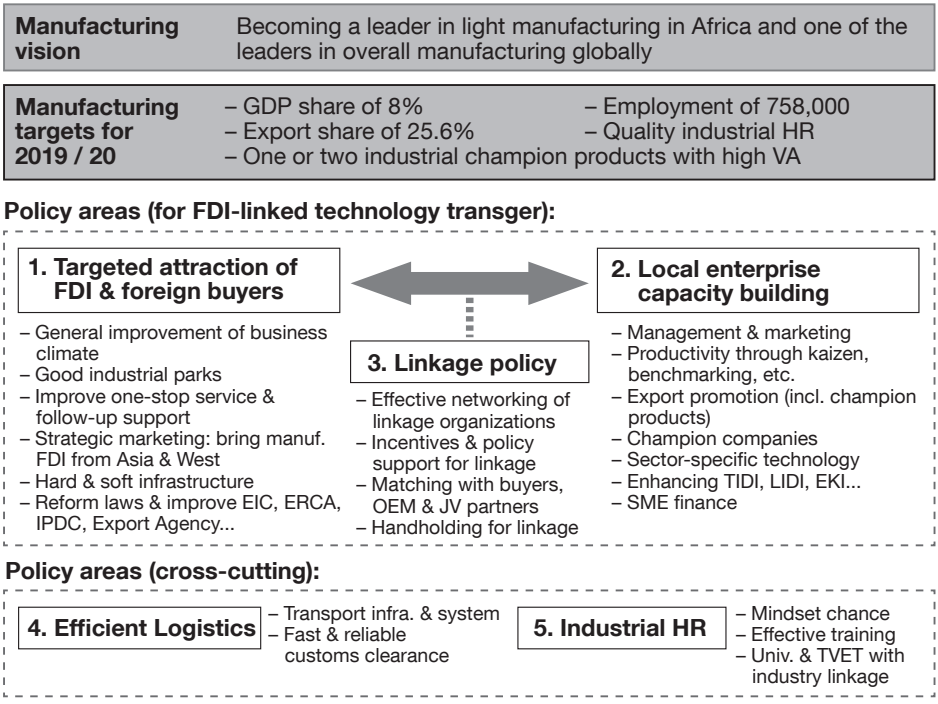
During the next decade, Ethiopia can learn global management, skills, design, technology, marketing, and standards faster by working closely with sharp-eyed foreign producers and buyers who demand high quality and reliable delivery rather than going it alone. Kaizen, technology institutes, management training, science and technology universities, and TVET should all be mobilized to attain this goal instead of implementing them for general improvement without a concrete objective. After Ethiopia reaches middle income, around 2025, policy weight should shift gradually from FDI linkage to more autonomous competition.

The five-part strategy shown in Figure 2-1 was presented to the Ethiopian government before, but details have been revised to reflect our current knowledge and ideas. It should be used as a check list for policy formulation. The three most important policy areas are FDI policy, enterprise policy, and linkage policy. Logistic efficiency and industrial human resource must also be added as enabling conditions. During GTP II and GTP III, policy effort must be exerted to carry out and deepen each component under each policy area. Some of the components are already in place in Ethiopia but they need to be strengthened. Others need to be newly introduced.

In FDI policy, Ethiopia has already embarked on revisions of Investment Proclamation and Regulation, creation of organizations and incentives for industrial park development, and enhancement of one-stop investor service. These are appropriate entry points, and continued effort should be made to improve investment support. Ethiopia now targets FDI not only from emerging economies such as Turkey, India, and China but also from advanced economies such as Japan, the United States (US), and the European Union (EU). What is still missing in this policy area is improvement of general business environment. Ethiopia's current conditions in this aspect, such as reliable power supply, logistics, foreign exchange control, tax administration, customs clearance, and other bureaucratic hassles, are not up to the standards of developing Asia or Africa. To improve them, realistic action plans, an effective interactive mechanism with investors, and serious reform and enhancement of the Ethiopian Revenues and Customs Authority (ERCA) and foreign exchange management are needed.

In enterprise policy, Ethiopia already practices benchmarking, and kaizen is expanding from a pilot project to advanced kaizen, national movement, and instruction to other African countries with Japanese support. Export promotion has also been a policy focus, with monthly high-level monitoring of export performance conducted

Figure 2-1. Five-part Industrialization Strategy for Ethiopia



for more than a decade. Under Economic and Business Diplomacy, the Ministry of Foreign Affairs (MOFA) directs Ethiopian ambassadors around the world to attract FDI and promote export. Champion products and national branding were added to the policy menu recently. In October 2015 the Export Promotion Agency was created under the Ministry of Trade which may become the focal point for Ethiopia's existing and future export promotion activities. Its functions and capabilities need to be monitored.

But there is much room for improvement and expansion in this component. SME policy in Ethiopia is still in a very early stage. Japan, Taiwan, and Malaysia have highly developed SME support mechanisms and JICA also has standard measures for assisting SME policy formulation in developing countries. From such perspectives, three key components of SME support—management, sector-specific technology, and finance—are still missing or very weak in Ethiopia. Among these, strategic enterprise management capability, including marketing, should be top priority. Ethiopia should broaden the scope of enterprise support in proper speed and steps (quick and random

expansion is not recommended). This requires, among other things, further strengthening of the Ethiopian Kaizen Institute (EKI), the Textile Industry Development Institute (TIDI), the Leather Industry Development Institute (LIDI), the Metals Industry Development Institute (MIDI), the Ethiopian Horticulture Development Agency (EHDA) and other technical support institutes in terms of functions, staffing, and budget. When basic support for management, kaizen, technology, and finance become available up to a certain level, Ethiopia should begin pilot handholding by combining these supports. EIC, EKI, TIDI, LIDI, the Ethiopian Management Institute (EMI) and others offering various industrial services should form teams to intensively support a small number of selected Ethiopian firms for one objective such as breaking into a new export market, creation of FDI/buyer linkage, import substitution, and so on. Handholding should be started on a pilot basis during GTP II, to be scaled up later (See 3-4).

Linkage policy is virtually nonexistent because of the small size of manufacturing FDI in Ethiopia in the past.[2] But in the future, this policy must be activated. Policy components include (i) creating opportunities for foreign and domestic firms to meet and discuss business (supplier-meet-buyer program, trade fairs, reverse trade fairs, buyer seminars, factory tours, etc.); (ii) information service or database for locating suitable domestic partners; (iii) financial incentives for eligible matching and linking activities; (iv) follow-up, monitoring, and trouble-shooting after matching; and (v) creation of an effective network of public and private organizations that support matching and linking. Among Southeast Asian countries, Thailand has a relatively well-developed mechanism in this regard, with Japanese and Thai private and public institutions playing their respective roles and cooperating with each other to collectively serve interested Japanese and Thai firms (See 3-3).

2-2. The wage-productivity nexus

As explained earlier, the three compelling magnets for FDI are labor advantage, large domestic demand, and natural resources. If any of them is present, FDI will pour in even if business climate is unfavorable. Ethiopia's current attraction is low-cost labor with reasonable quality and discipline, an advantage that few other African countries can duplicate. To sustain industrialization, it is imperative that this labor

[2] The only exception has been the strong request by the Ethiopian government to individual industrial or infrastructure projects undertaken by foreign firms or governments to use as much domestic input and labor as reasonably possible and train workers during the initial construction stage of the project.

advantage be jealously guarded at least for the next decade or two.

Great attention must be paid to the developments of wage and labor productivity. An appropriate ministry or agency should monitor them. Since accurate and comprehensive datasets are difficult to obtain at first, data collection must start with what is available and possible, to be expanded and upgraded later. Productivity is the right focus for Ethiopia during the GTP II period and even up to 2025. Later, when middle income is attained, when unskilled labor supply is exhausted, and when the nation has produced a sufficient number of high- and middle-level managers and engineers, policy attention must shift to creativity and innovation as was done in Japan, Taiwan, and Korea. Malaysia and Thailand are currently trying to make such a shift.

Wage and productivity data

Ideally, manufacturing wage data should be collected and published annually for three categories: unskilled workers (start-up level), mid-level engineers and technicians, and managers. If data are limited initially, unskilled worker wages in industrial zones and large and medium enterprises (LMEs) in the Greater Addis Ababa Area and other industrial cities, and only for garment, footwear, leather, and floriculture, may suffice for monitoring Ethiopia's wage competitiveness in the first years. Over time, the wage data should be expanded sectorally and geographically as budget and experience increase.[3]

Regarding productivity, labor productivity (value-added per worker) should be the indicator to which greatest policy attention should be paid, as in Singapore and Malaysia. Labor productivity should be measured in the following two levels:

(i) Sectoral (manufacturing) and sub-sectoral (textile, footwear, etc.) labor productivity using existing datasets such as value-added and number of workers.

(ii) Micro (factory) level labor productivity for selected processes in the priority sectors, such as productivity of garment workers, leather shoe workers, flower pickers, etc. (for example, number of shirts cut or sewn per worker per day) based on firm surveys.

The results should be published annually together with corresponding data in

[3] During Japan's high growth era in the 1950s and 60s, the Ministry of Labor monthly surveyed wages disaggregated by sector, occupation, worker's gender and age, and establishment size. Labor productivity data were also collected by sector and establishment size. Such frequent and detailed data are not realistic at present in Ethiopia, but should be planned in the medium to long run.

competing countries. Additionally, other measures such as the incremental capital-output ratio (ICOR) (for measuring capital efficiency), total factor productivity (TFP) (for measuring overall efficiency), and technical efficiency estimates for sectors and individual firms (Data Envelopment Analysis (DEA), Stochastic Frontier Analysis (SFA), etc.),[4] may be used for a broader picture, but they should not be viewed as officially monitored indicators because of data deficiency and the lack of robustness in measurement.

As we noted earlier, wage increase in many East Asian economies is outstripping labor productivity growth. Wage is driven up by aggressive labor unions and/or politicians who need votes. Politicized wage settlement in the absence of comparable productivity growth is a very serious problem in developing economies in Southeast Asia today. Sooner or later, they will face a middle income trap where simple manufacturing is no longer possible due to high labor cost but advanced manufacturing does not emerge because necessary human capital is lacking. Ethiopia should not get into this bind.

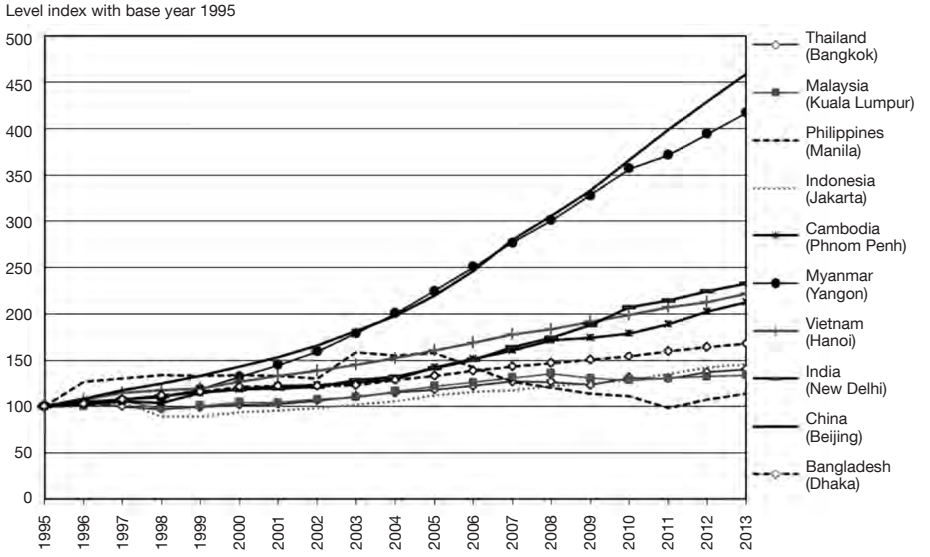
Figures 2-2 and 2-3 illustrate manufacturing labor productivity and wage levels in Asia. As for labor productivity, from 1995 to 2013, only China (8.8%) and Myanmar (8.3%) registered relatively high growth (Myanmar's performance may have to be checked for data quality). Labor productivity growth in other countries, such as India (4.8%), Vietnam (4.5%), and Cambodia (4.3%), was lower than 5% per year. In Malaysia, Thailand, and Indonesia, it grew only about 2% per year. The Philippines' actually declined from 2005 to 2011.

As for wage, until about a decade ago wages in most Asian countries fluctuated annually without clear trends. More recently, however, China, Malaysia, Thailand, Indonesia, Vietnam, and Myanmar began to allow significant wage increases far beyond labor productivity growth. It should be noted that wage data here are expressed in USD which means they reflect both domestic wage settlement and exchange rate movement.

Meanwhile, East Asia's early industrializers—Japan, Singapore, Taiwan, Korea—did not face this problem. Wage and labor productivity rose in tandem during their high-growth periods preserving wage competitiveness. They soared to high

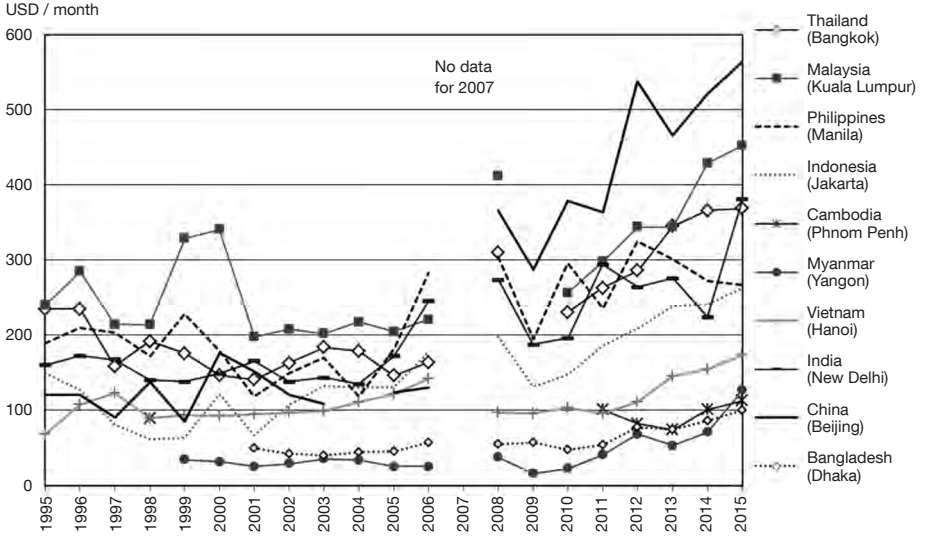
[4] Such technical estimates were made in Kidanemariam Berhe Hailu, "Technical Efficiency and Firm Growth Dynamics in the Ethiopian Manufacturing Sector," doctoral dissertation, GRIPS, 2014. Mr. Kidanemariam was a PhD student under the supervision of Kenichi Ohno and received a doctoral degree from GRIPS in September 2014. He is now a lead researcher at Meles Zenawi Leadership Academy.

Figure 2-2. Asia: Manufacturing Labor Productivity Index



Source: Asian Productivity Organization website.

Figure 2-3. Asia: Worker Monthly Wage



Source: JETRO annual survey on Comparison of Investment-related Costs among Major Cities and Areas in Asia. Data for 2007 is unavailable.

Table 2-1. Average Monthly Wage in Ethiopia

	Textile			Leather			Flower			Average			Birr/USD (end Dec)	CPI
	USD	Nom. Birr	Real Birr	USD	Nom. Birr	Real Birr	USD	Nom. Birr	Real Birr	USD	Nom. Birr	Real Birr		
2010/11	74.8	1205	1205	83.0	1337	1337	34.3	553	553	64.0	1032	1032	16.1178	100.0
2011/12	76.5	1339	999	82.3	1441	1075	37.4	654	488	65.4	1145	854	17.4963	134.1
2012/13	75.3	1377	905	83.6	1527	1004	42.9	783	515	67.3	1229	808	18.2784	152.2
2013/14	83.8	1598	971	97.8	1865	1134	49.1	936	569	76.9	1466	891	19.0748	164.5
2014/15	88.7	1783	1017	95.1	1911	1090	58.0	1166	665	80.6	1620	924	20.0956	175.4

Source: See footnote 6. The wage data includes tax payment and social security contribution.

income without hitting any traps. For example, during Japan's high growth period (1955-1970), manufacturing labor productivity rose 10.0% per year and manufacturing wage rose 10.2% per year.[5] At the same time, the exchange rate was fixed at $1=360 yen from 1949 to 1971. Thus, Japan kept wage competitiveness for 15 years as industrialization proceeded at high speed with improving quality and expanding product variety.

A recent JICA-commissioned study on wage and labor productivity in Ethiopia[6] produced the following results. Based on a firm survey, average wages in garment, leather, and floriculture sectors, inclusive of social security and tax payments, are presented in Table 2-1.

From the same study, Ethiopia's manufacturing labor productivity, computed as real value-added in manufacturing per employee using the Central Statistical Agency (CSA) and the Ministry of Finance and Economic Development (MOFED) data, is reported in Table 2-2. Average growth of manufacturing real value-added from 2000/01 to 2011/12 was 9.9%, which was mostly due to the quantitative expansion of workforce (7.0%) rather than improving labor efficiency (2.7%). The annual growth of manufacturing labor productivity of 2.7% is low by the Asian standard discussed above. In East Asia, even countries having labor productivity growth of 3-5% per year are facing middle income traps. For Ethiopia, manufacturing labor productivity growth of 5-10% per year should be a realistic target provided that proper policy and

[5] Because the Japanese labor market was nationally integrated, wages in all sectors, not just manufacturing, rose about 10% annually during 1955-1970. Average inflation in consumer prices during that period was 4.3% per annum, which was slightly higher but not much different from those in other industrial economies.

[6] Ethiopian Inclusive Financial Training and Research Institution, "Basic Empirical Research on Productivity and Wage in Ethiopia," a JICA commissioned study, September 2015.

Table 2-2. Ethiopian Manufacturing: Value-added, Employment, and Labor Productivity (Real birr per employee per year)

	Manufacturing value added in million ETB (Real)	Manufacturing employment	MVA / employee (real ETB)
2000/01	5,032	93,737	53,684
2001/02	5,044	98,986	50,960
2002/03	5,117	101,404	50,464
2003/04	5,512	105,381	52,307
2004/05	6,152	109,150	56,366
2005/06	6,992	118,468	59,022
2006/07	7,655	134,963	56,721
2007/08	8,618	131,803	65,385
2008/09	9,504	148,817	63,867
2009/10	10,797	185,086	58,336
2010/11	12,324	173,397	71,073
2011/12	14,284	198,088	72,108
Average annual change	9.9%	7.0%	2.7%

Source: JICA study (see footnote 6) based on CSA's Large & Medium Size Manufacturing Survey and MoFED's GDP data.

popular mindset are in place. Policy instruments discussed in chapter 3 below should be actively mobilized to attain it.

Social compact

We propose a tripartite social compact that will deliver a "win-win-win" solution for management, workers, and government, and can also serve as a background for National Kaizen Movement. A social compact such as this was launched by Singapore (the Charter for Industrial Progress) in 1965, the year of its independence, to cope with hostile management-labor relations and the rise of Communism. The compact still guides Singapore's socio-economic policies even today. More practically, such a compact is also needed to avoid a situation where annual wage demand greatly exceeds labor productivity growth, a malaise seen in Southeast Asia as discussed above.

Under the three-way compact, the following pledges should be made.

(i) Each party shall make maximum effort to raise productivity—management by conducting benchmarking, kaizen, shindan, handholding, etc.; workers by actively participating and adopting positive mindsets and attitudes; and government by introducing effective policies and incentives.

(ii) Wage increase should be equal to labor productivity increase (of the previous year, some smoothing may be necessary to remove the effect of

business cycles). Reliable official statistics for labor productivity must be created and announced.

(iii) Fruits of economic growth should be shared fairly among management, workers, and consumers. Government has the duty to make sure that this is the case.

To implement such a virtuous circle, government should regularly monitor wage and labor productivity trends, appeal to the public the importance of balanced movements in wage and productivity, and take remedial measures when excessive wage increase or sluggish labor productivity is detected. Citizens and entrepreneurs should be informed that this formula is necessary to maintain wage competitiveness, achieve higher income and full employment, and build a proud nation.

Additionally, macroeconomic policy for inflation control and exchange rate management is vital for avoiding overvaluation and keeping wage competitiveness in the medium to long run. This important issue is not the topic of Industrial Policy Dialogue and therefore will not be touched further.

Anticipating and minimizing labor problems

Unemployment is a big problem in many developing countries. However, labor shortage is also an acute problem in countries that absorb a large amount of manufacturing FDI. Even if there is unemployment at the national level, pockets of labor shortage can develop if the labor market is not integrated and/or if workers are not equipped with required skills. FDI usually concentrates in a few areas where infrastructure and business conditions are good, such as industrial parks near large cities or deep seaports. Meanwhile, the supply of workers fit for labor-intensive tasks (for example, young females with high school diploma) or mechanical works (engineers and technicians) in any locality is limited. When each FDI firm hires hundreds or thousands of workers, and when such firms multiply, the local supply of suitable workers is quickly depleted, high salary search and job hopping become rampant, and firms start poaching workers from each other. Wages start to rise. This happened in Penang, Malaysia in the 1980s; Ho Chi Minh City, Vietnam in the 2000s; and Thailand currently faces an acute shortage of manufacturing workers of all types in all locations. To ease this problem, a number of solutions are possible.

First, market-driven labor migration from rural to industrial areas, in pursuit of cash income, may occur spontaneously. Such labor migration may be temporary, sea-

sonal, medium-term (2-3 years), or more permanent. Since it is market-driven, whether and how much such internal migration will occur is entirely up to workers.

Second, labor-using FDI firms may relocate from urban to remote areas in search of labor supply. Local governments are naturally happy to receive FDI as a job generator, and workers can commute from their villages (and accept lower wages for this advantage). Such internal relocation of factories is also widespread in Southeast Asia. For this to happen, however, remote areas must meet minimum standards in transport, power, and other business necessities. Government also often encourages geographical diversification of FDI for economic and political reasons. In Ethiopia, geographical diversification of industrial zones is already a national strategy. This policy will bear fruit only if it addresses private sector incentives properly. Thailand, Malaysia, and Indonesia tried to divert FDI to rural areas with geographically differentiated incentives but the results were not encouraging.

Third, a specialized TVET facility can be established near an industrial park to train young people with skills appropriate for the type of industries located in the industrial park. Singapore built a TVET center to teach electronic skills to middle and high school graduates next to Vietnam-Singapore Industrial Park in Binh Duong, Vietnam, where several hundred electronics FDI firms operate. This made firms, workers, and local government all happy.

Fourth, some high and middle income countries (Singapore, Korea, Malaysia, Thailand, etc.) import foreign workers for simple manufacturing as well as for basic services such as trade, catering, construction, and domestic service. However, governments are sometimes ambivalent about this policy because the presence of foreigners considerably eases labor shortage but it may also create social tension.

Ethiopia should forecast the size and nature of labor problems in advance. It should not be too difficult to estimate the total number and type of workers demanded by light manufacturing FDI when Bole Lemi 1 and 2, Kilinto, and other industrial zones near Addis are filled. The supply of suitable local workers should be estimated on various assumptions about internal labor migration, geographical boundaries for daily commuting, education and skill levels, etc. Labor demand and supply for other industrial zone locations such as Hawassa and Dire Dawa should similarly be studied. It is not yet clear how much internal labor migration will occur in Ethiopia and what pattern it will take, and whether ethnic and cultural differences across regions deter migration. But it is perhaps safe to assume that significant internal labor mobility

will occur given the fact that Ethiopians are already working in the Middle East and elsewhere.

Social issues surrounding industrial workers should also be anticipated and dealt with. Migrant workers often share cheap rooms or live in company-provided dormitories (if available). Labor authorities should ensure that industrial workers have full rights as well as adequate housing, food, nutrition, and hygiene. They should also have safe and healthy working conditions and be paid properly including overtime. In many Asian countries, labor disputes arise over inhuman labor treatment or nonpayment of salaries, often leading to wildcat strikes and sit-ins. In Vietnam, "professional" labor agitators roam around industrial parks to cause trouble at FDI factories. Constructive management-labor relationship is a proper concern for policy makers. On the worker side, they should be taught to know their rights and responsibilities, form career plans and upward mobility, and strive for long-term skills acquisition instead of hopping jobs at the slightest difference in monthly salary.

Government should provide incentives for firms to train their workers, by preparing training programs and centers, creating a Skill Development Fund to which all firms must pitch in and from which they can withdraw for training workers, and offering other conditional subsidies.

2-3. Industrial policy timeline

Industrialization is a long and staged process. A student must begin with basics, then proceed to more complex and advanced challenges with right speed and under proper guidance, and finally graduate into an independent and full-grown player who can lead and teach others. Just as education from kindergarten to university, proper sequencing must be followed in industrialization. Jumping grades and skipping lessons is possible for an exceptional few, but too much leapfrogging is not advisable for normal students. This is particularly true for a country having a large farming population who must be taught skills and provided with gainful employment in increasingly difficult tasks and sectors. While more than one development pattern should be permitted in light of different national conditions, random deviations from the norm are not recommendable.

For a country embarking on FDI-led industrialization, such as Ethiopia, East Asian experiences can provide a norm. As explained earlier and illustrated in Figures 1-5 and 1-6 above, East Asian economies exhibit clear technological orders and struc-

tural patterns with strong intra-regional linkage. Production cooperation in East Asia has evolved dynamically from simple teaching to more complex competition including overtaking. But this hardly implies that all countries are now alike or converging to the same technological level. The death notice of Flying Geese is highly exaggerated; East Asian birds are still flying with different capabilities and functions.

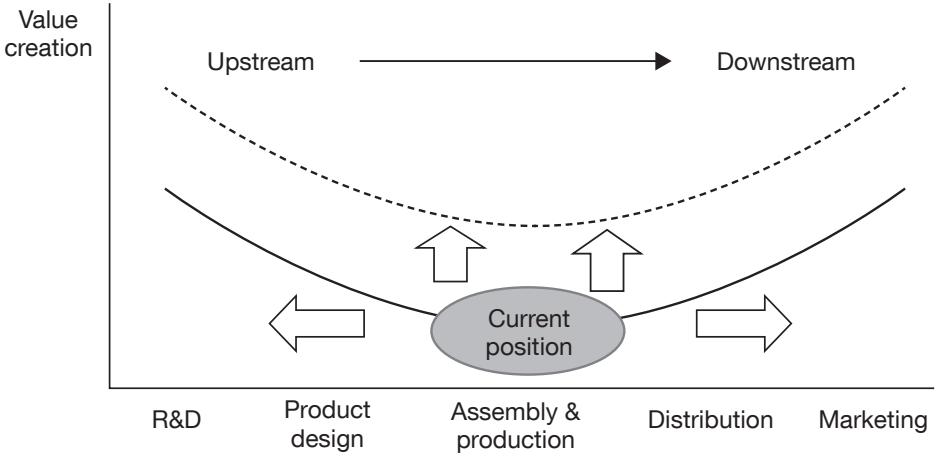
Countries like Ethiopia should first attract a sufficient amount of manufacturing FDI (mainly light manufacturing but also supporting and associated industries and services as well) by activating proactive industrial policy and improving business environment. Arrival of a few to several thousand foreign manufacturing establishments, as seen in Thailand, Indonesia, and Vietnam, can be considered as successful completion of this initial stage. Continuous vigorous FDI inflow can attain it in about a decade or two in any country.

The next challenge is a shift from quantity to quality, as well as from foreigners' value creation to domestic value creation (Figure 1-6 above). This calls for more advanced industrial policy such as FDI-linked technology transfer, creation of linkages and clusters, SME promotion, supporting industry development, enhancing top-level managers and engineers, national productivity movement, and what Malaysia in its Industrial Master Plan 1996-2005 called "Manufacturing Plus Plus." This is a desire to strengthen capabilities of domestic industries both horizontally and vertically (hence two pluses), first by engaging in more value-creating processes, both upstream and downstream, and second by improving productivity of each process along the value chain curve, as shown in Figure 2-4. By internalizing value creation and replacing foreign managers and engineers, a country becomes a globally competitive exporter of high-value products and/or components.

Finally, a country must graduate from being an efficient copycat to a true pioneer. Instead of mass-producing what the US or Japan invented with high quality and low cost, value must now be generated by bringing something entirely new to the world in what Schumpeter termed Creative Destruction, and replacing an old industry by a new one. Technology, innovation, Research and Development (R&D), higher education, attracting people with high competence and knowledge, creation of high-end industrial clusters, and protection of intellectual property rights become the main focus in this stage.

These three stages may have overlaps, but no nation can jump to the last stage without mastering the first two. Nice-sounding words such as high-tech, Information

Figure 2-4. Malaysia: Manufacturing++



Source: The Second Industrial Master Plan 1996-2005, an interview with Malaysian industrial planning officials in 2006, and the website of the Ministry of International Trade and Industry of Malaysia.

and Communication Technology (ICT), software, new energy and materials, nano-technology, bio-technology, and the like, are often randomly thrown into policy documents of developing countries. Anyone can use ICT or new energy, and academic research in frontline science can be done at any university. But commercialization of high-tech industries such as these is hardly possible in a country where factories have never heard of 5S (Seiri, Seiton, Seisou, Seiketsu, Shitsuke) or muda elimination, high school graduates do not have the right attitude or competence, and engineers with basic operating skills are in acute shortage.

Ethiopia, as a latecomer, should currently mind the first and second stages while the third can be dealt with later. At one of the High Level Forum sessions, participants asked if it was proper for Ethiopia to focus on light manufacturing, especially garment, in view of the fact that garment was only a labor-intensive, low-skill sector from which Asian countries now tried to get out, and because Ethiopia must also graduate from it in the future. Our answer was a resounding Yes to garment FDI now, because proper steps must be taken by any country on the way to industrialization—and light manufacturing is the proper first step for Ethiopia to learn management and technology. The large inflow of light manufacturing FDI is the great opportunity that only Ethiopia, among all African countries, is now beginning to enjoy. Ethiopia should take full advantage of it to create a large light industry cluster, and build domestic capability

around it by working with FDI firms.

Import-substituting and heavy industries

In February and August 2014, Prime Minister Hailemariam explained to the Japanese policy dialogue team that light manufacturing was the current policy focus but that did not mean Ethiopia would not develop heavy industries with large domestic demand. The Ministry of Industry (MOI)-Adama University Study of Ethiopian Industrial Development in 2013 listed many heavy and "high-tech" industries to be promoted during GTP II and GTP III.

We support promotion of import-substituting industries that have large domestic demand. This includes certain industrial machinery and parts; construction materials such as steel bars, tin roofs, and cement; and certain consumer goods such as processed food, drinks, household items, and popular medicine. Large and growing domestic demand should justify investments in these areas. We believe Ethiopia has no plan at this time to create export-oriented heavy industries. But we would like to make a few cautionary remarks because import substitution is more subtle than export promotion, which is straightforward in its policy formulation and performance criteria. We acknowledge that policy played an important role in developing such industries as cement, leather, and flowers in the past.[7] But as private and FDI players become more active, policy must move to a new phase. We would like to emphasize the following.

First, light manufacturing must be the main driver of growth, in the sense that without it Ethiopia cannot attain robust and sustainable industrialization during GTP II and GTP III. Heavy industries will also be important, but they are supplementary in the sense that their demand is derived from rising income generated by an expansion of export-oriented light manufacturing (hopefully not by land bubbles), and that their growth alone cannot bring structural transformation or middle income status to the country. Thus light manufacturing should be the top national priority.

Second, the pursuit of import substitution should be selective, conditional, and tentative. Not all inputs need to be produced domestically in this globalized world. Domestic production must be justified by international competitiveness in terms of cost, quality, and reliable supply, and not just by the fact that the country needs to reduce imports. Government should assist domestic producers to improve performance,

[7] See chs.4-6, Arkebe Oqubay, *Made in Africa: Industrial Policy in Ethiopia*, Oxford University Press, 2015.

but assistance should be terminated if they are unable to deliver results or become able to compete by themselves. Subsidies and protection should be used only initially and temporarily. Failed export is automatically eliminated by merciless global markets, but there is no mechanism to end support for failed import substitution unless government is willing to do so.

Third, the private sector should be the investor and producer. When income grows and demand for certain goods rises, there will be a natural incentive for FDI and/or domestic firms to invest in that sector whether it is cement, construction steel, textile machines, garment accessories, instant noodles, shampoo, or tooth paste, because (anticipated) large demand is the strongest business motive. There is little need for government to directly produce these items or encourage more business entry through policy measures. However, even in such circumstances government still has a very important role to play. It should (i) create demand forecasts for guiding private investors; (ii) provide coordinated support and incentives for skill formation and technology learning; (iii) solve labor, logistic, environmental, and other bottlenecks; (iv) set and enforce quality and safety standards; (v) prevent excess entry and a mutually destructive race toward low price and low quality (as often seen in China); (vi) police illegal and irresponsible activities; and (vii) counter dumping, cartelization, and other damaging behaviors of foreign countries and firms. In a nutshell, policy must create and manage markets in which private firms can play smoothly and productively.

For these reasons, import substitution in general, and of heavy industries in particular, requires more experience and sensitivity on the part of policy makers. It requires much more work than just drafting master plans with quantitative targets or expressing desire to fill a certain percentage of demand by domestic production. Ethiopia should acquire necessary experience and sensitivity as it promotes heavy industries with deliberation and care.

Evolution of FDI policy

FDI policy must also evolve as the national economy develops and government's policy capability rises. Broadly speaking, the policy must start with the provision of comfortable business environment aiming at absorbing a critical mass of FDI (especially manufacturing FDI), then proceed to the stage where quality and value creation of FDI, rather than sheer quantity, becomes an overarching objective. Let us elaborate.

In the first stage, the policy objective is provision of good business conditions.

A country just opening up to the global market typically has poor business conditions and low policy capability. Infrastructure must be built, legal frameworks must be established, and FDI policy and incentives must be created and improved. Government officials must be trained and new agencies must be formed. Irregularities and delays should be detected for correction. Corruption and arbitrary decisions must be replaced by open and transparent rules. Up-to-date information and one-stop service must become available to all investors. Industrial parks of one kind or another need to be created to provide exceptionally good operational conditions. If these efforts bear fruit, FDI will come to the country in large volume and begin to visibly transform its industrial structure. This is the quantitative FDI achievement in the early stage of industrialization.

In the second stage, the policy objective is domestic value creation. The country already has reasonable—if not perfect—business climate and risen in the World Bank Doing Business ranking, and a large number of FDI firms are operating. However, most of value-creating activities such as business strategy making, R&D, technology, product design, production management, quality control, global procurement, marketing, branding, and so on, are still in the hands of foreigners while the country's contribution is mainly in the forms of unskilled labor and industrial land. Though wages gradually rise and poverty declines, the levels of technology and income are still low or moderate. To overcome this "middle income trap" situation, policies and institutions must be upgraded to encourage (or even force) improvements in human capital, productivity, and (later) innovation. FDI policy must shift from general attraction to conditional and strategic attraction. In this stage, foreign firms that facilitate domestic value creation is welcomed while labor-intensive, simple-process manufacturing is asked to leave—or they spontaneously leave under the pressure of rising wages and unskilled labor shortage.

These two stages of FDI policy may be subdivided into many phases. Moreover, the two stages normally overlap with the weight of the first-stage gradually falling and the weight of the second gradually rising. But the important point is that any country that successfully completes the quantity-driven stage of industrialization must shift from general improvement of business conditions to domestic value creation. At the same time, it is not advisable to try to jump to selectivity before comfortable and smooth business conditions are established.

Among the countries in Southeast Asia, Myanmar is the latest comer just begin-

ning to integrate into the world economy with embryonic FDI policy and weak institutions. The cases of Vietnam, Indonesia, and the Philippines are mixed; they should start moving from the quantitative to the qualitative stage, but their governments seem unable to take the correct steps.[8] Malaysia and Thailand, which already attained the upper middle income status with large FDI accumulation, practice selective FDI policy for domestic value creation.[9] Highly advanced economies such as Singapore and Taiwan are primarily interested in enhancing competitiveness through innovation. Their FDI policies and business conditions are already first-rate and no further great improvement is needed.

Quality manufacturing and infrastructure

Two related concepts of quality manufacturing and quality infrastructure can be introduced. They are also closely related to the notion of FDI-linked technology transfer.

Quality manufacturing is the term the Ethiopian government already uses to describe manufacturers that contribute to Ethiopian industrialization. Its scope and criteria need to be defined more precisely, and it should not mean the use of expensive high-tech machines or frontline capital-intensive technology. We believe the concept must satisfy at least some—preferably all—of the following conditions.

(i) Creation of sufficient domestic value-added.

(ii) Application of skills and technology appropriate for Ethiopia's current reality and desire to accelerate industrialization (not necessarily the most advanced technology).

(iii) Training of Ethiopian engineers, technicians, and workers not just for normal operation but also for safety, maintenance and repair, problem-solving, efficient operation, muda elimination, and other actions and proposals for improvement.

(iv) Use of as many local machines, parts, and materials as technically and

[8] Indonesia is highly demanding to FDI with various requirements to bring value and process raw materials within the country, but its general investment climate remains primitive and unfriendly. As a result, the country attracts a large number of foreign firms that target the large domestic market but few technology-transferring FDI is arriving.

[9] Thailand recently made a big change in FDI policy from zone-based incentives (rural FDI received more incentives than urban FDI, and all manufacturing FDI was welcomed) to a scheme where incentives are given only to designated sectors and activities that enhance Thai technology and value creation. The new policy, introduced on January 1, 2015 after a one-year publicizing period, was inevitable because Thailand has already attained upper middle income ($5,370 in 2014) and faces severe labor shortage of all types.

commercially possible for construction, equipment, and daily operation of the project.

(v) Full compliance with local laws and regulations governing labor, commercial, industrial, environmental, financial, tax, customs, land, and other matters.

Quality infrastructure is the term the Japanese Ministry of Land, Infrastructure, Transport and Tourism (MLIT) is beginning to use in order to promote Japanese design, construction, and maintenance in the global infrastructure market. Exact definition of quality infrastructure is still under consideration at MLIT, but in our opinion should include such features as below.

(i) Excellent physical quality including safety, comfort, disaster proof, and durability.

(ii) Life-cycle efficiency including observance of contracted construction cost and period, long life, and easy and low-cost maintenance.

(iii) Technology transfer in construction, operation, and maintenance.

(iv) Existence of a regional development plan with the infrastructure project as a core component, which includes local government's planning capacity, engineer and worker training, industrial zones, agricultural development and marketing, construction of residential areas, efficient logistics, traffic management, etc.

Despite high quality, Japanese infrastructure is often criticized for high cost and long procedure. It is actually difficult for Japanese contractors to beat Chinese rivals in terms of construction cost and speed. Low-cost and fast construction is attractive for countries in haste with a tight budget. But expensive infrastructure may not be so expensive if durability, maintenance, and integrated use for development are taken into account. Toyota Corolla and Hi Ace run almost forever with proper maintenance while cheap cars break down immediately. Also, dishonest contractors push up costs deliberately in the middle of a construction period, after securing the contract by offering a seemingly low price. Opting for quality infrastructure thus requires long-term, multi-faceted perspective to judge the true value of infrastructure projects as well as sufficient financial resource to overcome the short-term budget constraint.

A long-term liberalization roadmap

Ethiopia is one of the countries that maintain a relatively tight control on foreign

business penetration. Manufacturing and agricultural investments are welcomed with the red carpet but many service areas remain closed or severely restricted to FDI. The positive list of permitted sectors to FDI, summed up from the EIA/EIC investor brochure in 2013 and 2014, are as follows.

Manufacturing, agriculture, ICT, power generation, hotel and tourism, grade 1 construction, real estate, secondary and higher education with own building, TVET, health service with own building, architectural and engineering technical service, publishing, import of liquefied petroleum gas (LPG) and bitumen, designated export and wholesale trade

Meanwhile, prohibited sectors for FDI include the following.

(i) Government monopoly areas—postal service, power transmission and distribution, passenger air transport.

(ii) Joint venture with government required—weapons and ammunition, telecom services.

(iii) Areas only for domestic investors—certain designated items in the following sectors: export, import, and wholesale trade; textile; leather; construction; construction materials; education; medical service, printing, etc. (for details of designated items, consult EIC or EIC documents)

(iv) Areas only for Ethiopians—financial service, insurance, broadcasting, legal service, advertisement, domestic air transport, shipping business, etc.

Some of these restricted sectors are understandable for low-income countries while others are more controversial. The controversial areas include financial service, (large-scale) retail trade, telecom service, and domestic land transport. Some countries—Cambodia and Rwanda, for example—choose to open up these markets in the early stage of industrialization, thereby building domestic financial, commercial, telecom, and logistic infrastructure and networks by foreign technology and investment. Others reserve these markets for domestic operators only, even with limited knowledge and resources, to avoid foreign dominance. Ethiopia adopts the latter strategy. Mr. Meles explained to the Japanese team that this was necessary for retaining sufficient policy instruments for development. Another justifying reason may be to shield and assist domestic firms in these sectors until they are strong enough to compete with foreigners (the infant industry protection argument).

We support the current policy of the Ethiopian government that keeps designated service sectors off-limits to FDI. We do not subscribe to the idea that immediate liber-

alization and opening up of all sectors will benefit poor countries. We believe that the above two arguments are valid under some circumstances.

But we do not support the Ethiopian policy unconditionally. As we explained above, development strategy must evolve as situations change. This is true not only for industrial and FDI policy but also for external liberalization. Even though protection of key service sectors is appropriate for a low-income country with subsistence agriculture and weak industries, such protection is not defendable forever. As the country advances toward lower-middle income and above, a plan should be drawn up to open up these service markets partially, conditionally, and step-by-step. Even in this stage, we do not recommend a sudden, big-bang liberalization. Unprepared opening is fraught with dangers even for high-income countries.[10] But we consider it important that Ethiopia starts to prepare a long-term roadmap for global financial and service integration during GTP II and GTP III.

The key variables that determine the scope and speed of such liberalization are (i) growth of domestic industries and markets; (ii) policy awareness of and preparation for possible integration risks; and (iii) the degree of global financial and service market instability. Among these, (i) calls for significant effort on the part of domestic players, and (ii) requires serious policy learning by the government. The liberalization schedule must also be synchronized with the accession negotiations of the World Trade Organization (WTO). It should be stressed that the announcement of such a roadmap, even if liberalization does not occur immediately, bestows confidence to the psychology of investors, both domestic and foreign, and makes it easier for them to plan their businesses in the long run. Also, in some cases, entry of globally competitive foreign firms into the home market can break inefficient domestic monopoly and improve competitiveness of the sector.

In sum, proactive industrial policy and external liberalization are the two sides of the same coin. They must be implemented in a strategic and mutually consistent way.[11]

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[10] Financial liberalization of Japan in the 1980s prompted commercial banks to lend carelessly to real estate and SME projects leading to a land bubble and its crash. Capital market liberalization in Southeast Asia led to large inflows of short-term bank loans and its sudden reversal in 1997-98 causing the Asian Financial Crisis. After the Lehman Shock of 2008, few countries are willing to support unregulated high-tech financial engineering.

[11] An industrial official in India explained to us that, thanks to continued liberalization, the negative list of restricted sectors to large or foreign firms, which numbered over 800 items in 1991, was reduced to only 27 items by 2012. However, the problem of Indian industrial policy is the lack of interest and measures to enhance domestic human resource and firms. Without strengthening domestic players, progress of external opening alone will not automatically bring prosperity.

We believe the time is approaching for the Ethiopian government to begin to seriously study the areas, sequencing, and speed of external liberalization for the future.

Policy procedure and organization

In Ethiopia, FDI attraction and industrial park development were recently placed under the Prime Minister for speed and effectiveness. Champion products and national branding may soon be handled by EIC, which also reports directly to the Prime Minister. We suspect that other key policies, such as ERCA reform, might also be centrally managed.

It is understandable that a developing country with limited policy capability wants to set up a powerful agency directly under the president or prime minister to push key national agenda forward rather than assigning them to weak line ministries. In 2008, Rwanda created the omnipotent Rwanda Development Board (RDB) covering FDI, industrial zones, SMEs, ICT, tourism, private sector development, and employment generation. Similarly, Cambodia is bestowing various policy authorities—Official Development Assistance (ODA), FDI, industrial zones, and even industrial policy making—to the Council for the Development of Cambodia (CDC) established in 1994. Ethiopia also adopts central policy management as this is a critical moment for the country and the window of opportunity should not be missed.

But this may generate a new problem—the problem of a central agency becoming too big and overstretched while line ministries remaining fragile and under-utilized. In Rwanda and Cambodia, policy planning has been enhanced but MOI remains as weak as ever and ground-level works to assist farmers, workers, engineers, SMEs, etc. also remain weak. This is a problem of balancing policy speed with the need to strengthen line ministries. We do support the current centralization of industrial policy authorities in Ethiopia but we also hope that the right balance will be struck between the two goals in the long run.

A strong MOI is needed for long-term industrialization with quality because the Prime Minister's Office cannot be commanding an ever-increasing number of individual measures forever. There are governments with strong MOIs (or equivalent ministries) such as Japan, Taiwan, Singapore, and Malaysia and governments with weak MOIs such as Indonesia, Vietnam, Tanzania, and Mozambique. It is essential that MOI's capacity and functions are reinforced, especially in implementing concrete programs and projects. It is our hypothesis that much of the cross-country differenc-

es in industrial performance is explained by policy quality. The quality of industrial policy must be institutionalized in MOI rather than relying on the personal quality of a national leader.

More specifically, we suggest the following assignment strategy. During GTP II (and possibly GTP III also), the Prime Minister's Office should directly manage FDI and industrial park policies. This will break institutional barriers and place the country firmly on track toward FDI-led industrialization. Meanwhile, MOI should strive to deliver results in other "core" policy measures that strengthen domestic capability such as industrial training, kaizen, handholding, fostering manufacturing SMEs, creating manufacturing export champions, FDI-local firm linkage, technology transfer, and technical support for key industries (textile, leather, food processing, chemicals, mechanics, etc.) through sectoral institutes and international cooperation. When MOI's capability has sufficiently improved, policies such as FDI and industrial parks can be returned to MOI.

To strengthen industrial policy, we additionally propose that the Ministry of Industry and the Ministry of Trade should be re-united as the Ministry of Trade and Industry (MOTI) as before (or any other name). Joined industry and trade ministries are observed in Japan, Taiwan, Singapore, Korea, Malaysia, Thailand, and Vietnam. After the merger, new MOTI must be greatly enhanced in all respects including mandate, budgeting, staff capacities, and organizational structure.[12] Two ministries may not immediately blend after the merger, but they will gradually integrate as new officials are recruited and old ones retire.

Another perennial problem observed in many countries is the tax and customs authority (ERCA in the case of Ethiopia) acting on its narrow mandate of securing fiscal revenue without regards to broader national objectives. This increases costs, hassles, and delays for producers and traders. Industrialization is the national goal and fiscal revenue is one of the means. The latter should be made to serve the former instead of creating obstacles. This cannot be realized only by the self-effort of the tax adminis-

[12] The organizational structure of Japan's Ministry of Economy, Trade and Industry (METI), Taiwan's Ministry of Economic Affairs (MOEA), and Malaysia's Ministry of International Trade and Industry (MITI) consist of four main components: (i) administrative units handling ministerial, personnel, and legal affairs; (ii) policy making units which are classified into vertical (sectoral) bureaus and horizontal (cross-cutting) bureaus which together provide core policy functions; (iii) deliberation councils or other mechanisms for interacting with various government and private stakeholders for drafting and executing policies; and (iv) implementing agencies for SMEs, productivity, industrial estates, quality and standards, etc. Ethiopia needs to enhance (ii) and (iii).

tration; the clear instruction must be given from a higher level.

The National Planning Commission (NPC) was created to draft GTP II in an effort to strengthen and systematize development planning in Ethiopia. The capacity of NPC staff needs to be built up from a long-term perspective. Furthermore, the existence of a planning commission and national development performance are not really correlated. Some of the Asian governments, such as Korea, Malaysia, India, China, Thailand, Indonesia, and Vietnam, have used central planning mechanisms to draft development plans but economic results were varied (by now Korea and India have abolished such mechanisms). Post-World War Two (WW2) Japan, Singapore, and Taiwan did not rely on central planning. If NPC is to produce development plans with proper direction and high implementability, it must improve vision and goal setting, research functions for macro, sectoral, and social issues, and guidance and coordination over line ministries. International best practices should be referenced to strengthen NPC. Other areas that need to be studied over the long run include the following.

- Legal status, authority, standing within government, and scope of work of NPC
- Organizational structure, appointment of the commissioner, and staff recruitment
- Concrete drafting procedure (drafters, duration, sequence, stakeholder involvement, inter-ministerial coordination, approval process, etc.)
- Document—length, structure, content, and methods of dissemination
- Budgeting, international cooperation, foreign members and advisors, etc.

Should NPC internalize the think tank (research) function, or should it outsource it? Both strategies are possible. Even if policy research is outsourced, NPC must retain high research capacity so it can effectively initiate, organize, and evaluate outsourced research. We believe the pragmatic path will be to gradually strengthen internal research capability of NPC while some (most, at the beginning) of the background papers are commissioned out. By providing proper instruction and healthy competition, NPC can create a market for high-quality policy research within Ethiopian academic circles. The Ethiopian Development Research Institute (EDRI), universities, research institutes, economics associations, and private consultant firms should all participate. Taiwan offers an interesting case where the all-powerful Ministry of Economic Affairs set up two think tanks—Taiwan Institute of Economic Research (TIER) and Chung-Hua Institution for Economic Research (CIER)—which currently operate as private institutes and compete for MoEA's policy works. Both TIER and CIER produce high-quality inputs that go into Taiwan's economic policy.

Chapter 3

Key Policy Components

In this part, policy components which we believe will become important for Ethiopia in accelerating industrialization are selectively discussed. They are not necessarily exhaustive. The purpose is not to give a general explanation of each policy component—which is provided in the other volume of the JICA-GDF Report, "Case Studies of Key Industrial Policy Measures in Asia and Africa"—but to point out main policy issues that must be considered by Ethiopian authorities in the context of GTP II and possibly also GTP III.

3-1. Kaizen and national productivity movemen

Japan in general, and the National Graduate Institute for Policy Studies (GRIPS) and JICA in particular, are proud and happy to see Ethiopia learn, internalize, and own kaizen. We do not doubt the seriousness of Ethiopian kaizen movement. Prime Minister Hailemariam once stated that "the kaizen fire has already been ignited and no one can stop it," and we believe it is indeed the case. JICA's cooperation taught kaizen to 30 pilot companies (Phase 1, 2009-2011) and trained Ethiopian experts and enhanced Ethiopian institutional capacity to carry on kaizen (Phase 2, 2011-2014). Through these phases, 249 firms adopted kaizen and 409 Ethiopian experts were trained. By now, basic kaizen such as 5S, muda elimination, equipment layout, and quality control can be coached and practiced by Ethiopians alone; Japanese experts are no longer needed there. JICA is continuing with Phase 3 which aims to transfer advanced kaizen to Ethiopia. We hope Ethiopia will become a solid African model of kaizen, teach the practice to other nations, and spread it throughout the continent. Kaizen training of other African countries by the Ethiopian Kaizen Institute (EKI) has already started.[1]

Vision 2025 must be attained by the brain and hard work of the Ethiopian people

[1] There are three stages of JICA's kaizen assistance. The first is improving a certain number of factories, hospitals, or offices by dispatching JICA experts with no continuation or national ownership after the work is done. The second is training local kaizen experts and creating local institutions so kaizen will continue after JICA experts leave. The third is broadening kaizen to entire firms, citizens, and public servants so it becomes a part of permanent national culture, and the country may even become an instructor to others. Most countries stop at the first or second stage but Ethiopia is moving rapidly to the third stage, as Singapore did in the 1980s and 90s.

leading to the structural transformation of the economy, not by a mineral discovery or other unearned advantage. This means that Ethiopia should become a middle income country *with quality*, with a prospective to become a high income country in the future. For this purpose, the nation should concentrate first and foremost on *productivity improvement* during the GTP II period, building on and expanding the past achievements and institutional preparations. While kaizen is not the only way for improving industrial competitiveness, it should be featured as the key policy tool in GTP II and GTP III now that Ethiopia has already started on this path. Kaizen-based productivity movement should be the central pillar of Ethiopian industrialization.

This upbeat assessment and high hope do not however mean that Ethiopian kaizen is going smoothly. On the contrary, there are many important issues that need to be discussed, solved, or strengthened as Ethiopian kaizen moves up to a more advanced stage. We would like to list six points.

First, kaizen must be truly owned and practiced by all Ethiopians, not just by a small number of government officials or factory managers. The Ministry of Education should introduce programs and school curriculums for efficiency and discipline. This should include reforms in pre-work standard education from kindergarten to university as well as adult education for farmers, workers, women, youths, etc. Basic efficiency principles such as attentiveness, honesty, punctuality, good arrangement, and upward mobility should be taught to all children. Adults should learn planning, cooperation, elimination of muda, immediate reporting of and attending to problems, etc. Changing the mindset of entire population is a formidable task requiring many years but it will surely expand the base of the pyramid upon which more challenging kaizen can be built. In Addis Ababa, taxi drivers have already heard of kaizen; now they must own and implement it. Theory must be put into practice.[2]

Second, a kaizen skills certification system must be in place. GTP II will probably list numerical targets for kaizen experts and kaizen-practicing companies for 2020 and 2025, which is highly welcome. But numerical targets require an official certification system with transparent criteria to recognize different levels of kaizen achievements. We believe EKI and JICA's Kaizen Phase 3 will work on this. When Ethiopia's kaizen

[2] The two Prime Ministers we have had the honor of having policy dialogue with both stressed that kaizen should be a trigger for a deep and permanent attitudinal change, not a toolbox for quick results. Ethiopia's kaizen awareness has risen considerably but it is mainly directed to the "usefulness" of kaizen as a productivity tool and not to spiritual awakening. To shift the balance of awareness from the former to the latter will require a national movement with necessary components as discussed in this section.

criteria are established, numerical targets in GTP II may have to be revised as necessary. One possible problem is the fact that something like globally common kaizen standards already exist but details often differ depending on experts. Each Japanese kaizen expert has ideas about required steps and skills which are slightly different from each other. Standardization and local adaptation must be attained simultaneously, with variations coming from country specifics rather than experts' personal opinion. The National Kaizen Council, with inputs from JICA and EKI, should straighten this matter.

Third, incentivization is critical. Success of a national kaizen movement critically depends on incentives for all stakeholders to carry the torch. This includes workers, mid-level technicians and engineers, top managers, as well as consultants and instructors at kaizen-assisting institutions such as EKI and TVET. We hear from one kaizen-award winning Ethiopian company that its workers are not really willing to continue because they see only temporary praise but no financial reward. We also realize that retaining trained experts is a big headache for EKI. Incentivization of various kaizen stakeholders should be seriously discussed at the National Kaizen Council. Suggested solutions include skill-based and experience-linked remuneration and promotion, official provision of consultancy opportunities, conferring academic degrees, and social recognition through publication and media.

Fourth, Kaizen Month must be continued at least for the coming several years or until Ethiopia feels confident that kaizen is part of irreversible national culture. We greatly appreciate the quick initiation of Kaizen Month in September 2014 despite a short preparation period, and the second Kaizen Month was organized in 2015 with the attendance of the Prime Minister featuring an award ceremony, the kaizen master course graduation ceremony, and an official inauguration of the kaizen plan in the next five years and advanced kaizen, all taking place on September 19, 2015, followed by month-long media events. A meeting of the National Kaizen Council, seminars, and some dancing and singing can also accompany. We hope that the annual kaizen speeches of the Prime Minister will be made available in visible and easily retrievable form in websites and publication as a historical record for future reference.

Fifth, kaizen must be privatized in the long run. At the start, kaizen can be initiated, expanded, and institutionalized by the strong hand of the government. Through this process, it is hoped that Ethiopian people and companies will be convinced of the value of kaizen and become willing to carry on rather than being forced to do it.

When this psychology is firmly established, kaizen can be passed on to private hands in proper steps. This includes companies, schools, and hospitals willing to do kaizen without official prodding as well as emergence of private kaizen consultants offering service on a fee basis. In Singapore, the national productivity movement in the 1980s went through Awareness, Action, and Sustainability stages. In Singapore, sustainability meant passing kaizen from government to the private sector. Ethiopia is currently doing Awareness and Action stages but Sustainability should also be kept in mind.

Sixth, while EKI is the hub agency for kaizen, Ethiopian Management Institute (EMI), Civil Service University, National Research Institute, Meles Zenawi Leadership Academy, and other policy-oriented research institutions, as well as the army (as Singapore did), should be mobilized for deepening and broadening kaizen. The modern and spacious facilities of EMI in Addis Ababa can be a venue for incorporating kaizen into standard management training. The Civil Service University is a natural place to teach efficiency to a large number of government officials. The army is similarly an ideal place to teach efficiency and discipline to young males. Meanwhile, academic institutions can analyze kaizen and its adaptation to Ethiopia. In the end, kaizen and enterprise management should be integrated, and research should effectively communicate the knowledge of kaizen to all interested people in and out of Ethiopia.

In January 2014, Prime Minister Abe announced establishment of an industrial human resource development center ("TICAD Human Resource Development Centre for Business and Industry"), the first such center in Africa, in Addis Ababa with EKI serving as the base. This initiative is a natural development of JICA's kaizen support in Ethiopia and should become fully operational during GTP II. Japan should continue to support the knowledge and infrastructure components of this initiative. Official inauguration of the Center, appointment of its Director and staff, and allocation of initial budget should be followed by the teaching and dissemination of industrial human resource capability to other African countries with kaizen as the core curriculum but with possible addition of other subjects.

3-2. Industrial parks

Ethiopia has chosen industrial parks as the current pillar of industrial policy. They are considered necessary to provide comfortable investment climate to attract quality FDI. Fencing small areas to offer good support and services to foreign firms, when general business climate cannot be improved immediately, is a standard strate-

gy. Starting in 2013-2014, industrial park policy in Ethiopia was upgraded from the ministerial to the prime minister's level with significant strengthening of related laws and regulations, organizations, staffing, budget allocation, policy measures, and policy attention. There are many ways to accelerate industrialization, and industrial parks are just one of them. However, developing country governments cannot adopt all policies at once. The Ethiopian choice of creating good industrial parks as a first step is sound and practical even though it is not the only one. This gives a sharp focus and clear monitoring criteria. The policy is also quite appropriate for a country beginning to receive a large amount of manufacturing FDI.

We support the government's plan to mobilize all necessary measures, institutions, and resources around this strategy to make industrial parks successful. At the same time, industrial policy in Ethiopia, though evolving dynamically, is still in an embryonic stage. Ethiopia should continue to learn to make its industrial zones more attractive and fully functional through experimentation and foreign support. Below, issues directly related to industrial park construction, management, and operation are discussed while other issues, such as improving general investment climate and creation of industrial areas reserved for Japanese firms, will be considered in other sections.

The first point we would like to make is that industrial parks are a real estate business with inevitable ups-and-downs and factors beyond the control of park operators or a host country. Success depends much on good luck because many critical determinants of FDI inflow such as global business conditions, regional political instability or economic crisis, wars and terrorism, cross-border epidemics, economic conditions of source countries, and strategies of competitor countries and individual FDI firms are beyond the power of any single country or government. If these conditions are favorable just when an industrial park becomes operational, it will soon be occupied. Otherwise, it will have to wait for customers. For this reason, quick sales of factory space and rental factories cannot be ensured by well-prepared policy or business strategy alone. In Vietnam, Thang Long Industrial Park Phase 1 (developed by Sumitomo Corporation) and Nomura-Haiphong Industrial Zone (developed by Nomura Securities) took as long as a decade or more to fill, but both are now very successful with many Japanese tenant firms. In Cambodia, Phnom Penh Special Economic Zone (PPSEZ) established in 2006, also took a long time and much marketing effort to sell, but it has now become the largest concentration of Japanese manufacturers in that country.

We are a little afraid that Ethiopia has not learned the hard lesson yet. The first industrial zone developed by the Ethiopian government (Bole Lemi 1) was sold out immediately, and Hawassa is also going very quickly. This may be partly due to dynamic policy and partly due to good luck—given the poor investment climate and the absence of industrial zones in the past, there was a pent-up demand for industrial land in Ethiopia. An accelerating exodus of light manufacturing from high-wage emerging economies also helped. But reality is that excess demand for industrial land does not last forever and investors who promised to come do not always come. We hope that Ethiopia will not become complacent and will instead double its effort to improve the quality of existing and future industrial zones.

Second, infrastructure services in and around an industrial park must satisfy global (and Japanese) standards. At the basic level, this includes cleanliness and tidiness; reliable power and water supply; sufficient roads and space for transport and loading/unloading; high-standard waste water and solid waste treatment; protection against violence, theft, and fire; proper drainage (if the terrain is prone to flooding); high-quality internet and telecom service at reasonable cost; housing and dormitories for workers; and so on. These should be commonly demanded by all investors regardless of sector or nationality. In addition, firmness of ground (piling is required if soil is soft); stability of power voltage and water pressure; and on-site provision of a bank or ATM, courier service, a medical clinic, a supermarket, and restaurants are needed to attract picky investors. Amata Nakorn Industrial Estate in Thailand, which has attracted about 400 Japanese manufacturers, has comfortable living quarters, Japanese restaurants, schools, a clinic, and even a golf course inside the estate.

Another problem is what you see (on the blueprint) may not be what you get. Infrastructure works at industrial zones in many countries—ground preparation, shed construction, a transformer station, waste water treatment, etc.—are fine in approved design but actual results fail to satisfy tenant firms because contractors do not follow instructed design or procedure and/or substitute with less or inferior materials. There should be a monitoring mechanism to avoid this situation.

Ethiopia should first ensure the quality of basic infrastructure services, then proceed to offer additional ones. Even Bole Lemi 1 may need enhancement. In October 2015 when we last inspected, pavement materials and debris were scattered on industrial zone roads and sidewalks; a concrete cover of underground drainage was broken; the main gate was unusable because a connecting road to outside was unfinished;

and the back road currently used by all investors and visitors remained rough and unpaved. From a Japanese eye, these problems should have been fixed before Bole Lemi 1 opened for business. Also, the management office complex is not exactly what we expected. At Dong Van 2 Industrial Zone in Ha Nam Province of Vietnam where about 40 Japanese firms operate, power failure is rare but Japanese manufacturers still complain about voltage fluctuation and instantaneous power interruptions which damage sensitive equipment. They also want improvement in water quality; underground water supplied to Dong Van 2 meets the Vietnamese environmental standard but not the Japanese. To correct the situation, JICA has a plan to assist building a new water plant from a surface water source. One Japanese firm complained about low water pressure, which was corrected by adding a new pump.

Third, one-stop investor service must be truly helpful. It must provide good support before, during, and after investors move in. Most countries set up one-stop windows or services but they often remain in names only. When investors approach them there is still considerable bureaucracy, ambiguity, and waiting. Vietnamese officials joke that there is one door but many locks hang on it. By contrast, at industrial parks operated by Taiwanese or Singaporean companies, the "Customer-Is-King" attitude is firmly established. Sudden visitors without appointment are greeted immediately with smile and tea, and park staff will be more than happy to provide any information that potential investors or even academic researchers require.

Table 3-1 lists standard services offered by a Japanese industrial park management company to Japanese corporate tenants—in this case, Long Duc Industrial Park in Vietnam developed and managed by Sojitz Corporation. On the receiving side, Table 3-2 presents Ten Pledges made by the top leaders of Ha Nam Province, Vietnam to attract Japanese manufacturing and SME investors. These pledges guarantee the quality of infrastructure services as well as investor support. Both cases offer direct channels for receiving claims and coping with emergencies (Japanese staff on duty, Japan Desk, 24-hour hotline, etc.) Both also hold regular meetings with tenant firms to systematically share information and solve problems. The Long Duc Industrial Park management provides information on changes in taxes, laws, and regulations as well as wage issues. Ha Nam Province meets with Japanese investors a few times a year where collected investor complaints are studied ahead of the meeting and the Party Secretary (provincial leader) announces proposed solutions.

Table 3-1. Industrial Zone Services Offered to Japanese Investors

Before moving in
• Prepare documents for corporate registration on its behalf. • Obtain company seal and tax codes. • Assist conducting Environmental Impact Assessment. • Advise on obtaining visas, work permits for Japanese. • Introduce real estate agent. • Introduce accounting firms, law firms, etc. • Assist loca staff recruitment. • Provide support to any issues whenever possible.
After moving in
• Professional management by Japanese staff always on site. • Stable supply of power and water, operations of a wastewater treatment system around the clock. • Staff recruitment center (located within the industrial park). • Provide and coordinate various services (IT, logistics, lunch box delivery & catering, etc.) • Exchange and share latest information on new laws and regulations, staff wage, coping with labor disputes, tax issues (personal income tax, etc.) • Organize social gathering, parties, golf competition, etc.

Source: Izumi Ohno's research and information provided by Long Duc Industrial Park, Vietnam developed and managed by Sojitz Corporation.

Table 3-2. Ten Pledges of Ha Nam Province, Vietnam to Japanese Investors

WE GURANTEE
1. Sufficient and stable power supply (24 hours). 2. Good infrastructure (water, sewerage, internet, banks, etc.). 3. Free provision of land to be used for dormitories for workers (outside the industrial park). 4. Efficient administrative procedures (investment license to be approved in a few days). 5. Sufficient labor supply, developing a university town (1,000 ha secured for universities relocating from Hanoi). 6. Facilitating procedures for setting up and operating companies, tax incentives, and subsidies for training Vietnamese staff. 7. Public security and safety for companies. 8. Flexible administrative response to accommodate unanticipated changes in investors' business plans. 9. Prevention of strekes (local and foreign companies). 10. Hotline to Japan Desk for any troubles (by assigning Japanese–speaking staff).

Source: Izumi Ohno's research and information provided by the People's Committee of Ha Nam Province.

Additionally, Japanese manufacturing SMEs require even more pampering and special attention in comparison with large corporations. It is widely known that SMEs that supply precision components with QCD (strict requirements on quality, cost, and delivery), not big-name automotive or electronic giants which buy and assemble such components, are the true source of Japan's high technology. However, small manufacturers lack capital, management capacity, marketing skills, and foreign experience despite their high technical capacity. From around 2010, Japanese central and local governments as well as various economic organizations (including JICA and the Japan External Trade Organization (JETRO)) began to actively support overseas expansion of Japanese manufacturing SMEs. This includes business information, trade fairs and tours, management consultation, finding customers abroad, recruiting staff and workers, matching and linking with foreign partners and service providers, financial support for feasibility study and pilot projects, and so on.

Together with Japanese consumers, Japanese investors are perhaps the choosiest in the world. They want super-care not demanded by other international investors. But if Ethiopia wants to create very good industrial parks, listening to the voices of Japanese and other hard-to-please foreign investors and implementing their recommendations—selectively and in proper sequence—is a reasonable strategy. Japan in turn should offer systematic expert opinions on the infrastructure services and investor support at the existing industrial parks in Ethiopia.

Fourth, in order to attract high-quality manufacturing SMEs, Ethiopia should offer various investment options. For the moment, large-scale, stand-alone, and often vertically integrated garment and footwear investors such as Ayka, George Shoe, Huajian, and Kanoria attract attention. Similarly, the PVH subcontracting group is coming to Hawassa, each with relatively large factory space. They are expected to contribute greatly to the next stage of Ethiopian industrialization. But when a latecomer country advances from simple light manufacturing to mechanical production such as automobiles, electronics, industrial equipment, and their components, a complex web of component suppliers and service providers become crucial (they are called *supporting industries* in East Asia). These industries require hundreds and thousands of precision parts whose specifications change frequently. Unless suppliers are located inside or near the country where final assembly takes place, time and logistic costs become formidable, and just-in-time production at globally competitive price is hardly possible. Japanese manufacturers have already established such a network in East Asia, and

Thailand alone has about 2,300 first-, second- and third-tier automotive component suppliers the vast majority of which are Thai firms. That is one of the reasons why Japanese firms—both assemblers and component suppliers—are unwilling to move from there to Africa or elsewhere.

Manufacturing growth without reliable supply of inputs and services tends to be shallow and transitory. A deep and multiple layers of manufacturing SMEs is needed to maintain competitiveness of final assemblers. Large multinational corporations (MNCs) will not come or leave the country soon if strong industrial clusters do not form. Thailand and Vietnam noticed this, and have been promoting supporting industries since the 1990s (Thailand) or the 2000s (Vietnam). Mr. Mai Tien Dung, the Party Secretary of Ha Nam Province, says "We target Japanese supporting industries and SMEs because they will bring large MNCs." The fact is that large assemblers and small suppliers present a chicken-and-egg problem. Existence of one will attract the other, and the question is how to first attract either of them. To attract the chicken, hard and customized negotiation with targeted MNCs is advisable. To attract the egg, various options to minimize initial cost and risk of SME investors should be offered.

Because manufacturing SMEs do not need large sheds over 1 hectare, other possibilities to enter small should be available. Original Equipment Manufacturing (OEM), *line gari* (renting a production line of an existing factory), license manufacturing, small-size rental factories (250m^2, 500m^2, 1,000m^2, etc.), even smaller "incubation" space (100m^2, for example), investment in a group, *nokisaki* arrangement (renting unused factory space to others for a limited time), and joint venture with a reliable local partner are common options for reducing or entirely doing away with initial investment of Japanese SMEs in Southeast Asia. As business expands, they usually move from incubation space to a rental factory, then build their own factories. Others start from *line gari* or OEM to explore market possibilities, then proceed to full investment. There are many small Japanese manufacturers that grew to become large firms in East Asia.

Finally, the problem of FDI data should be mentioned. We understand that the Ethiopian government only counts implemented and operational FDI and does not even report the number of registered projects which may or may not invest. Mr. Fitsum Arega, Ethiopian Investment Commissioner, states that actual inflow (implemented FDI) was $1.0 billion in 2013/14 and $1.5 billion in 2014/15. We approve EIC's effort to recognize only serious investors and not opportunistic license hunters. We also

highly evaluate its recent move to eliminate ghost investors from the dataset, create teams that follow up and assist key investors until they become operational, and nudge license holders to quickly implement in what they promised. We see that the lessons learned in Malaysia and elsewhere are put into practice.

Nevertheless, after many inquiries and interviews, we are still unable to fully grasp Ethiopia's FDI statistics. The fact that there is no consistent time-series data going back to the 1990s is understandable, but even current numbers puzzle us. There are two issues here. First, besides implemented FDI, other information should be provided. In East Asia it is common to regularly report the number of projects and USD values of FDI registered, implemented, and cancelled. FDI registration can even be reported monthly with the full understanding that not all registered projects will be realized. Moreover, information on size, sector, and nationality of investors is also made available. With this array of information, it is easy to analyze shifts in the implementation ratio, type of investors, distinction between serious factories and window-shoppers, the areas to which policy attention should be directed, etc. Second, as Ethiopia improves FDI reporting in an experimental and incremental way, it is desirable to check if the Ethiopian practice is compatible with global standards. Data compatibility is necessary to compare Ethiopia's FDI performance with other developing countries. Professional help, from the International Monetary Fund (IMF)'s Statistical Department for example, should be sought for diagnosis and advice. Data quality is a critical matter for setting goals and monitoring progress toward the 2025 vision.

3-3. Linkage formation

Business linkage can mean many things and can be formed by various partners. Here we focus on commercial cooperation between FDI manufacturers and domestic firms where the latter supply industrial materials, components, and services to the former on a regular basis. Additionally, linkage formation with foreign buyers that demand high quality on domestic suppliers as a condition of purchase is also worth considering. In such vertical linkages, technology transfer may occur through standardizing, demanding, teaching, training, and other instructions. This is creation of "supporting industries" mentioned in the previous section.

FDI-local firm matching may occur spontaneously through private channels but the amount of such activities is usually much lower than what policy makers hope for. Thus, official support is needed to accelerate and maximize match-making. After

attracting high-quality foreign investors to the home country, linkage can be promoted by (i) direct service provision by the state such as creating information datasets, and hosting events and opportunities for two parties to meet, know each other, and hopefully engage in business; and (ii) incentivization, namely providing subsidies and other supports to qualified private activities that promote matching, teaching, local procurement, and technology transfer.

Linkage promotion in Thailand

In our opinion, Thailand offers a very good—though not perfect—matching mechanism for other latecomers to study and selectively follow. Since the mid-1980s, Thailand has introduced a large number of supporting industry promotion programs, among which FDI-local firm industrial linkage development is one. Table 3-3 lists main players in this mechanism.

There are three salient features of Thai matching and linkage promotion. First, the network is informal and flexible rather than rigid and hierarchical. While the Board of Investment (BOI, an investment agency under the Prime Minister's Office) and the Ministry of Industry (MOI) are the key official coordinators, no institution dominates nor is the system governed by explicit rules. Each member organization performs its tasks separately and refers clients to other institutions when necessary. Personal rapport among officials and experts at various institutions matters greatly in ensuring speedy and effective service. Such loose working style is typical of the Thai government. Second, the private sector plays a significant role. Some Thai industrial NPOs, such as the Technology Promotion Association (TPA) and the Thai-Nichi Institute of Technology (TNI), are self-supporting private bodies receiving little government help while others, such as the Thailand Automotive Institute (TAI) and the Alliance for Supporting Industries Association (A.S.I.A.), are established and coached by MOI until they become fully operational and effective. Third, management, technical, and financial support to SMEs are to be integrated, or at least that is the intention of Thai MOI. Shindan reports (SME diagnostics and advice) are now required for the Bureau of Supporting Industries Development (BSID)'s technical support or SME Bank loans so manufacturing SMEs have an incentive to receive shindan in advance. TPA plans to combine firm matching service with technical support to Thai SMEs so they will become competent partners of Japanese firms, with the Technology Advanced Metropolitan Area Cluster (TAMA Cluster) of Tokyo as a model.

Table 3-3. FDI-Domestic Firm Linkage Promotion in Thailand

Organization	Status	Functions
DIP (Department of Industrial Promotion)	Government; MOI's leading department	Design policies; monitor implementation and analyze performance
BSID (Bureau of Supporting Industries Development)	Government; estab. 1996; one technical bureau of Thai MOI	Provide technical support & training to Thai supporting industries; develop prototype products; promote subcontracting, shindan, and industry associations
BUILD (BOI Unit for Industrial Linkage Development)	Government; estab. 1992; one unit of the Board of Investment (central FDI agency)	FDI-Thai firm matching including Vendors Meet Customers (VMC) program, supplier database (with ASEAN), SUBCON Thailand (annual subcontracting exhibitions)
TAI (Thailand Automotive Institute)	NPO; estab. 1999 by MOI but now self-financing; one of 10 industrial institutes	Automotive policy research and master plan drafting; promote supporting industry clustering; export promotion; automotive testing center
A.S.I.A. (Alliance for Supporting Industries Association)	Private; a collection of twelve Thai industrial associations	Information exchange, technology learning, and receiving policy support for member associations and firms; coached by MOI
TPA (Technology Promotion Association)	Private NPO; estab. 1973 by Thai alumni who studied engineering in Japan	Offer technical & management courses; conduct business consultation; publish & translate books; teach Japanese language (all fee basis)
TNI (Thai-Nichi Institute of Technology)	Private university; estab. 2007 by TPA	Teach Japanese style manufacturing in both theory & practice (engineering, IT, business administration, MBA); 4,000 students; active cooperation with Japanese FDI
Japan Desks (two desks at DIP and BOI)	Government; staffed by Japanese experts	Appointments, events, and logistic support for Japanese SMEs and local governments visiting Thailand for business partnership

Source: Research by the GRIPS Development Forum and the Vietnam Development Forum in 2005, 2009, 2013, and 2015.

BSID and the BOI Unit for Industrial Linkage Development (BUILD) deserve special mention. The Director of BSID is Mr. Panuwat Triyangkulsri, an experienced industrial official who speaks fluent Japanese. He has been instrumental in developing Thai supporting industries since the 1980s. BSID has taken a step-by-step approach to strengthening the capacity of Thai industries. Initially, when the private sector was weak and the number of supporting industry firms was limited, BSID directly provided technical and managerial support. When the number of firms grew to approximately 1,000, BSID established and managed thematic forums of supporting industries (de-

sign, metal, machinery, foundry, etc.), serving as their coach and secretariat. Gradually, these forums gained experience and developed into 12 privately-run industrial associations.[3] They are beginning to provide technical support and training to member companies without BSID's help. In 2008, A.S.I.A. was established, again with the guidance of BSID, to promote networking among existing industry associations. Currently, BSID, industrial institutes such as TAI, A.S.I.A., and A.S.I.A.-affiliated industrial associations jointly work to strengthen supporting industries.

Likewise, *shindan* (SME management consultant system) service was initially provided by the government, but now it is willingly conducted at individual firms that have come to understand its benefits. The current role of BSID in shindan is setting the diagnostic criteria and establishing a mechanism in which shindan reports can be used effectively to address concrete problems. As noted above, Thai companies are obliged to present shindan reports in applying for BSID's technical support or loans from the SME Bank. BSID also manages a database for Thai supporting industries. In this way, the degree of Thai government's direct involvement in enterprise support was strong at first, but has decreased over time as the private sector developed its capacity.

On the other hand, the objective of BUILD is to provide one-stop services for FDI firms wanting to procure domestic inputs or find Thai partners for joint venture, OEM, patent use, or production contract. Main activities of BUILD are as follows.

(i) *Sourcing service*—when an inquiry is received from a foreign buyer, the BUILD website solicits expression of interest from potential Thai suppliers. One-on-one meetings can also be arranged. Inquiries from foreign firms are received via email, telephone, the One Start One Stop (OSOS) Investment Center, or overseas offices of BOI.

(ii) *SUBCON Thailand*—started in 2007 and held annually, this is the largest industrial subcontracting exhibition for industrial parts and business matchmaking in the Southeast Asian region.

(iii) *ASEAN Supporting Industry Database (ASID)*—this is an information service of the Association of Southeast Asian Nations (ASEAN) that lists manufacturers of parts and components in the ten member countries on

[3] Thai Machinery Association, Thai Composites Association, Thai Foundry Association, Thai Embedded Systems Association, Thai Plastic Industries Association, Thai Logistics and Production Society, Thai Tool and Die Industry Association, Thai Air Conditioning Traders Association, the Association of Thai Software Industry, Thai Subcontracting Promotion Association, Hazardous Substance Logistics Association, and the Association of Thai Small and Medium Entrepreneurs.

the internet for global access. Thailand is the most active country in this database.

(iv) *Vendors-Meet-Customers (VMC) Roadshow*—this program supports Thai component suppliers to participate in overseas trade fairs for widening knowledge and possible link with global supply chains.

BUILD is run by one director and ten staff members, with each staff assuming responsibility for sourcing service for different individual buyers. According to the BUILD Director, business matching is not an easy task with partner search more difficult than procuring local inputs. It sometimes takes more than one year to locate suitable partners. BUILD does not have data on the number of buyer inquiries or the number of successful search. However, about half of the FDI firms that made inquiries subsequently send a thank-you email and report progress to BUILD.

While the Thai model has a long history and many experts and institutions, and cannot be copied immediately, Ethiopia should start with what it can do. The government should prepare a list of competent Ethiopian firms—component suppliers, producers and distributors of agro inputs and raw materials, service providers, etc., just as building contractors are graded. This may take the form of an enterprise database or, more informally and realistically, prompt and precise information provided by EIC, MOI, Ministry of Agriculture (MOA), EKI, TIDI, LIDI, MIDI, EHDA, etc. An information referral and matching network should be set up among these institutions.

Technology transfer

Technology transfer is not a natural or automatic phenomenon. It calls for serious effort by domestic entrepreneurs to connect and work with foreign firms as well as effective official actions to facilitate and incentivize the learning. Policy should use incentives, subtle prodding, and encouragement instead of forcing FDI to transfer technology by laws, regulations, and penalties because such coercion usually backfires and keeps FDI away. Only China, with its gigantic domestic market, can demand technology transfer and still attract FDI. Normal-size countries should not take this approach. Ethiopia should learn how to push FDI softly to teach skills and technology in a voluntary and mutually beneficial manner. This requires thorough understanding of the objectives and behavioral patterns of FDI as well as alignment of their profit motive with national development goals. This is a subtle and difficult policy path that Ethiopia should master.

Moreover, WTO prohibits requiring FDI firms to procure locally produced parts and materials as a condition for receiving incentives. Even so, import substitution is an important policy objective for latecomer industrialization and should not be entirely ruled out. Exactly what is prohibited and how much is allowed under WTO is often unclear and depends much on technical and political factors. Violation is not officially recognized unless the country is sued and loses at the WTO Dispute Settlement Court. International politics, including mutual non-accusation among violating countries, is also at play. Many countries engage in grey and even black activities with impunity. Under such circumstances, what strategy a non-WTO member like Ethiopia should take is complex and controversial. Former Prime Minister Meles requested major investors and project donors to procure local goods, services, and labor as much as reasonably possible and also train engineers. Such persuasion and encouragement without legal obligation may still work in enticing FDI firms to make effort in the desired direction. We recommend that promotion of local procurement and technology transfer should be soft, indirect, and well-arranged rather than legal, direct, and ad hoc.

The kind of technology transfer that Ethiopia should seek is not invention or commercialization of frontline technology, be it fuel-cell cars with automatic drive or new medicine based on latest bio-medical research. High-tech, bio-tech, nano-tech, internet of things (IoT), and other fancy terms should not be randomly thrown into plan documents. For latecomer countries, putting globally known non-proprietary (and free-of-charge) knowledge into practice, and using acquired skills to link with FDI and participate in global competition and value chains are the most meaningful objective. This will improve quality and productivity, reduce cost, and ensure prompt delivery. A country should master such basics first before attempting to innovate and compete with advanced scientific research. It is difficult to talk about innovation when factories are scattered with unused materials, university graduates are not equipped with knowledge required by industry, or firms do not keep proper books or pay taxes.

Japanese firms are willing to teach if local partners seriously want to improve QCD (quality, cost, and delivery) and become their reliable suppliers. Such cases abound in East Asia. Toyota, Denso, Honda, and Nissan trained Thai automotive parts makers in Toyota Production System, manufacturing management and skills, mold and die technology, and the skill certification system; Colgate and Sanyo coached Vietnamese plastic injection firms for producing parts with quality; a fishery company taught how to produce high-quality frozen shrimp for the Japanese market; and virtu-

ally all Japanese manufacturing firms teach and practice kaizen at home and abroad. All of these cases are "win-win" for both parties, with Japanese firms expanding sales and profits with improved inputs. It is crucial to identify mutual commercial interests when technology transfer and skills teaching are promoted. Otherwise, learned technology will remain unused.

What needs to be learned from FDI is not very high-tech. It should start with proper attitude toward work—pride, honesty, punctuality, long-term vision, upward mobility, pursuit of excellence, customer orientation, safety, and mutual respect. Dynamic management and appropriate information flow must be in place. Target setting, clean environment, labor management, muda elimination, benchmarking, statistical analysis, and efficient machine operation and maintenance may be added. Sector-specific technology may be introduced and global marketing skills can be acquired. Management should be attentive to the workers' rights, welfare, and future career paths.

Government should create mechanisms and opportunities for learning. It should also provide financial incentives for transferring skills and technology from FDI to Ethiopian firms. This will require defining eligible training, teaching, and technology transfer as well as conditions and terms of incentives. Subsidies must be sufficiently large, say 50% of the training or teaching cost, up to even 80-90% of the cost if they are for top priority activities or for manufacturing SMEs. Subsidies can be financed by government budget, through ODA, or by setting up a fund, such as the Skills Development Fund in Singapore, where a levy is collected from all firms according to the number of workers but firms can reclaim the money when they send their workers to designated training programs. All of these methods require proper administrative and monitoring capacity.

A few words about the Metal and Engineering Corporation (METEC) and the Endowment Fund for the Rehabilitation of Tigray (EFFORT) companies may be in order. They are among the most technically competent firms in Ethiopia because of their historical background. At the same time, foreign observers often blame them as government-linked producers benefiting from special privileges and suppressing private firms. This is a very unfortunate situation. EFFORT companies in Mekelle such as Mesfin and Messebo have basic technology and willingness to learn. If market and technical guidance are made available from outside, these companies should be able to produce quality goods, including industrial and agricultural equipment and small engines. Would it not be possible to transform them to the global standard of corpo-

rate governance in ownership, management, information disclosure, etc. so foreigners can no longer complain about their secrecy or official connection? At present the EFFORT website is still primitive in providing corporate information. These companies are among the best candidates for FDI linkage, and corporate governance reform will surely improve their chances.

3-4. Handholding

Handholding is a program that offers multi-faceted assistance to a small number of selected SMEs that show potential. It is also called hands-on or yorisoi assistance (*yorisoi* in Japanese means staying close as a friend or a helper). Handholding must satisfy all of the following conditions.

- It is an officially provided service for SMEs with no or little fee charged.
- A clear business goal (only one) is set in advance.
- There is a screening mechanism to select eligible firms.
- Duration of assistance is 2-3 years (usually non-renewable).
- Multiple and customized help is offered with the content of assistance based on the diagnosis of and consultation with individual companies.
- A high success rate is expected.

Handholding aims to produce excellent companies rather than just creating jobs. It is targeted at a selected few rather than available to all enterprises. Government proactively seeks candidates for strengthening rather than waiting for customers to arrive. It is an advanced and highly labor-intensive program requiring mobilization of many experts as well as coordination and monitoring. This type of enterprise support is widely practiced in East Asia.

In Japan, JETRO annually assists 150-200 Japanese SMEs to break into new export markets as well as 1,500 SMEs to invest abroad (the latter program started in FY2012). Abenomics plans to assist additional 10,000 SMEs to export or invest abroad by FY2017. Japan can help many SMEs simultaneously because it has a large pool of experienced industrial experts willing to work for public purposes through JETRO, JICA, the Organization for Small and Medium Enterprises and Regional Innovation (SME Support), local governments, or business associations.[4] Taiwan's SME

[4] The number of officially certified Japanese shindanshi (SME consultants) was 21,837 as of March 2013. Apart from this, there are an unknown but much larger number of active or retired industrial managers and engineers who can coach firms but who are not formally registered as shindanshi. Many of them work as JICA experts in developing countries.

Administration, Korea Trade-Investment Promotion Agency (KOTRA), and Malaysia External Trade Development Corporation (MATRADE) also provide handholding to SMEs although the number of assisted firms in Malaysia is still small (24 SMEs per year for export promotion). These countries can launch new handholding programs by recruiting domestic experts and re-arranging existing functions and programs. The point is that successful handholding requires a sufficient number of good instructors and competent organizations already in place.

Each handholding program serves only one pre-set business goal. It may be first-time export (including creation of champion products), investing abroad, acquiring technology (including FDI-linked technology transfer), developing a new product, or becoming a regular supplier to FDI firms and becoming a player in a global value chain. Taiwan also provides handholding for a group of companies to form a new industrial cluster at the village or township level. Prime Minister Hailemariam Desalegn inquired about the possibility of handholding for transforming short-term traders into true manufacturers that take risks for long-term investment in technology and equipment. We have not heard of such handholding but the idea may be well worth exploring in the Ethiopian context. For example, coffee traders may be encouraged to become a coffee processor with latest technology, quality guarantee, a brand name, attractive packaging, effective marketing, and stable overseas customers. Similarly, traders and service providers in priority sectors such as garment, leather, and horticulture may be supported to become producers through handholding. Importers and distributors of metal and plastic products may likewise be assisted.

Selecting candidate firms for handholding is relatively easy if official agents already know the willingness level and potential of all firms through regular contacts and visits. In Ethiopia, EKI, TIDI, LIDI, and EHDA have such ground information in respective sectors. Some countries have standardized enterprise evaluation such as Japan's shindan system and Malaysia's SME Competitiveness Rating for Enhancement (SCORE). SMEs may also apply through an open competitive process. After selection, detailed diagnosis should be done by a management consultant to identify a concrete goal, a roadmap, problems to overcome, and an assistant program unique to each firm. Support areas may cover strategic planning, marketing, technology, finance and accounting, use of ICT, linkage, labor management, or information about available official support. A team of two or three experts is assigned to help each SME, with additional specialists brought in when needed.

Handholding is one of the most advanced and labor- and knowledge-intensive form of enterprise assistance. Because Ethiopia currently does not have a sufficient number of industrial experts or functions, handholding needs to be introduced in proper speed and steps without overburdening existing human and institutional resources. Expertise in industrial assistance must be built up in quality and quantity over the years, and handholding should be started in a small and pragmatic way using existing industrial consultative services, to be scaled up later. We propose that, apart from kaizen, four key policy components for enterprise enhancement should be added in Ethiopia.

First, *management* is the basic and most critical factor that determines business performance. This covers a wide ground such as (i) basic knowledge of economics and business, (ii) finance and accounting, (iii) corporate management, (iv) corporate operations, (v) legal matters, (vi) effective use of ICT, and (vii) knowledge and use of government support measures.[5] In Japan, the SME Shindan (diagnostics and advice) System was launched in 1948 and institutionalized in 1952. Key institutions that support the Japanese Shindan System are the Small and Medium Enterprise Agency (SME Agency), a state-authorized shindanshi (enterprise consultant) certification mechanism through exams and renewal procedure, SME Universities, and the Japan SME Management Consultant Association (J-SMECA). In Ethiopia, short-term management courses for entrepreneurs may be available at EMI, universities, and donor-funded projects but comprehensive and systematic management support with a concrete objective is lacking. Other countries that have a good public-sector SME consultation system include Taiwan, Korea, Singapore, and Malaysia.

Second, *external activities* such as marketing, export promotion, customer response and services, cluster formation, business associations, use of ICT, and enterprise matching of various sorts (FDI-local, buyer-supplier, joint venture partners, technology transfer, OEM and production contracts, etc.) is critical. These can be regarded as part of management functions but they are so important that we prefer to set them apart. Producing what customers want, rather than selling what you produce, should be the norm.

Third, *sector-specific technical support* must be available. While 5S and muda elimination apply to all sectors, enterprises also need special technical skills and tech-

[5] These seven subjects are those actually given in the Primary (written) Exam for Japanese Shindanshi, while actual practice of business consultation is required in the Secondary Exam.

nology to compete. In East Asia, basic "supporting industry" skills such as die-and-mold, welding, machining, casting, forging, pressing, stamping, plating, and heat treatment are commonly taught and learned. Garment firms may want to acquire design capability and latest dyeing technology while tanneries need to know environmental requirements for export. Coffee and sesame growers and exporters must be familiar with WTO's Sanitary and Phytosanitary (SPS) Measures and food safety standards of advanced markets. Ideally, industrial experts from TIDI, LIDI, MIDI, EHDA, and so on, should be able to teach these. If Ethiopian experts are unable to teach at present, foreign experts must be mobilized to teach these skills and knowledge as well as upgrade the capabilities of Ethiopian institutes.

Fourth, financial support for SMEs must be provided. Here the policy menu is broad and includes financial incentives for designated activities, soft loans through public financial institutions (SME Bank, for example), two-step loans (public money channeled through commercial banks), subsidies or quotas on commercial bank lending to SMEs, factoring and leasing, venture capital, credit guarantee, an SME debt resolution mechanism, and an SME credit database. Ethiopia has the Development Bank of Ethiopia (DBE) that finances big projects as well as micro-finance institutions, but small and medium firms have no place to turn to (the so-called "missing middle problem" [6]). Building effective SME financial support is a challenge that usually takes many years to produce results. Policy effort should be started now with a long-term perspective.

Our suggestion is that Ethiopia should prepare these multiple supporting functions in fast but realistic pace. At some point during GTP II, a pilot project in hand-holding may be launched when at least some of these functions become operational. MOI should be the lead ministry in cooperation with other related ministries and agencies. A few carefully chosen firms should be supported by a joint team composed of a management consultant and experts from EKI, TIDI, LIDI, MIDI, etc. A pilot project should be scaled up later, as usual. Foreign experts may also join the team. Besides Japan, which can provide kaizen, shindan, and sector-specific technology, development partners such as Germany, World Bank, EU, the Department for International Development (DFID), USAID, and Malaysia may be approached. Bilateral partners should be happy to introduce buyers in their home markets. Management, foreign informa-

[6] However, we hear that DBE will start lending to SMEs during GTP II.

tion, accounting, marketing, quality and safety standards, ICT, etc. can also be assisted by such development partners. At the same time, it is essential that the Ethiopian side has a firm grip on and coordinate these activities by foreign experts.

It would be nice to have a database of Excellent Ethiopian Enterprises for facilitating firm matching and linkage as well as choosing candidates for handholding. The list of good kaizen-practicing firms, the list of productivity award winning companies, and the list of firms evaluated highly by EIC, TIDI, LIDI, MIDI, EHDA, and other institutions should be integrated. The important thing about a database is regular contact with nominated firms to update information and assessment. This is a very labor-intensive work. EIC, EKI, TIDI, and LIDI already continuously monitor and support companies in their responsibilities, which is a great asset in Ethiopian industrial policy. A database need not be high-tech or expensive; an Excel sheet should suffice for the moment (avoid a donor that pushes fancy software supplied by a home company). It is more important that Ethiopian officials from one of these agencies can provide up-to-date, reliable, and detailed information on any firms on the list to interested investors. If an initially contacted person does not have the information, the client should be quickly directed to the right place.

More generally, as we look at the policy situation in Ethiopia, basic SME support functions such as management, technology, skills training, export promotion, FDI attraction, FDI-local linkage, finance, etc. are highly underdeveloped by East Asian standards, and the number of Ethiopian officials and private experts who can lead and teach them are few. At the same time, we must acknowledge that the Ethiopian government is clearly aware of this weakness and making great effort to improve it in recent years. Many organizational changes have been made and many new instruments have been introduced.

Ethiopia should continue to build up industrial policy capabilities in human resources and institutions, which will inevitably be a long-term endeavor. At the same time, it should experiment with new instruments such as matching and linkage, FDI-linked technology transfer, and handholding with existing policy capabilities, starting from the simple and basic and gradually climbing the ladder. A possible plan for such staged scaling up is suggested in Table 3-4. While handholding is a relatively advanced form of SME support, its introduction in proper pace and sequencing within an overall plan will surely contribute greatly to the quality and scope of Ethiopian industrial policy.

Table 3-4. Scaling Up of Core Industrial Policy Functions: A Suggestio

Funcation	Now	Intermediate solution	Final solution
SME support	**TVET, Femseda Remseda,** System and master plan are laid out but support functions remain weak on the ground	Scale up & enhance quality & scope of support; start pilot handholding (HH)	Fully developed SME support with sufficient experts, effective handholding, etc.
Large & medium enterprise support	**TIDI, LIDI, MIDI... (sectoral); EKI (functional)** Support functions under development	Strengthen existing institutes; train experts; improve technology support functions; start pilot HH	Well-developed sectoral & functional institutes; handholding for creating champion companies
FDI marketing & investor services	**EIC & one-stop service being strengthened; top sales; Business Diplomacy** Enhancement under way	Enhance and expand EIC's functions incl. one-stop service, matching, post-investment support	EIC with full functions accompanied by top sales diplomacy
Industrial zones	**IPDC** created & expanding; BL 1&2, Hawassa, Dire Dawa, etc. Currently prioritized	Improve IZ & service quality; increase private developers	Quality & quantity of IZs ensured; less state involvement
FDI-local linkage & technology transfer	Very little up to now	MOI & sectoral institutes to launch pilot linkage; offer incentives; possible JICA & HIDA support	Full linkage programs by MOI & sectoral institutes
Export promotion	**Export Streering Committee; MOFA, MOI, MOT, MOA; sectoral institutes;** Export Promotion Agency just formed under MOT; champion products & national branding	Build effective export promotion policy; integrate & enhance functions under EPA	Full-fledged export promotion with strategic support & champion products

3-5. Champion products and national branding

By 2011 at the end of Phase 1 of Ethiopia-Japan Industrial Policy Dialogue, kaizen had been launched successfully and industrial policies of East Asia had been analyzed. However, kaizen is only one component of industrial policy dealing with efficiency within the confines of factories. The scope of industrial policy had to be widened. Moreover, great attention of Ethiopian policymakers then was directed to supply-side concerns—productivity, TVET, technology, investment, industrial materials, etc.—while demand-side issues such as strategic marketing, customer response, and national image building seemed neglected. For this reason, in 2012, we decided to stress the latter aspect and proposed export promotion as the first main topic of Phase 2 of Industrial Policy Dialogue. After studying the experiences of Japan (JETRO),

Malaysia (MATRADE), and Thailand (foreign missions), we selected the creation of champion products as an entry point for strategic export promotion. Later, national branding was added. Both were discussed at high levels and supported with concrete JICA projects. Although champion products and national branding constitute only a small part of export promotion, they are particularly suitable for elevating the mindset of Ethiopian stakeholders—manufacturers, service providers, exporters, and agencies that support them—prompting them to realize the importance of aiming at high quality and having the pride of making things for global high-end markets. Moreover, that is the kind of export promotion policy that Japan can teach most effectively.

Many people still remember Ethiopia as a poor, war-torn, and famine-prone country. Although this is an outdated image, popular perception is slow to change. Meanwhile, for investors and developing partners working in Africa, the image of Ethiopia has already improved significantly in the last several years. This was a combined result of intellectual leadership that Ethiopian top leaders have shown in the global and regional arena, continuous high growth even amid global recession and falling commodity prices, and the recent strong inflow of manufacturing FDI. Proactive industrial policy of the Ethiopian government also has contributed. These unfolding events have attracted much attention of business media and economic analysts. As long as Ethiopia's international and regional leadership, high growth, and manufacturing FDI remain intact, the investors' image of Ethiopia will continue to shift for the better.

This is good news but it is not enough. Positive change in perception has been partial and incomplete. Ethiopia is getting high marks on political stability, cheap labor, and proactive policy (macro-level enabling factors) but it is not yet praised for quality, diligence, productivity, creativity, or entrepreneurship (micro-level growth drivers). The enlightened global business community remains a small circle, and the world at large still cannot distinguish Ethiopia from the rest of Africa. National image can be transformed through both evolving events and deliberate policy. To improve Ethiopia's image faster and more coherently, the following are needed: (i) broadening of policy scope and external publicizing from just growth and FDI to infrastructure, agro-products, tourism, services, education, transport, and so on; (ii) relentless pursuit of quality and customer satisfaction in these areas and rejecting low-quality substitutes; and (iii) a professionally guided campaign to advertise current achievements and project Ethiopia as a newly emerging industrial economy with quality and a model for African industrialization.

Existing bright spots of Ethiopia include the Light Manufacturing Vision, Ethiopian Airlines, kaizen experts and national movement, emergence of champion products, arrival of high-quality manufacturing FDI, Addis-Adama Expressway, French wines and strawberries produced in the Rift Valley, export quality roses, great marathon runners, and the construction of Grand Renaissance Dam. These unique features of Ethiopia must be strategically combined to project a new national image. Visitors are often amazed to see these in a country that suffered famine and conflicts in the recent past. But these achievements are not known to people outside Ethiopia and they are not presented with a clear connecting message. They must be effectively joined to generate a perception of an industrializing country with quality, to replace the past image. This requires a well-planned professional work.

However, we must also acknowledge that excellence is not yet ubiquitous in Ethiopia. Bureaucracy and inefficiency at some (not all) of the state agencies are incredible. Regular procedures such as checking in and checking out at many (not all) hotels are very slow and full of muda. World heritage sites do not have adequate food, amenities, or transportation expected from foreign travelers. Domestic trade and distribution systems, including shopping centers and supermarkets, are still at a primitive level. Of course, Ethiopia is a low-income country and perfection cannot be expected of everything. But these negative factors are disappointing many tourists and investors. Rwanda is equally poor but the streets of Kigali are clean and well organized. In the mid-19th century, Westerners reported Japanese people to be poor and technologically backward but also civilized, friendly, and disciplined. Income is not the only variable that determines national characters.

One of the problems of JICA's champion product and national branding projects in Phase 2 was the lack of core authority for promoting these initiatives despite the fact that everyone was excited about the concepts and happy to participate as members. No Ethiopian organization, public or private, was responsible for planning, coordinating, or trouble-shooting the project. This pointed to the risk that the fever would end when JICA experts left. At present, we hear that champion products and national branding may come under EIC. If EIC promotes these with full authority and an appropriate roadmap, the problem of no focal point may be solved, and we welcome such a move.

JICA's national re-branding and promotion project 2014-2015 proposed CREATIVITY in MOTION as a national image and produced a video associated with it. It also suggested creation of HIGHLAND LEATHER brand for Ethiopian high-quality

leather products using the country's unique leather materials. Using this brand, some Ethiopian firms already found buyers in Japan. But such effort must essentially and ultimately be carried out by Ethiopian public and private stakeholders, and it is also they who must decide whether these brands suggested by JICA experts are appropriate for Ethiopia.

The two initiatives to elevate Ethiopia's national image—champion products and national branding—should be continued with Japanese support but with an increasing role on the Ethiopian side. More initiatives may be started if additional resources are available from other donors and investors.

At the same time, we would like to suggest a few actions that do not require huge funding but may have great impact on the national image. They are related to Bole International Airport, posting of announcements, and house numbers.

The facilities of Bole International Airport are reasonably modern but its other aspects have room for improvement. This includes the quality of shops in the departure area where at present spaces are rented out to shops with similar display quality as supermarkets and shopping centers outside. There should be a few antenna shops where champion products are showcased with professionalism so tourists can purchase the best among Ethiopian coffee, honey, wines, leather products, scarves, gemstones, handicrafts, etc. Additionally, normal airport procedures such as parking, meeting, security checks, check-in, passport control, quarantine, baggage claim, visa issue, etc. should go through kaizen and benchmarking. We are even more disappointed with the quality of these procedures at local airports. The airport is where most visitors get the first impression of Ethiopia and its services should be strategically upgraded.

We are always intrigued at tilted announcements, posters, and banners pasted with scotch tapes on the walls of government offices and other prominent buildings. To place them straight at the right location, height, and angle with proper adhesive seems to us a very easy and costless thing, and it does not require a university degree. Proper posting of documents and photos should be taught as one of the basic kaizen lessons at primary schools and to the general public.

Another puzzle is the lack of house numbers on the streets of Addis Ababa, or at least their invisibility. Business cards only show P.O. Box numbers or crude maps, and our drivers must ask around. This problem may not be unique to Ethiopia but prevalent on the continent. But in Vietnam, houses and shops in all cities and towns are numbered in a predictable way and displayed clearly for easy discovery. At every major

intersection there is a sign showing street names. What is needed is an instruction on numbering rules to district police (use of odd and even numbers, which side to start, how to add more numbers later, coping with narrow lanes, etc.) and an order to display numbers on every residence and establishment. This should be done in all cities and towns, not just Addis Ababa.

3-6. Improving business climate

It has been asserted above that Ethiopia's business climate remains poor by the global standard and that the Government must seriously work on improving it. It has also been noted that general business conditions alone are not the main factor that attracts FDI, but their improvement will surely accelerate the inflow of quality FDI provided that the labor advantage, Ethiopia's major attraction for investors, remains intact. It is essential that Ethiopia set clear goals and implement concrete and consistent actions for this purpose during GTP II and III instead of just talking about improving business climate. In this section, some suggestions on how such actions should begin are given.

In all of the issues raised, we propose that action plans for improvement should be drafted with concrete targets and timetable, responsible person or organization should be designated, progress along the action plan should be regularly reported to the Government, top leaders should give prompt instructions to solve any problems, and necessary technical and financial cooperation should be mobilized from the international community. Establishment of a council, committee, or agency solely responsible for overseeing the entire task of business climate enhancement is a possibility. Raising Ethiopia's place in the World Bank's Doing Business indicators should be part of its mandate, but the policy goal must be larger than that because global ranking and what truly attracts investors are two separate things. Becoming sensitive to what quality FDI needs is important.

For all issues below, we suggest that, even before the action plan is implemented, the goals and measures of the plan be publicly announced to existing and potential foreign investors. Such policy announcement will naturally be construed as official commitment, and we hope that the Government will also take it seriously too (not just lip service). This will enable FDI firms to make a long-term business plan, commit more resources in Ethiopia, and bear the current inconveniences. It will also be easier to find willing donors and NPOs to support components of action plans.

JICA is currently conducting a comparative survey on business environment in selected African countries, and Ethiopia was chosen as its first target country. In Asia where Japanese manufacturing firms are abundant, such surveys are done annually by JETRO and the Japan Bank for International Cooperation (JBIC) and we already know major problems in each country and how they have evolved over time. We hope that the results of JICA's African survey will be a useful input to Ethiopia's policy formulation.

ERCA

Our first focus is the Ethiopian Revenues and Customs Authority (ERCA), responsible for tax administration and customs inspection, because this agency seems to receive the largest number of claims and complaints from FDI. This does not however mean that ERCA officials are lazy or corrupt. On the contrary, we believe ERCA recognizes its weaknesses and is making best effort to improve the situation. ERCA Director General explained to us how this was being done including the introduction of the Authorized Economic Operator (AEO) system in 2010 and more recent adoption of the UNCTAD's Automated System for Customs Data (ASYCUDA), IFC-supported Single Window Service, and One Stop Border Posts with Djibouti, Kenya, and Sudan. Additionally, DFID has assisted with tax, accounting, and anti-corruption systems since 2006, the Korea Customs Service helps with modernization of customs procedure, and JICA provides training for improving customs clearance.

In our opinion, ERCA's remaining problems mainly come from incompetence rather than corruption. Unlike many other countries, we do not hear very much about customs officials asking for bribe in Ethiopia. Delays and unreasonable assessments do occur, but that is often because Ethiopian officials seriously try to do their job without having sufficient knowledge about the industry or the product, or under inconsistent instructions and coordination. When products unknown to customs officials arrive, it usually takes a very long time to check their commercial value through internet or other media, during which the container sits idle for days and weeks. In 2013, JICA encountered a serious lack of competence and coordination among Ethiopian ministries and agencies when it shipped champion products to Yokohama for the fifth Tokyo International Conference on African Development (TICAD V) exhibition. In Vietnam, Japanese FDI complain that rare metal precision shafts used for high-tech die and mold production are levied the same high tariff as cheap construction steel

rods which can be produced by local firms and therefore the government wants to protect. Similar confusion can occur in Ethiopia because customs officials do not really have in-depth knowledge of industrial materials and components.

If this view is correct, the main solution lies in well-targeted training of ERCA officials. Additionally, a scrutiny of operational and reporting systems within ERCA as well as provision of incentives for ERCA officials to encourage learning and long stay, good practice and its dissemination, prompt problem reporting, and quick and friendly customer response are needed. There should first be a full review of ERCA's problems and subsequent drafting of a doable action plan with clear goals and timetables. Donor support should not be mobilized randomly but for executing programs in this action plan. The Prime Minister's Office, or any other appropriate body, should monitor the progress regularly.

The Ethiopian accounting system follows non-standard rules and practices, which puts considerable burden on foreign investors. A revision of the accounting system in line with global standards should be part of the tax administration reform under ERCA.

Foreign exchange

Another big source of headache is the shortage of foreign exchange, and associated problems of required sales of 90% of foreign currency earnings within 28 days and a long and uncertain wait for obtaining foreign currencies for import. The situation is worse for SMEs and non-exporting companies in comparison with prioritized large exporting firms. The law says foreign investors have the right to make outward remittances in convertible foreign currency of profits and dividends, principal and interest payments, etc. but legal rights may not translate to actual receipt of foreign currencies if banks are unable to allocate them.

Thus Ethiopia still practices the foreign currency surrender system—a legacy of socialist past and a temporary crisis management device used only by countries going through severe stress (Japan adopted this mechanism during an economic crisis immediately after WW2). True, Ethiopia is a low income country with a limited capacity to earn foreign exchange and underdeveloped financial systems, but this type of control cannot be justified as a permanent mechanism for allocating foreign exchange. There are many developing countries that face trade deficits and foreign exchange constraints, but most of them manage to operate far more liberal currency markets.

Ethiopia should draft a roadmap to transit to a more normal foreign exchange system in proper steps.

The long-term final solution will be the fostering of competitive agriculture and industry that can earn ample foreign exchange supported by a highly developed domestic financial sector. But this will take some time so short-term solutions must also be devised. One such solution proposed by our team is the Cut-Make-Pack (CMP) mechanism used in Myanmar and other latecomer countries in which a buyer abroad provides materials to a garment firm operating in a developing country "free of charge" and pays only the labor cost for cutting and sewing, thereby eliminating the need for the garment firm to obtain foreign currency to import materials. We do not insist on this mechanism only, as it is just one of the temporary and imperfect ways to minimize delays and inconveniences until a more proper system is in place. Other short-term solutions must be studied to ease the problem at hand. For both long-term and short-term solutions, professional diagnosis and advice should be sought from an appropriate organization, such as technical assistance of the IMF or other international institutions versed in underdeveloped financial markets—because foreign exchange problems are outside the scope of our Industrial Policy Dialogue.

Logistics

Transport infrastructure remains generally underdeveloped in Ethiopia. However, construction is proceeding at full speed to the extent that some are even worried about too much public investment and future debt sustainability. In terms of volume, China is the largest donor and builder of new transport systems in Ethiopia. Major projects include Ring Road and other roads and intersection improvements in Addis Ababa, Light Rail that started operation in 2015, Addis-Adama Expressway completed in 2014 and other expressway plans, new or improved long-distance roads and railways, and aggressive expansion of Ethiopian Airlines in fleet, international routes, and ground facilities. Particularly important is the new railway connecting Addis and Djibouti, to be completed in the near future (we hear the tracks are already laid while aerial lines and facilities are being worked on). When this railway becomes operational, a large part of logistic problems (i.e., coastal access from Addis) may considerably ease. The Government should start announcing the details of this railway including type of trains and freighters, freight cost, running time, timetable, associated facilities such as dry ports and connection to other transport modes, and any other details that

allow assessment of competitiveness of the new railway vis-à-vis trucking. This will be valuable information for potential investors.

The Government is also improving connectivity to cities that will host future industrial zones such as Hawassa, Mekelle, Mojo, Dire Dawa, Adama, etc. New railway lines, roads, and air strips are planned.

The World Bank published a report on transport and logistics a few years ago. We do not know if the report can serve as a national transport master plan with a comprehensive list of priority projects and other projects for the entire nation and all modes. In any case, revisions and updates are needed to reflect the rapidly shifting reality of Ethiopia. Besides hard infrastructure, soft components must also be strengthened including competition and anti-monopoly policy, trucking services, warehousing, container depots and dry ports, integrated electronic handling of cargo, storage, customs, and other documents, and so on. Again it is important to paint a future picture, even if some changes and delays may occur, and publicize it to reassure investors of expected improvements in transport and logistics.

In this connection, we would like to recommend implementation of business process re-engineering (BPR), benchmarking, and/or kaizen—whichever method(s) the Government thinks suitable—at Bole International Airport and major domestic airports in Ethiopia. Passport control, customs inspection, security checks, health checks, check-in counters, baggage pickup, on-arrival visas, bank counters, car access and parking, souvenir shops and restaurants, hotel desks and shuttles, and other soft components that collectively make air travelers either happy or irritated should be reviewed for serious improvement. Airports are where foreigners get the first impression of the country. At present, we do not detect any superiority of Ethiopian airports compared with other African airports. The generally low quality of procedures and services at Ethiopian airports offsets the dynamic business expansion plan of Ethiopian Airlines.

Power

Power shortage is another serious problem for investors at present, with sudden and frequent blackouts, yet this problem may be largely removed when the Grand Renaissance Dam becomes fully operational at 6,000MW. It will not only greatly expand Ethiopia's power source but also allow electricity to be exported to neighboring countries eagerly waiting for project completion such as Sudan, Kenya, Uganda, Rwanda, and Tanzania. Expected completion is 2017 but uncertainty remains as with any other

large-scale infrastructure projects. Measured by the construction process, the dam is about 50% finished and power distribution lines are also being built. The main uncertainty comes from the water sharing issue with Egypt which fears less water supply during the filling period of the dam. The six-party committee consisting of Ethiopia, Sudan, Egypt, the United Kingdom (UK), Netherland, and France is deliberating the issue. Even after completion, it is not clear how many years it will take to fill the dam which depends on weather as well as the outcome of the water sharing negotiation.

Thus the timing of final solution to Ethiopia's power shortage is unknown. When it is known, it should be widely publicized which will certainly have a very positive impact on quality FDI attraction. It is also advisable to proclaim the nation's long-term strategy for electricity pricing, power distribution and export, industry organization, competition and liberalization policy, energy mix (including renewable and decentralized energy sources), and other aspects which may affect business strategies of all firms. For these, a national power master plan may have to be drafted.

In the meantime, short-term measures must be implemented. The Government promises that industrial zones will be prioritized for power supply so companies operating in any of them will not face any sudden power cuts. Any stoppage, including for maintenance and repair, should take place with sufficient advance notice and preferably on weekends. We need to see if these promised actions are actually put into practice. Each industrial zone and the Industrial Parks Development Corporation (IPDC) should keep records of all power-related irregularities for inspection and analysis.

Listening to FDI

We understand that the Ethiopian government already listens to the voices of FDI and usually solves their problems quickly. Ambassadors and commercial officers of major investing countries such as China, Turkey, and India as well as smaller investing countries often approach top leaders for consideration and correction in business matters. Large FDI firms may have direct access to the Government. These are problem-solving of ad hoc and case-by-case type practiced by virtually all governments. Individual firms may become happy but such moguratataki (strike-as-you-go) approach has no end unless new laws, regulations, and policies are put in place to systematically change the ground rule. We propose that the hearing mechanism should be upgraded to an open, regular, and institutionalized dialogue forum with benefits automatically accruing to all domestic and foreign firms in Ethiopia whether large or

small, or new or old, not just the ones that complained.

A formal and regular government-FDI dialogue for improving investment climate is a standard bilateral procedure where many Japanese manufacturing firms operate such as Vietnam, Indonesia, Cambodia, and Myanmar. In these countries, Japan is the leading nation in manufacturing FDI and therefore takes the responsibility for improving general business conditions. Modality differs somewhat from country to country. Participants are usually Japanese businesses and government working together to negotiate with the host government. Several working teams are created corresponding to problem areas, each of which raises issues, sets action plans, and monitors results.[7] Discussion may take place annually, irregularly, or in two-year cycles of problem-solving (as in Vietnam). Sessions are presided by an appropriate minister or the head of an FDI agency on the host country side, and an ambassador or a high-level official from Tokyo on the Japanese side.

In Vietnam, for instance, the Vietnam-Japan Joint Initiative was started in 2003. The Japanese ambassador led the team of MOFA, the Ministry of Finance (MOF), METI, JICA, JBIC, JETRO, Keidanren (Japan Business Federation), and the two Japanese Business Associations in Vietnam. On the Vietnamese side, the Minister of Planning and Investment invited relevant ministries to solve raised problems. For each two-year cycle, the first step is to collect problems and complaints from the Japanese business community in Vietnam. The second step is to discuss and agree with the Vietnamese government on each problem and its solution (action plan). The third step is implementation with the Vietnamese government changing laws and policies and Japan supporting necessary actions with technical and financial support. The results are monitored, graded, and publicly announced. The summary of five phases so far is shown in Table 3-5.

It is evident that many problems ranging from legal matters to macroeconomic stability have been discussed. Some problems such as one-stop service, industrial master plans, supporting industries, tax and customs procedure, and worker and wage issues were raised more than once. The successful action rate is relatively high because the process has formal issue-raising and monitoring mechanisms participated by strongly committed stakeholders on both sides, and also because the Japanese gov-

[7] In Phase 5 of the Vietnam-Japan Joint Initiative, explained below, the following 13 working teams were created: law, tax, logistics and customs, labor, IPR, environment, retail and distribution, nonbanks, services, food export, infrastructure, industrialization strategy, and macroeconomy.

Table 3-5. Vietnam-Japan Joint Initiative for Improving Business Climate

	Period	No. of issues raised	Successful action	Selected highlights
Phase 1	Dec.2003-Nov.2005	44	85%	Supporting industry M/P, one-stop service, personal income tax, visa exemption, trading company liberalization, labor & land law, import registration, technology transfer…
Phase 2	Jul.2006-Nov.2007	46	94%	Board of Directors rule, one-stop service, shareholding by foreigners, tax hearing, corporate tax procedure, bidding process, transfer pricing, electronics & auto part tariffs…
Phase 3	Nov.2008-Dec.2010	31	81%	One-stop service, worker facilities at IZs, food security, retail distribution, macroeconomic stability, loss accounts in corporate tax, illegal strikes, salary scale rule, auto M/P…
Phase 4	Jul.2011-Nov.2012	70	87%	BOT, IPP/power market, HR & TVET at IZs, minimum wage, exchange rate stability, supporting industry attraction, IPR, customs procedure…
Phase 5	Jul.2013-Dec.2014	104	78%	Foreign contractor tax, personal income tax, e-customs, WTO commitments, Japanese language, TVET, skills certification system, welfare of IZ workers, labor & minimu

Source: Extracted from the homepage of the Japanese Embassy in Vietnam.

ernment provides necessary assistance for implementation. Generally speaking, rule change is easier to adopt than formulation of an effective industrial policy. As a result of a series of bilateral negotiations, Vietnam's business conditions have steadily and significantly improved not only for Japanese FDI but also for Vietnamese, Korean, Taiwanese, European, and other enterprises. This positive spillover effect is an additional reason to welcome such bilateral initiatives. As of 2015 Vietnam's position in the World Bank Doing Business indicators is 78th, certainly with much room for improvement. But in the past, the country's business climate was even more terrible and very arbitrary. Vietnam has made good progress with Japanese assistance.

In a more advanced investor dialogue, each session not only raises problems but also solves them immediately. In Ha Nam, a small province of 500,000 people in Northern Vietnam where about 50 Japanese firms already operate, the Party Secretary (provincial leader) reviews raised problems in advance, and proposes solutions at the government-Japanese FDI meeting. He also safeguards that his solutions are actually implemented. All companies attend these meetings, and any director general who is on a business trip sends his deputy to the meeting.

It is difficult for Japan to replicate the same leading role in Ethiopia where Japan is only a small investor. We know that China, Turkey, India, Germany, and others are meeting to discuss Ethiopian business environment, and the Japanese Embassy is also invited. We are exploring ways to activate the existing government-FDI dialogue in Ethiopia, and also how and how much the Ethiopian government should be involved to substantiate the process.

Chapter 4

Assessing GTP II

4-1. Industrial content of GTP II

The Second Growth Transformation Plan (GTP II) 2015/16 – 2019/20 was finalized and approved in December 2015. Drafting of GTP II was coordinated by the newly formed National Planning Commission (NPC) with extensive stakeholder interaction including Regional States, various social groups and the donor community. For the donor community, an English summary draft was circulated in September 2015 and a meeting was organized on October 20-21, 2015 where Prime Minister Hailemariam explained key policy areas and responded to foreigners' questions.

The Japanese team of the Ethiopia-Japan Industrial Policy Dialogue is very interested in the final content of GTP II because it intensively discussed its various aspects with Ethiopian authorities and proposed certain issues that should be highlighted in GTP II during the drafting process. Our advice and inputs to GTP II were prepared in response to the request made by Prime Minister Hailemariam in April 2013 in Yokohama. Being a five-year development plan, GTP II covers a wide ground. Here, our assessment focusses on its industry-related chapters and sections only, especially regarding the manufacturing strategy, because GTP II aims to greatly increase the contribution of manufacturing to Ethiopian development and also because this has been the main topic of our policy dialogue.

Table 4-1 lists selected targets of GTP II concerning industry and structural transformation. To become a lower middle income country by 2025, Ethiopia plans to grow at 11.0% per year to reach per capita income of $1,177 by 2019/2020, from the current $691. The double-digit growth target is ambitious but not entirely incredible, given the fact that the country has actually grown at such speed for more than a decade. However, fast growth in the past was not generated by the dynamism of the manufacturing sector as the sector's contribution to GDP has long stagnated around 5% without showing any great performance in export or productivity. During the GTP II period, the manufacturing sector is expected to grow at 21.9% per year and rise to 8.0% of GDP from the current 4.8% of GDP. With an increasing inflow of manufacturing FDI and continued active policy, such growth is certainly possible. But growth must come

Table 4-1. Selected GTP II Indicators Related to Industry and Structural Transformation

Indicator	Baseline 2014/15	Target 2019/20
Per capita income	$691	$1,177
Growth (real GDP)	10.2%	11.0%
Agriculture	6.4%	8.0%
Industry	23.5%	20.0%
(Of which) manufacturing	21.4%	21.9%
Service	10.2%	10.0%
Share of GDP		
Agriculture	38.5%	33.5%
Industry	15.1%	22.3%
(Of which) manufacturing	4.8%	8.0%
(Of which) medium & large manufacturing	3.8%	5.9%
Employment by large and medium manufacturing	380,000	758,000
Export revenue		
Manufacturing (% of GDP)	0.6%	3.0%
Agriculture (% of GDP)	3.6%	6.5%
Manufacturing (% of merchandise export)	12.5%	25.6%
Labor productivity (VA/worker)		
Agriculture	8,437 birr	11,771 birr
Medium & large manufacturing	68,158 birr	91,869 birr

Note: growth targets are average rates for 2015/16-2019/20. The measurement of labor productivity is somewhat ambiguous. It must be expressed in real terms with a base year and usually in percentage change or index form.

not only from quantity but, more importantly, from quality. Manufacturing growth *with quality* must be ensured by the conscious joint effort by the Ethiopian government and the private sector because, as experiences of other latecomer countries reveal, quality, productivity and competitiveness of the domestic manufacturing sector do not automatically arise just because foreign manufacturers arrive in big numbers.

In GTP II, policy targets for industrialization are contained in three different places. It is difficult to concisely summarize what these chapters and sections say because there are many overlaps and repetitions as well as certain awkwardness in logical flow. The following are somewhat arbitrary representations of what we think are important in these chapters and sections based on the official English translation published by NPC in May 2016 as well as an unofficial English translation prepared by JICA.[1]

[1] The Amharic original, the official translation by NPC, and the unofficial translation of the Amharic original by JICA are not exactly the same. This is not just a matter of nuances or proficiency of translation. We detect different chapter and section titles as well as altered or newly inserted sentences regarding Major Departures of GTP II and the light manufacturing vision. We have raised this issue to Ethiopian

First, in Part II Chapter I (Basis, Departures, Objectives and Strategic Pillars of GTP II), an overall picture of GTP II, including industry and manufacturing, is presented. In the Basis section, the country's top vision is set to "become a lower middle-income country by 2025." In Major Departure section, manufacturing is elevated to the role of strongly realizing structural transformation. The bold statement, "A new vision has been set to render the country a leader in light manufacturing in Africa and one of the leaders in overall manufacturing globally" (official English translation) is particularly noteworthy.[2] Quality, productivity and competitiveness are highlighted with kaizen and benchmarking as two tools. *Domestic private sector transformation* (or *development*), by which traders are encouraged to become manufacturers and micro and small enterprises are to become medium and larger enterprises, is promulgated. Export promotion, technology, management of urbanization, and green economy are also mentioned. The Objectives and Pillars Strategies sections basically repeats the same main points except a few new areas such as job creation and FDI-local firm linkage are added. The overall policy direction expressed in this part of GTP II is reasonable and encouraging.

Second, Part II Chapter II (Macroeconomic Sector Plan) discusses some interesting issues related to manufacturing. In Section 2.3 (Structural Change), the idea of becoming Africa's light manufacturing hub is frequently mentioned (official English translation).[3] Moreover, the targeted share of manufacturing in GDP (8%) and the targeted share of merchandise export in GDP (11.8%, of which manufacturing occupies 3.0%) are proposed as two concrete targets of structural transformation. Nevertheless, it is a little strange why these key industrial targets are discussed in this way in the Chapter on Macroeconomic Plan rather than as the core components of national vision and/or the manufacturing strategy.

Third, Part IV Section 4.2 (Manufacturing Industry) is structured as Strategic Directions - Objectives - Industrialization Targets - Growth and Structural Change of the Manufacturing Industry - Implementation Strategies, again with many overlaps and

authorities. As of this writing (July 2016), the question has not yet been clarified to our satisfaction. Our discussion below is based on the official translation by NPC.

[2] However, the corresponding sentence in the Amharic original we have received reads "A new vision has been set to bring a leap in light manufacturing in the country," without mention of becoming a leader nation. Moreover, becoming "one of the leaders in overall manufacturing globally" is a bolder goal than what we have discussed, namely to become one of the leaders in overall manufacturing *in Africa*.

[3] In the Amharic original edition (unofficial translation), focus on light manufacturing and the desire to become a hub of light manufacturing in Africa are mentioned for the first time here (Part II Chapter II).

repetitions within the Section as well as from previous chapters.[4] The section begins with the emphasis on the role of manufacturing in achieving economic transformation and industrialization. The following desirable features are listed: productivity, quality and competitiveness; labor-intensive light manufacturing; the role of medium and large manufacturing industry in earning foreign exchange and technology transfer; attracting both domestic and foreign investment in quantity and quality; linkage between firms; industrial parks and clusters; and the reiteration of the vision of "becoming a leading manufacturing hub in Africa and among the leading [manufacturing] countries in the globe."

Sections on Objectives and Industrialization Targets are basically reiteration of previous discussions.

Section on Growth and Structural Change of the Manufacturing Industry also repeats numerical manufacturing targets propounded earlier. It also stresses the need to "ensure that real wage rate does not exceed labor productivity" although data are insufficient to analyze the productivity-wage nexus any further. This section additionally gives targets for seven sub-sectors (textile, leather, metal & engineering, meat & dairy, chemical & construction inputs, agro-processing and pharmaceuticals) concerning output, revenue, foreign exchange earnings, job creation, and so on.

Implementation Strategies present eight programs:

A) Implementation capacity building (i.e., policy enhancement)
B) Manufacturing industry investment expansion (for both FDI and domestic investment)
C) Productivity, competitiveness, quality and technology
D) Providing comprehensive support (including industrial parks, policy support, credit and finance, and other incentives; this item covers a wide ground)
E) Prioritized and selected industries[5]
F) The role of state-owned enterprises
G) Micro and small enterprises
H) Climate resilient green industry

Some of these "programs" are fairly long and contain many complex issues while others are relatively terse. They collectively present key industrial policy components

[4] In the Amharic original edition (unofficial translation), section titles and presentation style are different.
[5] This should properly be included in earlier sub-sections rather than in Implementation Strategies.

of Ethiopia in the five years to come. However, we have the impression that they are not shown in orderly fashion and they contain too many points of seemingly equal importance. Furthermore, each point is not sufficiently concretized to guide formulation of realistic and implementable "action plans." It is highly advisable to re-arrange and re-shape these same points with clear groupings, structure and prioritization, with duplications eliminated, so Ethiopian industrial policy can be more clearly and simply understood and communicated.

4-2. Assessment

Based on these chapters and sections of GTP II, let us evaluate the quality of documentation of Ethiopian industrial policy. Compared with the previous Plan for Accelerated and Sustained Development to End Poverty (PASDEP) and GTP I, the spirit and content of GTP II are quite different. It is not a mere copy of the previous plan with minor updates and revisions. As explained above, the "Manufacturing Industry" section is rewritten significantly in comparison with the previous "Industry" section of GTP I—though within-sector structure is basically similar. Another striking feature is that many things the Japanese policy dialogue team discussed with the Ethiopian leaders and authorities have been incorporated in the final version of GTP II. The fact that Japanese inputs have been properly noted and actually used encourages us very much. Especially we are pleased that:

- Manufacturing (overall) has reasonable numerical targets and sufficient discussion.
- Quality, productivity and competitiveness are mentioned throughout GTP II.
- Kaizen as a philosophy, not just tools, is also mentioned frequently. Concrete targets of kaizen are also provided.
- Quality FDI, FDI-local firm linkage and technology learning are highlighted.
- The productivity-wage nexus is touched upon. A few productivity targets (though still primitive) are given.
- High-tech and future industries are targeted but with moderation (as we suggested).
- National image building will be undertaken.

These are notable new features of GTP II. The guidance of national leaders as well as the works done by the advisors, ministries and especially NPC which brought these changes are highly appreciated. However, this does not necessarily mean that all

changes are for good or that all numerical targets are appropriate. There are still gaps that need to be considered for improvement. Regarding industry in general and the manufacturing sector in particular, four issues can be raised.

First, the Japanese team is still confused and not entirely happy with the way the Light Manufacturing Vision is presented. In October 2015, NPC confirmed that this vision would be highlighted as one of the major departures from GTP I in the chapter where GTP I review ended and GTP II began (Part II Chapter I). While the goal of becoming a leading nation in light manufacturing in Africa is clearly declared in the expected place ("Major Departures") in the official English translation, the same vision is not found in the Amharic original (and its direct English translation). The light manufacturing vision is mentioned in two other places in GTP II, the Macroeconomic Chapter and the Manufacturing Industry Section, but as one of the many points to be heeded.

Second, while the terms *quality, productivity* and *competitiveness* are cited many times, there is no chapter dedicated to the analysis and concrete goal setting on this issue. We were previously informed that there would be a new chapter on Quality, Productivity and Competitiveness. In plan documents such as this, the important thing is not how many times the word is mentioned but how clearly the essence of the problem is analyzed and policy direction is set. Analysis of quality, productivity and competitiveness must be deepened, and concrete targets and action plans must be crafted.

Third, the policy template may have to be improved as the current formats are highly confusing. We have already pointed out the problem of overlaps, too many points and unnatural logical flow. GTP II basically follows the within-chapter and within-section structures of GTP I. For example, most sectoral sections are structured as Strategic Directions - Objectives - Targets - Implementation Strategies (with necessary revisions and additions for particular sectors). However, this may not be the most appropriate format for expressing policy as it tends to invite repetitions as well as ambiguities as to what item should go into where. Policy should be presented in a more concise and logical way even to the extent that its essence can be summed up in a compact one-page diagram—as it is often done in policy formulation of Japan, Taiwan, Malaysia and Thailand. How to write industrial policy documents effectively was one of the topics taken up by Phase 1 of our Industrial Policy Dialogue. We may choose to continue this discussion in the following phase of Industrial Policy Dialogue.

Fourth, there should be stronger and broader actions for improving the investment

climate. GTP II mentions this problem only lightly. Compared with most other developing economies in Asia and Africa, Ethiopia's business conditions have much room for upgrading. Arbitrary and cumbersome procedures on implementation grounds are a major barrier for attracting quality FDI to Ethiopia despite the fact that top leaders and advisors are highly motivated and well informed. To begin with, the foreign currency problem and ERCA's efficiency need to be targeted with concrete action plans. We know that policy actions have already been initiated. GTP II should have highlighted them more loudly.

4-3. Japanese alignment with GTP II

The Japanese policy dialogue team will continue to combine policy discussion with Japan's concrete industrial projects. In Phase 3 of Ethiopia-Japan Industrial Policy Dialogue, a broad direction of bilateral industrial cooperation for the next five years should be set in advance, instead of setting agenda each time without knowing where we are going eventually. This does not mean that all cooperation must be agreed in advance; sensible adjustments should be made as policy interest, circumstances and budget availability change. Both sides should promise to do their best to pursue agreed goals while leaving the details of individual projects open and flexible. By doing this, we are exploring a new form of bilateral development cooperation which is more binding than the scattered, anything-goes approach but more flexible and trust-building than pre-set and rigid conditionalities.

Japan would like to closely align its industrial cooperation with GTP II. Despite the presentational weaknesses of GTP II mentioned above, this is possible because the main thrusts of industrial policy are agreeable. Among all industrial targets and policies mentioned in GTP II, we would like to select the areas in which Japan has a comparative advantage and can make most effective contribution. This will be done on the foundation of our past industrial cooperation such as kaizen, champion products and discussion of FDI and linkage policy, which will be continued, but new cooperation will also be added.

From Part IV Section 4.2 (Manufacturing Industry) of GTP II, we would like to extract elements from sections on Strategic Directions and Objectives for Japanese alignment. They are re-classified into four groups: (i) strengthening Ethiopian enterprises; (ii) attracting quality FDI; (iii) FDI-local firm linkage; and (iv) productivity-wage nexus. As for the remaining sections of Section 4.2 of GTP II, Japan will se-

lect targeted sub-sectors and implementation measures in such a way so the above four goals are supported most effectively. In other words, we propose to align Japanese industrial cooperation with the policy directions and objectives (upper structure) rather than sub-sectors or implementation programs (lower structure) to avoid confusion, because there are many redundancies among these different levels as noted earlier.

To show what Japan will do more concretely, the two-page table at the end of this chapter presents our proposal for Japanese contribution to these four groups of industrial goals of GTP II. The table has already been agreed in principle by the high-level Ethiopian authorities, and the next step is to work out details of each project between the two governments. Several points are in order.

First, we would like to clearly state *Vision* and *Targets* for our cooperation as shown at the top of the table. Our proposed vision for bilateral industrial cooperation is for Japan to "help Ethiopia become a high-quality manufacturing nation which has seriously and selectively learned the developmental experiences of Asia including Japan." For Targets, we would like to set numerical indicators by which progress will be monitored. They cover industrial human resource, strengthening Ethiopian manufacturers, champion companies, champion products, and attraction of Japanese FDI. These will give us the sense of where we are going in the medium to long run.

Second, *Policy areas* and *cooperation components* in the table are the areas in which Ethiopia and Japan may be able to perform joint interventions. These components are the ones that at least one of the Japanese cooperation organizations are interested in providing, and the Ethiopian government also agrees with these components in principle as noted above.

Third, Japan must consider what role it should play to improve Ethiopian investment climate when it is still a small investing country. Japan's engagement should be selective and targeted, and generate synergy and avoid duplication with other donors.

Fourth, the Japanese government and private sector will continue to work on promoting Japanese investment in Ethiopia, including the proposed Japanese investment area in Kilinto. Private developers and manufacturing firms will be the investors, while Japanese public organizations such as METI, MOFA, the Japanese Embassy, JICA, GRIPS, JETRO, JBIC as well as UNIDO Tokyo will support all types of Japanese investors interested in Ethiopia. Such support has been extended in the past, and it will also continue in the future.

Fifth, we will continue to use Industrial Policy Dialogue Phase 3 as the main vehi-

cle to discuss policies with Ethiopia. Apart from the proposed industrial projects listed in the table, we will conduct policy studies which contribute directly to the execution of GTP II. Instead of Japanese experts offering information and analysis unilaterally to the Ethiopian audience, we plan to actively involve Ethiopian policy research institutions such as the Ethiopian Development Research Institute (EDRI), the Policy Study and Research Center (PSRC), universities and its centers, economics associations, and so on, in doing policy research and making proposals. Details of such joint research will be worked out in coming months. This can be interpreted as "import substitution" and "technology transfer" in pragmatic policy research with the aim that Ethiopian researchers will be able to do high-quality policy research for GTP II and GTP III even when foreign advisors leave.

Japan's Industrial Cooperation during the GTP II Period

(Possible Policy Areas and Cooperation Components)

■ **VISION--Japan's industrial cooperation vision is to "help Ethiopia become a high-quality manufacturing nation which has seriously and selectively learned the developmental experiences of Asia including Japan."**

■ **TARGETS--targets for Japan's industrial cooperation are "strengthening industrial human resource," "transforming Ethiopian firms into competitive manufacturers," "creation of champion companies," "creation of champion products," and "attraction of sufficient Japanese FDI."** (We would like to set numerical targets for each, if these targets are agreeable to the Ethiopian government.)

Policy area	Cooperation component	Remark	Actions required by the Ethiopian Remark Government	Possible support by other countries/donors
1. Policy learning (bilateral policy discussion)	1-1. Industrial Policy Dialogue	Continue to discuss policy (Phase 3); align with industrial objectives of GTP II. Monitor all other cooperation projects below.	Continued active participation & policy implementation effort.	NEPAD (PR to other African members)
2. Kaizen	2-1. Promotion & upgrading of kaizen in Ethiopia	JICA' TA support in progress (Phase 3). Monitor activities under the new ministry.	Strengthen & expand human resource of EKI; incentivize kaizen staff/experts & other stakeholders for long-term commitment.	
	2-2. Kaizen National Movement	The movement must go on until productivity becomes part of irreversible Ethiopian culture.	Continue movement & Kaizen Month during GTP II; active use of National Kaizen Council.	
	2-3. Dissemination to other countries	A request for cooperation for this purpose was received from NEPAD in April 2016. Also link with TICAD VI.	Active involvement in dissemination; active use of AU, NEPAD & other frameworks.	NEPAD (PR to Africa), ACET (research)
	2-4. Infrastructure (kaizen center)	In progress. Technical issues need to be resolved.	Solution of remaining technical issues.	
3. Domestic Private Sector Transformation	3-1. Management improvement	Mainly for SMEs; JICA's TA support related to ODA loan is under consideration.	Designate Ethiopian counterpart; long-term commitment; discuss content & modality with Japanese side in the near future.	DFID (PEPE) (-2020) EU (TTF) (-2017) WB & others (WEDP) (-2017) GIZ (STEP) (2016-)
	3-2. Creation of champion companies	Mainly for LMEs; candidates can be small in number. First agree on method, then screen & select candidate firms from a short list.	Provision of short list and related information for company selection; cooperation in implementation	
	3-3. FDI-local firm linkage and technology transfer	Discuss concrete and realistic modality first.	Discuss content & modality with Japanese side in the near future.	WB (CJC Project) (-2020)
	3-4. Export promotion	Champion products & national branding. Continued promotion of Ethiopian Highland Leather including managerial and technical support. Support for quarantine inspection.	Clarify & give sufficient mandate to organization, department & staff responsible for export promotion; inter-ministerial coordination.	
	3-5. Industrial human resource	Strengthen human resource needed for 3-1 to 3-4 above. ABE Initiative.	Mobilize and/or adjust existing institutions & policies in cooperation with Japan.	
	3-6. Research on productivity and wage	The first study already done by JICA. GTP II often mentions productivity & wage but needs more analysis.	Implementation by an appropriate research body (with Japan supporting and strengthening from the sideline); use of other donors' support if available.	EDRI/use of French fund?

Policy area	Cooperation component	Remark	Actions required by the Ethiopian Government	Remark	Possible support by other countries/donors
4. Improving investment climate	4-1. Improving investment climate (general framework)	Support creation and management of a roadmap in cooperation with EIC.	Active implementation of discussed and proposed measures; use of other donors' support if available.		IFC&others (Investment Climate Program) (-2017)
	4-2. Shortage and allocation of foreign currency	These are critical issues for all investors including Japanese. However, Japan needs to consider what role it should play as a relatively small investing country in Ethiopia. JICA is conducting a comparative study of investment climate in selected African countries including Ethiopia.			
	4-3. Tax and customs clearance (ERCA)				Netherlands (-2016)
	4-4. Logistics				UNDP (National Logistic Strategy) (-2015?)
	4-5. Power				WB (Geothermal Sector Development Project) (-2020)
	4-6. Bilateral investment agreement & bilateral tax agreement	Negotiate via official channel; in addition to investment agreement, the possibility of tax agreement is being studied by related organizations.	Discuss & agree on content that conforms to international standard, not just Ethiopia's current practice.		
5. Strategic FDI attraction	5-1. Investment promotion & investor support in general	Preparation & implementation of investment promotion strategy. Improvement of one stop service & investor services. JICA is preparing TA for EIC & IPDC. JETRO will promote Japanese FDI in cooperation with EIC.	Active use of Japanese experts. Work closely with JETRO. Serious consideration of Japanese advice for realizing Japanese standard in soft and hard investment support conditions.		
	5-2. Improving quality of industrial zones	Establish infrastructure quality standard; strengthen investor service, operation & management at IZs. Japanese expert dispatched to IPDC.			WB (CJC Project) (-2020)
	5-3. Establishment & operation of industrial area for Japanese FDI	Under study by PPSEZ (private developer). Japanese government will facilitate private developers' initiatives.	Maintain special treatment for Japanese area creation (including allocating Kilinto land) until end 2018 at the earliest and possibly beyond. Provide support for operation.		Work closely with Dohwa (Korea, supervising Kilinto construction)
	5-4. Attraction of Japanese FDI	Information, seminars, business missions, trade fairs & partner matching. Possible support for joint investment with Turkish, Indian and other foreign partners.	Creation of Japan Desk (possibly at EIC) with staff having clear mandate & cooperating actively with JETRO & other relevant Japanese agencies.		
	5-5. Providing investment & loan facility for Japanese FDI and / or industrial zone developers	Support from JICA & JBIC available for eligible Japanese firms under certain conditions.			

Note: drafted by the GRIPS Development Forum based on information available on June 4, 2016. Japanese support is subject to government policy, cooperation instruments & budget availability and may not be available for all policy areas and cooperation components listed above.


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