THE ROLE OF THE STATE IN EAST ASIAN INDUSTRIAL DEVELOPMENT:

THE KOREAN EXPERIENCE AND LESSONS FOR ETHIOPIA

By

HAREGOT, Abebe Aynalem

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
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ABSTRACT

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The paper describes that; economic expansion depends on the states interventions that create a favorable environment and direct economic activity toward greater investment. To hold this argument, Supportive evidence will be presented focusing on the policy of strong state intervention practiced in the newly industrialized countries (NICs) in general and the Korean experience in particular. It also assesses the problems of the neoliberal prescriptions fostered by the World Bank/IMF which currently encouraged/pressured many under developed economies especially sub-Saharan Africa including Ethiopia to undertake structural adjustment program (SAPs) measures based on the experience of the NICs, in this case, the analysis will argue that these institutions have ignored the recognized activist role of the state in the transformation of the NICs and preclude the lessons to be learned. Consequently, the paper will contend that, for under developed economy like sub Saharan Africa, a highly motivated and development oriented activist state is indispensable to direct, promote and facilitate the economy in order to bring structural transformation and allow entering in the global economic competition. Finally, the paper draws lessons for Ethiopia suggesting some important considerations need to be taken in formulating broad based development strategy.

Dedicated to My Family

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TABLE OF CONTENTS **page**

Preface

The paper describes that; economic expansion depends on the states interventions that create a favorable environment and direct economic activity toward greater investment. To hold this argument, Supportive evidence will be presented focusing on the policy of strong state intervention practiced in the newly industrialized countries (NICs) in general and the Korean experience in particular. It also assesses the problems of the neoliberal prescriptions fostered by the World Bank/IMF which currently encouraged/pressured many under developed economies especially sub-Saharan Africa including Ethiopia to undertake structural adjustment program (SAPs) measures based on the experience of the NICs, in this case, the analysis will argue that these institutions have ignored the impediments to structural transformation under SAPs in these countries. The fact that, these countries are characterized by backward economy, existing in a stage of factor-driven development and underdevelopment, having low level of technological capacities, getting market indicators and macroeconomic fundamentals right will not be enough, a highly motivated and development oriented activist state is indispensable to direct, promote and facilitate the economy in order to bring transformation and allow entering in the global economic competition. Finally, the paper draws lessons for Ethiopia suggesting some important considerations need to be taken in formulating broad based development strategy.

1. Introduction

Much of the existing literature on economic performance in East Asia and sub Saharan Africa (SSA) countries shows that East Asia and SSAs, in the 1950s, 1060s, and 1970s, the income levels were similar. Only in the 1980s and 1990s there is an enormous gap evolving, because East Asia grew very fast and (SSA) stagnated (1). SSAs have been recognized as the worst performers of the developing world, the growth has not only been the slowest of all regions in the world since 1960 but it has also attained negative per capita values in many countries over the period 1965-90 (Easterly and Levin 1995; 2). Ethiopia as the group of SSA country has also been one of the poor performers in this regard. Agriculture is the backbone of the economy. It accounts for about 50% of the GDP, more than 90 % of the foreign export earnings and engages over 85%of the population. Manufacturing forms only a minor part of the Ethiopian economy. As a result, the turn of the millennium finds Ethiopia, one of the oldest continuous civilizations in the world, as one of the most destitute of nations, in all possible dimensions (2).

In explaining the major reason for the phenomenal success of the East Asian countries, various schools of thoughts have interpreted in different ways. One of the prominent views in this area, which occupied the main stream of the economics profession, is the neoclassical school. They like to treat the market system as the major reason for the high-speed development. The failure of them However is that they never pay attention to the active role of the state for which it disregards the comprehensive intervention practices promoted in the economic development process of the NICs.

The first purpose of this paper is to demonstrate that the state played crucial role in the development of the NICs; indeed the practical experience provides supportive evidence.

To me, East Asia, in this particular reference the Korean case; the strong role of government is the major reason for the success and the unprecedented industrialisation results achieved with in a mere three decades.

This paper mainly uses Korean development experience as a reference. The reasons why I focus on the experiences of Korea is that, Korea before the 1960s had a backward economy based on subsistence agriculture with all the difficulties facing a typical less under developed countries especially for most sub Saharan Africa including Ethiopia today.

Korean per capita income in the early 1960s was $82. Besides, South Korea was barely recovering from the ruins of the Korean War, which had left 45% of the factories substantially damaged.[i] With such a low-level income, domestic savings were negligible. The population growth of nearly 3% a year in an already densely populated country meant that the country had to depend on foreign aid for sheer survival. Unemployment, underemployment and poverty were widespread with over 40% of the nation’s population suffering from absolute poverty. Nevertheless, Ethiopia even other SSAs have lost ground, and still marginalized with respect to other regions of the NICs with equal and even less promising starting conditions in the early 1960s. For example the per capita income of Korea in the early 1960s was lower than those of Haiti, Ethiopia, and Yemen and about 40% below India’s. Moreover, in describing this phenomenal economic transformation, "The Economist" June, 1997, noted that in just three decades, South Korea catapulted itself from a level of economic development no higher than that of Ghana in the early 1960's.

How ever, from a position uncomfortably close to the bottom of the international income scale and with out the benefit of significant natural resources,

Korea embarked on a course of industrial growth with in three decades that become one of the outstanding success stories in international development. Korea is now an industrial, modern state providing a classic example where the policy of strong government has been successful for which it established Korea as the eleventh largest economy in the world.

Meanwhile, following an ideology known as neoliberalism, and spearheaded by the international financial institutions, Structural Adjustment Policies (SAPs) have been imposed in developing countries. They argue for a minimalist state under the fabric of structural adjustment programs (SAPs) and good governance. These institutions promoted this approach as a means of reducing poverty worldwide especially this has held sway in Africa since the 1980s. SAPs are designed to foster through privatization state owned and operated enterprises, liberalisation, removal of government subsidies, deregulation, outward orientation, export promotion and so on**.**

The truth of the matter is that there is a respectable and accumulating body of opinion and evidence to challenge the theoretical and empirical adequacy of neo- liberal prescriptions as manaceas for the development problem.

In this respect the second argument to be made here is that the issue as to whether the state should play an active or a passive role in the economy is not as closed, as proponents of SAPs would have it, the issue remains an open one and as such it is best to suspend the dogmatism about SAPs, and it is incumbent for underdeveloped economy like SSAs to vigorously debate the relative merits of government intervention in the economy. In this regard I contend that the way beyond SAPs is through an activist state, guiding, and governing the market toward economic development.

As shall be described later, it is my contention that the fundamental weakness of SAPs is their inability to accommodate and properly inform on an activist and dirigist role of the state to govern and guide the market toward the attainment of the goal of economic development.

To deal with these issues, the structure of the paper will be as follows. The following section reviews the literature on the role of government in the economic development of East Asia. In this section the explanation of the East Asian miracle focusing on the criticism of the neoliberal Model and the Arguments in Favour of Government Intervention will be discussed.

Section three describes the major policy tools the Korean government used in promoting speedy economic development correspondingly; other initial conditions and political factors that contribute to the economic growth will be reviewed. In section four, SAPs will be assessed first in relation to the goal of economic development. Then, It assesses the problem of the neo liberal prescription and the need for an activist state beyond these prescriptions. The last section draws the possible lesson for Ethiopia and concludes by suggesting some important considerations need to be taken in formulating broad based development strategy.

II. Literature review on the role of the state in the economic development of East Asia

Since late 1950s, East Asia's economic development has become a new phenomenon in the global economy. In a short period of time, East Asian economies, whether a war defeated like Japan or with low starting point like South Korea developed with unprecedented rate in which they became a leading economic power (Japan) or newly industrialized economies like Korea, Hong Kong, Singapore, and Taiwan.

This remarkable performance of the East Asian economy has inspired many economists to study the background of the rapid growth and various streams of literature have emerged to assess the reasons of the astonishing growth. Interestingly, different economists interpret this success in entirely different ways. There are those who hold that East Asian economic success is ascribed to economic openness, as advocated by the market mechanism, neo classical economics approach.

Other interpreters challenged the studies by neoclassical economists by focusing on the active role played by the state in leading the process of economic development among latecomer developing nations. Ranged against them, in varied degree of opposition, are a number of other views. Some emphasize on the socio cultural factors, other highlight on external factors, which is linked to western defense against communism and some others, underline on the emergence of entrepreneurs and institutional factors.

This section reviews the explanation of the East Asian miracle focusing on the Criticism of the Neoliberal model and the arguments in favor of government Intervention, it presents the theoretical, empirical and historical evidences that shows the policy of strong government intervention has been successful.

To start with, beginning from the 1980s a new neo-liberalism seems to have taken over which sought, a-historically, to correlate the absence of market distortions with allocative efficiency and economic growth. What is generally advocated in this neo-liberalism is export-orientation as against import-substitution, trade liberalization, limiting government activity in the realm of development to the provision of general infrastructure for growth, such as law and order, general education, maintenance of a favourable macro-economic environment, and providing for "rare" market failures through "neutral" policy measures, massive commercialization and privatisation of state enterprises, and major reforms in the government bureaucracy." Governments have no business being in business". Free trade and factor mobility reduces rent-seeking by restraining the interest and preventing cartels from forming.

The failure of government intervention and the positive contributions of the market mechanism were elaborately discussed in studies by, among others, Balassa (1977), Corbo et al. (1985), Hughes et al. (1988), Krueger (1978), Little, Scitovsky, and Scott (1970), and Michaely et al. (1987). These studies considered the East Asian countries as examples of countries where the market mechanism had positively influenced the process of economic development. More specifically, to quote for example, (Balassa, 1971; Little et al., 1970) have stated that reliance on market forces and the adoption of market-driven export-oriented development strategies was said to have led to efficient exploitation of the comparative advantage of these countries in cheap labour.

Foremost in the exercise of denial of a positive role for the state in industrial development is the World Bank/IMF especially in their attempt to force the evidence from the high performing East Asian countries into its neo-classical mold of "getting the prices right.

Here, it must be recognized that the wrong kind of government intervention or economic statism can also be highly detrimental as it may generate its own problems. A most telling testimony against state intervention is the dismal results that were achieved by most developing countries which practiced extensive state intervention. However, this did not automatically mean that the neoliberal alternative provided a correct interpretation of the backgrounds of the successes in East Asia (Wade, 1991). Besides, the problem with the dogmatic proponents of neoliberals is that in their insistence to castigate state intervention and safeguard against the resort to the failed past import substitution or socialist strategies which have been one form of government intervention, they have gone to the other extreme ignoring the recognized active and dirigist role of the state in the development of the NICs. This easily manipulable base for comparison simply does not exist.

The first presentation for African consumption of the lessons from Asia from the neo-liberal perspective was the "Berg report" (World Bank, 1981), which has been the definitive document on adjustment for 17 years. There have been amendments, subtractions, additions and refinements of the argument, but as Adjustment in Africa (World Bank, 1994) clearly suggested, the World Bank was almost congenitally tied to the core argument of the Berg report with its faith in the market and a minimalist view of the state.

However, the truth of the matter is that there is a respectable and accumulating body of opinion and evidence to challenge the theoretical and empirical adequacy of neo- liberal view.

The theoretical basis for state interventions has been justified by development theoretists since the decade of the 1950 and 1960's. They held the idea of "Structuralism" as a conviction in common.

According to the idea, the essential economic structure of LDC is different from that of developed country (DC), and the economic gap, industrial gap and life level gap seemed to increase. Thus, they found the main question of development study in exploring the reason of poverty and the method to escape from it. Most scholars in this field saw economic development as a dynamic process of non-marginal change. The process was characterised by large investments, increasing returns to scale, the pervasiveness of externalities, market imperfections and failures. Most development theorists saw change as neither smooth nor automatic, and argued convincingly that although the price mechanism provided adequate signals for marginal changes; it could not be relied upon to induce dynamic resource allocation necessary for industrialization. This provided the theoretical basis for state interventions required either to support investors or to invest directly "to break critical bottlenecks" resulting from market failures.

According to the development theorists argument, the omission of the state as an explicit actor is a fundamental flaw since they relied on the state as an agent of change and presumed that it had the requisite political autonomy and administrative tools to carry out the task. In the presence of widespread market failure, the superior capacity of government functionaries to allocate resources became an article of faith. The state's ability to undertake sectoral targeting and its fiscal capacity for direct intervention were taken for granted.

The historical evidences also show that, most industrialized countries' governments intervened and continue to chart the course and pace of industrial development either by default or design. The US, Japan, Germany, Italy and lately South Korea, Taiwan and China intervened and continue to intervene massively to accelerate the pace and structure of industrial development through industrial policy, direct state ownership and other non-market mechanisms.

Certainly, any other regions than the East Asian economies demonstrate such high development performance and the greater part of countries holds government with strong leadership.

Subsequent empirical analysis has also shown that neo-classical reading of experiences of development in Asia has been tendentious, deliberately downplaying the role of the state in the "success stories". "Revisionist" literature on the Asian experience presents a picture quite different from that projected by neo-classical interpretation of that same experience. These countries were far from paragons of laissez-fairism and, instead, were highly "dirigiste" economies in which the states had "governed markets" to ensure high levels of accumulation, technology absorption and conquest of foreign markets. The general conclusion of this literature is that "market failure" so prominent in development economics is still a problem that warrants government intervention and that since such "failures" differ in intensity, scope and location, a selective set of interventions is required.

The most significant lesson has been the central role played by a "developmental state" in the process of development. Several researchers like Kwon (1994), Lall (1994), Perkins (1994), Amsden (1994) have publicized that East Asian countries have intervened massively with unprecedented industrialisation results and have shown the weakness of the neoliberal attempt. To quote Kwon (1994), the East Asian miracle report of the World Bank (on Japan, Hong Kong, the Republic of Korea, Singapore, Malaysia, Taiwan, Thailand and Indonesia). " makes an all-out effort to assert that the East Asian economic success has nothing to do with government. If government is to deserve any credit it only does so because it's various forms of interventions (in pricing, interest rates, wages, bank credit, monetary and fiscal policy, protection of domestic industries, export promotion and subsidies and industrial policies and so forth) must have by some magical coincidence, jelled into a neoclassical formulation (The Bank) blatantly ignores a significant body of literature counter-factual to its evidence," (pp 635-636). Lall (1994) calls it "a flawed work p. 646" for similar reasons.

More over, the comprehensive research by the developmental statist political economists in explaining the economic success of the Asia's newly industrialized economies, have shown unambiguously the unconvincing arguments posed by the mainstream neo classical economists schools. They clearly indicated that East Asian economies, which embrace "strong government", have achieved conspicuous development ironically.

The Japanese study by Johnson (1982), the study of Korean rapid economic development by Amsden (1989) and also the report of Taiwan market by Wade (1990) have emphasised the significant role of government in industrialisation period.

Each of them is targeting separate regions, but has a common message, i.e., each government substitutes the infant market function and it is thought to be the element of successful development.

This, at the same time, denies the argument of government failure by neoclassical view, and development state view demonstrates evident case in which government can push development actively. Moreover, the discussion by Amsden (1989) that government intervention distorting immature market function itself has been the significant, criticised sharply to the myth of free trade market. She insists that Korean government intervened by getting price wrong to stimulate export industry, then, it succeeded to economic development through accelerated export. This argument is completely opposed to the conclusion of Balassa (1990) that focused on the policy change from import substitution to export orrientation with "getting price right ".

Unfortunately, neo-classical economists seem to refuse to admit these theoretical, historical and empirical facts. In attacking state intervention they "posit an idealized market instead. However, in recent periods the staff of the World Bank touched the role of government and recognized that active government involvement effectively worked in the East Asian miracle. According to the world bank report in 1991, following four factors have to be satisfied by government: (1) the investment to elementary education, public hygiene or family planning to improve human capital, (2) deregulation and maintenance of infrastructure to promote the competition in private sector, (3) the open policy by import protection abolishment or mitigation of FDI, and (4) macro economic stability. These policies are named as fundamental policy. The market friendly approach implies that the government involvement should not make any special treatment to individual enterprise or industry, but improve the framework of whole market. Hence, this approach has avoided that government runs enterprises or promotes specific industry by protections and regulations. However, recent criticism by Ha-Joon Chang, 2003, highlights the failure of neoliberalism, especially in developing countries, or what he terms “the intellectual bankrapcy”, which he believes, “stems ultimately from its failure to base its discourse on a balanced and sophisticated theory of the interrelation ship between the market, the state, and other institutions”.

At this point of discussion, it is imperative to note that although there is a growing consensus that governments can play a vital role in successful development efforts, the proponents of the developmental state failed to address the question of why the state intervened in the way it did or problematic consequences of such intervention**.** In his paper “Recasting Korean Dirigisme”, by focusing on the case of Korea, Park, Hun-Joo clearly counters the developmental state arguments by elucidating the political nexus of power, and how state power holders used their position to direct development and divide the benefits in an imbalanced manner, with the majority of the benefits accruing to a certain few chosen as proxies in business to carry out the orders of the power holder. Furthermore, Park asserted the lack of people centeredness which he termed “diseased dirigisme” as the fundamental flaw in Korea’s militaristic growth at any cost modernization campaign.

Thus, it should be noted that the problem with a dirigist state in under developed economies is best appreciated by considering the meaning and implications of economic development as a goal. The process entails economic growth, structural transformation and increases in economic welfare and some minimum degree of equity, at least.

III. The role of the state in the economic development of Korea

The idea of a government intervening in the process of economic growth was appealing to many politicians. It contributed to developing models of central planning, and it stimulated to using trade policies, such as import quota, export subsidies, and fixed exchange rates, introducing price controls and subsidies in markets for goods and production factors, and establishing public enterprises in important sectors like mining and heavy industries. Many governments pursued policies of import substitution (and later also export promotion). A good example for this is the Korean experience that proved to be successful in achieving economic growth by way of government intervention

The remainder of this section will discuss in more detail several of the above-mentioned aspects of the NICs intervention policy focusing on the Korean experience, such as the characteristics of industrial policies, the instruments that were used to stimulate specific investments, the institutional context, and the preconditions.

1. Korean intervention policy

1.1 Industrial development policy

In 12 January 1973, President Park Chung Hee announced his intention to launch the HII Plan. According to the HCI Plan, six industries were designated as "key" industries to be promoted: steel, nonferrous metal, machinery (including automobile), shipbuilding, electronics, and chemical [7]. Separate from these six industries, five projects were already under way, with strong government support, to develop special steel, brass, foundry heavy machinery, and shipbuilding (Hyundai) plants.

Most of the industries were designed to develop as future leading export industries, whose share in commodity exports was expected to exceed 50 percent by 1980 (13).

The government mobilized domestic capital by encouraging savings, determined what kinds of plants could be constructed with these funds, and reviewed the potential of the products for export. In this sense, the will of the government to undertake economic development played a crucial role; the role of the government, however, was not limited to such measures as mobilizing capital and allocating investments. The Economic Planning Board established export targets that, if met, yielded additional government-subsidized credit and further access to the growing domestic market.

The government especially stimulated those industries that were thought to be of crucial importance to the long-term development of South Korea. Whereas in the 1960s mainly export-oriented industries were stimulated, in the 1970s emphasis was placed on the development of heavy and chemical industries, the electronics industry, and shipbuilding. In the 1980s the centre of attention of industrial policies shifted towards stimulating the development of high-quality industries. As a consequence, due to government intervention South Korea became a leading producer of microchips, and had an important share in the world markets for consumer electronics, cars, and in shipbuilding. The relatively long time these industries require to reach maturity, and the limited profitability (or even temporary loss) during the initial phase cause these industries to be rather unattractive when it comes to private investment. This provides a justifiable reason for an active industrial policy by the government.

1.2 Tools of government intervention

The Korean government used various instruments that enabled to influence the organization of production decisions and the allocation of production factors; in order to achieve those scarce resources would be applied in the areas they preferred.

These instruments primarily aim at creating rents, instrument i.e. providing subsidies for certain investments. Initially, subsidies were granted by means of programmes for cheap credit and selective credit loans.

In Korea, the government had a significant impact on determining the nominal deposit and loan rate in the 1960s and 1970s. Moreover, Korea introduced guidelines with respect to the allocation of bank loans to the private sector. Thus, they were able to stimulate the development of specific industries and private activities by granting them access to external funding and by subsidizing this funding. Furthermore, instruments like tax advantages, selective granting of available foreign currencies, and the stimulation of cartels were used to positively influence the investment behavior of the private sector. Finally, in certain specific cases, like for example the case of the South Korean shipbuilding industry, the government explicitly guaranteed that possible unprofitable investment decisions would be compensated for. Rodrik 1994, refers to this as "...the socialization of investment risk in selected sectors."

Apart from granting subsidies in order to stimulate certain types of investment, in several cases governments were actively involved in taking specific investment decisions aiming at improving the coordination and cooperation between different projects present several examples that show that the governments of South Korea and Taiwan the decisions in order to develop certain new industrial activities and subsequently supervised and participated in the implementation of these activities.

1.3 The role of the export promotion policy

Korea in the 1950s, more than two-thirds of its population engaged in the primary sector, possessed all the familiar characteristics of an extremely underdeveloped economy.

With an energetic execution of export-oriented growth strategy since the early 1960s, however, the growth rate of the Korean economy jumped from about 4 percent per annum on average in 1953-61 to about 8 percent in 1962-66 and to about 9 percent in 1967-88.

The proportion of persons employed in primary sector declined from about 64 percent of total employed persons in 1963 to about 20 percent in 1988, while that in manufacturing sector expanded from about 8 percent to 27 percent.

Some new interventionists stressed the fact that government intervention stimulated especially those export industries for which competition in international markets was fierce, in order to stimulate the building up of a competitive external sector. Moreover, they put much more weight into the role of government intervention to develop such a competitive external sector. They argue that international competition can be regarded as an efficiency check of interventionist policies and the policy measures used. The success or failure of export producing firms provided the government with information, which enabled it to decide whether or not to continue support to particular industries, and to decide on the extent of this support.

Thus, protection measures and the granting of subsidies were linked to the performance of firms with regard to the development of sales in foreign markets.

1.4 Government business relations

Several studies have examined the question concerning the way governments were able to dispose of sufficient information to efficiently coordinate investment decisions and to determine which industries were important in realizing a dynamically efficient allocation of scarce resources. These studies show that very close ties existed between the government, banks, and the private sector.

These ties led to frequent contacts between the government and the private sector about the economy's weaknesses and strengths. In this way, the government gained a better understanding of the nature of the coordination problems that played a role in the economy. On the basis of this information the government was better able to take decisions concerning intervention.

In South Korea, civil servants from different ministries, bank managers, and managers of large companies regularly met on so-called deliberation councils.

Apart from this there were also monthly export meetings. At these meetings, presided by the president of the country and attended by senior civil servants, managers of banks and companies, economic bottlenecks were directly discussed, and decisions were taken concerning the outlines of the industrial, trade, and financial policies. Specific attention would be paid to the performance of the export industries, and if necessary the export policy would be adjusted on the basis of the information available.

2. Other Initial conditions and political factors

2.1 initial conditions

The new interventionists emphasise that in these countries the educational system and the level of education of the labour force were of a relatively high standard as early as the 1950s, especially compared to countries in Latin America and Africa. This positive initial condition had various positive consequences.

To start with, this meant that labour productivity was relatively high and that the East

Asian economies were at least capable of working with relatively high-grade production processes as early as the 1950s. Moreover, this meant that the copying of Western technologies - which according to Amsden is the essence of late industrialisation - could be executed faster. Finally, the high level of education had a positive effect on the quality of the civil service.

The latter was not to be underestimated as an aspect of the success of the East Asian intervention policy. Several authors have therefore paid special attention to the aspect of the quality of the civil service. An efficient apparatus of government was of great importance in order to translate the information on coordination problems in the economy into a policy that could contribute to increasing economic growth. Moreover, the work ethic of the average civil servant in the Eastern Asian countries was also important in explaining the efficiency of government intervention.

In many developing countries civil servants seemed to be easily corrupted, whereas in most East Asian countries this was relatively less common. Consequently, the abuse of, for example, the granting of subsidies and other benefits to firms could be kept rather limited. To explain this phenomenon the new interventionists argued, among other things, that in such countries as South Korea and Taiwan a high degree of social responsibility had been developed and introduced through the educational system. Education very much contributed to a sense of social awareness. This led to the fact that a position as a civil servant involved a high social status. This may be an explanation for the fact that the best students often accepted a position with the government whereas a similar position in the private sector would pay far more. This high status would also contribute to a lower degree of corruptness as compared to that in many other developing countries. Moreover, a career with the civil service was considered the perfect way to a high position in the private sector later (see e.g. Wade, 1991; and World Bank, 1993).

5.2 political factors

Apart from these initial conditions, several authors argue that the political economic circumstances in the East Asian countries contributed to the fact that government intervention could concentrate on the efficient use of scarce resources.

As is well-known from the public-choice literature, a government may implement a policy because they are being pressurised by certain groups in society that are crucial to a possible re-election. In such case, in their policy the government may to a certain extent want to comply with the wishes of their future voters, rather than pursue a policy that contributes to economic growth as much as possible. For example, they may not use subsidies to support certain important economic activities; instead subsidies may be used to secure political support.

In many Latin American and African countries such a populist policy has been pursued in the past with all the associated negative consequences to general economic growth. In case of a more autocratic government, the government will use part of the means available to bribe representatives of powerful lobbies who could put at risk the government's continuity or to forcefully suppress these lobbies.

In South Korea and Taiwan the government hardly ever faced lobbies of real importance so that a populist policy was not necessary. Therefore, they could develop and pursue their policies independent of any lobby and they could efficiently employ subsidies and other instruments to promote economic growth, rather than use them in order to gain political support (see, among others, Haggard, 1990; and Rodrik, 1994). There were several different reasons for this particular circumstance, according to the new interventionists. Schuknecht (1996), among others, for an empirical analysis of such kind of political economic processes, countries like South Korea and Taiwan were characterised by a relatively equal income distribution (Rodrik, 1994) due to which the governments of these countries were less pressurized into taking popular measures to please certain lobbies. The equal income distribution was mainly the result of the land reforms of the 1950s, which took place both in South Korea and Taiwan. Thus, equal income distribution had been realised before the start of the period of rapid growth.

More recently, empirical support for the positive relation between equal income distribution and economic growth has been found (Alesina and Rodrik, 1994; and Persson and Tabellini, 1994).

Moreover, some mention the fact that both the South Korean and the Taiwanese society were characterised by a relatively cultural unity (Wade, 1991). This meant that this potential source of political instability was less strong than it often was in other developing countries, and that this made it easier to develop a solid nation state.

Some authors also mention the fact that the Japanese oppression of South Korea before 1945 drastically reduced the role of lobbies in this country.

To conclude this section, the growing amount of research on the experience of Korean rapid development showed that government could indeed contribute positively to growth by means of comprehensive intervention in the economic development process. In this regard, the Korean case is an evidence for the proposition that economic expansion depends on the states interventions that create a favorable environment and direct economic activity toward greater investment.

IV. The role of the state beyond the neoliberal prescription

1. Impediments to structural transformation under SAPs

The main features of SAPs are decentralization of administrative regions, an institution of free trade policies, capital market liberalization, privatization of state owned and operated enterprises, removal of government subsidies, and other austerity measures such as increased taxation, currency devaluation to increase exports, institution of high interest rates, and an increase in export production.

The Problem with current structural adjustment programmes especially in Africa is that their basis is to initially re-entrench and reconsolidate the economies in the factordriven stage with no clear indication as to how that will lead to the transition toward the investment-driven stage.

The most immediate expectation of SAPs is to stimulate traditional exports, all of which, in Africa are tied to natural factor endowment competitive advantage. They are, in the medium to long term, also expected, however, to stimulate non-traditional exports, efficient import-substitution of tradeables, and production of non-tradeables such as housing and buildings. The most general effect of SAPs has been to induce a stag-flationary situation in which traditional exports may increase but nothing else happens, except perhaps a marginal degree of resuscitation.

Under such circumstances, SAP measures might generate some degree of economic growth based on the growth of traditional exports but may not even begin to initiate processes toward economic development based on the growth of indigenised technological clusters and capacities.

Briefly, some of the impediments to structural transformation under SAPs are as follows:

1. SAPs reinforce traditional forms of comparative advantage that have insignificant spill over effects in terms of the development of national technological capacity (NTC), sectoral technological capacity (STC), or industry technological capacity (ITC);

2. SAPs have the effect of hastening de-industrialisation and the general closure of firms that cannot survive in the new environment at a faster pace than new firms can develop to take advantage of the new policy environment.

SAPs have largely been predicated on attracting foreign investment which has not been forthcoming because not only are investors unsure about the government's commitment to the market-oriented policies compatible with the needs of globalised monopoly capital, but the absence of conducive technological clusters and capacities has been a hinderance. When the latter's absence has not been a hindrance, foreign investment has come in on the basis of turn-key investments linked to external technological clusters exploiting export incentives without cumulative technological capacity building spill-overs;

3. Implicit in SAPs is the assumption that technological capacity is a tradeable which can be imported, and yet in many respects, since technological capacity, consists of the evolution of critical minimum thresholds and configurations of geographically concentrated clusters which make it a non-tradeable non-importable factor of development, even if individual components may be imported. Further, as such, it is not attained solely on the basis of incremental piecemeal changes in investment, trade and production;

4. The domestic private sector has been saddled with high input costs, inadequate capital, skilled manpower shortages, inadequate infrastructure, inability to access modern

technology relevant to competition in the new global environment and an absence of infrastructure to penetrate non-traditional foreign markets, thus making the private sector unable to seize upon the new policy environment as a basis for domestic and international competitive advantage, and, finally;

5, the inability of such countries to control the stag- flationary consequences, let alone, the social consequences, of SAP-related policies has dampened business expectations and optimism thereby discouraging domestic private investment of a long term nature.

2.2 The need for an activist state

The problem with SAPs and the need for a dirigist state in a factor driven economies is best appreciated by considering the meaning and implications of economic development as a goal. Economic development is the economic process whereby a country achieves sustainable increases in the per capita gross domestic product of its citizens through the efficient use of its productive capacities and resources. The process entails economic growth, structural transformation and increases in economic welfare and some minimum degree of equity, at least. The crucial qualitative criterion is the ability of the economy to evolve economic structures that are articulated through vertical and lateral linkages, that are diversified enough to absorb internal and external shocks, and that interact in a mutually supportive manner to internally generate and sustain secular economic growth in the long term.

Consequently, in the absence of indigenised technological clusters and capacities, inadequate capital, skilled manpower shortages, inadequate infrastructure, inability to access modern technology relevant to competition in the new global environment and an absence of infrastructure to penetrate non-traditional foreign markets, relying on the private sector as the presumed engine of growth, while simultaneously trimming the state of its potential role in guiding and directing the economy, are a sure recipe for stagnation and being stuck in the factor-driven stage.

One of the most outspoken critics of the globalization process and SAPs has been Joseph Stiglitz, according to him the most successful economies achieved their accomplishments by following a course opposite the one being proposed for the countries of the developing world. The G7 countries as well as most successful Asian economies never adopted these rules during their rise to economic prosperity. For example, the Asian Miracle of the past three decades that has put countries like China, South Korea, Thailand, Malaysia and Indonesia at the economic forefront was achieved precisely because these countries avoided adopting IMF prescriptions in the form of SAPs. Contrary to IMF mandates, the governments of these countries played a major role in all aspects of development. They instituted high tariffs, let state-owned industries flourish, invested in education and health, and adopted trade liberalization after strengthening their industries. The U.S., Western Europe and Japan maintained tightly shut financial markets until the 1970's, ensuring that their markets had ample time to develop and withstand any outside competition.

The need for an activist state for under developed economies like SSAs is made all the more necessary if the goal is economic development rather than a mere revival of economic growth.

The difference between economic development and economic growth is easily brought home by noting that a country like Botswana has had phenomenal rates of economic growth over the past 15 years and has a per capita income almost twice that of

Zimbabwe yet the latter with much lower rates of economic growth remains more `developed' in terms of its technological capacities and clusters than the former.

Thus something is missing in Botswana's development strategy, which is factor-driven (diamonds, livestock and copper) and as free and open as any SAP economy can be and this is the creative role of the state, to shift the economy from a factor-driven one into an investment-driven one based on higher order comparative advantage requirements. Thus, in the stage of factor-driven development and underdevelopment, a dirigist state is needed for the following reasons:

- To foster the development of domestic technological clusters and capacities which can act as gravitational growth poles in economic and spatial terms;
- To guide domestic and foreign investment into activities leading to the development of technological capacities in higher order comparative advantage, particularly strategic industries relying on modern technology, with increasing returns and economies of scale, with positive externalities and spill-overs to other firms, industries and sectors, and with the ability to develop home demand;
- To facilitate the acquisition of foreign technology in the desired strategic industries, and to assist in the penetration of foreign markets;
- To develop and enhance physical and human capital in a manner facilitating the development of strategic industries;
- To provide supply-side and demand-side incentives to encourage the growth of strategic industries with the potential to spear-head an investment driven economy; and
- To mobilise savings, and regulate the allocation of investment funds towards strategic industries.

All of the foregoing considerations suggest that SAPs, by relying on the private sector as the presumed engine of growth, while simultaneously trimming the state of its potential role in guiding and directing the economy, are a sure recipe for stagnation and being stuck in the factor-driven stage.

V. Lessons for Ethiopia and Considerations to be taken in formulating development strategy

The discussion described in this paper on the proactive role of the government in the economic success of the NICs in general and the Korean experience in particular is highly interesting since it may also provide lessons to Ethiopia and other Sub Saharan Africa countries. The response of the interventionists to the common neoliberal view concerning the role of the government versus the market has resulted in more explicit evidence to a number of important aspects in the process of economic development.

In this regard, Ethiopia and other SSA countries can draw important lessons from the Korean experience, in this particular point I will focus on Some lessons relevant to the statist approach; guided by a dirigist developmentalist state and highlight considerations need to be taken in formulating broad based development strategy. Before taking this issue, I will briefly introduce the background history of the economy and the role of the state focusing on the current development strategies in the Ethiopian experience.

1. An overview of the Ethiopian development experience

With a total area of 1,097,000 square kilometers and a population of about 65 million, Ethiopia stands as the fourth largest in size and the second populous country in Sub-Saharan Africa. It is land-locked, lies in the northeast corner of Africa.

As in most developing countries, agriculture is the main stay of the economy. It accounts for about 50% of the GDP, more than 90 % of the foreign export earnings and engages over 85%of the population. Manufacturing forms only a minor part of the Ethiopian economy. The country has one of the lowest exports per capita in the world; coffee accounts for a large portion of merchandise exports.

Given the country's agriculture-centered economy, Ethiopia is particularly vulnerable to the adverse effects of fluctuations in commodity prices (especially coffee), and drought, which is frequent. Famine resulting from failure of the rains is a frequent threat for millions of Ethiopians.

Meanwhile, The turn of the millennium finds Ethiopia, one of the oldest continuous civilizations in the world, as one of the most destitute of nations, in all possible dimensions. At USD 116, Ethiopia's real per capita GDP is among the lowest in the world and only about one fifth of the Sub-Sahara African (SSA) average.

Since the mid-1970s the Ethiopian economy has undergone two major shifts in policies. The first occurred in 1975, when the Imperial government (who had ruled since 1930-1974) was overthrown by a group of military officers known as the Derg. The Derg replaced mainly liberal policies of the Imperial era with a centralized socialist regime that discouraged a market economy and private property. Land and medium-size and large enterprises were nationalized. Prohibitive tariffs, extensive quotas, and complicated licensing procedures restricted foreign trade. Manufactured goods were rationed. Small farmers were forced to join cooperatives and to deliver grain to a government-marketing agency.

The performance of the economy between 1974 and 1991 showed a dismal picture. Real GDP growth, after averaging 4 per cent per annum for 10 years before 1974 fell to about 1.5 per cent in 1974-91. In contrast, population growth picked up from 2.6 per cent to about 3 percent, rendering a continuous fall in per capita income and worsening living conditions. The macroeconomic balances were also consistent in describing the situation: low gross domestic saving averaging between 0 and 7.5 per cent of the GDP, low level of capital formation, inflation reached its peak between 1989/90 and 1990/91, averaging 21 per cent, and the current account deficit, financed mainly from external sources grew to unsustainable level with mounting debt of about 4 billion USD (excluding military related credit) by 1992. The growing deficits in the Government budgets and balance of payments as well as the increase in external debts servicing ratio further created constraints in the national capacity to improve the situation.

A combination of factors explains the recorded poor economic performance, including economic mismanagement, severe fluctuations in weather conditions and excessive military outlays diverting resources away from productive use. To sum-up, Ethiopia's economic performance has been constrained by: Overall economic structural problems attributed to the wrong economic policy pursued by the previous regimes; Protracted civil war: Recurrent drought, and Low level technology.

These policies, combined with the political repression, led to civil conflict. The conflict ended with the downfall of the Derg and the assumption of power by the Ethiopian People’s Revolutionary Democratic Front (EPRDF) in 1991.

Since the end of the civil war in 1991 the EPRDF established the transitional government of Ethiopia (TGE). The TGE mainly focused on reorienting the economy through market reforms, including a structural adjustment programs.

Since 1992, under the auspices of the WB and the IMF structural adjustment programme (SAP), a range of reforms has been implemented. As a result the state's direct role in economic activity has declined. Tariffs have been cut, quota constraints relaxed, licensing procedures simplified, foreign exchange controls eased, compulsory cooperative membership and grain delivery discontinued, and privatization begun. The government has also adopted agriculture-led industrialization as a central plank of its development programme, with a focus on productivity growth on small farms and labour-intensive industrialization.

These reforms, combined with peace and favourable weather conditions for most of the past decade, have shown positive trends. During 1992–2001 real GDP growth averaged 6% a year. Exports grew by about 5% a year, though there was considerable volatility across years. Annual inflation averaged about 4%. And by 2000/01 investments had risen to 16% of GDP. These outcomes are much better than those in 1975–91. However, Ethiopia still remains one of the world's poorest countries. About a decade has elapsed since the implementation of the SAP however, the expected result of improved the country's competitiveness position could not be attained. The structure of the economy remains largely unchanged, with rain fed agriculture generating nearly half of GDP, more than 85% of employment, and almost all exports. The country remains dependent on a few primary exports that suffer from deteriorating terms of trade, resulting in volatile export earnings. Growth is also constrained by heavy external debt. And the recent war with Eritrea did not help matters. Moreover, income inequality appears to have increased in both rural and urban Ethiopia. Urban unemployment has grown and, perhaps due to that, urban poverty has raised.

2. Impediments for developmental state in Ethiopia

After the fall of the communist regime in 1991, the new transitional government have ushered in a new era of radical transformation in both political and economic spheres in the country's recent history.

The political transformation ‘consisted mainly of changing the unitary state into a federal system, one-party system in to a multi-party system, the command economy into a market economy, and instituting human rights buttressed up by an independent judiciary. Indeed, a new order of state and society was launched in the country.’ (Report by the Government of the FDRE at the GCA Economic Committee Meeting, August 1996).

In the economic sphere, the transitional government, soon after its establishment, launched a new economic policy, which represented a radical departure from the past. The essence of the new economic policy became the transformation of the command economy inherited from the previous regime into a functioning market-based economy. ‘The emphasis was to dismantle the Byzantine labyrinth of perverse state intervention and to limit the role of the state in economic activity. The systematic reduction in the role of the public sector in productive activities was to be undertaken in favour of the expansion and deepening of the private sector.’ (Ethiopia: Industrial Development Review Series, UNIDO1996).

In my opinion both the internal and external political and economic factors are the key motives to undertake the aforementioned radical transformation that involved cutting back the activist role of the state. Briefly, the following two reasons may explain as to why Ethiopia hasn't made a developmental state.

1. Commitment of the new government to exercise free market economy

The wrong economic policy pursued by the previous regimes; especially the 17 years domination under the military government combined with strong political repression, protracted civil war and recurrent drought put the country as the most marginalized and destitute nation in the world.

In the economic arena, the transitional government (TGE) inherited a shattered country. As indicated by the TGE, Ethiopia's coffers were empty; moreover, some 7 million people were threatened with starvation because of drought and civil war. Economic performance statistics reflected this gloomy assessment.

Thus, to resolve these problems embarking on sweeping changes to moving away from centrally planned and destitute economic condition to a better economic standard had been mandatory to overturn the gloomy past experience inherited from the previous regime.

Holding this conviction along with the strong need of the citizens to enjoy an enormous democratic practice and peace dividend on a new development path, the government committed to peace and development and initiated a new economic policy that pursued a systemic reduction of the role of the state. It began dismantling the country's command economic system and shifted toward a market-oriented economy with emphasis upon private initiative.

2. SAPs as a means to receive external loans

Meanwhile, since mid 1992, under the auspices of the World Bank and the IMF the new government has engaged in massive SAPs.

As is well known, in the past internal efforts and sufficient domestic resource mobilization used to play predominant role for successful economic development. Currently, however, whatever domestic efforts are undertaken, they are unlikely to be effective unless the rest of the world supports them. Thus, in the current international economic order, external financing plays pivotal role in developing countries.

In this regard, Ethiopia needed new loans to pay its outstanding debts and to meet critical domestic needs. The growing deficits in the Government budgets and balance of payments as well as the increase in external debts servicing ratio further created constraints in the national capacity to improve the situation. The World Bank and IMF became key providers of loans to countries that were unable to borrow elsewhere. Consequently, Ethiopia remained one of those countries receiving the IMF and the World Bank financial and technical assistance.

To be eligible for structural adjustment loan however, the borrower country is required to full fill conditionalities required by the institutions. The conditions attached to these loans required Ethiopia and other countries to submit to economic changes that favored "free markets."

It involved cutting back the role of the state and promoting the role of the private sector, correcting trade imbalances and government deficits, consequently the institutions cede control over the economic decision-making of the country.

To sum-up, getting market indicators and macroeconomic fundamentals right will not be enough. A highly motivated and development oriented activist state is indispensable to direct, promote and facilitate the economy in order to bring transformation and allow entering in the global economic competition. Thus, following own sense of economic direction and programme ownership may ultimately led to impressive results by rising cordial relations with internal and external development partners.

3. Lessons for Ethiopia

To discuss on how to bring competitive and sustained development in the Ethiopian economy, we should go far beyond the neo classical way of explaining the experience of East Asian countries and the narrowest view of the Structural Adjustment Program that underplay the proactive role of the state. The scope of this paper is limited to the economic policy aspect and draws some experiences based on the East Asian in general and the Korean experience in particular. The lessons listed below are some that I believe can suit to the specificities of the countries situation under the present globalized world.

The most crucial element for successful technological development is education. Human capital accumulation was the key factor for East Asian countries' success. Emphasis should be given not only to basic literacy level but also to training the labor force that will be useful to industry and to develop capacities in science and technology for future development of the Ethiopian economy in the high-tech era and for assimilating and upgrading the imported technology.

The choice of trade policy is also vital to the evolution of industry. The free trade policy of structural adjustment program has not end with a good industrial performance as was predicted but rather end with exposing infant and diminutive industries to giant external predators. For instance, in 2001 several shoe factories in Ethiopia have been reported to be closed and most others reduced their labor force due to the cheap Chinese shoes, which crossed the free trade boarder of the country. The experience of East Asia, however, shows that the more rapid export growth is possible through protection of domestic industries until they become matured and competitive. So, export oriented policies should be backed by some degree of infant industry protection aimed at nurturing the industrial sector and strengthening and sustaining the export sector.

The government's role in export promotion through participating in international trade fairs and displaying the country's products, dispatching trade missions to potential markets, in finding markets for the country's products, and preparing trade exhibitions and expos and more importantly in participating in business activities where the private sector is unable or not interested to invest was also crucial in East Asian success in trade. So, what the government of Ethiopia can learn from this is not to retreat from business activities but to change its way and aim of intervening in the activities in such a way to organize and lead the private sector to the nations goal of achieving a competitive economy.

Other policies such as finance, labor, foreign investment, etc, should be geared towards the development of industry, agriculture and technology and to increase the country's competitiveness.

Selecting Industries to be Promoted: The lesson here is that the state should direct private investment into activities that have the highest technological and economic spin-offs in terms of generating clusters, Technological Capacities, economies of scale, increasing returns, and indigenisation of technological capacity through learning-bydoing.

Balancing Growth and Development Goals With Equity: The lessons from the NICs, especially the dirigist practice of the Korean case clearly indicate that the need for economic development and the building of human and open society.

Establishing a Structure of Incentives (rewards and punishments): In order for the state to govern the market, it needs a structure of incentives and disincentives aimed at inducing firms to invest in desired activities and to discourage them from others. Indeed, a structure of rewards and punishments may be needed.

The crucial requirement here is that such structures be temporarily targeted to the beneficiary to be influenced, or the firm to be penalised and generally refrain from being macroeconomic and permanent. Further, policies to reduce the effect of their negative consequences have to be incorporated.

Establishing Consultative Structures: There is a need to ensure that a consensus is developed around the desired future course of the economy, the desired future economic structure of the economy and the structure of incentives and disincentives. Such a consensus can only be brought about through the establishment of consultative structures, which involve key partners in the economy (corporations, labour and government), and major interest groups in civil society. In this regard, a proper balance is needed between a 'hard' and a 'soft' state to ensure compatibility of the statist strategy, with democratic precepts, and to safeguard against corruption.

Indeed, if the state is truly developmentalist along the lines of a statist strategy then its legitimacy should really depend on its ability to govern the market effectively in a manner that yields tangible economic successes.

More knowledge has been obtained concerning the role certain factors play in the process of economic development, such as human capital, the capability of the civil service, and the political economic relations between the government and lobbies in society. It has become clear that in relation to this latter set of factors the East Asian countries were different from most other developing countries and that the economic success of the East Asian model as compared to economic growth in other regions can be at least partly explained by means of these differences.

4. Conclusion

The general conclusion of this paper is that "market failure" so prominent in development economics is still a problem that warrants government intervention and that since such "failures" differ in intensity, scope and location, a selective set of interventions is required. The most significant lesson has been the central role played by a "developmental state" in the process of development. Thus, it can be noted that in almost every one of East Asian cases, government played a far more active role than typically envisaged in what has come to be known as the Washington consensus. Governments went beyond the conventional prescriptions of sound macro-economic policies, including low deficits and inflation. They put markets at the center of their development strategies, but they were not loath to intervene in markets, or, to use Robert Wade's expression, to "govern markets." The East Asian states set out to create and regulate institutions, which promoted savings and helped allocated resources, including scarce investment. They promoted investments in infrastructure, human capital, and the advancement of technology.

In this regard, simply deregulating and opening up the private sector does not generate sufficient impetus for development if the country is saddled with underdeveloped markets, lack of human resources and technology, and low productivity. In order to initiate an economy trapped in the vicious circle of low income, low savings, and low technology, the role of government is crucial as an external agent imparting order and direction to the national economy.

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