

Chapter 7

The Korean Creative Economy Strategy as industrial policy

This chapter examines recent experiences with industrial policy in Korea and other OECD countries. The merits and demerits of sector targeting are examined. The chapter considers the possibility of jointly pursuing a sectoral and technology-based approach. Drawing on international experience, suitable characteristics of a sectoral approach are also discussed.

Korea has long been regarded as one of relatively few examples of the successful application of industrial policy to achieve economic catch-up. Since the 1970s, successive Korean governments have used a variety of selective-strategic industrial policies to shape the development of the economy. The current Park government, however, has not yet announced such efforts, even though the Creative Economy Strategy includes some aspects of industrial policy. This chapter analyses recent experiences with industrial policy in other countries, and the merits and demerits of sectoral targeting. It also reviews the possibility of pursuing sectoral targeting together with a technology-based approach, and finally recommends how Korea might develop industrial policy under the Creative Economy Strategy.

7.1. Experience with industrial policy in Korea

As set out in the opening sections of the report, Korea has targeted certain sectors of the economy in a succession of five-year economic development plans. Action to support priority sectors has been taken across several policy areas, including innovation and technology, trade and investment, education and training and infrastructure. As the economy has developed, the sectors targeted by industrial policy have evolved. As was shown in Chapter 2 (Table 2.1), the initial emphasis was on light industry, infrastructure and energy but over time the focus has shifted first to heavy and chemical industries, and subsequently to high tech industries, notably consumer electronics.

From the 1990s, Korean industrial strategy became more technology-focused and the emphasis switched more to the promotion of R&D and innovation. The Roh Government of 2003-2008 adopted the Next Generation Growth Engine Programme in September 2003, under which ten high-technology industrial sectors were identified as priorities in Government R&D programmes, the Lee Government of 2008-12 promoted the Green Economy and classified 17 sectors of the economy as “new growth engines”, namely:

- *Green technology.* New and renewable energy, low-carbon energy, advanced water processing, LEDs, green transportation systems, and high-tech green cities;
- *High-tech convergence.* Broadcasting and communications, IT convergence, intelligent robots, nanotechnology, biopharmaceuticals and medical devices, food industry;
- *Value-added services.* Healthcare, education, green financing, content and software, and conventions and tourism.

The Lee government also introduced the Leading Industries Programme aimed at supporting job creation and regional growth by targeting 12 leading industries in the “5 + 2” economic regions.

The present government has so far put less emphasis on sectoral priorities. The Creative Economy Plan includes some industrial policy initiatives, particularly under the sub-strategy for the creation of growth engines to pioneer new markets and new industries. For example, there are initiatives to strengthen the digital content industry (music, movies, games and animation) and the infrastructure for new web-based businesses. Promising sectors with growth potential are to be supported, especially industries based on biomedical, nano and environmental technology and large-scale national strategic industries such as satellites and nuclear reactors. Traditional sectors are not neglected, as support is to be provided by means of a cross-government project to use science, technology and ICT to improve management and productivity in agriculture,

culture, the environment, food, government, infrastructure and safety. The emphasis seems to be to promote the Creative Economy through strategic technologies, and it is not yet clear what role sectoral targeting will play in the Government's Industrial and Technology Policy.

7.2. Recent experience with industrial policy elsewhere

The reduced emphasis on explicit setting of sectoral priorities in Korea is in line with conventional economic thinking about the practical difficulties of picking winners and the dangers of capture by vested interests. However, it comes at a time when, for a variety of reasons, some OECD countries are experimenting with new approaches to industrial policy. Some countries are concerned that their economic growth trajectory has not been sufficiently balanced, with some sectors declining excessively and other sectors taking too prominent a role (see Westlake, 2013). In some cases there are concerns that manufacturing production has declined too much, and that knowledge and capabilities have been irreversibly lost. In various countries there are calls for industrial policies to strengthen specific sectors, technologies or areas of economic activity, such as advanced manufacturing, knowledge-intensive business services or the 'green' economy, with the aim of fostering new sources of economic growth. Warwick (2013) sets out examples of new industrial policy initiatives in a number of countries, discusses the reasons for the resurgence of interest and traces the evolution of industry policy over time, contrasting its most recent incarnation with earlier versions.

Two countries that illustrate the renaissance of interest in explicit sectoral targeting are the Netherlands and the United Kingdom. The Dutch example is interesting because, until recently, the Dutch experience with industrial policy had been more oriented towards horizontal policies – creating excellent framework conditions in terms of macroeconomic stability, competition, entrepreneurship, infrastructure and skills, and an overall environment in which business can flourish. Similarly, the United Kingdom only recently explicitly embraced a formal industrial strategy. However, first in *New Industry, New Jobs* (BERR, 2009) and then in *The Plan for Growth* (BIS and HM Treasury, 2011), successive governments have set out a vision for the UK economy which includes not only horizontal measures but also the identification of key sectors where work will be undertaken to improve capabilities and address barriers to growth.¹

The Dutch 'Top Sectors' approach brings together enterprise and innovation policy, focusing on nine sectors in which the Netherlands occupies a leading position worldwide.² A 'Top Team' has been put together for each sector, consisting of a sector expert (typically a well-known business figure), an innovative SME entrepreneur, a high-ranking civil servant and a representative from a research institution. Action plans have been prepared detailing their ambitions and recommendations and a plan of approach. Parties collaborating in the top sectors have established 19 Top consortia for Knowledge and Innovation (TKIs), which have started to implement the research agendas set out in Innovation Contracts. These include cross cutting agendas on ICT, nanotechnology and the bio-based economy.

In the United Kingdom, the Government is also building strategic partnerships with key sectors (BIS, 2013) and has given particular focus to developing business competitiveness in the following areas:

- *Advanced manufacturing*: Aerospace, automotive, life sciences and agri-tech;
- *Knowledge-intensive traded services*: Professional/business services, the information economy and internationally traded aspects of education;
- *Enabling industries*: Oil and gas, nuclear energy, offshore wind and construction.

Sector strategies have been published for each of these 11 areas.³

Other countries to have adopted a selective sectoral approach include Japan which in 2010 adopted a new industrial policy plan (METI, 2010) targeting five strategic areas: infrastructure-related and infrastructure system exports; environmental/energy problem-solving industries (including green vehicles); culture (fashion, food & tourism); medical and healthcare; and advanced areas traditional to Japan (robotics, space, aerospace).

In contrast to older, more traditional approaches to industrial policy, the newer approaches typically put more emphasis on instruments based on improving systems and, in particular, interventions designed to build networks, improve co-ordination and secure strategic alignment. At a time of fiscal austerity in many countries, they typically involve a shift away from support for single firms, state aids, tariff protection and product market-focused interventions. Government's role is primarily to act as a facilitator, both to enable closer co-ordination between individual economic agents and to allow for experimentation in the economy. The idea is to move away from one-time attempts to "pick winners" and instead design better processes for search and "self-discovery" of ways to promote growth. In the process, it is accepted that mistakes are inevitable: the policy challenge is to design governance procedures to detect and correct them and to manage the associated vested interests (Rodrik, 2008).

7.3. Merits and demerits of Sector targeting

There is still ongoing debate for and against targeted industrial policy, and the debate is centered on what advantages there are in following a sectoral approach and what are the risks and limitations of such an approach. Empirically, the evaluative evidence in favour of sectoral targeting is scattered and ambiguous (Box 7.1).

The arguments for a sectoral approach may be divided into four broad categories:

First, externalities and other market failures may differ from one sector to another. They may be particularly prevalent in enabling sectors such as ICT or transport infrastructure or in industries with a tendency to natural monopoly, for example the utilities. External spill over effects may be particularly strong in innovation and technology-intensive sectors such as electronics or aerospace. Taking account of the diversity of the economy can also help inform the design and delivery of the policy and avoid unintended consequences. Knowledge of how economic conditions vary by sector can even help target horizontal policies, for example skills policy or spatial planning policy, more effectively.

Second, because sectors vary in the market conditions and constraints they face, they also vary in terms of what needs to be done to upgrade their capabilities. The strategic concerns of the automotive or electronics sector may be very different from those of the creative industries or renewable energy sector. A sectorally differentiated approach to removing constraints and upgrading capabilities may be required, for instance in areas such as technology policy and skills.

Third, in many areas, government has a direct sectoral interest in the sense that government policy is actually delivered through the specific contribution made by certain sectors of the economy to the policy goal. This is true in areas such as climate change policy where government objectives can only be achieved with the active participation of industries such as construction, transport and renewable energy. More generally, government procurement plays an important and sometimes dominant role in sectors such as defence, education, healthcare, other forms of social provision and some areas of transport.

Fourth, businesses are themselves often organised by sector, as can be seen by the number of sector-specific trade bodies. Trade associations or other sector bodies provide a natural conduit for government in its dealings with business. Working with business within and across sectors, government can play a role as a facilitator and help address the co-ordination and systems failures that hold back economic performance.

In principle, government could pursue a sector strategy for each and every sector of the economy, varying the approach according to the economic conditions and constraints, in line with the considerations above. In practice, however, there is a need to focus, for the simple reason that the resources available, whether for financial support, technology development or the design and delivery of policy, are limited. Setting sectoral priorities is then a way of ensuring that policies are fully aligned across government departments responsible for diverse policy areas including technology, skills, infrastructure, tax and regulation. In the absence of high level strategic priority-setting, departments and agencies will still have to make choices, but there is no guarantee that this will be done consistently or effectively. Attempts to attract foreign direct investment are arguably more likely to be effective if global investors can see that there is a joined-up approach to policy affecting the sector in which they are being asked to invest.

There are of course risks. Even if the need for a sectoral approach can be identified, governments may lack the capacity to intervene or may not be able to do so in a cost-effective way. Governments do not have the information or expertise required to pick future winners and political priorities may take precedence. There is a risk of capture by vested interests and policy may become subject to undue influence from lobby groups and large corporations. The sectoral approach inevitably favours existing players and leaves out potential entrants – support goes to the “incumbents” and not the “insurgents”. This consideration is critical in the Korean context, where large firms play a dominant economic role and where the Creative Economy Strategy is seeking to bring increased dynamism among new firms and SMEs. There is also a danger that a sectoral approach can become overly bureaucratic and slow the decision-making process. Finally, there is the criticism that a sectoral approach is obsolete in a world of rapidly changing technology and global value chains – industrial policy in these circumstances might better focus on tasks and activities (e.g. IT, logistics, and design) rather than sectors. Such considerations lie behind the shift away from explicit industrial targeting in Korea over the last two decades, following the mixed success of the heavy and chemical industries drive in the 1970s. However, the practice of designating certain industries and technologies as ‘strategic’ and providing targeted support has continued, albeit much reduced in scale and scope.

Box 7.1. Sectoral targeting: Evidence of efficacy

The evaluation of sectoral approaches is conceptually and empirically challenging. The evidence is at best scattered and dispersed, and meta evaluation studies are scarce. There are a number of reasons for this. Industrial policy (within which sector targeting is subsumed) often has multiple objectives, and uses multiple instruments, so its impact may be difficult to disentangle from other influences. Data problems and time lags in policy impact also hamper evaluation. That said, and although opinion is divided, it is possible to draw some conclusions about the circumstances in which industrial policy is more likely to be successful and how it should be designed and delivered. Similarly, for clusters policy – which, like sector policy, combines different policy measures – it has proved possible to draw some inferences from the evidence about what works and does not work and the priorities for policy (see for example Potter and Miranda, 2009).

It is rare for evaluations of industrial policy to attempt to identify the value added by sectoral targeting *per se*. Moreover, even if there were clear conclusions about the value added by sectoral targeting, the findings would be more than usually context-dependent. A successful case of sector targeting in the presence of technology targeting and sound framework conditions might not read across to a situation where the institutions were different and the authorities were relying on sector targeting alone.

Another reason why the evidence on sector targeting is incomplete is that sector targeting on its own is not a well-defined policy. If a sector is identified for support, the instruments used need to be specified and the choice can range across the whole spectrum from traditional state aids through factor subsidies to support for public private partnerships or a co-ordination and facilitation role.

Given the patchy evidence and the methodological limits to gauging the efficacy of sectoral targeting, the conclusions that can be drawn about sectoral targeting are not very different from the general conclusions that can be drawn about industrial policy:

There are undoubtedly successful examples of explicit sectoral targeting. The rise to prominence of Korean electronics firms such as Samsung and LG in the 1990s can be traced to support provided in earlier decades. Rodrik (2004) pointed out that there are examples of successful targeting not just in East Asia but Latin America as well and commented that “it is not true that there is a shortage of evidence on the benefits of industrial policy. To the contrary, it is difficult to come up with real winners in the developing world that are not a product of industrial policies of some sort”.

However, it is more difficult to find systematic evidence of a relationship between sectoral support and sectoral performance. Studies by Beason and Weinstein (1996) and Lee (1997) failed to find a clear association between sectoral support and total factor productivity growth in Japan and Korea respectively during the years of rapid catch-up and growth.

New industrial policy puts less emphasis on product market support measures and more emphasis on support for technology and skills, public private partnerships and a government role in facilitation and co-ordination. These approaches are newer and by their very nature harder to evaluate.

Sectors offer a natural conduit for pursuing this form of industrial policy and the targeting of key sectors will help policy makers prioritise their efforts and also help create clarity of vision and an alignment of interests around shared objectives

Combining sector with technology approaches

Another lesson from recent international experience of industrial policy is that countries may focus, as indeed Korea has tended to do, on a strategic choice of technologies rather than sectors. The United Kingdom effectively does both. The United Kingdom Government has identified 11 sectors with which it has developed strategic partnerships and has also identified “eight great technologies”⁴. Sector partnerships and technologies are in fact two strands of the United Kingdom’s overall approach to industrial strategy, which comprises commitments to:

- develop strategic partnerships with industry
- support emerging technologies
- improve access to finance for businesses
- work with business to help develop skills that businesses will need
- publish government contracts to provide confidence to business investment.

In the Netherlands, technology policy is more formally incorporated into a sector framework. The TKIs set up by the top sectors are responsible for drawing up roadmaps for the relevant technologies and part of the Government's research funding is earmarked for top sector projects, alongside fiscal incentives for collaborative research. However, more general technology foresight exercises are also still conducted and only a proportion of the overall research budget is routed automatically to the top sectors.⁵

The present Korean Government has so far put more emphasis on technology targeting than sector targeting. The 30 priority and 120 strategic technologies that have been identified cover energy, environment, ICT and healthcare fields. More specifically, priorities include smart grids, carbon capture and storage, big-data applications and personalised pharmaceuticals. MSIP plans to draw up a strategic roadmap for the 30 priority technologies, together with other ministries.

There are several advantages of adding a sectoral dimension to a technology approach. One is that it can provide a vital channel linking science and technology to the needs of industry. As already argued, a sectoral approach also allows the government to take account of the heterogeneity of the economy. It can give insight into the nature of sector-specific market failure and real world understanding of how policy should be designed and delivered. Businesses sharing common suppliers, markets and market conditions often have a natural conduit for interaction with government and the research community through their sector councils or trade bodies. And setting sector priorities can be useful in focusing scarce policy resources, promoting a more holistic cross-government approach and improving the effectiveness of policies in related areas, for example inward investment promotion, education and training or the design of regulation.

Where both a technology dimension and sector dimension are present in industrial policy making, the risk is that priorities conflict or that policy appears less coherent, with multiple stakeholders and multiple demands on the government. However, as can be seen from the examples of the United Kingdom and the Netherlands, it is not impossible to join up the two approaches. Whether industrial strategy is seen primarily through a sector lens or a technology lens, there can be advantages in being systematic and explicit about the choices being made, as long as policy makers remain aware of the risks.

Considerations affecting the design of a sectoral approach

If a government wants to seek sectoral policy, it will need to think about the governance arrangements and how sectors should be selected. On the first of these, one lesson of the new industrial policy literature is the importance of a partnership approach involving business, government and the research community, through arrangements such as public private partnerships, industry councils and other networks. In the Netherlands, Top Teams play this role and in the United Kingdom each of the sector strategies is guided by a strategic partnership between government and industry. Korea will need to have in place similar institutional arrangements or other governance mechanisms.

As regards the selection of sectors, ideally this should be done in a systematic way according to agreed criteria. In the Netherlands, the sectors identified by the Government were those that (a) occupy a leading position worldwide, (b) are knowledge-intensive, export-oriented and usually subject to sector-specific regulation and (c) have the potential to make an important contribution to societal needs. The establishment of head offices in the Netherlands was seen as helping to sustain the country's strong economic profile, which makes it important for all top sectors.

In the United Kingdom an attempt was made (BIS, 2012) to identify sectors where: societal drivers indicate there is likely to be significant increasing domestic and global demand; United Kingdom business has a comparative advantage and the capabilities to exploit new market opportunities; and, where for theoretical and practical reasons a sector-based approach has a clear role.

Drawing on Dutch and United Kingdom experience, considerations that Korea should take into account in selecting sectors might include:

Future drivers of growth, including: future needs arising from societal challenges such as climate change and sustainability; population aging and other demographic changes; the opportunities afforded by globalisation and the competitive challenge from emerging markets; and, new developments in technology. While the market might be expected to respond to these needs, information asymmetries, uncertainty and externalities may lead to under-investment in the absence of government action.

- *Sector strengths*, which can be assessed using metrics such as total factor productivity, export performance, revealed comparative advantage and revealed technological advantage. Government intervention is more likely to be effective in sectors where the economy already displays evidence of comparative advantage.
- *Sector linkages of regional or national importance*. Where a sector is highly interconnected with other sectors, through purchases/sales of goods and services, exchange of knowledge and ideas, technology or infrastructure, then spillover and system or network effects are likely to be more important.
- *The prevalence of market failure*. Sectors vary in the extent to which they are affected by market failures such as innovation and knowledge-related externalities, labour market imperfections, natural monopolies, or information failures (e.g. industries with large financing requirements and long investment cycles).
- *The importance of the sector in the provision of public goods or in meeting public procurement needs*. Government already plays a significant role in these sectors and Government or regulatory failure may be more likely in these sectors.
- *The effectiveness of government action*. Without access to the appropriate levers, government intervention is unlikely to be cost-effective and the risk is that government failure might replace market failure.
- *Continuity of policy*. Companies plan for the long term and policy instability can disrupt investment planning and inhibit risk-taking.

According to this framework, the choice of sectors should depend on an assessment of future needs, sector strengths, and the opportunity and capacity to intervene successfully. It is the combination of factors that is important – there is no point in selecting a sector based purely on future needs if there is no evidence of potential com-

parative advantage or of market or systems failure. Again, it is a tenet of the new industrial policy literature that government is not uniquely well placed to make these choices. Decisions need to be made in consultation with industry and the research base, and in the full knowledge that mistakes may be made and adaptation needed.

7.4. The Creative Economy and sectoral priorities

Following a period during which sectoral approaches to industrial policy fell into disrepute in many countries, there is now a resurgence of interest in ways of using industrial policy to support growth and employment, with a particular focus on advanced manufacturing and other high value added sectors of the economy. It is ironic that this comes at a time when Korea is putting increased emphasis on a technology approach which is more horizontal and less sectorally focused than in the past. So what can Korea learn from experience elsewhere? At the outset, it must be recognised that ‘one size does not fit all’. Industrial policy will inevitably be context dependent and it is appropriate to vary the approach according to factors such as the country’s stage of development, institutional features of the business environment and the specific characteristics of the sector being targeted. Given Korea’s stage of economic development and economic structure, an emphasis on services and the creative economy is understandable.

A second lesson from OECD experience is that an approach based on sectors is not the only approach – although the Netherlands and United Kingdom have an important sectoral dimension to their policies, it is not the only dimension, even in these two countries. Increasingly industrial policy around the world may be focused on technologies, activities or tasks, or cross-cutting issues. However the different approaches are not mutually exclusive. It is possible to target technologies, sectors and wider goals at the same time, on the proviso that there must be sufficient instruments available to policy makers and policy must be integrated to ensure consistency and clarity of purpose.

There are various ways that the Korean Government might choose to combine the Creative Economy priority with a sectoral dimension to industrial policy. One way would be to designate the creative industries as one of the priority sectors for industrial policy. The Netherlands has done this explicitly, with the creative industries named as one of the nine top sectors. Progress, however, has not been as fast as in some other sectors, partly because the creative industry sector consists of a large number of relatively small and relatively new SMEs, with no history of organising in this way. The United Kingdom has not made creative industries a priority for a strategic partnership approach, but has set up a Creative Industries Council to promote a sustained dialogue between government and the sector. In Korea, the Lee Government’s New Growth Engines included a number of creative industries, namely broadcasting and communications, digital content and software. This approach could be continued or extended.

An alternative (and possibly complementary) approach to ensuring consistency between the Creative Economy Plan and a sectoral approach to industrial policy would be to add an additional requirement to the criteria set out for identifying priority sectors, namely a sector’s potential contribution to the wider goals of the Creative Economy Plan.

The emerging consensus is that the risks associated with selective-strategic industrial policy can be minimised through a ‘soft’ form of industrial policy, based on a more facilitative, co-ordinating role for government, with the emphasis on systems, networks, institutions and capabilities. Successful implementation of such an approach will require well designed plans for monitoring and evaluation, especially of strategy and policy

programmes. Ideally, such plans should be put in place before the programme begins, so that data gathering and real-time tracking of progress against deliverables and outcomes can take place from the outset.

Korea has considerable experience with the successful application of more traditional forms of industrial policy. For new industrial policy, institutional arrangements may need to evolve to support a more facilitative role for government, drawing on business expertise and existing links with business while maintaining the openness of the system to new entrants and particularly to SMEs. It will also be important to have clarity about the objectives, goals and mechanisms of industrial and technology policy and in particular about the role of sectors within it. Finally, monitoring and evaluation arrangements should be put in place as early as possible to enable an iterative approach to the design of effective interventions.

Notes

1. O’Sullivan et al (2013) say that in the United Kingdom “the evolution of policies towards industries over recent years shows a marked trend from so-called ‘horizontal’ measures and regional focus to a more strategic national approach in partnership with industry to key sectors”. They also note that the approach represents “a significant departure from previous patterns not least by providing a clearer vision and working as important catalysts for new investments and public-private dialogue”.
2. The nine sectors are: agri-food, horticulture and propagation materials, high tech, energy, logistics, creative industries, life sciences, chemicals, water. Head offices were later added as a priority.
3. www.gov.uk/government/organisations/department-for-business-innovation-skills/series/industrial-strategy-government-and-industry-in-partnership
4. Willetts (2013) lists the technologies as: the Big Data revolution and energy-efficient computing; satellites and commercial applications of space; robotics and autonomous systems; life sciences, genomics and synthetic biology; regenerative medicine; agri-science; advanced materials and nano-technology; energy and its storage.
5. For example NWO, the national research council of the Netherlands, expects to devote approximately 40% of its budget to the top sectors. This funding leverages part of the block-funded fundamental research by universities and research institutes. The applied research institutes in the Netherlands tie most of their research to the mission-oriented top sectors approach and other support for specific Top Sectors comes from the relevant ministries and through TKI support (MEA/MECS, 2013).

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