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The East Asian Experience:
The Poverty of “Picking Winners”

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ABSTRACT

Many leaders in Africa argue that East Asia's success in economic growth and development is due to special prowess in "picking winners." That is, the state is assumed to have adequately identified future growth areas and effectively channeled investments into specific firms or industries. We argue, however, that this assessment is not accurate. Even where states have attempted to follow this path, they have frequently made a hash of it. The wrong sectors or firms have been identified. Public monies have been squandered or siphoned off for private enrichment. Instead, the successful East Asian states have focused their attention on consistently creating competitive market environments. They have invested in the hard and soft infrastructure (like road, ports and education) necessary for success in an increasingly globalized economy. It is these types of policies that currently hold out the greatest prospects for growth in Africa.

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The East Asian Experience:The Poverty of "Picking Winners"

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Barry Desker and Deborah Elms

The East Asian Experience:The Poverty of "Picking Winners"

Barry Desker and Deborah Elms[1]

Achieving economic growth and development is a tricky, complex business. Accurate predictions of success are equally fraught with dangers. For example, an informed pundit fifty years ago would likely have argued that the economic success stories of Asia were going to be found in the Philippines and Burma, while South Korea and Taiwan would be laggards.[3] As we know half a century later, South Korea and Taiwan have vaulted into the ranks of the developed world, while the Philippines continues to struggle and Burma has become an economic basket case.

What did institutions like the World Bank and others that were triumphantly predicting success in the Philippines or Burma miss? Our explanation is that the success of Asian "Tiger" states like South Korea, Taiwan, Hong Kong and Singapore is not attributable to some special powers of picking the right "winners." Government officials in South Korea and the Philippines used a variety of strategies to encourage economic growth but the Tiger states were no more or less successful at choosing industries and channeling investment than the government in the Philippines. Some attempts at "choosing winners" did lead to growth, but most did not. Even when growth took place, it often did so at great expense or at the cost of less growth in some other arena. State governments are generally less efficient and less successful at discerning opportunities than markets.

The crucial elements to economic success are exercising good governance, nurturing sufficient state capacity to implement desired policies, following continuous outward-oriented economic policies, setting up appropriate conditions for market mechanisms to succeed and then getting out of the way.

This does not, however, imply that there is a simple blueprint available that equals good governance. Each of the Tigers (and each of the successful areas of

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[2] Conference co-sponsored by The Brenthurst Foundation of South Africa, IDSS at NTU in Singapore, and the Konrad Adenauer Stiftung of Germany.
[3] See "Asia's Emerging Economies," Special Report, *Economist*, Vol. 321, November 16, 1991.

growth and development in other Asian states) confirms that there are multiple paths to good governance. Setting up an appropriate structure requires a keen awareness of local conditions, caution in setting up necessary and appropriate institutions, laws and regulations governing the marketplace, a careful nurturing of desirable traits in government actors like an outward orientation, and commitment to market forces and incorruptibility. Once these factors are in place, conditions are ripe for economic growth and development. Without them, states will falter under the onslaught of globalization.

The priority is creating an appropriate environment for economic development. This does not mean handing over power or resources to a selected few, but rather a focus on international competitiveness. Because most of the Asian economies had limited domestic market potential throughout most of the past 50 years, governments that oriented policies outward have produced significantly better results than those that focused attention inward. At every step, governments that created conditions for internationally competitive individuals and firms boosted prospects for rapid economic growth and development. Those that did not, have languished.

We begin our discussion by laying out some key assumptions. Our path to success relies heavily on liberal economic theories of states and market behaviors. We then discuss specific examples of the perils of "picking winners" in a variety of states. We highlight key factors that we believe do a better job of explaining success and failure in the Asian context and conclude with a short section of relevant policy prescriptions for government actors.

Liberalism as the Base

Our most basic assumption lies at the core of liberal economic theory. It is that markets are better at ferreting out opportunities than any other form of economic organization. Individual actors and firms, responding to the incentives of demand, will start or ramp up production to meet the needs of potential customers. Some of these actors will become successful in meeting these market demands and build thriving firms and industries. Others will not and will shift their resources into more productive areas in the future.

The power of the market can only be unleashed, however, with sufficient attention to private property. If I cannot be certain that my small plot of land is my own and will remain my own in the future, I will not have incentives to invest in it. I will not buy fertilizer for my fields or build a warehouse for my inventory. If there is no avenue for me to shift my labor, I will not have the incentives to receive a better education or upgrade my skills. If I cannot be certain that my shop will remain open next week, I have no reason to invest in new products or in searching for new customers and suppliers. I must also, as Hernando de Soto has argued, have some suitable means of representing my property so that I can use my land deed, for example, to obtain a business loan or easily sell it to people I do not know.[4]

The need to ensure that private property rights are protected gives rise to the importance of an adequate legal system. It need not be identical to others—it could involve multiple court jurisdictions and the development of a cadre of trained lawyers, or it may involve mediation by village elders. It should include respect for traditional (pre-colonial) land rights. The important point is simply that the legal system must be seen as a fair and legitimate place to adjudicate disputes over ownership.

Many will argue that the East Asian success stories like South Korea did not follow liberal economic tenets. Governments did not merely set up conditions for the marketplace and then get out of the way. They were not laissez faire, but were actively involved in channeling resources and developing firms and industries. This is certainly true in some areas of the marketplace like steel or shipbuilding. Singapore's government, for example, was actively involved in the early 1960s in building the first manufacturing plant, NatSteel, on the island.[5]

The East Asian economic crisis of 1997/98 especially exposed the dangers of following an approach of channeling investment too narrowly to specific firms or creating too many state-owned industries.[6] South Korean growth came to a screeching halt. The social costs and dislocations caused by the fallout were significant. In the aftermath, the Korean government has pursued much more "hands off" policies, including letting some of the biggest conglomerates (*chaebol*) in Korea declare bankruptcy, and allowing the marketplace rather than government to determine success. The Korean economy has rebounded more quickly than anticipated.

[4] Without an adequate means of representing property, it becomes "dead" capital and cannot be used efficiently and productively. See de Soto, *The Mystery of Capital* (New York: Basic Books, 2000).
[5] See Ngiam Tong Dow's speech on the Singapore government's efforts to shape their economic destiny. Excerpts in *Straits Times* (Singapore), October 24, 2005.
[6] We are not, however, arguing that picking winners somehow lead to the Asian economic crisis, just that it provided another clear illustration of our basic argument—governments rarely do a good job of narrowly focusing policy on "picking winners."

The crucial point that appears to connect the success stories of East Asia to one another is that governments have had success when they focus their efforts on creating conditions for a highly competitive marketplace. Singapore's NatSteel was turned over to market forces and sold to Tata Steel of India. Singapore, Malaysia and Taiwan, for example, built extremely successful markets in electronics with government assistance. Governments helped the market by creating industrial parks, training skilled technicians, and expanding university education in information technology fields, electronics and engineering. Something similar appears to be happening today with biotechnology in South Korea and Singapore with emphasis on stem cell research and tropical diseases. Singapore, for example, has created a special complex, Biopolis, for biomedical research and development and has aggressively sought multinational firms and local entrepreneurs to take up office space and share synergies that come from having skilled workers mix with others.

Those states or sectors where the government has attempted to shelter domestic firms from competition—and especially from foreign competition—have had less success. Malaysia, for example, has a long history of sheltering its domestic auto manufacturer, Proton, from competition. The outcome is extremely inefficient, as only Malaysian consumers buy Protons and these cars are priced considerably higher than they would be in the wake of competition. Protecting "infant industries" rarely succeeds, largely because the "infant" never grows up and the state finds it increasingly difficult to throw open previously protected markets.

People, as William Easterly has argued persuasively, respond to incentives.[7] Government does have a crucial role to play, but its efforts must be in creating the appropriate backdrop and conditions for competition to thrive. This role for government has become even more critical over time. New global trade rules in the World Trade Organization (WTO) and elsewhere have made it ever more difficult for states to directly channel investments to specific firms and industries. But global trade rules do not prohibit the kinds of outward-oriented, highly competitive strategies we recommend. This is the arena for state activism today.

[7] Easterly, *The Elusive Quest for Growth* (Cambridge, MA: MIT Press, 2001).

The Poverty of "Picking Winners"

The importance of creating a system that protects private property and a legal structure to resolve disputes is central to understanding the success of some states in Asia. This thesis stands in marked contrast to a contending explanation for Asian success—that success comes from government prowess in "picking winners."

This alternative explanation argues that most of the developmental successes of the Tigers and others stems from active government involvement in the economy. Government can either work directly in the marketplace, through state-owned enterprises, or work indirectly by channeling resources or developing policy plans in concert with industry. In either approach, government actors in Asia have done an outstanding job of upending the tenets of liberalism (government should get out of the way and let markets decide) and have successfully guided their economies on to high and sustained economic growth.

To a certain extent, government involvement in the economy is true in all states, even the most liberal. In the United States, for example, which follows a basically liberal economic model,[8] government actors can fashion legislation or create regulations that favor one industry or approach over another. By electing not to tax gasoline as high as the Europeans, for instance, the U.S. government provides little incentive for firms and industries to search for alternative sources of energy or devise automobiles with ever-increasing gasoline mileage.

But this misses the overall point. Even when governments have tried to intervene in the marketplace, they frequently fail. These failures range from small scale economic challenges to large and costly investments of public funds in ultimately losing enterprises.

Three examples of unhelpful state interference in the economy can be drawn from the broadly liberal United States and the European Union. The U.S. government has been involved in a long process of trying to retain textile and footwear jobs in America. Liberal economists have repeatedly argued that the United States is simply uncompetitive in nearly all sectors of the textile industry. Labor costs are too high relative to elsewhere and, since labor constitutes the bulk of investment in textile production, this is one industry that ought to be allowed to die off in the United States.

[8] Liberal with a small "l" and not liberal as in Democrat in the American context.

American workers should be shifted to other industries where the U.S. retains a comparative advantage like services.

Yet for political reasons, the economic solution has been deeply resisted. Instead, the U.S. has sought to protect the textile industry through a combination of protectionist barriers and limits on imports as well as a host of local, state and government subsides to industry. The economic cost of this protection and government interference is significant. After more than 40 years of assistance, the number of garment workers in the United States has fallen from over a million to fewer than 300,000. The average cost per job saved has been nearly $200,000.[9]

A similar story can be told about U.S. government interference in the domestic steel industry. Repeated protectionist approaches have been unable to stem the decline in jobs or the closure of steel mills throughout the United States. This has not stopped the government from trying. Indeed, the government has been trying to stem job loss since the late 1960s with a variety of plans. One such attempt, the Steel Revitalization Act of 2001, has maintained jobs at an average of $360,000 for each of the 23,500 jobs saved.[10]

European farm supports provide a third example of government interference in the marketplace with potentially disastrous results. After decades of attempting to circumvent market signals, the European Union now spends the majority of its budget attempting to prop up the uncompetitive farm industry. Despite a total employment of seven percent of the European workforce in agriculture, half of the EU budget is still spent on agricultural supports. The oft-cited statistic states that each European cow receives $2.50 a day each in subsidies. Even the United States and the European Union, with substantial governmental capacity, rarely manage to succeed when they intervene in the marketplace. Government involvement in micromanaging the economy has significant consequences.

The spectacular rise and fall of Daewoo, a South Korean conglomerate, also illustrates the pitfalls of ignoring market signals. In the early 1990s, Daewoo was

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[9] "Protection's Price," Federal Reserve Bank of Dallas, Annual Report 2002. Protection in other industries carries an even higher price tag. The Bank reports that 216 jobs were saved in benzenoid chemicals (used in producing suntan lotions) at an average cost of over $1.3 million each, or 226 jobs were saved in the luggage industry at a cost of nearly the same amount. The United States has even spent $142 million dollars to protect the costume jewelry industry, saving just over 1,000 jobs for American workers.

[10] These workers were displaced between 1997 and 2000. Gary Clyde Hufbauer and Ben Goodrich, "Steel: Big Problems, Better Solutions," Institute for International Economics, July 2001.

looking to expand production of its automotive unit. The company went on an unprecedented buying spree as it attempted to quadruple car production from 500,000 units to 2 million autos per year. It bought a truck factory in southern Poland for $700 million, a car plant in Romania for $300 million, a Czech truck manufacturer for $200 million, and a 51 percent stake in a Romanian shipyard. The most significant acquisition, however, was its purchase of Fabryka Samochodow Osobowych (F.S.O.) for $1.1 billion in early 1996.

The FSO purchase left industry analysts scratching their collective heads. General Motors (GM), the world's largest auto manufacturer, had also been in competition to buy the Polish facilities. GM had spent five years in talks about the acquisition of one of the least-efficient auto manufacturers in the former communist country. As part of the deal, GM argued it would have to eliminate 22,000 jobs to make the company competitive.

But Daewoo not only promised to pay more money for the company, it also pledged a three-year employment guarantee. Daewoo also said it would keep producing outdated Polonez autos and use the existing factory facilities to build new Daewoo cars. The deal with Daewoo was accepted.

Yet at the time, Daewoo had lost over $460 billion in the previous four years.[11] It was the third largest car manufacturer in Korea with expansion plans set for Eastern Europe, India, Iran, the Philippines, and Vietnam. The head of Daewoo, Kim Woo Choong, said he was financing the investment in FSO by borrowing 60 percent of new ventures from international banks, with the rest of the funds coming from new equity issues, European bonds and profits from new acquisitions.[12] But none of the foreign plants were profitable. Car sales never matched any projections from the company.

When the Asian economic crisis hit South Korea in December 1997, a fuller picture of Daewoo's finances was revealed. The banks began calling in debts. With no profits, the company could not pay. The Chairman disappeared. The company foundered and finally imploded in early November 1999. It was the world's biggest bankruptcy, with Daewoo debts estimated at $73 billion or one fifth of Korea's gross domestic product.[13] Unraveling the finances took years, and creditors were forced to

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[11] John Burton, "Daewoo Motor Drives Deep into Eastern Europe," *Financial Times (London),* September 6, 1995.
[12] Jane Perlez, "European Beachhead for Korean Ambition," *New York Times*, July 24, 1996.
[13] John Burton, "Controlled Implosion," *Financial Times (London),* November 5, 1999.

wait. In the end, the South Korean government's hands were evident in the complex financial ties between Daewoo and its various bank creditors.

An industry spokesperson for General Motors said recently that GM had been highly surprised by Daewoo's offer for FSO in the mid 1990s.[14] Careful analysis of the market in Poland and Eastern Europe, coupled with a thorough study of the firm's debts and liabilities, had lead GM to make a conservative offer designed to restore profitability. Daewoo's offer was considerably higher and came with greater benefits for local employees. The offer simply did not make economic sense. It was only after the collapse of Daewoo that GM realized they were not simply competing with a private company over FSO, but with a company blessed with the Korean government's financial backing and support. Against these deep pockets, GM could not compete. But neither, as it turned out, could Daewoo.[15]

Another classic example of government's challenges in guiding the economy comes from Japan's efforts to develop high definition television (HDTV). Japan worked for more than 35 years on a project to develop HDTV and turn Japanese firms into world leaders in this area. HDTV sets can receive five times more video information than standard television sets and provide a better, more realistic range of colors and improved quality sound. HDTV, therefore, represented the next stage of the evolution of television and the benefits of a new system were apparent decades ago.

The Japanese government began work in conjunction with private industry on HDTV in 1964 and spent over US$1.5 billion in the first 25 years attempting to commercialize the technology.[16] The government-owned broadcasting corporation, NHK (financed by a mandatory subscription fee from each television household), began research on a new approach to television production and broadcasting in 1970. NHK directly coordinated the research efforts of equipment suppliers. The government also provided low interest loans and tax advantages for additional research and development, the production of HDTV materials and for the use of products associated with HDTV. The government also created holding companies to purchase the expensive equipment needed to create programming and then leased this

[14] Personal interview with author, September 2005.
[15] In one of life's ironies, some of Daewoo's investments, including the manufacturing plant in Vietnam, were bought up by General Motors. The Polish FSO investments were liquidated to create some revenue for anxious creditors as no buyer could be found for the factories.
[16] "The Race for HDTV," *Newsweek*, Vol. 118/25, 66.

equipment to producers and broadcasters.[17] To encourage Japanese consumers to purchase new, expensive HDTV models NHK began using its satellite to broadcast eight hours of daily HDTV programming in 1991.

With such an early start, the Japanese elected to use analog technology for their systems (the Europeans were following a similar program and also selected analog systems). The American government, by contrast, did not become directly involved in creating HDTV standards, nor did it channel public investments into research and development.[18] Instead, several private consortia developed four different digital compression systems and did not rely on existing analog standards.

The issue of standards became critical. Only if the United States and Europe opted for analog technology would the Japanese investment in HDTV fully pay off.[19] If the American system of digital technology were selected for the North American marketplace, it would be impossible for Japanese producers to recoup the investment of public and private funds into the Japanese system that operated only in the relatively small domestic marketplace in Japan. In the end, the Federal Communications Commission (FCC) in the United States selected the digitally-based standards for use. These standards, argued the FCC, gave American consumers the best possible outcomes over the long run, since it allowed for a smooth transition from traditional television to HDTV sets, provided continued opportunities for local programming and broadcasters, and accommodated changes in the future. Market forces followed, and the systems developed in Japan and in Europe never became a commercial success.

Governments certainly have the power to influence market outcomes through setting standards and regulations. In HDTV, the FCC decision ultimately reverberated worldwide as most firms switched to systems matching the FCC-approved standards.

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[17] Joy Butler, "HDTV Demystified: History, Regulatory Options and the Role of Telephone Companies," *Harvard Journal of Law and Technology*, Vol 6, 1992.

[18] Cynthia Beltz notes that American taxpayers ultimately paid less than $200 million for HDTV, while Japanese and European public funds amounted to $1-2 billion. "Lessons from the Cutting Edge: The HDTV Experience," from *High-Tech Manuevers: The Industrial Policy Lessons of HDTV* (Washington, DC: American Enterprise Institute, 1991). The HDTV experience did, however, set off a heated debate in the United States, as many argued that the United States ought to better integrate government with business. Some even went so far as to argue that the United States could no longer compete with Japan unless the U.S. created its own institutional equivalent of Japan's Ministry of Trade and Industry (MITI).

[19] The Japanese did not appear to learn from the HDTV experience either, as their mobile telephone network runs on standards different from either the United States (analog) or Europe's GSM (that has gone on to become the global standard). In both cases, Japan has suffered from its isolation and lack of interoperability.

This makes the use of standards a potentially powerful tool. In this case, the FCC acted prudently by opting for a standard to benefit the broadest range of American consumers. The FCC did so without regard to the origin of the technology—it could just as easily have selected a Japanese or European system. To the extent that a government elects to intervene in the marketplace, selecting broader standards and regulations designed to foster greater competition is always preferred.

States do not always use regulations and standards to foster competition, however. State governments frequently use these tools to restrict access to the marketplace. For example, Japanese government officials used to argue that because Japanese intestinal tracts were different from others, it was prudent government policy to restrict imports of foreign beef for the health and safety of Japanese consumers. Or that foreign skis should be prohibited since Japanese snow was different from foreign snow and would cause unnecessary accidents on the ski slopes. While legitimate health and safety issues ought to be considered, the use of standards and regulations should be kept to a minimum. Otherwise, consumers are deprived of the right to make choices about their own purchases in the marketplace. It may turn out that Japanese consumers simply prefer highly marbled, carefully nurtured beef products and shun cheaper, leaner cuts of meat from Australia, Brazil or the United States. But consumers should be allowed to make this determination without undue government interference.

In an increasingly globalized economy, it gets ever harder for states to "pick winners." Even if a state were successful in discerning the future direction of the marketplace and put into practice significant investments in research and development, and effectively coordinated and focused the activities of all potential players in the marketplace, there is no guarantee that the returns from this investment will flow to domestic firms and industries. In a world where it is difficult to determine the "local" content of any complex item or pinpoint one purely domestic element of a service like tourism, picking winners may simply be anachronistic.

This feature makes it all the more critical that states aggressively court foreign direct investment (FDI). Potential foreign investors are more likely to carefully scrutinize markets and firms before putting down money. Domestic investors may elect to write off their investments in one sector, given potential gains elsewhere, especially in developing "political goodwill" with the domestic government.

A series of governmental decisions in Singapore illustrate how government actions can lead to unintended consequences with potentially significant economic implications. After Singapore became independent in 1965, the government announced a concern with the rise in population on what was already a small, densely populated island. By the early 1970s, it had created a set of programs collectively known as "Stop at Two." These programs were designed to raise the costs (economic and otherwise) of having third or fourth children. It included policies like no maternity leave for civil servants after the first two babies, higher birthing fees starting with a third child, and top priority for school entrance at the most desirable primary schools for first or second born children.

Whether directly attributable to the "Stop at Two" program or not, by 1975 Singapore's birth rate had fallen so sharply that it was below the replacement rates. One government minister argued that without changes made, Singaporeans would be witnessing their own extinction.

By 1986, the government had to shift gears, replacing the previous programs with "Three or More" policies designed to encourage women (particularly educated women) to have at least three children. The economic incentives provided by the government for babies continues to this day, including tax rebates, day care subsidies, and preferential placement in housing for couples and families (over singles).

Despite nearly two decades of programs designed to raise the birth rate, however, the government of Singapore has struggled to change individual decisions over having children. Low birth rates are common in most advanced industrial states as well, but the legacy of the "Stop at Two" programs appears to reverberate in Singapore well after the programs were halted. Most Singaporeans recall vividly the efforts to limit family size and appear to have taken to heart the arguments in favor of smaller family sizes.

The case of coconuts in the Philippines offers two cautionary lessons about the challenges of "picking winners." First, states have an extremely difficult time properly organizing the market to meet expectations. Second, when states do elect to intervene in the marketplace, it sets up powerful incentives for large-scale corruption among government officials and cronies.

Under martial law in the late 1970s, Eduardo Cojuangco, Jr., a friend of President Ferdinand Marcos, in collaboration with Defence Minister Juan Ponce Enrile, formed United Coconut Oil Mills Inc. (Unicom). Unicom quickly absorbed nearly all coconut oil mills and formed a monopoly of oil exportation. Mills not owned or controlled by Unicom were denied subsidy payments to compensate for price controls on consumer products derived from coconuts. Conjuango also established the United Coconut Planters Bank for financing.[20] With 60 percent of world coconut production and 80 percent of world coconut exports, Unicom quickly became one of the biggest firms in the Philippines.

In 1985, the International Monetary Fund (IMF) and World Bank demanded a breakup of government-backed monopolies. Unicom was dismantled, but Cojuangco was president of two of the five firms that bought out Unicom. He also formed nine trading companies to operate in the five mills and owned 40 percent of each of the trading companies.[21]

Table 1 highlights the potential consequences that flow from a lack of true market forces in coconuts. After rapid growth in the number of hectares harvested from 1970 through 1979, after the formation of Unicom, hectares harvested from 1980 through 2004 remained flat. This is not a consequence of a flattening market for coconuts, however, since other states like India and Indonesia rapidly and consistently increased the area harvested over the entire period from 1970-2004.

Table 1: Hectares of Coconuts Harvested (in Thousands of Hectares)[22]

	1970	1975	1980	1985	1990	1995	2000	2004
India	1,045	1,070	1,083	1,226	1,475	1,833	1,890	1,900
Indonesia	1,258	1,534	1,803	1,975	2,262	2,585	2,837	2,660
Philippines	1,883	2,283	3,236	3,270	3,112	3,064	3,149	3,253

Instead, the figures likely reflect the consequences of monopoly control of a key export for the Philippines in the hands of one, very powerful friend of the government. Under the Unicom system, farmers lacked appropriate market incentives to grow additional coconuts. With the credit system also tied up, independent farmers were unable to access sufficient funds to make large-scale new investments. As a

[20] Cojuangco was later sued by Philippine coconut farmers for using 150 billion pesos in coconut levy funds to buy stocks in the Bank in 1975. He also ran into trouble with some of the same groups in 2003 for using San Miguel funds (which were partially owned by coconut farmers) for his personal presidential campaign.

[21] Cojuangco's tentacles did not stop with coconuts, however, as he also ran the wheat and sugar monopolies and was chairman of San Miguel, the country's largest food and beverage manufacturer.

[22] Source: FAOSTAT data, 2005.

result, the coconut industry as a whole in the Philippines stagnated and other states began to grab larger shares of the global market.

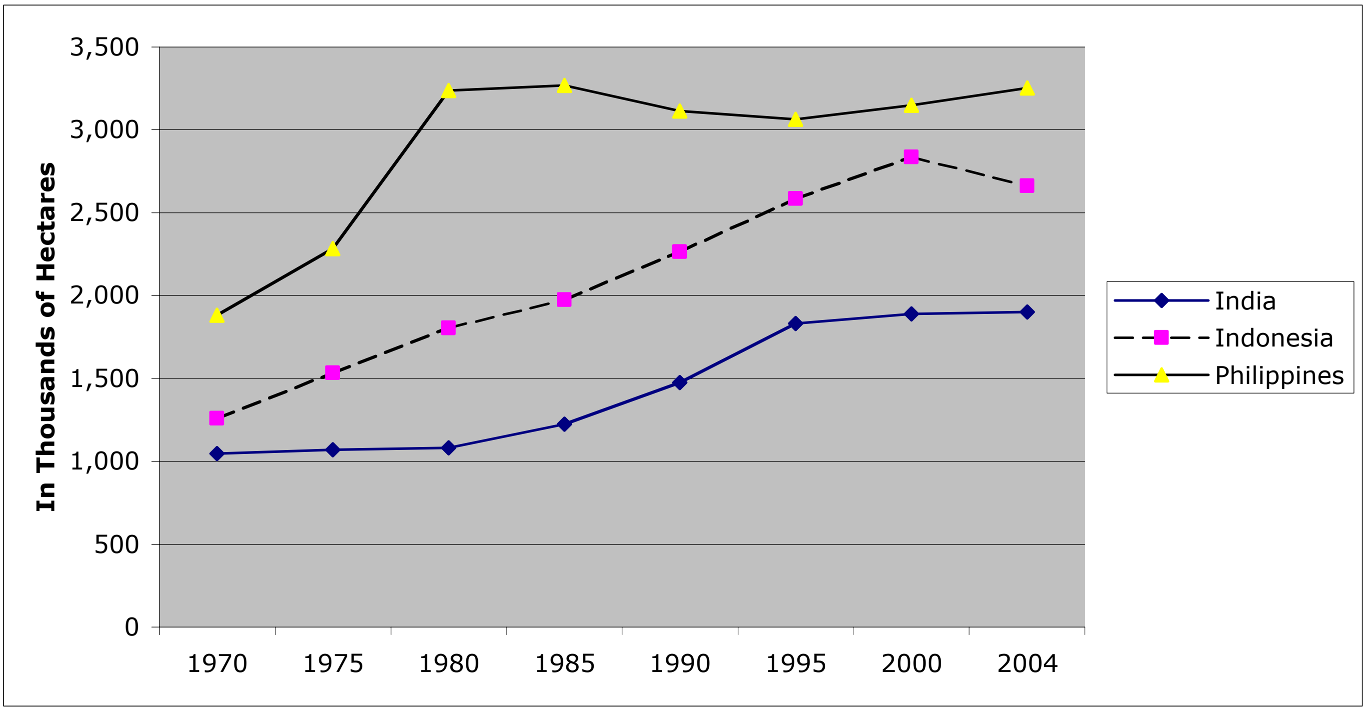

Figure 1: Hectares of Coconuts Harvested

Contrast this outcome with the market for palm oil in Malaysia. In 1960, only 55,000 hectares (ha) had been planted with oil palm trees. Most of the available land was used for cultivating rubber trees, with increasingly limited market potential as synthetic substitutes became widely available. The government of Malaysia embarked on a plan to encourage diversification, including the establishment of industrial plants for processing palm oil and increased investment in ports and other infrastructure necessary to get palm oil seeds from plantations to export markets worldwide. Palm oil trees are high yielding, producing more than twice as much edible oils per hectare than soybeans, rapeseed or any other source of oil. By 2000, 3.4 million hectares were in palm oil production, for a total of 54 percent of total agricultural land use and 30 percent of total agricultural exports.

Smallholders account for 41 percent of the total land held, with the remainder in private estates.[23] Many of these smaller landholders obtained their titles through government programs designed to provide land to landless rural workers suffering from abject poverty. After being given land deeds, most of the extreme poverty in Malaysia was eliminated.[24] Farmers had incentives to invest resources into increasing yields in their farms. With less arable land available in Malaysia for the future, farmers have additional reasons to upgrade their plantations to get more oil seed production out of existing croplands.

Almost as crucial for the elimination of poverty and the development of a thriving market for palm oil, the government invested heavily in infrastructure projects designed to connect rural areas of Malaysia to the market. They built roads and port facilities to deliver palm oil seeds to refining plants and then to ship the finished products out to export markets. The creation of superior infrastructure was critical in Malaysia, since the bulk of the crop is exported and the country accounts for 58 percent of global palm oil exports and 27 percent of the global fats and oils trade.[25]

The government also invested in a variety of programs to strengthen regulations aimed at ensuring high quality exports, and sponsored additional research and development for the industry. The Malaysian Palm Oil Board uses a compulsory fee per ton of harvested oils to increase promotion of the product in export markets, facilitate joint venture programs, and provide funds for researchers. As the production of palm oil increased, so did opportunities for additional investments in the industry, including milling, refining, kernel crushing, marketing, transportation, and trading.

The industry is continuing to explore new avenues for final products. In addition to new food products, researchers are exploring the use of palm oil in greater non-food applications like soaps or even as a form of biochemical fuel. The fronds, trunks and empty fruit bunches have been used in particle board for furniture,

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[23] Nearly 25 percent of the total land area is managed by the public sector, especially through the Federal Land Development Authority (FELDA) that manages just over 100,000 settler properties. Under the land management scheme, nearly 49,000 settlers have been granted individual land titles. Arif Simeh, and Tengku Ariff Tengku Ahmad, "The Case Study of Malaysian Palm Oil," Paper presented at the Regional Workshop on Commodity Export Diversification and Poverty Reduction in South and Southeast Asia, Bangkok, April 3-5, 2001.

[24] The incidence of poverty in the agriculture sector declined from nearly 70 percent in 1970 to just under 12 percent in 1997. In palm oil smallholders alone, poverty fell from 30 percent in 1970 to eight percent in 1980. See Arif Simeh and Tengku Mohd Ariff Tengku Ahmad, April 2001.

[25] Datuk Peter Chin Fah Kui, Minister of Plantation Industries and Commodities, "The Malaysian Palm Oil Industry: Contributing Towards Global Business," Speech to the National Institute of Oilseed Products, March 16-19, 2005, Las Vegas, Nevada.

converted to mulching mats (used to stop the encroachment of the Gobi Desert in China), and turned into paper products.

The Malaysian palm oil case also highlights the potential for even greater economic growth. In 2003, the government and state schemes continued to manage nearly 30 percent of oil palm holdings in Malaysia.[26] The government has taken steps to ensure that market signals guide their plans, including offering competitive salary scales for bureaucrats running the programs and eliminating civil service tenure. But, if palm oil production continued to increase so dramatically with government interference, it is possible that individual farmers would see even greater rewards if the market were completely freed. The marketplace, after all, continues to provide better signals to producers and consumers than any other system.

If Not Picking Winners, then What?

Because private property rights are so essential to the workings of a market, government's first priority must be to enshrine these rights. Individuals and firms must be free of the worry that the state or other actors will, without warning and at any moment, confiscate or appropriate property. The specific requirements of guaranteeing this essential economic freedom will vary from state to state.

Failure to consolidate property rights into a single, coherent system also leads to inefficient, time consuming processes and thwarts efforts to create internationally competitive firms and industries. A businessperson attempting to start a new company, however small, operating in a legal environment or with a data system that is not integrated takes months or even years to negotiate. To legally purchase residential property in the Philippines takes 168 steps, involves 53 private and public agencies, and takes 13-25 years to complete.[27] It takes 8-10 years to obtain a land title in Indonesia. Clearly, governments plagued with such inefficient processes risk being left behind in a world of increasingly mobile firms and investments.

If bureaucrats along the way demand payment for processing each step, it only drives the economy further underground. Small-scale or petty corruption also creates a serious drag on the economy. Given the choice between spending hundreds of hours attempting to legally register a firm and operating without formal approval, most opt

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[26] Malaysian Palm Oil Association and Sustainable Palm Oil, RSPO Public Forum on Sustainable Palm Oil, January 6, 2005.

[27] See de Soto, p. 20.

for the latter. This creates a highly inefficient outcome for all parties. One Thai academic, Phasuk Phongpaichit, estimates that corruption in Thailand has created an underground economy worth 20 percent of the country's gross national product.[28]

By setting up the best possible systems of property rights and then allowing the market to decide the best allocation of resources, the incentives for corruption in government officials is significantly reduced. By not directing state resources to one favored firm or industry, but by letting competition rule, government actors remove many of the incentives to manipulate the outcome.

Another promising method of reducing corruption at all levels is to take the Singapore government approach. If government workers receive sufficient salaries up front, they have reduced incentives to supplement their legal income. In Singapore, government officials receive salaries indexed to top wages in the private sector. This makes government employees at all levels some of the highest paid workers in the state.[29] This pay scale is combined with meritocratic hiring practices for government officials.

Singapore and other states that have successfully fought off corruption have also invested in institutions designed to seek out and punish individuals breaking laws banning corrupt practices. The best approach seems to combine elements of both the "carrot" and the "stick."

The East Asian experience also highlights the critical importance of investments in hard and soft infrastructure. States without adequate roads, air transportation, and port facilities cannot attract multinational business firms in sufficient numbers to create jobs and revenue. Individuals and firms need adequate telecommunications networks to communicate about the demands of the marketplace. Every state that has been successful in the region began by directing government funding to infrastructure investments. These investments have to be made with an eye to creating a competitive marketplace for the future.

Just as important are investments in soft infrastructure, especially in education and health systems. Each successful state in the region has upgraded the skills of its workforce. Cheap labor alone is rarely a sufficient comparative advantage. Today, firms demand some degree of skill from their employees, although the composition of

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[28] Shefali Rekhi, "Rooting Out Money Politics," *The Straits Times* (Singapore), September 24, 2005.

[29] And even this does not entirely stamp out the incentives for corruption, as Singapore had 56 civil servants taken to court in 2004 for accepting bribes or dipping into official funds. See Rekhi, September 24, 2005.

skilled labor differs by state. In Singapore, skilled workers can be found in the knowledge and service sectors, as well as manufacturing. Even highly skilled knowledge workers, however, are finding they must constantly upgrade their skills to keep making productivity gains in an increasingly complex world. Developing and keeping such a pool of workers pays dividends as more and more firms are willing to invest in places like Singapore.

In Malaysia, some of the skilled workers are in agriculture. The Malaysian government set up a comprehensive system of agricultural extension facilities, designed to provide ongoing education to planters and even to workers about new and improved methods of farming and better crop strains. The extension services also connect research and development to decisions made in the plantations, farms and fields to create new crops for the future. Several Asian states have nurtured the creation of technical training facilities to continuously upgrade the skills of their employees.

In a globalized society, states that are not competitive will not succeed. The East Asian experience suggests that a strategy of "picking winners" is deeply flawed. This is not, however, to suggest that there is no role for government to play in development efforts. The state has a critical role in fostering and nurturing the type of competitive marketplace that can emerge in today's environment. The right investments in property rights, an adequate legal system, and hard and soft infrastructure are necessary components of success. States ought to continuously survey the global environment, avoid operating in isolation, adopt some of the best practices developed abroad and adapt them to the local conditions.

Paying government officials more money, setting up adequate systems for enforcing property rights, and creating necessary infrastructure is expensive. This makes it all the more imperative that states look outside for funding. This funding need not come in the form of aid or handouts, but does require outside assistance. By setting up an attractive and competitive environment, business and investors will be drawn to new projects. These new projects will create the necessary seeds for further economic growth and development.

Options for Africa

In this paper we have chosen to focus on the challenges of "picking winners" directly in response to multiple conversations with African leaders about the East Asian experience. Frequently, these leaders have argued that—since Asia succeeded by following a careful, state-led and managed development strategy—Africa should use the same approaches. But we believe we have highlighted two key flaws in this argument. First, Asian states did not achieve the levels of development they have experienced by picking winners. When governments have attempted to follow these strategies and have invested public funds into companies, given tax advantages to specific firms, crafted legislation or rules to benefit preferred businesses and so forth, they have frequently made a hash of it. The record clearly shows at least as many failures in this regard, as it shows successes. Failure comes at a high price, especially for states with limited resources. Second, what Asian governments have done that have proven far more lasting, is to carefully invest resources into creating competitive environments for the global market to flourish domestically. Picking winners usually comes with a host of attached policies to protect the chosen industry or firm from competition. The net effect is not helpful and should not be imitated.

Asian governments did not pursue laissez faire policies and we do not advocate a purely hands-off model for African leaders either. Successful states in Asia have shown a clear role for government efforts. In particular, states have had tremendous success in building up the necessary underpinnings for the marketplace. This includes setting up a legal framework, as we have noted, to adequately protect and enforce private property rights, and investing in both hard and soft infrastructure, including education and basic health care.

Fifty years ago, most of the states in Asia were extremely poor, with apparently worse conditions for development than those in Africa. It was not at all obvious that they would ever be successful. Capital was in extremely short supply. Investments in education, for example, looked highly doubtful. State leaders began the process of building competitive environments quite slowly. Citizens were encouraged, for example, to save small amounts and invest in their children's education for the future. Government investments in infrastructure projects, likewise, began small and leveraged on funds received from outside sources including foreign aid and multinational firms. States in the region gradually built up their own governing capacity. They borrowed “best practices” for governance from any available source.

An outward orientation helped Asian governments shift their comparative advantages from raw materials into new arenas entirely like manufacturing and services. Even in agriculture, Asian states encouraged diversification and movement away from reliance on one crop. Malaysia, for example, began work on new uses for rubber and the wood from the trees and created a palm oil industry from scratch. The region has consistently urged private firms to experiment and innovate by lowering barriers to entry and encouraging competition. It is no coincidence that states with the lowest barriers to entry and exit have also been those with the highest levels of growth and development. Markets manage growth better than governments.

This lesson is especially important for states that lack the capacity to manage the economy. Implementation of complex policy outcomes is highly unlikely to be done successfully in many developing states. Any attempt to channel scarce resources into one particular firm or industry is likely to be squandered.

Only an outward-looking state, determined to create a competitive market, can set up the virtuous cycle of investments that will best ensure economic growth into the future. Growth can happen swiftly. Remember, it was less than 50 years ago that South Korea and Taiwan were condemned to the “trash heap” while Burma was set to triumph. The right policies can make all the difference.

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