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Country Role Models: Synthesis of Ireland, Japan and Switzerland

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Abstract

This paper provides a synthesis of the three papers on the non-Nordic developed economies, Ireland, Japan and Switzerland along the following themes: role of the state, openness, education and human capital, and macroeconomic stability. It then draws lessons for developing countries of today.

Keywords: economic growth, economic development, industrialization, Ireland, Japan, Switzerland

JEL classification: O5, O14, O15, O38

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1 Introduction

The notion of 'country role models for development success' can be interpreted as either selecting from among the present set of developing countries some examples of notable success for their peers to emulate or, alternatively, the past historical experience of already developed countries to provide templates for possible replication, in so far as changing circumstances will allow. The set of three countries to be discussed here are all at present highly developed, in terms of per capita GDP and associated indicators, with Ireland by far the most recent to join the ranks, while Switzerland was arguably the first country, with the possible exception of Belgium, which followed Britain into the Industrial Revolution as early as the first half of the 19th century. Japan of course famously became the first Asian country to successfully 'modernize', beginning with the Meiji Restoration in 1868. By 1905 it had defeated a European great power in the Russo-Japanese War and acquired an empire by occupying Taiwan in 1895 and Korea in 1910. Switzerland's assemblage of small political entities, the 'cantons', were independent since the Middle Ages and politically unified in 1848. Ireland, on the other hand, like the vast majority of contemporary developing countries, was a colony that only became an independent republic in 1921. Switzerland has always had the disadvantage of being landlocked, but this is offset by the tremendous advantage of common borders with the three great continental states of France, Germany and Italy. Ireland is divided from Britain by a mere strip of water, while Japan's proximity to China has exposed it to stimulating cultural influences since at least the early seventh century. It is easy to argue therefore that these three countries have a fortunate geographical location and a historical experience of sustained development that is so far removed from that of the typical developing country of today in South East Asia, Africa or Latin America that it would be futile to expect any feasible, currently relevant lessons to be learned by them from a study of that experience. I do believe, however, that there are some highly relevant general principles of development that are exemplified by the achievements of our three countries, and that it is in this sense that they can usefully serve as 'country role models' to the contemporary developing world.

The topics on which all three of the papers (Kimura 2009; Teague 2009; Weder and Weder 2009) under review have relevant lessons to provide are (i) the role of the state, (ii) the importance of openness in the markets for both goods and the factors of production, (iii) education and human capital formation and (iv) flexibility and adaptability in economic policy formulation, particularly in relation to macroeconomic stability.

2 Role of the state

Switzerland, which was a relatively peaceful part of Europe since an agreement with France in 1516, was invaded by a French army in 1798 that brought the centralizing ideology of the French Revolution to a region of small independent communities, the thirteen cantons and associated territories, setting up what was known as the Helvetic Republic in an attempt to provide a more unified and modern administration on the French model. This proved unworkable in the light of Swiss traditions as was realized by Napoleon himself. The Congress of Vienna recognized a modified Swiss Confederation in 1815, with borders that have remained largely unchanged to the present day. Liberal reformers created a new federal constitution in 1848 with a bicameral structure modelled on that of the United States of America, establishing a very loosely centralized regime that preserved extensive local autonomy. No less distinguished a political commentator than Alexis de Tocqueville described the creation of the modern Swiss constitution as ‘one people, composed of several races, speaking several languages, with several religious beliefs, various dissident sects, … two societies, one very old and the other very young, joined in marriage despite the age difference’ (Fritzsche 1996: 129). In this respect at least Switzerland has something in common with the many multiethnic and multiconfessional states of the developing world of today.

The constitution of 1848 created a unified national market with a common currency, standardized weights and measures, a unified foreign trade policy and federal discretion over large scale public works, such as railways, with all Swiss cities connected by rail by 1862. Taxation, public education, criminal and civil law were largely entrusted to subsidiary authorities in accordance with Swiss tradition. This political framework has largely survived in its essentials to the present day. Weder and Weder (2009) rightly characterize Switzerland’s political system as a ‘highly contestable’ one, in Baumol’s sense of a system or market where a high degree of *potential* entry ensures competitive outcomes that preserve the interests of all individual voters and subsidiary political entities. The ‘direct democracy’ permits a right of referendum that is open to any group or cause that can collect 50,000 signatures, making political parties anxious to compromise before risking a delay or rejection of legislation as a result of a referendum. The US-style bicameral legislature requires a majority of both individual voters in the popular assembly and of cantons in the second chamber. Autonomy over taxation and local public goods such as schools leads, as they point out, not to a ‘race to the bottom’ with the lowest tax and service levels, but to a Tiebout-style diversity of choice between higher or lower provision of services and corresponding tax rates. Given Switzerland’s long experience with democracy and self-government this liberal provision of potential veto rights has not caused gridlock or paralysis, as it might have if introduced into polities with less wholesome traditions of political behaviour in the contemporary developing world.

The modern era of Japanese economic development begins with the Meiji Restoration of 1868. The Meiji reformers had the arduous task of dismantling the remaining feudal elements of the Tokugawa era and opening the country to the new influences coming from the West, while at the same time preserving its political sovereignty and cultural identity. There is almost universal agreement that they accomplished this in a remarkably creative and effective way, but there is still considerable controversy about many aspects of this successful transition to modernity. The Meiji state unified the national administration, established a modern currency and banking system, put the public finances on a sound footing and built a strong army and navy that made it the most powerful state in East Asia before the First World War. In addition the state was responsible for introducing modern Western technology into the industrial, transport and communications sectors by setting up projects and bearing the initial losses before selling them on concessional terms to an emerging private sector, which included the large conglomerates known as the ‘zaibatsu’. One useful lesson for contemporary developing countries is the manner in which agriculture was taxed directly by a fixed percentage tax on the assessed value of land, which gave the farmer the incentive of the full market price of his crop, rather than by export taxes or marketing board manipulations that have been so prevalent more recently.

By the 1930s the Japanese state fell under the influence of extreme nationalist and militarist elements. Defense spending increased substantially and heavy industry was subsidized with a view to building up the country's war potential. Military intervention took place in Manchuria and China and eventually Japan went to war with the Allied Powers. After notable initial successes the country was defeated and occupied after suffering devastating losses. The MacArthur administration, however, introduced several important reforms that enabled the country to recover the pre-war level of development after ten years, as Kimura (2009) notes. Growth continued at remarkably high rates and Japan became by 1990 the envy of the world, particularly for its dynamic manufacturing export sectors in electronics and automobiles. Much of this success was attributed to the role of the Ministry of International Trade and Industry, or MITI as it is popularly known, in operating a system of industrial policy which was supposed to infallibly 'pick winners' in new industries, to be nurtured and guided by the state though under private ownership. Admiration for the alleged success of MITI in these endeavours was widespread in the developing world, as indicated most prominently by the 'Look East' slogan of Dr. Mahathir in Malaysia. Kimura, however, indicates quite convincingly that the success of the new export industries such as automobiles came despite, not because of, the MITI interventions. The lesson here for developing countries is of course that if even the mighty MITI was unable to systematically select and promote new industries for export they should be careful about trying to emulate that example.

Ireland is by far the most recent of the three 'success stories' that we have under review. The fate of the native Catholic Irish, as distinct from their Protestant Anglo-Irish overlords, had long been a tragic one, particularly during the potato famine of the 1840s that was only partly alleviated by a massive emigration to the United States. Black (1972: 194) says that 'Ireland in the half century before the Great Famine presented the phenomena of economic underdevelopment in almost classic form' and despite its connection to Britain probably had a per capita income not that much higher than contemporary Tokugawa Japan and certainly lower than Switzerland. Independence from Britain in 1921 was followed by continued dissension and conflict, and the Great Depression and the Second World War also prevented any sustained economic progress. Attempts at self-sufficiency and economic separation from Britain also had largely negative consequences. It was only from the mid 1950s, as Teague (2009) points out, that sound and consistent economic policies began to be framed, which got a substantial boost from EU grants for infrastructure. Despite these efforts Fitzpatrick (1989: 229) said that 'Ireland is still one of the poorest parts of Western Europe and seems likely to remain so'. Teague notes that Irish GNP per capita was only 67 per cent of the EU average in 1990, barely above the 64 per cent that it was in 1970. Since then, however, it has been 'nothing short of spectacular', averaging 10 per cent per annum in the second half of the 1990s, so that it was 96 per cent of the EU average in 2000 and about 7 per cent above it today, making Ireland one of the richest countries in Europe, indeed second only to Luxembourg in a recent estimate. The keys to this remarkable success have been a number of critical steps taken by the state in the fields of policy towards trade, FDI, education and stabilization policy that we will examine later in this paper.

3 Openness

All three countries have been highly open during the most successful phases of their development, with Switzerland as the most consistently so. A small, landlocked country, it had to rely for centuries on external markets for its goods and services. In medieval and early modern times it was the services of its mercenary soldiers, the most formidable infantry on the battlefields of Europe, whose earnings bolstered the meagre incomes of its peasants and artisans. Then the famous watch industry, created by Huguenot refugees who brought it to Geneva from where it spread gradually to the Jura and the canton of Neuchatel, captured most of the European markets and went even further afield. Fritzsche (1996) reports the remarkable fact that by 1850 two-thirds of the entire world market, a full million watches, was produced in the Jura regions alone. As the economic historian Biucchi (1973: 647) says ‘Swiss industry was born to export and born free’. He also observes (ibid.: 648) that ‘harassed by Napoleonic protection and the continental blockade, Swiss industry had the ready intuition to seek its salvation, in the midst of the Industrial Revolution, by integration into the world economy’. He quotes a contemporary source to the effect that exclusion from nearby European markets forced Swiss exporters to venture to ‘Persia, Astrakhan, Moscow, St. Petersburg, New York, Rio de Janeiro and Havana’.

The textile sector, first silk but later and more importantly cotton, was the major branch of Swiss industry throughout the 19th century, and provided the bulk of exports. In 1800 cotton textiles employed about 100,000 workers, about half of total manufacturing employment Fritzsche (1996). British machine-spun yarn replaced the local hand-spun sources and maintained the competitiveness of the weaving sector in the face of stiff British competition, before Swiss producers established their own mechanized spinning factories after 1830. The same source also says that exports were about one-third of national income from about 1850 to 1913, with about three-quarters of these going to overseas markets, largely the Americas, remarkable for a landlocked country. By later in the 19th century the Swiss industry became more oriented to ‘high-tech’ sectors like mechanical engineering and chemicals, but these themselves developed out of earlier roots in the textile industries, textile machinery in the first case and dyes for the silk industry in the second, important instances of ‘forward linkage’. Food processing, including the famous Nestle chocolate, was another important new industrial and export sector. Banking and financial services also emerged as major sectors on the world stage.

Weder and Weder (2009) consider a high degree of market or ‘economic competition’ as being one of the two key factors, along with political contestability, that were responsible for Swiss success. This factor in turn can be seen as the outcome of the almost complete openness, with the notable exception of agriculture, that the economy has maintained for so long and with such consistency. In line with what we have already noted they point out that major sectors such as chemicals, textiles, watches and chocolate had over 90 per cent of output exported in most cases in 1920. Their Table 4 shows Switzerland as fourth on the index of globalization in 2005, and first by a wide margin over the UK in capital stock owned abroad as a percentage of GDP, a remarkable 107 per cent as compared with 63 per cent for the UK. Switzerland is also first in ‘global migration intensity’.

Japan became exposed to global trade influences by contact with the Portuguese and Dutch in the 16th century, who brought Chinese raw silk into the country in exchange for large flows of silver from Japanese mines. Japanese merchants also traded actively with South East Asia. The Tokugawa regime, however, eventually introduced the famous exclusion policy that limited European contact to a small Dutch outpost on the island of Deshima near Nagasaki. Trade with the West did not resume until the forcible opening of the country by Commodore Perry’s ‘black ships’ in the 1850s. Raw silk and tea, followed later by cotton textiles, were the main exports. Raw silk was consistently above 30 per cent of total exports from the beginning of the Meiji Era to the beginning of the 1930s. Tea fell from about a quarter in the early 1870s to below 10 per cent in the 1890s, becoming insignificant thereafter. Cotton fabrics emerged only around 1900 but then rose sharply to nearly 20 per cent by the 1920s and 1930s, with over half of the total production being exported. The export of machinery rose from barely 1 per cent in 1935 to nearly 6 per cent by 1938. Japan's growth rates of industrial production and manufactured exports were both around 9 per cent per annum from 1911–3 to 1926–9, the highest in the world. After the Second World War the industrial growth rate was over 12 per cent and the export growth rate a remarkable 19 per cent per annum during the 1950s, well above the West German 'Wirtschaftswunder' performance of 8 per cent and 14 per cent for the same indicators during this period (see Shinohara 1964). Shinohara also mentions some special factors that contributed to the rapid growth of Japanese exports during these earlier years. One was the lack of tariff autonomy which imposed a virtual free trade regime due to the 'unequal treaties', which allowed many traditional industries to collapse and permit the rapid growth of raw silk and tea exports; the silkworm disease in Europe that fostered the further growth of raw silk exports; the decline in the value of silver relative to gold that acted like a sustained exchange rate depreciation stimulating exports, and perhaps most important of all, a combination of rapid productivity growth combined with low wages that gave Japan a strong edge against Asian and European competitors.

Kimura (2009) takes the view that Japan in the aftermath of the Second World War was essentially in the same position as today's newly industrialized countries at the start of their development. We should not forget, however, that though the physical and human costs of the war may have lowered statistical measures of economic status to comparable levels, the institutional memory of Japanese businesses and government agencies of their earlier impressive achievements must have contributed significantly to their success in not only reconstruction and recovery but in taking the economy to new heights that it had never reached before. Exports increasingly shifted their composition from textiles and iron and steel to sophisticated machinery and transport equipment, which constituted about 60 per cent by 1985 according to Figure 10 of Kimura's paper, while imports became dominated by petroleum, accounting for over 40 per cent. In other words Japan ascended to the top rungs of the 'ladder of comparative advantage' during this period. Trade policy initially relied heavily on direct administrative controls before gradually being replaced by tariffs, which sharply fell from a peak of 8 per cent in 1963 (measured as a ratio of customs duties to total imports) to just 2 per cent 20 years later.

During these years much was made by both admirers, such as Chalmers Johnson, and critics such as Karel van Wolferen, of MITI's efforts at guiding Japanese development by means of a sophisticated industrial policy, controlling the entry and exit of firms and their choice of product mix and technology to promote exports and the penetration of foreign markets in a mercantilist fashion. Kimura argues essentially that while MITI did make strenuous efforts in this direction, the beneficial results were obtained not because of, but despite these efforts. The main example he gives is regarding the automobile sector. Here MITI wanted to have a sole supplier for a single small model to take advantage of economies of scale but the industry ended up with multiple firms and models, some of which were extraordinarily successful while others failed. As he says, MITI's main error was to consistently underestimate the dynamism of the private sector.

While I tend personally to share his skepticism about industrial policy I am sure that its many enthusiasts will not be convinced.

Unlike both Switzerland and Japan, Ireland's path to global integration has largely been through a massive inflow of FDI, beginning in around 1960. In this respect Ireland resembles Singapore more than any other country. Teague (2009) says that Ireland's long affair with FDI started in the 1960s and since then attracting multinationals has been the backbone of economic development in the country. This came after a realization by the mid-1950s that the earlier attempts at import substitution and self-sufficiency, familiar as nationalist reactions to a painful colonial past, had been counterproductive. Protectionism was given up and a lowering of tariff barriers was undertaken in the effort to integrate Ireland more closely with the European and world economy. A major new state entity, the Industrial Development Authority (IDA), was created with a broad mandate to attract foreign firms into the country by tax concessions and other financial incentives. These measures by themselves would not have been significant had they not been backed up by the appeal of a young, well-educated and English-speaking work force at relatively low wages by European standards. The tax rate was at 10 per cent of profits on exports, which made Ireland very competitive as a destination for FDI. The proportion of GNP produced by foreign firms rose from about just 2 per cent in 1960 to 16 per cent by 1973, about 40 per cent of industrial output. The investment was initially in mainly in low-tech, relatively labour-intensive sectors that created employment opportunities to offset contractions in the agricultural sector. By the 1970s however IDA took steps to shift the composition of FDI towards higher-tech sectors such as engineering, chemicals and pharmaceuticals, and then electronic and computing firms whose demands for skilled labour were met by appropriate educational measures to provide a matching supply. By 1990 FDI was accounting for two-thirds of manufacturing employment, with the number of foreign firms increasing from 650 in 1986 to over a thousand by 1997, a year in which manufacturing production increased by 16 per cent. An International Financial Services Centre in Dublin also attracted more FDI. As Teague (2009: table 1) shows, the US is by far the major source of all FDI in Ireland, accounting for almost half the firms and about 70 per cent of employment. He also points out that IDA takes considerable pains to design specific, customized incentive packages for the foreign firms that it particularly wants to attract, rather than simply offering general, across-the-board measures. In this respect IDA could be said to engage in a selective industrial policy that 'picks winners', so far apparently with a great deal of success.

Teague interestingly also observes that 'FDI has led to the diffusion within Ireland of advanced technological innovations and production methods as well as state-of-the-art organizational and managerial practices: multinationals have helped upgrade the Irish business environment' (Teague 2009: 11). Ireland thus provides another instance of the role of FDI in promoting technology transfer to domestic firms by giving them examples to emulate and imitate, as argued in Findlay (1978).

The other main component of Ireland's strategy of openness has been its entry into the EU. Even before joining the EU in 1973 Teague says that Ireland took steps to prepare for the shock of entry by lowering trade restrictions unilaterally and also by the 1965 Anglo-Irish Trade Agreement. He reports that the favourable trade creation effects of the customs union outweighed the unfavourable trade diversion effects. As part of the necessary restructuring, 20 per cent of domestic firms in mature industries went out of business, but the loss of employment was more than compensated by the dynamic new sectors opened up by the FDI. The EU membership reinforced the attractiveness of Ireland for FDI from the US as a platform from which to penetrate the market of the union as a whole. Another benefit of EU membership was to end Ireland's long attachment to the UK by reorienting the trade patterns toward the continent instead, a result that the earlier attempts at economic independence to accompany the political independence of 1921 had not been able to accomplish. This has given the Irish a new 'European' identity to offset that of the colonial past under British hegemony. Irish farmers were also able to benefit from the Common Agricultural Policy of the EU. The EU Structural Funds enabled Ireland to considerably expand and modernize its infrastructure, which also enhances the attractiveness as an FDI destination.

4 Education and human capital

Fritzsche (1996: 136) observes that during the 19th century 'in comparison with the rest of Europe, the degree of literacy was remarkably high: there can hardly be any doubt that human capital was the mainstay and the most important stimulating factor of the economic growth'. This enabled Switzerland to enter the Industrial Revolution on at least equal terms with Great Britain but also to enter new high-tech fields such as engineering, chemicals and the pharmaceutical industry. Japan, on the eve of the Meiji Restoration, is reputed to have had, according to an estimate of R. P. Dore, 40 to 50 per cent of boys and 15 per cent of girls receiving formal schooling outside of the home. Kimura (2009: figure 4) indicates universal primary education existing by 1948 at least, while upper secondary school enrolment increased from 40 per cent in 1950 to over 90 per cent by 1985 and university and junior college enrolment rose from 10 per cent in 1954 to just under 30 per cent in 1985. His figure 5 shows the number of 'researchers' increasing from about 50,000 in the early 1950s to almost ten times that number by 1985.

Teague says that Ireland's development in the 1950s was held back by a very poor educational system in which over 50 per cent of children left school at the age of 13, what he calls 'an appalling figure compared to the rest of Europe'. It was only in 1967 that secondary level education was provided free. Since then the country has invested heavily in education and caught up rapidly with the rest of the Europe. Nearly 60 per cent of students are now staying on for some form of tertiary education, a sixfold increase over the past 30 years. Very significantly, Ireland is shifting the focus of its tertiary education increasingly to 'Institutes of Technology', which now account for half of all students at this level. It is the graduates of these institutions that are providing the skilled labour force for the FDI and domestic firms engaged in electronics and other high-tech sectors. Even more remarkably there was a tenfold increase in the number of computer science graduates over five years. The coordination between educational institutions and development agencies is very notable. Taken together all these educational improvements are estimated to have added at least 1 per cent to the annual growth rate of the country.

5 Macroeconomic stability

Although usually considered a short run problem, the sustained maintenance of macroeconomic stability is increasingly recognized as an important determinant of long term developmental success. All three of the countries reviewed here provide strong evidence in favour of this view. Switzerland has been renowned for its financial stability for centuries, with traditionally low rates of not only inflation but unemployment as well, due to the flexibility of its labour markets combined with conservative monetary and banking policies. Japan resorted to deficit financing early in the Meiji Era before the famous Matsukata Deflation of the 1880s set the country on a more orthodox monetary-fiscal path up to the Great Depression. Finance Minister Korekiyo Takahashi, who has been described as ‘a Keynesian before Keynes’, taking office in 1931, combined an expansionary fiscal policy with exchange rate depreciation to give Japan a higher level of economic activity and employment than any other major economy during the first half of the 1930s before he was murdered in 1936, with military spending and the outbreak of war with China in 1937 leading to further expansion and even the emergence of inflation for the rest of the decade. The war and post-war phases of the 1940s were financially chaotic before an effective stabilization policy with a unified exchange rate of 360 yen to the dollar was adopted under the so-called Dodge Plan of 1949. Since then Japan has for the most part pursued conservative monetary and fiscal policies, perhaps excessively so in the opinion of some observers.

Ireland as a more typical small open economy has the most relevant experience for lessons to developing countries. As Teague says reliance on naïve Keynesian policies in response to the oil shock of the early 1970s did not increase employment, but only increased inflation and the public debt, so that by the middle of the 1980s unemployment was 18 per cent, inflation 15 per cent and the public debt 16 per cent of the GNP. Starting in 1987 the government put the country on a more austere monetary-fiscal path, cemented by membership in the Euro zone. Teague also mentions the important role that the idea of ‘social partnership’, government mediating between business and labour, has played in maintaining macroeconomic stability.

6 What are the lessons?

We conclude by briefly summarizing what the experience of these three already developed countries has to teach the developing countries of today. From Switzerland the most important thing that they can learn is that religious, linguistic and other cultural differences between various segments of the population can be overcome by peaceful political compromise, despite a brief civil war in the 1840s. Adam Smith said that little was required for a state to prosper beyond ‘peace, easy taxes and a tolerable administration of justice’. A better illustration of his contention than Switzerland would be difficult to find, but Japan also has an excellent record in this respect. After the Tokugawa Shogunate ended the period of ‘Warring States’ in the early 1600s, the country has been free from civil war, with the exception of the Satsuma Rebellion of 1877. The state in both Switzerland and Japan took good care of the provision of essential infrastructure, but in Japan it had to play a far more active role in adopting modern technology and institutions after 1868 to close the gap with the West. Despite the exaggerated claims for MITI and industrial policy, the private sector has played the main role in Japanese economic development. Both countries have also consistently maintained macroeconomic stability. Ireland is a relative latecomer, and its long status as a colonial dependency of Great Britain also makes this case the most relevant of the three for contemporary developing countries. Inward FDI has been the main engine of growth for Ireland, unlike Switzerland and Japan that both relied more on their own domestic private sectors. Ireland, however, has not been a mere passive recipient of FDI but has actively filtered and channelled it through the agency of IDA, which would be a more relevant role model for developing countries to follow than the much better known and vaunted MITI.

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