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In the 1950s Japan embarked on an economic developmental path that came to be known as the flying geese model. It proved to be a great success and was soon adopted by other East Asian countries, which too enjoyed decades of remarkable economic growth. An important element of the model is growth driven by export to the United States and Europe. As a result of the 2008 financial crisis, the traditional markets of the geese are shrinking. The new situation poses grave challenges to both the existing flying geese economies and latecomer economies which wish to follow the model. Another aspect is that though China follows the key ideas of the model, it faces problems that are different from those faced by Japan. The US does not see China as a close ally. At the same time, China is unlikely to be as willing as Japan to contribute to Washington's expenses in maintaining the world order.

Introduction

It has been widely accepted that the economic progress of Asia is one of the remarkable developments of the 20th century. At the time of independence several decades ago, many of the ex-colonies in Africa were at par with their Asian counterparts. But they are so very different today. "In 1960, South Korea's GDP matched Sudan's, and Taiwan's was about equal to that of the soon-to-be-independent Belgian Congo. By the 1990s, both Asian countries boasted living standards that rivaled those in the West. More than 400 million people have been lifted out of poverty in China alone since the country began liberalizing its economy in 1980."[1]

An important element of the story is the flying geese model based on the Japanese experience.[2] The model harks back to the end of World War II. The country had been devastated, and its industry lay in shambles. With few natural resources, Japan needed to import raw materials, but it lacked the foreign exchange necessary to do so. The answer presented itself in the form of using whatever industrial capacity still remaining to produce goods to sell to the world market and generate the money to buy more advanced equipment and raw materials. The circumstances of its birth explained why the development path came into being without any real debate and

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1 Brian P Klein and Kenneth Neil Cukier (2009), "Tamed Tigers, Distressed Dragon", *Foreign Affairs* July/August, vol. 88, issue 4.

2 Other elements are high domestic savings and interventionist role of the state. The role of a strong developmental state is only briefly treated in the course of the paper as it is not the focus of the paper.

without any generally accepted theoretical foundation.[3] Having said this, it is still to the credit of the Japanese elites that they managed to pull themselves together and embarked on what turned out to be a successful programme of economic reconstruction.

A defeated Japan had to follow the policies imposed by the US-led allied forces which occupied the country until 28 April 1952. In the aftermath of the war, the supreme commander for the allied powers exercised total control of the foreign trade. Imports such as coal and oil were kept to a minimum.[4] "As a result, industrial production gradually declined, reaching a trough in January-February 1947 as inventories of basic materials ran out."[5] With the advent of the Cold War in 1947 after the World War II, the aim of occupation policy was to turn Japan into a bastion to contain communism. Japan's fortune changed fundamentally with this new geopolitical situation. The task of economic reconstruction was made much easier with the outbreak of the Korean War in June 1950. The United States began to procure large quantities of goods and war materials to service its military operations in the Korean peninsula. The US acted as the main source of advanced technologies as well as the main market for its manufactured goods. And with the defense umbrella provided by the US, Japan was in a position to commit its scarce resources to economic development.

The postwar reconstruction imperatives and the global geopolitical environment were two key elements that explained the trajectory of economic development path of Japan. Japan's path was different from those which guided the development elsewhere in Asia then. There were two other models of development followed by their political leaders. One was the Marxist-Leninist model inspired by the Soviet Union. The other was the import substitution model. The goal was independence from imperialism which had oppressed them for so long. "Both called for state-directed capital accumulation and autarkic development, although the latter did allow for market mechanisms to function at the local level. Both boasted an extensive theoretical literature. In early postwar Asia, China would be the champion of the former, India of the latter."[6]

Leaving aside the obvious differences between the Marxist-Leninist model and the Japanese model, there were clear distinctions between the Japanese model and the import substitution model. Though both aimed at the development of domestic industry behind protectionist walls, they differed crucially in their stance towards the existing global economic order. India sought to eliminate its dependence on that order. On the other hand, Japan chose to work within that order which it judged could serve its agenda best. Largely for geopolitical reasons, the United States was happy to

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3 R Taggart Murphy (2008), Asia and the meltdown of American finance http://japanfocus.org/-R_Taggart-Murphy/2931 (accessed on 12 Dec 2009).

4 Juro Teranishi, *Evolution of the Economic System in Japan* (Cheltenham, UK: Edward Elgar, 2005).

5 Ibid. pp.172.

6 R Taggart Murphy (2008), Asia and the meltdown of American finance http://japanfocus.org/-R_Taggart-Murphy/2931 (accessed on 12 Dec 2009).

accommodate Japan's drive to reinvent itself into an economic power in the shortest possible time and join the ranks of the non-communist developed nations.[7]

The Flying Geese Model

Very much in the tradition of the Meiji reform, Japan embarked on a trajectory by learning from the success of others. And it did so in a step-by-step fashion. It did not aim to create new industries. It began by concentrating on industries like textile and toy manufacturing, and then moved on to shipping and steel, consumer electronics and consumer durables, machine tools and capital equipment. It focused on rapid accumulation of dollars so that it could buy the capital equipment it needed. It is a story of industrial upgrading, from low-tech to high-tech, from low value-adding to high value-adding. This pattern is captured metaphorically in the "flying geese" model.[8] The flying geese pattern of investment refers to movement of industries in response to changes in factor prices. The initial stage of industrialization was marked by setting up of labour-intensive industries to take advantage of cheap and abundant supply of labour. As wages rose with rapid deployment of labour in these countries, investment in more capital-intensive activities took place and there was a movement of labour-intensive industries to other countries. In other words, the model has thus three aspects:[9]

1. Intra-industry aspect: product development within a particular developing country, with a single industry growing in three steps, i.e., import, production, and export.

2. Inter-industry aspect: sequential appearance and development of industries in a particular developing country, with industries being diversified and upgraded from consumer goods to capital goods and/or from simple to more sophisticated products.

3. International aspect: subsequent relocation process of industries from advanced to developing countries during the latter's catching-up process.

At the level of business practice, the Japanese model is well-known for its traditional practice of lifetime employment and seniority system. Under a business networking system known as *keiretsu*, companies that do a lot of business with each other hold each other's equities. At the core of each group is a major bank which has great control over the companies in the *keiretsu*. As financier, it performs the function of monitoring of the companies and as an emergency bailout entity. Besides acting as an organizational structure against hostile takeover, it facilitates cooperation and information exchange among members of the group.

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[7] R Taggart Murphy (2008), "Asia and the meltdown of American finance" http://japanfocus.org/-R_Taggart-Murphy/2931 (accessed on 12 Dec 2009).

[8] Kename Akamatsu (1962), "A historical pattern of economic growth in developing countries", *Journal of Developing Economies*, Mar-Aug vol.1, no. 1, pp. 3-25.

[9] Flying geese model http://www.grips.ac.jp/module/prsp/FGeese.htm (accessed on 28 January 2010).

At the national level, there is a close collaboration among business, government bureaucracy and ruling political party. The state uses national resources to build the physical and social infrastructure to underpin rapid industrialization. While not denying the roles of free market and private enterprise, the state plays a strategic role in overcoming marketing imperfections, for example, by favouring potentially competitive export-oriented industries with cheap credit. The approach has been captured in the concept known as developmental state, which implies a strong state.[10] Indeed, the developmental state is a distinct element of the modernization programme in East Asia. Even though it is not part of the formal description of the flying geese model, it has been informally associated with it as an indispensible part of East Asian model of economic growth.

The economic performance of Japan exceeded anyone's expectations. In 1955 the final elements of the postwar Japanese system were put into place. In 1969 its growth began to alter the global economic ecology which had fostered it. Within this period, Japan boasted the highest growth rates that had ever been recorded by any economy in human history. Between 1950 and 1973, the Japanese economy doubled in size every seven years, and it had achieved one of the highest standards of living in the world.[11] In the four decades until 1990, Japan stole the show in economic development. It had the world's highest saving rates and displayed an endless and amazing capacity to adapt to the latest industrial technologies. Japanese manufacturing became legendary. It coped pretty well with the inflationary spurt in the wake of the OPEC oil price hikes in 1973.

After the 1970s, the technological strength of Japan's machinery and other manufacturing industries continued to prop up the economy, using exports as a lever. This strength was based on the innovative capacity of its technological firms.[12] Japan's emergence came as a tremendous shock to many Western nations. They entered and successfully competed in high-tech terrains which were previously the preserve of the US and European multinationals. The German camera industry had been the indisputable world leader. But it was almost wiped out by the Japanese competitor in just a decade from 1965 to 1975. Many US home appliances and machine tools were driven out of business. Until 1965 or so these industries were thought to be without rivals.

Their prowess measured in terms of patents and productivity was the result of systematic and continuous investment in research and development (R&D). A study of the US Academy of Engineering published in 1987 observed that Japan was superior to the US in 25 of 34 critical technologies.[13] Based on its technological strength and financial power, Japan has managed to produce world-class companies like Mitsubishi, Sony, Toyota and Toshiba.

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[10] Richard Appelbaum and Jeffrey Henderson, eds. *States and Development in the Asian Pacific Rim* (Newbury Park, CA: Sage, 1992).

[11] Magnus Blomström, Byron Gangnes and Sumner la Croix, eds., *Japan's new economy* (Oxford: Oxford University Press, 2001).

[12] Hiroshi Yoshikawa, *Japan's lost decade* (Tokyo: The International House of Japan, 2001).

[13] National Academy of Engineering, *Strengthening U.S. engineering through international cooperation: some recommendations for action* (Washington, DC: National Academy Press, 1987).

Pax Americana and Japan

It is mentioned earlier in the paper that Japan has benefitted economically from the defense umbrella provided by America. To be more concrete, "Pax Americana also provided Japan with liberal, stable environment for foreign trade, technology transfer, and a monetary system. Sufficient supplies of cheap energy and resources from abroad, easy access to advanced technologies of the West, and favorable conditions of the international payment system, all ingredients of Pax Americana, acted in concert and brought about the rapid economic growth experienced in Japan."[14]

Since 1968, Japan moved up to become the second largest economy. As its economic power grows, Japan is called upon by America to play its role in maintaining the US-led world order. In his speech on 15 August 1971, President Nixon conveyed this to the American trading partners, "Others should bear their fair share of the burden of defending freedom around the world and agree to exchange rate changes that would enable major nations to compete as equal…There is no longer any need for the United States to compete with one hand tied behind her back."[15]

Japan was pressured to assume her share of maintaining the international economic system. The demand consisted of three points: realignment of exchange rate, opening up the domestic market, and assuming more share of defense burden.[16] These three-pronged objectives have formed a cornerstone of the US policy towards Japan until today. They provide a background for the understanding of the Plaza Accord of 1985.[17]

In other words, it was not just a "one way traffic". Japan has contributed time and again to the costs of maintaining the US-led economic and political world order.[18] A well-known example of Japan's contribution to the US military campaign is the Gulf War in 1990-1991. Washington asked Tokyo to contribute to the campaign, arguing that "such actions would head off congressional criticism of Japanese free

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14 Hiroshi Shibuya, Makoto Maruyama and Osamu Ito, "A Viewpoint to analyze Japan's Social Economy and American Impacts", in Hiroshi Shibuya, Makoto Maruyama and Masamitsu Yasaka, eds., *Japanese Economy and Society under Pax-Americana* (Tokyo: University of Tokyo Press, 2002), pp. 4.

15 Alfred E Eckes, Jr, *A Search for Solvency: Bretton Woods and the International Monetary System 1941-1971* (Austin: University of Texas Press, 1975), pp. 263, quoted in Hiroshi Shibuya, Makoto Maruyama and Masamitsu Yasaka, edited (2002).

16 Robert Solomon, *The International Monetary System 1945-1976: an Insider's View* (New York: Harper & Row, 1977).

17 The goal of the Plaza Accord was to reduce the US dollar exchange rate in relation to the Japanese yen and German deutsche mark by intervening in currency markets. The Accord was signed by France, West Germany, Japan, the United States, and the United Kingdom.

18 Hitoshi Higuchi, "The Impact of Burden-Sharing on Japan: international fiscal policy responses to the decline of Pax Americana", in Hiroshi Shibuya, Makoto Maruyama and Masamitsu Yasaka, eds., *Japanese Economy and Society under Pax-Americana* (Tokyo: University of Tokyo Press, 2002).

riding."[19] Japan contributed US$13 billion, a significant amount compared to US$17 billion and US$16 billion contributed by Saudi Arabia and Kuwait respectively. The incremental costs (i.e., beyond the normal operating costs of US military) of the war were estimated variously at US$70 billion, US$61 billion and under US$50 billion.[20]

Whenever the US was in dire financial situation, it would call on Japan for assistance, and however grudgingly, Japan would oblige. "At crucial junctures in the past (the so-called Reagan Revolution of the early 1980s, for example, or the aftermath of the 1987 stock market crash), Japan had both the will and the ability to provide crucial assistance to Washington's recovery efforts. As America's principal external supplier of credit, Japan offered essentially unlimited, low-cost financing for the United States."[21] In a way, Japan has little choice. It depends on Washington for defense protection, as export market and for maintaining a global order congenial for Japanese economic interests abroad.

The Asian Tigers and China

The stellar economic performance of Japan did not go unnoticed by its neighbours. Hong Kong, Singapore, South Korea and Taiwan enthusiastically adopted the model in the 1960s and 1970s. They in turn were joined by Indonesia, Malaysia, Thailand, Vietnam and China. This model of export-led growth was actively encouraged by the Western powers. In 1975, Robert McNamara, then president of the World Bank, urged Asian leaders to "turn their manufacturing enterprises away from the relatively small markets associated with import substitution towards the much larger opportunities flowing from export promotion."[22] More than three decades on, the effects have been remarkable.

These adopters of the flying geese model displayed both similarities with and differences from Japan. The Japanese developmental state model emphasizes the troika (ruling party, bureaucracy, and business); other Asian countries on their own designed generally a state-led developmental model before the flying geese model was articulated. Through trial and error, the Japanese bureaucracy managed to use the state resources to intervene in an otherwise market economy in pursuit of economic modernization.[23] The policies formulated by the Ministry of International Trade and Industry have steered business to produce industrial expansion and economic growth. Japan is also relatively protectionist. Certain economic sectors do not welcome

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[19] Andrew Bennett, *et al.*, ed., *Friends in Need: burden sharing in the Persian Gulf War* (London: Macmillan, 1997), pp. 147.

[20] Hitoshi Higuchi (2002).

[21] Tanaka Kiyoyasu (2009), "Japan's Trade Collapse and Road to Recovery: Vertical foreign direct investment the key", *The Asia-Pacific Journal*, vol. 20-4-09, available on Japan Focus website (accessed on 10 January 2010).

[22] Brian P Klein and Kenneth Neil Cukier (2009), "Tamed Tigers, Distressed Dragon", *Foreign Affairs* July/August, vol. 88, issue 4.

[23] Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford: Stanford University Press, 1982). Chalmers Johnson, *Japan: Who Governs? –The Rise of the Developmental State* (W. W. Norton & Company, 1995).

foreign participation. At the same time, it erects tariff walls or imposes quotas on certain imports deemed vital to its national culture, like rice. On the other hand, Hong Kong and Singapore are paragons of free market and open economy. In South Korea, the state used naked power to suppress labour unrests and nurtured the development of giant family-owned industrial complex known as *chaebol*.[24] In Taiwan, the state-implemented land reform, which created a class of ex-landowners with capital.[25] These new capitalists invested their cash in subsequent industrialization. The Taiwanese government formulated a set of industrial policies to aim at export, heavy industry and chemicals, and later on electronics. The state was also able to use the US foreign aid efficiently to develop its industrial base. Under state tutelage, Taiwanese industries moved from cheap, labour-intensive manufacturing into more capital-intensive and high-tech areas. The most remarkable is its semiconductor industry which ranks as the third or fourth in the world. In short, different members of the flying geese "club" exhibit their own features, partly shaped by culture and historical experiences, and the political concerns of the political leadership.

Unlike Japan which has been lukewarm to foreign investment, other East Asian countries have thrown opened their doors to multinational companies to set up factories in order to provide employment, facilitate the transfer of technology and management skills, and earn foreign exchange. This approach is in line with the interests of the advanced industrial economies. To cope with rising costs of production, they relocate their production facilities to the emerging market economies to take advantage of cheap labour and land. The incentive to do so is even greater when the industries involved are polluting industries. Fierce competition posed by Japan ratcheted up pressure to relocate overseas.[26] The products are then exported back to the rich countries. The flying geese model has proved to offer a win-win economic model to all the parties concerned. This is pretty evident in the impressive economic development experienced by the Asian Tigers.

Perhaps the most eminent follower of the Japanese model is China. Since the economic reform initiated by Deng Xiaoping in 1978, China has gradually opened its doors to foreign investment. Most of the exported products from China are made by American, European, Japanese, Korean or Taiwanese companies, or produced under original equipment manufacturer agreements. This is in contrast to Japan, which placed heavy restrictions on foreign investment, and exported to the West under their own brand names. This approach has helped to avert major trade frictions though there are relatively minor ones now and then. But it is not able to avoid the issue of employment. The voice of workers in America and Europe is very likely to grow louder in pressurizing their companies to move back.

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[24] Alice H Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (Oxford: Oxford University Press, 1989). Ho-Joon Chang (1993), "The political economy of industrial policy in Korea", *Cambridge Journal of Economics*, vol. 17, no. 2.

[25] Robert Wade, *Economic theory and The Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990).

[26] Robert Brenner, *The boom and the bubble: the US in the world economy* (London: Verso, 2003). Robert P Brenner, Seong-jin Jeong (2009), "Overproduction not Financial Collapse is the Heart of the Crisis: the US, East Asia, and the World", *The Asia-Pacific Journal*, vol. 6-1-09, 7 February.

From Post-Cold War to the 1997 Asian Financial Crisis

East Asia has some seductive properties–political stability, an enormous pool of educated and hardworking workforce, rich natural resources and macroeconomic prudence. Since mid-1980s, these countries had been chalking up impressive growths. Hong Kong, South Korea, Singapore and Taiwan were known as the four Little Dragons while Indonesia, Malaysia, the Philippines and Thailand the four Asian Tigers. For example, from 1985 to 1995, Thailand might justifiably be seen as the showcase of an emergent economy. With an average GDP growth of 9.8 per cent per annum it was the fastest growing country in the world during the period.[27]

Beginning in the early 1990s, soon after the end of Cold War, global capital rushed into emerging markets in unprecedented quantities. Asia was the main destination of the deluge. The most fundamental change in the majority of East Asian economies in the 1990s was the dramatic increase in inflows of international capital. In 1996 alone, total net capital flows amounted to US$110 billion compared to an annual average of under US$17 billion a decade earlier. The same year saw a new inflow of US$93 billion of private capital to Indonesia, Korea, Malaysia, the Philippines and Thailand.

It was a period of free flow of private capital in huge quantities from the rich countries into East Asia. The motive was to have a share in profits produced in these high-growth economies. However, such free-flowing capital was speculative in nature, and they leave at the first sign of what the investment community perceived to be a would-be trouble. In the midst of favourable report of the economic performance of these countries, the Asian financial crisis broke out in July 1997 and caught many by surprise. Many commentaries, papers and books were published in its aftermath, attempting to understand and explain what went wrong. In the beginning, a popular version had it that state-guided industrialization had morphed into crony capitalism and corruption. Other factors were poor supervision of their financial sectors, especially when governments adopted a fixed exchange rate regime, etc. However, as time went on, such line of argument lost some traction. For one thing, Hong Kong and Singapore could not be anyway tarnished with crony capitalism; moreover their financial sectors were well supervised. As for the rest of the countries, the reality of crony capitalism and industrial policies were around for quite a long time. At this point of writing, the most convincing factor appeared to be concerted currency attacks by international speculators who suspected some real or apparent flaws in the economic fundamentals. The Asian financial crisis provides empirical basis for many economists to argue for the merits of some forms of currency control, a position recently endorsed by the International Monetary Fund (IMF). Perhaps we need some more years to really go to the roots of the problem. For more detailed discussion of the causes of the crisis, interested readers may refer to the endnote.[28]

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[27] Mihir Rakshit, *The East Asian currency crisis* (New Delhi: Oxford University Press, 2002), pp. 44.

[28] For the Asian crisis, see for example the following books:
W T Woo, J D Sachs and K Schwab, eds., *The Asian Financial Crisis: lessons for a resilient Asia* (Cambridge, MA: MIT Press, 2000). Gregory Noble and John Ravenhill, eds., *The Asian financial crisis and the architecture of global finance* (Cambridge: Cambridge University Press, 2000). Gerald Tan, *The Asian currency crisis* (Singapore: Times Academic Press, 2000). Mihir Rakshit, *The East Asian currency crisis* (New Delhi: Oxford University Press, 2002). Pierre-Richard Agenor, Marcus

It is interesting to note the different approaches adopted by the US in regard the 1997 Asian financial crisis and the 1994 Mexico peso crisis.[29] Washington acted promptly and decisively to contain the Mexican crisis and helped the economy on track again. Uncle Sam obviously did not like the idea of a flood of workers and farmers made destitute by the crisis streaming across the border. The victim countries of Asian countries could not enjoy similar American attention because they would not pose the same problem. There is also the factor of geopolitics after the fall of the Berlin War.[30]

Moreover, in the post-Cold War era, the US is less indulgent towards its allies because they are no longer needed to contain a Soviet Union that had collapsed… The US economic interests have increased in relative importance to security concerns and it was prepared to take advantage of the crisis in order to seek greater deregulation and market penetration into East Asian markets for the US corporate interests.

Taking cues from Washington, the IMF imposed tight monetary and austerity fiscal policies as conditions of assisting those countries hit by the crisis. These policies hurt the poor and the innocent victims of the crisis. The IMF was criticized for protecting the interests of Western bankers at the expense of the borrower countries. The criticisms drew sympathetic agreement from some Western scholars and even bankers like George Soros. It has been noted that "the US government took advantage of the crisis to push long-sought trade goals."[31] The crisis was used as an opportunity for the US to strengthen the grip of its hegemonic power. "With the end of Communism, the Asian tigers were seen in Washington as competitors, increasingly independent of US tutelage, hence the need to re-subordinate them…The IMF entry means the return of US hegemony and the decline of Asian capitalism as an independent and competitive pole."[32]

Miller, David Vines and Axel Weber, *The Asian Financial Crisis –causes, contagion and consequences* (Cambridge: Cambridge University Press, 1999).

[29] For the Mexico crisis, consult for example the followings:
Thomas W. Slover, *Tequila sunrise : Mexico emerges from the darkness of financial crisis* (London: London Institute of International Banking, Finance & Development Law, 1998). U.S. General Accountability Office (1996*), Mexico's financial crisis: origins, awareness, assistance, and initial efforts to recover,* http://www.gao.gov/archive/1996/gg96056.pdf (accessed on 29 November 2009). G A Calvo and E C G Mendonza (1996), "Petty crime and cruel punishment: lessons from the Mexico debacle", *American Economic Review*, Proceedings of the American Economic Association, vol. 86, no. 2, May 1996. Francisco Gil-Diaz (1998), "The origin of Mexico's 1994 financial crisis", *The Cato Journal*, vol. 17, no. 3.

[30] Lam Peng Er (2000), "The Asian financial crisis and its impact on regional order: opening Pandora's box", *The Journal of Pacific Asia*, vol.6, pp. 57-80.

[31] Gregory W Noble and John Ravenhill (2000), "Causes and consequences of the Asian financial crisis", pp. 22, in Gregory W Noble and John Ravenhill, eds., *The Asian Financial Crisis and the Architecture of Global Finance*, (Cambridge: Cambridge University Press, 2000), pp. 1-35.

[32] Quoted in Paul Burkett and Martin Hart-Landsberg (1998), "East Asia and the crisis of development theory", *Journal of Contemporary Asia*, 28, 4: 435–56, pp. 451.

One cardinal lesson of the Asian financial crisis is that sound economic fundamentals are a poor guarantee against concerted attacks by a band of international speculators. Once they managed to emerge from the crisis, those affected countries–either badly or not so badly–decided that they would no longer live under the mercy of global financial speculators. They then resolved to build up their foreign reserves as war chest to ward off global speculative attacks. And this huge foreign reserve has formed one factor in understanding the 2008 financial crisis.

Not all Geese are the Same

Because of the geopolitical background, we must be cautious in drawing parallels between Japan and China in discussing the flying geese model. Japan is a close ally of America in East Asia. In exchange for military protection provided by the US and the American market for Japanese goods, Japan is willing to open the wallet for the privileges. For several decades, the relationship has proved to be very productive for both sides as a whole.

The same certainly cannot be said of Beijing's relationship with Washington. Due to ideological differences and issues like Taiwan and Tibet, America will not treat China as a second Japan. Neither will China be willing to behave like Japan in regard its relationship with America. China is not going to pay for part of American military expenses in maintaining the present world order. Some Washington officials may argue that America has been spending tremendous resources to maintain Pax Americana by suppressing piracy and fighting terrorism, and China is behaving like a free rider. But this view is not shared by Beijing officials.

That does not mean that the two powers will inevitably clash. Many big US corporations have a vested interest in the well-being of China. In terms of trade and investment, China is more open than Japan. Boeing is a big supplier of China's airlines. Wal-Mart depends on China to supply cheap consumer products. Many American companies have manufacturing facilities in China. In fact, most of the products to America are made by American companies based in China. After China's accession to the World Trade Organization in 2001, Western transnational companies (TNCs) invested heavily in China–both to make good use of the cheap labour and to gain a foothold in the vast market. Unlike investment from overseas Chinese before this, these TNCs brought special benefits to China in the form of technological transfer. China is shrewd enough to use its market size to negotiate deals which include transfer of high technology, for example, the deals with Airbus to produce planes in China, and semiconductor production plants.[33] The relationship between America and China is complex and has to be handled with care, wisdom and commitment to mutual interests. As noted by a lead article in a recent issue of *The Economist*: "…America and China are not just rivals for global influence, they are also mutually dependent economies with everything to gain from co-operation."[34]

[33] Michael Heng Siam-Heng (2008), "China's Semiconductor Industry–opportunities and challenges", in E Thomson and J Sigurdson, eds., *China's Science and Technology Sector and the Forces of Globalisation* (Singapore, World Scientific, 2008), pp. 173-189.

[34] "Facing Up to China", *The Economist*, 6 February 2010, pp. 9.

Implications of the 2008 Financial Crisis

As a result of the success of the flying geese model, an interesting pattern has appeared in global trade. Japan and emerging economies rely on export-oriented strategy to drive their economic growth. Using part of the export earnings, they build up substantial foreign reserves as a defensive measure against speculative attacks. The money is held in US dollars, which is used by America to finance public and private consumption. Over the years, this builds up a global imbalance in the form of ballooning the US trade deficits and fiscal deficits. With the outbreak of the financial crisis in September 2008, these twin deficits have featured prominently in discussions on the economic outlook of America. In the short term, Western consumers are working hard to repair their household balance sheets by cutting down consumption. "Exports from East Asian countries to their traditional market in the West have plunged across the board, and they are unlikely to recover soon. The West's great consumption binge is unlikely to return anytime soon, leading to excess industrial capacity, financial difficulties for businesses, and rising unemployment throughout Asia."[35]

Two points need highlighting, namely the dwindling market in the West, and excess industrial capacity. The implication is that the flying geese model in the present form is not sustainable, and China may well be the last member to have successfully joined the flight. China has been known as the workshop of the world for some time. Unless there is a huge market for consumer goods appearing suddenly somewhere, it is difficult to see how another country can repeat China's export experience.

What does it mean for other countries which want to modernize and industrialize? Before the outbreak of the crisis, these questions could be pushed to the backstage. After all, the West seemed to exhibit an inexhaustible appetite and capacity in absorbing the manufactured goods. As long as the going was good, problems arising from the global financial imbalance could only command the attention of a tiny group of people. The crisis has brought the question to the agenda of the existing members of the flying geese. How should East Asia adjust their economic policies to cope with the new situation?

One evident answer is provided by the stimulus policy adopted by China and other countries. As much has been written on this, this paper will not dwell on it, except to point out that the allocation for education and healthcare is far too small. The economic recession justifies running fiscal deficits to prime pump the economy and governments would do well to make good use of the opportunity to invest in social infrastructure and institute social safety net. It has been observed that in the age of globalization, the quality of state expenditure as part of Keynesian stimuli is very important.[36]

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[35] Brian P Klein and Kenneth Neil Cukier (2009), "Tamed Tigers, Distressed Dragon", *Foreign Affairs* July/August, vol. 88, issue 4.

[36] Richard C. Koo, *The holy grail of macroeconomics*, revised and updated edition (Singapore: John Wiley, 2009).

Running fiscal deficits weakens the financial position of a country, and may attract speculative attacks on its currency. As a safeguard, emerging economies can follow the policy of Chile or China and India to restrict free currency flow. Perhaps this should be adopted as a policy during normal times too. This reduces considerably the need to keep huge foreign reserves as a defense against currency speculators, and the money can be more profitably used for socially useful and economic productive investment. Besides social spending, a good way to spend some of the money is to buy appropriately advanced technologies from the West. Not only are they generally cheaper in times of recession, the move will reduce the trade deficits of countries like the US and Great Britain. This will help to redress the global imbalance.

Finally, East Asian countries should broaden and deepen their existing economic linkages among themselves and develop new ones. This follows the response towards East Asian regionalism after the 1997 Asian financial crisis. Until the crisis, even though the tide of regionalism was sweeping across the region, it was not firmly based. The Asian crisis provided the occasion for the affected countries to work for closer Asian integration in trade, investment, production and consumption. The current global recession has given yet another push towards deeper and tighter regional integration. This will build on the various initiatives to build the physical infrastructures.[37] However, challenges still lie ahead for meaningful and rewarding regional integration. Most crucial of all is the imperative to cooperate in evolving complementary industrial policies, which will form the solid basis for trade and economic integration. Should East Asia fail in this project, they have only themselves to blame.

Concluding Remarks

The flying geese model has proved its merits in the form of remarkable economic performance of East Asia. Even though it has failed to provide conceptual pointers for Japan to get out of its "lost decade" after the bursting of the bubble in 1991, it has continued to guide the economic trajectory of other East Asian countries. One useful insight is that the state can play an effective role in economic development through various forms of interventions. This goes against fundamental tenets of canonical liberal market economy.

As it is pretty evident from its genesis, the flying geese model is a pragmatic response to the pressing needs of the time, a sort of model based on situational logic rather than any grand and coherent economic theory. This happens to be a feature of the financial policy of China and India. The two countries have gone against the strong current of financial liberalization which started in earnest in mid-1980s. Though their financial policy is not seen as an integral part of the flying geese model, it may be seen as following the spirit of the model.

If Asian countries follow such spirit in facing the challenges of current global recession, they may be able to provide valuable solutions both for themselves and the rest of the world.

[37] Asian Development Bank, *Infrastructure for a Seamless Asia* (Manila: ADB, 2009).