

CHANGES IN JAPANESE FOREIGN AID POLICY

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Abstract

The main part of Japanese aid is directed to Asia and there has been a strong emphasis on economic infrastructure, that is building railways, roads and ports etc. Recently however there is a refocusing towards environmental aid and “softer” types of aid such as poverty alleviation and social infrastructure. ODA that used to be based on the request from the recipient countries has become much more politicised, with Japan itself making country assistance plans indicating what fields they are willing to provide aid in. This is not always popular with the recipient government as in the case of China. In this case it has actually made Japan’s already complex relation with China even more complicated.

The paper will start with a short historic review of Japanese ODA policy and the characteristics of Japanese aid. This will be followed by an explanation of the changes going on in Japanese foreign aid policy and finally we will see how this how this effect aid to China and the role of aid in the future Japan-China relationship.

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Japan was the world's largest donor of Official Development Assistance (ODA)¹ between 1990 and year 2000. Due to the severe fiscal situation in Japan foreign aid is now, since two year back, being cut by 10 percent a year. The U.S. has regained its position as the top donor and announced further increases in aid spending. The European Union has also set new goals of increasing spending. This makes Japanese government officials worry about influence wane. At the time of the World Summit on Sustainable Development in Johannesburg Yomiuri Shimbun had an article on how reduced ODA as well as a delayed implementation of the Kyoto Protocol had destroyed Japan's dream of playing a leading role at the summit.² At the same time as the budget is cut and the slogan of valuing "quality over quantity" is heard more frequently there are substantial changes being undertaken in Japanese foreign aid.

The main part of Japanese aid is directed to Asia and there has been a strong emphasis on economic infrastructure, that is building railways, roads and ports etc. Recently however there is a refocusing towards environmental aid and "softer" types of aid such as poverty alleviation and social infrastructure. ODA that used to be based on the request from the recipient countries has become much more politicised, with Japan itself making country assistance plans indicating what fields they are willing to provide aid in. This is not always popular with the recipient government as in the case of China. In this case it has actually made Japan's already complex relation with China even more complicated.

The paper will start with a short historic review of Japanese ODA policy and the characteristics of Japanese aid. This will be followed by an explanation of the changes going on in Japanese foreign aid policy and finally we will see how this how this effect aid to China and the role of aid in the future Japan-China relationship.

A short historic Review of Japanese Foreign Aid

In 1994, Japan celebrated, according to the Foreign Ministry, the 40th anniversary of its ODA program.³ But since the term ODA (see footnote 1) was first used by OECD in 1969, one has to assume that Japan meant the 40th anniversary of its foreign aid program, or rather its program of economic co-operation (*keizai kyō ryoku*), a terminology most commonly used in Japan. Economic co-operation is a wider concept consisting of three parts that besides aid (ODA) includes other official flows (OOF⁴) and private direct investment. It is within this framework that Japanese aid is firmly placed.

Japan's contribution of USD 50,000 to the Colombo plan in 1954 together with the war reparation agreements with Burma in 1954, the Philippines in 1956 and Indonesia in 1958 are seen as the origin of Japan's aid program. The war reparations were given to build up what had been damaged during WW II. It was tied to procurement from Japanese companies, and in that way it also served the purpose of promoting exports from Japan. In 1957, the yen loans from the Export-Import Bank started. They went mainly to Asia, and besides filling certain needs in the developing countries they also served the purpose of establishing Japanese industry in the area. Aid in the 1960s was almost exclusively directed towards Asia and overwhelmingly served Japan's commercial purposes. This pattern changed with the oil crisis of 1973 when a huge aid-package began for the Arab world to secure the supply of oil. As a consequence of this crisis, a stable supply of natural resources became another ingredient of Japanese aid policy.

Trade was a prerequisite to obtaining resources, and Japan recognized its interdependence with developing countries and a certain amount of infrastructure was needed to conduct such trade. This is one of the reasons for the huge amount of aid money being spent on infrastructure development in Asia. It was seen as a necessary cost for achieving a secure and peaceful world as well as Japan's own economic development. Humanitarian considerations, as a reason for aid, did not appear with any weight until the late 1970s.

In 1977, the first of a number of aid doubling plans was announced. The wish to be respected in the international community was another motive for those plans that eventually turned Japan into a leading donor. It was also a way of improving Japan's image in Asia where Japanese businessmen had left far from favourable impressions of their country. This was the start of the gift-giving diplomacy (*omiage gaikō*), which Japanese Prime Ministers touring Asia has extensively used.

The Characteristics of Japanese Aid

During the 1990s, Japan was the world's biggest donor of ODA in absolute terms. However, in terms of percentage of GNP the figures are much less impressive. Japanese ODA in 1998 was 0.28 per cent of GNP⁵, which was below average among DAC countries. Still it was a considerable increase compared with 1996 when it was only 0.20 per cent of GNP, one of the lowest figures among the DAC countries. When it comes to the quality of aid (as measured in purely economic terms, by grant share and grant element), Japan has performed very poorly. This clearly demonstrates one of the peculiarities of Japanese aid: it is to a large extent based on loans and the recipients are expected to repay them although the loans come with a long grace period and a low interest rate.

A significant difference between Japanese loan aid and that distributed by others (mostly multilateral organisations) is its limited staff number. OECF, the organization distributing Japanese ODA-loans in the 1990s, used to have a staff of around 300 people. The World Bank with loans slightly more than double those of OECF, has a staff of around 6000.⁶

Another characteristic of Japanese aid is its heavy emphasis on Asia. In 1998, 62.4 per cent of all bilateral aid went to Asia. Asian countries receive the main part of their aid in the form of loans, receiving a total of 91.5 per cent of all the loan-aid. The number one recipient on a cumulative basis is Indonesia. China has a much shorter history of receiving aid but is quickly catching up and was the largest recipient during much of the 1990s.

A comparison of the content of Japanese ODA with other countries clearly shows an emphasis on economic infrastructure development (39 per cent of total). Within the category of economic infrastructure, transport receives the largest amount of ODA. A total of 23.5 per cent of Japanese ODA is in this sector.

In the 1990's, Japanese ODA, at least verbally, became more politicised and more environmentally conscious. The 'ODA Charter', which was adopted in 1992, called for the consideration of the following principles in aid implementation.

1. Environmental conservation and development should be pursued in tandem.
2. Any use of ODA for military purposes or for aggravation of international conflicts should be avoided.
3. Full attention should be given to trends in recipient countries' military expenditure, their development and production of weapons of mass destruction and missiles, their export and import of arms.
4. Full attention should be given to efforts for promoting democratisation and the introduction of a market oriented economy, and the situation regarding the securing of basic human rights and freedoms in the recipient country.

These principles were well in line with the policy of other major donors at the time. That Indonesia and China have remained the main recipients of Japanese ODA after the adoption of this charter makes it very clear that it is not the performance in these areas that are decisive in Japan's decision to extend aid or not. It is the trends in these areas that the Japanese authorities claim that they are watching. The validity of the first principle as such can be questioned as Japanese ODA has a strong emphasis on economic infrastructure development and such projects usually implies a certain amount of environmental destruction.

The third principle has been applied, to a certain extent, in connection with Chinese nuclear tests, which led to a temporary stop of a minor part of the aid-flow (see below).

Policy Changes

In its latest five-year medium-term policy document on ODA, announced in August 1999, the future approach and priority issues are outlined. Japan will emphasize DACs "Development Partnership Strategy" in which the improvement of living standards of all humankind is the main objective of development co-operation. A number of specific goals for social development are also formulated. They include a reduction by one half the proportion of people living in extreme poverty, provision of universal primary education, and the elimination of gender disparity in education. The key to realizing these goals lies in self-help efforts as developing countries work towards economic take-off. The importance of improving the environment for private sector activities and inflow of private funds is emphasized, as is increased opportunities for Japanese business to participate in ODA projects as well as further coordination between the different forms of economic co-operation (that is ODA, OOF and private investment).

According to this policy document, special "country assistance programs" are to be formulated for major recipients. The programs will specify the significance of the assistance provided by Japan, its basic objectives, the priority issues and fields and the forms of assistance to be deployed. These programs will take into account coordination with other donors as well as the private sector.

This is a considerable change from the earlier policy of approving ODA on a request basis. It will further strengthen the Japanese influence on how its aid money will be used and therefore it might not be so popular among the recipients. It also implies that there will be stronger co-operation between the two implementing agencies: JICA (that deals with the grant aid and technical assistance) and JBIC⁷ (that is in charge of the loan aid as well as OOF).

The Japanese-Chinese ODA Relationship from Past to Present

War reparation from Japan was never paid to the Peoples Republic of China although they suffered under the Japanese aggression. After WW II both the Peoples Republic of China and Taiwan renounced reparations. The Japanese Peace Treaty was not signed by the Peoples Republic of China in 1951 and a year later Japan, an ally of the United States, signed a treaty with Taiwan. From the inception of its aid program, Japan extended assistance to Taiwan. This continued until the initiation of Japan's diplomatic relations with the Peoples Republic of China in 1972.

An ODA program to the Peoples Republic of China commenced after the declaration of an open door policy and Prime Minister Ohira Masayoshi's visit to China in 1979. Since that time ODA has grown enormously. Between 1982 and 1986, China was the single largest recipient of ODA from Japan. The incident at Tiananmen Square in 1989 led to a temporary cessation of ODA, but aid was soon resumed, Japan being the first nation to restore friendly relations with China⁸. In August 1989 it lifted the freeze on ongoing projects and in October that year the World Bank resumed its lending to China for humanitarian aid. After that, Japan extended grant aid and in July 1990 it announced that all aid would gradually be resumed. Soon after that other industrialised countries followed one after another. Since then China has remained as one of the major, if not the top, recipient of Japanese aid.

On a bilateral level Japan has been the largest contributor of ODA to China. It has usually contributed twice as much as the second donor and often more than the largest multilateral donor IDA of the World Bank.

The largest part of the aid is given in the form of loans. This has made up 75 per cent of the total aid. The loans have been announced in the form of four packages of five year each⁹, matching with the Chinese five-year plans. In fact, the Japanese loan-aid has been provided only to projects included in the Chinese own plans. This is a strong deviation from Japan's

regular budgetary procedures of annual commitments. This is a special treatment that has been extended only to China.

The five-year packages have all been orally announced by Japanese Prime Ministers to Chinese leaders on different occasions. This can be seen as a proof of the political importance of ODA loans to China. Such matters are not delegated to the bureaucracy to handle but are presented by Japanese Prime Ministers in connection with meetings where other matters are also discussed.

The first two packages of ODA loans (1979-1984: 331 billion yen and 1984-1989: 540 billion yen) were characterized by the fact that financing for transportation infrastructure project, particularly for coal transportation had been emphasised. In the third package (1990-1995: 810 billion yen) the scope was somewhat broader as was the number of projects. In addition to transportation projects there were water supply and sanitation, gas supply, communication projects to link together several cities, fertilizer plant projects and infrastructure projects in economic development zones.

The concession by the Japanese to accommodate the Chinese five-year plans has a number of practical implications. One of these is that it has been difficult to make major changes during this period even if the priorities of Japanese ODA policy changes.

When the Japanese ODA charter was adopted in 1992 it could not be applied to the content of the third yen loan package as this had already been approved. That is one of the reasons why the Japanese side now has decided to abandon the five-year package system and provide Japanese ODA on a yearly basis from 2001.

The Chinese nuclear testing in 1995, which was in direct violation of Article 3 of the ODA Charter, led to a temporary 'freeze' of Japanese grant aid. This was partly due to a strong local opinion in Japan against the testing. As grants are only around six per cent of the total aid, it did not effect the amount of aid to China in any major way. The freeze was ended

when the testing was over in 1997. The withholding of aid while China was making nuclear tests created a lot of bad will in China. The Chinese saw this as a major change from the days when aid was given partly for geopolitical reasons such as a strong Japanese interest in Chinese natural resources and its market and partly as a compensation for the war reparations that were never paid¹⁰. It was also a deviation of the old Japanese policy of trying to separate politics from economics (*seikei bunrei*).

In a Japanese climate where foreign aid, and especially that directed to China, is being questioned, there have been attempts to use ODA to put power behind Japanese demands in other areas. The most recent example is the special yen-loans for the ‘Beijing Urban Railway Construction Project’ and the ‘Xi’an Xianyang International Airport Terminal Expansion Project’ (17.2 billion yen). Agreement was supposed to be reached in the summer of 2000, but although there was no formal freeze, procedure was slowed down due to opposition raised in the ruling Liberal Democratic Parties foreign affairs committee. The main reason for the opposition was that these were strictly economic infrastructure projects, which were no longer a priority area for Japanese ODA. However, there were also voices that opposed due to the increase of Chinese naval vessel activities in Japan’s exclusive economic zone, which were perceived as a military threat.¹¹ Foreign Minister Kono Yohei brought up this issue during his visit to China in August and at that time the two countries agreed to set up a formal notification mechanism for naval vessels entering into their respective exclusive economic zones. On September 7 the foreign affairs panel members approved the loans, and final signing took place in Beijing on October 10 2000 just before the Chinese Prime Minister Zhu Rongji’s visit to Japan.

This new tendency of using aid as a leverage in discussion on other issues is likely to lead to friction in the future. During his visit the Chinese Prime Minister warned Japan against

using ODA to China as a diplomatic card.¹² In China, such actions are seen as an attempt to intervene in their domestic affairs.

Policy Changes

The fourth yen loan package (1996-2000: 580 billion yens for the first three years and 390 billion for the following two), in addition to the economic infrastructure undertaken so far, emphasized the environment and agriculture and in terms of regional development, the development of the inland.

Environmental preservation, put forward as a priority area for Japanese ODA in general, received a share of 16 per cent of the yen loans. A majority of the projects in the last two years of the fourth yen loan package, 18 out of 28, were directed at the inland area.

Figures from OECD¹³ show that the Peoples Republic of China was the single largest recipient country of ODA in 1998. It received 2.4 billion US dollars, 6.7 per cent of all ODA. Japan is the main provider of ODA to China at present. A problem with it is that it is not all that popular in Japan. Neither is ODA in general. Aid to China has been in the center of the debate. Articles like the one by Komori Yoshiki in *Chū ō Kō ron*¹⁴ has pointed out how it has been used to build luxurious subways that very few people use in Beijing whereas people in Tokyo have to put up with old and very crowded one. He compares the Beijing airport with its 51 elevators with the much smaller crowded Narita airport in Tokyo, suggesting that the Japanese government should rather think of their own taxpayers than wasting money in China. Others have also suggested substantial changes in Japanese aid to China.¹⁵

According to the present plan for ODA, Japan is to formulate a 'country assistance program' for all the major recipients. MOFA (the Ministry of Foreign Affairs) is in charge of formulating such a program and it started to do so for China three years ago. Due to severe criticism of the aid to China in the mass media and the political debate on the aid to China

even within the governing LDP party formation of the program was stopped¹⁶. The main points of criticism were that:

- China itself is an aid-providing country and does not need to be a recipient country.
- Japan's aid to China is not visible to the Chinese people.
- Aid projects are not properly evaluated.
- Aid allows the Chinese government to allocate more of its budget to a military build up.
- China must take its own initiative in solving problems such as poverty

To solve the deadlock over the country assistance program to China a round table conference composed of 15 people from academia, the private sector and non-governmental organizations was organized to give advice. In their report published in December 2000¹⁷ they suggested radical changes of Japanese ODA. These were adopted as official policy in the Autumn of 2001.

Aid decisions should be made according to the conditions at the time and how well the project matches with development priorities in the country assistance program. This is a radical change. Before the change China, as well as many of the other recipient countries in Asia, has known roughly how much money to expect every year. Now China has to come up with suggestions that are considered interesting enough for Japan to support and can not take for granted that they will get a certain support.

Concerning the priority areas, a move from infrastructure development in the coast areas towards more environmental and social infrastructure in the inland is adopted and the focus on inland and environment has been be sharpened. There is also a decision of more 'soft' type of aid such as help to strengthen the legal framework for economic transactions as well as good governance. Other priority areas are an increase of mutual understanding through an increase in exchanges on a number of levels, poverty alleviation and different

measures to support Japanese business interests in China. Money is also put aside for the specific purpose of making the Japanese aid visible in the form of advertisements etc.

This new policy became clearly visible when ODA yen loans were extended in March 2002.¹⁸

Of the 15 ODA loan commitments, seven projects or 54% of the total loan amount (161,366 million yen) are for the environmental protection. Six projects or 19% are for the higher education projects, two projects or 27% of the total loan amount are for the regional development projects. Of the 15 ODA loan commitments, 13 projects or 85% of the total loan amount are for inland region assistance projects and are expected to narrow the income gap between the coastal and inland regions in a comprehensive way.

The Role of Aid in the Future Relationship

As for ODA to China, it seems that the Japanese government is now trying to take the initiative over what projects that its aid money is used for. Up to now the decisions with regard to the most important projects for economic development has been done by the Chinese government. Now there is a new thinking that it is Japan that should set the priority areas according to their own policy and that Japan's own national interests also should be taken into consideration¹⁹. One sign of this is the cessation of the five-year loan-aid packages coordinated with the Chinese five-year plans. Another is the emphasis on environment and anti-poverty measures, the areas that are not necessarily the main priorities of the Chinese government.

On the political level, ODA will continue to be of importance in the two countries' relationship. Japanese Prime Ministers are likely to continue with their gift giving diplomacy in connection with meetings with Chinese leaders where other matters are also discussed. In a sense ODA will have the function of being the glue that keeps the relations together.

The positive way of using ODA, having it as a proverbial carrot, will still be important. The negative use, such as freezing grant aid in connection with Chinese nuclear

testing, is likely to cause frictions. The Chinese continued the testing according to its own schedule and the freeze of aid only created a lot of ill feelings and a sense of distrust. The prolonging of the procedure for the special yen loans in the summer of year 2000 is an example of how the public opinion at home can make Japanese politicians use ODA to make their protests against Chinese behaviour heard. This way of using aid is quite risky however, as it might arise anti-Japanese feelings. The internal debate in Japan on ODA to China has also clearly revealed Japanese sentiments towards China²⁰. To a certain extent ODA has already become another 'issue' between the two countries.

Japan has strong motivations for wanting to integrate China into the world community and help it prosper rather than trying to isolate it and impose sanctions. One, Japan is one of the main holders of Chinese debt. Two, a policy of isolation would most likely also hurt Japanese business interests and, three, it might create instability in China, which is something Japan would not like to have.

Still, there is a great need for capital in China as there are many projects that need financing. Japanese ODA loans are one of the most favourable ones available on a large scale, since IDA of the World Bank stopped theirs. This makes it likely that the Chinese will read the Japanese country assistance plan carefully and try to squeeze some of the projects they already have in the pipeline into the different priority areas so that they will be eligible for aid. To a certain extent they will agree to Japanese ODA loans even for projects that might not be their highest priority. The interest is likely to decrease as conditions are increasing however and in no way, will they let Japan govern their development process.

In the future there is likely to be a decrease of ODA considering the policy changes and the severe fiscal situation in Japan as well as the fact that China has reached a higher developmental level itself and has a booming economy. It should be pointed out that although China is the largest recipient ODA, it only amounted to 0,2 per cent of Chinese GNP, which is

rather low.²¹ Foreign direct investment and trade will grow in importance and there will be an increase in OOF instead of ODA. This will be the case especially in the coastal areas, that is not a priority area of ODA any longer, but where there is a great interest from the Japanese business community. Conditions might be less favourable for OOF than for ODA, but this is a field where there is less transparency and Japanese business interests can more easily be promoted.

¹ Aid will be defined here according to the same rules as ODA within the OECDs Development Assistance Committee which means that it should be 1) resources provided by official agencies or by their executing agencies; 2) the main objective being the promotion of the economic development and welfare of the developing countries; 3) its concessional character is due to the effort to avoid placing a heavy burden on developing countries, and thus consists of a grant element of at least 25 percent.

² Yomiuri Shimbun, August 26, 2002.

³ Foreign Ministry, *Waga Kuni no Seifu Kaihatsu Enjo 1994*, p. 1 as well as in the OECF *Annual Report 1994*, p. 3.

⁴ Different kind of official flows that have conditions that are not concessional enough to make them qualified as ODA.

⁵ The following figures are from Foreign Ministry, *Waga Kuni no Seifu Kaihatsu Enjo 1999*.

⁶ Marie Söderberg (ed.), *The Business of Japanese Foreign Aid – Five Case Studies from Asia*,

London, Routledge, 1997.

⁷ JBIC, Japan Bank of International Co-operation was created through a merger in 1999 of the Japan EXIM Bank, which used to deal with OOF and OECF, the Overseas Economic Co-operation Fund that was implementing agency for the ODA loans.

⁸ For a detailed account of this see Quansheng Zhao, *Japanese Policymaking, The Politics Behind Politics- Informal Mechanisms and the Making of China Policy*, Oxford and New York, Oxford University Press, 1995 pp. 161-185.

⁹ The fourth package was divided into three plus two.

¹⁰ See for example Jin Xide, 'Chū nichi Seiji Masatsu no Koozu, Genin Oyobi sono Sū sei', in *Senshū Daigaku Shakaikagaku Kenkyū jo Geppō* No.430, Tokyo 1999.

¹¹ The Daily Yomiuri Aug. 9, 2000.

¹² Japan Times October 9, 2000.

¹³ OECD, *The DAC Journal Development Co-operation 1999 Report*, Volume 1, No 1, 2000.

¹⁴ Komori Yoshihiki, 'Machigaidarage no Chūgoku Enjo', *Chū ō Kō ron*, March 2000 pp. 94-109.

¹⁵ See for example Miyamoto Yūji, ‘Tai Chū Keizai Enjo Dō Suru ka’, in *Gaiko Forum* 8, 2000 pp. 78-82.

¹⁶ Interviews at JICA in Tokyo, June 2000.

¹⁷ 21Seiki ni Muketa tai Chu Keizai Kyō ryoku no Arikata ni Kan Suru Kodankai. Their proposal can be found at

http://www.mofa.go.jp/mofaj/gaiko/oda/seisaku/seisaku_1/sei_1_13_4.html

¹⁸ JBIC News Release March 29 2002.

¹⁹ See for example OECF Japan News Letter, Special Report on China, Their proposal can be found at

http://www.mofa.go.jp/mofaj/gaiko/oda/seisaku/seisaku_1/sei_1_13_4.html March 1999.

²⁰ A recent example of this is Tomoyuki Kojima’s, Chū goku o ‘Sekinin aru taikoku’ ni suru tame, *Gaikō Forum* 2 february 2001.

²¹ OECD, *The DAC Journal Development Co-operation 1999 Report*, Volume 1, No 1, 2000.