

# Japan's Official Development Assistance: Recent Issues and Future Directions

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**ABSTRACT:** This paper discusses recent issues related to Japan's official development assistance (ODA) and possible future trends for the provision of such assistance. While Japan remains the world's largest donor nation, given its prolonged economic stagnation and mounting public sector debt, the Japanese government is under increasing public pressure to reduce ODA budgets and to use ODA in more explicit pursuit of Japan's own economic and political interests. Internationally, Japan continues to attract criticism for its emphasis on infrastructure-related projects and for its restrained willingness to participate in multilateral partnerships. This paper argues that Japan can meet these domestic and international challenges by developing a coherent national strategy for ODA, broadly designed to enhance effectiveness, accountability and transparency.

## INTRODUCTION

This paper presents an overview of recent issues surrounding Japan's official development assistance (ODA) and recommends desirable directions for the future. The importance of this topic cannot be overstated. Japan has been the world's largest provider of ODA since 1991; its ODA in 2000, at US\$13.1 billion, far exceeded that of the second largest donor country, the United States, valued at \$9.6 billion. However, recent economic and political developments have already substantially altered (and will continue to alter) the way Japanese ODA is administered. For example, for the first time in history, the ODA budget for fiscal year (FY) 2001 was reduced

from the previous budget, by 3 percent for general account allocations and by 4 percent for overall budgetary allocations. In the coming years, such changes will undoubtedly have a major impact not only on Japan's international economic relations but also on the international development community at large.

The issues involved are multidimensional. On the domestic front, the Japanese economy continues to stagnate, with large fiscal deficits and mounting public debt. As a result, the business community has been increasingly vocal in opposing the provision of ODA, which has not benefited Japanese economic interests directly. The public has called for greater accountability, and lamented the "faceless" tendency (lack of



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visibility) of Japanese assistance. Many argue that Japan has not captured returns commensurate with costs, even if ODA is considered merely a diplomatic tool. Provision to countries with rising military expenditures and/or weapons of mass destruction has also provoked public outrage. In particular, recently deteriorating relations with the People's Republic of China have influenced ongoing public debates on ODA.

Despite Japan's generous contributions to multilateral institutions, many in the international development community criticize Japan for heavy emphasis on bilateral loans to economic infrastructure-related projects and for restrained willingness to participate more openly in a multilateral framework. Experts generally agree that effective development aid depends on the existence of sound policies and institutions and that, owing to the fungibility of development aid, the return on a project is nothing but the marginal return on the overall development program of the country concerned. Thus, a reorientation of Japanese aid toward policy reform and institution building, within the context of a broader cooperative framework, would benefit the developing world. Japanese policymakers are aware of these criticisms but have made only a limited (though by no means insignificant) effort in this direction. They are, however, under domestic and international pressure to formulate a coherent ODA strategy subject to an entirely new set of constraints.

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The rest of the paper is organized as follows. Section II provides an overview of Japanese ODA in historical and comparative perspectives, Japan's motives for giving development assistance, and the institutional setup. Section III summarizes the salient features of Japanese ODA, including the high proportion of loans, the dominance of untied aid, the large share of ODA going to Asia, the dominance of hard infrastructure, and Japan's restrained willingness to participate in partnerships with other stakeholders. Section IV discusses the nature of the emerging criticisms of Japanese ODA, the waning public support for ODA, and the recent and prospective cuts in ODA budgets. Section V takes up the thorny issues relating to the People's Republic of China. Finally, by way of conclusion, Section VI summarizes several recommendations for the future of Japanese ODA.

### JAPAN AS THE WORLD'S LARGEST DONOR NATION

#### 1. Comparative and historical perspectives on Japanese ODA

According to the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), Japan has been the world's largest provider of ODA since 1991 (Table 1). In 2000, for example, the volume of Japanese ODA, at \$13.1 billion, far exceeded that of any other major donor country, such as the United States (\$9.6 billion), Germany (\$5.0 billion), the United Kingdom (\$4.5 billion), or France (\$4.2 billion), although it was about a half the aggregate amount of all European Union countries combined (\$25.4 billion). Moreover, excluding contributions and subscriptions to multilateral institutions and including both ODA and other official flows (OOF), whose concessionality is generally lower than that of ODA, Japan has also been the largest provider of bilateral official assistance to developing countries, giving nearly \$18.8 billion in 1999 (the latest year for which detailed breakdown

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**Table 1. ODA Flows Provided by Major DAC Members in Selected Years**  
(Billion US dollars; percent of total in parentheses)

	Japan	USA	European Union							Total Bilaterals *
			Germ.	UK	France	Neth.	Denm.	Italy	Total *	
<b>1990</b>	9.1 (17.2)	11.4 (21.5)	6.3 (11.9)	2.6 (4.9)	7.2 (13.6)	2.5 (4.7)	1.2 (2.3)	3.4 (6.4)	28.6 (54.0)	53.0 (100.0)
<b>1995</b>	14.5 (24.6)	7.4 (12.6)	7.5 (12.7)	3.2 (5.4)	8.4 (14.3)	3.2 (5.4)	1.6 (2.7)	1.6 (2.7)	31.7 (53.8)	58.9 (100.0)
<b>1998</b>	10.6 (20.4)	8.7 (16.8)	5.5 (10.6)	3.8 (7.3)	5.7 (11.0)	3.0 (5.8)	1.7 (3.3)	2.3 (4.4)	27.7 (53.3)	52.0 (100.0)
<b>1999</b>	15.3 (27.1)	9.1 (16.2)	5.5 (9.8)	3.4 (6.1)	5.6 (10.0)	3.1 (5.6)	1.7 (3.1)	1.8 (3.1)	26.8 (47.5)	56.4 (100.0)
<b>2000</b>	13.1 (24.6)	9.6 (18.1)	5.0 (9.5)	4.5 (8.4)	4.2 (8.0)	3.1 (5.8)	1.7 (3.2)	1.4 (2.6)	25.4 (47.9)	53.1 (100.0)

Note: Net disbursements, including bilateral ODA and contributions to multilateral institutions. Figures for 1990 include the debt forgiveness of non-ODA claims, except in total bilateral figures. Figures for 2000 are provisional.

Source: OECD, DAC.

\* Totals include donor countries not itemized in this table.

is available).<sup>1</sup> The total amount of Japan's bilateral official assistance (including OOF) exceeded even the aggregate total of the EU countries combined, which stood at \$17.0 billion.

Japan's development assistance program began on a modest scale in the mid-1950s, in the form of reparations and quasi-reparations for the wartime damages Japan had inflicted upon the Asian countries. Reparations were paid to four countries (Burma, the Philippines, Indonesia and South Vietnam) over 1955-1965, for the amount of about \$1 billion. Additional economic assistance was provided to other Asian countries that had renounced their claims to formal reparations, including Thailand, Korea, Singapore and Malaysia; as these funds were provided in the spirit of reparations, they were called "quasi-reparations" in Japan (Takagi 1995). At the same time, Japan also initiated a technical cooperation program as a participant in the Colombo Plan.<sup>2</sup>

In the early 1960s, Japan gradually began to expand its development assistance program, and

became an important member of the international donor community. In 1960, it became one of the nine member countries of the Development Assistance Group, which was reconstituted as the DAC within the OECD in the fall of 1961. In the same year (1960), it joined the International Development Association (IDA), a World Bank affiliate, and contributed \$33.5 million to the total capital of \$1 billion. Japan also played the leading role in the establishment of the Asian Development Bank (ADB) in 1966, with the initial contribution of \$200 million, equal to that of the United States.

Throughout the 1960s, the volume of Japanese ODA increased steadily, rising from about \$100 million per year to about \$500 million. By 1970, Japan had become the fifth largest donor country, behind the United States, France, West Germany and the United Kingdom. Japan surpassed the United Kingdom in 1972, West Germany in 1983, France in 1986 and, temporarily, the United States in 1989. In the 1970s and 1980s, the US dollar value of ODA increased by almost twenty-fold, from about \$500

<sup>1</sup> See Appendix Table C. According to the convention adopted by the DAC, an official flow must be aimed at promoting economic development and welfare in developing countries and be provided at concessional financial terms (i.e., with a grant element of at least 25 percent) in order to qualify as ODA. Otherwise, the official flow is classified as OOF. According to DAC practice, moreover, official flows that otherwise meet the ODA requirements are not considered as ODA if they are directed to countries on Part II of the DAC List of Aid Recipients (i.e., transition or high-income economies) and to multilateral institutions which primarily benefit them. Such aid is called official aid (OA) and is not included in ODA in Table 1 or Table 2.

<sup>2</sup> The Colombo Plan was initially established by the British Commonwealth countries in 1950 as an arrangement for facilitating technical and financial assistance to the member countries of South and Southeast Asia. Japan became a member in late 1954.

million to about \$9 billion. After Japan became the largest provider of ODA in 1991, the volume continued to rise steadily in the 1990s. Over these periods, the net US dollar value of OOF fluctuated up and down corresponding to the value of interest and amortization receipts; in gross terms, however, the value of OOF was almost as much as, if not more than, the value of ODA on an annual basis.

## 2. Institutional setup of ODA administration—multiple motives for giving aid

The large size of Japanese ODA (and OOF), supported by Japan's expanding economy over the years, reflects the country's pursuit of both economic and political interests. First, as a trading nation, it is in the interest of Japan to help promote the economic development of its trading partners, particularly in neighboring Asia, and to create and preserve a world of peace and stability, a necessary condition for stable trade and investment. In the early years of its official assistance program, economics was undoubtedly the overriding motive for giving aid. Japan used aid as a way to secure sources of raw materials for its industry and to open markets for its exports (Takagi 1995). Economic considerations

continue to play an important part in policy making; the preferences of the business community are voiced through the Ministry of Economy, Trade and Industry (METI).<sup>3</sup>

Second, the constitutional limitation on military spending has not only allowed a larger budgetary allocation on development assistance (relative to other countries), but also increased its usefulness as a tool of international diplomacy. Over the years, as the position of Japan as a major economic power was solidified, the Japanese government has assumed an increasingly assertive attitude towards use of aid as a diplomatic tool. Reflecting the rising influence of the Ministry of Foreign Affairs (MOFA) in ODA decision making, in a cabinet decision of 1992, the Japanese government issued an "ODA Charter," setting forth the principles of (1) concern for the environment, (2) avoidance of military use of ODA, (3) attention to ODA recipients' military expenditure and development of weapons of mass destruction, and (4) attention to the promotion of democracy, market economy, and basic human rights (see Box 1).<sup>4</sup>

These economic and political motives in part correspond to what Hook and Zhang (1998) have

**Table 2. Net Official Flows to Developing Countries, 1999**  
(Million US dollars)

	ODA Flows				ODA and OOF Flows			
	Total	Asia	Africa	Americas	Total	Asia	Africa	Americas
<b>Bilateral Flows</b>								
<b>Japan</b>	10,476	6,997	1,214	814	18,751	17,403	978	-657
<b>United States</b>	6,848	1,675	1,970	1,238	11,641	2,436	2,066	5,193
<b>European Union</b>	16,810	3,078	6,253	1,897	16,915	3,452	6,640	1,084
<b>France</b>	4,125	321	2,075	167	4,121	315	2,336	-98
<b>Germany</b>	3,278	1,072	1,063	398	3,238	1,421	1,082	37
<b>United Kingdom</b>	2,249	503	806	306	2,184	418	829	327
<b>DAC Total</b>	37,862	12,647	10,291	4,240	52,344	24,981	10,542	6,395
<b>Multilateral Development Banks</b>	14,206	4,673	5,474	1,764	28,022	10,571	5,132	10,008

*Note:* ODA includes grants and concessional loans only. Bilateral ODA (or OOF) flows in the table exclude donors' contributions to multilateral institutions. Excludes Part II countries.

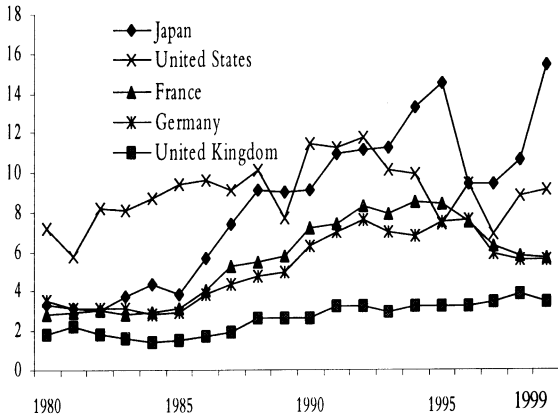
*Source:* OECD DAC.

<sup>3</sup> As part of the major reorganization of the central government administration in January 2001, the Ministry of International Trade and Industry (MITI) was renamed the Ministry of Economy, Trade and Industry, with a slight change in its responsibilities. The MITI's influence over ODA loans was strong in the past, when substantial part of disbursement was tied, because of the ministry's knowledge of firms interested in procurements. As ODA loans became less tied and more open to foreign firms, however, its influence began to wane.

<sup>4</sup> Essentially the same principles had been announced in April 1991, in the so-called "four principles" (Arase 1993; Takagi 1995).

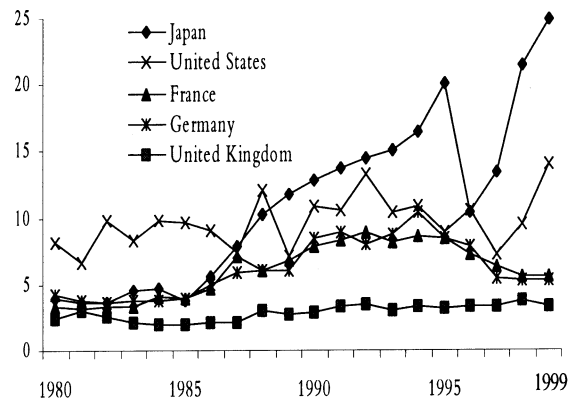


**Figure 1. Total Official Development Assistance, 1980-1999 (Billion US dollars)**



Includes bilateral assistance and contributions to multilateral agencies  
 Source: OECD, DAC

**Figure 2. Total Official Development Assistance and Other Official Flows, 1980-1999 (Billion US dollars)**



Includes bilateral assistance and contributions to multilateral agencies  
 Source: OECD, DAC

characterized, respectively, as the “METI discourse” (advocating the use of aid to advance Japan’s own economic interest) and the “MOFA discourse” (advocating the use of aid to support Japan’s international diplomacy and to pursue the internationally accepted goal of improving the economic and social conditions of low-income nations).<sup>5</sup> MOFA’s view more closely reflects those of United Nations (UN) agencies, since MOFA maintains jurisdiction over contributions to the UN.<sup>6</sup> Between these two opposing constituencies, the Ministry of Finance (MOF) enters the decision-making process from the standpoint of fiscal authority (Hirata 1998) and as a self-appointed guardian of the international financial system (Table 3). The MOF has generally concerned itself with growth in the total volume of ODA and with limiting the level of exposure to any one country, and has preferred loans to grants as a way of conserving fiscal resources. Using aid to

maintain an orderly international financial system—as demonstrated during the Latin American debt crisis of the 1980s and the East Asian financial crisis of 1997-98—may rightly be termed “the MOF discourse.”<sup>7</sup> The MOF also has an institutional interest in increasing appropriations and contributions to multilateral financial institutions, such as the World Bank and the International Monetary Fund (IMF), over which it has exclusive jurisdiction. What this implies is that the MOF oversees multilateral assistance through the MDBs, while the MOFA, in principle, oversees bilateral development assistance.

To outside observers, the fragmented decision-making apparatus has been a source of controversy concerning the nature and motives of Japanese ODA. Arase (1993), for example, has observed that the willingness to use aid for political purposes, particularly the promotion of democracy and human rights, has been more rhetorical than real. Likewise,

<sup>5</sup> In their original phraseology, the METI should be replaced by the MITI.

<sup>6</sup> Prior to January 2001, the Economic Planning Agency (EPA) was also part of this ODA policymaking apparatus, as the supervisory agency of the Overseas Economic Cooperation Fund (OECF). However, its role was only nominal. It was given jurisdiction over the OECF in the first place because the other three powerful ministries could not agree on which of them should be given jurisdiction. When the functions of the EPA were merged into the Cabinet Office, its jurisdiction over ODA decision making was eliminated, and the MOFA was given jurisdiction over the Japan Bank for International Cooperation (JBIC)—see footnote 12. The Cabinet Office has a say over ODA from the perspective of macroeconomic management. No agency, however, has a coherent institutional apparatus to oversee Japan’s ODA activity from an integrated point of view.

<sup>7</sup> We owe this view to Jiro Tominaga, who provided insightful comments on this issue.





### **Box 1: Principles of Japan's Official Development Assistance Charter**

Taking into account comprehensively each recipient country's request, its socioeconomic conditions, and Japan's bilateral relations with the recipient country, Japan's ODA will be provided in accordance with the principles of the United Nations Charter (especially those of sovereign equality and non-intervention in domestic matters), as well as the following four principles.

- (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 paid to trends in recipient countries' military expenditures, their development and production of mass destruction weapons and missiles, their export and import of arms, etc., so as to maintain and strengthen international peace and stability, and from the viewpoint that developing countries should place appropriate priorities in the allocation of their resources in their own economic and social development.
- (4) Full attention should be paid to efforts for promoting democratization and introduction of a market-oriented economy, and the situation regarding the securing of basic human rights and freedoms in the recipient country.

*Note:* Cabinet Decisions, June 30, 1992. For a full text, see [www.mofa.go.jp/policy/oda](http://www.mofa.go.jp/policy/oda).

Hook and Zhang (1998) have argued that, despite the “rhetorical alignment of Japanese aid policy” with those of most other donors and international development organizations (as championed by the “MOFA discourse”), economic and commercial motives (as championed by the “METI discourse”) remain dominant. Moreover, according to their view, while the METI and MOFA discourses continue to frame the debate on Japanese ODA, the divergence between the two had virtually disappeared by 1998, as the Japanese government took a more explicit stance towards development assistance as an instrument to promote its own economic revival (Hook and Zhang 1998).

These views, however, do not seem to be consistent with the generally untied nature of Japanese ODA (for details, see the next section). In fact, it was the MOFA that vigorously promoted the untied aid policy to allow foreign firms to take part in bids for Japanese ODA loan projects, despite strong opposi-

tion from the METI and the business community (Hirata 1998). The MOFA has also been attempting to make greater use of aid for improving the economic, social and political conditions of the poor nations, including basic human rights, poverty alleviation, women in development, South-South cooperation, and other issues of common interest to wider members of the international development community. Katada (2000) has called these divided motives of Japanese aid policy a “two-track aid approach” and argued that this “schizophrenia” reflects the reality of the decision-making apparatus. Moreover, contrary to the views of Hook and Zhang (1998), she argues that the two discourses have increasingly diverged in recent years. In our view, however, what appears as “schizophrenia” is a mere reflection of the lack of political leadership and, hence, of a national strategy on ODA, resulting in the expression of uncoordinated views of different ministries with different aid motives.<sup>8</sup> In contrast,

<sup>8</sup> The METI, MOFA and MOF discourses should not be taken literally as the ironclad positions of the respective government ministries. Rather, they should be viewed collectively as a convenient way of modeling the fundamentally conflicting views of ODA held within Japanese society, each broadly (but not necessarily exclusively) aligned with the jurisdictional interests of the ministry concerned. Hence, what Katada (2000) has called “schizophrenia” may not be a clear-cut institutional split. Through the process of coordinated decision making across the MOFA, MOF and METI, a certain degree of consensus and convergence of views has been achieved on specific issues. Moreover, government ministries do not function in a vacuum but are subject to the influences of vested interests, public opinion and political economy. When Hook and Zhang (1998) observed that the METI and MOFA discourses had converged by 1998 to take on a decisively more mercantilist orientation, they were in fact noticing the impact of the business community's vested interest on the MOFA's attitude towards tied aid, given its desire to maintain business support for ODA.



most other major donor countries have a more focused aid philosophy, in part possibly reflecting the more centralized nature of aid administration.<sup>9</sup>

### 3. The budgetary process of Japanese ODA

Japan's ODA budget is funded from (a) the general account of the central government budget, (b) the Fiscal Investment and Loan Program (FILP), and (c) interest payments and repayments of principal on previous ODA loans as well as carryovers from previous years, under the trust funds (special accounts) of the central government budget. Two types of budgets, the ODA budget in the general account and the overall ODA budget, are prepared every year (see, for example, the fiscal 2001 budgets in Table 4). The overall ODA budget is the sum of the ODA budget in the general account and other sources. Typically, in gross terms, the overall budget is close to twice the size of the general account budget.

Though not shown in the table, Japan's OOF is financed mainly by non-general account sources.

Non-general account sources are funded through the FILP, which is an off-budget, government-supervised program of borrowing and lending. Most of the resources in the FILP have come from postal savings deposits, postal insurance premiums, and provident pension fund contributions entrusted with the Trust Fund Bureau of the Ministry of Finance, but some have also come from capital market funding. Almost all OOF activities have been financed by borrowing from the Trust Fund Bureau and the capital market. In April 2001, the FILP restructuring process began to separate the lending activities from the statutory funding activities in order to bring greater market discipline into the FILP.<sup>10</sup> As a result, postal savings deposits, postal insurance premiums, and provident pension fund

**Table 3. Japan's ODA Administration—Institutional Setup**

<b>Ministries (Bureaus) in Charge</b>	<b>Objectives; Agencies; Jurisdiction</b>
<b>Ministry of Foreign Affairs (MOFA)</b> <i>Economic Cooperation Bureau</i>	<ul style="list-style-type: none"> <li>● Promotion of Japan's international diplomacy.</li> <li>● Improvements of economic and social conditions in poor nations.</li> <li>● Implementing agencies: JICA (grants, TA); JBIC (ODA loans).</li> <li>● Jurisdiction over UN agencies.</li> </ul>
<b>Ministry of Finance (MOF)</b> <i>International Bureau</i>	<ul style="list-style-type: none"> <li>● Preservation of fiscal soundness of ODA budget and country exposures.</li> <li>● Securing a stable international financial system.</li> <li>● Implementing agencies: JBIC (OOF).</li> <li>● Jurisdiction over the IMF and MDBs.</li> </ul>
<b>Ministry of Economy, Trade and Industry (METI)</b> <i>Trade and Economic Cooperation Bureau</i>	<ul style="list-style-type: none"> <li>● Promotion of Japan's economic interest through expansion of trade and investment.</li> <li>● Assisting the development of environmental industries.</li> <li>● Implementing agencies: JICA (TA), JBIC (OOF)</li> </ul>

<sup>9</sup> For example, according to the United Kingdom's official position, its "development strategy is now focused on the reduction of abject poverty in the world" and is committed to focus all of its "development efforts on the achievement of the International Development Targets," as formulated by DAC members in May 1996 (United Kingdom, Department for International Development, *White Paper on International Development, 2000*). The position of the United States, on the other hand, is somewhat more diffused, as it attempts to accomplish both foreign policy objectives and humanitarian goals. Even so, its aid philosophy is focused on dealing with "the two most distinctive trends in the world since the fall of the Berlin Wall, globalization and conflict" and its aid activities are carried out under three "pillars": economic growth and agriculture, global health, and conflict prevention and development relief (Testimony of Andrew Natsios, Administrator of USAID, before the Senate Appropriations Committee, May 8, 2001).

<sup>10</sup> Starting in April 2001, the Trust Fund Bureau began to issue FILP bonds to finance its FILP activities. However, as a transitional measure to a more fully market-oriented regime, the postal savings and insurance, as well as pension fund schemes, are required for seven years to channel the contributed funds to the Trust Fund Bureau through purchases of these FILP bonds. The Trust Fund Bureau lends money to JBIC for extending concessional (ODA loans) and nonconcessional loans (OOF). To finance the negative interest rate spread for ODA loans that need to be provided at a low interest rate, JBIC receives interest subsidy from the general account.

**Table 4. Japan's ODA Budget, FY 2001 (Billion yen)**

	General Account	Other Sources	Overall Budget
<b>Grants</b>	740.3	179.2	919.5
<b>Bilateral</b>	606.6	23.9	630.5
<b>Multilateral</b>	133.7	155.3	289.0
<b>Loans</b>	306.3	660.5	966.8
<b>Gross Total</b>	1,046.6	839.7	1,886.3
<b>Less repayment</b>	--	374.8	374.8
<b>Net Total</b>	1,046.6	464.9	1,511.5

Source: Government of Japan.

contributions, which have served as an easy and plentiful source of funds for ODA loans, may no longer be directly available for this purpose. The non-general account sources may have to be raised in the market through issuing specific bonds (such as JBIC bonds). In short, ODA will continue to be financed by a mixture of the general account and borrowed funds, with the latter's funding sources possibly shifting away from the Trust Fund Bureau to capital markets over time. OOF will have to rely almost exclusively on capital market funding.<sup>11</sup>

While a number of government ministries and agencies are involved in the administration of ODA and other official assistance, in terms of both influence and volume, by far the most important are the MOFA, MOF and METI. Based on the decisions of these government ministries, an overwhelming proportion of bilateral assistance is administered by the MOFA and implemented by the Japan International Cooperation Agency (JICA) and the Japan Bank for International Cooperation (JBIC). The JICA is the main executing agency for grants and technical assistance. The JBIC is the principal executing agency for ODA loans (concessional) as well as OOF loans (commercial or nonconcessional).<sup>12</sup>

The average interest rate on yen-denominated ODA loans has been about 2 percent, with ten years of grace period and thirty years of maturity.<sup>13</sup> As long as the market interest rate remains low, ODA loans can be financed through borrowing from the

Trust Fund Bureau with limited government subsidies. If the market interest rate rises, however, ODA loans will face a greater negative spread and require greater subsidies from the general account. As the FILP restructuring process is completed (including the possible privatization of the Postal Savings System in the long run), the government must make a hard decision as to the extent of government subsidies provided to ODA loan activity, or the allocation of fiscal resources between ODA and other activities, and between grants and loans within the ODA resources.

As an additional point, it is worth noting that the ODA budgetary process is fragmented among ministries and agencies. In essence, different ministries and agencies prepare their own ODA budgets without coordinating among themselves, in terms of development program priorities of recipient countries or global and regional considerations. In other words, there is no overall strategic principle to govern the ODA budgetary process, particularly regarding the allocation of resources between bilateral and multilateral assistance, between loans and grants, and across countries and sectors.

#### SALIENT FEATURES OF JAPAN'S DEVELOPMENT ASSISTANCE

ODA consists of bilateral grants (including grant aid and technical assistance), loans and multilateral assistance (provided to multilateral institutions, such as

<sup>11</sup> Though bonds issued for OOF (i.e., JBIC bonds) are not government guaranteed, the market continues to regard them as de facto government guaranteed because of the availability of budgetary support in case of possible financial loss.

<sup>12</sup> JBIC was created in October 1999 by merging the Overseas Economic Cooperation Fund (in charge of ODA loans) and the Export-Import Bank of Japan (in charge of providing OOF including commercial credits and other nonconcessional loans).

<sup>13</sup> Reflecting the low interest rate policy of the Bank of Japan in recent years, the average interest rate on yen-denominated nonconcessional loans (OOF) dropped to less than 2 percent in the late 1990s and became virtually the same as the terms of ODA loans.





the World Bank, the ADB, and United Nations agencies). Japan's ODA has certain salient features that reflect its institutional setup as well as the aid philosophy born out of its own development experience.

### 1. A high proportion of loans

Japanese ODA has been characterized by a much larger share of loans (hence a correspondingly smaller share of grants), relative to the DAC average. Of the total ODA of \$15.3 billion in 1999, for example, loans accounted for 32.2 percent, grants 36.0 percent (of which 20.8 percent was for technical assistance), and multilateral assistance 31.8 percent. In contrast, the proportion of grants typically exceeds 90 percent in other DAC countries. Japan's share of around 40 percent over the years is the lowest among the DAC countries. Partly as a result, the grant element of overall ODA (including both loans and grants) is also the lowest. In this way, the more balanced mixture of loans and grants that characterizes Japanese ODA resembles the operation of most multilateral development banks (MDBs), where commercial and highly concessional operations exist side by side, such as of the International Bank for Reconstruction and Development (IBRD) and IDA in the World Bank Group.

The high proportion of loans in Japanese ODA has reflected the institutional setup of the Japanese aid administration, in which funds borrowed from the FILP have accounted for a large share. In effect, FILP funds have been used to finance ODA loans, with the general account being used to finance their subsidy (or grant element) portion. This setup has allowed a rapid expansion of ODA over the years without resorting to a correspondingly large general account allocation, although the recent restructur-

ing of the FILP may in the future place a limit on the quantitative expansion of borrowed resources for ODA loans. The high proportion of loans in Japan's ODA has reflected the government's desire to leverage ODA resources; if one dollar is spent as a subsidy to finance the negative interest spread, it can generate a much larger volume of loans. Meanwhile, a one dollar grant increases ODA by only a dollar. On a more substantive level, the heavy reliance on loans also reflects the Japanese aid philosophy, with emphasis on the role of self-help. The recipients can develop their economies more effectively when they are faced with the requirement to repay, as they are forced to allocate scarce resources more efficiently for economic development. As the recipient economies grow, greater fiscal revenues will allow the repayment of the loans.

As an unintended consequence of the high loan content of Japanese ODA, some recipient countries have suffered in recent years from debt management difficulties arising from the secular appreciation as well as the large fluctuations of the Japanese yen (in which Japanese ODA loans are denominated) against the US dollar and other currencies. At least from the perspective of the recipient's debt management, the yen has not been a desirable currency of denomination. For this reason, some have called on the Japanese government to denominate its ODA loans in the recipient's own currency or to allow the recipient to choose the currency of debt denomination (as the World Bank has done in some cases). It should be noted, however, that currency risk can be hedged effectively through swap and other arrangements, albeit at a cost. Yen-denominated debt can also be better managed by a prudent exchange rate and reserve policy, directed at reducing the negative impact of yen rate fluctuations.<sup>14</sup>

**Table 5. Share of Untied Bilateral Assistance (Percentage)**

	1980	1985	1990	1995	1998	1999
<b>Japan</b>	25.8	60.8	77.0	96.3	93.6	96.4
<b>United States</b> <sup>(a)</sup>	26.8	40.9	69.5	27.3	NA	NA
<b>European Union</b>	54.7	47.4	43.5	64.1	72.9	81.2
<b>France</b>	43.3	42.5	47.1	58.4	66.8	NA
<b>Germany</b>	82.2	63.7	43.6	60.3	86.5	84.7
<b>United Kingdom</b>	25.2	27.6	NA	86.2	79.6	91.8
<b>DAC Total</b>	44.1	47.3	59.4	69.6	81.4	87.8

Note: (a) The latest figure for the United States is not available, but it is believed to be virtually zero.

Source: OECD, DAC.

<sup>14</sup> This can be done through, for example, the adoption of a currency basket system (by stabilizing the exchange rate against a basket of currencies where the weight of the yen is reasonably large) and holding a more balanced portfolio of foreign exchange reserves (by increasing the yen's share).

**Table 6. Share of Japanese ODA Loan Procurements by Nationality (Percentage)**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
<b>Japan</b>	27.0	31.3	35.4	29.4	27.4	27.3	33.3	27.9	20.5	19.3	23.5
<b>Other Developed Countries</b>	21.2	20.8	12.9	17.6	15.4	12.9	13.5	11.6	16.4	9.3	8.7
<b>Developing Countries</b>	38.0	38.6	40.5	35.2	34.7	34.2	25.5	28.9	35.8	38.0	35.9
<b>Local Counterpart Costs</b>	13.8	9.2	11.3	17.8	22.4	25.7	27.8	31.5	27.2	33.4	31.9

Note: Data include commodity loans. The share of procurements by developing countries is for yen-denominated ODA loans.

Source: Japan Bank for International Cooperation.

## 2. Dominance of untied aid

The other side of the high loan share (and the correspondingly low grant share) is that Japanese ODA is generally untied to the purchases of goods or services from domestic suppliers. According to the international norm, loans should not be tied, but grants can be, so that donor country firms benefit outright only from free money. In 1980, only 25.8 percent of Japanese ODA was untied, one of the lowest among the DAC members. As a result of the MOFA's conscious effort, the share of untied aid rose rapidly in the 1980s, and became the highest among the top donors. In 1999, 96.4 percent of Japan's total bilateral ODA commitments was untied (an additional 2.9 percent was partially untied), whereas the untied ratio was 84.7 percent for Germany and 91.8 percent for the United Kingdom (Table 5). The EU average was 81.2 percent. It is believed that the figure for the United States is much lower, close to zero.

The large volume of Japanese ODA loans has created a large "untied market" for non-Japanese firms. In fact, the share of Japanese firms in the procurements of ODA-related contracts has been declining in recent years, in part reflecting their increasingly higher cost structure. Fujisaki et al. (1996-97), for example, report that the share of contracts given to Japanese firms in ODA loan projects declined from nearly 70 percent in the 1980s to 27 percent in 1994. Table 6 shows that the share declined to a mere 19 percent in 1999 (and 24 percent in 2000) while fluctuating in the rest of the 1990s.<sup>15</sup> As a result of this low and declining share of Japanese firms in ODA loan procurements, many in the Japanese business community have come to perceive that ODA does

not serve the economic interests of Japan. This perception has weakened the business community's support for ODA in recent years, particularly as the Japanese economy has stagnated and the construction industry has been among the hardest hit. Consequently, national policy towards ODA must be reformulated so as to clarify its role and benefits for the Japanese public at large (particularly the taxpayers).

## 3. A large share of ODA to Asia

Another feature of Japanese ODA is that a high proportion of total ODA goes to Asia. Although Asia's share has declined from the range of 90 percent in the early 1970s, it remains high and has increased markedly in recent years following the East Asian currency crisis.<sup>16</sup> In 1999, for example, Asia accounted for \$7 billion out of the \$10 billion total provided in bilateral assistance (Table 2). Asia's share is even greater when total official flows (including both ODA and OOF) are considered, since the relatively developed Asian economies are less eligible for outright grants. In 1999, for example, Asia accounted for \$17 billion out of the \$19 billion total provided in bilateral ODA and OOF. The five largest cumulative recipients of Japanese ODA are Indonesia, China, the Philippines, Thailand and India.

Geographical distribution of official assistance usually reflects special historical or political relations between donors and recipients. Therefore, the high share of Asia should not be surprising for Japanese ODA, reflecting its genesis as war reparations and quasi-reparations to Asian countries. European countries, on the other hand, provide a comparatively larger share of ODA to Africa (Table 7). On a deeper

<sup>15</sup> According to the Overseas Construction Association of Japan, Japanese firms currently account for only about 15 percent of ODA-related construction contracts.

<sup>16</sup> Following the East Asian crisis, Japan announced assistance measures totaling about \$44 billion (including financing on commercial terms) through the end of November 1998. This was followed by the New Miyazawa Initiative, announced in October 1998, whereby Japan agreed to extend concessional and non-concessional assistance totaling \$30 billion to the crisis-affected East Asian countries.



level, however, the large share of Asia also corresponds to the large share of loans in Japanese official flows, because loans tend to be provided to middle-income developing countries.

**4. Request-Based Assistance**

According to the tenet of “self-help” established over the years, the request for assistance must, in principle, come from the recipient country, after it has formulated and prioritized its own development program. This principle embodies the idea that Japan will help only those countries that are willing to help themselves. The principle of self-help has also been invoked to justify the high proportion of loans in Japanese ODA.

Requiring recipients to design their own projects or programs has, in the past, limited access to Japanese ODA, given that many developing countries lack human resources and institutional capacity. The process has also created room for the private sector to enter the planning phase and to propose desired projects or programs. Consequently, some companies—particularly Japanese consulting and construction firms—have pursued profit for themselves by proposing wasteful projects to recipient governments.<sup>17</sup> As a result, the number of “request-based” projects has expanded, and the Japanese aid authorities and agencies have responded by increas-

ing loans. However, projects thus proposed often are incoherent with the national development program of the recipient country and, hence, are unproductive and even wasteful, without contributing much to economic development. Partly to address such unintended consequences, Japanese policymakers have made exceptions to applying the “request-based assistance” principle in recent years, most notably in the JICA’s so-called “country-specific approaches.”

**5. Dominance of Hard Infrastructure Assistance**

In applying the “request-based assistance” principle, the Japanese government has tended to stress the economic rather than the social needs of recipients. Coupled with the preference of many developing countries for big visible projects—often dubbed “white elephants”—this helps explain the large share of Japanese aid earmarked for construction of physical infrastructure, such as seaports, airports, roads, railroads, subways, power plants, and communication facilities. In 1999, the share of economic infrastructure in Japan’s bilateral ODA was 32 percent, compared with 13 percent for the United States and 12 percent for the United Kingdom (Table 8). Given the lack of adequate human resources to implement assistance in soft areas, large-

**Table 7. Total ODA to Five Largest Recipients by Donor Country 1990 and 1999 (in terms of annual net flows)**

	1990	1999
<b>Japan</b>	Indonesia, China, Philippines, Thailand, Bangladesh	Indonesia, China, Thailand, Vietnam, India
<b>United States</b>	Egypt, Israel, Philippines, El Salvador, Honduras	Egypt, Bosnia Herzegovina, Indonesia, Colombia, Jordan
<b>European Union</b>	China, Egypt, India, Tanzania, Mozambique	China, Egypt, Tanzania, Bosnia Herzegovina, Mozambique
<b>France</b>	Cote d’Ivoire, New Caledonia, French Polynesia, Senegal, Morocco,	French Polynesia, New Caledonia, Egypt, Senegal, Morocco
<b>Germany</b>	Egypt, Turkey, China, Jordan, India	China, FYR-Serbia, Egypt, Pakistan, Tanzania
<b>United Kingdom</b>	Bangladesh, India, Kenya, Pakistan, Malawi	India, Bangladesh, Uganda, Ghana, Tanzania
<b>Multilaterals</b>	Bangladesh, India, China, Pakistan, Kenya	India, Bangladesh, China, Honduras, Vietnam

*Note:* Includes grants and concessional loans only. If OA (aid to Part II countries) were included the five largest recipients would include Israel (in 1999 for the United States), Poland, and some countries of the former Soviet Union.

*Source:* OECD, DAC

<sup>17</sup> It is often claimed that easy availability of ODA resources for Japanese consulting/construction firms has adversely impacted their efficiency, productivity and international competitiveness.

**Table 8. Distribution of Bilateral ODA by Sector for Selected Countries, 1999**  
(Percentage of total bilateral commitments)

	Social & Adm. Infrastructure	Economic Infrastructure	Production		Multi- sector	Program Assistance
			Agriculture	Industry		
<b>Japan</b>	18.9	31.5	7.6	5.7	4.8	11.2
<b>United States</b>	31.3	12.9	2.3	0.1	9.9	9.9
<b>European Union</b>	36.8	6.4	4.7	0.9	7.2	2.4
<b>France</b>	39.2	9.0	5.7	0.9	7.6	2.2
<b>Germany</b>	34.7	25.8	3.9	0.7	9.9	2.4
<b>United Kingdom</b>	29.2	12.2	9.4	4.1	2.9	8.7
<b>DAC Total</b>	29.9	17.2	5.5	2.2	7.4	6.9

Source: OECD, DAC

scale physical projects—funded predominantly by loans—have been favored by the Japanese bureaucracies as a means of disbursing ODA quickly (Fujisaki et al. 1996–97).

Correspondingly, the share of social development, such as the environment, poverty reduction, education, health and nutrition, has been limited in Japanese bilateral ODA. In 1999, the share of social infrastructure was 19 percent, compared with 31 percent for the United States and 37 percent for the European Union. Given the increasingly important role private capital is expected to play in financing hard infrastructure, particularly in middle-income developing countries, this feature of Japanese ODA will not be sustainable. Japan will then face the challenge of having to shift its emphasis from hard infrastructure towards soft infrastructure (such as education, health and basic medical care) and policy reform-related assistance.

#### 6. Dominance of Government-Led ODA

In terms of both design and execution, Japanese ODA is weak in the participatory approach, being typically administered by governments and other official agencies. The involvement of non-governmental organizations (NGOs) and of civil society in general is limited. To be sure, grass-root participation by NGOs has begun and the Japanese government has announced a more accommodating policy towards the involvement of NGOs (see Tominaga and Sera 2000 for details),<sup>18</sup> but the size remains small in comparison with the situation in other major donor countries.

According to DAC data for 1997, the share of NGO-participated grants was only 2 percent of total ODA in Japan, while the share was much high-

er in other major DAC countries, such as the United States (37 percent), Germany (16 percent) and the United Kingdom (9 percent). Reflecting the large absolute size of Japanese ODA, however, the value of NGO-participated grants in Japan (\$223 million) was the fourth largest.

The alleged lack of visibility of Japanese ODA may stem from the fact that ODA activities are carried out mainly by governments, and contracted to large consulting firms, with little grassroots participation by Japanese NGOs and individuals, or by members of local civil society in the recipient countries.

#### 7. Preference for a Bilateral Approach—Hesitation Regarding Partnerships

While many DAC donor countries emphasize the importance of working as partners, Japan has shown a preference for working only with the governments of the recipient countries. To be sure, there is no denying that Japan has been a generous provider of resources to multilateral financial institutions—the share of contributions to multilateral institutions (of total ODA) was 32 percent in 1999, in contrast to 25 percent for the United States and 37 percent for the European Union—and, to that extent, Japan has shown a willingness to work with the international development community at large. Japan has also worked frequently with the MDBs in cofinancing and other partnership arrangements, in part to benefit from the MDBs' technical expertise.

When working with the MDBs in cofinancing arrangements, however, Japan has taken pains to preserve its separate identity. In part, this preference for a bilateral approach may reflect the large size of Japanese ODA, which allows the Japanese government

<sup>18</sup> The Cabinet decision of August 1999, "The Medium-Term Policy on Official Development Assistance," recognized a "growing demand for finely tuned assistance that directly reaches local populations" and a "growing need for collaboration with NGOs in the implementation of ODA projects" (as quoted in Tominaga and Sera 2000).



to enjoy certain economies of scale and leverage. In contrast, smaller donor countries (particularly northern European donors) can only benefit from economies of scale by entering into partnerships with each other and with the MDBs. At a deeper level, however, Japan's dual position as a generous multilateral provider and a hesitant bilateral partner reflects the fact that its policies towards multilateral assistance (administered mainly by the MOF) and bilateral assistance (administered mainly by the MOFA) are not well coordinated. As a result, the aid implementation agencies (JICA and JBIC) are often unsure as to how to interact with the MDBs (the World Bank in particular) in country programs.

Even so, the thinking of the international development community is changing in this regard, led by the World Bank's move towards what it calls a Comprehensive Development Framework (CDF).<sup>19</sup> In response, Japan has made some efforts to work with other stakeholders, particularly in some African countries where it lacks the depth of knowledge, expertise and experience it enjoys in Asia, with the common objective of promoting economic development and poverty reduction in the recipient countries. Japan, however, seems to distance itself from attempts of European DAC donors to create a "common fund" from the pooled resources. For the most part, when it comes to the use of bilateral resources, Japan still prefers to work alone, fearing that its already low visibility will become even more diminished if its resources are to be pooled with other donors' resources and used for common objectives.

#### EMERGING CRITICISMS OF JAPANESE ODA

The Japanese government regards official assistance (ODA and OOF) as an important diplomatic instrument to ensure national security by promoting economic development and political stability in the developing world. However, the stagnation of the Japanese economy, with rising fiscal deficits and debt, has made it increasingly difficult in recent years to generate the same level of public support for ODA as in the past. To be sure, in absolute terms, public support for ODA remains high, relative to

other major donor countries. Even so, according to a recent opinion poll, those who favored "more ODA" declined from 41 percent in 1991 to 28 percent in 1998; those who favored "less ODA" rose from 8 percent to 19 percent over the same period (Katada 2000). Certainly, there is declining support for the large size of ODA that Japan has provided to developing countries.

Within Japan, some of the criticisms of the current administration of ODA are as follows:

- It has no coherent national strategy.
- It lacks transparency and efficiency and is wasteful.
- The principles embodied in the ODA Charter of 1992 have not been strictly followed. In particular, ODA should not be given to those countries, such as China, with large military spending and weapons of mass destruction.
- It is excessively biased towards hard infrastructure and places insufficient emphasis on soft infrastructure and social sector development.
- It is not participatory and does not promote partnership with other stakeholders in the international development community, including other bilateral donors and civil society.
- It is "faceless" and does not benefit Japan or its taxpayers commercially, diplomatically or otherwise.

As a result of these and other criticisms, and given the current economic realities, a budget cut has been proposed for ODA since FY1998. However, the outbreak of the East Asian Crisis postponed the cut's implementation.<sup>20</sup> The government finally made the decision and curtailed the ODA budget for the first time in FY2001 (covering April 2001–March 2002) by 3 percent for the general account and 4 percent for the overall allocation. The cut is almost entirely accounted for by a reduction in the MOF allocation for the MDBs and ODA loans (for the general account), and more than accounted for by a 7 percent reduction in ODA loans (for the overall budget). It is expected that the tight budgetary stance will continue, especially in the provision of concessional loans. It should be noted, however, that Japan is not the only country that has cut its

<sup>19</sup> The World Bank has proposed a comprehensive approach to assist sustainable economic development through structural, human and physical factors (see Wolfensohn 1999). This approach emphasizes program comprehensiveness, the recipient country's ownership of the program, and partnership among stakeholders (the country's government, international organizations, donor countries, civil society and the private sector).

<sup>20</sup> All of the increase in ODA in 1998 and 1999 was allocated to the crisis-affected East Asian countries.



ODA budget in recent years. In fact, budgetary support for ODA has been declining in many donor countries, including the United States.

Looking beyond the domestic scene, from the standpoint of the international development community, Japan will need to improve the effectiveness of ODA. A recent World Bank report on aid effectiveness concludes that recipient countries *must* reform economic policies and institutions in order to achieve growth and poverty reduction through aid flows (World Bank 1998). Data support the view that countries with *strong economic policies* (defined as low inflation, fiscal balance or surplus, and trade openness) and *high-quality institutions* (defined as rule of law, effective public bureaucracy, and minimal incidence of corruption) benefit the most from aid by achieving the highest growth rates.<sup>21</sup> Moreover, “ideas” are shown to be more effective than “aid flows” in generating reform and in improving the quality of public services. The report concludes that “well-designed assistance can help countries find the policies that they need, and help communities improve important public services that make for a better life today and contribute to long-term development.”

Given the large size of ODA it provides, and given the lack of any other effective diplomatic tool, it is understandable that Japan prefers a bilateral approach to aid as a means of enhancing visibility and political leverage. Given its own development experience, and given its particular institutional setup for aid administration, it is also understandable that Japan emphasizes loans to finance economic infrastructure. However, by now it is clear that development involves a multi-dimensional transformation of society; to the extent that funds are fungible, “the net benefit from financing any individual project is...the net benefit of the marginal government program” (Stiglitz 1999). What determines the success or failure of development assistance is not the choice of a particular project, but the whole set of policies and institutions adopted by the recipient country, including its own governance structure.

In short, Japan needs to adopt a strategic approach to assisting economic development and

poverty reduction in low-income countries, in greater coordination with other stakeholders in the international development community. For aid to be effective, institution building and economic reform need to be emphasized, even for hard infrastructure projects. Providing “ideas” can be more important than providing a large amount of financial resources. Indeed, Japan must be more involved in providing “ideas” for institution building and policy reform in the recipient countries, based on its own historical experiences. This is the only realistic way to improve the “effectiveness” and “quality” of development assistance, particularly at a time when the volume of aid is expected to decline.<sup>22</sup>

To improve the “effectiveness” and “quality” of ODA, the Japanese policymakers must explicitly define Japan’s aid goals and make ODA activity more transparent and accountable to taxpayers. First, clear objectives must be defined, such as: “to assist sustainable economic development of low-income countries, focusing on poverty reduction and environmental improvement, and thereby contributing to stability, peace and prosperity in the international community.” This objective emphasizes the need to provide “international public goods” through ODA. Second, the aid authorities and implementation agencies must support effective, comprehensive development programs in recipient countries, and partnerships with the international development community. Third, to improve transparency and accountability to taxpayers, the post-project evaluation system needs to be strengthened and be made credible.

The Japanese policymakers are well aware of these criticisms and issues. In June 1998, for example, the “Council on ODA Reforms for the 21st Century,” a government advisory body, presented to the Foreign Minister a report emphasizing the need to (a) formulate country assistance programs, (b) emphasize poverty alleviation and social development with a focus on people-oriented development, (c) increase assistance for human resources development, (d) give broader intellectual support, and (e) form global partnerships and cooperation with other countries, multilateral institutions and

<sup>21</sup> From the standpoint of the recipients and the international community, the effectiveness of aid can only be measured in terms of its ability to achieve the ultimate objectives of growth and poverty reduction. However, we also recognize that, as a sovereign nation with its own national interests, Japan can legitimately have other objectives for ODA.

<sup>22</sup> In discussions of ODA, “quality” is sometimes used as a synonym for “concessionality.” Here, however, “quality” refers more generally to the degree to which aid contributes to the ultimate objectives of sustained economic development, as measured, for example, by the outcome to cost ratio.



private sectors, among others (MOFA 1999). Implementing these new initiatives would, in turn, require Japan to build its own capacity to think strategically about the sector-wide and economy-wide impacts of its projects in the recipient countries.

### THE CHINA CHALLENGE

Following the normalization of diplomatic relations between the two countries in 1978, Japan became the first non-socialist country to provide concessional assistance to the People's Republic of China (hereafter, simply China). In May 1979, the Japanese government decided to provide a loan of ¥420 billion to help jointly extract natural resources and energies (Zhao 1993). In August 1979, the Chinese government followed by approaching the Japanese government with a request for a loan to finance major infrastructure projects. Over the years 1979–99, Japan extended ¥2.7 trillion of ODA and ¥3.4 trillion of untied loans (OOF) to China, making China the second largest recipient of Japan's development assistance after Indonesia.

By far, Japan is the largest bilateral donor of ODA and the second largest provider of official assistance to China after the World Bank. In recent years, Japan has provided ODA exceeding \$1 billion on an annual basis, well over half of the total bilateral assis-

tance that China has received (Table 9). By contrast, the share of the United States—legally prohibited in principle from providing concessional assistance to a communist regime—has been miniscule. These large financial flows from Japan to China reflect not only China's large economic size, but also the nature of assistance as, at least initially, quasi-reparation for wartime damage—notwithstanding that China had formally renounced all war-related claims against Japan.<sup>23</sup>

However, as China has developed and modernized over the last twenty years and become a major military power, many Japanese have begun to wonder if current levels of ODA (and OOF) are too high. Public perceptions of Sino-Japanese relations have also influenced the debate. Given the pacifist principles embodied in the ODA Charter of 1992 (see Box 1), public outcry over the 1995 Chinese nuclear tests led the Japanese government to suspend grants (except for humanitarian aid) to China. The suspension continued until March 1997, when China made a token gesture to stop nuclear testing and to sign the Comprehensive Nuclear Test Ban Treaty (Katada 2001).

The climate for development assistance to China has since remained tenuous at best (Deng 1997). To make matters worse, Japanese public opinion towards China deteriorated rapidly in 1998, when

**Table 9. Net Flows of ODA to China in Selected Recent Years**  
(Millions of US dollars; percent of total in parentheses)

	1990	1995	1998	1999
<b>Japan</b>	723.0 (34.6)	1,380.2 (39.6)	1,158.2 (48.8)	1,226.0 (52.5)
<b>United States</b>	--	--	0.4 (0.0)	38.3 (1.6)
<b>European Union *</b>	674.2 (32.2)	1,020.1 (29.2)	478.0 (20.1)	477.1 (20.4)
<b>France</b>	88.0 (4.2)	91.2 (2.6)	29.8 (1.3)	46.2 (2.0)
<b>Germany</b>	228.9 (10.9)	684.1 (19.6)	321.3 (13.6)	304.6 (13.1)
<b>United Kingdom</b>	33.3 (1.6)	47.8 (1.4)	55.4 (0.2)	59.3 (2.5)
<b>Total Bilaterals *</b>	1511.7 (72.4)	2,531.3 (72.5)	1,731.7 (73.0)	1,821.6 (78.1)
<b>Total Multilaterals</b>	577.4 (27.6)	958.0 (27.5)	639.5 (27.0)	512.2 (21.9)
<b>Grand Total</b>	2,089.1 (100.0)	3,489.3 (100.0)	2,371.2 (100.0)	2,333.8 (100.0)

Note: ODA includes grants and concessional loans only.

Source: OECD DAC.

\* Totals include donor countries not itemized in this table.

<sup>23</sup> Japan's official position, however, remains that the provision of ODA is unrelated to China's renunciation of all war-related claims.

Chinese President Jiang Zemin, on his first official visit to Japan, repeated that Japan should officially apologize in writing for the 1937 invasion of China (Johnstone 1998). In addition, certain recent developments and public perceptions have helped magnify the public's misgivings about the continued provision of ODA to China:

- China's military spending has been rising continuously over the last 12 years, reaching the level of about 13 percent of its national budget. In effect, Japanese taxpayers' money is being used as low-cost, fungible funds to help the overall build-up of China's military capacity, through the construction of highways, railroads, airports and other facilities that are critical for military mobilization.
- China, while receiving a large sum of official financial assistance from Japan, is providing a relatively large amount of economic assistance of its own to other developing countries for strategic objectives, including the debt cancellation of 10 billion yuan (¥130 billion) granted to African countries.<sup>24</sup>
- Several ODA-financed projects, such as airports, railroads, and highways, either have been—or are being—privatized, without consulting or even notifying the Japanese government. Privatization is contrary to Japan's long-established policy regarding ODA, which should only be used to finance those projects that cannot be financed by private sources.
- While the Chinese government regards Japan's ODA as essential, the Chinese public does not seem to be aware of its size or significance, and shows no appreciation or gratitude for Japanese generosity.

Reflecting these concerns, the Japanese government is taking the view that China should increasingly rely on domestic savings and foreign private capital to build hard infrastructure, and that the domestic intra-governmental fiscal transfer system should be strengthened to address poverty reduction, particularly in the Western Provinces. The Japanese government seems to believe that Japan's concessional and nonconcessional assistance in financing the construction of economic infrastruc-

ture in the coastal areas has played out its historically important role of promoting China's economic development and modernization. At the same time, the Japanese government appears to view ODA as useful leverage in encouraging China's transition towards a market economy and integration with the world economy. The Japanese government may also use public pleas for a review of ODA policy to expedite a political settlement with China over longstanding diplomatic issues such as the demanded written apology.

For Japan, China is too big to be ignored, and Japan's economic future depends on deepening its economic interdependence with emerging East Asia, including China (in addition to the ASEAN countries). Japan cannot afford to mismanage the political relationship with China, given China's impending accession to the World Trade Organization (WTO) and the resulting expansion of its markets and trade with the rest of the world. Business leaders would certainly demand maintenance of ODA to China to support their economic activities, emphasizing the continued need for physical infrastructure in the coastal area.

Even so, the nature of ODA to China will change. In this context, a government advisory body has recently recommended that future emphasis should be placed on (a) environmental protection (containing air pollution and acid rain and preserving clean water), (b) economic and social developments in the Western Provinces including poverty reduction, education and health, (c) human resources development and capacity building, and (d) promotion of mutual understanding. Moreover, Tokyo would like to see Beijing (a) intensify public relations activity within China to encourage awareness of Japanese ODA, and (b) promote transparency and accountability of the Chinese government and military.

The two countries still perceive Japanese assistance in very different ways. The Chinese tendency is to see the ODA as atonement for Japan's wartime aggression—this view is perhaps strengthened by Tokyo's reluctance to issue an official written apology.<sup>25</sup> The Japanese opinion, on the other hand, is that Japan has already sufficiently paid for past

<sup>24</sup> In 1999 and 2000, for example, China provided (or decided to provide) economic assistance in the form of loans and grants to Bangladesh, Botswana, Cambodia, Cote D'Ivoire, East Timor, Ghana, Kenya, Laos, Mongolia, Nicaragua, North Korea, Papua New Guinea, Tanzania, Yugoslavia, Vietnam, and Zimbabwe (*Sankei Shimbun*, December 5, 2000).

<sup>25</sup> This is particularly so, given that the Japanese government issued an official written apology for South Korea in December 1998.



behavior; any further economic assistance has nothing to do with war-related compensation. In this view, China's exertion of "moral pressure" should cease.

In order to establish a mature bilateral relationship, the two countries must close this perception gap. This is entirely possible if both sides take bold and forward-looking political gestures.

### CONCLUDING PERSPECTIVES: THE FUTURE OF JAPANESE ODA

Japan's ODA is at a crossroads. The challenges to the current mode of ODA administration come from both domestic and international quarters. Domestically, given the large fiscal deficits and mounting public debt, the Japanese government no longer enjoys public support to maintain the current level of ODA, which has made Japan by far the world's largest donor country during the past decade. A small cut has already been made in the fiscal 2001 ODA budget, and a further cut may be forthcoming. Given the stagnant economy and the largely untied status of Japanese ODA, the business community has increasingly urged that ODA should more explicitly serve Japan's own economic interests. The public is critical of the low visibility of Japanese contributions (as being "faceless"), making it ever more challenging to muster support for contributions to multilateral financial institutions, for which the MOF is the only domestic constituency. The public is also alarmed by violation of the 1992 ODA Charter, and is demanding greater accountability and transparency in ODA administration. The recent restructuring of the Fiscal Investment and Loan Program (FILP), which terminated the direct use of postal savings deposits, postal insurance and provident pension fund premiums for ODA purposes, may further squeeze the future growth of ODA loans.

Internationally, notwithstanding recognition of Japan's generous contributions to multilateral institutions, many criticize Japan's tendency to lend for infrastructure-related projects and its hesitation to participate more openly within a multilateral framework. Given the fungibility of development assistance, the international development community has increasingly accepted the idea that aid effectiveness depends on the quality of a country's overall development program and on the existence of strong policies and institutions that promote economic growth and poverty reduction. In light of these views, Japan will need to work more closely with the wider developmental community, includ-

ing other donors and civil society, in order to maximize the impact of its ODA. Japanese policymakers have expressed an intention to move in this direction. For example, to generate public support for ODA (if for no other reason), they have announced greater accommodation of NGO involvement. However, the Japanese government can progress only so far without a substantial political and bureaucratic reorientation of its aid administration apparatus.

The single most pressing issue facing Japanese ODA at present concerns policy towards China. China's emergence as an economic competitor and potential military threat has eroded Japanese public support for current ODA levels. Given the principles of the ODA Charter, the public has protested continued assistance to a country with rising military expenditures and weapons of mass destruction. A general souring of Sino-Japanese relations—caused partly by Beijing's repeated demands that Tokyo issue a written apology for the 1937 invasion—has complicated the situation. As a result, Japanese ODA to China is likely to shift, as it should, toward social development, particularly in the Western Provinces, leaving the bulk of traditional economic projects to the private sector.

To meet these domestic and international challenges, Japan must develop a coherent national strategy for ODA. The strategy must focus on poverty reduction and environmental improvement, thereby helping to prevent conflict and instability and assisting sustained economic development in the developing world. In the past, such a focus has been hampered by the fragmentation or "schizophrenia" of aid administration, characterized by competition and bargaining among ministries and agencies with different vested interests. A coherent ODA strategy is possible only through reconciling these various demands and pressures. Currently, aid is being pressed to serve a variety of different ends, including international diplomacy (MOFA), support of domestic constituencies (METI), a stable international financial system (MOF), and convergence with international norms. At the same time, in an environment of economic stagnation and waning public support, MOF hopes to trim ODA budgets. Strong leadership from the Prime Minister is necessary to consolidate the aid administration, perhaps by creating a single development aid agency.

To make ODA more efficient, transparent, and accountable to taxpayers will be no easy task. Meeting these goals will require an effective post-

**Box 2: Making ODA More Visible through Grassroots Participation**

The following scheme may be considered to encourage wider participation by Japanese civil society in ODA activity.

First, the Japanese government grants ¥1–3 million to a group with promising ideas to improve social conditions and alleviate poverty in low-income developing countries. The group—an NGO or any group of individuals, including high school or university students—uses this “seed money” to identify and design a program and to visit potential target villages or communities for consultation.

Second, once Japanese and local participants agree on a program in collaboration with local NGOs and/or communities, they submit a formal grant request to the “Committee on Small-Scale ODA Activity” for evaluation. If approved, the program is granted up to ¥10 million for implementation.

Only ¥10 billion would cover one thousand such programs (the total ODA budget for FY 2001 exceeded ¥1.5 trillion, with ¥920 billion for grants only). Yet, this scheme would have a large positive impact on villages and communities worldwide, and render Japanese contributions more visible at local levels. Moreover, Japanese citizens would have an active role in development and poverty reduction, gaining awareness of international cooperation to the benefit of the whole Japanese society. To implement such a scheme, the administration of ODA must become more flexible in delegating decision making authority, and less restrictive in the use of funds for current expenditures or in the requirement of local counterpart contributions.

project evaluation system that can operate within the context of a recipient country’s overall development strategy. Japan must also respond to pressures to shift ODA away from hard infrastructure and to improve aid quality through collaboration with the wider developmental community, including other donors and civil society. Japan should encourage grassroots participation and NGO involvement to help identify, establish and implement small-scale, community-based projects that truly benefit local communities. In our view, such a participatory approach would not only enhance ODA’s effectiveness, but would also—paradoxically—increase the visibility of Japan’s “face.” There is no better way to make Japan’s ODA more perceptible than having its citizens work side by side with local people and institutions (see Box 2).

In regard to larger projects, Japan must attend to the impacts that its aid is having on recipient countries—both at the sector-wide and economy-wide levels—including policy reforms induced by ODA. Moreover, Japan should strive for “voice” as well as “visibility,” and bring ideas based on its own historical experience to development debates. In greater collaboration with international stakeholders such as the World Bank and other MDBs, Japan will acquire valuable knowledge about the economic, political and social conditions of low-income countries, as well as best practices.

In sum, Japan must respond to the challenges of the times by forming a national ODA strategy. Such a scheme may require a new, unified aid agency or at least a cabinet-level Strategic Council for Development Assistance, involving the MOFA, MOF, METI, and other ministries. A national ODA strategy must involve: (1) clear objectives, including the provision of international public goods such as sustainable development, and with focus on poverty reduction and environmental improvement in low-income countries; (2) total allocation of the national ODA budget toward these objectives; (3) balance between bilateral and multilateral assistance, and distribution among types of aid (i.e., grants, technical assistance, and loans) across recipient countries and across sectors (both globally and within each country); (4) enhanced effectiveness, transparency and accountability through a strengthened post-project evaluation system; (5) enhancement of Japanese taxpayers’ visibility and voice in aid activity; and (6) coordination with international development partners.

Japan’s fiscal woes—along with the pressures of restructuring the FILP—may well be a blessing in disguise, the necessary catalyst for developing a new ODA strategy. By following the above guidelines, and with the support of the international community, Japan can implement better policies and institutions and shift from a “quantity” spender to a “quality” partner in development.





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## Appendix Table: Net Official Flows to Developing Countries

## (A) Official Development Assistance to Developing Countries (Million US dollars)

	1990	1995	1996	1997	1998	1999
<b>Japan</b>	9,069	14,489	9,439	9,358	10,640	15,323
<b>Bilateral</b>	6,786	10,419	8,207	6,552	8,553	10,476
<b>Grants (incl. TA)</b>	3,014	6,298	5,438	4,985	4,901	5,475
<b>Loans</b>	3,772	4,120	2,769	1,568	3,652	5,001
<b>Multilateral</b>	2,282	4,071	1,232	2,806	2,087	4,848
<b>United States</b>	11,394	7,367	9,377	6,878	8,786	9,145
<b>Bilateral</b>	8,367	5,614	6,917	4,939	5,988	6,848
<b>Grants (incl. TA)</b>	8,529	6,387	7,672	5,633	6,574	7,638
<b>Loans</b>	-162	-773	-755	-694	-585	-790
<b>Multilateral</b>	3,027	1,753	2,460	1,939	2,798	2,297
<b>European Union</b>	28,552	31,358	31,476	26,785	27,641	26,805
<b>Bilateral</b>	19,704	20,499	20,018	17,295	17,007	16,809
<b>Grants (incl. TA)</b>	16,364	19,361	19,417	16,915	17,316	17,060
<b>Loans</b>	3,339	1,138	600	380	-309	-250
<b>Multilateral</b>	8,848	10,859	11,459	9,490	10,634	9,996
<b>(1) France</b>	7,163	8,443	7,451	6,307	5,742	5,637
<b>Bilateral</b>	5,612	6,429	5,754	4,777	4,185	4,125
<b>Grants (incl. TA)</b>	3,714	5,890	5,634	4,906	4,540	4,320
<b>Loans</b>	1,898	538	120	-130	-355	-195
<b>Multilateral</b>	1,551	2,015	1,697	1,530	1,557	1,512
<b>(2) Germany</b>	6,320	7,524	7,601	5,857	5,581	5,515
<b>Bilateral</b>	4,479	4,815	4,535	3,639	3,491	3,278
<b>Grants (incl. TA)</b>	4,525	4,392	4,507	3,406	3,315	3,236
<b>Loans</b>	-46	423	29	233	176	42
<b>Multilateral</b>	1,841	2,709	3,066	2,218	2,090	2,238
<b>(3) United Kingdom</b>	2,638	3,202	3,199	3,433	3,864	3,401
<b>Bilateral</b>	1,474	1,716	1,790	1,979	2,132	2,249
<b>Grants (incl. TA)</b>	1,567	1,746	1,782	1,926	2,328	2,067
<b>Loans</b>	-92	-31	8	53	-196	182
<b>Multilateral</b>	1,164	1,487	1,409	1,454	1,732	1,153
<b>(4) Netherlands</b>	2,538	3,226	3,246	2,947	3,042	3,134
<b>Bilateral</b>	1,833	2,245	2,275	2,133	2,133	2,162
<b>Grants (incl. TA)</b>	1,707	2,545	2,509	2,302	2,323	2,359
<b>Loans</b>	126	-300	-234	-169	-190	-198
<b>Multilateral</b>	705	981	971	813	909	972
<b>Total DAC Countries</b>	54,490	58,927	55,622	48,497	52,084	56,378
<b>Bilateral</b>	38,688	40,628	39,119	32,429	35,204	37,862
<b>Grants (incl. TA)</b>	32,282	36,184	36,534	31,282	32,465	33,910
<b>Loans</b>	6,405	4,444	2,585	1,147	2,739	3,951
<b>Multilateral</b>	15,802	18,299	16,503	16,068	16,880	18,517

Source: OECD DAC

**(B) Other Official Flows to Developing Countries (Million US dollars)**

	1990	1995	1996	1997	1998	1999
<b>Japan</b>	3,367	5,544	947	3,975	10,804	9,507
<b>Bilateral</b>	3,077	4,522	1,290	3,854	8,727	8,276
<b>Multilateral</b>	290	1,021	-343	121	2,076	1,231
<b>United States</b>	-450	1,473	1,119	287	618	4,793
<b>Bilateral</b>	-450	1,473	1,119	287	618	4,793
<b>Multilateral</b>	0	0	0	0	0	0
<b>European Union</b>	5,117	2,550	2,787	711	-8	-180
<b>Bilateral</b>	5,072	2,783	2,972	781	154	147
<b>Multilateral</b>	45	-234	-185	-70	-162	-327
<b>(1) France</b>	642	43	-284	94	-191	-3
<b>Bilateral</b>	642	43	-284	94	-191	-3
<b>Multilateral</b>	0	0	0	0	0	0
<b>(2) Germany</b>	2,110	879	194	-482	-321	-179
<b>Bilateral</b>	2,112	1,159	527	-193	-37	-43
<b>Multilateral</b>	-2	-280	-332	-288	-284	-136
<b>(3) United Kingdom</b>	628	213	81	-113	-54	-24
<b>Bilateral</b>	628	213	81	-113	-54	-24
<b>Multilateral</b>	0	0	0	0	0	0
<b>(4) Netherlands</b>	50	90	57	-193	253	-8
<b>Bilateral</b>	50	90	57	-193	253	-8
<b>Multilateral</b>	0	0	0	0	0	0
<b>Total DAC Countries</b>	8,631	9,872	5,562	6,125	13,491	15,477
<b>Bilateral</b>	8,388	9,084	6,089	6,074	11,483	14,528
<b>Multilateral</b>	242	788	-527	51	2,008	949

Source: OECD DAC

**(C) Official Development Assistance and Other Official Flows to Developing Countries,  
Total (Million US dollars)**

	1990	1995	1996	1997	1998	1999
<b>Japan</b>	12,436	20,033	10,386	13,315	21,444	24,830
<b>Bilateral</b>	9,863	14,941	9,497	10,406	17,280	18,752
<b>Grants (incl. TA)</b>	3,014	6,298	5,438	4,985	4,901	5,475
<b>ODA Loans</b>	3,772	4,120	2,769	1,568	3,652	5,001
<b>Bilateral OOF</b>	3,077	4,522	1,290	3,854	8,727	8,276
<b>Multilateral</b>	2,572	5,092	889	2,927	4,163	6,079
<b>United States</b>	10,944	8,840	10,496	7,165	9,404	13,938
<b>Bilateral</b>	7,917	7,087	8,036	5,226	6,606	11,641
<b>Grants (incl. TA)</b>	8,529	6,387	7,672	5,633	6,574	7,638
<b>ODA Loans</b>	-162	-773	-755	-694	-585	-790
<b>Bilateral OOF</b>	-450	1,473	1,119	287	618	4,793
<b>Multilateral</b>	3,027	1,753	2,460	1,939	2,798	2,297
<b>European Union</b>	33,669	33,908	34,263	27,496	27,634	26,625
<b>Bilateral</b>	24,775	23,283	22,989	18,076	17,161	16,956
<b>Grants (incl. TA)</b>	16,364	19,361	19,417	16,915	17,316	17,060
<b>ODA Loans</b>	3,339	1,138	600	380	-309	-250
<b>Bilateral OOF</b>	5,072	2,783	2,972	781	154	147
<b>Multilateral</b>	8,894	10,625	11,274	9,421	10,473	9,668
<b>(1) France</b>	7,806	8,486	7,168	6,401	5,551	5,634
<b>Bilateral</b>	6,254	6,472	5,471	4,871	3,994	4,122
<b>Grants (incl. TA)</b>	3,714	5,890	5,634	4,906	4,540	4,320
<b>ODA Loans</b>	1,898	538	120	-130	-355	-195
<b>Bilateral OOF</b>	642	43	-284	94	-191	-3
<b>Multilateral</b>	1,551	2,015	1,697	1,530	1,557	1,512
<b>(2) Germany</b>	8,430	8,403	7,795	5,375	5,260	5,336
<b>Bilateral</b>	6,591	5,974	5,062	3,446	3,454	3,235
<b>Grants (incl. TA)</b>	4,525	4,392	4,507	3,406	3,315	3,236
<b>ODA Loans</b>	-46	423	29	233	176	42
<b>Bilateral OOF</b>	2,112	1,159	527	-193	-37	-43
<b>Multilateral</b>	1,839	2,429	2,733	1,930	1,806	2,102
<b>(3) United Kingdom</b>	3,266	3,416	3,280	3,320	3,810	3,377
<b>Bilateral</b>	2,103	1,929	1,871	1,866	2,078	2,225
<b>Grants (incl. TA)</b>	1,567	1,746	1,782	1,926	2,328	2,067
<b>ODA Loans</b>	-92	-31	8	53	-196	182
<b>Bilateral OOF</b>	628	213	81	-113	-54	-24
<b>Multilateral</b>	1,164	1,487	1,409	1,454	1,732	1,153
<b>(4) Netherlands</b>	2,588	3,316	3,303	2,754	3,295	3,126
<b>Bilateral</b>	1,883	2,335	2,332	1,940	2,386	2,154
<b>Grants (incl. TA)</b>	1,707	2,545	2,509	2,302	2,323	2,359
<b>ODA Loans</b>	126	-300	-234	-169	-190	-198
<b>Bilateral OOF</b>	50	90	57	-193	253	-8
<b>Multilateral</b>	705	981	971	813	909	972
<b>Total DAC Countries</b>	63,120	68,798	61,183	54,622	65,575	71,855
<b>Bilateral</b>	47,076	49,712	45,208	38,503	46,687	52,390
<b>Grants (incl. TA)</b>	32,282	36,184	36,534	31,282	32,465	33,910
<b>ODA Loans</b>	6,405	4,444	2,585	1,147	2,739	3,951
<b>Bilateral OOF</b>	8,388	9,084	6,089	6,074	11,483	14,528
<b>Multilateral</b>	16,044	19,087	15,976	16,119	18,888	19,466

Source: OECD, DAC.



## (D) Official Aid and Other Official Flows to Part II Countries (Million US dollars)

	1995	1996	1997	1998	1999
<b>Japan</b>	636	1,082	481	2,007	1,591
<b>Official Aid</b>	250	184	84	132	67
<b>Other Official Flows</b>	386	898	397	1,874	1,524
<b>United States</b>	1,272	1,670	2,523	2,706	3,425
<b>Official Aid</b>	1,280	1,694	2,516	2,726	3,521
<b>Other Official Flows</b>	-8	-24	7	-20	-96
<b>European Union</b>	12,591	2,056	1,219	9,976	596
<b>Official Aid</b>	6,295	1,028	609	4,988	298
<b>Other Official Flows</b>	6,295	1,028	609	4,988	298
<b>(1) France</b>	770	711	574	823	539
<b>Official Aid</b>	770	711	574	823	550
<b>Other Official Flows</b>	0	0	0	0	-11
<b>(2) Germany</b>	8,639	2,237	1,125	5,139	997
<b>Official Aid</b>	4,514	1,329	660	654	729
<b>Other Official Flows</b>	4,124	908	465	4,485	268
<b>(3) United Kingdom</b>	406	362	336	434	326
<b>Official Aid</b>	406	362	337	435	326
<b>Other Official Flows</b>	0	0	-1	-1	0
<b>(4) Netherlands</b>	305	7	126	341	39
<b>Official Aid</b>	305	13	7	130	22
<b>Other Official Flows</b>	0	-6	119	212	17
<b>Total DAC Countries</b>	15,920	7,470	6,260	12,954	9,214
<b>Official Aid</b>	9,202	5,696	5,331	6,040	6,193
<b>Other Official Flows</b>	6,718	1,774	929	6,914	3,021

Source: OECD, DAC.

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