

The Center for International Economic Growth

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JAPANESE FOREIGN AID: DEFINING AMERICA'S INTERESTS

INTRODUCTION

Just a quarter-century ago, Japan was borrowing money from the World Bank. Now Japan is giving its money away. This summer Tokyo pledged another \$35 billion for its foreign aid program, bringing total spending commitments between 1987 and 1992 to \$65 billion. If these figures are correct (and they may not be), and if Japan carries through on its assistance promises (it has not always), it will become the world's largest foreign aid donor, a position held by the United States since the end of World War II.

Japan's emergence as a big-time donor is to be welcomed. The question is: What goals will be furthered by the Japanese largesse? American aid, by and large, has sought humanitarian and economic benefits for the recipient country and economic and security benefits for the U.S. So far, according to Bush Administration officials, Tokyo is shortchanging the humanitarian and security goals. Japan has been using its aid mainly as a kind of subsidy to Third World purchasers of Japanese exports. These subsidies then are labeled "aid to the poor."

Ill-Founded Reaction. While the Bush Administration's concern about the Japanese foreign aid program is well founded, its reaction is not. It proposes to send representatives from the U.S. Agency for International Development (AID) to instruct the Japanese on how to establish an effective assistance program. The problem is that AID's record on this is extremely poor. To make matters worse, the Bush Administration proposes to counter Japan's use of foreign aid to finance exports by spending American money in a similar manner. Congress plans on holding hearings on this issue, perhaps as early as this spring.

The poor of the world will be losers if Tokyo and Washington use foreign assistance funds to battle one another for export markets. History

demonstrates that the best means by which a poor country can develop — as the new governments in Eastern Europe reaffirm — is through a free market economy. America, therefore, instead of competing with Japan's aid program, should work with the Japanese to construct programs that promote market-oriented economic growth and sound economic policies in less developed countries.

JAPANESE FOREIGN AID AND AMERICAN INTERESTS

The U.S. long has understood the importance of worldwide economic prosperity. Humanitarian reasons alone argue for a world free from poverty. In addition, worldwide economic prosperity creates markets for American products, meaning jobs for Americans, and gives Americans access to a greater variety of imported products. Finally, a prosperous world promotes America's security interests. Countries with healthy, growing economies are less susceptible to internal disorder and communist subversion. It was for these reasons that the U.S. aided Western Europe and Japan after World War II.

In the past decade, Japan has become a major foreign aid donor. In 1987, the Japanese government unveiled a \$30 billion foreign aid program. This summer it pledged an additional \$35 billion, for a nominal total of \$65 billion to be spent by 1992. Of the additional \$35 billion Tokyo claims that \$13.5 billion will go to its Export-Import Bank, \$7 billion to its Overseas Economic Cooperation Fund, and \$14.5 billion to a recycling fund for grants, loans, and other aid to less developed countries. There is confusion, however, about just what these figures represent. The Japanese government has been unable or unwilling to provide a clear accounting of where the initial \$30 billion was supposed to go and where and how much of it in fact has been spent.

Disguised Subsidies. Such confusion has been typical of the Japanese programs. When reporting the figures for its foreign aid program, which the Japanese call "economic cooperation," Tokyo usually reports the pledges or promises of funds to be spent. The Japanese tend to be generous in their pledges. On disbursements, or the actual money spent, the figures are less accessible.

In Japan's Official Development Assistance (ODA) Report released in March 1989 by the Ministry of Foreign Affairs, for example, it is unclear whether the figures are the pledges or disbursements. The figures sometimes also are listed as a percentage of the total ODA program. This makes it difficult to determine just how much money was actually spent in any particular country. The U.S. Agency for International Development (AID), by contrast, provides detailed figures on actual spending, spelling out where the assistance goes. Such data allow policy makers to determine effectiveness of their programs. Critics of the Japanese program persuasively maintain that much of Tokyo's foreign aid is not aid at all, but thinly disguised subsidies to boost exports of Japanese goods and services, often at the expense of policies promoting Third World economic growth.

STRUCTURE OF JAPAN'S ASSISTANCE PROGRAM

Most of Japan's foreign assistance funds are administered as part of the Official Development Assistance program. In 1987, some 65 percent of Tokyo's total ODA disbursements went to Asia.¹ Between 1983 to 1988 Japan has been increasing its aid to Africa from \$286 million to \$593 million. Japan now is the largest donor in Ghana, Kenya, Nigeria, and Zambia.

The main ODA programs include:

Grants. These are funds given by Japan directly to developing countries without requiring repayment. The Ministry of Foreign Affairs approves grant requests from less developed countries and draws the funds from its own budget. Most grants go for specific economic development projects. A more general program is the Aid for Increased Food Production and Food. Its relatively modest outlays provide funds for less developed countries to purchase approximately 300,000 tons of food annually. This is Japan's contribution under the Food Aid Convention of 1980, in cooperation with the U.S. and European Community. In addition, used farm equipment and fertilizers occasionally are given to needy nations.

Technical Cooperation. Technical assistance projects also funded by the Ministry of Foreign Affairs, recruit and train technicians, both Japanese and foreigners. The program provides the staff and equipment for most of Japan's development projects. Areas of staff training include: medical care and public health, mining and industry, public works and utilities, and agriculture. This technical cooperation program also dispatchs experts and survey teams to less developed countries to determine local needs, provides equipment and materials, and dispatchs development teams to analyze progress.

International Lending Institutions. Japan, like the U.S., contributes to such international lending institutions as the International Monetary Fund (IMF), World Bank, Asian Development Bank, and the United Nations Development Program. As of last April, Japan was contributing 9.43 percent of World Bank funds and 4.53 percent of IMF funds and has a respective percentage vote in these bodies. The U.S. was contributing 16.33 percent of World Bank funds and 19.14 percent of IMF funds.²

Loans. Long-term, low interest loans from the Japanese government to developing countries must be approved by the Ministries of Foreign Affairs, Finance, International Trade and Industry, and Economic Planning Agency. Project loans go mainly to private Japanese companies involved in specific projects in such areas as telecommunications, transportation systems, power generation, irrigation and water management in less developed countries. These loans are to pay for the goods and services needed for a project.

¹ *Japan's Official Development Assistance 1988 Annual Report*, Ministry of Foreign Affairs, p. 24.

² *International Monetary Fund Annual Report 1989 and World Bank Financial Statements*.

Commodity loans allow countries suffering balance of payments problems to import such necessary commodities as rubber, fertilizer, and grain. Debt relief loans help countries pay their creditors or refinance existing loans. Debt relief usually is offered when Japanese exporters are in danger of not being paid by less developed nations.

ORGANIZATIONS THAT DEAL WITH JAPAN'S ASSISTANCE PROGRAM

Three major institutions, often with overlapping responsibilities, manage Japan's assistance program:

The Japanese Export-Import Bank (Eximbank). The Eximbank, an independent government institution with commitments of \$10 billion in 1988, finances services needed for Japan's international economic cooperation programs. Under Japan's Official Development Assistance (ODA), the Eximbank conducts the programs that include the loan aid to the public and private sectors of less developed countries. Further, the Eximbank oversees foreign direct investments by the Government of Japan and by the Japanese private sector in less developed countries. Additionally Eximbank assists Japanese companies to finance their exports by using Export-Import credits.

For example, suppliers credits go to Japanese firms exporting plants, equipment, and services to less developed countries. Buyers credits are extended to Third World importers of Japanese products. Import credits go to Japanese businesses importing natural resources. For specific projects and overseas investments Eximbank lends funds for such programs as direct foreign investments and joint ventures.³

The Overseas Economic Cooperation Fund. The OECF administers the Official Development Assistance program. In March 1988, some 63 countries were receiving OECF loans for development purposes. In 1987, the average interest rate for the loans was 3 percent. The repayment period was 25 to 30 years with an average of 28 years.

These loans are used primarily to purchase equipment and services needed for such Japanese capital projects in less developed countries as bridges, dams, electrical plants, and roads. The project loans to foreign governments include: Project Loans, Engineering Services Loans, and Rehabilitation Loans. Program Loans include: Structural Adjustment Lending, Sector Adjustment Lending, Commodity Loans, Financial Intermediary Loans, and Sector Loans.⁴

³ The Import-Export Bank of Japan, Annual Report 1988.

⁴ "What Is The OECF?" The Overseas Economic Cooperation Fund Roles and Function, OECF, 1989.

The Japan International Cooperation Agency. JICA designs all of the overseas development projects. This agency decides what resources a project will need, what kinds of materials will be used, and every detail of how the project will be conducted. It also recruits foreigners for technical training in Japan, dispatches Japanese experts and survey teams around the world through the Overseas Cooperation Volunteers to work on projects, trains Japanese experts for technical assistance, and supplies the necessary equipment for the program.⁵

FOREIGN AID AS TRADE AND INVESTMENT FINANCING

Over the past decade, Japan has been criticized for using its foreign aid primarily to finance Japanese exports and overseas investments. Tokyo is accused of doing this by tying its grants, loans, and other forms of assistance to the exports from Japanese firms for aid projects. Bowing to such criticism, Tokyo claims that it has begun untying its assistance. The evidence suggests the contrary.

Example: transportation and telecommunications equipment (usually abbreviated as Transcom), which includes construction vehicles, telephones, and the infrastructure for each, are frequently exported as part of development assistance. In the past few years, Japanese exports of such equipment to Asian countries increasingly has been financed through foreign aid funds. In 1987, Japan exported \$1.6 billion in Transcom products to China, Indonesia, Malaysia, the Philippines, and Thailand. In that same year, \$1.4 billion in Japanese aid was sent to these same countries earmarked for purchases of Transcom products. By contrast, in 1987, the U.S. exported \$3.8 million in Transcom equipment to the countries with only 3 percent or \$11 million financed by American aid. (See Table)

Restricting Bids. The Japanese foreign aid program prevents other countries from securing contracts for equipment and services supplied to poorer countries as part of Tokyo's assistance programs. Critics observe that, when a prospective client for aid is identified, JICA representatives are sent to that country to develop a program. The project design predictably favors Japanese companies. This means that even if there is competitive bidding, Japanese companies have the advantage and usually get the contract. At times, moreover, bidding is restricted to Japanese companies.

The Japanese also appear to use such overseas capital projects as bridges, telecommunication systems, power plants, roads, dams, and hospitals to help Japanese businesses. While such projects may be most needed by developing countries, Tokyo tends to promote them generally in economically more advanced countries where Japanese firms invest heavily. Not only does this help

⁵ JICA reports: "JICA: Japan's ODA Programme, A Development Study," "JICA at a Glance," and "The Japan International Cooperation Agency."

**Japanese Aid and Transcom Exports
(millions of current U.S. dollars)**

	1984	1985	1986	1987
China	301	567	502	568
Indonesia	195	196	397	526
Malaysia	216	224	135	183
Philippines	51	92	67	88
Thailand	245	199	217	288
Total Exports	1,008	1,277	1,316	1,658
Japanese Aid*	297	589	513	1,403
Aid Share of Exports	30%	46%	39%	85%

**U.S. Aid and Transcom Exports
(millions of current U.S. dollars)**

	1984	1985	1986	1987
China	39	107	158	204
Indonesia	36	44	73	42
Malaysia	40	31	33	28
Philippines	60	44	28	36
Thailand	75	54	71	79
Total Exports	250	280	361	381
U.S. Aid*	0	0	0	11
Aid Share of Exports	0%	0%	0%	3%

* Total Five Countries

Source: United Nations Trade Data and OECD Development Assistance Committee ODA commitments.

Japanese investments in such countries, it also improves the infrastructure in a manner that attracts new Japanese investments.

To help American businessmen gain Japanese foreign assistance program contracts, U.S. AID sponsored a conference last May in Washington. The result was the opposite of AID's intention. Rather than being encouraged to seek opportunities for American business participation in Japanese projects in developing countries, many American businessmen concluded that the purpose of the conference was to demonstrate the impossibility of gaining contracts in Japanese capital projects. The Japanese aid officials participating in the AID conference were typically vague, offering absolutely no information on procurement practices of their programs. At the conference, the American businessmen found it impossible to apply for contracts from Japanese funded projects. No evidence was offered of any foreign company securing major contracts from Japanese funded programs. When asked if any American firm had ever received a substantial contract, Japanese officials responded that they did not know of any. By contrast, overseas projects funded by American foreign aid frequently use non-American suppliers and

contractors. In practice AID often allows third country procurements for its economic support funds.

Further, one crucial way to promote development in less developed countries is for developed countries to keep their markets open to exports from third world countries. Trade protection closes markets to these countries and fosters economic stagnation.⁶ Japan's market is closed to many imports from less developed as well as industrial nations; therefore, while there are serious questions concerning the effectiveness of Japan's aid program, there is no question that its trade policy robs Third World countries of markets for their goods and thus of opportunities to better their economic conditions. Trade is crucial to the Third World. A report issued by the U.S. AID last February finds that all of the foreign assistance given by more developed countries to less developed countries does not quite offset the damage done to poorer countries through trade protectionism.⁷ Therefore, Japan might assist in eliminating worldwide poverty by reforming its own trade practices.

Disturbing Report. With their new, more prominent role as a foreign aid donor, the Japanese will be offering more advice to less developed countries. As a consequence of its expected increased contributions to the IMF and World Bank, it will have a greater voice in decisions made by those organizations. How it will use this voice is another matter. It is not certain that Japan will be pushing the policies of less government control and regulation of the economy necessary for economic growth. A report issue last August by Japan's Ministry of International Trade and Industry (MITI) states:

In the case of developing countries, merely eliminating factors which hamper private sector economic activities does not necessarily guarantee the success of economic and social development....In such cases, the governments of the developing countries should provide support guided by industrial policies that would include bringing together industry and government to form a consensus on future planning and decision making...⁸

"Industrial Policies" is a term synonymous with the economic planning and overregulation typical of most less developed economies. Industrial policies usually mean government subsidies, and using public funds for certain businesses. This policy attempts to pick the winners and the losers among competing industries and usually results in trade protectionism to promote the development of domestic industries. Such policies, especially in less

6 *Development in the National Interest: U. S. Economic Assistance Into the 21st Century*. A Report by Alan Woods, Agency for International Development, Washington, D. C., 1989. Hereinafter referred to as the Woods Report.

7 *Ibid.*

8 "White Paper on Economic Cooperation," Ministry of International Trade and Industry, August 1989.

developed countries, hamper the private sector, restrict competition, and hinder economic growth. When Japan has used such techniques in its own domestic economy, consumers have suffered. If MITI's remarks are a reflection of Japan's development philosophy, then little help can be expected from Tokyo in dealing with the fundamental causes of world poverty.

CRAFTING A U.S. RESPONSE

If Japan's foreign assistance program continues to be used mainly to assist its exporters, with little emphasis on promoting market-oriented economic growth in Third World economies, then U.S. interests in global prosperity and opened markets are threatened. Prosperous countries are better able to purchase American goods and to provide products for the U.S. market. Further, prosperous countries tend to be less susceptible to internal disorder and subversion. Rather than recognize the threat to U.S. interests, the Bush Administration merely plans to station U.S. AID officials in Tokyo to help the Japanese to develop a foreign aid program similar to that of the U.S. and increase the American use of export financing.

The problem is that the ability of the U.S. program to assist less developed countries has come under considerable criticism for its own inadequacies. In a widely acclaimed report, "Development in the National Interest," released by AID last February, little correlation was found between the amount of aid money received by a recipient country and the degree of economic growth achieved. For example, some countries that received substantial funds per capita, such as Tanzania, had very poor development records. Further, the report found that countries with fewer restrictions on trade and foreign investment and a greater reliance on market mechanisms enjoyed greater growth. A report also released last February by the Task Force on Foreign Assistance, chaired by Representative Lee Hamilton, the Indiana Democrat, and Representative Benjamin Gilman, the New York Republican, finds AID's effectiveness limited and suggests a greater emphasis on promoting economic growth. Before AID thus attempts to promote an approach similar to its own efforts in Japan, it must be sure that its efforts can deal with underdevelopment in less developed countries.

Fruits of Freedom. In addition, some policy officials, including many within AID, have criticized the U.S. program and maintain that more assistance should be spent directly on alleviating what they call "basic human needs" — illiteracy, high infant mortality rates, and low levels of health care. The lesson of the past decade is that such problems can only be resolved through economic growth. Free countries such as the Republic of China on Taiwan and South Korea, for example, have done a better job at meeting basic needs

than the economically (and politically) tightly regulated People's Republic of China and North Korea. The free economies enjoy a generally faster rate of economic growth.⁹ The basic human needs approach tries to treat the symptoms of poverty while failing to address the causes. This in the long term, could result in increased poverty.

Bad to Worse. In light of this, capital projects, including such things as roads, hospitals, and schools, at least tend to help the economy over time by providing the necessary infrastructure for any functioning economy. Congress last year tried to pressure AID to devote more resources to the basic human needs policy with the Global Poverty Reduction Act. If AID officials intend to tell the Japanese to abandon capital projects in favor of the basic human needs approach, they would be forcing Japan to move from bad to worse.

Aside from sending AID officials to Tokyo, the Bush Administration also plans to combat Japanese export financing by increasing American export financing. The plan would be used to promote American exports through the use of U.S. foreign assistance funds. It would increase the support funds from \$10 million in 1989 to \$100 million by 1990. The U.S. Export-Import Bank would control the funds through an account called the war chest.¹⁰ This approach is subject to the same criticism U.S. officials direct toward the Japanese and contradicts the Administration's stated desire to end export financing. There is little indication that this will have any impact on Japanese behavior. Rather, this program would create another special interest group with American business reaping the benefits. Further, this program will divert resources away from beneficial programs that emphasize economic development. Both approaches – sending AID officials to Tokyo and increasing the use of the U.S. war chest – are inadequate.

WHAT THE U.S. GOVERNMENT SHOULD DO

This spring, Congress will hold hearings on the subject of Japanese foreign assistance and what the U.S. policy response should be. American policy makers would do well to focus on free market economic growth in less developed countries as means of eliminating poverty. Congress should seek to discover how well the Japanese program conforms to this approach. The American response to the Japanese should include the following:

1) Do not send AID officials to Tokyo to advise the Japanese how to establish an aid program. The U.S. has its own problems running a foreign aid program. After spending \$250 billion in the Third World since 1961, the U.S. has had a poor record in promoting economic growth. The U.S. should hold back

9 Stephen Moore and Julian L. Simon, "Communism, Capitalism, and Economic Development: Implications for U. S. Economic Assistance," Heritage Foundation *Background* No.741, December 8, 1989.

10 From the statements of John D. Macomber, President of the U. S. Export-Import Bank, before the U. S. Senate Banking Committee, September 13, 1989.

advising the Japanese on how to establish an effective assistance program until it has demonstrated that it can run an effective program itself.

2) Send AID representatives to Tokyo to find out more about the Japanese program. AID officials should focus on getting the numbers and statistics about Japan's programs. The Japanese are very secretive about the tied aid nature of its program. Finding out how the Japanese spend their foreign aid money would be a prerequisite to working with the Japanese in the future on development strategies.

3) AID and Japan should emphasize sound economic policies that help Third World countries. The main focus of foreign aid should be to create economic opportunity in less developed countries that will trigger the economic growth that raises the quality of life for all people. Relying on the "basic human needs" approach, which neglects the economic basis of prosperity, and using capital projects as a way to promote the donors' industries — with little consideration of potential impact on the economic, social, and environmental situation in a developing country — only diminishes the effectiveness of promoting economic growth.

4) Abandon the "war chest" approach in dealing with Tokyo's foreign aid program. By using the U.S. program as a way to promote American exports changes America's foreign aid mission from promoting economic growth to promoting its exports. Likewise, this approach may lead to the continuation of the Japanese export supports, which the Administration and Congress seek to end. Rather than promote exports, the U.S. and Japan should open their markets to goods from less developed countries, which would provide opportunities for economic growth.

CONCLUSION

As Japan becomes one of the world's largest foreign assistance donors, U.S. policy makers must ask what interests Tokyo's aid program is promoting. Economic prosperity, which creates markets for exports, and enhances political and social stability in Third World countries is in the interest of both the U.S. and Japan. This interest, however, is served neither by Tokyo's capital projects approach nor Washington's basic human needs approach because they do not lift less developed countries out of perpetual poverty. What is as bad, Japan's use of aid funds to promote its exports and America's retaliation through the use of a similar policy tells less developed countries that America's rhetoric about concern for the world's poor and the benefits of free markets is just an excuse to subsidize America's own business.

Opening Markets. The U.S. and Japanese could work together to promote market-oriented economic growth in less developed countries. U.S. policy makers should start by learning more about the Japanese program and finding out where their money goes. The U.S. and Japanese should work to end trade barriers, which do real damage to Third World economies, and open American and Japanese markets to products produced in less developed

countries. Finally, the U.S. Congress and the Bush Administration should reform the Agency for International Development, making the promotion of economic growth in less developed countries its prime objective.

The U.S. now has an opportunity to make great strides promoting economic growth in the Third World and the newly independent Eastern European countries. By working with the Japanese to promote economic growth through a sound foreign assistance program, less developed countries will have the best chance to reform their stagnant economies.

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