

# E ffective Overseas Aid

By Yasuhiko Torii



Japanese economic aid has a vital role to play in overcoming stagnation in the world economy. The effects and potential of Japan's economic assistance have changed greatly over the years, and in order to reflect these changes there needs to be a reorganization of such assistance. The changes in the economic environment can be summed up in the following five points:

(1) The flow of money from developed countries to less developed countries (LDCs) has been drastically reduced. Considering the foreign exchange fluctuations and the drastic fall of primary commodity prices since 1985, the flow of money from LDCs to developed countries was greater than that going in the other direction. Now, the industrialization of the LDCs, which has at long last begun to take off, is facing the danger of stalling. Although LDCs feel the need for economic cooperation today more strongly than ever, they are suffering from the heavy burden of accumulated debts and a drastic reduction in the flow of funds from developed countries. It is the responsibility of Japan and other developed countries to step up the flow of funds to LDCs.

(2) The reduction in the flow of funds from the United States and other developed countries to LDCs has caused structural changes in the relations between official development assistance (ODA), other official flows, private flows and those from nongovernmental organizations. Throughout the first half of the 1970s, concessional funds, including ODA and other official flows, provided the bulk of assistance. As a result of the rapid industrialization of the newly industrializing economies (NIEs) and LDCs in the second half of the 1970s, the flow of private funds increased. In 1981, for instance, economic cooperation totaled \$139.1 billion, of which 54% consisted of private funds. From 1984 through 1985, however, private funds decreased by as much as 45.5% on a world-



wide basis. We are now faced with a serious problem of how to revive the flow of private finance.

(3) U.S. economic assistance and funding, which had sustained world economic development, began to decrease in 1982 and the slowdown became dramatic in 1985. On several occasions since World War II, the United States had requested Japan to take over the responsibility of providing economic assistance to Asian countries. It seems that since 1985 the United States has been trying to drastically reduce its money supplier's role not only in Latin America and Asia but in the entire world. The U.S. retreat in economic cooperation creates a state of vacuum, endangering the balance of the economy, politics and security in the world today. Japan can play a part in filling that vacuum.

(4) The U.S. has also cut back in providing public funds, reducing its ODA budget year after year to as little as \$8.8 billion in fiscal 1988. It is expected that 1989 U.S. official development assistance will rebound to \$9 billion, but this amount is still less than Japan's \$9.7 billion. Japan is being looked to to alleviate the acute worldwide shortage.

(5) Economic cooperation itself has ironically become an integral part of today's global economic imbalance. In the past, economic cooperation was supposed to help LDC economies develop and produce profit in excess of the debt repayment. Today, however, economic cooperation causes debts to grow, which in turn creates an imbalance in the international flow of funds, and makes the foreign exchange market unstable. Also, economic cooperation accelerates the industrialization of LDCs and intensifies their competition with developed countries. In the long term, however, the developed countries need to use some of their accumulated economic power to help the LDCs. The world should then be able to overcome the current state of imbalance. Japan's responsibility in achieving these goals is enormous.

The restructuring of Japanese economic cooperation must be studied from the six angles of (1) quantitative expansion, (2) qualitative improvement, (3) di-



Electrification program in Bhutan, one of the aid projects supported by Japan

versification of use, (4) allocation, (5) methods and systems and (6) philosophy.

**Quantitative expansion:** Japan has often been criticized for the smallness of its ODA and urged to increase it. This criticism is no longer justified. Japan allocated ¥1,348.7 billion for ODA in its fiscal 1988 budget, equivalent to about \$10 billion, which was more than the \$8.8 billion allocated by the United States. According to an announcement made by the Foreign Ministry on June 10, however, Japanese ODA in calendar 1988 on a net disbursement basis totaled \$9.1 billion, up 22.5% from 1987, but remained the second-largest behind the U.S. with some \$9.8 billion. In Japan's fiscal 1989 budget ¥1,369.8 billion (about \$9.7 billion) which will be about 8% greater than the United States' \$9.06 billion, is allocated for ODA. It is expected that Japan may overtake the U.S. as the biggest ODA provider in 1989.

Japan, like the United States, had been plagued by a perennial fiscal deficit, and adopted the so-called "zero ceiling" policy in compiling the national budget from fiscal 1982 through fiscal 1987, pegging spending at the preceding year's level. But allocations for ODA and defense were exempt from this zero ceiling policy. As a member of the Administrative Reform Study Council, I requested a substantial increase in ODA despite the zero ceiling principle. The request was unanimously approved by the council.

In 1983, the first year of the zero ceiling policy, ODA was exceptionally raised by

8.9%, even greater than the 6.5% increase given to the defense budget. The fourth medium-term ODA expansion plan announced in June 1988 is set to double the \$25 billion 1983-87 five-year ODA disbursement to \$50 billion in five years from 1988 through 1992. As far as the quantitative expansion of Japan's ODA is concerned, Japan is clearly taking the initiative.

**Qualitative improvement:** Japan has been criticized that its ODA leans heavily toward loans, whereas U.S. and European ODA consists mainly of grants. We recognize that the need for grants was strong when the urgent objective of ODA was to alleviate poverty and help reconstruction. The principal objective of economic cooperation is shifting, however, to the construction of infrastructure, industrialization and relief of debt crisis, so grant-biased assistance is not always suitable.

Instead of the stereotyped argument that Japan's ODA should be made grant-biased like American and European aid, it is necessary to divide Japan's ODA clearly into grants and loan-type aid and to institutionalize it. Grants, such as those given for poverty alleviation, famine, emergencies and refugees, as well as for education and technology, should be distinguished clearly from loan-type assistance.

Japan has started the New Aid Plan and other comprehensive assistance programs to help LDCs' industrialization. Moreover, Japan is trying to increase assistance not only in basic education and





Trainees from Bangladesh, Egypt, Kenya and Pakistan at a Japanese automobile plant

training needed to sustain infrastructure and industrial plants, but also technical assistance in a wide range of fields, including high technology, engineering, medical care, population control and protection of cultural property.

**Allocation:** The allocation of Japan's economic cooperation, affected by the Cold War after World War II, used to be heavily biased toward protecting the security and economic development of Asian countries. Today, Asian countries' needs for assistance are changing. The NIEs like South Korea no longer need assistance. ASEAN countries are just about to take off in their industrialization. Assistance to the countries of Indochina, the Pacific islands and West Asia, to which the allocation of assistance has been small, must be substantially increased. Also, the burden of providing assistance even to Latin America and to African LDCs, formally American and European concerns, is now falling on Japan's shoulders.

**Methods and systems:** It is necessary to reorganize Japan's ODA, other official flows and contributions to international organizations, by revising the whole process of economic assistance, from the choosing of projects to their assessment after completion.

Japan's ODA is severely hampered by inflexible principles and complicated mandatory procedures. Specifically, Japan allocates its ODA only for projects for which assistance is requested, provides assistance on a single-year budget basis, and requires detailed receipts for all disbursements. In the future, the screening, inspection and assessment should be conducted in a more transparent way.

**Philosophy:** The philosophy of economic cooperation has been changing over time, as have Japan's national interests. No consensus exists either in the government or in the private sector regarding the philosophy of economic cooperation. In Japan, unlike the United States, the economic cooperation budget is discussed in the Diet, but the actual projects for which cooperation is to be given are not discussed. The implementation of assistance is entrusted to the Overseas Economic Cooperation Fund, the Japan International Cooperation Agency and the Export-Import Bank of Japan, under the supervision of the Ministries of Foreign Affairs, Finance, and International Trade and Industry and the Economic Planning Agency.

As a result, assistance is supervised by the administrative branch of government in the absence of scrutiny by the public, so that Japan's economic cooperation is a reflection of the administration's world strategy based on the exigencies of economic and political diplomacy. Ideals and principles based on national consensus are absent.

As the world today becomes increasingly pluralized, there is need for a revision and diversification of the scale of economic assistance and the ways and means by which it is given.

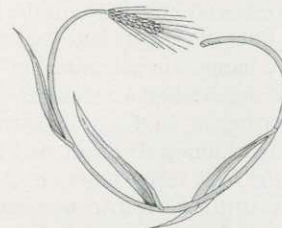
I propose to divide economic cooperation in the broad sense into four categories with a distinct mechanism for each category: (1) Aid, (2) Assistance, (3) Cooperation and (4) Coordination.

**Aid** is for alleviating poverty, helping nation-building and providing emergency relief. In today's world, there are still many desperately poor countries, and

also quite a number of very poor people even in countries which have achieved considerable economic progress. Aid is given primarily to satisfy the basic needs of poverty-stricken people and to provide them with the opportunity and motivation to work for a better standard of living and to give them hope for a better future for their children.

Aid is needed for people who cannot through their own efforts obtain basic hard infrastructure such as housing, roads and highways, arable land and water supply systems, or soft infrastructure such as education and medical care. It is our responsibility to help them from the humanitarian standpoint. Other important objectives of aid are disaster relief, help for famine victims, refugees and victims of regional conflicts, relief in case of sharp falls in commodity prices and for alleviation of losses due to sharp rises in crude oil prices.

It is right that aid should be given as a grant, and Japan should attach more importance to this kind of assistance. It is necessary to restructure a permanent aid system providing a package of free financial aid, free technical assistance, the leasing of goods on easy terms and assistance by private-sector volunteers. Japanese diplomatic missions overseas and aid organizations should be entrusted with the selection of projects for aid and with the procedures for implementing them. Also, the simplification of procedures is absolutely necessary for speeding up the extension of aid.



**Assistance** is for LDCs to build up a sophisticated infrastructure, achieve industrialization and resolve debt problems, things which are most urgently needed in the present stage of the world economy. The present stage of industrialization in many LDCs is extremely fragile. In order to succeed in full-scale



industrialization, they need airports, ports and harbors, roads and highways, railways, telecommunications networks and facilities to provide education and research in sophisticated technologies essential to modern industries. This is a field in which cooperation provided in the form of loans is effective.

Also necessary for LDCs' industrialization is pre-start engineering, such as in market research, feasibility studies and basic design in the planning stage, and also procurement of machinery, equipment and materials. Also needed are transfer of technological and management know-how in operating plants, rapid technological advancement and worldwide marketing of their products. The Japan International Cooperation Agency is now conducting research, as a technical cooperation project, on the feasibility of providing such backup support in a package by MITI, the Japan External Trade Organization and the International Development Center of Japan.

To help alleviate debt, a two-pronged approach is necessary—to control debt-inducing factors and to provide necessary financing. To control debt-inducing factors it is necessary to provide assistance in reducing fiscal deficits, narrowing the investment-savings gap and alleviating current account deficits, as well as providing financial assistance and technical cooperation to support industrial policies.

As regards financial assistance, measures for supplying short-term funds and reducing the debt burden arising from foreign exchange fluctuations are necessary. The present mechanism of Japan's ODA does not enable recipient countries to make up for exchange losses arising from the fact that Japan's assistance is denominated in the recipient country's currency. Measures to rectify this are

urgently needed. The insurance scheme to cover loss suffered by private Japanese donors has been improved markedly since fiscal 1989.

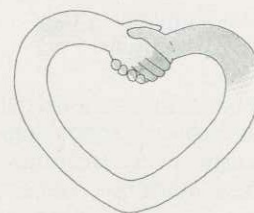
**Cooperation** should be extended on an equal footing. This includes not only cooperation to promote mutual trade and investment, to make industrial adjustment, to develop resources jointly and to promote large-scale projects, but also cultural cooperation and cooperation to ensure national security.

The cooperation for promoting trade and investment has been provided principally by the Export-Import Bank of Japan. Cooperation for industrial adjustment should be controlled by existing market forces, but a greater amount of ODA funding should be allocated to promote research and consultations to maintain the compatibility of industrial policies among Japan and other countries.



Promotion of joint development of resources and large-scale projects are the most important ways to create demand in the world economy. In order to achieve these goals it is necessary to have a complete revision of the current system of appropriating a budget on a single-year basis and the eradication of sectionalism existing among Japanese government ministries and agencies. Full cooperation among the ministries and agencies is essential to create large projects and resources development.

Cultural cooperation is another field in which Japan needs to increase its efforts. According to the "graduation theory," countries where the average income reaches a certain level are likely to no longer receive cultural cooperation, but it is desirable for Japan to continue such cooperation.



**Coordination** is a field which was not previously included in the ODA concept. In the past, policy coordination meant adjustment of economic, financial and monetary policies between the industrially advanced countries at their summit conferences or at high-level consultations. In the future, however, coordination with developing countries and NIEs will become increasingly necessary as their economies gradually catch up with the economies of industrially advanced countries. Coordination must step beyond the conventional concept of summit conferences and high-level consultations.

It will be necessary to have many people with knowledge of the systems and situations of each other's country. Exchanges between people in the political, administrative, business, press and academic circles in Japan, developing countries and the NIEs must also be stepped up. Many people in the United States and Asian countries are well versed in Japanese affairs, but not many Japanese are really knowledgeable about other countries. It is necessary to have swift communication between countries of public announcements, notifications, legislation, law revisions and economic and political information. ODA funds must be used to build up such a system.

Japanese economic cooperation will be more highly valued by all countries if it can be reorganized under the four categories of aid, assistance, cooperation and coordination as described here.

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