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Integration of Macroeconomics and the Institutional Approach in Developmental Aid Policies
—Proposing a Method Using Policy Management Studies—

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September 2007

The 21st Century Center of Excellence Program
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—Proposing a Method Using Policy Management Studies—

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Abstract

Policy Management Studies is an academic discipline that presents a new methodology for specific subjects through a multidisciplinary and cross-disciplinary approach to existing academic domains. Okabe (2005) states that one of the characteristics of policy management studies is the integration of three dimensions: method, actor, and process. This paper will focus on economic disparity and poverty issues, which are key global issues necessitating an urgent response, as well as the role of aid as an applicable example of these aspects. The author will explore the aid methodology, which enhances the effectiveness of achieving economic growth in developing countries and reducing poverty, while providing an overview of recent research trends in development assistance strategies. In particular, aid allocation and methodology will be examined by integrating both the macroeconomic approach and the institutional aspects from the perspective of policy management studies.

Key words: Development assistance, aid methodology, Millennium Challenge Account, World Bank

Introduction

Policy management studies is an academic discipline that presents a new methodology for significant themes facing Japan and the world today, utilizing existing academic disciplines in an interdisciplinary and multi-dimensional manner. Okabe (2005) indicates that one of the characteristics of policy management studies is represented in its methodology and integration of three dimensions: method, actor, and process. This is thought to deliver the most worthwhile value in a series of processes: first, presenting new research methods and perspectives tailored to the objectives; developing them into a more practical and realistic form through discussion and feedback with scholars from various fields, policy makers, practitioners, and private organizations; proposing a policy for a common subject matter; and promoting its implementation and dissemination.

In "Economic Development and Human Security in Asia: How to Improve Governance at the Inter-Governmental, Government, and Private Sector Levels," which is one of eight projects of the 21st COE Program "Policy Innovation Initiative: Human Security Research in Japan and Asia," research and dissemination activities are conducted with a strong notion of integrating these three dimensions. As aid strategies to end the spread of global poverty are put into greater use world-wide, the theme addressed by this project encompasses timely and important global issues.

In September 2000, 198 nations gathered for the Millennium Summit and adopted the UN Millennium Declaration. Peace and security, development and poverty, environment and human rights, sound governance, and special consideration to the needs of Africa were presented as the main issues of the United Nations. Thereafter, through repeated discussions among the World Bank, International Monetary Fund (IMF), and Organization for Economic Co-operation and Development (OECD), the UN General Assembly endorsed the Millennium Development Goals (MDGs) as specific targets for developing countries in order to achieve a reduction in poverty by 2005[1]. Specifically setting a target date of 2015 as well as numerical targets, the declaration is a groundbreaking move stating that developing and developed countries as well as international organizations will work toward achieving these goals with a sense of common purpose.

To combat global poverty, the recipient developing countries, the donor developed countries and the international organizations are required to fundamentally re-examine traditional socioeconomic development strategies and aid methods to make substantial

1) MDGs are eight goals to be achieved by 2015: (1) Reduce by half the percentage of the population accounted for by those living in poverty; (2) Achieve universal primary education; (3) Eliminate gender disparity in education; (4) Reduce child mortality; (5) Improve maternal health; (6) Combat HIV/AIDS, malaria, and other diseases; (7) Ensure environmental sustainability; (8) Develop a global partnership for development.

improvements. While the recipient countries work to develop appropriate economic policies and the environment for institutions/governance so as to enhance the effectiveness of aid on economic development and poverty reduction, the developed countries and the international organizations are expected to increase aid as well as to consider more effective aid methods. In February 2002, the World Bank estimated that it would require between US$40–60 billion a year in additional Official Development Assistance (ODA) to attain the MDGs, provided that developing countries could implement the appropriate reforms and policies. At the United Nations International Conference on Financing for Development, held in Mexico in March 2002, the suggestion that the target ratio of ODA to GNI for donor countries be increased to 0.7 % was adopted (Monterrey Consensus). In 2003, donor countries delivered a total of US$68 billion in ODA, which is 0.25 % of GNI. While the main developed countries have switched to increase aid, Japan has reduced its ODA due to its severe financial conditions since 2001. Japan, once a top donor country, has decreased its ratio of ODA to GNI from 0.28 % in 2000 to 0.19 % in 2004. If this situation were to remain unchanged and MDGs fail to be achieved mainly in Sub-Saharan Africa (the area of the African continent lying south of the Sahara desert), it would result in Japan facing criticism that its negative stance toward foreign economic cooperation was a contributing factor. To avoid such a scenario and to exercise its leadership toward solving world issues, the time has come for Japan to seek new aid strategies.

Having established a study group comprised of professionals in the fields of economics, sociology, politics, regional studies, as well as multiple policy makers and international organizations along with practitioners in the project of "Economic Development and Human Security in Asia: How to Improve Governance at the Inter-Governmental, Government, and Private Sector Levels" of the 21st COE Program, we are attempting to refine a new methodological framework to address urgent issues such as reducing global income disparity and poverty, while having already developed a merger of actors and an integration of processes. This project is based on the following three goals:

(1) Foreign economic cooperation, which is conducted by developed countries and aimed at promoting the economic development of developing countries, consists of Official Development Assistance (ODA), other official funding (OOF), and private-sector funding. Although individual data is available with regard to each of these flows, they are not quite being comprehensively comprehended in a systematic manner. This project explores and proposes a new way of economic cooperation, pursuing a study of the flow of funding and its effects on economic development and poverty reduction in the developing countries.

(2) Furthering the study of the relationship between economic and social infrastructures as well as information and communication technology (ICT), and development and poverty reduction, it searches for new aid strategies. As the causal relationship of ITC to the poverty reduction and pro-poor growth along with its relationship to the existing economic and social infrastructure have not been covered by any study, the role of ICT as to how it should be incorporated into the existing pro-poor model is to be examined.

(3) The public-private partnership as a new economic cooperation method has drawn much attention in recent years. Studies concerning new finance methods, such as issuing revenue bonds for individual investment projects, defining commerciality, and building institutions are needed. This project proposes new aid policies for Japan toward reducing poverty through an expansion of the economic and social infrastructures and the development of ICT industries in developing countries.

In this paper, the author will attempt to present a perspective for a new approach to development assistance as the initial step, focusing on method integration rather than integrating actors or processes. When considering comprehensive socioeconomic development strategies for developing countries, the economic approach based on macroeconomics had been the mainstream. However, non-economic aspects, especially the quality of institutional/governance environment of the recipient countries which had not received much attention from international organizations and economists, have recently been emphasized. This paper will examine recent trends in aid methodology focusing on the institutional environment. In addition to this, while taking into account the policy environment, poverty conditions, and external debt status, methodologies to determine the amount of aid will be explored.

This paper consists of five parts. In the first part, while taking an overview of recent studies, the question of whether aid can lead to improvements to the economic policies of developing countries will be examined. Examples of advanced research regarding selected recipient countries will be surveyed in the second part. The third part will introduce development assistance methodology concerned with concession loans of the World Bank and a new aid strategy of the United States. In the fourth part, an aid methodology based on the new criteria will be demonstrated. The fifth part, in conclusion, will summarize the importance of policy management studies and its policy implications.

1. Review of Advanced Research

1-1. Can aid change recipient countries' policies?

While international development financial institutions, such as the World Bank and IMF provide concessional loans, it is common for these to be accompanied by loan conditionality under adjustment programs. This is premised on the reasoning that by requiring sound economic policy and structural reforms as conditionality, the policies of recipient countries are able to be modified. However, it has become increasingly clear that recent experimental studies do not support such a premise. Killick (1991), Ranis (1995), Mosley et al. (1995), and the World Bank indicated that a stable relationship between aid and the quality of economic policy has not been observed. Devarajen et al. (2001) analyzed the relationship of economic policy (macroeconomic policy, structural reform, public sector management, and social relief policy) to aid by utilizing data from the period 1993-99 for ten countries in the Sub-Saharan African region. They showed that there is no correlation between the two and that aid is not a key determinant of economic policy in developing countries. Burnside and Dollar (1997, 1998, 2001) also indicated that aid does not affect the quality of macroeconomic policy in developing countries.

Dollar and Svensson (2000) observed 220 structural reform programs sponsored by the World Bank, and showed that success in these programs depends upon the domestic political situation of the recipient country. Rose and Hay (2001) examined 958 conditional loans made by the IMF and World Bank in the 1980s and 1990s, and indicated that government mismanagement continued and that the shift to implement conditionality was inadequate in low-income countries. Easterly (2001) pointed out that international development financial institutions continued to provide loans even when the recipient countries' economic policies showed no prospect of growth. It was also noted that they often continued providing new loans to enable these countries to pay off their accumulated foreign debt regardless of conditionality.

From among those developing countries the IMF has been providing loans to, it (2002) has been conducting analyses which randomly select a ten-year period and define countries that have received loans for seven years or longer as the long-term borrowers. The results indicate that there exist multiple long-term borrowers extending their loans for significant periods of time. For example, the Philippines has been receiving loans from the IMF for approximately 25 years, while Panama, Pakistan, Haiti, and Senegal have also been long-term borrowers of over 20 years. The borrower countries are basically expected to achieve economic growth and independence by utilizing the aid funds effectively, however many of them remain dependent on IMF loans. The IMF (2002) suggested that a reason for the existence of long-term borrowers is the external payment deficit of the low-income country is rooted in structural causes that are time-consuming to adjust, and therefore results in a repetition of short-term loans form the IMF. The IMF report also said that continued long-term IMF loans are expected in the international community and pointed out changes in the global environment where loans form the IMF have come to be considered as a "stamp of approval" in order to receive new loans and debt relief measures from other international institutions and lender countries. In addition to that, the gap between the optimistic growth forecasts of developing countries and their reality as well as the lack of the latter's commitment to the appropriate relevant policies for the agreed-upon adjustment programs were also pointed out. Meanwhile, it was highlighted, as an issue pertaining to international institutions, that adjustment programs were not flexibly designed to take into consideration uncertain elements, such as changes in trade terms and unseasonable weather. Thus, it is evident that it is often difficult to realize and sustain sound policies, despite the IMF's imposition of conditionality that developing countries implement appropriate economic policies.

1-2. New Approach to Aid Provision Supporting Reform Efforts

Recently, there has been a growing awareness that the recipient government's accountability, political and social institutions guaranteeing political rights and civil liberties, political factors such as government stability, governance capacity of the bureaucrats, and the extent of corruption as well as judicial and legislative factors all have a strong bearing on whether or not the appropriate economic policy can be carried out. It has come to be realized that sustaining the appropriate economic policies and structural reforms is difficult if the institutional/governance environment is underdeveloped, and if government stability, governance capacity of the bureaucrats, and exposure of corruption are inadequate (Rose and Hay 2001). Dollar and Svensson (2000) showed that the success of economic reform programs depended upon political and economic factors such as the duration of a political regimen and whether or not political leaders are selected democratically and supported by the people.

Reflecting this view, an aid approach differing from existing ones has been proposed: aid should be determined not by elements such as income level and poverty conditions of developing countries, but by taking into account achievements in economic policy and institutions of developing countries as well as the quality of the governance environment; and there is a growing view that the type of aid and its amount (project aid and non-project aid, loans and grants, etc.) should be determined in accordance with the policies, institutions and progress of governance in individual country in a manner that enhances the people's support for reform. The institutional/governance environment, in a limited sense, refers to the government's governance capacity, and, in a broad sense, it refers to the environment including judicial and legislative institutions, which includes intellectual property protection, efficient financial and capital markets, and a democratic system. The government's governance capacity indicates the existence of a bureaucratic organization and the ability to pursue policies for long-term economic development, carrying out adjustments among various concerned parties, which are comprised of individuals, corporations, NGOs, and other entities, while being accompanied by poverty reduction and fairness. Such terms as the quality of bureaucracy, government stability, accountability, and corruption are often used as its indexes.

The recent prevailing view on aid methods is that, with regard to countries where adequate economic reforms and improvements of their institutional/governance environment have not been adequately implemented, aid based on technical assistance and policy discussions is conducted instead of immediate assistance being provided. In the phase where improvements in the institutional/governance environment start to show after reform implementation, loans accompanied by an obligation to implement policies becomes the main form of aid along with continued policy discussions, and thereafter, the amount of aid will be increased in incremental steps. If and when the political will to pursue economic reforms is firm, and improvements of institutional/governance environment are also recognizable, imposed restrictions and conditional ties will be loosened so as to enhance their degree of freedom while aid provision continues,

As a case example that such method is valid, Devarajan et.al. (2001) illustrated the experiences of Uganda and Ghana. These countries, whose regimes were established as a result of coups d'etat, both achieved economic success by implementing economic reforms. Devarajan et.al. (2001) stated that the method utilized by the aid donor was a link to this success. Immediately after the coups, both countries maintained production systems based on price controls, trade restrictions, and state enterprises, along with their overvalued monetary systems under the influence of Stalinism and were relying on aid from communist countries. However, when they found such policies unworkable, they switched to the market economy model and launched economic reforms. In response to these changes, international institutions and donors (of the capitalist camp) initially implemented assistance that was mainly technical assistance and policy discussions, offering only modest amounts of aid and taking a wait-and-see stance. As economic reforms started to take effect, they built up their aid by incrementally increasing the amount with a focus on loans accompanied by the obligation to implement proper economic policies and structural reforms. The amount of aid rapidly grew in the mid-1980s, and it rose in response to fulfillment of economic policies required as conditionality under aid programs supported by the IMF and World Bank. In the 1990s, as the loans from international institutions declined relatively, in turn, the proportion of aid shifted to bilateral aid. The type of aid shifted accordingly from loans to grant-aid based cooperation as well. Devarajan et al. (2001) stated that, in Asia, Vietnam has followed this process in the stages of economic development and methods of aid provision.

In contrast, it has been indicated that, despite the fact that sound policies were not implemented in Nigeria and the Democratic Republic of the Congo, these nations were able to receive large sums of aid in the initial stage, resulting in a failure to implement the necessary economic policies and preserving rampantly corrupt administrations. As this shows, in such situations where the institutional/governance environment is inadequate, the necessary economic policies failed to be fulfilled even though an obligation to implement economic policies was imposed along with the aid. Thus, it can be seen that in Ghana and Uganda whose initial amounts of aid were small, there was fortunately no alternative but to implement economic reforms because the countries were unable to depend fully on aid, resulting in reforms being promoted and the aid being highly effective. Devarajan et al. (2001) pointed out that the low effectiveness was caused by the fact that donors and international institutions had not selected the type and amount of aid in accordance with the progress level of economic reforms in the developing countries and the institutional/governance environment, and that they had provided similar aid packages to the countries solely for the reason that they were poor countries.

As is clear from the experiences of Uganda and Ghana, global support has recently gained for the view that aid should be more actively provided to countries voluntarily strengthening their commitment to economic reforms and attempting to improve their institutional/governance, in other words, to countries with sound policies and a good governance environment. This is also a reflection of donors' experiences where it has been difficult to determine at what point the governments of developing countries move toward sound policies (World Bank 1998). Therefore, it can be concluded that in order to enhance effectiveness, amounts of aid for countries having sound policies and a governance environment should be increased to further promote and strengthen them rather than providing aid to countries lacking sound policies and governance environment through the imposition of conditionality aiming for modifications. Devarajan et al. (2001) pointed out the possibility in which shifting direction of the existing aid approach can promote the formation of a sound policy environment in recipient countries.

2. Donor Selection Method: Integration of Macroeconomics and Institutional Approach

2-1. Aid Method Focused on Poverty Conditions and Institutional/Governance Environment (1)

Collier and Dollar (2002) estimated an aid flow equation taking into account the poverty level of an individual country and sound policies, the institutional/governance environment to examine the most suitable aid allocation for each country. Based on data of the amount of ODA, they calculate the preferable aid allocation for each country and placed them into the following four categories: (1) good policy, institutional/governance environment with high poverty; (2) poor policy, institutional/governance environment with high poverty; (3) poor policy, institutional/governance environment with low poverty; (4) good policy, institutional/governance environment with low poverty. The World Bank's Country Policy and Institutional Assessment (unpublished) (CPIA) is used as the policy index. Poverty conditions are assessed by the poverty headcount ratio. The CPIA consists of 20 aspects grouped in four equally weighted clusters of indicators: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions.

Collier and Dollar (2002) suggest that, based on the above classification, poverty reduction can be maximized by providing aid to the countries classified as (1) and (2), especially if the countries classified as (1) are given higher priority for allocation over countries classified as (2). According to this classification, it would be preferable to allocate 68% of the actual amount of aid flow to countries in (1) good policy, institutional/governance environment with high poverty, and 28% to countries in (2) poor policy, institutional/governance environment with high poverty. These estimates can serve as a useful reference when determining future ODA allocation, especially when selecting how the increased portion should be allocated, as efforts are made to increase the target for ODA ratio of GNI to 0.7 % in accordance with the Monterrey Consensus signed at the UN Conference on Financing for Development in March 2002.

2-2. Aid Method Focused on Poverty Conditions and Institutional/Governance Environment (2)

Heller and Gupta (2002) present several criteria on how an increased portion of aid should be allocated to which country on the assumption that the Monterrey Consensus will be carried out. As the first criterion, they assume a distribution of priority aid to those countries with high poverty headcount ratios, which is the first target of MDGs, i.e. low-income countries with annual per capita incomes of less than $500 as of 1998, having, moreover, a good institutional/governance environment as well as those pursuing appropriate economic reforms. In addition to this, the size of these countries' economies is also taken into account (as it can be considered that the larger the size of the economy, the greater its capacity to absorb the flow of aid). By this criterion, aid flows are not distributed to those countries whose annual per capita incomes are over $500. Therefore, such lower-middle-income countries as India, Nigeria, and Pakistan as well as China, Indonesia, and the Philippines are not eligible for aid under this criterion. As the second criterion, they introduce a method to distribute priority aid to countries with a greater concentration of the absolute poor. By this criterion, however, as more aid would go to countries with a greater number of poor people, it would be highly possible that many of the poorest countries with high poverty headcount ratios but with less poor people due their smaller population size would be excluded.

Consequently, based on the results of a study by Collier and Dollar (2002), Heller and Gupta (2002) applied three scenarios for aid allocation. The first scenario is a method to allocate the bulk of the total amount of aid including additional aid to low-income countries having high poverty headcount ratios and have a good policy and governance environment. By this criterion, the aid ratio to GDP would be much higher for Ethiopia (90%), Uganda (52%), Burundi (60%), Vietnam (48%), Nicaragua (43%), Guyana (57%), and Kyrgyz Republic (74%). In this scenario, however, adequate aid would not be distributed to such countries as China and India that have large numbers of absolute poor and low poverty headcount ratio, even if they are of good policy and institutional/governance environment (these countries would account for approximately 11% of total ODA). China, India, Indonesia, Nigeria, Pakistan, the Philippines, and Vietnam would receive $86 billion of total additional aid, and Sub-Saharan Africa would receive $52 billion (of which $10 billion would be allocated to Nigeria). If the aid allocation to low-income countries were to increase as projected in this scenario, macroeconomic aid challenges, such as Dutch disease and the induction of corruption would intensify (Shirai, 2005).

In the second scenario, the criterion of Collier and Dollar (2002) is used to increase the allocation to China and India. China and India would receive a total of $116 billion (of which $76.4 would be allocated to China, and $40 would be allocated to India) out of the projected total of $175 billion in ODA, while Nigeria, Pakistan, the Philippines, and Vietnam would together receive only $25 billion. Only $30 billion would be allocated to the low-income countries (of which one-third of this would be allocated to Bangladesh). Sub-Saharan Africa would receive no more than $20 billion, of which $4 billion would be allocated to Nigeria. If the larger share of aid were allocated to countries with larger per capita incomes than low-income countries with per capita incomes less than $500, aid absorption capacity would be larger because of the larger size of the economies. Thus, it would be more likely to avoid a worsening of the macroeconomic challenges of aid.

The third scenario is a method to allow ODA allocation in proportion to the population living on an income of or consuming less than $1 a day. In this scenario, China and India together would receive $112 billion. Although it is almost the same total as in the second scenario, India would receive more ($73 billion) than China ($39 billion) because it has a greater number of poor people. Sub-Saharan Africa would receive $33 billion. Hence, if the amounts of aid were calculated based on the numbers of poor people, aid to South Asia and East Asia would increase. Aid to these countries would enable a reduction in the number of poor people in the world.

As MDGs are focused on the poverty headcount ratio, the first and second scenarios would accordingly be more valued than the third scenario. Expanding aid to China and India where there are large numbers of the absolute poor would be required to be determined based on the status of progress in reducing poverty in these countries, the likelihood of achieving MDGs, and other factors. It would also be important to assess a well-balanced allocation strategy taking into account the third scenario.

2-3. Aid Method Focused on Poverty Conditions and Institutional/Governance Environment (3)

Devarajan et al. (2002) used a similar method as above to calculate amounts of aid to recipients. Based on the poverty headcount ratio which is the first target of MDGs, they divided the recipients into two groups: Group 1 comprising 86 countries of good progress in the status of poverty reduction, and Group 2 comprising 65 low-income countries in considerable need of increased aid. It was determined that an aid increase was not required for the group 1 countries. The group 2 countries were further classified into two groups: 43 countries of good institutional/governance environment in macroeconomics, structural reform, quality of governance, and social policy for the weak and vulnerable, and 22 countries having a poor such environment. As for the former, they calculated that the amount of aid would need to be increased to $54 billion annually by 2003–05, or $39 billion annually more than the 1999 level.

As for the latter, two scenarios are presented. Scenario A improved the savings rate and incremental capital output ratio (ICOR) in such countries up to the level of other countries that have achieved success by improving their policies. For such countries, the amount of aid required in order to reach the MDGs' first target had to be increased yearly from $3 billion to $18 billion by 2003–2005. In scenario B, they indicated that, in the case of countries whose savings rates and incremental capital output ratios would have improved only to the level of 1990, the amounts of aid required in order to reach the MDGs' first target must be increased yearly from $3 billion to $26 billion. That is, in scenario B where economic conditions did not show improvement, larger amounts of aid were required. If scenario A could be realized with policy improvements, $8 billion of aid would be saved in comparison to scenario B. This saved amount would be equal to more than double the total of the actual aid distributed to these countries in 1999.

If the increase in aid as well as the improvements in policy, institution, and governance were conducted synchronically, it would be possible to achieve the MDGs. In particular, it would require large amounts of aid to accommodate the group 2 countries, and it would require even more aid to be distributed to those countries with poor policy implementation because of low aid effectiveness. Devarajan et al. (2002) indicated that, if the existing policies were continued, the amount of aid required for group A would be $62 billion, while only $54 billion in additional aid would be required if scenario B was realized after the implementation of policy improvements. However, though careful assessment is required since issues such as data quality and availability exist for each countries as well as the presence of ICOR instability, these estimates can be useful as a methodology for country selection and aid allocation.

3. Practicing Aid Distribution Methodologies Based on Integration of Macroeconomics and Institution Approach

3-1. World Bank's Concessional Loan Financing Method

Reflecting the above-mentioned study results, the view that increases in aid should be directed to countries, which implement appropriate policies and are of good institutional/governance environment because the effectiveness of such aid is high, has recently been growing (Collier and Dollar 2001). The reason for this is that, in the case where inappropriate policies are implemented, institutional/governance environment is inadequate, and poverty is rampant, distributing a large amount of aid cannot be justified because the point of diminishing returns will be reached relatively quickly. In addition, the view that good policy and institutional/governance environment enhance not only the poverty reduction effect, but also the economic growth effect of aid is become more and more prevalent (Collier and Dollar 2002).

Based on these views, the World Bank is developing a better understanding of the relationship of economic policy and institutions/governance to aid effectiveness. The International Development Association (IDA), which provides concession loans as a part of the World Bank, has already introduced the Performance Based Allocation (PBA) system for fund allocation and adopted a policy of increasing IDA allocation for better PBA performing countries while decreasing it for poor PBA performing countries in the case of borrowers being at the same income (poverty) level. The PBA is implemented as follows.

First, the PBA consists of the above-mentioned Country Policy and Institutional Assessment (CPIA), the Portfolio Performance Rating and the Annual Report on Portfolio Performance (ARPP). The World Bank prepares a questionnaire with specific questions, presents it to government and receives the answer. It, then, selects two benchmark countries for each region, compares the individual country's rating with its regional benchmark ratings and reaches its conclusion. The ARPP performs its rating according to the implementation status of the World Bank Portfolio. While focusing on the quality of the World Bank's development projects and program management, it rates individual country's implementation status utilizing the Annual Report on Portfolio Performance edited by the World Bank.

Second, a weighted average rating is calculated, the weights being 80% for CPIA and 20% for ARPP. Third, this average is multiplied by a governance factor, and then the IDA country performance rating is completed. The governance factor is an unweighted average rating taken of 7 governance criteria (6 scores from CPIA and 1 score from ARPP). This average score is, then, divided by 3.5 (the mid-point of the 1–6 scoring range), and this ratio is raised to the power of 1.5. The value of this multiplied by the weighted average gives the IDA country performance rating. Fourth, the IDA allocation is determined reflecting the IDA performance rating and per capita GNI (proxy variable for poverty).

3-2. New Development Assistance Method by the United States: Millennium Challenge Account

The United States, which had previously taken a negative stance towards the increase of ODA, has recently initiated a new aid strategy. In March 2002 at the International Conference on Financing for Development, President Bush proposed establishing the "Millennium Challenge Account" (MCA) aimed at providing $5 billion worth of aid funding for economic growth and poverty reduction to low-income countries that "govern justly, invest in their people, and encourage economic freedom." The plan is to increase development assistance by 50% from FY2004 to FY2006. In January 2004, the US Congress passed a "new compact for global development" and authorized the creation of the Millennium Challenge Corporation (MCC) to administer the MCA with an initial funding of $1 billion in FY 2004. In April 2004, the MCC published "Guidance for Developing Proposals for the MCA Assistance in FY 2004" and "Sample Elements of a Proposal for Millennium Challenge Account Assistance" to help eligible countries develop their proposals. These guidelines state that eligible countries are to submit proposals to the United States on their own free will, which illustrate a summary of the government's economic growth as well as the poverty reduction strategy and development program, address key impediments to economic growth and the poverty reduction strategy in their country, as well as describe how the government proposes to utilize the MCA assistance.

The candidate countries are those that have per capita incomes of $1415 or less and are eligible for IDA, except for countries that are ineligible to receive United States economic assistance under the Foreign Assistance Act of 1961 (Myanmar, Burundi, Zimbabwe, Sudan, etc.). Under the MCA eligibility rules, eligible countries are rated according to 16 performance indicators covering the above-mentioned three categories of performance: "governing justly" (civil liberties, political rights, voice and accountability, government effectiveness, rule of law, control of corruption), "investing in people" (public expenditures on health as percent of GDP, immunization rates: DPT and measles, public primary education spending as percent of GDP, primary education completion rate), "promoting economic freedom" (country credit rating, inflation, financial policy, trade policy, regulatory quality, days to start a business). All potentially eligible countries must score better than the median on at least half of each of the performance criteria under all three dimensions of performance. They are also required to score above the median on the control of corruption rating from the governance performance indicators in order to qualify for MCA assistance. Therefore, countries that do not meet this requirement will not be qualified even if they satisfy other ratings. Once they meet all these requirements, potentially eligible countries may submit a proposal. Applicant countries are encouraged to include a wide rage of information in their submissions: descriptions of priority areas by sector and specific goals in the proposed areas as well as the intended beneficiaries of the MCA assistance (where possible, by income level, gender, and age); an explanation to justify why the proposed program is a high priority; a description of the public/private consultative process used to develop the proposal; a multi-year financial plan including estimated contributions to the proposed program.

In accordance with above criteria, 63 candidate countries in the first year (FY 2004) and 70 candidate countries, including the first-year countries, in the second year (FY 2005) were announced. In May 2004, the MCC selected 16 countries from among these candidate countries based on the above criteria. In the period from May 20th to June 25th, the MCA staff visited these eligible countries to conduct briefings. While these developments of the MCA are worthy of note in terms of a new aid strategy, the consideration not to increase the administrative burden of beneficiary governments needs to be addressed. It is preferable that such developments on a bilateral basis further strengthen partnerships with the international development institutions and other donor countries while concurrently taking the form of supplementing the Poverty Reduction Strategic Paper (PRSP) compiled at the initiative of developing countries, which the World Bank and IMF adopted in 1999. The PRSP analyzes and describes comprehensive and medium-term socio-economic development strategies (Shirai 2004). It is prepared by the developing country in cooperation with the IMF and World Bank as well as donor countries and NGOs, and its contents include a description of the participatory discussion process employed in its preparation, poverty analysis, means of achieving poverty reduction targets, indicators, and monitoring as well as the required policies and policy priorities. Countries eligible for substantial debt relief as Highly Indebted Poor Countries (HIPCs) and countries that receive concessional loans from the World Bank and IMF are required to prepare a PRSP.

4. Country Selection and Development Assistance Pattern Based on Two Selection Criteria

4-1. Two Selection Criteria: Poverty Ratio to Number of Poor

In accord with above advanced research, we independently present two ODA allocation criteria and explore a new perspective for selected countries on the basis of recent developments of aid strategy. The first criterion is based on the view of emphasizing the achievement of MDGs and strengthening aid to countries that are considered to have difficulty in achieving them. Here, we focus on the reduction of poverty headcount ratio, the first target of MDGs. We arrange countries in order from high to low poverty headcount ratios and select the top 15 countries. We also pay attention to countries where poverty ratios are high and show no sign of increase or a slight decreasing trend compared to the comparison year (1999—comparison year of MDGs— in principal, the following year if data is unavailable). These countries with limited possibilities for halving poverty by 2015 are classified as countries at risk. It is thus determined that aid should be concentrated more on these countries. Focusing on data related to the poverty headcount ratio, the MDGs' first target, we utilize the following three indexes: (1) proportion of the population below $1 (PPP) a day, (2) proportion of the population below the poverty line (headcount ratio), and (3) poverty gap ratio, $1 a day. As poverty data is not available and not of good quality for many developing countries, these three indicators are used here. Based on each indicator, 15 countries are selected, and the percentage changes for these indicators are calculated by comparing the most recent year to the comparison year. Then, the average of indexes (1) and (2) are compared to index (3), and the top 15 countries are selected (given the consideration of the poverty level, the latter should be accorded priority over the former). If improvements are not observed at multiple indexes looking at the percentage changes of these indexes, the applicable country is determined to be a country at risk (marked with +). The data in Millennium Indicators Database (http://millenniumindicators.un.org) on the UN site is utilized.

Figure 1 illustrates the selection results. The countries at risk that are ranked in the top 15 of all three indicators with severe poverty conditions are Madagascar, Niger, Nigeria, Zimbabwe, Burundi, Nicaragua, Malawi, Mozambique, and Ghana. These countries can be thought of as countries needing an increase in aid in order to achieve MDGs. 14 of the 15 countries are concentrated in Sub-Saharan African region with all countries' per capita GDPs being $700 or less. Their poverty conditions are also severe, as their poverty headcount ratios are high and show no sign of increase or a slight decreasing trend compared to the comparison year. The absolute number of poor in these countries is about 200 million, which only accounts for 19% of the total number of poor in the world. However, because the poverty population as a percentage of the total population in each country is large, many countries face difficulties in achieving MDGs. Therefore, further concentration of aid is expected in this region.

The second selection criterion is a method of selection that looks at the absolute number of the poor. Here, we select the top 15 countries using the latest available poverty headcount ratios to figure out the number of poor by multiplying that number and the population size of the individual country. The number of poor is obtained by utilizing the poverty headcount ratios for $1 or less a day and the data for the ratio of the population below the poverty line (poverty headcount ratio) that are of the latest year available and, then, multiplying that by the population size as of the year 2003. With the averages of these two kinds of numbers which we obtain, countries are ranked in order of high to low for the number of poor. The results are shown in Fig. 2. According to these results, India is seen as the country with the highest number of poor (330 million), followed by China with 140 million. Other countries with a high number of poor include: Nigeria, Bangladesh, Indonesia, Pakistan, Vietnam, Russia, Brazil, Ethiopia, the Philippines, Uganda, Columbia, Tanzania, and Kenya. As we can see, the countries selected by this criterion have a more regional variation than the first criterion: 5 countries in Sub-Saharan Africa, 4 countries in East Asia, 2 countries in Central and South America, and Russia. To note, China and India are included for the reason that, with their poverty headcount ratios being low, they are not inclusive in the first criterion, but have a high number of poor because of their large populations. As the total number of poor in the top 15 countries for the second criterion reaches 880 million and accounts for 86% of the total number of poor in the world, in order

Fig. 1 First Selection Criteria: Countries with high poverty headcount ratios (Top 15)

Poverty Headcount Ratio			Poverty Headcount Ratio (below $1)		
	%	Percentage Change		%	Percentage Change
Zambia	72.9	5.3	Uganda	84.9	–1.2
Madagascar	71.3	–2.7	Mali	72.3	–
Mozambique	69.4	–	Nigeria	70.2	18.6
Malawi	65.3	20.9	Central African Republic	66.6	–
Kirghiz	64.1	25.7	Zambia	63.6	–1.5
Gambia	64.0	–	Madagascar	61.0	31.7
Columbia	64.0	6.7	Niger	60.6	45.3
Republic of Chad	64.0	–	Zimbabwe	56.1	68.5
Mali	63.8	–	Burundi	54.6	20.8
Bolivia	62.7	–0.8	Nicaragua	50.5	5.4
Guatemala	56.2	–	Tanzania	48.5	–
Armenia	53.7	–1.8	Burkina Faso	44.9	–28.3
Republic of Honduras	53.0	6.0	Ghana	44.8	147.5
Eritrea	53.0	–	Malawi	41.7	–
Kenya	52.0	30.0	Nepal	39.1	–

Poverty Gap Ratio			Country in Need of Much Aid	Poverty Indicator: Increased (+) Decreased (–)	Per Capita GDP for 2003 (1995 Rate)
	%	Percentage Change			
Uganda	45.6	–4.5	Uganda	–	366
Mali	37.4	—	Zambia	–	437
Nigeria	34.9	19.1	Madagascar	+	229
Niger	34.0	172.0	Mali		338
Zambia	32.6	–16.2	Niger	+	211
Madagascar	27.9	58.5	Nigeria	+	275
Tanzania	24.4	–	Zimbabwe	+	521
Zimbabwe	24.2	168.9	Burundi	+	139
Burundi	22.7	64.5	Nicaragua	+	496
Nicaragua	22.6	10.8	Malawi	+	163
Lesotho	19.0	–6.4	Mozambique	+	234
Ghana	17.3	355.3	Tanzania	–	221
Malawi	14.8	–	Lesotho	–	667
Burkina Faso	14.4	–47.6	Ghana	+	447
El Salvador	14.1	39.6	Burkina Faso	–	295

Note: In the "poverty indicator: increased/decreased" column, the comparison year data for Mali is left blank due to unavailability.
(Source) Compiled by the author, based on data from http://millenniumindicators.un.org/unsd/mi/mi_goals.asp.

to reduce the overall number of poor in the world, we can see that poverty reduction aid to these countries is also essential.

As we apply the second criterion, we must distinguish between countries that show a decreasing trend in the number of poor and countries that show an increase in the number of poor or show almost no trend toward improvement, and then focus on the latter in increasing aid. Fig. 2 illustrates the percentage changes (compared to the baseline year) of headcount ratios and individual poverty headcount ratios at $1 or less a day. If these percentage changes show an increasing trend in both indexes, they are marked with +, or a – mark if a decreasing trend is shown. If one index shows an increasing trend while the other shows a decreasing trend, the applicable country is marked as mixed. The reasons for not utilizing a percentage change in the number of poor itself are that the longitudinal data upon which the poverty headcount ratio index is based, is almost unavailable in many countries, and the number of poor may possibly change significantly due to differences in calculation times of the population data and the poverty headcount ratio.

The countries at risk with increasing poverty headcount ratios are Nigeria, Vietnam, Columbia, and Tanzania, and it is determined that more efforts are called for to increase aid to these countries. In the case of China, while its absolute number of poor remains high, it has achieved significantly high economic growth at 9% average real growth rate and at 8% per capita real GDP growth rate over the previous 20 years, and the number of poor has decreased by over 150 million. It is predicted that by 2015 the number of poor will have dropped to 40 million (World Bank 2004). Furthermore, although the total amount of ODA it received in 2000–02 accounts for only 0.1% of its GNI by average (about 6% even in the highest years of 1990–94), the ratio of GNI to direct investment inflow has exceeded 5% every year. In addition to this, because its foreign currency reserves surpassed $650 billion due to a sustained trade surplus, it has become the world's second-largest holder of foreign reserves. Therefore, it has been determined that, although a reduction of the number of poor as well as the rural-urban income disparity are significant issues for China, it has its own national strength to respond to them as domestic policy issues. As it is predictable that China will continuously sustain its economic growth, and that much private capital will flow in, the role of aid is further decreasing. It is thus required that loan aid to China be gradually reduced, the focus of aid be shifted towards technical assistance in energy and environmental policies, and grant assistance be provided for social infrastructure in some poor regions, and aid to lower-income countries in severe poverty conditions be increased.

Additionally, in determining aid distribution, we must take into account not only the degree of progress in regard to the poverty condition, but also the level of per capita income. As shown in Fig. 2, since Russia, Brazil, and Columbia are middle-income countries

Fig. 2 Second Selection Criterion: Countries with High Number of Poor

Poverty Headcount Ratio Basis			
	Number of Poor (A)	% to Total Number of Poor	Percentage Change in Poverty Headcount ratio
India	299,911,333	27.5	–20.6
Bangladesh	67,570,632	6.2	–2.4
China	58,898,400	5.4	–23.3
Indonesia	57,375,036	5.3	72.6
Pakistan	47,238,052	4.3	14.0
Nigeria	45,279,685	4.1	–
Russia	44,517,941	4.1	–
Vietnam	40,935,816	3.7	–
Brazil	30,534,874	2.8	0.6
Ethiopia	29,710,356	2.7	–2.9
The Philippines	29,419,392	2.7	–9.4
Columbia	27,989,120	2.6	6.7
Kenya	16,299,400	1.5	30.0
Ukraine	15,443,289	1.4	–
Peru	13,107,010	1.2	–8.4

Poverty Headcount ratio at Less than $1 a day			
	Number of Poor(B)	% to Total Number of Poor	Percentage Change in Poverty Headcount ratio
India	363,878,435	35.6	–17.6
China	212,546,400	20.8	–49.7
Nigeria	93,215,070	9.1	18.6
Bangladesh	48,846,240	4.8	0.3
Uganda	20,885,400	2.0	–1.2
Pakistan	19,416,868	1.9	–72.0
Tanzania	17,062,785	1.7	–
Indonesia	15,878,700	1.6	–56.9
Ethiopia	15,460,140	1.5	–26.5
Vietnam	14,235,048	1.4	21.2
Brazil	14,307,769	1.4	–41.4
The Philippines	12,071,544	1.2	–23.7
Madagascar	10,026,570	1.0	31.7
Ghana	8,918,915	0.9	147.5
Nepal	8,432,875	0.9	–

(A+B)/2	Number of Poor	Percentage Change in Poverty Headcount ratio: Increased (+) Decreased (–)	Per Capita GDP in 2003 (1995 Rate)
India	331,894,884	–	525
China	135,722,400	–	1024
Nigeria	69,247,378	+	275
Bangladesh	58,208,436	Mixed	410
Indonesia	36,626,868	Mixed	1090
Pakistan	33,327,460	Mixed	538
Vietnam	27,585,432	+	438
Russia	26,653,136	–	3528
Brazil	22,421,321	Mixed	4577
Ethiopia	22,585,248	–	115
The Philippines	20,745,468	–	1239
Uganda	15,854,700	Mixed	366
Columbia	15,787,613	+	2321
Tanzania	14,811,201	+	221
Kenya	11,723,030	Mixed	320

(Source) Compiled by the author, based on data from http://milleniumindicators.un.org/unsd/mi/mi_goals.asp.

whose per capita GDPs in 2003 were $3528, $4677, and $2321, respectively, it can be said that their aid needs are relatively lower. For these countries, poverty issues can be improved by appropriately expanding financial transfer policies and social security systems. It is thus determined that it is important to strengthen aid to low-income countries to lower- and middle-income countries such as Nigeria, Vietnam, and Tanzania.

4-2. Two Selection Criteria and Institutional/Governance Environment

Whether to utilize the first selection criterion based on the poverty headcount ratio of individual countries or the second selection criterion is debatable. As long as the first target of MDGs is to halve the proportion of people with an income of less than $1 a day between 1999 and 2005, the first criterion should be emphasized. However, the second criterion can well be a considerable option for promptly reducing the number of poor in the world. As shown in Fig. 1 and Fig. 2, the countries that meet both criteria are Tanzania, Uganda, and Nigeria. Aid to these countries will not only lower the poverty headcount ratios and poverty gap ratios, but also will contribute to a reduction of the number of poor in the world.

Next, based on above selection criteria, we examine the macroeconomic status (economic risk), foreign debt status (financial risk), and status of institutions, governance, and politics (political risk). The International Country Risk Guide Rating (ICRG) indicators, constructed by the PRS Group, a US-based think-tank, which has produced data gathered through its unique method covering 140 countries since 1984, are utilized here as data. Economic risk reflects the relative goodness of the macroeconomic situation. An increase in this rating indicates a more improved macroeconomic status. Its multiple indexes include: per capita GDP, real annual GDP growth, annual inflation rate, fiscal revenue and expenditures as a percentage of GDP, and the current account balance as a percentage of GDP. Financial risk indicates the sustainability of foreign debt. Its increase suggests a higher sustainability for foreign debt. It also offers multiple indicators, consisting of foreign debt as a percentage of GDP, foreign debt service as a percentage of exports of goods and services, current account as a percentage of exports of goods and services, net liquidity as months of import coverage, and exchange rate stability (to the US dollar). They are both rated from a minimum number of 0 points to a maximum number of 50 points. Among the 15 countries, the top rated country with the lowest economic risk is Tanzania, and the country with the lowest financial risk is Nigeria.

Political risk includes components such as government stability, bureaucratic quality, accountability, corruption, law and order, investment profile, socioeconomic conditions, external conflict, internal conflict, military involvement in politics, and religious tensions. As the index for the whole measure of government governance, the risks to bureaucracy quality, government stability, and corruption are cited. The bureaucracy quality risk indicates the degree to which capacity and expertise to minimize revisions of policy are maintained when governments change. The government stability risk measures the government's ability to stay in office and carry out its declared programs. The corruption risk reflects such conditions as excessive nepotism, patronage appointments, political slush funds, political-business collusion, and bribery demand in executing policy. The minimum number of points for each component is 0, and the maximum number of points for these components is, respectively, 4 for bureaucracy quality, 12 for government stability, and 6 for corruption. The reason for differences in the maximum number is that the PRS Group places a different weight on each component in rating multiple political risk indicators. In addition, a higher number of points indicates a lowering of risks and better governance status.

As additional indexes for measure countrywide governance in terms of political risk, it has been pointed out that there are the law and order, democratic accountability, and investment profile risks. The law and order risk indicates the strength of the foundation of judicial system. The firmer it is, the lower the crime rate may be. The democratic accountability measures how responsive government is to the people. The more mature a society's democracy is, the lower its democratic accountability. The minimum number of points for each component is zero, and the maximum point of points is, respectively, 12 for law and order and 6 for democratic accountability. The investment profile is made up of risk factors, which do not reflect economic and financial risks, including contract viability, profit repatriation, and payment delays. Socioeconomic conditions indicate whether or not there are socioeconomic pressures restraining a government's activities and absorbing the general public's dissatisfaction, and are made up with reference to indexes such as unemployment, consumer confidence, and poverty conditions. The political risk is rated with a minimum number of points of 0 and a maximum number of points of 100. The top rated country with the least political risk is Mozambique.

The last part of Fig. 3 shows these three risk factors, which are individually rated, simply averaged, and ranked in the order from high to low. According to this, Ghana, Uganda, Nigeria, and Mozambique are awarded high overall ratings, followed by Burkina Faso, Tanzania, and Madagascar. These countries achieve relatively good economic policy, and foreign debt status of each is comparably stable as well as their political risks being low. It is thus considerable that, if aid is prioritized to these countries, it may effectively offer them economic growth and poverty reduction.

In Fig. 3, as the index that enables the recipient to achieve a certain improvement from its own effort, five risk factors, bureaucratic quality, corruption, democratic accountability, investment profile, and law and order, are presented among other components of political risk. Even if the overall political risk rating is high, these five factors

Fig. 3 First Selection Criterion: Policy Environment of Countries with High Poverty Headcount ratios (Top 15)

	Economic Risk	Financial Risk	Political Risk	Bureaucracy Quality	Corruption
Uganda	33.5	5.0	56.0	2	2
Zambia	26.0	24.0	57.5	1	2
Madagascar	28.0	32.0	60.0	1	4
Mali	24.0	31.5	61.5	0	3
Niger	31.0	25.5	58.0	1	1
Nigeria	32.0	38.5	44.5	1	1
Zimbabwe	9.5	21.0	40.5	2	0
Burundi	–	–	–	–	–
Nicaragua	22.0	27.0	59.5	1	3
Malawi	26.0	27.0	56.5	2	2
Mozambique	25.5	34.0	63.0	1	2
Tanzania	34.5	21.0	60.5	1	2
Lesotho	–	–	–	–	–
Ghana	29.5	33.5	61.5	2	3
Burkina Faso	29.5	23.5	62.5	1	2
Average	28.6	30.3	58.6	1.4	2.2

	Democratic Accountability	Investment Profile	Law and Order	Rating
Uganda	3	9	9	2
Zambia	4	6	6	10
Madagascar	5	8	8	5
Mali	3	8	8	8
Niger	5	8	8	8
Nigeria	3	5	5	2
Zimbabwe	1	2	2	13
Burundi	–	–	–	–
Nicaragua	6	8	8	10
Malawi	4	8	8	10
Mozambique	3	9	9	2
Tanzania	4	8	8	5
Lesotho	–	–	–	v
Ghana	3	7	7	1
Burkina Faso	4	9	9	5
Average	3.8	7.4	7.4	

Note: (–) indicates no data.

(Source) Compiled by the author, based on database of PRS Group.

do not all necessitate a high rating. The institutional/governance indexes, which are awarded very low points, should be viewed as areas to be further improved. For example, Tanzania (1 for bureaucracy quality, 2 for corruption), Bangladesh (1 for corruption, 2 for bureaucracy), and Kenya (2 for bureaucratic quality) were awarded significantly low ratings in these indexes. Therefore, aid that will bring improvements as expressed in these institutional/ governance indicators must be provided to these countries. For instance, some method of placing greater weight on these indicators in allocating aid is significantly worth considering.

4-3. Two Selection Criteria and Foreign Debt Status

Fig. 4 illustrates similar ratings for the countries selected by the second selection criterion based on the absolute number of poor. China and Russia are rated at the top, followed by India, the Philippines, and Vietnam. Kenya, Tanzania, Pakistan, and Bangladesh are also rated relatively high. While India is awarded a high overall rating, its poverty headcount ratio has decreased, so if aid is to be continued as with China, focusing aid on further substantial reductions of the number of poor and aid that contributes to environmental policies, such as global warming, is significant.

In a comparison of the first selection criterion with the second criterion, Uganda, Nigeria, and Tanzania included in both country selections. However, they are awarded

Fig. 4 Second Selection Criterion: Policy Environment of Countries with High Poverty Populations (Top 15)

	Economic Risk	Financial Risk	Political Risk	Bureaucracy Quality	Corruption
India	35.5	44.0	59.5	3	2
China	39.0	45.5	70.0	2	2
Nigeria	32.0	38.5	44.5	1	1
Bangladesh	35.5	39.5	49.0	2	1
Indonesia	36.5	33.5	51.5	2	1
Pakistan	37.0	40.5	50.0	2	2
Vietnam	36.0	37.5	65.0	2	2
Russia	40.0	43.0	67.0	0	2
Brazil	33.0	31.0	70.5	2	4
Ethiopia	33.0	31.5	53.5	1	2
The Philippines	36.0	36.5	65.5	3	2
Uganda	33.5	35.0	56.0	2	2
Columbia	32.5	36.5	53.5	2	3
Tanzania	34.5	21.0	60.5	1	2
Kenya	32.0	38.5	61.5	2	4
Average	35.1	36.8	58.5	1.8	2.1

	Democratic Accountability	Investment Profile	Law and Order	Rating
India	6	9	9	3
China	1	11	8	1
Nigeria	3	5	5	15
Bangladesh	3	11	7	7
Indonesia	5	9	6	7
Pakistan	1	10	4	6
Vietnam	1	11	7	3
Russia	4	12	9	2
Brazil	5	10	8	7
Ethiopia	4	7	7	13
The Philippines	5	8	9	3
Uganda	3	9	9	11
Columbia	3	8	9	13
Tanzania	4	10	8	11
Kenya	5	9	10	7
Average	3.5	9.3	7.7	

(Source) Compiled by the author, based on database of PRS Group.

high overall ratings on the first criterion, rating respectively the 2nd, 2nd, and 5th, while their ratings on the second criterion are almost as low as the last place: the 11th, 15th, and 11th, respectively. The reason that the ratings of Nigeria and Tanzania are reversed on the two criteria is that the overall ratings obtained from their averages differ as the respective risk index ratings differ. With Nigeria's political risk, in particular, being rated lower than Tanzania's, nevertheless the gap in this indicator's rating becoming greater is a cause reversing the rating. These countries' ratings are largely worsened by the second criterion, but it does reflect that the overall economic and financial risks of the countries selected by the first criterion are at poorer levels compared to the countries selected by the second criterion. Fig. 3 and Fig. 4 show the selected countries' average ratings for economic and financial risks. According to these figures, the average ratings of the countries selected by the first criterion are, respectively, 28.6, 30.3, and 58.6, while the averages of the second criterion are 35.1, 36.8, and 58.5, respectively. From these values, we can see that both groups of selected countries do not differ greatly in their political risk, but differ mainly in their economic risk. It is important that the countries having the highest level of poverty headcount ratios and stagnant economic growth are concentrated in the Sub-Saharan African region, and many of these countries are included among the countries selected by the first criterion. This suggests that macroeconomic policy enables the improvement of not only institutions/governance as typified by the political risk, but also the macroeconomic performance itself, which is also required for the economic development strategy.

Finally, we demonstrate the preferred method of aid, reviewing individual foreign debt status based on Fig. 3 and Fig. 4 which illustrate the overall ratings for economic, financial, and political risks of these countries. The ratio of outstanding foreign debt to GDP and the ratio of foreign debt service payments to exports (foreign debt service ratio) are utilized as variables for foreign debt status. Although they are included in financial risk indexes, these two variables have recently grown in significance. This is connected to a recent trend in which donors attempt to shift from loans to grants, which is a refection of their concern about the accumulated foreign debt of low-income countries. It, therefore, is preferable to define the countries that are in need of grants, which is determined by their foreign debt status, and then based on these variables, to divide them into two groups: those to be provided grants immediately and those which will be gradually provided as their policies and institutional/governance environments improve.

Fig. 5 illustrates the ratios of outstanding foreign debt to GDP and the ratios of foreign debt service payments to exports in 2003 obtained from the PRS Group. In general, though the ratio of outstanding foreign debt to GDP in low-income countries is at high levels due to many grants and concessional loans, their foreign debt service ratios are at low

Fig. 5 Foreign Debt Status and Forms of Development Assistance

The First Criterion	Foreign Debt / GDP (2003)	Foreign Debt Service Ratio (2003)	Aid Form
Uganda	57.0	12.4	Amount Increase
Zambia	167.8	28.0 Debt Relief	Gradual
Madagascar	92.0	16.0	Amount Increase
Mali	114.0	9.8	Amount Increase
Niger	85.0	36.4	Gradual
Nigeria	66.1	9.9	Amount Increase
Zimbabwe	173.5	0.0 Debt Relief	Gradual
Burundi	–	– –	–
Nicaragua	279.9	9.4 Debt Relief	Gradual
Malawi	180.4	20.0 Debt Relief	Gradual
Mozambique	91.0	8.2	Amount Increase
Tanzania	425.0	30.0 Debt Relief	Gradual
Lesotho	–	– –	–
Ghana	91.4	5.0	Amount Increase
Burkina Faso	63.0	24.8	Amount Increase
Average	145.1	16.1	

The Second Criterion	Foreign Debt/ GDP (2003)	Foreign Debt Service Ratio (2003)	Aid Form
India	19.0	11.8	Amount Increase
China	13.7	11.5	–
Nigeria	66.1	9.9	Amount Increase
Bangladesh	33.5	9.1	Amount Increase
Indonesia	64.7	25.7	Amount Increase
Pakistan	48.1	6.8	Amount Increase
Vietnam	38.3	7.5	Amount Increase
Russia	46.6	10.1	–
Brazil	47.8	60.3	–
Ethiopia	102.3	22.4	Amount Increase
Philippines	71.4	17.2	Amount Increase
Uganda	57.0	12.4	Amount Increase
Columbia	55.9	38.0	–
Tanzania	425.0	30.0	Amount Increase
Kenya	37.5	8.2	Amount Increase
Average	75.1	18.7	

Note: (–) indicates no data.
(Source) Compiled by the author, based on World Development Indicator database.

levels. The ratio of outstanding foreign debt to GDP would be the main criteria in this case. The ratios of outstanding foreign debt to GDP of the countries selected by the first selection criterion are high, and their average ratio of outstanding foreign debt reaches 145%, which is almost twice as much as the countries' selected by the second selection criterion. This accounts for 57% in Uganda, the lowest, and goes up to 145% in Tanzania, the highest. In Zambia, Zimbabwe, Malawi, and Tanzania, in particular, the outstanding debt ratios are considerably high. They can be considered to be countries in need of immediate debt relief.

Furthermore, with regard to countries that are firmly committed to relatively good policy and of a healthy institutional/governance environment, aid absorption capacity is considered high even with an immediate increase in aid. The countries which have a good institutional/governance environment include Uganda, Madagascar, Mali, Nigeria, Mozambique, Tanzania, Ghana, and Burkina Faso, and it is determined that immediate increases in aid to these countries are desirable. Meanwhile, as other countries' aid absorption capacities are thought to be relatively low, aid mainly in the form of technical assistance and policy discussion should be conducted, but not such that it provides an immediate increase in aid. Concurrently, the provision of aid to NGOs that work to combat infectious diseases such as Malaria, Tuberculosis, and HIV/AIDS and promote primary education in these countries is advisable. Then, if and when the environment is developed and improvements are observed, it is preferred to gradually increase aid to these countries.

Next, the countries selected by the second selection criterion are considered appropriate for removing high-income countries such as Russia, Brazil, and Columbia as well as China from the candidate list, for the reason stated previously. Of the countries in this group, most are eligible for an immediate increase in aid. As Indonesia was awarded a low overall rating due to its political risk being low, it has been determined that its aid absorption capacity is high, and, thus, it is eligible for an immediate increase in aid loan.

4-4. Two Selection Criteria and Donor Countries' Aid Achievement

We now look into the status of aid from the 22 member donor countries (including Japan) of the OECD's Development Assistance Committee (DAC) to countries selected by the first and second selection criteria. Fig. 6 illustrates the ratios of countries with a high ranking based on poverty headcount ratios in the first selection criterion, to the total amount (net amount) of ODA from Japan and the 22 countries (excluding former communist countries and graduated countries). Fig. 7 shows the ratios of the countries ranked high based on the poverty headcount ratios in the second selection criterion, to the total amount (net amount) of ODA from Japan and the 22 countries. In addition to these, by dividing into the periods 1960–1989 and 1990–2002, the respective ratio for the total amount is

Fig. 6 First Selection Criterion: Status of ODA Net Disbursement to Countries with High Poverty Headcount Ratios (Top 15)

	% to Total Amount of Japan's ODA		% to Total amount of DAC Countries' ODA	
	1960–1989	1990–2002	1960–1989	1990–2002
Uganda	0.1	0.3	0.5	1.5
Zambia	0.1	0.9	0.9	1.6
Madagascar	0.5	0.4	0.7	0.8
Mali	0.2	0.3	0.9	0.9
Nigeria	0.3	0.3	0.7	0.6
Nigeria	0.8	0.2	0.4	0.5
Zimbabwe	0.2	0.6	0.5	0.8
Burundi	0.1	0.1	0.4	0.4
Nicaragua	0.0	0.6	0.4	1.3
Malawi	0.4	0.5	0.6	0.9
Mozambique	0.3	0.5	0.9	2.3
Tanzania	1.1	1.4	1.9	2.2
Lesotho	0.0	0.0	0.3	0.2
Ghana	0.7	1.2	0.8	1.3
Burkina Faso	0.1	0.2	0.7	0.9
Total	4.9	7.5	10.6	16.2

(Source) Compiled by the author, based on OECD database.

Fig. 7 The Second Selection Criterion: Status of ODA Net Disbursement to Countries with High Poverty Headcount Ratios (Top 15)

	% to Total Amount of Japan's ODA		% to Total Amount of DAC Countries' ODA	
	1960–1989	1990–2002	1960–1989	1990–2002
India	4.6	7.0	11.0	3.8
China	9.1	13.2	2.0	4.9
Nigeria	0.8	0.2	0.4	0.5
Bangladesh	6.1	2.5	3.8	2.8
Indonesia	14.8	13.0	3.5	3.2
Pakistan	4.2	3.2	3.7	2.4
Vietnam	0.6	3.9	1.8	1.9
Russia	–	–	–	–
Brazil	1.4	1.3	1.0	0.5
Ethiopia	0.0	0.0	1.2	1.9
Philippines	8.3	6.5	1.5	1.9
Uganda	0.1	0.3	0.5	1.5
Columbia	0.1	0.1	0.5	0.4
Tanzania	1.1	1.4	1.9	2.2
Kenya	1.5	1.4	1.5	1.3
Total	52.7	54.0	34.3	29.2

(Source) Compiled by the author, based on OECD database.

calculated. The reasons for the dividing point being at 1990 are that consciousness on poverty reduction on the donor side started to rise in the 1990's, and there is a possibility of a change in recipient countries due to the end of the cold war.

From the figures above, it is clear that there is a substantial regional disproportion of donees in Japan's ODA. The percentage of Japan's aid to countries ranked high in the first selection criterion is low, rising from 4.9% in 1960–1989 to only 7.5% in 1990–2002. As aid from all 22 countries to such nations increased from 10.6% to 16.2, it is clear that Japan's aid to the first criterion countries is relatively low. Meanwhile, with regard to aid to countries ranked high in the second selection criterion, Japan's aid delivery ratio is far higher than the 22 countries'. The reason for this is that many Asian countries such as China, Indonesia, and India are included in the top 15 countries. The fact that Japan's ODA distribution tends to be weighted toward Asian countries is linked to aid which was commenced during post-war reparations and quasi-reparations, and in the midst of the economic recovery, it used ODA as momentum for export expansion.

Nevertheless, Japan's aid continues to be concentrated on Asia. It is apparent from the fact that aid delivery ratios to countries based on the second selection criterion show almost no difference between 1960–89 and 1990–2002. A high degree of recognition of its counterparts, geographical closeness, and keen financial interest can be noted for this emphasis on Asia. The more information on counterparts is available, the lower the risk of loan non-payment is. As the East Asian Region has, in fact, achieved economic development along with a relatively sound institutional/governance situation, yen-loan payments often proceed smoothly. In this sense, Japan's traditional aid leaning toward Asia has likely contributed to ODA's economic development of East Asia and been used relatively effectively. In addition, it cannot be denied that aid has been used as a means of economic diplomacy to enhance economic relations can be viewed in any country.

However, while the MDGs have globally gained importance and donor countries' contributions are to be expected, in terms of increasing aid to Sub-Saharan African countries whose institutional/governance environments are comparably good, it is presumable that expectations for Japan's leadership will continue to rise. Japan currently does not provide aid to Sub-Saharan Africa with any special assistance category being put in place. The UK and France, on the other hand, have provided much aid to this region because of their historical experiences with colonization. As for the US, it not only has provided aid to the geographically proximate Central and South America as well as the Middle East where the US has a strong interest in securing oil resources, but it has also recently increased aid to Sub-Saharan Africa in spite of the geographical remoteness. Northern European countries with no historical experience of colonization have increased aid to this region as well. As the global poverty issues are now focused on Sub-Saharan Africa and the donor community has announced increases in aid to this region, it is thought that Japan will inevitably have to shift toward ensuring a certain proportion of aid to Sub-Saharan Africa.

Meanwhile, as countries that had been the main recipients of Japan's aid including as Korea, Taiwan, Malaysia, and Thailand have graduated from the status of being recipients of international assistance, the number of countries that are now closer to graduation is also growing. This indicates that the number of donees of Japan's aid is becoming less than before. With this alone it implies that Japan's aid policy must shift direction from a one-sided focus on East Asia to a diversified selection of the donees.

5. Conclusion: The Importance of Policy Management Studies

In recent years, donor countries and international institutions have begun to more actively pursue their aid strategies, and it is within this trend of global transformation that Japan must work to present its own new aid strategy, which should be specific and clear as well as being convincing to other nations. Japan's current moves, which are restricted by the difficulty of significantly increasing ODA under a severely limited budget, could potentially run counter to the moves of other donor countries that clearly present their stances on poverty reduction. As an alternative to existing aid methodology based on quantity, it must develop a more effective economic diplomacy strategy with a long-range perspective as the world's second economic power. If it is facing difficulty in responding to the issue quantitatively in continuously increasing ODA because of the current financial situation, it is now time that it should explore possible qualitative aid policy options. While its efforts in assisting Afghanistan and Iraq operations as well as the victims of the Sumatra earthquake can be highly regarded, if it is not capable of expanding aid to low-income countries, Japan's overall evaluation in aid policy area is likely to fall. It requires a new aid policy to counterbalance the negative image created by the decrease in aid.

Japan's traditional aid policy has been conducted on a request basis, however such a policy could give the impression that a clear aid policy is lacking. As Japan has a tendency to evaluate results in terms of individual matters and aid categories (yen-loans, grant aid, technical assistance, multilateral aid, etc.), there remains the institutional issue in which it is difficult to adopt a comprehensive strategy due to the intercrossing of aid-policy offices and executing organizations. From the perspective of whether the whole aid policy of Japan plays an effective role in each recipient country, an aid framework is required that flexibly coordinates the amount and combination of aid according to a mix of perspective types of aid (i.e. project and non-project, grant and yen-loan, and economic and social infrastructures) and stages of development. It is also preferable to further strengthen cooperation among donor countries, focusing on actively supporting the Poverty Reduction Strategy Papers (PRSPs) prepared mainly by governments of developing countries. This means that Japan must shift its direction from a passive request-based policy to an active aid policy.

In this paper, we have explored aid methodology, which would enhance the effectiveness of reducing poverty by changing aid allocation among recipient countries, based on the assumption that Japan's total amount of aid would be maintained out of consideration for Japan's severe financial circumstances. We have also presented an aid methodology, based on a policy management studies-based approach, focusing not only on the existing macroeconomic view, but also the institutional/governance environment and others elements. Although such methodology is a trial proposition, it is aimed at integrating methods (a comprehensive usage of various research methods), which is one of the significant characteristics of policy management studies indicated by Okabe (2005). To enhance the effectiveness of Japan's ODA and improve global income disparity and poverty issues, a fundamental review of the existing aid methodology and further exploration of a new approach are required. Japan needs to consider prioritizing the allocation of a portion of its total ODA (30% of total ODA, for example) to achieve the MDGs of low-income countries. In doing so, however, it must take into consideration balance as in the first criterion based on the poverty headcount ratio and the second criterion based on the absolute number of poor as demonstrated in this paper. As some of these countries are burdened with foreign debt issues, if it is determined that there is a low payment capacity, it is desirable to provide large-scale debt relief assistance as well as grant funding. The significant point is that, taking into account the recipients' willingness toward reforms and the quality of the institutional/governance environment, donors also must pursue an aid methodology to enhance incentives of such as improving cooperation with recipients. It is apparent that strengthening cooperation between donors and donees is essential.

At the same time, improving global issues such as economic disparity, poverty, and terror threats and building a politically, socially, and economically stable environment in this new environment of globalization developed with information and communications technology, cooperation between experts in economics and experts in politics, sociology, and law is also required. We, too, are asked to test our sincere stance and endeavors leading to new approaches and solutions for global issues. Policy management studies is not simply a group of vertically divided scholastic systems based on traditional academic domains, but has the distinguishing feature of demonstrable results analyzed through new perspectives and methodologies, based on a multidisciplinary or cross-disciplinary approach to solving global issues (Kojima and Okabe, 2003). In the 21st Century COE Program's "Policy Innovation Initiative: Human Security Research in Japan and Asia" project, new methodologies are elaborated through interaction and feedback with diverse actors and policy proposals are actively disseminated both inside and outside Japan. We plan to further address significant issues that Japan and the world face with a continued notion of integration of the method, actor, and process.

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Revised December 22, 2004

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