

Title	Japan, the IMF and global governance : inter-disciplinary approach to human security and development
Sub Title	
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Publisher	慶應義塾大学大学院政策・メディア研究科
Publication year	2004
Jtitle	総合政策学ワーキングペーパーシリーズ (Policy and governance working paper series). No.51
JaLC DOI	
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Notes	The 21st century center of excellence program "Policy innovation initiative: human security research in Japan and Asia"
Genre	Technical Report
URL	https://koara.lib.keio.ac.jp/xoonips/modules/xoonips/detail.php?koara_id=BA76859882-00000051-0001

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Japan, the IMF and Global Governance

—Inter-Disciplinary Approach to Human Security and Development—

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September 2004

The 21st Century Center of Excellence Program
“Policy Innovation Initiative: Human Security Research in Japan and Asia”
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This paper was prepared for presentation at the Japan and Global Governance Workshop held in Kyoto in September 13-14, 2004, organized by Universities of Sheffield (coordinator Glenn Hook) and Tokyo (coordinator Takahashi Susumu).

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—Inter-Disciplinary Approach to Human Security and Development—

Sayuri Shirai

Abstract

Over the last two decades, one of the most important challenges for improving global governance is poverty reduction in low-income countries. This reflects that the prevalence of extreme poverty is closely associated with internal, regional and global conflicts; with marginalized groups of people and resultant social tensions; and, with an imbalanced of global prosperity. This paper examines the role of the International Monetary Fund (IMF) as one of the major international financial institutions providing concessionary loans to low-income countries. Also, its recent initiatives aimed at achieving poverty reduction and stable economic growth are reviewed. It also focuses on Japan as one of the major donor countries and undertakes a critical overview over its recent efforts in promoting a better system of global governance. The paper also provides policy recommendations.

Key Word: Poverty, IMF, ODA, Millennium Development Goals, HIPC Initiative

1 Introduction

Over the last two decades, one of the most important challenges for improving global governance is poverty reduction in low-income countries. This reflects that the prevalence of extreme poverty is closely associated with internal, regional and global conflicts; with marginalized groups of people and resultant social tensions; and, with an imbalanced of global prosperity. Despite the rising global living standards over the period looked at here, nearly half of the world's 6 billion people still live on less than US\$2 a day; while one-fifth live on less than US\$1 a day and are without basic human needs. Between 1987 and 1998, the number of people living on less than US\$1 a day has risen by 48 million in South Asia and by 73 million in Sub-Saharan Africa in contrast to East Asia where the number of such poor has dropped by 139 million.

Given this background, various international financial organizations have since the 1980s begun to tackle the economic development of low-income developing countries by providing highly concessional lending to these countries. The International Monetary Fund (IMF) is no exception: it introduced the low-interest medium-term structural adjustment facility (SAF) in 1986, followed by the enhanced structural adjustment facility (ESAF) in 1987. The IMF, together with the World Bank, introduced the Highly Indebted Poor Countries (HIPC) Initiative in 1996 in order to reduce the external debt burdens of developing countries to sustainable levels. The IMF also launched the Poverty Reduction Growth Facility (PRGF) from 1999, replacing the ESAF, with the aim of making the objectives of poverty reduction and growth more central to lending operations in low-income developing countries. The IMF (and the World Bank) has also begun to stress country ownership in designing a country's development strategy, as evidenced by the introduction of the Poverty Reduction Strategic Paper (PRSP).

The growing global concerns about problems associated with poverty have also led to the United Nations Millennium Development Declaration of 189 nations, and to joint commitments by the United Nations, IMF, World Bank and the Organization for Economic Cooperation and Development (OECD) in 2000, with respect to achieving specific targets for poverty reduction known as the Millennium Development Goals (MDGs). The achievement of the MDGs depends on effective economic policies and the collaboration of all stakeholders including international organizations, developing countries, donor countries and NGOs. To assist developing countries to meet the MDGs, 22 Development Assistance Committee (DAC) donor countries are expected to raise the amount of their Official Development Assistance (ODA) from the current level of 0.2% of Gross National

Product (GNP) to the 0.7% target established in the 1970 Pearson Commission Report and re-confirmed by the donor countries under the 2002 Monterrey Consensus. Given that Japan's ODA accounts for only 0.2% of GNP and its amount of ODA has shown a declining trend, its greater contribution and initiatives for promoting global governance has been increasingly expected by the world; especially as Japan is the world's second largest economic power.

This paper consists of three sections. Section II examines the role of the IMF as one of the major international financial institutions providing concessionary loans to low-income countries. Also, its recent initiatives aimed at achieving poverty reduction and stable economic growth are reviewed. Section III focuses on Japan as one of the major donor countries and undertakes a critical overview over its recent efforts in promoting a better system of global governance. Section IV concludes and provides some policy recommendations.

2 Economic Growth, Poverty Reduction and the IMF

2.1 Limited Impact of the IMF Policies

The Article 1(2) of the Articles of Agreement stipulates that the purpose of the IMF is "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy." While this purpose could be considered as its long-term and ultimate goal, the immediate goals of the IMF concern prudent macroeconomic policies and related structural reforms (e.g., exchange rate policy, tax policy, fiscal management, privatization, domestic price reform).

Notwithstanding these goals, the results of the impact of IMF economic policies on macroeconomic performance have been mixed. For example, Reichmann and Stillson (1978) and Connors (1979) found that IMF programs had no effect on the balance of payments. On the other hand, Pastor (1987), Gylfason (1987), and Bird (1996) reported an improvement in the balance of payments in IMF-program countries. Moreover, many studies found that IMF programs had no effect on inflation (Bird, 1996; Edwards and Stantaella, 1993; Pastor, 1987; Gylfason, 1987; Connors, 1979), while Killick (1995) reported that IMF programs were effective in reducing inflation. In addition, Connors (1979), Killick (1995), and Pastor (1987) found no effect of IMF programs on the international current account, while Khan (1990) and Edwards and Santaella (1993) discovered their positive

contribution. Furthermore, Reichmann and Stillson (1978), Connors (1979), Pastor (1987), and Gylfason (1987) reported no effect of IMF programs on economic growth, while Killick (1995) found ambiguous effects. Meanwhile, Conway (1994) found that while growth declined in the first year of the programs, the negative effects diminished thereafter.

As for the impact of IMF economic policies on poverty reduction, the results have been largely negative. For example, Pastor (1987), focusing on IMF-supported programs in 18 Latin American countries for 1985-91, compared macroeconomic indicators in the year preceding the program to those in the final year of the program. Using nonparametric techniques, Pastor found that the program reduced labour's share of income relative to both the pre-program levels and a control group of Latin American countries that did not undertake IMF-supported programs. Assuming that the average changes in total income were positive, the finding suggests that returns to capital increased amid a declining share of income for labor; hence poverty and inequality worsened.

In the recent literature, Easterly (2000) examined the effect of IMF (and World Bank) adjustment lending on poverty reduction, based on household survey data of 65 countries for 1980-98. Using the number of adjustment loans per year during the poverty spell, no direct effect was traced for lending on poverty reduction. However, he found that such lending had a strong positive interaction effect with economic growth. Namely, such lending lowers the growth elasticity of poverty reduction by smoothening consumption for the poor and lowering the rise in poverty for a given contraction, but lowers the fall in poverty for a given expansion. This result is not favourable for the IMF, because it gives the poor less of a stake in overall good economic performance, and thus, suggests that growth under adjustment lending is less pro-poor than in economies without it.

In addition, Garuda (2000) estimated the effects of IMF-supported programs on income measures of both poverty and inequality based on a database of 58 programs in 39 countries for 1975-91. Garuda introduced counterfactual thinking by using a propensity score estimation method in order to reduce the selection bias inherent in comparing program and non-program countries. Propensity scores represent the probability that either program or nonprogramme countries would have agreed to an IMF-supported program at some point before the decision is made, regardless of what they ultimately decided to do. Once the scores are generated, observations are divided into groups by the extent of the scores, within which countries are further subdivided into program and non-program countries to control for systematic differences between them prior to the decision. Garuda found that countries with a low propensity and IMF involvement showed an improvement of 10-15 percentage points in their Gini Coefficient, average level of income, and income level of the

lowest quintile, relative to the control groups. As propensity scores increase, countries with IMF-supported programs showed less significant improvements than those that did not have IMF support, suggesting that the IMF role in lowering poverty and inequality has been less effective.

Furthermore, Shirai (2004a) examined factors affecting the level of poverty and the impact of the IMF-supported programs on poverty reduction by focusing on 77 countries (those eligible for ESAF/PRGF assistance) rather than extending to broader ranges of developing countries as done in many previous studies. In the absence of income measures of poverty for many low-income countries, Shirai (2004a) used non-income poverty measures, typically education and health indicators, and found a weak or negative impact of the IMF on poverty reduction, based on panel data for 1981-2000. The results suggested that the IMF needs to redesign their programs targeting low-income developing countries toward more education- and health-oriented objectives.

2.2 IMF Initiatives toward Poverty Reduction

The weak effect of IMF economic policies is consistent with growing criticism over IMF programs. In the past, the IMF has placed priority on improving macroeconomic performance over poverty reduction. This reflected the view that achieving an overall improvement in macroeconomic performance would help lower poverty in developing countries. However, prolonged sluggish economic growth and a world-wide prevalence of poverty in developing countries have given rise to doubts about IMF adjustment programs. In particular, it has been criticized that ESAF-supported programs have failed to achieve economic growth and external debt sustainability in developing countries. Moreover, the programs have been criticized as prioritizing short-run stabilization (i.e. fiscal and monetary tightening) over poverty reduction, by squeezing education and health care spending (IMF 1999). The growing criticisms finally persuaded the IMF to undertake an internal staff review of the ESAF in 1997, followed by an external evaluation in 1998 (IMF 1997 and 1998). These reviews concluded that more should be done to ensure that macroeconomic, structural, and social policies complement each other and that ESAF-supported programs aim to accelerate growth and shift the composition of fiscal expenditure in favor of health care, education, and other basic social/economic infrastructure.

In response to these recommendations, the IMF replaced ESAF with the PRGF in 1999 to integrate the objectives of poverty reduction and growth more fully into its operations for low-income countries, and to base these operations on national poverty reduction strategies prepared by the country (IMF 2000). While PRGF-supported programs

still focus on prudent macroeconomic policies and structural reforms, they now include poverty and social impact analysis (PSIA) of the policies adopted, which has enabled countries to weigh the trade-offs arising from the implementation of the policies and thus take countervailing measures to mitigate adverse impacts. These programs also more flexibly accommodate rising budget deficits, and place more emphasis on an increase in budgetary resources for poverty-reduction purposes.

While it is still too early to make a comprehensive assessment, an internal staff reviews concludes that the PRGF-adopted countries do now allocate more resources to education, health care, and capital expenditure as measured in terms of gross domestic product (GDP) and total government spending (IMF 2002). However, the review concluded that PSIAs should be performed more systematically, and that the quality and efficiency of government spending should be improved. In addition, Inchauste (2002), an IMF staff member, concluded that there is room for improving program designs and implementation of countervailing measures used to offset potentially negative impacts.

In 1999, the IMF in close collaboration with the World Bank, introduced PRSP, a comprehensive country-based strategy for poverty reduction. It is formulated around a participatory process involving the governments of low-income countries, the IMF, the World Bank, donor countries, NGOs and other relevant stakeholders with the goal of meeting MDGs. The PRSP also provides the operational basis for IMF and World Bank concessional lending (ESAF/PRGF and International Development Association [IDA] loans, respectively) and for debt relief under the HIPC Initiative, described later. It is updated every three years with annual progress reports, describing a country's macroeconomic, structural and social policies and programs over a three year or longer horizon to promote broad-based growth and reduce poverty, as well as associated external financing needs and major sources of financing.

One of the challenges faced by the IMF is that while the macroeconomic and structural reforms described in the PRSP should be consistent with the PRGF, it is not necessarily so since the former are developed in a participatory manner while the latter is developed in close collaboration between just the IMF and the recipient country. Thus, better collaboration is necessary to produce mutually consistent development programs. Moreover, Shirai (2004b) reviewed the PRSPs of 13 selected countries and found that they lacked proper sequence and adequate coordination between policies (for example, between rural development and education policies). Also, too much emphasis was being placed on describing poverty analysis and governance issues, thus providing little in the way of detailed, step-by-step strategies. Moreover, the PRSPs were seen to pay little attention to

trade policies, notwithstanding that the domestic markets in these countries are small, indicating that they need to develop export-oriented economic growth strategies. Thus, the content of PRSPs needs to be greatly improved to make them more realistic country-strategic papers.

2.3 HIPC Initiative

Since 1956, OECD countries have formed an informal group called the “Paris Club” to develop coordinated and sustainable solutions to the payment difficulties experienced by debtor countries through rescheduling debt due to them. Rescheduling provides a country with debt relief through a postponement and a reduction in debt service obligations. The debt rescheduling is negotiated in close consultation with the IMF, and thus generally accompanies IMF-supported programs aimed at reducing borrowing needs. Most rescheduling treatments fall under the following pre-defined categories defined by a consensus of the creditor countries: (1) classic terms (standard treatment), (2) Houston terms (applying the 1988 Toronto terms of 33% debt reduction targeting the poorest countries) in 1990 for highly-indebted lower-middle-income countries, (3) Naples terms (67% debt reduction) introduced in 1994 for highly-indebted poor countries, and (4) Cologne terms (100% debt reduction on ODA loans and 90% on non-ODA loans) introduced first in 1996 and then expanded in 1999 for countries eligible for the HIPC initiative. Eligibility for the different terms is assessed by creditors, on the basis of track records of the debtor country with the Paris Club and the IMF, as well as other considerations (such as per capita income level, size of indebtedness and debt service burden).

The HIPC initiative was introduced by the IMF and the World Bank in September 1996 to provide a comprehensive generous debt relief mechanism involving all creditors (bilateral, multilateral and commercial creditors) with new inflows of aid. It was followed by the “Enhanced HIPC” Initiative in October 1999, which eased the eligibility criteria by lowering the ratio of total external debt to annual exports from 200-250% to 150%. The HIPC initiative differs from the previous Paris Club restructurings, since multinational creditors (i.e., the IMF, the World Bank, and the regional development banks), which have historically held the preferred creditor status and thus have not rescheduled their loans, now have to provide debt relief. It is agreed that half of the debt relief to be provided under the HIPC Initiative will be on multilateral debt (IDA 20%, the African Development Bank 10%, and IMF 10%), while G7 countries bear 30%, other Paris Club member countries 10%, and non-Paris Club member countries 10%, respectively.

To be considered as eligible for HIPC Initiative assistance, a developing country must (1) face an unsustainable debt burden (i.e., external debt of more than 150 percent of annual exports) and (2) have established a track record of reform and sound policies through the IMF- and World Bank-supported programs for more than three years. Once an eligible country has prepared a PRSP, it is able to reach the “decision point,” when the needed debt relief is assessed/committed and interim debt relief is provided and front-loaded. As soon as successfully implementing a set of predefined reforms envisaged in the PRSP for at least one year, the country is able to reach the “compression point,” when the full stock-of-debt reduction is performed. As of April 2004, the HIPC debt reduction packages have been approved for 27 countries (23 of them in Africa), providing US\$31 billion (net present value terms) in debt service relief over time. The HIPC Initiative has shown that the IMF, together with other multinational organizations, plays a crucial role in reducing the external debt of the extremely poor countries and, at the same time, promoting debt relief from creditor countries and commercial banks. The HIPC Initiative became possible through the establishment of the HIPC Trust Fund, funded by the IMF (based on the interest earned on subscriptions contributed by member countries and contributions from bilateral countries), the World Bank (financed by earnings on its loans to middle-income countries and donor contributions), and other regional development banks (by own resources and donor contributions). The IMF also helps governments formulate sound macroeconomic policy and related structural reforms.

3 Economic Growth, Poverty Reduction and Japan

3.1 Japan’s ODA Policy and Contributions

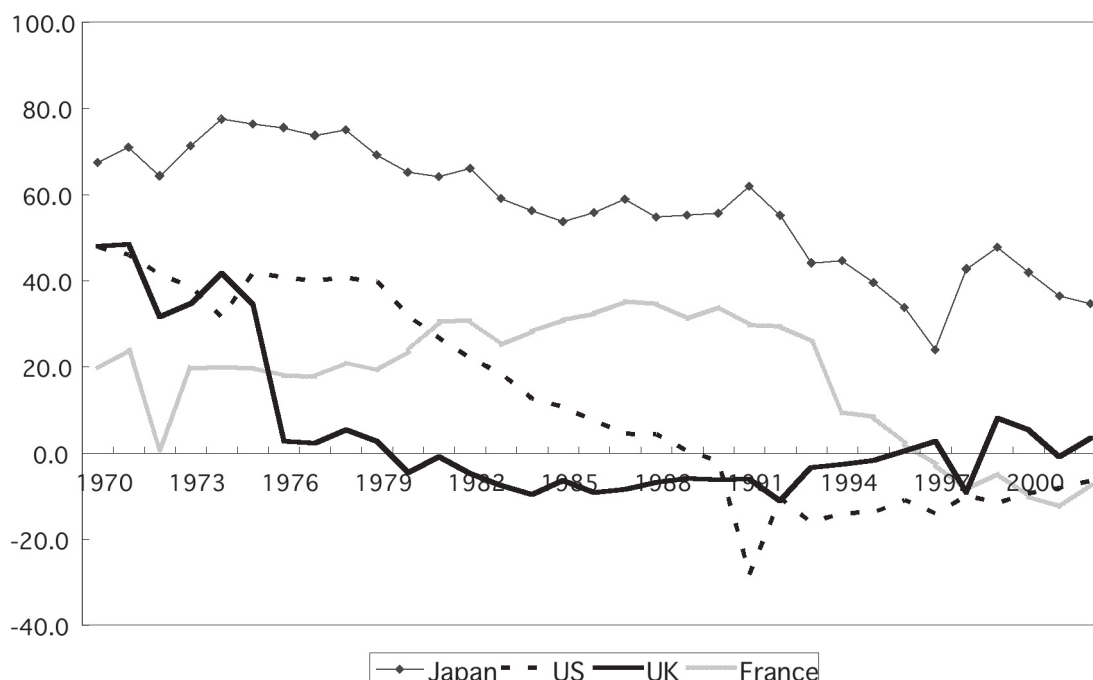
The amount of total ODA of 22 DAC countries has been declining since the end of the Cold War, but recently this trend was somewhat reversed in the face of growing terrorism and global conflicts. If the Monterrey Consensus is successfully achieved, the amount of ODA would raise from the current level of about US\$55 billion to US\$175 billion. To meet the MDGs, it is necessary for DAC countries to contribute a greater amount of ODA for developing countries, particularly to Sub-Saharan African countries. In recent years, moreover, improving aid effectiveness and policy coherence among ODA, trade and investment policies by donor countries has been increasingly recognized as one of the important steps necessary for achieving poverty reducing development strategies.

Since the 1980s, Japan has given ODA a high national priority and enlarged the size and variety of its aid programs. As a result, Japan became one of the world’s top ODA

donors in value terms, and maintained its status as the largest ODA provider until 2001. Since then, Japan has been the second largest ODA provider after the United States. As of 2002, Japan's ODA amounts to US\$9.28 billion, accounting for 15.9% of total net ODA of DAC countries; second largest after the United States (US\$13.3 billion and 23%). Japan's bilateral ODA (excluding contributions to international organizations) amounts to US\$6.7 billion, accounting for 16% of total net ODA of DAC countries. Moreover, the ratio of tied loans has been low since the 1970s; the share of untied and Less Developed Countries (LDC)-untied ODA loans achieved 100% in 1980. Japan's untied ratio for total ODA has been high as compared with other donor countries, because of the greater share of ODA loans. For example, the share of net ODA loans in total ODA accounted for 25% in Japan, compared with -5.9% in the United States, -0.1% in Germany, and -0.5% in the United Kingdom. Chart 1 indicates the ratio of net ODA loans to total bilateral net ODA for the four largest donor countries. The greater ratio of ODA loans in Japan reflects two factors: one is that about one fourth of Japan's ODA is financed by the Fiscal Investment and Loan (ZAISEITOUYUSHI) whose funds are largely originated from postal savings deposits, public insurance premiums, etc. The other factor is related to Japan's principle that ODA should be used to promote "self-reliance" incentives among recipient countries, rather than promoting dependence on foreign grants with no repayment obligation. Furthermore, the declining tied loan ratio and appreciation of the yen (resulting in high procurement costs) reduced the rate of order acceptances accrued to Japanese firms to less than 30% by the late 1990s.

In terms of geographic contribution, Japan's ODA policy has played a crucial role in helping achieving high, sustainable economic growth in many Asian countries. Also, ODA, together with massive private credit flows from Japan to Asian countries, has contributed to their high economic growth. Japan's active outward foreign direct investment (FDI) since the 1980s has helped to improve the productive base, increase employment, accumulate foreign reserves, and raise corporate income tax revenues in these recipient countries. Further, Japan's ODA has been instrumental in helping lay down essential economic infrastructure and set the stage for an economic takeoff for many Asian countries that have registered impressive recent economic gains. For example, Japan allocated ODA loans to establishing industrial sea ports and industrial estates in Map Ta Phut (¥12 billion on a contractual basis) and Laem Chabang (¥19 billion) in Thailand in the mid-1980s. These loans have contributed to attracting FDI from Japan as well as other countries, and thus helped Thailand to achieve higher export-driven economic growth. In addition, Japanese firms operating abroad have employed more than 3 million people (nearly 2 million in Asia) each year during 1999-2000. The Japan Bank for International Cooperation (JBIC),

Chart 1 Trends on Bilateral Net ODA Loans (% of Total Bilateral Net ODA)



Source: OECD/DAC Geographic Distribution of Financial Flows to Developing Countries.

an administrator of ODA loans, has provided an assessment that Japan's ODA loans from 1980 to 1999 raised 1999 GDP by 3.2% (on year-average, 0.17% each year) in Thailand and 1.4% (0.08%) in the Philippines (JBIC 2002).

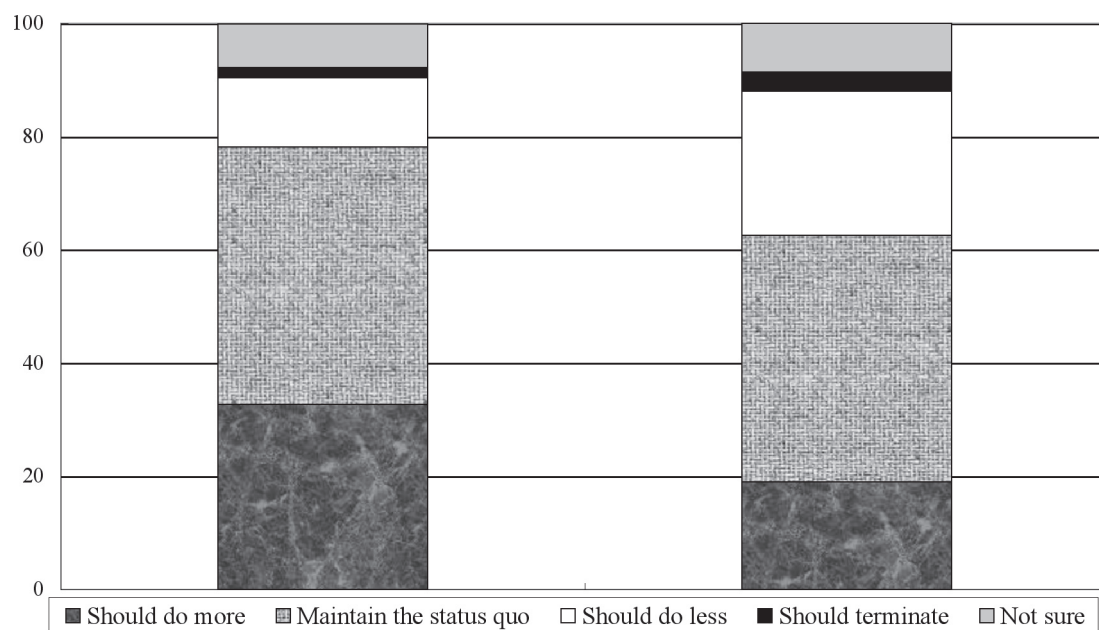
Moreover, Japan's food aid, which is included in the Ministry of Foreign Affairs (MOFA) ODA budget, has been LDC-untied, so that recipient countries are able to purchase rice from other countries (such as from Thailand and Myanmar) using Japan's grant, thus helping rice exporting developing countries to accumulate foreign reserves and generate income. Further, Japan's aid for food speed-up production, although the volume has been declining in recent years, helped a number of developing countries to achieve food self-reliance by enabling them to purchase fertilizer, agricultural equipment, and learn advanced farming skills. Consequently, some countries, such as Thailand, Cambodia, Vietnam and Myanmar, have increased rice production and been transformed from positions as net rice importers to net rice exporters. According to the DAC, 37% of all agriculture-related ODA comes from Japan.

3.2 Japanese Public Views and Challenges over ODA Policy

The amount of Japan's ODA began to decline from 2002, since Japan's fiscal deficit problems led the government to make fiscal reform a top priority; illustrated by the passing

of the Fiscal Restructuring Law in December 1997. Moreover, the prolonged recession and growing unemployment rate in Japan, together with a growing fiscal deficit, induced the Japanese public to question whether Japan should continue to provide aid assistance to other countries when it faces so many domestic problems of its own. Public feeling increasingly has stressed that national interest should be more emphasized, and that this should be reflected in official economic cooperation programs toward developing countries. The public opinion survey conducted by the Cabinet Office in 2003 with respect to the level of ODA, for example, revealed that 73% of respondents supported “maintain status quo,” “should do less,” or “should terminate”, increasing from 59.5% in 1993 (Chart 2). The public has also criticized Japan’s ODA policy that it lacked transparency and effectiveness and that it should contribute to helping overcome Japan’s recession (Chart 3).

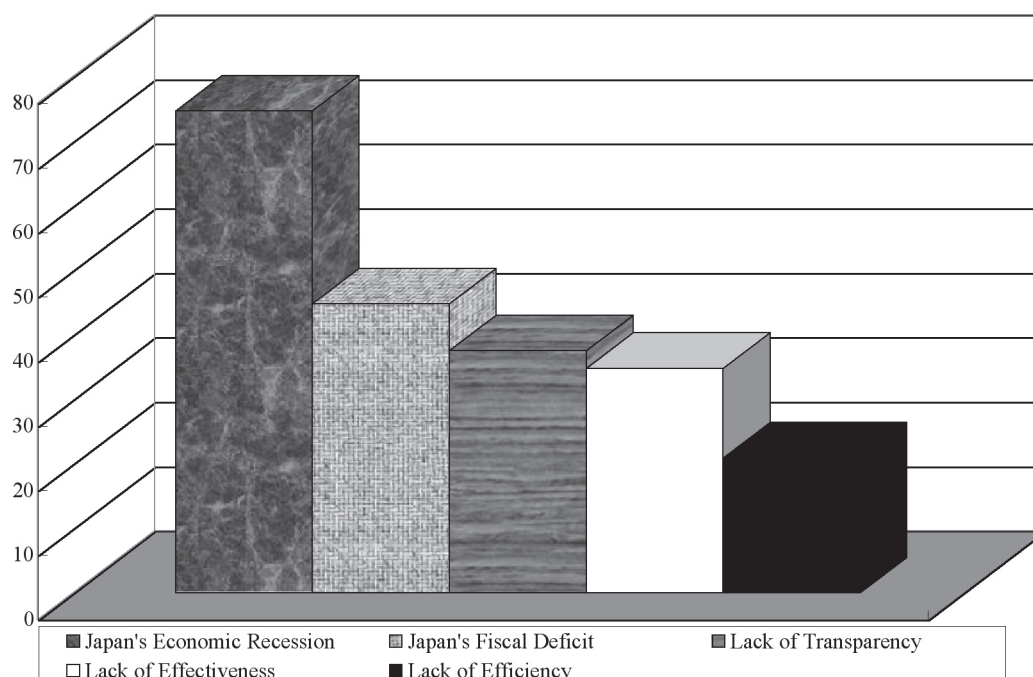
Chart 2 Public Opinion Survey Concerning the Amount of ODA (%)



Source: Cabinet Office, Gaiko Kansuru Yoronchosa, 2003.

The growing criticism over Japan’s ODA policy has left the government no choice but to increase the ratio of tied loans since 1999, while increasingly allocating ODA toward environmental areas (currently more than 30%), human rights, peace restoration, etc. Many now have the view that Japan’s ODA loans should not be used to hire companies operating in other OECD countries to build highways or other infrastructure under their corporate names in developing countries, since residents in recipient countries are unlikely to notice Japan’s contribution. Since ODA constitutes part of Japan’s foreign policy, the public view

Chart 3 Public Opinion Survey Concerning Reasons for Choosing “Should Do Less or Terminate (%)



Source: Cabinet Office, Gaiko Kansuru Yoronchosa, 2003.

is that money should be used as policy “to explicitly reveal Japan’s face.” In other words, there is a growing consensus that Japan’s national interests should be more emphasized in ODA policy, as reflected in the revised ODA Charter (revised in 2003), while allocating ODA more intensively to restore peace in Afghanistan, Sri Lanka, Iraq, and other conflict countries, and to solve environmental problems.

Given the close economic linkages and geographical proximity, Japan’s ODA has been historically concentrated in Asia, even though ODA has been extended to 150 nations. While the ratio of Japan’s bilateral ODA toward Asia to total bilateral ODA has declined from 98% in 1970, to 71% in 1980, and further to 57% in 2002, the ratio remains high. One reason for Japan’s bias toward Asia is explained by the fact that ODA was initiated in the process of paying post-war compensation and quasi-compensation to Asian countries on the basis of the 1951 San Francisco Peace Treaty. Another reason is that ODA was used to promote Japan’s economic recovery from economic devastation through promoting export to neighbouring countries including India. While these two reasons explain Japan’s bias toward Asia in the early stage, it may be no longer justified since many of these assisted Asian countries have achieved high economic growth and have been enjoying inflows of private sector capital from the rest of the world. The persistent Asian bias reflects Japanese public view that ODA should be used in a manner that is mutually beneficial. According

to the afore-mentioned Cabinet Office survey, 49% of respondents pointed to Asia as the region to enhance further economic cooperation, while Africa accounted for only 9%. As a result, the revised ODA Charter stresses an achievement of mutual economic growth in East Asia where economic linkages with Japan have been strong.

As for ODA toward China, on the other hand, the provision of substantial amounts of ODA to China (the second largest recipient, accounting for about 10% of total Japan's ODA) has generated strong criticism in Japan (for example, by the Economic Cooperation Evaluation Subcommittee of the Liberal Democratic Party's Special Committee on External Economic Cooperation and the Advisory Group on Japan's Economic Assistance to China in the 21st Century). Criticism has mainly reflected China's massive military expenditure; concerns about her violation of basic human rights; the lack of public recognition/appreciation by the Chinese citizens for Japan's aid; China's assistance to other countries (it is rumoured that part of Japan's ODA has been reallocated to countries of strategic importance to China); and, her high economic growth and position as a net exporter.

Japan's ODA policy faces various challenges. First, Japan has to provide a greater amount of debt relief to HIPC countries, given that the ratio of ODA loans to total ODA has been largest among DAC countries. In accordance with the HIPC initiative, moreover, the government has decided to write-off the relevant ODA debts for HIPCs in 2003, instead of providing grant aid for debt relief as it had been doing; in order to reduce administrative and foreign currency procurement burden on the part of developing countries. For example, the amount of Japan's debt relief reached US\$9 billion (of which, ODA loans reaches US\$8 billion), accounting for 26% of total debt relief undertaken by the G7 nations. Despite the efforts, the large amount of outstanding ODA loans to developing countries makes it difficult for Japan to expand the HIPC initiative or other debt relief beyond the current level, making it difficult for Japan to take a lead over the debt relief initiatives. Additionally, the growing expectation regarding Japan's leadership on the issue of debt relief suggests that a greater portion of grants, not loans, should be provided to low-income developing countries in future ODA allocations.

Second, despite the large amount, Japan's ODA has been small in terms of its GNP, accounting for only 0.23% (18th ranking) and being far below the 0.7% target committed under the Monterrey Consensus (Table 1). Also, Japan's per capita ODA reaches only US\$77.4 (9th ranking). The severe fiscal deficit (more than 7% of GDP) and growing public debt (about 140% of GDP) make it extremely difficult for Japan to increase ODA from the current level. This indicates that Japan needs to play a more active role in reducing poverty in developing countries, mainly through improving the effectiveness of its ODA policy. In

Table 1 Net ODA of DAC Countries (% of GNP)

	%of GNP Ranking	2002	Per Capita Ranking	2001
Denmark	1	0.96	2	304.9
Norway	2	0.89	3	298.4
Sweden	3	0.83	5	187.2
Netherlands	4	0.81	4	198.4
Luxembourg	5	0.77	1	320.5
Belgium	6	0.43	7	84.3
Ireland	7	0.40	11	74.7
France	8	0.38	12	70.9
Finland	9	0.35	10	74.8
Switzerland	10	0.32	6	125.6
UK	11	0.31	8	77.9
Canada	12	0.28	15	49.3
Germany	13	0.27	14	60.6
Portugal	14	0.27	21	25.9
Australia	15	0.26	13	65.6
Spain	16	0.26	17	43.1
Austria	17	0.26	16	44.8
Japan	18	0.23	9	77.4
New Zealand	19	0.22	19	29.1
Greece	20	0.21	22	18.4
Italy	21	0.20	20	28.4
US	22	0.13	18	40.1
Average1/		0.23	61.20	

Note: Per capita ODA refers to per capita ODA for total DAC countries.

Source: ODA White Paper 2003, Ministry of Foreign Affairs.

particular, a greater amount of ODA needs to be allocated to Sub-Saharan African countries with more carefully-designed ODA policy targeting the poor and, at the same time, promote private sector trade and investment flows. It may be necessary to earmark a certain portion of ODA for Sub-Saharan Africa. This regional reallocation of ODA budget is necessary for Japan in order to assist developing countries to fulfil MDGs. In doing so, the amount of ODA could be reduced for some Asian countries that are able to receive private sector capital flows, and this reduction could be offset partially by an increase in OOF (official loans other than ODA loans) toward them.

Third, Japan's ODA concentrates on economic infrastructure covering transportation

and energy infrastructure relative to social infrastructure (such as education, health, and access to safe water). The ratio of economic infrastructure accounted for 35% of total bilateral ODA in 2001, greater than the United States (3.6%), United Kingdom (8%), France (7.7%) and the DAC average (14.9%). Many donor countries allocate more funds for social infrastructure (Charts 4a and 4b in the case of Japan and the United States). As the development community now understands that developing better institutions and promoting human capital and basic human needs are essential for raising contributions to economic infrastructure for economic growth, Japan needs to shift its emphasis from economic infrastructure to social infrastructure.

Chart 4a. Sector Allocation of Japan's Bilateral ODA in 2001(Commitment Base, % of Total)

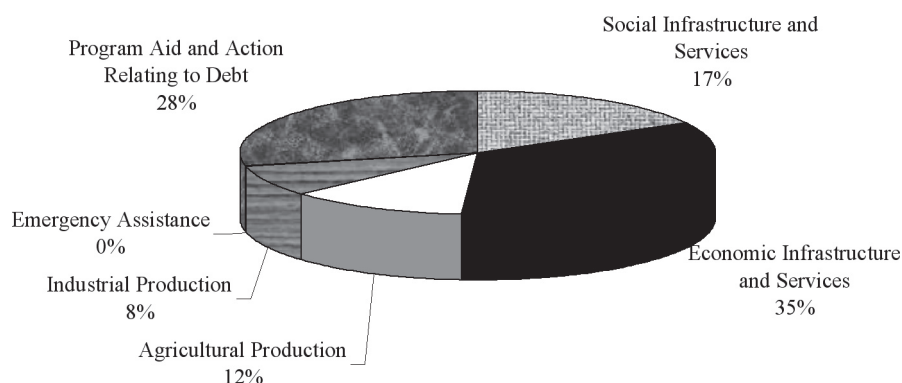
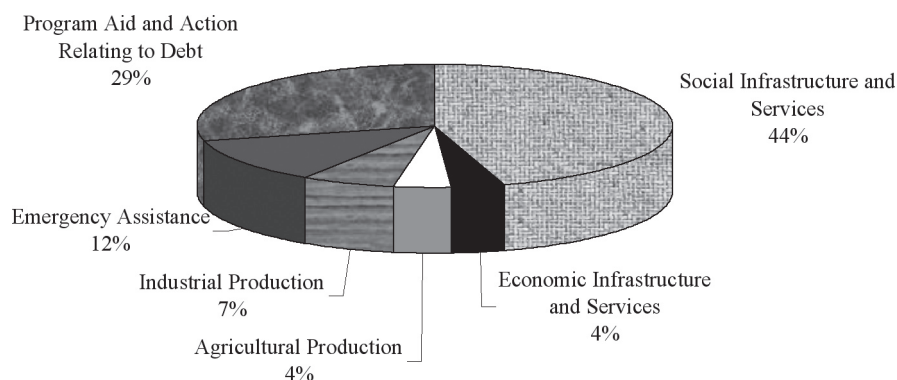


Chart 4b. Sector Allocation of US's Bilateral ODA in 2001(Commitment Base, % of Total)



Source: ODA White Paper 2003, Ministry of Foreign Affairs.

3.3 Policy Coherence toward an Integrated ODA Policy

In recent years, policy coherence has become an important issue related to ODA policy. Policy incoherence occurs when contradictory policies are implemented by donor countries. For example, countries may spend large amounts of ODA to strengthen trade capacities in developing countries, while at the same time restricting access to their markets (OECD 2002). Formally, policy coherence can be thought as being attainable through three stages: (1) between the different instruments of development cooperation (e.g. grant, loans, humanitarian aid, and technical cooperation), (2) between development and domestic policies (e.g. agricultural and fishery policies), and (3) between development policies and other areas of international policy (e.g. international investment, trade, security, and environmental policies). It has been increasingly recognized in the international development community that donor countries should expand their economic cooperation for development in low-income countries not just by increasing ODA and improving its effectiveness (as envisaged in Stage 1), but to promote broader economic cooperation through achieving better policy coherence (as envisaged in States 2 and 3).

With respect to first stage of policy coherence aimed at achieving an integrated ODA policy, Japan has been making efforts to achieve greater ODA policy coherence between the different instruments of development cooperation (although a lesser degree of efforts have been made for the second and third stages). One factor making Japan's ODA policy complicated and opaque arises from the complicated ODA budgetary allocation process. Japan's ODA budget has been allocated among 12 ministries and the Cabinet Office. The lack of an integrated budget makes it complicated for the government to implement a mutually consistent ODA policy. In particular, close collaboration between the MOFA and the Ministry of Finance (MOF) is the key to achieving an integrated ODA policy, given that most of the budget is allocated to MOFA (31.5% of the total budget) and MOF (60%). The MOFA's budget is allocated subsequently to technical cooperation executed by the Japan International Cooperation Agency ([JICA] accounting for 35% of the MOFA's total budget), contributions to international organizations (20%), and grants including food aid (50%). The MOF's budget is distributed to the JBIC (accounting for 80% of the total the MOF's budget) and contributions to other international organizations, such as the World Bank and the Asian Development Bank. The rest of the budget (8.5%) is allocated to sector-based assistance programs (largely, technical cooperation) executed by the remaining ministries and the Cabinet Office. In the past, yen-denominated loan projects were determined through coordination among MOFA, MOF, the Ministry of Economy, Trade, and Industry (METI), and the Cabinet Office, while grants and technical cooperation programs used to be determined by the MOFA.

In recent years the government has adopted several measures to improve coordination of ODA policy: First, the *Council of Overseas Economic Cooperation-Related Ministers* was re-opened in December 2000, after its abolishment in 1993, with growing awareness of the need to promote exchanges of views and improve collaboration among relevant ministries. However, the Council, presided over by the Chief Cabinet Secretary and participated in by the ministers of relevant ministries, does not meet regularly. This is a high-level council to discuss Japan's main foreign policy, positioned above the Inter-Ministerial Meeting on ODA described below. The Secretariat is located in the Cabinet Office. Agenda items discussed are generally coordinated in advance by the MOFA through communications with relevant ministries. In this sense, the Council has been passive since issues have been selected from the bottom up, not at the initiative of the Ministerial Council, which would be top down and more active on the part of the council. So far, the Council has discussed and made decisions to revise the ODA Charter; to formulate medium-term ODA policy; and to invite public opinions/comments on the ODA Charter.

Second, the *Inter-Ministerial Meeting on ODA* was established in March 2000 to serve as a forum for discussion on major ODA-related issues among the 12 ministries and the Cabinet Office. For example, a meeting discussed measures to be taken by Japan in reaction to the September 11 terrorist attacks on the United States in October 2001. In March 2002, it discussed support for the reconstruction of Afghanistan. The meeting discussed the total ODA budget and inter-Ministerial collaboration in September 2002 and the basic principle of the ODA Charter revision in March 2003.

Third, the *Bureau Meeting for Inter-Ministerial Groups on ODA* now functions as a forum to conduct discussions and collaboration at a desk work level to support the Inter-Ministerial Meeting on ODA among the 12 ministries and the Cabinet Office. All important negotiations take place at this level. Thus, the meeting of this forum takes place more frequently than the Inter-Ministerial Meetings. For example, in October 2002, the Bureau Meeting discussed a proposal for ODA Reform made by the Liberal Democratic Party's Special Committee on External Economic Cooperation, the transformation of the JICA to an Independent Administrative Institution, the ODA White Paper, and assistance to Afghanistan. In January 2003, the Bureau Meeting discussed the final report on ODA Reform submitted by the Liberal Democratic Party's Special Committee on External Economic Cooperation, the schedule/direction of ODA Charter revision, and the present conditions and future plans in relation to country assistance programs. In addition, a Bureau Meeting has been reported from the three subordinate Experts Meetings described below.

Fourth, given that all ODA-budged ministries provide technical cooperation, the

Experts Meeting of Technical Cooperation was established in April 1997 as a forum to exchange information/views and collaborate on related projects in order to implement projects effectively and efficiently, and to reduce overlapping of projects among the 12 ministries and the Cabinet Office. The Directors of these ministries serve as members. In addition, the *Experts Meeting of ODA Evaluation* was established in July 2001 with members being the division directors from relevant ministries, along with scholars, experts, and representatives of NGOs and international organizations as observers. This meeting provides a forum to formulate guidelines on project evaluations and to review evaluation outcomes related to ODA in order to strengthen Japan's ODA evaluation system. In March 2002, the meeting adopted the *Reference Method of Technical Program Evaluation* in ODA-related ministries to use as a reference in evaluating ODA activities involving the dispatch of experts and the acceptance of trainees overseen by various ministries. In November 2002, February 2003 and April 2003, meetings discussed the Reference Method and reviewed evaluations performed by relevant ministries and agencies.

Moreover, the *Experts Meeting of Financial Cooperation* was established in November 2002. These meetings provide a forum to discuss and coordinate programs and projects in developing countries in relation to grants, ODA loans, OOF and trade credits among the MOFA, MOF, METI, JICA, JBIC, and the Nippon Export and Investment Insurance. For example, in November 2002 the meeting discussed the present conditions of financial cooperation with Indonesia and Vietnam. It discussed mainly financial cooperation with India in January 2003; with Sri Lanka and Vietnam in February 2003; with Bangladesh, and collaboration between the JICA and JBIC, and bilateral and multilateral financial assistance in March 2003; with China, and the strengthening of field-level collaboration in April 2003, and with Cambodia and Thailand in June 2003.

Fifth, in addition to the role of coordinating ODA projects among relevant ministries, the MOFA has been given a stronger mandate to formulate country assistance programs with close collaboration with governments in recipient countries, the Board on Comprehensive ODA Strategy, the ODA Task Force (both discussed below), embassies, international organizations, other donors, NGOs, and the general public. The MOFA has been making efforts to better align the country assistance programs formulated by Japan with recipient country-owned development plans including the PRSPs. Also, efforts have been made to better align Japan's aid projects/programs to those of recipient country-owned sector strategies. Japan's ODA policy has now shifted toward formulating/strengthening existing country assistance programs in line with the revised ODA Charter. To support this move, the MOFA is currently being reorganized to back up its strengthened authority

with respect to its overall responsibility for ODA policy and to coordinating roles with other ODA-budgeted ministries. Additionally, in April 2003 the MOFA strengthened collaboration with related ministries in relation to ODA policy by newly appointing a Senior Vice-Minister in charge of ODA. To further enhance inter-ministerial coordination, the Director General of the *Economic Cooperation Bureau (ECB)* of the MOFA was appointed from METI, and the Deputy Director General and the Senior Coordinator (to the Loan Division of ECB) both from the Cabinet Office.

Sixth, the *Board on Comprehensive ODA Strategy* was established in June 2002 and is chaired by the Minister of Foreign Affairs. The members consist of the Senior Vice-Minister, a journalist, a development journal editor, NGO representatives, experts, academics, think tank representatives, firm representatives, etc. In addition to reviewing the ODA Charter, its mandate is to review and formulate country assistance programs, and discuss major ODA agenda. The meeting is generally held once a month. Relevant ministries, JICA and JBIC send staff as observers. The Board plays an important role in determining future target countries where assistance programs are to be applied and reviewing/revising the existing 15 country assistance programs (those already formulated before the establishment of the Board). However, the fact that Board members are public representatives and that the Board is essentially an advisory council to the MOFA makes it difficult to expect it to emerge as a place to negotiate policy coherence issues, although discussions on policy coherence can be had. Even though other relevant ministries send their officials as observers to the Board, their roles are more likely to report discussions to their respective ministries and the Cabinet Office.

Seventh, in line with its mandate to improve the transparency and effectiveness of ODA policy, the MOFA has strengthened field-level participation in the process of policy formulation. At the end of 2002 the MOFA instructed embassies, JICA and JBIC representative offices to organize *ODA Task Forces* for 51 countries (covering Asia, Latin America, Middle East, Eastern Europe, and Africa) and to form field-level networks with JICA experts, NGOs, the Japan Foundation, and others. The ODA Task Force collects information in relation to macroeconomic performance and development plans of recipient countries, exchanges views and negotiates with recipient governments, and closely collaborates with other donors and international organizations to reduce administrative overlapping or burden on governments in recipient countries. The Task Force organizes frequent meetings in the recipient country and reports regularly to MOFA headquarters, which in turn utilizes the information and suggestions in formulating country assistance programs and in selection of country strategies.

3.4 Successful Examples of Policy Coherence toward Integrated ODA Policy

Vietnam (Japan is its top aid donor) is the first country whose existing country assistance program (formulated in 2000) has been revised based on a consensus achieved at the Board on Comprehensive ODA Policy. This move significantly differs from past practices of formulating country assistance programs, since the Embassy of Japan in Vietnam and representative offices of the JICA and JBIC have been closely collaborating with members of the Board on Comprehensive ODA Policy in the process of revising Vietnam's country assistance program. This field-based approach is different from that followed in the past; when such field-level collaboration and collaboration between field-level agents and the MOFA was limited. Close collaboration with other donors and partners such as the World Bank, the IMF, and the United Nations Development Program (UNDP) has also been successfully realized.

Other example is that Japan has been promoting the *Tokyo International Conference on African Development* (TICAD) process since the 1990s with a view to realizing ownership and partnerships in development and economic adjustment programs in countries in Africa. This process represents Japan's continuing commitment to Africa's problems and its determination to work in cooperation with Africa in the international community. As part of its initiative in the area of investment, the MOFA held the Tokyo International Conference on Investment to Africa in February 2003. The conference featured lively discussions in which participants drew on their experiences, and many constructive proposals were made regarding issues that should be addressed to promote investment in Africa. At the end of September 2003, TICAD III was held in Tokyo.

In January 2001, as another example of policy coherence, Japan re-examined the development approach that it has been taking to improve sustainable development in East Asia, and the methods being used to ensure the effectiveness of ODA, as well as proposed the *Initiative for Development in East Asia* (IDEA) to encourage discussions on development as an issue of common concern within the region. At the ministerial meeting held in Tokyo in August 2001, it was agreed that, in view of the diversity of the region with respect to income levels, levels of growth as a market economy, social conditions, and conditions of the environment, it would be necessary to continue providing assistance and advancing cooperation to meet different developmental needs. Based on this awareness, Japan plans to cooperate actively not only by providing bilateral assistance to meet specific needs and requests, but also to encourage intra-regional and South-South cooperation. At the same time, the Ministers agreed that the knowledge and experience gained in the development process in East Asia, where a balance between economic growth and poverty reduction was

achieved, should be shared actively with the rest of the world to foster closer international cooperation on this issue. Japan is of the view that the East Asian development approach could be an alternative worthy of consideration for Africa and other regions that suffer from dire poverty and urgently need to take action to achieve the MDGs.

4 Conclusion and Policy Recommendations

Given that the links between macroeconomic policies and poverty are complex, economic theory and empirical analysis has not been able to guide how one should contemplate the impact of macroeconomic policies on poverty reduction until today. What is clear so far is that a one-for-one response from growth to poverty, as had been viewed in the past, cannot be taken for granted and that development strategies should give greater attention to preparing appropriate conditions for the poor to benefit from growth, and further for growth rates to rise and be sustainable. These conditions include easing constraints on domestic credit markets, reducing labor market distortions, building human capital, and increasing access to trade markets.

This process is closely associated with the HIPC initiative, since debt relief frees up financial resources from debt servicing for the task of poverty reduction, particularly in the areas of education and health care spending. However, improving education and health care levels depends on how efficiently available funds are spent and how well they are targeted to the poor; this requires well-designed and well-sequenced pro-poor economic development strategies. In this sense, the PRSPs should be more carefully designed with greater focus on producing mutually consistent, well-sequenced realistic policies. So far, in preparing the PRSPs, stakeholders spend less time on prioritizing the allocation of available resources in line with poverty reduction targets than on analysis of poverty and governance/institution. Also, little work has been done on the direct relationship between external debt and poverty, as well as policies on how to achieve both external viability and poverty reduction. Thus, the IMF in close collaboration with other stake holders needs to make greater efforts to produce more realistic and pro-growth poverty reduction strategies.

As for Japan, while the government has implemented new measures to improve an integrated ODA policy, a more systematic approach is necessary to increase the effectiveness of its ODA. While Japan's ODA policy development is on the right track, it appears that it will take some time to develop more integrated field-level approaches equivalent to that taken in Viet Nam, given the lack of sufficient human resources and institutional capacity in the field. To facilitate this process, the MOFA needs to allocate a bigger budget allowance

to provide for training experts and JBIC/JICA/Embassy staff together with some kind of reallocation of ODA budget towards achieving this end.

An ideal way to produce a mutually consistent ODA policy would be to establish one aid agency that managed all ODA budgets and formulated integrated and consistent ODA policies by setting priorities for various projects in accordance with the needs expressed by recipient countries, and in close collaboration with other donor countries and international organizations. While this would facilitate policy coherence with other relevant ministries, the realities of the current political and vertical bureaucratic structures make it unrealistic to envisage such reorganization. Another way could be to strengthen the role of the Council of Overseas Economic Cooperation-Related Ministers, at least to a level equivalent to the *Council on Economic and Fiscal Policy*, as a place to regularly discuss the issues of policy coherence and formulate ODA and external strategies among the Ministers of relevant ministries, the Prime Minister, high-level government officials, private sector representatives, academics, etc. To do so, the Secretariat of the Council of Overseas Economic Cooperation-Related Ministers needs to develop an analytical and information-gathering capacity. One severe constraint, however, is that support for such a proposal is unlikely to be gained from members of the Diet (the Japanese parliament), the MOFA, and the general public, given that their interests are more focused on domestic economic policy issues. Also, the fact that the ODA budget has an inevitable declining trend makes this policy an even less urgent agenda item.

A more realistic way to achieve policy coherence is to use the Council on Economic and Fiscal Policy as a place to regularly discuss ODA and related coherence issues in addition to domestic economic policy issues. This proposal is relatively easier to achieve than the two noted above, since the Council on Economic and Fiscal Policy has gained analytical capacity and support from several divisions of the Cabinet Office, which have been fully devoted to the Council as providers of information and analytical outputs. To achieve this proposal it will be necessary to convince members of the Council on Economic and Fiscal Policy and the public of the strong rationale involved. This means that it is time for Japan to develop comprehensive and forward-looking visions of its mandate to promote global governance. Moreover, the MOFA needs to improve the analytical and information-gathering capabilities it needs for assisting this move and formulating an integrated ODA strategy. Currently, there are few economists among MOFA staff; which mostly have backgrounds in law or political science. This makes it difficult to improve the MOFA's analytical capability beyond the capacity of policy assessment (now generally undertaken by hiring external consultants).

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(http://www.jica.go.jp/activities/report/kyakuin/200403_03.html).

Abbreviations

Development Assistance Committee (DAC)
Enhanced Structural Adjustment Facility (ESAF)
Highly Indebted Poor Countries (HIPC)
Initiative for Development in East Asia (IDEA)
International Development Association (IDA)
International Monetary Fund (IMF)
Japan Bank for International Cooperation (JBIC)
Japan International Cooperation Agency (JICA)
Less Developed Countries (LDC)
Millennium Development Goals (MDGs)
Ministry of Finance (MOF)
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Official Development Assistance (ODA)
Organization for Economic Cooperation and Development (OECD)
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1) The manuscript should be typed with double line-spacing (including all notes and references) on A4 size paper.

2) The font size should be 10.5-11point in the case of Japanese or Chinese, and 11-12 point in the case of English. (In the case of other languages than these three, interpret the guidelines appropriately here, and below also.)

3) The title page (page 1) should contain the following information: (1) the title; (2) the name(s) and affiliation of the author(s), (3) the email addresses of the author(s) , (4) the background of the paper, such as conference presentation, and acknowledgments (if applicable). If the paper is in any way funded by the COE or its related programs, it must be so mentioned.

4) The second page is for the abstract of the paper. The abstract must be in a single paragraph that summarizes the main argument or the conclusion of the paper in about 150 words in the case of English, and 7-12 lines of characters in the case of Japanese or Chinese. At the end of the abstract, a list of four to six keywords should be included. If the paper is written in languages other than Japanese or English, a corresponding Japanese or English version of the abstract should also be printed.

5) Main text should begin on page 3. Beginning from the cover page (page 1), all pages should be numbered consecutively.

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7) Tables and charts may (1) be placed in the appropriate place in the text, or (2) be prepared on separate pages and attached at the end of the text, provided that the place to be inserted is indicated in the text.

8) Reference list must be attached at the end of the text. Only works referred to in the text should be included in the list.

9) Although there is no exact limit of the length of the paper, the editorial committee requests that the paper be of approximately 15-30 pages in length.

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11. **(Correspondence)**

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