

INVITED EMINENT PAPER SERIES

**CAPITAL FLOWS FOR DEVELOPMENT
FROM JAPAN AND THE UNITED STATES**



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CAPITAL FLOWS FOR DEVELOPMENT FROM JAPAN AND THE UNITED STATES

GUSTAV RANIS* and STEPHEN KOSACK

1. Introduction

The past few years have witnessed a profound rethinking among donor nations of the nature and purpose of foreign assistance. After decades of decline, partly in response to 9/11, aid is again in vogue; in spite of the current financial crisis aid budgets are holding their own in many countries, and considerable thought and political capital is being invested to try to make aid more effective. Nevertheless, in recent times official aid has been overtaken by FDI and, interestingly, by other private flows — in particular through the activities of NGOs and remittances sent home by migrants. In this paper, we examine the recent performance of two of the largest providers of both aid and private capital to the developing world — Japan and the United States — in a comparative context.

The US and Japan have long collaborated in Official Development Assistance (ODA) as part of a “Cold War Burden Sharing” arrangement under which Japan repaid the US for the latter’s security guarantees by supplementing US ODAs and by following the US lead in aiding development in the contested “Third World”. But this cooperation belied deep differences in attitudes about development, attitudes born of very different historical development experiences of the two countries. These differences led the two donors to provide aid differently, and led to intellectual disagreements over the proper method of assisting the world’s poorer countries. Over the decades these disagreements grew. Yet in recent years, there has been surprising convergence between the two sides, in reality if not in rhetoric. For example, the US seems to have recently adopted Japanese skepticism about conditionality — most prominently in its new Millennium Challenge Cooperation initiative — and both sides now seem to be giving aid in similar ways and are adopting similar attitudes concerning its role in both promoting development and as a tool of foreign policy.

Yet if the two countries are coming together on publicly delivered ODA, they remain far apart on some private development assistance flows, i.e., on ODA delivered through NGOs, and on remittances sent by migrant workers to their families in developing countries. The US continues to deliver an ever increasing quantity of its ODA through

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private channels in an effort to leverage private funds and market forces to increase the impact of its aid. By contrast, Japan is a nation which has less tradition of private giving, and any NGO activity remains in its infancy, despite recent government efforts to stimulate it. In the arena of remittances, the differences are also stark. Though Japan has traditionally been inhospitable to immigrant workers, the migrant workers who do make it to Japan send home much more money and, at much lower transactions costs, than migrant workers in the US, a nation long seen as a haven for migrant labor.

In this paper, we analyze the history and current state of three types of capital flows — ODA, NGOs, and remittances from the US and Japan, paying special attention to the similarities and differences between them. In Section 2 we examine ODA, and in Section 3 NGOs and remittances. We conclude, in Section 4, with some suggestions for how the US and Japan may further modify their institutions and policies to better serve both their own interests and development in the world's poor countries.

2. ODA

2.1. *Cold war divergence in patterns of giving*

Today the United States and Japan are still among the world's largest donors; together they provided nearly \$30 billion to developing countries in 2007 — 28% of the more than \$103 billion contributed by all donors that year. The United States has long been the largest donor in absolute terms — it provided the most ODA in all but three of the last 48 years. Japan joined the ranks of the world's top donors relatively recently; it was a relatively small donor until the 1980s, when it moved into second place in terms of absolute size. In the mid-1990s it was Japan that overtook the US for the only three years when the latter was not the top donor. In fact, if measured as a percentage of GNI, Japan has been the more generous donor since the late 1970s. In recent years, the US has retaken the absolute top spot, while Japan is generally second or third.¹ The current international financial and economic crisis, however, has caused a leveling off of US ODA and a substantial decline in Japan's contribution. Figure 1 shows the pre-crisis historical contributions of the US and Japan to the total; Figure 2 shows absolute flows from the two, and Figure 3 shows them as a percentage of their GNIs.

The US and Japan are also two donors whose generosity, more than most, was driven by a strategic rationale — and for both donors that rationale was initially the Cold War. The US's foreign aid programs had been seen, until 1989, as a way to buy the loyalty of Cold War allies. Japan's rationale was different, though related: its aid was mainly viewed as “Cold War burden-sharing.” That is, Japan's ODA was given under US pressure and was tacitly seen as a way to compensate the United States for including Japan under its security umbrella.

Japan itself was once the recipient of large amounts of US assistance, under the Government Aid and Relief in Occupied Areas (GARIOA) program, which helped rebuild Japan's economy after the war. Japan's own giving began around 1955, in the form of a modest post-World War II reparations program for its Southeast Asian neighbors. Around

¹ Though occasionally it has fallen further — in 2004 it was fifth, and in 2007 it was sixth.

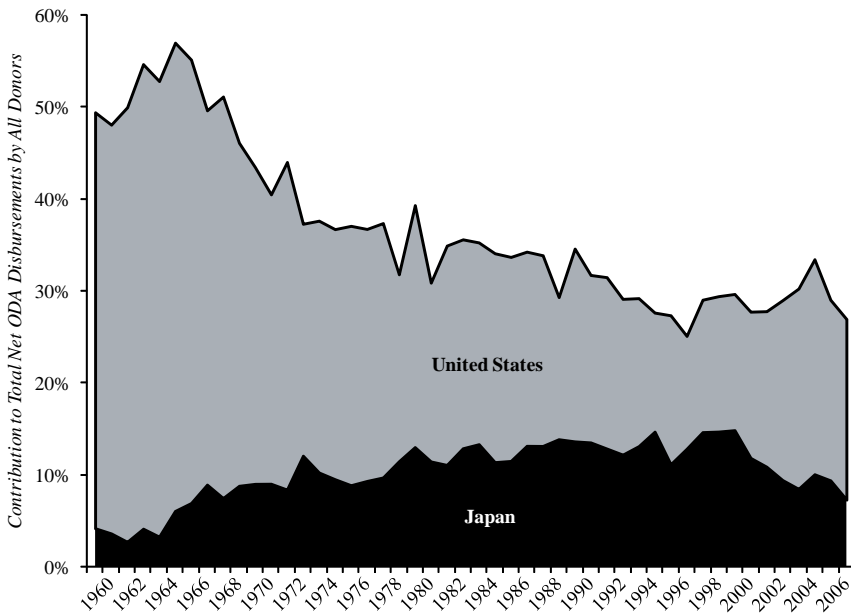


Figure 1. Contribution of the US and Japan to Total ODA, 1960–2007

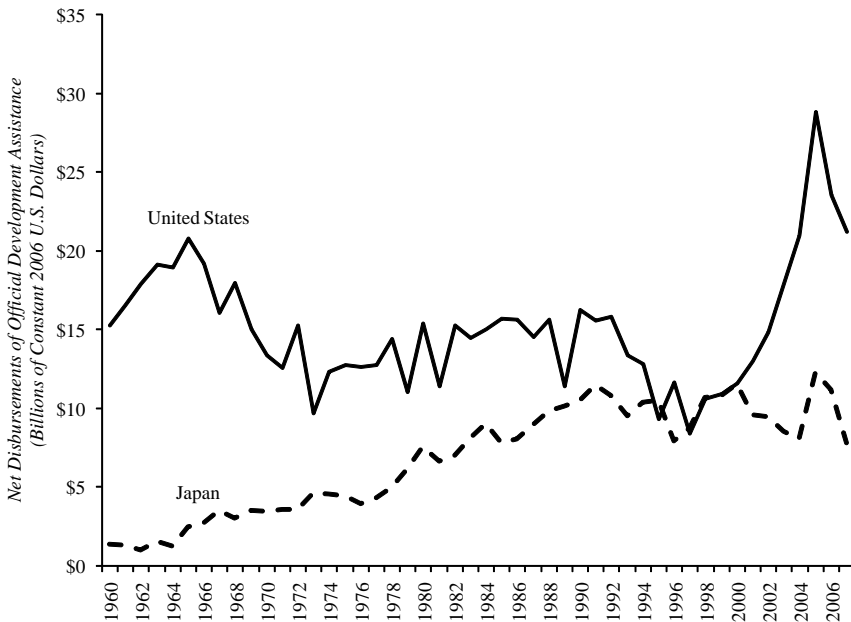


Figure 2. US and Japanese Aid, 1960–2007

These figures represent disbursements of Official Development Assistance: “those flows to developing countries and multilateral institutions provided by official agencies, including state and local governments, or by their executive agencies, each transaction of which meets the following tests: a) it is administered with the promotion of the economic development and welfare of developing countries as its main objective; and b) it is concessional in character and conveys a grant element of at least 25%” (DAC, 2008b).

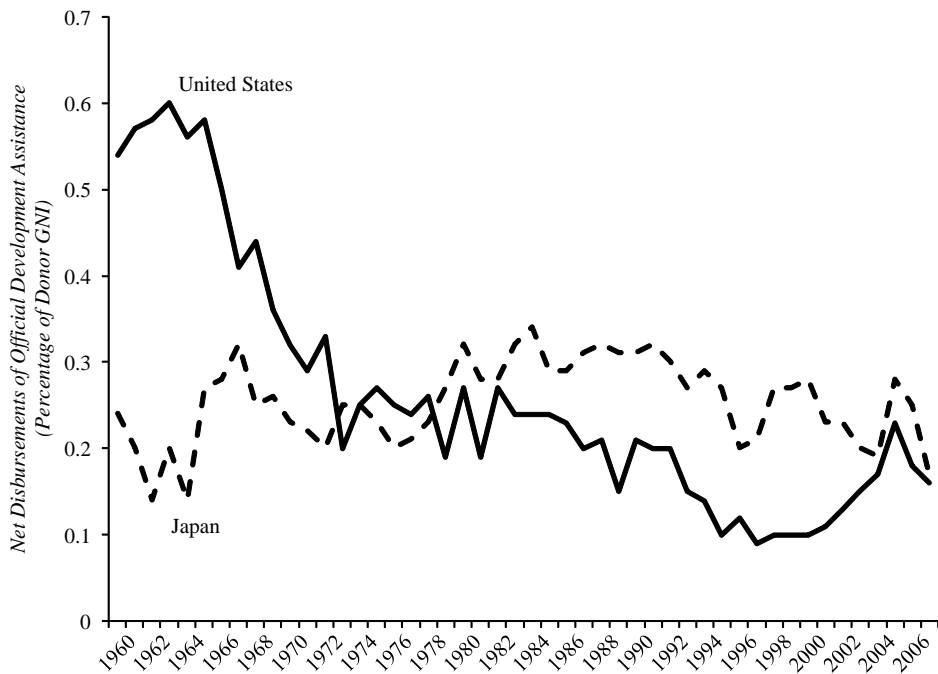


Figure 3. US and Japanese Aid as a Percentage of GNI, 1960–2007

this time, conflicts in Korea and Vietnam were revealing Southeast Asia as a vital strategic front in the Cold War. Thus, as the Japanese economy recovered, the US pressured Japan to move beyond reparations to a full foreign aid program for the region. Japan responded with large aid packages for Korea, Indonesia, and the Philippines.

The particular strategic rationale behind US and Japanese ODA is reflected in a few similarities in their patterns of giving. For instance, both countries have historically preferred bilateral aid which gives them more control.² The breakdown of aid into bilateral and multilateral is presented in Figure 4 for the US and Figure 5 for Japan. Yet, in most respects, the US and Japan give aid very differently. Japan had its own reasons for accepting “Cold War burden-sharing” reasons that reflected Japan’s unique historical experience and its political economy. In fact, from the 1970s, aid became an increasingly central ingredient of Japan’s foreign economic policy. Aid to her resource-rich neighbors allowed Japan, which lacked natural resources, to secure raw material imports, and also supplemented its export-led development strategy by developing new markets for Japanese construction and engineering projects.³ Later, in the 1980s, the old export promotion approach was replaced by support of Japanese FDI in manufacturing, for which ODA was also useful.⁴

²The US has historically preferred bilateral aid despite its overwhelming influence over the resource commitments and development agendas of the multilateral institutions, and even though aid given through multilateral institutions has proven easier to coordinate with aid from other donors and is usually less politically suspect to recipients.

³See, for example, Doss (1996). Ensign (1992) estimates that more than half of Japanese aid from 1966 to the 1980s was for infrastructure, and that the relevant contracts were overwhelmingly given to Japanese engineering firms.

⁴On the shift in focus, see Arase (1994).

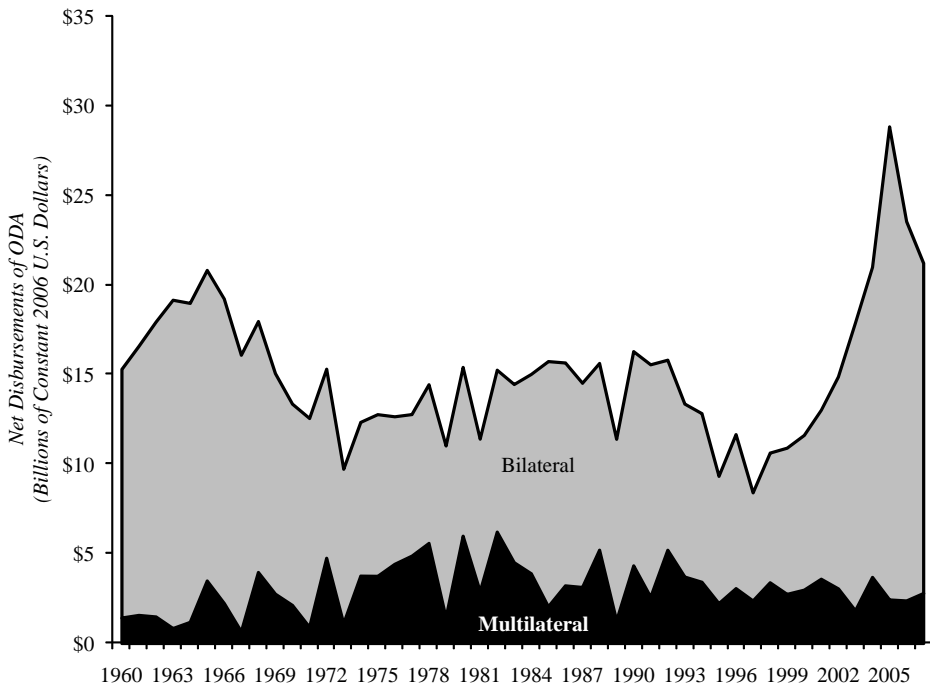


Figure 4. Breakdown of Total US Aid Disbursements between Bilateral and Multilateral, 1960–2007

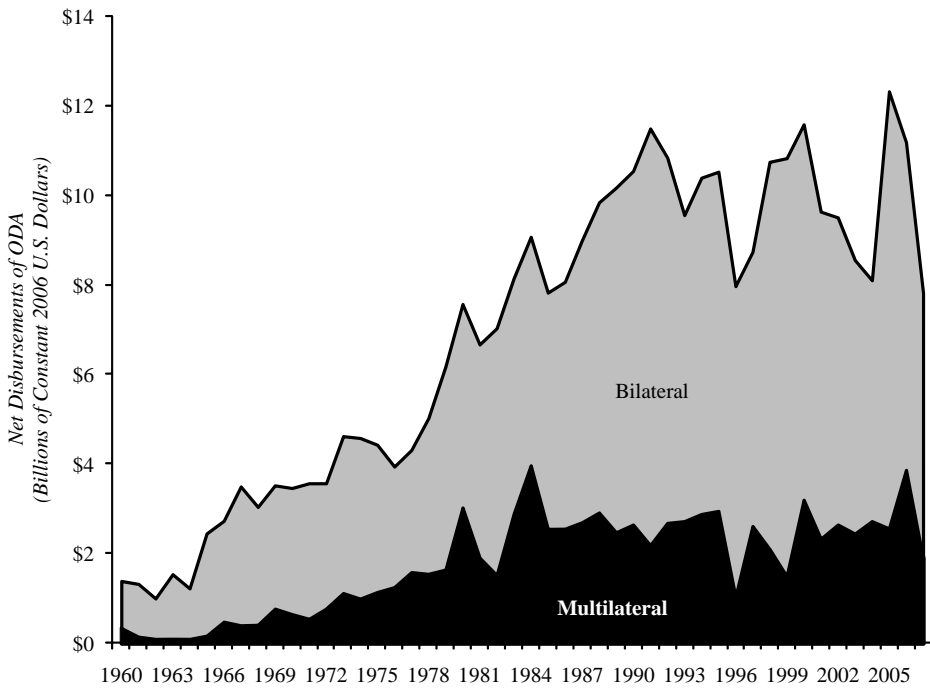


Figure 5. Breakdown of Total Japanese Aid Disbursements Between Bilateral and Multilateral, 1960–2007

These additional reasons for Japanese giving were reflected in patterns that were very different from the US's. In the remainder of this section we highlight four areas of divergence: in the preference of each for program versus project aid, in the sort of projects or program each funded, in the preference of each for giving aid in the form of loans or grants, and, finally, in the degree of “tying” aid to domestic purchases. In Section 2.2 we delve more deeply into the intellectual roots of these divergences.

Japan, in contrast to the US, traditionally preferred to fund specific projects rather than programs. Project aid often made use of politically powerful Japanese engineering firms whose influence was crucial to the continuing Diet approval of aid allocations. Also key to this preference was undoubtedly Japan's post-war development experience, in which large infrastructure projects played a key role. The US, by contrast, has been more willing to utilize fast-flowing program assistance, evident by its support of conditionality-laden Structural Adjustment Loans (SALs). The breakdown of the two countries' aid commitments between program and project aid over time is shown in Figure 6 for Japan and Figure 7 for the US.

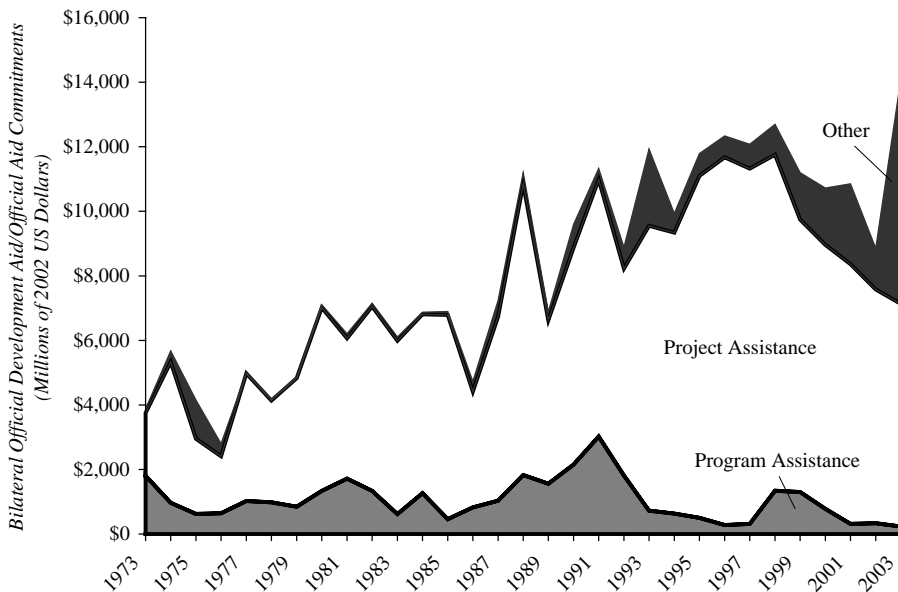


Figure 6. Breakdown of Japanese Aid Commitments into Project and Program Assistance, 1973–2003.

In Figures 6 and 7, “Program Assistance” represents “all general developmental contributions other than debt reorganization, made available with no pre-imposed sector allocation, e.g., balance of payments and budget support and funds made available for capital projects at the recipient’s choice, but not subject to agreement by the donor. This item includes, in particular, sector-unallocated “structural adjustment assistance”; “Project Assistance” represents aggregation across sectors of “individual projects notified under the Creditor Reporting System” [authors’ calculations]; and “Other” represents the aggregate of “Action Relating to Debt”, “Emergency Assistance”, and aid that is “Unallocated/Unspecified,” according to OECD/DAC definitions (DAC, 2005). These figures were created using the accounting under a version of the Creditor Reporting System that has since been discontinued, hence the figures are only available through 2003, and differ slightly from other figures using OECD/DAC data.

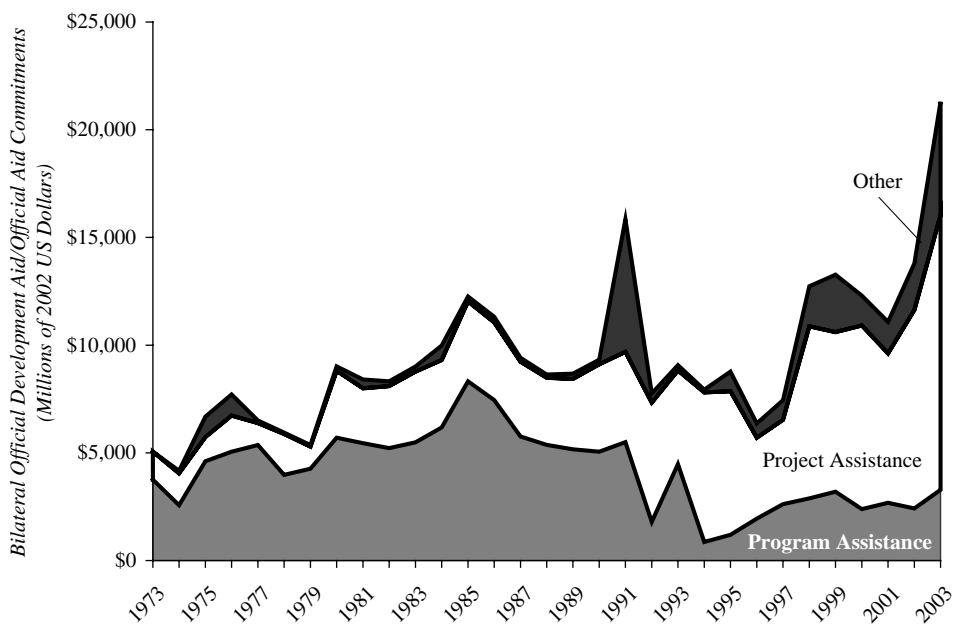


Figure 7. Breakdown of US Aid Commitments into Project and Program Assistance, 1973–2003

A related area of contrast between the US and Japan is over the *type* of projects each donor has tended to finance. The largest proportion of US aid has gone into the so-called social sectors — education, health, water and sanitation — reflecting a bias toward providing “basic needs” and promoting “human development.” By contrast, the influence of Japan’s own post-war experience, plus its powerful engineering lobby, made for a natural preference for large infrastructural projects in energy, transportation, and communications, as well as in some directly productive sectors: agriculture and fisheries, industry, mining, construction, trade and tourism.

Japan also had institutional differences with the US style of giving. Japan has always lagged far behind the US and its thousand-strong USAID missions, and thus has traditionally lacked the expertise for country-wide or even sectoral analysis, which requires in-country expertise to formulate macro strategies. Moreover, Japan’s relatively inflexible single-year budgeting system renders it extremely difficult for longer-term commitments to programs or even to sectoral project bundles. Figures 8 and 9 show the sharp contrast in the sectoral breakdown of US and Japanese aid commitments.

The third area of divergence is in the preference for giving aid as loans or grants. The breakdowns are shown in Figures 10 and 11. Figure 11 shows a clear US preference for grants over loans. Japan prefers loans (Figure 10) although these loans have generally been highly concessional, with an average grant element of 58% since 1973.⁵ This preference is based largely on the logic that, when countries know they are required to repay, they are more likely to allocate resources carefully.

⁵ DAC (2005). Authors’ calculations from loans reported in the DAC Credit Reporting System. The grant element measures the conditionality of a loan by “present value of an interest rate below the market rate over the life of [the] loan”.

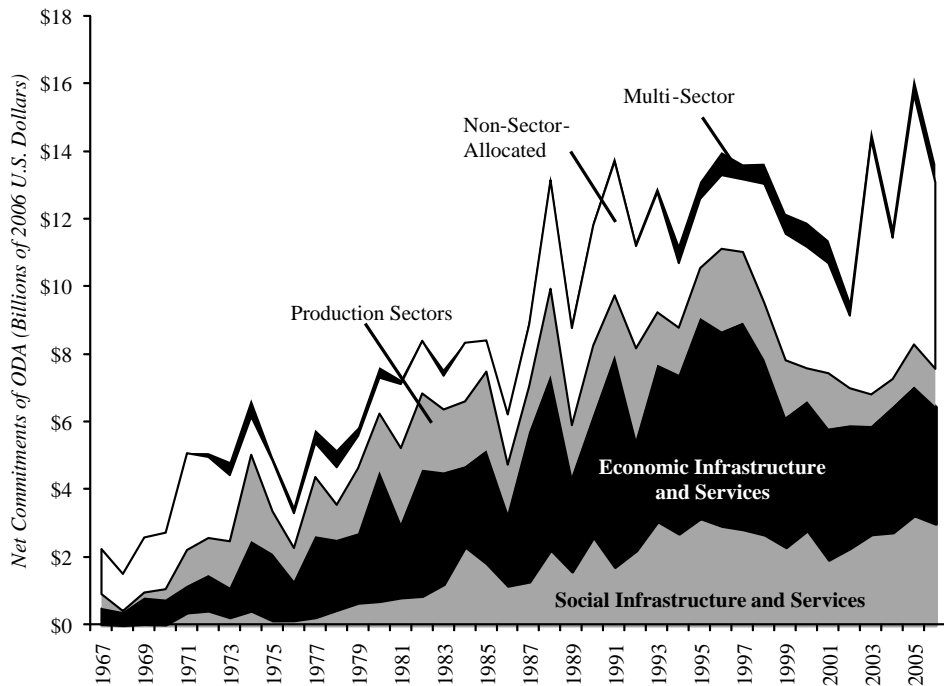


Figure 8. Breakdown of Japanese Aid Commitments by Sector, 1967–2006

Data are commitments, not disbursements. “Production Sectors” aggregates “contributions to all directly productive sectors”, comprising “Agriculture, Manufacturing, Trade, Banking and Tourism”; “Economic Infrastructure” aggregates “assistance for networks, utilities and services that facilitate economic activity”, including among others, “Energy, Transportation and Communications”; “Social Infrastructure” aggregates “efforts to develop the human resource potential and ameliorate living conditions in aid recipient countries”, including among others, “Education, Health, Water Supply” and “Multisector” comprises “support for projects which straddle several sectors, with a concentration on the environment, gender projects and urban and rural development” (DAC, 2008a). “Non-Sector-Allocated” is aid that does not fit into one of the sectoral categories, including commodity aid, action relating to debt, emergency assistance, administrative costs, support to NGOs, and unallocated or unspecified aid.

The fourth and final area of divergence is in the degree to which each country “tied” its aid to domestic purchases. Both countries are naturally under political pressure to retain the support of their exporters. In the US this pressure has translated into the tying of most aid to the purchase of US goods and services — thereby reducing its value by an estimated 15%. In fact, in 1996, under pressure, the US simply stopped reporting the tied percentage of its aid — despite formally agreeing to the OECD’s Development Assistance Committee’s (2001) “Recommendations on Untying ODA to the Least Developed Countries”. In the immediate post-war years, Japan too tied much of its aid, as a way of increasing the benefit to her engineering companies.⁶ But, with time, as Japan faced international pressure

⁶See Arase (1994).

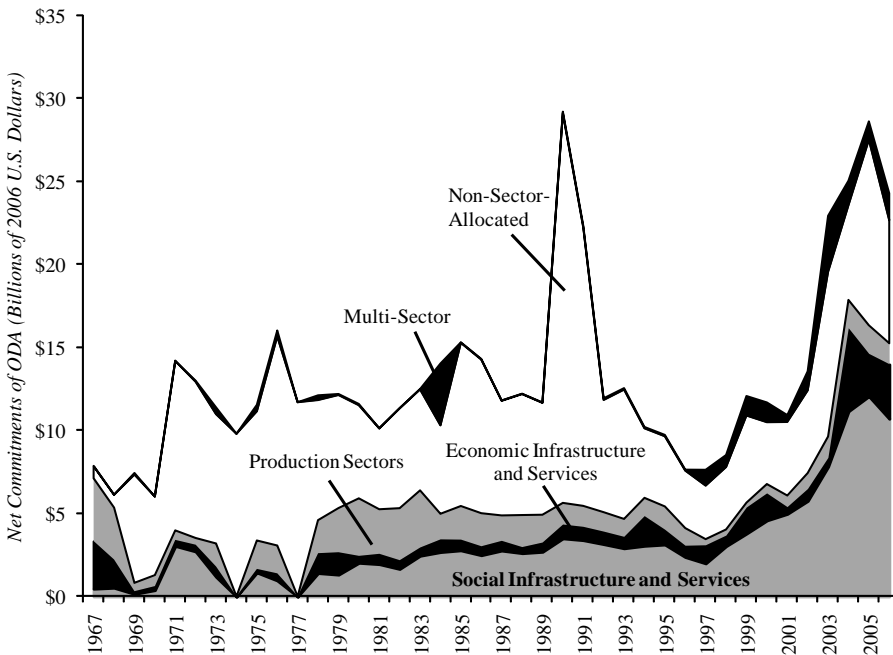


Figure 9. Breakdown of US Aid Commitments by Sector, 1967–2006

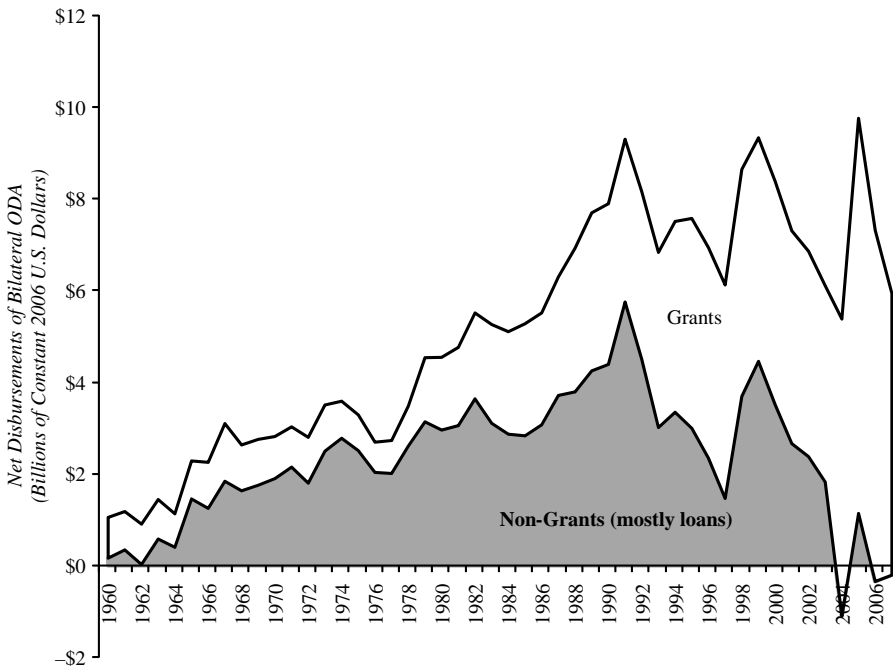


Figure 10. Breakdown of Japanese Bilateral Aid into Grant and Non-Grant, 1960–2007

“Non-Grant” ODA is mostly loans by government, but also includes equity acquisition, debt reorganization, and “other” non-grant ODA.

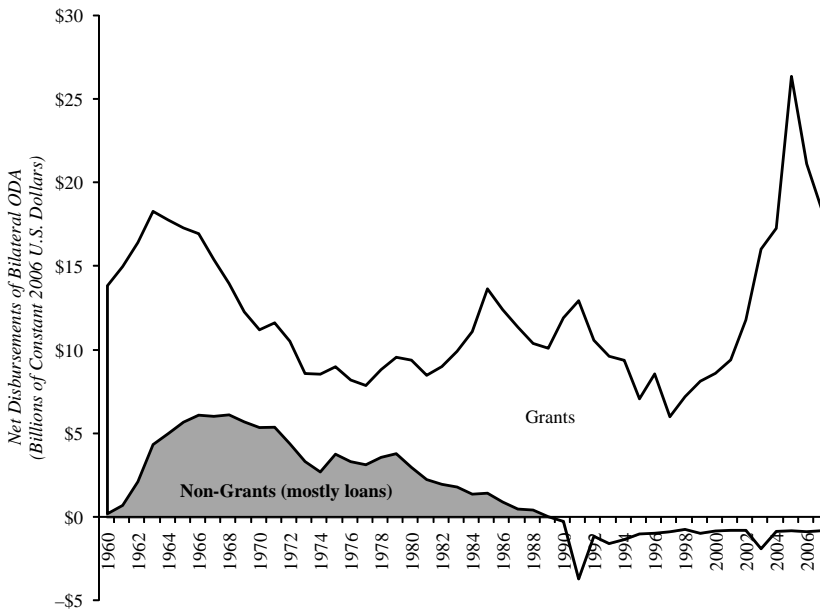


Figure 11. Breakdown of US Bilateral Aid into Grant and Non-Grant, 1960–2007

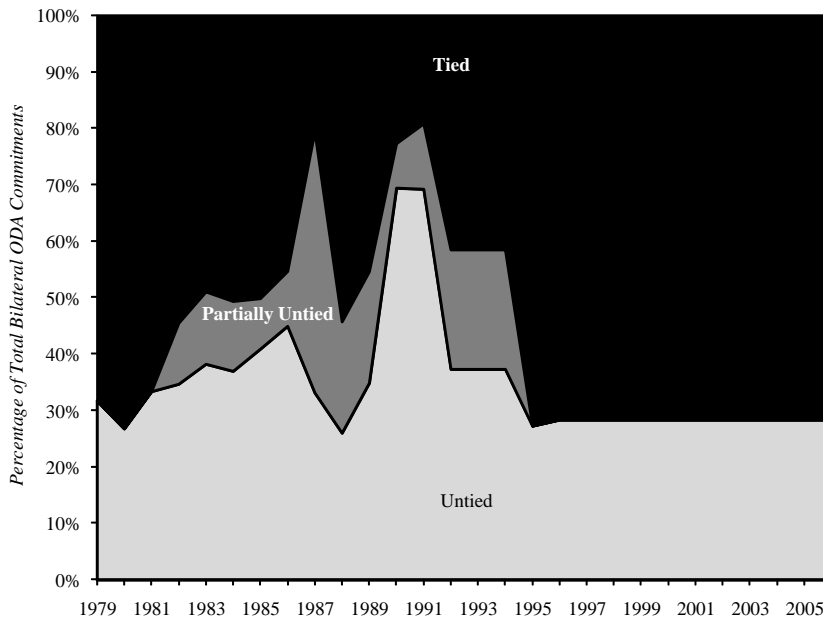


Figure 12. Percentage of US Aid Tied or Untied, 1979–2006

Because the US has not reported tying data since 1996, this figure assumes the same ratio of tied, partly untied, and untied aid from 1996 to 2005. Data in this figure and Figure 13 for Japan represent ODA commitments (not disbursements), excluding administrative costs and technical cooperation — items OECD/DAC members have agreed to disregard in calculating tying data. “Partially Untied” aid represents “the amount of [a] transaction which is in effect tied to the procurement of goods and services from the donor country and from a restricted number of countries which must include substantially all developing countries”. (DAC, 2008a)

to reduce its massive trade surpluses,⁷ the tied percentage of Japanese ODA declined. By 1997, only 0.05% of Japanese aid was even partially tied, and none was fully tied. Figures 12 and 13 compare the percentages of US and Japanese aid tied or partially tied.

2.2. *The intellectual divergence*

The aforementioned divergence in US and Japanese ODA patterns was a partial reflection of differences in US and Japanese attitudes concerning the ideal role of development assistance, rooted in the very different development models that prevailed in Washington and Tokyo. Yet, at least until very recently, Japan's hesitancy in pushing its intellectual position onto the international agenda meant that the US position remained dominant. Historically, Japan has generally accepted, if grudgingly, US intellectual leadership on aid.

Japan's posture stemmed from a reluctance to be interventionist in countries still smarting from their World War II experience, and from Japan's own post-war domestic economic policies, which were based on directed credit, selective assistance to promising industries, and heavy investments in infrastructure. The US, on the other hand, has until quite recently favored aid that is interventionist: it has often come with the requirement that recipients hew to certain policies. These requirements were developed centrally, based on the development thinking in vogue at the time, and applied with only moderate variability to different countries and contexts.

This issue of conditionality reflects the biggest historical differences between the philosophies of aid of the US and Japan. US aid has traditionally come with conditions attached, intended to improve the quality of recipients' behavior — though in practice the aid was generally given regardless of whether or not the recipient met these conditions (see [Ranis, 1996](#)). Japan, on the other hand, was and remains skeptical of “one-size-fits-all” Washington Consensus prescriptions⁸ and was especially reluctant to be interventionist in Southeast Asia, where it gave most of its aid. Japan's emphasis was on self-help and “request-based assistance”, which allowed it to minimize intervention in the domestic politics and policies of recipients, while still directing assistance to countries that Japan could assume were already self-motivated to help themselves.⁹ Japanese rhetoric on aid thus has always emphasized the importance of countries taking true “ownership” of their development programs — in contrast to the US and the International Financial Institutes (IFIs), who have only rediscovered the principle recently.

The Washington Consensus, as its name suggests, reflected the thinking among mainly US economists, and, unsurprisingly, Japan has found fault with it. Like other critics, the Japanese saw it as an unduly rigid program, applied wholesale to countries with widely varying situations, without sufficient regard for the costs imposed on its intended beneficiaries. Yet despite its grave reservations, Japan chose not to enter the debate forcefully.

⁷ It is worth noting that the economic arguments for aid-tying as a way to help a country's trade balance do not really hold water, though the issue remains highly salient politically.

⁸ The ten policy prescriptions are: fiscal discipline; redirect public expenditure; tax reform; financial liberalization; adopt a single, competitive exchange rate; trade liberalization; eliminate barriers to foreign direct investment; privatize state-owned enterprises; deregulate market entry and competition; ensure secure property rights ([Williamson, 1990](#)).

⁹ See [Takahashi \(2005\)](#).

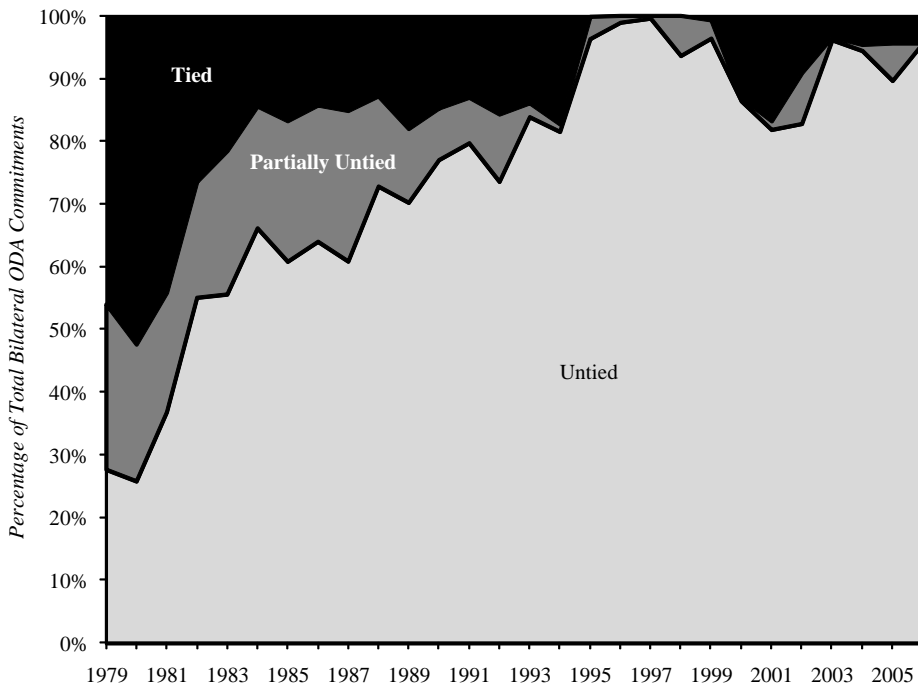


Figure 13. Percentage of Japanese Aid Tied or Untied, 1979–2006

Instead it offered its critique quite meekly in 1991, when the Overseas Economic Cooperation Fund (OECF), then Japan’s main aid agency, published its Occasional Paper #1 — the first such in its 30-year history. The paper criticized the Consensus’s excessive emphasis on market-oriented approaches, which seemed contrary to the lessons of Japan’s own post-war experience.¹⁰ Japan followed up this critique in public statements¹¹ and by advocating — and paying for — the World Bank’s high profile *East Asian Miracle* study, which was intended to provide theoretical and empirical support for an alternative development model. Yet Japan failed to follow up these critiques with detailed, continuous policy engagement. While striking a mildly critical posture, it did not try to mobilize its own intellectual firepower to match the powerful intellectual forces in Washington. Instead it continued, as in the past, to grudgingly follow the US’s lead on basic ODA and development policy.

In our view, this hesitancy is disappointing. In the first place, Japan potentially has a great deal to contribute to the debate. For instance, from its own pre-war historical experience, Japan had unique reasons for disagreeing with the Consensus, particularly its preference for government-led industrialization and its opposition to financial liberalization

¹⁰The report noted that: “Japanese fiscal and monetary policies in the post-war era...were centered on preferential tax treatment and development financial institutions’ lending” (OECF, 1991).

¹¹ Yasushi Mieno, then head of the Bank of Japan, added to this line of criticism at the Annual Meeting of the World Bank and the IMF in 1991: “Experience in Asia has shown that, although development strategies require a healthy respect for market mechanisms, the role of the government cannot be forgotten” (World Bank, 1991).

in the early stages of development when financial systems are generally still underdeveloped.¹² Second, while the Washington Consensus certainly deserved some of the criticism Japan offered, it was, in practice, not nearly as rigid as the Japanese seem to have assumed. While US advisors would often enter different contexts with the same paradigm in mind, the messiness of any individual situation would inevitably alter, often drastically, the application of policies so that two countries ostensibly undergoing Washington Consensus policy adjustment actually exhibited far greater differences than similarities.¹³ Thus both sides might have benefited if Japan recognized the fallacies of its assumptions about the Consensus, and entered the debate more actively, with confidence in the value of its own experience and perspective.

More recently, however, there are signs that this hesitancy may finally be waning. Japan seems to have taken small steps to increase both its intellectual firepower and its constructive engagement with the international aid community. Simultaneously, recent shifts in the strategic and intellectual landscape in the US have pushed Washington closer to the Japanese model.

2.3. Convergence

With the end of the Cold War, much of the strategic rationale for aid seemed, for a time, to evaporate. Peace and prosperity lulled many in the OECD countries into thinking that they had little to gain, strategically or economically, by assisting the development of the world's poorer countries. The residual moral argument — that rich countries have a duty to help the poor — was never an easy sell to voters who doubted aid's effectiveness and had no trouble thinking of better uses for their taxes.

In Japan, three decades of steady increases in aid came to a halt in 1990 (Figure 2). The end of the Cold War offered Japan the opportunity to reduce US influence and begin to assert itself as a development leader in its own right. But Japan had other higher priority concerns. It faced a sustained recession in the 1990s, a recession made all the more daunting by a large budget deficit and ballooning obligations to an aging population. Moreover, as most donors were cutting back on their aid, the sentiment among Japanese that a generous aid budget gained a country international respect also waned.¹⁴ In the 1990s, the Japanese aid budget stagnated; as a percentage of Japan's GNI, aid fell by nearly a third between 1990 and 1997 (Figure 3). In recent years this decline has accelerated.

In the US, the cutbacks in the 1990s were even sharper; aid in constant dollars fell by nearly 50% from 1990 to 1997; as a percentage of US GNI, it fell by 57% (Figure 3). But, unlike in Japan, in the US this decline had a definitive end: September 11, 2001. On that day, the strategic rationale for aid made an abrupt reappearance. Aid for development played a starring role in the much-publicized US National Security Strategy Memorandum

¹²Other particular concerns Japan had with the Washington Consensus were that it failed to appreciate the effect that adjustments can have on development, nor to take sufficient account, right from the start, of important institutional differences among countries, even if the problems each faced were broadly similar.

¹³Indeed, many of the most important prescriptions, such as those related to foreign capital controls or exchange rate regimes, were, in their implementation, characterized by more heterogeneity and flexibility than is usually allowed (see, for example, Naim, 1999).

¹⁴See Akiyama and Nakao (2005).

issued later that year, in which development was elevated to one of the three pillars of US foreign policy, alongside diplomacy and defense.¹⁵ Beginning at Monterrey, Mexico, in March 2002, the Bush Administration pledged substantial additional resources to fight AIDS and other diseases in Africa (PEPFAR), as well as poverty around the world with \$5 billion annually for at least three years to fund the newly created Millennium Challenge Corporation (MCC). In fact, US aid increased substantially between 2001 and 2005, more than doubling, in constant dollars, to nearly \$30 billion (2006 dollars; see Figure 2). It has since fallen back to \$21 billion in 2007.

There has also been a shift by the US in focus and on institutions that have rather unexpectedly brought the US closer to Japan's position. At the same time, several important developments in Japanese aid — a move away from loans for infrastructure projects toward grants, an acceptance of poverty reduction as an important goal for aid, and an increasing, if still limited, willingness to engage constructively with the international community on aid — have moved Japan closer to the US. The result, in our view, is a significant, if incomplete, convergence between the two donors — even if neither side seems fully aware of it.

2.3.1. *The Millennium Challenge Corporation and the US shift to non-interventionist aid*

The major shift on the part of the US is a move away from interventionist aid. Traditionally, this is Japan's predisposition, while the US has been more pessimistic about the ability of countries to act in their own interest and more willing to intervene as a consequence. But US attitudes on conditionality seem to have shifted in recent years. In tacit acknowledgment that conditionality, at least as practiced during the Structural Adjustment Loans (SAL) and even in the recent Poverty Reduction Strategy (PRSP) era, hasn't worked, the US is increasingly shying away from *ex ante* conditionality to rewarding already well-behaved recipients.

This shift has brought the US closer to the Japanese position. A good illustration of this partial convergence is the Millennium Challenge Corporation, the biggest new US aid initiative. The MCC's structure reflects a belief that the only aid that will work is aid to countries that have already demonstrated past progress toward good governance, sound economic policies, and resulting improvements in levels of health, education, etc. Eligibility for MCC funding is based on two sets of criteria, one of which is that the recipient must pass muster on 16 indicators of past performance in three categories: "ruling justly", "practicing economic freedom", and "investing in people".¹⁶

¹⁵The new strategic rationale for aid was supplemented by high-profile, humanitarian-oriented lobbying by Irish rock star Bono, as well as prodding from the UK's Tony Blair, who used the UK's position as an ally in the Iraq War to push the US to increase its aid budgets.

¹⁶The sixteen indicators (and their sources) are:

- (1) **Ruling Justly:** Control of Corruption (World Bank Institute, WBI); Rule of Law (WBI); Voice and Accountability (WBI); Government Effectiveness (WBI); Civil Liberties (Freedom House); and Political Rights (Freedom House);
- (2) **Investing in People:** Immunization Rate: DPT and Measles (WHO); Girls' Primary Education Completion Rate (World Bank); Public Primary Education Spending/GDP (World Bank); Public Expenditure on Health/GDP (World Bank); and
- (3) **Economic Freedom:** Cost of Starting a Business/GDP per capita (World Bank); Previous Year's Inflation (IMF); Three-Year Budget Deficit (IMF); Days Required to Start a Business (World Bank); Trade Policy (Heritage Foundation); and Regulatory Quality Rating (World Bank Institute).

The MCC seems to reflect a new paradigm in Washington, which might be summed up as follows: after decades of disbursing aid to countries on the promise of future reforms — but generally disbursing the aid regardless of whether the country actually adopted these reforms — the US seems to have concluded that aid simply cannot influence countries that are not already committed to helping themselves. Thus, instead of providing resources to encourage conditions to be met, the MCC is supposed to disburse only to countries where the conditions have already been met.¹⁷

While this philosophy is much closer to the Japanese position it is not a complete embrace, and in fact, the Japanese have generally been critical of the MCC. In their view, the MCC's requirements are as burdensome as any past conditionality, even if the point is to offer *ex post* rewards rather than requiring reforms *ex ante*. Moreover, they note that the implied severe selectivity eliminates the consideration of assistance for many countries that are desperately in need of it (Sunaga, 2004). It is also worth pointing out that the reality of the MCC has seemed to deviate somewhat from the rhetoric so far — though the program may still be too young to be accurately assessed.¹⁸ First, although the MCC criteria are theoretically objective and apolitical — and strategic only in the sense that they seek to direct aid only to where it will do the most to fight poverty, and thereby terrorism — in practice the US still does not seem to be able to keep itself from applying exceptions to its own rules, particularly in returning to its old habit of favoring its strategic allies.¹⁹ Second, although the initial idea for the MCC was to assist countries in continuing to do more of the good things, the MCC has so far preferred funding specific projects, rather than offering budgetary or program support — a shift that is likely a concession to Congress, which prefers that the products of US aid be easily identifiable. Sectorally, the grants are heavy on growth-inducing rural development, particularly agriculture and transportation; there is little emphasis on support for technology, health, and education, which were the focus of President Bush's announcement of the MCC. And, while the MCC grants were supposed to move fast enough and be large enough to induce those who are yet to qualify to change their behavior,²⁰ in reality the MCC has been very slow in disbursing resources.²¹

Yet, despite these continued disagreements and the gap between the MCC's rhetoric and reality, its establishment illustrates some convergence between the US and Japan. Moreover, the MCC is not the only area where this is apparent. Japan has also been

¹⁷ It is worth noting that while this philosophy takes the burden off the US to back up conditionality with credible threats to curtail aid, it also deprives the US of the possibility of affecting future outcomes in positive directions.

¹⁸ The MCC got off to a slow start. As late as 2005, it had signed compacts with only five countries, amounting, in total, to little more than a billion dollars over five years — a far cry from the nearly five billion dollars annually President Bush promised when he proposed the new institution in Monterrey in 2002.

¹⁹ For example, in 2006, the Board selected 18 out of the 26 “Low-Income” countries and two of the eight “Lower-Middle-Income” countries that passed the indicators as “eligible”, but it also selected three countries that did not pass the indicators (Herrling *et al.*, 2006a). A prime example of politics entering the MCC's decision-making process is Jordan. In November 2006, Jordan was deemed eligible to begin negotiating a compact, even though it did not really pass the indicators test, while better-performing countries in the same income category, like Brazil, Bulgaria, and Samoa, were passed over — a decision likely based on pressure to aid Jordan as an important regional ally, even though it is already one of the largest recipients of traditional US ODA (Herrling *et al.*, 2006b).

²⁰ Indeed, there was initially a concern that the grants would be *too* large (see Clemens and Radelet, 2003).

²¹ For more on the MCC's beginnings with particular reference to the points in this paragraph, see Rieffel and Fox (2005).

altering its aid delivery in ways that bring it much closer to the US. Recent years have seen Japan shifting from infrastructure to sectoral aid, with both donors moving from loans to grants — a break from the past, especially for Japan (Figures 10 and 11). The US began this shift earlier and is on record urging other donors and the International Financial Institutions to do the same.²² Even US loans have had an average grant equivalent of 59%, barely edging out the Japanese,²³ and in recent years the US has received more in repayments on past loans than it has provided in new loans, rendering its net loan contribution negative.

Japan's shift to grants has been slower, but by 2004 its net loan contributions were also negative (Figure 10). The biggest reason for Japan's shift away from loans is that Asian recipients have begun to increasingly object to the conditionality they see linked to loans, an objection to which Japan, a country reluctant to be seen as interventionist, paid special heed. But there are clearly other factors at play as well. In part, Japan may be responding to the growing consensus that loans simply burden future generations and lead to continued pressure for additional debt relief. There is also the more mundane concern, that loans are often not repaid (see Iimi and Ojima, 2005). On the other hand, there is always the danger that an increased reliance on grants will reduce future resource availabilities which depend, in part, on debt repayments. Indeed, since the mid-1990s, Japan has received more than \$2 billion (in 2004 dollars) annually in interest on development loans. In the coming years, increasing debt service repayments from China, Thailand, Malaysia, and Indonesia, among other mostly Asian countries, are likely to further reduce the net level of Japan's ODA. As its aid budget declines, the Japanese government has rhetorically pushed the theme of a "shift from quantity to quality". But to date it is hard to detect major policy shifts in that direction.

From the mid-1990s, Japan began to converge with the US in another area as well: the sectoral allocation of its aid. Japan appears to have recognized the limits of infrastructural investments not accompanied by institutional changes and improvements in human development. Thus, Japan has lately appeared more amenable to poverty reduction as an appropriate goal for aid, in contrast to its traditional focus on economic growth.²⁴ In addition, Japan gradually seems to have come to realize that its large volume of projects, suffering from inadequate coordination with other donors, had become excessively costly and inefficient. Instead, Japan appears to increasingly favor a more sectoral approach to aid. For example, the JBIC now uses Sector Program Loans, Commodity Loans, and Structural Adjustment Loans. After 1998, Japan's Ministry of Foreign Affairs pushed for a "sector/non-project grant" instrument. By 2006, the proportion of Japan's bilateral aid commitments allocated to "economic infrastructure" had fallen to 25%, down from 45% in 1997 (Figure 8).

²² In a speech at the World Bank in July 2001, President Bush urged "the World Bank to provide up to 50% of its assistance to the world's poorest nations in the form of grants rather than loans".

²³ DAC (2005), authors' calculations. See footnote 5.

²⁴ Although Japan now acknowledges the goal of poverty reduction, it continues to believe that economic growth ultimately is the best poverty reduction strategy (Shiokawa, 2003). For example, a 2003 statement by Zembei Mizoguchi, Vice-Minister of Finance for International Affairs of Japan, to the 68th meeting of the World Bank and IMF Joint Development Committee, argued that "economic growth is essential for poverty reduction" (Mizoguchi, 2003).

As the composition of Japanese aid has moved closer to the US's, Japan has also shown itself to be increasingly willing to work with other donors and participate intellectually in international debates about foreign aid. We noted in Section 2.2 the disappointing hesitancy with which Japan presented its blanket criticism of the Washington Consensus. But in two more recent developments in the international aid arena — the adoption of “Poverty Reduction Strategy Papers”, or PRSPs, and the Millennium Development Goals, or MDGs — the signs are that Japan has become more interested in constructive engagement.

PRSPs were adopted by the World Bank and the IMF following widespread appreciation in Washington that two decades of structural adjustment programs had been largely unsuccessful, and, in many cases, had prevented developing countries from exercising effective control over their own economies. In theory, PRSPs were to be more country-driven, an effort to give countries real “ownership” over their policies and resource allocation decisions, including all aspects of society — economic and political — in the context of a single, comprehensive, long-term anti-poverty strategy. That is the theory; in practice, PRSPs have probably done little to enhance the empowerment of developing countries or to tailor aid programs more closely to specific country needs.²⁵

Japan's reaction to PRSPs has decidedly been more positive than to structural adjustment lending. In 2000, in order to make better use of PRSP guidelines in reforming Japan's own aid programs, JICA established study committees to review its activities in various countries, and in 2001, Japan's Ministry of Foreign Affairs explicitly endorsed a multi-lateral engagement with the PRSPs: “We must pay more attention to the PRSPs. It is desirable that the PRSP should serve as development guidelines shared by all donors” (MOFA, 2001). In 2004, Japan's Finance Minister went so far as to recommend to the World Bank and IMF that they use PRSPs as a starting point for a general improvement in the quality of aid (Tanigaki, 2004).²⁶

Signs of Japan's increased engagement are also apparent in Japan's involvement with the Millennium Development Goals (MDGs).²⁷ Major elements of the goals played a prominent role in revisions Japan made to its ODA Charter in 2003 — though the Charter does not explicitly name them. Still, the MDGs emphasize far more uniformity among countries than the PRSP process, and, not surprisingly, Japan has been critical of this aspect, noting that the MDGs appear to allow for little heterogeneity among countries,

²⁵Analysis by Stewart and Wang (2005) demonstrates that PRSPs, in fact, continue to be largely driven by country perceptions that, in order to get funding, they need to propose packages focused on the sort of market-centered policies that Washington institutions prefer. Therefore, they vary little across countries. Indeed, Stewart and Wang argue that PRSPs may have paradoxically *increased* the relative control of Washington over the development strategies of many poor countries because the claim that PRSPs now insist on country ownership obscures their continued relative uniformity. See also Ranis and Stewart (2001) for a discussion of PRSPs in the context of the HIPC initiative.

²⁶Perhaps sensing the possibilities for more constructive engagement on its part, Japan has lately emphasized donor coordination of aid. Like the US, Japan was involved in, and a signatory to, the 2005 Paris Declaration on Aid Effectiveness, which stresses “Ownership, Harmonization, Alignment, Results, and Mutual Accountability”.

²⁷The eight millennium goals are to: eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality and empower women; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria, and other diseases; ensure environmental sustainability; and develop a global partnership for development. Each of the goals is associated with one or more specific targets, to be achieved by 2015.

conditions, or priorities. Yet Japanese officials did try to critique the goals constructively, arguing for “localization” of the MDGs to fit conditions on the ground, and offering PRSPs as a possible starting point for such an effort (see, e.g., [Tanigaki, 2004](#)).

2.3.2. Reading the tea leaves

The multiple convergences that have just been outlined have led both the US and Japan toward a middle ground that, in our view, is more effective than the Cold War model — though there is still much room for improvement. Although the US is still clearly the dominant partner, the new paradigm seems to accept lessons from the other side’s viewpoints, and has ended up being less interventionist and more focused on human development. The real danger is that, given the current global economic malaise, both countries will be reducing the quantity of aid. Moreover, if current moves on the quality side are any indication, both countries seem to be moving towards aid structures which are both leaner and possibly more focused on short-term foreign policy goals, to the detriment of aid effectiveness.

In the US, substantial reorganization has occurred. Both the US Agency for International Development (USAID), started in 1961, and the newly-initiated MCC, are now under a new Director of Foreign Assistance in the Department of State who simultaneously serves as the Administrator of USAID. Other smaller programs within the Department of State, 18 in total, were to be integrated to enhance the governance and effective use of aid.

This reorganization has left out some important issues. The proliferation of smaller aid programs in many of the US line ministries, initiated in the Clinton years and causing much overlap and confusion in recipient countries, has not been addressed. Nor has the accumulated number of barnacles or Congressional earmarks in the Foreign Assistance Act which have substantially impeded USAID’s efficiency in the past.

In short, past reorganization efforts may well enhance efficiency but are also likely to emphasize short-term political as opposed to longer-term development objectives. The first signs were already apparent in the Bush Administration’s budget request for 2008: USAID’s Development Assistance money is down by almost a third, while the politically-focused Economic Support Fund went up by nearly a third. It remains to be seen whether the Obama administration, which emphasized a renewed focus on development assistance during the campaign, will reverse this trend.

In Japan, aid did not experience a similar boost after 11 September 2001, and Japan’s post-Cold War aid budget has ebbed and flowed. It recovered somewhat in the wake of the Asian financial crisis but fell again immediately thereafter. In 2005, it rose once more, but mainly on the back of contributions to Iraqi reconstruction and \$500 million in donations to the Asian tsunami recovery effort. Since those events, aid has continued to decline consistently, and promises to increase it — such as former Prime Minister Koizumi’s announcement of a three-year, \$10 billion ODA increase at the Hong Kong WTO meeting in December 2005 — have not materialized. Japan’s biggest challenge is to satisfy increasingly skeptical voters and convince them that aid is strategically important. Its recent institutional changes seem geared toward meeting this challenge by increasing

institutional efficiency and integrating Japanese aid more closely with Japanese foreign policy, while also making some efforts to increase Japan's intellectual firepower and engagement with international aid debates.

One implication of Japan's focus on national interest has been the changing regional pattern of Japanese aid in the 1990s. In many respects, Japan's national security and economic and political interests still reside in Asia, and this regional concentration is still recognized in the new Japanese ODA Charter.²⁸ Yet, Japan is also beginning to cast a wider net, significantly reducing its relative contributions to Asia and increasing its relative contribution to regions it has traditionally ignored, such as Africa.²⁹ At the same time, Japan largely ignored US calls for major increases in aid to the newly independent states of Central and Eastern Europe — perhaps a sign of Japan's burgeoning assertiveness.

Japan is currently implementing a series of institutional reforms intended to restructure and rationalize the number of ministries involved in aid-related policy-making. Historically in Japan, unlike in the US, a single ministry or executive agency has not had primary control over development policy; rather, as many as 15 different ministries have been involved. Today, three main ministries vie for control: the Ministry of Foreign Affairs (MOFA), the Ministry of Economy, Trade, and Industry (METI), and the Ministry of Finance (MOF). Their preferences generally follow their jurisdictions. MOFA advocates the use of aid to support Japan's international diplomacy by improving the economic and social conditions of low-income countries. Its increasing influence over aid policy in the 1990s is reflected in the large share of Japanese aid that is now untied (Figure 13). METI's view, in line with business interests, is that aid should be used to promote an expansion of trade and investment opportunities. The influence of METI has somewhat waned in recent years, but it regained some influence during the recent Abe administration, which viewed development assistance more explicitly as an instrument to promote national objectives. Indeed, in recent years, Japan has again begun to tie some of its aid,³⁰ though it still remains at the low end among donors. The third main ministry is the Ministry of Finance, whose interest is far more basic: to maintain fiscal discipline and to use aid to maintain an orderly international financial system. This has led the MOF to push for a decline in the total volume of ODA and argue for limiting the amount of aid allotted to any one country.

The aid bureaucracy is also in flux. Having only recently combined its two main aid agencies, the soft-loan Japanese Overseas Economic Cooperation Fund (OECF) and the hard-loan Export-Import Bank of Japan (JEXIM) under the Japan Bank for International Cooperation (JBIC), Japan further consolidated its loans and grants under a "New JICA",

²⁸ Japan's current ODA Charter dates to 29 August 2003.

²⁹ Japan began to focus more attention on Africa in 1993, at the time when, following the end of the Cold War, international interest in Africa was waning. Japan went in the opposite direction, launching the TICAD (Tokyo International Conference on African Development), which has had success in pushing for an international commitment to the continent based on the principle of African countries "owning" their own development programs. At the third Tokyo meeting of TICAD in 2003, in the company of 23 African heads of state and 22 heads of international organizations, the Japanese government pledged a new era of cooperation in African development.

³⁰ In 1998 in particular, Japan's Bank for International Cooperation (JBIC) established a "special yen loan" — a concessional loan tied to work by Japanese construction companies.

or Japan International Cooperation Agency, traditionally the institution responsible for basic technical assistance and training. As part of this reform, New JICA has formed a “JICA Research Institute” to improve Japan’s capacity for development research.

Also under discussion is the placement of the latter institution directly under the Cabinet Office, with a reduced number of ministries (from 13 down to five) involved, and with the Ministry of Foreign Affairs taking the lead, a potentially important shift that would surely further reorient Japanese aid toward shorter-term foreign policy objectives. However, whether such heavyweight ministries as Finance and METI will really prove willing to concede pride of place to the Ministry of Foreign Affairs remains to be seen. Past reorganizations have often amounted to less than advertised.

Amid much uncertainty, there is the fact that Japan seems to be taking steps to increase its intellectual engagement with the international aid community. Japan has embraced the value of knowledge transfers and is gradually improving her capacity in this arena, using JICA as the main instrument. In 2003, 8,066 individuals from 149 countries and regions took part in JICA’s Technical Cooperation Project in Japan, while another 6,531 participated in the program in developing countries. On the intellectual front, the merger, in 1998, of the Japanese Institute of Developing Economies (IDE; *Asia Keizai Kenkyusho*), with the Japan External Trade Organization (JETRO), has shifted the former’s focus from general economic, social, and political research to the more explicit promotion of trade and economic cooperation. IDE has also established an educational arm — the IDE Advanced School (IDEAS) — to train future scholars in development economics.

Regardless of the precise outcome of Japan’s institutional reforms, the process shows substantial similarities with what is happening in the US. Aid in both countries, as during the Cold War, is again viewed mainly as a political instrument to advance the foreign policy and national security objectives of the donor — objectives which may or may not prominently include economic growth and poverty alleviation in the recipient countries.

3. NGOs and Remittances

The convergence between the US and Japan in official development assistance is not reflected in private flows, both in those that are delivered through NGOs and those sent home as remittances by migrant workers. NGOs account for a miniscule percentage of Japanese ODA, but today deliver a large and growing percentage of US aid — at least 30% of USAID donations. Remittances, which now vastly exceed ODA, follow the opposite pattern; migrant workers in Japan consistently send more money home at lower transactions costs than migrant workers in the US. The following sections examine these patterns and their causes.

3.1. NGOs

The relationship between aid and NGOs is one where there remains substantial divergence between the US and Japan. Japan has little history of private giving, and, despite recent lip service to the value of NGOs by the Japanese government, such activities, after a period of

some growth in the mid-1980s and early 1990s, have remained modest, as has government assistance to them, most of which go to private organizations that are closely related to corporations or government ministries. Contrast this with the US, with its decades-old tradition of private involvement in development activities: in 2005, US NGOs provided more than 30 times as much to the developing world as Japanese NGOs. The relatively minor role played by Japanese NGOs does not necessarily inhibit Japan's aid effectiveness, but the lack of private involvement by Japanese citizens and civil society generally in the country's foreign aid effort undoubtedly affects its waning support among the Japanese public.

NGOs have long been important players on the international stage and have grown increasingly influential since the 1990s, fueled by the assumption that they carry distinct advantages in aid delivery, and a feeling that their roots among both donor and recipient public build support for aid at a time when support for directly-delivered official aid was falling. As a consequence, official donors and the IFIs have grown increasingly willing to deliver aid through NGOs. The World Bank estimates that in 1980, international NGOs working in development received less than 10% of their budgets from official sources; by the late 1990s, this had ballooned to 35% via a far larger and more influential community of NGOs (World Bank, 1998). Increasingly, NGOs are now part of the aid establishment, sanctioned by governments, delivering large amounts of aid, and exerting a considerable influence over aid policy. The 2005 Paris Declaration on Aid Effectiveness, for instance, was drafted with the help of inputs from representatives of more than 50 NGOs. While most NGO funding is provided by ODA, an estimated 20% is provided by religious and other private organizations. Figure 14 presents data on grants by US and Japanese NGOs to developing countries. The increase after about 1980 is clearly apparent. The scale and heterogeneity of NGO-giving renders data collection difficult, and these numbers probably underestimate substantially total flows.

The aid apparatuses of the US and Japan have had historically far different relationships with NGOs, reflecting the widely-divergent attitudes of the two governments toward the private sector. In the US, the tradition of voluntary organizations is historically strong; Alexis de *Tocqueville* (1841) credited them in part for the strength of American democracy. US aid policy has followed this tradition, working closely with both the profit and non-profit private sectors since it began giving aid; today the US consistently touts the importance of "public-private partnerships". In Japan, the tradition of voluntary organizations is comparatively new and weak, and NGOs have played much less of a role, both domestically and in relation to the developing world. Yet in recent years the NGO community in Japan has grown considerably and the Japanese government has increased its support.

Public-private interactions in US aid also have support from the unique US tax code.³¹ Since the 1936 Tax Act, individuals and corporations have been able to deduct charitable donations from their income taxes. And beginning with the Marshall Plan aid to Europe after World War II, the US government has made a conscious decision to work with the

³¹See *Smillie and Helmich* (1999) for a good history of the development of US development NGOs.

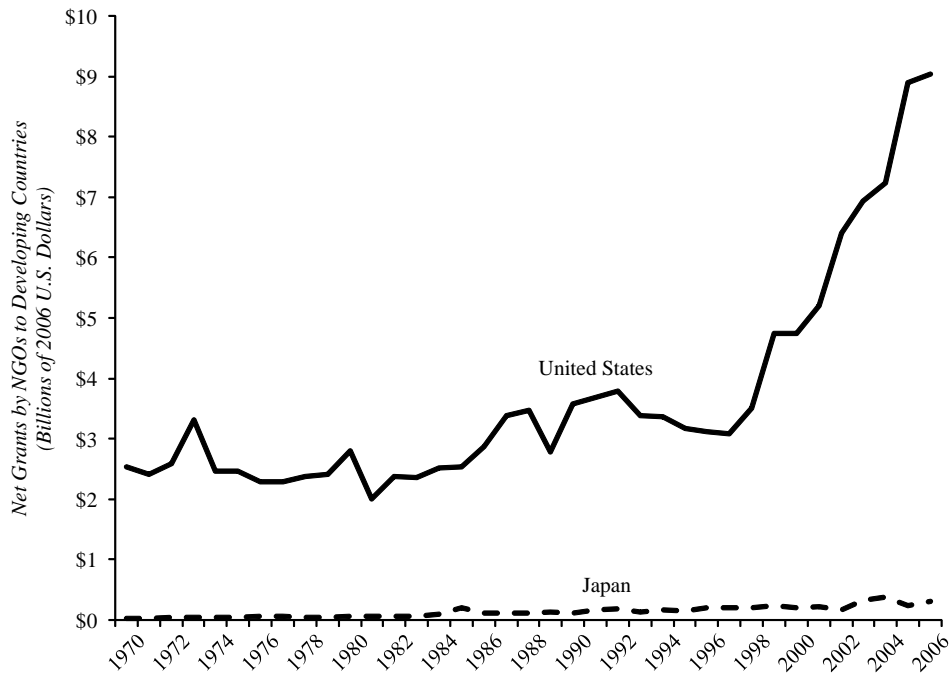


Figure 14. Grants by US and Japanese NGOs to Developing Countries, 1970–2006

private sector to deliver assistance. In the beginning, the US government relied on NGOs mostly to deliver short-term humanitarian assistance, particularly using the large US food surpluses which, after 1949, Congress authorized to be delivered as aid. However, from the 1970s, NGOs, frustrated by decades of band-aid solutions and made increasingly aware of conditions in the developing world by legions of returning Peace Corps and other volunteers, began to focus more on activities that promote development. Mindful of this transformation, and concerned with making aid more efficient and popular at a time of declining public support, the formal US aid apparatus, in particular USAID, began making increasing use of NGOs. This was attractive to Main Street as well as Congress and permitted AID to reduce its direct hire personnel. In 1993, the Presidential Advisory Committee on Voluntary Foreign Aid noted that US official and private aid organizations had increasingly convergent motives and recommended closer ties. Since then, many US NGOs have grown into virtual arms of the official aid apparatus, pursuing projects along the lines of official US aid policy and maintaining elaborate operations in Washington to lobby for government contracts. Initially, the leveraging purpose of these partnerships was explicit. The 1986 Foreign Assistance Appropriations Act required that any NGO eligible for USAID grants or contracts had to get at least 20% of its funding for international activities from sources other than the US Government. But, in keeping with the general trend toward outsourcing, this requirement was dropped in 2005. Yet, in contrast to the close relationship many NGOs have with the US Government, other NGOs have resolutely maintained their independence and either set a cap on the proportion of their budgets they obtain from official sources, or refused government money altogether.

There is no systematic data on the proportion of US aid delivered through NGOs; unlike other countries, the US does not report these figures to the OECD/DAC. But there are figures for USAID, the agency from which many NGOs receive US government contracts. Generally, USAID delivers about 30% of its aid through what it calls “private voluntary organizations” (PVOs) (Lancaster, 2000). Although registration in the US for non-profit status is relatively simple, registering with USAID is a cumbersome and time-consuming project, requiring a range of independently audited documents beyond the capacity of many NGOs. The process grew even more complex during the 1990s when, with declining support for aid among the US public, Congress attached increasingly onerous conditions to ODA. Today, the mere cost of making an application to USAID for a government contract can run into tens of thousands of dollars. Such high overhead costs are a major reason why some are today questioning whether NGOs are indeed more efficient in delivering aid. Other reasons relate to the relative lack of accountability of NGOs — the other side of the independence coin.

Today, those PVOs eligible for assistance are listed in the USAID database. As of 2005, 503 US PVOs and 55 international PVOs were registered. In FY 2004, these PVOs provided a total of \$20 billion for development work. \$2.6 billion of this total was from USAID and another \$2.4 billion from other official sources. The remaining \$15 billion was from private sources — foundations and individuals. International PVOs added another \$1.6 billion, \$80 million of it from USAID and \$794 million from other official sources (USAID, 2006).

The community of slightly more than 500 registered PVOs is somewhat smaller than the NGO community in most DAC countries. However, the high bar set for registering means that these figures fail to account for unregistered and small, active NGOs in international development, of which there are probably hundreds, if not thousands.³² Although USAID’s registration requirements are often outside the capacity of many NGOs from developing countries, USAID has made efforts to partner with indigenous developing country NGOs, occasionally going as far as setting up endowments for their future operations.

Japan’s aid has always been more centered on its public institutions. It has never shared the US tradition of private giving and support of charitable organizations, beyond the traditional Buddhist support for temples and private specialized schools for religious study. Moreover, the Japanese tax code discourages private donations. Aside from the self-employed, most Japanese do not report their income for tax purposes, but have their taxes deducted from their wages. To get a tax deduction for a charitable gift, a Japanese citizen must file special paperwork; traditionally the only gifts eligible for such deductions were for “experimental research corporations”, i.e. private entities engaged in R&D. In the 1990s, such eligibility was expanded to cover development assistance, but such organizations still face substantial hurdles. Foundations require a large capital fund and associations require a large membership base, so that eligible development NGOs are usually the

³²These figures contrast somewhat with official statistics from the OECD/DAC. These list gross outflows from US NGOs as \$8.4 billion in 2005, up from \$4.4 billion in 2000 and accounting for more than half of the DAC total (2004 dollars). All outflows from US NGOs were in the form of grants.

creation of corporations and government ministries, in addition to a few large international NGOs with bargaining power.

As a result, the NGO sector in Japan, while growing, is still small. Today, the Japanese NGO Center for International Cooperation (JANIC) estimates that only 10% of the few hundred NGOs engaged in international development have legal status. The Japanese NGO community dates from anti-government protests in the 1960s and 1970s and their concern with developing countries stems from such antecedents such as the post-Vietnam War refugee crisis, Japan's overall increasing involvement in world affairs, and the return to Japan of Cooperation Volunteers (JOCV), who, like returning US Peace Corps volunteers, added to public awareness of development issues.³³ Some of the larger Japanese NGOs active in development are also either products of Japanese Christian organizations or branches of foreign — mainly US — organizations. In the mid-1980s, these NGOs emerged as activists, pressing for changes in Japanese foreign aid, in particular challenging the traditional Japanese focus on infrastructure projects, which they called “faceless”. They urged for more of a focus on the needs of local people and for the aid apparatus to be more transparent.

This public pressure had some effect. In the mid-1980s, for example, the government began to publicize more details of its aid activities. And since the 1990s, as part of the aforementioned shift in purpose away from Cold War burden-sharing and decreasing public support for aid, the government began to take account of the wishes and activities of NGOs with increased seriousness. Economic recession and a series of high-profile corruption scandals in a once-revered bureaucracy further enhanced the appeal of NGOs (Hirata, 2002). The government began channeling some aid through NGOs. In 1991, the government officially began cooperating with NGOs under the banner of “Visible Japanese Aid”, in the hope that this would prove to be more creative, cost-effective and transparent (Nanami, 2002).

The projects funded under this initiative were mostly small-scale, and tried to take advantage of the greater flexibility of NGOs and their ability to implement grassroots projects, using appropriate technology, with sensitivity to environmental effects. But the administrative rules governing the subsidies deployed hampered their effectiveness. Unlike USAID/NGO contracts, for example, they relied on single-year budgeting and did not cover personnel or administrative costs. Consequently, the flows remained small; according to the OECD, support to Japanese national NGOs in 2004 dollars was only US\$133 million in 1990, and \$212 million by 1995. More significantly, an “International Volunteer Savings Scheme” was set up in 1991 to allow private citizens with post-office savings accounts to donate 20% of their after-tax interest to NGOs through the Ministry of Posts and Telecommunications. The response revealed that the lack of charitable giving by Japanese citizens had been due to the result of negative institutional incentives more than a lack of concern by the public for development issues. In the first two

³³ Like the Peace Corps, JOCV sends Japanese abroad to use their skills in helping developing countries in an effort to add what the Japanese call a “human face” to their activities in the developing world. Since it was founded in 1965, JOCV has sent more than 25,000 volunteers abroad. Currently 2,331 volunteers are stationed in 69 countries.

months, 2.1 million citizens enrolled, generating 1.1 billion Yen (\$9.25 million) in donations. Yet, this response also reveals the public sector orientation that continues to characterize even private Japanese aid: it was not until an officially-sanctioned outlet for donations was opened that Japanese began to donate in large numbers to development activities.

The role of NGOs was further institutionalized with the establishment of an NGO-MOFA Regular Council Meeting in 1996, a quarterly gathering of officials of the Ministry of Foreign Affairs and 10 representatives of the NGO community. Their NGO-MOFA Council was followed in 1999 by an NGO-JICA Council, more focused on the particulars of implementation. Following a decade of irregular but growing collaboration, for the first time, in 1999, MOFA began the regular subcontracting of projects to NGOs (Hirata, 2002). The number of Japanese NGOs active in international development consequently has grown substantially. In 1980, a directory noted a total of 59; by 1993, there were 290 NGOs and by 1996, the number was 368 (Japanese NGO Center for International Cooperation 1994; Saotome 1999). Today, MOFA monitors more than 400 Japanese NGOs engaged in international activities.

Yet there are important caveats. In the first place, many of these NGOs are involved exclusively in education or are Japanese branches of international NGOs; only about 100 are regularly engaged in development as part of a wider range of activities, and only a little more than 50 have foreign aid as their main activity.³⁴ Furthermore, the basic definition of an “NGO” in Japan is very different from that in the US; it is broad enough to include corporate foundations and extensions of various government ministries. Clearly, “NGOs” linked closely to or even created by corporations and government ministries differ from their US counterparts; yet they receive the lion’s share of government aid. By the mid-1990s, the OECD estimates that only about 10–12% of Japanese government aid to NGOs, i.e. about \$10–20 million, actually went to private NGOs engaged in grassroots activities. It is also notable that the assistance to NGOs as recorded by the OECD/DAC — of which, again, assistance to grassroots NGOs is only a small fraction — has stopped growing since the late 1990s.

3.2. Remittances

Remittances — money that emigrants to developed countries send back to relatives at home — are an increasingly important source of private capital for developing countries. Figure 15 shows remittances in a comparative context. Since the late 1990s, remittances have far outstripped ODA as the second-largest source of foreign capital, after FDI, reaching \$166.9 billion in 2005, four-fifths of which went to low-income and lower-middle-income countries. And because so much of remittances flow through informal channels, their total may be as much as 50% higher than these data show (World Bank, 2006). The largest regional recipients were the neighbors of the US and Japan: Latin America and the Caribbean, and East Asia and the Pacific, each of which received about

³⁴Exact numbers on Japanese NGOs are difficult to obtain. The Japanese NGO Centre for International Cooperation (JANIC) maintains a list of NGOs, but there are inconsistencies and its lists are not regularly updated.

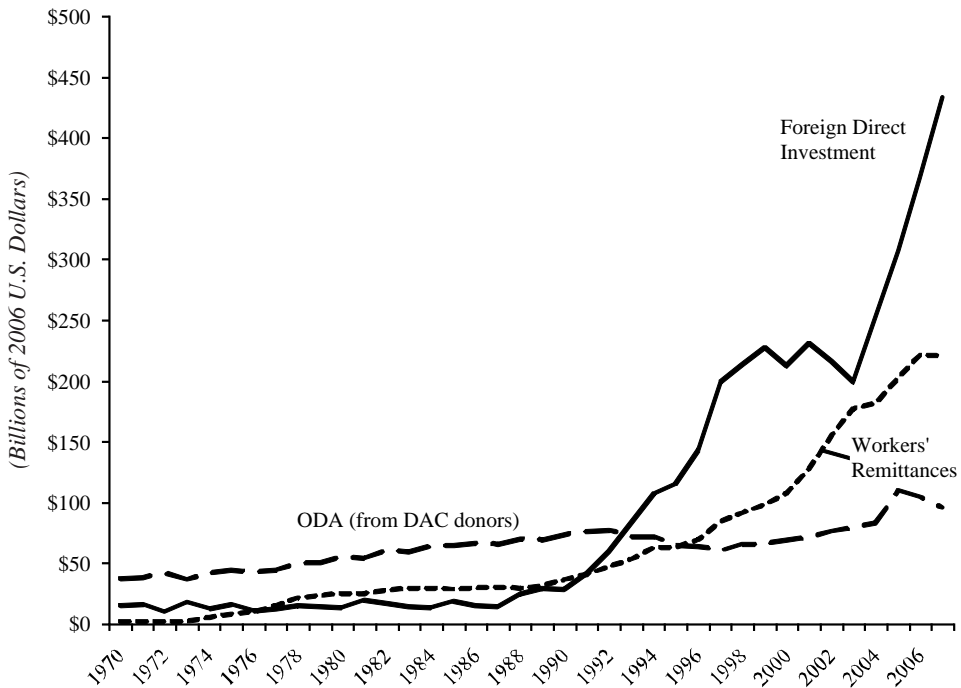


Figure 15. Resource flows to Developing Countries, 1970–2007

Sources: ODA: OECD, as in previous figures. FDI and Remittances: World Bank, *Global Development Finance*. FDI and remittances figures were converted to 2006 dollars using the Unit Value of Imports (World) from the IMF's *International Financial Statistics* (authors' calculations). The data on FDI are from all countries, not just DAC donors as in previous figures. The definitions of the flows also differ slightly from previous figures; they are as follows:

- Foreign Direct Investment: “The net change in foreign investment in the reporting country. Foreign direct investment is defined as investment that is made to acquire a lasting management interest (usually of 10% of voting stock) in an enterprise operating in a country other than that of the investor (defined according to residency), the investor's purpose being an effective voice in the management of the enterprise. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments”.
- Workers' Remittances: “Current transfers by migrant workers and wages and salaries earned by non-resident workers. In addition, migrants' transfers, a part of capital transfers, are treated as workers' remittances in *Global Development Finance*. See GDF Volume 1 for more details. Data are drawn mainly from the files of the IMF, complemented by World Bank staff estimates”.

(World Bank, 2008)

\$43 billion. (Sub-Saharan Africa lags behind in this dimension as well: it received only \$8.1 billion in 2005, the lowest of any region.)

Remittance flows also have the advantage of going directly to families, not only permitting increased consumption, but also enhancing investment and entrepreneurial activities. They are therefore potentially important in helping the reduction of poverty. Adams and Page (2005), for example, estimate that a 10% increase in per capita remittances lowers the share of people living in poverty by 3.5%. Individual country studies

have found that remittances are responsible for reducing the headcount poverty rate (set at 1993 US\$1 per person per day) by 11 percentage points in Uganda, six percentage points in Bangladesh, and five percentage points in Ghana (Adams, 2005). Since it is not the poorest families who can afford to send members abroad, remittances are not likely, however, to improve the distribution of income.

Both Japan and the US represent important sources of remittances. Especially the US has long been a favored destination for immigrants. The largest group, 16.5 million adults, is made up of those born in neighboring Latin America. More than 60% send money home at least four times a year, with the average person sending more than once a month. While the average Latin American worker in the US will send home only about 10% of his or her income, this still constitutes anywhere from 50 to 80% of the recipient household's total income. And the total volume of these flows is likely to grow with time; over half of all those sending money home have lived in the US for over a decade. According to the Inter-American Development Bank, if current trends hold up, as they are not likely for remittances to Latin America and the Caribbean alone may total as much as \$500 billion cumulatively over the decade 2001–2010, the lion's share from the United States (IADB, 2004). Mexico alone is estimated to have received \$20 billion in remittances during 2005, again mostly from the US — more than it received in FDI (World Bank, 2006). However, the current US recession is resulting in a decline in remittances everywhere.

Japan has traditionally been far less open to immigrant labor than the US. Nonetheless, the relatives of those families who do find work in Japan send substantially more remittances than the relatives of migrant laborers in the United States. The case of Latin America is illustrative. A higher proportion of the 435,000 Latin Americans currently living in Japan send money home than Latin Americans living in the US — 70% versus 60% — and they send it more often, about 14.5 times a year, on average. They are also more educated and earn an average of \$50,000 a year, twice as much as Latin Americans in the US, which permits them to send back twice as much, i.e. 20% as opposed to 10% of their incomes. Not unrelated is the fact that more of the money actually ends up in the hands of relatives rather than financial intermediaries because transaction costs for remittances from Japan are just 3%, against more than 7% for remittances from the US.³⁵

These advantages — the larger proportion of migrants sending money home, more frequently in larger amounts, and at lower cost — would seem to make Japan's remittances worthy of emulation. The Inter-American Development Bank has indeed declared that “the Japan to Latin America remittance market is the model for much of the rest of the world” (IADB, 2005). Yet, a closer look at Japanese remittances reveals that they represent a very special case and are difficult to replicate. The vast majority of Latin Americans living in Japan are, in fact, descendants of Japanese who emigrated to Latin America in the first half of the 20th century, often with the help of government subsidies, and who subsequently returned. Today, 1.5 million Japanese still live in Latin America, the largest concentration of Japanese anywhere outside Japan. This diaspora has generally been successful economically, and as a result Latin Americans of Japanese descent who emigrate back to Japan are educated far

³⁵Data on remittances from Japan to Latin America are from IADB (2005).

better than Latin Americans who make their way to the United States; 85% of Latin American adults living in Japan have at least a high school diploma, compared to just 17% in the US. This superior education level is a primary factor behind the much higher incomes Latin Americans earn in Japan. It is similarly related to the low transactions costs Latin Americans in Japan face when transmitting money home; more than 90% have a bank account in Japan, and more than half retain bank accounts in their home country, enabling them to simply send money from one account to another. By contrast, only half of Latin Americans in the US have bank accounts, and almost all of the more than 100 million remittance transactions between the US and Latin America are made at high cost outside the formal financial system.

This is not to say that there is nothing to be learned from the Japanese example; certainly it points to the importance of reducing the transactions cost of remittances by migrant laborers. Remittances represent one of banks' and other money transfer operators' most profitable activities, and fees in lightly-used non-competitive remittance corridors can amount to more than the actual cost of the transaction. Across the world, remittance costs can run as high as 20% of the transferred amount, and average around 12% ([World Bank, 2006](#)). Yet, in the US, there are some bright spots, including the US-Mexico remittance corridor, one of the busiest in the world. Despite increased scrutiny associated with the "war on terror", costs of remitting between the US and Mexico have fallen sharply in recent years. The [World Bank \(2006\)](#) estimates that the cost of sending \$300 to Mexico fell by nearly 60% between 1999 and 2005, from \$26 to a still admittedly high of \$11. They attribute this decline to growing competition. New players like Citibank³⁶ — who have recognized the tremendous potential for profits as remittances skyrocket — as well as the growing number of smaller players have in recent years made the US-Mexico remittance corridor one of the most competitive.

Some credit must also go to the US Government. For example, since February 2004, the US and Mexico have linked their central banks' automated clearing houses to offer a remittance-transfer service, at a cost of just 67 cents per transaction and with an exchange-rate spread of just one-fifth of 1%. Today, this system handles 23,000 payments a month, despite the difficulty of coaxing large banks, who have grown used to the fat fees they can get from ad-hoc money transfers, to participate. Yet the US-Mexico corridor is the exception and costs in other, less competitive corridors remain extremely high: an average bank remittance from the United States to Colombia, for example, costs 17% ([World Bank, 2006](#)).

In the US, the volume of remittances made outside the formal banking system, and the resulting high costs, is but one symptom of a far larger problem — the large volume of illegality associated with US migrant labor. The Pew Hispanic Center estimates that there are currently about 11–12 million illegal or "undocumented" immigrants in the US ([Passel, 2005](#)), with an estimated half a million more entering each year. More than 80% of recent immigration from Mexico is illegal. Because these migrants work for lower wages and in worse conditions than many Americans would, they have undoubtedly been a boon

³⁶Citibank's \$12.5 billion takeover in 2001 of Banamex was reportedly motivated by the bank's remittance business ([World Bank, 2006](#)). Other US banks have followed suit.

to the US economy, spurring its growth and keeping inflation at historic lows even as open unemployment falls. As the US workforce ages, the need for immigrant labor will only increase. Nevertheless, there are many problems associated with such a massive workforce laboring outside the boundaries and protections of the law. The Bush Administration has repeatedly made noises about comprehensive immigration reform — involving a temporary guest worker program coupled with increased border controls and employer enforcement — to help bring this massive black labor market into the open. Senators John McCain and Edward Kennedy introduced related legislation in the Senate. But such efforts to date have stalled in the face of the concerns of many Americans' over a perception that the reform would grant amnesty to illegal immigrants and would likely allow foreigners to take away American jobs. Consequently, the Bush Administration has been forced to fall back on reinforced border patrols and building a fence, rather than a comprehensive immigration reform package. The current Great Recession has curbed migration and remittance.

Issues of immigrant labor are also one of the most salient topics of debate in Japan. Officially, Japan has historically admitted very few foreign workers beyond its aforementioned returned Latin American émigrés. However, the need to bring in younger workers from neighboring countries to do the “dirty work” that Japanese are increasingly unwilling to do as incomes rise, has made itself felt. Moreover, and far more than in the US, the demand for the admission of immigrants has also been bolstered by Japan's falling birth rate and the graying of its population. On the one hand, the diminishing number of children will result in a serious labor shortage in the future; it is estimated that Japan's working population will decrease by approximately 4.75 million between 2005 and 2025, and employed workers will fall by 6.1 million (Ida, 2005). The rapid aging of the population, combined with fewer cohorts of working age, is creating a social security crisis.

Consequently, here, as in the US, there has been some willingness to close one eye to the increasing number of undocumented immigrants. Moreover, since 1998, a number of reform proposals has been aired, focused on increasing the legal influx of foreign workers. However, traditional Japanese resistance, for cultural, security and other reasons, remains strong. Only a few exceptions have been made to date, e.g. in 2004 Japan decided to accept nurses and caregivers for the elderly from the Philippines by means of an Economic Partnership Agreement — a sign of the enhanced flexibility which may eventually have to come.

4. Suggestions for the Future

Throughout this paper we have noted signs of convergence between the US and Japan with respect to their behavior on some capital flows to the developing world. In keeping with the 2005 Paris Declaration on Aid Effectiveness, efforts are currently under way in both countries to consolidate the number of aid-dispensing spigots which historically have been the source of a great deal of confusion, not only in Washington and Tokyo but also, and perhaps more importantly, in the recipient countries. Inefficiencies result not only because of the absence of coordination but also due to dysfunctional competition among donor agencies, and the ability of recipients to play spigots off against each other. In this context,

we applaud the US's steps to consolidate aid under the State Department and the planned Japanese consolidation of its aid apparatus around the "New JICA", even though it will take time for the new organizations to find their feet. But we also note that, at least in the US, consolidation has been partly offset by an increased role for the Defense Department associated with the "war on terror". In 2002, Defense managed only 6% of aid allocations; in 2005 it managed 22%. At the same time, USAID's share has fallen from half of total ODA in 2002 to 39% in 2005, undermining some of the benefits of consolidating US aid under the State Department.

The current aid reorganization efforts in both countries, with the US State Department and Japan's Ministry of Foreign Affairs taking increasing control of ODA, seem to imply an enhanced politicization of aid. Inevitably, especially in the US, we can therefore anticipate the increased use of ODA as an instrument in the "war on terror", through the promotion of democracy and other nation-building activities concentrated in present or potentially friendly countries. This is particularly true of USAID's activities; but even in the case of the Millennium Challenge Corporation, which is ostensibly meant to concentrate on rewarding countries for displaying good past development performance, politicization is clearly creeping in. The upside of politicization is, of course, greater support among the public, as aid is seen as directly serving national security interests. As long as this argument is successful, we can anticipate, at least in the US, a continuation of the post-9/11 trend toward somewhat larger aid flows in the future, in spite of increasingly severe budget constraints.

The irony — a serious one in our view — is that the national security argument might resonate even better without the politicization of aid. In poor developing countries, the antidote to terrorists' siren song is aid that works, not aid that rewards corrupt but US-friendly governments. Most terrorists are extra-state actors, while states are mainly enablers — they do not cause terrorism. It is poverty and inequality that breed terrorism, born of a feeling among the disadvantaged that they are perpetual losers in a world system where countries like the US and Japan always win. Thus, US foreign policy goals might even be better served if the US were perceived as actually relieving global imbalances with the help of aid and private capital flows, rather than using them to encourage a recipient country's elite to support the US foreign policy agenda. In fact, that was the initial promise of the MCC. In our view, the consistent provision of such aid would do more to support the long-term "war on terror", and be more compelling to both Main Street and Ginza than current arguments. This point was echoed in the recent OECD peer review of the US aid apparatus, which noted, with some concern, the US's overwhelming emphasis on short-term goals, and urged these to be balanced with allocations based on a longer-term strategy that considers both US and recipient country objectives (OECD, 2006).

Turning to Japan, which is less invested in the global "war on terror", the apparent increased influence of the Ministry of Foreign Affairs is likely to favor short-term foreign policy interests. Such a shift probably means more attention will be paid to countries supplying Japan with necessary raw materials, supporting Japan in its efforts to gain a seat in the UN Security Council, enhancing its voting power in the IFIs, and the like. In spite of the aforementioned recent convergence, Japan is likely to become more reluctant to follow

US leadership on aid volume and quality and to show its annoyance with the IFIs by reducing its multilateral contributions. While the reasons differ, it can also be anticipated that both countries will, at the margin, be shifting more of their aid resources from multilateral to bilateral channels. Even when it comes to the promise of international public goods, such as the fight against global pandemics like HIV/AIDS, malaria and bird flu, bilateral funding seems to be preferred; one indication is the recent US decision to set up its own AIDS fund instead of contributing to the multilateral Global Fund equivalent. The Bush Administration's recent FY2008 budget request includes more than double of the previous year's funding for HIV/AIDS — after national security it is by far the most domestically popular reason for foreign aid — from \$1.8 billion in FY2007 to \$4.5 billion in FY2008.³⁷

While country allocation decisions are very likely to become increasingly politically tinged in both the US and Japanese aid programs, the issue of how much additional development can nevertheless be generated remains important for all the parties concerned. It is admittedly difficult to pursue two objectives with one instrument; yet both aid programs would benefit, in our view, by deviating from the current models in a number of ways. Both Japan, for some time, and the US, more recently, have come to the conclusion that condition-laden Structural Adjustment Programs or their successor, the Poverty Reduction Strategy Programs, have generally been a failure. The alternative model, represented by the US Millennium Challenge Corporation, is in its early days but potentially approaches Japan's stated preference for non-interventionist "request-based" assistance.

We suggest that a third model might be superior and worthy of consideration by both parties. This model does not reward recipients for the past but seeks commitments for the future. But what distinguishes it from past efforts is an insistence on true local ownership coupled with "self-conditionality" drawn up by aid recipients themselves. Donors would, of course, have a chance to negotiate the self-conditionality package proposed. The important change is the enforcement of compliance that self-conditionality allows: donors would restore credibility to the system by offering and carrying out the threat to cut off aid in the event of non-compliance. In the past, conditions were seldom taken seriously, since both parties ultimately began to realize that the money would eventually flow, regardless of the rhetoric. Conditions frequently ignored the political economy limitation of the recipient; and donors, facing their own political and financial pressures to continue lending, found it difficult to cut off assistance. But with recipients — who are in a better position to know what is possible and what is not — proposing the conditionality themselves, with donors accepting rather than imposing them, the possibility for real policy change would be much enhanced.

For this third model to work, donors must learn to be more passive and be ready to provide aid ballooning over a multi-year period.³⁸ The World Bank seems to be taking some small steps in this direction, but the current dispute over the application of country

³⁷ Budget of the US Government, Fiscal Year 2008.

³⁸ For more detail on this third model, see Ranis (2006). Our approach is forward-looking, and therefore differs from the "Payments for Progress" idea recently proposed by Barder and Birdsall (2006) which has a family resemblance to the MCC rationale.

corruption designations indicates that short-term political considerations may still be at work even in the multilateral institutions.

Relatedly, it is being increasingly recognized that aid flows can be counter-productive, not only because they can cause an unwelcome appreciation of the exchange rate and/or enhance aid dependency via a reduction in domestic private savings or tax levels, but also because, in an extended version of the “Dutch Disease”, they can lead to a relaxation of the policy reform decision-making process, along with a decline in accountability and an increase in clientilism and corruption. The only reliable way to try to avoid or at least diminish such undesirable side effects of aid is for the recipient to establish its own reform priorities and feel fully in charge of their implementation, both economically and politically.

This, and the need for donors to coordinate their efforts to avoid wasteful overlap and confusion in recipient countries, are indeed at the heart of the aforementioned 2005 Paris Declaration on Aid Effectiveness, to which both Japan and the US are signatories. That document set out 12 indicators, each containing benchmarks to be met by 2010, covering five categories: ownership, alignment, harmonization, managing for results, and mutual accountability. Although these indicators are somewhat less than revolutionary, they represent important steps toward making aid more effective. The World Bank and OECD have been conducting surveys of the 60 signatories — donors and recipients — to the Paris Declaration to determine progress on the indicators. Both Japan and the US should take the results of these surveys seriously and use them to motivate further reforms to their aid apparatuses.

A recent OECD peer review made a number of other recommendations which we believe the US should take seriously. Despite its declining relative share of aid given multilaterally, the US is still a large contributor to the multilateral institutions and can use this leverage to encourage greater efficiency and effectiveness in those institutions; a centralized system for tracking the performance of US contributions to the multilateral institutions would be a good first step. The review also urged that the new Office of the Director of Foreign Assistance become a coordinator of US aid, not only for the State Department, MCC, and USAID, but also extend its influence to other government ministries and agencies engaged in aid activities, including the Department of Defense. The corresponding 2003 OECD peer review of Japan’s ODA points for the need to take poverty reduction more seriously, which might also help reverse a recent slackening of public support. Among donors, Japan continues to maintain the highest proportion of loans in its ODA program.

Additional suggestions for enhancing the effectiveness of both Japanese and US aid would include the retention of non-project assistance as an important instrument, in spite of its past checkered performance in the SAL context. Any wholesale shift to project assistance, depriving recipients of welcome, fast-flowing balance of payments or budget support — which can be crucial in buffering an economy’s often painful transition from one set of rails to another — would be a mistake. Frequent current references in both Japan and the US to the use of aid to facilitate trade is mostly welcomed, both in its program form — easing import controls — and in its project form — providing critical transport,

power and communications infrastructure, currently a serious bottleneck in several countries. Both the US and Japan should also make sure that their aid programs keep in mind the importance of advances in human development, not only as an end in themselves but also as critical inputs for ensuring sustainable growth.³⁹

It seems well established that Main Street and Ginza are more favorably inclined to aid on largely humanitarian grounds than the two governments which are clearly more concerned with national, political or security objectives. Consequently, aid tying, presumably helpful in terms of domestic political support, should be abandoned, partly because, due to trade and financial fungibility, it doesn't really work and partly because it diminishes the real and the public relations impact on recipients. The potential loss of support from the agricultural export and shipping lobbies in the US and the engineering and construction lobbies in Japan is probably exaggerated, especially when such lobbying today is held under increased scrutiny in both donor countries.

While current nationalist tendencies, as referred to above, seem to be shifting toward a larger proportion of aid moving via bilateral rather than multilateral channels, both the US and Japan should recognize that even after current reorganization and consolidation efforts, coordination among the remaining plethora of aid programs remains very problematic. Recipient policy-makers continue to be literally plagued by the round-the-year and round-the-clock flow of donor missions, asking the same questions and often at competitive odds with each other — forcing some courageous recipients, like Tanzania, to take action by declaring an embarrassing “mission holiday” for several months. Shifting to a greater use of multilateral channels would not eliminate the problem but would certainly diminish it substantially.

Despite the real advantages of NGOs — not the least of which is the substantial and additional human and financial resources they bring to the table — we also have some reservations about the general enthusiasm about aid delivery through NGOs. The very features of NGOs that their admirers often point to — their small size, community basis, and flexibility — also carry some risks. Since they usually need to set up country management teams to run projects, they often incur additional administrative costs, with teams operating parallel to official agencies. They often duplicate capacity and represent a further strain on a recipient country's human resources. Thus, they may work against the laudable aim of the consolidation of aid spigots. Where the state is weak — for example, in some countries of South Asia and Africa — NGOs have proven to be more creative than official agencies at designing projects. But in the process they have often ended up substituting for the state, rather than working to improve state capacity; and fostering, rather than combating, aid dependency. For these and other reasons, a large study on the success of NGOs at rural poverty alleviation by Riddell and Robinson (1995) concluded that NGOs make a valuable contribution, but that it is limited and not likely to grow as NGOs proliferate. There is also the issue of the relative lack of accountability of NGOs which is currently getting more attention, now that the initial “honeymoon period” enthusiasm has waned a bit.

³⁹ See Ranis, Stewart, and Ramirez (2000), and Kosack and Tobin (2006).

Highly visible NGO success stories, such as Bangladesh, have to be judged in relation to the mass of literally thousands of NGOs that are now operating throughout the developing world. They generally pursue narrow programs with limited coordination with the efforts of either official agencies or other NGOs. This narrow focus makes systematic change elusive. For example, billions of dollars are now poured into African health care through private channels to tackle devastating diseases like HIV/AIDS, malaria, and tuberculosis. But because these efforts are directed at specific diseases and not at public health, they run the risk of leaving the recipient countries with few systematic and sustainable improvements in their health.⁴⁰

The greater reliance of Japanese aid on official agencies is, in this sense, positive, especially alongside the government's efforts to consolidate its aid delivery channels. But the lack of private involvement in Japanese aid is also a problem since it undoubtedly contributes to the declining support of the Japanese public.

Lastly, we would like to register continued disappointment with the aforementioned timidity with which Japan has promoted its alternative development strategy in the international arena. The end of the Cold War and of burden-sharing on aid presented it with a unique strategic opportunity to make its development vision a real alternative to the amended Washington Consensus. Yet, having pushed for and financed the World Bank's *East Asian Miracle* report in the early 1990s — a step in this direction — Japan has not really followed up to date. Despite its initial coolness toward the PRSPs and the Millennium Development Goals, Japan is now supportive once again and has failed to present viable alternatives.

Additional human resources and attention to the recently merged Japanese Institute of Developing Economies and the Japan External Trade Organization (IDE-JETRO) may help remedy the current lack of a base for analysis and intellectual firepower underlying any alternative approach, as it may happen with the "New JICA". Yet, we remain skeptical of the depth of commitment to the analytics that will underpin innovative policy departures. Over a half-century in the aid business, Japan has consistently recognized and bemoaned her second-class status in the realm of development thinking. But that conceptual deficit has never been due to an overall lack of qualified human capital — although careers in overseas development remain somewhat risky and inhospitable. Japanese policy-makers may grumble privately at Washington's dominance of development ideas but remain averse to "rocking the boat". If it can shake off this timidity, Japan should be in a position to construct a viable alternative development model based on her own historical experience, and generally take a more confident leadership role. The recent election results may be of help.

Yet, for all of ODA's importance, ultimately we know that aid is likely to become an even more junior partner to remittance flows from both the US and Japan in the future. Remittances not only add substantially to a recipient country's savings, but also often make major entrepreneurial contributions both before and after the return of the often temporarily migrant worker. To facilitate the smooth functioning and expansion of this particular, somewhat "under the radar", flow of private foreign capital, a few suggestions are in order. Since both sending and receiving countries stand to benefit from most types of migration

⁴⁰ See Garrett (2007) for a discussion.

and the associated remittance flows, reducing the high transaction costs of remittances should get priority attention. Moreover, many developing countries are sure to become more pro-active in providing information, and even financial support to potential migrants as some countries, including the Philippines, have done in the past. Most observers are realistically aware of the fact that barriers to permanent migrants, especially of the unskilled variety, are not likely to come down in the near future. However, a more generalized, multilaterally negotiated system encouraging temporary worker migration arrangements would benefit both parties. Among these benefits would be substantial and additional remittance flows for developing countries; and for developed countries, relief from the social security-related “graying problem” that many are facing. To allay the fear that “temporary” would become “permanent”, we suggest consideration of a multilateral version of something like the South Korean device of forcing migrants to deposit a portion of their earnings in a special savings account, which would be forfeited if the worker decided not to return home as promised.

All in all, once we emerge from the current recession, increases in resources and attention given to development mean that this will be an exciting time of challenge and opportunity for both Japan and the US. Cross-border flows of aid and remittances have the potential to spur development in much of the world, easing the strain of poverty for millions of people, allowing enlarged global commerce and prosperity in both developed and developing countries, and enhanced global security by undercutting the conditions of despair that nourish terrorism. The power of these flows carries attendant responsibilities for each country. For the US, whose national interests, particularly in security, are clearly linked to development, the most important thing is balance between the long and short term. The US currently faces a moment similar to the beginning of the Cold War, when it struggled to build an apparatus to spur development around the world in a way that furthered its strategic interests. It is now responding to new challenges with an effort to rein in the plethora of existing aid spigots. But the result has been an overemphasis in US strategy and planning on short-term political goals, at the expense of a longer-term development strategy, an overemphasis that ill serves both the US and the developing world. US strategy thus far has also failed to sufficiently take account of remittance flows, despite some small efforts and much rhetoric in that direction. Remittances from the US still face high, if falling, transactions costs and suffer from the aura of illegality associated with the immigrant population; and US aid, which inevitably rushes in to meet any short-term humanitarian crisis, usually fails to flow countercyclically to offset sudden outflows of foreign capital which often prove just as damaging as natural disasters.

In Japan, it cannot be said that the war on terror has replaced the Cold War as the overriding foreign policy priority, as it has in the US. Certainly, Japan continues to be helpful, as noted in her large aid packages to Iraq and Afghanistan. But so far this “war-on-terror” burden-sharing is far less than the burden sharing that justified Japan’s Cold War aid. Instead, Japan’s aid budgets are shrinking, and the Japanese are undertaking a flurry of institutional reforms and consolidations in an effort to make better use of its decreased aid, in particular to help secure needed supplies of natural resources from its neighbors and from Africa. This narrowing of focus and effort has corresponded with the persistence of

Japan's traditional timidity in showing leadership in development thinking, despite some rumblings in Japanese intellectual circles about pushing a new development paradigm based on its own development experience. In its private capital flows, Japan is showing more aggressiveness and effectiveness; foreign workers in Japan are generally able to send remittances home at far lower cost than those in the US. But there are still cultural limits to the willingness of Japan in accepting substantial numbers of legal immigrants, which adversely affects Japan's efforts on behalf of development in the world's poorer nations.

Despite these challenges, both countries have at their disposal a powerful and varied set of tools to enhance the effectiveness of both aid and remittance flows. We applaud the institutional efforts of both countries in consolidating the profusion of aid spigots that have traditionally confused and undermined aid delivery, as well as the general trend in poverty reduction as the basic objective, notwithstanding the continued pursuit of narrower political goals where country selection is involved. With the rekindling of interest in aid around the world, there is considerable opportunity for creativity in development thinking; both the US and Japan have shown some willingness to experiment with new mechanisms for delivering both traditional official aid, and for leveraging remittances and private donations to NGOs. At no time in recent memory has international development been so clearly linked to the national interest, even if it is defined differently by the two countries. It is our hope that this self-interest can increasingly be reflected in the achievement of enhanced and equitable development abroad.

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