Japan in the World: The Capital Recycling Programme

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Japan is one of the world's major international aid donors in absolute terms but has a relatively low ODA/GNP ratio. The $30 billion capital recycling programmes announced in 1986 and 1987 were intended to improve Japan's image in the world but have been widely criticised for their self-interest, ambiguity and low ODA content. Hiroshi Okuma, Professor of International Relations at Seijo University, Japan examines the intent and effectiveness of Japan's capital recycling programmes and how far they meet world expectations.

I Introduction

In his last general policy speech to plenary sessions of both Houses of the Diet on 6 July 1987, former prime minister Yasuhiro Nakasone used the following words to underscore Japan's responsibility as a member of the international community:

> The world has begun to see Japan in an entirely different light in the past five or ten years . . . Both in domestic policy and foreign affairs, Japan must consider itself an international power, and take steps to take a new, and a much greater role in world affairs . . . Japan has arrived at a major crossroads in its history. What kind of nation is most suited to Japan's position in international society today? I would say that it is to be a nation that puts itself in the position of other nations and other peoples, and is ready and willing to share their joys and sorrows. As Confucius taught, "Do not do unto others what you would not want done to yourself." . . . I am convinced that the best way to prepare for the challenges of the twenty-first century is to foster the awareness among all citizens of Japan's new place in the world . . . and to see that the government takes positive steps to clarify this new role, which it cannot evade, while humbly and courageously striking out on the uncharted course of future development.

How has this lofty political philosophy been reflected in Japan's foreign policy? In this paper, I shall explore the gap between the image and the reality of Japan as an international power, focusing on its financial assistance — development and debt financing — to the developing countries. Specifically, I will address the nature and problems of the series of programmes announced by Japan in 1986 and 1987 to recycle portions of the current account surplus to foreign nations in the form of aid.

II Japan's aid record

Japan's development aid programme started in the mid-1950s with post-war reparations to the nations of Southeast Asia. It was only in the 1960s, however, that Japan initiated a development aid programme in the strict sense of the term. From its inception, albeit not always steadily, Japan's aid has grown rapidly and remarkably. Japan has become one of the major donor nations of international aid and the rationale for its aid policies has become more complex. In the early stages of the programme policies were motivated by narrow economic interests. The major concern was the expansion of exports to Southeast Asia. This self-centred economic posture has given way to a variety of considerations. Japan's development aid has gradually undergone a series of changes, and the focus has shifted more to promoting the prosperity and stability of the international economy and responding to the recipient countries' development needs in particular. The aid programme has moved to the forefront of Japan's foreign policy. In the late 1970s and 80s, the Japanese government has moved towards using development aid politically and diplomatically. "Strategic aid" to countries and regions important to Western security (e.g. Thailand, Pakistan, Turkey) is a new aspect of Japan's development aid policy.

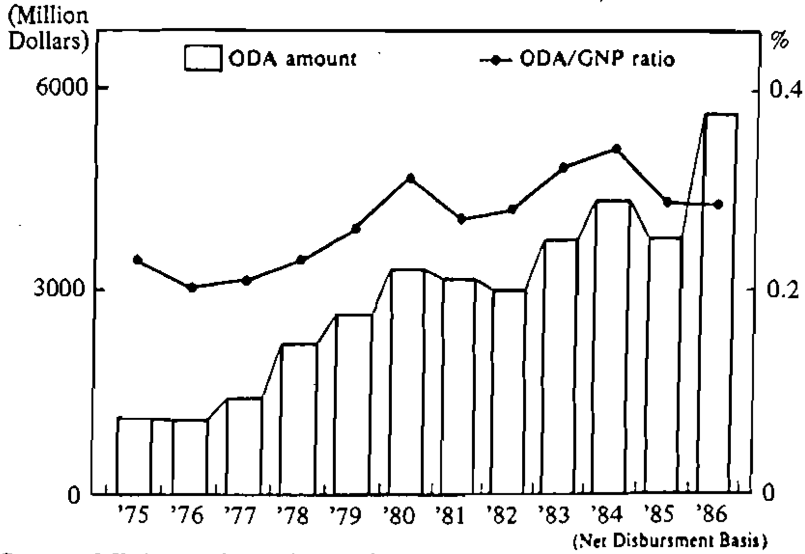
(a) *Overall ODA performance*

Japan's total ODA in 1986 (net disbursement) amounted to $5,634 million. This puts Japan in second place among 19 DAC members, next to the United States with $9,784 million. As a result of three successive "Medium-Term Targets" (aid-doubling plans) first adopted in 1977, Japan's ODA has steadily grown and is in sharp contrast with other DAC members suffering from "aid fatigue".

However, Japan's ODA/GNP ratio has been significantly less than the UN-recommended 0.7% target (see Figure 1). It is also lower than the DAC average. Japan's 1986 ODA/GNP ratio was only 0.29%, compared with the DAC average of 0.36%. It ranked 14th among DAC members and placed Japan second only to the US (0.23%) on the low end of that yardstick among major donor countries.

FIGURE 1

JAPAN'S TOTAL ODA VOLUME AND ITS ODA/GNP RATIO



Source: Ministry of Foreign Affairs, Japan, *Japan's ODA 1987*, Chart I-1-3.

Japan's bilateral ODA is the main element of the total. In 1986 it accounted for 68.3% with mutilateral aid accounting for the remainder. Generally, two-thirds of Japan's ODA has been bilateral.

The share of grants in Japan's total ODA is the lowest of all the DAC members and well below the DAC average. In 1986 it was 60.7% compared with the DAC average of 84.3%.

The tying status of Japan's ODA is relatively good. In 1986 71.0% was wholly untied, 15.6% partially untied, 13.4% tied. Japan performed better than the DAC average on general untied and tied ODA, but has more partially untied ODA than the DAC as a whole.

The geographical distribution of Japan's bilateral ODA is distinctive (see Table 1). Most has been concentrated on Asia, with which Japan has traditionally had close relationships. In the 1960s, almost all bilateral ODA was directed to Asian countries. From the latter half of the 1970s, however, Japan began to globalise its aid and provide more aid to Middle Eastern, African and Latin American countries. Thus the share of Japan's total bilateral ODA to Asia began to decline. In 1986, the share for Asian countries was 64.8%, and for Middle Eastern, African and Latin American countries it was 8.8%, 10.9%, 8.2%, respectively.

TABLE 1

10 MAJOR RECIPIENTS OF JAPAN'S BILATERAL ODA (1984-86)

(Net Disbursement – Million Dollars)

	1984		1985		1986	
1	China	389.35	China	387.89	China	496.95
2	Malaysia	245.14	Thailand	264.10	Philippines	437.96
3	Thailand	232.02	Philippines	240.00	Thailand	260.41
4	Indonesia	167.69	Indonesia	161.33	Bangladesh	248.47
5	Philippines	160.07	Burma	154.04	Burma	244.14
6	Bangladesh	123.28	Malaysia	125.59	India	226.71
7	Burma	95.40	Bangladesh	121.48	Indonesia	160.83
8	Egypt	81.47	Pakistan	93.31	Pakistan	151.56
9	Pakistan	67.03	Sri Lanka	83.74	Sri Lanka	126.91
10	Sri Lanka	63.77	Egypt	73.01	Egypt	125.70

Source: Ministry of Foreign Affairs, Japan, *Japan's ODA 1987*, Table II-2-5

(b) *Aid administration and budget*

The legislature has not been actively involved in the formulation and implementation of Japan's development aid programme but the bureaucracy has traditionally played a major role. There has never been a single aid ministry, however. The main characteristic of aid administration is the division of responsibilities among various ministries and agencies. In particular, four ministries (Foreign Affairs, Finance, International Trade and Industry, and the Economic Planning Agency), have played a critical role. Decisions on yen loans which constitute an integral part of ODA, have been made primarily through consultations and discussions among these four ministries. The OECF (Overseas Economic Cooperation Fund), under the jurisdiction of the Economic Planning Agency, is in charge of its implementation. The OECF has played the key role in bilateral government loans. The Export-Import Bank of Japan encourages export and import financing as well as overseas direct investment financing for Japanese corporations. The Bank also provides foreign governments with less concessional loans with a grant element of less than 25%, which does not meet the requirements of ODA.

The decisions on the amounts and recipients of the grants, on the other hand, have been made solely by the Ministry of Foreign Affairs. Although the Foreign Ministry consults with other ministries concerned where necessary it has the final say. The JICA (Japan International Cooperation Agency), under the jurisdiction of the Foreign Ministry, supplements the latter's activities. In particular, the JICA is in charge of government-level technical cooperation programmes, and provides funds for social development, agricultural and forestry development, and mining and industrial development which the OECF and the Export-Import Bank of Japan would not finance.

Reflecting the complicated administration system, ODA is not an individual budget item. In 1987, the total ODA budget was divided into the budgets of 15 agencies and ministries.

(c) *DAC aid review of Japan*

In January 1987 the DAC reviewed the development assistance policies of Japan. The Committee pointed to the following areas needing improvement:

(i) the ODA/GNP ratio;
(ii) the share of ODA in the total budget;
(iii) the terms of aid;
(iv) the proportion of ODA going to the least developed countries;
(v) the degree of tying;
(vi) the aid management system.

III The capital recycling programme

(i) *The $10 billion Recycling Programme*

Finance Minister Kiichi Miyazawa first announced a plan to recycle approximately $10 billion in capital at the IMF/World Bank joint annual meeting in Washington in September 1986. The key elements (see Figure 2) which aimed to rechannel a portion of Japan's current account surplus — now approaching $100 billion per year — to developing countries, were as follows:

1. *Japan Special Fund* — $2 billion (Y330 billion)

   In order to recycle domestic private capital to developing countries through the World Bank. Japan will allow it to raise, on the Tokyo capital market, a total of about 300 billion in yen-denominated funds beyond the established quota between 1987 and 1990. In the same period Japan will also contribute to the World Bank a total of Y30 billion from its ODA budget. These funds, earmarked for technological aid, will be directed to developing countries untied.

2. *Loans to the IMF* — $3.6 billion (3 billion SDR)

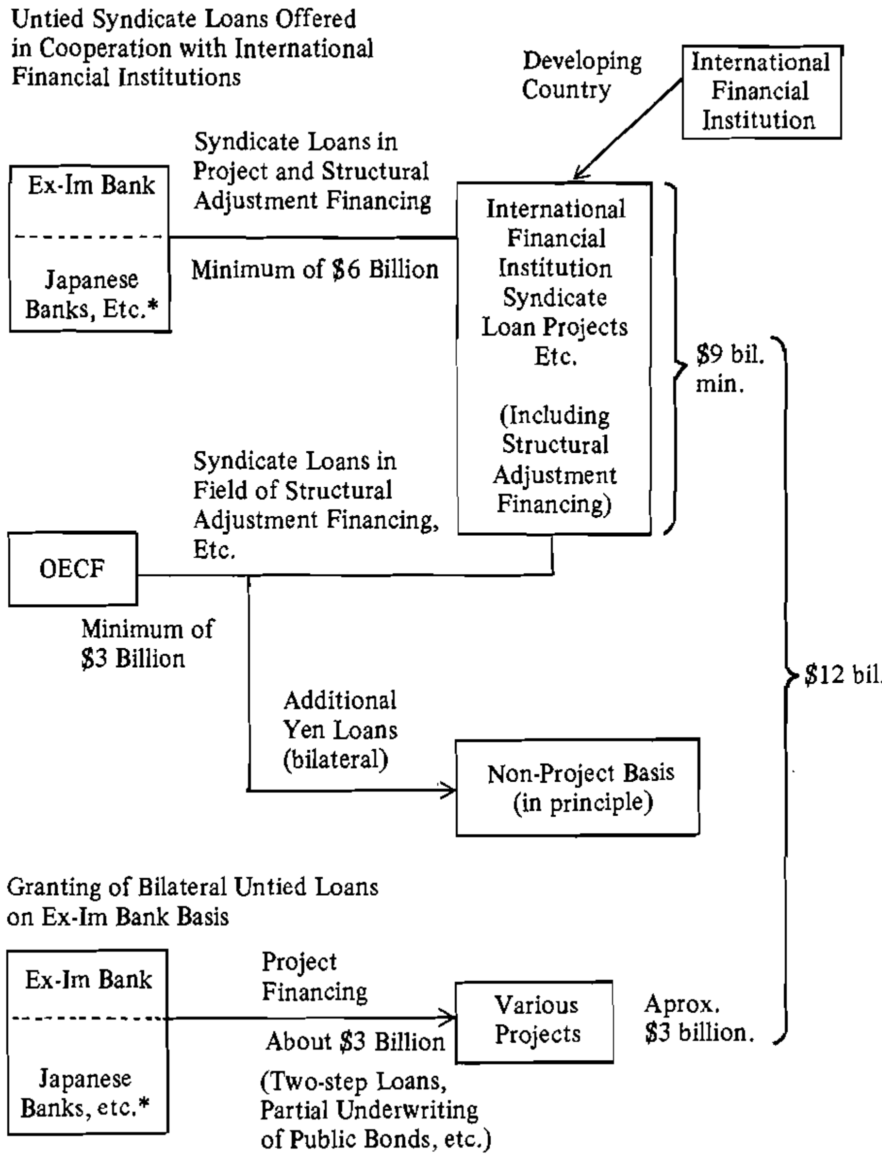
   To build up the IMF's financial base, thereby enhancing its ability to aid member nations burdened with international balance of payments deficits, Japan will lend to the IMF from its foreign currency reserves a total of 3 billion in SDR (Special Drawing Rights) over a period of four years. These loans will be separate from the funds available through the enlarged access system of supplementary financing but will be utilized together with such funds and ordinary IMF capital.

3. *Contributions to international development financing institutions (IDA, Asian Development Fund)* — $3.9 billion

   Japan's pledge to contribute $2.6 billion to the International Development Association (IDA) for its eighth capital increase (1987-1990) represents a 54.5 per cent increase over its last contribution ($1.68 billion) made at the time of the IDA's seventh capital increase. The Japanese contribution to the Asian Development Fund (ADF) for its fourth fund increase (1987-1990) will be $1.3 billion.

FIGURE 2

FLOW OF MONEY IN DIRECT LOANS TO DEVELOPING COUNTRIES



*Includes amount for Japanese commercial bank loans made simultaneously to the same entity.

(ii) *The $20 billion capital recycling programme*

At the Cabinet meeting on economic policy held on 29 May 1987, the Japanese government adopted a set of "emergency economic measures" regarding external economic relations and the expansion of domestic demand. This package was inspired by recognition that steps must be taken to expand domestic demand and correct the international trade imbalance to achieve harmonious economic relations with other countries. The proposal called for "positive contributions to international society," listing as concrete recommendations: (1) to advance the target date of ODA's third "Medium Term Target" (initially planned for 1986-1992) by two years, boosting ODA in 1990 to $7.6 billion or more, and (2) to provide about $500 million in non-project aid to African nations and other less developed countries over a period of three years.

In addition and as the second phase of the programme, it was decided that Japan should promote recycling of money to developing countries (especially debtor nations) through the contribution over three years of at least $20 billion in completely untied funds to international development financing institutions as well as the mobilisation of the Export-Import Bank of Japan, the OECF and private capital. Japan pledged to carry out this $20 billion capital recycling programme on top of the earlier $10 billion programme. This second programme can be outlined as follows:

1. *Contributions to international development financing institutions and cooperation through private capital* — about $8 billion

   As part of its direct financial aid Japan will establish new, and expand existing, special funds through contributions to institutions like the World Bank, Asian Development Bank (ADB), and the Inter-American Development Bank. In addition, issuing of bonds on the Tokyo capital market by the World Bank and other international development financing institutions will be actively encouraged to facilitate the recycling of private capital.

2. *Expansion of syndicate loans made with World Bank and other international development financing institutions through the OECF, Export-Import Bank of Japan, commercial banks, etc. and additional loans through the OECF to support economic policy (structural adjustment) in developing countries* — $9 billion or more

   To facilitate development projects, Japan, in cooperation with the World Bank and other financing institutions, will make available through the Export-Import Bank of Japan at least $6 billion in syndicate loans. (The total value may include those made through Japanese commercial banks as well.) In addition, at least $3 billion in financial aid will be extended to developing countries through the OECF to help them carry out structural adjustment. Specifically, this means that Japan will make syndicate loans through the OECF to the structural adjustment financing and loans (SAF and SAL) made available to developing countries (in particular, least developed countries eligible for IDA financing) through the IMF and the World Bank. Lastly, supplementary yen loans (non-project-based policy support loans) will be offered independently through the OECF to developing countries on a bilateral basis to provide backing for their structural adjustment policies.

3. *Expansion of direct financing for developing countries through Export-Import Bank untied loans* — about $3 billion Through the Export-Import Bank of Japan, Japan will provide a total of about $3 billion in untied loans to developing countries. (The total value may include those made as syndicate loans through Japanese commercial banks.) This means that Japan will expand financing to developing countries by two-step loans and underwriting some of the bonds issued by the governments of developing countries.

IV Discussion

Branded as a self-centred free rider, and finding itself isolated and buffeted by a storm of criticism, Japan launched a counter-thrust, using as its principal weapon a $30 billion capital recycling programme. By offering an aid package reminiscent of the Marshall Plan Japan was attempting to impress the world. Former Prime Minister Nakasone led the way in these efforts. The reason the programme was developed was because it was recognised that a major initiative would be needed if the desired impact upon foreign nations' (in particular, the US) perception of Japan was to be achieved.

Even before the formal decision to adopt the programme, Nakasone, during a visit to the US in early 1987 unveiled a plan for recycling to developing nations up to $30 billion in government and private funds. In a speech to the National Press Club, he announced that the full amount would be in completely untied loans, and that he was convinced the programme would contribute to general development, structural adjustment, and the solution of debt problems in developing countries, especially those of Asia and Latin America. Japan's capital programme was also brought up at the Venice summit in June 1987, where the Japanese initiative was welcomed.

The initial international response to Japan's $30 billion programme was generally favourable. But as debate continued on the content expectations gave way to disillusionment. For international society, and especially the developing countries, the most important aspect of the programme will be its implementation. In other words, the extent to which it can supply attractive funds to the developing countries on favourable terms. Disillusionment set in when it became apparent the programme was extremely vague on this score and had many inherent problems.

Nor did it escape criticism at home. On 19 June 1987, just after its formal adoption, the Japan Committee for Economic Development presented a proposal entitled "Toward a New Phase in International Cooperation Policy" which sharply criticised the heavy reliance upon private capital. "It is estimated that approximately one-third of the money [to be recycled] in this programme will be raised on the Tokyo market by the World Bank and regional development financing institutions (i.e. on a commerical basis); only about one-sixth will correspond to ODA. This may invite international criticism. The government will have to raise the ratio of ODA in this programme by a large margin." On 8 December 1987, the Federation of Economic Organisations published its "Proposals for Promoting the Recycling of Capital to Developing Countries," which applauded the capital recycling programme, but drew attention to the inadequacy of the various measures for promoting the recycling of private capital and urged the government to establish a back-up system at once.

The fundamental problems of the programme can be summarised as follows:

1. *Opacity*

   The details, in particular, the component $20 billion programme, are so unclear as to engender needless misunderstanding and excessive expectations. For instance, many nations are under the mistaken impression that the $20 billion will be entirely ODA. Some Latin American countries believe, incorrectly, that the programme will reinforce or even replace the "Baker Plan" of October 1985, which gives priority capital support to Latin American countries burdened by cumulative debt. A similar misunderstanding exists within the US government. The four Japanese ministries with jurisdiction over the programme have reached no clear consensus on the issues involved. Rather, each seems to be developing its own capital recycling plan. As a result, explanations of the programme to foreign countries have been varied and inaccurate, inspiring distrust abroad.

2. *Slim share of ODA*
The weight of ODA is relatively small. In the initial $10 billion programme, ODA accounted for over $4 billion, but in the subsequently formulated $20 billion programme, the ODA portion was reduced to just over $3 billion. The bulk of the capital to be recycled consists of private capital and Export-Import Bank yen loans that are not included in ODA. In this sense, the quality of the money to be recycled is by no means appealing. The programme might only increase the debt of some developing countries. One important determinant of success will be the extent to which it can recycle capital to developing countries at rates of interest lower than the market rate.

3. *Fat share for Export-Import Bank of Japan*
The Export-Import Bank of Japan plays a major role, particularly in the second phase, and is entrusted with handling most of the funds. The question is just how much this bank can accomplish, i.e., how much financing it can actually recycle in three years. Most developing countries are wary of incurring additional debt, and this tendency has been reinforced by the high yen/cheap dollar trend of recent years. Moreover, choice development projects are beginning to dry up, just as these nations' severely limited capacity for absorbing loans from foreign countries is becoming apparent. The way the Export-Import Bank agonises over disposing its allocation each year reflects this harsh reality. Even if it made vigorous efforts to promote two-step loans and expand syndicate loans made in cooperation with international development financing institutions, there would still be severe limits to what it could accomplish.

4. *Raising of additional yen-denominated funds on the Tokyo capital market by the World Bank*
Prompting the flow of private capital to developing countries is one of the programme's major tasks, and one method proposed is for the World Bank to raise additional yen-denominated funds on the Tokyo capital market. The World Bank has been doing this for a long time through syndicate loans and by issuing World Bank bonds for loan recycling on a commercial basis to developing countries, but definite limits were imposed. The

amount of yen-denominated capital that could be raised was limited with the consent of the Japanese government to about 20 per cent of the total. By contrast, the programme approves additional procurement of yen-denominated funds by the World Bank beyond the existing limit.

Still, some problems remain. The first of these is whether the amount of additional yen-denominated capital will be significant. In the past four years, the World Bank raised the following amounts in yen-denominated capital: 1984—Y395 billion; 1985— Y544 billion; 1986 Y374 billion; 1987—Y360 billion. How much real significance will there be in newly approving the additional raising of 300 billion yen over three years? The second problem is the additionality of the capital. Would the raising of yen-denominated funds on the Tokyo capital market bring about the mobilization of new money? Or would it only mean a change in the place of issue from London to Tokyo, for example? This problem has a very important bearing on the total amount of capital that can be used by the developing countries. The third problem is the motivation and object of the purchase of World Bank bonds with Japanese private capital. World Bank bonds have an AAA rating, making them an extremely attractive portfolio investment. As a consequence, the question of who will benefit from additional purchases of World Bank bonds will always hang over the project.

5. *Inadequacy of the back-up system for promotion of syndicate loans offered in cooperation with commercial banks*

The capital recycling plan envisages mobilizing large quantities of private capital and promoting the recycling of massive amounts of private capital to developing countries by encouraging syndicate loans. The system for backing up these endeavours is not sufficiently developed, however, and the commercial banks are skeptical about such loans to developing countries. Since rescheduling of payments to the IMF and World Bank is not allowed, priority in the repayment of syndicate loans is given to international development financing institutions, while those to commercial banks are often deferred. The commercial banks are emphatic about the need to rectify this situation.

Although risk is inevitable in extending loans to developing countries, the commercial banks demand that the Japanese government, through the Export-Import Bank of Japan, take steps to reduce such risk. For one thing, they want it to guarantee all additional loans made independently by commercial banks. They insist that the Export-Import Bank meet the developing countries' urgent demand for foreign currency loans and bear the exchange risks involved itself. With regard to overseas investment insurance, the banks hope the government will allow much greater flexibility as well as help strengthen the financial base for trade insurance.

When it comes to projects contributing to the recycling of capital to debtor countries and their economic development, they expect to see the government act from the standpoint of economic cooperation, free from the principle of balancing revenue and expenditure. In the area of taxation, the commercial banks seek the increase of legal reserves against losses in overseas investment and the implementation of preferential measures for direct investment through the conversion of debt into stocks. Essentially, what the commercial banks are asking is the establishment of a solid base upon which to promote the recycling of private capital to developing countries.

V Conclusion

The $30 billion capital recycling programme will have a powerful impact. Japan declared that it was prepared to contribute actively to remedying the current tensions in the world caused by cumulative debt problems in Latin America and other developing countries that threaten to spark global panic. This declaration did not stop at mere abstractions; it was backed by concrete and objective figures. In this sense, it marked a major departure from Japan's usual international stance.

It was not long before the programme met with strong international opposition. This was in part because of its ambiguity in regard to details. More essentially it soon showed that contrary to initial impressions, it was not grounded on Japanese self-sacrifice. The basic line of thinking that ran through the programme was this:

> Japan's current account surplus was chiefly generated by private sector activity and has accumulated in that sector. The public sector (the government) is faced with an enormous budget deficit and cannot make any more large-scale additional disbursements. Therefore, Japan will utilize the market mechanism to recycle private sector surplus to developing countries. In doing so it will make full use of the advisory and catalytic functions of the international developing financing institutions. All that the Japanese government is capable of doing is to create a favourable environment for these activities.

This argument reflects no real commitment on the part of the Japanese government to solving the problems of developing countries, and so it is quite natural that the world views the programme with scepticism. The world expects—and demands—that Japan commit itself to helping to an extent commensurate with its ability and directly bear the costs involved. The community of nations has repeatedly voiced criticism of Japan's low ODA/GNP and grants/ODA ratios. The attainment of Japan's ODA programme's third medium-term target on a dollar basis has been scarcely recognised at all internationally due to the rapid rise of the yen and fall of the dollar. This gives us an idea of the standpoint from which international society evaluates Japan's initiatives.

In December 1987, Japanese Prime Minister Noboru Takeshita, attending the summit of ASEAN leaders, announced the establishment of the "ASEAN/Japan Development Fund." This fund, as part of the capital recycling programme, would grant a total of $2 billion to ASEAN nations over a three year period for use in fostering the development of private enterprises, over and beyond the existing bilateral aid programmes. In addition, the Japanese government appropriated from the draft budget for fiscal 1988 Y2 billion (abut $16 million) and Y3,500 million (about $28 million), respectively, for gratuitous contributions to the Asian Development Bank and Inter-American Development Bank. Thus, the programme gradually has begun to take shape after having passed the scrutiny of four government ministries and offices. There is still one point at issue, however: that is, the nature of the funds made available. The success of the capital recycling programme depends on the extent to which Japan can humbly accept international criticism and provide attractive loans to developing countries. Concretely, it is crucial that the programme be closely coordinated with ODA policy. Needless to say, its goal must not be to promote Japanese exports.

In addition to the nature of funds to be recycled outward, Japan must pay adequate attention to feedback from the recipient countries. This is because capital recycled to the developing countries aims to promote structural adjustment and, ultimately, economic growth in those countries. It will, as a result, lead to expanded manufactured exports from these countries to Japan. This programme might in some cases actually work to the detriment of Japan through a boomerang effect. Japan must cope with whatever situation emerges through progressive efforts to open its markets. Only in this way can the programme construct a "loop" for beneficial exchange between Japan and the developing countries. Only this kind of programme can help Japan realise the goal of becoming a fully fledged member of international society.

In recent months, in order to secure effective and quick capital recycling to developing countries, the Japanese government has undertaken various measures. The Export-Import Bank of Japan began to expand and strengthen the system for foreign currency loans to reduce the exchange risks for the recipient countries. Also, the Bank was authorised to make equity investments in developing countries' corporations or joint ventures. As for the yen loans, the interest rate was reduced by 0.4%, and the average interest rate went down from 3.0% to 2.6%, below the DAC average. Furthermore, the improvement and more effective use of insurance schemes for overseas investment and trade was initiated.

In parallel with these measures, the Japanese government has progressively implemented the $30 billion capital recycling programme. On a commitment basis, by the end of April 1988, the Japanese government had implemented $21.06 billion, which accounts for 70.2% of the total capital to be recycled. The capital recycling programme is now in progress, and it is quite difficult to determine its significance. We can safely say, however, that what is of critical importance is not the very idea of capital recycling but its implementation in a manner that satisfies the rising expectations of the international community.

Anthony Sampson has commented:

> A major increase in Japanese funding to the third world would call for a radical reappraisal of the whole balance of aid—behind which Japan would have to throw its full diplomatic weight. And the question is: will Japanese politicians and officials be ready to take this strain, with all the exposure to criticism and debate that it will involve? . . . While industrialists and bankers can move swiftly to adjust to new trading conditions, governments and bureaucracies take much longer to adjust their sights or their field of vision. (*Newsweek,* 31 December-7 January 1987)

This argument may be hard to refute.

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