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8 Foreign Aid and Burdensharing: Is Japan Free Riding to a Coprosperity Sphere in Pacific Asia?

Shafiqul Islam

> The Americans concentrate on a vision of Japan as a closed society, driven by totally selfish economic motives, unfairly exploiting American military protection to dump its industrial-technological products on America while driving Americans out of their jobs.
>
> ZBIGNIEW BRZEZINSKI

> The way *Japan Inc.* operates also facilitates the formation of an Asian co-prosperity zone: government and business work hand-in-glove and business moves jointly. They move together as a group, because they are so keenly aware of vulnerability on their own. The decision will be made by consensus, and the rest is routine.
>
> RUDIGER DORNBUSCH

8.1 Introduction

Americans routinely label Japan an international free rider.[1] The accusation is rooted in one simple fact: America spends 5–6 percent of its GNP on maintaining its military supremacy while Japan, committed to nonaggression formalized by its "peace constitution"—and protected by the 1960 United States–Japan mutual cooperation and security treaty—limits its military spending to about 1 percent of GNP.[2] Since neither America nor Japan's Asian neighbors wish to see Japan—already an economic superpower—engage in rearmament and emerge as a military superpower, how to prevent Japan from enjoying a security free ride to economic supremacy has become a matter of increasing

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1. See, among others, Johnson (1986), House Armed Services Committee (1988), Schroeder (1988), Reed (1983), and MacIntosh (1987).

2. Popular sentiment against war and the military is probably a more binding barrier against a sharp rise in Japan's defense expenditure than the war-renouncing clause (Article 9) inserted by the American victors in the 1947 "peace constitution." The 1 percent of GNP limit on defense expenditure was established by Prime Minister Miki in 1976. While this limit was broken de jure when the Diet approved a fiscal 1987 defense budget at 1.004 percent of GNP, conventional wisdom notwithstanding, the *actual* defense spending so far has not exceeded the 1 percent limit.

concern to some Americans.[3] One resolution to this conundrum is official development assistance (ODA): there is virtual consensus on both sides of the Pacific that Japan should assume greater global responsibility by substantially expanding its economic assistance to the Third World.[4]

The "foreign aid solution" to the free rider problem, however, has created a new quandary and concern: some Americans are now complaining that Japan is creating a new "coprosperity sphere" in Pacific Asia, with official aid driving private trade and investment. The accusation now is that Japan is providing aid primarily to promote its trade and investment interests in Pacific Asia, and not so much to meet the developmental needs of the recipient countries.[5]

This paper reviews the evidence and concludes that there is little basis for singling out Japan's behavior as globally irresponsible and mercantilist and regionally neocolonialist. Section 8.2 critically reviews the popular concepts of burdensharing and military free ride, and questions the notion that the U.S. national defense is an international public good. Section 8.3 presents an empirical assessment of the view that Japan engages in unfair aid practices (provides low-quality aid) and aid mercantilism (gives aid to serve its own commercial and trade interests) in Pacific Asia and elsewhere. Section 8.4 looks at additional evidence to assess the thesis that Tokyo is implementing an official aid

3. Johnson (1986) sums it up as a Japanese defense dilemma: "Fear of revived militarism, then, constitutes the first horn of the Japanese defense dilemma. The other horn of the dilemma is, of course, the persistent charge that Japan is taking a free ride on the backs of the Americans, Koreans, Taiwanese, and all the other peoples of the Pacific Basin who take seriously their responsibilities to try to maintain a stable and secure environment. This free ride is doubly galling since no nation profits more from international political and military security than does Japan." See also Yamamura (1989), Hellmann (1989), and Brown (1987).

4. Balassa and Noland (1988, 188) suggest this resolution: "Japan could increase its defense capabilities by building up its conventional forces, naval strength, and air defenses. Japan would still rely on the United States for nuclear protection and for the defense of distant interests and would thus remain a significant free rider in defense matters. The government could partially offset that, however, by increasing its financial assistance to developing countries." See also Kissinger and Vance (1988), McNamara (1992), Robinson (1986), Peterson (1987), Okita (1989, 1986), Murakami and Kosai (1986), Nakasone (1986), Takeshita (1991), and Kaifu (1989).

5. See, for example, Arase (1991, 1988), Harrison (1991), Maidment (1989), Brown (1991), and Garten (1989–90, 95). Two chapters in this volume also propound this thesis: Katzenstein and Rouse (chap. 6) and Doner (chap. 5). For example, Katzenstein and Rouse write: "In January 1987 MITI unveiled in Bangkok a program known as the New Aid Plan, dealing specifically with the issue of infrastructural difficulties in Asia and their relation to the developmental needs of Japanese industry and the restructuring of the Japanese economy in general. . . . The program is an attempt to relocate selected Japanese businesses to Southeast Asia through loans and technical assistance to governments. These loans will be used for the improvement of infrastructure, including industrial estates, ports, and improved telecommunication services. . . . MITI, the Overseas Economic Cooperation Fund (OECF), and the Ministry for Foreign Affairs, are attempting . . . to coordinate different aspects of this plan, the details of which are negotiated bilaterally with each government." Rich Doner says: "One of its [the New Aid Plan's] goals was to facilitate Japanese domestic restructuring. The other was to provide assistance to export-oriented industries in developing Asia, including help in targeting particular sectors for development. These may be part of MITI's efforts to extend its industrial planning and coordination activities into foreign economies in response to the expansion of Japanese FI and the lack of coherent industrial policies in host countries (Wade 1992, 290)."

plan to create a new coprosperity sphere—a regional economy in East Asia to serve Japan's economic interests. Section 8.5 examines the dynamics of United States–Japan cooperation and conflict in the Philippines and the Asian Development Bank (ADB) to further address the issue of Japan's free-riding behavior and its strategy for gaining regional hegemony with mercantilist means. Section 8.6 summarizes the key conclusions.

8.2 Burdensharing and Japan's Free Ride: Is U.S. Defense Spending an International Public Good?

Burdensharing and military (security) free ride are intimately related concepts. An ally that fails to bear its "fair share" of common defense burden, by definition, is enjoying a military free ride. (A country's burden is typically measured by its share of military spending in its GNP). When Americans first coined these terms, this burden referred to that of common defense of the members of NATO against a possible attack from the Soviet Union, and the security free riders were America's underburdened European allies.[6] By the late 1960s, Japan joined the ranks of free riders as it began to catch up with the West and posed a growing competitive challenge to American supremacy in manufacturing. During the 1980s, Japan emerged as the top "unfair burdensharer" as it transformed into an economic, financial, and technological superpower and threatened America's supremacy in high finance and high technology. Meanwhile, the United States maintained economic growth and rising living standards by borrowing huge sums from overseas—a large chunk of it from Japan—and turned almost overnight into "the world's largest debtor nation."[7] Consequently, the perception heightened that Japan had taken a free ride to economic supremacy at the expense of America, which is lying flat on its back under the burden of defending its economic adversaries.[8]

Japan, however, posed a unique conundrum to the applicability of the concept of burdensharing. Having renounced war and aggression in its 1947 "peace constitution" after massive death and destruction and a humiliating defeat in World War II, in 1976 Japan decided to limit its military (self-defense) spending to 1 percent of GNP. This nonaggressive military posture enjoys immense support within Japan and abroad. With the United States devoting 5–6 percent of its GNP to maintain its military superpower status, there is thus only one way Japan can eliminate its "defense burden deficit" and stop free riding: by increasing its defense spending by 4–5 percent of GNP. While Japan has continued to increase host nation support for U.S. military bases, has extended its defense responsibility over sea-lanes to a distance of 1,000 nautical miles,

6. See, for example, Bull (1964) and Pincus (1962).

7. For a detailed analysis of the causes and consequences of America's debtor status, see Islam (1988).

8. This perception appears partly to explain the popularity of "the imperial overstretch" thesis advanced by Paul Kennedy (1987).

and is now participating physically in the United Nations peacekeeping force, it has long been considered virtually impossible for Japan to increase its defense spending three- to fourfold. This is because neither the American security experts, nor the Japanese people, nor Japan's Asian neighbors think that rearming the rising sun even to a modest degree for the sake of fairer burdensharing will enhance global peace and security.

This paradox by the late 1970s led to a reformulation of the goal: how to reduce Japan's free ride without rearming it into a military-nuclear superpower. More recently, this reformulation has led to a redefinition of the global security burden: the burden now is not confined to military spending alone, but includes other "international public goods," items such as development assistance, alleviation of the Third World debt problem, international peacekeeping, preservation of the environment, the fight against international terrorism and drug trafficking, prevention of international transmission of communicable disease, and so on.[9]

Thus the reconstructed concept of burdensharing (or responsibility sharing, as more balanced and sophisticated observers correctly rephrase it[10]) envisions a division of labor in global roles. In this "new world order," the United States will continue to provide a security umbrella to Japan and other allies by carrying "the burden of being the world's only military superpower," and Japan will try to match the costs of maintaining the downsized but still massive American military machine by spending huge sums on development assistance and other international public goods. Incidentally, the Gulf War appears to have broadened the scope of burdensharing/responsibility sharing even further: now the presumption seems to be that if the United States fights a war, especially with a seal of approval from the United Nations Security Council, then Japan has a perfect one-shot opportunity to temporarily reduce its free ride by picking up a large share of America's war expenses. In other words, Japan in this post–Cold War, post–Gulf War world is to bear its fair share of the burden by paying for not only nonmilitary international public goods, but also wars that the United States decides to wage to selectively defend freedom and democracy.

Many advocates of burdensharing seem to rest their case on essentially three propositions: (1) America's relative economic decline and Japan's economic prosperity are rooted in Japan's security free ride under U.S. protection. (2) U.S. national defense spending is an international public good in the context of not only NATO, but also the 1960 United States–Japan mutual coopera-

9. See McNamara (1992) and Peterson (1987).

10. Burdensharing, by construction, is a one-sided concept: it focuses solely on a hegemonic nation's financial and human cost of assuming leadership of a collective security arrangement, and ignores the power, privilege, and prestige that comes with it. By contrast, responsibility sharing is a more balanced concept because it recognizes the positive correlation between burden and power; that is, greater burdensharing will result in greater power sharing. The adherents of the burdensharing school appear to avoid the issue of power sharing.

tion and security treaty. (3) Japanese ODA is also an international public good and is highly substitutable for Japanese and American defense spending. The rest of this section argues that these presumptions rest on faulty foundations.

The central argument supporting the first proposition runs as follows: while the United States devotes a disproportionately high share of national resources to military spending and thereby weakens its global competitive position by diverting resources away from productive investments, Japan, protected by the U.S. security umbrella, spends little on defense and devotes freed-up resources to improving economic competitiveness, and thereby beats hands down its military protector in the international marketplace (see Harrison and Prestowitz 1990).

While this is not the place to settle this debate, I would simply stress that the alleged negative security-economics linkage has little empirical grounding; it is simply another example of the fallacy *post hoc, ergo propter hoc.* The proponents of this linkage are fully satisfied with the prima facie evidence that high-defense America appears to be losing its competitive edge to low-defense Japan. One wonders whether they really believe that if Japan spent 6–7 percent of its GNP on defense in the postwar period, it would have failed to catch up with the West and to attain its legendary manufacturing prowess. One can just as easily argue the opposite: with a high proportion of resources devoted to defense, Japan would have not only become an economic superpower; it could have also achieved what it does not have today—supremacy in military technology and in other areas where this technology and the associated R&D spending have spillover effects (aviation, for example). The proponents also seem to forget that the United States reached new economic heights in the wake of two world wars while it devoted a much larger share of its GNP to military spending. During the 1950s and 1960s, the United States reached the peak of its economic supremacy; these were also the years when the nation assumed a much larger burden of defense as compared to the last two decades.[11]

Looking around the Pacific, three out of the four so-called Asian dragons—Taiwan, Singapore, and South Korea—devote a much larger proportion of GNP to defense than does Japan. (Hong Kong is a British colony where the resource allocation statistics are either unavailable or messy and difficult to interpret.) If high defense spending did not stop Taiwan—a small island with no history of past glory and power—from achieving economic prosperity, one may wonder why it should have stopped Japan—the only Asian country to have approached the level of industrial development of the Western nations before World War I—from emerging as an economic superpower. Having

11. One can argue that the economic ills of the 1970s and 1980s are precisely the lagged effects of excessive defense spending of the earlier decades—effects of diverting scarce resources to fight the Korean War, the Vietnam War, and above all the Cold War. The available econometric and other empirical analyses offer mixed answers. For an analysis that does not support the above thesis, see Weidenbaum (1968).

committed the sin of engaging in causal empiricism, let me absolve myself by referring to the higher authorities: the large and growing empirical literature on the subject turns up mixed evidence—there is no clear-cut linkage between a country's defense spending and its economic performance.[12] A country's saving rate and other characteristics may influence this linkage significantly. In the case of Japan, at least one study found little evidence of the free ride contributing to its economic prosperity (Okimoto 1982). Thus it does not appear that America made a mistake by providing Japan military protection—even without it, Japan would likely have emerged as an economic superpower. Indeed, those who fear Japan's militarism may wish to find comfort in that the free ride has kept Japan from becoming a military superpower, and is likely to keep it from challenging America's preeminence in the military sphere over the foreseeable future.

The second presumption that the U.S. and the Japanese defense contributions to the United States–Japan security treaty can be interpreted as *international public goods* is fraught with a series of questionable assumptions.[13] To begin with, it is difficult to statistically determine how much of the U.S. national defense expenditure (and the Japanese national defense expenditure) is a contribution to the United States–Japan security treaty (or the United States–Japan alliance, to use a term favored in the 1980s), and how much is not. Some observers implicitly assume both countries' total national defense expenditures (America's 5–6 percent of GNP defense burden and Japan's 1 percent burden) to be their contributions to the alliance, while others view the estimated costs of the U.S. military presence in Japan (or in the Pacific) as America's burden of defending Japan. Analytically the more significant issue, however, is that a hegemonic nation's international commitments cannot be neatly separated from its national interest: America's financial and human costs of assuming leadership of a collective security arrangement (NATO, the United States–Japan security treaty, and so on) are precisely what bring it various economic, political, and psychic benefits. In other words, the burden that the United States seems increasingly unwilling—and apparently unable—to bear is the burden of being the superpower: this burden forms the basis of America's global power, prestige, and privilege.

In the language of the theory of public goods, U.S. national defense at the international level is thus at best a *mixed good* with a dominant private good

12. See, for example, Benoit (1973, 1978), Deger and Sen (1990), Faini, Annez, and Taylor (1984), and Kaldor (1978).

13. Olson and Zeckhauser (1966) did the seminal work where they analyzed common defense within an alliance as a public or collective good. Murakami and Kosai (1986, 34), among others, extended the concept of international public goods beyond common defense. More recently, Balassa and Noland (1988, 173) applied the concept of international public good to U.S. and Japanese expenditures on defense and foreign aid: "The responsibilities of world leadership require Japan to take a more active role in the collective management system and in the provision of international public goods. In this chapter, we have examined two potential areas for action—military security and assistance to developing countries."

feature. Put another way, defense produces joint products—these may include anything from positive economic spillovers of military R&D spending to the ability to use the military to serve nonalliance national security objectives—that are not, or only partly, appropriable by the members of the alliance.[14] In addition to this obvious mixed good characteristic of defense in the alliance, three other shortcomings of interpreting the U.S. or Japanese defense spending as international public goods are worth stressing. First, the widely accepted notion that defense at the national level is a pure public good is only partly accurate. For example, while the deterrence resulting from national defense can be viewed as a pure public good because it meets the *nonrivalness* and *nonexclusion* criteria,[15] the same cannot be said about defense when deterrence fails. This is because the instruments of defense will not protect all communities and all regions within the country in the same way, thus failing the nonrivalness criterion.[16]

Second, the public good characteristic of defense when it is a contribution to an alliance such as NATO becomes even more diluted. Deterrence passes the nonrivalness test, but not the nonexclusion test, as one leading member (say, the United States) can lower its deterrence for a particular ally (say, France) by eroding the credibility of defense for that ally. If deterrence fails and an attack ensues, neither criterion of a pure public good is met. The defense in the wake of an attack from the common enemy fails the nonrivalness test as more attention to the security of its own citizens may prevent a member (say, the United States) from providing the same degree of protection to its NATO allies. It also fails the nonexclusion criterion. For example, the United States may give itself more protection than its European allies.

Finally, the international public good feature of common defense is further diminished when it to comes to the United States–Japan security treaty. For one, the treaty appears to have incorporated two separate objectives: to defend against the common enemy, the Soviet Union; and to ensure that Japan did not become a military and nuclear superpower. In other words, part of the agreement was actually to ensure that one ally remained the military and nuclear superpower by spending a lot on defense while the other one maintained limited national defense capability by spending much less. Put another way, Japan's "military free ride" was a mutually agreed-upon component of the treaty because both parties saw it as serving their own national interests.

While this mutually beneficial bargain is not explicitly stated in the treaty,

14. Olson and Zeckhauser (1966, 272) recognize this: "Another assumption in the model developed in the foregoing section was that the military forces in an alliance provide only the collective benefit of alliance security, when in fact they also provide purely national, non-collective benefits to the nations that maintain them."

15. *Nonrivalness* refers to the fact that one can consume a public good without reducing the amount consumed by others. *Nonexclusion* means one cannot prevent others from consuming a public good even if they do not pay for it. See Samuelson (1954) and Head (1962).

16. This paragraph and the next draw heavily on De Strihou (1967).

it is implicitly referred to in Article 3, with a mention of constitutional provisions: "The Parties, individually and in cooperation with each other, by means of continuous and effective self-help and mutual aid will maintain and develop, subject to their constitutional provisions, their capacities to resist and attack." The significance of this seemingly innocuous reference to "constitutional provisions" becomes clear when one recalls chapter 2 of Japan's constitution.

> Aspiring sincerely to an international peace based on justice and order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as a means of settling international disputes.
>
> In order to accomplish the aim of the preceding paragraph, land, sea and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized.

One interpretation of this treaty could be that the United States agreed to provide Japan a mixed good in exchange for a limit on Japan's provision of a mixed good. Moreover, both the United States and Japan (and many of Japan's Asian neighbors) continue to view a substantially enlarged Japanese defense capability as an "international public *bad*." Clearly many security experts believe that if one of the parties pulls out of this treaty—especially in the context of deteriorating bilateral relations—Japan will sharply increase its defense expenditure, starting an arms race in the region, and perhaps inducing the United States to respond by spending more. This brings out another interesting point: in the absence of an alliance, national defense of individual countries can be interpreted as partly an international public bad.[17] The central point, however, is that Japan's low defense spending cannot be interpreted as a free ride, because both the United States and Japan appear to believe it to be in their national interest to limit Japan's military spending, as both view significantly increased Japanese defense spending as an international public bad.

The end of the Cold War does not invalidate the above arguments. With the disappearance of the Soviet Union as the common enemy, NATO as well as the United States–Japan alliance now face more than one "common enemy"—they are multidimensional, diffuse, and unpredictable (for example, future ethnic wars within a nation or regional conflicts between two erstwhile friendly countries). All of this only weakens the argument that Japan is a free rider, as the face of the common enemy becomes fuzzier and mutual need for containing a rise of militarism in Japan becomes greater.

Finally, the GNP-share-based methodology to measure the burden and deter-

17. This interpretation follows directly from the theory of externalities: without cooperation or public intervention, a public bad (pollution) will be overproduced. Olson and Zeckhauser (1966, 272) mention this result without any reference to defense as a public bad: "Allied nations may be suspicious of one another, even as they cooperate in the achievement of common purposes, and may enlarge their military forces because of conceivable future conflicts."

mine the bilateral burden imbalance assumes that defense and foreign aid—of the United States and of Japan—are all *highly substitutable* international public goods. This is again a dubious assumption. Applying reasons already advanced, one can see that the case for ODA as an international public good is even weaker: the political credit goes to Japan—and not to other donors—and both the nonrivalness and nonexclusion criteria fail even more clearly. For example, Tokyo's aid to Thailand does not confer on the United States the same economic benefits as it does on Japan (nonrivalness fails), and Japan can partially exclude the United States from benefits of its foreign aid to Thailand (nonexclusion fails). ODA is thus a mixed good where its private good feature seems dominant.

The practical problem arises from the way many observers treat U.S. defense spending and Japanese aid spending as perfect substitutes—a clearly invalid presumption. When it comes to measuring a country's burden, the share of GNP devoted to military spending is added to that devoted to other international public goods.

Typically, the basket of other international public goods is reduced to one good—ODA (McNamara 1992; Kosminsky and Fischer 1989; Pharr 1988; WIDER 1987). Thus the burden is often measured by adding the share of GNP spent on development aid to that spend on defense. Yamamura (1989, 229) sums up this approach succinctly: "The logical and realistic course for Japan is to increase its 'sacrifice' by sharply increasing its nonmilitary contributions to the alliance and to world peace—that is, by increasing its official development assistance (ODA)." Robinson (1986, 8) presents his burden calculations as follows: "Japan could make a commitment sufficiently large that the world would have to take notice. How large? Well, what about $60 billion a year? Where did I get this figure? The United States spends about 6.5 percent of its GNP on defense and foreign aid. Japan spends about 1.5 percent of its GNP—5 percent less. Five percent of Japan's $1.2 trillion GNP comes to $60 billion, or roughly ¥11 trillion."

Making no distinction between one country's military spending and another's foreign aid spending, and the using combined spending on military and foreign aid as the measure of the burden, however, appears to make little economic, political, or even moral sense. For example, such an approach implies that if America decides to spend 1 percent of its GNP on "Star Wars," then Japan is being a selfish free rider if it does not follow by allocating 1 percent of its GNP to development assistance. Or that if the United States spends 5 percent of its GNP on defense and Japan spends only 1 percent, then the goal of fair burdensharing dictates that Japan spend 3–4 percent of its GNP on foreign aid or be doomed to the status of a free rider. In this view, the overriding objective is for Japan to spend some x percent of its GNP on some nonmilitary items; who gets the money and how it is used are less important. The following line of reasoning advanced by one prominent observer of United States–Japan relations, Yamamura (1989, 231), is widely shared:

> Another reason to argue that even Takeshita's seemingly ambitious goal for ODA in the 1988–1992 period is inadequate is that Japan's military expenditure and ODA will remain significantly less than those of its Western allies (except Canada), which spend 4 to 6 percent of GNP for defense in addition to ODA. . . . Therefore, if Japan provides ODA of $10 billion per year as projected by the Takeshita proposal, it is still likely to be criticized by its allies for failing to do its share. Given its GNP of nearly $2.5 trillion, ODA equivalent to 1 percent of Japan's GNP (the amount needed to bring the sum of the defense expenditure and ODA to 3 percent) would be $25 billion. This suggests that, even allowing for a steady increase in Japan's military expenditure, many in the Western alliance are justified in demanding that Japan not only maintain the current pace of increase in its defense expenditures but also increase its ODA and other international contributions substantially as soon as possible from the projected level of $10 billion to about $25 billion per year.

The central point of this section is not to question the need for Japan to assume greater global responsibilities; it is to challenge the conventional premise and modalities for doing so. Japan should play a greater global role, but not because it should pick up a fair share of its burden by compensating for its military free ride. There is a much more simple and compelling reason: Japan is a global economic superpower, and despite recent progress its global commitments and obligations still fall far short of its capacity for undertaking global responsibilities. Since Japan is a nonnuclear pacifist power, and so far the international community on balance prefers it remain so, it seems sensible that Japan make contributions in nonmilitary areas by addressing the problems of poverty, economic underdevelopment, natural disasters, environmental degradation, and other transnational "common enemies."[18]

While both U.S. and Japanese political leaders are increasingly using the term "global partnership" to characterize the bilateral relationship, an adequate and satisfactory elaboration of what this term means still seems to be lacking. In my view, the concept of global partnership or "collective responsibility sharing," if properly defined and applied, can effectively deal with an increasingly unsustainable global imbalance causing much of the bilateral friction—the imbalance between monetary might and military muscle of the world's top two economic superpowers. A credible exercise of hegemonic leadership requires both monetary might and military muscle. As the Gulf War has demonstrated, if a superpower assumes the burden of flexing its military muscle but lacks the monetary means, it runs the risk of becoming the world's police-for-hire; similarly, if an economic and financial superpower unburdened with military

18. In response to the U.S. pressure—intensified during the Gulf War—for sweat and blood in addition to money, Japan has also begun to participate in the United Nations peacekeeping force. Future historians may look back at this development as a first step toward Japan's rearmament. The historical irony is that the country—the United States—that helped Japan embrace pacifism after World War II is the one that may turn out to be responsible for pushing Japan to break out of it half a century later.

prowess tries to help with money alone, it risks becoming a push-button cash dispenser.

The principle of global partnership reduces these risks arising from this monetary-military imbalance. While burdensharing assumes that America is selflessly carrying the burden of defending freedom and peace, and that it is only fair that its allies share it (through military and monetary means), global partnership rests on the premise that promoting global peace and prosperity is the collective responsibility of the leading nations, and that they should exercise joint leadership within a multilateral framework and contribute jointly according to their respective national advantages.

The underlying assumption here is that promoting global peace and prosperity is a responsibility—it is a burden as well as a source of power and influence—and that since the world is dominated by a group of major powers, this responsibility has to be shared, although not necessarily equally. Nations with greater economic, military, and leadership capacity may shoulder more of the responsibility and consequently may project more power and influence. For example, with a chronic shortage of financial resources the United States is no longer the supreme superpower it was in the 1950s, but it is still the only nation on earth that is both an economic and a military superpower. In other words, America is first among equals and thus is still the only power capable of being the leading, or senior, partner of a global partnership—or the largest "shareholder" of collective responsibility.

The principle of global partnership thus implies that mechanical formulas involving dollar figures and GNP shares may not be the way to determine Japan's monetary and other contributions to the global community; the nature and the magnitude of Japan's contributions should be assessed on a case-by-case basis depending on the needs in a particular area relative to Japan's capacity in meeting them. It also implies that America's unilateralist instinct in dominating multilateral organizations should be contained; the tendency to hold on to political power while prodding Japan to shoulder the ever-growing financial burden only erodes the credibility of American leadership and subverts the emergence of a true United States–Japan global partnership or of a new world order promoting peace and prosperity.[19]

8.3 How Unfair and Mercantilist Is Japanese Aid to Pacific Asia?

Many of America's Japan experts believe that Japan provides low-quality aid primarily to meet its own commercial needs. For example, Hellmann (1989, 262) asserts: "Roughly 70 percent of aid is tied—in fact, if not formally—to the Japanese economy." Pharr (1992, 18) says: "In all these [quality of aid, grant element, terms, and portion of grant to loan aid] areas, Japan repeatedly has been found wanting in OECD reviews"; however, she adds that

19. For more details on the concept of global partnership, see Islam (1991, 216–24).

"Japan is committed to making improvements."[20] Indeed, the view that Japan gives aid to serve its own narrow economic interests constitutes an important bridge between the theme of global free ride and that of an East Asia co-prosperity sphere. The purpose of this section is to see whether this bridge can take the weight of empirical evidence.

It is useful to classify the myriad criticisms of Japanese development aid into two broad categories: unfair aid practices and aid mercantilism. I focus on two specific criticisms under the category of *unfair aid practices* (low aid quality): the share of grants in total ODA is too low, and the loans are not concessional enough; and too little aid goes to support "basic human needs" of the poorest of the poor (too much goes to finance economic infrastructure). While overlapping indirectly with unfair aid practices, *aid mercantilism* subsumes the following specific criticisms: Japan makes extensive use of *tied aid* (limits aid money to procurement from Japan) and *mixed credits* (subsidizes sales of Japanese goods by spicing up export credits with concessional developmental loans) to boost exports; and it promotes Japanese high-technology sales with excessive focus on capital projects and physical infrastructure.

Before trying to assess the empirical validity of these criticisms for Pacific Asia, it may be useful to address the criticism that Japan gives too little aid (low aid quantity) and most of it goes to Asia (inequitable geographical distribution) (Pharr 1988; Bloch 1991, 76). Table 8.1 reports the relevant aid data for the Group of Seven (G-7) countries. On aid volume, three points are worth emphasizing. First, while in nominal dollar terms Japan replaced the United States as the top donor nation in 1989 for the first time in the "history of ODA" (ODA is a post–World War II phenomenon with a very short history) before returning to the number two position in 1990, it had to provide only 0.31 percent of GNP to accomplish this feat. That is because the United States spent only 0.15 percent of its GNP on ODA in 1989 and was able to recapture its traditional top donor position in 1990 with a 0.21 percent of aid-to-GNP ratio. While 0.31 percent of GNP looks pitifully small, Japan should not be singled out for being "stingy": in 1990, two (the United States and the United Kingdom) of the other six major countries did worse, and one (Italy) did about the same. To put it the other way, only half of the other six did modestly better. Indeed, Japan's 0.31 percent of GNP contribution was only 0.04 percent less than the Development Assistance Committee (DAC) average of 0.35 percent. The issue here is not to argue that these numbers are necessarily adequate, but to point out that Japan is not behaving particularly differently from the other G-7 countries.

The comparison with the Nordic countries that contribute a much higher percentage of GNP to ODA is misleading because it ignores the enormous difference in economic size. For example, Norway contributes more than 1

20. See also Pharr (1988), Pyle (1989), and Preeg (1989b). Yamamura's (1989, 230) comment is typical: "Japanese ODA has been known for both its high proportion of tied loans and the high interest rates it charges."

Table 8.1 G-7 Countries, ODA Disbursements and Geographical Distribution

	Net Disbursements				Bilateral ODA: % of Gross Disbursements									
	$ million		% of GNP		Sub-Saharan Africa		South Asia		Other Asia and Oceania		Middle East and North Africa[a]		Latin America and Caribbean	
	1989	1990	1989	1990	79/80	89/90	79/80	89/90	79/80	89/90	79/80	89/90	79/80	89/90
Japan	8,965	9,069	0.31	0.31	10.4	13.5	32.6	16.9	41.3	52.5	8.6	8.8	7.1	8.2
United States[b]	7,676	11,366	0.15	0.21	12.7	14.0	11.8	10.3	10.1	7.1	54.4	48.2	11.0	20.5
Germany	4,948	6,320	0.41	0.42	32.5	36.4	20.9	12.3	7.2	13.6	29.6	26.2	9.8	11.4
France[c]	5,162	6,571	0.54	0.55	45.2	54.3	2.0	2.7	14.4	14.0	13.0	9.7	25.3	19.2
United Kingdom	2,587	2,647	0.31	0.27	36.3	50.5	40.7	26.7	9.4	10.5	6.8	4.5	6.8	7.8
Italy	3,613	3,395	0.42	0.32	54.1	55.9	3.1	4.4	10.4	6.0	21.2	13.5	11.3	19.9
Canada	2,320	2,470	0.44	0.44	41.1	53.4	35.3	14.1	4.9	12.0	7.6	6.7	11.1	13.9
Total DAC	46,712	54,077	0.34	0.35	29.2	34.3	18.4	11.8	16.7	21.2	22.9	18.4	12.9	14.5

Source: OECD (1991a).

[a]Includes small amounts of ODA to southern Europe.

[b]For 1990, includes forgiveness of non-ODA military debt of $1.2 billion.

[c]Excludes net ODA flows to the Overseas Departments and Territories (DOM/TOM).

percent in GNP, but in 1989 it came to less than $1 billion; that year Japan's GNP was more than thirty times that of Norway. If Japan's net disbursement of ODA were 1 percent of GNP in 1989, it would have provided $30 billion. That sum is equal to the two-thirds of the 1989 total net DAC disbursement. It is not clear how Japan could have effectively disbursed such a huge volume of aid.

Second, while avoiding a formal commitment to reach the United Nations target of 0.7 percent of GNP within a specified period of time, Japan pledged to "improve steadily the ratio of its ODA to GNP" in its Fourth Medium-Term Target of ODA announced in June 1988 (OECD 1991, 12; Ministry of Foreign Affairs 1990, 155). By contrast, the United States has rejected such a target and has made no commitment to increase its ODA/GNP ratio. Given the domestic political and administrative constrains as well as the limited—and slowly expansive—absorptive capacity of the recipient countries, it seemed until recently that Japan would be unable to raise its aid/GNP ratio substantially in the near future. With rising demand for official resources in some new areas—especially environmental challenge in the Third World, opening up of Indochina, and economic reform and development of nations (old and new) in central and eastern Europe and the former Soviet Union—a window of opportunity has, however, opened for Japan to increase its contribution rapidly through bilateral as well as multilateral channels.

Finally, without denying the role of additional external resources in promoting growth and development in the Third World, the important issue is not how to reach a magic quantitative target for aid: it is how to use the money effectively to promote equitable, environment-friendly, and self-sustaining development. Excessive focus on who gives what percentage of GNP can distract one from the real goal, which is how to employ foreign assistance as an effective catalyst in the development process and help the developing countries to help themselves. This point is particularly important in view of the fact that ODA so far seems to have been more successful in creating a growing ghetto of aid-addicted dependencies rather than in assisting countries to "graduate" and take off on a path of sustainable development (Lele and Nabi 1990; OECD 1985; World Bank 1990, 127–37).

Two observations are in order with regard to the criticism that Japanese aid is excessively concentrated in Asia. First, it is true that almost 70 percent of Japanese aid goes to Asia. But the intra-Asia distribution has changed dramatically during the 1980s—there has been a shift away from South Asia toward Southeast Asia and China. For example, while the share of Japanese aid going to South Asia has dropped from 33 percent in 1979/80 to 17 percent in 1989/90, the share going to "other Asia and Oceania" (largely Southeast Asia and China) has risen from 41 percent to 53 percent (table 8.1). Before one jumps to the conclusion that Japan is diverting resources from poor South Asia to richer and getting-even-richer Southeast Asia to serve its own economic and commercial interests, it should be noted that the absolute dollar volume of Japanese aid to South Asia has actually risen, although not sharply. The share shift has largely occurred due to a sharp rise in Japanese net aid disbursements to two countries: China and the Philippines (table 8.2). While Indonesia has remained the number-one recipient of Japanese aid, its share has actually declined over the 1980s. These countries are where much of the poor—not only of Asia, but of the world—live. This is one reason why despite this shift to the east from the south within Asia, Japanese share of aid to the least-developed countries has actually increased during the 1980s (table 8.6). It is also noteworthy that the increase in Japanese aid to the Philippines has been very much in response to the U.S. request for support of the military bases there and to the overall American (and Japanese) security interests in Pacific Asia. Increased aid to China reflects U.S.-Japanese interests in fostering market reforms there as well as the Japanese goal of improving relations with Beijing. And it is essentially a continuation of an old policy to expand dollar volume aid to Indonesia, the poorest and most populous country in Southeast Asia, where Japan's energy policy interests mesh well with its developmental goals.

Second, there is no economic logic why a donor should distribute its ODA more or less equally among various geographical *regions* of the world. An appeal for a better balance in distribution in terms of *sectors* (say, physical infrastructure versus basic human needs), or *income levels* (middle-income versus low-income countries), or *allocation channels* (bilateral versus multilateral) is at least more compelling, though not necessarily convincing. On geographical distribution, however, one can sensibly reason that bilateral aid is likely to be more effective if it is allocated in areas with which the donor country has close historical, political, and economic relationships, and where it is more familiar with and knowledgeable about the nature of local institutions, values, and attitudes. Indeed, this is the norm among the major donor countries: the British and the French allocate most of their bilateral aid to their former colonies. Once again Japan is no different in this respect, except that none of its major aid recipients is its former colony, although Japan had colonial ambitions toward some of them before the Second World War.

Interestingly, the United States is the outlier here whose security interests dominate its regional and country allocation of aid (table 8.1). Almost half of U.S. aid goes to the Middle East and North Africa, with 30 percent allocated to two countries out of political/security motivations: in 1989/90, 17 percent of its aid was allocated to Egypt and 12 percent to Israel (a high-income country with the 1989 per capita income of $9,790). While the share of those two countries in U.S. aid has declined, in 1989/90, they received more economic aid than all countries of Latin America and the Caribbean combined (20.5 percent).

Having questioned the economic logic of criticizing Japanese aid's Asian concentration, it is useful to point out that Japan is poised to become the world's top donor nation and remain so over the foreseeable future. That means the geographical distribution of Japan's aid can no longer be dictated by economic logic alone: political, security, and other considerations will begin to

Table 8.2 **Net Disbursements of ODA to Asia, Japan and the United States (millions of U.S. dollars)**

	Japan							United States						
	1980	1985	1986	1987	1988	1989	1990	1980	1985	1986	1987	1988	1989	1990
NIE	81	5	3	20	27	56	49	13	−24	−28	−26	−30	−39	34
South Korea	76	−4	−14	7	13	41	50	21	−19	−23	−22	−26	34	−31
Taiwan	0	0	0	0	0	0	0	−8	−5	−5	−5	−5	6	5
Hong Kong	1	1	2	3	3	4	9	0	0	0	0	0	0	0
Singapore	4	8	15	11	11	11	−10	0	0	0	1	1	1	2
ASEAN-Four	700	791	897	1,666	1,905	2,118	2,308	184	202	444	289	164	253	309
Indonesia	350	161	161	707	985	1,145	868	117	43	46	36	22	31	31
Malaysia	66	126	38	276	25	80	373	1	0	−1	0	−1	−1	0
Philippines	94	240	438	379	535	404	648	50	135	367	230	121	192	248
Thailand	190	264	260	302	361	489	419	16	24	32	23	22	31	30
South Asia	587	525	1,066	1,132	1,346	1,139	947	362	452	542	341	616	529	405
India	37	22	227	304	180	257	87	83	29	49	39	91	69	24
Bangladesh	215	122	249	334	342	371	374	174	165	146	146	120	138	169
Pakistan	112	93	152	127	302	178	194	42	144	194	90	339	263	167
Myanmar	153	154	244	172	260	71	61	0	8	9	11	10	2	1
Sri Lanka	45	84	127	118	200	185	176	55	85	127	35	41	43	75
Nepal	24	51	68	77	62	77	55	8	21	17	20	15	14	17
Indochina	4	8	11	14	17	23	18	0	1	1	3	5	7	7
Vietnam	4	1	6	0	5	2	1	0	1	1	1	1	2	2
Kampuchea	0	0	0	0	1	2	0	0	0	0	2	4	5	5
Laos	0	8	5	14	11	19	17	0	0	0	0	0	0	0
China	4	388	497	553	674	832	723	0	0	0	0	0	0	0
Grand total	1,375	1,717	2,440	3,385	3,968	4,168	4,045	559	631	959	607	755	750	687

Source: OECD (1992, 1991b, 1988, 1982).

shape Japan's national and regional aid allocation. This implies not only some equitable geographical distribution of Japanese aid, but also future shifts in the distribution within Asia and around the globe. For example, Indochina and central Asian republics of the former Soviet Union are likely to become increasingly important recipients of Japanese economic assistance, and some Latin American nations, say, Brazil and Mexico, may receive substantial environmental aid.

Having dealt with two global criticisms of Japanese aid, we can now turn to assessing the empirical validity—in Pacific Asia—of the criticisms summarized earlier. But before doing so, it would be useful to look at the evolution of Japanese and U.S. aid to the developing countries of Asia as a whole. Table 8.2 reports dollar figures for net disbursements of Japanese and American ODA to developing Asia. The numbers reveal several interesting facts. First, the much talked-about phenomenon of Japanese aid driving trade and investment in the four Asian NIEs—South Korea, Taiwan, Hong Kong, and Singapore—if present earlier, certainly ceased to exist by the 1980s. This is because since 1980 Japan has given little or no aid to these countries. Therefore, the oft-discussed aid-trade-investment linkages with Japan only apply to the four ASEAN countries and China. This is well known yet often forgotten in a broad discussion of these linkages in East or Pacific Asia.[21]

Second, as regards the rest of developing Asia, South Asia is the largest recipient of Japanese aid. Indochina receives very little at this moment, but given the recent Cambodian settlement and Vietnam's market reforms, this region can soon become a major absorber of Japanese development assistance.

Third, even the raw dollar figures on the destination of Japanese aid money seem to contradict the view that Japan's aid program is driven only by commercial motives. For example, until recently Japan had provided substantial sums of aid to Myanmar. This has a lot more to do with the history of Japan's relations with Myanmar than with profit motive of Japanese companies. Similarly, private business interests do not explain Japanese aid to Bangladesh; development and humanitarian considerations do.

Finally, the United States is no match for Japan when it comes to development aid in Asia. Among ASEAN countries, the Philippines is the only country to receive substantial U.S. aid, although it is still less than half of Japanese aid disbursement. South Asia is the only other region where the United States has a significant presence, but it also gets more than double the U.S. aid from Japan. A closer look reveals that Pakistan and Bangladesh account for the lion's share of U.S. aid to South Asia. In 1991, however, the United States suspended all aid to Pakistan. All this boils down to a striking observation: the United States provides nontrivial amounts of development assistance to only two

21. For example, Katzenstein and Rouse (chap. 6 in this volume) assert: "Japanese business and government elites view ASEAN (and the NICs) as one economy, requiring a comprehensive perspective on aid, trade, and investment. The provision of the necessary infrastructure . . . will serve the interests of Japanese companies and promote economic growth in Asia."

countries in Asia—the Philippines and Bangladesh. And both of these countries receive from Japan more than double what the United States provides.

Experts on United States–Japan relations often talk enthusiastically about the potential for United States–Japan aid cooperation in Pacific Asia (for example, CSIS 1991). One cannot help wondering, however, how Japan can cooperate with the United States in an area where the United States has little presence. With withdrawal of military bases, the Philippines may not even remain an exception for too long, as U.S. aid to that country is likely to dry up as well. With little U.S. aid going to Pacific Asia, United States–Japan aid cooperation in that region may remain alive only in conference rooms filled with United States–Japan relations experts.

The purpose of table 8.2 is partly to identify the major Asian recipients of Japanese development aid. The rest of this section will focus on those countries, namely, four ASEAN countries, five South Asian countries (India, Pakistan, Bangladesh, Sri Lanka, and Nepal), and China. Although this paper is concerned with Pacific Asia, the data on South Asia will serve as a point of reference and comparison, especially vis-à-vis the United States. Also, whenever possible, Japan's performance will be compared with that of the United States or that of the DAC donors, so that Japan's behavior is assessed not against an absolute standard but against the existing U.S. or international norm.

Table 8.3 reports Japanese and U.S. aid to ASEAN, South Asia, and China in shares of total ODA these countries receive from the DAC members. The data confirm the increasing dominance of Japan in the regions' aid arena, accompanied by a shrinking American role. As early as 1980, Japan dwarfed the United States as an aid donor to the region. For example, while Japan accounted for almost half of the DAC aid going to ASEAN countries, the U.S. share was only 15 percent. The gap widened by the end of the 1980s. The only exception is Pakistan, where the share of U.S. aid rose during the 1980s. But that reflected U.S. response to Soviet invasion of Afghanistan.

By the end of the 1980s, two-thirds of the DAC aid going to ASEAN came from Japan, while the U.S. share dropped below 10 percent. The Japanese aid share in South Asia rose one-third. The U.S. share in South Asia remained at about 15 percent, thanks to the temporary Afghanistan bonanza to Pakistan; the share of U.S. aid in every other country of South Asia fell. Finally, the Japanese share of aid to China rose from one-fifth to a peak of three-fourths in 1986, and has since declined to about a half by the end of the decade. It is worth noting that the United States does not give any aid to China.

With this preliminary review of the trend and pattern of Japanese and U.S. aid to Asia, we can now try to assess the specific criticisms of Japanese aid. Within the category of unfair aid practices, we begin with the criticism that the quality of Japanese development assistance is low because the share of grants in it is "too low" and ODA loans charge excessively high interest rates. For

Table 8.3 **Net Disbursement of ODA to Asia, Japan and the United States (percentage of total net ODA from DAC countries)**

	Japan							United States						
	1980	1985	1986	1987	1988	1989	1990	1980	1985	1986	1987	1988	1989	1990
ASEAN-Four	48	52	44	64	66	65	61	14	15	22	13	8	8	9
Indonesia	41	32	27	63	66	67	57	14	9	8	3	1	2	2
Malaysia	62	62	22	78	26	60	81	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Philippines	46	55	49	54	68	53	59	24	31	41	33	15	25	23
Thailand	62	69	67	69	70	74	57	5	6	8	5	4	5	4
South Asia														
India	6	4	22	32	19	23	12	13	6	5	4	10	6	3
Bangladesh	25	20	33	36	37	38	34	20	27	19	16	13	14	15
Pakistan	33	22	25	29	30	26	30	12	34	32	20	34	39	26
Sri Lanka	15	25	33	36	46	47	44	19	25	17	11	9	11	19
Nepal	29	41	40	41	28	31	23	10	17	10	11	7	6	7
China	19	68	75	64	56	56	51	0	0	0	0	0	0	0

Source: OECD (1992, 1991b, 1988, 1982).

N.A. = not applicable; zero or negligible.

example, according to Pyle (1989, 51), "The quality of aid has been low: Japan gave away less and lent more on tougher terms than most other donors."

Table 8.4 confirms that the share of grants in Japanese ODA is indeed low, although the country-specific shares vary a great deal from year to year. For example, the grant ratio for Indonesia was 17 percent in 1980, rose to 47 percent in 1985, declined to 13 percent in 1989, and rose to 19 percent in 1990. These variations, however, do not obscure the low grant shares: in 1990 the grant ratio was about 25 percent for ASEAN, 45 percent for South Asia and 30 percent for China. These figures contrast sharply with grant shares of 90 to 100 percent for other major donors, including the United States.

A sole focus on the *grant ratio*, however, is somewhat misleading. A better measure of the overall degree of concessionality of ODA is the average *grant element*, which takes into account the interest rate, grace period, and maturity of all loans. By definition, the grant element of a grant is 100 percent, whereas the grant element varies from loan to loan even for the same donor. Table 8.5 reports the average grant element of ODA for Japan, the United States, and the DAC countries as a group (unfortunately, similar data on the grant element for specific Asian countries are not available). Two points are worth highlighting. First, while the Japanese grant element is lower than that of the United States and the DAC countries, the difference is insignificant when it comes to the least-developed countries. In other words, Japan takes into account the income levels of the recipient countries in determining the concessionality of its aid across countries, and this is reflected in Japan's aid to the poorest countries, which is as concessional as aid provided by the United States and other donors.

Table 8.4 **Net disbursements of Japanese ODA Grants**

	Grants (millions of U.S. dollars)				Grant Ratio (% of Japan's Total ODA)			
	1980	1985	1989	1990	1980	1985	1989	1990
ASEAN-Four	178	287	586	552	25	36	28	24
Indonesia	59	76	147	167	17	47	13	19
Philippines	36	70	176	153	38	29	44	24
Thailand	70	117	205	172	37	44	42	41
South Asia	160	174	427	392	37	47	40	44
India	28	14	35	34	76	64	14	39
Bangladesh	53	62	152	152	25	51	41	41
Pakistan	29	43	89	68	26	46	50	35
Sri Lanka	30	14	94	91	67	17	51	52
Nepal	20	41	57	47	83	80	74	85
China	3	43	164	201	75	11	20	28
Total	341	504	1,177	1,145	30	33	29	29

Source: OECD (1992, 1991b, 1988, 1982).

Table 8.5 Grant Element of ODA, 1989–90 (percentage)

	Japan	United States	Total DAC
Grant element of			
total ODA	81.2	98.8	92.8
ODA loans	59.8	63.1	58.6
ODA to least-developed countries	96.8	98.9	97.8
Grant equivalent of ODA (% of GNP)	0.27	0.19	0.35

Source: OECD (1991a).

Notes: Grant element figures are based on ODA commitments data, excluding debt reorganization. Grant equivalent figures are calculated on a gross disbursement basis.

[a]The figure for total DAC excludes several member countries for which data are not available.

Second, while the grant equivalent of Japan's ODA in percentage of GNP is lower than that of the DAC countries as a group, it is higher than that of the United States. Put more simply, when all is said and done, Japan contributes a higher percentage of GNP to concessionality-adjusted aid than the United States does. The point once again is that, if the Japanese quantity of "quality-adjusted" aid is low relative to its economic capacity, that of the United States is even lower.

More important, the share of grants in total ODA or even the grant element per se says little about the quality of aid. Whether a particular project should be financed by grants or loans depends on the nature of the project. There is no reason why a commercially near-viable fertilizer factory should be financed by grants, and there is every reason to provide grants for a primary school or a health center. Also, given the differences in development requirements, a low-income country is likely to be a candidate for a higher share of grants than a middle-income country. The World Bank does not give any grants; that does not lower the quality of its aid. The quality of development assistance depends on its effectiveness in promoting self-sustaining development and not on some mechanical mix of grants and loans. If the leading bilateral donors believe grants are always better than loans, that does not make it necessarily right.

The preference for loans over grants in its development assistance program also reflects Japan's own growth experience as well as its development philosophy, that the most effective way to help countries to help themselves onto a path of sustainable development is not to get them addicted to an unending flow of foreign charity, but to pressure them to build up their productive capacity in a financially responsible way. This does not mean that the Japanese aid authorities believe that development assistance should be provided in terms of loans at market rates. They understand full well that the developing countries can boost their economic growth rates with the help of grants and concessional loans, as these foreign resources typically finance projects that private capital, foreign or domestic, will not touch (economic and social infrastructure—from roads and bridges to schools and hospitals), and yet are critical to promoting productive capacity and productivity. A case for concessional aid can also be made on the ground of low total factor productivity of developing countries, and in some situations, of raising consumption of basic necessities of the poor. As table 8.5 illustrates, Japan's aid program reflects these considerations. While one can question the appropriateness of loans for a particular project, or the mix of grants and loans for a particular country, there is little economics behind the view that the "quality" of loans is by definition lower than that of grants. Finally, Pyle's assertion notwithstanding, Japan does not lend on tough terms: in 1990, Japan's ODA loans carried an average interest rate of 2.5 percent (Ministry of Foreign Affairs 1991).

One of the more defensible global indicators of quality of aid is the proportion of aid allocated to the poorest countries. On this criterion, the quality of Japan's aid is higher than that of the United States. In 1988–89, Japan allocated 70 percent of its aid to low-income countries, whereas the United States gave them a little over 46 percent (table 8.6). Japan also gave more of its aid to the least-developed countries than the United States did (20 percent as opposed to 17 percent), but both countries fell below the DAC average of 25 percent. Given all the criticisms of Japanese *bilateral* aid, it is also noteworthy that Japan gives on average a greater share of aid to multilateral institutions than do the United States and the DAC countries.

The other major unfair aid practice Japan is accused of is that it spends too much aid money on economic infrastructure and large industrial projects, and not enough on social infrastructure and "basic human needs" (BHN). Detailed data to adequately assess this criticism in the case of Pacific Asia are not available. However, the 1989 data on sectoral distribution of aid put together by the DAC can throw some light (table 8.7). First, the proportion of its total ODA (18 percent) Japan allocated to social and administrative infrastructure (education, health, water supply, etc.) in 1989 was not much lower than what the United States (19 percent) or the World Bank (19 percent) allocated; but all three donors fell below the DAC average of 26 percent. Since there is no widely accepted definition of what constitutes aid for BHN, if we assume the

Table 8.6 Aid to Multilateral Institutions and Poor Countries, Japan and the United States (net disbursement as percentage of total ODA)

	Multilateral Institutions		Low-Income Countries		Least-Developed Countries	
	1983–84	1988–89	1983–84	1988–89	1983–84	1988–89
Japan	35.5	27.1	66.2	69.5	18.6	19.6
United States	28.5	23.7	53.4	46.4	16.6	16.6
All DAC countries	26.9	23.5	56.7	57.5	21.7	24.7

Source: OECD (1990, 1985).

Table 8.7 **Uses of Aid, Japan and the United States, 1989 (percentage of total ODA commitments)**

	Japan	United States[a]	World Bank[a]	All DAC Countries
Social and administrative infrastructure	17.5	19.2	18.7	25.7
Education	5.8	4.6	4.2	10.7
Health and Population	2.6	7.2	6.0	6.7
Planning and public administration	0.8	2.1	0	1.6
Other (including water supply)	8.4	5.2	8.0	6.7
Economic infrastructure	31.7	2.7	32.3	19.1
Transport and communication	19.3	1.2	13.4	11.7
Energy	6.3	1.4	18.9	5.4
Other	6.0	0	0	2.0
Production	16.9	14.3	38.1	18.6
Agriculture	10.0	9.6	24.0	11.3
Industry, mining, and construction	6.6	0.3	8.2	5.5
Trade, banking, and tourism	0.3	4.3	5.9	1.7
Multisector	1.8	0.1	0	2.6
Program assistance	20.6	22.5	10.5	12.4
Debt relief	3.6	2.1	0	2.1
Food aid	0.6	19.0	0	5.9
Emergency aid (other than food aid)	0.1	1.7	0	1.6
Administrative expenses	3.4	5.8	0	4.0
Unspecified plus support to private volunteer, agencies	3.8	13.8	0.8	8.0

Source: OECD (1990).
[a]1988 data.

social and administrative structure is a close proxy for BHN, then one has to conclude that to the extent Japan is guilty of neglecting BHN, the United States is too.[22] Second, the striking difference shows up in economic infrastructure: in 1989, Japan spent 32 percent of its aid money on transport, communication, energy, and other physical infrastructure projects, whereas the U.S. allocation was meager, less than 3 percent. The DAC average share was about 19 percent. Interestingly, Japan behaved more like the World Bank (which also allocated 32 percent of its funds to economic infrastructure) than other bilateral donors. The biggest outlier was not Japan, but the United States. It is also

22. Counting food aid or assistance for agricultural production as BHN aid is questionable. Indeed, the concept of human development is perhaps more useful than that of BHN in the context of development aid. United Nations Development Program (1991, 13) defines human development in the following way: "The real objective of development is to increase people's development choices. Income is one aspect of these choices—and an extremely important one—but it is not the sum-total of human existence. Health, education, a good physical environment and freedom—to name a few other components of well being—may be just as important. . . . A healthy, well nourished, well educated and skilled labor force is the best foundation for growth. . . . People must be at the center of human development. . . . It [development] has to be development *of* the people, *by* the people, *for* the people."

noteworthy that almost 20 percent of U.S. assistance was food aid. This aid item, however, is designed to assist U.S. farmers and not so much the developing countries; indeed numerous studies have shown that food aid—while desperately needed in situations of famine and natural disaster—if provided routinely may adversely affect food production in the developing countries.[23]

These data on sectoral distribution of aid do not, however, settle the issue of whether Japan's aid program pays too little attention to BHN and too much to economic infrastructure, because they do not tell us what the right mix is. The data show that the Japanese aid allocation to economic infrastructure significantly exceeds "the DAC norm"—although not the World Bank norm—and the divergence on social infrastructure is less pronounced. These observations raise questions that the data cannot answer: what reason is there to believe that the DAC norm represents the right mix of aid allocation, and why does each donor country have to have that same mix? It makes more sense to argue that with donors as a group coordinating their aid programs to maximize global development goals, each individual donor should design its aid program according to its own strengths and weaknesses. For example, while Japan should do its part in the area of social infrastructure, there is no reason why it cannot allocate a greater share of aid to economic infrastructure if it is relatively more effective in that sector. A much more important issue is how closely that aid is responding to the development priorities of individual recipient countries and how effectively the aid resources are being utilized.

Japan is routinely accused of aid mercantilism. Simply put, the proposition runs as follows: while the United States sacrifices its national economic interests at the altar of humanitarian considerations and global security concerns by providing untied aid to the developing countries, commercial interests motivate mercantilist Japan to provide tied aid, which primarily benefits Japan's private sector in its drive to promote exports and gain market shares in the recipient countries.[24] An adequate assessment of this proposition requires breaking it into several empirically verifiable components.

The first verifiable element is the assertion that Japan relies heavily on tied aid, whereas the United States and other leading donors do not. The data on tied aid collected by the DAC, however, suggest otherwise: Japan's aid is less tied than that of the DAC members as a group, while U.S. aid is more tied than the DAC average (table 8.8). For example, in 1989 only 17 percent of Japanese

23. For instance, World Bank (1986, 146–47) state: "The quantity of food aid is more closely related to the needs of donors than those of recipients. For example, U.S. legislation on food aid—Public Law 480—makes explicit mention of foreign policy considerations, surplus disposals, and the avoidance of conflict between commercial and concessional exports. Donors give food aid as a convenient way of disposing surplus stocks, particularly of milk products. . . . Food aid is also provided to supplement domestic production in normal times. As a result, domestic prices may fall, discouraging local production and reducing farm profits."

24. See, for example, Pharr (1988), Bloch (1991), Hellmann (1989), and Preeg (1989b, 179; 1989a, 9).

Table 8.8 **Tied Aid, Bilateral ODA, Japan and the United States (percentage of total ODA)**

	1982–83 (gross disbursements)			1989 (commitments)		
	Japan	United States	Total DAC	Japan	United States	Total DAC
Fully tied[a]	17.1	30.3	30.0	13.8	40.2	33.0
Partially tied[b]	15.7	10.7	7.2	3.0	17.5	5.6
Fully and partially tied	32.8	41.0	37.2	16.8	57.7	38.6

Source: OECD (1991a, 1990, 1985).

[a]Mainly aid tied to procurement in the donor country; also includes amounts available for procurement in several countries, but not widely enough to qualify as "partially untied."

[b]Contributions available for procurement from donor and substantially all developing countries.

bilateral aid was fully and partially tied, whereas the DAC group average of the proportion of tied aid was almost 40 percent. By contrast, the United States fully and partially tied 58 percent of its bilateral aid. Also note that while Japan cut back its reliance on tied aid during the 1980s, the United States seems to have headed in the opposite direction: Japan's tied aid ratio fell from 33 percent in 1982–83 to 17 percent in 1989; during the same period the U.S. ratio rose from 41 percent to 58 percent.

The adherents of "the Japanese aid mercantilism school" find these DAC data unpersuasive: they argue that though de jure Japan's aid is no longer heavily tied, de facto it is so. In this view, with the Japanese private sector playing an active role in identifying and implementing aid projects, much of the officially untied aid turns into tied aid in practice.[25] Some light can be thrown on this issue by the data collected by the Japanese Ministry of Foreign Affairs on the nationalities of procurement contractors of Japanese ODA loans (table 8.9). The evidence suggests that while the de facto tying thesis was largely valid during the early eighties, it was no longer valid by 1990. While Japanese firms obtained 63 percent of the procurement contracts generated by untied Japanese ODA loans in 1983, their share dropped to 20 percent by 1990. During the same period, the procurement share of the contractors from the developing countries rose from less than 30 percent to 55 percent, and that of the contractors from the other DAC countries increased from 10 percent to 25 percent. That only 20 percent of the untied ODA loan contracts went to Japanese firms in 1990, if true, is actually remarkable: even without any tying and subsidy in their favor, one would expect the strongly competitive Japanese firms to do much better than 20 percent in open and free competition in markets they are greatly familiar with.

25. For example, Pharr (1992, 16) states: "The real issue today is *de facto* tying that results from the informal role played by the Japanese private sector abroad in lobbying Third World governments to request Japanese aid projects that are favorable to their interests." See also Preeg (1989b).

Table 8.9 **Procurement Share of Japanese ODA Loans by Nationalities of Contractors (percentage, contract basis)**

	1983	1985	1987	1988	1989	1990
United ODA loans						
Japan	63	52	37	27	25	20
Other DAC countries	9	15	15	22	27	25
Developing countries	28	33	48	51	48	55
Total ODA loans						
Japan	70	68	55	43	38	27
Other DAC countries	6	8	10	16	21	21
Developing countries	24	24	35	41	41	52

Source: Ministry of Foreign Affairs.
Note: The data are for Japanese fiscal years (April 1 to March 31).

Estimates available from the U.S. General Accounting Office (GAO) support these conclusions. For example, the GAO reckons that the United States ties its aid far more tightly than Japan does: it estimates that in 1987 the share of fully and partially tied aid in total *bilateral* ODA was 48 percent for Japan and was over 90 percent for the United States. On procurement, the GAO calculations imply that, in 1987, about 60 percent of Japanese bilateral ODA was spent on Japanese goods and services, while the U.S. ratio was about 70 percent.[26] Even these statistics do not persuade the critics, who argue that many of those so-called developing country contractors are nothing but fronts for the Japanese firms. The critics, however, do not feel it is necessary to go beyond citing one or two anecdotes from Thailand or Indonesia to convince themselves and others of what the Japanese are really up to (see Preeg 1991, 115–16; Bloch 1991, 72; Orr 1990, 62).

Another way to assess the empirical validity of the proposition that the Japanese government and business work hand in glove in using ODA to promote exports is to look for such a linkage in the data on Japanese aid and exports to the region. Opting for simplicity, I propose that, if aid were indeed playing a significant role in promoting Japanese exports to Pacific Asian developing countries, we would expect the following: (1) countries that receive the largest volumes of Japanese aid tend to be the ones where Japan also exports the most; and (2) countries that are top recipients of Japanese aid, and/or have been blessed with the fastest increase in Japanese aid, are where the United States has the smallest markets, and/or has been least successful in expanding exports. Once again, none of this discussion has any relevance for the NIEs be-

26. See U.S. GAO (1990). The U.S. procurement ratio is lower than the tied aid ratio because some of the aid is only partially tied and the data modestly overstate the tying of U.S. aid. The fact remains, however, that in 1987 a higher fraction of U.S. aid was used to buy U.S. goods and services than was the case for Japan. And 1987 was not the first year when that happened; as early as 1982–83, the United States was more guilty of tied aid than Japan was.

cause they currently receive little or no aid from Japan: East Asia or Pacific Asia really boils down to five countries—four ASEAN countries and China. The data on Japanese ODA and exports to those countries and South Asia seem to contradict the above two implications of the aid-driving-trade thesis (table 8.10).

First, the top three current recipients of Japanese aid are Indonesia, China, and the Philippines, whereas the top three markets for Japanese exports are China, Thailand, and Malaysia. During 1989–90, Japan's annual average aid flow to Indonesia was $1 billion with annual exports averaging $4.2 billion; by contrast Japan exported on average $8 billion to Thailand, which received only $450 million in aid. China—the number-two recipient of Japanese aid and number-two market for Japanese exports—seems to fit the aid-driving-trade model; but with a per capita income of less than $400 and a very anti-Japan communist regime, this is not the country the critics think of when they accuse Japan of building a coprosperity sphere with interlocking wheels of aid, trade, and investment. The Philippines also poses a contradiction: it was the third largest recipient of Japanese aid in 1989–90 yet provided a strikingly small market for Japanese exports ($2.4 billion)—about the same as captured by the United States. Bangladesh adds yet another question mark to the thesis that Japan's aid is commercially motivated: Japan offered the fifth largest share of its total ODA to one of the world's poorest countries in return for about $370 million of exports.

Second, the top three largest and/or fastest growing markets for U.S. exports are China, Malaysia, and Thailand. Two of these countries—China and Thailand—are also top recipients of Japanese aid, and all three of them are top markets for Japanese exports. Note also that, though the United States gives little aid to the region, during 1977–90, U.S. exports to China and the Philippines grew faster than Japanese exports, at only a slightly lower pace for the other three ASEAN countries. By contrast, Japanese exports grew a bit faster than U.S. exports in South Asia—not a region where Japanese aid is supposed to be acting in full force to promote exports. The picture that seems to emerge from all this is that, aid or no aid, markets for foreign goods are growing rapidly in these countries, and Japan as well as the United States is benefiting from this boom.

Another simple way of examining the Japanese aid-trade linkage is to take a close look at the behavior of the ratios of Japanese exports to aid across time and countries, vis-à-vis the United States. One can propose three null hypotheses. (1) If Japan gives aid primarily to promote exports, then one would expect it to provide most aid to those countries where its exports/aid ratios are the highest, that is, where for each dollar of aid, the exports gains are the greatest. (2) If it is also true that Japanese exporters use tied aid to enter a new market and establish a foothold from which to expand market shares, then one would expect the exports aid ratio to rise over time. (3) Even assuming away possible competitive advantages of Japanese exporters over their American

Table 8.10 **Trade and Aid, Japan and the United States in Asia (millions of U.S. dollars)**

	Japan					United States					Change 1977–90 (%)	
	1977	1980	1985	1989	1990	1977	1980	1985	1989	1990	Japan	United States
Exports to												
ASEAN-Four	5,160	9,163	7,360	16,576	22,241	2,710	6,144	4,562	8,629	10,786	331	298
Indonesia	1,812	3,476	2,191	3,288	5,052	763	1,545	795	1,256	1,897	179	149
Malaysia	870	2,070	2,184	4,107	5,529	561	1,337	1,539	2,875	3,425	536	511
Philippines	1,108	1,692	946	2,370	2,510	876	1,999	1,379	2,206	2,472	127	182
Thailand	1,370	1,925	2,047	6,811	9,150	510	1,263	849	2,292	2,992	568	487
South Asia	1,087	2,150	3,052	3,744	3,552	1,289	2,697	2,983	4,033	3,950	227	207
India	508	920	1,610	2,007	1,711	779	1,689	1,642	2,463	2,486	237	219
Bangladesh	120	320	314	349	370	156	292	219	282	182	195	17
Pakistan	362	626	793	1,023	1,088	293	642	1,042	1,136	1,143	201	290
Sri Lanka	75	237	273	294	316	53	62	73	143	137	321	158
Napal	14	39	62	71	59	8	12	7	9	10	321	25
China	1,955	5,109	12,590	8,477	6,145	171	3,755	3,856	5,807	4,807	214	2,711

Net ODA to												
ASEAN-Four	260	700	791	2,118	2,308	199	184	202	253	309	787	55
Indonesia	148	350	161	1,145	868	102	117	43	31	31	485	70
Malaysia	30	66	126	80	373	3	1	0	−1	0	1,164	N.A.
Philippines	31	94	240	404	648	86	50	135	192	248	2,018	188
Thailand	52	190	264	489	419	8	16	24	31	30	709	275
South Asia	147	433	372	1,068	886	280	362	444	527	404	504	44
India	29	37	22	257	87	64	83	29	69	−24	202	N.A.
Bangladash	66	215	122	371	374	81	174	165	138	169	468	109
Pakistan	29	112	93	178	194	88	42	144	263	167	576	90
Sri Lanka	19	45	84	185	176	37	55	85	43	75	846	103
Napal	5	24	51	77	55	10	8	21	14	17	1,070	70
China	0	4	388	832	723	0	0	0	0	0	N.A.	N.A.

Sources: OECD (1992, 1991b, 1988, 1982); IMF (1991, 1984, 1980).
N.A. = not applicable.

Table 8.11 **Exports/Aid Ratio in Asia, Japan and the United States (ratio of donor exports to net ODA disbursement)**

	Japan					United States				
	1977	1980	1985	1989	1990	1977	1980	1985	1989	1990
ASEAN-Four	20	13	9	8	10	14	33	23	34	35
Indonesia	12	10	14	3	6	7	13	18	41	61
Malaysia	29	31	17	51	15	187	N.A.	N.A.	N.A.	N.A.
Philippines	36	18	4	6	4	10	40	10	11	10
Thailand	26	10	8	14	22	64	79	35	74	100
South Asia	7	5	8	4	4	5	7	7	8	10
China	N.A.	N.A.	32	10	8	N.A.	N.A.	N.A.	N.A.	N.A.

Sources: OECD (1992, 1991b, 1988, 1982); IMF (1991, 1984, 1980).
N.A. = not applicable; net ODA disbursement was negligible, zero, or negative.

counterparts, one would also expect the U.S. exports/aid ratios on balance to be lower than those for Japan.

Exports/aid ratios reported in table 8.11 exhibit a great deal of year-to-year and cross-country variations, casting doubt on the existence of any discernible relationship between aid and exports. Indeed, they seem to contradict the three implications of the presumed aid-trade linkage mentioned above. First, Indonesia, China, and the Philippines—the top three recipients of Japanese aid—are characterized by Japanese exports/aid ratios that are lower than those for Malaysia and Thailand. Second, except for Thailand, these ratios seem to have declined since 1980. Finally, the U.S. exports/aid ratios for all these countries are much higher relative to Japan. In the framework of the aid-driving-trade thesis, this would imply that the United States is getting a much greater export bang for a buck spend on aid. The implication that the United States is generating a much larger volume of exports for a dollar of aid relative to Japan, however, casts doubt over the validity of a significant cause-and-effect linkage between aid and exports, for Japan and for the United States.[27]

The evolution of Japan's share of import markets of its major Pacific Asian aid recipients can provide further evidence on Japan's aid mercantilism (table 8.12). An increase over time of these import ratios would at least be consistent with, though by no means conclusive evidence of, the view that Japan is gaining market share with the use of tied aid. The data show otherwise: Japan's market shares since 1975 have largely remained steady, and in some cases (notably, China, Indonesia, and the Philippines) have actually declined. With no evidence of increasing market shares and no evidence of tied aid, one wonders

27. This impressionistic evidence can be supplemented by econometric analyses that test for the presumed causal effects of aid on the pattern of trade using a simple gravity model. Time constraint does not allow me to pursue this course at this time, but I hope to carry this out—perhaps for a follow-up NBER conference on the same topic!

exactly what type of research is carried out by those who continue to assert that Japan uses tied aid to gain market shares.

I conclude this section by briefly addressing the allegation that Japan's aid program promotes capital goods exports by financing capital projects with mixed credits. An April 1989 study by the U.S. Export-Import Bank showed that American companies were losing $400–800 million in potential exports each year to Japan and other foreign competitors benefiting from mixed credits from their governments. In May 1990, the U.S. Exim Bank and the U.S. Agency for International Development (U.S. AID) jointly announced a new $500 million program of mixed credits; aid money and export credits would be used together to promote export of American power plants, telecommunications gear, construction equipment, and other capital goods to four countries where Japan is the top donor—Indonesia, Pakistan, the Philippines, and Thailand. The program was to use the Exim Bank's "war chest" of $110 million in fiscal year 1990.

According to the Exim Bank report to the Congress for fiscal year 1991, the bank used virtually all of the war chest grant authority appropriated by Congress ($150 million). These transactions are expected to support $532 million in U.S. exports and include a commitment of $58 million in Economic Support Fund (ESF) money from U.S. AID. All this effort to offset an estimated loss of less than $1 billion (or even, say, $5 billion, assuming the Exim Bank severely underestimated the loss) in U.S. capital goods exports is for a country that exported $116 billion of capital goods in 1990. It is also surprising that the Exim Bank appears very proud that their program is expected to raise U.S. capital goods exports by half a billion—that is, by 0.4 percent of the U.S. 1990 exports in that category.

8.4 A Coprosperity Sphere?

Unlike burdensharing and military free ride, the "Greater East Asia Coprosperity Sphere" is a phrase that Americans did not coin; the Japanese did.

Table 8.12 **Japan's Share in Merchandise Imports of Its Major Asian Aid Recipients (imports from Japan as a percentage of total imports)**

	1975	1980	1985	1987	1989	1990	Changes 1975–90
ASEAN-Four	28	25	23	24	25	26	−2
Indonesia	31	31	26	28	23	25	−6
Malaysia	23	23	23	22	24	24	1
Philippines	25	20	14	17	19	18	−7
Thailand	32	21	26	26	30	31	−1
South Asia	15	8	10	12	11	10	−5
China	34	27	22	16	16	14	−20

Sources: OECD (1991b, 1988, 1982); IMF (1991, 1984, 1980).

Japanese militarists and imperialists came up with this concept as early as 1919 and popularized it to give a positive economic meaning to their military campaign in the 1930s to replace the European colonial domination over East Asia with their own (Storry 1979). The death and destruction the Japanese war machine imposed on Asian countries in pursuit of this colonial goal transformed the term *coprosperity sphere* into a symbol of Japanese ruthlessness and steamroller approach to establishing regional dominance. The recent return of this phrase to the discussion of Japan's emerging economic relations with its Asian neighbors reflects this history. But it also constitutes yet another example of the problem of "damned if you do and damned if you don't" that Japan often seems to face: while some are accusing Tokyo for being a selfish free rider spending too little on foreign aid, others are indicting it for using aid money to build a coprosperity sphere in Pacific Asia. Growing Japanese economic presence in East Asia is fueling the perception that since the 1980s Japan has begun to do by peaceful economic means what it could not do by violent military means during the 1930s.

Dornbusch (1989, 270) asserts, "The Asian co-prosperity scheme is the most likely option for Japan," but the concept of a coprosperity sphere harks back to subservient economic, political, and military relationships many of today's developing countries had with their European colonial masters before World War II; those relationships do not describe Japan's current economic and political interactions with the dynamic and vibrant economies of Pacific Asia. To begin with, it is useful to remind ourselves that, unlike the United States, Japan does not project military power in Asian countries with which it has economic relations. Indeed, while economic domination does lead to political influence, in an ultimate showdown, the relative leverage of the dominant country (Japan) is muted when it has no military power to back up its economic and political power.

There are at least two additional reasons why *coprosperity sphere* is the wrong phrase to describe Japan's relations with East Asia. First, Japan is not forcing its growing aid-trade-investment linkages upon its Asian neighbors; these are two-way relations reflecting comparative advantage and the stages of development from which both sides are benefiting. If that were not the case, these Asian economies would not be wooing and welcoming Japanese goods, services, capital, and technology. Clearly, the economic boom these countries are enjoying does not seem to indicate economic relations serving only Japan's economic interests. Incidentally, the only country performing poorly in this region is the Philippines, a country that ranks at the bottom within Southeast Asia in terms of its economic relations with Japan and one that has had a long colonial economic and military relationship with the United States.

Second, the view that Japan is gradually consolidating its hold on its Asian neighbors in the sense that it is increasingly influencing their economic policies and domestic politics is at best an unwarranted fear, and at worst an insult to the people of these sovereign countries. These independent nations are no longer the weak colonies of imperialist powers unable to thwart foreign domination and assert sovereignty; they are some of the most dynamic economies of the world with highly proud people and powerful nationalist governments guarding against any possible encroachment on their sovereignty. With the memory of Japanese militarism still alive, they are specially sensitive to any hint of Japanese influence in their internal affairs.

With these general remarks, let me turn to two interrelated specific theses advanced by some Japan watchers. One is that in the wake of the 1985 *endaka* (the yen appreciation) triggered by the Plaza currency accord, the Japanese government articulated a plan to use public resources (development finance, technical cooperation, and MITI planning) to help Japanese private capital and technology develop a regional East Asian economy to serve Japan's current restructuring needs and its long-term global economic interests (Arase 1988, 1991; Maidment 1989). The other related thesis is that Japan is developing neocolonial economic relationships with the East Asian economies, in particular the ASEAN countries, where trade and investment flows primarily serve Japan's economic interests and not the development requirements of the recipient/host countries (Smith and do Rosario 1990; Sinha 1982).

One clear articulation of the thesis that Japan Inc. is implementing a plan to create and manage regional economic hegemony can be found in a survey article in *The Economist.* It identifies a 1988 study by the Economic Planning Agency (EPA) and a series of MITI white papers released during the late 1980s as the official intellectual source of this new "Asian Industries Development (AID)" plan. In particular, the EPA study with a mouthful of a title, "Promoting Comprehensive Economic Cooperation in an International Economic Environment Undergoing Upheaval: Towards the Contribution of an Asian Network," is credited with formulating the goal of this plan: to integrate the East Asian economies into a greater Japan Inc. According to the *Economist* piece (Maidment 1989, 11–13),

> Industrial policy would be coordinated from Tokyo. The EPA study talks of this being done by something it dubs the "Asian Brain." This would control the disposition of industrial investment throughout Japan, the NICs and the new NICs and co-ordinate the necessary policy support by the governments of those countries. The "Asian Brain" is clearly intended to be the Japanese civil service, just as MITI was the brain behind Japan Inc. in the 1960s. . . . the Japanese government is now committed to taking the initiative in promoting greater regional economic co-operation, starting in East and South-East Asia. It would do so not on the basis of bilateral relations or even with ASEAN as a block, but by regarding Japan, the NICs and the new NICs as one economy. . . .
>
> Japan's new hidden agenda is different, because the needs of the country's economy are different. (It is also better concealed.) The New AID Plan commits government money for the relocation of Japanese industry into lower-cost Asian countries as an inducement for private industry to serve whatever policies the civil servants want to pursue.

Arase (1991, 270–71) summarizes this plan in the following way: "Since 1987, Japan has been seeking to coordinate ODA, trade and FDI to construct a regional economy managed from Tokyo. [It] points to the deliberate construction of an economic sphere in the Asian-Pacific region. . . . This is different from the old ODA policy because the new one attempts to structure production and trade within the Asian-Pacific region according to a grander conception of Japan's regional and global economic role."

Katzenstein and Rouse (chap. 6 in this volume) explain that this New Aid Plan is supposed to work in four stages: "First, Japanese loans support the development of roads, ports, and other infrastructural supports. Second, the Japanese government sends technical experts to assist in coordinating industrial plans for each country. Third, Japanese loans are extended to various industries within participating countries. Finally, Japanese bureaucrats and businessmen take steps to facilitate access to Japanese markets and to ensure the distribution of products imported from offshore factories to Japan. . . . In short, the plan suggests that Japanese business and government elites view ASEAN (and the NICs) as one economy, requiring a comprehensive perspective on aid, trade, and investment. The provision of the necessary infrastructure, as one part of this plan, will serve the interests of Japanese companies and promote economic growth in Asia."

A closer look at the available evidence leads to the following conclusion: as usual, the Japanese civil servants and the MITI bureaucrats are getting way more credit than they deserve for their ability to carry out such a complex, comprehensive, and coordinated plan, but to the extent they are succeeding it is a good thing for not only Japan but the developing economies of the region as well. If the United States had been able to do in the Latin American economies with its Alliance for Progress initiative in the 1960s what Japan is allegedly doing in East Asia in the 1990s, it would have been hailed for promoting democracy and development in its poorer neighbors with a second Marshall Plan, and not indicted for serving its political and economic interests with a mercantilist industrial policy program.

More specifically, four points are worth emphasizing. First, while the New Aid Plan reportedly targets "the NICs and the new NICs," by definition it cannot involve the NICs because they receive little or no official aid from Japan. Among the ASEANIEs, the plan evidently is not working so well for the Philippines, which is getting lots of aid from Japan but not much private money or capital. Malaysia can only be a partial participant in the New Aid Plan, where Japan is cutting back its official aid while the private trade and investment linkages are growing by leaps and bounds. That leaves Indonesia and Thailand. If there are only two (or at most three) countries for which the Japanese New Aid Plan can possibly be relevant, then one cannot help doubt the validity of the proposition that Japan Inc. is creating and managing a greater East Asian economy to serve its own economic interests.

Second, even though the East Asian regional economy boils down to Indonesia and Thailand with Japan at the center, it seems worthwhile to examine how effectively the New Aid Plan is being implemented in these two countries. The first point to note is that the complex cooperation and stage-by-stage coordination between the Japanese visible hand and the invisible hand is much harder to discern than one might expect from the blueprint presented by Arase (1991) or Katzenstein and Rouse (chap. 6 in this volume). To be sure, a lot of Japanese aid is going to both countries to build physical infrastructure—highways, bridges, railroads, ports, dams, telephone lines, power plants, and so on. But Japan has been devoting a large chunk of its foreign aid budget to build infrastructure in the recipient countries since long before the advent of the New Aid Plan, and it has been doing so from Bangladesh to Burundi. This is so because Japan correctly believes that a minimum level of physical infrastructure is critical to long-term development of a poor and backward economy. The World Bank did the same to put war-devastated Western Europe on a path of long-term recovery and growth, and has been building physical infrastructure in the member developing countries since the 1950s. It is true that the Japanese private sector is heavily investing in both Indonesia and Thailand to establish low-cost production bases for exports of manufactures; it is also continuing its investment in the oil and energy sector in Indonesia. And finally, it does not require sophisticated analysis to see that new and improved infrastructure financed by Japanese official aid is greatly facilitating the task of establishing profitable export bases by the Japanese private companies and enhancing their efficiency and productivity.

But the argument that Tokyo is using aid money to essentially serve the interests of Japanese multinationals is misleading.[28] The Japan-financed highways and telephone networks are essentially public goods: they are not closed to the local investors and consumers and non-Japanese foreign companies. Nor is it the case that the American companies are paying higher tolls and fees for their use of these transport and communication facilities. Indeed, one can reasonably argue that American multinationals are getting a free ride on Thai highways built with Japanese taxpayers' money. The central point, however, is that what is good for Japanese business in Thailand is on balance also good for Thailand's economic development.

While Japanese public aid is benefiting the Japanese private business in Thailand and Indonesia, there is little evidence that a regional economy is being created and managed by MITI with various Japanese government and private agencies working hand-in-glove with clockwork precision. On the contrary, various features of the Japanese aid machinery—severe interministry rivalry, serious shortage of aid staff, too many agencies involved in the decision-making process, too few staff people on the ground, bilateral nature

28. Katzenstein and Rouse (chap. 6 in this volume) state: "Evidence from Thailand suggests that the Japanese have met with some success both in creating the types of infrastructures that will benefit Japanese multinationals and their partners, and in obtaining large contracts for Japanese companies for building such infrastructure."

of the aid request and delivery process, and so on—make it virtually impossible to implement a plan for the region with any sort of consistency and precision. Interviews with the recipient aid authorities and experts also do not seem to indicate that decisions are being made under the directives and guidelines of a single and well-coordinated Japanese plan.

This conclusion is shared by two veteran observers of Japanese aid. Orr (1991, 38) refers to MITI's New Aid Plan as an example of "how Japanese aid policy is hampered by its turf-conscious aid decision making system" and points out that "the Foreign Ministry, which usually makes aid-related announcements, had no perceivable involvement in the policy nor was there much support within MOFA for this undertaking." Rix (1992) argues that "the aid implementation mechanisms for individual projects remain unchanged and in this sense, MITI is unable to exert control over the ASEAN aid process."

Third, to the extent the MITI bureaucrats are able to implement the New Aid Plan, it is a good thing not only for Japan but also for the recipient countries. ODA that encourages flows of foreign private capital and technology to take advantage of regional division of labor and creates an infrastructural and policy environment conducive to their effective operation has the greatest chance of succeeding in helping the recipient country get on a path of self-sustaining development. Such aid strategy is much more likely to promote economic development than the current American strategy of assisting countries where the United States has political, security, and military interests, and using the money to meet multiple—and often contradictory—domestic and foreign objectives ranging from helping U.S. farmers, to keeping the pro-American antidevelopment governments in power, to burning coca crops in Bolivia in its fight against the drug problem in the Bronx, to funding various and sundry development projects on an ad hoc basis. So the Japanese plan for regional development should not be greeted with anxiety and alarm; it should perhaps be welcomed as a model for development assistance with valuable lessons for the veteran donors.

Finally, the idea that Japan is pursuing a "regional industrial policy" in East Asia may be seen as yet another Japanese attempt to threaten "the liberal world economic order." But this is an emotional response to what is more a matter of semantics than of substance. Many economists and some political free market idealogues respond to the phrase "industrial policy" with allergic reaction. Industrial policy is considered a Japanese and Asian phenomenon, reflecting anti-Western values—in short, a bad thing to be avoided and resisted at all costs. The reality is that not a single major industrial nation of today developed without an industrial policy (see Hobsbawm 1969, 225–48; Mukherjee 1974, 397–406), and even today each one of them, including the United States, has a de facto industrial policy. The only issue worth debating is to what extent each of them pursues industrial policy, and to what extent the policy is helping or hurting the industrial restructuring and international competitiveness of the economy in question. This is not the place to debate this issue. Instead, the point that needs emphasis is that regional industrialization in East Asia is primarily being driven by market forces, with the Japanese private sector playing a significant role within that context; the extent to which the Japanese government is aiding this process is, if unique, not undesirable.

Now we turn to the other version of the coprosperity sphere thesis that propounds Japan's alleged neocolonial economic relationship with its Southeast Asian neighbors. One can identify three major elements that underpin this view.

First, there is concern that Japan has captured too high a market share of imports of its poorer neighbors. We can see from table 8.12 that Japan's share in imports of the four ASEAN economies has ranged from about 15 to 30 percent: in 1990, Japan's market share was the highest in Thailand (about 30 percent), and lowest in the Philippines (about 20 percent). Also, as noted earlier, these shares have not grown relative to the levels prevailing in 1975. They are, of course, quite sizeable, but that is what one would expect, given Japan's relative economic size, its relative geographical proximity to these countries, and the long history of their economic interactions. The United States supplied over 60 percent of Canada's imports in 1990. Economic nationalists may not like this degree of "economic dominance" in their country by an economic superpower, but that is exactly what results from growing regional and global economic integration.

Second, another often-heard complaint is that as elsewhere Japan pushes its exports to its Third World neighbors while keeping its doors closed to imports from them and building up huge trade surpluses. By contrast, the United States is viewed as the importer of least resistance, absorbing massive and growing volumes of goods from these trade partners of Japan.

There are at least two problems with this view. (1) Japan is a major importer of ASEAN goods. Japan's persistent surpluses with these economies are no evidence of closed markets: it makes sense for the fast-growing developing economies to run deficits with savings-rich advanced countries; indeed, that is the only way they can import much-needed foreign capital vital for their growth and development. (2) With *openness* properly defined, it does not appear that the United States is more open to imports from the ASEAN countries than Japan is. A larger economy is likely to import more from its trading partners in absolute volume than a smaller economy. To adjust for the difference in size of the importing economy, it is necessary to see how U.S. imports relative to its GDP compares with Japanese imports relative to its GDP. On this measure, Japan is more open to the countries in question than the United States is (table 8.13). For example, while U.S. imports from the ASEAN countries in 1989–90 were 0.3 percent of its GDP, the comparable ratio for Japan was about 0.8 percent. Looked at from this perspective, the real difference between Japan and the United States is not that Japan imports too little from the ASEANIEs but that the United States exports too little.[29]

Finally, we turn to the aspect of Japan's rising economic presence in Asia

29. A more satisfactory way to look at this issue would be to make use of a gravity model.

Table 8.13 **Merchandise Imports from Asian Recepients, Japan and the United States (percentage of importing country GDP)**

	1975		1980		1985		1989		1990	
	Japan	United States	Japan	United States	Japan	United States	Japan	United States	Japan	United States
ASEAN-Four	1.2	0.3	1.7	0.4	1.2	0.3	0.8	0.3	0.8	0.3
Indonesia	0.7	0.2	1.1	0.2	0.8	0.1	0.4	0.1	0.4	0.1
Malaysia	0.1	0.1	0.3	0.1	0.3	0.1	0.2	0.1	0.2	0.1
Philippines	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Thailand	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1
South Asia	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
China	0.3	0.0	0.4	0.0	0.5	0.1	0.4	0.2	0.4	0.3

Sources: OECD (1991b, 1988, 1982); IMF (1991, 1984, 1980); *International Financial Statistics,* various issues.

that seems to create the most anxiety—Japanese direct investment. As noted earlier, the rapid rise in Japanese labor cost since the 1985–87 yen appreciation and increasing labor shortage have induced many Japanese companies to shift their production base to the low-labor-cost ASEAN countries. Japanese direct investment has indeed surged in these economies, and Japan appears to have already become the dominant direct investor in the region.[30]

Is Japanese direct investment in the ASEANIEs primarily benefiting Japan at the expense of the host countries? The answer is no. The ASEAN governments are welcoming these investments with open doors because Japanese capital and technology are contributing significantly to their growth and development. To be sure, profit-seeking private business, unrestrained by government regulation, often causes various negative externalities, such as environmental damage, health and safety problems for workers, sector-specific or economy-wide booms and busts, and so on. In a situation where the host country is economically and politically much weaker than the home country and thus has less leverage and an inferior bargaining position, the foreign investors will have a greater capacity to cause these negative externalities. If the history of U.S. direct investment in Asia and Latin America is any guide, it would be naïve to believe that there are no negative consequences of Japanese investment in ASEAN economies. Also, the complaints that Japanese companies are reluctant to transfer advanced technologies to the host nations and that they rarely promote local employees to top management positions are largely valid. This is exactly what the American and European multinationals did in the past and still do today. Japan is hardly different in this regard. It is also true that, with growing economic presence, Japan will wield greater political power in the region. All of this, however, does not negate the central point: Japanese direct

30. The bad quality of available data prevents one from being sanguine on this point.

investment in the ASEAN economies is not a neocolonial phenomenon benefiting mostly the foreign invaders—it is an economic relationship voluntarily entered into and beneficial to both parties.

The alarm over surging Japanese foreign direct investment (FDI) in the ASEANIEs appears to be much stronger in the United States than in the host countries themselves. This American anxiety seems to reflect a concern, not about the economic welfare or political sovereignty of the ASEAN countries, but over the loss of this country's long-held status as the dominant direct investor in the region. This is yet one more element of the overall reaction of America—long used to being the number-one economic power with worldwide dominance and influence—to its economic hegemony challenged by an economically ascending Japan. Clearly the shifts in relative economic dominance will have major political and security implications for the region. And it is a subject worth analyzing. But the point here is there is little evidence that Japanese FDI is more neocolonial in nature than American FDI.

I would like to conclude this section with two broad observations. First, on the issue of an Asian coprosperity sphere, it is instructive to note that the Japanese New Aid Plan is not too dissimilar from the 1961 United States–initiated Alliance for Progress to utilize $10 billion of official funds and $10 billion of American private capital over a ten-year period to develop a regional Latin American economy. This plan was and is interpreted as an act of American benevolence to help its southern neighbors. Infrastructure financed by Japanese aid in Indonesia and Thailand is seen as a part of an official plan to benefit the Japanese investors, yet this was precisely a major goal of the Alliance for Progress. In emphasizing this objective of the alliance, its U.S. coordinator, Teodoro Moscoso, in a 1963 speech criticized the view that "all that Latin America needs is a friendly climate for private enterprise" and pointed out that "this view disregards the need for building roads, ports, power plants, and communications systems which must be built at least in great part with public funds and which in many areas are a prerequisite for the effective and profitable investment of private capital" (Horowitz 1970, 57). One key difference between the Japanese New Aid Plan and the American Alliance for Progress is, of course, that the ASEAN economies are growing rapidly with little direct implementation of the Japanese plan, whereas most of Latin America remained trapped in underdevelopment despite the launching and implementation of the alliance with much fanfare.

The Enterprise of the Americas Initiative (EAI) announced by President Bush in June 1990 appears to be a reincarnation of the Alliance of Progress three decades later. According to the U.S. undersecretary for international affairs, David Mulford (1991), the initiative "is designed to deepen and expand for our mutual benefit the wider array of trade and investment ties which link the United States with its neighbors in Latin America and the Caribbean. . . . our long term goal is to establish a hemispheric free trade area. . . . By itself, a free trade agreement would not necessarily succeed in bringing substantial economic benefits. But free trade is a cornerstone of a broader economic system based on market principles. It is that broader system that the Enterprise for the Americas Initiative seeks to foster jointly through its trade, investment and debt pillars." No one is calling this a U.S. plan for a Greater American Co-prosperity Sphere; the only complaint is that the United States is mostly talking and not doing enough. But one can imagine the Western reaction if tomorrow Prime Minister Miyazawa announced an Enterprise for Greater East Asia Initiative with a long-term objective of creating a regional free trade area.[31]

The final broad observation is that Japan's ODA policy is not based on one-dimensional commercialism: it has numerous economic, political, security, and moral objectives, and it is becoming increasingly multidimensional and complex over time. In that sense, Japan's ODA policy is becoming more like that of the other major donors, including the United States. In the area of human rights and production of armaments, Japan, at least in principle, has now gone beyond the United States: on April 12, 1991, Prime Minister Kaifu announced that, in giving aid, Japan would take into account the recipient nation's human rights record, its promotion of democracy, and whether it is developing and manufacturing weapons of mass destruction, including nuclear weapons. To be sure, Japan will not be able to stick to these guidelines with any semblance of consistency; China alone will make a mockery of this. But this announcement should still be considered a great leap forward.

The diversity and the nonuniqueness of Japanese aid policy is summed up well by Koppel and Orr (1992):

> ODA is a post World War II invention. It was born from a marriage of anti-communism with needs for supporting economic reconstruction. . . . Japan's ODA was born from the same impulses as American and European aid, but unlike any other donor, its ODA was not born from a desire, however tacit, to maintain colonial links (as was the case e.g. with French aid), not to build, in effect, neo-colonial networks, but rather from a recognition that her own development depended on peaceful international economic relations, especially in Asia and an acknowledgement that damages she had caused during the war required reparation.

8.5 The Politics of Japanese Money and American Power: The Philippines and the Asian Development Bank

The thesis that Japan shirks global responsibility but is using aid money to achieve regional economic hegemony can be further assessed with a deeper probe into two Asian entities. One is a country, the Philippines, and the other

31. Academics and experts must face squarely this issue of double standard and asymmetric interpretation of facts; if they fail to do so, they will only supply emotional views under the guise of objective analysis, and thereby contribute significantly to the confusion and conflict that continue to characterize the United States–Japan relationship in Pacific Asia and elsewhere.

is a multilateral regional organization, the Asian Development Bank (ADB). Both have something in common—special and close involvement with Japan as well as the United States. No other country or institution appears to offer a more suitable real-life laboratory for examining the dynamics of cooperation and conflict between Japan and the United States than the Philippines and the ADB.

I take up the Philippines first. The evidence does not fit the image of a free-riding Japan gaining economic domination with aid money. On the contrary, facts seem to paint a picture of a cooperative Japan extending a generous helping hand to the United States: Japanese development aid to the Philippines has increasingly compensated for what the Filipinos see as an inadequate American aid package to pay for "rents" of the U.S. military bases.

I have already argued that the linkage between the visible hand of Japanese official aid and the invisible hand of Japanese trade and investment appears very tenuous in the Philippines. The Japanese government has been pouring massive amounts of development aid into the Philippine economy, but Japanese business is not exactly rushing in with their goods, capital, and technology. Indeed, American aid seems to be twice as effective in commercial and economic terms as the Japanese aid: the United States provides less than half of what Japan gives, yet the American economic presence in the Philippines in terms of exports and direct investment flows is comparable to that of Japan. These facts suggest that Tokyo's aid is not playing a very active role in helping expand Japanese economic presence in the Philippine economy or in shaping it to fit into a regional economy serving Japan's economic and commercial interests.

Three additional observations are worth emphasizing. First, an "aid plan" for the Philippines was drawn up in July 1989; it was initially proposed not by the MITI bureaucrats in Tokyo, but by members of Congress in Washington. With the prospect for economic crisis and communist insurgency growing as People Power overthrew former U.S. ally President Ferdinand Marcos, and with negotiations for the renewal of the 1947 military bases agreement under way, some concerned American politicians argued that only a mini–Marshall Plan could save democracy and foster development in the debt-ridden economy of the Philippines (Japan Economic Institute 1988). The only twist was that this mini–Marshall Plan, unlike the original, was to be financed multilaterally and the lion's share was to come, not from the United States, but from Japan.

In July 1989, nineteen countries and seven international organizations met in Tokyo and pledged a total of $3.5 billion ($2.8 billion, according to the Philippines authorities) for the 1989–90 period as the first installment of a $10 billion package to be disbursed over five years. With the World Bank acting as the coordinator of what became known as Multilateral Assistance Initiative (MAI) or the Philippine Assistance Program (PAP), Japan pledged the largest amount, $1.6 billion. By contrast, the United States promised $200 million, of which Congress ultimately appropriated $160 million. The MAI donors met again in February 25–26, 1992, in Hong Kong and pledged a total of \$3.3 billion. Japan again topped the list with \$1.57 billion, with the United States promising \$160 million. These facts do not exactly paint a picture of a free-riding Japan. What they say about the United States is, however, less clear: one interpretation could be that America is turning into a Japanese aid–dependent military superpower.

Second, while Japan is likely to continue its massive development assistance program for the Philippines, the United States will sharply cut back its aid as it withdraws its military bases. The United States may appropriate less than \$100 million for MAI funds, and there is pressure to cut base-related aid from \$363 million in FY 1992 to zero (Awanohara 1992). These facts add up to a simple conclusion: until recently, both Japanese and American aid to the Philippines had at least one common strategic purpose—to pay for America's military bases. With the military bases gone, America seems poised to simply disengage financially from the Philippines, which is increasingly viewed as a former colony with little strategic importance, while Japan would likely continue to provide assistance to promote regional peace and stability as well as regional economic development. Paradoxically, the only argument that may persuade the United States to provide aid to the Philippines is precisely the neocolonial and mercantile one that Japan is routinely accused of: aid would promote America's economic and commercial interests; a complete disengagement will only create an economic vacuum that Japan will surely fill.

Finally, the Japanese private sector is already stepping in to fill the vacuum—one not created by U.S. cut-off of aid, but by the scheduled withdrawal of the U.S. military from Subic Bay Naval Base in late 1992.[32] The Philippine authorities have already approved a three-stage plan to transform the naval-base complex into an industrial zone with a Hong Kong–style free port. At the time of this writing, at least seventeen major Japanese private enterprises—trading companies, banks, and construction companies—have lined up to capture a part of what appears to be potentially a rich and growing pie. While the Japanese companies seem to be ahead of the line, others are not far behind. Philippine, other Asian, and American businesses have joined the competition. Some twenty-eight Philippine companies, businesses from Singapore and Hong Kong, and twenty-one U.S. firms have already showed interest. Even H. Ross Perot, the third candidate in the 1992 U.S. presidential race, plans to operate Subic Bay airfield as a regional air traffic hub and to participate in the construction of a coastal road linking Subic Bay to Manila. So far, none of this is being funded by Japanese official aid. Only the World Bank and the ADB are

32. There is much less interest in nearby Clark Air Base, which the United States abandoned in June 1991 in the wake of severe damage from the eruption of Mount Pinatubo. The conversion plan of this former home of the U.S. Thirteenth Air Force has been hampered by continued ash emissions from the volcano, as well by the loss of air communication due to the damaged runways. See Baguioro (1992, 23) for more details.

considering funding feasibility studies and technical assistance. This example seems to indicate that, while security-motivated official development aid to the Philippines may decline, private capital—from Japan and elsewhere—will probably more than make up for it, and in all likelihood will generate higher growth and development.

The ADB constitutes an excellent case study for examining the evolution of Japan's assumption of global (or at least regional) responsibility, the U.S. response to this evolution, and United States–Japan cooperation and confrontation on economic policy and political power in Pacific Asia. This case study offers yet another illustration of Japan's shouldering its international responsibilities; it also rejects the view that Tokyo is using foreign aid and its dominant role in the ADB to establish economic hegemony in the region. Instead, the ADB experience demonstrates forcefully that, while the U.S. government and opinion leaders continue to prod Japan to assume greater global responsibility, their attitudes and actions often keep Japan from doing so.

I would like to substantiate the above conclusion with six specific observations. First, the ADB is perhaps the earliest and most significant demonstration of Japan's willingness to assume regional, if not global, responsibility, Tokyo played a leading role in planning, designing, and founding the bank in 1966. And it guided and managed the bank actively in its formative years. Japan was intimately involved in formulating the legal structure of the bank and setting its agenda. It also took responsibility for dispatching bank presidents and a large cohort of professional staff, as well as putting up the necessary amount of money (Yasutomo 1983). Japan did not undertake this initiative under U.S. pressure or *gaiatsu.* The United States insisted on equal status in terms of voting power, and Japan apparently agreed.

Second, the criticism that Japan uses the ADB to promote its commercial interests while the United States does not, if true earlier, seems no longer valid (see Wihtol 1988, 43). To begin with, it should be noted that the United States has prevented the bank from funding palm oil, sugar, and citrus fruits in response to domestic commercial interests (Yasutomo 1992). There have been no such analogous efforts from Tokyo. In the area of procurement for ADB projects, by the end of 1989, Japan won 21 percent of all contracts funded by the Ordinary Capital Resources (OCR), 19 percent of Asian Development Fund (ADF) contracts, and 5 percent of Technical Assistance Special Fund (TASF) contracts. It is worth noting here that, by the end of 1988, Japan provided almost 40 percent of ADF money and 57 percent of TASF money. The procurement share of Japanese companies has declined in recent years. For example, Japanese share of the OCR and ADF contracts in 1988 was only 12 percent, and it fell to 7 percent in 1989. Similar data for the United States are not available, but one piece of information is relevant. These contracts include goods, relative services, civil works, and consulting services. The U.S. companies have been the leading contractors of goods for some time and have recently taken the top position in consulting services. Note that by the end of

1988, the United States contributed 18 percent to the ADF and 2 percent to the TASF (Yasutomo 1992, n. 30).

Third, Japan's role in the ADB is going through a critical transitional period, creating new grounds for conflicts as well as cooperation with the United States. While playing a leading role in establishing and organizing the bank during its infancy, Tokyo adopted a low-key approach (the so-called SSS approach of "silence, smile, and sleep") when it came to projecting its vision and participating in the policy debate. The main focus was to cooperate with the United States, adequately fund the bank, ensure its survival and prosperity, and maintain its reputation and, with it, that of Japan. This survival-cum-image-oriented vision-shy approach continued through the 1970s and the early 1980s.

During the second half of the 1980s, however, there was a dramatic change: prodded by the international community and especially the United States to assume much greater global responsibility as Japan became the world's largest creditor and capital-exporting nation boasting a superstrong yen, it became an activist development-aid power with profound implications for its role in all multilateral financial institutions, including the ADB. It dispatched a new breed of "young Turks" to the ADB, who were more articulate and assertive and who were more willing to voice their views in what should be the philosophy and policy agenda of the bank. Also, Japan wanted to end voting-right parity with the United States and be the number-one shareholder of the bank. This shift toward forward-looking activism has created two types of tensions. One is more like a Japanese schizophrenia—the clash between the traditional habits of old SSS and the move toward a new SSS—"speak, smile, and snap." The other is a U.S.-Japanese bilateral conflict—over a Japanese desire to be the bank's top shareholder and over the bank's development philosophy and its future direction.[33]

Fourth, with rising Japanese activism, Japan's relationship with the United States can still be characterized as one of overall cooperation with underlying differences and tensions, which occasionally surface as outright conflicts. Japan's efforts to maximize cooperation with the United States and minimize conflicts within the ADB reflect the imperatives of maintaining an overall friendly bilateral relationship with the United States, as well as concerns over the effectiveness and reputation of the bank. Japan's cooperative attitude and actions toward the United States—however reluctant it may be at times—shows up in various ways. One recent example is Tokyo's support for the U.S. nominee for ADB vice president in the face of opposition not only from some developing member countries (DMCs), but even from European members. Another is Japan's support for the U.S. opposition to resumption of lending to China and its conspicuous silence on concessional loans to China and India. Yet another example would be Japanese hesitation in expressing its views on the U.S. rejection of a $10 billion infusion of new funds into the ADF.

33. This paragraph and the rest of this section draw heavily from Yasutomo (1992).

Fifth, within the overall cooperative framework, conflicts between Japan and the United States have rocked the ADB repeatedly since 1985. These frictions have arisen from a variety of sources, ranging from mundane personality clashes among top personnel to lofty disagreements over development philosophy and lending policy and practices of the bank. And then, of course, there is the issue of a persistent and perhaps increasing money-power gap, with the Japanese running a deficit and the Americans a surplus—a point I elaborate in my sixth observation. In the domain of personality clashes, the United States and some other members saw Masao Fujioka, appointed president in 1981, as a major problem. He was criticized for his policies and management skills, and more for his abrasive temperament. He earned the nickname Shogun for his assertive, acerbic, and arrogant personality. On the other hand, many saw the American executive director Joe Rogers as an inexperienced ideologue with little understanding of Asia, trying to use his "textbook knowledge" to help develop Asia.

Japan has tried to mitigate the "Fuji-friction" within the top management by selecting in 1989 a low-key, conciliatory, and amiable Ministry of Finance official as flamboyant Fujioka's successor. The new president, Kimimasa Tarumizu, is noted for his typical Japanese bottom-up consensual management style and considers himself an honest broker in mediating differences between Tokyo and Washington. Japan has, however, balanced Tarumizu's kinder and gentler approach to management and decision making by appointing high-posture, assertive, and articulate executive directors. These directors are not hesitant to speak their minds at board meetings: they challenge their American counterparts on policy issues and express their disagreements even with the Japanese president himself. For example, the current executive director, Ken Yagi, is young, knowledgeable about bank operations, and not shy about expressing his opinions.

On the policy front, the U.S.-Japanese differences go deeper and are not easily reconcilable. To resolve these differences as well as to review the bank's roles and missions in the 1990s, an independent five-member advisory panel led by the Japanese wiseman Saburo Okita produced a report in 1989. Among other things, it called for a greater bank role in two areas—poverty alleviation and arresting environmental degradation, including an emphasis on designing environment-friendly projects. The report also recommended increased private sector lending. While Tokyo and Washington agree on these goals, the divergence shows up in the means and methods of achieving them. For example, Japan (and the DMCs) find the American insistence on strict conditionality for policy-based lending contentious and counterproductive. Some Japanese and Asian members feel that the United States does not really understand Asia, and its inflexible across-the-board ideological approach is inherently incapable of appreciating the diversity of Asia and thus a threat to development. Many Asian DMCs enjoying rapid economic growth consider the perceived American obsession with dubious policy conditionalities as wrong-headed condescension in view of the lackluster performance of borrowing members of the Inter-American Development Bank (IDB)—a regional development bank where the United States plays the dominant role in enforcing policy conditionalities. They also find it annoying that the U.S. hand is unduly heavy in imposing policy conditionality, but when it comes to funding the bank, the same hand suddenly turns empty.

Finally, the fundamental source of conflict is neither personality clash nor policy difference, but the politics of power and purse. More specifically, Japan wants to expand the capital base and strengthen the financial health of the ADB and take a leading role in doing so. But the U.S. insistence on maintaining parity in voting rights combined with its unwillingness to put up additional money essentially prevents the ADB from playing a greater role and Japan from assuming greater responsibility. For example, in 1988, Tokyo wanted to achieve the top shareholder position by increasing its share in the bank's OCR through a special capital increase. This was motivated by Japan's frustration at not getting representation commensurate with taxation, and its desire to have others recognize that reality. By 1988, Japan's contributions accounted for nearly 40 percent of the ADF and 57 percent of the TASF. By contrast, the U.S. share was 18 percent of the ADF and less than 2 percent of the TASF. Currently, the United States is also running an arrear of $175 million in the ADF.

Japan wanted to formalize this "U.S. free ride" by ending the parity in voting rights, but Washington insisted on maintaining the traditional parity by matching the Japanese contributions to the OCR, thus continuing its representation with insufficient taxation. U.S. Treasury secretary Nicholas Brady argued (1991, 6) that the voting right parity with Japan "will enable us to maintain our influence in the ADB. We will thus avoid ceding a measure of our influence in Asia in general, the world's most rapidly growing region." In congressional testimony, one Asia watcher put this rationale more forcefully: "I think the Asian Development Fund offers an effective channel for American support for the economic development of both India and China, two giant subcontinental political conglomerates that cannot be easily absorbed into the Japanese-centered economic grid now being consolidated in much of the rest of Asia. So the main reason I present for the new emphasis that I would like to see on the Asia Development Fund is the need for a long-term American effort to build countervailing economic power in Asia to offset that of Japan."[34]

Another example of America's (and some European members') efforts to undermine Tokyo's leadership at ADB is its vehement opposition to President Fujioka's 1989 proposal to establish a private sector lending affiliate—the Asian Finance and Investment Corporation (AFIC)—capitalized jointly by

34. See Harrison (1991, 23–24). Elsewhere in the same congressional testimony, Harrison claims, "Japan has attempted to make Bank lending policies serve its effort to establish a latter-day 'Co-prosperity Sphere' centered in nine countries of East and Southeast Asia" (89).

ADB and private banks and financial institutions. This opposition partly reflected genuine policy differences, but the politics of economic competition perhaps played a more important role: while most Asian DMCs generally supported the idea, America and other European competitors of Japan saw it as Tokyo's ploy to give business to the Japanese banks. The proposal was finally approved when an agreement was reached to reduce the maximum share of Japanese private financial institutions from 40 to 30 percent, and the ADB made special efforts to recruit American financial institutions to join AFIC. The irony in this AFIC fiasco is that Washington objected vociferously to a Japanese proposal that in fact was a response to the U.S. criticism of the ADB for its excessive focus on the public sector and to the U.S.-supported advisory panel's recommendation that the ADB establish a body to grant private sector loans.

The ADB represents a microcosm of the overall United States–Japan relationship, in Pacific Asia and elsewhere. The bilateral money-power imbalance seems to drive the dynamics of conflicts in an otherwise cooperative relationship. The United States wants to preserve the old power structure, but it is unable to put up the money to sustain it. That puts Japan in a no-win situation: on the one hand, Tokyo is chastised for practicing checkbook diplomacy and not exercising global leadership; on the other hand it is blocked from doing so by the U.S. refusal to cede its own power and status.

8.6 Conclusions

This paper reaches four key conclusions.

1. There is little analytical foundation for the view that the national defense and foreign aid of the United States (and of Japan) within the context of the 1960 United States–Japan security treaty can be considered as international public goods. The analytical and empirical basis for viewing Japan as a military free rider is also weak. Thus the notion that Japan can compensate for its military free ride with a huge expansion of its foreign aid budget is highly questionable. It is, however, perfectly reasonable to argue that as a global economic power Japan has global responsibilities and should play a greater role in various nonmilitary areas, including foreign aid and measures for addressing environmental and other transnational problems.

2. There is little evidence that relative to the United States and other donors, the quality of Japan's aid is relatively low. Also, Japan gives less tied aid than do other donors to promote exports and gain market shares. The Japanese foreign aid program, in Pacific Asia and elsewhere, seems to be becoming increasingly multidimensional in nature, embracing economic, political, security, humanitarian, and developmental objectives.

3. The interpretation of Japan's growing economic ties with Pacific Asian economies as a Japanese plan to create a coprosperity sphere to serve its own economic interests is a complete misapplication of a colonial concept of yes-

terday to the new realities of modern international economic relations. It is also factually incorrect. Japan provides little or no aid to the so-called NIEs. Out of the four ASEAN economies, its recent aid allocation to Malaysia has been modest, and its trade and investment linkages with the Philippines are quite weak, leaving only Indonesia and Thailand where the coprosperity thesis could be potentially valid. Available evidence, however, does not validate the thesis that Tokyo is using ODA incentives and instruments to essentially promote trade and investment interests of Japan's private sector in those two countries. There is also little evidence that the Japanese bureaucrats are implementing a foreign aid plan for creating and managing a regional economy to serve Japan's economic interests; market forces are largely responsible for these increased regional linkages.

4. A closer examination of the U.S.-Japanese interaction in the Philippines and in the ADB turns up additional evidence against the view that Japan is a free rider or that it is attempting to build a coprosperity sphere in Pacific Asia. Instead, Japan seems to be genuinely cooperating—financially and politically—with the United States to support security interests of both nations. Conflicts arise inevitably, especially at the ADB, when Japan attempts to assume greater responsibility and challenge the U.S. tendency of maintaining a "power free ride."

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Comment Stephen D. Krasner

Shafiqul Islam's discussion of Japanese official development assistance (ODA) takes on virtually every objection that has ever been raised about Japan's behavior and concludes that almost all of these criticisms are unwarranted. The issue that activates Islam's paper is whether Japanese ODA is different from that of other major donor countries and whether it is worse or better in terms of the benefits that it provides to recipients.

Foreign aid is a new development in the history of the international system. Before the Second World War there were no public capital transfers designed to promote the general development of poorer countries as opposed to the specific economic, political, or security interests of the lending state (Lumsdaine 1993). Much of the current transfer of development assistance cannot be explained by the narrow national interests of the donor countries. This is most obvious for small wealthy European countries such as the Netherlands or the Nordic countries, which commit relatively large proportions of their GNP to ODA yet cannot expect to reap much in the way of specific security or economic benefits.

Is Japanese ODA more closely related to identifiable economic interests than is the case for other donor countries? This volume is concerned specifically with Pacific Asia. In this area, as Islam points out, the ties between Japanese trade and investment interests and foreign aid may not always be obvious. At the global level, however, there is a closer relationship between Japanese ODA and Japanese economic interests than is the case for any other major

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donor country. As table 8.1 points out, in 1989/90 69 percent of Japan's bilateral disbursements went to Asia, the developing area where Japan has, or might expect to have, the most concentrated economic interests. In contrast, about half of American assistance goes to the Middle East, specifically to Israel and Egypt. This assistance is designed to enhance the military and economic security of the region, a benefit that accrues to all oil importers, not just to the United States. The bilateral assistance of the major European countries is concentrated in Africa, an area of limited economic consequence. (In 1987 3.2 percent of Western Europe's exports went to Africa and 2.8 percent of Western Europe's imports originated in Africa. The Middle East accounted for 3 percent of North America's exports and 2 percent of its imports. In contrast, South and East Asia accounted for 23 percent of Japan's exports, and 29 percent of its imports [GATT 1988, table AA10].)

Correlation coefficients between the level of trade (exports plus imports) and the level of bilateral aid for the ten largest recipients of ODA were .68 for Japan, .41 for the United States, −.12 for France, and .54 for Germany—the four largest donors.[1]

This is a simple measure. Trade is not the only indicator of economic involvement. These figures do suggest, however, that there is a closer relationship between aid and economic interest for Japan than for any of the other three largest donor countries.

The fact that Japan's aid is concentrated in Pacific Asia, the developing area where it has the highest level of economic interest, does not imply that this aid is in any way economically harmful to the recipients. On the contrary, the more favorable the terms of aid, the greater the likelihood of generating dependent relations that would limit the options available to aid recipients. It is the creation of asymmetrical opportunity costs of change that allows one economic actor to exercise power over another. Coercive threats can only be credible if the implementation of the threat would be more costly for the target than for the threatener; that is, if the donor country can explicitly or implicitly threaten to withdraw aid at little cost to itself and the target country would suffer if the threat were implemented. This relationship between economic transactions and political power was analyzed more than fifty years ago by Albert Hirschman (1945). Japan's relations with East Asia in aid, investment, and trade are completely consistent with an effort to create a set of economic links that engender asymmetrical opportunity costs of change and thereby enhance Japanese power.

Such a policy is neither mysterious nor reprehensible. On the contrary, given the level of global uncertainty engendered by the end of the Cold War and the fear if not the reality of rising regionalism, Japanese efforts to establish a more predictable and stable environment in Asia, by making Asian countries more dependent on Japan than Japan is on them, reflects a prudent concern with

1. Derived from figures in OECD (1990, section E, table 43) and International Monetary Fund (1990, country pages).

Japanese national interests. Such a motivation is, however, different from the more diffuse and altruistic concerns that have motivated ODA from many other countries.

Islam asserts that "the view that Japan is gradually consolidating its hold on its Asian neighbors in the sense that it is increasingly influencing their economic policies and domestic politics is at best an unwarranted fear, and at worst an insult to the people of these sovereign countries. . . . they are some of the most dynamic economies of the world with highly proud people and powerful nationalist governments." This is a vacuous analytic argument. The extent to which one state can exercise influence over another as a result of economic transactions is a function of relative opportunity costs of change, not national pride. Aid, trade, and investment can all contribute to such asymmetries. So long as the United States remains actively engaged in Asia both economically and militarily, Japanese leverage will be limited. But if Asian trade and investment do become more focused on Japan, such leverage would increase.

Of the many specific points made in Islam's paper that bear closer scrutiny, the most provocative is his assertion that "Japan is more open to the countries in question [the ASEAN-Four] than the United States is." The data supporting this argument are presented in table 8.13. Islam admits that assessing openness in terms of the percentage of GNP accounted for by imports is not the best measure. Large countries generally have lower trade ratios; the normal expectation would be that the United States would import less from the ASEAN-Four than Japan does.

This point aside, many of the complaints about the closed nature of the Japanese market have emphasized manufactures rather than general merchandise imports. Table 8C.1 shows the percentage of Japanese and American imports accounted for by manufactures (SITC numbers 5–8) from the ASEAN-Four, as well as from other major Asian trading countries.

In every instance a substantially higher proportion of American imports from Asian countries is accounted for by manufactures. Japan is markedly more closed to manufacturing imports than the United States is.

The U.S.-Japanese relationship is, as Islam points out, troubled in the area

Table 8C.1 Manufacturing Imports as a Percentage of Total Imports

	United States	Japan
Indonesia	48	15
Malaysia	86	18
Philippines	83	33
Thailand	77	48
Singapore	96	41
South Korea	99	80
Taiwan	98	69

Source: Figures in OECD (1992, 3:11–86, 4:11–85).

of foreign aid and elsewhere. Japan is now the second largest economy in the world. Its GNP, which was about 10 percent that of the United States after the Second World War, is now 60 percent. Japan, unlike any of the European states, has continued to grow at a faster rate than the United States. The growth of Japan, coupled with the collapse of the Soviet Union, constitutes a major change in the international distribution of power. Neither the United States nor Japan has yet found an effective way to manage this power transition.

Islam points out in his discussion of U.S.-Japanese relations in the Asian Development Bank that American policymakers have not been enthusiastic about sharing decision making with other states, including Japan. The ADB is no exception. At the same time, Japan's behavior in the area of ODA, as in other arenas, has been closely oriented toward specific Japanese interests. Japan has not exercised effective leadership in any global issue area.

The bilateral relationship between the United States and Japan is the most important in the world; it is not being handled well by either country at either the regional or the global level. Asia is not inherently stable. Without the United States, Japan would be threatening to its neighbors but would not be strong enough to impose a stable order. Establishing a viable long-term relationship between the United States and Japan must involve a recognition by the United States that power configurations have changed and that policymaking must be more bilateral, if not multilateral, in Asia.

At the same time, Japan must recognize that stability can be maintained only if Japan is willing to give other countries a greater stake in the Japanese market. Such a stake can be created only if Japan becomes more open to the manufactured products of other Asian countries as well as of the United States and Europe. The most effective leadership that could be offered by Japan would be to make the Pacific more truly interdependent. Unfortunately, Japan shows fewer signs of doing this than American policymakers do of truly sharing decision making. For Japan, as opposed to any other advanced industrialized country, real leadership means changing internal behavior more than foreign policy.

Since 1945 Japan has consistently pursued a policy in ODA and elsewhere that has been closely related to specific Japanese national interests. The United States has been much more oriented toward milieu goals. Japan is now too big, and the United States too small, to continue such policies in the future. Glorifications of Japanese behavior, such as Islam's paper, do no more to contribute to viable long-term U.S.-Japanese cooperation than do similar celebrations of America's faltering leadership.

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Comment Robert Dekle

Some analysts have claimed that Japan after World War II has been one of the principal beneficiaries of an international political stability that came mostly at the expense of U.S. taxpayers (Prestowitz 1988, 331; Schroeder 1988). This potential "free ride" is said to have provided Japan with the resources to grow at over 9 percent per year between 1951 and 1971 and at an average annual rate of over 4.3 percent thereafter.

In this comment, I critique the above claim by reviewing recent studies that have shown that even a markedly higher level of Japanese defense spending would not have significantly lowered Japan's real economic growth rate, especially until 1970. The literature suggests that had Japan raised its defense budget–GNP level from its customary 1 percent to the U.S. level of approximately 6.5 percent, Japan's annual real output growth rate would have declined by an average of only 0.5 percent between 1970 and 1985. During Japan's rapid economic growth period that lasted until 1971, this fall is negligible, although a 0.5 percent annual fall is more significant during the subsequent slower growth period. However, I argue that, after 1970, part of the potential fall caused by the increased defense spending could have been offset by increased technological progress, a possible externality arising from defense.

This comment has three parts. In part 1, I review Japan's defense spending and provide adjustments to Japan's defense budget to make it comparable to America's. In part 2, using a result from the theory of public goods, I argue that during the Cold War era it was probably not unreasonable for Japan's allies to expect Japan to contribute between 3.4 and 6.5 percent of its GNP on security-related activities. In part 3, I review two recent studies on the relationship between defense spending and economic performance in Japan.

1. Table 8C.2 lists Japanese defense expenditures for 1991. The American and Japanese defense budgets over time are compared in table 8C.3, which shows that during the 1980s American defense spending was on average ten times higher than that in Japan. American and Japanese defense budgets are not directly comparable. The American budget includes spending on regular military forces and military pensions. The Japanese defense budget omits military pensions. In addition, the Japanese government's support for U.S. forces

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Table 8C.2 Japanese Defense Expenditures, 1991

	Billions of Yen	Billions of Dollars (135 yen = $1)
Salaries, food	1,757	12.86
Procurement of equipment	1,216	9.0
Research and development	103	0.824
Maintenance of facilities (airports, housing)	136	1.00
Maintenance of equiment, training	697	5.16
Maintenance of civilian areas surrounding military bases	425	3.15
Other	53	0.39
Total	4,387	32.49

Source: Japanese Self-Defense Agency (1991).

stationed in Japan, listed as $1.2 billion in the 1991 defense budget, is probably an underestimate of Japan's true economic cost.

Military pensions actually paid by the Japanese government in 1991 totaled 310.1 billion yen or $2.29 billion. In Japan, there are sixteen American bases, including eight in Okinawa prefecture. These bases house 50,800 people in the American military. The Japanese government is partially responsible for the physical maintenance of these bases and for the salaries and benefits of the Japanese working there. Surprisingly, the economic opportunity cost of the use of Japanese government land is omitted from the Japanese defense budget. For the six bases in the greater Tokyo area, the opportunity costs seem very high.[1] It is estimated that American bases occupy 20 percent of the total area of Okinawa island and almost 60 percent of the prefecture's navigable harbors. The U.S. Defense Department's *Allied Contributions to the Common Defense* lists an estimate of the opportunity cost of the use of Japanese land in 1991 as $0.71 billion. Assuming that this estimate is based on official land price data, the true opportunity cost could be five times as large.[2] Accordingly, we multiply $0.71 by 5 and obtain $3.55 billion. Adding to the 1991 Japanese defense budget the $2.29 billion of military pensions and the $3.55 billion of land use opportunity costs, we get $38.33 billion, or 1.09 percent of Japan's 1991 GNP.

In the spring of 1991, Japan completed its $13 billion payment to the Gulf Peace Fund to underwrite the Multinational Force's war against Iraq. As does the United States, Japan omits military aid from its defense budget. U.S. mili-

1. Yokota, Zama, Atsugi, Yokohama, Kamiseya, Yokosuka.

2. After the rapid rise in land prices in the late 1980s, the market price of land can be up to five times the official price reported by the Japanese government (Ito 1992, 417).

Table 8C.3 Japanese and American Defense Expenditures Compared

	Japanese				United States	
	Defense (billions of 1988 yen) (1)	Defense (billions of 1988 dollars) (2)	Defense/GNP (3)	Defense/ Government Budget (4)	Defense (billions of 1988 dollars) (5)	Defense/GNP (6)
1955	1480		1.78	13.61		
1965	1568		1.07	8.24		
1975	2008		0.84	6.23		
1976	2169		0.9	6.22		
1977	2270		0.88	5.93		
1978	2476		0.9	5.54		
1979	2617		0.9	5.43		
1980	2625		0.9	5.24		
1981	2727	21	0.91	5.13	221	5.7
1982	2863	22	0.93	5.21	241	6.3
1983	3004	23	0.98	5.47	259	6.5
1984	3127	24	0.99	5.8	271	6.4
1985	3268	25	0.997	5.98	290	6.6
1986	3439	26	0.993	6.18	305	6.7
1987	3571	27	1.004	6.5	301	6.4
1988	3700	28	1.013	6.53	296	6.1
1989	3775	29	1.006	6.49	289	5.8
1990	3968	31	0.997	6.28	268	5.7

Sources: Columns (1), (3), and (4) are from Japanese Self-Defense Agency (1991). The figures are deflated by the deflator for Japanese government expenditures. Columns (2), (5), and (6) are from SIPRI (1991).

tary aid, called "security assistance," is in the budget of the State Department, and in 1991, it totaled $8.8 billion. When Japan's $13 billion Gulf payment is added to its defense budget, Japan's defense GNP share rises to 1.47 percent. Since the Gulf contribution is unlikely to be repeated, we omit it from Japan's defense budget in the discussion below.

2. The 1.09 percent of GNP figure puts Japan's security contribution below those of Italy (2.7 percent), Canada (2.2 percent), and even the non-NATO European nations, Austria (1.3 percent) and Finland (1.4 percent). In Dekle (1989), I argued that in the immediate aftermath of the Reagan defense buildup, Japan's benefits from world security were consistent with its spending between 3.4 and 6.5 percent of its GNP on defense. The argument rests on a well-known principle in public finance: to have an optimal supply of a public good, it is sufficient to tax each person an amount equal to his marginal benefit from the public good. If the marginal benefit of defense is proportional to GNP, then Japan's defense contribution should be between 3.4 and 6.5 percent of GNP, the defense-GNP shares of Germany and the United States, respectively. Japan's GNP is between America's and Germany's in size.[3]

3. Changes in a country's defense spending affect the country's economic performance from both the aggregate demand and supply sides. The demand-side effects predominate in the short and medium runs when the economy is adjusting to a different full-employment level. Most large-scale econometric models emphasize the demand side, and these models usually predict the following effects when, say, the United States runs a fiscal or defense expansion without monetary accommodation. The dollar, the U.S. real GNP, and the real interest rates rise, and the U.S. multilateral current account deteriorates. Imports increase due to higher GNP and higher prices for domestically produced goods. Exports fall because of more expensive exportables. Depending on the model, the current account worsens more than the trade balance; the higher interest rate on foreign debt raises interest payments made abroad. For example, the Japanese Economic Planning Agency predicts that a 1 percentage point increase in the U.S. government spending–GNP ratio will worsen America's current account–GNP ratio by 0.77 percentage points (Economic Planning Agency 1988).

In the medium to long run, most economists would argue that the supply-side effects dominate in the world. Recently Dekle (1989) and Wong (1989) have separately examined the supply-side effects of increases in defense spending, the former for the period between 1961 and 1971, the latter using data between 1970 and 1985.

From the aggregate production function, making some simplifying assumptions, we know that growth in output is equal to

3. There is no presumption that this allocation is fair. To make an assessment of fairness, we must make an assumption of what distribution of national income among allied nations is desirable. Such an assumption will always be arbitrary.

$$\frac{\text{Output}}{\text{Growth}} = \frac{\text{Capital}}{\text{share}} * \frac{\text{Growth in}}{\text{capital stock}} + \frac{\text{Labor}}{\text{share}} * \frac{\text{Growth in}}{\text{labor stock}} + \text{Residual.}^{4}$$

An increase in defense spending will draw capital and labor from productive use. The degree to which output is affected depends on the size of the residual, which is said to represent technical progress. The larger the residual, the smaller is the effect on output of a change in the factor inputs, assuming that technological progress is disembodied from capital. In Japan, the residual is large, accounting for over 55 percent of the Japanese economic growth rate, which may explain why Japan's economic growth is lowered by only 0.5 percent when Japan's defense spending–GNP ratio is raised from 1 percent to 6.5 percent (Denison and Chung 1976).[5] If technological progress is embodied in capital, the results below may underestimate the negative impact of defense spending.[6]

Dekle (1989) borrows from the growth accounting framework of Denison and Chung and shows that, if Japan's defense-GNP ratio had been approximately the U.S. level of 6.5 percent, Japan's national income would have grown between 1961 and 1971 at 8.76 percent a year, instead of the actual 9.29 percent, a decline of 0.53 percent. The reason for the relatively small fall is that many other factors besides the growth of capital were responsible for the rapid growth of Japanese national income. Dekle assumes that defense spending crowds out investment in nonresidential structures and equipment one for one. Unlike Wong (1989), Dekle assumes that investment in different years is uncorrelated, and declines in the capital stock are not cumulative.

Wong's (1989) study takes into account changes in both capital and labor. He finds that an increase in defense spending seriously dampens the accumulation of the capital stock in the private sector. An increase in the Japanese defense expenditure–GNP share to the U.S. share of 6.5 percent lowers the Japanese capital stock by 37 percent between 1970 and 1985. The reason the capital stock falls so much is that, in Wong's model, investment is a function of GNP. A fall in investment this year is said to lower current GNP, which lowers investment next year. That is, the damage to the capital stock is cumulative. Private sector labor also falls as more people are enlisted in the Japanese armed forces. Since labor supply is less plausibly related to GNP, next period's labor supply is unaffected by this period's labor, so the fall in labor supply is not cumulative and is negligible, declining by only 2 percent between 1970 and 1985. The

4. Note that the equation is not structural; determinants of the growth in capital and labor are not specified.

5. The growth accounting literature pioneered by Denison (1967, 1974) has found that, for almost every country, output growth cannot be explained by the growth in capital and labor. There are often difficulties in accurately measuring the growth in capital and labor, and the size of the residual may partly reflect measurement error in addition to technical change.

6. The assumption of technological disembodiment from capital is probably false. It is well known that Japanese technological progress has proceeded by the rapid introduction of the latest vintage of capital equipment. The Japanese steel industry, for example, became highly efficient by incorporating oxygen-processing and large-scale, open-hearth furnaces.

combined effects of the annual declines in both capital and labor result in Japan's 1985 GNP being lower by about 7 percent than otherwise. The reason for the rather small decrease in GNP relative to the large decline in capital is that the capital share of output in Japan is only about one-fourth. A cumulative 7 percent decline occurring over fifteen years (1970–85) implies a 0.48 percent fall in the annual growth rate of output, which is very close to Dekle's estimate above. In contrast, however, to the near double-digit growth in the 1960s, Japanese GNP grew at only an average real rate of 4.38 percent between 1970 and 1985.

By assuming disembodied technical progress, both Wong and Dekle have ignored the relationship between defense and technical progress. The effect of defense spending on technical progress depends on what the spending is used for and which component of private investment is on the margin crowded out. If increased defense expenditures results in more military manpower at the expense of private R&D, technical progress may be retarded.

Zvi Griliches (1987) cites econometric results showing the differential impacts of military and private R&D. He finds that all R&D spending increases the annual growth rate of U.S. corporate output by 33 to 62 percent, depending on the year. Basic R&D has a premium over general R&D spending by several hundred percent. Griliches, however, does show that basic research undertaken by the private sector has a higher return than basic research undertaken by the government. Defense R&D is often characterized by inefficient featherbedding and cost-plus-profit procurement.

During the 1960s, most of Japan's technological progress was due to its catching-up with the best practice in the United States. The marginal value of defense R&D during this period was probably very low. In fact, it might have been negative if technological progress were embodied in capital; a crowding-out of private capital accumulation would have been detrimental to technological progress. Since the mid-1970s, however, Japan has almost caught up with the United States technologically. Higher military R&D could have helped Japan move up further along the technological frontier. While the U.S. government finances about half of the total U.S. R&D expenditures, the Japanese government supports only about 20 percent. Japan is not strong in rocketry, supercomputing, and computer software. The development of these fields entails a high degree of problem solving and unpredictability and requires an ability to integrate complicated systems. With no guarantee of government demand for new products, Japanese companies have followed a fairly conservative approach to R&D, emphasizing projects with a high degree of commercial feasibility. The absence of risk taking may have slowed Japanese technological development since the early 1970s, especially in frontier areas such as aerospace, satellites, and new materials. Increased defense R&D could have also improved Japan's basic research capacity. Relative to its strength in applied research, Japan is weak in basic research. A counting of citations in international scientific journals has revealed that Japan is fifth in the world in physics, fifth in chemistry, and third in the biological sciences.

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Comment Takashi Inoguchi

It seems that the organizing concept of the conference was regionalism in Pacific Asia. By regionalism I mean possible or actual Pacific Asian regional arrangements that might affect positively or negatively what is seen as the United States' stake in the region. It is a good strategy to organize such a conference. In my view, it has been a successful strategy too. Yet it is somewhat narrow when one looks at the daunting set of issues confronting Pacific Asia in the beginning of the post–Cold War era.

Global Context

Let me briefly summarize what I see as the essential features of the world order after the end of the Cold War in general and those in Pacific Asia in

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particular (Inoguchi n.d.): (1) U.S. military dominance and the increasingly shaky foundations to sustain it in the longer term; (2) concurrent movements toward globalization and regionalization; and, (3) trends for liberalization and democratization and their destabilizing potentials.

With the end of the Cold War, the United States has emerged as the sole military superpower. Yet its longer-term economic and technological underpinnings are increasingly called into question in the United States. More vigorous efforts to counteract such deterioration in its competitive position are wanted. Political temptations to go isolationist are on the rise, especially in the year of the presidential election. Furthermore, potentials for competition and destabilization among regional powers abound in the longer term, at least when the United States' steady downsizing of its presence in the region is not yet made up for by some imaginative regional arrangements.

Technological progress has made the globe smaller and global economic transactions much easier. At the same time, intermittent structural adjustments become more or less unavoidable even to less competitive countries. The result is the increasing temptation to protectionism and regionalism of a malign kind. Pacific Asia needs global market access because the region as a whole has a much smaller market than its actual and potential productive capacity. Hence its vigorous movement to globalize its economic activities. Its need for globalization is made imperative, furthermore, first because the other two major regions of dense economic activities on the globe, Western Europe and North America, are manifesting increasing self-closure and second because the momentum for successfully concluding the Uruguay Round of GATT seems to be waning somewhat. Hence the need for the two concurrent tasks of globalizing Pacific Asian economic activities and enhancing intraregional economic transactions.

The entire globe has of late been in the process of economic liberalization and political democratization. The end of the Cold War has coincided with the trend of unraveling excessive economic regulation and control and of loosening political tyranny and authoritarianism. If Francis Fukuyama calls these processes the end of history, one might as well call these processes in Pacific Asia the midway of history. Economic liberalization in Pacific Asia has been slower than the other regions of dense economic transactions on the globe. Political democratization in Pacific Asia has been slower than in many Northern Hemisphere countries. The fact that Pacific Asia enjoys a high economic growth rate means that structural adjustments are both unavoidable and rapid. However, structural adjustments, when mishandled, tend to create social strains and political instability. Hence the need for the careful management of liberalization and democratization in Pacific Asia.

America's Anxiety

In the conference, the first and third sets of issues were not well addressed, while the second set of issues such as trade, aid, investment, technology, and bloc formation were more closely examined. While these mainly economic issues were discussed, the occasional surfacing of America's anxiety points to the importance of recognition of at least three themes that were not discussed but that underlay the whole discussion: (1) compatibility of Japan with the rest of the world (read the United States); (2) competitiveness of Japan vis-à-vis the rest of the world (read the United States); and (3) contributions of Japan to the rest of the world (read the United States).

Compatibility. America's anxiety is that Japanese may not be compatible with Americans; the Japanese look different and we may not be able to go along with them; they should be made compatible with us, as in further market openings; if not, we should close our door to them, whether it is trade, investment, or technology.

Competitiveness. America's anxiety is that Japan has unfairly acquired its advantage over the United States: the Japanese would be well advised to play the game on the level playing field. Furthermore, their unfairly acquired competitiveness should be reduced by encouraging them to divert their resources to two major tasks: more global financial contributions (e.g., the Gulf War) and more social infrastructure investment (e.g., the Structural Impediments Initiative talks).

Contributions. America's anxiety wavers between two extremes of "Japan's contributing too little, too late" and "Japan's contributing too much, too fast." The former extreme is America's reaction to Japan's reactiveness in the Gulf War, while the latter extreme is America's reaction to the Seattle-based business firms' purchase of the Seattle Mariners, in which Nintendo America contributed most by shouldering 60 percent of the whole cost of the purchase.

America's anxiety over Japan's possible or actual rise to predominance in Pacific Asia has been real. A number of questions come to mind immediately. How should the United States counteract Japan's rise to regional economic hegemony? How should the United States take advantage of its security hegemony to block Japan's rise to overall regional hegemony? How should the United States draw a strategy to keep Japan's neighbors closer to the United States than to Japan? These and related questions were raised in the conference, although they were much more textured and nuanced most of the time.

Creating Vulnerability through Technology?

It seems to me that, by allowing oneself to be guided by these questions, one is deliberately creating new sources of strain between Japan and the United States. For example, the argument advanced by David Friedman and Richard Samuels (chap. 7 in this volume), augmented by Peter Katzenstein and Martin Rouse (chap. 6 in this volume), is an impressive one, coming from those who know the subject so well. Yet their policy prescription is located in the sense of America's anxiety. They argue that, given Japan's tenacious way of borrowing, developing, and indigenizing technology from abroad without subsequently sharing much of their technological improvement with others, the United States should press Japan to open the market of technology so that technology learning would become a two-way flow. If this strategy fails—as their argument would go, I suspect—the United States should legitimately cut off technology flows to Japan. Furthermore—as their argument would go, I suspect—the United States should not allow Japan to penetrate the U.S. electronic and other markets in order to undermine the technological and manufacturing foundations of U.S. national security, since Japan's ingenious strategic use of economic and technological interdependence creates U.S. vulnerability to Japan by supplying parts of military weapons.

Japan's counterargument would be as follows: Japan is devoid of natural resources, especially energy and food, and does not enjoy strategic depth in national defense. Japan's many eggs—food, energy, technology, and security—are predominantly and thus dangerously in one basket called the United States. In other words, Japan's vulnerability to the United States is incredibly deep and manifold. Thus it is natural for Japan to enhance its autonomous ability in some of these areas to a certain extent and at the same time to divert some of its eggs from the United States to other regions, such as Pacific Asia and Western Europe, especially when the United States is increasingly critical of Japan. Even if Japan is able to create U.S. vulnerability to Japan in a few areas, that would be a much lighter kind of vulnerability than Japan's overall vulnerability to the U.S. Recognizing mutual vulnerability is one of the essential points of economic interdependence, after all. Even if mutual vulnerability is not symmetrical, it could lead to a more stable and sustainable friendship when it is managed with self-confidence and mutual trust. To resurrect the already stereotyped suspicion of Japan so tenaciously held in the United States, if inadvertently, by overemphasizing Japan's technonationalistic policy and its alleged negative effect on the United States, could spoil the overall friendship of the two countries and undermine the otherwise more productive interdependence between them. And the entire globe will suffer from more restricted flows of technology. More speculatively, the tendency to rely on patent fees for benefits might accelerate U.S. firms' tendency to make profits out of nonmanufacturing and their decline in competitiveness. It would be more productive to develop the scheme of sharing the R&D and manufacturing system and to allow a wider range of people to enjoy the benefits of technological progress while giving due credit to the innovators of science and technology.

Aid as a Trojan Horse?

Turning to Japan's aid, it seems to me that two kinds of perspective mingle nonsystematically in the minds of many Americans. One is that of burdensharing while the other is that of hegemonic cycle (Islam, chap. 8 of this volume). The former perspective says that Japan's aid is fundamentally commercially motivated. Thus Japan is seen as using aid to benefit Japanese business firms more than recipients; it is seen as being less interested in grants than loans; it is seen as being not so interested in raising the income level of ordinary people; it is seen as using aid to promote Japan's exports to recipients. The latter perspective says that Japan's aid is used to promote the state-designed scheme of economic hegemony in Pacific Asia. Thus Japan's aid is seen as an instrument of economic bloc formation; it is seen as an instrument of political-economic domination of recipient countries. What is confusing to me is that these two perspectives are arbitrarily chosen in order to advance whatever argument one wants to make about Japan's aid.

In order to make Japanese counterarguments, one needs to say a little about how Japan's foreign aid is conducted. It started as Japan's war reparations to some neighboring countries of Pacific Asia. Japan was obliged to pay them reparations because it inflicted suffering on them during the war, and defeated Japan had to pay them before the resumption of diplomatic relationships. Japan made the best use of these payments to increase commercial opportunities for Japanese business firms and to accelerate its own economic reconstruction. It does not seem that at that time there was any conception of war reparations as public goods either by Japan or by the United States, let alone any cooperation on the allocation of public goods between the two countries. Japan's official development assistance grew larger, in tandem with its steady economic growth. Japan's official development assistance has been based on its philosophy of thrift and self-help (Oshin, the heroine of a highly popular TV program in the early 1980s, and the Ministry of Finance are two good exemplars) and of "manufacturing matters" (Noboru Makino of the Mitsubishi Research Institute and the Ministry of International Trade and Industry speak for this). Related to these is an implicit Japanese developmental model (Inoguchi 1990): that developing countries must rely primarily on themselves, that too many grants spoil recipients, that recipients must be able to yield more benefits than mere interest payments by their ideas and efforts, that manufacturing is the basis of industrialization, that industrial infrastructure must be built ahead of almost anything else, and that, in doing all this, market forces take command, not politics, in the longer term. These tenets of the Japanese developmental model have surfaced recently in the publication of a World Bank study on industrialization of India, Indonesia, and South Korea. Masaki Shiratori, one of its executive directors, pushed this study against the mainstream view of the World Bank about developmental finance. The study underlined the importance of the government in economic development along with market forces.

Aside from these philosophical tenets, Japan's developmental assistance assigns a major role to two actors: recipient countries and Japanese business firms. The Japanese government has been working until recently on the strict principle that only upon request from recipients does it consider giving aid concretely. Naturally not only recipient governments but also local business firms and Japanese business firms cooperate in drawing up requests for aid, as many requests are in the areas of manufacturing and industrial infrastructure. Here is how market forces are mingled with Japanese aid, perhaps relaying Japan-led economic dynamism to recipient economies. Also important in Japan's official development assistance is that a large bulk of it comes from postal savings and government pension programs for which the government must be ready to make interest and other kinds of payments. Because of this heavy foundation, the Japanese government can make its aid sustainable for a long time, largely independent of economic vicissitudes from which normal tax revenues tend to suffer.

Since the basic picture of Japan's official development assistance should be clear by now, I should summarize the thrust of Japanese counterarguments.

First, as for the criticism of burdensharing, Japan's counterargument is simple and straightforward: one does not need to carry the Cold War ideological baggage in order to assess aid practices. Having moved into the post–Cold War era, one needs to fathom more carefully the ideas and institutions evolving within national borders and to think what kind of cooperation can be done on that basis toward the enlargement of global welfare, or more specifically in terms of economic development, technological progress, social equality, and political democracy. Here the notion of global contributions may be more helpful in assessing aid practices than burdensharing. According to this view, the wide-ranging areas of common policy agendas, like controlling carbon dioxide, arms control, telecommunications networks, codevelopment and comanufacturing of industrial technologies and commodities, and training bureaucrats and business managers, are to be taken as global contributions of one sort or another, especially when these endeavors are conceived and implemented as multilateral action, with Japan embedding itself in international institutions (Inoguchi 1992). When the post–Cold War era witnesses many competing perspectives on how the globe will evolve and how it should be managed, such a global-contributions perspective ought to be taken up more widely, even when the role of Japan and the United States is the main subject.

Second, as for the criticism of Japan's attempting to use aid as a Trojan horse for economic bloc formation or political domination, Japan's counterargument is simple and straightforward: one does not need to be awed by Japan. Japan's power tends to be exaggerated in the United States, if only to mobilize Americans for self-revitalization. Japan would not benefit in the longer term from bloc formation. Japan (and Pacific Asia) needs global market access, not access to one bloc. Bloc formation is counterproductive in Pacific Asia. Japan would not benefit from political domination, either. If Japan's official development assistance is termed a success, it is due in no small part to its largely market-conforming aid policy. No less important is the resilience of recipient countries, especially in Pacific Asia. Their nationalism is very strong. It is a force in Pacific Asia that has never been fully fathomed by Americans, even after the Vietnam War.

Pride and Prejudice

In working out the relationship between Japan and the United States in Pacific Asia, I would like to evoke the themes of Jane Austen's novel *Pride and Prejudice.* Both Japanese and Americans have pride. The United States has its hegemonic pride, while Japan has pride in its manufacturing competitiveness. That it has pride is natural and legitimate. We cannot suppress it. We should use it for good purposes. Both Japanese and Americans are prejudiced against each other, sometimes poisonously, often in racist terms. Their prejudices should not be encouraged to grow so far as to reach the level of the 1940s. Both Japanese and Americans need to moderate pride and mitigate prejudice to work out their relationship.

More specifically, the two peoples may be encouraged to think about themselves in a new fashion. I believe that Americans should be encouraged to think in terms of "America among equals" and that Japanese should be encouraged to think in terms of "Japan among responsibles." America has been the leader until now and will be for some time to come. Yet America's power will be found more in its ability to coordinate among equals as *primus inter pares.* Its attempt to hold onto its position of absolute preponderence, for a longer time to come than its own power bases suggest, would accelerate its downscaling in power and prestige. Its attempt to punish and mold others in its own fashion beyond the direction of market forces would be like spitting against Heaven, resulting in its own spit falling down back onto its face. Japan has so far been a half-hearted supporter of the United States–led global community. As Hegel says, however, Minerva flies out only in the dusk. In other words, only in the declining phase of the leadership can its leader theorize its world vision and ideology in a clear, consistent fashion. Japan is not the leader; it has been on the rise for only the last two decades; its plateau-like stagnation is speculated to come around 2010. Therefore it is not difficult to find that Japan's role in the global community has tended to be largely partial, piecemeal, pragmatic, and sometimes problematic. Yet Japan's role should be increasingly a responsible supporter. Its attempt to flirt with the notion of an autonomous, independent molder of global affairs is bound to be a farce in the era of global interdependence. Nor would its attempt to evade the exercise of coleadership in global management promise success. In the final analysis, however, I am of the view that both Japanese and Americans can adapt to the new environment and to their respective new roles, as they are two of the most dynamic nations on the globe.

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