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A New Model of Foreign Aid Drawn from the Experiences of Japan and the United States

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Abstract

This chapter compares Japan and the US as they provide different types of capital to the developing world, focusing especially on foreign aid and, to some extent, also on remittances and the role of NGOs. The main focus is on the quality of aid and on past conceptual differences and on an emerging convergence between these two major donors, with Japan having the potential advantage of being able to bring its own historical experience in development to bear.

Key words: foreign aid, remittances, NGO, Japan, U.S.

JEL Codes: O11, O15, O16, O23

Introduction

Japan and the United States have long been two of the largest donors of foreign aid. For a long time, the United States has led international thinking on foreign aid, while Japan has generally deferred to the US's lead. Although Japan's own development experience often contradicted US thinking, it has seldom pushed back. Even when Japan did register resistance, as with the World Bank's *East Asian Miracle* study, it has generally failed to follow-up, content, instead, to signal its position rhetorically while continuing to follow the US.

This hesitancy is disappointing. Today, there is appreciation, even in Washington, that structural adjustment programs adopted by the World Bank and the IMF in the 1980s and 1990s were largely unsuccessful. There is clearly a need for a new model of foreign aid. Japan has a great deal to offer this debate. It has a wealth of accumulated knowledge, borne of its own unique path to development and experiences as one of the world's largest donors.

Although "modesty" is considered a virtue in Japanese society, it should be realized that less "modesty" on Japan's part may assist the bottom billion of poor in the third world. In this paper, we examine the historical and recent trends in foreign aid and related capital flows by Japan and the United States in a comparative context, and identify some promising areas of convergence that may provide the basis for a new, more effective model of foreign aid. In the first section, we briefly review the experiences of Japan and the United States. In the second, we suggest a new model of foreign aid. The final section concludes with some suggestions for the future.

I. AID EXPERIENCES: THE US AND JAPAN

1. During the Cold War

1) Cold War Divergence in Patterns of Giving

Today the United States and Japan are still among the world's largest donors; together they provided nearly $35 billion to developing countries in 2008 – 30 per cent of the more than $112 billion contributed by all DAC donors that year. The United States has long been the largest donor in absolute terms - it provided the most ODA in all but one of the last 48 years. Japan joined the ranks of the world's top donors relatively recently; it was a relatively small donor until the 1980s, when it moved into second place in terms of absolute size; in 1995 it was Japan that overtook the US (Figure 1). In recent years the US has retaken the absolute top spot, while Japan has fallen substantially to fifth place in 2007. The current international financial and economic crisis, however, has caused a leveling off of US ODA and a substantial decline in Japan's contribution as well.

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

Japan's ODA began around 1955, in the form of a modest post-World War II reparations program for its Southeast Asian neighbors. Around this time, conflicts in Korea and Vietnam were revealing Southeast Asia as a vital strategic front in the Cold War. Thus, as the Japanese economy recovered, the US pressured Japan to move beyond reparations to a full foreign aid program for the region. Japan responded with large aid packages for Korea, Indonesia, and the Philippines.

Although both countries have historically preferred to give aid bilaterally, in most other respects the US and Japan have provided aid very differently. There are four areas of divergence: in the preference of each for program versus project aid; in the sort of projects or programs each funded; in the preference of each for giving aid in the form of loans or grants; and, finally, in the degree of "tying" aid to domestic purchases.

Japan traditionally preferred to fund specific projects rather than support country programs. Project aid often made use of politically powerful Japanese engineering firms whose influence was crucial to the continuing Diet approval of aid allocations. Also key to this preference was undoubtedly Japan's post-war development experience, in which large infrastructure projects played a central role. Japan's aid also supplemented its export-led development strategy by developing new markets for Japanese construction and engineering projects.[1] The US, by contrast, has been more willing to utilize fast-flowing program assistance, as evidenced by its support of conditionality-laden Structural Adjustment Loans (SALs).

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

The third area of divergence is in the preference for giving aid as loans or grants. Figure 4 shows a clear US preference for grants over loans. Japan prefers loans (Figure 5) although these loans have generally been highly concessional. This preference is based largely on the logic that, when countries know they are required to repay, they are more likely to allocate resources carefully.

The final area of divergence is in the degree to which each "tied" its aid to domestic purchases. Both countries are naturally under political pressure to retain the support of their exporters. In the US this pressure has translated into the tying of most aid to the purchase of US goods and services, thereby reducing its value by an estimated 15 per cent. In fact, in 1996, under pressure, the US simply stopped reporting the tied percentage of its aid, despite formally agreeing to the OECD's Development Assistance Committee's (2001) "Recommendations on Untying ODA to the Least Developed Countries." In the immediate post-war years, Japan tied too much of its aid, as a way of increasing the benefit to her engineering companies. But with time, as Japan faced international pressure to reduce its massive trade surpluses, the tied percentage of Japanese ODA declined. By 1997, only .05 per cent of Japanese aid was even partially tied, and none was fully tied.

(2) Theoretical Framework of Aid

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

The US, until quite recently, favored aid that is interventionist: it has often come with the requirement that recipients hew to certain policies. These requirements were developed centrally, based on the development thinking in vogue at the time in the United States, and applied with only moderate variability to different countries and contexts.

Japan's posture, on the other hand, stemmed both from a reluctance to be interventionist in countries still smarting from their World War II experience and from Japan's own post-war domestic economic policies which were based on directed credit, selective assistance to promising industries, and heavy investments in infrastructure. Japan's emphasis was on "self-help" and "request-based assistance," which allowed it to minimize intervention in the domestic politics and policies of recipients while still directing assistance to countries that Japan could assume were already self-motivated to help themselves. Japanese rhetoric on aid has thus long emphasized the importance of countries taking true "ownership" of their development programs, in contrast to the US and the IFIs who have rediscovered this principle only recently (a point we discuss below).

The Washington Consensus, as its name suggests, reflected the thinking among mainly US and IFI economists, and Japan, unsurprisingly, has found fault with it. Like other critics, the Japanese saw it as an unduly rigid program, applied wholesale to countries with widely varying situations, without sufficient regard for the costs imposed on its intended beneficiaries. Yet despite reservations, Japan chose not to enter the debate forcefully. Instead, Japan offered its critique quite meekly in 1991, when the Overseas Economic Cooperation Fund (OECF), then Japan's main aid agency, published its Occasional Paper #1, the first such paper in its thirty-year history. The paper criticized the

Consensus's excessive emphasis on market-oriented approaches, which seemed contrary to the lessons of Japan's own post-war experience. Japan followed up this critique in public statements[2] and by advocating – and paying for – the World Bank's high profile *East Asian Miracle* study, which was intended to provide theoretical and empirical support for an alternative development model. Yet Japan failed to support these critiques with detailed, continuous policy engagement. While striking a mildly critical posture, Japan did not try to mobilize its own intellectual firepower to engage the powerful intellectual forces in Washington. Instead it continued, as in the past, to grudgingly follow the US lead on basic ODA and development policy.

In our view, this "modesty" is disappointing. In the first place, Japan potentially has a great deal to contribute to the debate. For instance, from its own pre-war historical experience, Japan had unique reasons for disagreeing with the Consensus – in particular, a preference for government-led industrialization and opposition to financial liberalization in the early stages of development when financial systems are generally still underdeveloped. Second, while the Washington Consensus certainly deserved some of the criticism Japan offered, it was, in practice, not nearly as rigid as the Japanese seemed to have assumed. While US advisors would often enter different contexts with the same paradigm in mind, the messiness of any individual situation would inevitably alter, often drastically, the application of policies so that two countries ostensibly undergoing Washington Consensus policy adjustment actually exhibited far more differences than similarities. Thus, both sides might have benefited had Japan recognized the fallacies of its assumptions about the Consensus and entered the debate more actively, with confidence in the value of its own experience and perspective.

2. After the Cold War

(1) Convergence of Aid between the US and Japan

With the end of the Cold War much of the strategic rationale for aid seemed, for a time, to evaporate. Peace and prosperity lulled many in the OECD countries into thinking that they had little to gain, strategically or economically, by assisting the development of the world's poorer countries. The residual moral argument – that rich countries have a duty to help the poor – was never an easy sell to voters who doubted aid's effectiveness and had no trouble thinking of better uses for their taxes. There is a remarkable corollary to the loss of this strategic rationale: in a surprising number of areas it has led to some convergence between US and Japanese aid.

In Japan, three decades of steady increases in aid came to a halt in 1990 (Figure 1). The Cold War's end offered Japan the opportunity to reduce US influence and begin to assert itself as a development leader in its own right. But Japan had other, higher priority concerns. It faced a sustained recession in the 1990s, one made all the more daunting by a large budget deficit and ballooning obligations to an aging population. Moreover, as most donors were cutting back on their aid, the sense among the Japanese that a generous aid budget gained a country international respect also waned. Consequently, in the 1990s the Japanese aid budget stagnated; as a percentage of Japan's GNI, aid fell by nearly a third between 1990 and 1997. In recent years this decline has accelerated.

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

Memorandum issued later that year, in which development was elevated to one of the three pillars of US foreign policy, alongside diplomacy and defense. President Bush announced an initiative called "a new compact for development" in March, 2002, in which he pledged a 50 per cent increase in foreign aid, amounting to $5 billion from 2004-2006, to fund the newly created Millennium Challenge Account (MCA), run by the Millennium Challenge Corporation. In reality, the US more than doubled its aid between 2001 and 2005.

There has also been a shift by the US in focus and institutions that have rather unexpectedly brought the US closer to Japan's position (see Figures 2 & 3). Several important developments in Japanese aid – a move away from loans for infrastructure projects toward grants, an acceptance of poverty reduction as an important goal for aid, and an increasing, if still limited, willingness to engage constructively with the international community on aid – have moved Japan closer to the US. The result, in our view, is a significant, if incomplete, convergence between the two donors, even if neither side seems fully aware of it.

The major shift on the US's part is a move away from interventionist aid. Traditionally, the US has been more pessimistic about the ability of countries to act in their own interest and more willing to intervene as a consequence. But US attitudes on conditionality seem to have shifted in recent years. In tacit acknowledgement that conditionality, at least as practiced during the Structural Adjustment Loan (SAL) and even the more recent Poverty Reduction Strategy Paper (PRSP) era, hasn't been effective, the US is increasingly shying away from *ex ante* conditionality to rewarding already well-behaved recipients. This shift has brought the US closer to the Japanese position. A good illustration of this partial convergence is the Millennium Challenge Corporation, the biggest new US aid initiative. The MCC's structure reflects a belief that the only aid that will work is aid to countries that have already demonstrated past progress toward good governance, sound economic policies, and resulting improvements in levels of health, education, etc. The recipient must pass muster on seventeen indicators of past performance, in three categories: “ruling justly,” “practicing economic freedom,” and “investing in people.”

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

While this philosophy is much closer to the Japanese position, it is not a complete embrace and, in fact, the Japanese have generally been critical of the MCC. In their view the MCC’s requirements are as burdensome as any past conditionality, even if the point is to offer *ex post* rewards rather than requiring reforms *ex ante*. Moreover, they note that the implied severe selectivity eliminates from consideration many countries that are desperately in need of assistance (Sunaga 2004).

It is also worth pointing out that the reality of the MCC has so far seemed to deviate somewhat from the rhetoric, though the program may still be too young to be accurately assessed. First, although the MCC criteria are theoretically objective – apolitical, and strategic only in the sense that they seek to direct aid only to where it will do the most to fight poverty, and thereby terrorism – in practice the US still does not seem to be able to keep itself from applying exceptions to its own rules, particularly in returning to its old habit of favoring its strategic allies. Second, although the initial idea for the MCC was to assist countries in doing more of the good things they were already doing, the MCC has so far preferred funding specific projects, rather than offering budgetary or program support – a shift that is likely a concession to Congress, which prefers that the products of US aid be easily identifiable. Sectorally, the grants are heavy on growth-inducing rural development, particularly in agriculture and transportation. There is little emphasis on support for technology, health, and education, which were the focus of President Bush's announcement of the MCC. And, while the MCC grants were supposed to move fast enough and be large enough to induce those who don't yet qualify to change their behavior,[3] in reality the MCC has been very slow in disbursing resources.

Japan, too, has been altering its aid delivery in ways that bring it much closer to the US The US shifted its aid from loans to grants earlier and is on record urging other donors and the International Financial Institutions to do the same. In recent years the US has received more in repayments on past loans than it has provided in new loans, rendering its net loan contribution negative (Figure 4).

Japan's shift to grants has been slower, but by 2004 its net loan contributions were also negative (Figure 5). A reason for Japan's shift away from loans is that Japan may be responding to the growing consensus that loans simply burden future generations and lead to continued pressure for additional debt relief. There is also the more mundane concern, that loans are often not repaid (see Iimi and Ojima 2005). On the other hand, there is always the danger that an increased reliance on grants will reduce future resource availabilities.

From the mid-1990s, Japan began to converge with the US in another area as well: the sectoral allocation of its aid. Japan appears to have recognized the limits of infrastructural investments not accompanied by institutional changes and improvements in human development. In addition, Japan seems gradually to have come to realize that its large volume of projects, suffering from inadequate coordination with other donors, had become excessively costly and inefficient. Instead, Japan seems to increasingly favor a more sectoral approach to aid. For example, after 1998, Japan's Ministry of Foreign Affairs pushed for a "sector/non-project grant" instrument. By 2006, the proportion of Japan's bilateral aid commitments allocated to "economic infrastructure" had fallen to 25 per cent, down from 45 per cent in 1997 (Figure 3).

In Section 2 we noted the hesitancy with which Japan presented its criticism of the Washington Consensus. But in two more recent developments in the international aid arena – the adoption of "Poverty Reduction Strategy Papers," or PRSPs, and the Millennium Development Goals, or MDGs – the signs are that Japan has become more interested in constructive engagement.

Poverty Reduction Strategy Credits (PRSCs) were adopted by the World Bank and the IMF following widespread appreciation in Washington that two decades of structural adjustment loans had been largely unsuccessful, and, in many cases, had prevented developing countries from exercising effective control over their own economies. The idea behind PRSCs is that developing countries make up their own development plan which is called Poverty Reduction Strategy Paper (PRSP) and the World Bank and developed countries then extend PRSCs to support the plan. In theory, PRSPs were to be more country-driven, an effort to give countries real "ownership" over their policies and resource allocation decisions, including all aspects of society – economic and political – in the context of a single, comprehensive, long-term anti-poverty strategy. That is the theory;

in practice, PRSPs have probably done little to enhance the empowerment of developing countries or to tailor aid programs more closely to specific country needs.

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

Signs of Japan's increased engagement are also apparent in its involvement with the Millennium Development Goals (MDGs). Major elements of the goals played a prominent role in revisions Japan made to its ODA Charter in 2003, though the Charter does not explicitly name them. Still, the MDGs emphasize far more uniformity among countries than the PRSP process, and, not surprisingly, Japan has been critical of this aspect, noting that the MDGs appear to allow for little heterogeneity among countries, conditions, or priorities. Yet Japanese officials did try to critique the goals constructively, arguing for "localization" of the MDGs to fit conditions on the ground, and offering PRSPs as a possible starting point for such an effort (see, e.g., Tanigaki 2004).

(2) Toward a New Paradigm?

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

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

This reorganization has left out some important issues. The proliferation of smaller aid programs in many of the US line ministries has not been addressed. These programs were initiated in the Clinton years and have caused much overlap and confusion in recipient countries. The accumulated number of barnacles or Congressional earmarks in the 1961 Foreign Assistance Act which have substantially impeded USAID's effectiveness.

In short, past reorganization efforts may well enhance efficiency but are also likely to emphasize short-term political objectives as opposed to longer-term development objectives. The first signs were already apparent in the Bush Administration's budget request for 2008: USAID's Development Assistance money was down by almost a third, while the politically focused Economic Support Fund went up by nearly a third. It remains to be seen whether the Obama administration, which emphasized a renewed focus on development assistance during the campaign, will reverse this trend. Thus far, it seems clear that the entire subject has not received much attention.

In Japan, aid did not experience a similar boost after September 11th, and Japan's post-Cold-War aid budget has ebbed and flowed. It had recovered somewhat in the wake of the Asian financial crisis but fell again immediately thereafter. In 2005, it rose once more, but mainly on the back of contributions to Iraqi reconstruction and in donations to the Asian tsunami recovery effort. Since that time, aid has continued to decline consistently, and promises to increase it – such as former Prime Minister Koizumi's announcement of a three-year, $10 billion ODA increase at the Hong Kong WTO meeting in December 2005 – have not materialized. Japan's biggest challenge is to satisfy increasingly skeptical voters that its aid is strategically important. Recent institutional changes seem to be geared toward meeting this challenge by increasing institutional efficiency and integrating Japanese aid more closely with Japanese foreign policy, while also making some efforts to increase Japan's intellectual firepower and engagement with international aid debates.

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

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

The aid bureaucracy is also in flux. Having only recently combined its two main aid agencies, the soft-loan Japanese Overseas Economic Cooperation Fund (OECF) and the hard-loan Export-Import Bank of Japan (JEXIM), under the Japan Bank for International Cooperation (JBIC), Japan further consolidated its loans and grants under a "New JICA," or Japan International Cooperation Agency, traditionally the institution responsible for basic technical assistance and training. As part of this reform, New JICA has formed a "JICA Research Institute" to improve Japan's capacity for development research. Also under discussion is the placement of the JICA Research Institute directly under the Cabinet Office, with a reduced number of ministries (from thirteen down to five) involved, and with the Ministry of Foreign Affairs now in control, a potentially important shift that would surely further re-orient Japanese aid toward shorter term foreign policy objectives. However, whether such heavyweight ministries as Finance and METI will really prove willing to concede pride of place to the Ministry of Foreign Affairs remains to be seen. Past reorganization efforts have often amounted to less than meets the eye.

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

3. Aid and Non-Governmental Organizations

The convergence between the US and Japan in official development assistance is not reflected in private flows, neither those delivered through NGOs or as foreign direct investment (FDI), nor those sent home as remittances by migrant workers. This section examines NGOs; the following section takes up FDI and remittances.

The relationship between aid and NGOs is one where there remains a substantial divergence between the US and Japan. Figure 6 shows net flows to developing countries through NGOs from both governments. NGOs account for a miniscule percentage of Japanese ODA, but today deliver a large and growing percentage of US aid – at least 30 per cent of USAID donations. Japan has little history of private giving, and, despite recent lip-service to the value of NGOs by the Japanese government, such activities, after a period of some growth in the mid-1980s and early 1990s, have remained modest, as has government assistance to them. Most of this assistance, in fact, goes to private organizations that are closely related to corporations or government ministries. Contrast this with the United States, with its decades-old tradition of private involvement in development activities. In 2005, US NGOs provided more than 30 times as much to the developing world as Japanese NGOs. The relatively minor role played by Japanese NGOs does not necessarily inhibit Japan's aid effectiveness, however, the lack of private involvement by Japanese citizens and civil society in general in the country's foreign aid effort undoubtedly affects its waning support among the Japanese public.

NGOs have long been important players on the international stage and have grown increasingly influential since the 1990s, fueled by the assumption that they carry distinct advantages in aid delivery and by a feeling that their roots among both donor and recipient publics build support for aid at a time when support for directly delivered official aid was falling. As a consequence, official donors and the IFIs have grown increasingly willing to deliver aid through NGOs. The World Bank estimates that in 1980 international NGOs working in development received less than 10 per cent of their budgets from official sources. By the late 1990s, this had ballooned to 35 per cent via a far larger and more influential community of NGOs (World Bank 1998). Increasingly, NGOs are now part of the aid establishment, sanctioned by governments, delivering large amounts of aid and exerting a considerable influence over aid policy. The 2005 Paris Declaration on Aid Effectiveness, for instance, was drafted using the input of representatives from more than 50 NGOs. While most NGO funding is provided by ODA, an estimated 20 per cent is provided by religious and other private organizations.

The aid apparatuses of the US and Japan have historically had far different relationships with NGOs, reflecting the widely divergent attitudes of the two governments toward the private sector. In the US the tradition of voluntary organizations is historically strong; Alexis de Tocqueville (1841) credited them in part for the strength of American democracy. US aid policy has followed this tradition, working closely with both the profit and non-profit private sectors since it began giving aid; today the US consistently touts the importance of "public-private partnerships." In Japan, the tradition of voluntary organizations is comparatively new and weak, and NGOs have played much less of a role, both domestically and in relation to the developing world. Yet in recent years the NGO community in Japan has grown quite a bit and the Japanese government has increased its support somewhat (see Figure 6).

Public-private interactions in US aid also have support from the unique US tax code.[4] Since the 1936 Tax Act, individuals and corporations have been able to deduct charitable donations from their income taxes. And beginning with Marshall Plan aid to Europe after World War II, the US government has made a conscious decision to work with the private sector to deliver assistance. In the beginning the US government relied on NGOs mostly to deliver short-term humanitarian assistance, mainly using the large US food surpluses which, after 1949, Congress authorized to be delivered as aid. However, starting in the 1970s NGOs, frustrated by decades of bandaid solutions and being made increasingly aware of conditions in the developing world by legions of returning Peace Corps and other volunteers, began to focus more on activities that promote development. Mindful of this transformation and concerned with making aid more efficient and popular at a time of declining public support, the formal US aid apparatus, in particular USAID, began making increasing use of NGOs. This was attractive to Main Street as well as

Congress and permitted AID to reduce its direct hire personnel. In 1993, the Presidential Advisory Committee on Voluntary Foreign Aid noted that US official and private aid organizations had increasingly convergent motives and recommended closer ties. Since then, many US NGOs have grown into virtual arms of the official aid apparatus, pursuing projects along the lines of official US aid policy and maintaining elaborate operations in Washington to lobby for government contracts. Initially the leveraging purpose of these partnerships was explicit. The 1986 Foreign Assistance Appropriations Act required that any NGO eligible for USAID grants or contracts had to get at least 20 per cent of its funding for international activities from sources other than the US Government. But, in keeping with the general trend toward outsourcing, this requirement was dropped in 2005. Yet, in contrast to the close relationship many NGOs have with the US Government, other NGOs have resolutely maintained their independence and either set a cap on the proportion of their budgets they obtain from official sources, or refused government money altogether.

Although registration in the US for non-profit status is relatively simple, registering with USAID is a cumbersome and time-consuming process, requiring a range of independently audited documents and is beyond the capacity of many NGOs. The process grew even more complex during the 1990s when, with declining support for aid among the US public, Congress attached increasingly onerous conditions to ODA. Today the mere cost of making an application to USAID for a government contract can run into tens of thousands of dollars. Such high overhead costs are a major reason why some are today questioning whether NGOs are indeed a more efficient way to deliver aid. Other reasons relate to the relative lack of accountability of NGOs, the other side of the independence coin.

The community of a little more than 500 registered US NGOs is somewhat smaller than the NGO community in most DAC countries. However, the high bar set for registering means that these figures fail to account for small unregistered NGOs active in international development, of which there are probably hundreds, if not thousands.[5] Although USAID's registration requirements are often outside the capacity of many NGOs from developing countries, USAID has made efforts to partner with indigenous developing-country NGOs, occasionally going so far as to set up endowments for their future operations.

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

As a result, the NGO sector in Japan, while growing, is still small. Today the Japanese NGO Center for International Cooperation (JANIC) estimates that only 10 per cent of the few hundred NGOs engaged in international development have legal status. The

Japanese NGO community dates from anti-government protests in the 1960s and 1970s and their concern with developing countries stems from such antecedents as the post-Vietnam War refugee crisis, Japan's overall increasing involvement in world affairs, and the return to Japan of Cooperation Volunteers (JOCV), who, like returning US Peace Corps volunteers, added to public awareness of development issues.[6] Some of the larger Japanese NGOs active in development are also either products of Japanese Christian organizations or branches of foreign – mainly US – organizations. In the mid-1980s, these NGOs emerged as activists, pressing for changes in Japanese foreign aid, in particular, challenging the traditional Japanese focus on infrastructure projects, which they called "faceless." They urged more of a focus on the needs of local people and for the aid apparatus to become more transparent.

This public pressure had some effect. In the mid-1980s, for example, the government began to publicize more details of its aid activities. Since the 1990s, as part of the aforementioned shift in purpose away from Cold War burden sharing and decreasing public support for aid, the government began to consider the wishes and activities of NGOs with increased seriousness. Economic recession and a series of high-profile corruption scandals in a once-revered bureaucracy further enhanced the appeal of NGOs (Hirata 2002). The government began channeling some aid through NGOs. In 1991 the government officially began cooperating with NGOs under the banner of "Visible Japanese Aid," in the hope that this would prove more creative, cost-effective and transparent (Nanami 2002). The projects funded under this initiative were mostly small-scale, trying to take advantage of the greater flexibility of NGOs and their ability to implement grass-roots projects using appropriate technology and mindful of environmental effects. But the administrative rules governing the subsidies hampered their effectiveness. For example, unlike USAID/NGO contracts, they relied on single-year budgeting and did not cover personnel or administrative costs. Consequently, the flows remained small. According to the OECD, support to Japanese national NGOs in 2004 dollars was only US $133 million in 1990 and $212 million by 1995. More important in these early years was the "International Volunteer Savings Scheme," set up in 1991, to allow private citizens with post-office savings accounts to donate 20 per cent of their after-tax interest to NGOs through the Ministry of Posts and Telecommunications. The response revealed that the lack of charitable giving by Japanese citizens had been far more the result of negative institutional incentives than a lack of concern by the public for development issues. In the first two months, 2.1 million citizens enrolled, generating ¥1.1 billion ($9.25 million) in donations. Yet this response also reveals the public sector orientation that continues to characterize even private Japanese aid: it was not until an officially-sanctioned outlet for donations was opened that Japanese began to donate in large numbers to development activities.

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

Yet there are important caveats. In the first place, many of these NGOs are involved exclusively in education or are Japanese branches of international NGOs; only about 100 are engaged regularly in development as part of a wider range of activities, and only a little more than 50 have foreign aid as their main activity.[7] Furthermore, the basic definition of an "NGO" in Japan is very different from that in the US; it is broad enough to include corporate foundations and extensions of various government ministries. Clearly "NGOs" closely linked or even created by corporations and government ministries differ from their US counterparts; yet they receive the lion's share of government aid. By the mid-1990s, the OECD estimates that only about 10-12 per cent of Japanese government aid to NGOs, i.e., about $10-20 million, actually went to private NGOs engaged in grass-roots activities. It is also notable that Japanese assistance to NGOs as recorded by the OECD/DAC – of which, again, assistance to grass-roots NGOs is only a small fraction – has stopped growing since the late 1990s.

4. Other Associated Flows to Developing Countries

Foreign aid can also play a catalytic role in attracting private capital, international flows of which have indeed dwarfed foreign aid in recent years. Figure 7 shows foreign aid alongside FDI (Foreign Direct Investment) and remittances. The Asian financial crisis and the subsequent worldwide economic downturn led to a temporary reversal, but by 2003 private capital flows were again on the rise and have since far outstripped ODA as the main source of external capital from the OECD donor countries.

The US and Japan have always been among the largest sources of private capital flows to developing countries. With rare exception the US has been consistently the largest. In 2005, for example, the US accounted for 39 per cent of the DAC total. Japan was usually number two except in the immediate aftermath of the Asian financial crisis. Yet as a percentage of GNI, private capital outflows from the US and Japan have been remarkably similar, both averaging a little less than 3 per cent since 1968.

As to destination, not surprisingly, Japan's FDI has been concentrated in its Asian neighbors, while the US provides more to Latin America and Central and Eastern Europe. The sphere of influence in both donor cases is undoubtedly based on some combination of geography, politics, history and the law of comparative advantage, in some order open to dispute. Undoubtedly, the ready supply of inexpensive labor in South-East Asia was attractive to Japanese firms pushing relentlessly to lower production costs. Japanese investors did not count heavily on these same neighbors as markets for Japanese goods, which are more tailored to meeting the demands of developed country consumers. The US, given its comparative advantage in high tech manufacturing and services, has been more successful in selling its products to domestic consumers in developing countries, especially in Latin America, while taking tropical fruits and raw materials, sometimes produced by US firms, in exchange.

With respect to sectoral preferences, Japan's foreign direct investment has, for some time, been more or less split between manufacturing and services, while very little has been directed to agriculture and mining. The US, by contrast, has usually invested far more in the primary sector, although in recent years new investments have also been increasingly concentrated in manufacturing and services, including transportation, tourism, construction, and financial services. Until the 1990s, Japan actually led the US in the absolute size of investments in the service sector, but, since then, US service sector investments have skyrocketed. In manufacturing, the US and Japan invest very similar amounts, but this, of course, reveals a strong Japanese preference for this sector, given its smaller total GNI as well as FDI.

Recent trends follow these historic patterns. While the US has always been stronger abroad in non-price competitive manufactured goods, Japan has mostly used its overseas direct investments to lower its production costs in relatively competitive standardized manufactured goods markets. This has meant that much of Japanese foreign direct investment has been concentrated in manufacturing. This has also conditioned the nature of Japanese investments which emphasize the transfer of technology through learning-by-doing, often in a joint venture context, less likely to transfer technology wholesale, in contrast to the “turn-key” project preference often encountered in the US case. US firms are famous for utilizing secret technology and patent-protected methods of production embedded with their investments abroad, frequently using the wholly owned subsidiary vehicle.

Until recently, less-well-known, remittances – money that emigrants to developed countries send back to relatives at home – represent another increasingly important source of private capital for developing countries. Figure 7 shows remittances in a comparative context. Since the late 1990s such flows have far outstripped ODA as the second-largest source of foreign capital, after FDI, four-fifths of which goes to low income and lower middle income countries. And because so much in remittances flow through informal channels, their total may be as much as 50 per cent higher than official data indicate (World Bank 2006).

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

Both Japan and the United States represent important sources of remittances. The United States especially has long been a favored destination for immigrants. The largest group, 16.5 million adults, is made up of those coming from neighboring Latin America. More than 60 per cent send money home at least four times a year, with the average person sending more than once a month. While the average Latin American worker in the United States will send home only about 10 per cent of his or her income, this still constitutes anywhere from 50 to 80 per cent of the recipient household's total income. While the current financial crisis has reduced these flows, Mexico alone is estimated to have received $20 billion in remittances during 2005, again, mostly from the US and more than it received in FDI (World Bank 2006).

Japan has traditionally been far less open to immigrant labor than the US Nonetheless, those families whose relatives do find work in Japan send substantially more remittances than do the relatives of migrant laborers in the United States. The case of Latin America is an example. A higher proportion of the 435,000 Latin Americans currently living in Japan send money home than do the Latin Americans living in the US – 70 per cent versus 60 per cent – and they send it more often, about 14.5 times a year, on average. In Japan, they are also more educated and earn an average of $50,000 a year, twice as much as Latin Americans earn in the US, permitting them to send back twice as much – 20 per cent as opposed to 10 per cent of their incomes. Not unrelated is the fact that more of the money actually ends up in the hands of relatives rather than financial intermediaries, because transaction costs for remittances from Japan are just 3 per cent, compared to more than 7 per cent for remittances from the US.[8]

These advantages – the larger proportion of migrants sending money home, in larger amounts, more frequently, and at lower cost – would seem to make Japan's remittances worthy of emulation. The Inter-American Development Bank has indeed declared that "the Japan to Latin America remittance market is the model for much of the rest of the world" (IADB 2005). Yet a closer look at Japanese remittances reveals that they represent a very special case, difficult to replicate. The vast majority of Latin Americans living in Japan are, in fact, descendants of Japanese who emigrated to Latin America in the first half of the 20th century, often with the help of government subsidies, who subsequently returned. Today 1.5 million people of Japanese descent still live in Latin America, the largest concentration of Japanese anywhere outside Japan. This diaspora has generally been successful economically, as a result of which Latin Americans of Japanese descent who emigrate back to Japan are far better educated than Latin Americans who make their way to the United States. Eighty-five per cent of Latin American adults living in Japan have at least a high school diploma, compared to just 17 per cent in the US. This superior education level is a primary factor behind the much higher incomes Latin Americans earn in Japan. This is not to say that there is nothing to be learned from the Japanese example; certainly it points to the importance of reducing the transactions cost of remittances by migrant laborers.

III. SEARCHING FOR A NEW MODEL OF FOREIGN CAPITAL FLOWS

Leaving other flows such as NGO, FDI and remittances to one side, we finally return to the one issue of foreign assistance, currently under attack and most in need of change. We have previously noted signs of convergence between the US and Japan with respect to their behavior on foreign aid. This convergence raises the possibility of a "third way” of delivering aid, which draws on the advantages of both sides. Such a “third way” will require both a lessening of Japan’s historical modesty on aid, as well as a greater willingness by the US and Japan – and indeed of donors generally – to rely on recipients themselves to develop their own development plans independently of donors, and then to hold recipients to their word by withdrawing funds if “self-conditionalities” are not met. Japan’s substantial involvement in the recent Vietnamese PRSP may be a sign that it is more willing to innovate and build on the lessons of its own development experience. The resulting paper, called the “Comprehensive Poverty Reduction and Growth Strategy (CPRGS),” heavily emphasizes investments in growth-enhancing infrastructure, alongside the traditional social sector investments in health and education. Vietnam’s first two PRSPs were light on infrastructure investments: they included only investments in power lines and rural farm roads as elements of infrastructure (Kitano and Ishii 2003). The Japanese government subsequently approached the Vietnam government and the World Bank to suggest including large-scale investments in infrastructure. Japan’s ideas were subsequently incorporated into Vietnam’s third PRSP, which Japan co-financed (Kitano, Ishii and Karasawa 2004).

Initially, the Japanese government did not show much interest in Vietnam’s PRSP. According to Kitano, Ishii, and Karasawa, who was the representative of the JBIC at Hanoi at the time, there were two reasons for this (Kitano, Ishii, and Karasawa 2004). The first is that the original PRSP only focused on social sectors and did not include the large-scale investment in infrastructure which was considered important for Japanese foreign aid historically. The second is that Japan found no strategic reason to co-finance the PRSC. In the case of co-financing SALs in the 1980s and 1990s, Japan had been under pressure by other donor countries to reduce its substantial balance of payments surpluses. But by the time PRSPs came into the picture, Japan was no longer under such pressure. Furthermore, the Japanese public did not support ODA as it had before. Incorporating the approach of poverty reduction through large-scale investments in infrastructure was possible because Japan was the largest ODA donor to Vietnam and had a long history of cooperation with it.

Vietnam adopted the *Doi Moi* reform policy in 1986, was able to stabilize the economic situation and began to grow vigorously by 1992. JICA initiated a Country Study for Japan's Official Development Assistance to Vietnam in January 1994 and supported a research project called "Study on the Economic Development Policy in the Transition towards a Market-Oriented Economy in the Socialist Republic of Vietnam" from August 1995 to March 1998. The research project was led by Professor Shigeru Ishikawa, Emeritus Professor of Hitotsubashi University and supported by the JICA. More than ten professors and researchers from Japan, government officers of the Ministry of Planning and Investment (MPI) and researchers of the Development Strategy Institute (DSI) of Vietnam participated in the project. The main tasks of the project were to comment on the draft of the Five-Year Plan for Socio-Economic Development which was presented at the Eighth National Congress in June 1996, to analyze the problems emerging during the Five-Year Plan and, to propose policies to resolve the problems. According to Tran Van Tho, some of the Japanese professors who participated in the project knew well the historical development experience of Asian economies such as Japan and China. They focused on the supply-side of the economy and preferred gradualism to Washington Consensus reforms (Tran 1999). The government of Vietnam seems to have studied the development experiences of its Asian neighbors and its own economic problems and realized the importance of large-scale infrastructure investments.

There is a related project, the Japan--Vietnam Joint Initiative, through which the government of Vietnam was able to study the importance of large-scale infrastructural investments. This is a framework established in April 2003 to improve the investment circumstances of Vietnam to attract foreign direct investment. The members are the Japanese government, Nippon Keidanren (Japan Business Federation), the Japan Chamber of Commerce and Industry at Hanoi and Ho Chi Minh City, and the Vietnamese government. They identified problems of the Vietnamese investment environment, worked out action plans to resolve these problems, and monitored the results of the action plan. There is no doubt that the knowledge acquired through this initiative contributed to the preparation of the CPRGS.

As a result of Japan's involvement, Vietnam produced a third PRSP that is arguably more balanced than its first two. The original PRSP took account of the social sectors which the United States prefers based on the concept of human development. By contrast, the third PRSP, the CPRGS, included large-scale economic infrastructure investments which Japan considers very important based on her own development experience. The catalytic role of such foreign aid to attract private capital is fully recognized in the Vietnamese CPRGS. As a sign of Japan's increasing assertiveness in the development arena, this is a positive development. Yet there is also a risk that, just as Japan has criticized the US for offering one-size-fits-all advice to countries with very different situations and needs, Japan's advice to Vietnam may reflect an over-emphasis on infrastructure investments as a panacea for development. While Vietnam clearly benefited from Japan's advice, there is some question as to how much its new CPRGS is truly Vietnam's home-grown, and therefore fully "owned," development plan.

With this central problem of recipient "ownership" in mind, we suggest that a third model might be superior and worthy of consideration by both parties. This model does not reward countries for pledging to follow donors' advice, nor does it reward recipients for the past, as the MCC does. Instead, our third model delivers aid based on recipient's future commitments. What distinguishes it from past efforts is an insistence on true local ownership coupled with "self-conditionality" drawn up by aid recipients themselves. Donors would, of course, have a chance to negotiate concerning the self-conditionality packages proposed. The important change is in the enforcement of compliance that self-conditionality allows: donors would restore credibility to the system by offering, and carrying out, the threat to cut off aid in the event of non-compliance. In the past, donor conditions have seldom been taken seriously, since ultimately both parties realized that the money would eventually flow, regardless of the rhetoric. Conditions frequently ignored the reality of the political economy of the recipient, and donors, facing their own political need to continue lending, found it impossible to cut off assistance. As noted, PRSPs have been as vulnerable to this problem as any past efforts, in their implementation if not in their design. Indeed, experience indicates that policy change promised under external pressure rarely "sticks." But with recipients who are in a better position to know what is possible and what is not, proposing the conditionalities themselves, with donors accepting, rather than imposing them, the possibility for real policy change would be much enhanced.

For this third model to work, it is important that the preparation of the reform package be at arm's length from the donors, allowing true local ownership. If the recipients need assistance, they must be assisted by independent third parties, not the donors. Likewise, it is important for donors to learn to be more passive, i.e., ready to provide aid ballooning over a multi-year period.[9] The World Bank seems to be taking some small steps in this direction, but the current dispute over the application of country corruption designations indicates that short-term political considerations may still be at work even in the multi-lateral institutions.

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

IV. SUGGESTIONS FOR THE FUTURE

Aside from this “third way” approach, which we hope both sides will consider, there are additional steps that the US and Japan can take in the future to improve the effectiveness of their capital flows. In keeping with the 2005 Paris Declaration on Aid Effectiveness, efforts are currently under way in both countries to consolidate the number of aid-dispensing agencies, which historically have been the source of a good deal of confusion, not only in Washington and Tokyo but also, and perhaps more importantly, in the recipient countries. Inefficiencies result not only because of the absence of coordination but also due to highly dysfunctional competition among donor agencies, and the ability of recipients to play the agencies off against each other.

But we also note that, at least in the US, consolidation has been partly offset by an increased role for the Defense Department associated with the “war on terror.” In 2002, Defense managed only 6 per cent of aid allocations; in 2005 it managed 22 per cent. At the same time, USAID’s share has fallen from half of total ODA in 2002 to 39 per cent in 2005, undermining some of the benefits of consolidating US aid under the State Department.

The current aid reorganization efforts in both countries, with the US State Department and Japan’s Ministry of Foreign Affairs taking increasing control of ODA, seems to imply an enhanced politicization of aid. Inevitably, especially in the US, we can, therefore, anticipate the increased use of ODA as an instrument in the “war on terror,” through the promotion of democracy and other nation-building activities concentrated in presently or potentially friendly countries.

The irony – a serious one in our view – is that the national security argument might resonate even better without the politicization of aid. In poor developing countries, the antidote to terrorists’ siren song is aid that works, not aid that rewards corrupt but US-friendly governments. Most terrorists are extra-state actors, while states are mainly enablers; they do not cause terrorism. It is poverty and inequality that breed terrorism, born of a feeling among the disadvantaged that they are perpetual losers in a world system in which countries like the US and Japan always win. Thus US and Japanese foreign policy goals might be even better served if their activities were perceived as actually relieving global imbalances with the help of aid and private capital flows, rather than using them to encourage a recipient country’s elite to support donor foreign policy agendas.

With respect to Japan, which is less invested in the global “war on terror,” the apparent increased influence of the Ministry of Foreign Affairs is likely to preference short-term foreign-policy interests. Such a shift probably means more attention will be paid to countries supplying Japan with needed raw materials, supporting Japan in its efforts to gain a seat in the U.N. Security Council, enhancing its voting power in the IFIs, and the like.

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

Yet for all of ODA’s importance, when all is said and done, we know that aid is likely to become an even more junior partner to remittance flows from both the US and Japan in the future. To facilitate the smooth functioning and expansion of this particular, somewhat “under the radar,” flow of private foreign capital, a few suggestions are in order. Since both sending and receiving countries stand to benefit from most types of migration and the associated remittance flows, reducing the sometimes quite high transaction costs of remittances should get priority attention. Multilaterally negotiated system encouraging temporary worker migration arrangements would also benefit both parties. To allay the fear that “temporary” would become “permanent,” we suggest consideration of a multilateral version of something like the South Korean device of forcing migrants to deposit a portion of their earnings in a special savings account, which would be forfeited if the worker decided not to return home as promised.

Lastly, we would like to register continued disappointment with the aforementioned timidity with which Japan has promoted its alternative development strategy in the international arena. The end of the Cold War and of burden sharing on aid presented Japan with a unique strategic opportunity to make its development vision a real alternative to the amended Washington Consensus. Yet having pushed for and financed the World Bank's *East Asian Miracle* report in the early 1990s – a step in this direction – Japan has to date not really followed up. Despite initial coolness toward the PRSPs and the Millennium Development Goals, Japan is now supportive. With over a half-century in the aid business, Japan has consistently recognized and bemoaned her second-class status in the realm of development thinking. However, Japan should now be in position to construct a viable alternative development model based on her own historical experience, and generally take a more confident leadership role. Japan's role in shaping Vietnam's recent CPRGS may be a sign that Japan is increasingly willing to move in that direction once the current global crisis has ended.

All in all, this remains an exciting time of challenge and opportunity for both Japan and the United States. Inevitably, both countries are currently focusing on their domestic economic problems. But both have shown a willingness to experiment with new mechanisms for delivering official development aid and to recognize the relationships between aid and other capital flows. At no time in recent memory has international development been so clearly linked to the national interest, even as somewhat differently defined by the two countries. It is our hope that this self-interest can increasingly be reflected in the achievement of improved mechanisms and successful development abroad.

Endnotes

[*] Gustav Ranis is the Frank Altschul Professor Emeritus of International Economics at Yale University, Stephen Kosack is Assistant Professor at the Kennedy School, Harvard and Ken Togo is Professor in the Economics Department of Musashi University. The research assistance of Shinsuke Tanaka and Atisha Kumar, students in economics at Yale, is gratefully acknowledged, as is the support of the Toyota Foundation.

[1] See, e.g., Doss (1996). Ensign (1992) estimates that more than half of Japanese aid from 1966 through the 1980s was for infrastructure, and that the relevant contracts went overwhelmingly to Japanese engineering firms.

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

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

[4] See Smillie and Helmich (1993) for a good history of the development of US development NGOs.

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

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

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

[8] Data on remittances from Japan to Latin America are from IADB (2005).

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

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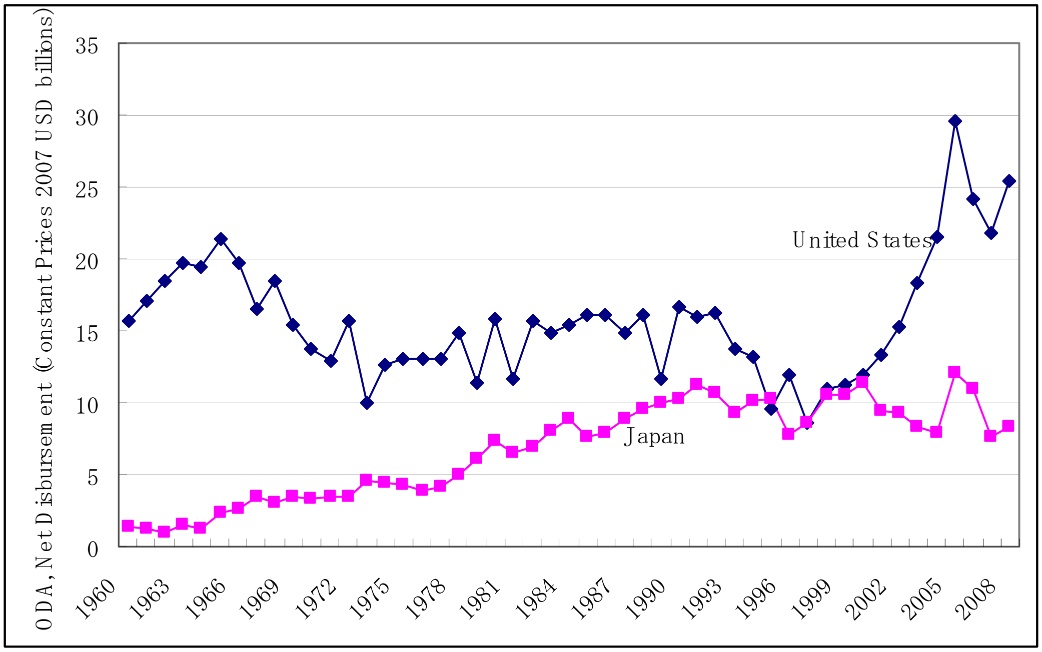
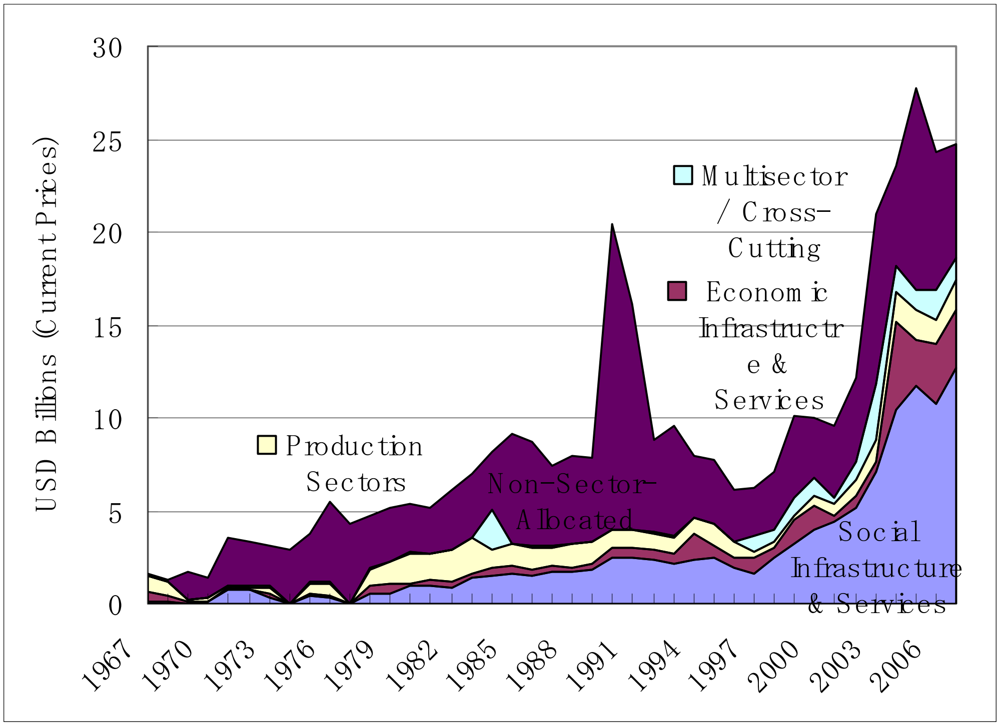
Figure 1. Net Disbursement of ODA: US and Japan (1960-2008)



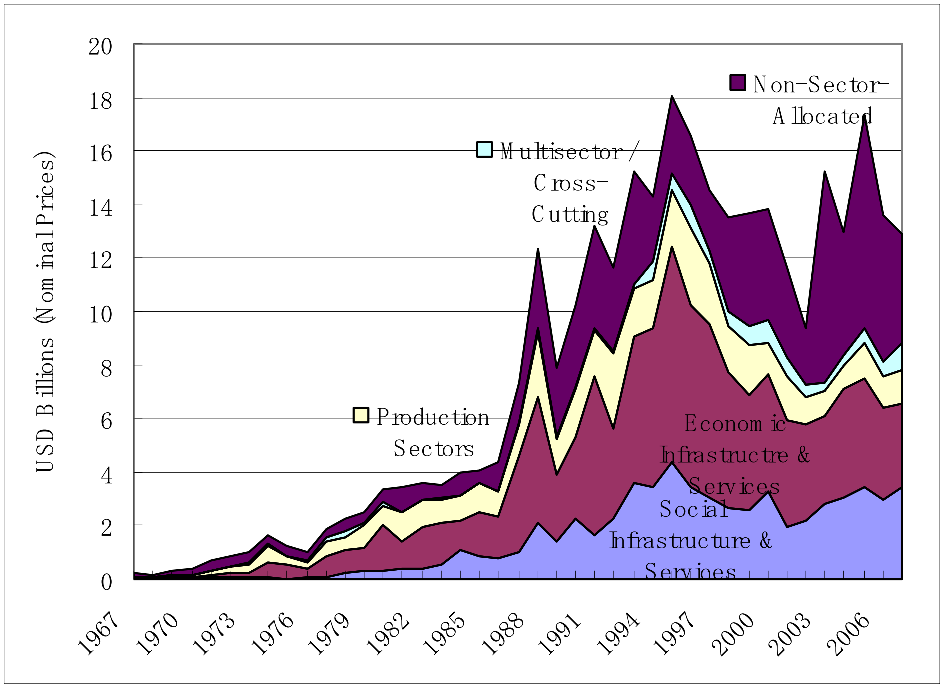
Source: OECD

Figure 2. Breakdown of US Aid Commitments by Sector, 1967-2007



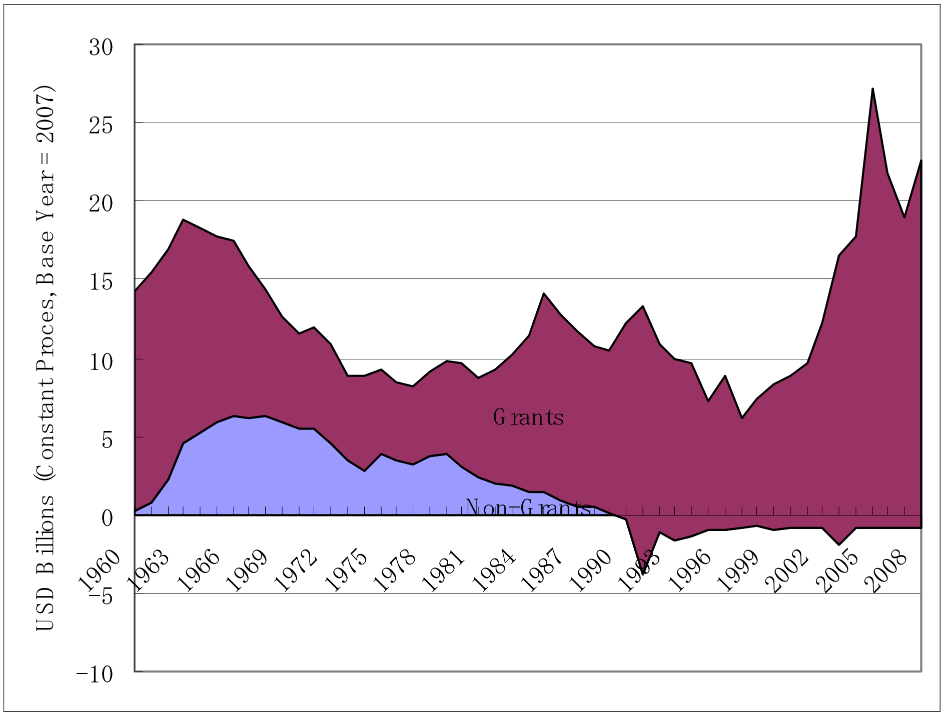
Source: OECD

Figure 3. Breakdown of Japanese Aid Commitments by Sector, 1967-2007



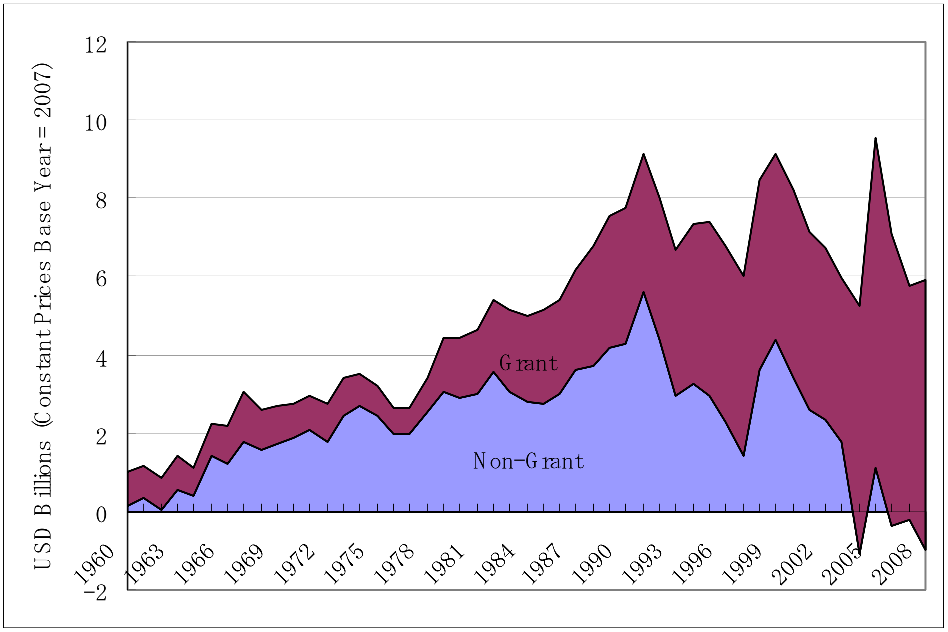
Source: OECD

Figure 4. Breakdown of US Bilateral Aid into Grant and Non-Grant, 1960-2008



Source: OECD

Figure 5. Breakdown of Japanese Bilateral Aid into Grant and Non-Grant, 1960-2008



Source: OECD

Figure 6. Net Grants by NGOs to Developing Countries

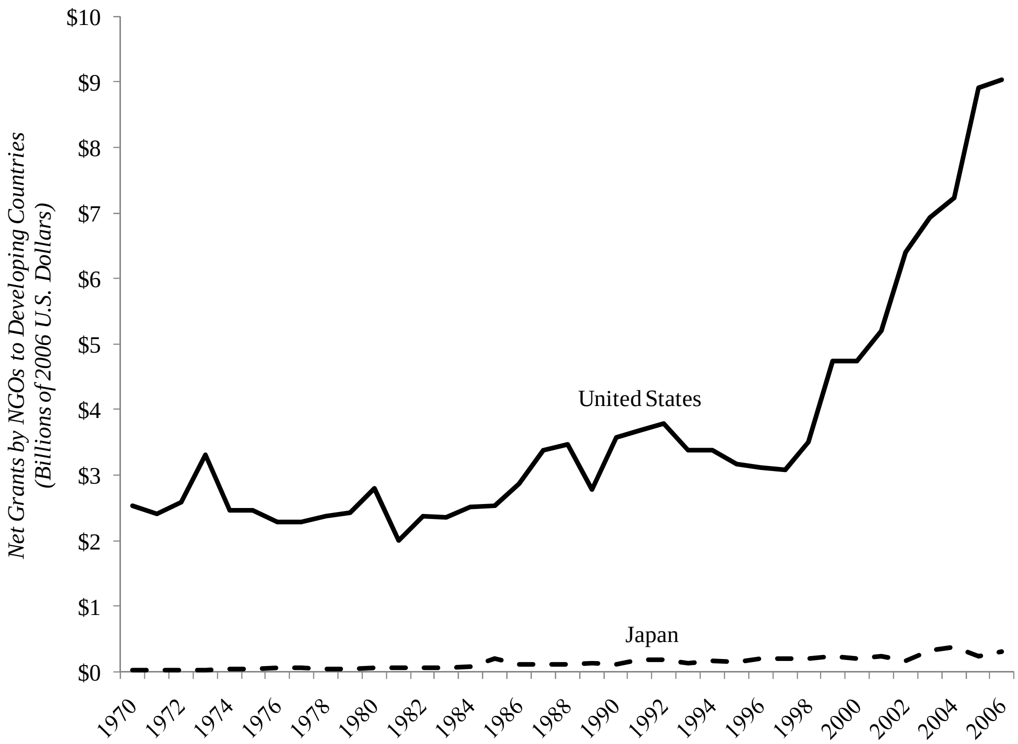
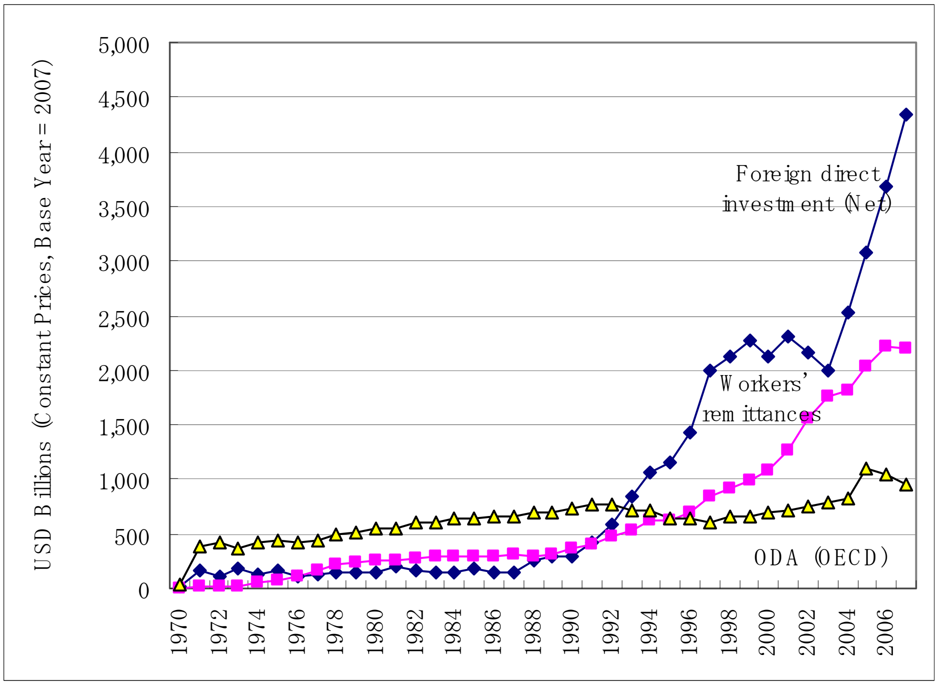


Figure 7. Total Capital Flows



Source: OECD and World Bank