Pro-poor Growth and Aid Coordination from the Japanese Perspective

Kenichi Ohno
National Graduate Institute for Policy Studies, Tokyo

Topics for Discussion
1. Pro-poor growth 2003
2. Development experience of East Asia
3. Aid harmonization
4. Japan’s engagement principle
(1) Pro-Poor Growth 2003

- The first round of poverty reduction drive is over (MDGs, PRSP)
- Renewed recognition that growth is needed for sustained poverty reduction
- Attention now turns to:
  -- Ensuring “pro-poor growth”
  -- Trade, investment, infrastructure
  -- Contents of growth strategy

“Pro-poor growth”???

Morally correct, politically convenient and currently very popular, but...

- Definition?
- Desirability?—is more equality always good? Should we not balance equality and incentive?
- Channels and linkages—many ways to cut poverty, direct and indirect. Strategy should be geared to each country.
Equity vs. Incentive Tradeoff

John Rawls: “Choose the society which maximizes the welfare of the poorest”
Deng Xiaoping: “Those who can, get rich first. Let others imitate and follow”

- Innovation requires reward, but too much inequality destabilizes society. The right mix is needed for each country.

- Perfect equality is the ideal of communism. Does pro-poor growth (faster rise of the poor) support it?
  --Where do we stop (criteria)?
- Society can be too equal and stagnant:
  --General poverty in poorest countries
  --Transition from socialist egalitarianism
  --Welfare state in excess
East Asian Way to Success

Two-tier approach

- **Primary**: create source of growth.
- **Supplementary but very important**: deal with problems caused by growth—income gap, regional imbalance, environment, congestion, drug, crime, social change, etc.

Yasusuke Murakami: “industrialization policy must be combined with supplementing policies or it will fail” (*Theory of Developmentalism*, 1994)

Revised Technocratic Model (E. Asia)

- **Economic growth**
- **Rising inequality**
- **Political stability**

START
Developmental state

(checked)
Supplementing policies

END
Freer & more democratic society a few decades later: ex. Korea, Taiwan)

Three Channels of Pro-Poor Growth

(1) Direct channel (impacting the poor directly)
--- Health, education, gender, rural jobs & development, etc.

(2) Market channel (growth helps poor via economic linkages: a.k.a. trickle down)
--- Inter-sectoral and inter-regional labor migration (cf. Chinese TVEs)
--- Increasing demand (cf. proto-industrialization, multiplier effect)
--- Reinvestment (formal, informal and internal financing)

Three Channels (contd.)

(3) Policy channel (supplementing the market channel)
--- Price support, taxes, subsidies
--- Fiscal transfer, public investment, infrastructure
--- Micro and SME credit and other financial measures
--- Proper design of trade and investment policies
--- Pro-poor legal framework
Broadening the Scope

- So far, disproportionate attention on direct channel—question of sustainability and the risk of permanent aid dependency
- Emerging emphasis on pro-poor growth
  --Focus still too narrow, not integrated
  --Past studies have not been incorporated
  --The right mix depends on each country

(2) East Asian Experience

- Growth driven by trade and investment
- Collective growth, not isolated or random
- Staggered participation in the regional production network
- Region as an enabling environment for catching up (model and pressure)
Asian Dynamism (Flying Geese)

- Geographic diffusion of industrialization
- Within each country, industrialization proceeds from low-tech to high-tech
- Clear order and structure (with possibility of re-formation, new entry and dropouts)

Per Capita GDP
(In 1990 international Geary-Khamis dollars)

**Per Capita Income (2000)**

- **Graph:** per capita income
- **Source:** World Bank, World Development Indicators 2002.

**Manufactured Exports**

- **Graph:** manufactured exports (% of total exports)
Structural Transformation in East Asia

East Asia's Trading Partners
### Foreign Direct Investment Flows

**Foreign Direct Investment Flows**

*(Billions of USD / year)*

**[1st Half of 1990s]**

- **Japan**: 2.4
- **NIEs**: 7.8
- **ASEAN4**: 9.8
- **China**: 1.3

**[2nd Half of 1990s]**

- **Japan**: 2.6
- **NIEs**: 8.5
- **ASEAN4**: 11.5
- **China**: 1.3


Note: Flows less than $1 billion are not shown. The “NIEs to China” flow excludes Hong Kong.

### Trade in Machine Parts

**Trade in Machine Parts**

*(Billions of USD / year)*

**[1990]**

- **Japan**: 18.6
- **NIEs**: 5.0
- **ASEAN4**: 7.2

**[1998]**

- **Japan**: 8.5
- **NIEs**: 29.9
- **ASEAN4**: 21.7


Note: Flows less than $5 billion are not shown.
Poverty Reduction in East Asia

- Extreme poverty in E Asia already halved (1990: 27.6% ➔ 1999: 14.2%)
- National strategy for *equitable growth* in place (even before PRSP/MDGs)
- Aid coordination centered on pro-poor measures is unlikely to work in East Asia

Redefining “Good Governance” and “Selectivity”

- To initiate trade-driven growth, different and narrower conditions are needed
  --Strong leader(ship) with ownership
  --Strong administration for policy consistency and effective implementation
- High-performing East Asia did not have
  --Transparency, accountability, participatory process, clean government, privatization, free trade
    (maybe not necessary for initiating growth?)
(3) Aid harmonization

- Harmonize aid practice to reduce transaction costs!
- Japan gives only conditional support
  - Yes we recognize the value of coordination BUT
    - Don’t impose uniform modality (non-project aid) on all countries and sectors
    - Don’t deny or discredit ODA loans
- Japan reacts strongly to harmonization hardliners, but accepts its milder form

“Best Mix” Approach

- Nonfungibility of ideas & strategy
  - Multiple options for different countries
- Inseparability of money and ideas
- Donors according to their comparative advantage
- Harmonization for *aid implementation*?
  - Policy & institution also key to effective development
  - Need to also discuss contents of growth strategies
Regional (VN) & Global (Rome) Forums on Harmonization

Japan intervenes to relativize harmonization:

- “Ensure partner country ownership”
- “Adopt country-based approach”
- “Ensure diversity of aid modalities”
- “Cost-benefit analysis of harmonization is necessary”

Diversity in Strategy Formulation & Implementation

Strategy Formulation:

Choosing from Alternative Strategic Options

- Strategy A
- Strategy B
- Strategy C
- ...

Implementation:

Diverse Modality under Common Framework

- Projects
- Non Projects
- Pooled TA
- Non Pooled TA

Adoption
Jointly with Client Country
### Matching Aid Modality with Needs

<table>
<thead>
<tr>
<th></th>
<th>Non Project Aid</th>
<th>Project Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recurrent-exp. intensive (esp. social sector)</td>
<td>○</td>
<td></td>
</tr>
<tr>
<td>Investment-exp. intensive (esp. infrastructure)</td>
<td></td>
<td>○</td>
</tr>
<tr>
<td>Policy Reform</td>
<td>○</td>
<td></td>
</tr>
<tr>
<td>Pilot innovation (requiring trial-and-error)</td>
<td></td>
<td>○</td>
</tr>
</tbody>
</table>

### Matching Technical Assistance Modality with Needs

<table>
<thead>
<tr>
<th></th>
<th>Pooled TA</th>
<th>Non Pooled TA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer of universal skill and knowledge (established best practice)</td>
<td>○</td>
<td></td>
</tr>
<tr>
<td>Transfer of tailor-made skill and knowledge (choosing from alternative models)</td>
<td></td>
<td>○</td>
</tr>
</tbody>
</table>
Japan Also Needs to Change

Take advantage of harmonization to:
- Enhance dialogue with other donors
- End unnecessarily rigid procedures
- Reduce high grant cost → greater use of local human resources
- Delegate authority to field offices, and strengthen their capacity

(4) Japan’s Engagement Principles

Japan’s Uneasiness:
- The gap between current strategy and E Asian development experience
  --Due to cultural and historical differences
- Inability to clearly articulate Japan’s aid goals: unspoken ideas, systemic rigidity, language barrier
- ODA budget is declining (-5.8% in FY03) while EU and US are increasing aid
- Uncomfortable with aggressive aid harmonization (budget support, SWAPs...)
- Fear that Japan’s aid will be discredited or marginalized (though still large)

---

**Japan’s Approach to ODA**

- Two-track principle
  1. For the prosperity of Japan and East Asia
  2. For solving global issues (poverty, education, health, environment, refugees, peace building...)

- Helping the “self-help” effort of LDCs
  - Aid is not humanitarian charity
  - To grow and become equal trading partners
  - Not for all LDCs; but we encourage eligible countries to try
Japan’s Approach (contd.)

- Respect for each country’s uniqueness
- Long-term and holistic perspective
- Tacit knowledge, shared experience (rather than explicit rules/matrices and quantified targets)
- Real-sector concern (trade, investment, key industries, technology...)
- Help in good times as well as bad

Growth Contents Differ

**West:** privatization, free trade, rule of law, clean & transparent government, level playing field, market comes first...

**Japan:** active government, national dev. vision, proper design of industrial, trade, FDI policy, sector/industry specific intervention...

**Common:** political & macro stability, HRD, SME support, environment, HIV...

⇒ Back to the 1980s? (unresolved issue)
New ODA Charter

- New ODA charter by Fall 2003?--with inputs from LDP (ruling party), ODA Comprehensive Strategy Council, NGOs, general public, etc.

- Likely to feature:
  - Two-track principle (*for Japan* and for world)
  - From request-based to multiple policy dialogue
  - Human security, peace building, MDGs
  - Country Assistance Plans (clearer goals & strategy)
  - Strengthening transparency, evaluation, popular participation

New Country Strategy Plan for Vietnam

Now *Short Draft*, final draft Sep. 2003

- Clarifying national interest
  - Vietnam’s role in Japan’s China-ASEAN diplomacy & economic ties
  - Humanitarian and social needs
  - Vietnam as Japan’s ODA model country

- Vietnam at crossroads
  - Soar and join the geese or stagnate? (need to dramatically improve FDI policy)
Vietnam (contd.)

- ODA for *growth, social needs, and institution building* (targeted areas, subsectors, etc. to be clarified by September)
- Quantitative direction linked (loosely) to policy performance and absorptive capacity

Strategies for Sri Lanka, Mongolia, Indonesia, Pakistan, India also under review

---

What Japan Should Do

- Japan should be fully engaged in global aid strategy, not isolation or rejection
- Japan should bring a new perspective as a non-West industrialized country
- To do so, Japan should clearly define its aid goals and comparative advantage
- Leadership, networking, and institutional reform are needed
Japan as Aid Partner

--Japan is a clumsy speaker
--Japan is very sensitive to what others say about its policy (fear of isolation)
- Understand, and even respect, Japan’s vision while noting mutual differences (praise works better than criticism)
- Help it voice its views (when possible)
- Don’t tread on its sensitive spot

Japan-DfID Partnership?

Potentially very fruitful:
- Complementarity because we are different in aid goals, modality
- East Asia: Japan has money, but needs intellectual partner
- Infrastructure as entry point
  --Start with joint study on its growth/poverty impact
  --Cooperation in social sectors also?