The ending of Japan’s ODA loan programme to China – All’s well that ends well?

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Introduction

Official Development Assistance (ODA) is the most important instrument of Japan’s postwar diplomacy, and nowhere has this been more the case than in Japan’s China policy after the start of Beijing’s economic reform programme in 1978. The amount of Japan’s ODA to its neighbour is truly impressive: Between 1979 and 2005, Japan transferred ¥3.13 trillion to China in loan aid (yen loans), 145.7 billion yen in grant aid, and 144.6 billion yen in technical cooperation and became thus China’s greatest bilateral ODA donor for many years.(1) Loan aid is not only by far the largest aid segment in the transfers to China, but reflects a general feature of Japan’s ODA. Together with Japan’s multilateral aid to China, one can certainly state that Japan has to be credited with one of the most important external contributions which made China’s economic development so fast and impressive.

The ODA programme has given Japan in the past considerable political leverage over China, helped to keep disputes at a more manageable level (e.g. the territorial dispute over the Senkaku/Daiyutai Islands in 1996) and to exert pressure on China against its military policies.(2) Japan sent a negative signal to China in the wake of the Tiananmen repression in 1989 when it joined Western sanctions by suspending its ODA although its resumption before that of most other Western donors also constituted a powerful positive signal.
It is in the very nature of a successful ODA programme that it has to end one day, and governments and international aid institutions have criteria linked to developmental levels of recipient countries for the phasing out of aid. However, in 2005 the Japanese government decided to end its loan aid to China by 2008, the year China will stage the Olympic Games, without applying the usual guidelines. In view of the importance of the yen loan programme for Japanese-Chinese relations and the acrimonious exchanges which accompanied the decision this article proposes to investigate the reasons and background to it.

To understand the process leading to this decision and its wider implications I will look at the rise of Japanese criticism of the ODA programme to China against the background of a general deterioration of bilateral relations as well as a revision of Japan’s overall ODA policy (quantitatively as well as qualitatively) and ODA administration. With the gradual power shift from the Ministry of Foreign Affairs (MOFA) as the main decision maker to the LDP, leading politicians critical of China (and supported by a broad anti China mood swing of the general public) were thus able to push a reluctant MOFA in 2004 to a fundamental ODA change, i.e. the ending of ODA loan to China by 2008.

Economic assistance or reparations?

Japan’s ODA programme to China started when Tokyo granted Beijing in December 1979 $200 million for six construction projects as well as a grant of $61 million to assist in the building of the China-Japan Friendship Hospital. The doors to receiving foreign aid were opened by the Chinese government’s reorientation of its foreign economic policy in 1978.(3) Like in the case of most policies, the Japanese decision to give ODA to China was the outcome of the workings of overlapping policy constituencies and political orientations.

The Japanese government under Prime Minister Ohira conceptualized economic assistance as part of its policy to assist China with its modernization, expecting that this approach would make China a peaceful player and make China follow a moderate policy consistent with Japanese interests.(4) This policy is part of Japan’s engagement policy (kanyo seisaku) which consists of providing political and economic incentives to China (e.g. ODA) while at the same time hedging with political and military power balancing (e.g. the Self Defence Forces and the Japanese-American security alliance.(5) As such, providing ODA to China was a highly political decision, carried by politicians whose prewar biography was closely linked to China (‘Koain Group’, or ‘Asian Development Agency Group’). Moreover, it was the biggest ODA programme which Japan had ever for a
Providing ODA was facilitated by Japan’s high foreign currency reserves and trade surpluses. This approach also corresponds with Japan’s political inclination to use economic power to create a peaceful international environment, while playing down the Realist aspects of its policy as embodied in its political and military alignment with the US. This economic approach is based on the premise that support of China’s economic reform programme will create a peaceful and Western-oriented China. It plays down the risk of freeing Chinese government funding for military purposes and the possibility of China (later) hijacking its economic strength for non-peaceful purposes. In terms of Japan’s domestic mood, there was full support for economic aid to China since public opinion was very favourably disposed towards China and willing to accept the political and economic rationales although by 1979 the ‘Panda euphoria’ of 1972 had already waned somewhat.

Japanese business interests were keen on government loans to China in order to secure major orders from China and in particular to salvage as much as possible of China’s huge plant contracts which had been severely reduced in spring 1979 by the Chinese government when it realised that it had overreached itself. Perhaps not surprisingly this loan programme gave rise to American concerns that Japan was acquiring an unfair trade advantage in China. Internationally, conditions for ODA to China were facilitated when the Development Assistance Committee (DAC) of the OECD classified China as a Less Developed Country which enabled Japan to provide loans to China as ODA and thus quiet concerns in developed as well as developing countries about Japanese gaining an unfair advantage in economic dealings with China and favouritism for that country, respectively.

Other factors of a moral and normative kind had also an important bearing on public Japanese support for the ODA programme. One was Japanese gratitude for the Chinese renunciation of reparations in 1972 which had been motivated by the desire to win over the Japanese public, to avoid antagonizing the still very strong pro Taiwan forces in the Japanese ruling party, to strengthen its strategic position against the Soviet Union by establishing diplomatic relations with Japan and to avoid appearing less generous than the Taiwan government which had earlier done the same. However, this renunciation was also made against the mutual implicit understanding that good relations between China and Japan would be good for
China`s economic development in the future. This unspoken understanding translated into Chinese expectations for economic assistance from Japan after China`s economic opening in 1978 and a certain Chinese disillusionment with the Chinese-Japanese economic relationship.

In fact some reparations had been paid to then Republic of China under the Guomindang between 1948 and 1949, but soon the Allied occupation authorities under American leadership changed their mind in view of the onset of the Cold War. In June 1947 24 Japanese military and civilian ships had been sent as reparations to Shanghai, Qingdao and Taiwan. Some Japanese production facilities in China were given to the Chinese government as Japanese reparations.(9) In 1952 Taiwan renounced in its Peace Treaty with Japan any reparations, `consistently pushed by Japan`. (10) The leadership of the People Republic of China had also by 1964 concluded to waive compensation claims when it would come to the normalization of relations. At the time of the establishment of diplomatic relations in 1972, there was, however, no explicit link between this Chinese waiver of reparations and ODA because China was not yet even contemplating allowing foreign direct investment, let alone aid into the country.

A link between the renunciation of reparations and ODA was established only at the end of the 1970s as can be observed in numerous statements and writings in both countries. There are references to Japan`s obligation to reflect on its past by giving China ODA, apart from other more self interested considerations by Japan (e.g. geostrategic considerations; direct economic interests of Japan`s plant exporters, ODA as an important part of Japan`s engagement policy). Kokubun Ryosei argues that neither side said at the time formally mentioned or established in documentary form such a link and it could therefore only be surmised that the link was made psychologically by the generation that had experience of the war. (11) Iokibe Makoto refers to ODA as ‘quasi reparations’ (jun baisho). (12) The link was also used as an argument to convince the opponents of economic aid to China. (13) Japan`s business representatives were actively using China`s reparation waiver to press the government for special loan treatment of China. In April 1978, just when Japan was hit by China canceling many plant orders, the chairman of Nippon Steel as well as of the Association of Japan-China Economic Cooperation, Inayama Yoshihiro, was quoted as saying that `Since China did not take reparations from Japan, the Japanese government should make special exceptions to such things as loan interests`. (14)

The Japanese government itself used the link between reparations and ODA when it tried to win support for the programme. In 1983, when Japan`s second Yen loan
programme was being debated, Foreign Minister Abe Shintaro reminded the members of the Diet’s Budgetary Committee that China’s renunciation of reparations had made the normalisation of bilateral relations possible, and that Japan upon reflection of the past wanted actively to cooperation with China’s construction work.(15)

One can therefore conclude that by the end of the 1970s the Japanese side had established a link between China`s renunciation of reparations and ODA for moral as well as practical reasons, and the Chinese side expected after the 1978 economic opening that Japan would show itself grateful and generous. At this time China had also become somewhat disillusioned with the economic relationship and some Chinese blamed Japan for the need to cancel many plant orders. This morphing of reparations into ODA was, however, to have political costs for the Japanese as well as Chinese side. It considerably diminished China`s gratitude for Tokyo`s largesse in the following years because the aid was seen as something China was `owed` for its generosity after having suffered so much from Japan`s encroachment before 1945. On the Japanese side the opportunity to undo the harm of the past by providing ODA which Japan gives to many other countries as well may not have helped many Japanese to come to terms with its past, or at least not to a degree which would satisfy the Chinese side. ODA has not the same emotional impact as reparations. Fujiwara Kiichi argues that, in comparison with Southeast Asian countries to which Japan gave reparations, the war responsibility of Japan is now considered a matter of the past, whereas in the case of China, although the Chinese understand Japan’s ODA as reparations, it is officially not called reparations. He concludes therefore that Japan paid a high price for the Chinese waver.(16) Finally, and this would play an important role in the Chinese rhetoric when faced by Japan`s decision in 2005 to end the ODA loan programme, if the Chinese had now begun to consider ODA as a Japanese obligation as a result of their past sufferings and their waver of reparations, how can one come to an agreement of ending such an obligation? Even before the issue of ending loans came onto the agenda, the Japanese felt often annoyed or embarrassed when the Chinese side reminded them about this link in order to extract more assistance and/or better conditions. For example, in 1987, at a moment of Chinese dissatisfaction with Japan`s export surplus and other economic grievances, Deng Xiaoping reminded Komeito Secretary General Yano Junya that China had renounced reparations and that in the Eastern order (toyou jori) this meant that Japan should make more contributions to China`s development. This was rebutted by a Gaimusho statement which aroused great emotions in China, and in which it is said that Deng Xiaoping was seemingly already sitting on a cloud.(17) When Japan suspended the major part of its grant aid in 1995 in protest against China`s resumption of nuclear tests, the People`s
Daily wrote that Japan`s grant aid had a special historical background.(18) It was therefore not surprising when in 2005 the Chinese Foreign Ministry spokesman criticized the Japanese intention of ending the yen loans by saying: "Yen loans are a mutually beneficial arrangement that came into being under special policies and against a historical backdrop).(19)

“For Japan’s benefit”

This latter quote contains also a further point which affects negatively Chinese recognition and gratitude for Japan`s ODA programme, i.e. the Chinese perception of Japan beneficiating economically itself from the programme. However, ODA is never pure charity, and we have seen above the business interests (as well as political interests) involved in starting and sustaining the programme. Based on a Realist perspective of international relations there is the general conviction that ODA is beneficial two both donor and recipient and is not a favour given by the former to the latter. This is clearly understood by Chinese scholars who have written on Japan`s ODA.(20) Still, the Chinese attitude of over-emphasizing Japan`s economic benefit, reinforced by the implicit linkage to the reparation waiver, reduces the weight of other Japanese motives for ODA and thus the Chinese need for gratitude and recognition.

Some of this criticism of `Japan beneficiating itself` derives from the tying of ODA to business interests in the donor country. Japan particulary has often been criticized for this link, but nowadays most of the ODA loans are untied and the share of resulting orders for Japanese companies has gone down from around 50 % in the latter half of the 1980s to 15 % in 1998.(21) However, grant aid is tied to procurement from Japanese companies. But most of the criticism is due to the fact that ODA loans have to be repaid with (albeit very low) interest, and there is the general impression that they are therefore a kind of business and for the benefit of Japan.(22) This is true to a certain extent but the interest and repayment conditions are much more generous than for commercial and international financial institutions` loans, otherwise these loans would not qualify as ODA according to the guidelines of the OECD to which Japan adheres. In the 1990s the repayment of these yen loans temporarily put considerable strain on China because of the rise of the Yen and China complained about it. However, China has always repaid the loans in time. Finally the overwhelming part of Japan`s ODA has been loans which are invested in China`s economic infrastructure which often is linked to Japanese trade interests (e.g. ports and roads).(23)

Japanese grievances
1. China’s economic success and its impact on Japan

The most obvious circumstance to consider about ending of aid is the recipient’s economic success. Since the middle of the 1990s public opinion, the media and the political-economic leadership in Japan became increasingly aware of China’s fast economic progress and its various direct and indirect implications for Japan itself and for the region. Particular lighting rods have been China’s own aid programme and iconic achievements like the begin of manned space craft launches. The Chinese space flights in October 2003 and 2005 exerted a particularly negative influence on Japanese public opinion because of the budgetary extravagancy for a country beset with so many developmental problems like China and the lack of anything comparable in Japan to the Chinese space programme.

Some of the implications of China’s economic achievement have been perceived as negative for Japan and have therefore become arguments to support an end to the loan programme: China’s economic development carries the seeds of self-destruction in terms of ecological unsustainability, political unsustainability (the creation of social imbalances and dislocations), and even economic unsustainability (for example the possibility of a collapse of the underlying economic model of export-led and FDI-driven development due to an international recession). These negative developments have started to affect Japan by way of transboundary pollution, illegal immigration, transboundary crime and the loss of competitiveness in many manufacturing sectors. The success of China’s economic development generates also increased international competition for scarce raw materials, food and energy resources on the international market. Finally, China’s economic success with its demographic and geographic dimensions will not fail to affect Japan’s relative economic position and identity as the world’s second largest economic power.(24)

However, it is also recognized in Japan that China’s economic success has become a prerequisite for Japan’s economic recovery and in 2004 China overtook the US as Japan’s biggest trading partner. Prime Minister Koizumi declared already in April 2002 at the Boao Forum on Hainan island that China’s economy was not a threat but an opportunity and this has been consistently Koizumi’s official line. On the other hand, all this raises the question in Japan why the country should any further provide China with ODA.

The Japanese government normally applies a variable scale of economic achievement indicators which have been developed by the World Bank to
determine when to finally end various categories of aid programmes. In the case of ODA yen loans, the executing Japan Bank of International Cooperation JBIC, formerly the Overseas Economic Cooperation Fund) works with five categories (GNI based on 2003 figures):

Least Developed Countries (LDC)
Poor countries (under $765 per capital GNI)
Low income countries (between $766 and $1,465)
Middle Income countries (between $1,466 and $3,035)
Medium developed countries (between $3,036 and $5,295)

(25)

The fact that based on such indicators China has to be graded as a Low Income country indicates that spectacular economic growth and phenomenal exports do not directly translate into a high category which would graduate a country from all loan programmes. The reason for this circumstance is, of course, China`s huge population and widening income differentials. Even according to official Chinese statistics, already in 1999 the per capita GDP was Yuan30,000 in Shanghai, 10,000 Yuan in the coastal areas from Beijing down to Guangdong, but under 5,000 Yuan in middle and western inland regions.(26) If an assessment of China`s loan eligibility would be based on the above scale, China would simply lose some particularly concessionary loan programmes, such as happened with the special super-low interest rate long-term financing programmes of the International Development Association and that of the ADB.(27) In 1999 China lost its eligibility for concessionary IDA lending under the lending guidelines of the World Bank. The latter is mentioned in the Foreign Ministry`s Economic Cooperation Programme for China of October 2001, but with no hint to Japan ending any kind of loan programme. Britain stopped since 1997 to extend ODA loans to China and has since then only provided grants and technical aid.(28) China will probably reach by 2008 the level of $1,600 per capita if current growth rates of 9 % can be sustained, but still not rank among the middle income countries. However, China`s favourable economic situation raises at least questions about the government`s choice of budgetary allocations as well as about the availability of loans at commercial conditions. Since China has developed so well and has an economy which is relatively open it has become much easier for it to find as well as to afford loans at normal commercial rates. Prime Minister Zhu Rongji is even quoted having said in October 2001 to a group of overseas Chinese technologists that what China was not having sufficiently was high technology and modern management know how, not capital.(29)
Still, applying or not applying the above scale is in the end a political decision. Japan committed to South Korea from 1983 to 1990 ODA loans amounting to $1.8 billion which were disbursed until the end of the 1990s. (30) Japan stopped offering grant aid to Thailand in fiscal 1994, while continuing to offer yen loans and technical cooperation. It stopped offering grant aid to Singapore in Fiscal Year 1988, and ended all forms of ODA to the country in fiscal 1999.

2. Japan`s loss of leverage

One of the major objectives of Japan`s ODA programme towards China has been to gain some leverage over the direction of China`s economic and political development. Economically, these objectives have been achieved to a considerable extent, and, together with the competition of ODA from other countries (notably some sectors like the environment where thanks to international ODA competition the government can actually chose the donor) and the increasing availability of loans at commercial rates, Japan`s leverage is naturally declining. With China`s economic strengthening, any political leverage is also rapidly declining. In 2001 Jin Xide, a researcher at the Chinese Academy for Social Sciences, still argued that the Japanese ODA programme had also been a success in so far as it has suppressed to some extent trouble originating from issues related to Japan`s past and the Japanese-US security treaty. (31) In 2000 the temporary withholding of a decision on ODA in relation to Japan`s demands for `prior notification` for Chinese research vessels wanting to operate in Japan`s Exclusive Economic Zone (EEZ) in the East China Sea had helped to find a compromise. But while in 1995-97 Japan could still send an important political message to China with the suspension of its grant programme in response to China`s resumption of nuclear testing (even if it had only a very limited impact on China), such influence has become now even more doubtful in view of China`s economic success and the resulting growing assertiveness and self-confidence. (32) In addition, political-economic conflict and rivalry have increased since the second half of the 1990s while Japan`s dependence on the China trade has become crucial for Japan`s economic revival. Against this changing background, any political operationalization of Japan`s ODA would only inflame Chinese political opinion.

Closely linked to Japan`s loss of leverage is the lack of Chinese recognition for Tokyo`s economic assistance. The relative ignorance of the Chinese people about Japanese aid or at least their incomplete understanding of the character of ODA as explained above has naturally also limited its political fungibility. Moreover, this lack of gratitude and recognition has become a major argument in the public
discussion about the ending of ODA to China. In their report on ODA in November 2004, the Upper House representatives e.g. complained that the memorial plate informing about Japan’s contribution to the building of the Beijing airport was hardly visible.(33) The Chinese government has lately recognized that this Japanese perception is reducing the political sustainability of ODA among the public in Japan. In October 2000, Prime Minister Zhu Rongji admitted he had not sufficiently conveyed to his compatriots the extent of Japan’s ODA.(34)

The Chinese recognition of the aid programme has also been handicapped by the language used to describe the programme. Both sides refer to what is translated in English as ‘economic cooperation’ and is called in Japanese keizai kyoryoku whereas the Chinese use jingji hezuo which gives particularly in Chinese the impression of economic cooperation of equals for mutual benefit. However, ODA by definition is not cooperation between equals, otherwise it would not be necessary. This problem is even more acute in the case of ODA loans as is e.g. illustrated by Jin Xide of the Japan Research Institute of CASS who said in an interview that the yen loans which are the major part of Japan’s ODA are seen in China as part of the introduction of foreign capital and not as aid.(35)

3. China’s own aid programme

Since around 2000 China’s own aid programme has also become an important argument for ending Japanese ODA. According to the Japanese Ministry of Foreign Affairs China transferred in 2000 $450 million (54 billion yen) in assistance to 58 countries. (36) In October 2005 China announced as its contribution to the UN Millenium Programme $10 billion over the next three years in terms of loans and export credits. It is not only the fact that China is seen as having enough budgetary means to extend economic assistance itself, but the government is also concerned about the non transparency of this development aid (e.g. conditions, recipient countries). Moreover, some of this aid are exports credits which under the DAC rules are not ODA but referred to as Other Official Flows (OOF). Since its economic conditions are not made public, the Japanese government officially refrains from referring to this Chinese assistance as ODA. The Economic Cooperation Programme for China of October 2001 expresses this Japanese concern by saying that `in the future, Japan will urge China to improve transparency in its third country assistance by encouraging China to make public the results`. However, at least what concerns the principle of an ODA-recipient providing itself already ODA, Japan has to remember that it was still itself a recipient of economic assistance when it started to give ODA from 1954 onwards when joining the Colombo Plan. It received World Bank loans for infrastructure
projects (including the first Shinkansen line) until 1964. This was also admitted by Iimura Yutaka, then Director-General of the Economic Cooperation Bureau of the Ministry of Foreign Affairs when confronted with this criticism in 2000. Finally, India, which is now among Japan’s top three loan recipients, has itself a considerable ODA programme.

4. China’s military buildup

It has been particularly China’s military rise and its military policies which not only fed the argument that China was now rich enough and no longer in need of ODA but also that Japan was ill advised to nurture a growing military threat through its aid programme. Security concerns had already surfaced when Japan debated the start of its ODA programme to China in 1979 because of Beijing’s nuclear power status and Japan’s ban on arms exports. Naturally any economic assistance can at least indirectly contribute to the recipient’s military efforts since it frees the recipient’s scarce resources for them. In order to exclude at least the transfer of military hardware, Prime Minister Ohira promulgated in 1979 what became known as the three principles of economic cooperation with China and which explicitly excluded military aid.

With the Chinese military’s two-digit annual increases starting in 1989 the Japanese government had since at least March 1991 on several occasions linked the continuation of ODA with the expansion of China’s military budget and greater transparency. In April 1991 the Kaifu government established its four ODA Guidelines which became in June 1992 part of the Official Development Assistance Charter of Japan. Among a series of principles, the following were related to security:

- the avoidance of aid being used for military purposes or the aggravation of international disputes

- consideration to be given to defence expenditures, development and production of weapons of mass destruction and missiles; attitudes towards export and imports of weapons

The first principle can certainly be applied to China as long as Beijing does not rule out the use of force in the resolution of the Taiwan issue which can be classed as an ‘international dispute’ (which is not the case in China’s eyes!). However, the ODA principles (including the fourth one on the promotion of democracy and a market-oriented economy, fundamental human rights, protection of freedom) were
promulgated with many different objectives in mind, and the Japanese government always responded when asked about inconsistencies in the principles’ application that it would consider each country on its own merits. However, since their promulgation government representatives have tried in their meetings with Chinese officials to link China’s security policies with the terms and conditions of Japan’s ODA although this did not have any practical consequences. The influential conservative Japan Forum on International Relations demanded in a policy recommendation paper on China in January 1995 that the four ODA principles should be strictly applied to take a clear position on China’s military buildup.(40)

In the end, the only application of the military-related principles of the ODA Charter to China occurred when China resumed nuclear testing in 1995 to which Japan reacted with the suspension of grant aid for the fiscal year 1995 to March 1997.(41) Takamine Tsukasa argues that a brief suspension of ODA loans in 1996 – although not publicly announced – was a Japanese warning signal against China’s missile tests and manoeuvres in the Taiwan Strait.(42) Also not explicitly related to the ODA principles was the brief postponement of a ¥17.2 bn special loan package to China by the LDP’s Foreign Affairs Committee in summer 2000 to protest against the increasing number of Chinese naval incursions into Japan’s territorial sea and EEZ as mentioned above.

In the end, the territorial conflicts in the East China Sea around the ownership of the Senkaku/Diaoyu Islands and the fixation of the maritime border, the Chinese naval buildup as well as its military incursions into EEZs claimed by Japan became important arguments for demands to end the loan programme and to shift the emphasis of Japan’s ODA to the interior provinces, to poverty alleviation, to the protection of the environment and even to the improvement of the Chinese Japan perception (e.g. through youth exchanges).

At the beginning of the new millennium a series of demands related to various Chinese military policies emerged from some of the media (43) and from within the ruling LDP. In May 2000 Foreign Minister Kono Yohei told his Chinese counterpart Tang Jiaxuan that the government would review its policy on official development assistance to China, citing Tokyo’s concern about a steep increase in China’s military spending to which Tang responded that ODA should not be discussed in a ‘political context’. (44) In November 2000 Kamei Shizuka, the Chairman of the LDP Policy Research Council, startled the public by demanding a 30 % reduction of Japan’s ODA to China as a ‘shock treatment’ against China’s military buildup. (45) In July 2001 Finance Minister Shiokawa Masajuro called it “foolish” for Japan to give ODA to “a country that may attack Japan with an
atomic bomb or missiles.” (46) Reference to the ODA Charter and in particular to China’s military expenditures were made in the Economic Cooperation Programme for China in October 2001 which became a turning point in the reorientation of Japan’s economic assistance. The Programme recommended that ‘Attention must be paid to ensure that Japanese ODA to China does not lead to a strengthening of Chinese military capacity or other developments inconsistent with the "Principles" of the "ODA Charter."’(47)

General change of Japan’s ODA policy and their implications for China

Before coming to the developments in 2004-05 leading to the decision to end the loan programme, it is also necessary to consider the general changes of Japan’s ODA policy since the second half of the 1990s and their implications for the economic assistance programme to China.

In the 1990s, Japan’s ODA underwent changes at the level of involved decision makers, aided sectors, distribution, quantity and political conditionality. The latter, as we had seen above, became official policy in April 1991 when the Kaifu government established its four ODA Guidelines which became in June 1992 part of the Official Development Assistance Charter of Japan. Japan’s budgetary constraints (by 2006, the state’s debt burden in relation to the country’s GDP amounted to 170 %) prompted the government to slash the ODA budget by over 30 % since 1999. The ODA budget for FY 2006 was cut by 3.4 %, a decrease for the 7th straight year, i.e. down to 759.7 billion yen ($6.5 billion), from 786.2 billion yen in the previous year.(48) However, the true picture is rather more complicated because at the same time the FY2006 budget was approved by the cabinet, the latter also approved ODA spending in the supplementary budget for fiscal 2005, which rose to 32.3 billion yen, about twice the amount of last year's supplementary budget which was 15.5 billion yen.(49) Moreover, Japan is under pressure to reverse the decrease of ODA. The 2005 report by Jeffrey Sachs to U.N. Secretary General Kofi Annan says wealthy nations must increase their ODA to 0.7 percent of their gross domestic product (GDP) by 2015 if the U.N.'s Millennium Development Project is to achieve its poverty-reduction target. The Japanese government declared in response that it wants to aim for such an increase without being specific.(50)

As a result of several critical reports, ODA scandals and public criticism of traditional ODA policy, focus is now put on poverty alleviation, environmental sustainability, and human security. Increasingly, the government relies on the
distribution of ODA by NGOs, whether Japanese or foreign. More attention is paid to the efficacy of ODA, accountability and maintaining public support.

Finally, an important development has been the relative decrease of influence by the Ministry of Foreign Affairs to the benefit of a much stronger role by politicians of the ruling coalition and public opinion, both having become much more critical of China. Whereas the start of ODA to China in 1979 was also mainly driven by pro-China politicians (supported by a pro China public opinion), and then for over 20 years carried out by bureaucrats under MOFA leadership, the situation had now changed back again to a politician-driven policymaking process, but no longer with a China-friendly approach. Moreover, ODA has generally become of greater interest to politicians because of the government`s budgetary constraints. The deterioration of Japanese-Chinese relations has politicized ODA as a foreign policy tool. The role of the bureaucracy in general has become a popular target of criticism, and the China School of the Foreign Ministry has been singled out for being too soft on China.(51) As a result, some diplomats of the China School became China policy hardliners themselves.(52) The future of ODA and the role of the Foreign Ministry in it has become a critical issue for the latter because most of its budget is ODA-related. Whereas the ODA share in its budget was less than 20 % of the Ministry`s total budget at the beginning of the 1960s, this increased to over 70 % in the 1980s.(53)

These developments affected directly policies towards the Chinese ODA programme. One of the earliest consequences was the shortening of the allocation period. China had been the only Japanese aid recipient which received ODA loans on a multi-year commitment basis instead of on a single-year basis in order to accommodate China`s five year planning system. But to regain more control and leverage over its loan programme, the Japanese government agreed in 1998 with its Chinese counterpart to end this system from Fiscal Year 2001. However, in reality MOFA is still trying to work within the Chinese long-term time framework which is also often more natural because of the duration of many projects.

In 2000 a Foreign Ministry Advisory Panel under the chairmanship of Miyazaki Isamu suggested that the amount of official development aid (ODA) to the PRC could be reduced in light of Japan`s severe fiscal conditions and various public criticisms of China.(54) On the basis of it the Gaimusho planned to prepare the Country Assistance Programme to China, but at the request of the LDP the title was changed to Plan of Economic Cooperation to China in order to express the idea that the LDP no longer considered China a developing country.(55) It stated that from now on Japan`s as well as China`s national interest should be taken into
account when selecting projects. This meant support for projects related to the environment, economic reform, policies to eliminate poverty in inland areas, and training of people to improve mutual understanding. Particularly relevant in our context is the proposal that infrastructure project should now be undertaken by China itself and loan commitments be put on a single-year basis. The Ministry’s White Paper on its ODA published at the end of March 2001 admitted that among the Japanese public there were ‘harsh views’ concerning ODA to China. (56)

A report by the LDP published also in December 2000 was much harsher that that of MOFA, taking up more of the criticisms mentioned above. Particularly relevant in our context is the LDP’s proposal to enhance the political effect of Japan’s aid by including untied loans – non-ODA government loans- as a component of Japanese development funds to China. (57)

A report in July 2002 by an advisory panel to Prime Minister Koizumi (headed by Okamoto Yukio) recommended in its general ODA recommendation to be careful with any ODA reduction (sakugen ni shincho ni), and on ODA to China it recommended that ODA should be redirected towards the interior of the country as well as environmental conservation, energy projects, a better understanding of Japan (e.g. youth exchanges) and the creation of a better legal system for intellectual property rights (‘good governance’). (58)

The loan package for FY2004 reflects the new direction of Japan’s loan policy. Of the seven projects, six are environmental conservation projects, accounting for 94 % of the total amount. Although called ‘environmental conservation projects’, this includes loans for ensuring better water supply and water treatment systems or even installing a natural gas pipeline to convert energy sources from coal to gas, thus still having much the character of infrastructural projects. (59)

Declining loans and rising repayment

Against the above background, ODA loans to China have dropped significantly. Having achieved their highest level in 2000 with Y2,144 bn, they declined to Y889 bn in 2004 (cir. $870 million) (see Table 1). This put China fourth after India, Indonesia and Turkey whereas for a long time China was either 1st or 2nd after Indonesia.

Table 1

Japanese Yen Loans to China on a Commitment basis (Unit: Yen100 million)
At the same time as the cumulative total is still growing, so is the repayment total. This development is hardly mentioned in the public discussion in Japan, and the incomplete information provided by the Japanese government as well as the confusing terminology is not helping either. The Japanese government does not disclose the interest element of loan repayments for a specific year although it makes public the interest rate of a loan when the commitment is made. The terminology and the categories used by the Japanese side and the OECD are also diverging. The Japanese statistics are based on commitment, the OECD’s only on disbursement. The figures refer to net disbursement which means gross disbursement minus repayment of principal. Therefore the OECD loan figure for 2002 is $971.9 million, but the figure published by the Japanese government is $1,020 bn (Yen1,212 bn). (60)

The irony is therefore that while the discussion about ending the loan programme is going on and commitment figures have been halved since their peak in FY2000, actual disbursement of loans to China has been increasing: The gross disbursement to China in 2003 was Yen1,149 bn which increased in 2004 to Yen1,271 bn. The reason for this is that it can take up to 5-7 years from loan commitment to final disbursement. As a result actual disbursement will still increase until 2008. There have even been reports in the Japanese media that China’s annual repayment is already higher than new loan commitments. (61) This does not seem yet the case but the figures are very close: The gross disbursement to China in 2003 was Yen1,149 bn whereas the repayment amounted to about Yen1,052 bn (consisting of Y652 bn in principal repayment and an estimated Yen400 bn in interest).

Looking at JBIC’s figures for FY 2003, the following complex picture of the current loan situation emerges:

- 25 projects committed: Yen 967 bn
- Gross disbursement: Yen 1,149 bn
- Repayment of principal: Yen 652 bn
Outstanding balance of principal  Yen 16,808 bn
Total number of projects since the beginning  338
Total commitment  Yen 30,904 bn

Source: JBIC Loan Report 2004, p. 52

The discussion of closure 2004-05

It is against this background of a general as well as China-specific reorientation of ODA, mounting grievances against China, and a significant drop of new loan commitments to China that the official discourse from 2004 onwards began to refer to the ending of Japan’s ODA. The year 2004 had seen a further deterioration of the bilateral relationship, with China still refusing a summit meeting in either country because of the Prime Minister’s Yasukuni Shrine visits, anti-Japanese outbursts at the Asian Cup soccer matches in the summer, the ratcheting up of the territorial conflicts in the East China Sea, the Chinese refusal of accepting an EEZ around Japan’s Okinotori island in the Pacific, and the November intrusion by a Chinese submarine into Japanese territorial waters.

Public demands for ending at least the yen loan programme had been heard since about the middle of the 1990s. In 1995 the Japan Forum on International Relations called in a policy paper for a serious reexamination of ODA to China and asked whether Japan should continue yen loans to China.(62) It also demanded a strict application of the four ODA principles to China and expression of concern about China’s military modernization. In 1997 a paper by the ruling LDP on ‘Japan’s Strategy towards the Asia-Pacific Region’ had referred to the era of loan credits drawing to a close.(63) The demands for reviewing ODA to China were also encouraged by the furore created on 9 November 2000 by Kamei Shizuka’s 30 % ODA reduction demand for FY2001 although in the end the cuts amounted to only 3 %. (64) Finally the government had to yield to this mounting pressure and at the end of November 2000 it was reported for the first time that the government had decided to reduce the amount of ODA to China (65).

According to my research the first official references to the ending of the Yen loan programme at the highest government level came in October 2004. On 3 October 2004, just after taking up the post of foreign minister, the hawkish Machimura Nobutaka told an ODA-related gathering in Tokyo (‘Gaimusho Town Meeting’) that China would graduate from Japanese aid "someday" but with many impoverished people still in the inland area it was now still too early.(66) On 22 November 2004 the minister mentioned that it was appropriate that China would
graduate from Japan’s ODA in the ‘near future’. This statement was echoed by Prime Minister Koizumi on 28 November on his way to an ASEAN meeting in Laos when he said that that ‘the time to graduate [from ODA] had come. According to Masuda he said ‘I hope that China would become a donor in the future. We would like to think of what to do with ODA from a broader perspective’ (Chugoku ga shorai, enjo suru gawa ni mawatte itadakereba to kitai shite iru. Taikyokuteki ni kongo no ODA no arikata wo kangaete ikita). The government’s statements were generally supported by the media. Even the liberal Asahi Shimbun argued that ‘When the recipient of economic assistance has become self-sustaining, it is only natural to end the assistance or divert it to a different area or another nation’. In November 2004, a House of Councillor commission published a report on ODA on various countries, including China, and recommended in the case of China to eventually end ODA because it was not necessary. As reasons were mentioned China’s economic success, Japan’s own financial problems, the increase in military expenditure, China’s manned space venture and the anti-Japanese education. The argument that Japan’s ODA should contribute to eliminate the great wealth disparities in China was rebutted with the idea that such redistribute tasks were a domestic Chinese issue.

The Chinese government showed its displeasure about the linkage between Japan’s ODA and criticism of its policies and took a defiant attitude. When asked about his Japanese counterpart’s announcement on 22 November, Foreign Minister Li Zhaoxing was quoted as saying "The Chinese people only need to rely on their own intelligence, power, unity and determination to build a developed country". According to a senior official of the Ministry of Foreign Affairs, members of the Chinese Finance Ministry even expressed the opinion to the Japanese side in talks in 2005 that China no longer needed yen loans. Other comments were more guarded. Prime Minister Wen Jiabao was quoted as saying that Beijing wanted to ‘deal with the issue appropriately’. A few days later he was quoted as having said that the bilateral relationship would be shattered if economic assistance would be ended. The Deputy Spokesman of the Chinese Foreign Ministry declared on 30 November that he hoped that ODA would play an active role in the development of the bilateral relationship. ‘Irresponsible discussions will only damage Japanese-Chinese relations’ and ‘We cannot understand the Japanese domestic discussions. ODA has to be seen against a special political and historical background’. The Chinese official news agency Xinhua published an editorial on the abandonment of the loan programme in which it mentioned that the Chinese Foreign Ministry considered that there was still today a special historical background to this issue, thus indirectly referring to the perception of Japan’s ODA being reparations. It was later reported that Prime
Minister Wen Jiabao reacted rather cool to Koizumi’s above proposal and while expressing his appreciation of the positive role of Japan’s ODA for China’s economic development he urged the Japanese prime minister to ‘end well what had started well’ (shan shi shan zhong) and to avoid that ending the yen programme would become a new political problem. They reached an understanding in general to conduct working level negotiations which would lead within several year (su nen) to an end of new loans. (79)

Probably in response to these Chinese reactions, Foreign Minister Machimura had become more guarded. In December 2004 he mentioned a review of the aid policy with a view of reducing and eventually ending it, but with a soft-landing scenario in mind (nanchakuriku). (80) On 14 December the Foreign Ministry Spokesman even put the consideration of any changes to the next ODA country plan for China ‘within a year or two’. (81)

From the very beginning of 2005, however, the Japanese government hardened its stance and forced the pace. In January the new Vice Foreign Minister Yachi Shotaro urged to decide when to terminate ODA and said that "There is no need to provide ODA to a nation that does not feel the need to receive it". (82) The Sankei Shimbun reported on 16 January that the government had decided to propose to China that the two governments should jointly compile a report by summer which would agree on a positive note about the ending of the loan programme, and consider the possibility of extending ODA to developing countries. (83) At the end of January it was reported that the Gaimusho’s ‘Comprehensive ODA Strategy Committee’ (ODA Sogo Senryaku Kaigi) had decided on 24 January that it would start a fundamental review process at its next meeting in March. (84) In March the government finally let it known that it had told China about plans to begin cutting the size of its low-interest yen loans from this fiscal year, aiming to phase them out entirely by fiscal 2008, while grants and technical aid would be given for training and environmental protection programmes. (85) Grant aid was also to be phased out at some point in the future. The year 2008 was obviously chosen because of the Beijing Olympics which in Japanese eyes marks a country’s graduation from ODA loans as it has done for Japan when it staged the Olympics in 1964. On the 17 March the Foreign Affairs Committee of the LDP (Gaiko Kangei Godo Bukai) confirmed the intention of the party to end the loan programme by 2008 after having listened to a statement by Foreign Minister Machimura. This was endorsed by the chairman of the Special Committee on ODA, former Foreign Minister Takamura Masahiro who is also chairman of the Japan-China Parliamentarian League (Nitchu Giren). The hawks of the party even demanded a total end of Japan’s ODA, including grants. (86) In the press conference of the Foreign Ministry
on 29 March 2005, the spokesman mentioned that `Japan is planning to phase out the new yen loans to China by the time of the Olympic Games in Beijing in 2008.

In the same month the Deputy Spokesman of the Chinese Foreign Ministry used again the same expression of `shan shi shan zhu’ (in Japanese: yushu no bi wo kazareru yo) which Prime Minister Wen Jiabao had used in November 2004 to achieve an amicable ending of the aid programme. He pointedly repeated the Chinese view of the loan programme when he said that "Yen loans are a mutually beneficial arrangement that came into being under special policies and against a historical backdrop". On the occasion of the above mentioned LDP meeting of 17 March the Chinese Foreign Ministry spokesman Liu Jianzhao declared that the relationship as a whole should not suffer damage from the outcome of the talks and the politization of the ending of the Yen loan programme should actively be avoided. According to the *Tokyo Shimbun* he confirmed the begin of consultations with Japan on ending the yen programme. Foreign Minister Machimura declared in March that he had basically agreed with Foreign Minister Li Zhaoxing in a telephone conversation that new ODA loan commitments would be completed by the 2008 Beijing Olympics. He was, however, on the same day contradicted by the Chief Cabinet Secretary who stated that the two sides were still negotiating, and this was echoed by the Chinese Foreign Ministry’s spokesman. That no formal agreement had been reached at least at that point is also supported by reports that the Chinese side showed its interest in continuing the loan programme since, as announced by the Japanese Chief Cabinet Secretary, China ‘proposed a number of new projects that would require the extension of a huge amount of yen loans’. However, for the Japanese government, the ending of the loan programme by 2008 was decided.

Conclusions

The developments leading to the Japanese government’s decision in 2005 to end all ODA loans by 2008 was clearly taken for political reasons, taking into consideration the criticism of certain Chinese policies, the deterioration of Japan’s relations with China, the fast economic development of China with its implications for Japan’s interests, and a general aid fatigue of public opinion against the backdrop of Japan’s economic and budgetary problems. The political character of the decision is obvious from the fact that the government at no point referred to its usual guidelines for ending ODA loans or explained the standard by which China would be considered to have graduated to become a developing country. It would have demanded considerable political foresight by the relevant government agencies and the politicians to face the inevitable need of graduating China from
yen loans in order to avoid that the decision making process could be hijacked by the vagaries of Japanese-Chinese political relations. However, apart from inertia, there were strong political and bureaucratic interests which worked against this. For the Ministry of Foreign Affairs, the ending of yen loans (and thus the possible opening of the Pandora’s Box of a total ending of ODA to China) would deprive the Ministry of its most potent foreign policy instrument vis-à-vis China while sending (more) negative signals to China and setting a precedent for either other ODA cuts or for reinforcing the current momentum of restructuring ODA policymaking at the expense of the Foreign Ministry. The Japanese government can also not be interested in losing a debtor which so far had always punctually repaid its loans from Japan. This cannot be said of Indonesia which is among the top three debtors. Although there are certainly needier countries than China for yen loans, China with its excellent repayment record will be difficult to replace.

This lack of foresight has led to acrimonious exchanges between the two countries, further inflamed the history issue (reparation-ODA linkage) which is already at a critical point because of Koizumi’s Yasukuni Shrine visits and reduced even more China’s willingness to properly appreciate Japan’s ODA loan programme. Instead of being able to celebrate the successful closure of Japan’s main ODA category and serving as a welcome opportunity to reduce tensions at a difficult moment in the bilateral relationship, the programme ends under what the Chinese side perceives as a punitive cloud. Moreover, it seems that the ending of the loan programme has now also opened the way to end the grant programme. It was reported in December 2005 that no new grant aid might be scheduled from FY 2006. Japan's grant aid to China totaled about 5.2 billion yen in fiscal 2003, making China the ninth-largest recipient country of such aid from Japan. Among Asian countries, China ranked fifth, after Pakistan, Vietnam, Cambodia and the Philippines.(94) As of October 2005 there was, however, no discussion about ending technical aid.(95)

But the greatest loss to Japanese-Chinese relations may be in the longer term that the decline of ODA and the very much China threat-motivated reinforcement of the Japanese-American security cooperation will further disequilibrate Japan’s engagement policy towards China, by putting more emphasis on political and military power balancing to enhance Tokyo’s deterrent and leverage over China at the expense of the political and economic enticement elements of that policy. The Chinese side cannot escape responsibility for this development.

Both sides have been trying to deflect some of the damage. The Chinese government is clearly still interested in receiving as much ODA from Japan as
possible in view of its economic and political ambitions as well as the growing domestic unrest over increasing income disparities. The Japanese government showed with its `soft-landing` approach concern for any negative impact on its China policy. From early on there have been ideas and proposals to use ODA in other ways and for other purposes to advance the bilateral relationship. The Foreign Ministry’s Advisory Group under the chairmanship of Miyazaki Isamu in its 2001 report had proposed that Japan and China should cooperate in assistance to third world countries (South-South Cooperation), in the same vein as Japan was already doing with Singapore, Malaysia and Thailand.(96) In January 2005 it was proposed in the media that ODA might be used to fund the increasingly expensive removal of Japanese chemical weapons left over in China after 1945, as well as for environmental preservation and the protection of the intellectual property rights of Japanese companies.(97) However, at least the former proposal is not likely because it would require to change the current setup under which the prime minister`s office is in charge of the removal programme. There was also the proposal from a participant in a Upper House committee (Research Committee on International Affairs) that Japan should declare that it would be the last to cut off all ODA to China or that Japan should concentrate its ODA to the northeastern region with which Japan has closer relations.(98) It can only be hoped that the experience with the ending of the loan programme will from now on ensure more attention by both sides to the future of the grant and technical aid elements of Japan`s ODA and to the equilibrium of Japanese-Chinese relations in general!

Footnotes:

(1) MOFA statistics. According to the Japan Bank for International Cooperation (JBIC) Annual Report 2005 the corresponding figure is Yen3.17 trillion which is due to slightly different calculation methods.


(6) Email from Okada Minoru, 19 February 2006.


(8) Shuja, Sharif M. *China after Deng Xiaoping: Implications for Japan East Asia* vol. 17 no. 1 Spring 1999, p. 89.


(12) Iokibe Makoto, *Han Chu ‘genrishugi’ wa yugaimueki de aru (Anti-Chinese ‘Fundamentalism’ is

(13) Suh 2004, p. 81; Rose 2005, p. 43.


(15) Suh 2004, p. 129.


(17) Suh 2004, p. 139.


(23) Masuda, Masayuki, Japan’s changing ODA policy towards China, China Perspectives, no. 47 May-June 2003, p. 40.


(30) http://www.mofa.go.jp/mofaj/gaiko/oda/shiryo/jisseki/kuni/j_99/g1-03.htm. This website gives South Korea’s per capita GNP as $5,400 in 2003.


(33) Sangiin 2004, p. 45.


(37) Masuda 2003, p. 43.

(38) Drifte 2003, pp. 43-44.

(39) Drifte, Reinhard, Japan’s Foreign Policy for the 21st Century (Houndmills/Basingstoke: Macmillan/St Antony’s College, 1998), p. 129.


(49) http://www.mofa.go.jp/mofaj/gaiko/oda/index/shiryo/yosan.html.

(50) Press Conference of the Ministry of Foreign Affairs 7 June 2005 (MOFA homepage).

(51) Drifte 2003, p. 79.


(54) Japan Times 19 December 2000.

(56) Masuda 2003, p. 41.

(57) Takamine 2002, pp. 204-5.


(59) JBIC Press Release.

(60) OECD Report 2004, p. 120. ODA Seifu Kaihatsu Enjo Hakusho 2003 nenban, MOFA Tokyo March 2004, p. 56.

(61) Sentaku, September 2004


(63) Japan’s Strategy towards the Asia-Pacific Region, Liberal Democratic Party, 28 November 1997.

(64) Asahi Evening News 30 November 2000.


(70) Asahi Shimbun 2 December 2004.

(71) Sangiin 2004, p. 77.

(72) Sangiin 2004, p. 79.


(74) Interview 6 October 2005.

(75) International Herald Tribune 1 December 2004.

(76) Yomiuri Shimbun 4 December 2004.


(89) Tokyo Shimbun 4 March 2005.

(90) IHT/Asahi 18 March 2005.

(91) Japan Times 19 March 2005.


(93) Masuda 2003, p. 47.

(94) Yomiuri Shimbun 13 December 2004.

(95) Interview with a JICA official 18 October 2005.

(96) Masuda 2003, p. 47.