

Development with Alternative Strategic Options

A Japanese View on the Poverty Reduction Drive and Beyond *

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May 20, 2002

(revised)

Development must be achieved on cumulative efforts, not impulsive shifts. The recent global passion for cutting poverty may have gone to extremes. Poverty must be reduced, but in a way that permits pursuing other development goals and strategies reflecting the diversity of poor countries. To supplement the current pro-poor policies, Japan proposes an alternative, more dynamic concept of development assistance for the purpose of helping latecomer countries to be integrated in the world economy as active trading partners. It is up to each developing country, and not donors, to decide whether the ultimate national goal is poverty reduction, industrial dynamism, or otherwise. Japan hopes to continue to use ODA for supporting global causes as well as East Asia's dynamism. Japan is also prepared to transfer East Asian experience to other developing areas where such aspiration is embraced and conditions are right.

* Prepared as a background paper for the OECD Forum, Paris, May 13-15, 2002. The author has benefited greatly from the inputs of a large number of Japanese officials and scholars participating in the ongoing discussions for reshaping Japan's development cooperation policy. While this paper reports an emerging consensus among them as the author sees it, it is not an official statement. All responsibility for its contents rests with the author alone.

1. Strategic convergence on poverty reduction

Despite intense effort in the last half century, development remains an unresolved problem. Some countries have succeeded brilliantly in catching up with the forerunners, but too many others continue to be trapped in social and economic stagnation. Many strategies were tried to lift them out of poverty, from socialist planning to laissez-faire and from health and educational support to building roads and power plants. But the world has not yet found a single cure that works in all cases. Maybe there is no such panacea in the first place.

But the international economic organizations are constantly in search of one miracle solution. The World Bank's policy focus has shifted from infrastructure and industrial projects in the 1960s to basic human needs in the 1970s, "structural adjustment" in the 1980s, and privatization and institution building in the 1990s.¹ A few years ago, its policy again shifted dramatically to an exclusive attention to poverty reduction. Certainly, poverty is a very legitimate concern in development. Furthermore, adjusting policies to changing reality is not only desirable but necessary. But the transformation of what the World Bank considers the key policy ingredient is a bit too fast and too radical; wisdom of the past should not be thrown out so quickly when the Bank staff stampede to a new development credo (especially after the inauguration of a new Bank president).

By now, poverty reduction has captured the hearts of aid officials around the globe, making it synonymous with the entire development process. In 1999, World Bank President James Wolfensohn launched a new initiative called the comprehensive development framework (CDF) and poverty reduction strategy paper (PRSP). Of these, CDF provides the basic ideas and procedure for policy formulation stressing *ownership* (i.e., leadership) of the developing country and *partnership* among various development actors. On the other hand, PRSP is a document that concretizes targets and needed actions and allocates them among actors. Initially, only a small number of poor countries asking for debt reduction were supposed to prepare PRSPs. But the scope of PRSP was subsequently enlarged, and all poor countries are now required to engage in this process. Once agreed, PRSP becomes an overarching framework for budgeting, prioritizing, project selection, evaluation, and donor coordination for that country. This situation reminds us of "structural adjustment" reforms universally applied to countries with

¹ World Bank economist Easterly also critically reviews the shifting ideas in development in the last half century (William Easterly, *The Elusive Quest for Growth*, MIT Press, 2001).

balance-of-payments difficulties in the 1980s.

Furthermore, the United Nations Group has linked up with the World Bank in fighting poverty. The UN Millennium Summit in 2000 adopted the Millennium Development Goals (MDGs) that called for concrete social achievements by 2015, including halving the ratio of people in extreme poverty. The World Bank's PRSP is going to be used as the instrument to achieve these goals. The Bank economists estimate that this would require \$40-\$60 billion in additional external assistance per year, implying roughly doubling the current global ODA.²

In the current global excitement over MDGs, the EU and US are to bolster their aid spending to levels unthinkable from their past stinginess. The EU has promised to increase ODA to 0.39 percent of GNP (amounting to an additional \$7 billion or so per year) while the US has declared to add \$5 billion annually during the next three years for the benefit of poor countries with "good practice." There seem to be two reasons for the outburst of goodwill particularly in 2002. The first is the newly found nexus between terrorism and poverty after the September 11 attack, making some countries more generous. The second is a series of international conferences in 2002 that feature development.³ With so many opportunities for publicity, it is natural that national and international bureaucracies strive for greatest visibility.

The renewed global interest in development is welcome, but we have some worries. We are not worried too much about the fact that even the superb generosity of the EU and US will fall short of the required ODA targets calculated by the World Bank. Nor do we lament exceedingly that Japan, the top donor until 2000, is unable to participate quantitatively in this humanitarian effort due to its fiscal crisis. Our concern is over the

² For the contents and costing of MDGs, see S. Devarajan, M.J. Miller and E.V. Swanson, "Goals for Development: History, Prospects and Costs," World Bank Discussion Paper no.2819, April 2002; and "The Costs of Attaining the Millenium Development Goals," World Bank pamphlet at Monterrey, Mexico, March 18-22, 2002. However, it is puzzling that all additional funding for growth or poverty reduction is assumed to come from ODA, not from private or domestic sources. If policies are improved (as the authors assume), even poor countries should be able to mobilize these sources. To deny this is to underestimate their potentiality as well as to contradict many of the World Bank's own programs for private sector development and financial sector reform.

³ These include the World Economic (Davos) Forum in New York (January-February), UN-hosted International Conference on Financing for Development in Monterrey, Mexico (March), OECD Ministerial Summit in Paris (May), G8 Summit in Kananaskis, Canada (June), and the World Summit on Sustainable Development in Johannesburg, South Africa (August-September), in addition to the regular World Bank-IMF annual and development committee meetings.

strategic soundness of poverty reduction rather than its finances. With all enthusiasm and determination, the global drive to cut poverty may go off track if the sense of balance and continuity is lost. Poverty has always been a tough problem in human society. We are now confronting the toughest part of it, extreme poverty in the poorest countries, which past efforts failed to eliminate. To succeed, cool heads, not just religious fervor or herd instinct, should be in the driver's seat.

The Japanese government has supported the current poverty reduction initiative, but with caution. First, we do not think jumping from one idea to another every several years is the right way to promote development. Ideas and policies should be more stable and cumulative. Second, strategic convergence is positively harmful. Reflecting the great diversity in the social and economic conditions of poor countries, there should be more than one path to development from which they can choose. Whether or not cutting poverty should be the principal national goal is up to each developing country to decide.

2. East Asian development as a catching up process

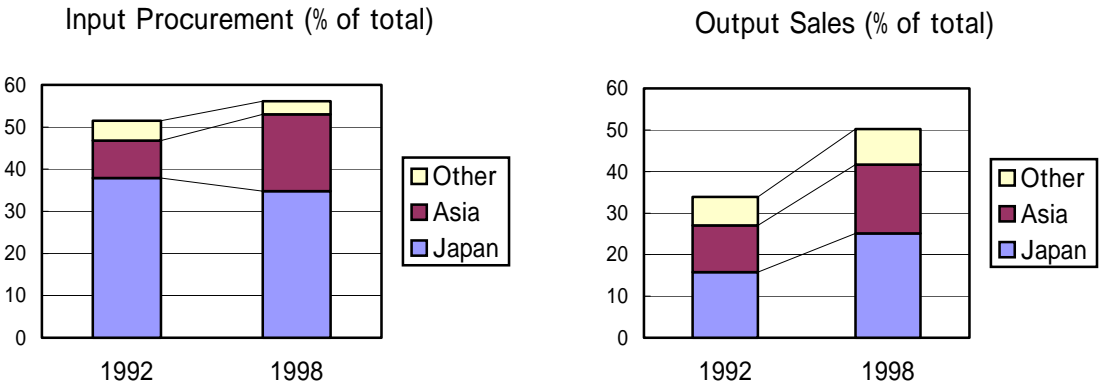
The current approach presupposes developing countries with weak capability. It assumes a world where politics is unstable, growth is low, industrial promotion invariably fails, and foreign debt forgiveness is taken for granted. Such countries cannot hope to relieve mounting social misery by their efforts alone, so external help is requested. Even under the best scenario, it is unrealistic to expect them to surge as “factories of the world” challenging the high-tech industries of advanced countries. Under such circumstances, development must necessarily take a humanitarian turn. The immediate policy goal should properly be to lift as many individuals, families and villages as possible out of the abject and dehumanizing condition of extreme poverty. Though fairly gloomy, this is one legitimate idea of development. Unfortunately, there are many countries that this description largely fits. Among them, failed development in Sub-Saharan Africa is especially striking as a collective, regional phenomenon.

But this is surely not the entire picture. At the other extreme, developing countries in East Asia have emerged from dire poverty and social instability into the state of industrial competitiveness and much higher living standards within a few decades. During the 1950s and early 60s, real income and living conditions in East Asia were similar to—and sometimes below—those of African societies. East Asia has had its share of crises including hot and cold wars, military coups and threats, economic stagnation and currency attacks. Moreover, there were differences in development stage and growth performance among them. But despite all this, over time and as a region, their

socio-economic achievements have been truly outstanding.

Their success was not a matter of sheer luck. East Asian growth was realized by staggered participation in the regional production network through trade and investment. The supply linkage was first formed between Japan and NIEs (Korea, Taiwan, Hong Kong and Singapore), then spread to include ASEAN4 (Malaysia, Thailand, Philippines and Indonesia). Later, China and Vietnam joined. Once captured by this regional dynamism, each country was under constant pressure to master technology, improve human capital and enhance competitiveness for survival. Multinational firms (including Japanese) played a key role as bringers of capital, technology and management as well as agents of economic integration (Figure 1). On the demand side, it is noteworthy that East Asian growth depended heavily on the existence of huge external markets, especially American.

Figure 1. Japanese Firms as Builders of Asian Production Network
International Transactions of Asian Affiliates of Japanese Firms

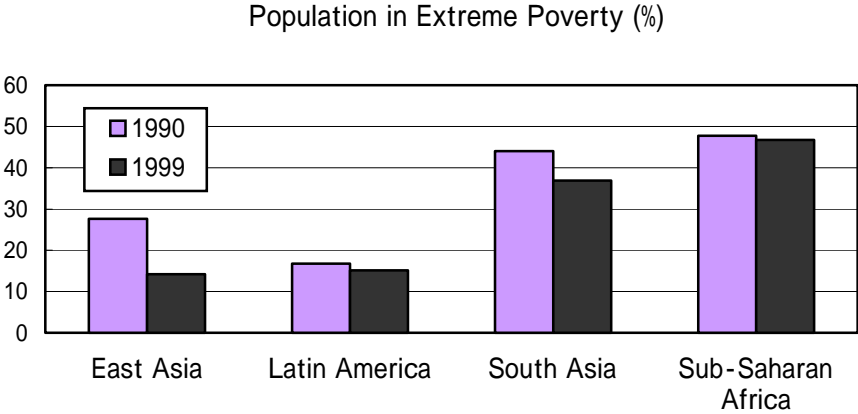


Note: the remaining procurement and sales are domestic.
Source: Shujiro Urata, "A Shift from Market-led to Institution-led Regional Economic Integration in East Asia," presented at the Conference on Asian Economic Integration, RIETI/UNU, April 2002.

For East Asian countries, development was not poverty reduction but a social process of catching up with the front-runners, driven by national pride and the acute sense of threat and inferiority. Their strategy consisted primarily of generating high economic growth and managing the negative aspects of such growth. In most cases, a strong state, not necessarily democratic by Western standards, orchestrated the entire process. For East Asia, the concept of poverty reduction was too static; instead, more dynamic objectives, such as coping with emerging income gaps and maintaining social equity in the growth process, were preferred. The incident of poverty also fell sharply, but this was the result of their successful development, not the cause (Figure 2). By now, East Asia has already

attained the principal target of MDGs, namely, cutting extreme poverty in half between 1990 and 2015.

Figure 2. East Asia Cuts Poverty Despite Currency Crisis



Source: S. Devarajan, M.J. Miller and E.V. Swanson, “Goals for Development: History, Prospects and Costs,” World Bank Working Paper no.2819, April 2002.

Development as poverty reduction and development as a catching up process are two entirely different phenomena, which must be clearly distinguished. East Asian development experience and aspiration can hardly be discussed or interpreted within the framework of poverty reduction, which is too narrow. In addition to the current development approach centered on poverty reduction, we propose an alternative approach consistent with a national desire for industrialization under global integration. It is odd that the lessons of East Asia as a developing region with highest performance have not so far been firmly incorporated in the policies of the international organizations. That will be the first step toward strategic diversity in development. We hope there will be even more approaches in the future reflecting the multiplicity of development experience.

Some may object that the East Asian model is an exception that cannot be easily transferred to other regions. We agree that it presupposes certain conditions which we hope to elucidate on another occasion. It may be more realistic to expect that only a few countries can make a full use of this model at first. But outright denial of transferability is tantamount to discounting the ambition and potentiality of poor countries. We know that many developing countries outside East Asia share an earnest desire to be integrated meaningfully into the world, not as permanent aid receivers but as active players in the global trade game.

3. Japan's ODA vision: for Asia and for the world

Japan is in the process of reformulating its economic cooperation policy. This is partly due to ODA budget cuts necessitated by fiscal austerity. But more fundamentally, Japan has reached a point where it can no longer remain a silent partner to the global development trend with which it feels considerable unease. Intense donor coordination and poverty reduction drive in the last few years have made it impossible to ignore what others are doing and pursue its own development agenda. Japan is challenged to cast off passivity and make its position clear, contributing actively to global aid schemes where such support is warranted but speaking out loudly where it thinks improvements are needed. Without such engagement, Japan runs the risk of being marginalized in development cooperation and forced to provide money and personnel for the cause not of its own.⁴

It is not that Japan wants to depreciate the importance of attacking poverty on a global scale. Japan also wishes to contribute positively to environmental protection, education and healthcare, refugee assistance, elimination of epidemics and other common causes of the world. But at the same time, we want to support industrial development and economic integration of developing countries where such goals are entertained and conditions are right. We want to continue to use ODA as one of the tools for such support as we did in the past. We hope that global aid philosophy will not only accommodate but actively embrace this type of ODA.

In Tokyo since last year, a group of economists including myself have advanced a vision of Japanese ODA consistent with the dual aspects of Japan's policy goals noted above. This vision, called the *two-track approach to economic cooperation*, urges the Japanese government to proclaim *contributing to global goals* and *supporting Asian dynamism* as two pillars of development cooperation, and conduct external policies including ODA accordingly (overlapping of the two goals is permissible). We have advocated this in the Study Group on Asian Dynamism of the Ministry of Economy, Trade, and Industry (METI), policy consultation with officials from the Ministry of Foreign Affairs (MOFA) and ODA implementing agencies, as well as through media and conferences. Official reception has been very favorable. Our next step is to present more visually and

⁴ In the area of financial and exchange rate policies, projection of Japan's own ideas onto the world already began with the New Miyazawa Plan for helping Asian crisis-hit countries (1998) and the Chiang Mai Initiative for regional central bank cooperation (2000). These were triggered by deep dissatisfaction with the IMF's policy response at the time of the Asian crisis. In trade, Japan concluded a free trade agreement (FTA) with Singapore (2001) and proposed FTAs with Korea, Mexico, ASEAN and so on. But similar activism has been slower in coming in the area of ODA policy.

concretely what the East Asian experience is for external dissemination.⁵

The two-track approach to economic cooperation is not really new. It is simply an affirmation of Japan's dual identity, engraved by its history since the mid 19th century, as an Asian nation on the one hand and as a member of the developed West on the other. Our proposal is to turn this dual identity, which plagued the policy makers in the past, into an advantage for active and flexible use in economic diplomacy. It should provide a framework for interpreting, appreciating, and expanding Japan's economic cooperation.

Looking back, Japanese ODA has contributed significantly to building infrastructure, human resource development, technical transfer, growth of small and medium enterprises, crisis response and so on, with East Asia as a main target. Simultaneously, Japan has cooperated constructively with developed countries in Europe and North America to tackle issues of global dimension. Asian dynamism and global concern have long been the two pillars of Japan's external contribution which are unlikely to go away. Affirmation of this situation will enable Japan to do both even better. It also permits Japan to moderate global development trends which sometimes go to extremes. But most important of all, the two-track approach will restore pride and confidence to the Japanese in their conduct of development cooperation.⁶

4. Industrial support in the age of globalization

To promote industries in East Asia and elsewhere, supporting policies must be the ones suitable for open and market-driven economic environment. The old-style industrial policy of fostering baby industries under the high wall of import protection is no longer available in our age of globalization. Newcomer countries are required to liberalize their trade regimes at much earlier stages of development than Japan and the West in the past, or even Korea and Taiwan in the 1960s and 70s. Policy innovation in industrial promotion is called for.

This hardly means that the government should stand idle. The experience of ASEAN

⁵ The World Bank's famous *East Asian Miracle* report (1993) did not win full approval of Japanese economists partly because it gave only a hedged nod on what East Asian officials considered as the essence of their development experience, and partly because it failed to analyze the region's production network as an enabling external environment for synergic growth; the report evaluated the policies of each country separately.

⁶ For more on this approach, see I. Ohno and K. Ohno, "Global Development Strategy and Japan's ODA Policy," GRIPS Development Forum Discussion Paper no.1, March 2002; and K. Ohno, "Reconfiguring Japan's ODA," *Japan Echo*, February 2002.

clearly indicates that the key to industrial development in open economies is attracting foreign direct investment (FDI) in both quality and quantity and using its impact to raise domestic capability over time. To accumulate FDI, economic opening is not enough. To offer superior locational advantages and low costs of doing business, additional targeted measures to improve domestic skills, infrastructure and institutions are needed. Efficient government services and good management of industrial and export processing zones also help. Primary education is important, but that alone will not upgrade domestic industries unless engineers and managers are also supplied. Traditional factors such as domestic market size, natural resources and low wages have become relatively less important.

At regional and global levels, policies are also required to supply international public goods, correct externalities and market failures, cope with international income gaps, coordinate macroeconomic and other policies, integrate economies and harmonize procedures, prevent and manage crises, and so on. We believe that the case for collective official action in the international arena is strong, especially when countries with different stages of development are involved.

Surely, these are not top-down, heavy-handed state intervention but much lighter, market-enhancing policies. Nevertheless, they must be executed well in order to take full advantage of foreign impact and build domestic capability. Laissez-faire policy will not do. In this area, too, ODA and other forms of economic cooperation can go a long way to supplement domestic efforts.

5. Vietnam: does PRSP work in East Asia?

Vietnam is a country with typical East Asian aspiration. It is located in the heart of dynamic Asia, but its economy has lagged seriously behind its neighbors due to the long period of wars and economic planning. The Vietnamese government is keenly aware of this situation, and hopes to catch up with the ASEAN forerunners as soon as possible. Domestic economic liberalization called *doi moi* began in 1986. From around 1993, Vietnam ended self-imposed isolation and normalized relations with international organizations and Western countries, including the US. It also joined ASEAN in 1995 and APEC in 1998.

A decade of international integration has transformed the Vietnamese society enormously. The economy has grown at an average rate of 7 to 8 percent, despite a mild slowdown in the recent years. Growth is driven mainly by external stimuli including FDI, ODA, tourism, and remittances from overseas Vietnamese and migrant workers. The export

base has already shifted significantly from primary commodities (crude oil, rice, fish, coffee) to manufactured products (garments, footwear, electronic components). However, a decade is not enough to escape from backwardness. Vietnam's market economy remains seriously underdeveloped and technology and competitiveness are very low. The per capita GDP in 2000 was still as low as \$390 (World Bank data). Vietnam's national goal is *industrialization and modernization* by 2020 and the key official documents for this are the Ten-Year Strategy and the Five-Year Plan. In sum, Vietnam is trying to participate in the East Asian production network as a latecomer—as its neighbors have done in the past.⁷

Since 1999, the World Bank and other donors (led by UNDP, UK, and Nordic countries) have introduced an aid coordination scheme for poverty reduction in Vietnam. Vietnam became a pilot CDF country and produced an interim PRSP (2000) and a full PRSP (2002). It is of great interest to know how PRSP, intended for a country with weak initiative, is received by the Vietnamese policy makers with strong pride and beliefs. Other countries in the region which must draft their own PRSPs (Indonesia, Laos, Cambodia, etc.) as well as some African countries are carefully watching the evolution of Vietnam's PRSP.

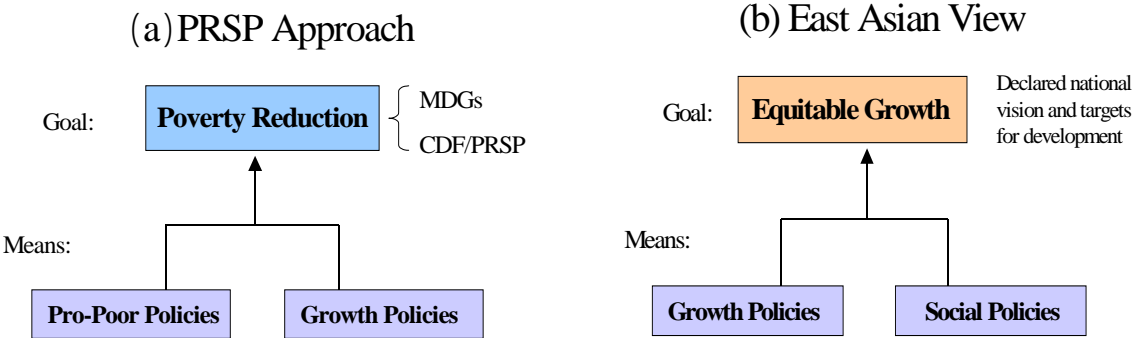
On the surface, Vietnam's PRSP is considered a great success by the World Bank and the international community at large. The main reason for this is Vietnam's strong *ownership* of the PRSP process, with a national team drafting the main report and adjusting its contents (it is hardly like that in most poor countries). The process has been even renamed to the Comprehensive Poverty Reduction and Growth Strategy (CPRGS), adding the term *growth* which the Vietnamese side insisted. At first, the authorities and the World Bank were at odds over the prioritization of growth versus direct poverty measures, but both sides exercised restraint so the process proceeded "successfully." All agree that growth and poverty reduction are closely related, but the precise relationship between them is left unclear.

Aid donors want to influence Vietnam's policies through CPRGS, but whether that will be acceptable to Vietnam is moot. Besides Japan, there are some donors in Vietnam who remain skeptical. My seven years of research experience in Vietnam also tells me it is highly unlikely. Compared with the Ten-Year Strategy and the Five-Year Plan, public

⁷ The Japan International Cooperation Agency is conducting a joint research project with Hanoi's National Economic University on Vietnam's industrialization strategy under globalization. This is a typical Japanese-style intellectual ODA featuring real-sector concern and respecting the individuality of each country and sector. See <http://www.neujica.org.vn/> for details.

recognition of CPRGS is very low. If CPRGS goes beyond simply copying and supplementing the existing official documents and begins to tilt the budget and public investment towards pro-poor policies, it will surely meet stiff resistance. For Vietnam, equitable growth is the declared goal which must be realized by a combination of growth and social policies (Figure 3). Poverty reduction as an exclusive national goal is an alien concept to the Vietnamese who fought long wars for independence and freedom. CPRGS can survive only as long as neither side rocks the boat by raising this issue.

Figure 3. Different Views on Growth and Poverty



Vietnam’s experience already clearly shows the impossibility of fitting East Asian aspiration into the PRSP framework. The deep conceptual gap may be papered over, but no real gain can be had by such a bureaucratic act. In a country with such strong ownership, we must ask fundamentally: why do we need a PRSP at all?

6. Not just in East Asia

I have argued—and the Japanese government is beginning to argue—for respecting the multiplicity of development experience. There should be diverse paths to prosperity, from which each developing country can select the right mix with ownership. At present, country ownership is limited to active participation in the common poverty reduction framework laid out by the donors, which is not enough. Furthermore, even goals of development should be many, since it is for each country to decide whether or not individual welfare and self-esteem should be always held above national pride and dynamism. For efficiency, aid procedures can be harmonized. But strategic convergence should be rejected in a world of great diversity. Difficulty emerges when procedure and strategy are not easily separable.

ODA for poverty reduction is charity in its essence, a benevolent transfer of income and knowledge from rich to poor. By contrast, ODA for active participation in global trade is aimed at releasing a young country's potential to become an equal partner or even competitor in the future. This may be too difficult for some of the poor countries to undertake today. But the door should always be open. We have no right to tell them that fighting poverty should be their only dream.

This is true for Sub-Saharan Africa as well. In fact, there are countries in Africa, Central Asia, Middle East, Latin America and elsewhere with high aspiration for excellence as in East Asia. They may not be in the majority yet, but policies should not be designed only for the majority. To help them, conditionality, policy matrices and other bureaucratic micromanagement are often counter-productive. Excellence is contagious. Good performance by a country galvanizes its neighbors. Let them copy good practice, but make sure to fully respect their autonomy and pride. From the sideline, donors can support them with proper encouragement, knowledge transfer and financial assistance. At its best, Japanese ODA in East Asia has had this character. Despite failures and disappointments, we have never lost faith in development assistance based on the principle of self-help. Outside East Asia, however, Japanese effort in this direction has so far been modest. It is time that the demonstration effect of excellence should be extended globally.