A comparative analysis of China and India
# BACKGROUND

- Official Development Assistance (ODA) from Japan has always been driven by a dual motive: developmental and strategic.

<table>
<thead>
<tr>
<th>Developmental (MOFA Discourse)</th>
<th>Strategic (METI Discourse)</th>
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<tbody>
<tr>
<td>ODA has been directed towards economies lacking in development and facing high poverty, disparity, environmental degradation</td>
<td>These developing economies are largely the ones noting high growth, thereby offering as a lucrative destination - huge market and growing demand; ability to pay back on ODA loans that conserves their fiscal resources</td>
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<td>The purpose of aid has largely been to help the developing economies build their infrastructure and generate employment for its large and growing population</td>
<td>The emphasis on infrastructure fulfils the needs of the recipients, while providing an opportunity to play on their own strengths; wherein they can engage through technical cooperation or future investments (DMIC, Metro) - “guided capitalism”; the large population is a source of cheap labour</td>
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<tr>
<td>Maintain peace, stability and prosperity in the East-Asian region and in the overall international community though this bilateral cooperation</td>
<td>Higher aim of building lasting economic cooperation for the benefit of Japan’s security and reestablish regional economic ties, while maintaining their presence at the UN Security Council. Moreover, aid has been biased towards the various south East Asian countries.</td>
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SALIENT FEATURES OF JAPANESE ODA

- Japan’s ODA program began in the form of reparations for war time damages inflicted on Burma, Philippines, Indonesia and South Vietnam over 1955-65 of the order of about $1 bn. To Thailand, Singapore and Malaysia it took the form of quasi-reparations.

- A high proportion of loans, negligible grants:
  - Emphasis on the role of self-help
  - Conserving fiscal resources as interest payments finance future ODA

- Dominance of untied aid
  - In 1980, only 25.8% of Japanese aid was untied (lowest among DAC countries) but through MOFA’s conscious effort, the untied component has risen rapidly to be among the highest today (almost 100% over 2007-09; OECD)

- ODA concentrated on Asian countries- ASEAN, China and India
  - Historical and political relations (war reparations)
  - Loans provided to middle income developing Asian countries

- Request based assistance

- Dominance of Hard infrastructure assistance
  - Stress on economic needs than social, creating visible infrastructure

- Government led and administered by JICA

- Preference for a bilateral approach than multilateral interventions or partnerships
Japan and China signed a peace and friendship treaty in 1978 following which the first ODA loan was sanctioned in 1979. This marked the beginning of Japan-China development assistance cooperation.

Japan has been China’s largest bilateral aid donor during the two period between 1979 and mid 2000s.

The share of Japan’s ODA in the total ODA received by China from DAC countries has been consistently high: starting at 60% in 1979, peaking at 80% in 1982, and plummeting post 2005 from 61% to a mere 12% in 2009.

Denominated in Yen, the loan aid from Japan has been declining since 2001, corresponding to the year in which China surpassed Japan in terms of GDP.
**WITHDRAWAL OF AID FROM CHINA**

Japan has recently reviewed its ODA policy for China, approving no new loans since FY2007; even though grant aid and technical cooperation continue. Japan’s view and criticism of providing aid to China are:

| Economic | • Japan dealing with fiscal strains and political turmoil within the economy  
• China gaining national power to become the 2nd largest economy after US, and surpassing Japan in terms of GDP  
• Astounding development in China’s coastal regions; with private firms now being able to raise funds from international markets, than rely only on ODA  
• With the ‘hard’ aspects of development in terms of infrastructure having dealt with, China now requires soft assistance in the form of institution building, development of legal systems etc; that cannot be solved using monetary assistance / funds |
| --- | --- |
| Political | • Modernization of Chinese military and their presence in the Japanese waters  
• Maritime disputes with Chinese in the South and East China sea  
• Nuclear testing by China, that questions the ‘use’ of Japanese ODA for defense purposes and reinforcing military power rather than undertaking developmental activities.  
• Lack of transparency in usage of funds |
| Strategic | • China assisting and providing ODA to other 3rd World countries  
• Lack of appreciation and gratitude for ODA from Chinese side |
Economic co-operation between India and Japan began in the year 1958 with the disbursement of the first ever ODA loan. The share of Japanese development assistance in total ODA received by India has been significantly increasing over the past few years to stand at 42 percent in 2010.

The ODA disbursements from Japan have been rising, reaching as high as 236.05 billion Yen in 2008; with the maximum rise of 21 percent over 2006-07. Even with the global economic downturn impacting Japan severely, the ODA disbursements to India have decreased only by approx 6.5 percent to reach 203.56 billion Yen in 2010.

Shift in priority of Japanese ODA flows from ASEAN to China and now to India, greatly corresponds to the importance Japan has placed on closer relations with each of these countries.
ANALOGY OF JAPAN'S AID PROGRAMS IN CHINA AND INDIA

<table>
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<th></th>
<th>India</th>
<th>China</th>
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<tbody>
<tr>
<td>Sectors of importance</td>
<td>Electric power and Gas Transportation Social Services</td>
<td>Transport Social Services Electric Power and gas</td>
</tr>
<tr>
<td>Total Disbursements</td>
<td>3,471 bn yen</td>
<td>3,316 bn yen</td>
</tr>
<tr>
<td>Total projects</td>
<td>231</td>
<td>366</td>
</tr>
<tr>
<td>Environmental projects</td>
<td>75 (33%)</td>
<td>110 (30%)</td>
</tr>
<tr>
<td>Enviro disbursement</td>
<td>1,527 bn yen (44%)</td>
<td>1,000 bn yen (30%)</td>
</tr>
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</table>
CHINA AND INDIA COMPARISON

Economic ties between China and Japan seem to be stronger than that for India and Japan:
- China is Japan’s largest trade partner; Japan too is the largest import partner for China
- India does not figure as an important trade partner for either of China or Japan.
- Japanese FDI to China has been of a much higher order than for India, declining since 2008, while surging in China post 2010
- Post 1979-80, China has consistently been a prominent recipient of Japanese ODA, with India surpassing China only in 2008- the year when Japan withdrew ODA from China!

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<tr>
<th>CIA, 2011</th>
<th>Export Partners</th>
<th>Import Partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>US, Hong Kong, Japan</td>
<td>Japan, South Korea, US</td>
</tr>
<tr>
<td>India</td>
<td>UAE, US, China</td>
<td>China, UAE, Switzerland</td>
</tr>
<tr>
<td>Japan</td>
<td>China, US, South Korea</td>
<td>China, US, Australia</td>
</tr>
</tbody>
</table>
JAPANESE ODA- A VANGUARD FOR FDI?

- Aid effectiveness literature proclaims that aid leads to growth; and investments form an important catalyst for achieving growth. The process can be defined as follows:

- Kimura and Todo (2007) found that aid facilitates FDI in less developed countries with the effect being peculiar in the case of source-recipient pairs where Japan was the source country for aid and FDI.
- With ASEAN-4 (Indonesia, Malaysia, Philippines, Thailand) and China having been the prominent Japanese aid and FDI recipients in the past, Blaise (2009, 2005 resp.) investigated the nexus between Japanese ODA and FDI for each, to find that aid flows did have a significant impact on private investor’s location choice.
- Today, India is the prime destination for Japanese ODA:
  - So, it may hold the key to raising the investment levels from Japan that are seen to be far below potential at present.
  - Aid and technical assistance in building infrastructure though aid flows (DMIC, Metro)
  - Country offices that disburse and manage aid could be important sources for information to the source country about the host economy (Embassy, JBIC, JICA); “quasi-government guarantee”.

"ODA" "FDI" "Growth"
ODA- A VANGUARD FOR FDI IN INDIA

- We recently conducted an analysis to test the effect of ODA flows on FDI received by India from five major donor and investor countries:
  - Japan, United States, United Kingdom, Germany and France

- We used robust OLS and System GMM estimation methods. The results are as follows:
  - Aid inflows in India (total, for infra activities or humanitarian purposes) has a significant and positive impact on FDI from DAC countries; 1% increase in ODA resulting in about 0.3% increase in FDI.
  - In the case of Japan, aid of all forms (infra or total) are seen to have an even higher positive impact on FDI; 1% rise in ODA leads to 1% increase in FDI.
  - The vanguard effect of ODA was found to be absent in the case of all the other DAC countries.
OECD’s policy guidance (2006) emphasizes on the role of ODA in mobilizing domestic and foreign investment; through a complementary process between the public and private sectors.

- The new aid approach is very similar to the way the Japanese have been providing their development assistance!
- “The policy making structure that governs Japanese ODA incorporates Japanese private sector to a greater degree than is commonly supposed” David Arase.

The firm - productivity literature states that it is the most efficient firms that investment, while the less efficient ones that trade. Hence, the low levels of trade between India and Japan should not be the reason for withholding investments, rather they may infuse higher bilateral trade through:

- Vertical FDI: higher trade due to exchange of intermediate goods
- Horizontal FDI: higher trade due to export of finished goods
- Though CEPA signed in August 2011 will also be significant, FDI could pay an integral role in raising bilateral trade levels.

<table>
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<tr>
<th>Year</th>
<th>Exports (Jap to Ind)</th>
<th>Share</th>
<th>Imports (Ind to Jap)</th>
<th>Share</th>
</tr>
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<tbody>
<tr>
<td>2011</td>
<td>US $ 11,045,255,000</td>
<td>1.4 %</td>
<td>US $ 6,789,259,000</td>
<td>0.8 %</td>
</tr>
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</table>
CONCLUDING REMARKS

- According to the Ministry of Foreign Affairs Japan, ODA for India is one of the important tools to strengthen India-Japan relations set forth by “Japan-India Strategic and Global Partnership.”
- The strengthening bilateral cooperation and the rising importance of India for Japan could bring higher investment which could potentially raise Indo-Japan bilateral trade as well.
- Since mid 2000’s the growth of Japanese companies in India has been phenomenal, second only to China with 926 Japanese Companies registered in Oct’12.
  - As per Japanese investor’s perception, India emerges as the most promising country for overseas business in the next 10 years (JBIC Survey Report 2012)
  - Tamil Nadu (followed by Maharashtra, Karnataka, Haryana and Delhi) is going to be the most promising state for investments in the next three years
- Though India and Japan relations have been growing stronger, they are far below China - Japan economic relations and are likely to rise as and when Japan withdraws from China. But the question is, would India be able to rise as high as China did?
  - Prof. Shinji Takagi claims that “India will not be the next China” seeing the abysmal investment and trade relations between India and Japan.
  - But rising levels of ODA and investments to make India a production and export base may prove otherwise!
- Japanese relations with ASEAN and China hold lessons for India; but the withdrawal of aid from China should make India wary of the future of its relationship with Japan
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- Blaise S. (2009); Japanese Aid as a Prerequisite for FDI: The Case of Southeast Asian Countries; Asia Pacific Economic Papers No.385
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- Embassy of Japan in India