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**JAPAN ENDS ITS YEN LOANS TO CHINA**  
**A study of the role of ODA in the bilateral relationship**

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## Summary

Japan has provided China with ODA since 1979, 75% of this aid has been given as yen loans. The loans have greatly contributed to China's economic growth through funding of industrial infrastructure projects. Next year when China hosts the Olympic Games in Beijing, Japan will phase out these loans. Although it will continue to provide China with grant assistance and technical cooperation the ending of the loans will have an impact on their future bilateral relationship. This is not only due to the amount of money that has been given but also due to the important role the loans have played since their initiation.

The yen loans have been at the core of Japan's engagement policy towards China. Through engagement Japan has sought to encourage peaceful and stable developments in China, both in terms of an open economy and in terms of a stable society. At the outset of Japan's aid program to China in 1979, China represented a potential huge market for Japanese trade, and Japan wanted to encourage China to keep up its open and reform policy which had been announced by Deng Xiaoping the previous year.

After the Tiananmen Square Incident in 1989, Japan started to reconsider its aid to China. The incident was a clear indication that considering Japan's motives for engagement, the policy did not achieve the desired results. The Japanese public was outraged by the actions taken on June 4 1989 and the public was to gain a more decisive say in the domestic Japanese politics as the LDP rule came to an end in 1993. That year a coalition government implemented new electoral rules and later governments established administrative reforms which gave the public more insight into and influence over Japan's foreign aid policy making.

As Japan suffered an economic recession after the burst of the bubble economy in the early 1990s, the public started to debate how much aid Japan should give and to which countries. China became a target for this discussion with its rapid economic growth, rising military expenditures, and actions it took that were deemed threatening to Japan's national interests, such as the nuclear tests in 1995.

This paper argues that the decision to end the loans is the result of a process that started in the early 1990s and which caused the Japanese foreign aid policy makers to review their engagement policy towards China. The ending of the yen loans can be seen as the end of a stage in the bilateral relationship, but Japan will continue its engagement policy towards China through grant assistance and technical cooperation. The target areas will no longer be industrial infrastructure but environmental conservation and human resource development in China. These are areas that are important to Japan's national security today.

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## Abbreviations

ASEAN	Association of Southeast Asian Nations
CCP	Chinese Communist Party
CHINCOM	China Committee of the COCOM
COCOM	Coordinating Committee for Multilateral Export Controls
CTBT	Comprehensive Test Ban Treaty
DAC	Development Assistance Committee
EC	European Community
EEZ	Exclusive Economic Zone
EPA	Economic Planning Agency of Japan
FDI	Foreign Direct Investment
FY	Fiscal Year
G7	Group of Seven (Canada, France, Germany, Italy, Japan, UK and US)
GDP	Gross Domestic Product
GNI	Gross National Income
JBIC	Japan Bank of International Cooperation
Keidanren	Federation of Economic Organizations (Japan)
LDP	Liberal Democratic Party (Japan)
JCP	Japan Communist Party
JEXIM	Japan Import-Export Bank
JMSDF	Japanese Marine Self-Defence Force
METI	Ministry of Economy, Trade and Industry (Japan)
MITI	Ministry of International Trade and Industry of Japan
MOF	Ministry of Finance of Japan
MOFA	Ministry of Foreign Affairs of Japan
NATO	North Atlantic Treaty Organisation
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development

OECE	Overseas Economic Cooperation Fund
OEEC	Organization for European Economic Co-operation
NPT	Non-Proliferation Treaty
OOF	Other Official Flows
PPP	Purchasing Power Parity
SDF	Self-Defence Forces in Japan
SDP	Social Democratic Party (Japan)
USSR	Union of Soviet Socialist Republics

## Introduction

During a visit by the Chinese Premier Wen Jiabao to Japan in April 2007 he and his Japanese colleague, Prime Minister Shinzo Abe, issued a joint press statement touching upon several issues within their bilateral relationship.<sup>1</sup> Concerning the economic cooperation between the two countries, they stated that: “Both sides shared the view that the Japanese yen loans to China which will conclude in 2008 played a positive role in the economic development of China and Japan-China economic cooperation...”(MOFA, 2007).<sup>2</sup> Japan has since the start of its ODA program to China in 1979 assisted China economically in three ways; through loan aid, grant assistance and technical assistance. Of the total amount of aid China has received, 75% has been in the form of yen loans, totalling 3, 1331 trillion yen by the year 2005(Söderberg, 2002a:9; MOFA, 2005b).<sup>3</sup> The yen loans given by Japan to China have been the most significant contribution to China’s economic growth because it is these loans that have supported China’s development of its industrial infrastructure (Takamine, 2006).

Japan’s decision to end its yen loans to China was officially announced at a press conference in the MOFA in March 2005. The MOFA’s Press Secretary, Hatsuhsa Takashima, confirmed that Japan was in consultations with the Chinese government about ending yen loans to China by the time the Olympic Games will be held in Beijing in 2008 (MOFA, 2005c). According to Mr. Takeshima, China’s remarkable economic development made it less necessary for Japan to provide big loans. Takeshima also stated that China’s organizing of the Olympic Games marks the major achievements by China and is therefore a suitable timing for the termination of the loans (MOFA, 2005c). The belief that China is ready to graduate from its loans may be linked to Japan’s own history as an aid recipient; Japan repaid its last loan to the World Bank in 1990. Now Japan is announcing that it observes a level of economic growth and development in China that Japan thinks qualifies China for graduating from receiving yen loans.

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<sup>1</sup> Throughout this paper I will refer to the *People’s Republic of China* as *China* and to the *Republic of China* as *Taiwan*. This choice has been made on the grounds of brevity and also because these are the terms used by the Japanese Ministry of Foreign Affairs.

<sup>2</sup> The abbreviation MOFA will be used throughout this paper to refer to the Ministry of Foreign Affairs of Japan.

<sup>3</sup> *ODA* is an abbreviation of Official Development Assistance; Japan gives ODA in the three following ways. *Loan aid* is loans given at concessional conditions such as a relaxed interest rate, and with a long repayment period. *Grant aid* is financial assistance that is given without the recipient country being obligated to repay it. *Technical cooperation* is the technology provided to a recipient country to promote the usage of technology in developing countries and to develop the technical skills of people there (MOFA, 2005b).

Although Japan has stated that China's economic growth has rendered its aid to China unnecessary; this explanation hardly addresses all the underlying reasons. Japan's aid to China has from the beginning been the core feature of its engagement policy towards China; an engagement policy that has been premised on multi-faceted motives. This paper argues that the decision to end the aid is based on a number of motives. To find the underlying reasoning behind the decision we must go back to the beginning of the 1990s. It was then that a turn came about in Japan's aid policy towards China; a difference triggered by domestic changes within Japan and in the international community. On the basis of this assumption, I will seek to answer the following question in this paper:

### **Why is Japan ending its yen loans to China?**

To answer that question I will investigate the underlying motives for Japan's inception of aid to China and look at how these have been influenced by changes in the international community and by domestic changes within Japan. As the intention of this paper is to explain Japan's decision according to its motives, this paper will be based on Japan's perspective of the aid relationship. Other studies of this topic have sought to investigate why Japan has provided China with aid although China is seen as an economic and strategic rival by Japan. Tsukasa Takamine (2006) seeks to answer that question and focuses on the continuance of ODA in spite of strained relations. My focus however is the discontinuation of the loan part of this aid and the process leading up to it. This has not been a one-dimensional development, rather it has been a dynamic process in which Japanese policymakers have been influenced by, and have influenced the role ODA has come to play in the bilateral relationship between Japan and China.

### **Structure of the paper**

The paper is divided into seven parts. The first outlines the theoretical base for the further discussion. It discusses the term ODA and offers a brief presentation of existing theories of Japan's motives for giving aid. The second part gives an historical outline of Japan's aid; starting with the context in which Japan's post war foreign economic policy came into existence and continues with the development of ODA as a diplomatic tool. An historical overview will then be given for Sino-Japanese relations from the end of the Second World War up to the initiation of Japan's ODA to China in 1979. This part aims to show the underlying interests that triggered Japan to start providing China with aid. Part three discusses



Japan's aid to China from 1979 until the aftermath of the Tiananmen Square Incident. Part four points to the changing perception of China that has developed in Japan as China has experienced a phenomenal economic growth, increased its military budget and taken actions deemed threatening to Japan's national interests. Part five outlines domestic changes within Japan which have affected Japan's aid policy towards China; electoral reforms, administrative reforms, and the changing role of the MOFA and the LDP in the making of aid policies towards China. Part six takes its basis in the ODA Charter and further discusses how Japan's aid to China has become increasingly political since the early 1990s. Three cases in which Japan has used its aid to sanction China will be referred to. One is the unilateral sanction by Japan following China's nuclear tests in 1995, the second is the delay of negotiations for the third aid package following the Taiwan Strait Crisis, and the third is the freezing of aid as a consequence of Japan and China's rivalling claims to the seabed surrounding the Senkaku/Diaoyutai Islands. The final part looks at how a review by Japan of its ODA to China resulted in a redefinition of target areas for Japan's ODA to China since 2001. This part ends with closing remarks on the current state of Japan's aid to China and the role it could get in the bilateral relationship after the Beijing Olympics are over.

## 1. What is ODA?

The term "ODA" was introduced by The Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD) in 1969. It defines ODA as a flow of money that has certain characteristics. It should be given by the official sector, have welfare and economic development in the recipient country as its main objective, and be given at concessional rates.<sup>4</sup> Another type of aid is Other Official Flows (OOFs) which are given by the official sector but do not meet the requirements of ODA either because they have a grant element of less than 25% or because they are not primarily aimed at development (DAC, 2007).<sup>5</sup>

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<sup>4</sup> The full definition of ODA is: Grants or Loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) which are: (a) undertaken by the official sector; (b) with promotion of economic development and welfare as the main objective; (c) at concessional financial terms [if a loan, having a Grant Element (q.v.) of at least 25 per cent]. In addition to financial flows, Technical Co-operation (q.v.) is included in aid. Grants, Loans and credits for military purposes are excluded. For the treatment of the forgiveness of Loans originally extended for military purposes, see Notes on Definitions and Measurement below. Transfer payments to private individuals (e.g. pensions, reparations or insurance payouts) are in general not counted (DAC, 2007).

<sup>5</sup> The grant element is found by looking at the interest rate and the time of repayment of a loan. The lower the interest rate and the longer the period the recipient has for repaying the loan the higher the grant element. Grants have a grant element of a 100%, loans are required to have a grant element of 25% to be termed as ODA (Japan Bank of International Co-operation, 2007).

The reason why I have chosen to look at Japan's ODA to China instead of its Foreign Direct Investments (FDIs) or its OOFs is because of the close link between ODA and Japan's foreign policy. According to the MOFA; Japan's ODA is Japan's most important instrument of foreign policy to promote peace and is a vehicle for international contribution (MOFA, 1994). Concerning Japan's ODA to China the aid has come to play an even more extensive role; it has become the core of Japan's attempt to influence China. In Japan's Economic Cooperation Program for China (2001) it is stated that it is in Japan's interest to encourage a continued open and reform policy in China and to encourage China to take an active role in the East-Asian region to promote stability and peace. It is further stated that ODA plays an important role in that process.

### 1.1 The origins of ODA

ODA as an expression was introduced by the DAC in 1969, but the roots to large-scale economic aid can be traced back to the year the Second World War ended in 1945. The European economies were devastated after the Second World War. There were two countries contesting for superpower status in the international community; the USA and the USSR (Union of Soviet Socialist Republics). The year the war ended representatives from 50 countries gathered at a UN conference in San Francisco; in the UN Charter drawn up there they stated that they would work "to promote social progress and better standards of life..." and "to employ international machinery for the promotion of economic and social advancement of all peoples" (Führer, 1996:4). At a speech held at Harvard University June 5, 1947 the US Secretary of State George C. Marshall presented the idea of US support for a recovery program for the European states. The program meant massive aid within a cooperative framework aimed at reconstruction (Führer, 1996). The year after the recipient states signed the Convention establishing the Organisation for European Economic Co-operation (OEEC), the predecessor to the current OECD. The Marshall Plan was initiated that same year.

There is no doubt that there were several interests underlying this large-scale programme by the Americans, some less altruistic than others. Acknowledging the fact that the US did empathize with the European countries that had suffered such terrible losses, in a war that had damaged the US too, trade would not amount to much if the US did not have the European markets to trade with. The overarching reason for the aid provisions however is found in the Cold War climate that existed at the time. This was officially pronounced at President Truman's inauguration in 1949; the American aid would be expanded and include

developing countries that were threatened by communism (Degnbol-Martinussen and Engberg-Pedersen, 2003:8). In 1950 this was incorporated into the Act for International Development which was approved by the Congress. The former USSR also used aid as political leverage. Stalin believed that it was in the interest of world communism to reconstruct and strengthen the USSR and to keep control over the Eastern bloc and China (Goldman, 1967).<sup>6</sup> Development assistance was therefore from its very beginning used as a political lever. In the Cold War days this was used in a power play between the two superpowers, in latter decades it has been used for different reasons, but nevertheless aid remains highly political.

Already with the introduction of the Marshall Plan political conditions were put on the aid given to the European countries. One of the conditions was that the European recipients should promote a market economy, (Stokke, 1995). Another condition was that the money should be used to buy goods from the US and that these should be shipped across the Atlantic on American merchant vessels (US.INFO.STATE.GOV, 2007). Conditions have been put on aid ever since, although the nature of these conditions has changed in accordance with changes internationally. In the mid-1950s aid to Western European countries was phased out and areas such as the Middle East, Asia, and later Latin America and Africa became new areas of attention (Stokke, 1995).

## 1.2 Foreign aid and international relations

Theories of international relations offer different answers to the question of donor countries' motives for giving aid to developing countries. The idealist school claims that aid is a measure to obtain world peace and prosperity, and views it largely as a moral obligation the developed countries have towards the developing ones (Pankaj, 2005). Three reports that have been very influential within this argument are the Pearson Report issued in 1969 and the Brandt Commission Reports issued in 1980 and in 1983.<sup>7</sup> All three emphasize the

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<sup>6</sup> The Eastern bloc included the following Eastern European countries: the Soviet Union and its allies; Albania, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania and Yugoslavia (Goldman, 1967).

<sup>7</sup> The Pearson report was the result of the work of the Pearson Commission; headed by the former Canadian Prime Minister Lester B. Pearson. The aim of the Commission's work was to review the result of aid given during the previous 20 years and to give recommendations for the future. At the time of the Report the international community was struggling with decreasing enthusiasm for international development. Recommendations in the report included giving specific targets for aid; total aid should amount to 1% of GNP and official aid should make out 0, 70%. The report further brought attention to fusing aid giving for moral reasons together with reasons grounded in nations' national interests (World Bank, 2003). In 1980 the Independent Commission on International Development Issues chaired by former German chancellor Willy Brandt issued what has become known as the Brandt report. This report too was ordered by the World Bank to provide new clues to the widening gap between the increasingly benevolent North and the increasingly

interdependency between the world's developed and developing countries. The reports state that because of the interdependency between developed and developing countries, aid will be beneficial to aid donors as well as to aid recipients. In a study of the growing role of NGOs in Japan, Keiko Hirata (2002) finds that an increasing influence of Japanese NGOs since the mid-1990s has resulted in a stronger emphasis on humanitarian concerns in Japan's ODA. The number of NGOs working with international cooperation in the country increased from 59 listed in 1980 to 368 in 1996 (Hirata, 2001:11). These NGOs are representing the viewpoints of the recipients of Japanese ODA and since the 1990s NGOs have cooperated with the MOFA in seminars, symposiums and conferences about aid. Japan has, and continues to be through its aid to China, concerned about the welfare of the Chinese people and the aid is also given on a humanitarian basis. It can be said that idealism is one of many motives present in Japan's aid to China, but it can hardly be related to Japan's decision to end its yen loans.

Liberalism views foreign aid as a benign tool to reduce frictions between countries; the more countries interact with each other economically, the higher the stakes of conflict for both parties (Polacheck, Robst, Chang, 1999). Liberalism is based on the belief that those with greatest gains from trade will risk the highest costs by entering into conflict. Therefore trade between countries will bring all those cooperating, economic benefits in the long run and will be discouraging to any conflicts (Polachek, Robs and Chang, 1999). Thus, countries engaging with other countries will reduce the danger of conflict with each other. This was also one of the initial motivations behind Japan's engagement policy with China. From the outset of the bilateral relationship between Japan and China after the war the Japanese Prime Minister, Yoshida Shigeru, was eager to pursue economic ties with China and thereby bring China closer to Japan and the US and away from the Soviet Union (Green, 2003). This was typical of the thinking of the time in which trade and aid were used as means to establish and keep allies.

The realist school views foreign aid as a foreign policy tool to promote the donor country's national interests. The theory arose in the Cold War era when aid was given primarily to influence the judgements of recipients (Hattori, 2001). Hans Morgenthau (1962) views foreign aid as a part of the political policies that are at the disposal of the donor country, and equals it to diplomatic and military policy. According to Morgenthau these three are all

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impoverished South. The report recommended large-scale transfers of resources to developing countries given on both concessional and market terms (World Bank, 2007a).

“weapons in the political armoury of the nation “(Morgenthau, 1962:309). In Japan’s case foreign aid becomes more important because it lacks one of the two others; an army. Due to Japan’s Constitution, Article 9, Japan can not have an army. A consequence of this is that Japan focuses more on its political and foreign aid policy, both of which have been actively used in its dealings with China. Another reason for Japan’s focus on aid is the military protection it had under US rule which also resulted in a strong influence by the US on Japan’s foreign policy.

Realism however, does not cover Japan’s motives; one reason is that Japan has kept its military build-up on a restricted scale. The fact that Japan has continued to provide China with aid in spite of the latter’s rise in military expenditures also questions if realism is sufficient to explain Japanese motives. Now that Japan is ending its largest portion of aid to China, one could claim that this is a move to restrain China and therefore say that the discontinuation is used as a diplomatic tool to restrict China’s military growth. Even though Japan’s loans have been significant to China’s development however, Japan’s ending of the loans will not be the end of economic support for China. Through efforts to deepen trade relations and the continued provisions of grant assistance and technical assistance after 2008, Japan is showing that it still wants to have a close relationship with China but that it is convinced there are better ways of doing so at the current state of affairs. Realism might offer some valuable insights, but seems too simplistic to explain the spectre of motives governing Japanese objectives for its aid.

### 1.3 Japan’s motives for giving aid

Japan has been criticized for targeting its aid too much on its own national and economic interests, such as in the Peer Review of Japan in 2003, published by the DAC in 2004.<sup>8</sup> In its recommendation for the future aid program of Japan it recommended that Japan should make sure that its narrower national interests do not weigh more heavily than the broader objective of development in the recipient country (DAC, 2004). Most aid donors have a combination of motives for providing developing countries with aid. As Schraeder, Hook and Taylor (1998) found in their cross-country study of Swedish, American, French and Japanese motives for giving aid; these are closely linked to national interests of the donor

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<sup>8</sup> A *peer review* by the DAC is aimed at monitoring individual member countries’ policies and efforts in the area of development co-operation. Reviews of countries are done every four years by representatives from the DAC’s Secretariat and officials from two of the DAC’s member countries. After research has been done in the country under review, a draft report is presented and other DAC members can pose questions to official representatives from the country in question. A report is then presented with findings and recommendations for the country that has been reviewed (DAC, 2004).

countries, such as trade interests. In the case of the US they found that motives were also linked to security alliances.

Even though Japan is not the only country to observe foreign policy interests in its aid provisions, there are fundamental differences in the traditional basis of its aid donations. Two factors are imperative to take into account when discussing Japan's aid. One is the fact that there has never been a long tradition for charity in Japan in the form it has been found in missionary activities by Western countries. In Norway the ODA programme initiated in 1953 to India, was given to a country in which Norwegian missionaries had been active. The aid given to India was given through a collective collection campaign and the Norwegian Government contributed with 14 million Norwegian Crowns (Bøås, 2002:5). Later Norwegian aid was also given to primarily Anglophone areas of the African continent. These African countries had also been the aim for Norwegian missionary activities and because people in these countries already spoke English, it facilitated further development work in the area. The Christian tradition of providing poor people with aid in Scandinavian countries has a long history. Amongst the most important aspects of this is the "tithe" that citizens of Christian countries had to pay (Söderberg, 2005). This meant that citizens paid a tenth of their income to the Church; a part of this was given to the poor. In Japan, no such tradition had existed. Although there was a concept of "dāna" within Buddhism which meant religious giving to Buddhist monks, this was mostly given on an individual basis for each citizen to improve their karma and was not a state orchestrated effort (Ornatowski, 1996).

The other is that Japan itself has a history as an aid recipient; this has fostered a sense in Japan of providing developing countries with help to self-help. Japan became a member of the World Bank in 1952 and received a total of US\$863 million in loans from 1953 and until the final loan agreement was signed in 1966 (World Bank, 2007b). Two underlying reasons why Japan has been accused of having a foreign economic policy that puts a too strong focus on its own economic interests is the large proportion of tied aid, at least until the 1980s, and the strong focus on giving aid to the development of the industrial sector in recipient countries (DAC, 2004). The role Japan's economic aid to other countries played in Japan's economic recovery, and Japan's need to reconstruct its industry and gain access to export markets after the Second World War, gave a special context for Japan's aid donations. This context has resulted in other objectives for Japanese aid than may be found in Western countries, and should be taken into consideration when discussing Japan's aid vis-à-vis other countries. The following section starts with a discussion of theoretical approaches to Japan's motives for giving aid. The final part of this section provides an historical outline of the development of

Japan's aid program from its beginning in the 1950s and until 1979 when its aid to China was initiated.

#### 1.4 Theoretical approaches to Japan's motives for giving aid

There are various approaches to explaining Japan's underlying motives for giving aid. These will briefly be outlined here to give an assessment of how they relate to Japan's aid to China.

##### 1.4.1 Gaiatsu, or foreign pressure

The term "gaiatsu" means foreign pressure but has come to refer to American pressure on Japan. Kent E. Calder (1988) found that it was Japan's reliance on the USA for military protection in the post war era that formed the tendency by Japan to follow the Americans' foreign policy. Calder further states that the Japanese domestic social and political structure which was rather fragmented with several ministries vying for their own causes, made Japanese policy-makers more prone to rely on US initiative. One of the examples he offers is that of the American's pressure on Japan to start providing South-East Asia with war reparations in the 1950s to lessen the appeal of China to Japan as a foreign market (Calder, 1988). That Japan followed the Americans in providing the reparations is evident, but at the same time Japan did use available channels to trade with China even during the Korean War when Japan and China were on opposite sides of the conflict (Iriye, 1990).

Akitoshi Miyashita (1999) supports Calder's claim that Japan is reactive but differs when it comes to the choice Japan has. Whereas Calder describes Japan as unable to resist pressure from the US, Miyashita claims that it is Japan's desire to avoid disruptions in its bilateral relationship with the US that causes it to respond to US pressure. This is the result of a policy that Japan has chosen rather than a result of inability to resist the pressure. He refers to Japan following the lead of the US and Europe in both using its aid to sanction China after the Tiananmen Square Incident, and in lifting the sanctions the following year.<sup>9</sup> A more detailed discussion of the actual process of Japan's response to outside pressure following the Incident in 1989 will be given in the section about that topic. There are several examples of Japan taking an initiative towards China that have not been based on US recommendations.

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<sup>9</sup> In this paper I will refer to what happened at Tiananmen Square in Beijing in 1989 as the "Tiananmen Square Incident". There is an ongoing discussion as to whether this should rather be called a massacre. Although I do acknowledge the violence of the actions, I have chosen to refer to it as an incident. The main reason is that this is the way it has been referred to by official Japan and the wording also describes Japan's careful approach to what happened there. It is however, not my intention to downplay the event in any way.

One is the initiation of Japan's aid to China in 1979. The move was supported by the US but was not initiated nor suggested by it. Another example is the unilateral sanction taken by Japan towards China after the latter's nuclear tests in 1995 (Katada, 2001).

#### 1.4.2 Proactive state approach

Contrary to the view of Japan as a reactive state, Dennis T. Yasutomo (1989-1990) claims that in the field of foreign economic aid Japan has shown a great deal of activism and involvement. Through a historical outline of the usage of Japan's aid within its policy framework he claims that since the 1980s Japan has used aid to pursue broader diplomatic and political objectives.

#### 1.4.3 Aid as a commercial instrument

It has been a widely shared belief that Japan has used its aid to promote its own trade interests. Margee M. Ensign (1992) finds in her study of Japan's provisions of aid that the country's aid program is still, despite a shifting official rhetoric, largely governed by commercial interests. The shifting official rhetoric referred to here is Japan's implementation of an ODA Charter in 1992, which will be discussed in part six. Steven W. Hook and Guang Zhang (1998) agrees with her position and states that the so-called METI discourse which advocates promoting Japan's economic and trade interests through its aid is still influential.<sup>10</sup> This in spite of the implementation of the ODA Charter which was influenced by the MOFA discourse; advocating the pursuit of political reforms in recipient countries which was promoted by the international community at the time (Hook and Zhang, 1998).

Looking at aid flows from Japan to recipient countries, the sectors they support and their tying status, Ensign finds that Japan's bilateral aid is based on mercantilist policies (Ensign, 1992). According to her study Japan has been focusing capital on projects that are commercially sound, and is primarily concerned about promoting its own commercial interests. David Arase (1994) also finds Japan's ODA policy to be closely connected to Japan's economic interests and explains this with the structure of the aid policymaking and implementation. According to Arase, close connections between the bureaucracy and the private business sector has resulted in business interests having a strong influence on the way Japan deploys its aid (Arase, 1994). Another reason is the role played by the METI in setting up Japan's economic cooperation program in the 1950s. Japan's post war economic

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<sup>10</sup> The METI is the successor of the METI (Ministry of Economy, Trade and Industry) which it replaced in 2001 (METI, 2007). I will refer to the METI throughout this paper.



cooperation program was based on the need both to improve relations with other countries and to promote industrial recovery and growth. The emphasis on industrial and trade policy goals gave the METI a prominent role within the economic cooperation program.

China presented a huge potential market for Japan after the Second World War and the decision to initiate aid to China came partly as a result of Japan's wish to re-establish the plant contracts that had been lost as China had not been able to keep its part of the bargain in 1979 (Takamine, 2006). That was not the only motivation however, ensuring a stable China politically was just as an important incentive behind Japan's aid program. Since 1979 Japan's commercial interest in China has contributed to a close relationship between the two powers but it has not been the only reasoning behind it. Explaining Japan's aid motives solely based on commercial interests would be to simplify a set of aid motivations that are far more complex. The case of Japan's aid to China has been just as influenced by politico-strategic interests as it has by commercial ones.

#### 1.4.4 Mercantile realism/reluctant realism

There are also those approaches to Japan's aid that try to combine commercial and strategic interests. Recognising that Japan's motives for giving aid are complex and influenced both by mercantilist interests and politico-strategic ones, Eric Heginbotham and Richard J. Samuels (1998) use the term "mercantile realism". This refers to Japan pursuing both commercial and security interests through its foreign economic policy. In cases where military and economic activities have clashed, they claim that Japan has given supremacy to the economic interests (Heginbotham and Samuels, 1998).

Another term which points to the dualistic motives underlying Japan's aid is the term of "reluctant realism" employed by Michael J. Green (2003). According to Green; Japan relies primarily on economic tools for power and influence in the international community. He does acknowledge that there has been a shift in Japan's approach towards a more realist approach as China has come to be perceived more as a rival in economic and military terms since the beginning of the 1990s. Green points to the interplay between economic and military interests in Japan's aid to China but claims that the weight of these considerations have shifted in Japan's engagement with China. From being based on commercial liberalism, by that is meant the belief that economic engagement with another country will spill over into other areas of the bilateral relationship, to a more realist approach. Japan does not strictly follow the realist approach however. Such an explanation would not have been able to explain Japan's continued engagement of China in spite of China's development as an economic and military

rival to Japan. In trying to explain Japan's motives for giving aid to China and for ending aid to China, the policy of engagement seems to offer the most complex insights.

### 1.5 The policy of engagement

In dealing with Japan's complex ODA relationship with China, the policy of engagement seems applicable because it enables us to consider economic and political motives as well as domestic and cultural motives. Tsukasa Takamine (2006:18) refers to the concept of engagement as "a relationship of sustained interaction over a long period initiated by one state to promote positive relations with another state". In writing about Japan's aid to China, Takamine uses the term "engagement" to describe Japan's attempt to interact with China militarily and economically.

A basic proposition underlying engagement is the belief that close contacts between nations increase communication and interdependence, therefore the cost of entering into conflict becomes greater and less tempting (Schweller, 2006). Aid has been the core of Japan's engagement policy vis-à-vis China although the motives for this engagement have changed according to changes in the bilateral relationship. Reinhard Drifte (2002) claims that engagement is based on both liberalism and realism. He acknowledges the liberalist element in engagement through its focus on enhancing economic interdependence between countries thus promoting a peaceful international community, but also points to the element of balancing other powers through the use of engagement. Japan's security policies towards China have focused on hedging against China with a close alliance with the USA, while engaging China through economic and political co-operation. It can be claimed that the liberalist element had the upper hand when Japan's aid program to China was initiated until the beginning of the 1990s and that the realist element has gotten a firmer hold as Japan's image of China has changed.

It was the Japanese Prime Minister after the Second World War ended, Yoshida Shigeru, which advocated the policy of engagement to bring China closer to Japan and the US (Green, 2003). Until 1979 this was done via trade, which was possible due to the policy of "separating politics from economics", but external as well as domestic restraints hindered any official economic assistance before 1979. Another motif for Japan was to gain access to the vast market that China represented. A third motive was Japan's wish to encourage China to continue its newly announced policies of opening up the country to more trade with the outside. It was Japan's intention to encourage China to have a more open, stable society and to take greater responsibilities as a member of the international community (MOFA, 2001).

When the power relations between the two countries started to change however, Japan's aid took on new roles within the engagement. As Japan saw China rising economically and militarily and as this increasingly came to be seen as a threat to Japan's own interests, the engagement Japan was pursuing vis-à-vis China took on a different role. Japan started to use it to influence China to pursue policies that would not be detrimental to neither Japan nor to the wider international community.

I would like to base the further discussion on Randall Schweller's definition of engagement: "engagement as a strategy is the "use of noncoercive means to ameliorate the non-status quo elements of a rising power's behaviour" (Schweller, 2006:36). Since the beginning of the 1990s, Japan has used its aid as political leverage in engaging a China that is rapidly progressing, both economically and militarily. Following this development Japan's aid tool has been used more to press for a policy that it believes will be in Japan's own national interests. In this way, Japan has made the connections between its foreign policy strategies and foreign aid policy towards China correlate. Despite other skirmishes in Sino-Japanese relations, one factor has remained constant; Japan's wish to engage China. The motives for this engagement and therefore for Japan's aid however, have changed following changes in the international community as well as domestically within Japan since the beginning of the 1990s.

It is this process of how changes have affected Japan's engagement strategy that will be investigated in the following sections. Suffice it to say that the theoretical background for the further discussion of Japan's aid to China is that Japan has wanted and still wants to engage China economically and politically. ODA has been and continues to be the most prominent tool available to Japan to be able to do so. Since Japan's aid has become one of its most important diplomatic tools in foreign relations, a shift in Japan's foreign policy approach to China has spurred a new usage of Japan's ODA in its engagement with China.

When aid began in 1979, China was a poor country with 250 million people living under the poverty line. Since the beginning of the 1990s however, economic growth rates have averaged more than 9% annually. In 2001 the number of rural poor in China had been reduced to 20 million (Fan and Chan-Kang, 2005:9).<sup>11</sup> Aside from the improvements in living standards shown by these numbers, the power relations between Japan and China have changed and this has also caused Japan to redefine its aid to China (Drifte, 2006). Still within

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<sup>11</sup> These numbers are found by using China's estimate of the poverty line which is US\$0, 66 per capita per day. Had the international standard for poverty line of US\$1, 00 been used however, the World Bank estimates that the number of rural poor in China in 1998 was 100 million and the number of urban poor was 20 million (Fan and Chan-Kang, 2005:9).

the parameters of engagement, the way it has engaged China has changed. As China started its advancement in the international community, its neighbouring countries had to decide how they could best deal with the rise of China. When Japan started to use its aid to sanction China, this could be seen as a consequence of the failure of that engagement policy. When the country committed to engaging another sees that this policy fails, it may use its diplomatic tools as rewards or threats to make the power it engages conform to the desired behaviour.

Japan has chosen to continue its economic engagement, and will continue to provide China with aid beyond 2008. That aid, however, will be in the form of grant aid and technological assistance and will mostly be used for social and environmentally linked projects. The changes in Japan's aid policy that have caused the decision to terminate the loans have thus not caused the end of economic engagement, but a change in the motives for it. It was after the Tiananmen Square Incident that Japan started to redefine its usage of aid in dealing with China, as a consequence of what Japan perceived as the failure of its prior engagement policy. It was not the incident itself that triggered it, but it correlated with changes in Japan vis-à-vis China that made the changes in China seem threatening to the national interests of Japan.

This is seen in terms of Japan's aid to China several times from the late 1980s onwards; first after the Tiananmen Square Incident in 1989 when Japan used its aid as a tool to sanction China for the first time. It was seen more clearly when Japan unilaterally froze aid to China following China's nuclear tests in 1995. Since the end of the 1990s Japan has continued to engage China but this has been in new areas adapting to the changing environment surrounding the aid. The problems that are addressed now and that were outlined in the MOFA's "Economic Cooperation Program for China" issued in 2001, point to improvement in environmental conservation and to decreasing the disparities between China's richer urban population and poorer rural population as new target areas. The engagement policy has remained but has changed its expression and focus areas.

## **2. Japan's aid**

Japan's aid program came into existence within the Cold War climate and under patronage of the United States. Following the Second World War Japan's Prime Minister Yoshida Shigeru put great emphasis on the US-Japan alliance in Japan's foreign policy. This policy of close alliance with the United States, minimal military rearmament and a focus on economic recovery shaped the basics of Japan's foreign policy well beyond the immediate post war years (Green, 2003). Understanding what has come to be known as the Yoshida

Doctrine is vital to understand Japan's relationship with the outside world then and now. In 1947 Japan's Constitution was approved and its article 9 stated that Japan could not have an army (Green, 2003). The only form of protection which was allowed was the Self-Defence Forces (SDFs), which were formed to protect Japan from outside threats and to uphold law and order on the islands. These forces were not allowed to participate actively in any conflict abroad. The consequence of this is that, in the words of Morgenthau (1962), Japan has one weapon less in its political armoury. Japan therefore puts a stronger emphasis on the latter two; diplomacy and foreign aid.

## 2.1 Actors in Japan's ODA policy making

Before briefly outlining the historical development of Japan's ODA it is important to mention Japan's system of ODA policy making. Three ministries and a bureau have all come to the negotiating table with different interests to vanguard. The four main actors involved in the Japanese ODA policy making have been the MOFA, the METI, the Ministry of Finance (MOF), and the Economic Planning Agency (EPA).<sup>12</sup> All these actors have their own interests to protect and their own constituencies to please. The MOFA, which has close relations with foreign governments, is liable to outside pressure for Japanese aid to address international concerns (Hook and Zhang, 1998). The METI is eager to address Japanese economic concerns and to please the business sector in Japan. The MOF on its hand tries to keep tight control over the money being disbursed as that is the ministry with the money for disbursement. Since the start of Japan's program of economic cooperation, the METI and the EPA have worked with Japanese industry and commerce to acquire raw materials and to establish export markets (Arase, 1994).

The MOFA is seen as the coordinator of Japanese aid; the applications for aid are given to them and it is here that the decisions are made. The MOFA has traditionally had the most access to diplomatic information concerning China, such as first-hand experienced diplomats which have served there. Therefore the MOFA has had great influence on aid policy making towards China (Takamine, 2006). The MOFA has the overwhelming authority in terms of grant aid and multilateral assistance. Concerning yen loans it is, theoretically at

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<sup>12</sup> The EPA was eliminated from the ODA policy making process in 2001 when its functions were taken over by the Cabinet Office. It had up until then supervised the functions of Japan's Overseas Economic Co-operation Fund (OECF), which was merged with the Japan Export-Import Bank (JEXIM) in 1999 to become the Japan Bank for International Cooperation (JBIC). The supervision of the JBIC are now under the jurisdiction of the MOFA (Kawai and Takagi, 2004:6).

least, the JBIC established in 1999, which is in charge. In practical terms however, all three ministries and the EPA have had authority over every loan extended.

Aid from Japan to China is implemented through cooperation between several ministries within both countries. Yen loans are handled by the Chinese State Planning Commission. They decide how much money China can borrow from abroad; this is regulated under the philosophy that China should not use foreign loans to cover more than 50% of the cost of a project (Söderberg, 2002b:119). This policy enables China to keep control over all projects. At the initial stage the relevant ministry or planning committee in China which is seeking support from Japan applies to the Chinese State Planning Commission for permission. Upon receiving these applications the Commission decides which projects should be financed with Japanese loans. Afterwards the list is sent to China's State Council for approval. Then the State Planning Commission presents the list to the Foreign Financing Administration of the Finance Department at the Ministry of Finance in China. Finally it is the State Planning Commission and the Ministry of Finance which start negotiations with officials from the Japanese government over loans to be implemented (Söderberg, 2002b).

## 2.2 An historical overview of Japan's aid

To Japan, its aid represents a constructive diplomatic tool through which it can boost its image as a country that takes responsibility in the international community and that can take assertive action in dealing with other countries (Yasutomo, 1998-1990). Due to Japan's difficult record in the region because of war aggression in the Second World War, it has focused on the act of giving foreign aid as a way to pursue an active foreign policy in a way that does not arouse fears in neighbouring countries. In the following part I will divide Japan's history as an aid donor into three sections; (1) mid-1950s when the war reparations started until 1973 when the OPEC oil crisis broke out, (2) 1974 to 1979 when Japan's aid policies were affected by the oil crisis and by Prime Minister Tanaka's ASEAN trip to Southeast Asia and (3) 1979 to 1985 when aid started to be given to areas of strategic interest. The aim of this historical background is to assess the factors that influenced Japan's aid over time and to establish the external context in which Japan initiated its aid program to China.

### 2.2.1 1955 to 1973: war reparations and the start of "economic cooperation"

Japan's aid was initially initiated in the form of economic co-operation and technical assistance to Asian countries. It was decided in the Potsdam Declaration issued on July 28 1945 that Japan should pay war reparations to the countries it had occupied during the

Second World War (Arase, 1995:24). It was the Secretary of State from the USA, John Foster Dulles that initially pressured Japan into giving reparations to countries that had suffered under Japan's war aggression during the Second World War (Bøås, 2002).

A total of 1,000 factories were to be transferred as reparations to other countries. Because of a disagreement between the US and the Soviet Union on how the distribution of these assets should be done, it was decided that 30% of them should be divided among several countries (Arase, 1995:25). Taiwan would get half; the rest should be given to the Philippines, Holland and to England. These transfers were largely completed by 1950 when the US stopped further transfers fearing that it would be damaging to Japan's further development.

That same year Japan offered its first economic assistance through the Colombo Plan, an inter-governmental body focused on the economic and social development of member countries in the Asia-Pacific region.<sup>13</sup> Japan pledged to give US\$50,000 through the Colombo plan in 1954. It also started giving war reparations to Burma that year, reparations to the Philippines followed in 1956 and to Indonesia in 1958 (Söderberg, 2002b:5). These reparations were focused on re-building what had been destroyed during the war, and were often tied to procurements from Japanese companies. From the outset of war reparations these were guided by the wish to promote exports for Japan's heavy and chemical industries and to secure resources. This led to an emphasis on the Southeast Asian region.

The Americans were aware of Japan's need for new markets to replace China as a source of raw materials and as a destination for exports of industrial goods and saw Southeast Asian countries as a viable alternative. Prior to the War 27% of Japan's exports had gone to China and imports from China had made up 27% of total imports to Japan (Armacost and Pyle, 2001:13). The loss of a market of the scale China had been to Japan meant a great deal and the US understood that if it wanted to keep Japan away from China it needed to provide Japan with a viable alternative. A good trade relationship between Japan and South-east Asian countries was believed to encourage the South-east Asian countries to stay in the non-Communist camp. This rationale was instrumental in Japan's provisions of aid to these countries (Takamine, 2006). It can be claimed that both mercantilist and political objectives governed Japanese aid this initial stage.

The start of Japan's loans came in 1958 with the signing of a yen credit to India worth \$50, million. The yen loan would be extended over a three-year period by the JEXIM to the Indian government and would finance India's payments for Japanese services and plant

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<sup>13</sup> The Colombo Plan was the result of a Commonwealth Conference held in Colombo, Sri Lanka in January 1950.

equipment (Arase, 1995:39). Throughout the 1960s, aid was given almost exclusively to Asian countries, that all changed with two important events in the 1970s which made Japan appreciate the usage of aid as diplomatic tool. One was the OPEC oil crisis, the other was Prime Minister Tanaka's tour to member countries of the Association for Southeast Asian Nations (ASEAN).

### 2.2.2 1973-1978: aid as a foreign policy tool

In 1973 the member countries of OPEC (Organization of Petroleum Exporting Countries), together with Egypt and Syria, declared a boycott on oil shipments to any country that had supported Israel during the Yom-Kippur war. Among these were the US and Japan which was a close ally of the US. At the time Japan relied on the OPEC countries for 80% of its oil supplies, so the oil embargo imposed by the Arab countries shook Japan's economy (Pookong, Nakada, Take, 1996: 13). It experienced its first negative growth rate since the end of the Second World War. Right after the crisis, Japanese high-level emissaries went to the Middle Eastern and Northern African countries to improve Japan's image and economic activities there.

The ODA commitments that were made were connected to getting access to petroleum. This move had two important consequences for Japan's further aid-policy; it was the first time Japan had actively taken a different position from the US in its foreign policy and it made Japan realize that its aid could be used to gain policy concessions such as natural resources from other countries. In the period 1973 to 1978 the share of Japanese ODA going to the Middle East and Africa increased from 2,7% in 1973 to 29% in 1978 (Arase, 1995:76). This move was successful and the oil embargo was eventually lifted. China represented a geographically more approximate import market for oil and gas. The complementarities between the two countries' economies, China's vast oil and gas resources and Japan's technological expertise, were key foundations behind the initial trade agreement signed between the two countries; the Long Term Trade Agreement (LTTA), signed in 1978.

There was a growing anti-Japanese movement in ASEAN countries in the early 1970s; by 1973 to 1975 this movement had spread to universities in almost the entire ASEAN region (Atarashi, 1984-1985). It culminated in January 1974 when the Japanese Prime Minister Kakuei Tanaka went on a trip to ASEAN countries and was met with riots in Jakarta and Bangkok. The Japanese were discouraged by these events as they had given large sums of ODA to the region. They believed that the anti-Japanese sentiments had been triggered by an image of Japanese operating in those countries as only serving their own economic interests



and saw the need to enhance efforts to increase mutual understanding. These reflections were the origins of the so-called Fukuda doctrine, announced in 1977, which emphasized that Japan would contribute to cooperation with the ASEAN countries in a peaceful manner; through ODA and efforts to enhance cooperation and understanding. Military action was renounced as a way of action in the future.

### 2.2.3 1979-85: from “economic cooperation” to “aid”

The second oil crisis in 1979 solidified Japan’s belief that aid was an important tool to ameliorate relations with countries strategically important to Japan. An interesting change in Japan’s discourse about its foreign aid came about in the early 1980s. Previously the Japanese had used the term “economic cooperation” when referring to foreign aid; this term covered ODA, OOFs and private flows. From the early 1980s however, the term “aid” was referred to (Yasutomo, 1989-1990). This verbal change signified a more practical change as well; the move from aid as a part of a foreign economic policy was now being openly incorporated into Japan’s foreign policy. Japan also started to put more emphasis on humanitarian needs in recipient countries. This was expressed in a speech by the Japanese Prime Minister Zenko Suzuki in Bangkok January 1981, the last stop on a tour of ASEAN countries. Although similar viewpoints had been stated earlier, he announced that in the future Japan’s aid would focus on (1) rural and agricultural development, (2) development of new and renewable energy, (3) human resource development and developments of small and medium-sized businesses in recipient countries (Brooks and Orr, 1985:7). In spite of statements like this, the need for an overall clearer aid philosophy was pressing, especially as Japan suggested using it as a contribution to the U.S. - Japan alliance. Their bilateral relationship had been fraught by trade frictions in the 1980s and Japan came under increasing pressure from the U.S. to assist the US more as a consequence of the Soviet invasion of Afghanistan and the Vietnamese invasion of Cambodia (Yasutomo, 1989-1990).

As a response, Japan suggested that it could support the US’s military operations by providing aid to countries strategically important to the US. Under Prime Minister Masayoshi Ōhira, Japan started providing aid to countries that were important to Western interests. Amongst the countries that were added to Japan’s list of recipient countries in this period was China (Yasutomo, 1989-1990). The US did not deem Japan’s attempt of this “check book diplomacy” as sufficient and Japan’s lack of a clear aid philosophy did result in criticism from the US when the problem of aid and international contribution again came to the forefront following the Gulf War in 1990-1991.

### 2.3 Sino-Japanese relations after the Second World War

The Japanese government headed by Yoshida Shigeru was from the end of the Second World War interested in pursuing economic relations with China. This philosophy was based on commercial interests as well as political ones. In the context of the Cold War the belief that aid could be used for influence also influenced Japan's aid program. To Shigeru, China was vital to the economic recovery of the devastated post war Japanese economy. He further believed that if Japan engaged China economically, that would steer China away from Moscow by providing an economic alternative to reliance on the Soviet Union (Green, 1999). According to Prime Minister Shigeru; if Japan contributed to a prosperous China he believed that this would encourage China to become friendly with Japan and the United States (Green, 1999). As Japan was occupied by the allied forces headed by the US however, trade with China was barely allowed and proved increasingly difficult as the US tightened its grip on its allies in Japan.

Following the end of the Second World War China plunged into a civil war which eventually made the Nationalists flee to Taiwan to form the Republic of China and for the Communists to rule on the mainland, forming the People's Republic of China. From 1945 to 1952 Japan was ruled by the SCAP (Supreme Commander of the Allied Forces) and formed a strong alliance with the USA with the signing of the US Japan Security Treaty in 1951. The Chinese formed a close alliance with the Soviet Union with the signing of the "Sino-Soviet Treaty of Friendship, Alliance and Mutual Assistance" February 1950 (Takamine, 2006). Thus Japan and China belonged to two different camps after the war ended, which inhibited a close relationship between them.

### 2.4 Within the framework of the Cold War

The Japanese business community was keen to re-establish and develop economic relations with China after the end of the Second World War. Under US administrative control, this was not easy. It was with China's participation in the Korean War that the US started to take a hard line towards China, as Chinese and American troops clashed on the Korean peninsula. This view was further strengthened when the United Nations labelled China as an aggressor for its intervention in the war. From then on, the US started a policy of containment of China, and Japan which depended on the US for its military security, followed the Americans' foreign policy (Takamine, 2006).

Although Japan and China were never in direct confrontation with each other, they were involved in the conflict on opposite sides. Upon request from the USA Japan formed a

defence force of 75,000 soldiers which was the first remilitarization in Japan since the end of the Second World War and which evoked criticism in China. The decision by China to cross the Yalu River in 1950 was partly related to the establishment of this force (Iriye, 1990:3).

What should also be noted however is that trade continued, although at a small scale, even in the years 1950-53 when the Korean War was fought. Already in 1952 Japan dispatched trade missions to China which on her hand sent the first missions to Japan in 1955. It was the framework of “separating politics from economics” that governed the economic relationship in this period; the belief that even though the two countries did not have a formal diplomatic relationship with each other they could still pursue economic relations.

The policy of containment meant that Japanese business would not get the trade relations with China that they wanted. In 1951 the “Mutual Defence Assistance Control Act” was passed by the American congress, preventing aid to any country that did not adhere to the American standards of control over exports to Communist countries. In the end of 1950 Japan therefore imposed an embargo on exports to China, resulting in a decline in bilateral trade from US\$39,6 million in imports and US\$19,6 billion in exports in 1950, to US\$14,9 million and US\$599,000 respectively two years after the embargo was imposed (Takamine, 2006:26). In addition to these constraints there was the establishment of the Co-ordinating Committee for Multilateral Export Controls (COCOM) by the NATO countries except for Iceland, Australia and Japan in 1949. The aim of the COCOM was to regulate the exports of materials to the Soviet Union and to other Communist countries that could be of strategic use. Further restrictions came when the US established the China Committee (CHINCOM) as a branch body of the COCOM in 1952, 200 more items were added to the list of embargo items in trade with China (Takamine, 2006:26). While Japan and several Western countries were imposing several restraints on trade with Communist countries, China and the Soviet Union cemented their two countries’ mutual security and economic partnership through the signing of the Sino-Soviet Treaty of Friendship, Alliance and mutual Assistance in 1950.

## 2.5 The road to normalization

Several changes in the international community triggered the normalization of diplomatic ties between Japan and China in 1978. The three most influential were (1) the Sino-Soviet split which made China redefine its security situation and made it look for new sources of aid. (2) The admittance of China into the UN and the eviction of Taiwan which enhanced China’s legitimacy in the international community. (3) The “Nixon shock” which

signalled to Japan that it could pursue diplomatic relations with China with the support of the US and triggered it to hasten the process of doing so ahead of the US.

### 2.5.1 The Sino-Soviet split

In 1950, the same year as the alliance treaty between China and the Soviet Union was signed; they also signed an agreement for the Soviet Union to provide China with aid. At the time aid from the Soviet Union and trade with the Communist block was important to China's economy. The Soviet Union was the most advanced socialist economy in the world and could provide China with advanced military technology and satellites to mention but a few. Up until 1957 China received approximately US\$2, 2 billion in assistance, including aid, from the Soviet Union. In the same period China's trade with the Communist block constituted 75% of its total trade (Takamine, 2006:35).

The friendly relations were challenged later in the 1950s when conflicts over ideologies came to the forefront. In 1958 Mao initiated the "Great Leap Forward" which drew on Soviet experiences. Khrushchev however, was sceptical to Mao's usage of communes and warned Mao that the commune was a dangerous experiment which disregarded economic laws and the experiences of other Socialist states (Khrushchev cited in Gittings, 1964:11). When Khrushchev openly criticized Stalin at a meeting for the Soviet Communist Party three years later Mao reacted negatively (Takamine, 2006). It was not good for him that Stalin, which China's own policies had drawn their ideological justification from, was criticized. As China's population was suffering from the "Great Leap Forward" which resulted in widespread hunger, Mao did not want any additional criticism from fellow socialist countries. China decided to minimize its economic and military dependence on the Soviet Union in 1958 and the year after the Soviet Union responded with cancelling the promised provision of its nuclear weapon production technology. The refusal by the Soviet Union to provide China with neither sample of an atomic bomb nor share the technology needed to make one increased the rift in the two countries (Gittings, 1964). In 1960 the Soviet Union pulled out its technicians from China, numbering 1,390 people (Takamine, 2006:45). The "Great Leap Forward" came to a halt the same year.

The split had significant consequences for the bilateral relationship between Japan and China. Having lost its economic and security provider, China was in need of capital and heightened security provisions as it had a new rival in the Soviet Union. The hard line policy that had been adopted by Japan previously became reduced because for China improving

relations with Japan now became of great interest in the new international climate the country found itself in.

### 2.5.2 The admittance of China into the UN

Un-official ties were promoted by forces within Japan such as the business community, politicians with strong connections to the China and also within the Japanese Government. In 1962 the Japanese Foreign Minister Masayoshi Ōhira wrote on the importance of maintaining personal, non-political contact between the two countries due to their long history of relations, through trade, culture and art (Ōhira, 1964). On the other hand he did not think Japan should take an active position on settling the question of which of the two China's that was the legitimate ruler of the country, fearing that this could upset the international power balance which was already unstable in the region. Rather he recommended that Japan should await the decision taken by the UN. That decision came in October 1971 when China was admitted to the UN and Taiwan was excluded (Takamine, 2006).

### 2.5.3 The "Nixon shock"

What has come to be referred to as the "Nixon shock" in July 1971; the visit of the American President Nixon to Beijing, further paved the way for Japan to get closer political ties with China. July 15 that year the American President Nixon announced that he would go on a visit to Beijing. The Japanese were informed about this sharp turn in American China policy just hours before the announcement was made public. Although this reversal came as a shock to the Japanese and the short notice given to them was particularly upsetting, it did also trigger them to hasten the normalization process to get ahead of the US. In December 1972 the Japanese Prime Minister Kakuei Tanaka and the Chinese Premier Zhou Enlai signed the documents that ended the de-facto state of war that had been between the two countries since 1937 (Takamine, 2006).

### 2.6 The issue of war reparations

China's decision to not demand reparations from Japan was closely linked to the way Taiwan dealt with the same issue. Since the US only had diplomatic relations with Taiwan until 1979, all assistance prior to the normalization of ties between Japan and China in 1972 went to Taiwan. In 1947 24 Japanese military and civilian ships was given to the Nationalist controlled Chinese cities Shanghai, Qingdao and Taiwan as reparation (Drifte, 2006:97). The year after some reparations were also paid, but with the Cold War looming and the

Communists taking over control over mainland China, these reparations were terminated. Taiwan renounced war reparations in the negotiations for a settlement through the Peace Treaty that was signed by Japan and Taiwan in 1952.

China waved any claim to receive war reparations during its negotiations with Japan for normalization. This decision had been taken by China already in 1964, and there were several reasons for this. One was that China did not want to seem less generous than Taiwan had been. They were also anxious not to provoke strong pro-Taiwan forces within the LDP, to strengthen relations with Japan at a time when the Soviet Union appeared as a threat to China, and also to secure a favourable image of China in the Japanese public. It was not until the 1970s that war reparations became linked to ODA (Drifte, 2006). This linkage was made by Japanese advocating the start of Japanese ODA to China. They argued that Japan was obligated to extend ODA to China because of its treatment of China in the Second World War. The decision by China to waive war reparations was threatened during the negotiations for normalization. This was due to the Japanese side claiming that China did not have any right to demand reparations as Taiwan had waived them. Although this angered Zhou Enlai, he and Mao Zedong did in the end agree to waive any claims to such reparations (Armacost and Pyle, 2001).

## 2.7 The Open and Reform Policy

Even though the two countries had normalized their relationship, it would still take some time for trade to be resumed to pre-war levels. This was due to several factors, among them Japanese business' scepticism to the stability of China. The Cultural Revolution had caused much upheaval in China and the Japanese were careful in investing in the country. Economically, China lacked the foreign currency reserves needed to purchase Japanese merchandise (Takamine, 2006).

In 1978 the 3<sup>rd</sup> Plenum of the 11<sup>th</sup> Chinese Communist Party Central Committee declared that the Party would move towards modernization; this was the start of the "Open and Reform Policy" of the Chinese Communist Party CCP. In 1978 the Japanese and Chinese government signed the LTTA, under which both countries engaged in trade with each other worth US\$20 billion totally in the period 1978 to 1985 (Takamine, 2006:48). The aim of the agreement was to make use of the complementarities of the two countries' resources. Japan had advanced equipment and technology that China needed and China had natural resources that were vital to Japan. This was especially prescient after the two oil crisis earlier in the 1970s which had made Japan eager to find alternative markets to import from to lessen its

dependence on the volatile Middle Eastern region. Japan would export plant and industrial technology worth US\$7-8 billion and materials worth US\$2-3 billion. China would then in return export crude oil and coal to the value of US\$10 billion to Japan (Takamine, 2006:48).

However, the agreement did not go as planned. The first project under the LTTA was a project through which the Japanese steel manufacturer Shin Nihon Seitetsu would provide technological support for the construction of a steel plant in Baoshan, a city located near Shanghai. Shin Nihon Seitetsu agreed to construct a plant that would have an annual capacity of 6 million tons, China would pay for this with exports of Chinese crude oil and coal to Japan. Because of technical problems, China did not succeed in increasing its oil output and could therefore not get the foreign earnings it needed. The foreign currency reserves fell short of expectations and together with inflation and deficits in the Chinese budget they prompted the Chinese authorities to cancel to plant projects, the Baoshan steel project had been one of totally seventy-four plant projects. The decision was announced to the Japanese in February 1979. Shortly thereafter, Deng Xiaoping hinted to the Japanese that if they were to start providing China with aid, China might reverse its decision. In December that year the Japanese Prime Minister told the Chinese while visiting Beijing that Japan would provide China with a 300 billion yen loan for the period 1979-83 (Takamine, 2006:52).

### **3. Japan's aid to China**

The decision to initialize aid to China was made because Japan wanted to encourage certain developments in China. At the outset these were connected to the wish of seeing China continue to open up its economy and society. They also saw it as a possibility to get access to the gigantic market that China represented and to establish good trade relations and facilitate trade through development of infrastructure. These interests were fronted by two different ministries. The METI was concerned about promoting Japan's economic interests in China and to strengthen the presence of Japanese businesses there. The MOFA on the other hand, wanted to use ODA to support the pragmatic approach taken by the leadership of Hua Guofeng and Deng Xiaoping (Wang, 1993). The first aid packages to China reflected both of these initial priorities.

The two first aid packages were focused on developing the transportation infrastructure projects, particularly for coal transportation (Söderberg, 2002a). These packages were given on five-year terms; the first was worth 331 billion yen and covered the period 1979-1984 (Söderberg, 2002a:9). The majority of the first aid package was targeted at financing projects that were either directly or indirectly related to the trade agreements that

had been made under the LTTA. Two projects were to fund improvement of infrastructure in the two ports of Port Shijiusuo and Port Qinhuangdao which were the starting point of most of the Chinese coal exports to Japan. The second was given from 1984-1989 and totalled 540 billion yen (Söderberg, 2000a:9). Both supported China's modernization and contributed to alleviating the Soviet threat which was an important issue for China at the time (Wang, 1993). The third package covered the years 1990-1995 and had a somewhat wider scope than the two previous ones; it also included projects aimed at water supplies, sanitation, gas supply, and communications enabling links between cities and, fertilizer plant projects and infrastructure projects in development zones (Söderberg, 2000a:9). The latter package was disturbed after the Tiananmen Square Incident which resulted in Japan's first use of aid as a sanctioning tool towards China. This will be treated in the following section.

The actions taken by Chinese authorities in 1989 would have strong repercussions not only for the third loan package but it would also have strong repercussions for the bilateral relationship in total. In many ways, it started the developments that would result in the MOFA announcing in March 2005 that it would end its yen loans to China. This was not exclusively because of the incident itself, but also because it drew attention to a changing China that seemed more as a threat than as a partner in many ways.

### 3.1 The Tiananmen Square Incident

In April 1989, Hu Yaobang, a former secretary-general, died. He had been a well-known reformer and had tried to rehabilitate those persecuted in China during the Cultural Revolution. He was forced to resign in 1986 after student protests, which rulers in the Communist Party believed were the result of Hu's friendly attitude toward intellectuals (Takamine, 2006). After his death three years later, many people mourned over him at the Tiananmen Square. The same month as he died, the Beijing Student's Autonomous Federation was formed, the month after saw the establishment of the Beijing Workers' Autonomous Federation. These federations were the first two social organizations created outside the influence of the CCP, and posed a grave challenge to the ruling regime.

The mourners were upset by the lateness of funeral arrangements after Hu Yaobang's death. Their mourning turned into mounting protests against what they perceived as the wrongful sacking of Hu and the CCP's failure to implement political reform and end political corruption (Takamine, 2006). Martial law was introduced on May 20 1989 and the protests which had now mounted into demonstrations were crushed on June 4 1989. The numbers of



people is killed is unknown. Amnesty International estimates that hundreds of unarmed civilians were killed and that thousands were injured (Amnesty, 2000).

The same day as the demonstrations were put down by force, Watanabe Taizo, a spokesman for the MOFA, said that it was unfortunate that force had been used to end the protests (Takamine, 2006:57). On June 5, the chief cabinet secretary Masajuro Shiokawa stated that Japan was closely monitoring the developments in China, that it was regrettable that so many people had lost their lives and that Japan was hoping for a speedy end to the political turmoil (Shiokawa cited in Kesavan, 1990:671). June 7, the Japanese Prime Minister Sosuke Uno emphasised the difference between Japan and the US in their relations with China stating that Japan had several considerations to take in light of its past war aggression. On June 18, he expressed his hope that China would not be isolated from the international community; this was a possible consequence that Japan feared as it was making efforts to further stabilize the East Asian region.

Chinese authorities' reactions to the demonstrations came at a time when Japan had made efforts to encourage further developments and policies in China that would be increasingly open to the outside world. Around the time of the Tiananmen Square Incident Japan was working consistently with improving regional stability amongst itself and its neighbours. The Chinese Prime Minister Li Peng had visited Tokyo in April 1989 and focused on the importance of Japanese technology and investment for China's future development. During his visit he asked Japan to soften its COCOM rules so that China could more easily access Japanese technology. He also gave the Japanese more details concerning the impending Sino-Soviet summit that was to be held in Beijing in May 1989. While stating that the relations between China and the Soviet Union were soon to be repaired, he assured the Japanese that this would not affect China's future foreign policy (Kesavan, 1990).

Believing that an improvement in relations between China and the Soviet Union was in sight, Japan too sought to improve its relations with the Soviet Union. According to the Japanese, better relations between its two biggest neighbours would be beneficial to the tense situation on the Korean Peninsula. In May 1989 the Japanese Foreign Minister Sosuke Uno visited Moscow to enquire about the possibilities of improving relations between Japan and the Soviet Union, he and his ministry were glad to hear Mikhail Gorbachev state during the Sino-Soviet summit that the Soviet Union would also like to improve its relations with Japan. In addition to progress in relations with the Soviet Union, Japan was also making efforts to improve its relations with North Korea, and there were plans to open a representative office there. In the context of these efforts by Japan, the military crack-down was greatly disturbing,

and it also provides us many clues as to why the Japanese response, compared to the Western one, was so vague.

### 3.2 Aid as sanction

The Western countries were not as careful as Japan in their statements about the Chinese actions, and condemned the way in which the Chinese authorities had acted. The day after the Tiananmen Square Incident the U.S. President George Bush declared that the US would implement measures aimed at stopping military supplies to China and to freeze high-level contacts with the country (Simon, 1990). The countries of the European Committee (EC), now EU, stated on June 6 that the EC unanimously condemned the actions taken by the Chinese government, and several countries imposed bilateral sanctions. Germany, Italy and Belgium suspended grants, loans and aid and Great Britain imposed an arms embargo. At the EC summit in Madrid on June 27 the member countries issued a joint declaration stating that the EC would impose diplomatic and economic sanctions. An unspecified arms embargo was also initiated, this embargo has of yet not been removed despite mounting calls from several countries to do so (Kreutz, 2005). The US imposed an arms embargo in February 1990, the EC countries' sanctions, excluding the arms embargo, were lifted in October 1990 declaring that from then on China-EC relations should be on a path to improve relations.

Japan was very reluctant to use aid to sanction China, believing it would aggravate the situation. Both the Ministry of Finance (MOF) and the MOFA stated that they were not willing to suspend the yen loans to China, which constituted the largest share of Japan's aid. They took a hesitant stance, claiming it was too early to make any decisions on the subject. The old attitude of separating politics from economic was evident when MOFA said that Japan's commitment to support the Chinese modernisation should be separated from issues concerning human rights (Takamine, 2006:58). Japan's reluctance to impose sanctions on China was also deeply founded in Japan's national interests. Out of the nations reacting to the Chinese actions, Japan was the country with the largest economic stakes in China. In 1989 Japan was the biggest bilateral ODA donor to China, giving US\$832,2 million equalling 55,6% of the total amount given to China in that period (Katada, 2001:49). Although Japan's share of ODA disbursements had decreased relative to other countries and institutions giving more, Japan was still by far the largest bilateral donor.

In addition to the economic concerns, Japan's geographical proximity to China meant that an unstable China could pose a threat to Japan's security. A massive exodus of Chinese refugees coming to Japan was a consequence Japan's authorities considered with great

concern. It was believed that a domestically unstable China with a stagnant economy could possibly trigger the Chinese government to arms-build up. Thus, Japan like earlier felt that the best way forward was to keep engaging China economically, rather than committing to sanctions that might lead an unstable country into an isolation that in the end could prove damaging to Japan itself.

In the end however, international and domestic pressure became too strong for Japan to resist, especially that of the US. Japan-US relations were strained at the time owing to a series of trade disputes in the previous years (Katada, 2001). The US congress started to debate Japan's reluctant response (Kesavan, 1990). Further international criticism came when it became known that by June 10 some Japanese companies had ordered staff back to China to manage existing contracts and to gather information (Miyashita, 1999). The move was criticized as being a way for Japan to try to get exclusive shares in a market that for the time being was cleared of Western business. The Japanese government then urged the companies in question to observe self-restraint. Pressure was also mounting within Japan, with the chairman of Nissan Co., Ishihara Takashi, stating in a press conference on June 6 that Japan's past war aggression was not a sufficient reason for Japan not to take a tougher position in its dealings with China. Additionally, Japanese Diet members from the Liberal Democratic Party (LDP), the Japan Communist Party (JCP) also started to criticize the lack of response given by the Japanese government (Katada, 2001).

Japan engaged in several diplomatic efforts to lessen the sanctions that would be imposed by the international community. Before the G7 summit that was to be held in Paris on July 14, the Japanese Foreign Minister Hiroshi Mitzuzuka visited Washington June 25-28. He was there to discuss China with the US President Bush and the Secretary of State James Baker, fearing that Japan's position on the China question might become a topic at the impending summit. The talks prior to the G7 summit went well as the US representatives agreed with Japan that China should not be isolated, and the final outcome of the conference was that the G7 as a group would not implement any new, joint sanctions (Takamine, 2006). Actions taken by member countries unilaterally, was a different matter.

In Asia, Japan approached the ASEAN member countries at their annual conference in Brunei. During meetings between these countries after the conference, Japan sought support for its stance on China. Again, the Foreign Minister upheld the view that if China was isolated, it might cause detrimental consequences. Interestingly, an argument that was used was that isolating China might bring it closer to Soviet Union (Kesavan, 1990). The final outcome of

the conference was that, although ASEAN condemned China's actions none of its member countries would break off ties with Beijing.

Despite Japan's continued efforts not to isolate China, the domestic and international pressure did push it to implement economic sanctions against China. The building stone of the Japanese-China relationship had been economic engagement. In 1988 Sino-Japanese bilateral trade amounted to \$19, 3 billion (Kesavan, 1990:679). Economic concerns together with Japan's wish to encourage a continued opening of China through engagement, prolonged an economic response. On June 20 the Japanese government announced that it would freeze its third loan package to China, worth ¥810 billion yen for the period 1990-95 (Takamine, 2006:58).

#### **4. Engaging a rising power**

*China? There lies a sleeping giant. Let him sleep. For when he wakes he will move the world.*<sup>14</sup>

What happens if the country that tries to engage a rising power does not believe it succeeds in doing so? According to Schweller (2006) such a situation will trigger the engaging state to pursue a mixed policy towards the rising power, one in which both rewards and punishments are used. Within such a policy a desired behaviour by the rising power will be rewarded with benefits while failure to do so will be punished with sanctions. The increase of both threats by Japan to cut aid and to freeze it and actual sanctions employed towards China are evidence that Japan in several ways sees its engagement policy towards China as having, at least partially, failed. Japan's belief in commercial liberalism started to vanish after the Tiananmen Square Incident and as a consequence of developments that changed the international community and Japanese domestic politics (Green, 2003).

##### **4.1 China's economic growth**

In addition to a deterioration of China's image concerning human rights, there was a growing anxiety in Japan of China's economic power which was increasing along with China's increasing military expenditures. Japan on its hand, plunged into an economic recession after the burst of the bubble economy, a point which will be discussed in more detail later.

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<sup>14</sup> Quote by Napoleon Bonaparte, sited in Söderberg; *Chinese-Japanese Relations in the Twenty-first Century*, "Introduction", 2002:1).

From 1978 to 2002 China's GDP grew with about 9% annually while per capita income grew with about 8% (Fan and Chan-Kang, 2005:7). 1993 saw the publication of two reports which put China's economy on the international agenda. One was written by the World Bank which claimed that in terms of purchasing power parity, and also including Hong Kong and Taiwan, China would surpass the US in Gross Domestic Product and would be the world's largest economy by 2002. The other was released by the International Monetary Fund and claimed that in terms of PPP China had already in 1992 become the third largest economy in the world after the US and Japan (Takamine, 2006:63).

#### 4.2 China's military expenditures

It was not China's economic growth in itself which caused anxiety amongst analysts around the world; rather it was the fear that this economic growth could be turned into military power. The basis of this fear was found in the China threat thesis, which had been voiced in the Western and the Japanese academic community and media since the early 1990s. In Japan this thesis was articulated by the Japanese Professor Tomohide Murai at the National Defence Academy (Takamine, 2006). In August 1990 he wrote an article called "On the Potential Threat of China" published in the *Academic Journal* for Tokyo Defence University. In it, he described China as a possible adversary considering its national strength and sustained development.

Table 4.3 Official figures for China's defence spending 1985-2002.<sup>15</sup>

<i>Year</i>	<i>Amount (millions of yuan)</i>	<i>Share in Gross Expenditures (%)</i>	<i>Growth rate (%)</i>
1985	19,153	10.4	6.0
1986	20,075	8.6	4.8
1987	20,962	8.6	4.5
1988	21,800	8.1	3.9
1989	25,146	8.3	15.4
1990	29,031	8.4	15.5
1991	33,031	8.7	13.8
1992	37,786	8.6	14.4
1993	42,580	8.1	12.7
1994	55,071	9.5	29.3
1995	63,672	9.3	15.6
1996	72,006	9.1	13.1
1997	81,257	8.8	12.8
1998	92,857	8.6	14.3
1999	104,650	8.5	12.7
2000	120,500		12.7
2001	141,000		17.7
2002	166,000		17.6

China's official figures of military expenditures did nothing to reduce such concerns; from 1989 onwards China's military expenditures rose with more than 10% annually between 1989 and 2002, see above table. One should approach such numbers with caution however; one of the reasons is that in the period between 1992 and 1995 China experienced high inflation. In the span of these years total military expenditure rose with 51, 8% but in the same period the price of commodities rose by 66, 6% (Wang, 1999:15).

<sup>15</sup> Source: Reinhard Drifte 2003:42, *Japan's Security Relations with China since 1989: From balancing to bandwagoning?*, RoutledgeCurzon, London and New York; *East Asian Strategic Review*, 2000, Tokyo: National Institute for Defense Studies, 2000, p.217; for 2000: *China Daily*, 8 March 2000; for 2001, 2002: *Reuters*, 4 March 2002.

Because of China's level of secrecy around its military expenditures; it is hard to get accurate numbers. Budget functions are often curtailed under other expenditure posts such as construction, administrative expenditures and state organizations. Furthermore several expenditures that may be connected to military expenditures are omitted such as funding for research and development and revenues gained from arms imports (Bitzinger, 2003:6).<sup>16</sup> China's high expenditures on its military were not a new development; in 1951 China spent 40% of its budget on military expenditures. This trend continued in the 1960s when China was the third biggest military power in the world when it came to defence spending; the country was only surpassed by the USA and the Soviet Union (Iriye, 1990:3). In 1964 China detonated nuclear devices for the first time (Iriye, 1990:5). Thus, China's seemingly increasing military expenditures are added to a picture of a threatening rising power rather than being the single factor behind it.

One of the reasons for criticism in Japan of ODA to China is the fear that Japan's economic assistance might be used for military purposes by the Chinese (Drifte, 2006). This is because industrial infrastructure can also be used for military purposes. Fears rose about this because of many Japanese citizens' lack of trust in China's ambitions and intensified as China showed its military capabilities through nuclear tests in 1955 and military drills at the time of the Taiwan Strait Crisis.

##### 5. Domestic changes within Japan

As China started to be perceived as an economic threat as well as a military one, Japan changed its foreign policy towards it. A more active foreign policy was being outlined in Japan, and the one employed towards China was not an exception. The redirection of Japan's foreign aid policy to China was facilitated by changes in Japan's domestic politics; an increasing involvement in aid policy by the LDP and a smaller role in the aid-policy making by the "China School" within the MOFA. An explanation for this will have to go back to 1993, the year Japan got its first non-LDP government and the end of the 1955 system.

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<sup>16</sup> Expenditures that are generally believed to be omitted from China's official military expenditures figures are, besides research and development and arms imports, the following: (1) expenses for the People's Armed Police, (2) funding for military industry hereunder defence industries and (3) earnings gained from businesses run by the People's Liberation Army (Bitzinger, 2003:6-7).

## 5.1 The end of the 1955 system

The so-called “1955 system” is named after the year The Liberal Democratic Party (LDP) was formed. That party ruled the country without interruption until 1993. As Japan was experiencing high economic growth and was ensured military protection by the US, voters were generally content with the situation. The ruling LDP was divided into several factions, but other than intra-party rivalry this had no consequence for the party at large. If the voters were unhappy about a certain leader, they could vote for another faction-leader. Japan’s electoral system at the time was based on a multi-member single-ballot system, meaning that if a party wanted to have a majority in the parliament it needed to have several candidates elected in each constituency. Thus elections came to be more focused on personal rivalry rather than rivalry between parties, diminishing the interest in national issues and bringing narrower, often economic issues to the focus of election campaigns (Green, 2003).

After the Second World War ended Japan was characterized by a concentrated financial and industrial structure and a powerful national bureaucracy (Pempel, 1997). There were close links between politicians and the bureaucracy; this was especially evident in the arrangement of *amakudari* meaning “descent from heaven”. Through this system bureaucrats could have a second career in regulated or semipublic corporations linked to the relevant ministry (Green, 2003). Together with the *Keidanren* (Federation of Economic Organizations in Japan), the politicians and the bureaucrats formed a close-knit network that aided Japan in its economic success as well in the stability of the country. It also explains the mercantilist motives that are found behind a lot of Japan’s aid policy-making, but from the early 1990s the close bonds were if not broken, more visible and accessible to the Japanese public.

The end of the 1955 system came in 1993 after a series of changes that toppled the 1955 system; these were related to economics, politics and demography. The Plaza Accord in 1985 resulted in a rapid appreciation of the yen, which eventually led to the burst of Japan’s economic bubble.<sup>17</sup> With the burst of the bubble, the previously egalitarian Japanese society was challenged as the differences between those owning land and those who rented or had to buy (Green, 2003). In this situation LDP politicians took advantage of their positions to get valuable insight into the real estate and stock markets. The outsourcing of Japanese production sites, many to China, was also a source of new distances within Japanese society.

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<sup>17</sup> The Plaza Accord was the meeting in 1985 of finance ministers from the five leading economies in the world; the USA, Japan, West Germany, France and the UK. The meeting was called out of a concern for the devaluation of the US dollar. At the meeting all countries made individual promises; Japan’s was to loosen its monetary policy and to implement financial-sector reform. For Japan these changes led to a cut in interest rate which resulted in an economy-bubble with priced stocks and real estate (Britannica, 2007)



Increasing urbanization further contributed to a lessening of the ties between local LDP politicians and the public. In 1945 50% of the Japanese population was farmers, by 1990 that number had decreased to 6% (Green, 2003:39). With this development local politicians had less influence on voters and media came to play a more important role in forming Japanese voters' preferences. As a result, broader national issues started to have a larger impact on setting the political agenda and on elections.

Scandals surrounding politicians was not a new phenomenon to the Japanese public, the 1970s saw the disclosure of the Lockheed scandals in which several members of the Japanese government and business officials were accused of receiving payments from Lockheed to enhance the company's business prospects in Japan (Blaker, 1995). In the 1970s however, the situation in Japan was different. With the new disclosures of corruption both amongst the politicians and within the bureaucracy, the Japanese public was not so inclined to let such scandals pass. When it was discovered in 1992 that a member of the LDP, Shin Kanemaru had received gold and unmarked bonds from the president of a shipping company in exchange for favourable treatment of the latter regarding Transport Ministry regulations on its drivers, this damaged the LDP's image amongst its voters (Green, 2003). Added to this situation was the debut of bureaucrats in corruption scandals. In Japan, the bureaucrat has traditionally been looked upon as a reliable, selfless person; the disclosure of several scandals involving bureaucrats in the 1990s shook this belief.

Political corruption was one of the reasons why Ichiro Ōzawa together with forty-three other LDP members broke off to form the Japan New Party in June 1993. The move was triggered by the failure of then Japanese Prime Minister Kiichi Miyazawa to introduce political reform as he had promised. In the end he failed to do so because of pressure from leaders from other factions (Green, 2003). Together with seven other parties Morihiro Hosokawa from the Japan New Party formed a government in July 1993, gaining the majority in the parliament.

## 5.2 Electoral reforms

One of the primary goals of Hosokawa's coalition government was political reform. This was to come in two ways: through changes in the electoral system and through administrative reforms (Nakano, 1998). Under the 1955 system Japan had used a single ballot system with multimember districts. This meant that each voter had cast one vote for one candidate. The electoral reforms implemented by Hosokawa which came into effect January 1 1995 radically changed this.

The new electoral rules meant that each voter could now cast two ballots; one for the political party of his/her choice and one for a single candidate in a the new one-member district system. For the lower house this had vast implications. Previously the lower house had consisted of 511 members coming from multimember districts. After 1995 there were 500 member seats in the lower chamber consisting of 300 legislators chosen from single-seat constituencies and 200 elected according to the share their political party had gotten in the election. The aim of this was to put more focus on political parties rather than people and to lessen the usage of money-politics, the overall aim being to shift the focus from persons to public policy issues. Whether this has actually happened is a question of debate. Whereas there are those that argue that Japan has changed beyond comparison, T.J. Pempel (1997) argues that there has not been any increase in debates about public policy issues. For Japan's aid policy to China the reforms did have significant effects as China became a concern for the media and the public in Japan and forced it onto the political agenda. As these issues became important to the politicians they demanded more insight into and influence over the process of Japan's ODA to China.

### 5.3 Administrative reforms

Until the mid-1990s, political interference in Japan's aid policy was a rarity that mostly occurred when it was a topic in the media, such as when the Tiananmen Square Incident happened or when Japan came under international criticism for failing to respond quickly to the Gulf War. This changed following a series of administrative reforms implemented in the late 1980s and in the 1990s that made the bureaucratic process behind ODA decision making more accessible for external interference (Takamine, 2002).

The initial administrative reforms implemented in the period of 1981-83 came as a consequence of increasing government indebtedness. Increasing expenditures but decreasing revenues following economic sluggishness and the aftermath of the oil crisis caused alarming government expenditure (Masujima, 2005). In 1981 the government of Nakasone implemented the First Administrative Reform Council which had as its goal to privatise three state-owned enterprises controlled by the central ministries. From then on until 1983 the aim of the reforms was fiscal reconstruction and improved efficiency in public administration. The system of close connections between the bureaucracies had been a prominent feature of Japanese society since the advent of modernization in the late 1800s. The reforms were initiated to lessen the policymaking power of the central ministries. The Second Council on administrative reforms was established by the Takeshita government in 1987, aimed at further

decreasing the power of the ministries over private businesses. Deregulation was the main objective. Three years later the Third Council was established during the reign of the Kaifu government which primarily focused on increasing the diplomatic abilities of the Prime Minister's Office to lessen the MOFA's monopoly over foreign policies (Takamine, 2002).

The administrative reforms implemented in the period 1990-93 were to harmonize public administration partly by halving the number of ministries and partly through deregulation and decentralization. The result was that the total number of central government ministries was reduced from 22 to 13 in 1997 (Takamine, 2002). This year a law on government information disclosure was passed which meant that politicians were obliged to disclose administrative information. If they didn't people had the right to appeal it to a court to force them to do so. Upon the insistence of the party Sakigake deliberative councils started to publish minutes from their meetings already in 1995 (Nakano, 1998).

#### 5.4 Rising tensions between the MOFA and the LDP

Until the mid-1990s Japanese foreign aid policy-making was mostly left to the bureaucrats at the MOFA. They were the people with the highest level of expertise on subjects concerning foreign relations; the staff of the MOFA practically had a monopoly on these issues. From the middle of the 1990s however, LDP politicians started to get more involved with Japan's foreign policy. This was partly due to the increasing public attention given to Japan's aid to China and also due to the fact that since 1996 LDP had only led coalition governments. In a situation when the LDP needed to state policies making them unique in relation to the other parties, aid to China became an important area for LDP involvement.

#### 5.5 The China Division

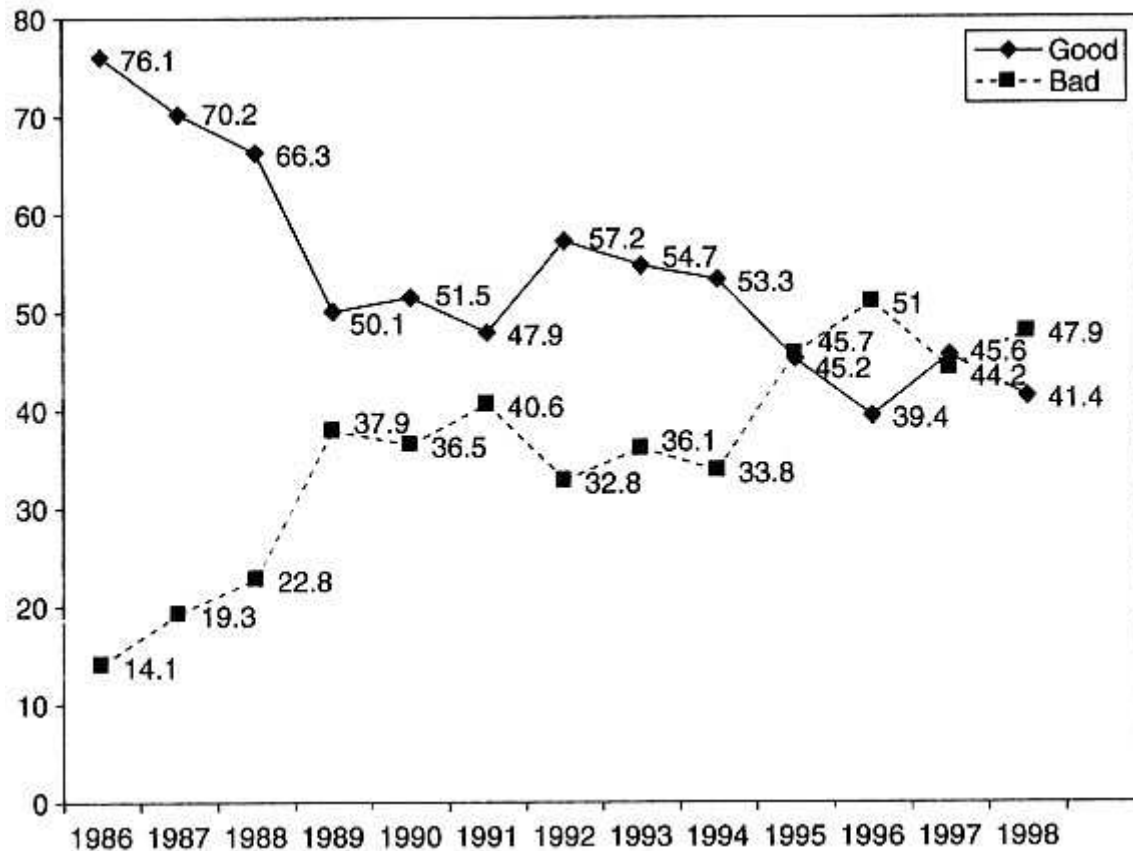
The China Division also referred to as the "China School" within the MOFA, has traditionally been responsible for the diplomatic side of the bilateral relationship with China. The Division consists of former diplomats to China which are trained in the Chinese language and therefore have a considerable amount of expertise on China. This Division has clashed with other Divisions when there have been conflicting interests. Since the different sections of the MOFA have responsibilities for different regions abroad, their interests have sometimes been conflicting. One example is when the Tiananmen Square Incident occurred. While the MOFA's Bureau of North American Affairs stressed close cooperation with the United States and other Western countries, the Bureau of Asian Affairs argued that Japan should maintain

friendly relations with China. Until recently the China Division practically held authoritative power to outline Japan's policy towards China. Consisting of former diplomats to China and hopeful candidates for such positions in the future; the China School was a collection of bureaucrats with experience in China and China specialists who are advocating a good relationship between the two countries (Kōji, 2006). Since the mid-1990s increasing interference by LDP politicians' into foreign aid policy and the reforms opening up the bureaucracy has lessened the MOFA's role in foreign aid policy making towards China. The China Division has especially been criticized by politicians and the Japanese public alike for taking a "too soft stance" on Chinese actions that have aroused criticism in Japan. This will be described in more detail regarding the two aid sanctions of 1995 and 2000.

#### 5.6 The changing role of LDP politicians in Japan's aid policy to China

The Tiananmen Square Incident was detrimental to the Japanese public's view of China. Polls conducted by the Prime Minister's Office in Japan in the period 1986-98 showed that the percentage of those holding favourable views of Sino-Japanese relations decreased from 76, 1% in 1986 to 50, 1% in 1989. In the same period, the percentage of those viewing Sino-Japanese relations as bad increased from 14, 1% in 1986 to 37,9% in 1989. See table below for the development of these perceptions (Takamine, 2006:82).

Figure 5.7 Japanese public perceptions of Sino-Japanese relations, 1986-98.<sup>18</sup>



Brought on by the increasing attention given to Japanese aid to China, the LDP politicians felt they had to take action to show that they would take a more assertive role towards China and also tried to encourage the MOFA to do the same. Since 1994 the LDP has led coalition governments in which the LDP needed to show that it had unique policies distinguishing itself from the other parties (Green, 2003).

The LDP's foreign policy-making capabilities were enhanced towards the 1980s when the LDP Policy Research Council was formed, which is now the policymaking body of the party. Several of the members of this zoku have experience from the MOFA. One of them is Takemi Keizō who served as a MOFA vice-minister from July 1998 to October 1999. Because of his strong ties to former colleagues he is exercising considerable influence over several bureaucrats from the MOFA (Takamine, 2002). The domestic factors underlying the LDP's increasing involvement in Japan's foreign aid policy to China is the Japanese public's interest in the topic. External factors are actions taken by China that have upset the politicians

<sup>18</sup> Source: Tsukasa Takamine 2006:82; Adapted from Sōrifu (Prime Minister's Office, Japan), *Gaikō ni kansuru yoron chōsa* (Opinion Polls Regarding Diplomacy), Tokyo 1998.

and the public alike. LDP politicians and MOFA bureaucrats have been involved in several confrontations concerning which actions Japan should take towards China. In the following section I will take a look at some of these incidents which show the changes that have occurred; Japan's unilateral sanctioning of China after it concluded nuclear tests in 1995 and the discussion about a possible freeze on loans after a heated dispute about the contested Senkaku/Diaoyutai Islands in 2000.

## **6. Aid turns political; the ODA Charter**

The tradition of “separating politics from economics” that had been favoured from the outset of Japan's economic engagement with China came to an end with the creation of Japan's ODA Charter in 1992. The Charter was Japan's first outlining of an official aid philosophy and was to signify Japan's reforms in its aid program; taking more responsibility and showing the Japanese public that their taxes were going to the right causes. In the case of Japan's bilateral relationship with China, the new political attachments that the charter attached to Japanese aid turned the case of ODA into another on the list of contentious issues amongst the two countries. A series of issues led up to the creation of the Japanese ODA Charter, they will be further discussed below.

### **6.1 International triggers**

When the Gulf War started in 1990, Japan assisted the allied forces with US\$13 billion dollars which was funded by tax increases in Japan (MOFA, 1991) as well as sending seven groups of 66 persons engaged through the Japan Disaster Relief Teams after the cease-fire in Iraq. The personnel that were sent were involved in activities such as environmental conservation, assisting refugees and minesweeping. These initiatives were not seen as sufficient by the international community and brought Japan under criticism for providing “too little too late”. This prompted the Japanese government to review its foreign policy; a development that had been under way since the 1980s but was further emphasized after the Gulf Crisis was over. The MOFA acknowledged the need for Japan to outline a clearer identity for its foreign policy; Japan's ODA that was still seen as the most important policy instrument was central to the increasingly progressive foreign policy outlined by Japan.

The Japanese Prime Minister Toshiki Kaifu acknowledged this in his State of the Union Speech in October 1990. He outlined four principles for Japan's future role in the international community. (1) the guarantee of peace and security, (2) respect of freedom and democracy, (3) securing the prosperity of the world under a system of an open market

economy and (4) to establish stable international relations based on dialogue and cooperation (MOFA, 1991). These four principles were the basis of the four guiding principles that were outlined in the ODA Charter the following year.

## 6.2 The Charter

It was only after being pressured by the LDP that the MOFA outlined what were to become the underlying principles of its ODA. The LDP had been pressured from outside; responding to the Japanese public which demanded an overhaul of Japan's ODA policy. The financial contribution to the Gulf War provided by Japan had been financed through tax increases and when the public saw that the Japanese efforts in the crisis had failed they demanded a review of current policies (Takamine, 2006). In June 1992 the Cabinet approved the ODA Charter, although the Charter is long it is the four principles outlined there that have received the most attention. Taking into consideration Japan's relationship with the recipient country, it should observe the following four principles in its provision of aid: (1) environmental consideration and development should be pursued simultaneously, (2) use of ODA for military purposes or for any aggravation of conflicts should be avoided, (3) attention should be given to trends in the developing countries' military expenditure, development and production of weapons of mass destruction and missiles and to their export and import of arms, and (4) attention should be given to efforts to promote democratization, the introduction of a market economy and to securing basic human rights and freedoms in the recipient countries (MOFA, 2003).

## 6.3 China and the ODA Charter

The implementation of the ODA Charter had several implications for the future of Japan's ODA to China. First of all the third yen plan for China which stretched over the period 1990-1995 could not be adjusted to the new policies set forth in the Charter which was approved in 1992. This was one of the reason why the Economic Cooperation Program published by the MOFA in 2001 stated that from then on ODA to China would be given on an annual basis, shifting it from the earlier provisions of five-year packages (Söderberg, 2002b:8). In the 1990s China committed actions that violated article (3) of the charter, concerning the recipient country's military expenditures, several times. Although this did not mean that Japan necessarily reacted towards China in the same way as it did towards other states, it did give the Japanese public a fundamental basis for questioning and react to Japan's ODA provisions to China.

### 6.3.1 China's nuclear tests result in Japan's first unilateral sanction against China

On May 15 and August 17 1995 China conducted nuclear tests. It was after the second in August that Japan announced that it would suspend the grant aid portion of aid to China and that it would observe caution in extending new yen loans. Further, the negotiations for the next five year loan package were stopped and although no public statement was made on the issue, the Chinese government was made aware that Japan's funding would dry up if its position was not respected (Self, 2006).

The Japanese public and the authorities were outraged by the tests, especially as they came only three days after China had expressed its support for the indefinite extension of the Nuclear Non-Proliferation Treaty (NPT) and after the Japanese Prime Minister Tomiichi Murayama had tried to convince China not to go through with the tests on a visit to Beijing. Strong criticism against the actions had broad support amongst politicians in the leading coalition of the LDP, the Social Democratic Party (SDP) and the Sakigake, within the Japanese business sector and within the public. Polls taken in the aftermath of the tests showed that the numbers of Japanese favourable to China fell to 39, 4% with the number of those feeling that the relationship was bad increasing to 51% in 1995 (Takamine, 2002:199).

It was the first unilateral action Japan had taken against China. Although the tests were criticized in the US and in Western countries too, Japan took it one step further by freezing its grant aid assistance. Although the grant assistance did not constitute a large portion of total aid, US\$78 million compared to US\$1,4 billion in loan aid for fiscal year 1994, it did send a strong diplomatic message to China (Katada, 2001:46-47). Acknowledging the strong public opposition to the tests that existed in the Japanese public they hardly had a choice; an opinion poll conducted by the newspaper Asahi Shimbun showed that 90% of the respondents were very angry about the Chinese tests as well as the French tests which had been done around the same time (Katada, 2001:55). There were also calls for the total suspension of Japan's aid to China based on the claim that the tests had violated Japan's ODA Charter. Grant aid was resumed in 1997 after China had promised to not go through with anymore tests.

### 6.3.2 The 1995-96 Taiwan Strait Crisis

The actions taken by China towards Taiwan in 1996 contributed strongly to a changing perception of China in Japan. The crisis brought attention to the US-Japan Security Alliance and the sensitive subject of Taiwan in the bilateral relationship between Japan and China. Perhaps most importantly however the reminder it gave Japan that China was willing to use military force and that it possessed missiles. It was the US decision to allow the



Taiwanese president, Li Denghui come to the US to participate in a reunion at his old university, Cornell University, in 1995. As a response to the Americans granting Denghui a visa and to show the importance of reunification for China's security policy, China initiated military exercises on July 18, 1995 (Drifte, 2003:64). Several military planes and ships were used, and also missiles were fired into the East China Sea north of Taiwan.

A third round of military exercises was held just before the presidential elections on Taiwan in November 1995. These were responded to by the Americans; they sailed an aircraft carrier through the Taiwan Strait. China responded in February 1996 by holding yet another round of exercise along the south eastern border of China and sent up another set of missiles which came closer to Taiwan this time; landing only 30 miles away from Taiwanese soil (Drifte, 2003:65). The move was countered by the US sending the largest group of ships that had been seen in the area since the end of the Vietnam War.

As the US and China were determined to show the other party that neither would back down, Japanese reactions became stronger in 1996. The close proximity to the area in which the conflict took place put a focus on the security threat posed to Japan. One of the missiles fired in 1996 landed approximately 60 km from the Japanese Island of Yonaguni.

The Japanese government led by Ryutaro Hashimoto responded to the Chinese actions by delaying talks with the Chinese government about 40 projects that had been scheduled to be funded by Japan as part of its fourth yen loan package (1996-2000). The projects were worth ¥580 billion and should have been implemented in the years 1996-98 (Takamine, 2006:127). Japan had already in 1996 told the Chinese government that it would suspend grant aid because of China's nuclear tests (Katada, 2001). The delay in 1996 may have been motivated by both the military intimidation of Taiwan and the nuclear tests although this is uncertain (Takamine, 2006).

#### 6.3.4 Responding to the conflict over the Senkaku/Diaoyutai Islands

The episode that really emphasized the mounting tensions between the MOFA and the LDP was the clash over how to respond to China's increasing activity within Japan's exclusive economic zone around the disputed Senkaku/Diaoyutai Islands. In 2000 China conducted several naval activities within Japan's Exclusive Economic Zones (EEZs). The number of Chinese research vessels sighted by Japans Marine Self-Defence Forces (JMSDF) went up from 2 in 1998 to 27 in 1999 (Self, 2006:85). In 2000 a Chinese icebreaker conducted mapping of the ocean in the area of the EEZ. This happened while Japan and China were involved in a conflict over how to draw up the borders of ownership of this area. Whereas

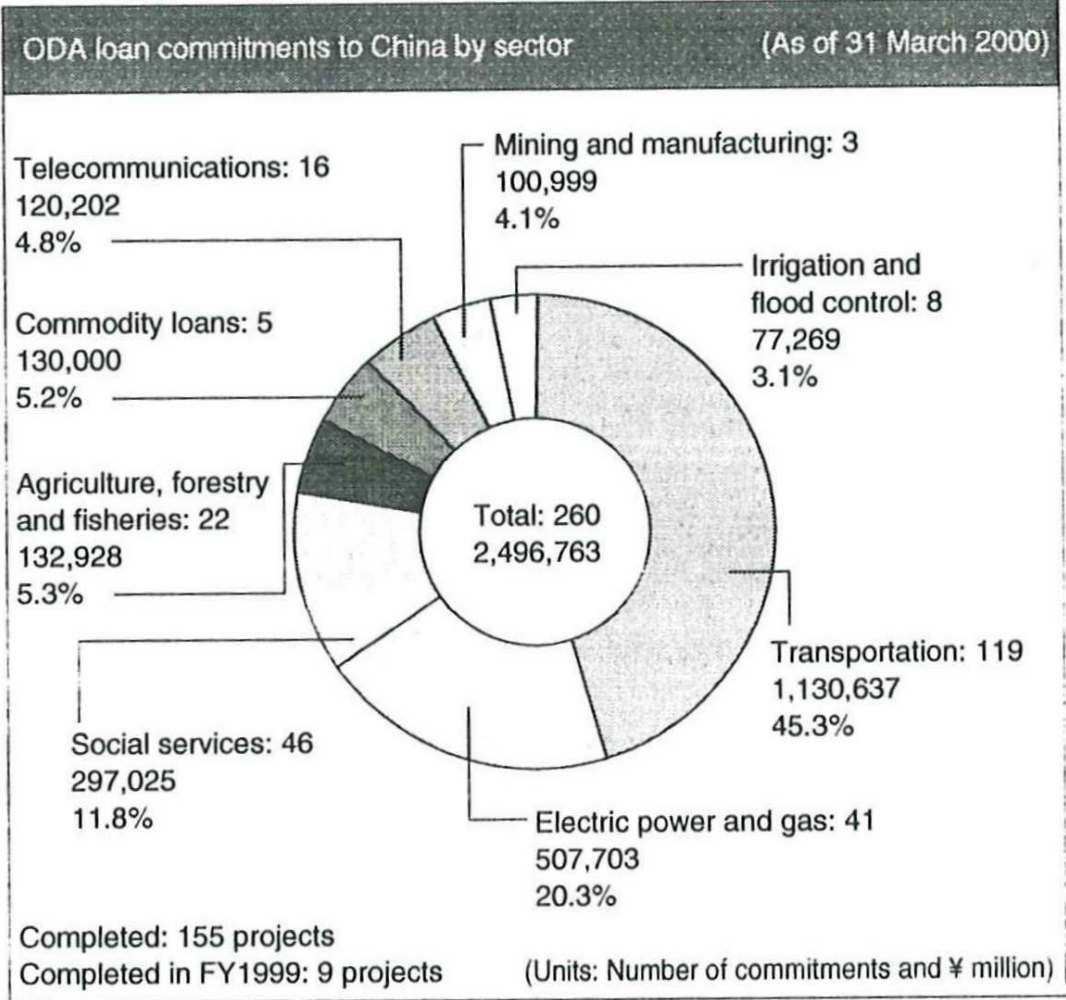
LDP politicians felt it would be wrong for Japan to continue to support China after these actions, the MOFA rejected linking Japan's ODA to that issue.

Disagreement on the future loans to China became visible during the process of approving yen loans to the "Beijing Urban Railway Construction Project" and the "Xi'an Xianyang International Airport Terminal Expansion Project" that were supposed to be concluded by the summer of 2000 (Söderberg, 2002b). The projects, worth a total of 17 billion yen were postponed by the LDP's Foreign Affairs Committee (Drifte, 2006). Several politicians claimed that the loans were a violation of the new guidelines for Japan's aid to China. Because they focused on the development of infrastructure projects, they were not to be implemented. Rather Japan should focus its efforts on areas such as the environment and human resource development.

In a meeting in 2000 between the Japanese Foreign Minister Yohei Kono and the Foreign Minister in China; Tang Jiaxuan the issue was discussed and it was agreed that both parties should notify the other prior to any activities in the area (MOFA, 2000b). The meeting only restated the previous position; that there had not been agreement on how to draw up a demarcation line but that negotiations would ensue promptly. Regardless of whether this meeting was efficient to a solution to the conflict or not, the decision of mutual notification calmed Japanese criticism to a certain degree. The loans were approved in September 2000. During the visit Kono Yohei also informed the Chinese that an advisory group had been set up to discuss the future of ODA to China as this was being debated in Japan. He further stated that the recommendations made by the panel would form the basis of the Economic Cooperation Program that would be presented in 2001 (MOFA, 2000b).

**7. A reorientation of Japan’s engagement: a shifting focus of aid to China**

Figure 7.1 ODA loan commitments to China by sector, 1979-2000.<sup>19</sup>



As can be seen from the above figure, Japan’s loan commitments to China have traditionally had a strong focus on developing China’s infrastructure. This has been in line with China’s priorities since the 1980s on developing its industrial infrastructure (Fan and Chan-Kang, 2005). China’s Tenth Five Year-Plan covering the period 2001 to 2005 points to new areas of priority. The Plan was announced at the 9<sup>th</sup> National People’s Congress in March 2001 (MOFA, 2001). Of the points the Chinese government presents, the MOFA took special notes of China’s focus on implementing poverty alleviation programs, development of rural

<sup>19</sup> Source: Takamine, 2006:98; Japan Bank for International Cooperation, “ODA Loan Report 2000”, Tokyo, 2001.

economies and a focus on environmental conservation. These target areas are also of concern to Japan. As acid rain falls on 30% of China's territory and has detrimental effects on Japan's environment.

As the economic recession in Japan continued throughout the 1990s, Japan's aid program came under criticism. Especially the aid directed at China was much debated in Japan. There are various reasons for this criticism, but the most prominent reasons for it are: (1) China's economic growth, (2) China's increasing military expenditures and (3) China's behaviour which breached with the Japan's ODA Charter.

The factors mentioned above contributed to a reorientation of Japan's ODA to China. Prior to a visit to China by the Japanese Prime Minister Ryutaro Hashimoto in 1997, he announced his views on how Japan's future foreign policy towards China should be. He stated that he was proud of the contribution Japan had made to China's economic development (MOFA, 1997). He also assured that Japan would continue to pursue economic cooperation with China, but that this would change in form.

Taking as its basis factors that had changed the environment for aid provisions and China's new priorities, Hashimoto gave some recommendations on how the aid program should be implemented in the future. Of areas that would be focused on from the Japanese side, he particularly emphasized the issues of environmental protection and energy conservation. China's air and water pollution is directly affecting Japan through acid rain (MOFA, 1997). Regarding energy, he stated that China's increasing appetite for energy sources is not complemented by energy-efficiency, which is only one tenth of Japan's.

### 7.3 Recommendations for the future

Because of mounting criticism of ODA to China in Japan, an advisory group was established in 2000 to make recommendations for the future of Japan's ODA. It was chaired by Mr. Isamu Miyazaki, former Minister of State in Charge of the EPA, and the recommendations were presented as: "Recommendation by the 'Advisory Group on Japan's Economic Cooperation to China in the 21st Century". The Economic Cooperation Program which was outlined for China in October 2001 was mainly built on the recommendations made in that report. The report acknowledged that because of Japan's severe fiscal situation after the burst of the bubble, there had been an increasing discussion within Japan about the country's future ODA (MOFA, 2000a). Especially the ODA given to China had come under attack, and the report sought to outline some recommendations for the future provisions of aid to China. One was that the focus areas of aid were to be redirected away from infrastructure

project in coastal areas in the east to a focus on environmental protection and human resource development in inland areas.

On the basis of these recommendations, the MOFA announced its Economic Cooperation Programme for China in 2001. The programme was called an “economic cooperation program” and not a “country assistance program” which was usually the case for other recipients of Japan’s ODA. This was the result of pressure from the LDP that it should be referred to as a program of “economic cooperation” instead of “country assistance” to reflect that Japan did not consider China to be a developing country anymore (Drifte, 2006). The Economic Cooperation Programme responded to the domestic criticism against aid to China and to the changing environment for the aid following China’s development. The programme presented several guidelines to the future of Japan’s ODA to China., and the following were especially emphasized.

(1) Japan should support efforts that address environmental issues and human resource development. Acid rain covers about 30% of China’s territory and storms of yellow sand are to an increasing degree also effecting Japan (MOFA, 2001). The loan package for FY 2004 reflected the growing emphasis on environmental conservation. A total sum of 85,875 million yen was promised for support for seven projects. Of these, six were directed at environmental conservation and the seventh was directed at a project for higher education (MOFA, 2005a).

(2) Assistance for poverty alleviation

One of the biggest challenges facing the regime in Beijing today is the problem of income differences between coastal areas and western and inland areas. Income disparities are considerable as suggested by a comparison of the city of Shanghai, the coastal region ranging from Beijing to Guangdong, and inland areas, which was made in 1999. In Shanghai per capita GDP was 30,000 yuan, in the coastal region from Beijing to Guangdong it was 10,000 yuan, and in the middle and western inland regions it was less than 5,000 yuan (MOFA, 2001). In 2002 it was reported that rural per capita income in China was only one third of that in urban areas (Fan and Chan-Kang, 2005:10). The rising number of protests that have taken place in the Chinese countryside is worrying to the Japanese, which see an unstable China as a risk to peace and security in the region.<sup>20</sup> A potential inflow of refugees is also alarming, a problem Japan is already struggling with. The policy points in the Economic Cooperation

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<sup>20</sup> Official figures reported 87,000 “mass incidents”, or violent protests in the Chinese countryside in 2005. This was an increase from 74,000 in 2004 and 58,000 in 2003 (Miller, 2006).

Programme were supported by the Advisory Group to then Prime Minister Junichiro Koizumi, which in 2002 presented their findings in the document “A Fundamental Strategy for Japan’s Diplomacy for the 21st Century: A new age, a new vision, a new diplomacy”. The report advised Japan to target its future aid on decreasing disparities between cities and inland regions and to improve the environment through measures such as better management of water resources (MOFA, 2002). Significantly, the report also proposed strengthening measures by Japan to promote mutual understanding between the two countries through youth exchange and cultural exchange.

## **Conclusion**

By the time Japan phases out its yen loans to China next year, it will have made a crucial contribution to China’s economic development. This has also been acknowledged by the Chinese side as the press statement in the opening of this paper shows (MOFA, 2007). Japan’s ODA, and yen loans as the largest portion of this aid, have always been conducted in a difficult political climate. That is because they have been used by Japan both to engage China and to function as a political lever towards it. This is difficult under any circumstances, in the case of Japan and China it is even more complicated because of the different connotations given to the aid, such as viewing them as a substitute for war reparations. The ending of the yen loans is not the end of Japan’s engagement policy towards China, it is a part of a process in Japan of redefining how best to engage China.

The debate about Japan’s aid to China started after the Tiananmen Square Incident in 1989 and has increased in intensity since then. When domestic structural changes came about in Japan’s electoral system and bureaucracies, the debate started to have a stronger impact on Japan’s aid policy towards China. China’s behaviour from the early 1990s did nothing to stem the criticism, and contributed to the process which eventually resulted in the 2005 announcement of Japan’s decision to phase out the yen loans in 2008.

The decision to end the yen loans is officially due to China’s economic growth making them unnecessary. If one looks at the history of the yen loans in the bilateral relationship since the early 1990s however, one can see it as the culmination of a political process within Japan. That process has resulted in the acknowledgement that the yen loans are not resulting in China’s compliance with Japan’s neither values nor motives as these have been sought by Japan. Japan’s engagement policy towards China still holds true, but the role of the yen loans in it are coming to an end. The close connection Japan makes between its national interests, energy security and environment conservation is reflected in the grant and technical aid that it

will continue to give to China. Focusing on projects such as reforestation, conservation of eco-systems, and development of human resources, it addresses problems it is also in Japan's interest to solve.

What effects will the ending of the yen loans have on the future of the bilateral relationship? There are discussions between the two parties as to what the exact timeframe for the ending should be (Drifte, 2006). The way this issue is handled will surely influence the effect the termination will have on the future relationship. Also, the termination's effect on the future bilateral relationship will be closely connected to the way the two countries will perceive each other in the future; as partners or as rivals. Such perceptions will, as has been seen so far, be influenced by future developments in both the international community and within the two countries.

The ending of the yen loans will undoubtedly have a strong impact on the bilateral relationship, but the end of the loans can usher in new forms of cooperation. In the recommendations given to Prime Minister Koizumi in 2002, it was suggested that support should be given to efforts aimed at increasing mutual understanding through exchange (MOFA, 2002). Such a usage of Japan's aid to China could be constructive, as mutual understanding is important to good bilateral relations between the two countries in the future. Further, the joint press statement issued in April 2007 stated that talks will be held on cooperation between Japan and China on extending aid to a third country (MOFA, 2007). This would be a positive way to take advantage of both countries' experience as aid recipients. The ending of the yen loans marks the end of one stage in Japan's engagement policy towards China, a policy that is constantly being reviewed and adapted to a dynamic bilateral relationship.

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