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**Assessing The Developmental Role of Foreign Aid in Developing
Countries: A Special Reference to The Role of Japan's Aid in Far
East Asia**

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1. INTRODUCTION

The concept of aid or Official Development Assistance (ODA) takes root in the Charter of the United Nations adopted during the conference of San Francisco in June 26th 1945. Members were committed “to promote social progress and better standards of life in larger freedom, and to employ international machinery for the promotion of the economic and social advancement of all peoples”¹. Rebuilding the world economy destroyed by the Second World War and promoting economic development worldwide has been the main concern of the world leaders since the 1950s. The first aid was provided by the United States to its European allies, through the Marshall Plan. The economic motive behind this move was that economic recovery, particularly growth, was hampered by the deficiency of productive capacity and aid affects the level of production by increasing capital stock as well as foreign exchange reserve. The success of the Marshall Plan created strong optimism about the prospects for helping poor developing countries which had just gained independence from their former colonial power. Indeed their development was also constrained by lack of saving, lack of foreign exchange and lack of human resources. And it is obviously wrong to expect that the necessary resources will be provided through market mechanisms, especially in presence of high risk projects, high transaction costs and imperfect information. Foreign aid is thus considered as a powerful tool to cope with the failures of market mechanism and consequently to boost economic growth by augmenting productive investment and technical knowledge (Chenery and Strout 1966).

The Development Assistance Group (DAG) was thus established in 1960, became Development Assistance Committee (DAC) in 1961, and a Resolution on Common Aid Effort was adopted in London on 29 March 1961. In this resolution, DAC members which are convinced of the need to help the less-developed countries help themselves by increasing economic, financial and technical assistance and by adapting this assistance to their needs and requirements, agreed to provide aid, notably in form of grants or loans with favorable terms, to less developed countries². As a result ODA started to flow massively in these countries, with average annual current flows varied from US\$ 5.3 billion in the 1960s to US\$ 22.8 billion in the 1980s³. The figures were respectively US\$38.9 billion and US\$59.4 billion in the 1990s and 2000s⁴. Over the past 48 years, US\$3.1trillion 2007 price of ODA flowed to developing countries, with Africa accounting for more than 1/3 of them⁵. It is worthy to note that Sub-

¹ Charter of United Nations, preamble, available at <http://www.un.org/en/documents/charter/>

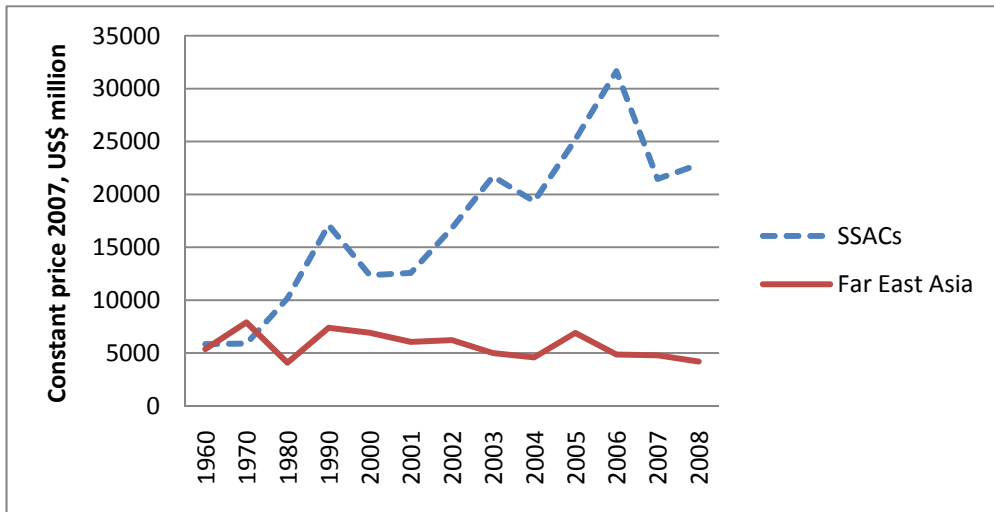
² The term “Less developed countries” was commonly used in the 1960s and 1970s, in opposition to developed countries, to describe the present developing countries

³ Calculated from OECD’s International Development Statistics online www.oecd.org/dac/stats/idsonline

⁴ *ibid*

⁵ *ibid*

Figure 1: Annual flows of net disbursements ODA



Source: OECD, International Development Statistics online

Saharan Africa (SSA) is the largest recipient region since the mid-1970s.

After almost five decades of massive aid inflows, some countries have been successful and had graduated from Low Income Countries (LICs) and aid dependency status whereas a large number have continued to show disappointing performance⁶. Many of the Far East Asian (FEA) countries belong to the first category⁷. Sub-Sahara African Countries (SSACs), characterized by very low or negative GDP per capita growth, remain in deep poverty as 70% of them are classified Least Developed Countries (LDCs). A close look at figure 1 & figure 2 shows this contrastive performance, especially since the turning point of the mid-1970s.

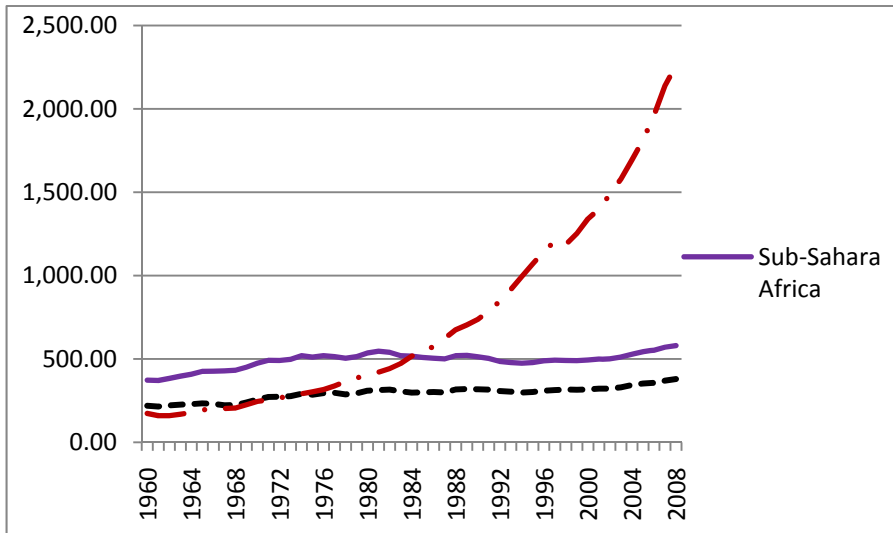
On the one hand, the SSACs have received increasing and substantial flows of ODA, which were powerless in overcoming their dismal economic performance since the mid-1970s. The 1980s is labeled the lost decade for SSACs as their average income per capita declined by 1.1% per year in average. This situation leads some scholars (see section 3) to conclude, with sophisticated arguments, that aid is ineffective and possibly damaging to recipient countries, especially that SSACs' growth in the immediate post independence period (1965-74) was fairly positive with GDP per capita raising about 2.6% p.a. (period of less aid inflows)⁸. The

⁶ Linking ODA to economic performance is subject to endless debate that will be discussed in section 2

⁷ Far East Asia includes: Brunei, Cambodia, Taiwan, Hong-Kong, Indonesia, Republic of Korea, Democratic Popular Republic of Korea, Laos, Macao, Malaysia, Mongolia, Philippines, Singapore, Thailand, Timor Leste, Vietnam

⁸ World Bank (1994), p17

Figure 2: GDP per capita (constant 2000 US\$)



Source: Author's calculation from World Development Indicators data, 2009

relatively high level of aid over an extended period in SSACs, 11.6% of their GNI in 2003, pushed these countries into aid dependency trap thereby impeding them from standing on their feet⁹. In other words, aid is not easily replaceable as it becomes an essential part of national expenditures and investment patterns, making aid politically and economically harmful in case of termination¹⁰. Moreover, initiative, responsibility and accountability of recipient governments are also adversely affected by aid dependence since donors, who finance significant proportion of government expenditures, make many of the decisions on investment expenditures (Lancaster, 1999). This situation is not promising, especially when fifteen SSA countries are considered as high aid dependent with a ratio of aid to GNI of more than 20%¹¹.

On the other hand, Far East Asian countries whose growth prospect was much lower than the SSACs in the earlier periods of independence have shown a steady economic growth, which has become more spectacular since the mid-1970s. As figure 2 shows, GDP per capita in East Asia & Pacific stood above that of SSACs (excluding the two biggest economies) in 1980, almost doubled in 1990 and increased fourfold between 1980 and 2000 to reach US\$ 1794 in 2005, against US\$ 323.8 for SSACs¹². In parallel to this outstanding economic

⁹ Calculated from the World Bank's *World Development Indicators*, 2007.

¹⁰ This is case when lending institutions had frequently interrupted Structural Adjustment Loans (SAL) in the 1980s (UNCTAD 2000)

¹¹ Calculated from the World Bank's *World Development Indicators*, 2007.

¹² *ibid*

performance, real inflows of ODA in the region have been in declining trend since the mid-1970s. It implies that, unlike in SSACs, aid dependency trap is not a serious issue in that region whereas some countries have graduated from “aid recipient” to become “aid donor”. Aid ratio to GNI has stayed below 1% since the mid-1970s and was 0.19% in 2003. Only two countries have a ratio superior to 20% (Mongolia and East Timor)¹³.

This contrastive economic performance has raised many questions about the determining factors of Asian’s economic success as well as of SSACs’ failure, and about whether it was linked or not to ODA. It is largely argued that prevailing economic policies in each country are the most plausible explanation. For example, in the East Asian success, the government’s role in setting and implementing sound economic policies is widely recognized even though the interpretation of this role as extensive or market friendly is still subject to debate. Likewise, the World Bank asserted that poor policies, such as overvalued exchange rates, heavy government spending, inward-looking trade policy, political and social instability, are largely to blame in SSACs’ sluggish performance while external factors (declining terms of trade, oil shocks and downturn in developed countries) are surmountable obstacles¹⁴. Asian countries had successfully coped with these problems in the 1980s *via* export-oriented growth strategies based on the promotion of Foreign Direct Investment (FDI) from Japan (Nishigaki and Shimomura 1998). This is not the case for SSACs.

Strong emphasis on the role of domestic policies in explaining economic performance means that any attempt to link ODA to recipient economic performance has to be done *via* analysis of prevailing economic policies in recipient countries. And one of the most influential paper about the ODA effectiveness argued that ODA is effective in countries with good economic policies (Burnside and Dollar 2000). This view is in support of aid disbursement conditionality imposed by donors, led by the World Bank and the IMF, to recipient countries. However, debate about aid’s effectiveness is far from closed and it is difficult to ascertain that ODA was entirely responsible of either failure or success in recipient countries. Indeed, the channels by which ODA affects the economic growth are interrelated and difficult to isolate.

Nonetheless, as it is stipulated in the UN charter and in the DAC’s Resolution on Common Aid Effort, ODA is supposed to help poor countries. In other words, it is expected to make positive economic contribution in recipient countries, by either eliminating barriers to economic growth or by strengthening growth factors. Therefore, following the contrastive economic performance described above, the questions which need to be answered are the followings. First, why ODA failed to produce positive outcome in SSACs? And why there is no improvement as SSACs still offer an image of deep poverty and misery after almost five

¹³ Ibid

¹⁴ World Bank, 1994, p.21

decades of ODA? Second, how did ODA work in FEA countries? Did ODA made great contribution to these Nations' sustained economic development, and how?

While answering to these questions, the purpose of this research is to attempt to establish the link between Japanese ODA and Far East Asian countries' better economic performance, Japan being the largest donor for that region. Underlying factors to aid effectiveness and aid ineffectiveness, especially at the donor side, will be thus identified through our analysis. These findings are intended to highlight relevant policy issues and to define alternative directions for future aid strategies for donors as well as for recipients.

The paper is organized as follows. Section 2 describes the trend and patterns of aid flows in developing countries with special focus on the two regions. Section 3 examines theoretical debates regarding aid effectiveness and explores three main approaches. The first is the rational of foreign assistance, known as the aid financed investment approach which emphasizes on the causal link from aid to investment and to economic growth. The second is referred by Collier (1999) as "aid dependency school" which argues that foreign aid deters growth and there is no causal link between aid and growth. The third is the conditional approach with an optimistic view about the effectiveness of foreign aid, provided that recipient countries exhibit certain characteristics. In light of the recent development in aid studies, relevant factors at donor side will be discussed as well. These studies paved the way toward increasing awareness of the importance of improving aid effectiveness, in support of Paris Declaration. In section 4, the experiences and the characteristics of Japanese ODA in Far East Asia, as illustrated by the case of Eastern Seaboard (ESB) Development plan in Thailand, is examined in order to establish the mechanism by which ODA can make a great contribution to economic development. Here the emphasis is on the role played by the distinctive characteristics of Japanese ODA, relative to western donors, in fostering economic development. We will conclude with alternative directions for future aid strategies for donors as well as for recipients.

2. TREND AND PATTERNS OF ODA IN SSACs AND IN FAR EAST ASIA (FEA)

Developing countries have received increasingly significant flows of ODA over five decades with more than half of them being disbursed during the last 18 years (Table 1). Bilateral aid accounts for the bulk of aid flows while grants gain more importance overtime. The largest aid flows for the period 2000-08 is an important outcome of the 2002 Monterrey's conference, based on the 2000's Millennium Development Goals agreed by the world leaders. Indeed, donors agreed to increase both aid volume and quality while recipients committed to focus on good governance and development priorities.

Table 1: Trends and Patterns of ODA from DAC countries
(Unit: constant 2007 US\$ millions)

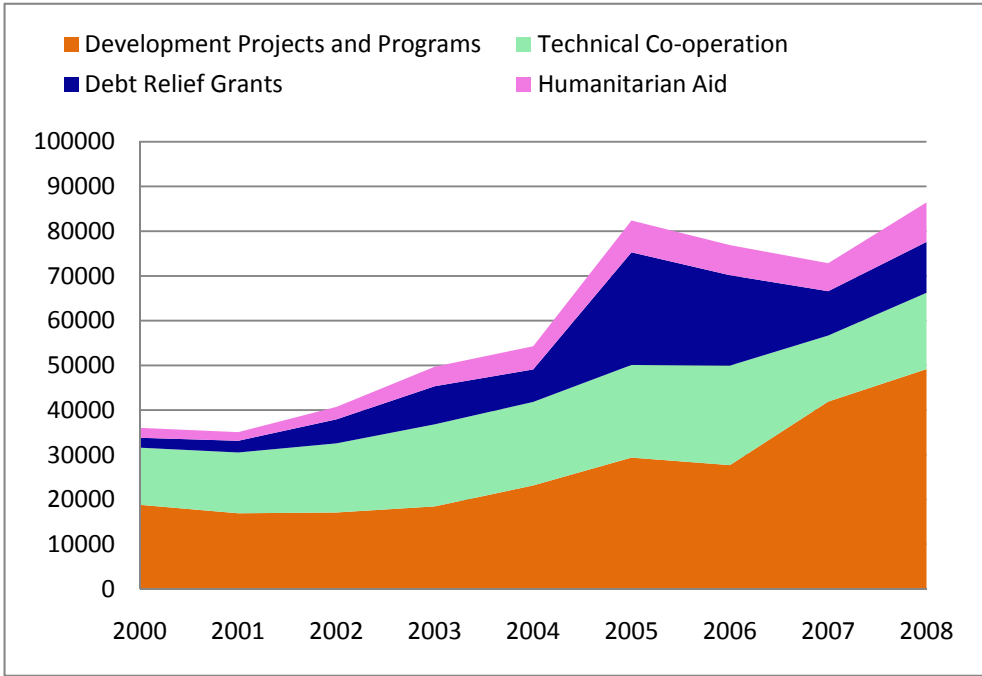
	1960s	1970s	1980s	1990s	2000-08	TOTAL	%
Developing Countries	414420.78	481350.74	676078.64	744044.61	857798.61	3173693.38	100.00%
Multilateral	54652.26	137573.02	214003.59	230656.53	251179.53	888064.93	27.98%
Bilateral	359768.52	343777.72	462075.05	513388.08	606619.08	2285628.45	72.02%
Grants	248885.30	229942.93	358790.60	465804.11	615717.56	1919140.50	83.97%
Loans	109855.15	113835.21	103284.33	47583.97	-9098.48	365460.18	15.99%
Sub-Saharan Africa	80658.29	111272.44	214877.95	229520.23	280635.36	916964.27	100.00%
Multilateral	10282.39	32940.45	67647.37	86856.69	94307.68	292034.58	31.85%
Bilateral	70375.90	78331.99	147230.58	142663.54	186327.68	624929.69	68.15%
Bilateral(gross disbursements)	74762.85	78764.28	142938.94	157434.44	199433.96	653334.47	100.00%
Grants	52961.44	58666.98	112635.60	134838.68	189628.58	548731.28	83.99%
Loans	21801.41	20097.30	30303.34	22595.76	9805.38	104603.19	16.01%
Far East Asia	61690	70543.32	69119.57	89155.82	69716.32	360225.03	100.00%
Multilateral	1127.34	8603.53	15400.41	22118.77	18217.42	65467.47	18.17%
Bilateral	60562.66	61939.79	53719.16	67037.05	51498.9	294757.56	81.83%
Bilateral(gross disbursements)	61417.61	64851.02	62702.19	88803.89	81401.23	359175.94	100.00%
Grants	47680.82	28707.63	25088.54	38785.38	42708.88	182971.25	50.94%
Loans	13736.79	36143.39	37613.65	50018.51	38692.35	176204.69	49.06%

Source: Calculated from OECD's International Development Statistics online

Efforts had been made to increase aid volume as for 2000-08, it was highest at 27% of the total, or two times of the 1960s’ level. Still donors have so far pledged for only 0.3% of their GNI, in average, which are less than half of the agreed target, 0.7% of GNI¹⁵.

Aid quality is always appreciated through the importance of grants and tying status. From this point of view, the quality of aid has improved significantly because the increase in net disbursement of bilateral aid from 2002 was entirely attributed to grants (Table 1). Technical cooperation is important but its share had declined overtime from 45% in the 1970s, to around 38% in the 1980s and 1990s, and to 28.7% for 2000-08. Nonetheless, it is worth noting that 63% of bilateral aid for 2000-08 was in form of special purpose grants, with debt relief accounted much of the increase (Figure 3)¹⁶. It had grown at 60% p.a between 2002 and 2005 (Le Houerou 2008).

Figure 3: Aid type: Annual Net disbursement from DAC countries
Unit: constant 2007 US\$ millions



Source: Calculated from OECD’s International Development Statistics online

¹⁵ Calculated from OECD’s International Development Statistics online www.oecd.org/dac/stats/idsonline

¹⁶ Special purpose grants includes technical cooperation, food aid, debt relief, humanitarian aid and administrative costs.

In addition, aid is increasingly untied as the ratio stood at 87.26% in average for all DAC members in 2008¹⁷.

Sectoral distribution shows that at the beginning (when SSACs had promising economic prospect) economic infrastructure, production sector and commodity aid were the top three sectors and accounted for 71.11% of total aid (Table 2). However, significant changes occurred during the next periods as donors' decision in aid allocation have been increasingly motivated by basic human needs, notably education, health and other forms of human capital. Indeed, the share of social infrastructure and services rose from 7.61% in the 1960s to its highest level, 35.22% in 2000-08 at the expense of the economic infrastructure and production sectors whose share fell respectively to 12.47% and 5.98%¹⁸.

Industry and mining, agriculture and energy are sectors that suffered most with shares falling respectively from 5.82%, 11.52% and 7.69%, in the 1980s, to 1.41%, 3.95% and 4.15% in 2000-08¹⁹. Another important change is the high share of debt relief, which ranked second during the last eight years (Table 2).

**Table 2: Sectoral distribution of ODA from DAC countries,
(Unit: constant 2007US\$ millions)**

	Year	1967-69	1970s	1980s	1990s	2000-08	TOTAL
I. SOCIAL INFRASTRUCTURE & SERVICES		5726.15	102004.33	156542.59	174030.56	269502.24	707805.87
II. ECONOMIC INFRASTRUCTURE & SERVICES		16693.44	56932.52	114523.96	111133.8	95428.16	394711.88
III. PRODUCTION SECTORS		20323.3	89568.52	124840.34	70054.11	45748.15	350534.42
IV. MULTISECTOR / CROSS-CUTTING		636.93	8149.46	17448.29	32438.43	52208.3	110881.41
VI. COMMODITY AID / GENERAL PROG. ASS.		16103.83	75444.8	88356.02	67610.9	33909.89	281425.44
VII. ACTION RELATING TO DEBT		4823.17	19992.54	15890	71908.71	118887.68	231502.1
VIII. HUMANITARIAN AID		0	4354.69	10624.61	32601.79	52775.29	100356.38
IX. ADMINISTRATIVE COSTS OF DONORS		0	0	14477.6	28212.22	38603.38	81293.2
X. SUPPORT TO NGO'S		0	0	9214.37	9527.02	22305.47	41046.86
XI. REFUGEES IN DONOR COUNTRIES		0	0	0	6223.03	18024.47	24247.5
XII. UNALLOCATED/UNSPECIFIED		10396.03	97559.29	45339.79	35284.28	17908.13	206487.52
TOTAL		74702.85	454006.15	597257.57	639024.85	765301.16	2530292.58

Source: Calculated from OECD's International Development Statistics online

¹⁷ Calculated from OECD's International Development Statistics online www.oecd.org/dac/stats/idsonline

¹⁸ The social sectors accounted for 57% of total sector allocable ODA for 2002-2006 (Le Houerou 2008).

¹⁹ Calculated from OECD's International Development Statistics online www.oecd.org/dac/stats/idsonline

Table 3: Top donors in SSACs

Years	1960s	1970s	1980s	1990s	2000s
DAC EU Members, Total	75.13%	48.56%	46.50%	44.78%	43.59%
France	32.82%	18.51%	14.93%	15.93%	10.36%
EC (multilateral)	8.00%	12.25%	9.86%	11.42%	10.88%
United Kingdom	23.19%	8.39%	4.85%	4.76%	8.92%
Germany	5.79%	7.40%	7.62%	6.72%	6.31%
United States	10.68%	5.99%	6.59%	5.91%	12.81%
Japan	0.09%	1.54%	3.17%	3.87%	3.43%
TOTAL (US\$ million)	80658.29	111272.44	214877.95	229520.23	280635.36

Source: Calculated from OECD's International Development Statistics online

Table 4: Top Recipients in SSACs (Unit, constant 2007 US\$ millions)

	1960s	1970s	1980s	1990s	2000s	TOTAL	
Nigeria	5.10%	2.84%	0.70%	1.33%	8.88%	36740.11	4.01%
Ethiopia	2.12%	3.35%	5.01%	5.44%	6.59%	47176.74	5.14%
Tanzania	3.95%	7.03%	7.37%	6.19%	6.49%	59284.29	6.47%
Congo, Dem.Rep.	9.86%	6.71%	4.49%	1.74%	6.48%	47248.39	5.15%
Mozambique	0.37%	1.11%	3.97%	6.65%	5.69%	41277.48	4.50%
Uganda	2.68%	1.23%	2.13%	4.25%	4.49%	30471.18	3.32%
Sudan	1.64%	6.00%	8.21%	2.54%	4.15%	43134.25	4.70%
Ghana	2.74%	2.74%	2.82%	3.64%	3.74%	30173.24	3.29%
Zambia	2.24%	2.81%	3.36%	4.83%	3.68%	33580.36	3.66%
Cameroon	2.43%	3.87%	2.35%	3.21%	3.26%	27833.15	3.04%
Kenya	6.20%	5.02%	5.34%	4.09%	2.79%	39297.34	4.29%
Senegal	3.10%	4.18%	4.34%	3.53%	2.59%	31856.59	3.47%
Madagascar	2.91%	2.58%	2.51%	2.49%	2.57%	23520.18	2.57%
Mali	1.42%	3.16%	3.27%	2.59%	2.42%	24446.18	2.67%
Cote d'Ivoire	2.52%	3.15%	2.13%	5.05%	1.49%	25894.66	2.82%
Others	50.74%	44.20%	41.99%	42.42%	34.68%	375030.1	40.90%
TOTAL	80658.29	111272.4	214878	229520.2	280635.4	916964.3	100.00%

Source: Calculated from OECD's International Development Statistics online

Distribution by income groups indicates that aid donors tended to favor Middle Income Countries (MICs) which were the largest recipients, with an average share of 39% of total ODA for almost four decades, calling into question the basic principle of DAC²⁰.

²⁰ Calculated from the OECD's international development statistics online

But in the years following the Monterey conference, Low Income Countries (LICs) have increasingly received more aid and are equally important to MICs with 34.28% share in 2008²¹.

By Region, SSA has been the top recipient since the mid-1970s and has accounted in average 33% of total annual ODA flows, with the DAC EU members and the European Community (multilateral) being the region's largest donor with 54.47% share for 2000-2008 (Tables 1 & 3). In terms of individual country, France had been the largest donor to the region until it was overtaken by the United States (12.81%) and Germany (10.88%) in 2000-08 (Table 3). Five countries in SSAC, namely Nigeria, Ethiopia, Tanzania, Democratic Republic of Congo and Mozambique, accounted for more than 35% of ODA flows in the region for the last nine years. Compared to developing countries' average, aid inflows to SSACs have the highest share in grants which was 95.08% of total bilateral aid flows for 2000-08 (Table 1). Japan plays a minor role and its share varies from 0.09% in the 1960s to 3.43% in 2000-08. Except Cameroon, SSA's top recipients are LICs and many are Least Developed Countries (LDCs). Tanzania is the top recipient country with 6.47% share of the total flows from 1960 to 2008 whereas Nigeria ranked first with 8.88% share for the period 2000-08 (Table 4).

As ODA is thought to foster economic development, it seems paradoxical that economic and production sectors in SSACs received less significant amount of aid. Moreover, their share

**Table 5: Sectoral allocation of ODA to SSACs, Commitment,
Unit: constant 2007 US\$ million**

SECTORS	1995-99		2000-08	
I. SOCIAL INFRASTRUCTURE & SERVICES	26816.67	31.54%	122155.18	37.71%
II. ECONOMIC INFRASTRUCTURE & SERVICES	14473.13	17.02%	39039.00	12.05%
II.1. Transport & Storage	<u>8310.21</u>	<u>9.77%</u>	<u>21807.51</u>	<u>6.73%</u>
II.2. Communications	<u>695.13</u>	<u>0.82%</u>	<u>1101.28</u>	<u>0.34%</u>
II.3. Energy	<u>3279.18</u>	<u>3.86%</u>	<u>9320.54</u>	<u>2.88%</u>
III. PRODUCTION SECTORS	8409.73	9.89%	23816.10	7.35%
III.1. Agriculture, Forestry, Fishing	<u>6763.64</u>	<u>7.96%</u>	<u>16527.21</u>	<u>5.10%</u>
IV. MULTISECTOR / CROSS-CUTTING	6951.11	8.18%	13831.44	4.27%
VI. COMMODITY AID / GENERAL PROG. ASS.	11784.72	13.86%	31927.22	9.86%
VII. ACTION RELATING TO DEBT	9456.10	11.12%	60490.98	18.67%
VIII. HUMANITARIAN AID	5642.43	6.64%	28220.45	8.71%
IX. ADMINISTRATIVE COSTS OF DONORS	72.27	0.09%	715.91	0.22%
TOTAL	85020.24	100.00%	323966.35	100.00%

Source: Calculated from OECD's International Development Statistics online

²¹ *ibid*

declined from 26.91% in the 1990s to a mere 19.40% in 2000-08 (Table 5). More precisely, two sectors, namely transportation and energy, whose deficiency is widely recognized to deter SSA's competitiveness and its ability to attract Foreign Direct Investment (FDI), received only 6.73% and 2.88% of ODA in 2000-08 (Table 5).

Social sector, especially primary education and basic health, is the prime target of ODA with 37.7% share while debt relief stood at 18.67%. A close look at the situation of top recipient SSACs shows that debt relief accounted for more than 80% of Nigeria's ODA in 2006 while Tanzania received almost 60% of its ODA as general program aid at the expense of economic and production sectors whose share was 8% only²². The same situation happens in Congo Democratic Republic and Sudan²³.

FEA exhibits some distinctive characteristics, compared to SSA, in terms of ODA flows. First, FEA has received less and less aid overtime as its share fell from 14.89% of the total in the 1960s to only 8.13% for 2000-08, or one forth of SSACs' (Table 1). Cumulative inflows since the 1960s were only 11.35% of US\$ 3.17 trillion ODA disbursed in the world. Moreover disbursed ODA is predominantly in form of loans and has low share of grants. Indeed, except for the 1960s, grants were under 45% of total bilateral aid; and even during the period of donors' highest pledge for grants (2000-08), those of FEA were half of the total aid it received. Second, USA and Japan are the largest donors in the region with the former playing the major role in the 1960s and the latter after that.

Japan is thus the largest donor (larger than all DAC EU members) of FEA, especially during the period of spectacular growth when these countries outpaced SSACs (Table 6). Japan still accounts for 25.39% of ODA disbursed in that region in 2000-08.

Table 6: Top Donors in FEA

	Year	1960s	1970s	1980s	1990s	2000-08	TOTAL
Japan		18.14%	25.65%	<u>35.63%</u>	<u>35.65%</u>	<u>25.39%</u>	<u>28.70%</u>
United States		<u>64.54%</u>	<u>34.12%</u>	5.55%	2.82%	7.04%	20.86%
Germany		3.93%	4.71%	8.55%	9.44%	7.40%	7.00%
Australia		0.99%	2.89%	4.36%	5.10%	6.93%	4.17%
France		2.48%	3.07%	3.90%	5.51%	4.67%	4.04%
United Kingdom		2.91%	3.40%	1.71%	2.21%	3.44%	2.70%
DAC EU		13.73%	20.07%	25.98%	26.91%	26.93%	23.14%
TOTAL (2007 US\$ million)		61690	70543.32	69119.57	89155.82	69716.32	360225.03

Source: Calculated from OECD's International Development Statistics online

²² OECD (2008), p53

²³ *ibid*

Table 7: Sectoral distribution of ODA in FEA(Unit: Current US\$ million)

	Year		1995-99		2000-08	
	Total		55300.93	100.00%	107154.4	100.00%
100: I. SOCIAL INFRASTRUCTURE & SERVICES			12069.29	21.82%	40139.46	37.46%
200: II. ECONOMIC INFRASTRUCTURE AND SERVICES			24273.39	43.89%	30214.17	28.20%
210: II.1. Transport & Storage			14481.72	26.19%	16445.66	15.35%
230: II.3. Energy			7988.856	14.45%	9062.761	8.46%
300: III. PRODUCTION SECTORS			6726.076	12.16%	10154.66	9.48%
310: III.1. Agriculture, Forestry, Fishing			5110.077	9.24%	7393.681	6.90%
400: IV. MULTISECTOR / CROSS-CUTTING			5943.482	10.75%	11055.55	10.32%
500: VI. COMMODITY AID / GENERAL PROG. ASS.			4144.339	7.49%	4764.939	4.45%
600: VII. ACTION RELATING TO DEBT			600.626	1.09%	4717.999	4.40%
700: VIII. HUMANITARIAN AID			1349.043	2.44%	4568.146	4.26%
910: IX. ADMINISTRATIVE COSTS OF DONORS			6.2621	0.01%	171.9048	0.16%

Source: Calculated from OECD's International Development Statistics online

Third, unlike in the SSACs, economic infrastructure has received the lion's share of ODA in the region as it accounted for 43.89% of the total in the 1990s. And if added to the production sector, their share stood at 56.05%. FEA, thus, received more ODA than SSACs in sectors that are more likely to foster high growth, US\$ 30 999 million for the former against US\$ 22 873 for the latter (Table 5 & 7). For 2000-08, FEA and SSA have the same share of ODA allocated to social sector but the former shows much higher share in economic and production sector (37.68%). Indonesia received a sizeable amount of ODA through the decades and was top recipient in the 1970s and 1980s with 33.99% and 27.98% share. China was ranked first a decade later while Vietnam took the lead with 26.67% share for 2000-08(Table 8).

Table 8: Top recipients in FEA (Unit: 2007 US\$ million)

Year	1960s	1970s	1980s	1990s	2000-08	TOTAL
Viet Nam	27.69%	22.20%	5.71%	10.48%	26.67%	17.94%
China	0.00%	0.06%	26.19%	34.77%	21.85%	17.87%
Indonesia	19.09%	33.99%	27.98%	19.31%	19.51%	23.85%
Cambodia	1.79%	4.03%	1.86%	4.12%	7.86%	3.99%
Philippines	6.95%	8.75%	13.98%	13.41%	7.42%	10.34%
Laos	5.01%	3.09%	1.58%	3.33%	4.74%	3.51%
Malaysia	3.00%	3.73%	5.69%	1.46%	1.74%	3.04%
Korea	22.77%	14.31%	1.68%	-0.42%	0.00%	6.92%
Thailand	4.77%	6.37%	12.78%	8.78%	-1.00%	6.50%
Far East Asia, Total	61690	70543.32	69119.57	89155.82	69716.32	360225

Source: Calculated from OECD's International Development Statistics online

3. THE AID DEBATES

3.1 *The Rational of foreign assistance, poverty trap and the “big push” theory*

The rationale for foreign assistance was based on the popular big push view of development in the 1950s pioneered by Rosenstein-Rodan (1943, 1944), and developed by Nurkse (1962). According to these theories, backwardness or underdevelopment is caused by insufficient investment across sectors of the economy and in infrastructure. Hence, they argued that developing countries, especially poor countries, are trapped in the vicious circles of poverty as their growth is constrained by low savings and lack of foreign exchanges. Indeed, for the majority of poor countries, ex-ante investment needs, determined by the Incremental Capital Output Ratio (ICOR), to generate long run growth cannot always find a source of finance due to insufficient savings. In addition, their exports are limited mainly to primary goods whose terms of trade deteriorate in the long term, exacerbating foreign exchange shortfalls thereby restricting imports of capital goods. This approach, known also as the dual gap model, is used to determine the financing requirements gap that must be removed in order to achieve the minimum required economic growth rate. Due to high risk of doing business and the imperfection of international capital market, poor countries find it difficult to attract private capital and to borrow on international markets. Consequently, foreign aid is considered as the appropriate means to ease these constraints by providing investible resources to supplement domestic efforts. In their basic model, Chenery and Strout (1966) assume that domestic savings in poor countries are at their maximum level, foreign aid will act as additional resources and will ignite economic growth, and will initiate virtuous circle of investment, growth and income. First, the level of investment will increase directly by the amount of aid; the developing countries can invest more than they can save. Second, aid will increase the rate of capital accumulation indirectly by raising the level of income and the rate of domestic savings. It is thus assumed that all aid is invested, thereby leading to higher rate of capital accumulation and a larger proportion of income being saved. In addition, economic growth is also said to be constrained by lack of technological knowledge that can be improved by foreign aid in form of technical assistance.

Aid is thus expected to spur growth by increasing the recipient's stock of physical and human capital. Amid criticisms regarding aid effectiveness, this approach remains in practice in many developing countries and is supported by numerous empirical evidences.

Papanek (1973), in a cross-countries regression analysis found that savings and foreign capital inflows (aid, private capital and other inflows) explained over a third of the growth rate, with the foreign aid having a more significant effect than savings and other sources of capital. The UNCTAD (1999) explained the insufficient amount of aid inflows as

the main cause of Africa's poor economic performance. It says that these flows had been insufficient in volume to offset the saving and foreign exchange gaps, which have widened since the 1980s due to low growth, adverse Terms of Trade (TT), increased imports as a result of economic liberalization.

Recent empirical studies associated aid effectiveness to its primary purpose and to where it was allocated. Aid transfers which enter the budget of government, by financing productive investments, increase long-run growth and welfare of the recipient countries (Chaterjee et al. 2003, Chaterjee and Turnovsky 2005). They suggested that aid allocation should be tied to public investments in order to foster growth. Similarly, Clemens et al. (2004), while stressing on the necessity of distinguishing between different types of aid before assessing its effectiveness, found a very strong, positive and robust relationship in which aids – such as balance of payment support, investments in infrastructure, and support for productive sectors such as agriculture and industry – cause growth. They qualified it as “short-impact” aid which stimulates growth in four years²⁴. The other categories of aid as defined by the authors are: (1) emergency and humanitarian aid which is likely to be correlated to growth according to them, and (2) aid allocated to the sectors – such as democracy, environment, health and education – and that affects growth only over a long period of time. Aid allocated to basic human needs is expected to affect growth on the long term while differential impact of aid among recipient countries could be asserted according to its sectoral allocation.

Nonetheless, the proponents of the dual gap approach are not likely to favor particularly “short-impact” aid because development is not only about physical capital. It is also about human capital which is more important than physical capital. Investment in human capital (education and health) increases labor productivity and will affect future growth (Chenery et al 1974). It is thought that serious limitations on human capital impede growth²⁵. This is the basic human needs approach to foreign aid which is strongly supported by the world leaders who set up the Millennium Development Goals (MDGs) under the guidance of the United Nations in 2000²⁶. Harvard's eminent economist, J.Sachs (in Sachs et al 2004, Sachs 2005), who leads the Millennium Project constructed a theoretical framework justifying the

²⁴ Four years period of observation is usually used by many researches on the impact of aid on growth. This finding helps to explain the effectiveness of Japanese ODA, which is biased towards economic infrastructure and production sectors in FEA (see section 4).

²⁵ For example, the United Nations (2006) assert that losses incurred to water and sanitation deficit, in Sub-Saharan Africa Countries (SSACs) – in terms of health expenses, productivity losses and labor diversions – reached 5% of GDP, or US\$ 28.4 billion p.a., that is greater than total aid flows in the region in 2003.

²⁶ Bias toward economic growth in the 1970s worsened income distribution in many developing countries and there was a growing call for new development strategy that can reach the poor directly. This issue is raised by Robert Mc Namara, former Director General of the World Bank, during his annual speech in 1972. It got extensive audience after the declaration of Cocoyoc in 1974 (Keza, 2005).

appropriateness of a “big push” to cope with the ailing SSA economies²⁷. In his “theory of Africa’s poverty trap”, policy and governance reform, by itself, will not be sufficient since, in even well-governed countries in Africa, extreme poverty leads to low national saving rates, which in turn lead to low or negative economic growth rates. And given the low capability of these countries to attract market-based foreign capital inflows, due to poor infrastructure, weak human capital and other perceived risks, SSACs are not likely to escape from poverty. He stated that “...when an economy begins with very low capital, both the capital-labor ratio and output per capita tend to decline over time. The very poor indeed get poorer, pushed into more extreme poverty by the lack of capital accumulation coupled with population growth. Only when an economy has a capital-labor ratio above a minimum threshold does it tend to achieve economic growth and converge to the steady-state”²⁸. A big push is thus needed, especially a large inflows of ODA to enable poor countries to achieve the MDGs, which he considered as useful intermediate targets (basic needs) for breaking poverty trap. Once poor households’ basic needs are met, they may save quite a lot of income, thereby removing saving constraints, allowing higher level of capital accumulation and higher economic growth, and leading to development. The revival of big push theory results into strong commitment to double aid to poor countries in SSA in order to achieve the MDGs, on the belief that the achievement of these targets will propel SSACs into a self-sustaining growth.

3.2 *Aid dependency approach*

In the big push approach, aid is considered as a temporary assistance to encourage certain long term behavior such as tax collection, investment in physical and human capital, increasing savings and the establishment of good institutions. In other words, aid is expected to only ignite the dynamics of economic growth and will be reduced or phase out after capital accumulation process is underway. In light of the success of Marshall Plan, this view is reflected in the Resolution on Common Aid Effort by DAC countries (need to help the less-developed countries help themselves) and has been supported by well argued theories to justify the large inflows of aid since the 1960s as well as the appropriateness of scaling-up aid to achieve the MDGS. The reality is however quite different for many recipient countries after more than four decades of aid inflows²⁹. Many countries in SSA, the poorest region in the world, continue to depend heavily on foreign aid for their economic survival. This situation

²⁷ Big push theory was pioneered by Rosenstein-Rodan (1943, 1944). He suggested that because of their indivisibility and their important positive externalities, massive public investment in economic and social infrastructure development must precede directly productive private investment. His thesis has been adopted as guiding principle of several multilateral and bilateral aid agencies later. The Millennium Development goals and Sachs’s theory about the poverty trap are seen as the extension of his theory.

²⁸ Sachs et al (2004), p126

²⁹ FEA countries receive less and less aid as their economic performance is improves overtime

calls in question the assumption about the temporary nature of foreign assistance. Moreover, several cross-countries studies, in challenging the big push approach, found no robust relationship between aid inflows and economic growth. First among others is the study conducted by Griffin and Enos (1970), who found no close association between the amount of aid received by fifteen African and Asian countries and the rate of growth of GDP for 1962-1964. The reason is that foreign aid encourages higher consumption and does not act as an increment but rather as substitute to domestic savings. They found that 75% of incremental aid went to consumption and only 25% was used to increase investment, meaning that a large proportion of aid is not used to increase investment as it is expected to be. In addition, the capital intensive nature of this low proportion of investment resulted into raising capital-output ratio and reduced the rate of growth. Dollar and Easterly (1999), when testing the aid to investment link, found that no African country satisfied the prediction that investment would increase by the amount of aid. They argued that if all aid went to investment, Madagascar's ratio of investment to GDP would increase and stood at around 19% in 1991 rather than actually stagnating around 2% over thirty years (Dollar and Easterly 1999).

Another persistent critic of foreign aid is Bauer (1966, 1974) who emphasizes that aid, especially grants, fosters moral hazard problems as it destroys incentives to adopt good policies leading to misallocation of scarce resources, thereby undermining growth. Referring to Marshall Plan as a potential value of foreign aid to poor countries is misleading. He said that "the economies of western Europe had to be restored while those of present recipients have to be developed", the formers being only constrained by shortage of physical capital and blessed with human capital and market opportunities (Bauer, 1966). His arguments were later discussed and developed through numerous empirical studies which concluded that foreign aid has no effect on growth or even deters growth. Indeed, there are evidences suggesting that aid tends to increase government consumption rather than to close the financing gap of productive investment (Easterly 1999). Consequently aid inflows increase demand and cause Dutch disease for many of the recipient countries (Harrigan, 2007). Given that aid recipient is supply-constrained, surge in demand will fuel inflation, leading to real exchange rate appreciation, thereby curtailing export competitiveness and making import cheaper in domestic currency. This situation will widen rather than narrowing foreign exchange gap (Harrigan 2007). Saving gap will widen as well because of moral hazard problems, not only in discouraging efforts to reform inefficient policies and institutions, but in altering recipient behavior in adverse way and in weakening institutions, especially economic institutions. High level of aid softens budget constraint making budgeting more flexible, and is likely to lead into fiscal indiscipline or budget distortion (Moss et al. 2008). There are evidences that recipient governments tend to reduce tax collection efforts along with aid inflows (Gupta et al, 2004, Brautigam et Knack 2004). By type of aid, grants had significant negative effect on state revenue while loans had a significant positive impact (Gupta et al, 2004). Macroeconomic imbalances are the most likely

outcome of excessive and unsustainable level of government consumption financed by foreign aid. In addition, Knack and Rahman (2004) found that aid can potentially harm the institutional quality because of the high probability of increased corruption, weak accountability and struggle for rent³⁰. Like natural resources, aid has a statistically significant negative effect on changes in political institutions, leading to weaker institutions (Djankov et al. 2008). This aid-institutions paradox is well developed by Moss et al. (2008) who argued that the harmful effect of aid on institutional development is one of the causes of economic performance dismal in SSACs. Recipients are therefore lacking the structural and the institutional capacity to effectively absorb aid without these distortionary effects. As a consequence, incremental aid inflows will eventually subject to diminishing marginal returns, further aggravating the negative impact of aid on growth and institutional quality. Many econometric studies have found negative returns to increasing aid beyond a threshold level of the aid to GDP ratio³¹. Since weaker institutions are likely to result in significant negative relationship between aid inflows and state revenue, the disincentive effects of aid and the moral hazard of the government will push recipient countries in aid dependency trap in the long run. Recipients are increasingly relying on aid as substitute for local resources as the governments tend to underinvest in developmental capacity, further damaging their absorptive capacity.

Given aid's powerlessness to reverse economic dismal in SSACs and given its damaging effects on structural and institutional capacity, and as evidences about the absence of links between foreign aid and growth are growing (Easterly et al. 2004, Easterly 2003, Hansen and Trap 2000 and 2001, Rajan and Subramanian 2007, Dalgaard et al. 2004), the proponents of aid dependency view suggest that ODA ought to be terminated or at least drastically curtailed (Bauer 2000, Moyo 2009). There are thus growing concerns about the capacity of SSACs to absorb large new inflows of aid due to weak management and weak government institutions.

3.3 The Conditional approach

Suggesting that aid is irrelevant or harmful to growth and development process and should be terminated would be wrong. The reason is that most of the evidences to support this view are based on cross-country studies which suffer from the failure to take into account country specificity and other limitations to be robust and conclusive in linking aid to economic growth. Indeed, there are evidences of some countries in Africa and outside Africa where aid had potentially made a difference and contributed to accelerating growth, development and

³⁰ This situation will encourage rent-seeking activities instead of profit-seeking activities.

³¹ Hansen and Tarp (2000) find that negative returns to aid set in once aid reaches about 25% of GDP while for Lensink and White (2001) the ratio is above 40-50% of GDP. Burnside and Dollar (2000) put it at 4% of GDP

poverty alleviation (Collier 1999, Maipose 2009, Carlsson et al. 1997, Potter 1996, Kohama 2003). Taking into account country's specificity in evaluating aid effectiveness implies that the recipient's socioeconomic context plays a determining role in to what extent aid can raise growth. In other words, aid effectiveness is conditioned by prevailing institutional and policy environment in recipient countries³². The most influential paper supporting this view is written by Burnside and Dollar (2000). Based on econometric analysis from cross country regressions, using data from 51 countries and six four-year periods from 1970 to 1993, their main argument is that aid, through its effect on the stock of capital, accelerates growth in presence of sound economic policies that are measured by trade openness (trade policy), inflation rate (monetary policy) and budget surplus (fiscal policy, good governance). This is the case of countries such as Bolivia, Botswana, El Salvador, Ghana, Honduras and Mali.

Whereas their finding is consistent with other authors' view (see section 3.2) that, in average, aid is ineffective to boost growth and it is subject to diminishing return, they assert that aid is not to be blamed for this failure. It is donor's ignorance in allocating more aid to countries with unsound economic policies that lowered the potential for aid to support growth. More importantly, it is bilateral donors (about two third of total aid) that do not favor good policy in their aid delivery and their aid tended to encourage government consumption (one of the reason of aid ineffectiveness evoked by aid skeptics). On the other hand, multilateral aid is always allocated in support of good policy. In the earlier version of their paper (Burnside and Dollar 1997), it is argued that aid (used for investment) is also effective in encouraging private investment as long as the policy environment is sound.

Burnside and Dollar's findings provide important policy implications and get strong support from the donors' community, especially the international aid agencies, and resurrect the widely criticized conditionality, known also as the Washington consensus, but with little change. Henceforth, aid does promote growth and it should be allocated in countries that have adopted good policies. Instead of conditionality, aid agencies used the concept of selectivity, or *ex post* conditionality in which aid allocation is performance-based. Aid is thus to be allocated to those countries which have already good policies and which are poor. Since aid does not systematically affect the quality of policies, aid should not be conditional on promises of reform³³. Large inflows of aid are only indispensable to poor countries after they have achieved significant progress with policy reform. Then, what should be done for those poor countries with poor policies and which lack the capacity to conduct policy reform leading to good policies? Collier (1999) had answered this question in suggesting a dynamic case for a

³² This environment is largely the product of a country's political economy, which is profoundly shaped more by local conditions such as endowments, historical legacies and global geopolitics (Rodrik 2003)

³³ This is based SSACs' experience for receiving Structural Adjustment Loans, in the 1980s, on promise of reform but they have failed to implement reform, thus to achieve economic growth.

temporary increase of aid. That is, to use aid to induce policy reform and to increase it even after policies improved because the resulted growth needs to be sustained within a situation of low private investment. In his own terms, “aid needs to *taper in* with policy reform (and ahead of private investment) rather than to *taper out* with reform as it is the actual donor behavior”.

Burnside and Dollar’s good policy environment indicators are viewed as too narrow to explain economic growth and World Bank’s Country Policy and Institutional Assessment (CPIA) index was introduced to extend the initial findings in Collier-Dollar model (2002). The main assumption becomes that it is possible to halve poverty by 2015 if aid is allocated optimally (in taking into account the diminishing return) to low income countries with high CPIA index.

The Collier-Dollar model supports the view that aid failed to yield significant positive outcome because the bulk of it is actually given to induce policy reform and for a variety of historical and strategic reasons, at least up to the mid-1990s. Countries with poor CPIA score should only be given the amount of aid necessary to carry out reform and future aid will be given based on reform performance. Even though “*Policy matters*” idea has been adopted by some aid agencies (IDA, DFID, The Canadian International Development Agency), growing evidences call into question its robustness and it would be wrong to decide aid allocation on the basis of only CPIA index.

First, “*Policy matters*” idea is self-evident but factors other than policy variables are likely to affect the positive relationship between aid and growth. These are, for example, institutions, geography, climate, political stability, per capita income level, social cohesion, initial conditions, and extent of poverty within the country. If we look back to the 1980s, the so-called lost decade for many SSACs which went under Structural Adjustment Program (SAP), it is true that the first disbursement of Structural Adjustment Loans (SAL) was done on promises of reform (conditionality). Aid was given to induce policy reform in countries with poor policy environment. However, the next disbursement of Enhanced Structural Adjustment Facility (ESFAF), as well as new loans and grants from bilateral donors, is conditional on the fulfillment of conditionality, meaning that performance-based aid allocation is not a new phenomenon and was widely applied to many countries in Africa.

Moreover, either original conditionality or “augmented” conditionality is very similar to Burnside and Dollar’s good policies and Collier-Dollar’s CPIA index³⁴. Although a large number of SSACs have been qualified as “good boys” (good followers of policy prescription), the program failed to produce positive outcome. There is evidence that many “good boys” failed while twelve of the fifteen countries with better economic performance in the mid-1990s

³⁴ Original conditionality includes 10 rules of good behavior but were increased to 20 rules after disappointing results (Rodrik 2003)

Box 1: Elements of the Country Policy and Institutional Assessment index

A. Economic Management

1. Macroeconomic Management
2. Fiscal Policy
3. Debt Policy

B. Structural Policies

4. Trade
5. Financial Sector
6. Business Regulatory Environment

C. Policies for Social Inclusion/Equity

7. Gender Equality
8. Equity of Public Resource Use
9. Building Human Resources
10. Social Protection and Labor
11. Policies and Institutions for Environmental Sustainability

D. Public Sector Management and Institutions

12. Property Rights and Rule-based Governance
13. Quality of Budgetary and Financial Management
14. Efficiency of Revenue Mobilization
15. Quality of Public Administration
16. Transparency, Accountability, and Corruption in the Public Sector

are “bad boys” (UNCTAD 1998). It implies that “*policies*” alone do not matter. Also, decision to suspend ESAF flows because of non-fulfillment of reform target, say increased current account deficit from falling commodity prices, had made even the outcome worse because the sustainability of the program is conditional on continued and increasing access to concessional lending, given the severity of economic imbalances and the high level of indebtedness in SSACs³⁵. However exogenous factors such as oil shocks and the deterioration of terms of trade of primary commodities were the cause of widening current account deficit, not wrong policy. Therefore, there is a doubt about the appropriateness of CPIA index in aid selectivity because it will disqualify de facto countries with unfavorable initial conditions (vulnerability to exogenous shocks).

³⁵ Many cases of interruption of ESAF and its ill effects are fully investigated by UNCTAD(2000)

Second, “*policies does matter*” idea was challenged by evidence attributing to geographical location and climate the reasons why aid has differential impact across countries (Dalgaard et al, 2004). The authors found that the interaction between policy and aid is weak while aid tends to be less effective in tropical areas. There is also a conflict between elements of CPIA index such budget balance (economic management) and improving access to health care and better education (building human resources). Easterly et al (2004), by extending data used in Brinside-Dollar model (2000), found that the interaction between aid and policies vanishes and aid allocation should not be strictly conditional of good policies.

Third, Ghana is cited among others as a successful case of aid working in good policy environment (Burnside and Dollar 2000). However there is evidence of Dutch disease in this country. Indeed, like many of the SSACs, Ghana underwent SAP in 1983 which resulted into drastic policy changes in the way wanted by the lending institutions and with extraordinary outcomes. Four years after a successful implementation of the Economic Reform Program (ERP), the country displayed a spectacular economic recovery as GDP growth rate stood at 5.7% against 0% before the ERP, gross domestic investment grew by 18.3% compared to -0.1% for SSACs’ average, exports increased amid adverse terms of trade, and public consumption regressed by -0.1% (Younger 1992). Successful policy reform coupled with satisfactory economic performance led to substantial aid inflows whose ratio to GDP climbed to 7% from 3% at the beginning of the ERP. However, the country started showing Dutch disease symptoms because aid flows and good policies failed to address supply side bottleneck. Indeed, despite tight credit policy and fiscal surplus inflation remained high at 30% (Younger 1992). The reason is that inflows of foreign aid drove up aggregate demand for domestic goods while making foreign exchange relatively abundant. The latter must be offset by a sterilization operation which, in Ghana’s case, consisted in contracting domestic credit because IMF conditionality imposed ceilings on money supply. This solution would have also the advantage of easing the increased in aggregate demand. However, this policy response has made credit to private sector extremely scarce, thus discouraging private investment amid growing demand for domestic goods.

Forth, in “*Policy matters*” idea, foreign aid crowds in private investment in good policy environment. The first reason is that good policy is one of the main determinants of private investment which, in turn, has a strong impact on growth only in a good policy environment (Dollar and Easterly 1999). The second reason is that initial income seems to be the most determining factor of private investment and explain why good policy environment alone could not encourage domestic private investment in poor countries. In this case foreign aid will play important role in stimulating private investment (both domestic and foreign), by “*creating confidence in the reform program and by helping ease infrastructure bottleneck*” (Dollar and Easterly 1999). Even though the authors found that 1% of GDP in aid crowds in 1.9

percentage points of private investment, there are evidences that this view could not hold. The case of Ghana mentioned earlier is one evidence whereas other factors, such as local demand sophistication, infrastructure, technological capability (Westphal 1990), skilled labor, availability of risk perception level, natural resources are important determinants of FDI (UNCTAD, 2004b). Indeed, SSACs have been less attractive to foreign investors, with less than 2% of annual total FDI inflows in the world, in the 1990s and during the first half of the 2000s. Recent surge in FDI inflows in SSA are mostly in the exploitation of natural resources. Fiscal policy, which is part of CPIA index, may also discourage private sector as high taxation is perceived as major constraint to investment in many SSACs.

Fifth, development experiences across the globe demonstrate that there is no blueprint single “good policies” to achieve development as there are so many ways to achieve those Rodrik (2003) called *Universal Principles*, and country’s specific characteristics play the most significant role. Consequently there are so many kinds of “good policies” leading to growth and development outcome³⁶.

Although these three approaches are supposedly different in analyzing aid ineffectiveness, it appears that they share the view that the reasons why aid is not effective are found within recipient countries. The conditional approach is more sanguine about that and puts the entire fault on the head of recipient countries whereas the big push which advocates the scaling-up of ODA to achieve MDGs is less critical to aid recipients but still favor the idea to give more aid to “well governed” countries (Sachs et al 2004). The dependency approach recognized that aid is ineffective in changing recipient’s bad behavior and accused both recipients and donors. Donors’ faults are: giving insufficient amount of aid (big push approach), giving aid to countries lacking good policies and good institutions (aid dependency and conditional approach). It appears thus that donors are ignorant for many decades and are not at fault. However recipients could not be held as the main responsible for aid ineffectiveness. Donors are equally, or even greatly responsible for why aid does not work in developing countries, especially in SSACs. Recent studies have acknowledged the existence of failures, other than giving too much or too small aid, at donor’s side whereas aid quality issue has gained increasing importance following the Monterey conference, leading to the Paris declaration and the Accra agenda.

3.4 Failures at donors’ side:

Another view about why aid does not or deters growth is related to donor’s motives. It says that most of donors give aid for foreign policy reasons other than poverty reduction and

³⁶ East Asian Experiences are generally qualified as unusual in many respects (Sakong 1993, Castley 1997, Amsden 1987,

aid will serve at first place donor's political, commercial and strategic interests (Moss 2007). Consequently non-developmental ODA has been and continue to be important though varying among donors over time (Riddell 2007). Keza (2005) argued that ODA's primary objectives are not growth; it was used for everything except for poverty reduction. It is not surprising that five decades of ODA experiences did not lead to significant improvement to the livelihood of major recipient countries. In this section we will identify the channels through which donor's excessive self interests-motivated behavior leads to ODA's failure.

a. Bypassing of absorptive capacity issues:

Bourguignon and Sundberg (2006) define absorptive capacity as “the ability of a country to use additional aid without pronounced inefficiency of public spending and without induced adverse effects, for instance the ‘Dutch disease’, or the crowding out of domestic saving”³⁷. According to this definition there is a threshold level of aid beyond which it produces more failures than success (see section 3.2). This is also called “the saturation point” which may arrive sooner or later, depending on the prevailing conditions in recipient countries. According to the World Bank (2004) there are five major determinants of absorptive capacity, or more precisely, five major constraints that limit the ability of the recipient to absorb aid efficiently, namely: macroeconomic constraints limiting the supply side response to surge of demand provoked by aid inflows, physical capital and infrastructure, human capital in terms of skilled labor, institutional constraints (bad governance) and sociocultural constraints. The absorptive capacity issues have two major implications. On the one hand, a relatively high level of aid inflows is more likely to lead into Dutch disease, weaker institutions, diminishing returns, low tax efforts, high level of consumption, low investment, large current account deficit, widening saving and foreign exchange gaps and high aid dependency. On the other hand, country-specific strategies are needed to address these constraints at the first place before increasing aid inflows, and Harrod-Domar model (dual gap model) is not sufficient to determine the amount of aid to be given to particular country.

Being strongly motivated in pursuing self-interests, donors often bypass the absorptive capacity issue and tended to give aid irrespective of recipient's absorptive capacity. Keza (2005) gives evidences of donors supporting non-competent, corrupted and badly governed states during the cold war. Alesina and Dollar (2000) shares this view and found that countries that share political position with western countries, as measured by their voting behavior in the United Nations, and former colonies tended to receive more aid. Hanlon (2004) demonstrates that pervasive corruption in Mozambique did not make donors refrain from granting more aid than it requested in 2001³⁸. Stone (2004), in defending the credibility of the IMF, attributed the

³⁷ Bourguignon and Sundberg (2006), p. 1. The ill effects of aid discussed in section 3.2 are part of it as well.

³⁸ Mozambique requested US\$ 600 million and was given US\$ 722 million

failure of poor performance of IMF lending in the 1990s to donor countries intervention to prevent rigorous conditionality enforcement in favor of former colonies and countries sharing donors' position in international scene. Moreover, several empirical studies had stressed the need of setting a threshold level of aid in order to produce more success (Hansen and Tarp 2000, Lensink and White 2001, Burnside and Dollar 2000).

b. Tied aid:

“Tied aid” is defined as loans and grants which are tied to procurement of goods and services from donor country (OECD 1987)³⁹. There are various ways of tying aid such as formal contract combined with trade promotion activities (subsidized export-credit schemes, aid to firms in bidding for tenders, sector targeting aid...) and informal arrangements pressuring recipients to purchase goods and services from donor-based companies.

In the past, tied aid held a significant portion of ODA. It was about 70% in 1985-87 and stood at 51% for 2000-02 (Clay et al. 2008). Even though untying status has improved, as a result of the 2001 DAC recommendations on untying ODA to LDCs (OECD 2001b), about one fifth of ODA are still tied, 54.5% for the USA (Clay et al. 2008). Nonetheless, some econometric studies assert that donors give more aid to those countries that import a higher share of donor's country goods (Neumayer 2003, Younas 2008).

Tied aid is thus commonly used by donors to protect their commercial interests while recipient countries found themselves bearing the high costs of this type of aid that reduce the real value of resource transfer. The raise of costs of goods and services purchased by aid averages 15%-30% (Jepma 1991,OECD 2008) but can reach as high as 40% for food aid (Barret et al. 2005,OECD 2006). Tied technical assistance (TA) has the highest costs that, in Uganda's case, range from 100% to 300% higher than that of the average cost of long term consultants at Commonwealth secretariat (Riddell 2007). At donor side, tied aid increased exports more than ten times the amount of aid. For example 1US\$ of aid generated US\$ 15 and US\$ 21 of exports, respectively, in the USA and Japan (Keza 2005).

Given the high level of aid dependency in many developing countries, especially in SSACs, high costs of imports stemming from tied aid deteriorate recipient's terms of trade, enlarging its trade deficit and leading to macroeconomic disequilibrium. Moreover, loans have the higher ratio of tied aid (51% in 2006), thus increasing the real costs of borrowing and debt burden, thereby further worsening macroeconomic disequilibrium. Tied aid has also the potential to distort international trade because ODA acts as subsidizes to donor's exports. In addition, indirect costs related to inadequate equipments and delay in the execution of the

³⁹ If procurement from all developing countries and from restricted number of donor countries is allowed, ODA is said to be partially untied

contract make the situation worse for the recipients. Food aid may discourage farmers through price shortfalls.

c. Volatility

As it is argued in the previous section, poor countries, especially SSACs, are highly dependent on foreign aid in financing their development. They are also more vulnerable to exogenous shocks such as oil price hike, commodity price volatility leading to terms of trade losses since the mid-1970s (UNCTAD 2000 and 2004a). For these reasons, poorly delivered aid – unpredictable and frequently procyclical – has important damaging effects on their growth. Several studies have demonstrated that aid volatility cause volatility in foreign exchange rate, inflation and fiscal policy (poor budgeting and underestimation of revenue)⁴⁰, making aid an important source of macroeconomic instability in developing countries that affects growth adversely (Neanidis and Varvarigos 2009, Karas 2008).

Aid volatility is thus a serious issue for these countries and is thought to reduce significantly aid effectiveness in many recipients by generating important deadweight losses. UNCTAD (2000) attributed the failure of SAP to several interruption of ESAF, while Pallage and Robe (2001) estimated the average volatility of aid (standard deviation) to 25% for African countries for 1969-95, varying from 8.7% to 48.2%. Aid volatility tends to be quite high since the late 1990s with a coefficient of variation between 40% and 60% of mean aid flows (Hudson and Mosley 2008). Project aids, which are usually used to finance physical infrastructure and human capital, are thought to be relatively stable. But recent studies by Fielding and Mavrotas (2005) found that they are also more volatile.

Kharas (2008) argues that aid volatility is similar for recipients irrespective of income level, type of states, degree of aid dependency and geographical location; but it is different by donor, suggesting that donor's policies are the underlying factors to aid volatility. For example aid allocation biased toward MICs is one of the reasons why poor countries have high ratio of volatility. Aid volatility exerts adverse effects on output, growth and welfare; and deadweight losses associated to aid volatility are estimated at about US\$ 16 billion in 2008, 15%-20% of total aid disbursements and on average 1.9% of recipient's GDP (Kharas 2008).

⁴⁰ Volatile and unpredictable aid makes it difficult for poor countries to formulate realistic budget plan to foster growth and to achieve development goals. Usually they make the budget plan on the assumption of less aid inflows, and consequently reduce the desired level of investment. It implies lower funding requirements that donors may interpret as a signal of low absorptive capacity, leading to lesser aid commitments, thereby closing the recipients in the vicious circle of poverty. For further discussion see Moss et al. 2008, Fatas and Mihov 2008.

d. Aid allocation

Despite sophisticated arguments in support of basic human needs approach to foreign aid, it appears that supply side bottleneck is a primary issue in SSA's growth and failure to address this issue makes aid ineffective in crowding in private investment, thereby generating Dutch disease. Consequently, donor's allocation bias in favor of social infrastructure at the expense of economic infrastructure explains why aid is ineffective in SSACs.

It is widely recognized that economic infrastructures, including transportation, energy, telecommunication, water supply and irrigation, contributes to economic development and poverty alleviation through various channels (Ojima 2006, Salehi and Ramirez 2003, Wang 2002).

First, economic infrastructures lower business risk and reduce the transactions costs, thereby improving the productivity of all inputs, enhancing competitiveness, allowing the production of positive externalities among firms and sustaining long-run growth. Since services provided by economic infrastructure enter directly or indirectly the private production process, thereby raising the rate of return to private capital, they crowd in domestic as well as foreign private investment. In this way, infrastructure is a means to overcome the supply side bottleneck that characterized the economy of many poor countries and produces clear economic benefits.

Second, poor countries exemplify the case of dual economy (Lewis 1954) but also the case of disarticulated economy where the mechanism of the classic two-sector model (agriculture and industry) is hampered by the lack of transportation facilities whose role is crucial to rural development⁴¹.

A large number of empirical studies demonstrate the link between infrastructure and economic development. For example, regional disparities in China were best explained by difference in infrastructure endowment, with notable role attributed to transportation and telecommunication facilities (Demurger, 2001). This is consistent with other findings about the important role of roads and telecommunications in reducing rural poverty in China (Fan et al. 2002). Using a dynamic two-sector model, Wang (2002) estimated the interrelation (spillover effects) between public infrastructure and private production and found that the responsiveness of the later to a 1% change in expected infrastructure output are positive and significantly different from zero, at 0.2% in seven East Asian countries, and very high at 1.5% in Singapore. In some case there is an increase one for one to GDP (World Bank, 2004), while other found even an increase of GDP exceeding the cost of service provided (Esfahani and Ramirez 2003). Poor infrastructure is considered as major obstacle to production and trade in SSACs as high

⁴¹ The sectors are mutually reinforcing with each sector generating spillover effects on the other.

transportation costs (Milner et al. 2000) and power outages (Ndulu 2006) affected adversely firms productivity and competitiveness.

Inefficient investment in infrastructure projects, often dubbed as “white elephants”, in the past is cited as a reason why donors give less and less aid to this sector⁴². They recommend deregulation and privatization across infrastructure sectors, such as water supply, telecommunications, transportation and energy (Ndulu 2006). However, it would be wrong to think that private sector is more efficient than public sector in providing economic infrastructure services, especially in poor countries, due to the nature of these public goods and to their huge positive externalities. Usually, they are associated with economies of scale and economies of scope that it would be difficult for a single private investor to undertake it. Past failure of these public investments is not a sufficient reason to disqualify economic infrastructure in aid allocation because it worked in other countries. Attention should be paid to the lack of policy coherence in preparing and in implementing these projects. And recipients are not solely responsible for that failure. Donor’s responsibility is also high.

The importance of the role of economic infrastructure in stimulating private investment is recently recognized by the donor community in 2005, following the Report made by the Commission for Africa (2005). This commission recommended that additional US\$ 20 billion of foreign aid is needed to meet SSA’s needs in infrastructure investments. The African Development Bank (2006) also singles out the major deficiencies in infrastructure quality and in delivery of infrastructure services, in SSACs. However, as table 2 shows, the amount allocated to economic infrastructure in the 2000s was lower than that of previous decades, and represented only 12.46% of total real flows, lower than debt relief.

e. Conditionality and lack of ownership

Leading international financial institutions (World Bank and IMF) questioned state intervention, proclaimed market supremacy and consequently recommended policy reforms in many developing countries in the early 1980s. Conditionality, known as the Washington consensus, has taken a central role in aid allocation and is thought to make aid more effective. Their reasoning is based on the neoclassical theory. However conditionality is pointed by

⁴² In SSA, there are many cases of inefficient but large investment in infrastructure projects because investment decisions were less grounded on economic justification and more motivated by political considerations. Inefficiency usually stems from lack of maintenance capability and non adaptation to the real needs of the economy (Keza 2005). This is the example of Senegal’s chemical industry financed by French ODA and using ultra-modern technology that Senegalese was not able to maintain in spite of a large amount of aid spent in training (Keza 2005). These inefficient infrastructure projects are numerous in SSACs in the 1980s and served nothing but to increase their debt burden. This is why they are often dubbed as “White elephants”. This is one of the reasons why Western donors in SSA are less keen to allocate more ODA in economic infrastructure. They favor the social infrastructure on the belief that it has direct impact to the poor.

many authors as inappropriate and explained the failure of SAP (Easterly 2005, Kanbur 2000, Mosley and Subasat 1995, Svensson 2003). For example, foreign reserve requirement makes that less aid is used to alleviate supply side bottleneck while procyclical recommended fiscal and monetary policies depressed growth and exacerbated cyclical events such as adverse terms of trade (Mosley 1995). Dreher (2006) analyzed the impact of IMF programs and compliance with conditionality in 98 countries for the period 1970-2000. He found a negative relationship between IMF programs and economic growth whereas the effect of compliance with conditionality on growth is quantitatively small. He argued that either “wrong advice” (non-adapted to the real needs) from The IMF or moral hazard is likely to be the reason.

It would be wrong also to think that growth strategies should be based on standardized policy (conditionality) because development experiences across the globe demonstrate that there are so many ways to achieve those Rodrik (2003) called *Universal Principles* and the need for indigenous economic policies which are adapted to country’s specific characteristics is mostly welcomed. In the same perspective, Mosley (1995) identified six policy instruments to promote growth in poor countries, but four of them— *fiscal deficit, public investment, agriculture subsidies and tariff protection*— are forbidden by the conditionality. Also, there is a conflict between two important policy instruments. Cutting fiscal deficit reduced government spending whereas devaluation increased it through various channels such as increased share of interest payments, stimulating capital flight, raising domestic interest rate (to stop capital flight), spreading insolvency and deepening fiscal deficit. Current account deficit would increase because of the high share of primary commodity (with low elasticity) in SSACs’ exports.

Moreover, the standardized policy required that reforms have to be completed within a short period of time (usually three years). It does not take into account the reality and needs of the recipients whose implementation capacity is usually very low. This kind of reforms is labeled by Nishigaki and Shimomura (1998) as radical reforms, inflicting high costs to the population.

Standardized policy does not match the development needs of recipients but they have to accept it because their bargaining power is weak. This donor-driven policy exemplifies the lack of ownership by the recipients who have no voice in aid process and are forced to undertake the reforms without being fully convinced of its efficiency. In most cases, the lending institutions (IMF and World Bank) intervene directly in the formulation of recipient’s budget plan but without any satisfactory results (Keza 2005).

Despite the increasing number of aid agencies, whose principal mission is to ensure full ownership by both donors and recipient through the mediation between donor’s and recipient’s

interests, or preferences, ownership issue is still persistent. Donors have recognized this issue in the Paris Declaration.

f. Aid channels proliferation and donor fragmentation

Developing countries are facing with multitude of donors who are not fully to share a single objective. Even though aid community has generally agreed in recent years around the single overriding objective of poverty reduction, the multiplicity of aid agencies (even within one donor) reflects the seriousness of preference misalignment (donor fragmentation), between donors, and between interest groups in donor countries.

Martens (2008) argues that the mission of aid agencies is not only to deal with the preferences between donors and recipients but also to mediate between donor interest groups at home (politicians, suppliers, citizens and other lobby groups). In this case it is unrealistic to assume that all these groups fully share the same objective of alleviating poverty in recipient countries. Aid agencies' primary concern is not thus to improve the welfare of recipient countries but to mediate these interests, and the outcome is function of the political compromise in donor countries. Such compromise may not necessarily reflect the recipient's needs because it is not taking part in the decision making process.

Le Houerou et al. (2008) raised this issue and found that there are at least 230 international organizations, funds and programs; and about half of bilateral contributions channeled to multilateral agencies went to sector or thematically targeted multilateral organizations. And this is likely to lead to priorities misalignment between donors and recipients, with less aid going to investments that would be important for growth and poverty alleviation.

There are also huge costs associated with aid channels proliferation and donor fragmentation that jeopardize aid effectiveness. They are the transactions costs related to tying status, rules and procedures for managing projects and programs, and some long lasting effects related to donor practices that would affect negatively the quality of governance⁴³. Donor fragmentation poses a huge challenge for recipient countries in terms of aid management because they have to comply with so many kinds of regulations and procedures in implementing and monitoring projects. This imposes enormous burden on their already weak implementation capacities as public officials spend most of their time dealing with donors rather than assuming their own works. In addition competition among donors is likely to lead to project overlapping and to offering more attractive fringe benefits, inciting government officials to neglect their core developmental function (Moss et al. 2008).

⁴³ For further discussion, see Knack and Rahman (2004, 2008).

Donor fragmentation reduces the overall potential impact of official aid *via* deteriorating quality of governance. On average one country has to deal with 30 donors and international organizations (Le Houerou et al. 2008) while one typical African country has to learn rules and regulations from 30 official donors and several dozens of NGOs, and bears the administrative costs of thousand projects (Knack and Rahman 2008).

Decade long poor result of ODA had been mostly put on recipient's account. But growing evidences had demonstrated that donors also had their part of responsibility in this failure. As a result, it is time to think about reforming aid apparatus and to increase its effectiveness as it is materialized by the Monterrey agreement in 2002, the Paris declaration in 2005, and Accra agenda in 2008. Donors and recipients have started working towards more recipient ownership, harmonization policies and procedures, alignment or convergence in objectives, and mutual accountability. But there is still a long road to go because true ownership suggests that, not only, recipient is able to exercise discretion over policy choices but also to have the leadership in aid negotiation and in selecting among donors' recommendations those which are well suited to its needs (see section 4). Recent emphasis on ownership and mutual accountability seems to be in experimental phase, explaining donors' skepticism about its efficiency. In fact, they are seriously concerned about recipient's capacity and prefer to be involved actively in decision making about recipient development policy. However, Japan's aid philosophy (self-help effort) and experience with FEA countries has proved the merit of true ownership by recipient countries. This is the object of the next section, which will discuss the effectiveness of Japanese ODA in FEA, based on its philosophy and distinctive features, and from which some lessons could be learnt to improve donor-recipient relationship towards the global targets stemming from the five principles of Paris Declaration.

4. THE EFFECTIVENESS OF JAPANESE ODA IN FEA COUNTRIES

FEA has achieved an outstanding economic performance, compared to SSA, whereas both regions were at the same level of development in the immediate post independence period. Both regions had relied on foreign aid for their development but with significant difference in terms of volume, amount per capita and trend. The FEA had received less aid (and in declining trend), compared to SSA. Less aid and extraordinary economic performance means that aid is more efficient in this region, compared to SSA. This aid effectiveness in FEA is explained by good policies according to Burnside-Dollar (2000) model. As we have discussed in section 3, the “*policy matters*” idea is self-evident and scholars and experts are unanimous that economic policies with the leading role of the government played primary role in the East Asian “economic miracle”, though they diverge on the interpretation of the nature of these policies (Amsden 1987; World Bank 1991, 1993; Wade 1990, Alesina and Rodrik 1994). However as it is discussed in section 3, “*good boys*” did not perform well in SSA and domestic policies are not only to blame for the failure of ODA. We have discussed that donor policies and behavior are determinant to aid effectiveness as well. Since Japan is the largest donor in FEA, I will investigate the role played by the Japanese ODA in fostering FEA’s economic development. I will identify those channels through which Japanese ODA has contributed to the economic success of FEA countries.

4.1 Overview of the distinctive features of Japanese ODA:

a. Objectives and Policies of Japanese ODA:

Since its inception, Japanese ODA has been used as important means to safeguard Japanese interests (Rix 1993, Sunaga 2004, Sudo 2001). This characteristic is shared among other donors and this is pointed by aid skeptics as the reason why aid is ineffective and it is used for everything except for poverty reduction (Keza 2005). Before the creation of the first ODA charter in 1992, Japanese ODA policies are mainly motivated by national security concern, peace building in the region (Southeast Asia) and by the needs to secure essential raw materials (Sunaga 2005, Rix 2001). From 1955 through the 1970s, ODA was given as part of war reparations, to re-establish trade diplomacy and to foster close relations with political elites in the region by supporting the economic bases of their regimes (Rix 2001). Resources rich Asian countries were provided with loans which were linked to resource exploration and exploitation and which were also tied to Japan’s exports. The outcome of such ODA policy was a growing anti-Japanese sentiments stemming from Japan’s economic dominance in the region within an international political environment governed by the cold war. There was a real threat to regional peace building that would never beneficial to Japan’s prosperity and

Japan had changed its diplomatic policy when Prime Minister Takeo Fukuda had the courage to establish a new attitude and mutual trust between the region and Japan in August 1977. This is known as the *Fukuda doctrine* with three basic principles of the Japanese policy towards South East Asia: (1) Japan is committed to peace and rejects the role of a military power, (2) Japan will do its best to consolidate the relationship of mutual trust based on “heart-to-heart” understanding with the nations of Southeast Asia, (3) Japan will cooperate positively with ASEAN while aiming at fostering a relationship based on mutual understanding with countries of Indochina and will thus contribute to the building of peace and prosperity throughout Southeast Asia (JICA 2007). The heart-to-heart approach is not an easy task since Japan was under US pressure to give more ODA to those countries that carried fight against communism (Sunaga 2004). This was the beginning of Japan’s positive relations with Southeast Asia. These relations were governed by the so-called Trinity-type (*sanmittai*) economic cooperation, integrating ODA, investment and trade, from the late 1970s until the early 1990s⁴⁴. The idea is that ODA is used in such way as to encourage Japanese FDI in Southeast Asia, to promote trade and to foster domestic economic development. This is one of the distinctive features of Japanese ODA related to other DAC donors. Since development strategy of many countries in the region was initially based on Import Substituting Industrialization (ISI), Japanese FDIs were limited and essentially domestic-market oriented while trade was developed in favor of Japan due to import effects of this development strategy. But the pattern of FDI and trade had changed since the mid-1980s when countries in the region began switching to export-oriented industrialization and to take advantage of the large wave of Japanese FDIs as a result of the Plaza Accord in September 1985. Trinity-type economic cooperation was reinforced by the initiation and the implementation of the New Asian Industries Development (New AID) plan and the Japan-Asia Development Fund (JADF) in 1986 (Rix 2001), which was at the origin of the extraordinary economic performance of many countries in the region. Asian economic development was thus less a goal in its own than a more appropriate means of winning the cold war and of safeguarding Japan’s national interests. But as we shall see in section 4.2, the Trinity-type economic cooperation exemplifies a win-win situation.

The fall of Berlin wall marked the end of the cold war and had affected Japan’s foreign policy orientation. There were increasing concerns about environmental issues, leading to Rio Earth Summit in 1992 where the world leaders were committed to deploy important efforts and resources to protect the environment and to support a sustainable development. Consequently, Japanese drafted its first ODA charter in June 1992 which was based on four principles emphasizing sustainable development, peace building and the promotion of democracy and market economies (MOFA 1992).

⁴⁴ Source: interview (April 2010) with Michio KANDA, Senior Technical Adviser at JICA, who is in charge of technical cooperation activities.

The September eleven terrorist attack in America, and the Millennium declaration shifted the priority into human security concerns. Consequently, the ODA charter was revised in 2003 and priority issues are: (1) poverty alleviation via more ODA to be allocated in education, health care, welfare, water and sanitation, and agriculture; (2) sustainable growth, (3) global issues, and (4) peace building (MOFA 2003). This explains the relative fall of ODA allocated to economic infrastructure and to production sectors for 2000-08 compared to the previous periods (Table12).

Since its inception, Japanese ODA has chosen East and Southeast Asia as priority region. This is another distinctive feature of Japanese ODA, as noted in the ODA Charter (MOFA 2003):

“...Asia, a region with close relationship to Japan and which can have a major impact on Japan's stability and prosperity, is a priority region for Japan. However, Japan will strategically prioritize assistance to Asian countries, fully taking into account the diversity of the Asian countries' socioeconomic conditions and changes in their respective assistance needs. In particular, the East Asian region which includes ASEAN is expanding and deepening economic interdependency and has been making efforts to enhance its regional competitiveness by maintaining economic growth and strengthening integration in recent years.”

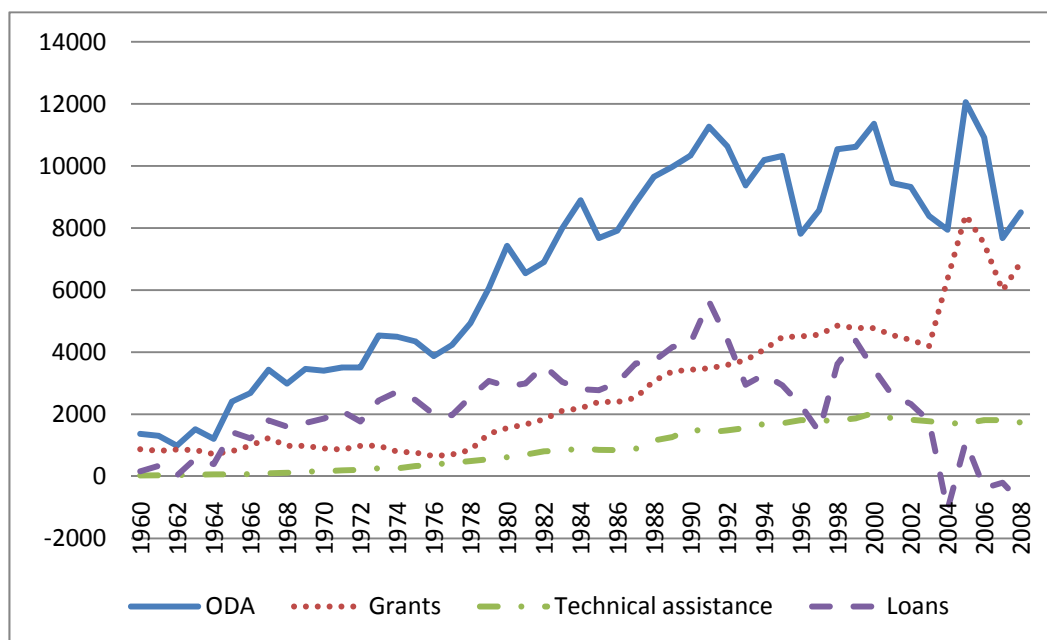
Above all, Japanese ODA has been based on “request first” principle and given to support self-help efforts in developing countries. It implies that Japan keeps itself from interfering in internal economic affairs of the recipient countries and emphasizes on real ownership. In this perspective the ODA charter notes that: “Japan will give priority to assisting developing countries that make active efforts to pursue peace, democratization, and the protection of human rights, as well as structural reform in the economic and social spheres” (MOFA 2003).

b. General Trend and patterns:

In order to achieve these objectives and in carrying out these policies Japan's had increased rapidly its ODA for the first three decades. Indeed, cumulative ODA had doubled every ten years from 1960 to 1989, increased slightly in the 1990s before declining in 2000-08 (Table 9). Around 55% of total net Japanese ODA was disbursed between 1980 and 1999, the fast growing period of FEA countries (figure 2) and when the Trinity-type economic cooperation was at its height. Loans had dominated aid giving until 1993 when priority shift occurred in the 1992's ODA charter. Even in the 1990s the ratio loans to grants was still higher at 45%-54% than that of other donors. This situation is closely linked to the prevailing ODA policies of that period where economic infrastructure and production sectors absorbed the largest portion of ODA (Table 11). Indeed, loan is more appropriate in financing large

infrastructure projects. Loans are usually concessional to be repaid within 29 years, with 2.5% average interest rate and 9 years grace period (Shimomura et al. 1998). Japanese ODA is labeled as low quality because not only its share to GDP is very low (less than 0.3%) but it has also low grant elements⁴⁵. Grants, which target usually low income and less developed countries and are used to finance social infrastructure such as housing, health, research, education and humanitarian aid, were very low (Table 9). Even in the 1990s, half of the grants were in form of technical assistance, leaving a small portion to address poverty issues in poor countries. However, loans' share fell sharply in 2000-08 when human security became the core priority in the 2003's charter, making grants the most appropriate type of ODA to be provided (figure 4 and Table 9).

Figure 4: Trend of net disbursement of Japan's ODA by type,
Unit: constant 2007 US\$ million



Source: Calculated from OECD's International Development Statistics online

⁴⁵ High share of loans does not necessarily mean low quality. On the contrary it is a quality making aid more effective. Gupta et al (2004) investigated the relationship between ODA and state revenue in 107 developing countries for 1970-2002 and found that loans have a significant positive impact on domestic revenue whereas grants had significant negative effect. Harrigan (2007) argues that loans encouraged revenue-raising whereas grants tend to displace savings. In this respect high share of loans in Japan's ODA is one of the reasons why ODA made a significant contribution to economic growth in FEA.

FEA countries have always been the top recipient region of Japanese ODA, absorbing respectively 60.73%, 56.90% and 44.19% of the total in the 1960s, 1970s and 1980s (Table 10). Their share declined the last twenty years as many of them have been successful in their development policies and consequently been able to rely more and more on domestic resources and FDI to finance their own development (figure 1, 2 & 8). Indonesia, Malaysia, Philippines, Thailand, Vietnam and China are the top recipients with more than 40% share of total net disbursements the first three decades, and about one quarter of the last two decades (Table 10). This reflects Japan's strategic interests in these countries as well as the self-help philosophy of Japanese aid. Indeed, these countries are Middle Income Countries (MICs) where self-help efforts are more likely to occur and where market failures are less relevant than in poor countries. They offer thus a favorable ground to "trinity-type" economic cooperation, making ODA more effective in safeguarding Japan's national interests and in generating high growth in recipient countries. As table 10 shows, the share of Japanese ODA going to MICs averages 62.70% and highest at 79.37% in the 1990s. These figures are higher than the average DAC countries (see section 2). Even after the prioritization of human security in the 2003's charter, only 17% of Japanese ODA went to poor countries, and if we consider the fact that debt relief accounted for 21.94% of Japanese ODA (Table 11), Japan's contribution in poor countries is very minimal and Japan is subject of harsh criticism from its DAC peers.

Another point of difference of Japanese ODA relative to other donors and which is the natural outcome of Japan's aid philosophy, objectives and policies, is in sectoral allocation. Economic infrastructure services absorbed the largest amount of Japanese ODA, of which 17.78% and 13.07% of the total commitment went to transport and energy sectors (Table 11). High commitment to energy development occurred in the 1970s and the 1980s in response to the oil shock of 1973 and 1979 that could have jeopardized development process in these countries. And if one thinks about the important damaged caused by exogenous shocks in SSACs (UNCTAD 2000), the role of Japanese ODA in favoring energy sector during difficult period is without contest very significant. Moreover, aids for economic development purpose (with the inclusion of production sectors) represented about half of the total (more than 60% in the 1970s, 1980s and 1990s). They are in form of project loans— *such as roads, railways, dams, ports, power plants, oil refineries, fertilizer factories*— and development finance loans, usually as two-step loans to support Small and Medium Enterprises and Industries. Technical Assistance (TA), which is mostly for economic development purpose (see section 4.2), has also come to play salient role as its share increased from 10.23% in the 1970s to 15.86% and 21.68% in the 1980s and 1990s (Table 9).

The quality of development assistance is also determined by tying status. Like the majority of donors, tied aid was initially high for Japan. There is evidence that ODA was used to subsidize exports by Japanese firms in the 1950s and 1960s (Shimomura et al. 1998). But it

has been improved overtime as 83.9% of Japanese bilateral ODA were untied in 1992 (Shimomura et al. 1998). This ratio was extremely high relative to other major donors such as the USA (37.4%), France (31.5%), United Kingdom (35.2%), and Germany (47.9%).

Table 9: Trends and Patterns of Japanese ODA (Unit: constant 2007 US\$ millions)

	1960s		1970s		1980s		1990s		2000-08	
Bilateral ODA	18343.75	100.00%	31799.1	100.00%	55736.55	100.00%	76728.91	100.00%	61833.41	100.00%
Loans	9239.21	50.37%	22938.09	72.13%	32599.03	58.49%	35215.11	45.90%	8771.77	14.19%
Grants	9104.51	49.63%	8861.03	27.87%	23137.51	41.51%	41513.83	54.10%	53061.64	85.81%
Technical Co-operation	703.82	3.84%	3252.11	10.23%	8841.5	15.86%	16633.66	21.68%	16261.75	26.30%
TOTAL ODA	21351.81		42891.38		81787.12		99657.77		85614.17	
ODA % GNI	0.26		0.27		0.31		0.27		0.19	

Source: Calculated from OECD's International Development Statistics online

Table 10: Geographical distribution of net Japanese ODA

	Years	1960s	1970s	1980s	1990s	2000-08	Total
Far East Asia		60.73%	56.90%	44.19%	28.63%	28.63%	38.90%
South Asia		38.32%	23.24%	21.86%	15.44%	15.44%	19.91%
Others		0.95%	19.86%	33.95%	55.93%	55.93%	41.19%
Indonesia		<u>22.18%</u>	<u>21.16%</u>	<u>11.89%</u>	5.72%	5.72%	10.68%
China		0.00%	0.02%	11.19%	<u>9.58%</u>	<u>9.58%</u>	7.88%
Philippines		14.63%	8.93%	7.47%	3.29%	3.29%	5.99%
Viet Nam		2.81%	2.44%	0.06%	7.91%	7.91%	4.84%
Korea		13.28%	14.00%	1.28%	0.00%	0.00%	3.32%
Malaysia		0.70%	3.49%	3.42%	1.48%	1.48%	2.17%
Thailand		2.09%	4.93%	7.97%	-3.09%	-3.09%	1.12%
Less Developed Countries		10.69%	16.10%	22.23%	17.34%	17.00%	17.73%
Middle Income Countries		60.81%	58.58%	62.72%	79.37%	48.70%	62.70%

Source: Calculated from OECD's International Development Statistics online

Table 11: Sectoral distribution of Japanese ODA

SECTORS	1967-69	1970s	1980s	1990s	2000-08	Total
I. SOCIAL INFRASTRUCTURE & SERVICES	0.94%	6.77%	16.62%	20.78%	21.06%	19.60%
I.4. Water Supply & Sanitation	0.00%	0.88%	5.05%	8.20%	9.30%	7.79%
II. ECONOMIC INFRASTRUCTURE & SERVICES	25.71%	32.94%	38.81%	38.75%	29.13%	34.90%
II.1. Transport & Storage	8.28%	6.25%	15.89%	20.00%	17.40%	17.78%
II.2. Communications	8.39%	4.00%	5.16%	2.87%	1.06%	2.62%
II.3. Energy	9.04%	20.31%	14.79%	14.48%	9.96%	13.07%
III. PRODUCTION SECTORS	9.10%	27.79%	21.40%	14.67%	9.42%	14.32%
III.1. Agriculture, Forestry, Fishing	1.48%	8.97%	10.77%	10.43%	6.57%	8.96%
III.2. Industry, Mining, Construction	7.63%	16.68%	9.47%	3.93%	2.13%	4.68%
IV. MULTISECTOR / CROSS-CUTTING	0.00%	5.63%	1.24%	3.10%	4.21%	3.31%
VI. COMMODITY AID / GENERAL PROG. ASS.	12.43%	5.50%	11.47%	7.95%	2.29%	6.31%
VII. ACTION RELATING TO DEBT	13.69%	4.41%	2.21%	5.62%	21.94%	11.14%
VIII. HUMANITARIAN AID	0.00%	0.21%	0.12%	0.88%	1.95%	1.13%
IX. ADMINISTRATIVE COSTS OF DONORS	0.00%	0.00%	2.00%	4.19%	5.36%	4.09%
X. SUPPORT TO NGO'S	0.00%	0.00%	0.33%	0.24%	1.80%	0.83%
XI. REFUGEES IN DONOR COUNTRIES	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
XII. UNALLOCATED/UNSPECIFIED	38.13%	16.76%	5.80%	3.81%	2.84%	4.37%
TOTAL	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Calculated from OECD's International Development Statistics online

According to the Policy brief of OECD (2001a), Japan, Switzerland and Sweden had the highest ratio (more than 90%) of untied aid. In 2006, Japan ranked 10th with untied ratio of 80%, far ahead of the USA, France, Italy, Germany and Canada (Clay et al. 2008). The low grant of Japanese ODA is thus offset by its high untying status.

4.2 Effectiveness of Japanese ODA linked to its distinctive features

It is widely agreed that private, rather than public investment, which plays a central role in sustaining growth. However, the growth of private investment in poor countries is constrained by severe market failures, low initial income and other impediments to attract foreign private capital flows. Foreign aid can thus contribute to sustained growth by easing these constraints, thereby acting as a catalyst for domestic and foreign private investment. Putting it another way, Japanese ODA is provided in support of the recipient country's efforts to address relevant market failures obstructing the growth of private investment. These efforts may include among others infrastructure development, building of business-friendly institutional capacity, investment promotion policies (various incentives given to private

sector), human resources development and development of soft infrastructures. This is the self-help principle of the Japanese ODA, which is also reflected in the sectoral allocation, geographical distribution and the loan bias of foreign aid.

a. The principle of The self-help efforts (jijo doryoku) and Trinity-type economic cooperation (Sanmiitai)

As stated in the ODA charter (see section 4.1), Japan respects recipient countries ownership and is willing to support self-help efforts in laying the basis of their development. This Japan's aid philosophy takes root in its own experiences, putting strong emphasis on economic growth and on self reliance principle. This is also motivated by Japan's experience as aid recipient in the 1950s and 1960s, giving Japan more advantage in understanding developing countries need compared to other DAC countries. Economic development is thus only possible when the country prioritizes economic growth and when the government and citizens make ceaselessly efforts to achieve and to sustain it (Nishigaki and Shimomura 1998). So, the question is: how to detect self-help efforts? Or How to make sure that developing countries are committed real efforts and sacrifices to achieve development? Nishigaki and Shimomura (1998) identify four check points for self-help efforts, based on Japan's own experiences.

The first is the "achievement motive" or strong desire to improve the existing situations. This is materialized in setting up high and appropriate goals and in developing plans to achieve them, by developing countries themselves. It implies high level of participation and more ownership by developing countries of their development policies. This would further strengthen their achievement motive and the ODA can play important role in supporting this state of spirit of these governments and their people, toward achieving the goals set in the plans.

The second, which is a natural consequence of the first check point, is the good economic governance or the government willingness to keep macroeconomic balance, *via* tax collection efforts, mobilization of other sources of revenue and reducing government consumption along with optimal allocation of budget. These efforts are reflected in the country's macroeconomic indicators and guarantee the capacity of the country to achieve development goals.

The third check point is the existence of domestic efforts in dealing with the drawbacks of external or exogenous shocks. These may include minimum borrowing and export promotion measures.

The fourth check point is the domestic efforts to increase saving and to promote education because it reflects the state of mind about sacrificing the present benefits for future gains.

When these four check points are found in a country it means that this country has the capacity of helping itself in its sake for economic development. Japan provides ODA to assist developing countries that make such efforts, and the volume and sectoral allocation of aid are commensurate with these efforts, or more precisely to the recipient absorptive capacity. Consequently, the role of Japan as donor is thus not to impose its policies or conditionality but rather to accompany recipient in its efforts to initiate and implement development projects aiming at tackling major market failures for economic development. There are two major implications of the aid delivery system based on self-help.

One implication of self-help effort principle and that could be a source of misunderstanding is that whether the country realized high or low score of self-help efforts (4 check points). According to Nishigaki and Shimomura (1998), low score does not necessarily mean that the country did not try hard. In fact it did make hard works but these went unrewarded; and ODA is necessary to support these efforts to produce good results. So, the key point is whether the country makes self-help efforts or not, whether the country has the political will or not, whether the country possesses this state of mind or not. Nishigaki and Shimomura (1998) argue that there are always seeds of self-help⁴⁶. Then, when there are self-help efforts, the country deserves ODA support. However, the volume, the use (sectoral allocation) and the type (grant or loan) of ODA would be consistent with the amount and the nature of the efforts done by the country. Indeed, Japan provides ODA on request basis, and this request reflects the country's needs, which are in turn determined by its real capacity. This is the reason why Japanese ODA is mostly disbursed in loans (self reliance principle), is concentrated in East and South East Asia, in MICs, and is mostly used to finance hard economic infrastructure and production sectors.

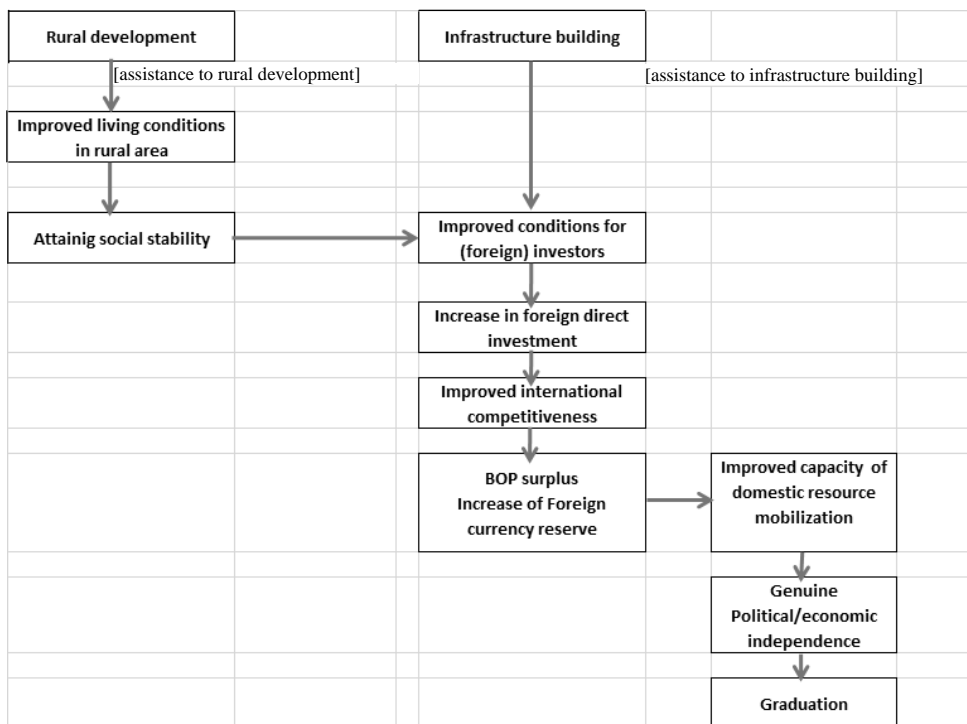
Another implication of the four check points mentioned by Nishigaki and Shimomura (1998) is that self-help efforts may be synonym of good economic policies. So, Japanese ODA was thus directed to countries with good economic policies, making this position very similar to that of Burnside and Dollar (see section 3), and thus favoring selectivity in aid delivery based on CPIA index. However, Shimomura argues that even though the self-help principle is shared with the World Bank and the proponents of "*policy matters*", there is a clear difference in terms of ultimate goal and the way to achieve it⁴⁷. He qualifies Japanese

⁴⁶ They cited the case of Grameen Bank, a system of micro-credit for poor in rural Bangladesh to indicate the existence of seeds of self-help efforts.

⁴⁷ Interview with Professor Yasutani Shimomura, co-author in Nishigaki et al. (2009)

ODA as “assistance to graduation” because its goal is to make recipient country be able to rely on its own resources to finance future development, not to indefinitely rely on ODA. Figure 5 summarizes the graduation process and explains why Japanese ODA is more concentrated in economic infrastructure and in agriculture production. In fact the catalytic role of ODA in inducing FDI, thereby improving international competitiveness and export capacity is the crucial point of this model. This is the case in FEA where countries have become gradually less dependent on ODA while achieving high economic performance (Figure 1 & 2). Another difference with the conditional approach is Japan paying important respect to recipient initiatives and political will, without attaching any conditionality, thereby reflecting a real ownership by recipient. There is no case of blueprint reform or standardized strategy of poverty reduction. This Japanese approach presupposes that recipient countries have sufficient capabilities to develop effective plan that really reflects their real needs⁴⁸.

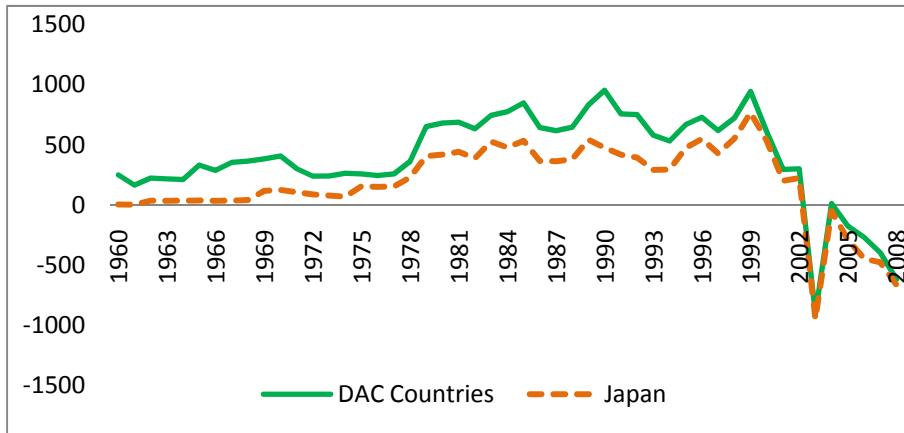
Figure 5: East Asian model of development/aid: assistance to "graduation"



Source: Shimomura, Y. in Nishigaki et.al 2009

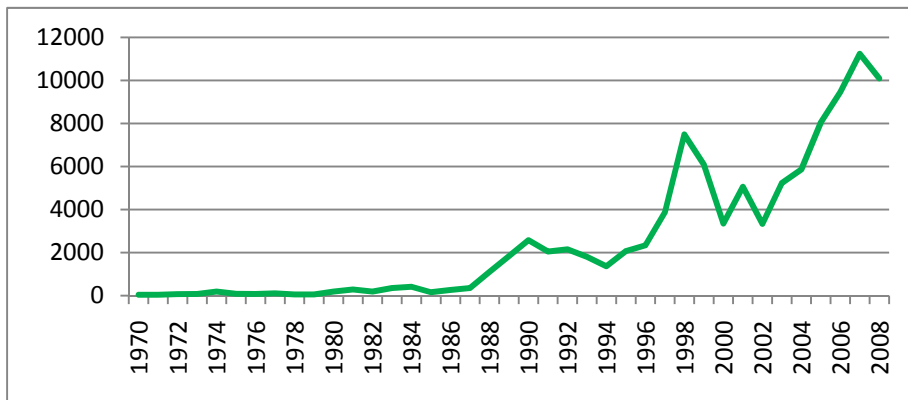
⁴⁸ However, this is not always the case in poor countries, especially those labeled as “failed states”, who suffered from serious problems of governance. Self-help efforts are more unlikely in these countries and that may probably be the reason why Japanese ODA is biased towards middle-income countries. This principle may disqualify *de facto* from ODA the neediest people in poorly governed developing countries. As a solution, Japan’s aid approach to such countries is based on more intensive policy dialogue to discuss effective policies and priorities (MOFA 1992) without any intention of intervening in their internal affairs.

Figure 6: Net ODA inflows in Thailand, (Unit: constant price 2007 US\$ millions)



Source: OECD, International Development Statistics online

Figure 7: Annual flows of FDI in Thailand, (Unit: US\$ million)



Source: UNCTAD's Foreign Direct Investment online database

Potter (1996) gave evidences supporting the view that Japanese aid to Thailand has supported the priorities set by the Thai government in its five-year development plans starting from 1967⁴⁹. As a result, Thailand had achieved extraordinary economic

⁴⁹ For example, during the second plan (1967-71), the bulk of Japanese ODAS to Thailand financed projects in transportation infrastructure (priority No 1 of the plan), in communication in Bangkok metropolitan, power plants. For the third plan (1972-76) two third of the 74 billion yens loans committed by Japan to Thailand were used in power and transport projects, while a quarter of Thai budget allocated to infrastructure and one third of that of energy development were financed by Japanese ODA (Potter 1996). Since the fourth plan (1977-81), Japan had become the single largest donor in Thailand and continued to support Thai development priorities. Among the most important is the Eastern Seaboard Development plan which accounted one third of ODA to support the fifth development plan.

performance, via successful policies to attract large inflows of FDI from the mid-1980s, and has been able to self finance its development while relying less and less on ODA (figures 6, 7&11).

In relation to the self-help principle, what distinguishes also Japanese ODA is its total approach to development with close interaction with private sector. Indeed, Japanese private sector actors are always included in policy making and implementing structures (Arase 1994). It is clear that Japan's development assistance serves at the first place the interests of its private sector in its sake for higher competitiveness, *via* FDI and trade. This is known as “*Trinity-type economic cooperation or Sanmiittai*”, integrating ODA, FDI and trade (Rix 1993). This is why a large part of ODA had been allocated to economic infrastructure, production sector and FDI promotion oriented technical assistance. To put it another way, ODA helps to tackle relevant market failures in recipient countries in order to create a more FDI-friendly economic and institutional environment and to promote exports. Moreover, this is done within a framework of policy coherence initiated by the recipient government to deal with major market failures. The ODA will act as support to implement the policy drivers for correcting these market failures⁵⁰.

When export-oriented FDI started to flow massively in FEA countries from the mid-1980s, Japan's ODA, by acting as a catalyst to Japanese FDI, is said to have played a very significant role in the outstanding economic performance of FEA countries⁵¹.

Japanese model of development assistance, based on self-help principle and *sanmiittai*, illustrates an appropriate donor's behavior towards aid in order to avoid the causes of failures mentioned in section 3, namely: lack of ownership, Dutch disease, moral hazard, adverse institutional effects, aid dependency issues, volatility, problems of absorptive capacity, conditionality, allocation issues and donor fragmentation⁵².

b. The role of economic infrastructure

Growth-centered self-help principle makes that Japanese ODA has been highly concentrated in economic infrastructure and production sector. Compared to the average of all DAC donor countries Japan directed a greater proportion of its bilateral ODA to these sectors

⁵⁰ Muto et al. (2007), identify four major policy drivers within the recipient country, namely: the development of infrastructure, the enhancement of the institutional and policy environment, policies to eliminate the information gap and to reduce risks and human resources development. Investment and trade policies of the developed countries are also relevant to policy coherence.

⁵¹ It is widely recognized that the unusual economic performances experienced by the Asian NIEs and then by the ASEAN 4 owes, in a large extent, to large inflows of FDI, along its spillover effects, and to the promotion of export-oriented industries (see for example World bank 1993).

⁵² Knack and Rahman (2008) argues that FEA countries have the lower donor fragmentation

Table 12: Japanese ODA allocated to economic infrastructure, Unit, US\$ million

	Year	1967-69	1970s	1980s	1990s	2000-08	Total
All developing countries	II. ECONOMIC INFRASTRUCTURE & SERVICES	190.21	4,479.67	20,894.10	54,576.41	36,353.93	116,494.32
	II.1. Transport & Storage	61.26	849.82	8,556.11	28,162.65	21,707.30	59,337.14
	II.2. Communications	62.06	544.25	2,778.44	4,048.81	1,322.48	8,756.04
	II.3. Energy	66.89	2,762.93	7,962.15	20,394.91	12,427.58	43,614.46
Far East Asia	Loans provided by Japan to FEA	4,420.62	15,196.36	24,083.17	33,990.99	30,950.47	108,641.61
	Share to Total Japanese Loans (%)	40.11%	52.87%	56.45%	58.12%	60.92%	56.67%
	II. ECONOMIC INFRASTRUCTURE & SERVICES*	76.29	2,368.53	11,793.92	31,721.67	22,148.22	66,016.37
	II.1. Transport & Storage	24.57	449.32	4,829.60	16,369.09	13,224.92	33,625.87
	II.2. Communications	24.89	287.76	1,568.32	2,353.31	805.71	4,961.98
	II.3. Energy	26.83	1,460.84	4,494.33	11,854.22	7,571.36	24,715.95

Source: Calculated from OECD's International Development Statistics online

*On the assumption that economic infrastructure is financed by loans, amounts were estimated by applying the share of loans going to FEA to total Japanese ODA allocated in this sector

and a lesser proportion to education, health and social development and welfare (Table 11). On the assumption that economic infrastructure is entirely financed by loans, Table 12 is constructed to show the growth of loan amounts allocated to this sector. It appears that economic infrastructure gained importance since the 1970s with priority given to energy development, which amounted to US\$ 1.46 billion or 62% of the total amount going to the sector.

In the 1980s, the amount for infrastructure projects grew more than five times, which is mostly accounted to transportation facilities whose amount had increased by more than ten times. The energy continued to be important with 38% of the total whereas communication projects increased from US\$ 287 million to US\$ 1.58 billion. The ascending trend continued throughout the 1990s and 2000s as economic infrastructure loans accounted for 60% of total Japanese loans and 35% of bilateral ODA received by FEA from all DAC countries. Allocation bias toward economic infrastructure is one of the important distinctive features of Japanese ODA and partly explains the reason why Japanese ODA made significant contribution to economic growth in FEA.

Economic growth *via* promotion of both domestic and foreign investment was due to domestic efforts in addressing severe market failures. These efforts (self-help efforts) could not produce any results or went unrewarded unless they are supported by ODA (Nishigaki and Shimomura, 1998). And this support would be provided within a policy coherence framework in order and to overcome coordination failures, and to produce efficiency. For

example, building infrastructure does not lead automatically to growth if domestic efforts reflected in good policy and institutional environment and human capital are not available to stimulate private investment (Easterly 1999, Burnside and Dollar 2000). But good policies, good institutions and high level human capital will go unrewarded unless reliable infrastructures are built to ease supply side bottleneck. Therefore, policy coherence is needed in supporting self-help efforts. The absence of policy coherence is one of the reasons why large amount of ODA as well as decade long policy reform did not yield good results in SSA. On the one hand, heavy investments in infrastructure development in the 1970s and in the early 1980s had no economic justifications, proved to be inefficient in many aspects and were known as the “White elephants” (see section 3). On the other hand, policy reform starting the late 1980s, through the 1990s failed to result into positive outcome because ODA was not sufficient to eliminate supply bottleneck. Indeed, the bulk of ODA was allocated to social infrastructure services and debt relief at the expense of economic infrastructure and production sector.

In order to efficiently crowd in private investment, especially FDI, large scale investment in infrastructure development is needed. This requires a large amount of capital, which poor countries lacked of, and consequently development loan (not grants) is the most appropriate form of aid provided by Japan to FEA countries. Thus, sectoral priorities reflected Japan’s greater use of loan instruments related to other DAC donors (Table 9). In addition, development loan is consistent with the self-help principle and is part of the policy coherence framework. Henceforth, recipients are not only supported in their development efforts but are incited to better prepare and implement the infrastructure projects, being conscious that loans have to be repaid, and being convinced about their needs for economic development . In other words, there are incentives for pursuing good policy and improving institutional arrangement.

Coming to assessing the effectiveness Japanese ODA in FEA, I argue that strong emphasis on economic infrastructure, within a policy coherence framework and in support of recipient’s self-help efforts, eased supply side bottleneck, crowded in domestic as well as foreign private investment, and thus made significant and positive contribution to economic growth in FEA countries, for the following reasons.

First, self-help principle and request based aid allocation mean that Japanese ODA, despite its self interest motives like other donors, responded to the needs and the priorities of the recipient countries (see section 4.2-a). This will reduce the risk of producing “White elephants” since the large investment in infrastructure are done within a policy coherence.

Second, having a stable and efficient source of energy is required in order to sustain a steady economic growth. Indeed, energy deficiency is a major impediment to the growth of

private investment *via* increased transaction costs⁵³. At their early stage of development, FEA countries felt the needs of developing efficient energy, and these needs got stronger following the first oil shock. So, the Japanese relatively high commitment to energy development, notably power plant projects, was a considered response to the oil shock and was of great help in easing the supply side bottleneck, thereby stimulating private investment. Indeed, more than 20% of ODA were used in that sector in the 1970s, of which 85% were disbursed during the second half the 1970s. This represents nearly 73% of total ODA allocated to economic infrastructure for the same period. Support to energy sector continued throughout the 1980s and the 1990s with 15% share of total ODA disbursed in each period (Table 12). Looking at individual countries, Japanese ODA played a crucial role to energy development in Thailand where power plant projects figured among the top five priorities of its second, third and fourth economic development plans from 1967 to 1981. Japan became the largest bilateral donor to Thailand since the second half of the 1960s (second plan), the first Yen loan was negotiated in 1968 to be finalized in 1972, and amounted to ¥64 billion (Potter, 1996) to finance infrastructure projects which were listed as *Priority 1* projects by Thai government. The power sector in this second development plan relied most heavily on foreign financing and the nine loans from Japan for power development were particularly significant (Potter 1996). During the third plan (1972-1976), power development had the largest share of ¥74 billion second yen loan package; and with the transportation and communication, they accounted for two third of this package. Loans allocated to the energy sector continued to be the largest portion and accounted for two third of the sector's budget during the fourth plan. Up to 1983, Thailand was the second largest recipient of Japanese loans, of which 24.2% were allocated to power development, or the equivalent of 18% of Thailand's power facilities (Rix 1993).

Third, several empirical studies have demonstrated the positive link between economic growth and the stock of infrastructure assets, especially roads, communication and power plants, (Demurger 200, Fan et al. 2002, Wang 2002, Esfahani and Ramirez 2003, World Bank, 2004, Calderon and Serven 2004), suggesting that large investment in infrastructure projects financed by Japanese ODA would probably have made significant contribution to the sustained high economic growth experienced by the FEA countries since the mid-1970s. An early attempt of evaluating the effectiveness of Japanese ODA was undertaken by the International Development Center, Tokyo (IDC) in 1986. ODA's effectiveness was calculated in terms of Internal Rate of Return (IRR) with the amount of aid as costs and income generated by aid the benefits. It found that the average IRR for sixty seven projects between 1965 and 1982 was quite high at 17.6%, which is much superior to the opportunity

⁵³ Power outages generated losses equivalent to 10% in Kenya and 6% in Uganda whereas one quarter of firms investment funds were spent in own power generators (Ndulu, 2006)

costs of capital (less than 14%), meaning that Japanese ODA is highly efficient in economic terms (Hasegawa 1989). The reason evoked by author is the Japanese preference for economically profitable projects as opposed to welfare goals related projects. We can appreciate the great contribution made by the Japanese ODA at country-level as well. For example as in 1983, in Thailand, Japanese loans financed 18% of electric power facilities, seven out of eleven Bangkok's bridges, all Bangkok freeways, the new Bangkok International airport, the small scale irrigation to 25% of rural households (Rix 1993). In Indonesia for the same period, Japan's ODA accounted for 31% of the country's electric power facilities, 14% of railways, 19% of toll roads, 50% of microwave communications, 76% of Djakarta electric power lines, 46% of Djakarta water supply (Rix 1993). In Malaysia 38% of electric facilities were financed by Japanese ODA in 1983, but in 2000 it had increased to 51% of Malaysia's total supply of electricity whereas the shares Japan's aid-financed railways and highways were respectively 21% and 19% (Sawada and Yamada, 2003). In addition, Sawada and Yamada (2003), after having established the nexus between infrastructure development and economic growth, via Total Factor Productivity (TFP), argue that Japanese ODA to Malaysia, emphasizing economic infrastructure have sufficiently enhanced growth and positively contributed to poverty reduction.

Forth, critical surge in FDI inflows in FEA happened after Japan had increased significantly its ODA in economic infrastructure and production sector (figures 8&9). Indeed, annual inflows of FDI increased more than double from US\$5.5 billion in 1986 to US\$12 billion, US\$ 13.8 billion and US\$ 12.7 billion for 1987, 1988 and 1989 (figure 8). More rapid increase even occurred in the 1990s to reach US\$ 66.2 billion in 1999 whereas Japan had tripled its ODA to economic infrastructure in favor of FEA countries (Table 12). It is true that there are several determinants of FDI inflows and it would be difficult to attribute the FEA's large Inflows of FDI to Japanese ODA. However, it is unthinkable for these countries to be able to attract such amount of FDI without an enabling business infrastructure such as transportation, communication and energy.

c. The role of soft infrastructure or the production sector

Economic infrastructure, as it is described above (hardware), is not enough to eliminate supply side bottleneck. Depending on the severity of market failures, soft infrastructure (software) is also needed. It is an incentive system to assist private sector development, and includes among others: simple and efficient procedures, simple and efficient taxation system, knowledge and knowhow of international marketing and sales promotion, financial support, skill development, other incentives to attract FDI.

As we have seen in previous section, Japanese ODA, in pursuing national interests, was at the beginning essentially motivated by trade promotion, needs to secure essential raw

materials and other resources, humanitarian concerns, political stability and peace building among its Asia neighbors. However, from the mid-1980s, the new emphasis was on promoting Japanese FDI. Two major developments on the international and regional scenes seemed to be at the origin of this shift.

First, the growing concerns from ASEAN countries about Japanese trade surplus and their debt burden. The Second Japan-ASEAN Ministers meeting was thus held on June 1985 to discuss about trade (more access for ASEAN exports to Japanese market), investment and transfer of technology (Sudo 2001).

Second, Japan had been pressured by its major partners to reduce its trade surplus and make more contribution to the global economy. Following the Plaza Accord of September 1985, Japan had to deal with the yen appreciation and raising labor costs. That makes the old trade and development pattern based upon vertical division of labor no longer tenable. The need for relocating adversely affected industries to lower cost sites in Asia is thus more pressing. Such a move will allow these industries to remain competitive while at the same time upgrade the competitiveness of more advanced industries in Japan, being henceforth supplied by cheaper inputs and intermediates.

The new push for industrial development in FEA countries was thus inevitable as there is recognition of mutual benefits of closer industrial cooperation with these economies. Since there are various determinants of FDI, hard infrastructure as well as cheap labor, though important, are not sufficient to relocate Japanese firms to Asia despite being severely penalized by the yen appreciation. Other market failures which impeded FDI had to be dealt with by the provision of soft infrastructures. In response to this industrial development need in FEA, the Japanese government took a major initiative in 1985 to henceforth use ODA to support: (1) investment activities, especially in export-oriented manufacturing, by Japan using funds from OECF, Eximbank and other sources, (2) the development of local Small and Medium Industries (SMI) and export promotion activities through OECF two-step loans, and (3) active technology transfer through technical cooperation activities involving public and private institutions (Rix 2001). The New Asian Industries Development (New AID) plan was set along with the ASEAN-Japan Development Fund (AJDF) in 1987; and it involved joint public-private sector activities (Rix 2001). At the beginning it was severely criticized as a new way for Japan to increase and strengthen its firm control over Asian economy (Phongpaichit et al 1986, Kojima 1992). Nonetheless, the New AID plan is a means to exploit horizontal division of labor between Japan and Asia and efforts were directed to support recipient's Master Plan of Development as well as sector-specific policies. The New AID plan involved three stages in each country (Rix 2001). The first is the making of the Master Plan of Development and Thailand, Indonesia, Malaysia, Philippines as well as India and Pakistan were the first eligible countries. The second is the making of industry plan based on

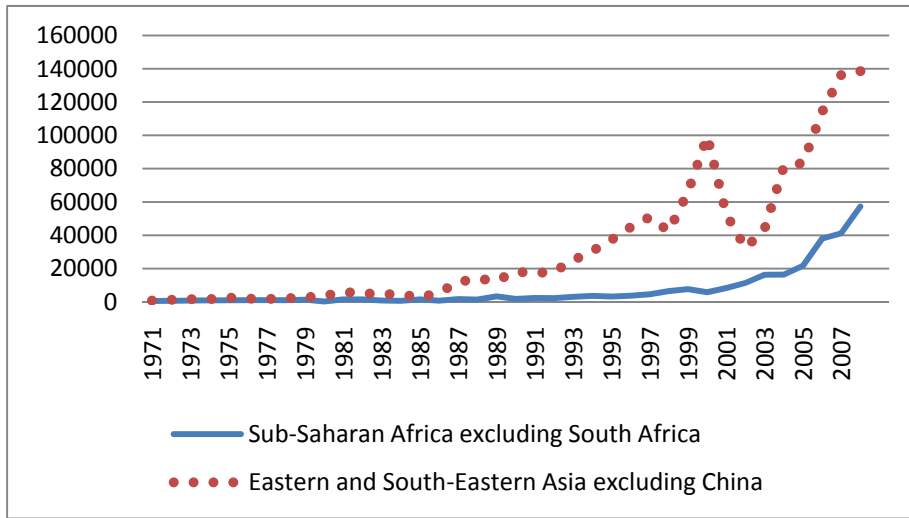
industry sector approach selecting export potential industries and setting up appropriate promotion policies⁵⁴. The third stage involves the implementation of plans, and it consisted of providing industrial development loans, undertaking the investments, setting-up internal finance system (two-step loan system), developing human resources and implementing export promotion measures. US\$ 2 billion loans were thus made available, in form of “two-step loans” to financial institutions in each recipient over three years. It is worthy to note that the New AID plan, in the context of the horizontal division of labor between Japan and FEA, involved greater joint venturing between Japanese and local firms (Rix 2001).

Industry is not the only sector concerned by the New AID plan. AJDF benefited also those export oriented Small and Medium Enterprises (SME) in other sectors such as agriculture, fishing, forestry, and tourism. US\$ 37 million loans were provided to Malaysia in 1988 to support SMEs in tourism sector whereas Indonesian SMEs in plantation received long-term low-interest US\$ 150 million in 1989 (RIX 2001). Japanese support to production had been particularly important in the 1980s and the 1990s. Indeed, from US\$ 3.8 billion in the 1970s, it had increased almost four times in the 1980s, half of which targeted industrial, mining and construction activities, or US\$ 5.09 billion (figure 9). Given that FEA accounted for almost 60% of Japanese loans, it is estimated that more than US\$ 3.05 billion of loans were provided to enhance industrial development in this region in the 1980s. The figure for 1990s was slightly higher at US\$3.5 billion for industries while the amount to support agricultural, forestry and fishing activities increased almost three times, to reach US\$ 8.8 billion in the 1990s.

The lack or the non-availability of local technical skills limits the ability of a country to attract FDI. Indigenous technological capability, developed through education, training and Research and Development, is therefore crucial in attracting FDI because it will determine the ability of the country to create new ideas and more importantly to absorb and assimilate foreign technology. Urata (2003) argues that domestic technological capability in ASEAN countries was low, and so was their technological level, measured by Total Factor Productivity or TFP, at the beginning of the 1970s.

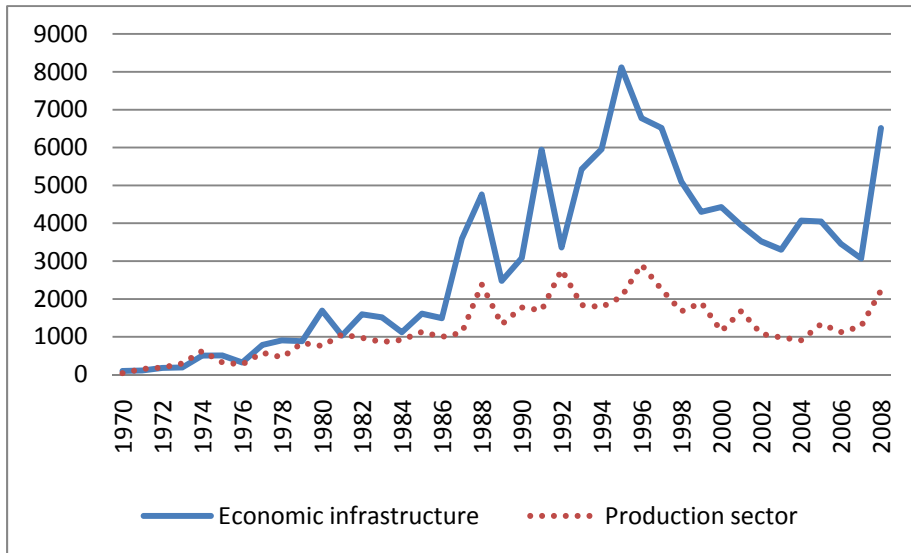
⁵⁴ For Thailand, textiles, furniture, ceramics, plastics, metals and toys were selected. For Malaysia, there were metals, ceramics and electronics, and for Indonesia, rubber, electrical goods, ceramics, plastics and aluminum goods were chosen (Rix 2001).

Figure 8: Annual inflows of FDI, Unit: US\$ million



Source: UNCTAD's Foreign Direct Investment online database

Figure 9: Annual flows of Japanese ODA by sector, Unit: US\$ million



Source: OECD, International Development Statistics online

Therefore, the promotion of Japanese FDI stipulated in the New AID plan required that active technology transfer program must be include in as an important component. There are several channels for technology transfer, such as trade, FDI by MNCs, licensing and Technical Assistance (TA) but effective and successful technology transfer is conditional on the availability of high level of domestic technological capability (Westphal 1990).

Consequently, TA was needed at the first place in FEA countries in order (1) to produce those skills needed by Japanese FDI, (2) to improve domestic technological capability, and (3) to further induce FDI, which will in turn be expected to generate more technology transfer. Furthermore, the technical assistance was used to introduce Japanese working style, technology, especially in the advanced sectors (Sudo 2001) as many Japanese firms complained about low technological capability of Asian workers at their affiliates (Urata 2003).

The decade of 1980s is characterized by a sharp increase of the share of TA in Japanese ODA as its amount was nearly tripled from US\$ 3.2 billion in the 1970s to US\$ 8.8 billion (Table 9). This trend continues throughout the 1990s and 2000s. As regard to FEA countries the increase was higher than the average in the 1980s when the region accounted nearly half of the TA provided by Japan (Tables 9 & 13). In the 1990s, the amount allocated to FEA was US\$ 7.8 billion, almost the double of the 1980s', with China, Indonesia and Thailand being the top recipients.

However it is worth noting that TA, usually tied to grant aids, is subject to *quid pro quo* in the development assistance circle and its effectiveness is put at doubt. Chang et al. (1999) proposed a new approach of measuring aid flows by excluding TA, considered as dubious value because it tends to go primarily to consultants instead of governments. Cambodian experience shows that donor-driven capacity building projects were disappointing, hindered capacity development and made the country to remain aid dependence (Goffrey et al. 2002). Nonetheless it is not to discard TA in the sense that it is supposed to increase the level of recipient's skills and technological capability, thereby crowding in private investment and generating growth. Attention must be paid on the nature and the contents of TA. In this

Table 13: Technical cooperation in FEA, Unit constant 2007 US\$ million

Year	1960s	1970s	1980s	1990s	2000-08
China	0.00	5.85	624.58	2202.89	2390.83
Indonesia	19.63	365.62	883.27	1317.29	896.51
Thailand	37.36	278.02	801.72	1105.64	609.19
Philippines	16.00	216.50	557.48	764.99	586.53
Malaysia	14.62	118.75	461.21	607.73	340.07
Korea	12.20	125.22	265.20	710.10	0.00
Viet Nam	12.25	46.45	24.46	268.71	659.35
Others	58.63	180.36	488.30	866.38	854.86
Total	170.69	1336.77	4106.22	7843.73	6337.34

Source: Calculated from OECD's International Development Statistics online

respect the Japanese TA is considered as effective in increasing the technological capability of FEA countries for the following reasons.

First, as it is argued previously that the New AID plan involved joint public-private sector activities. The Japanese private sector, through their representatives at the government committees on foreign aid, got actively involved in drawing the appropriate TA which would match the needs of Japanese firms willing to relocate in FEA (Rix 2001, Sudo 2001, Arase 1994). Kimura and Todo (2010) investigated the role of ODA as catalyst for FDI and found that in general the link was not significantly established in general. However, by analyzing ODA by donor, they demonstrated that Japanese ODA promoted Japanese FDI but does not crowd in FDI from other countries. The main reason is the close interaction between public and private sectors where the latter can propose aid projects that facilitate the implementation of business standards, rules, and systems specific to Japanese firms (Kimura and Todo 2010). It had lowered the recipient country's risks and would attract further FDI. Since FDI is commonly identified as an important contributing factor to the FEA's outstanding economic performance, Japanese ODA in the form of TA had thus made a great contribution to it. In addition it had improved directly the recipient countries' technological capability, and indirectly by encouraging FDI. Indeed FDI is generally thought to be an important channel of technology transfer either by intra-firm transfer or by spillover effects cause by labor mobility, imitation and competitive pressure.

Second, there are three agencies with specialized mission that are involved in the technical assistance activities. Their mission reflected the close interaction between the government and the private sector mentioned above. The Japan International Cooperation Agency (JICA) is the most important, accounting half of the funds allocated to TA, and its mission consists mainly in (1) inviting overseas participants in technical seminars in Japan, (2) dispatching technical experts, and (3) sending survey team member abroad. The latter is linked to various studies concerning other ODA financed projects and is not primarily aimed at improving recipient's technological capability. The first two activities are directly related to technological upgrading and played important role in transferring basic and general-purpose skills (Urata 2003). From 1954 to 2001, The ASEAN 4 (Thailand, Indonesia, Malaysia and Philippines) were the main beneficiaries of JICA's TA activities as they accounted for 32.3% of overseas trainees sent to Japan (77 579 participants), 32.95% of Japanese experts sent abroad (21456) and 25.8% of funds allocated to TA (Urata 2003). The Association for Overseas technical Scholarships (AOTS), whose mission is to invite managers and engineers from developing countries to train at private firms in Japan. Focus is mainly on technical and managerial skills development. From 1961 to 2001, more than 74 871 Asian engineers and managers, or 88% of the total, were trained by private firms in Japan (Urata 2003), half of them were from the ASEAN 4. The machinery sector (general

machinery, electric machinery and transport machinery) accounted for 57% of ASEAN 4 trainees while the majority of trainees in textiles (59.2%), petrochemicals (39.7%) and metals products (42.4%) were from these four countries. It is worthy to note that these participants were recommended by Japanese firms operating in ASEAN and AOTS has overseas offices in China, Philippines, Thailand, Indonesia and Vietnam. The Japanese Overseas Development Corporation (JODC) is specialized in sending Japanese experts to private firms in recipient countries. The manufacturing sector, notably textiles and machinery, had been the main beneficiary and accounted for 81.9% of experts sent to Asia from 1979 to 2002 (Urata 2003). More than 94% of experts sent by JODC were to Asia, half of them to ASEAN 4.

It is worthy to note that Japanese TA is more pragmatic and different from the western donors' TA. First, it emphasized the self-help effort, and capacity building involves usually two kinds of capacity: the core capacity which is defined as the strong will to learn and the creativity of the counterpart personnel, and specific technology capacity⁵⁵. Learning technology will not be successful unless the person had in advance developed his core capacity. Second, according to the Senior technical advisor at JICA, the western style is a *manual* approach TA. That is to have experts undertake survey and make a manual that is to be delivered through training seminar⁵⁶. He qualified it as simple guidelines only and could not lead to effective learning and technology transfer. The Japanese way can be qualified as a "man to man" approach and emphasizes the growth of practical knowledge, with the trainee making his own manual.

In sum, Japanese TA activities involved a close interaction between private sector and government, and focused mainly in FEA countries in order to build a Japanese FDI-friendly economic environment there. For that purpose several agencies are assigned with specialized missions and there is no overlapping. Even though the TA targeted at the first place Japanese economic interests, it is no doubt that in doing so the Japanese ODA allocated to TA contributes greatly and efficiently to the growth of technological capability of recipient countries, thereby playing crucial role in the promotion of FDI and in the outstanding economic performance.

d. The case of the Eastern Seaboard (ESB) Development plan in Thailand

The ESB's case is very instructive in understanding the special features of Japanese ODA and its role as catalyst of growth by stimulating domestic and foreign private investment, thereby leading to industrial agglomeration along with its spillover effects.

⁵⁵ Source: interview (April 2010) with Michio KANDA, Senior Technical Adviser at JICA, who is in charge of technical cooperation activities.

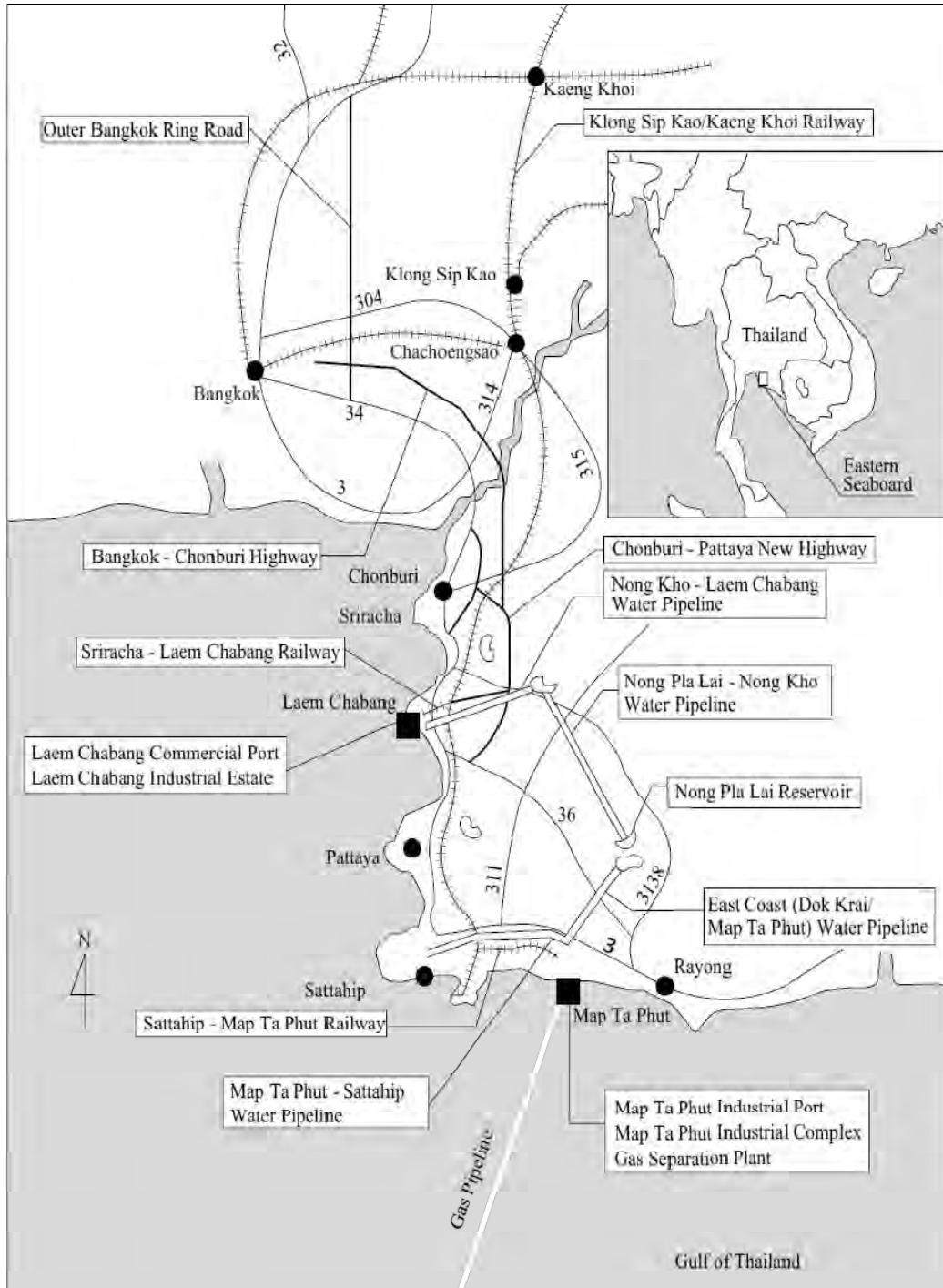
⁵⁶ Ibid

First, this project was not donor-driven, reflected the true ownership and the self-help efforts by Thai government. An early attempt to industrialize the country started in the 1960s and it was based on ISI strategy. Despite the shift into an export-oriented industrialization strategy in the third five-year plan (1972-1976), IS industries remained strong, were still at an earlier stage of development, and had adverse effects on the current account balance due to raising import bills caused by the two oil crisis and the sharp decline in terms of trade (Shimomura 2003). The slow growth of export industries and the raising import dependency of IS industries, making Thailand more vulnerable to external shocks, were the two major constraints that Thai government had to deal with. The need of industrial transformation and of deepening export-oriented manufacturing industrialization was strongly felt and they became the core objectives of the fourth and fifth plan⁵⁷. These efforts resulted in high growth of manufacturing sector, leading to structural change⁵⁸. However a third constraint appeared to slow down this industrialization process. It is the congestion of Bangkok where industrial activities were excessively concentrated, accelerating migration from rural area (Muto et Al. 2007). Consequently, the Thai government sought to develop a second industrial zone in the southeast of the Bangkok metropolitan area, known as the Eastern Seaboard. The Eastern Seaboard development plan was thus adopted in the fifth plan (1982-86) and it consisted in constructing two modern industrial complexes in Map Ta Phut (for heavy and chemical industries) and Laem Chabang (export oriented light industries) areas, with estimated costs of US\$ 4.5 billion or 13% of Thai GDP (Shimomura 2008). The World Bank and Japan were the two major donors but the former was concerned about the financial burden, became more reluctant in undertaking these large amounts of investment for building the two modern deep sea ports in the two areas and favored the use of existing ports (Shimomura 2003, 2007).

⁵⁷ Export promotion policy included various incentives schemes such as tariff reduction on imported inputs for export goods and low interest rate loans, the establishment of export processing zones and direct support to large exporters (Watanabe 2003).

⁵⁸ Manufacturing sector increased its share to exports from 25% in 1970 to 35% in 1980 at the expense of the primary commodities whose share declined from two third to half (Watanabe 2003, Shimomura 2003).

Figure 10: ESB projects financed by Japanese ODA



Source: Ariga and Ejima (2000)

On the contrary, Japan showed strong support to the project and had signed a series of loan agreements with Thai government. In the meantime, Thai cabinet reviewed carefully the rational of the project and in December 1985, the decision to postpone the ESB development plan, except for the construction of National Fertilizer Corporation (NFC), was taken amid serious concerns about deteriorating fiscal deficit and external debt burden. However, since the prospect of high economic growth and large inflows of FDI from Japan, as a result of Plaza agreement, became more visible, and since the bottlenecks in Bangkok's infrastructure were more apparent, Thai cabinet had resumed the implementation of projects in Laem Chabang (port and industrial estate) in October 1986, which were completed in March 1991. The decision to resume those of Map Ta Phut was taken in January 1988 but the Thai government cancelled definitely the NFC plant project (despite strong recommendation from the two donors) because its profitability would be adversely affected by the yen's appreciation and the volatile fertilizer price (Shimomura 2003, 2007). This situation is thus a showcase of Thailand's true ownership and effective self-help efforts in dealing with the challenges related to the gigantic ESB development plan. Japan had strongly supported the ESB plan and had committed a total of US\$ 894 million ODA loans to finance sixteen (16) projects (out of twenty seven) in industrial estates, ports, natural gas plants, waterways, railways and roads construction, accompanied with important technical assistance projects (Ariga and Ejima 2000, Watanabe 2003)⁵⁹. As a result, Japanese ODA inflows to Thailand had increased sharply from less than US\$ 400 million in 1987 to more than US\$ 600 million per year until the completion of the ESB plan 1996, and Japanese FDI started to flow in massively from 1987 (figure 11).

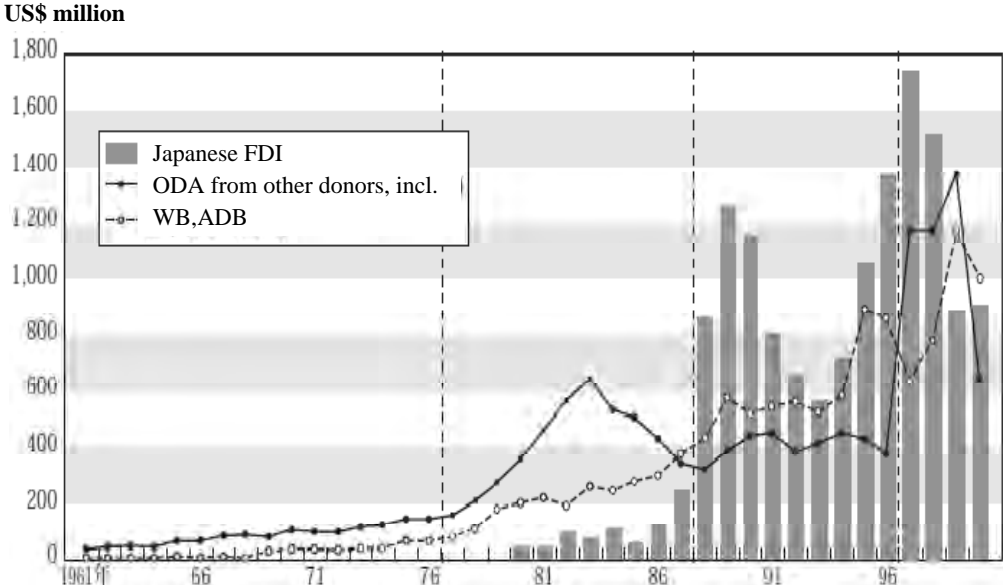
Second, Ariga and Ejima (2000) evaluated the overall impacts of ESB projects and found that, thanks to massive inflows of FDI and its linkages effects, Thai economy experienced high economic growth from the mid-1980s throughout the 1990s, with ESB areas showing the most remarkable performance (Table 14). Whereas Thailand average real GDP per capita grew at a high rate of 7.3% p.a. in 1991-95, the ESB areas had the highest rate, 12.1% p.a. Moreover, it registered the highest growth rate of manufacturing value added (22% against 10.7% for the nation), and in 1995 the ESB areas produced 15% of the country's manufacturing value added. It is worthy to note that the Chon Buri province had the highest GDP per capita growth rate (14.4% p.a.) and accounted for 11.3% of Thailand's manufacturing value added, or 75% of total ESB's. For 1991-95 Rayon province where heavy and chemical industries were concentrated ensured 41.7% of the country's mining industry value added which had grown by 43.8% p.a. from -18.2% p.a. in 1986-91 (Ariga and Ejima 2000). Since the year 2000, the three province of ESB have accounted for the largest in Thai manufacturing value added and outpaced Bangkok metropolitan area, the largest in 1995

⁵⁹ ESB development loans accounted for 21.2% of total loans Thailand received from Japan for 1982-1993 (Ariga and Ejima 2000).

with 63.2% share (figure 12). Thanks to this accelerated growth of the manufacturing sector, further industrial transformation occurred in Thailand at the expense of agriculture, whose share in GDP declined from 19.35% in 1985 to 10.67% ten years later (Shimomura 2008). Such extraordinary performance suggests that the ESB areas had attracted large inflows of FDI to Thailand (figures 7&11), facilitated rapid industrialization and formed industrial agglomerations. After the launch of ESB plan, the number of newly established firms increased dramatically and 213 firms were registered in the five industrial estates and 2420 outside the industrial estate, by the end of 1998 (Ariga and Ejima 2000). Cumulative direct investments in ESB were estimated at US\$ 40 billion in 2000 (Muto et al. 2007) owing to FDI inflows and an increased number of locally established firms moving into ESB areas⁶⁰.

The agglomeration of Thai automotive industry is well investigated by Watanabe (2003). Japanese automakers have established assembling factories in Thailand since 1960, owing to the ISI policy, and most of them were concentrated in Bangkok. Competitiveness gain offered by the ESB led assemblers to establish new factories with larger capacity there and to develop new models since the mid-1990s. This, in turn, encouraged many foreign automotive part suppliers to invest in, and during 1994-1997 FDI inflows were four times higher than the previous four years (figures 7&11).

Figure 11: Annual inflows of ODA, annual inflows of Japanese FDI in Thailand



Source: JICA 2003

⁶⁰ Capital composition of firms in the five industrial estates shows that wholly Thai-owned firms accounted 30.4% while JV with foreign capital stood at 48.5%; the remaining being wholly foreign-owned (Ariga and Ejima 2000).

Table 14: Real Gross Provincial Product (GPP) in the ESB areas (price 1988)

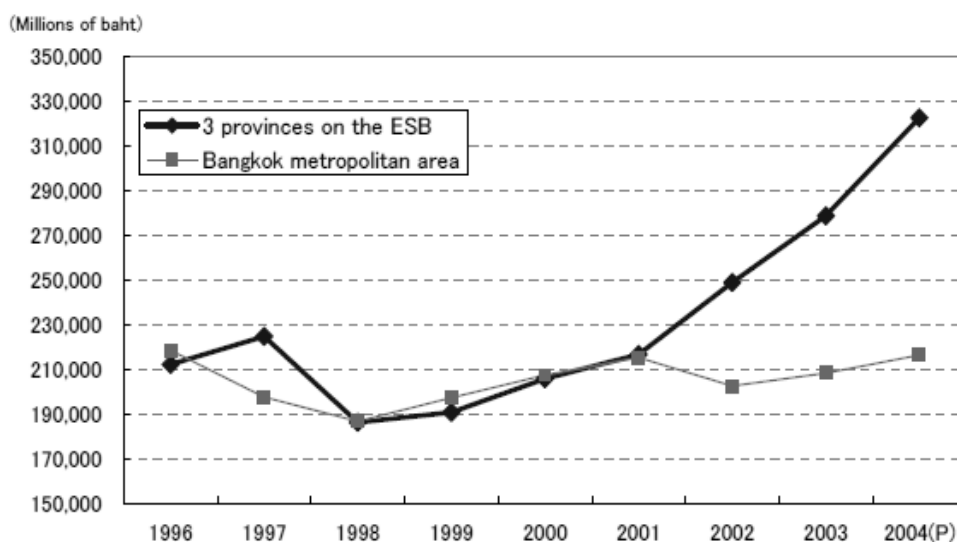
	Chon Buri	Chaechoengsao	Rayong
Real GPP per capita (Bahts)			
1981	52967	18000	25340
1995	157924	62693	122886
Real growth rate per capita (%)			
1981-86	4.5	8.7	16.0
1986-91	7.0	12.0	9.2
1991-95	14.4	6.9	10.4

Source: Ariga and Ejima (2000)

This is especially the case when more than 10 Japanese automotive parts manufacturers established factories in Laem Chabang industrial estate following the installation of new assembling plant by MMC Sitipol Co., Ltd, a subsidiary of Mitsubishi Motor Corporation, in 1990 (Ariga and ekima 2000). Henceforth, automakers sourced a large part of their inputs locally, making them more competitive especially after the 1997 crisis when the Baht depreciated.

As a result of this automotive agglomeration, the Thai automotive capacity expanded rapidly from 500 000 units in 1995 to more than 1 million in 1999 (Watanabe 2003).

Figure 12: Manufacturing value-added in ESB and Bangkok metropolitan area



Source: Muto et al.(2007)

The successful industrialization and structural change, which occurred in Thailand since the second half of the mid-1980s, owed more to the ESB development plan. Indeed, according to the survey conducted by Ariga and Ejima (2000), transport infrastructure, well equipped public utilities (electricity, waterworks, communications) and government incentive measures were mostly cited as very important in the decision of firms to locate their factories in ESB. Thus, government efforts in public investments in ESB played a very significant role in attracting these private investments; and these efforts were largely supported by Japanese ODA.

Japanese ODA in support of domestic efforts to implement successfully the ESB development had acted as catalyst for the rapid growth of private and foreign investment in Thailand. Since, export growth and FDI inflows have made important contributions to economic growth experienced by Thailand, it would not be wrong to assert that Japanese ODA had brought in a significant contribution. Moreover, Thailand has graduated from ODA and has been able to rely entirely on its own resources in financing future economic development (figures 6 &7). This situation also illustrates donor-recipient relationships, which reflects true ownership and mutual accountability and shows how ODA can be an efficient instrument in supporting self-help effort by recipient countries.

CONCLUSIONS AND IMPLICATIONS

It is widely agreed that in spite of increasing flows of ODA, recipient countries, particularly, those in SSA, have continuously shown poor economic performance throughout five decades. This situation has raised many questions about the relevancy of aid scaling-up within the framework of poverty alleviation and fueled the debate about aid effectiveness. Through the aid debates, it is difficult to ascertain that ODA was entirely responsible of either failure or success in recipient countries. Indeed, there are many determinants of economic growth and many factors that influence development performance. Since most of these factors are indigenous, development path depends thus on the prevailing policy and institutional environment within the recipient countries themselves, which determines their capacity to absorb aid. In this case when economic and social conditions in many aid recipient countries worsened overtime, ODA is not to be blamed for it. Therefore, the reasons must be found at recipients' side. Section 3 about aid debates shows that the common point between pessimistic and optimistic views is that both of them attribute most of the failures to the recipients. As a result, conditional approach to aid has gained the favor of many donors whose aid allocation is henceforth guided by selectivity.

However recipient countries could not be held as entirely or solely responsible of ODA's ineffectiveness. Donors' responsibility is also at stake and it is misleading to exclusively focus in recipient countries when one attempts to find out how to improve aid effectiveness. Ignoring donor's responsibility is likely to explain why past actions and efforts targeting aid effectiveness did not produce satisfactory outcome for decades. The paper has highlighted how some aspects of donor's behavior had contributed to ODA ineffectiveness. Indeed, it is proved that aid giving is primarily motivated by donor's self interests. As a result, donor's policies, in pursuing self-interests, do not forcibly take into account recipient's real needs for economic development.

However, there are few cases that recipient's economic prosperity is at donor's interests and ODA policies are geared towards this goal. This is, for example, the case of Marshall Plan, which is labeled as successful ODA and which is recently claimed by some Africa leaders. In fact, it was at US interests to quickly have the European allies recovered from the ill effects of the war in order to counter the spread of communism. This is also the case of Japanese ODA in FEA. In its aid policies, successive Japanese governments, especially since the 1980s, have recognized mutual interdependence and peace building with Asian neighbors. In other words, it was at Japan's political and economic interests to have FEA countries developed their economies. The paper have shown evidences about how effective

was Japanese ODA in supporting economic development in FEA *via* the promotion of exported oriented FDI, as it is illustrated by the case of ESB plan in Thailand.

Japan's experience with FEA is more interesting because it demonstrated how appropriate ODA policies, motivated by the recipients' development, taking into account their real development needs, granting more ownership and supporting recipients 'self-help efforts, can be a successful developmental instrument. Amid strong concerns about ODA effectiveness and about the need of scaling-up foreign aid in favor of SSACs, it is time to seriously think about donor aid policies *vis-à-vis* recipients. And the Japanese experience with FEA could be used as an example of good practice and lessons for future aid strategy. We must agree that some progresses have been made since DAC countries' Paris Declaration. The European community has also reformed its aid modality in few African countries (Madagascar, Benin, Burkina Faso and Uganda) towards stronger domestic ownership, accountability and better coordination since 2001 (Chambas et al. 2004). Recently, human security is the primary focus of ODA policies. FEA's experience has shown that it is better to achieve it *via* steady and sustainable growth. In other words, priority must be given to economically profitable projects and to other areas that have the potential to enhance economic growth, instead of welfare goals related projects.

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ACRONYMS

AJDF:	ASEAN-Japan Development Fund
AOTS:	Association of Overseas Technical Scholarships
ASEAN :	Association of South East Asian Nation
CPIA :	Country Policy and Institutional Assessment
DAC:	Development Assistance Committee
DAG:	Development Assistance Group
DFID:	Department For International Development
ERP:	Economic Reform Program
ESAF :	Enhanced Structural Adjustment Facility
ESB:	Eastern Seaboard
EU :	European Union
FDI :	Foreign Direct Investment
FEA:	Far East Asia
ICOR:	Incremental Capital Output Ratio
IDA:	International Development Association
IDC:	International Development Center
IMF :	International Monetary Fund
IRR:	Internal Rate of Return
ISI:	Import Substituting Industrialization
JADF:	Japan-Asia Development Fund
JICA:	Japan International Cooperation Agency
JODC:	Japanese Overseas Development Corporation
LDCs:	Least Developed Countries
LICs:	Low Income Countries
MDGs:	Millennium Development Goals
MICs:	Middle Income Countries
MMC:	Mitsubishi Motor Corporation
MNC :	Multinational Companies

MOFA :	Ministry of Foreign Affairs
New AID:	New Asian Industries Development
NFC :	National Fertilizer Corporation
ODA:	Official Development Assistance
OECD :	Organization for Economic Cooperation and Development
SAL:	Structural Adjustment Loans
SAP :	Structural Adjustment Policy
SMI:	Small and Medium Industries
SSACs :	Sub-Saharan Africa Countries
TA:	Technical Assistance
TFP:	Total Factor Productivity
TT:	Terms of Trade
UNCTAD:	United Nations Conference on Trade and Development

ABSTRACT

In the wake of the Second World War two, world leaders who gathered in San Francisco adopted the United Nations Charter and committed “to promote social progress and better standards of life in larger freedom, and to employ international machinery for the promotion of the economic and social advancement of all peoples”. The Official Development Assistance (ODA) is to be provided to developing countries within this context. Since then, developing countries have received significant inflows of ODA as cumulative amount of disbursed aid stood at US\$ 3.1 trillion (2007 price). Even though developed countries commitment is still far from the target (0.7% of GDP), substantial efforts had been made to improve aid delivery in terms of volume and quality (high share of grants and untied aid).

Despite huge amount spent in foreign assistance, the outcome is not commensurate with it, especially in Sub-Saharan Africa countries (SSACs), the largest recipient, which show continuous economic dismal throughout five decades. Failure is thus widely recognized by many experts and scholars even though their views diverge about its major determinants. On the other hand, countries in Far East Asia (FEA), who received relatively less aid and in declining trend, have been successful in closing development gaps and graduated from Low Income Countries (LICs) status. Whereas it is difficult to ascertain that ODA was entirely responsible of either failure or success in recipient countries, the contrastive performance between SSA and FEA has raised questions about how ODA can affect the development outcome of the recipient countries.

There are three approaches. The first is a more optimistic approach claiming the scaling-up of foreign aid and stresses that aid flows are too small to close the gaps and this is the reason why ODA did not work. But it claimed also that aid should be more effective if it is given to well-governed countries. The second is a pessimistic view arguing that aid makes things worse, undermines recipient’s institutions and growth *via* its disincentive effects (moral hazard, Dutch disease, increased consumption, low absorptive capacity), and there is no need for scaling-up. The third one is the conditional approach asserting that aid does work under good policy and institutional environment. Amid numerous challenging evidences, this third approach is very influential and gained strong support among donors who henceforth adopt selectivity-based aid allocation. From these

three approaches, it seems that most of the reasons why ODA failed to work effectively must be found at the recipient's side.

The paper argues that donors also are accountable for the failure and there are growing evidences supporting this view. Using ODA as foreign policy instrument to safeguard self-interests explain why donors' practices in aid delivery contributed to aid paradox in SSACs. They are namely: aid allocation irrespective of recipient's absorptive capacity, tied aid, aid volatility, allocation biased to social sectors, conditionality and lack of ownership by recipient, aid channels proliferation and donor fragmentation. Consequently, difference in donor's practices will likely to explain differential performance of ODA. The case of Japan's ODA in FEA is thus full of interests such that Japan has been the largest donor in FEA countries whose economic performance is commonly qualified as extraordinary in many respects.

Like other DAC countries, Japan's ODA delivery is strongly motivated by self-interests. But it is its distinctive features, relative to its Western counterparts, that make the difference in terms of outcomes. They are mainly: the philosophy of self-help efforts, aid delivery based on trinity-type economic cooperation (ODA cum Foreign Direct Investment cum trade), priority to economic infrastructure and soft infrastructures (production sectors, technical assistance), high share of loans, true recipient's ownership (request-first principle, no conditionality).

The paper gives evidences that, Japanese ODA is provided in support of FEA countries' efforts to address relevant market failures that obstruct the growth of foreign and domestic private investment. These efforts include among others infrastructure development, building of business-friendly institutional capacity, investment promotion policies, human resources development and development of soft infrastructures. The case of Japanese ODA-financed Eastern Seaboard (ESB) Development plan in Thailand is singled out to illustrate well this assumption. Japanese ODA in support of domestic efforts to successfully implement this gigantic project had acted as catalyst for the rapid growth of domestic and foreign private investment in Thailand. Since export growth and FDI inflows have made important contributions to economic growth experienced by Thailand, it would not be wrong to assert that Japanese ODA had brought in a significant contribution. Moreover, Thailand has graduated from ODA and has been able to rely entirely on its own resources in financing future economic development. The successful industrialization and structural change, which occurred in Thailand since the second half of the mid-1980s, owed more to the ESB development plan.

Putting aside, donors' self-interests, Japan's experience with FEA

demonstrated how appropriate ODA policies, taking into account recipients' real development needs, reflecting true ownership and mutual accountability, and supporting recipients 'self-help efforts, can be a successful developmental instrument.

Amid strong concerns about ODA effectiveness and about the need of scaling-up foreign aid in favor of SSACs, alternative directions for future aid strategy would be better based on past Japanese experience in FEA, especially in terms of giving priority to economically profitable projects and other areas that have the potential to enhance economic growth, instead of welfare goals related projects.