Official Development Assistance: Views from Japan and East Asia

by

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Background

• A major turning point of development aid:
  – From aid for economic growth to aid for poverty reduction
  – From projects to budget support
  – From loans to debt reduction aid and grants
  – From bilateral to multilateral aid.
  – Continued economic growth in Sub Sahara African countries since 2000

• “Anarchy” in ODA research: numerous studies on foreign aid but no consensus on aid effectiveness

• The lack of views from Japan and East Asian development experience
Presentation outline

1. Introduction
2. ODA: An Overview
3. The Roles of ODA
4. Views from Japan and East Asia
5. Concluding remarks
2. ODA: An Overview
What is ODA?

OECD definition

- Financial flows from developed countries to developing countries which satisfy the following three conditions:

  (1) Undertaken by the **official sector**;
  (2) With promotion of economic **development** and welfare as the main objective
  (3) At **concessional** financial terms (if a loan, having a grant element of at least 25 per cent).
Types of ODA

- ODA flows include contributions by donor government agencies at all levels to developing countries directly (i.e., bilateral ODA) or indirectly (i.e., multilateral institutions):

(1) Bilateral aid
- Grants= “transfers made in cash, goods, or services”
- Loans= “transfers for which repayment is required”
- TC= “activities to augment the level of knowledge and technical skills”

(2) Multilateral ODA
- Grants
- Capital contribution
- Concessional Lending
ODA Decomposition
(All donors total, Gross Disbursements, 2005 USD million)
3. The Roles of ODA
Policy instrument(s) to achieve target #1

• MDG goal #1 target #1: Halving global poverty 29.8% in 1990 by 2015.

(A) Direct transfer approach
  – Direct transfers to the poor

(B) Indirect growth approach
  – Indirect poverty reduction through facilitating growth, i.e., “pro-poor growth”
The role of aid in achieving MDG target #1

Direct poverty reduction

Aid \rightarrow Investments \rightarrow Growth \rightarrow Poverty Reduction
The role of aid in reducing poverty directly

• Besley and Burgess (2003): The amount of aid need to reduce global poverty only by pure income transfers

  Upper bound: \((1.2165 \text{ bill/2}) \times 1\text{USD} \times 365\text{days}=252.76250\text{ bill USD}\)
  Lowe bound: \((1.2165 \text{ bill/2}) \times 0.3\text{USD} \times 365\text{days}=75.82875\text{ bill USD}\)

• In 2000, total bi- and multi-lateral ODA = 65.5 bill USD

• Unrealistic to use aid to reduce poverty and achieve the target #1 directly.
Indirect approach by growth

- Growth is a necessary condition of poverty reduction [Dollar and Kraay (2002), Ravallion (2001), Besley and Burgess (2003)]

\[ \text{Dollar=}\text{Kraay (2002):} \]

Per capita income growth rate of the bottom 20%

Average per capita growth rate
Foreign Aid Governance Structure

Donors

- Grants
- TC
- Loans

Recipient

Outcome

Growth
(FDI, Trade, and Investments)
Foreign Aid Governance: Three Necessary Conditions

1. ODA should be allocated towards the poor countries.

2. ODA should be more tightly combined with the recipients’ efforts.

3. ODA should accompany significant international technology transfers to be sustainable.
Necessary Condition #1: ODA should be allocated towards the poor countries

Strategic nature of aid:

- Alesina and Dollar (2000) JEG: Donors behave strategically
Necessary Condition #1: ODA should be allocated towards the poor countries

Grant Allocation Consistency with Global Poverty Reduction

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<th>A donor:</th>
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<td>(1996-99 data)</td>
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<th>Governance/efforts:</th>
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<th>P₂</th>
<th>P₃</th>
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<td>(1995 data)</td>
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<th>G¹(α-1)</th>
<th>G²(α-1)</th>
<th>G³(α-1)</th>
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<td>(1995 data)</td>
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### Necessary Condition #1:
**ODA should be allocated towards the poor countries**

#### Table 1
**General Results, ODA/OA Grant of Bilateral Donors**

Dependent Variable: log(1+ODA/OA Grant per capita) for each country (avg. 1996-99)

**Estimation Method: Tobit**

<table>
<thead>
<tr>
<th></th>
<th>(1) France</th>
<th>(2) Germany</th>
<th>(3) Japan</th>
<th>(4) Netherlands</th>
<th>(5) U.K.</th>
<th>(6) U.S.A.</th>
<th>(7) Canada</th>
<th>(8) Italy</th>
<th>(9) Finland</th>
<th>(10) Norway</th>
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<td>0.091</td>
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<td>0.014</td>
<td>0.046</td>
<td>0.021</td>
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<td>(1.40)</td>
<td>(3.29)**</td>
<td>(4.71)**</td>
<td>(2.64)*</td>
<td>(0.41)</td>
<td>(3.60)**</td>
<td>(1.89)</td>
<td>(1.62)</td>
<td>(3.93)**</td>
<td>(2.52)*</td>
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<td>(0.72)</td>
<td>(0.25)</td>
<td>(0.86)</td>
<td>(0.23)</td>
<td>(0.20)</td>
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<td>(0.82)</td>
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<td>(2.53)*</td>
<td>(6.18)**</td>
<td>(3.92)**</td>
<td>(3.01)**</td>
<td>(2.75)**</td>
<td>(3.14)**</td>
<td>(1.45)</td>
<td>(1.34)</td>
<td>(1.11)</td>
<td>(3.22)**</td>
<td>(3.59)**</td>
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<tr>
<td>Constant</td>
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<td>(3.26)**</td>
<td>(8.11)**</td>
<td>(5.09)**</td>
<td>(4.01)**</td>
<td>(3.51)**</td>
<td>(4.23)**</td>
<td>(2.55)*</td>
<td>(1.74)</td>
<td>(1.37)</td>
<td>(3.85)**</td>
<td>(4.45)**</td>
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<td>83</td>
<td>83</td>
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</tbody>
</table>

Source: Sawada and Yamada (2003) Table 3

Note: Absolute value of t statistics in parentheses.  * significant at 5%;  ** significant at 1%
Necessary Condition #1:
ODA should be allocated towards the poor countries

Figure 5
Allocation of Japanese Grant

Necessary Condition #2: ODA should be tightly combined with the recipients’ efforts

- Governance of recipients should be good enough for aid to be effective:
  - Boone (1996) EER, Burnside and Dollar (2000) AER: Aid increases (government) consumption, not investment
  - Easterly (2004) “Samaritan’s dilemma”: Aid could actually worsen incentives to invest if the recipient believes that future poverty will call forth future aid.
Necessary Condition #2: ODA should be tightly combined with the recipients’ efforts

- A hypothesis from Japanese and East Asian viewpoint:
  - “disincentive effects (or Samaritan’s dilemma) will be potentially smaller in the case of loans than in the case of grants, since future repayments will impose discipline” (Kohama, 1995).

- To test the validity of this hypothesis, Sawada, Kohama, and Kono (2005) estimate cross-country aid growth regressions
**Necessary Condition #2:**

ODA should be tightly combined with the recipients’ efforts

### Table 2 Growth Regression with Aid Variable

**Sample period: 1970–97**

<table>
<thead>
<tr>
<th>Estimation method</th>
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<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
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<td>Log (initial GDP)</td>
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<td>-0.38</td>
<td>-0.38</td>
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<td></td>
<td>(-1.12)</td>
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<td>(-1.01)</td>
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<td>(-0.90)</td>
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<tr>
<td>Policy index</td>
<td>1.04***</td>
<td>1.26***</td>
<td>1.05***</td>
<td>1.19***</td>
<td>1.17***</td>
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<tr>
<td></td>
<td>(5.25)</td>
<td>(5.54)</td>
<td>(5.34)</td>
<td>(5.49)</td>
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<td>Ethnic fractionalization</td>
<td>-0.01</td>
<td>0.03</td>
<td>-0.02</td>
<td>0.09</td>
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<tr>
<td></td>
<td>(-0.02)</td>
<td>(0.04)</td>
<td>(-0.03)</td>
<td>(0.13)</td>
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<tr>
<td>Assassinations</td>
<td>-0.34</td>
<td>-0.37</td>
<td>-0.32</td>
<td>-0.34</td>
<td>-0.33</td>
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<tr>
<td></td>
<td>(-1.34)</td>
<td>(-1.45)</td>
<td>(-1.27)</td>
<td>(-1.31)</td>
<td>(-1.27)</td>
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<tr>
<td>Ethnic fractionalization × assassinations</td>
<td>0.12</td>
<td>0.20</td>
<td>0.10</td>
<td>0.15</td>
<td>0.13</td>
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<tr>
<td></td>
<td>(0.19)</td>
<td>(0.31)</td>
<td>(0.16)</td>
<td>(0.23)</td>
<td>(0.21)</td>
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<tr>
<td>Institutional quality</td>
<td>0.32***</td>
<td>0.32***</td>
<td>0.33**</td>
<td>0.33**</td>
<td>0.33**</td>
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<tr>
<td></td>
<td>(2.63)</td>
<td>(2.56)</td>
<td>(2.69)</td>
<td>(2.60)</td>
<td>(2.57)</td>
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<td>M2/GDP (lagged)</td>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td></td>
<td>(0.23)</td>
<td>(0.21)</td>
<td>(0.27)</td>
<td>(0.06)</td>
<td>(0.00)</td>
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<tr>
<td>Sub-Saharan Africa</td>
<td>-1.61***</td>
<td>-1.65***</td>
<td>-1.64***</td>
<td>-1.63***</td>
<td>-1.62***</td>
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<tr>
<td></td>
<td>(-2.92)</td>
<td>(-2.96)</td>
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<td>(-2.93)</td>
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<tr>
<td>East Asia</td>
<td>1.35</td>
<td>1.12*</td>
<td>1.34**</td>
<td>1.28*</td>
<td>1.32*</td>
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<tr>
<td></td>
<td>(2.62)</td>
<td>(2.18)</td>
<td>(2.62)</td>
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<td>Aid/GDP</td>
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<td>0.24</td>
<td>-0.25</td>
<td>0.83</td>
<td>-0.18</td>
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<tr>
<td>(Aid/GDP)*Policy</td>
<td>-0.18</td>
<td>(1.24)</td>
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<tr>
<td>Loan/GDP</td>
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<td>1.29*</td>
<td>1.40*</td>
<td>-0.72</td>
<td>-0.54</td>
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<tr>
<td></td>
<td>(0.66)</td>
<td>(1.67)</td>
<td>(1.69)</td>
<td>(-1.72)</td>
<td>(-1.43)</td>
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<td>(Loan/GDP)*Policy</td>
<td>-0.72</td>
<td>-0.54</td>
<td>-0.20</td>
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<tr>
<td>(Loan/GDP)*Policy</td>
<td>(0.66)</td>
<td>(1.67)</td>
<td>(1.69)</td>
<td>(-1.72)</td>
<td>(-1.43)</td>
</tr>
<tr>
<td>Grant/GDP</td>
<td>-0.14</td>
<td>-0.18</td>
<td>-0.20</td>
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<tr>
<td></td>
<td>(-0.73)</td>
<td>(-0.44)</td>
<td>(-0.47)</td>
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<tr>
<td>(Grant/GDP)*Policy</td>
<td>0.02</td>
<td>0.06</td>
<td>0.00</td>
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<tr>
<td>(Grant/GDP)*Policy</td>
<td>(0.11)</td>
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<td>R-squared</td>
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</table>

Necessary Condition #3: ODA should accompany significant international technology transfers to be sustainable.

• The effectiveness of technical co-operation aid has been largely unexplored:
  
  • Cassen et al. (1994): There is no ready methodology for measuring the effectiveness of aggregate long-run effects of TC. Difficulties to measure the impacts have hindered the academia from conducting quantitative evaluations of TC.

• Research Strategy: TC ↑ → TFP ↑

• Sources of tech. progress (int’l tech. transfers) in LDCs is multi-faceted:
  • Absorptive capacity (HC) (Lucas, 1993; Eaton and Kortum, 1996).
  • Channels of tech. diffusion
    • TC
    • FDI (Keller, 2004).
Necessary Condition #3: ODA should accompany significant international technology transfers to be sustainable.

\[
\frac{1}{T} \left( \log A_{iT} - \log A_{i0} \right) = 0.015 \left( h_i + 0.007TC_i + 0.0004FDI_i + 0.012OPEN_i \right) + \frac{0.014}{A_{i0}/A_{m0}} + \hat{u}_i
\]
Aid Proliferation

James D. Wolfensohn, the former president of the World Bank, stated that:

“Tanzania annually files 2,400 reports to aid donors and hosts 1,000 aid missions from donor countries each year”

Source: CRS/OECD, Commitment Base

Source: CRS/OECD, Commitment Base. Calculated by recipient countries and shown as regional averages.
Aid Proliferation

(1) Induces competition for local experts or resources (Knack and Rahman 2007; Arimoto and Kono 2009)

(2) Increases transaction costs and the effectiveness of aid is reduced significantly (Roodman, 2007; Acharya et al. 2006)

(3) Inefficient supply of aid in the recipient country because of the free-riding problem faced by the donors (Rahman and Sawada, 2010)
Aid Proliferation

- Inefficient supply of aid in the recipient country because of the free-riding problem faced by the donors (Rahman and Sawada, 2010)
- If this is so, the mere coordination of aid, such as general budget supports, will not solve the problem

Figure 8
Aid Proliferation

Source: Rahman and Sawada (2010). The result is based on a semi-parametric regression conditional on country fixed effects.
4. Views from Japan and East Asia
Japanese ODA:
Historical Characteristics

- From the end of World War II, Japan transformed itself from being a recipient of foreign aid to becoming one of the world’s largest donor countries.

(1) Japan as an aid recipient:

- 1946- Received humanitarian aid
  - GARIOA (Government and Relief in Occupied Areas), EROA (Economic Rehabilitation in Occupied Areas)
  - International organizations (WHO, UNICEF etc.);
  - NGO (CARE, LARA)

- 1952- Financed infrastructure investments
  - Investment loans from World Bank (IBRD): Total amount (1953-1966) $863 million (31 loans); Final repayment made in July 1990
Japanese ODA: Historical Characteristics

(2) Japan as a donor:

- 1954- Participated the Colombo plan (development consortium for South and Southeast Asia)

- 1951- Signed San Francisco Peace Treaty
  - Started foreign aid as reparation for the war

- 1960s, 1970s- Infrastructure financing by Yen loans and grants

- 1990s Became the largest aid donor counties in the world.
- 1992 ODA Charter by the Cabinet
- 2003 Revised ODA Charter by the Cabinet
Japanese ODA: Basic Characteristics

1. Very important diplomatic tool
2. High loan ratio
3. High allocation to economic infrastructure
4. High allocation to Asia but increasing to SSA
5. Complicated internal governance due to too many actors (13 ministries/agencies)
6. “The Aid Trinity”
The Position of Japan’s ODA

Chart III-5. Trends in the ODA of Major DAC Countries (Net Disbursement)

Notes: (1) Excluding assistance to Eastern Europe and graduated countries.
(2) US figures for 1990-1992 exclude military debt relief.
(3) Provisional value for 2007, except Japan.
As for means of aid, Japan has the lowest ratio of grants and thus highest ratio of loans among DAC countries

(2) Grant share of ODA by each DAC country

(Commitments, average of two years, unit: %)

Source: Development Co-operation Report 2006
Notes: (1) Countries are placed in descending order of their ratios of grants in the average of 2004 and 2005.
(2) Excluding debt relief.
ODA by sector

Chart I-9. Characteristics of Japan's Official Development Assistance shown in charts Part 1

Characteristics of Japan's ODA are shown as follows in the disbursement data in Development Co-operation Report 2006, featured in the OECD Journal.

Economic infrastructure accounts for a large portion among various sectors

(1) Share by sector in bilateral ODA promoted by DAC countries (2005)

- Share of social infrastructure
- Share of agricultural infrastructure (excluding food aid)
- Share of economic infrastructure
- Share of industry and other production segments
- Share of emergency aid (including food aid)
- Share of program assistance, etc.

Japan:
- Social infrastructure: 50.5%
- Agricultural infrastructure: 2.5%
- Economic infrastructure: 23.4%
- Industry: 15.5%
- Emergency aid: 0.7%
- Program assistance: 3.6%

United States:
- Social infrastructure: 42.8%
- Agricultural infrastructure: 2.5%
- Economic infrastructure: 42.0%
- Industry: 15.5%
- Emergency aid: 7.4%
- Program assistance: 7.8%

United Kingdom:
- Social infrastructure: 57.5%
- Agricultural infrastructure: 2.7%
- Economic infrastructure: 25.3%
- Industry: 7.4%
- Emergency aid: 7.3%
- Program assistance: 1.9

France:
- Social infrastructure: 50.5%
- Agricultural infrastructure: 9.4%
- Economic infrastructure: 25.2%
- Industry: 7.3%
- Emergency aid: 7.8%
- Program assistance: 1.9

Germany:
- Social infrastructure: 46.5%
- Agricultural infrastructure: 4.0%
- Economic infrastructure: 18.2%
- Industry: 17.9%
- Emergency aid: 7.3%
- Program assistance: 2.3

Italy:
- Social infrastructure: 70.3%
- Agricultural infrastructure: 10.9%
- Economic infrastructure: 10.5%
- Industry: 15.0%
- Emergency aid: 0.7%
- Program assistance: 2.6

Canada:
- Social infrastructure: 30.3%
- Agricultural infrastructure: 4.3%
- Economic infrastructure: 39.8%
- Industry: 34.1%
- Emergency aid: 7.1%
- Program assistance: 4.4

Australia:
- Social infrastructure: 13.6%
- Agricultural infrastructure: 5.3%
- Economic infrastructure: 45.2%
- Industry: 15.3%
- Emergency aid: 11.8%
- Program assistance: 3.8

Sweden:
- Social infrastructure: 36.5%
- Agricultural infrastructure: 3.9%
- Economic infrastructure: 27.6%
- Industry: 9.2%
- Emergency aid: 17.9%
- Program assistance: 2.9

DAC Average:
- Social infrastructure: 37.3%
- Agricultural infrastructure: 10.0%
- Economic infrastructure: 30.5%
- Industry: 8.3%
- Emergency aid: 3.3%
- Program assistance: 3.3

Source: Development Co-operation Report 2006
Notes: (1) “Share of industry and other production sectors” includes multi-sectors.
(2) Each country’s total of its all sectors may not be exactly 100 due to rounding calculations.
(3) Excluding aid for Eastern Europe and graduated countries/territories.
(4) Program assistance, etc. includes debt relief, administrative expenses, etc.
Japan’s ODA allocation by region

<table>
<thead>
<tr>
<th>Calendar year</th>
<th>Asia</th>
<th>Middle East</th>
<th>Africa</th>
<th>Latin America</th>
<th>Oceania</th>
<th>Europe</th>
<th>Assistance encompassing multiple regions</th>
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<tbody>
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<td>1970</td>
<td>98.2</td>
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<td></td>
<td>3.6</td>
<td>2.2</td>
<td>6.0</td>
<td>-0.3</td>
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<td>1980</td>
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<td>9.6</td>
<td>12.0</td>
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<td>2.3</td>
<td>7.1</td>
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<td>1990</td>
<td>59.3</td>
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<td>7.5</td>
<td>10.1</td>
<td>1.6</td>
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Notes: (1) ODA to the European region from 1990-2006 includes aid to the Eastern Europe.  
(2) If the amount received of loan aid exceeds its disbursements, the figure can be negative. 
(3) Assistance encompassing multiple regions includes the dispatch of survey groups, administrative costs and promotion of development awareness, all encompassing multiple regions.
Japan’s ODA allocation by region

- 1992 ODA Charter by the Cabinet
- 2003 Revised ODA Charter by the Cabinet
  - Supporting self-help efforts of developing countries
  - Perspective of “Human Security”
  - Assurance of fairness
  - Utilization of Japan's experience and expertise
  - Partnership and collaboration with the international community
- “Human Security”: The need to protect people against serious economic and violent threats to their lives, livelihoods and dignity.
- October 2008, New JICA
Chart I-12. Perspective of ODA Reform and Institutional Reform of MOFA

**Strategy**
- Establish the Overseas Economic Cooperation Council under the direction of the Prime Minister
  - Prime Minister
    - Chief Cabinet Secretary
    - Minister for MOFA
    - Minister of MOF
    - Minister of METI

**Policy Planning**
- Establish the International Cooperation Bureau within MOFA to strengthen the ministry's policy planning functions
  - International Cooperation Bureau
    - Development-related sections
    - UN administrative and financial issues-related sections
  - Organized coordination between bilateral assistance and assistance through international organizations
  - Implementation of effective and efficient assistance with mutually complementary and synergic effects

**Implementation**
- JICA is to be the sole entity to implement all of loan aid, technical cooperation and grant aid
  - Current
    - JBIC: International financial operations and loan aid
    - JICA: Technical cooperation
    - MOFA: Grant aid
  - After Reform
    - New JICA: Loan aid, technical cooperation and grant aid
“The Aid Trinity”
Japan’s ODA Philosophy?

• Complementarities between ODA, FDI, and economic growth are fabricated as the “ODA Trinity” hypothesis of METI.

• Yanagihara (1998): “framework approach” vs. “ingredients” approach
  – “Framework approach: donors set rules of the game according to which economic agents make decisions and take action.
  – “Ingredients approach” of Japan: details of tangible organizational units such as enterprises, official bureaus, and industrial projects are carefully designed and coordinated.
  – Japan as a donor is like a soccer coach who is eager to improve the skills of each player and design a winning strategy for the next World Cup.
Does aid facilitate FDI?

• Aid trinity?
  – Data for each source-recipient pair
  – Gravity equation, regressing $\ln FDI_{ijt}$ on $\ln Aid_{ijt}$
  – Blundell and Bond (1998) system GMM

• Results:
  – Foreign aid in general does not have any significant effect on FDI
  – Robust evidence that Japanese aid promotes FDI from Japan but does not attract FDI from other countries.
Is Korea-Japan Collaboration Possible?

Commitment to Development Index 2009

Rich and poor countries are linked in many ways by foreign aid, commerce, migration, the environment, and military affairs. The Commitment to Development Index (CDI) rates 22 rich countries on how much they help poor countries build prosperity, good government, and security. Each rich country gets scores in seven policy areas, which are averaged for an overall score.
Is Korea-Japan Collaboration Possible?

• Leverage in the DAC's rule making process and at G20
  – At the bottom of CDI, but the criteria (“framework”) biased?
  – Experience from recipient to donor
  – Loan, project-based aid

• Post-Political Disaster/Conflict Rehabilitation

• Global issues
  – Natural and disasters (adaptation, epidemics, natural calamities)
  – Economic disasters (CMI, AMF/ demarcation with ADB)
  – Environmental issues (mitigation and adaptation)

• Facilitate private sector investments
  – The trinity of Aid, FDI, and trade
Concluding Remarks

• Importance of views from successful development experience of Japan and East Asia

• Three necessary conditions for the successful ODA:
  – Consistency with global poverty targeting
  – Incentive mechanism to recipients
  – Sustainable international technology transfers

• Experiences of Japan and East Asia in providing “ingredients driven” ODA
  – in apolitical way to align international agendas
  – in utilizing loans to develop infrastructure: “ODA Trinity”
  – in achieving borrowed technology-driven industrialization with rapid human capital accumulation

• Korea and Japan ODA coordination