

RIET Workshop

*East Asian Experience and South Korea-Japan  
Collaboration in Official Development Assistance*

October 12, 2010

**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 tied aid to untied aid
  - From bilateral to multilateral aid.
  - Continued economic growth in Sub Sahara African countries
- “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

# Japanese ODA: Basic Characteristics

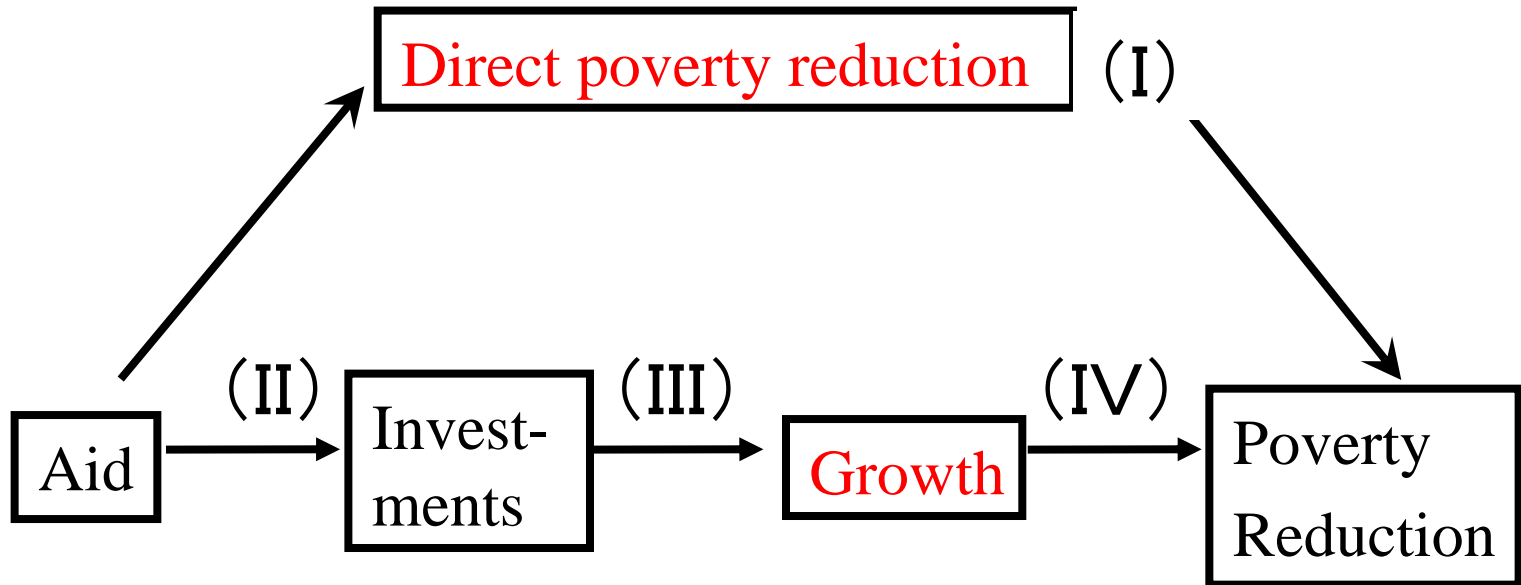
1. Very important **diplomatic tool**
2. High **loan** ratio
3. High allocation to **economic infrastructure**
4. High allocation to **Asia** (but increasing to **SSA**)
5. Complicated **internal governance** due to too many actors
6. “**The Aid Trinity**” or **Japan ODA model**
  - **Korea** shares the similar characteristics

# outline

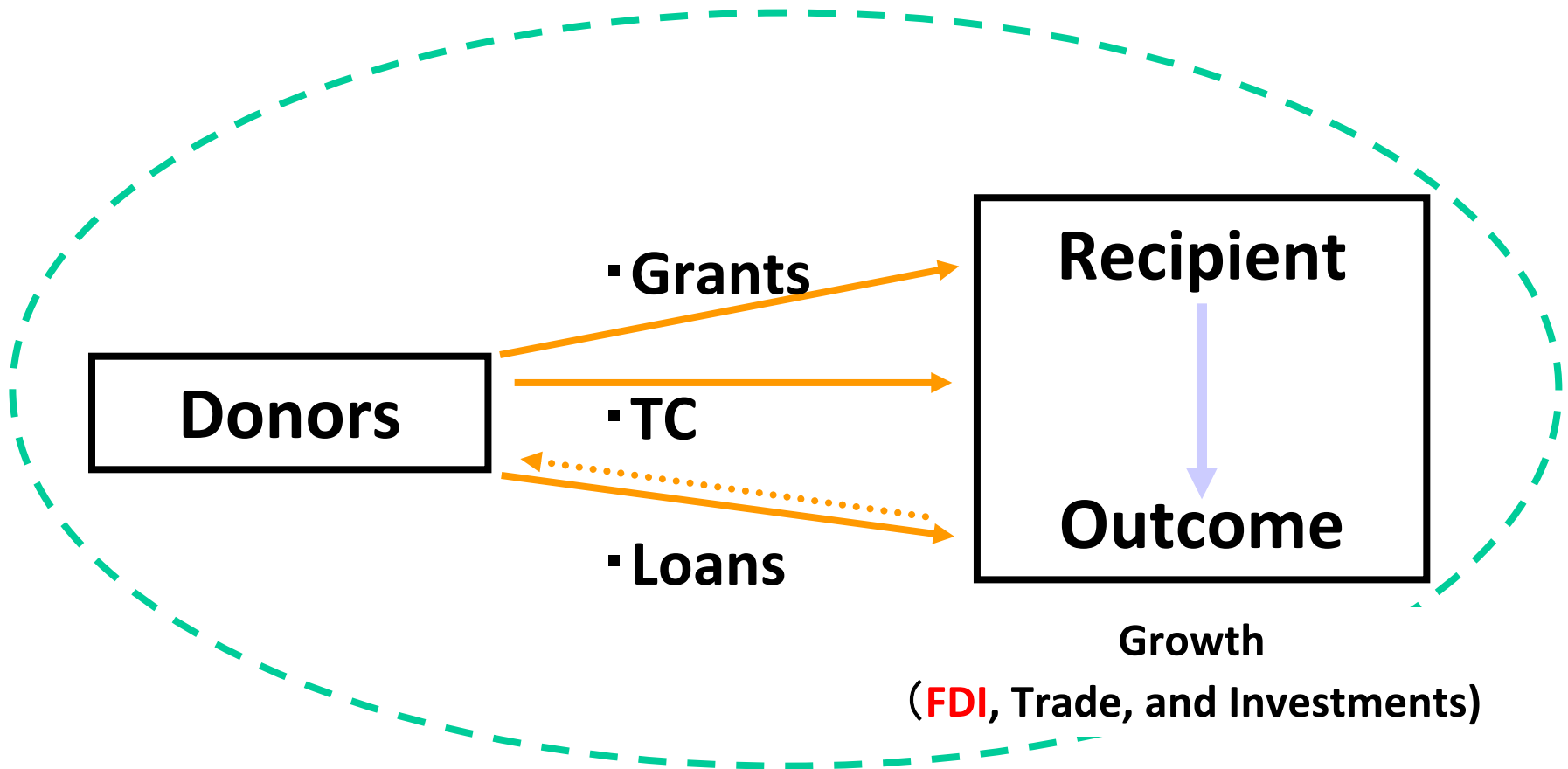
1. Introduction
2. The Roles of ODA: **Three necessary conditions**
3. Remarks

## **2. The Roles of ODA**

# The role of aid in achieving MDG Goal #1 Target #1



# Foreign Aid Governance Structure



# Foreign Aid Governance:

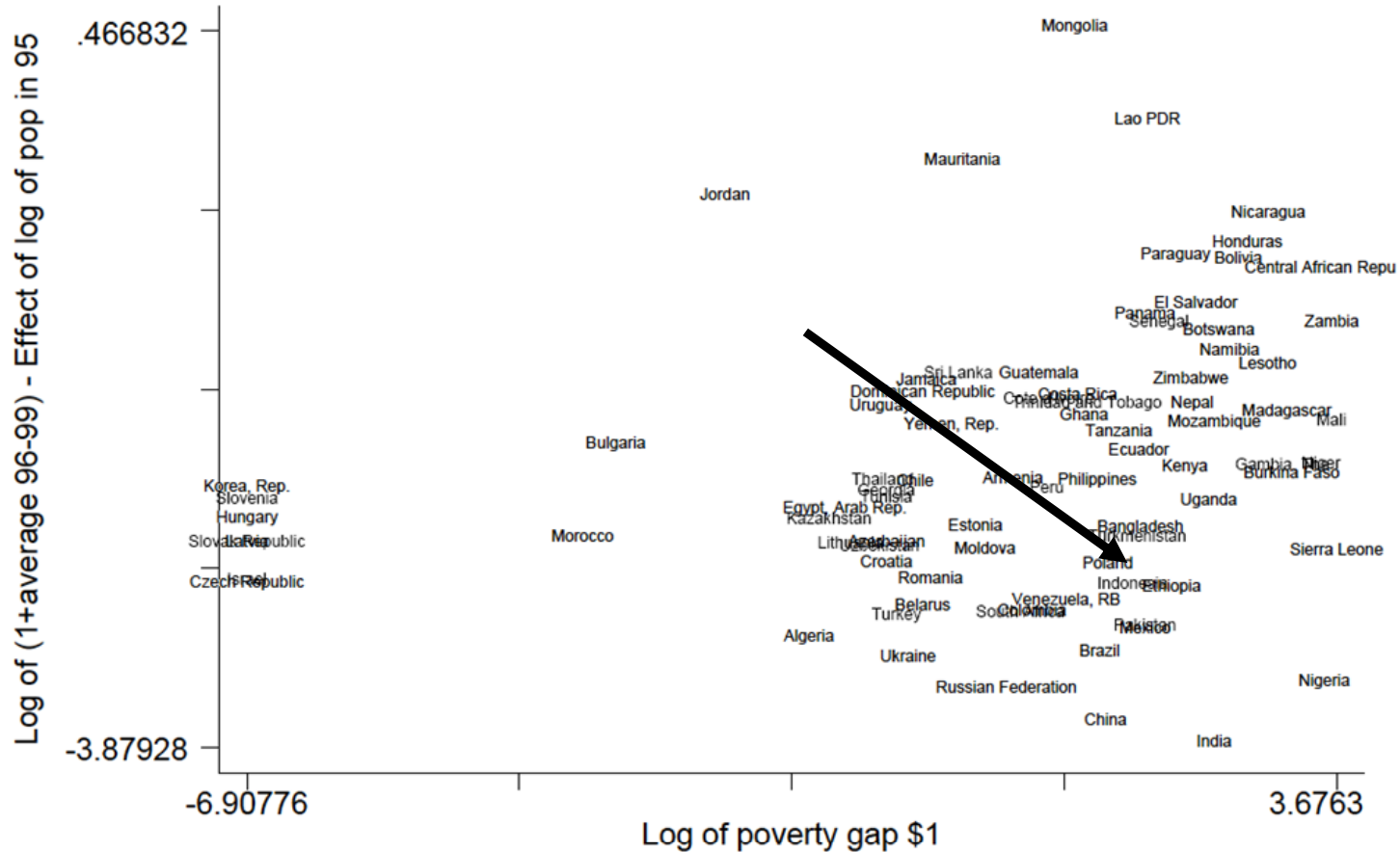
## Three necessary conditions

1. ODA should be allocated towards the poor countries.
2. ODA should facilitate economic growth
  - Private investments and economic activities.
3. Transaction costs of aid inflows should be minimized
  - Minimal aid proliferations
  - Recipient ownership and efforts



# Necessary Condition #1: ODA should be allocated towards the poor countries

Figure 13 Allocation of Japanese Grant



Source) Sawada and Yamada (2003)

**Necessary Condition #2:**  
**ODA should facilitate growth**  
**(Sawada, Matsuda, and Kimura, 2010)**

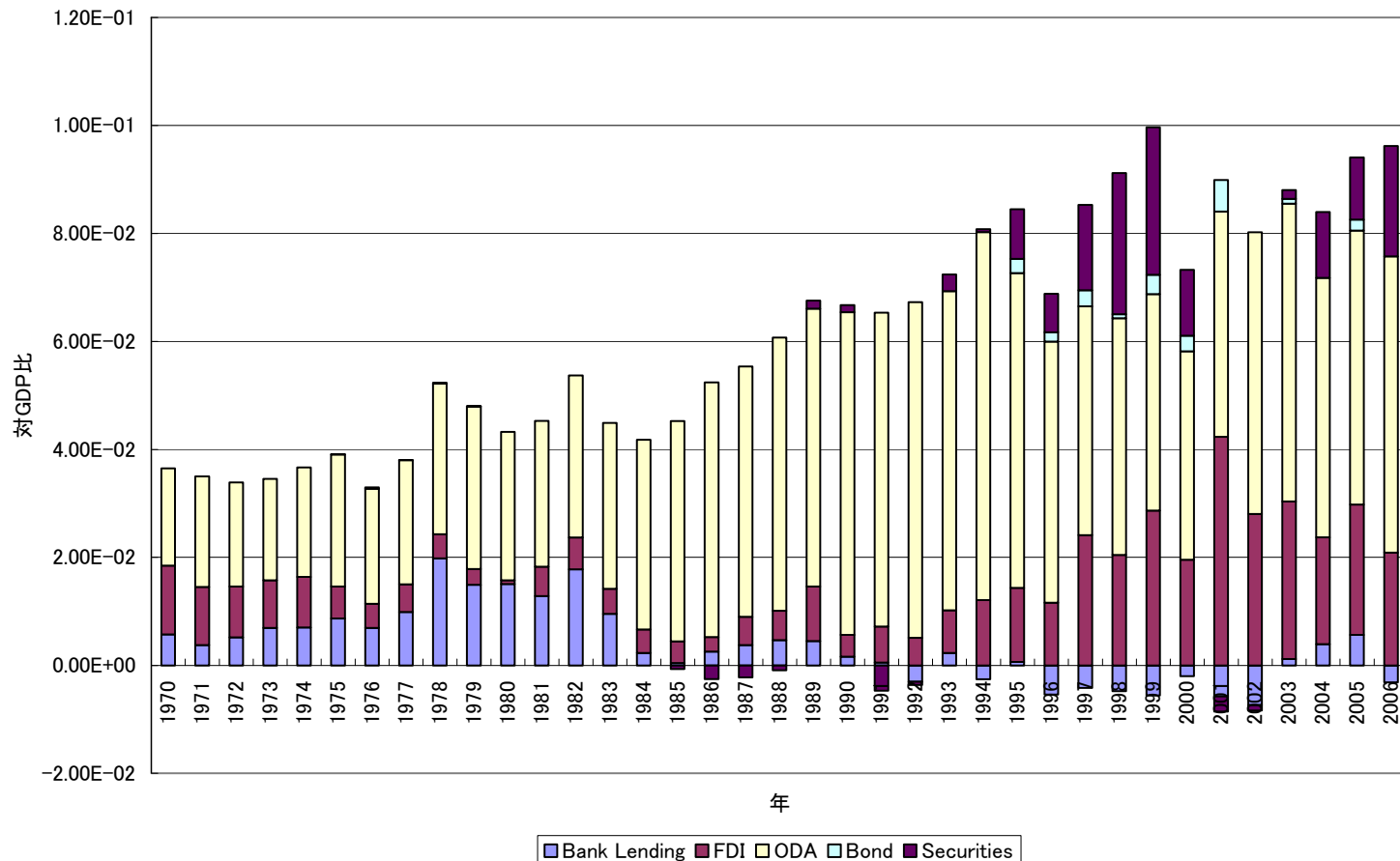
- **Direct channel: technical co-operation; TC ↑ → TFP ↑**
  
- The effectiveness of technical co-operation aid has been largely unexplored:
  - Cassen et al. (1994): There is *no ready methodology for measuring the effectiveness of aggregate long-run effects of TC*. Difficulties to measure the impacts have hindered the academia from conducting quantitative evaluations of TC.
  
- 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).
    - Int'l trade (Keller, 2004, Coe and Helpman, 1995)

## Necessary Condition #2: ODA should facilitate growth

- Indirect channels:
  - Financing infrastructure investments
  - Facilitating FDI
  - Facilitating growth indirectly
- Complementarities between ODA, FDI, and economic growth (exports) are fabricated as the “ODA Trinity” hypothesis of METI.
- ODA as a vanguard of FDI?

## Necessary Condition #2: ODA should facilitate growth

- Aid trinity or Japan ODA model? Aid as a vanguard of FDI?
- Financial flows to SSA countries



## Necessary Condition #2: ODA should facilitate growth

- **Kimura and Todo (2010)** *World Development* 38(4)
  - 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.
- **Kang, Lee, and Park (2010):**
  - Korea has a similar pattern.
  - **The vanguard effect is stronger** for Korean aid than Japanese aid.

# Necessary Condition #3:

## Aid proliferation should be carefully controlled

- 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”
- In East Asia, **Japan has been the dominant donor** and less problematic

Figure 6

Average Number of Bilateral DAC Donors (per recipient country)

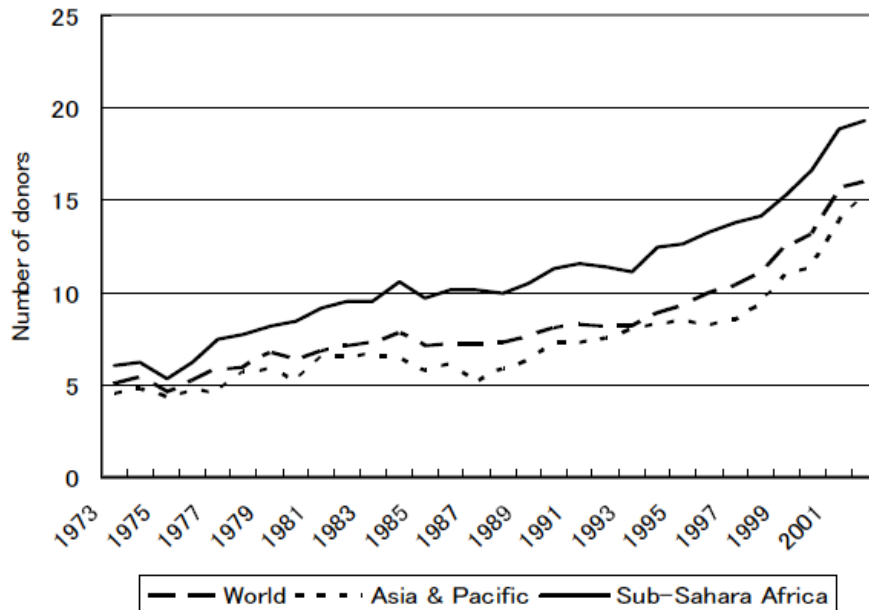
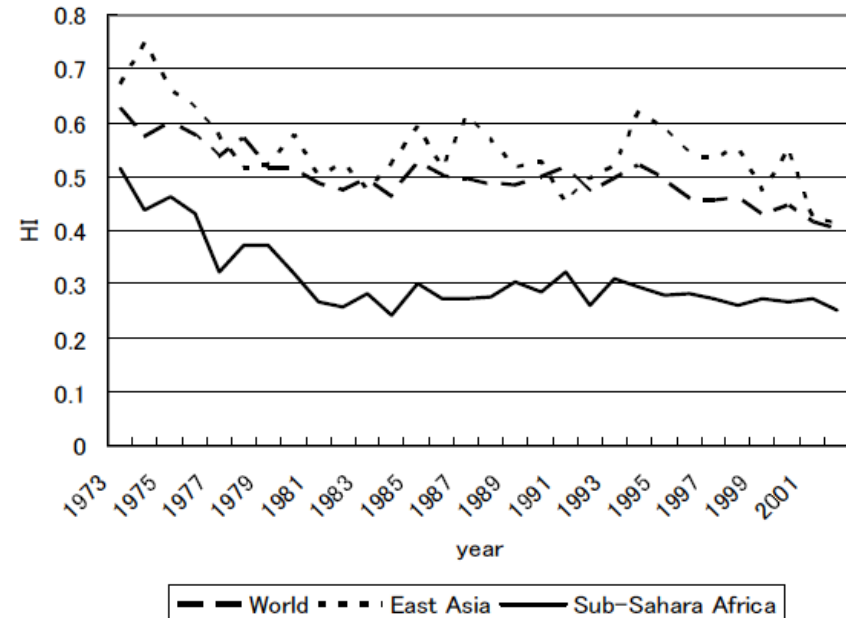


Figure 7

Trend of Herfindahl Index by Recipients



## **Necessary Condition #3:**

### **Aid proliferation should be carefully controlled**

- Aid proliferation is serious because:
  - (1)Induces competition for local experts or recipient's 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)Undermine efficient supply of aid in the recipient country because of the free-riding problem faced by the donors (Rahman and Sawada, 2010)

# Japan's ODA Philosophy?

- **ODA Trinity** as a key complementarity
- 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.
- **Current situation**: Ownership and donor coordination without explicit ingredients?



# 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
  - Growth enhancing directly and indirectly
  - Minimization of transaction costs
- Experiences of Japan and East Asia in providing “**ingredients driven**” ODA
- **Japan and Korea ODA coordination?**

# Is **Japan-Korea** Collaboration Possible?

- Leverage in the **DAC's rule making process** and at other levels
  - At the bottom of CDI, but the criteria (“framework”) biased?
  - Loan, project-based aid
  - Decoding experience from recipient to donor as int’l public goods
- Facilitate **private sector investments**
  - The trinity of Aid, FDI, and trade
  - TC in production sectors
  - PPP
  - BOP
- **Global issues**
  - Environmental issues (mitigation and adaptation)
- **Post-Political Disaster/Conflict Rehabilitation**

# Issues to be discussed

1. Sectors and modalities in Korea-Japan ODA collaboration
2. General issues of ODA
  1. Loans or grants?
  2. Economic infrastructure or social sectors?
  3. Tied aid or untied aid?
3. New modalities, e.g., PPP