

# THE MAJOR DONOR AND GOOD GOVERNANCE

## Has Japan's project assistance evolved ?

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### Summary

Specific countries have received enormous amount of ODA for a long term. At the same time, public sector which receives the economic assistance are expanding in those receipt countries. Rent-seeking activities for ODA have been generated in these countries. Countries such as India and Indonesia are the typical cases.

After the latter half of 1990s, World Bank and OECD has shown the attitude to request good governance to the system, the institution and the policy for the effectiveness of aid in the receipt countries. However, not only the major receipt countries but also the major donor countries have same problem. Rent-seeking activity will be caused if there is no appropriate monitor by NGO and the third party in the major donor country. In the bilateral assistance, Japan as donor had been the first place in the world during 1990s. In beginning of 2000s, Japan is the second place in the world by the amount of the donation of the bilateral assistance and the multilateral assistance. Even if this country is called ODA giant, no exaggeration.

This giant has melancholy like the rent-seeking activity as a major donor. However, under the economic recession after lost decade, Ministry of Foreign Affairs is promoting ODA reform without understanding such melancholy. In fact, the stake holders for ODA will maintain their interests as long as the bureaucrats reform by themselves.

### 1 ODA as Political Economy

#### Why is the development aid necessary ?

Economists are sharing a common conclusion so that the developing countries may take off toward the orbit of economic development. It is to be decided the economic growth of the country by the investment. This conclusion was emphasized further during 1960s. W. W. Rostow indicated the time of the take off in each country from the investment rate which occupied it to the national income.

Developing countries would depend on the economic assistance in case of the shortage for the investment they need. Therefore, they have to get the economic assistance so that it may make amends for the I S gap. The purpose of another necessity for the economic assistance is to make amends for the excess of imports in the trade balance. Economic growth of the country becomes difficult if not importable the machines, intermediate goods as the import

fortune, and the raw materials.

Economic growth rate of one country depends on the domestic savings rate and marginal capital coefficient (MCC) according to the Harrod Domar Model. The ratio of capital  $K$  and national product  $Y$  is capital coefficient. The ratio to new increase  $\Delta Y$  in  $Y$  caused by new addition  $\Delta K$  to  $K$  is MCC. The growth model is shown by the following identical equation.

$$G = S / \text{MCC} \quad (G = \text{economic growth, } S = \text{domestic savings rate})$$

If the developing country has the target of the economic growth rate 5% a year,  $G$  will be controlled by MCC or  $S$ . MCC in the country of the development stage initial is low usually. If the figure is assumed to be 2,  $S$  is shown as 10% ( $S = 2 \times 5$ ).

This developing country should have the domestic savings rate of 10%. However, there are unfortunately only 4% savings rate in this country. If it makes amends for 6% ( $10\% - 4\%$ ) of this dissatisfaction by the economic assistance, a first economic growth target will be achieved.

No exaggeration to say that poor countries in which it suffers from the population increase pressure owes the obligation which should achieve the economic growth rate ( $G$ ) more than population increase rate ( $P$ ).<sup>(1)</sup> The GDP growth rate of China was 10.8% (1990–2000 years, average), and that of India was 6%. East Asia and the Pacific Ocean countries were 7.1%, and South Asia countries were 5.6%. On the other hand, the average of population increase rate after 1975 did not come up to as much as 2% even in China and India. It was roughly near this population increase rate in the entire developing countries.

The average real economic growth rate of the entire developing countries which had excluded the high-income countries from 1980s was 2–3%. Therefore, it seems not to be difficult for the developing country to achieve such a rate of economic growth. However, African countries of the Sahara South were only 0.5% economic growth rate in 1990s. From these facts, bilateral assistance and multilateral assistance should be allocated to the least developed countries to suffer from such a low economic growth rate by priority.

#### Inequality, national interest and rent-seeking

ODA receipt situation in the world seems to have been balanced. However, actually, China, Russia, India, Indonesia, and Israel, etc. are major receipt countries in the world. Specific countries have received enormous amount of ODA for a long term though grant is offered to the least developed countries. Some in the specific countries suffer from the external debt including external private sector's liabilities or debts. They are in the vicious circle which cannot escape from the debt. China and India have received a large sum of ODA while obtaining a good economic performance. The granting distribution of ODA is remarkably unequal.

Especially, national interest and the peculiar strategy relate in the bilateral assistance. Bilateral assistance and public aid of the United States to Israel are typical cases. If the monitor by the citizens concerning ODA is not maintained in a major donor country, rent-

seeking might be causing in both the donor country and the receipt country. For instance, the tied loan and the economic assistance in the donor's currency have the same effect as domestic public works for the donor. If the asymmetry of information exists, the vested interest will be maintained for a long term.

Up to now, a lot of economists such as Krueger and Bhagwati have studied rent seeking.<sup>(1)</sup> However, most economists had aimed to study the problems of the country concerned where it had been generated, and to explain the economic backwardness like India. For instance, Japan's ODA is allocated in the projects in which the problem exists in the receipt country, and the cases where a high rent seeking cost is caused is not few there.<sup>(2)</sup> This does not have been caused in the public sector and a development paradigm in the receipt country alone. Electric power development and ODA in India are such typical cases according to the study of Y. Suzuki. He showed the allocation of ODA Funds have created overstaffing, low profits, low productivity, high capital cost, and loss through SEB (State Electricity Boards) by using the rent seeking model (Suzuki, 2002, pp. 26-41).<sup>(3)</sup>

Of course, such a case is not only India. It would be applied more or less in the receipt countries where the ratio that the public sector occupies to the nation's economy is high. Not forgetting is that such a situation is brought by the interaction of Japan's foreign aid policy and internal political economy in the receipt country. From the viewpoint of major donor side, I take a general view of the situation of ODA in Japan in this paper.

## 2 The History of ODA in Japan

### Japan's ODA started from the war compensation

Japan was the largest donor in the bilateral assistance in DAC countries. Japan granted 13.51 USD billion as net ODA in 2000, on the other hand, the United States granted 9.95 USD billion as net ODA. In the multilateral assistance to donate the capital to the international organization, Japan is the second place in the world. Japan is a huge donor which follows the United States in the amount of the investment to the World Bank and the United Nations. However, Japan's ODA had not the philosophies as the giant compared with other advanced countries.

The first bilateral assistance of Japan was the first half of 1950s. Japanese Government paid the war compensation to Southeast Asian countries (Burma, Philippines, Indonesia, and Vietnam) based on the San Francisco peace signature in 1951 and the compensation articles. Japan also gave the grants to Southeast Asian countries, and participated in the Colombo plan in 1954. The economic cooperation was described clearly by the bilateral accord as a reason why this time became the starting point of Japan's ODA.

However, the typical feature of Japan's ODA after World War II might start from the yen loan for India in 1958. With the participation in the Colombo plan, Japan was expecting the huge demand from India. Japan had been about to import the raw materials such as the iron

ore in India and export manufacture products to India for their economic reconstruction after World War II.

OECD (Overseas Economic Cooperation Fund) was established as an execution organization of the development aid in 1961 and JICA (Japan International Cooperation Agency) was established in 1974. Export-Import Bank and the antecedent organization of JICA had executed the development aid before the establishment of OECD and JICA. Japan had already begun a precocious development aid before it entered the high economic growth period. The appearance of this precocious donor accomplished the key role in a Japanese corporate group's acquiring the demand for the developing country through the yen loan. Two execution organizations were integrated by the administrative reform in 1999 and were reborn to JBIC (Japan Bank for International Cooperation).

After Japan joined OECD which was an advanced country club in 1964, Japan-Korea Basic Relations Treaty was concluded in 1965, then, Japan began the economic assistance to South Korea. The economic assistance of Japan was turned to Southeast Asian countries with the outbreak the Vietnam War, and it played a part peel prevention of the domino of making to communism. After this time, the largest receipt country of Japan's ODA was Indonesia.

When China did the reform and opening policy in 1978, Japanese Government began to give China the yen loan from next year. The first loan was 1,500 million dollars for China, thereafter, China became one of the largest receipt countries with Indonesia (Table-1, 2). The order in ODA receipt countries comes in succession almost at the investment destination of Japanese enterprises.

**Table-1** Bilateral Assistance Receipt Countries from Japan  
(disbursement, million dollars)

				(disbursement, million dollars)			
		1990	%			2000	%
		amount of receipt				amount of receipt	
1	Indonesia	867.78	12.78	1	Indonesia	970.10	10.06
2	China	723.02	10.65	2	Vietnam	923.68	9.58
3	Philippines	647.4	9.53	3	China	769.19	7.98
4	Thailand	418.57	6.16	4	Thailand	635.25	6.59
5	Bangladesh	373.57	5.50	5	India	368.16	3.82
6	Malaysia	372.62	5.49	6	Philippines	304.48	3.16
7	Turkey	324.21	4.77	7	Pakistan	280.36	2.91
8	Pakistan	193.55	2.85	8	Tanzania	217.14	2.25
9	Sri Lanka	176.07	2.59	9	Bangladesh	201.62	2.09
10	Poland	149.85	2.16	10	Peru	191.68	1.99
Subtotal (10 countries)		4,241.87	62.46			4,861.64	50.43
Total		6,939.56	100.00			9,640.10	100.00

ODA White Paper (1991) (2001)

**Table-2** Yen Loan Receipt (approval, million yen)

1	Indonesia	3,548,473
2	China	2,667,909
3	India	1,944,287
4	Thailand	1,912,873
5	Philippines	1,891,068
6	Malaysia	879,657
7	Pakistan	822,137
8	Vietnam	692,419
9	South Korea	645,527
10	Bangladesh	552,347

*ODA White Paper* (2001)**Tendency in recent years**

The ratio of grant which occupied it to Japan's ODA in 2000 was 60% (last year, 53%), and the amount of money recorded 5,813 million dollars. The grant ratio to LLDC (Least among Less Developed Countries) was results which filled the global standard within the range of 93–104% during 1992–2000 though the deterioration of the fiscal situation. According to Ministry of Foreign Affairs, the way which calculates the grant ratio is as follows.

the amount of the total grant/total bilateral assistance×100 (%)

If the loan exceeds the amount repayment, the grant ratio exceeds 100%. In Japan's ODA, the amount of the bilateral assistance for LLDC which occupied it to the amount of the total bilateral assistance was 10–13% in 1998–2000. LICs (Low Income Countries) and LMICs (Lower Middle Countries) accounted for 70% in the total bilateral assistance. These classifications according to the income are the one that the calorie intake, the literacy rate, and the average life span a person besides GDP per capita, etc. were tempered, and made an index by DAC. The United Nations recognized 49 countries as LLDC in 2001.

After 1980, China is one of the main ODA receipt countries from Japan. For China, economic cooperation for a fee accounts for 90% or more, and grants are very little. Majority of these development aids are yen loans. Recently, Japanese Government has reduced the development aid for China. Besides financial deterioration in Japan and the correspondence with ODA Charter (following description), other reasons that they reduced ODA for China are that China is both the donor country and the recipient country at the same time, and achieve a high tempo of economic growth. China is promoting the development of the west and the interior districts. The money source for the infrastructure construction might become a serious problem for a Chinese government in the future.

The shift to the tied loan has occurred again as a tendency in recent years though the shift from the tied loan to the untied loan continued at the past. Moreover, when Japan's ODA compares it with DAC countries, grant element (GE) which occupies it to ODA is low, and has not achieved ODA ratio 0.7% target which occupies it to GNI (Gross National Income) that the

United Nations defined. In addition, few technical assistance, their preference to the project loan are generally pointed out.

### Reconsideration on ODA Charter

Japan's ODA has been generally criticized so far so that they don't have the philosophy. Japanese Government made ODA Charter in 1992, and announced corresponding to such a criticism. The key words of this Charter are freedom, human rights, democracy, and environmental preservation. It says that the efficiency of the resource allocation of the developing countries, fair, and good governance are secured through the maintenance for a wide talent-making, domestic various systems, infrastructure, and basic lives to support the self-help effort for the take off of the developing country, and preferable economic development is achieved. These are the purposes of the development aid.

There are influence of the ideology of America and European countries, the World Bank, the United Nations, and OECD, and complete imitations if it says more accurately. Actually, after 1995, Japanese Government restarted the development aid to Myanmar at once. Therefore, the democracy movement people and NGO criticized Japanese Government. Because the military government in Myanmar had released democracy movement leader Aung San Suu Kyi from the house arrest, Japanese Government determined ODA granting restart. This case means Japan's ODA policy has not respect good governance as an essential philosophy for receipt countries.

## 3 Various Problems concerning ODA

### From the fact finding to the granting decision

There are two kinds of bilateral assistances in Japan. One is grants from the government budget. Another is cooperation as the loan. The latter capital source is postal savings and postal assurance, and those are also invested domestically. In the former case, the development aid is not transferred directly to the recipient country. It is transferred to the bank account in Japan, and the recipient country procures goods and services from Japan for the development aid.

The former is all tied assistance. After finishing the bubble economy, Japanese Government has promoted the tied loan and the yen loan as one of measures to boost the economy. The organization which takes charge of these is Ministry of Foreign Affairs, and JICA steams charge as for the activity in the recipient country. The latter cooperation is executed by JBIC. Granting the development aid is conferred between ministries concerned, and decided. This conference is a secret room conference, and disclosure of official information and the transparency to the citizens are insufficient. Two kinds of development aids are not very different in the process of decision making (Figure-1).

The selection process of the project order enterprise is also indistinct, and the order

**Figure-1** Procedure from Investigation to Decision (yen loan)

1. Request of recipient country ⇐ Investigation concerning adaptability to loan
2. Acceptance (diplomatic establishments abroad) ⇐ Dispatch of government investigation committee or execution organization investigation committee (if necessary)
3. Examination by execution organization (JBIC)
4. Granting idea making by Ministry of Foreign Affairs
5. Three ministries conference ⇐ Opinion listening from related each ministry (if necessary)
6. Report of granting beforehand
7. The Cabinet Council examination about exchange official document idea
8. The Cabinet Council decision
9. Exchange official document signature (Foreign Minister or ambassador and other party national administration prefecture or execution organization)
10. Conclusion of loan contract, JBIC and receipt national administration prefecture or execution organization
11. Tender
12. Successful bid
13. Conclusion of a contract, successful bid company and receipt national administration prefecture or execution organization
14. Starting constructing of project
15. JBIC pays to the company according to the progress of construction.
16. End of project
17. Evaluation to project

*ODA White Paper* (2001)

enterprises are syndicates in the development consulting company, the general contractor, and the trading company. Not diplomatic establishments abroad but the development consulting company and JICA have gone in project-finding. Originally, major trading companies had gone in project-finding. The influence power to their project-finding has not become weak. The reason is that the connection with the recipient country and the information are grasped by them.

The yen loan is divided into two (the project loan and the non-project loan). Free cooperation and the yen loan are continuous, large external demands for Japanese enterprises. The development consulting companies forms the associations to special industry specification, and these associations have received the subsidy from the government. These associations are very important for bureaucratic. Because they usually become the chief director or the director in those associations after their retire (Amakudari; getting a position a private company).

### **The vested interest and ODA**

The corruption scandal for ODA in Japan was few surprisingly in the past though the adhesion structure of politician, bureaucrats, and businessmen existed. As for this, they do not necessarily mean it is squeaky clean. This means the government has maintained the opacity



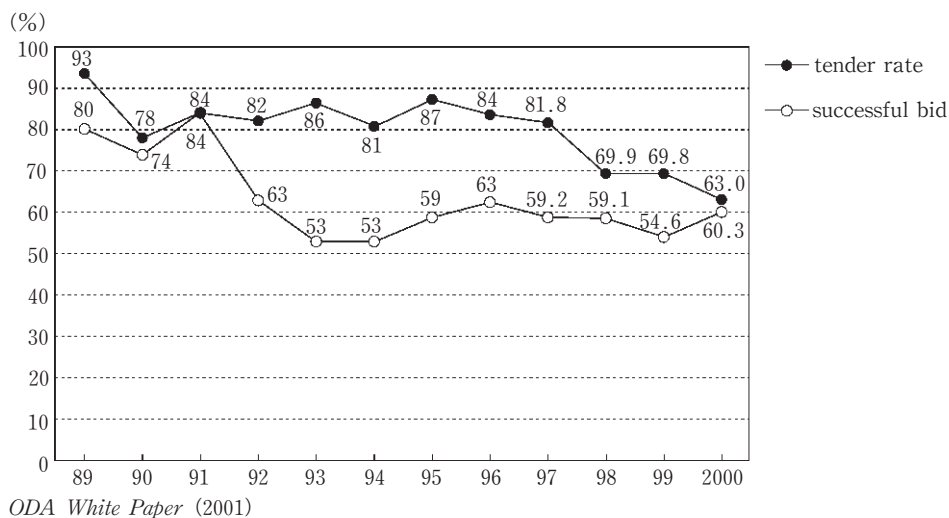
of information concerning ODA to the citizens. The scandal of Muneo Suzuki assembly member who had caused in 2001 was a good example. After the criticism Suzuki and Ministry of Foreign Affairs by mass media, Suzuki was arrested in ODA scandal. Ministry of Foreign Affairs started reforming with the administrative reform at a turning point of this incident.

When a private firm procures the business, Ministry of Foreign Affairs excludes it including the foreign company from the tender and the contract for two years or less. In the contract of the yen loan 1 billion yen or more, Japanese companies have the share of about 60% concerning both participation rates to tender and successful bid (Figure-2). Although the tender rate of Japanese companies has decreased than before, it is usual that the specific Japanese companies are taking part at the stage of the first project finding.

The scale of Japan's ODA budget still exceeds 1,000 billion yen in 2001 though total amount of the assistance has been reduced. Project assistance is the most important for them, the companies which have a know-how and past results and local information have the advantage. It is not unusual that the same enterprises get much more orders. In the case of the tied loan in 2001 to Asia, Japanese enterprises got 47 projects orders (Table 3).

For the economic assistance main receipt countries, in the past, the accountability to the residents was not enough like the cases of Narmada Dam (India) and Kotopanjang Dam (Indonesia) in 1990s.<sup>(4)</sup> Especially, when the asymmetry of information concerning ODA exists in the receipt country, the rent-seeking activity is caused easily in both the donor and the receipt country. It is necessary to have the rigid monitor for the action of the donor who piles up the economic assistance results for the budget digestion like the local government and other ministries in Japan.

**Figure 2** Tender and Successful Bid of Japanese Companies (contract over 1 billion yen, yen loan)





**Table-3** Project Orders by the Specified Companies

Consulting firm	P	7 projects
Consulting firm	N	4 projects
General contractor	K	5 projects
General contractor	T	5 projects

*International Development Journal*, 2002, March.

#### 4 ODA Reform by Ministry of Foreign Affairs

##### First step for the reform ?

Under the Foreign Minister, advisory committee for ODA reform started in 1997. The committee consulted the Foreign Minister about the following reforms as indicators.

- i ) Emphatic, efficient distribution of budget
- ii ) Correspondence between assistance for a fee, gratuitous financial aid, and technical co-operation
- iii ) Cooperation of private company, recipient country, and local residents

Afterwards, the rethinking concerning the assistance technique was done by Ministry of Foreign Affairs. ODA White Paper (2001) said that Ministry of Foreign Affairs would promote the following.

- i ) Adjustment of the government and cooperation among organizations in various cooperation forms.
- ii ) The cooperation by the government money (OOF) other than ODA and private companies.
- iii ) Support and cooperation to NGO.

Especially, it values the cooperation of NGO and the local government in the receipt country as resident participation about iii). Under a private advisory panel of Ministry of Foreign Affairs, they attached to the reconsideration of the evaluation method for the success and the efficiency of ODA project in 2001. While two or more scandals related to Ministry of Foreign Affairs were reported by media, more concrete proposals were done by the advisory panel. These important proposals are the citizen's participation, secure the transparency, and are the improvements of efficiency for ODA. Although the introduction of the audit system by external persons was discussed, it would not been executed at once.

Ministry of Foreign Affairs advances the discussion very slowly corresponding to the public criticism. Bureaucrats of Ministry of Foreign Affairs have stubbornly refused the new establishment of ODA special ministry other DAC countries have. As for the purpose of such

bureaucrats' resisting was to maintain the vested interest of Ministry of Foreign Affairs, and it also means that the politicians are powerless compared with bureaucrats. Sarcastically, as these reform propellers, Yoriko Kawaguchi who got the position as Foreign Minister in 2002 has bureaucrat's career (Ministry of Economy and Industry).

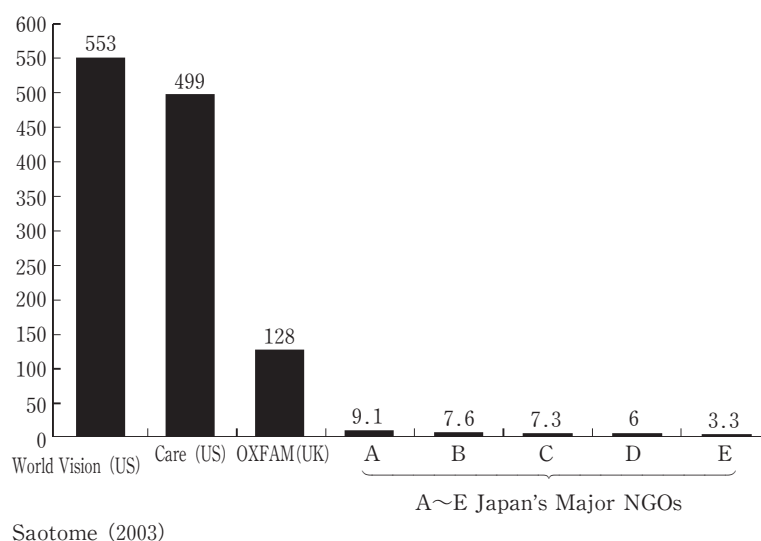
### Does NGO function in Japan ?

It was only NGO to be able to point out the doubt from which the construction cost and the price of materials of ODA were padded when two or more scandals for ODA were reported in 2002. Ministry of Foreign Affairs was delivering the subsidies for a coordinated strengthening with NGO. It gave about 540 million yen to Japan's NGO in 2000. On the other hand, it gave about 7,000 million yen to NGO, medical institutions and local public entities in ODA receipt country. Relatively, it seems that Ministry of Foreign Affairs is disregarding NGO in Japan.

To tell the truth, major NGO in Japan depend on the government subsidy, the dependence rate is high from the viewpoint of the international comparison. On the contrary, the fund of NGO in Japan is smaller than Britain, Germany, the United States, and Sweden. The income of major NGO in Japan were much smaller than that of the major NGO in Europe and America in 2000 (for instance, See Figure-3). Therefore, from the viewpoint of their income, Japan's NGO might not maintain their neutral standpoint in the future.

The short history of NGO in Japan has disadvantage compared with America and European countries. If we consider the indifference of politicians and bureaucrats to NGO in the past, it is no wonder that NGO Law (Law to Promote Specified Nonprofit Activities) was enforced in December 1998. In the budget retrenchment, no exaggeration to say that Ministry of Foreign Affairs is considering NGO to be their subcontract organization. They don't get the advocacy

Figure 3 NGO's Income (100 million yen)



ability though Japan's NGO obtained the position as the observer for ODA reform.

Japan's NGO should be going to progress the advocacy ability by an expansion of the fee income and the collaboration with other international NGO in the future.

## 5 Conclusion

Japanese Government began rethinking ODA Charter in 2003. It emphasizes the contribution to the national security and economic growth in this reconsideration. The contribution to economic growth obviously means the anti-recession policy to relieve general contractors and major trading companies who suffer from the structural recession. For whom has ODA reform been executed? It will be difficult to solve the various problems which have been described in this review as long as the major donor have not the good governance with appropriate monitor concerning ODA.

## Notes

- (1) The identical equation concerning this is as follows.  

$$G(Y/P) = G(Y) - G(P)$$
- (2) cf. Krueger (1974) Bhagwati (1993) Tollison, Congleton (1995).
- (3) The history of the electric power development and aids in India is so long. The electric rate has been set to the industrial sector high compared with an agriculture sector. The public sector such as governmental development banks and the statutory boards keep maintaining the vested interest. cf. Sawada (2002) Chapter 3, 4.
- (4) Indonesian residents who were destroyed their livelihood by the Kotopanjang Dam construction have joined a lawsuit against Japanese government, demanding compensation in 2003.

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