

Chapter 1 Introduction

1.1. Background of the Study

According to the press release of the DAC (Development Assistance Committee)¹ of OECD (Organization for Economic Cooperation and Development) in June 1996, Japan's ODA² (Official Development Assistance) in 1995 reached US\$ 14,489 million³. It means that Japan has maintained the position of being the largest donor of ODA for five years since 1991, surpassing even the United States. This amount is equal to the combined amount of ODA of the United States, the third largest donor⁴, and of Germany, the fourth largest.

The Japanese growth rate of amounts of ODA is 9.3%, an average over the three years from 1993 - 1995. It is favourable compared to other countries' rates, i.e. minus 3.8% for the U.S.,

¹ DAC was formed in 1961 under OECD. As of 1993, it consists of 21 member countries, all of which are developed countries. It aims at discussing development assistance among the donors.

² ODA consists of grant aid, technical cooperation, subscriptions and contributions to UN agencies and international financial institutions (all defined as grants), and government loans. And it meets the following tests:

- (i) It's provided by official agencies or by the executive agencies,
- (ii) Administered with the aim of economic development, and welfare of developing countries as its main objective.

- (iii) Concessional in character (to avoid severe burden on developing countries) and conveys a grant element of at least 25 percent.

ODA alone is internationally recognized as aid in the genuine sense.

³ This figure excludes ODA to Poland, Hungary, Czech, Slovakia, Bulgaria, Romania and also excludes ODA to EBRD.

⁴ France became the second largest donor in 1995 amounting to US\$8,439 million.

4.9% for France, 1.3% for Germany and 0.3 % for United Kingdom. This Japanese growth rate in ODA is one of the most conspicuous among developed countries, some of which show the tendency of "aid fatigue".

Despite this, the ratio of Japan's ODA to its GNP is still small, 0.28% in 1995, compared to the average of DAC's member countries in total, 0.30% in 1994. However, the amount of Japan's ODA is significant enough, it is 22.9% of the total DAC countries ODA. There are other financial flows to developing countries such as export credit or private investments. The fact that Japan's ODA has a share of 7.9% of total financial flows including the above, shows the significance of Japan's ODA for developing countries, as a major financial source.

Japan's ODA has been focusing on the Southeast Asia region⁵ because of its historical and geographical background. By the 1970s, half of Japan's total ODA had gone to Southeast Asia. The region's share decreased to a third during the 1980s because of diversification of recipient regions. Nevertheless, the importance of this region has not changed Japan's ODA policy, and some of the countries in this region still remain significant recipients of Japan's ODA.

In respect of the recipients, Japan's ODA is a major source of finance as shown in the fact that Japan's ODA comprises more

⁵ Southeast Asia is defined as 10 countries namely Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, The Philippines, Singapore, Thailand and Vietnam.

than half the total ODA received by the region. In the case of Indonesia, 56% of its total ODA came from Japan during 1990-1994. In the case of Malaysia, 63% came from Japan during the same period. As for the Philippines and Thailand, 52% and 57% came from Japan respectively. Japan's ODA is of major importance to governments as a revenue source. According to the research of the OECF (the Overseas Economic Cooperation Fund, Japan)⁶, Japan's ODA financed 9% of the development expenditure of the government in Thailand in 1992, 11% in Indonesia in 1993, and 33% in the Philippines in 1993⁷. In Malaysia, according to this study, 3.4% of the Federal Government's development expenditure in the 5th Malaysia Plan came from Japan's ODA.

Taking into account the above facts, it is then supposed that Japan's ODA has contributed, to a considerable extent, to the development of this region and that it is indispensable to the present economic growth of these countries.

The economic growth rate of each Southeast Asian country is nearly double digit, which is much better compared to other regions' performance. On the assumption that Japan's ODA contributes to their growth, the experience and role played by Japan's ODA in the past three decades should be examined to extract secrets of their development, which might be useful to other regions.

⁶ OECF is the implementation agency of Japan's ODA, mainly government loans.

⁷ OECF, *The Medium-Term Prospects for OECF Operation*, 1996.

1.2. Objectives of the Study

Briefly the objectives of this research are as follows;

- 1) To study the characteristics of Japan's ODA through its historical background, volume and quality.
- 2) To study the significance of Japan's ODA to each country in Southeast Asia
- 3) To measure the contribution of Japan's ODA to the development of each country from the macro-economic point of view, specific sector's view, and specific country's view.
- 4) To check the adverse effects of Japan's ODA.
- 5) To abstract lessons in order to further effective assistance

1.3. Significance of the study

The experience and contribution of Japan's ODA in this region has not been studied systematically. The few publications and research papers concerning Japan's ODA have focused on only its system, policy, forms and administration. They do not focus on the impact on the recipient countries' development. On the other hand, there are many studies which examine the effects of foreign aid on developing countries. Such studies focus primarily on aid from Europe, North America to conventional recipient regions such

as Africa, South Asia and Latin America. Some of the works have concluded that aid will not increase growth, and some showed a more adverse conclusion.

This research focuses on roles Japan's ODA have played in the development of Southeast Asia countries especially Malaysia. It is highly significant because of the following;

- 1) It is a first attempt to study the comprehensive history, characteristics and contribution of Japan's ODA to Malaysia.
- 2) To provide lessons for donor sides including Japan, to operate and achieve effective aid in Southeast Asia.
- 3) To present information to recipients to handle and utilize Japan's ODA effectively.
- 4) To suggest the possibility of applying this Southeast Asia experience especially Malaysia's to other regions.
- 5) To provide a guideline to a successful implementation and possible pitfalls of Japan's ODA.

1.4. Scope of the Study

This study limits its subject and area. The subject is Japan's bilateral ODA, say government loans⁸ (soft loans called "Yen Loan"), grant aid, technical assistance. Multilateral ODA is excluded from the scope.

The area is Southeast Asia as defined by its ten countries, Brunei, Indonesia, Burma, Cambodia, Laos, Singapore, Malaysia, the Philippines, Thailand and Vietnam. In order to highlight the role of Japan's ODA in the development of countries, chapter 3 and 4 covers only major recipient countries of Japan's ODA, namely Burma, Indonesia, the Philippines, Malaysia and Thailand. This role is explained in detail in the case of Malaysia in chapters 5, 6 and 7.

1.5. Literature Review

There are not many books or publications concerning Japan's ODA, especially in English. They tend to focus on the system, policy, decision making process of Japan's ODA.

⁸ Government loans are provided on a Government to Government basis with a grant element equal to or exceeding 25%. The average interest rate of ODA loans committed in the fiscal year 1995 was 2.54%, while the average repayment period for loans was 29 years and four months including an average grace period of nine years and seven months.

Rix⁹ outlines the root of Japan's aid policy and the complicated process of decision making for Japanese ODA. He observes that the lack of sustained political interest, in Japan, of aid has caused insignificant administrative and aid institution reform. Japanese aid agencies were overloaded and high-level advisory bodies weakened. And an absence of policy guidelines led to difficulties in coordination. Further the emphasis on detail and procedure, led to rigid aid administration.

Yasutomo¹⁰ highlights Japanese strategic aid after the late 1970s when Soviet Union's occupation in Afghanistan and Vietnam's invasion of Cambodia took place. He describes the change of aid policy and decision making process after the above for large sized aids to Thailand, Pakistan and Turkey as a front-line state exception. He pointed out the vagueness of Japan's aid policy and urged a clearer picture of the role of Japanese aid in the international community.

Orr¹¹ analyzes the decision-making process of Japan's aid. Japan's Foreign aid policy lacks philosophy or objectives. This lack seems to be caused by the fact that the Japanese Diet (parliament) does not set guidelines for aid, and that the four relating ministries

⁹ Alan Rix, *Japan's Economic Aid*, Croom Helm London, 1980
Alan Rix, *Japan's Aid Program: A New Global Agenda*, Australian International Development Assistance Bureau, 1990

¹⁰ Dennis Yasutomo, *The Manner Giving: Strategic Aid and Japanese Foreign Policy*, DC Heath and Company, 1986

¹¹ Robert Orr Jr., *The Emergence of Japan's Foreign Aid Power*, Columbia University Press, 1990

put priority on their own interests as to the decision process; the Ministry of Foreign Affairs considers foreign relationship with a bias to the US, the Ministry of Finance fears a burden to its budget, the Ministry of International Trade and Industry has its interest in things of a commercial nature, and the Economic Planning Agency thinks it is a supervising agency of OECF. Sometimes, the US pressure plays a definite role in a specific case such as, he raises, aid to Indonesia and Korea in the 1960s, Thailand and Pakistan in the 1970s and the Philippines and Jamaica in the 1980s.

Koppel and Orr¹² collaborated with researchers of Japan's ODA to several countries, Alan Rix for ASEAN, Jeff Kingstone for Indonesia, Akira Takahashi for the Philippines, Prasat Chittiwatanapong for Thailand and David Steinberg for Burma. Since there have been very few studies of Japan's aid policies in the context of specific recipient countries, their works have significance in conceptualizing Japan's aid policies with bilateral and regional relationships.

Mori¹³ notices the presence of Japan's "UN- centered" foreign policy as a neo-realistic notion to increase its greater multilateral ODA. And he realizes the predominance of Japan's ODA on economic infrastructure which has a rooted linkage to Japan's business community.

¹² Bruce Koppel and Robert Orr Jr., *Japan's Foreign Aid: Power and Policy in a new Era*, Westview Press, 1993

¹³ Mori Katsuhiro, *The political Economy of Japanese Official Development Assistance*, The International Development Journal, 1995

Matsui¹⁴ explains the history of Japan's ODA as the root of present problems, i.e. the vagueness of its philosophy, complicated administration and its commercial motivation. He assesses the present administration as doing well in spite of shortage of staff. He stresses the importance to have a clear philosophy on aid and it should be used effectively as bargaining power for Japan's diplomacy.

Suzuki¹⁵ describes a political structure of crises in Southeast Asia and the role of Japan's ODA in those crises as shown in the case of Indonesia and Malaysia.

Yoshizawa and Takayanagi¹⁶ assess Japan's ODA by focusing on agriculture and human resource development project in Thailand. They conclude that, despite Japan's aid contribution to economic growth, the aid benefiting people at grass-roots is perceived from the sociologist's point of view.

¹⁴ Matsui Ken, 経済協力：問われる日本の経済外交, *keizai kyôryoku: towareru nippon no keizai gaikô (Economic Cooperation: Japan's Economic Diplomacy with problems)*, Yûhikaku Sensho, 1983

¹⁵ Suzuki Yuuji, 東南アジアの危機の構造, *tônan ajia no kiki no kôzô (Structure of crises of Southeast Asia)*, Keisôshobô, 1988

¹⁶ Yoshizawa Shiro and Takayanagi Mituo, 日本ODAの総合的研究, *nippon no ODA no sôgôteki kenkyû (The comprehensive Study of Japan's ODA)*, Chuuo University Press, 1995

Lee¹⁷ explains Japan's ODA in Malaysia. He points out some complaints from the recipient side, to Japan's ODA as ; 1) the inordinate length of time for a loan request to be approved, or for a project to be implemented, 2) a lack of local participation in the consultant team or implementers of the project, 3) inflexibility and rigidity of the regulations governing ODA, and 4) the neglect of the problem of poverty.

1.6. Research Methodology

The writer has extensive experience in handling every stage of Japan's ODA to several Southeast Asia countries, which are in policy making, appraisal, operation, supervising and evaluation in Yen Loans as follows;

1980-82 Studying Japan's technical assistance to Manila for a master thesis when the writer was at the University of Tokyo.

1984-85 Being in charge of appraisal and supervising for Yen Loans to Indonesia when the writer was in the Operations Department of the OECF (Tokyo).

1986 Being in charge of policy making for the Philippines when the writer was in the Economic Cooperation Bureau of the Ministry of Foreign Affairs of Japan.

1986-89 Being in charge of Yen Loans to Burma when the writer was with the Embassy of Japan in Burma.

¹⁷ Lee Poh Ping, *Japanese Official Development Assistance to Malaysia*, Paper presented to Seminar by United Nations University, 1990

1989-92 Being in charge of policy coordination of overall Yen Loan when the writer was in the Coordination Department of the OECF (Tokyo).

1992-95 Being in charge of Yen Loan to Malaysia when the writer was at the OECF Representative office in Malaysia.

Based on experiential observation, this study was conducted by the following steps;

1. Summary of the writer's experiential observation
2. Collection of related literature and data.
3. Interviews with related officials and persons.
4. Quantitative analysis such as regression analysis and Input-Output analysis.
5. Analysis of comprehensive information.

1.7. Data Sources

As regards to data, two types of sources were used, primary and secondary. To obtain primary data, interviews were conducted with following agencies and institutions;

Malaysian side

- External Assistance Division, EPU
- Finance Division, Ministry of Finance
- Training Division, Public Service Department
- various sections of Tenaga Nasional
- Centre for Japan Studies, ISIS

- MIER
- contractors of the projects under Yen Loan
- Alumni of the Look East Policy Society

Japanese side

- Economic Cooperation Bureau, Ministry of Foreign Affairs
- International Finance Bureau, Ministry of Finance
- Economic Cooperation Department, MITI
- Economic Planning Agency
- Embassy of Japan
- various sections of OECF (Overseas Economic Cooperation Fund, Japan)
- various sections of JICA (Japan International Cooperation Agency) including experts in Malaysia
- KL office, JETRO (Japan External Trade Organization)
- KL office, AOTS (The Association for Overseas Technical Scholarship)
- KL office, JACTIM (The Japanese Chamber of Trade & Industry, Malaysia)
- consultants of the projects under Yen Loan
- contractor of the project under Yen Loan

The source of secondary data includes;

1. Books and publications obtained in the above agencies and libraries.
2. Official documents of the Japanese Government, OECF, JICA, JETRO, JACTIM
3. Official documents of the Malaysia Government

4. Survey reports on Japan's ODA conducted by several institutions,
5. Newspaper articles and journals

1.8. Organization of Remaining Chapters

Chapter Two presents some of characteristics of Japan's ODA. The historical background, philosophy, volume and quality are studied. There is an international perception that Japanese aid is tied to using Japanese companies. This will be examined in detail.

Chapter Three reviews the significance of the Southeast Asia region for Japan's ODA policy and also the role of Japan's ODA in each major recipient country, Indonesia, the Philippines, Thailand and Burma.

Chapter Four introduces the post-evaluation activities of Japan's ODA and its impact at the individual project level, sector level, and macro-economic level to Southeast Asia countries as derived from those evaluations.

Chapters Five to Seven focus on Malaysia. **Chapter Five** describes the development strategy of Malaysia and the roles which Japan's ODA played in each Five Year Plan. It also examines the negative impact of Japan's ODA i.e. the heavy burden caused by Japanese yen appreciation and the ODA's rigid system.

Chapter Six shows the contribution of Japan's ODA to the electrical power sector of Malaysia, to which the largest amount of Japan's ODA has been invested. This data will be shown via a quantitative survey chart in Input- Output analysis.

Chapter Seven studies the contribution of Japan's ODA in the Human Resource Development sector of Malaysia. Through Malaysia's Look East Policy Programme, Japan also played a significant role as with other technical assistance.

Chapter Eight, the last chapter, summarizes research findings and describes lessons for further effective assistance. Finally, the possibility of those lessons applied to other regions are considered.