

Does Japan Allocate its Foreign Aid  
towards Economic Relation?  
*Relationship between Foreign Aid and FDI*

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# Introduction

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## 1954

- ▶ Japan joined the Colombo Plan on October 6, 1954.
  - ▶ Foreign aid and technical assistance for the economic and social development of the South and Southeast Asia region.
  - ▶ For war reparation negotiations and economic cooperation with the Asian nations that Japan had occupied during the World War II.

## 1970-1980s

- ▶ Secure a steady supply of energy and other resources following the break of 1973 oil crisis



# Introduction

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## 1970-1980s cont...

- ▶ essential instrument to protect diplomatic interests with resource-rich countries outside of Asia.

## 1980-1990s

- ▶ building economic and political relation mainly among Asian countries.
  - ▶ Ministry of International Trade and Industry (MITI) wanted to use aid to restructure Japan's FDI and trade relations with Southeast Asia
  - ▶ Ministry of Foreign Affairs (MOFA), on the other hand, wanted to use aid as a diplomatic lever



# Introduction

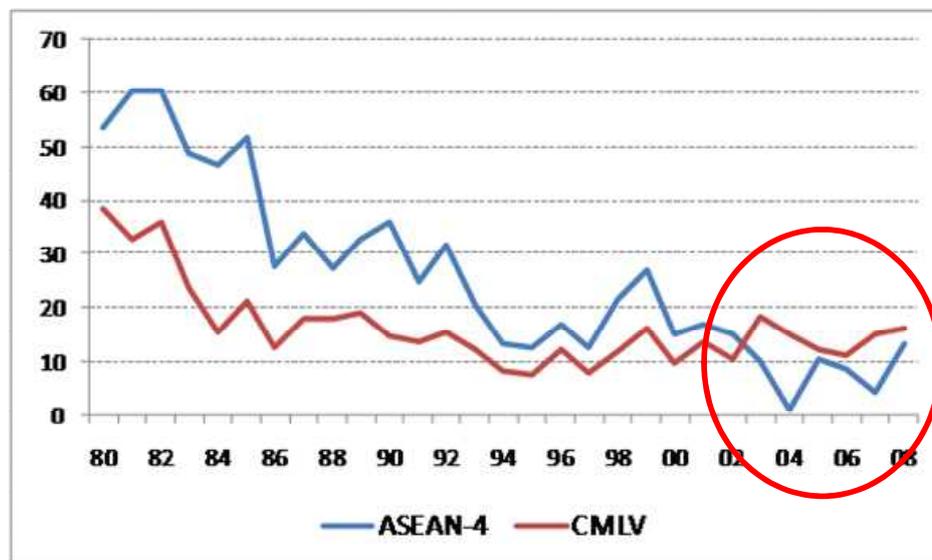
Table 1: Typology of foreign aid by DAC members

Size % of GNI	>0.5	0.3-0.5	<0.3
Humanitarianism	Denmark, Sweden, Norway, Netherland	Finland, Switzerland, Germany, Ireland	
Ex-colony Management	France	Belgium, United Kingdom	Australia, Portugal
Economic Relation		Canada, Austria	Italy, Greece, Spain, New Zealand, <b>Japan</b>
National Security			United States

Source: Bokyeong Park from Korea Institute for International Economic Policy, Korea and Hong Sik Lee from Inha University, Korea in their Working Paper Series Vol. 2008-08 for the The International Centre for the Study of East Asian Development, Kitakyushu

# Introduction

Graph 1: Japan's Aid Allocation to ASEAN (% of Total Aid)

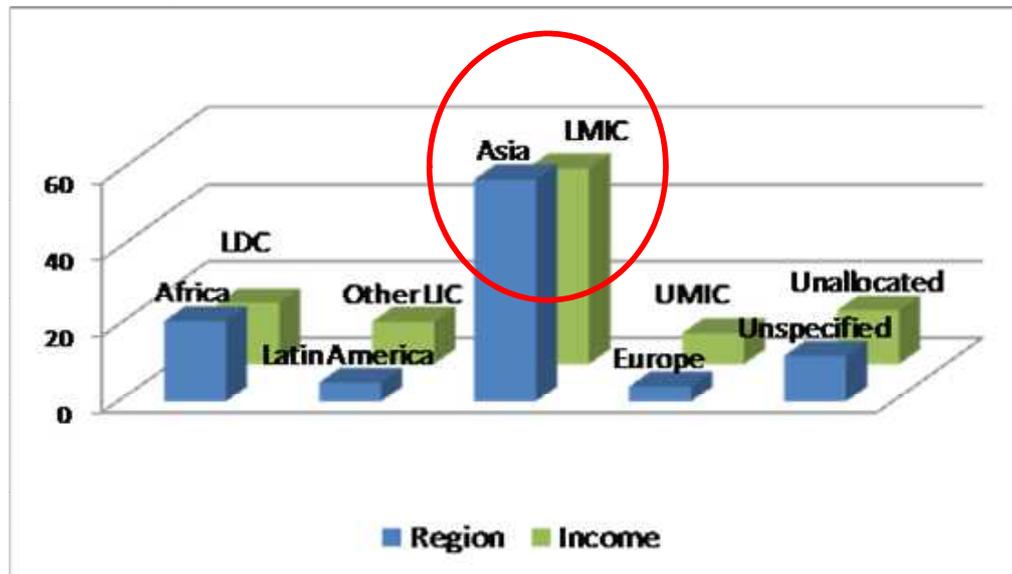


Source: OECD – DAC, [www.oecd.org/dac/stats](http://www.oecd.org/dac/stats)

# Introduction

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Graph 2: Japan's 2009 Aid Allocation by Region and Income (%)



Source: OECD – DAC, [www.oecd.org/dac/stats](http://www.oecd.org/dac/stats)



## Literature Review

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### Burnside and Dollar (2000)

- ▶ aid does not promote growth.
- ▶ aid allocate to sound governance country does promote growth.

### Alesina and Dollar (2000)

- ▶ political and strategic consideration plays an important part in foreign aid allocation pattern.
- ▶ political allies and colonial ties does play a significant role in aid pattern
- ▶ enforceability of contracts and openness are also important



## Literature Review

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Hidemi Kimura and Yasuyuki Todo (2007)

- ▶ robust evidence that foreign aid from Japan has a vanguard effect.

Gastanaga et al. (1998)

- ▶ uses policy and institutional variables
- ▶ lower corruption and nationalisation risk levels, and better contract enforcement are associated with higher FDI inflows.

Jun and Singh (1996)

- ▶ higher political risk attract less FDI.



## Methodology and Hypothesis

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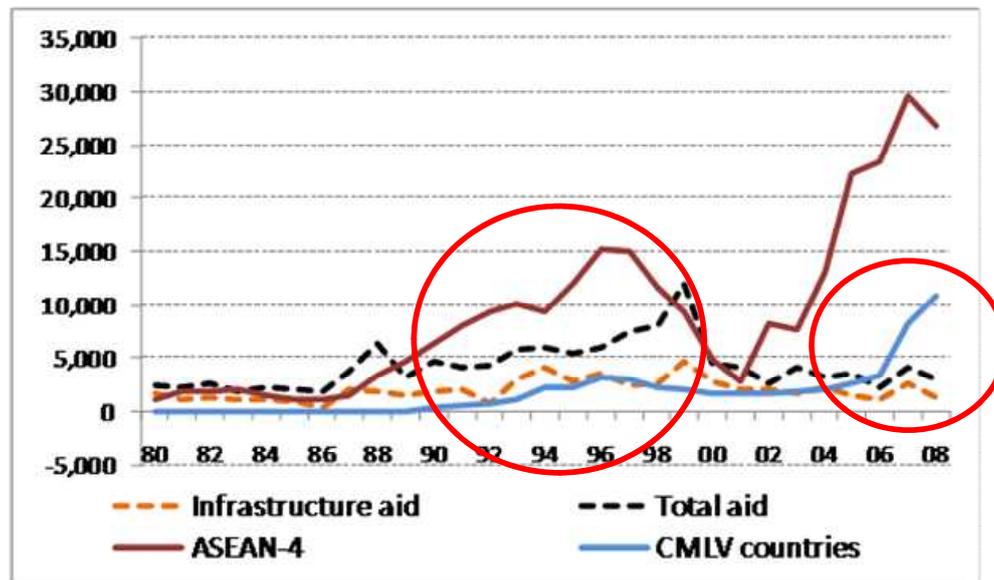
- ▶ To analyze whether foreign aid works through the trade and investment link it is necessary to show that
  - ▶ Foreign aid promotes economic development, and
  - ▶ Economic development promotes trade and investment.
- ▶ Therefore, the hypothesis is as below:

H<sub>1</sub>: Foreign aid promotes foreign direct investment (FDI) inflows.



# Analysis and Findings

Graph 3: Japanese Foreign Aid & FDI to ASEAN (USD million)



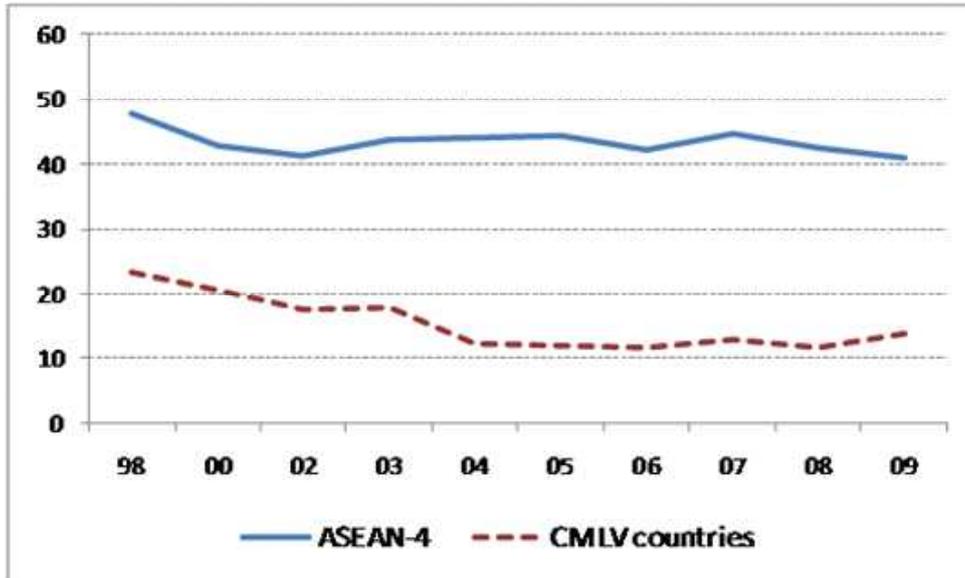
Source: OECD, [www.oecd.org/dac/stats](http://www.oecd.org/dac/stats), World databank, World Development Indicators (WDI), Asian Development Bank (ADB), Key Economic Indicators

# Analysis and Findings

- ▶ Establishment of the ASEAN Promotion Centre on Trade, Investment and Tourism in 1981 Foreign aid promotes economic development
  - ▶ promoting exports from ASEAN member countries to Japan, particularly semi-processed and manufactured products.
  - ▶ promote foreign investment from Japan
- ▶ Jointly funded by contributions from Japan (90%) and ASEAN member countries (10%)
  - ▶ Headquarters in Tokyo

# Analysis and Findings

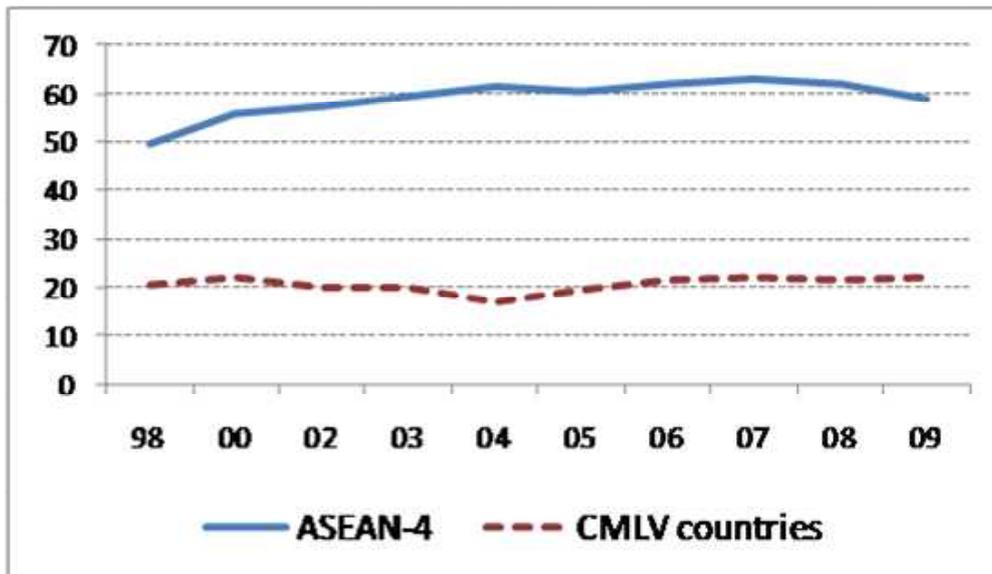
Graph 4: Control of Corruption: Percentile Rank



Source: World databank, World Governance Indicators (WGI)

# Analysis and Findings

Graph 5: Government Effectiveness: Percentile Rank

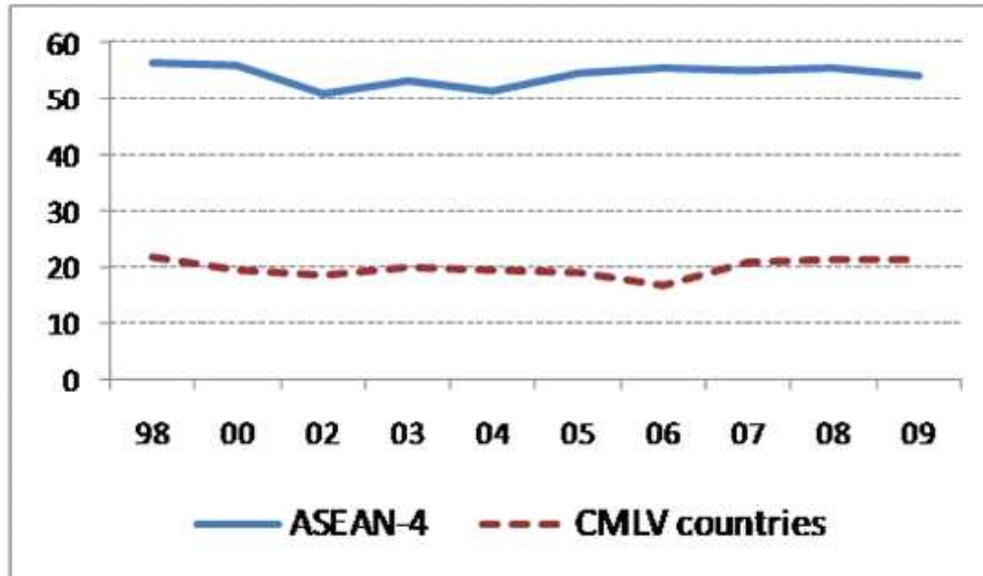


Source: World dataBank, World Governance Indicators (WGI)

## Analysis and Findings

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Graph 6: Regulatory Quality: Percentile Rank



Source: World dataBank, World Governance Indicators (WGI)



## Analysis and Findings

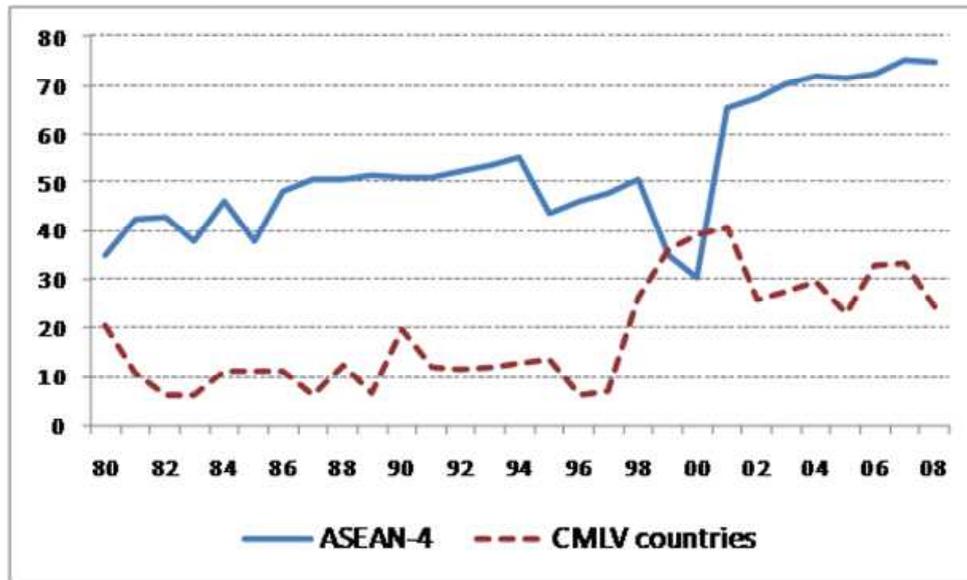
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- ▶ Have made tremendous effort in promoting government effectiveness and regulatory quality by the CMLV countries in recent years.
  - ▶ Vietnam's Ministry of Planning and Investment (MPI) has committed to strengthen the attention to capacity development in the public sector.
  - ▶ proposed to enhance public services and regulatory effectiveness



# Other Factors: Aid help improves Education Environment

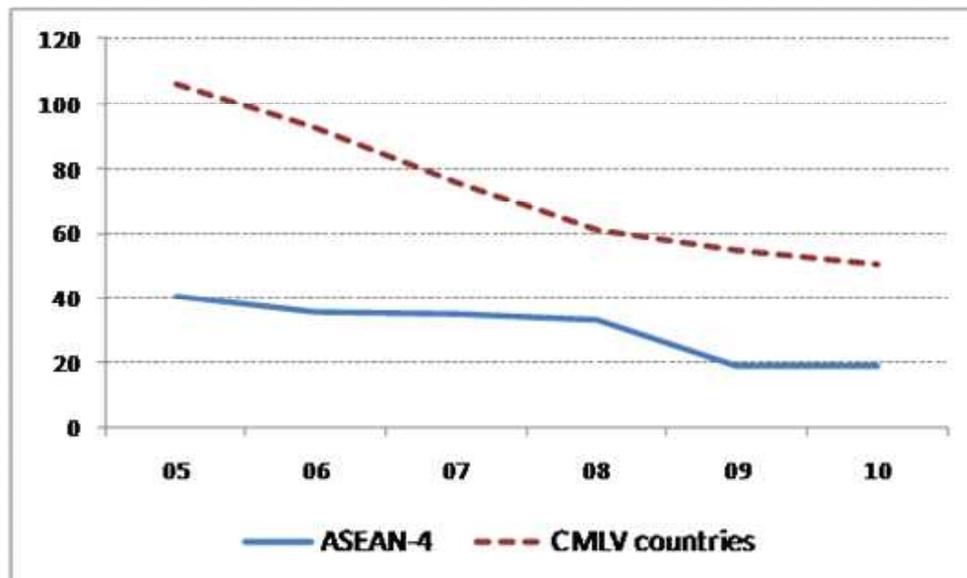
Graph 7: School enrolment, Secondary (% gross)



Source: World databank, World Development Indicators (WDI)

# Investment and Trade Policies: Determinants of FDI

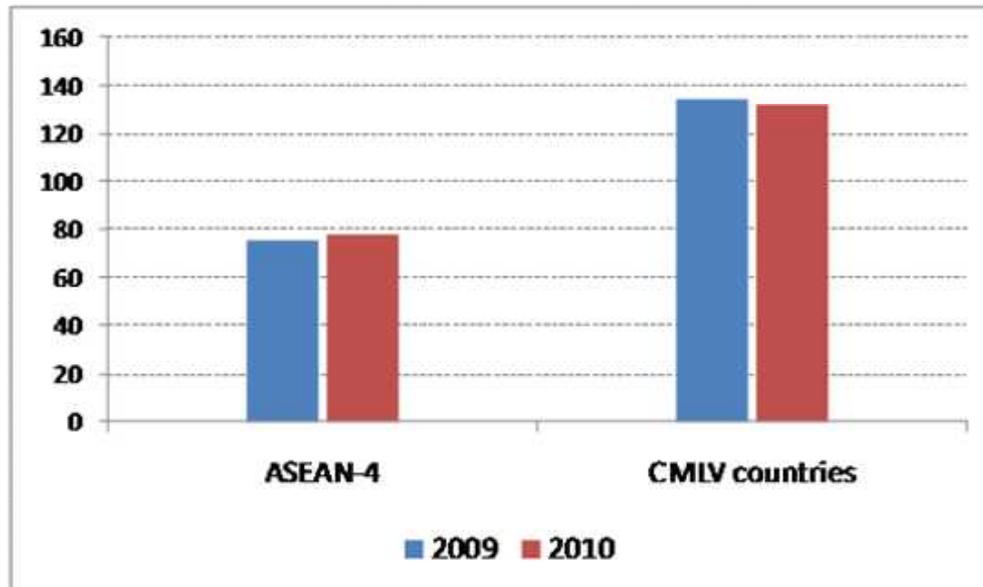
Graph 8: Cost to start a business (% of income per capita)



Source: World databank, Doing Business

# Investment and Trade Policies: Determinants of FDI

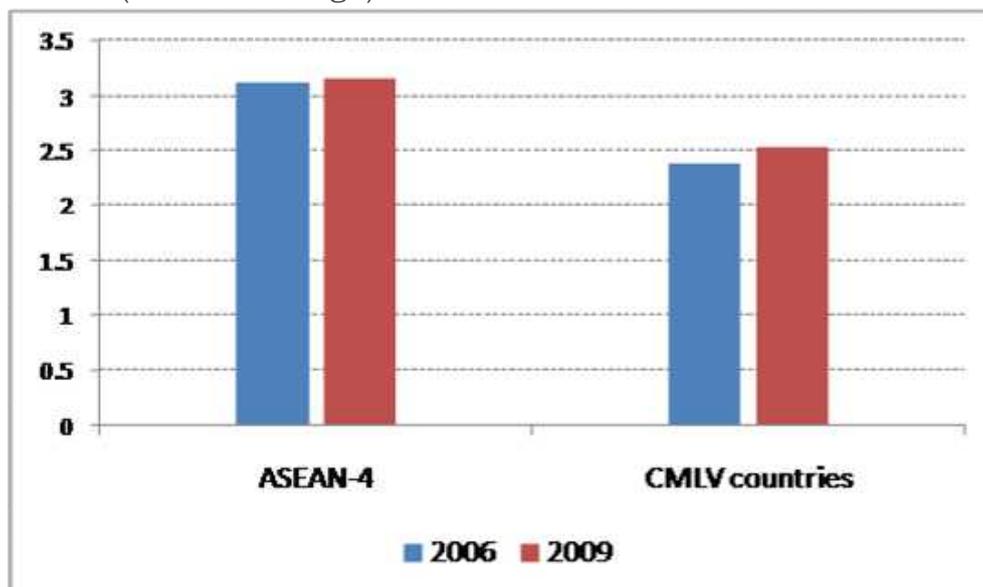
Graph 9: Ease of doing business index  
(1=easiest to 183=most difficult)



Source: World databank, Doing Business

# Investment and Trade Policies: Determinants of FDI

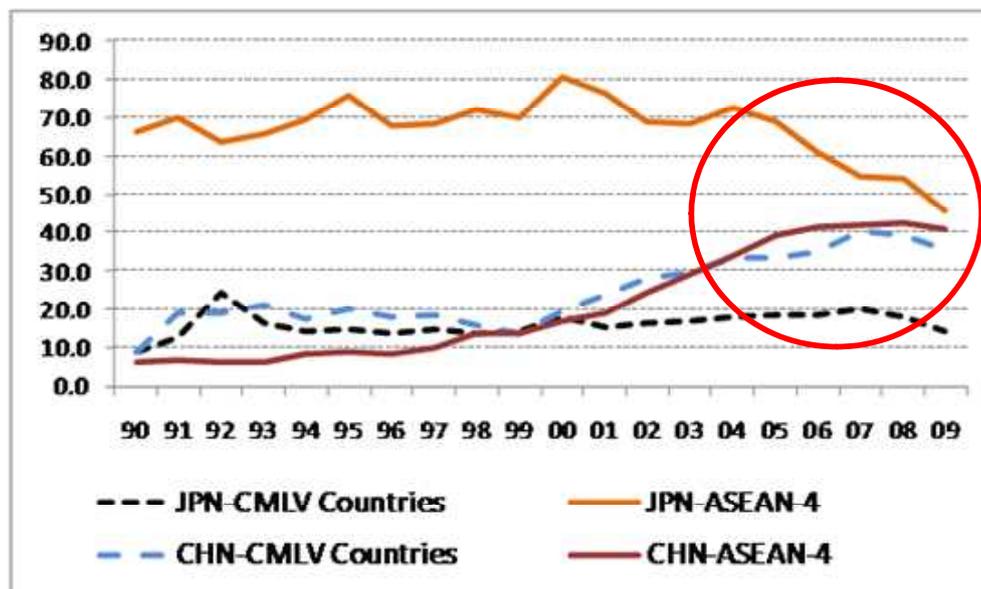
Graph 10: Logistics performance index:  
Overall (1=low to 5=high)



Source: World databank, World Development Indicators (WDI)

# Trade Pattern

Graph 11: Trade Openness (Export + Import, % GDP)



Source: Asian Development Bank (ADB), Key Economic Indicators

## Japan-ASEAN Economic Relations

Table 2: Japan's bilateral agreement

FTAs in force	Year	Participants
Japan-ASEAN Economic Partnership Agreements (EPAs)	signed in 1 April 2008	ASEAN
Japan- Brunei Darussalam Economic Partnership Agreement	signed in 2007	Brunei
Japan-Indonesia Economic Partnership Agreement	signed in 2008	Indonesia
Japan-Malaysia Economic Partnership Agreement	signed in 2005	Malaysia
Japan-Philippines Economic Partnership Agreement	signed in 2006	Philippines
Japan-Thailand Economic Partnership Agreement	signed in 2007	Thailand
Japan-Singapore Economic Partnership Agreement	signed in 2002	Singapore
Japan-Viet Nam Economic Partnership Agreement	signed in 2009	Vietnam

Source: Japan Ministry of Foreign Affairs (MOFA)

## Conclusion

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- ▶ Japan's foreign aid has been directed more towards building political and economic relation.
- ▶ Political and strategic consideration plays an important part in foreign aid allocation pattern.
  - ▶ Japan's foreign aid also has been allocated mainly towards infrastructure and building trade capacity.
  - ▶ Infrastructure and trade facilitation have helped in promoting trade and FDI between both donor and recipient country.
- ▶ Government policies, perceptions of corruption, trade barriers, and political institution play an important role in attracting FDI.



## Conclusion

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- ▶ Favourable labour markets in the form of relatively low wages and an educated workforce can also be very attractive to foreign corporations.



## Limitation and Recommendation

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- ▶ Percentage of ODA disbursement over commitment range from 45% to 90%.
  - ▶ The data imply that the total aid committed by a particular donor differ from the actually total aid disbursement.
- ▶ Establishment of an alternative agency run by the recipient country.
  - ▶ Diffusion of economic situation and political environment of recipient country.
  - ▶ Diffusion of business rules and standards specific.
- ▶ Stronger partnerships between the donor countries with the private sector



## Limitation and Recommendation

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- ▶ Strong cooperation between donors and recipients country also could help improve the disbursement. .
  - ▶ Monitoring and monthly or quarterly meetings between donor and recipient country.

