

# JAPANESE ODA AND PRIVATE SECTOR DEVELOPMENT IN THE PHILIPPINES AND THAILAND: A COMPARATIVE ANALYSIS

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After a long spell of support for the Keynesian approach of demand management by the public sector, official development assistance (ODA) has recently been used to promote greater participation in development through increased access of long-term funds by the private sector on projects highly supportive of building up local initiative. In this paper, the experiences of Thailand and the Philippines in the use of Japanese ODA are reviewed. In particular, the implementation of the two-step loan program (or formally called Financial Intermediary Loan Program) of the Overseas Economic Cooperation Fund (OECF) of Japan in the two countries is compared. The two-step loan program is intended to funnel long-term credits to small entrepreneurs, such as small- and medium-scale export-oriented businesses, including small farmers and agricultural cooperatives. The primary purpose of this study is to present the role of ODA in the development of the private sector and hence, partially explain the distinct difference in the two countries' economic performance. The paper also uses unpublished official data which were obtained from the interviews conducted.

## 1. Introduction

There is not much in common between the Philippines and Thailand except for their tropical climate and their

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being both recipients of a significant amount of Japanese ODA. The striking difference between them, however, lies in their economic performance (Table 1).

The difference in their performance was most pronounced in the early to mid-1980s. While Thailand suffered from a decline in real economic growth rate, the Philippines likewise dived into a negative growth. Correspondingly, the same trend was manifested in the per capita income. Although Philippine economy registered a positive growth rate in the second half of the decade, it remained far below those of Thailand and the rest of other ASEAN countries.

**Table 1 - Growth Performance of Thailand  
and the Philippines  
1970-1993**

Indicator	Year (period)	Thailand	Philippines
<b>GDP Real Growth</b>			
Rate (in %)	1970-1975	6.4	5.8
	1976-1979	8.8	6.5
	1980-1985	5.5	-0.2
	1986-1990	9.9	4.6
	1991	8.1	-1.0
	1992	7.6	0.1
	1993	7.9	1.7
<b>Per Capita</b>			
Income (US \$)	1970	179	177
	1975	353	362
	1980	714	729
	1985	762	588
	1990	1186	666
	1991	1327	753
	1992	1450	850

Source: World Bank, *World Tables*, 1991.

International Monetary Fund, *International Financial Statistics*, 1994.

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In view of the sluggish performance of its economy, the Philippines was tagged as the "sick man of Asia." On the other hand, Thailand's robust economic growth easily qualified it among the "Little Tigers of Asia." In the growth of these two countries, ODA, mostly coming from Japan, played a special role albeit with strikingly different impacts.

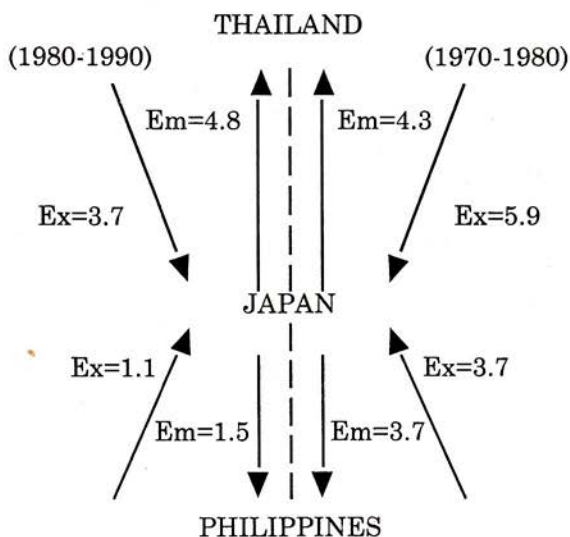
The purpose of the study is to analyze aid utilization strategies of the two countries by illustrating the role of Japanese ODA in the country's development. The discussion centers on the participation of the (recipient country's) private sector in the utilization of ODA. Highlight of the analysis is centered on the distribution and utilization of Japanese ODA under the OECF's Two-Step Loan Program (which is the only direct program in support of private sector development). Other components of the study include a brief review of their bilateral relations with Japan, a historical comparison of Japanese ODA — the volume, trend, pattern, structure, and quality of ODA — and a measurement of the countries' aid absorptive capacity (or the rate of ODA utilization).

### **2. Bilateral Relations with Japan: A Brief Review**

Japan's economic and political relations with Thailand and the Philippines are evident in the areas of trade, direct investment and ODA. A review of their bilateral relations shows that in the case of the Philippines strong support has been manifested only in the area of ODA, while Thailand gets an unwavering support in all three areas.

*Bilateral Trade.* Japan's trade with Thailand and the Philippines grew significantly in the 1970s. By 1980, Thai exports to Japan had increased to six times its 1970 export values, while Philippine exports to Japan had expanded by about three and a half times (Figure 1). Conversely, Japan's exports to Thailand and the Philippines during the same period expanded by about four times and three and a half times, respectively.

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**Figure 1 - Direction of Trade Between Japan, the Philippines and Thailand, 1970-1980 and 1980-1990**

**Note:** Figures represent trade expansion indices to and from Japan using the following formula:

$$E_x = X_{ijt} / X_{ijo}$$

$$E_m = M_{ijt} / M_{ijo}$$

where:

$E_x$  = expansion of exports ( $x$ ) to Japan ( $j$ ) by country ( $i$  = Philippines, Thailand) for year ( $t$  = current,  $o$  = previous)

$E_m$  = expansion indices of imports ( $M$ ), from Japan by country ( $i$  = Philippines, Thailand) for year ( $t$  = current,  $o$  = previous)

By 1990, however, trade relations became less favorable. While Thailand's exports to Japan managed to expand to three and a half times its 1980 levels (two and a half times less than the 1970-1980 expansion), Philippine exports showed minimal expansion.

According to the constant market share model (Ooms, 1967), analysis of export performance can be decomposed into two sources: (1) expansion effect of a change in import value of the partner country assuming constant market share; and (2) "residual effect"



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or market competitiveness attributable to a change in the market share. This is derived by the difference between the actual export index and the hypothetical export index.

Data request that using the formula for a constant market share, as shown below, Philippine exports in 1990 were not as competitive in the Japanese market as those of Thailand. The hypothetical export (expansion) index ( $E^*$ ) suggests that Philippine exports by 1990 should have increased by 12 times its 1970 levels. Actual expansion was only 4 times the 1970 export levels. Thailand, on the other hand, had a hypothetical expansion index for the same period of 13, but actual expansion was 22 times its 1970 export levels.

Hypothetical export (expansion) index:

$$E^* = \frac{X_{ijt}^*}{X_{ij0}}$$

$$\text{where: } X_{ijt}^* = X_{ij0} \left( \frac{M_t^T}{M_0^T} \right)$$

Actual export (expansion) index:

$$E = \frac{X_{ijt}}{X_{ij0}}$$

Definition of variables:

- $E^*$  = hypothetical export (expansion) index
- $E$  = actual export (expansion index)
- $X_{ijt}^*$  = hypothetical exports of country (i) to Japan (j) at time t
- $X_{ij0}$  = actual exports of country (i) to Japan (j) at base time 0
- $M^T$  = total Japanese imports from world

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What the figures imply is that Thai exports experienced both the expansion and residual effects (of the change in Japanese imports) while the Philippines failed to even retain its 1970-1980 share of the Japanese market. Philippine exports to Japan expanded as total Japanese imports increased, but registered a decline in market share. Thai exports, on the other hand, expanded with Japanese imports and at the same time, registered an increase in the share of total Japanese imports.

*Foreign Direct Investment.* Japan's direct investment in the Philippines increased by a compounded average annual rate of 23.4 percent from 1973-1990, a remarkable growth compared with that of US direct investment for the same period, which grew by only 18.9 percent (JETRO, 1990). But because Japanese foreign investment started from a low base level, despite the reported rate of growth, overall Japanese direct investment in the Philippines remained three times lower than that of United States' direct investment for 1990.

Thailand, on the other hand, shows a different picture. Japan's foreign direct investment grew by a compounded average annual rate of 40.8 percent between 1985 and 1989, thereby making Japan the leading foreign investor in the country.

### 3. Japanese ODA

Japan's ODA to Thailand and the Philippines rose in importance from 1970 to 1990. From US \$19.2 million in 1970, Japanese ODA disbursed to the Philippines jumped 20 times, reaching about US \$400 million in 1989. Thailand's receipts of Japanese ODA, on the other hand, increased by about 30 times, from US \$16.9 million in 1970 to US \$488.9 million in 1989 (Table 2).

The inflow of ODA funds in the two countries is depicted in Figures 2 and 3. Figure 2 shows the flow of Japanese ODA loans to the Philippines while Figure 3 shows the flow of Japanese ODA loans to Thailand. Negotiation of loan proposals is done directly between the OECF and the direct borrowers. In the same token, the borrowers are also

**Table 2 - Comparative Figures of Japanese ODA in Thailand and the Philippines, 1970-1990**

Item	Year	Thailand	Philippines
Japanese ODA disbursed	1970	US \$16.9M	US \$19.2M
	1989	US \$488.9M	US \$403.7M
Share of grants to total Japanese ODA	1970-1975	25.2%	57.9%
	1986-1990	43.7% (1986-1989)	29.0%
Share of loans to total Japanese ODA	1970-1975	74.8%	42.2%
	1986-1990	56.3% (1986-1988)	71.0%
Share of Japanese ODA to total bilateral ODA-all sources	1970-1975	29.5%	49.4%
	1986-1990	61.5%	51.6%

responsible for loan repayment. Disbursement of funds is done on a reimbursement basis directly to the contractor (non-bank private) through the OECF-designated foreign bank, which is the Bank of Tokyo.

One major difference between the ODA inflows to the Philippines and Thailand is that in the case of the former, majority of the OECF loans are coursed through the central government while in the latter, many independent borrowers (usually public enterprises) enter into direct contract with OECF. In other words, the debt burden is widely spread among borrowers (and users) in Thailand than in the Philippines where the bulk of the debt appears in the central government account. This setup made the Philippine ODA more vulnerable to political influence than that of Thailand.

Referring back to Table 2, it is important to note that Thailand had a better loan/grant mix than the Philippines. The share of Japanese ODA-grants to total Japanese ODA-disbursed to the Philippines declined during the period

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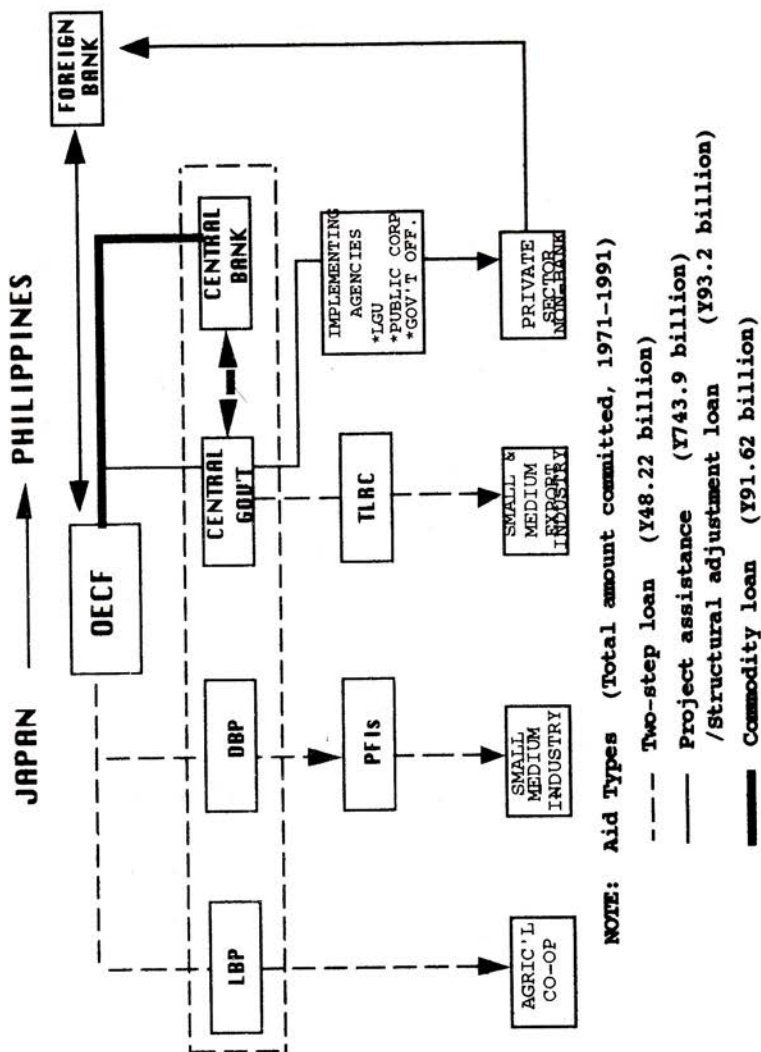
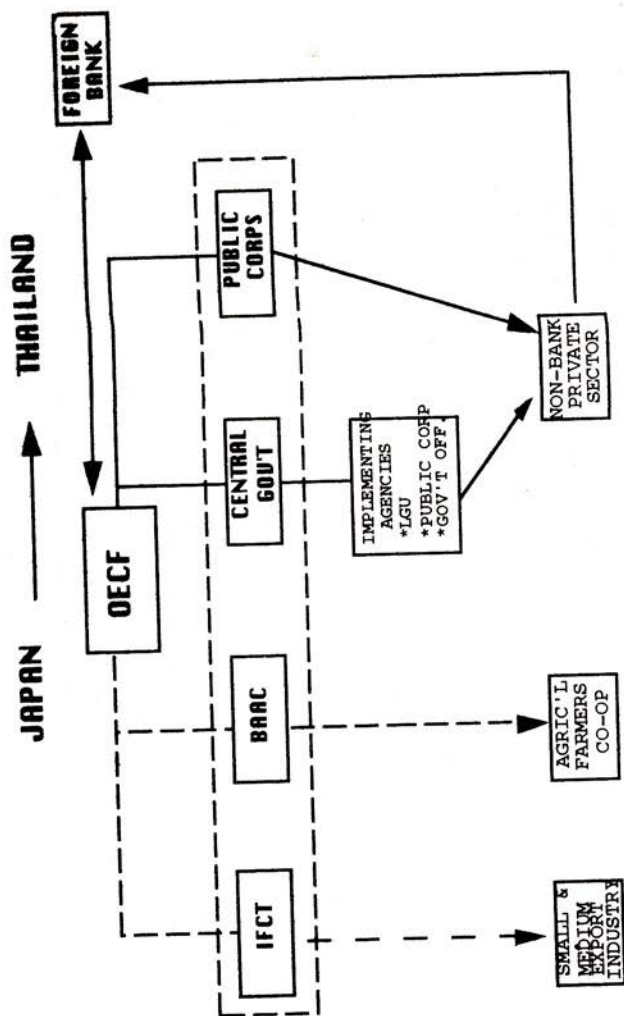


Figure 2 - Flow Japanese ODA to the Philippines





**Note:** Aid Types (Total amount committed, 1968-1989)  
 - - - Two-step loans (Y48.3 billion)  
 — Project assistance (Y798.9 billion)

Figure 3 - Flow of Japanese ODA to Thailand

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1970-1975 to 1986-1990, while the opposite was observed in the case of Thailand. Conversely for the same period, the share of Japanese ODA-loans to total Japanese ODA-disbursed to the Philippines increased while that of Thailand decreased. In both countries, however, the share of Japanese ODA to total bilateral ODA from all sources increased.

The distribution pattern of Japanese ODA depicts a seeming deviation from the so-called moral doctrine of giving foreign aid if one were to consider the case of Thailand. At the time when Thailand was experiencing strong economic growth, Japanese ODA increased. Why? This may actually be explained by the inherent 'character' of Japanese official development assistance which most Japanese officials would explain as follows:

Japanese aid is supposed to inculcate the values of hard work and sacrifices. It is said to teach the gospel of development through self-help by strongly giving preference to aid loans over aid grants (i.e., the pay back obligation of the loan would make the debtor more responsible in its use). This is the essence of the recommendation that middle income countries, like the Philippines, should be given more loans than grants since the latter type of aid may drive domestic efforts away from achieving self-reliance. On the other hand, Thailand turned out to be a 'success story' for Japanese ODA. Increasing ODA was accompanied by strong economic performance. If such spoke of the character of Japanese aid, then the increased ODA grants to Thailand was therefore not surprising because of its proven ability to generate growth with past ODA receipts. Whether ODA grants should be viewed as a 'reward' however was not the point driven at. Finding an explanation to the continued flow of ODA to Thailand despite its high economic growth made one think of the possibility that ODA was being used to goad private investment. To prove this connection, however, is beyond the scope of this paper.

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In terms of ODA quality as measured by the conditions contingent to its uses, Japanese ODA in the two countries was compared by looking at the procurement conditions<sup>1</sup> of ODA-loans (Table 3).

About 51 percent of total Japanese ODA in Thailand was "general untied" compared to only 45 percent for the Philippines. On the other hand, the portion of ODA that is "general untied with consultancy contracts LDC untied" was higher in the Philippines. These types of contracts may seem unrestricted but are actually "tied" in the sense that procurement of services is limited to a pre-approved list of prospective bidders from less developed countries and Japan, who would therefore have a far greater advantage of winning the contract bid. Hence, Japanese ODA in Thailand is of better quality than that in the Philippines.

A parallel observation is the higher participation of Thai contractors in Japanese ODA-financed projects in Thailand than Filipino contractors for Japanese ODA-financed projects in the Philippines. Data show that for approved projects in 1988-1991, the nationality of the principal contractors in Thailand was primarily Thai except for three projects, each awarded to companies from Japan, Italy and China. On the contrary, in the Philippines, except for two projects undertaken by a Philippine firm in partnership with Japan and other foreign firms, all other projects were awarded solely to Japanese companies. The trend continued in 1993. Out of the seven OECF-loan projects in the Philippines, three were awarded to Philippine-owned

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<sup>1</sup> There are four categories of procurement conditions: tied, general untied, general untied with consultancy LDC untied, and LDC untied. Tied means full restriction in procurement is observed, i.e. procurement is limited to Japanese products only; general untied means no restriction in the procurement method; general untied with consultancy LDC untied means procurement for the project has no restriction but services involving consultancy should be limited only to the list of pre-approved LDCs and Japanese contractors; and LDC untied means procurement can be made from Japan and the list of Japanese pre-approved LDCs.

Table 3 - Procurement Conditions of Japanese ODA-Loans to the Philippines and Thailand, 1968-1990

Country	Tied	General Untied	Gen. Untied (Consultancy LDC Untied)	LDC Untied
Philippines (1971-1990) Nos. 1-18 comprising 152 OECF projects	US\$701.1M (7.1% of total Yen Loan Amount)	US \$4399.9M (44.7% of total Yen Loan Amount)	US \$4016.3M (40.8% of total Yen Loan Amount)	US \$730.1M (7.4% of total Yen Loan Amount)
Thailand (1968-1990) Nos. 1-15 comprising 143 OECF projects	US \$556.0M (7.0% of total Yen Loan Amount)	US \$4089.3M (51.2% of total Yen Loan Amount)	US \$2721.4M (34.1% of total Yen Loan Amount)	US \$622.0M (7.8% of total Yen Loan Amount)

Note: Numbers 1-18 (Philippines) and 1-15 (Thailand) refer to the consecutive numbering of the Annual Yen Loan Agreements between OECF and the recipient Government. This is an official reference numbering used by OECF.



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contractors, three to Japanese contractors, and one to a joint venture between Philippine and Korean contractors. In Thailand, out of the 14 projects financed by OECF loans, six were awarded to Thai contractors, five to a joint venture between Japanese and Thai contractors, and three were awarded to contractors from other countries.

These differences in the quality of ODA go back to the basic philosophy behind Japan's international economic cooperation, which is to help the Japanese private sector. In Thailand where Japanese trade and direct investment are already on a high scale, Japanese private sector participation in the ODA is just a bonus item. However, the reverse is true in the case of the Philippines. The only avenue where the Japanese private sector is keen in actively participating is through its ODA.

In terms of ODA types received by the two countries, a remarkable difference lies in the considerable amount of commodity loans which the Philippines availed of and which Thailand never did (Table 4).

Commodity loans are extended to less developed countries (LDCs) that are facing severe imbalance of international balance-of-payments or a shortage of hard currency to import in sufficient quantities. Normally a list of goods is agreed upon to be purchased out of the commodity loan. The local currency generated by selling these goods to the domestic market may be used according to the terms agreed upon by Japan and the recipient government. It may be used either to (a) implement specific development projects or (b) stabilize people's livelihood and promote the well-being of the people.

The Philippines started to avail of commodity loans in 1971 until 1978. It will be remembered that this period was characterized by the implementation of an ambitious growth strategy by the Marcos Government. These high rates of investment led the import bill to soar as a substantial component of it consisted of imported capital goods. Thus, despite a recorded increase in exports, the

Table 4 - OECF Loan Commitment by Sector  
As of March 1992  
(In Million Yen)

Sector	Philippines		Thailand	
	Amount	% Share	Amount	% Share
Agric., forestry & fishery	21,938	2.1	30,051	3.4
Irrigation and flood control	91,555	8.8	54,840	6.2
Transportation	187,062	17.9	384,190	37.8
Electric, power and gas	186,540	17.9	180,847	20.5
Telecommunications	44,787	4.3	106,113	12.0
Mining & manufacturing	12,809	1.2	54,339	6.2
Social services	58,352	5.6	61,821	7.0
Financial intermediary loans (Two-Step Loans)	53,185	5.1	55,533	6.3
Commodity loans	313,130	30.0	0	0
Others	73,510	7.1	5,748	0.6

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country was beset with foreign exchange difficulties. Again in 1984, when the country lacked foreign exchange, commodity loans provided a reprieve in the acquisition of imported goods. At the same time, the local currency proceeds of the commodity loan somewhat eased the growing phenomenon of 'aid overhang' for it provided funds for use as local counterpart for foreign-assisted projects, specifically those financed by the OECF.

Until 1972, commodity loans were fully tied and until 1977 were partially untied. While commodity loans can be seen as the means to circumvent the foreign exchange bottleneck, this form of ODA however is less than ideal because of some inefficiency-related factors: one, imported goods paid out of commodity loans are typically more expensive than when purchased on a free competitive market; two, such mark-up in prices does not help much given an already burgeoning import bill; and three, availability and easy accessibility of this type of loans may create a disincentive for the government to work harder to generate the required foreign exchange (thereby affecting domestic resource mobilization pattern).

This section ends by quantitatively measuring the aid absorptive capacity or the rate of aid utilization of the two countries by using the formula:

$$U_t = D_t / [\Sigma C_{t-1} - D_{t-1}) + C_t]$$

where:

- $U$  : Rate of utilization;
- $D$  : disbursements (loans);
- $C$  : commitments (loans);
- $t$  : time period

The computed average rate of utilization from 1982-1989 is 26 percent to the Philippines and 15 percent for Thailand. These figures do not support the hypothesis that Thailand has a higher utilization rate consistent with its good economic showing. There are several explanations for this outcome namely: 1) 20 percent of the disbursed ODA to the Philippines consisted of programs loans i.e., quick-disbursing in nature, hence the higher disbursements



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recorded for the Philippines; and 2) the figures do not include grant disbursements, which comprised a significant percentage (44 percent) of total Japanese ODA to Thailand. In short, the rate of aid utilization of Thailand was underestimated, or as may be loosely stated, Japanese ODA in the Philippines was less productive because high utilization of ODA did not generate a high level of economic growth.

Using these figures to roughly calculate the productivity of Japanese ODA in each country between 1982-1989 gave the following results:  $0.5\% / 26\% = .019$  for the Philippines and  $7.7\% / 15\% = 0.51$  for Thailand. The figures simply show the greater productivity of Japanese ODA in Thailand than in the Philippines.

### 4. OECF's Two-Step Loan Program

The belief in a strong private sector role in development is somehow reflected in Japan's ODA program. The OECF's Financial Intermediary Loan Program or Two-Step Loan Program is a means to localize economic development. This program takes off from the Japanese experience in the 1950s and 1960s during which the flow of money was directed toward specific industries and provided at preferential interest rates. As the word implies, two-step simply means relending (of the OECF loan (ODA) by the OECF debtor (recipient government/agency) to a pre-identified group of creditors or program beneficiaries.

This aid strategy adopted by Japan conforms largely to the recent refocusing of the Organization for Economic Cooperation and Development — Development Assistance Committee (OECD-DAC) aid policies toward a dynamic and sustainable development and equitable diffusion of the benefits of economic growth to more people. A *sine qua non* of private sector development is believed to be the parallel evolution of domestic financial markets geared to providing the financial intermediation services needed by a growing number of small savers and small- and medium-sized enterprises (OECD, 1991).



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The principle behind the program is the development of local initiative, one which is synonymous to microenterprise development.

Microenterprises refer to those employing from two to ten employees: they also include self-employed individuals, who constitute the overwhelming majority. They are often established by poorer, marginalized members of society, they receive no assistance or consideration from government authorities, and they operate on the fringes of the recorded economy. The microenterprise sector is exceptionally heterogeneous, ranging from rural-based agribusiness and handicraft production to urban-based trading, service and manufacturing enterprises, and it is largely oriented to local markets. It comprises a vast — and otherwise untapped — pool of productive skills and organizational resources, and plays a key role in recycling materials and redeploying resources that would otherwise remain unused.

The economic advantage of a microenterprise is that it is perceived to generate income and employment to the poor and effectively allow them to integrate into society. They constitute a huge reservoir of human initiative and ingenuity, and their existence is central to the cultivation of a 'seedbed' of incipient entrepreneurs. Microenterprises provide crucial vertical and horizontal linkages between traditional and modern production systems, between agriculture and industry, between rural and urban areas, and between production and consumption patterns. These linkages enable the domestic economy to withstand external shocks and avoid severe structural bottlenecks and are vital to sustained, long-term economic growth (OECD, 1991).

This twist in the traditional way of ODA utilization was influenced by the recognition of the difficulties surrounding a rising population growth thriving in a poor 'enabling' environment (i.e., complex and/or often onerous fiscal,

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regulatory and legislative measures). Hence, this approach ushers in a new orientation of development that is broad-based, participatory and people-centered.

### 5. The Asian Experience

The Two-Step Loan Program has been included in the aid portfolio of Japan for about two decades now. It started in Thailand in 1975 and in the Philippines in 1980. As of January 1991, the Program has accounted for close to six percent of total OECF loans disbursed to Thailand, and 5.3 percent of total OECF loans to the Philippines.

*Thailand Experience.* The Government of Thailand used the Program to promote agricultural development and small-scale, export-oriented industries. Funds were administered by the Bank for Agriculture and Agricultural Cooperatives (BAAC) and the Industrial Finance Corporation of Thailand (IFCT). Beneficiaries of BAAC loans were (1) agricultural families whose annual income fell in the range of 30,000 to 50,000 bahts, and (2) agricultural cooperatives.

IFCT, on the other hand, extended credit to small-scale industries and to export-oriented industries. For effective implementation of the project, the Thai Government provided technical assistance to farmers/cooperatives and credit guarantee schemes for industries with no adequate collateral for loans.

Interest rate was set using a "cost plus" principle which meant OECF interest rate plus the cost of their (BAAC and IFCT) operation. Normally, the effective interest rate was 2-3 percent below the market rate, with 3-5 years grace period and 10-15 years maturity period.

BAAC loans basically supported mango production, cow raising and milking, and other activities that concerned development of inalienable, low-yielding agricultural land. Technical assistance was provided by the Agricultural

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Promotion Bureau of the Ministry of Agriculture. Loans to agricultural cooperatives were used for capital investment such as construction of warehouses and purchase of equipment and machineries.

An important component of the package is the ability of the Bank to keep a revolving fund generated from the credit transaction. Also, the relatively high rate of repayment of 89 percent gives the Bank a financially sound position as a financial institution.

The IFCT, on the other hand, accords high priority to small-scale industries and to export oriented industries. They provide a credit guarantee scheme for borrowers who do not have adequate collateral for their loans. The criteria for borrowing IFCT funds are as follows:

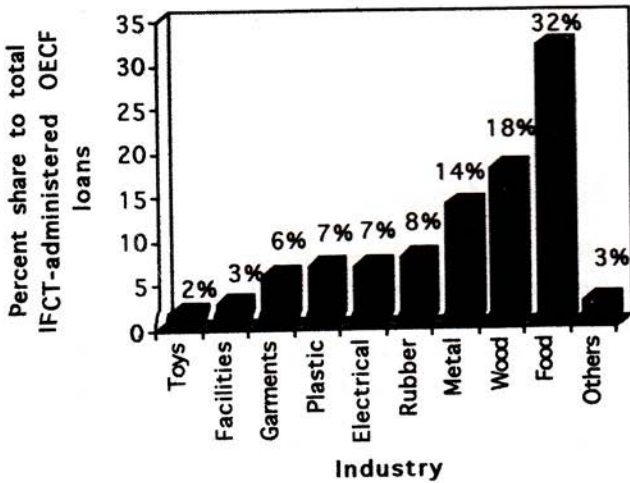
1. The proposed project should be less than 6 years. The use of funds may be for the purchase of machineries and equipment, expansion of working place, etc.;
2. Borrowers should be producers for export-oriented industries with the following classification:

Small borrowers - those with fixed assets of less than 10 million bahts will observe a loan limit of 200,000 to 5 million bahts;

Medium borrowers - those with fixed assets of 10 to 50 million bahts will observe a loan limit of 5 million to 20 million bahts.

3. At least 30 percent of total annual production is appropriated for export.
4. For new industry entrants, export production should be at least 30 percent of total production within 3 years from the start of operation.

A third of IFCT loans went to food processing while wood products and furniture industry, and the metal processing industry, came in second and third (Figure 4).



**Figure 4 - OECF-funded IFCT Loan Distribution by Industry in Thailand (As of November 1992)**

In the words of Mr. Sadao Amano of the OECF, Thailand is a "successful case of limited preferential finance policy. Through the loan, Thai farmers have purchased agricultural machinery, greatly improved their productivity, and the income of the farming family has been steadily increasing. And in terms of loan repayment, OECF has been receiving steady repayment because Thai farmers are sincere and clever, and aware of the risk of not receiving any further loans if they are late in repaying. Delinquencies occur only in 5 percent of all loans.<sup>2</sup>

<sup>2</sup> OECF, "Experience of East Asian Economic Development," Proceedings of the 30th Anniversary Symposium of the OECF, March 4-5, 1992, Tokyo, Japan.



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*Philippine Experience.* The Program used to be administered by the Technology and Livelihood Resource Center (TLRC), a government corporation operating under the Office of the President. Principal beneficiaries for the program were non-traditional, export-oriented small- and medium-scale enterprises. Support was provided for two purposes: for modernization of production capacities and for providing common service facilities if capital was insufficient to acquire the needed equipment.

The eligible borrowers may either be new or existing small- and medium-scale enterprises (defined as those with total assets not exceeding P20 million), export-oriented, and assets of any stockholder should not exceed P50 million. The top beneficiaries of the Program with their respective share of total Program fund were: general industry (38%), garments (33.2%), gifts, toys and housewares (29.5%) and food (20.3%).

Interest rate was set at 10 percent per annum with maturity of 5 years, inclusive of a one-year grace period on principal payments. The loan limit was set at 70 percent of proposed project cost for expansion, and 60 percent for start-up projects. The required collateral for minimum loan coverage was 100 percent, 90 percent for land, 80 percent for building or land improvements, and 60 percent for production and transport equipment.

Based on a 10 percent random sampling of the approved project proposals, the expected average increase in production to be generated by the loan was about 98 percent of existing capacity. A fair amount of the loan was proposed for the purchase of machineries, expansion of plant buildings, build-up of working capital, and renovation of existing plants.

While the Program fund has almost been exhausted, TLRC, as of 1992, was faced with the question of its ability to collect loan payments because of its non-banking personality. As of the same date, no revolving fund has yet been created (which makes the Program life vulnerable) and no follow-up efforts on present Program beneficiaries have been initiated. In view of the "personality" issue of TLRC and the hope to move ahead with the Program, new fund administrators were identified for the second round of the OECF Two-Step Loan Fund.

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With the intention of replicating Thailand's experience in the Philippines, OECF agreed to designate new fund administrators, namely, the Development Bank of the Philippines (DBP) for small- and medium-industry loans and the Land Bank for agricultural development, since these bear practically the same personality and functions as Thailand's BAAC and IFCT.

While credit terms were determined in similar manner as in Thailand, however, the Philippine implementation of the Program seems to be more stringent than Thailand to the extent that intended grassroots beneficiaries were hardly reached. For Land Bank-administered loans, only agricultural cooperatives (no farmers) were identified eligible for credit. Eligible expenditures included the purchase of equipment and machineries, construction of auxiliary facilities like storage buildings, and working capital.

DBP-administered two-step loans, on the other hand, catered to the long-term financial needs of the private industrial sector with total assets of less than P200 million before financing and with loan requirements of less than P100 million. Any investment projects found economically, technically and financially sound were eligible for financing except those which involved the production of explosives, dangerous drugs, furs, pesticides, inorganic pigments, paints containing hazardous solvents, chlorine and caustic soda with amalgam process, asbestos and asbestos cement, and armaments and ammunition.

The DBP relending finance covers only expenses for land improvements, construction/expansion of plants, acquisition of machinery, equipment and spare parts, and the cost of necessary services and initial working capital. It cannot be used to cover expenses that involve land acquisition, customs duties, taxes and purely working capital. As of November 1992, DBP had committed 84 percent of the OECF funds to manufacturing industries and 16 percent to non-manufacturing industries. The non-manufacturing industries include public communication, deep sea fishing, interisland water freight transport, concrete aggregates, ice plant and cold storage, and consumer goods retailing, wholesaling and warehousing.

The OECF-DBP loan funds are availed through accredited financial institutions. These institutions screen credit applications using bank-type criteria. When approved, the accredited financial institution relends the OECF loan fund (released to them by DBP) at a cost not more than DBP's operating cost plus a 5% spread (the spread represents the institution's fees). In effect, the OECF two-step loan became a three-step loan, accessed at a higher rate, and remained inaccessible to most grassroots entrepreneurs.

Figure 5 shows the distribution of DBP-administered and TLRC-administered loans.

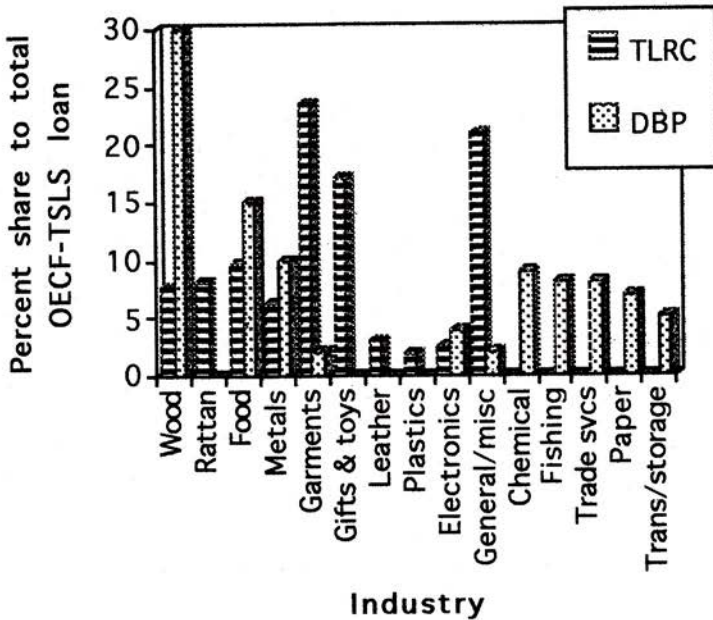


Figure 5 - Distribution of TLRC and DBP Loans by Industry (Figures as of September 1992)



### 6. Policy Implications

The quality and implementation of ODA in the two countries manifested differences in ODA impact on the development of the two countries' private sector. The Philippines' less growth-maximizing approach in ODA administration as compared to Thailand's implicitly cost the country foregone economic gains that could otherwise have helped strengthened its development base. While this may have been compensated in a few limited cases of ODA relending by the Philippine Government in recognition of the limits of its (public sector) absorptive capacity, this strategy ought to have been given more serious concern for bigger involvement of the private sector in development. After all, a stronger public-private partnership in development is what is warranted.

The major difference in the promotion of microenterprise development in the two countries largely lies in the absence of important infrastructure in the Philippines. To administer and manage the fund, the Philippines tapped an organization whose 'personality' to follow-up on the credit extended is under question. Moreover, technical assistance was unavailable. Furthermore, the DBP has set up inflexible project criteria and conditions which frustrate the overarching goal of reaching out to the grassroots. While no available data can strongly substantiate Thailand's "success" in the implementation of the Program compared to that of the Philippines, we can make a reasonable conjecture that such is the case based on the following: (1) BAAC identifies small farmers as loan beneficiaries as against that of the Land Bank of the Philippines which caters only to agricultural cooperatives; (2) as part of the Program, there has been a mention of support infrastructures such as technical assistance, revolving funds and credit guarantee scheme in Thailand but none was mentioned in the case of the Philippines; (3) with the personality problem that beset the TLRC, no follow up has yet been made on the credit; and (4) with the addition of a third tier of financial institutions in DBP-administered loans, the 'enabling environment' becomes less accessible to grassroots borrowers.

Overall, Thailand's mechanism to implement Japan's Two-



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Step Loan Program is more in keeping with the principles of microenterprises than that of the Philippines. In general, however, the design of the Program could be further improved to include the basic elements and considerations for a more effective and far-reaching system, as follows:

1. Greater amount of funds to be used for microenterprise development;
2. A commitment (from both donor and recipient) to promote self-help-based microenterprise development as a central element of economic development;
3. Enhanced role of recipient-country governments by putting in place a supportive policy and institutional environment for smooth resource transfers and flow;
4. Improved 'enabling' environment;
5. Investment in human resource development;
6. Strengthening of market forces and creation of new investment opportunities;
7. Assistance on a wholesale, not on a retail basis, and adoption of monitoring and control measures which maintain a proper balance between decentralization and coordination; and
8. Responsiveness to local initiatives

### 7. Growth Implications

Aid donors have been convinced that microenterprise development is a way of addressing future pressing problems of population growth, inadequate employment opportunities, urban migration, increased social segmentation and rising poverty as it constitutes spatially dispersed 'growth poles' of considerable dynamism and potential. Thriving microenterprises are expected

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to spread development in a microeconomic level, which in the long run can lead to broader structural change in the economy at large.

It should be recognized, however, that the success of a microenterprise is highly dependent on the 'enabling environment' of the economy as a whole. That is, its success is a function of general macroeconomic policies. According to Fry (1980), financial conditions do exert an impact on economic growth through the effects on the rate of savings (thus, on the pool of investible resources) and the efficiency of investment in which both national and foreign savings (ODA plus other foreign capital) are allocated.

The theoretical framework posits that the real rate of economic growth (or the rate of growth of aggregate output) is determined by both the quality (efficiency) and quantity (rate) of investment, which in turn are contingent on the supply of finance for capital formation. The pool of investible funds for capital formation, on one hand, is sourced from both national and foreign savings. The rate of national savings, on the other hand, is affected by the amount of foreign savings that flow into the economy.

An estimation of the Philippine savings and investment functions was conducted to check the interdependence of savings, investment and national income. In the investment function, selective credit (a proxy for microenterprise development) as a determinant was included. The hypothesis was that in order to increase domestic resource mobilization for investment, long-term credit to the grassroots level should be extended. In the Philippines where the "rich and powerful" has had monopoly over investment finances since time immemorial, selective credit policy such as the Two-Step Loan Program is important to stimulate and develop grassroot private sector initiative. It is seen to bring broader participation in development by providing access to credit and thereby increasing the absorptive capacity of the country.

The ratio of domestic credit to the government sector as a determinant of the saving ratio is tested to determine the relevance of the new approach to aid strategies (i.e., refocusing aid to private sector development and thus reducing the role of

government in resource allocation will have a positive impact on the savings rate).

The saving function is shown below:

$$(1) \quad \frac{S}{Y} = f \left[ Y_{gr}, \frac{S_f}{Y}, \frac{R_d}{P}, R_b, R_{usa}, \frac{DC_g}{DC}, \frac{DT}{Y} \right]$$

where

$\frac{S}{Y}$  : savings ratio

$Y_{gr}$  : rate of income growth

$\frac{S_f}{Y}$  : foreign savings inflow

$\frac{R_d}{P}$  : real deposit rate

$R_b$  : interest rate on government bond

$R_{usa}$  : world rate proxied by US lending rate

$\frac{DC_g}{DC}$  : ratio of volume of domestic credit to the government to total domestic credit

$\frac{DT}{Y}$  : ratio of foreign debt outstanding to national income

The investment function:

$$(2) \quad \frac{I}{Y} = f \left[ Y_{gr}, (Y_{gr})_{t-1}, TTG, TTG_{t+1}, TTG_{t-1}, \frac{DC_p}{DC}, \left( \frac{DC_p/P}{Y_{t-1}} \right), \frac{DT}{Y}, \frac{DC_g}{DC}, \frac{DS}{Y}, \left( \frac{I}{Y} \right)_{t-1} \right]$$

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where:

$\frac{I}{Y}$  : investment ratio;  $\left(\frac{I}{Y}\right)_{t-1}$  : lagged one year

$Y_{gr}$  : real growth of income;  $(Y_{gr})_{t-1}$  : lagged one year

$TTG$  : terms of trade at present;  $TTG_{t-1}$  : lagged one year

$TTG_{t+1}$  : one year from now

$\frac{DC_p}{DC}$  : ratio of volume of domestic credit to private sector to total domestic credit

$\frac{DC_g}{DC}$  : ratio of volume of domestic credit to public sector to total domestic credit

$\frac{\Delta(DC_p/P)}{Y_{t-1}}$  : proxy measure for selective credit extension which is the change in the real volume of private sector domestic credit scaled by lagged real GNP. This has a similar effect as the ratio of private sector domestic credit to GNP)

$\frac{DT}{Y}$  : ratio of foreign debt outstanding to GNP

$\frac{DS}{Y}$  : ratio of debt service to GNP

$P$  : domestic prices (Consumer Price Index)

The equations were estimated using ordinary least squares for the period 1974-1989. The resultant equations are as follows:



$$(3) \quad \frac{S}{Y} = 22.50 + 6.12 \frac{ODA^*}{Y} + .24 \frac{P_d^*}{P} + .25R_{usa}^{**} - .47 + \frac{DC_g^{**}}{DC} \\ + .19Y_{gr}^{***} - .08 \frac{DT^{**}}{Y} + 5.2D77^{**} + 2.45D79^{**} + 4.77D80^*$$

$$R^2 = .95$$

$$DW = 2.26$$

$$(4) \quad \frac{I}{Y} = 4.77 - 1.75 \frac{ODA}{Y} + .75Y_{gr}^* - .16TTG_t^* + .55 \frac{DC_p^*}{DC} \\ - .16 \frac{D_s^*}{Y} + .19 \left[ \frac{\Delta \left( \frac{DC_p}{P} \right)}{Y_{t-1}} \right]$$

$$R^2 = .92$$

$$DW = 2.05$$

Dummy variables were included in the equations. D77 represents the period of low absorptive capacity, and D79, D80 represent the after-shock of the second oil price hike. Variables significant at 1% level are superscripted with \*, 5 percent with \*\* and 10 percent with \*\*\*.

Focusing only on the variables relevant for this paper, it was confirmed by the estimates that there exists an inverse relationship between the volume of domestic credit to government and savings ratio. The same findings can be said for the investment ratio. Conversely, the higher the volume of domestic credit allocated to the private sector, the higher is the investment ratio. What this implies is that the more resources diverted from government use to the private sector, the higher would be the economic gains. Thus, the present refocusing of ODA is expected to lead into positive gains that will come from the expected increase in domestic capacity.

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With regard to selective credit, its relationship to investment rate was not found significant; however, the expected direction of the relationship (which is positive) depicts the possibilities that distribution of credit can influence the investment rate. The insignificant value of the t-value may partly be attributed to the small amount of funds which recently flowed to this area of investment.

### 8. Conclusions

Japanese ODA assumed an important role in the economic development of both Thailand and the Philippines. Thailand's ability to allocate aid in areas which provided positive incentive for maximum national effort, however, was not seen to have been duplicated in the case of the Philippines. While the latter focused its efforts on struggling against both natural and man-made catastrophies, Thailand on the other hand focused its efforts on striving for higher economic growth. A good thirty percent of total Japanese ODA to the Philippines went to commodity loans which as earlier discussed may not give optimum economic gains because its use is limited to a pre-approved list of commodities which may not perfectly fit into the required capital goods, not to mention the relatively higher price of the goods. Thailand, on the other hand, did not avail of any of these loans and may therefore have gained a greater leverage in utilizing ODA for or in support of other productive activities.

The Philippines' less growth-maximizing approach in ODA administration as earlier pointed out had implicitly cost the country foregone economic gains that could otherwise have helped strengthen its development base. While the Philippine Government has introduced relending of ODA to the private sector willing to undertake developmental projects, this strategy however ought to be given more attention to ensure bigger and wider involvement of the populace.

While no firm statistics are available to back up the proposition that Thailand's grassroots benefitted better from the Two-Step Loan Program compared to that of the

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Philippines, such conclusion may result merely by looking into the 'enabling environment' provided to this sector of the population in the two countries. In the case of Thailand, government support to effectively implement the Program was provided. As assessed by Hirsch (1990): "BAAC credit is clearly of immediate relevance to production. It gives recipients control over inputs that would otherwise be difficult to attain. In this respect, BAAC credit as the State's principal financial commitment to agriculture enhances participation in the high-input production regime that predominates."

Several factors need to be present to make this Program realize its intentions. One, to truly make the program a mechanism for economic growth, the amount appropriated for the program should be increased and the beneficiary sectors expanded. While attempts have been made to refocus future aid towards this type of development strategy, there is still too little attention given to it. Japan, for example, is still slow in increasing the portion of its total aid in support of this strategy. Two, the political commitment of the recipient country should go hand-in-hand with the commitment of its people toward participatory development. Although relending of ODA funds has started in the Philippines, it is still in its nascent stage. Concrete measures have to be taken to forge public-private partnership that involves a greater part of the populace. Three, the program should be integrated into the overall growth strategy of the economy. This simply means the need to carry out policy reforms that are supportive of the realization of the program's ultimate goal. This essentially concerns the 'enabling environment' which includes not only the access to credit but involves the whole gamut of government policies and inappropriate legal and regulatory frameworks that discriminate against the 'marginal' members of society.

Although important factors of development such as political stability, administration, and macroeconomic management were not quantitatively treated in the study, their importance and influence in the development course however is worth mentioning. In the Philippines where political ills have been linked to administrative ineptness



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and economic mismanagement, there is hardly no guarantee that ODA funds would be utilized for their intended purposes. It would be well to remember that all efforts to improve the economy would certainly generate trust and support from the international community.

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