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Governance and access to finance for development: an explanation of divergent development trajectories in Kenya and Malaysia

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Kenya and Malaysia embarked on quite similar development trajectories in the 1960s, but economic growth figures started to diverge widely in the 1980s and 1990s. Governance issues are often suggested as the major binding constraint in the Kenyan development trajectory whereas Malaysia scores well on governance indicators; but similar governance problems to those in Kenya can be found in Malaysia. However, Malaysia has the resources to overcome these, whereas access to finance appears to be a binding constraint in Kenya. Essential in the Malaysian development trajectory appear to be islands of efficiency that are relatively isolated from rent-seeking, notably the oil company Petronas. The paper therefore contributes to the debate on the role of institutions in the literature on the resource curse.

Keywords: development finance; governance; institutions; resource curse

Introduction

This paper compares the development trajectories of Kenya and Malaysia in order to explain radically different outcomes between countries that adopt similar development policies. The primary variable is the similarity in the two countries' development policy, but explanatory variables emerged from analysing narratives of the development trajectories. The comparative method is used here inductively and heuristically: the criterion for the value of a variable that emerges is whether it leads to significant insights into the direction taken in the development trajectories. Two variables appear to be salient in clarifying the development trajectories: governance and access to development finance. The first is widely seen as the explanation, but will be

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seen as wanting in this comparison. The second will emerge as the plausible factor explaining different outcomes.

Governance is widely credited as the source of Malaysia's development success and as the explanation for Kenya's stagnating performance. Indeed, Kenya scores much lower than Malaysia in governance ranking on the Economic Freedom Index as well as on the Corruption Perception Index. In a comparison of the least-corrupt countries, Malaysia ranks 56th whereas Kenya ranks 146th (Transparency International, 2009). With respect to economic freedom, Malaysia is ranked 53rd as compared to Kenya's placed at 106th (Heritage Foundation, 2011). On the World Bank Governance Indicators also, Malaysia scores much better than Kenya, the most striking being the difference in government effectiveness. Kenya scores 30.4 out of a hundred as compared to 89.5 for Malaysia (World Bank, 2010b).

The quality of Malaysia's institutions is also singled out in the literature on the resource curse, because the country has a record of high growth and it is a relatively resource rich country. It has thus escaped the resource curse: the widely observed correlation between low economic growth and resource wealth (Sachs & Warner, 1995). Malaysia is compared here with Kenya, a resource poor country. It may seem more relevant to compare Malaysia with an African country that is resource rich as well. However, a comparison that starts from the observation of a similar policy outlook may – in the light of recent writing on the resource curse – be more relevant.

Resource wealth translates in the paradigm of the resource curse into various forms of political and economic instability, and policy factors are given a central place to explain this. Ross (1999: 308) summarised the political explanations of the resource curse as follows:

> This larger effort [to explain the resource curse] entails a search for generalizable theories of policy failure – the proclivity of states to adopt and maintain transparently suboptimal economic policies. Theories of policy failure can be sorted into three groups: cognitive theories, which blame policy failures on the short-sightedness of state actors; societal theories, which cite the pernicious influence of privileged classes, sectors, client networks, or interest groups; and statist theories, which fault a state's institutional strength or weakness – its ability to extract and deploy resources, enforce property rights, and resist the demands of interest groups and rent seekers.

In other words, resource wealth leads, in the paradigm of the resource curse, to concentration on immediate income instead of building strong institutions. The neglect of building up a tax structure is particularly singled out. Government will in this view grow in size to placate political demands and not to fulfil development goals. However, the most important aspect is that the temptation to access mineral wealth for private gain will be difficult to resist. The resource curse paradigm avoids sheer determinism and identifies a group of countries that escape the curse because of their superior institutional quality leading to better policies. In this context, Malaysia is mentioned among the countries where the quality of institutions provides incentives for productive growth instead of an orientation towards consumption and short-term preferences (Robinson *et al*., 2006; Auty, 2007).

However, the explanatory power and deterministic character of the resource curse has been further undermined. Bulte *et al*. (2005) argue that access to resources is a confounding variable: institutional quality is the explanatory factor and not the access to resources. This is particularly relevant for this paper. If the way in which political institutions channel resources is the critical variable, then the comparison of Malaysia with an African country that is also resource rich would be the logical choice of framework. However, if the quality of institutions structuring incentives and the resulting policy orientation is crucial then a comparison of two countries that have a similar policy outlook – like Kenya and Malaysia – makes sense. The question is then how this relates to institutions and incentives.

Access to development finance appears as the second salient variable emerging from an analysis of development narratives rather than the literature. Such access tends to be seen as a dependent variable resulting from productive policies.[1] Domestic savings are singled out as a major explanation for Malaysia's high economic growth rates. *The East Asian Miracle* (World Bank, 1993: 204–205) covered Malaysia also, and it argued that economic growth led to higher saving and not the other way round. If they borrowed internationally, they engaged in a virtuous circle: they repaid out of growth and because of growth they could borrow more and increase their leverage.

Access to development finance is therefore seen as a logical consequence of sensible economic policies. It follows logically that there must be deficiencies in the management of an economy that leads to problems in accessing development finance. Indeed, an influential World Bank (1998) study argued that development aid – a source of development finance – was only effective in the right policy environment. Similarly, a major study on accelerations and decelerations of growth patterns in Africa identified mainly governance-related syndromes as obstacles to growth. This comprehensive study does not even discuss access to development finance as an issue (Ndulu *et al*., 2008).

However, it is argued below that access to development finance through oil income as well as access to long-term foreign financing is central in Malaysia's development trajectory and that a lack of access to development finance and problems in managing flows of finance from abroad are crucial in explaining Kenya's development trajectory. Closer examination shows that institutions in both countries had significant weaknesses. Access to finance made it possible to overcome these in Malaysia, whereas in Kenya these weaknesses turned into a binding constraint.

The problem to be clarified

Kenya and Malaysia embarked on similar development trajectories.[2] Marxist or radical socialist ideas did not strike root in either country. In both countries, the state has ventured to a limited degree into state enterprises, but private ownership of the means of production is the norm. Major attempts were, however, made to regulate the two economies. For example, the agricultural marketing boards in Kenya were seen as a means to direct savings and investment. In Malaysia, there has been elaborate regulation to further the economic interests of the Malay part of the population and counter the influence of the Chinese minority. Similarly, the Kenyan government has attempted to build a Kenyan capitalist entrepreneurial class alongside the local Asian one, and there has been a strong emergence of such entrepreneurs among the Kikuyu speakers. Privatisation and deregulation have, however, been accepted in both countries as corrective measures. Both countries have always welcomed foreign direct investment, and they are both relatively stable. In the period 1965–2002, Kenya had only two presidents: Jomo Kenyatta (1964–79) and Arap Moi (1979–2003). Two prime ministers have dominated post-independence Malaysia: Abdul Rahman (1957–69) and Mahathir Mohamed (1981–2003). KANU was the ruling political party in Kenya from 1964 to 2001, and in Malaysia the same political party has been in power since 1957.[3]

Although both countries embarked on similar development trajectories, there are major differences in the progress made by the two countries. Figure 1 shows

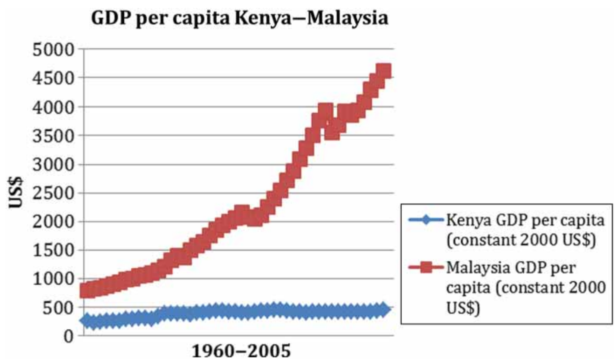

Figure 1. GDP per capita, Kenya and Malaysia.
Note: Unless otherwise stated, all figures used are taken from *World Development Indicators* (World Bank, 2010a).

how per capita economic growth in Kenya has been stagnant over the years and how it has increased almost exponentially in Malaysia.

This paper aims to clarify the divergent development paths. Firstly, it identifies the time of sharp divergence or turning point in the historical narrative. Secondly, it looks for the factors associated with this turning point. Thirdly, it addresses the question of whether the divergent growth paths are a consequence of differences in structuring incentives and institutions leading to differences in managing development finance (governance) or the result of access to government finance. The conclusion will be that the latter is the case.

Turning points in the development of Kenya and Malaysia

The pattern of economic growth in the two countries at first sight indicates merely differences between the two countries and seems not to give ground for comparison. Whereas gross domestic product (GDP) per capita in Malaysia has grown almost linearly upwards, GDP per capita in Kenya since independence has mainly been stagnant. There are incidents in the Malaysian trajectory where growth stalled: in the mid-1980s and during the Asian crisis in 1997. These are, however, temporary episodes and did not result in the stagnation that is characteristic of Kenya after a promising start in the 1960s.

Growth patterns were even more erratic than a comparison of per capita income suggests. Average economic growth over the period 1961–2009 was lower in Kenya (4.6 per cent) as compared to Malaysia (6.4 per cent), but the range in the time series was considerable, especially in Kenya after independence in 1963. It varied between a maximum of 22.7 per cent in 1971 at the peak of the coffee boom and a minimum of −4.7 per cent in the year before as a result of the oil shock. In Malaysia, growth reached its maximum value of 11.7 per cent in the equivalent time series at the beginning of the oil boom in 1973, and its lowest point was −1 per cent at the end of the oil boom in 1985.

In such an erratic pattern it is difficult to isolate growth accelerations and decelerations that are indicative of long-term processes. However, intuitive grouping of growth figures as in Table 1 leads to a meaningful pattern of divergence.

Firstly, there was always a divergence in growth rates between the two countries, but this divergence became more pronounced in the period 1981–2000 as compared to 1961–80. Secondly, in order to understand this discrepancy, the later period is subdivided into two. It appears then that the divergence is even more pronounced in 1991–2000 than in the preceding decade. Thirdly, further regrouping of average growth figures locates the divergence especially in the second half of the 1980s but the *onset of the divergence or turning point* seems to be located more specifically in the period 1988–93.

Table 1. Patterns of economic growth in Malaysia and Kenya as a percentage of GDP.

	Malaysia	Kenya
1961–80	7.2	6.4
1981–2000	6.7	3.0
1981–90	6.0	4.1
1991–2000	7.2	1.9
1986–90	6.9	5.6
1991–95	9.5	1.6
1988–93	9.3	2.7

A similar pattern emerges from a comparison of gross capital formation. Over the whole decade 1981–90, gross capital formation was on average 30 per cent of GDP in Malaysia as compared to 20 per cent in Kenya. Over the whole decade 1991–2000, the difference widened to 36 per cent in Malaysia as compared to 17 per cent in Kenya. In 1988–93, the likely period for the onset of divergence, it was 19 per cent of GDP in Kenya as compared to 33 per cent in Malaysia.

The slowdown in investment suggests that the Kenyan economy ran short of finance for development and consequently economic growth slowed down, whereas in Malaysia the pattern was reversed. Both countries relied strongly on borrowing from abroad, in addition to sources like savings, aid or foreign direct investment, to finance growth. Table 2 and Figure 2 show that this led in the late 1980s to high ratios of external debt to gross national income (GNI).

This changed in 1988 when this ratio started to decrease to much more manageable levels in Malaysia. In 1988, Kenya, however, was on the brink of an increase in long-term debt to unsustainable levels, reaching more than 100 per cent of GNI, and this only started to decrease after 1993.

Table 2. External debt stocks as a percentage of GNI.

	Kenya	Malaysia
1985	70.6	68.6
1986	65.8	82.9
1987	75.2	75.6
1988	72.3	55.7
1989	73.4	44.4
1990	85.8	36.4
1991	95.8	36.6
1992	87.7	35.7
1993	131.9	41.1
1994	105.0	42.8

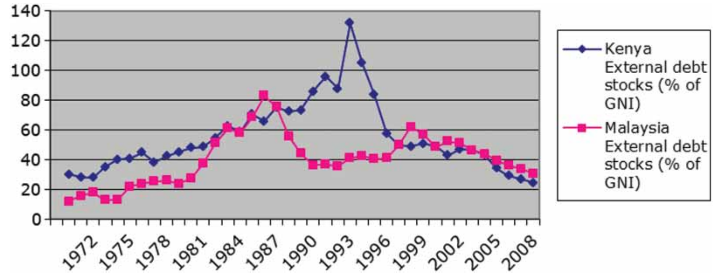

Figure 2. External debt as a percentage of GNI, Kenya and Malaysia.

Debt service as a percentage of exports shows a similar pattern. This dropped in Malaysia after 1986 to manageable levels well under 10 per cent, whereas in Kenya it remained well over 20 per cent until 1993 (Figure 3).

This decline in the rate of debt service as a percentage of exports in Malaysia did not mean that long-term debt decreased in absolute terms. Malaysia increased its long-term debt by 98 per cent in the period 1985–95. Although Kenya also increased its long-term debt in this period by 55 per cent, the proportion of debt in absolute terms increased thus much more in Malaysia than in Kenya. Figure 4 shows clearly the rapid increase in debt in absolute terms in contrast to the decline in relative terms in Figures 2 and 3.

There was thus much more finance from borrowing abroad available in Malaysia than in Kenya. A comparison of the availability of development finance per capita is even starker because Malaysia's population is smaller. In the course of time, the population of Kenya grew much faster than Malaysia's. In 1965, both countries had a population of 9 million inhabitants, but in 1993 this had increased to a little fewer than 26 million in Kenya as compared to 19.5 million in Malaysia. Long-term external debt per capita in 1988–93, the crucial period under consideration, was on average US$ 195 in Kenya, while in Malaysia it was US$ 865. The Malaysian economy had

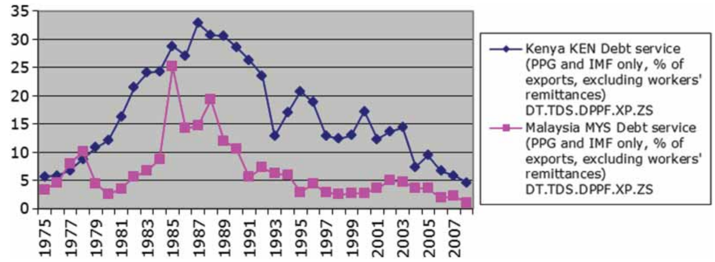

Figure 3. Debt service as a percentage of exports, Kenya and Malaysia.

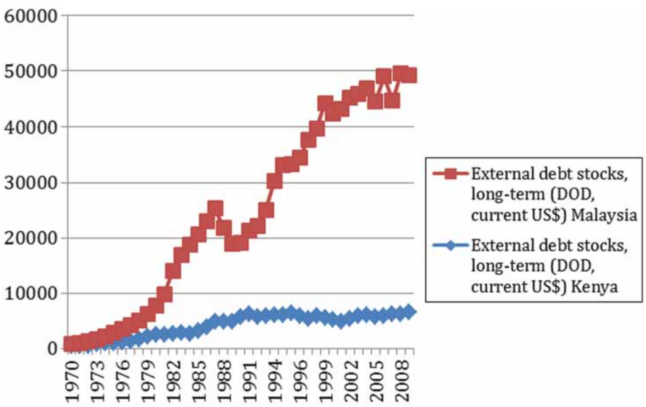

Figure 4. Long-term debt, Kenya and Malaysia US$ millions.

thus, per capita, much more access to development finance from long-term borrowing than the Kenyan one.

If one accepts the ratio of long-term debt to GDP/GNI as the crucial measure of sustainability, then Malaysia can and could carry much more long-term debt than Kenya. Malaysia's GNI in 1965 was 3.2 times higher than Kenya's. This increased modestly to Malaysia's GNI being four times as high in 1988. However, thereafter the difference widened quite fast; this is consistent with the postulation of a turning point: in 1993 Malaysia's GNI was nine times as high as Kenya's.

The explanation for the paradox of a decreasing debt service as a percentage of GNI and exports while there was an increase in the absolute level of debt seems obvious: Malaysia reached the virtuous circle where growth in the economy pays for the growing debt service: debt was serviced out of growth – this despite the fact that debt was cheaper for Kenya than for Malaysia. Debt service on long-term debt in Kenya was 12 per cent of the debt stock, while in Malaysia it was 22 per cent.

Summarising, long-term debt as a percentage of GNI suggests comparability with respect to how development was financed until the mid-1980s. Both countries relied on attracting long-term capital. After the mid-1980s, this led to serious imbalances in the Kenyan economy: debt rose to very high levels of GNI and debt service required a high percentage of export income. In Malaysia, there was a divergent development: although the level of long-term debt increased in absolute terms and debt service on long-term debt was high, external debt declined as a percentage of GNI to sustainable levels, and debt service was reduced to a manageable percentage of exports. As stated above, Malaysia embarked on a high rate of growth and that increased its potential leverage.

This can be explained as a result of trust in a much faster growing economy. In Kenya, a reverse process was at work: Kenya went into a downward spiral because debt servicing absorbed too high a proportion of exports. The level of debt also limited the possibility for Kenya to raise more long-term finance. Kenya understandably had to have recourse to the IMF in the second half of the 1980s.[4]

A financial explanation for divergent development trajectories

There are of course more sources for development finance than borrowing from abroad. Flows of overseas development aid (ODA) can be another significant source of finance for development, and Kenya received much more than Malaysia. The contrast between the two countries is stark when ODA is expressed as a percentage of GNI. Kenya received about 9.5 per cent a year on average during the 1980s, as against a mere 0.6 per cent in Malaysia. In the period under consideration 1980–94, ODA in the Malaysian case was not negligible, but minor as compared to Kenya, which received an average of US$ 30.6 per capita a year in ODA as compared to US$ 12.3 per capita in Malaysia.

A much more distinct difference in access to development finance emerges from a comparison of income from national resources.[5] These were not significant in Kenya as the country is resource poor, but oil in Malaysia provided a tax income of US$ 118 per capita in the period 1982–94. If tax income from oil and aid per capita is added, then Malaysia received on average a sum of US$ 133 per capita. Malaysia had thus – apart from the access to foreign borrowing – in absolute as well as in relative terms much greater access to development finance than Kenya, as visualised in Figure 5.

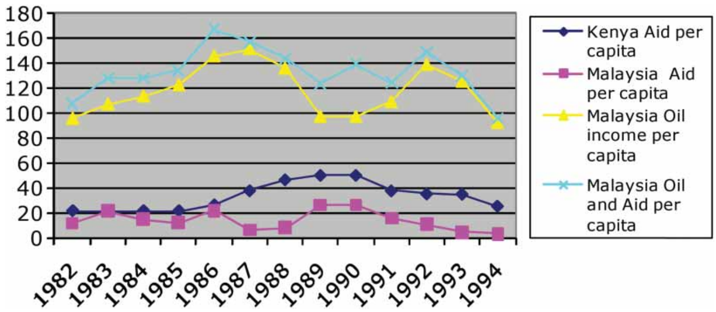

Figure 5. Aid and government income from oil in Kenya and Malaysia per capita (current US$) 1982–94.
Note: The Malaysian population has been estimated as on average 15 million for calculations per capita.
Source: Aid per capita: World Bank (2010a); oil income: Khan and Jomo (2000: 281).

Oil production has another important economic consequence besides tax income: oil exports loosen the constraints on access to foreign exchange. This has a favourable effect on the trade balance and consequently on the balance of payments. In the period 1980–94, Malaysia ran an average surplus of 5.8 per cent of GDP on its trade balance. If there had been no oil income, the country would have run a deficit of 1 per cent a year. The improvement on the trade balance affects also the ratio of debt service to exports and this improves the creditworthiness of a country. The average yearly amount of debt service for Malaysia over the period 1980–94 was US$ 3365 million, an amount that was not covered by the contribution of oil to foreign exchange income (US$ 3108) (Table 3).

Kenya had in this period an average deficit on its trade balance of 7.1 per cent of GDP, whereas Malaysia had a 5.8 per cent surplus, a difference of 12.9 per cent. Kenya's situation is thus in this respect much more unfavourable than Malaysia's. It is therefore pertinent to ask what the difference would be if Kenya had similar access to the benefits of oil. In order to make this comparison, the Malaysian trade balance has to be weighted by the relative size of GDP because the Kenyan economy is much smaller than the Malaysian one. Table 4 shows what the situation would have been if an oil sector relative in size to that in Malaysia had been in existence in Kenya: there would have been on average

Table 3. Contribution of petroleum exports to the Malaysian trade balance (current US$ millions).

Year	Trade balance	Petroleum exports	Trade balance without oil exports	GDP
1980	2010	2879	−896	24,937
1981	−29	2709	−2738	25,463
1982	−753	3302	−4055	27,287
1983	432	3393	−2961	30,683
1984	2981	3329	−348	34,566
1985	3575	3436	139	31,772
1986	3402	2069	1333	28,243
1987	5886	2493	3393	32,182
1988	5643	2338	3305	35,272
1989	3913	2913	1000	38,849
1990	1924	3933	−2009	44,024
1991	−262	4540	−4802	49,134
1992	3375	3108	267	59,151
1993	3037	3653	−616	66,894
1994	1577	2520	−943	74,481
Totals	36,711	46,615	−9931	
Averages	2447	3108	−662	40,196

Source: Europa Publications: *The Far East and Australasia* (various years).

Table 4. Hypothetical contribution of petroleum exports to the Kenyan trade balance (current US$ millions).

Year	Trade balance	Hypothetical petroleum exports	Trade balance with hypothetical oil exports	GDP
1980	−914	839	−75	7265
1981	−641	729	88	6854
1982	−421	762	341	6431
1983	−213	661	484	5979
1984	−266	598	332	6191
1985	−278	663	385	6135
1986	−235	530	295	7239
1987	−660	639	−21	7971
1988	−729	690	−39	8355
1989	−961	620	−341	8272
1990	−915	767	−148	8591
1991	−511	753	241	8152
1992	−495	432	−63	8221
1993	−239	314	75	5752
1994	−238	242	4	7148
Totals	−7716	9239	1558	
Average	−514	618	104	7237

Source: Europa Publications: *The Far East and Australasia* (various years).

a modest surplus on the trade balance (1.4 per cent of GDP) during this period. In the period 1980–94, this hypothetical oil income would have meant an extra income on the balance of payments of US$ 618 million, while the average Kenyan annual debt service in the period was US$ 506 million. It would have relieved the pressure of debt service and loosened the foreign exchange constraint on investment.

Besides easing the foreign exchange constraint, resources like oil contribute to balancing the budget. Tax income from oil in the period 1980–94 contributed on average 20 per cent yearly to the budget, while the Malaysian government ran on average a yearly deficit of 0.4 per cent of GDP. If there had been no income from oil, then this average yearly deficit would have been 5.1 per cent of GDP. Tax income from oil in the seven years when there was a budget deficit was on average US$ 1850 million and that is below the average of US$ 2104 million for the whole period, indicating the significance of oil income. Nevertheless, it is likely that from time to time the Malaysian government had recourse to borrowing in order to cover its deficits as the budgets fluctuated widely between a big deficit of 15 per cent of GDP and a surplus of 5 per cent of GDP. It shows again the importance for Malaysia of access to loan finance. Such borrowing would have been much more difficult, and would have been more badly needed, without the surety of oil. Malaysia has kept quite strict control over inflation, and this would have been much more difficult if there had been no income from oil. Tax income from oil supported not only monetary policy but also exchange rate policy. As most of the long-term debt is public debt (in Malaysia 80 per cent and in Kenya 87 per cent), debt service comes mainly from government resources. Malaysia had the resources to keep a stable – albeit slightly undervalued – exchange rate (Table 5).

A similar contribution from oil to the Kenyan government finances would have been even more significant than the effects of such income on the balance of payments would have been. In the period 1980–94, Kenya consistently ran a deficit on the budget and the average deficit was 4.2 per cent of GDP (Table 6). This indicates a structural rather than an incidental problem. A hypothetical oil income was calculated for Kenya by weighting government oil income in Malaysia by the relative size of GDP. This hypothetical equivalent oil income would have resulted in a modest average budget surplus for Kenya of 1.3 per cent in the period 1980–92.[6]

Such hypothetical income would have been particularly significant because the deficits are concentrated in the period 1988–93 when the debt situation became really unsustainable. Fifty-one per cent of the total deficits in the 15-year period are located in that 5-year period (a third of the time series). The dramatic negative turning point in the late 1980s could have been avoided.

Table 5. Contribution of oil income to government finance Malaysia (current US$ million).

Year	Revenue budget	Def/surplus	Income from oil	GDP
1982	7257	−4095	1660	27,287
1983	8017	−3666	1898	30,683
1984	8891	402	2249	34,566
1985	8437	−49	2342	31,772
1986	8569	−65	2105	28,243
1987	7088	−2349	1510	32,182
1988	8190	−2258	1760	35,272
1989	8318	−2270	1675	38,849
1990	10,814	893	2164	44,024
1991	12,221	1001	2855	49,134
1992	15,674	2865	2773	59,151
1993	16,018	3464	2507	66,894
1994	14,910	3815	1851	74,481
Total	1,34,404	−2312	27,349	
Average	10,339	−178	2104	41,096

Source: Budget figures: Europa Publications: *The Far East and Australasia* (various volumes); oil income: Khan and Jomo (2000: 281).

Table 6. Contribution of hypothetical oil income to government finance Kenya (current US$ million).

Year	Budget	Def/surplus	Budget/GDP	Hypothetical oil income	GDP
1980	1964	−142	0.27	317	7265
1981	2079	−22	0.3	365	6854
1982	2013	172	0.31	388	6431
1983	1907	108	0.32	418	5979
1984	1729	−427	0.28	496	6191
1985	1834	−501	0.29	516	6135
1986	1918	−372	0.27	464	7239
1987	2436	−22	0.31	332	7971
1988	2611	−232	0.31	387	8355
1989	2310	−575	0.27	372	8272
1990	2304	−637	0.27	422	8591
1991	2362	−637	0.3	474	8152
1992	2083	−663	0.25	385	8221
1993	1543	−470	0.27	216	5752
1994	2236	−173	0.31	178	7148
Total	31,329	−4593		5730	
Average	2088	−306	0.29	397	7237

Source: Budget figures: Europa Publications: *Africa South of the Sahara* (various volumes). Hypothetical oil income is based on figures on Malaysian oil income from Khan and Jomo (2000: 281) weighted by the relative size of GDP.

The role of governance: access to finance for development or the management of finance for development?

A comparative analysis of the Kenyan and Malaysian development trajectories shows the crucial importance of access to development finance to explain stagnation in the Kenyan case and sustained growth in the case of Malaysia. This is particularly significant to understand the diverging pattern that developed after 1985. Kenya went into a downward spiral of balance of payments problems and low growth. Malaysia emerged into a virtuous circle of increased access to development finance and growth accelerations. In the Malaysian case, because of oil exports and tax from oil, it was possible to avoid a spiral into increasing debt service resulting in pressure on the budget and balance of payments. Lack of access to development finance appears to be a binding constraint in the Kenyan development trajectory and this binding constraint was not present in Malaysia.

However, access to finance for development is probably a necessary condition for economic growth, but not a sufficient one. As mentioned in the introduction, the variables that emerged from the resource curse literature are institutions that are structured in such a way that productive policies emerge. Indeed, institutions and policies are often seen as determinant whether there is resource wealth or not. In the comparison of Kenya and Malaysia, the importance of this is suggested by the ratings on governance issues. A comparison of actual governance scandals rather than governance ratings, however, suggests a great deal of similarity between Kenya and Malaysia. The term rent-seeking is central in these explanations and refers to the unproductive use of government positions and regulations.[7]

The narratives of Kenyan development hardly pay attention to finance for development, but virtually all stress undue political influence and bad governance as determining factors. Several authors make a clear distinction between the years under President Jomo Kenyatta (1963–79) and those under Arap Moi (1979–2003) and associate decline with the latter (Barkan, 1992; Chege, 1998; Mwega & Ndung'u, 2008). Political factors or governance issues are thus the prime explanatory factors.

This is not merely the case in the political science literature; economists argue the same. Bigsten and Moen (1996) made the most cogent economic argument explaining Kenyan stagnation through governance factors. They see Kenya's economic problems as rooted in the political structure that binds parties as coalitions of interests through the distribution of rents: public employment, bribes and rent-seeking investments. This leads to two pronounced effects to the detriment of economic growth. Rents are disincentives to investment as they have to be paid upfront in contrast to taxes which are collected afterwards when the results of investment are reaped. Secondly, rent-seeking activities are by their nature in the short term more profitable, and rent-seeking investments therefore displace productive investments. They see rent-seeking also as a major constraint on the flow of foreign investments.

The Kenyan economy faced its most serious crisis in the early 1990s and governance issues were crucial in this. Macro-economic problems coincided with, and were caused partly by, the Goldenberg scandal. This was the perversion of a scheme to stimulate exports by draining money from government by declaring false gold exports. It is said to have cost the Kenyan government about US$ 800 million and to have had massive consequences. For example:

> Industries had closed as a result of huge indebtedness to the banks following the super inflation and skyrocketing interest rates occasioned by the Goldenberg scam and the huge domestic borrowing by the government that ensued so as to mop up excess money in the economy: both measures simply added more problems to the productive sectors of the economy. (Anyang Nyong'o, 2007: 4/5)

Politics is, in Anyang Nyong'o's view, again the driving force behind it:

> The previous regime injected billions of shillings during the Goldenberg crisis and 1992 elections in the economy. This created surging inflation in 1993 and sharply declined the shilling by 150 per cent. (Anyang Nyong'o, 2007: 44)

The Goldenberg scandal is an incident in a long history of rent-seeking in Kenya. Leys (1975) described how in the 1960s the court around President Kenyatta was the place where politics were decided and favours handed out. Kenyan financial institutions were subject to intensive political influence. Institutions meant to stimulate Kenyan entrepreneurship built up large portfolios of non-performing loans (Waweru & Kalani, 2009). The parastatal agricultural marketing agencies were faced with recurrent scandals about graft. The Anglo Leasing scandal was the major rent-seeking scam that attracted attention after the change in government in 2001. It involved sluicing money to private accounts abroad for fake deliveries to government. It was revealed by the official specially appointed to fight corruption, John Gitongo (Wrong, 2009).

However, the major examples furnished as examples of rent-seeking in Kenya can be found in Malaysia as well. For example, Bigsten and Moen (1996) mention that the extent of non-performing loans gives an indication of the misallocation of credit due to political interference in the political system. Directing credit on political grounds in Malaysia was part of the drive to emancipate the Malay population in the economic sector and break the power of the Chinese community in that sector. To that effect, special companies were established that were either state owned or connected to the UMNO, the dominant political party. Such companies regularly got into difficulties through inefficient and parasitic management and were then saved. Petronas, the majority (75 per cent) government-owned petroleum and gas company, played a key role in saving them.

The major case involved the government-owned Bank Bumiputra, which until the mid-1980s was the major bank in Malaysia. It got into severe difficulties when a wholly owned subsidiary (BMF) accumulated huge bad debts due to property speculation in Hong Kong in the early 1980s. A Hong Kong-based confidence trickster played a central role in this, together with two others. It appeared that two of the Malaysian executives had large private business interests with the impostor (Wain, 2009: 185/186). Bank Bumiputra was at the same time involved in offloading a failing banking interest from a major political friend of Prime Minister Mahathir, at a very high price. As a result, 'Bank Bumiputra had to be kept afloat with massive state funds from Petronas, the cash-rich national petroleum agency' (Gomez & Jomo, 1997: 79). In effect, Petronas became the owner of Bank Bumiputra from 1985 until 1990 (Wain, 2009: 165).

In the mid-1980s, Petronas was also crucial in an attempt to ride the tin market. Malaysia was a major tin producer and the price of tin was falling rapidly. The Malaysian government responded to the falling price by buying up stocks in the tin market to drive up the price. When the price reached a level at which they thought it prudent to offload, the tin market collapsed straight away. Bank Bumiputra carried out the operation at the behest of the government with finance provided by Petronas.

> Bank Bumiputra's coffers were in turn topped up with funds held offshore by the national oil and gas company Petroliam Nasional Bhd, known as Petronas. (Wain, 2009: 152)

Ultimately the losses were repaid from the National Provident Fund and out of a vote of funds for national security, which meant that it escaped parliamentary scrutiny.

The attempt to manipulate the tin market is unusual among the cases described here, as no Malaysian became any richer because of it. However, in the rich documentation of rent-seeking activity in Malaysia, the links between personal fortunes and government involvement in the economy are obvious. The most striking example concerns the son of Mahathir Mohamed. Mirzam Mahathir, the prime minister's son, had taken a 51 per cent interest in Malaysian International Shipping Company after privatisation. During the Asian crisis of 1997, the company got into difficulties and Petronas took it over (Wain, 2009: 323).

This is not the place to give a comprehensive analysis of the role of rent-seeking in the development trajectories of Kenya and Malaysia. That has been done elsewhere, and in the Malaysian case in an exemplary fashion (Gomez & Jomo, 1997; Wain, 2009). The above examples have been selected with two thoughts in mind. Firstly, both the Goldenberg scandal and the major affairs surrounding Bank Bumiputra illustrate a relationship between governance problems and macro-economic factors. Table 1 shows not only a very low growth figure for Kenya in the period 1990–95 coinciding with the Goldenberg scandal and its aftermath, but also a relatively low growth percentage in Malaysia in the period 1985–90 during the aftermath of the Bumiputra scandal and the failed tin speculation. Table 2 shows a spike in the ratio of long-term debt/GNI after 1985 in Malaysia, and in Kenya this reached extreme proportions in the early 1990s. Tables 5 and 6 show that in the respective countries there was also an associated rise in budget deficits in these periods. It may be a misperception to see Malaysia as governed particularly well and Kenya as suffering primarily from governance problems. They had quite similar governance problems and these had similar pervasive effects on macro-economic factors, but Malaysia managed to overcome these and Kenya did not manage to do so. Secondly, the Malaysian cases illustrate how Petronas was essential in overcoming these governance crises. Here, we mentioned only cases where Petronas was directly involved, but oil income was of course also essential in government finance. Malaysia could, unlike Kenya, afford to make big mistakes in governance because of its relatively significant access to government finance.

Conclusion

The value of this paper is not in new data unearthed but in the comparison of two development trajectories with the help of secondary data. The value of the heuristic use of comparison here is that it opens different perspectives than the ones with which we are familiar. A comparative analysis of the Kenyan and Malaysian development trajectories shows the crucial importance of access to finance for development to explain stagnation in the Kenyan case and sustained growth in the case of Malaysia. The development narrative of Malaysia consequently appears in a different light. For example, the significance of internal savings is often stressed in the Malaysian case and that is correct. In the period 1981–2005, the average annual savings rate in Malaysia was 33 per cent of GDP and in Kenya much lower: 19 per cent of GDP.[8] However, it also appears from the comparison that access to foreign loan finance is another essential part of the narrative of Malaysian development that has not been given the attention it deserves. It goes against the statistical record to maintain that the foreign sector did not provide a substantial amount of development finance in Malaysia apart from FDI (Murinde, 1996).

However, the most striking finding is that, despite the different ratings on governance indicators, the problems of governance in both countries are actually quite similar. The difference is that access to finance makes it possible for Malaysia to overcome these, whereas access to finance is a binding constraint for Kenya. Nevertheless, there is an institutional aspect to this. Certain institutions in Malaysia are insulated from these governance problems. Petronas was often essential in solving such governance problems, and therefore it was essential that this company remained efficient.[9] Similarly, the role of the central bank is strikingly different between the two countries. The *Bank Negara Malaysia* remained outside the fracas of governance problems and maintained monetary discipline throughout the years. Despite accusations of large-scale and ill-inspired currency speculation (Millman, 1995), Malaysia has had a stable currency throughout the years. The Central Bank of Kenya, however, was at the core of the Goldenberg scandal that wrecked the Kenyan economy in the early 1990s. Essential institutions in Kenya seem not to be removed from the arenas of rent-seeking. These have, for example, wrecked agricultural marketing boards, despite Kenya's dependence upon agricultural exports.

A changing perspective on development narratives should not lead to overgeneralisations. Prior to the instability of the late 1980s/early 1990s, the monetary management of the Kenyan Central Bank was seen as a major contributory factor to Kenya's relative development success in Africa (Killick, 1981). The Kenyan Tea Development Authority is seen as a prime example of productive development (Leonard, 1991). Pointing out governance issues in Malaysia does not belittle the achievements made. The perspective in this article emerged from a particular context in which the development trajectory was dominated by powerful personalities: Moi in Kenya and Mahathir in Malaysia. Yet, the perspective developed in this article shows its value in relation to present-day development. There are still big governance problems in Malaysia, despite the favourable ratings: the waste that is still evident, for example, in the eerie emptiness of the new capital Putrayaja and in the nearby high-tech corridor. The Kenyan economy revived in the early 1990s, and in the light of this analysis it is significant that this happened after massive debt reduction.

The perspective emerging from this analysis also clarifies wider analytical issues. This analysis has considered rent-seeking in the first place as wasteful – a position challenged by arguments advocating possible beneficial effects of rents. For example, Kang (2002) argued that rent-seeking in South Korea led to the realisation of public as well as private goods, whereas in the Philippines the drive towards private goods displaced the realisation of public goods. Khan (2000) suggested that rent-seeking in Malaysia had primarily beneficial effects:

> This is why the East Asian and, more recently, the South East Asian experiences are important. They suggest a more complex story about the efficiency and growth implications of rents and rent-seeking. They show that the simplifying assumption that all rents are always bad is questionable. In a world where learning and innovation have to be rewarded, distributive conflicts dealt with, where incentives have to be created to deal with asymmetric information and where scarce natural resources have to be conserved, many types of rents are socially desirable. (Khan, 2000: 7/8)

However, these beneficial effects do not emerge from the examples here. Malaysia's failed speculation in tin may be assigned a learning effect about how to operate on international commodity markets if one can find the application of such lessons afterwards. The other beneficial effects are not obvious. Indeed, Bank Bumiputra intended to deal with distributive conflicts between the Malay and the Chinese community. However, this goal was diverted to personal enrichment in the case of the Hong Kong property speculation and coping with the failed tin speculation. The Goldenberg and Anglo Leasing cases in Kenya are mere scams to divert public funds into private pockets. The problems surrounding the crop authorities in Kenya do not suggest beneficial effects for learning or equity.

It may be argued that such incidents are a logical phenomenon when countries experiment with development trajectories. More generally, it may be argued that the distribution of rents always runs the risk of being perverted – even if there are clear original goals – as the lure of unearned income is always there. However, such realism does not disprove that there is a waste of resources that can be very harmful if access to development finance is scarce.

Despite this, rent-seeking in Malaysia cannot be equated with rent-seeking in Kenya. This is particularly clear in the role of Petronas. It is considered an efficient company led by sound enterprise strategies. It is an island of efficiency in the Malaysian economy and its actual operations seem to be free of rent-seeking. The analysis of strategic institutions that manage to remain free of the rent-seeking cultural universe and speculating about such potential institutions may be crucial in understanding the divergence between Sub-Saharan Africa and South East Asia. It may be that the major factor in the divergence of development outcomes lies in these strategic pockets of efficiency that make it possible to overcome the governance problems that seem ubiquitous in development trajectories.

Notes

1. Scarcity of finance was seen as the major issue when development theory emerged as a special field, for example in order to close the gap between savings and investment or in the balance of payments (Browne, 2006: 24–25). However, this theme has virtually disappeared in the literature since the early 1990s.
2. This very brief characterisation owes much to Gomez and Jomo (1997) for Malaysia and to Chege (1998) for Kenya.
3. Centralisation in one political figure and political stability are common in both countries, and this suggests the predatory behaviour associated with stationary bandits who are metaphorically contrasted with roving bandits in Olsen's (1965) terminology. The former type of behaviour is considered to be less destructive than the latter as centralised power keeps rent-seeking under control. Lewis (2007) also considered this distinction essential in explaining the different development outcomes of Indonesia as compared to Nigeria.
4. The effects of structural adjustment are, especially in everyday speech, seen as the cause of Kenyan economic problems. However, this analysis suggests that the causes that necessitated Kenya to embark on structural adjustment have to be understood in the first place.
5. Government income from oil consists of various elements: profits from a nationally owned oil company, corporate taxes on companies in the sector and royalties for the mining of a non-renewable resource. The figures here are taken from Khan and Jomo (2000) and seem to refer to royalties and income tax. The term rent is avoided here because the compensation for a non-renewable resource cannot be compared to Ricardo's original meaning: one can get an income from land without the asset decreasing in value unlike the effects of mining operations.
6. This ignores the fact that, if an oil sector of relative size to Malaysia's had existed in Kenya, GDP would have been bigger and the surplus a smaller percentage of GDP.
7. This specific meaning of rent has been acquired in recent times (Tullock, 1967; Krueger, 1974) e.g. rent-seeking generally implies the extraction of uncompensated value from others without making any contribution to productivity (http://en.wikipedia.org/wiki/Rent-seeking). Despite the references made to Ricardo, it takes a stretch of the imagination to compare occupying a government position or implementing a government regulation to owning land. See, however, a different meaning by Khan (2000).

8. It would also be a mistake to see high local savings as the result of good governance. On the contrary, local savings have been used to solve governance problems. See above the role of the National Provident Fund in saving Bank Bumiputra. According to Jomo (2006), the Employees Provident fund was used during the Asian crisis of 1997 to bail out some of the most politically well-connected and influential individuals and organisations, including Mahathir's eldest son. See also Pepinski (2009).
9. Petronas is no longer the company it was under Mahathir and has developed more and more independently into an international company (Von der Mehden & Troner, 2007). The comparison with Indonesia's Pertamina is fascinating. Petronas was originally modelled on Pertamina. However, whereas Petronas has managed to increase its distance from the rent-seeking in the political arena, such rent-seeking has encroached more and more on Pertamina (Hertzmark, 2007).

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